

## Hughes Investment Advisory Service LLC

October 1, 2025

Dear Clients and Investors,

In the third quarter most asset classes performed well, with many indexes closing at record highs. Markets have rallied strongly following the April 8<sup>th</sup> softening of the tariff rhetoric. Here is how major asset classes have done YTD 2025:

AOM - S&P Target Risk Moderate Index (Stock/Bond mix):	+ 9.6%
IVV - S&P 500 Equity Index:	+ 13.7%
RSP - S&P 500 Equal Market Cap Weight Index:	+ 8.2%
EFA - Europe, Australasian and Far Eastern Equity markets:	+ 24.2%
AGG - I-Shares US Investment Grade Bond Index:	+ 3.2%
GLD - Gold:	+ 47.0%
FBTC - Fidelity Bitcoin Index ETF:	+ 25.4%

So where do we stand as we head into Q4 2025? The Administration is intentionally running the economy Hot and it's starting to show in the data. Despite today's US Government shutdown and other worthwhile concerns, we're currently in one of the strongest Bull Market moves higher in years.

The ongoing developments in the Middle East may have taken a positive turn this week with a US brokered peace deal signed onto by Israel and most of the important Arab countries. My sense is that we are at a turning point in this tragic war and one way or another the end of Hamas is near. The Ukraine war continues with no end in sight despite US attempts to broker a peace deal. It's looking more like an escalation is in store with NATO countries providing more deep strike munitions to Ukraine and Russian incursions into select NATO countries with drones and fighter jets. These developments are not positive.

On interest rates, as I expected, the Federal Reserve lowered rates by .25% at their recent September FOMC meeting. I still expect one more rate cut before year-end. The lowering of rates comes amid growing concerns about a weakening labor market. While lower rates are, on balance, positive for equity markets these lower rates raise other issues related to GDP growth and inflation which I will discuss below.

The Federal Reserve's dual mandate of maximum employment and price stability is becoming more challenging. Fed Chairman Powell admitted that a "risk free path" to manage inflation and unemployment does not currently exist. The Fed seeks to avoid stagflation, which is a period where stagnant economic growth, high inflation, and rising

unemployment occur simultaneously. I do not think that they can avoid stagflation and in fact is a low-key objective on the Treasury Dept and Treasury Secretary Bessent. More on the reasons why below.

Inflation remains high and about 50% above target. Two years ago, I argued that the Fed will need to adjust their long term 2% inflation target to a much higher number. I suggested 3% at the time and that has proven to be prescient. At the end of the day, I believe that they will in fact adjust their target inflation rate higher to the 2.5-3% range.

The S&P 500 earnings outlook for 2025 and 2026 is improving! Yardeni Research has slightly raised their 2025, full year S&P 500 earnings estimate from \$260 to \$265. For 2026 they're prediction is for 13% growth to \$300

What about this "Global Economic Reordering" that I have been referring to in recent Q letters? How do all these economic and geo-political forces somehow fit together in a manner that we can get our heads around as investors? I must say that this is a tall order! We are in a completely different investment environment than the previous 20 years before covid hit and really since 1981 when the 30-year long-term treasury yield hit 18.6%. Bonds rose and yields dropped from 1981 until 2020 however since then yields have been rising and bond prices dropping. Some on Wall Street predict a return to lower rates similar to the 1981-2020 period. I totally disagree and predict persistent higher inflation, higher long-term interest rates and Financial Repression.

The immediate US focus is on 3% GDP Growth, 3-million-barrel increase per day of US oil production and stabilizing annual budget debt to GDP at 3% down from 6% during the last administration. But that is only a starting point for a series of changes that must occur for the US to stabilize our 37 trillion in debt. We are at the tipping point that I have been writing about since the 2009 Great Financial Crisis. The chickens have come home to roost!

So, what is Financial Repression and why is it a necessary evil at this point in the economic cycle? Financial Repression is a set of government policies that keep interest rates artificially low and redirects funds from savers to borrowers – in this case to help the government manage its 37 T in debt and stimulate economic growth. President Trump and Secretary Bessent have plainly declared that this is what they intend to do. As an aside, this is also why they are attempting to stack the Federal Reserve with allies who will vote for these desired lower rates. Yes, this also touches on political issues related to Fed independence from White House control. This is an issue that I will leave alone for now except to say that after WW2 when the US faced a similar sized debt relative to GDP the White House and Federal Reserve did in fact work together using Financial Repression to get the debt situation back under control. So, this White House/Fed lack of independence is not new from an historical perspective. It's a necessity.

