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INVESTMENT SERVICES

Weekly Relative Value

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Market Strategist

WEEK OF MAY 12, 2025

Under Pressure

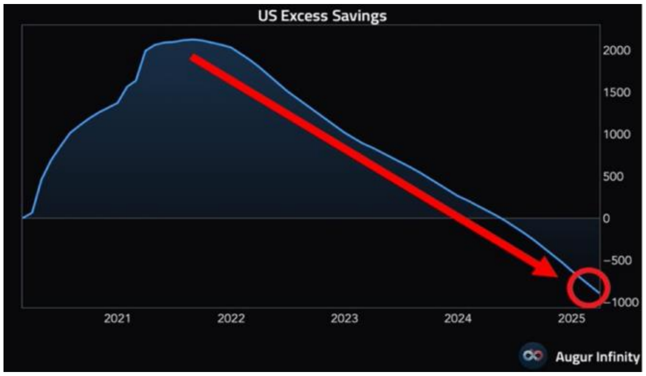
"What I'm hearing from retailers is that consumers are about tapped out…that means it's nice to say you're going to pass it on, but it's not as easy to pass it on as you might think." — Tom Barkin, President, Richmond Fed

"We are hearing more reports from businesses and others that consumers are starting to pare back some of that consumer spending."
— John Williams, President, New York Fed

Americans save 4% of their income. 4%. That's all.

We spend 96% of it.

From March 2020 through August 2021, Americans accumulated ~$2.1 trillion in excess savings. These savings were depleted in Q2 2024, and as households continued to spend, excess savings fell to -$900 billion. In other words, over the past year, Americans have been either spending their savings or falling into more debt.



Now that the $2.1 trillion of excess savings have been depleted, a high and rising number of American households are under mounting financial pressure. To wit: 6.6 million people are now late on their mortgage and 9.2 million are are already in default or delinquent on their student loans, and collections restarted May 5. (Those are gonna be nasty, ya'll.) This is a bigger headwind than most realize. Student debt has tripled since 2007 to $1.77 trillion, and the average monthly payment is in excess of $500.

THIS WEEK

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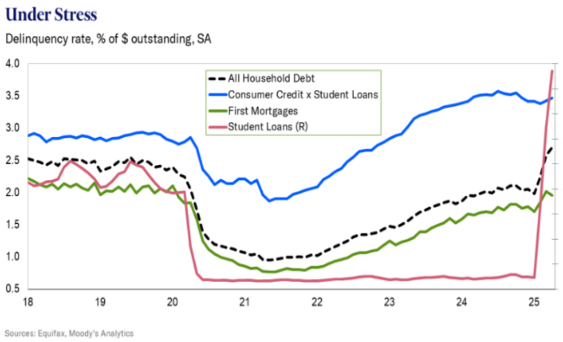
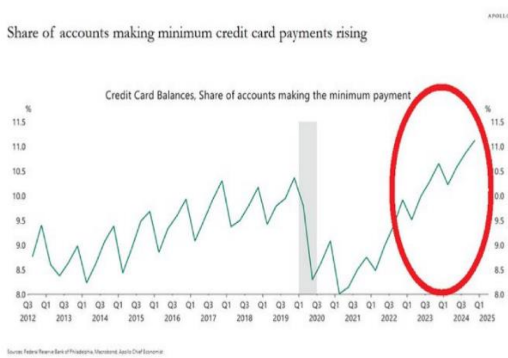
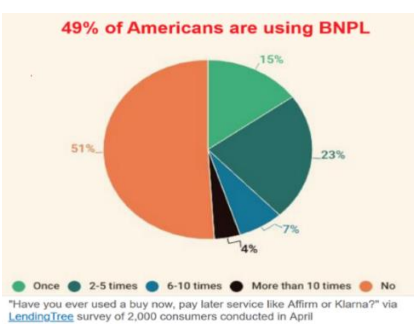
You can see the financial pressure the April delinquency rate data based on all the credit files in the country from the credit bureau Equifax. Delinquency as a percentage of the outstanding debt surged in the month to 2.7% (30 days and over), the highest it has been since coming out of the financial crisis. The resumption of student loan payments explains why, in part, but households are having serious trouble paying on their credit cards, auto loans, and even mortgages (mostly Federal Housing Administration loans, where the delinquency rate has exceeded 15%).



