

HUDSON ADVISORS

OUR VIEW OF THE MARKET

Volume 105 January 2026

We saw a quote from a stock market pundit that captures our mind frame regarding the year ahead in the stock market: “2026 won’t be about easy gains – it will be about earning them.”

We worked hard on client strategies in 2025. But the overall surge in the market – for the third consecutive year – did give us some extra good results. The market was driven by underlying resilience in the economy and the powerful interest in the potential of artificial intelligence. The rally moved past the uncertainties of President Trump’s April tariff announcements and worries over rising U.S. national debt, governmental shutdown, and the various geo-political events.

The predominant forecast for 2026 is for a fourth year of double-digit gains in the market. Only a handful of outlier analysts predict a pullback. Analysts polled by FactSet forecast, in aggregate, that the S&P 500 will finish close to 8,000 – another gain of 16%. This view is based upon a solid economy, strong corporate earnings, stimulus from the 2025 tax cuts, and the view of artificial intelligence as historically transformational.

We agree with this general optimism at Hudson Advisors. But we do have some important caveats about the market’s reliance on Big Tech names and AI enthusiasm. Over the past three years, the so-called Mag 7 have produced more than half the stunning 88% rise in the S&P 500 index. The valuations of these stocks are essentially a bet on future performance.

At Hudson Advisors, our approach will be to look across the market for value-oriented sectors with cash flow visibility rather than narrative growth. Our investment case is grounded in low valuations relative to profitability. Value gives us participation without overpaying for optimism. That is how we will earn good returns for our clients in 2026.

MARKET TRENDS

The accompanying chart summarizes stock and bond market trends for the fourth quarter and year-to date of 2025. It was a good year for both stocks and bonds.

Equity Market: The basic story of the stock market in 2025 was its upward momentum. The one rough spot followed the tariff announcements on April 2. The market plunged 12 percent within a week. The bond market also reacted badly. Mr. Trump was soon modifying and delaying the sweeping policy he first announced. This tariff delay and enthusiasm for technology stocks pushed the S&P 500 past previous record highs in every month from May through October. The rally did slow toward the end of the year.

On December 31, the S&P 500 was ahead at 1.62% for the fourth quarter and 16.45% for the full year. The Nasdaq Composite index was up 2.64% for the quarter and 20.57% for the year. The Dow Jones Industrial Average gained 2.51% for the quarter and 12.98% for the year. The Russell 2000 index of small stocks went up 2.44% for the quarter and 12.83% for the year. Small cap stocks peaked at their first record closing high in four years.

Fixed Income Market: The bond market reacted similarly to the fluctuating tariff policies. Yields on 10-year U.S. Treasuries reached a peak of 4.79% in January. Then they were they were down to 4.01% in early April. The Treasury market was more stable for the rest of the year with a yield of 4.18% on December 31. Bond investors seemed more relaxed in the second half. (Yields move inversely to prices.) The Bloomberg U.S. Aggregate Bond Index had a year-to-date return of 7.30%. In sum, 2025 was an overall positive year for bond investors.

MAJOR MARKET INDEXES

	4Q25 Return	YTD Return
Dow Jones Industrial Average TR	4.03	14.92
S&P 500 Index TR	2.66	17.88
Russell 2000 Index TR	2.19	12.81
NASDAQ Composite TR	2.72	21.14
EAFE Index NR	4.73	33.57
Bloomberg Aggregate Bond Treasury TR	0.90	6.32

Source: Morningstar® as of December 31, 2025

THE OUTLOOK

The Economy: We liked the description we saw of the US economy as: “Not a bust -- but not a boom.” Annual GDP growth for full year 2025 is expected to come in at around 2%. – slower than in 2024 but still positive. Consumer spending was upbeat and helped sustain economic activity. Average wages grew faster than inflation, with hourly wage gains of 3.8%, giving some workers slight real income gain. Investments in technology and AI-related capital expenditure contributed to growth. The Federal Reserve cut rates 3 times in the final months of the year.

But not all is robust with the economy. The labor market added about 580,000 new jobs in 2025 – the lowest gain since 2020 – and well below the 2 million added in 2024. Most of the 2025 job growth was in the health care sector and job seekers in other sectors struggled. Inflation remained above 2.5% and the still evolving impact of tariff policy complicated understanding of consumer price trends.

The outlook for 2026 is similar: for modest but steady growth. Forecasts for the GDP are in the 1.7%-2.2% range. Job growth will continue to be subdued. Inflation is expected to remain in the 2.5%-3.0% range. Some economists call the current situation ‘stagflation lite’ The Federal Reserve is being very guarded about intended monetary actions in 2026.

The Market: Given the economic outlook, forecasts for the stock market might reasonably be more restrained. But the driving force for the market is corporate profits. The consensus view is that earnings per share of the S&P 500 will be in the 12%-15% range. Some analysts see positive earnings growth in all 16 sectors for the first time since 2018. Increased sophistication in corporate pricing strategies and use of AI technology are big contributors to profit growth. Higher earnings offset some of the concern about rich stock valuations.

At Hudson Advisors, we will be participants not contrarians to stock market optimism. We are encouraged by the outlook for broadening sector growth and opportunities for stocks that have been undervalued in recent years.

All that said, we will be highly attuned to the possibility of unpredicted geo-political events that could quickly squash all this stock market good cheer.

OUR STRATEGIES

Asset Allocation: Most clients should stick to portfolio strategies previously identified. For new clients, we recommend a 60% allocation to equities to be phased in over a 12- to -18- month period. The other 40% of assets will be short to intermediate-term bonds, cash, and alternative investments.

Preferred Equities: As always, despite market conditions, we look for long-term equity opportunities. We are especially interested in value stocks. We want fundamentally sound companies with reasonable valuations and that pay dividends. We especially like the following sectors:

HEALTH CARE: This sector trades at a discount to its own history despite stable cash flows, strong balance sheets, and rising return on invested capital. AI should act as a margin enhancer. We like MedTech, diagnostics, and healthcare IT.

MATERIALS: These stocks remain inexpensive relative to normalized margins, even as AI-driven demand improves visibility into multi-year capital spending: especially in advanced materials, photonics, and special chemicals.

FINANCIALS: Financials trade at reasonable discounted multiples relative to ROE and capital levels. Balance sheets are strong and AI adoption should drive improvements in profitability, risk management, and cost efficiency. Preferred subsectors are payments networks, analytic providers, and insurers with data scale.

CONSUMER DISCRETIONARY: Valuations are compressed relative to historical growth rates, while AI-enabled efficiencies support margin recovery even in a choppy macro environment. We like the subindustries with data scale, premium brands, and experiential expenditure.

TECHNOLOGY: We have emphasis on software and services. Software valuations have normalized, while profitability and free cash flow remain elevated. AI monetization is increasingly embedded within existing budgets rather than dependent on greenfield spending. We especially like vertical software, workflow automation, and cybersecurity.

Other Assets: Our aversion to long-term bonds remains. But we explore various maturities through laddered investments with a mix of U.S. Government, municipal, and high- quality corporate bonds. We also are looking at structured products which give a piece of the stock market’s upside performance along with protections on the downside.

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