Some features of Financial Repression are:

- Caps on short term interest rates - to keep gov't borrowing costs low.
- Capital controls – limits on moving money across borders.
- Forced lending - banks may be required to hold gov't bonds via stable coins perhaps.
- Heavy Regulation - of banks and financial institutions.
- Inflation – which erodes the real value of the 37T in current debt.

Why use Financial Repression?

- It makes it easier for the government to repay high levels of debt
- It can stimulate economic growth by keeping borrowing cheap
- It's an alternative to more painful measures like raising taxes and cutting spending

On that last point, we have already seen that the Republicans tried to cut spending with Musk and DOGE which turned into a fiasco that while serious in fact had very little effect on the massive debt load of 37T. The deficit is the result of Medicare, Medicaid, Social Security and interest expense on the 37T debt burden. In reality, none of the above expenditures can be touched by today's politicians which leaves just one option, Financial Repression!

How did we get here? Washington with Wall Street cooperation spent 25 years moving our manufacturing base overseas to boost profits and keep inflation low. Remember all those cheap goods from China? Did we really think that there would never be a price to be paid? Have you ever been in a Christmas Tree shop? The price was the massive trade deficit and inability of the US to manufacture essential military, medical and other crucial products not just trinkets and toys. How can this be fixed? We're seeing the fix every day with new announcements of onshoring manufacturing and investments on our mainland. This will be a long process but when your military is dependent upon your potential enemy for the goods and commodities like rare earths to produce the weapons needed protect ourselves and our allies – we have issues!

All the above is complicated but is tied together in what we are seeing in Washington today resulting in a weaker dollar, higher inflation, lower short-term interest rates, higher long-term rates and strong GDP growth. What asset classes do well under this scenario? Companies whose profits outpace inflation or benefit from cheap borrowing, hard assets like gold/silver, real estate and other commodities and potentially bitcoin.

The last but equally important piece to the “Global Economic Reordering” relates to currencies and what is considered the worlds “Reserve Currency”. Reserve Currency is defined as the currency that other countries hold in their foreign exchange reserves and rely on for settling international transactions. It provides global liquidity and stability in cross-border trade and finance. Currently the dollar is considered the worlds reserve currency and is used in over 60% of international cross border transactions. While providing certain advantages, this Reserve Currency status for the US dollar has also created big problems for the US, specifically the 1 T dollar foreign exchange annual deficits.

It's now clear that since the invasion of Ukraine by Russia 3 years ago which resulted in the US freezing 330 billion Russian dollars located in the US, China, Russia and other emerging market countries are working together to create a neutral reserve currency to replace the dollar in their cross-border trade. What is a neutral reserve currency? A neutral reserve currency is a currency (or monetary unit) used in international trade and finance that is not directly tied to the economic or political interests of any single country.

I believe that Washington is currently working on their own new neutral reserve digital currency that might consist of the dollar backed by gold, bitcoin and other hard assets.

Where am I particularly optimistic and see opportunities in Q4 and 2026?

- US and Foreign equities.
- Strong corporate earnings and cash flows enhancing investments and shareholder returns via dividend increases and stock buybacks.
- Onshoring with increased factory construction, jobs, and foreign direct investment coming into the US.
- Productivity enhancement because of AI and its growing dominance in the technology space by US firms. We have entered a new era of technological advancement and productivity growth mostly dominated by US corporations.
- Record US energy production. Record liquified natural gas and oil exports to our allies overseas.
- A nuclear power renaissance and re-building the US power grid.
- The Utility Industry will benefit from increased energy demand and infrastructure buildout.
- Gold and other hard assets
- US Defense firms
- Pharma and medical technology

Overall, we continue to favor high-quality, large-cap, dividend paying, US based multi-national companies with strong balance sheets. We love businesses with irreplaceable brand names, wide moats, high margins, grow their dividends, and have modest debt. Risk/reward now strongly favors equities over fixed income. T-Bills, select REIT's, MLP's, and specialized bond/income funds look good as income producers. I believe that our portfolios are well positioned to produce consistently attractive long-term risk adjusted returns while preserving capital. We will remain vigilant, assume little, and continue to follow the investment guidelines that we know, through experience, work in the medium to long-term. Producing consistent returns with less risk than the typical 60/40 portfolio. Please do not hesitate to give me a call to discuss the above analysis.

Sincerely,

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