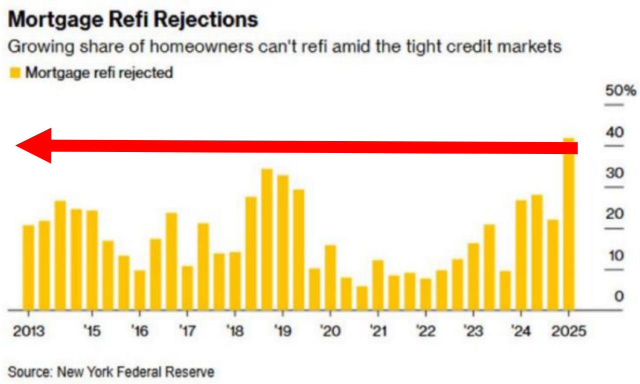
With $1.21 trillion in credit card debt outstanding, the share of active credit card users in the U.S. making ONLY minimum monthly payments rose to 11%, the highest in over 12 YEARS, when the series began in the aftermath of the Financial Crisis.



You can also see the consumer pain in the buy now, pay later (BNPL) services. In a survey of 2,000 U.S. consumers ages 18 to 79 conducted April 2-3, around half reported having used BNPL services. **Of those consumers, 25% of respondents said they were using BNPL loans to buy groceries, up from 14% in 2024 and 21% in 2023**. Needless to say, this is quite disturbing. Meanwhile, 41% of respondents said they made a late payment on a BNPL loan in the past year, up from 34% in the year prior.

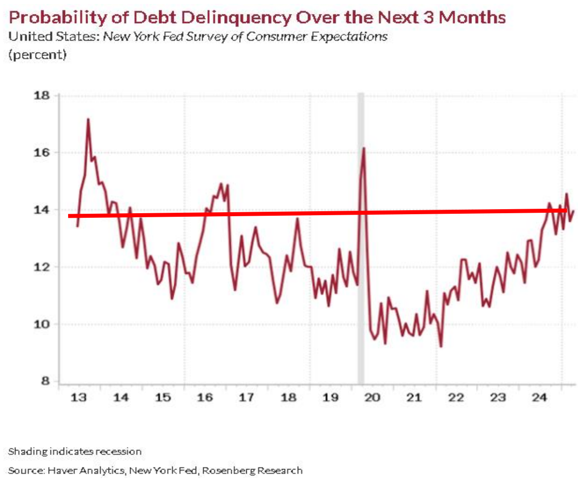


Also in light of the consumer pressure, it should not be a surprise that lending standards are tightening and banks are provisioning for losses. Suffice it to say that this is terrible for gaining access to credit cards, awful for auto loans and getting a lot worse for mortgages as rejection rates are climbing. In fact, as illustrated below, 42% of mortgage refinance applications are being denied — the highest rejection rate in at least 12 years.



In the same vein, the informative NY Fed Survey of Consumer Expectations shows that unemployment, credit and stock market views continue to tank, while inflation expectations are expected to increase as we enter the age of tariffs.

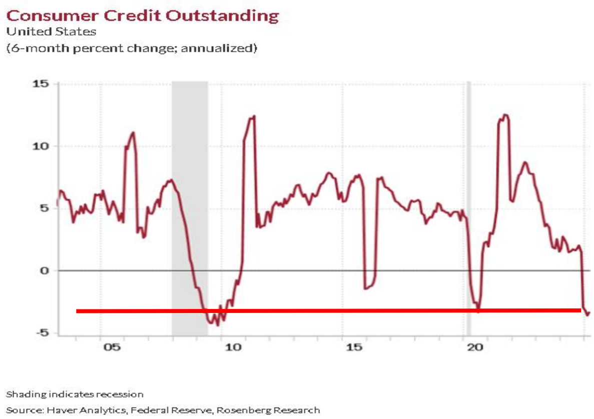
With credit remaining hard to get and the Fed unwilling to lower rates quickly the survey showed that 14% of the survey respondents expect they will not be able to make a minimum debt payment in the next three months. **That is near the pandemic level of 16% and is a deeply concerning data point.** This fits with the ongoing K-shaped consumer economy and will be a factor affecting low-end financial firms in the months ahead.



Bottom line: Even before the trade war, Americans were falling behind on bills — fast. Credit card, car and mortgage delinquencies just hit the highest level since the great financial crisis. This isn't just about student loans restarting. It's a red flag that households are running out of slack. Amazingly, this consumer pressure is building despite still low unemployment of nearly 4%, which augurs poorly as job growth is set to slow and unemployment to rise.

CREDIT CONTRACTS

In March, households increased their total credit by $10.2 billion — a sharp rebound from February's shocking -$0.6 billion falloff. However, six-month and twelve-month trends are both running negative. Indeed, revolving credit (which includes credit cards) fell by a total of -$54.7 billion in the first quarter and has dropped for five of the last seven months. Motor vehicle loans declined by -$10 billion in Q1 (the largest in the past 10 years). The trend in the data shows an increasingly concerned consumer prioritizing improvement in personal finances.

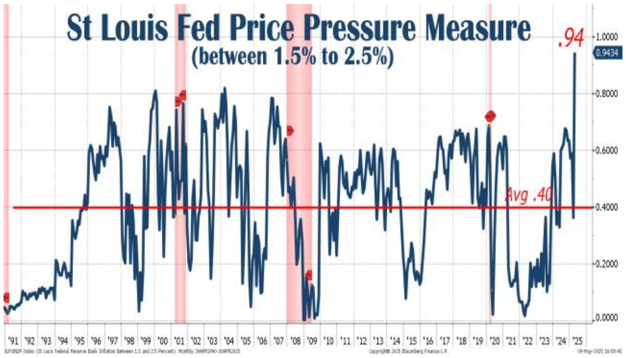


Bottom line: In the last six months, there have been three contractions of consumer credit — totaling a net reduction of -$86 billion. That equated to a -3.4% annualized change, the second-lowest since February 2010. As depicted in the above graph, a reduction of this size in consumer credit is typically associated with recession when looking at the historical data.

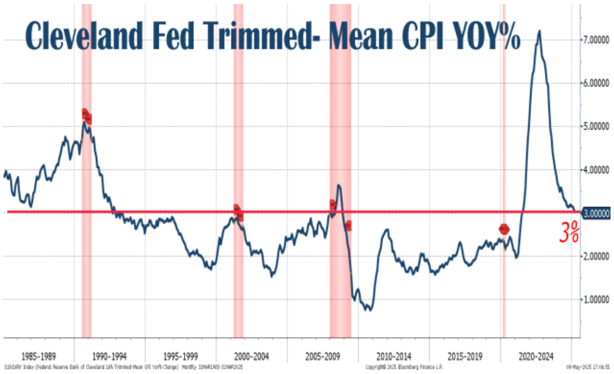
WAIT AND SEE

"'Too Late' Jerome Powell is a FOOL, who doesn't have a clue. Other than that, I like him very much! Oil and energy way down, almost all costs (groceries and eggs) down, virtually NO INFLATION, tariff money pouring into the U.S. — THE EXACT OPPOSITE OF "TOO LATE!" ENJOY!" — President Donald J. Trump

In the aftermath of what can only be described as a stellar set of personal consumption expenditures deflator data, the St. Louis Fed's measure of pricing pressures eased in April, to the lowest level since June 2020. The assessed probability of inflation lining up between 1.5% and 2.5% over the next 12 months jumped from 36% in March to a record high of 94% in April.



Likewise, the San Francisco Fed estimates that nearly one-third of the pricing pie is now deflating. This was ratified by the Atlanta Fed's flexible Consumer Price Index (CPI) metric, which deflated at a -7% annual rate in March in what was the steepest decline in two years. The comparable trend in the Cleveland Fed's 16% trimmed-mean CPI has wound down to levels last seen in the summer of 2021 and is hovering near levels during the 2001 and 2008 recessions.



Despite the disinflationary trends, Powell emphasized the Fed's "wait-and-see" approach to monetary policy, citing tariff uncertainty and a "strong case" to hold rates steady. He reiterated that the Fed's current monetary policy stance is "moderately restrictive" and that the central bank will continue to monitor economic data.

"There's so much uncertainty about the scale, scope, timing and persistence of the tariffs."
— Jerome Powell, Chair, Federal Reserve, post-meeting press conference, May 7, 2025

Powell also stressed that it's "too early" to know which side of the Federal Reserve's dual mandate (maximum employment and stable prices) should take priority, highlighting the uncertainty surrounding the impact of the new administration's policies. He stated that the Fed is "well positioned to wait for greater clarity" before considering any adjustments to policy.

In the context of the potential economic effects of tariffs, Powell acknowledged that they are likely to cause both higher inflation and slower growth. He emphasized the need to avoid a situation where a temporary rise in the price level becomes a persistent inflation problem, emphasizing the Fed's obligation to maintain stable inflation expectation.

The Fed clearly brushed off the mild contraction in first-quarter real gross domestic product (GDP), pointing to swings in net exports (mostly the pre-tariff import surge) and stuck with the word "solid" to describe the overall economic backdrop (consider it "cover" for not signaling any rate cut coming). The press statement was brief once again, but the new wrinkle was the addition of heightened risks around "higher unemployment and higher inflation." In other words, stagflation.

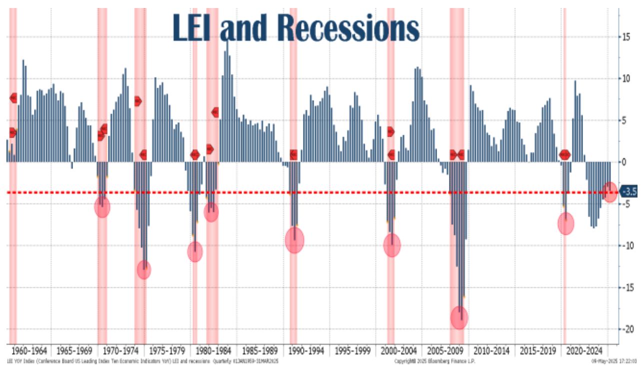
Bottom line: It is safe to say that if it weren't for President Trump and his tariff crusade, the Fed would be cutting rates and likely would have at last week's meeting. But Powell and crew are staring into a bog of uncertainty and are getting more nervous over a future of mild stagflation.

The hidden message is that the bar for Fed easing has been raised a touch in the commentary, and any political pressure to lower rates will surely be resisted.

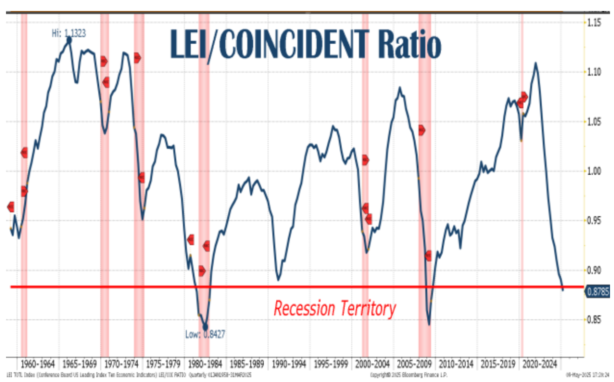
BLAME IT ON BIDEN

"I think the good parts are the Trump economy and the bad parts are the Biden economy because he's done a terrible job." — President Donald J. Trump

The Foundation for International Business and Economic Research (FIBER) "leading" economic indicator just rolled over into negative terrain for the first time since the summer of 2023. This followed on the heels of the Conference Board's Index of Leading Indicators (LEI), which fell yet again in March by -0.7% month over month and a deeper decline than the -0.2% reading in February. **This was the fourth consecutive decline, and the twelfth in the past thirteen, taking the index down to a near-decade-low.** The year-over-year trend, at -3.5%, has been under water now for every month since July 2022. As depicted in the graph below, this has historically been a surefire recession barometer.



Also noteworthy, the Index of Coincident Indicators barely budged and has seen its growth rate throttle back to a mere +1.1% annual rate so far this year (from +1.4% this time last year and +2.6% in 2023).



Bottom line: The official recession starts when the weakness in the LEI finally begins to morph into the Coincident Index…and we are nearing that point. In fact, the ratio of leading-to-coincident indicators strongly suggests the recession may have already arrived.

THE PAUSE

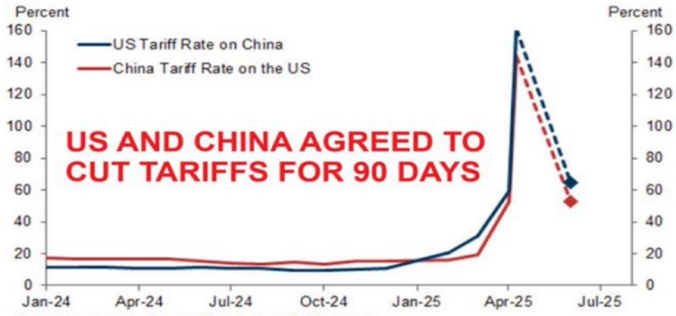
"As we say back in China, if the dishes are delicious, the timing doesn't matter…Whenever it gets released, it will be good news for the world." — Li Chenggang, Chinese Vice Commerce Minister

The trade talks between the U.S. and China began over the weekend. After two days of talks in Switzerland aimed at de-escalating a trade war, both sides agreed to a reset.

- The U.S. and China agreed to LOWER tariffs on each other for 90 days until further agreement is reached.
- The U.S. cuts tariffs on Chinese goods to 30% from 145% (a base 10% plus 20% fentanyl duty) from May 14.
- China cuts tariffs on American goods to 10% from 125%.
- Reductions DO NOT include sectoral duties imposed on all U.S. trading partners, and the tariffs applied on China during the first Trump administration remain in place.

The China trade deal simply pauses Trump's trade war for 90 days. The only deal is both sides roll back their escalated tariffs. This means we're in the same position we were before Liberation Day, except Americans are paying 30% tariffs while the Chinese are paying 10%.

Exhibit 1: We Expect US-China Tariffs to Fall from Prohibitive to Merely High



Note: Statutory rate. Dashed lines indicate GS forecasts.

Source: Goldman Sachs Global Investment Research

Treasury Secretary Scott Bessent said that neither side wants to decouple.

As a reminder, in 2018, both sides also agreed to pause, but the U.S. backed away from that, which led to more than 18 months of further tariffs and talks before signing a deal in January 2020. At the time, the president called it "historic" and said it was "righting the wrongs of the past." Nevertheless, China failed to fulfill the purchase agreement included in that deal and the U.S. trade deficit with China has widened even further.

"This is so exhausting. There's no playbook on how to trade this."
— Ken Mahoney (sitting on a 40% cash position), CEO, Mahoney Asset Management

Bottom line: While the stock market salivates over the word "deal," or in the case of the U.S.-China file, "substantial progress" being made over the weekend (Dow futures have soared over +800 points overnight), the fact of the matter is that all the waffling over trade and tariffs the past month and the "spin" coming out of the White House has only aggravated the extremely elevated level of economic and policy uncertainty. The excitement today could well end up being on fragile ground — a pause may end up being just a pause.

Thus, while a short-term relief for markets, we need to be wary that just one headline may reverse everything again.

Let’s also see how much damage the recent tariffs have done to the U.S. economy and follow the economic data that is coming in May.

Nobody should pretend to know where this all still leads. All we know is that volatility runs in both directions.

In other words, UNCERTAINTY still reigns supreme.

WHY THE PAUSE?

Both sides acknowledged a reduction in tensions and tariffs was necessary. Indeed, as depicted below, Chinese exports to the U.S. had been cratering and fears of pandemic-level shortages and supply-chain shocks likely contributed to the urgency to deescalate and allow global trade to begin again.

What does not make it to the media here at home is how Beijing, over the years, has flipped the leverage so that the world is reliant on China. China has been very strategic in expanding ties to the rest of Asia and also made itself vital to the world supply chain. As if we didn’t see this play out during the pandemic.

Not to mention how China has cornered the market for the development and processing of rare earth minerals, which are essential for assembling everything from cars to solar panels, wind turbines to missiles, drones to robots, and everything that falls within the realm of electronics.

On top of these strategic cards that Xi Jinping holds, the looming threat of empty store shelves and higher consumer prices is putting added pressure on the Trump administration to scale back this trade war and to do so in a hurry. As shown below, inflation from missing Chinese goods is already showing up at retailers. (See red line in graph below.)

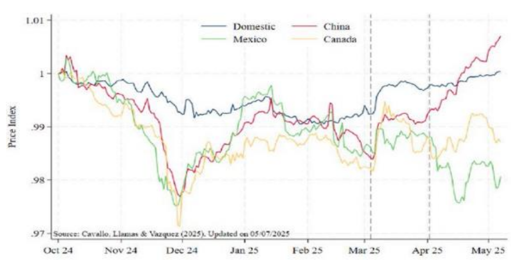


Figure 2: U.S. Retail Price Indices by Country of Origin

Bottom line: Regardless of any deals or frameworks in progress, the global baseline tariff rate imposed by the White House is moving to 10% from 2.5%. This represents a major shock to the $33 trillion global trade system.

Further, if we did all of this just to end up with a pause and have asset prices return to exactly where they were a month ago…why didn't we just…not do it?

Finally, not until the U.S. undergoes a dramatic change away from debt-fueled overconsumption can these trade surpluses ever end. Frankly, that is not a laudable goal to begin with.

CRONY CAPITALISM

*"**The United States was more than just a nation. It's a brand**. It's a universal brand, whether it's our culture, our financial strength, our military strength….**America rose beyond just being a country….It was like an aspiration for most the world. And we're eroding that brand right now." —** Ken Griffin, Founder and CEO, Citadel*

Speaking at the Milken Institute's Global Conference, Ken Griffin stated that the Trump administration's granting of tariff exemptions for products and industries signal that it's **"*very clear that we have roughly already — regretfully — unleashed an era of crony capitalism.*"**

After imposing 145% tariffs on China last month, days later the administration issued guidance that exempted broad categories of key tech imports, such as smartphones, chips and other electronics.

*"**Tariffs open the doors to crony capitalism.** The **government starts to pick winners and losers**…I thought that would play out over the course of years. **It's terrifying to watch this play out over the course of weeks.**"*
— Ken Griffin, Founder and CEO, Citadel

Similar comments were expressed by economist Douglas Irwin, who has warned that Trump's so-called reciprocal tariffs in particular "would fill the swamp, not drain it," as lobbyists for specific industries and companies pressure the administration for exemptions to individual rates.

Here's an example: After announcing the framework for a trade deal with the United Kingdom on Thursday that lowered tariffs on British cars to 10%, the U.S. auto industry criticized it for granting U.K. cars better treatment.

*"**This hurts American automakers, suppliers, and auto workers.** We hope this preferential access for U.K. vehicles over North American ones does not set a precedent for future negotiations with Asian and European competitors." — Matt Blunt, President, American Automotive Policy Council*

Bottom line: If this will be the way business gets done going forward, it will be a bad sign for America. If government favors certain businesses through regulations, subsidies or other means, it can and will harm the U.S. economy by distorting markets, hindering competition and potentially leading to a decline in overall economic growth and productivity. It would also erode public trust in the fairness of the system.

SOMETHING TO THINK ABOUT

***"We need to remember that a significant part of toy creation happens in America**…**Design, development, product engineering, brand management all happens in America. Making product, producing product in other countries, allows us to create quality products at affordable price points." —** *Ynon Kreiz, CEO, Mattel*

Comparative advantage is a theory created by British economist David Ricardo. It argues that countries can benefit from trading with each other by focusing on making the things they are best at making while buying the things they are not as good at making from other countries. This theory is based on the idea that every country has different cost structures and opportunity costs (costs in terms of other goods given up). By focusing on their strengths, they can produce more efficiently.

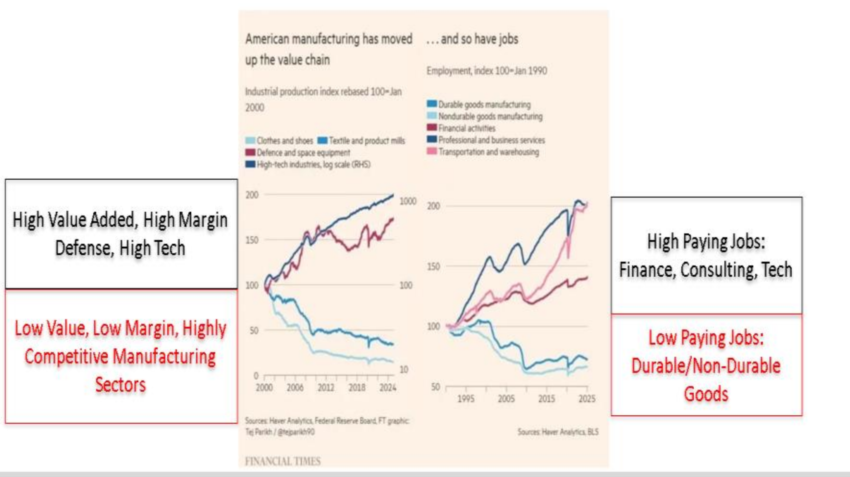
One of the goals of President Donald Trump's previous 145% tariffs against China is to drive manufacturing back to America. But the odds of that are low, at least when it comes to toys.

"We don't see that happening…*This is something we are committed to do…To continue to create quality product and find the right balance of price and value all in the service of the consumer." — Ynon Kreiz, CEO, Mattel*

Have a good look at the graph below. As the U.S. economy has advanced over the past two decades, we have shifted from "low" value to "high"manufacturing and jobs.

In other words, we replaced some of the lowest paying, longest hours, most competitive, most cyclical manufacturing jobs with quite literally the best jobs on earth. This is what any advanced economy should be doing.

Rather than weaving shoe laces and making T-shirts and producing toys, we are doing aerospace and research and development and consulting. I call this success.



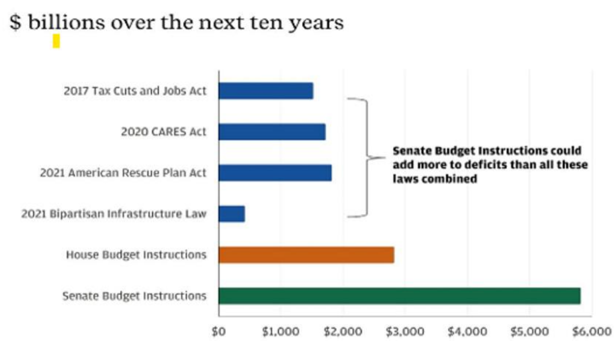
Bottom line: Trump wants to use tariffs to force U.S. companies to manufacture their products in the U.S. and wants U.S. retailers to sell fewer imported products. Apart from the fact that Americans should be free to produce where they want and buy what they want, Trump's authoritarian approach misses the bigger picture as to why domestic manufacturing is no longer viable.

U.S. companies would clearly prefer to manufacture domestically and U.S. retailers would similarly prefer to source their goods locally. The reason they don't is economics. Consumers want low prices, and the only way to satisfy that demand is through imports. Restricting imports does nothing to make domestic production more affordable. It just forces consumers to either pay higher prices for imports or look for domestic alternatives that are less expensive than tariffed imports.

Furthermore, for all the talk about how "globalization is evil," the Peterson Institute concluded in its research that the benefits from enhanced compensation and lower inflation brought by globalization have actually raised real GDP in the U.S. by +10% or almost +$20,000 per household.

WILL THE GOP DO THE RIGHT THING?

As the world gapples with the trade war, next up will be the fiscal budget negotiations and reconciliation between the House and the Senate. As the Congressional Budget Office points out below, both the House and the Senate versions will increase the debt by more than any recent law. That said, the Senate bill, if approved and enacted, would allow for a much larger debt impact than ANY recent law.



Sources: Congressional Budget Office, CRFB estimates, House

Meanwhile, 32 members of the House of Representatives sent a letter to House leadership laying out their conditions for supporting a reconciliation bill, reiterating that it should "adhere to the House framework" by including at least $2 trillion in budgetary savings or fewer tax cuts.

The members specifically call for the Ways and Means Committee's instruction to be lowered dollar-for-dollar in the event the other committees fall short on the minimum $2 trillion savings target as required under the budget resolution. They further add that savings must come from "real, enforceable spending cuts — not budget gimmicks."

The following is a statement from Maya MacGuineas, President of the non partisan Committee for a Responsible Federal Budget:

> *"At this moment — **when the national debt is skyrocketing, we spend more on interest than national defense, and trust funds are on the brink of insolvency — if there is one thing that should be clear from a fiscal perspective, it is that we should not be passing new policies that add more to the national debt.***
>
> *Accordingly, we are deeply concerned about the direction reconciliation plans are moving in and strongly oppose any approach that would add to the national debt. **This is a moment to reduce the debt, not grow it**.*
>
> *Both the House and Senate have come up with plans to pass tax cuts and defense and border security spending increases without requiring equal amounts of offsets. **They would allow $3 to $7 trillion in new debt — making it one of the largest deficit increases in history — while relying on unrealistic economic growth assumptions and budget gimmicks to paper over the extent of the additional borrowing.***
>
> *That said, **when comparing the House and Senate approaches, it is glaringly obvious that the House's approach is far superior (meaning less bad) to that of the Senate.** The House instructions call for smaller tax cuts and larger spending cuts while including an honest and consistent baseline and a mechanism to limit increases in overall borrowing. **The House would allow half as much added to the debt as the Senate and requires 500 times as much in spending cuts and reforms.***
>
> ***We absolutely should not pass any legislation that adds to the debt, and we encourage lawmakers to focus instead on a plan to reduce the national debt while fully offsetting any tax cuts or spending increase**. But should lawmakers insist on moving forward with additional borrowing under reconciliation, they should at an absolute minimum abide by the House framework — which, while still allowing too much borrowing, would leave the country in a much better position than borrowing up to what the Senate instructions allow."*

Bottom line: Will the GOP revert back to its conservative fiscal roots and do the right thing, or will they follow the spendthrift Democrats and continue to kick the can down the road?

I hope for the former but fear the latter.

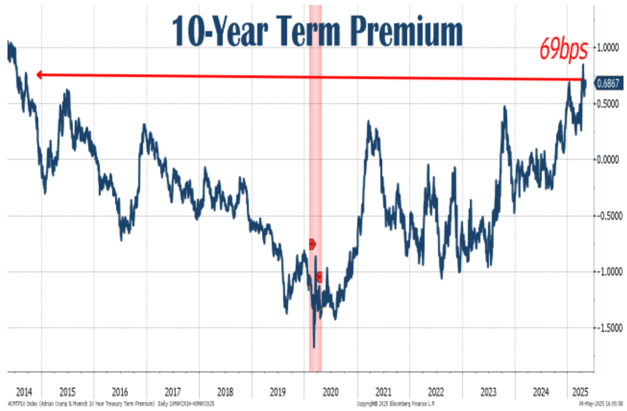
MARKET OUTLOOK AND PORTFOLIO STRATEGY

> *"Tariffs are the largest tax hike since the 1960s, so you can probably take 2-3% off growth. And you will probably hit new lows." — Paul Tudor Jones, Founder and CIO, Tudor Investment Corporation*

Risks are on the rise, and greater uncertainty is staring investors in the face.

The Fed's pause this past week was widely expected and had slightly hawkish notes, with uncertainty as the focus. The benchmark 10-year Treasury yield rose +5 basis points.

The following graph illustrates that the 10-year Treasury "term premium" (the additional compensation investors demand for holding longer-term bonds) is floating around at 11-year highs amid massive uncertainty.



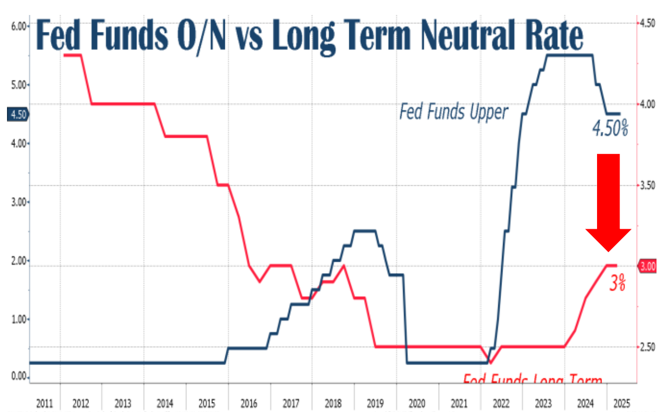
Indeed, Treasuries are facing an increasing number of crosswinds of late — from recent tariff fears, talk of de-dollarization, the end of “American exceptionalism,” lingering fiscal unease and overall heightened levels of uncertainty.

Yields have sold off despite what has been generally constructive pricing data and overall economic uncertainty. The conditions would otherwise be conducive for a flight-to-safety bid. But markets are seemingly experiencing the opposite as a rising term premium (a proxy for overall investor uncertainty) pushes market rates higher.

I do acknowledge that current conditions are rather unique. However, long-term, I expect these pressures to fade and a “normal” market backdrop to reassert itself — akin to what investors have become used to for the past 40+ years — ultimately pointing the trend in U.S. rates lower.

Interest-rate futures show the Fed is still expected to cut rates three times this year, but the timing keeps getting pushed out. The odds are at 60% now for three 25-basis-point reductions, down from 75% just before last Wednesday’s Federal Open Market Committee meeting and 88% the week before. Then again, this is a headline-driven market, not a policy-driven market, so all that really matters is the latest tweet or comment about trade deals coming out of the White House.

In the interim, a slower pace of rate cuts should “eventually” result in the Fed bringing rates lower towards neutral (as shown below estimated at 3.0%).



In terms of positioning, the maturities that “carry” the best risk reward are in the “belly” of the curve. Mid-single-digit total returns are available in the 5- to 10-year bucket, but credit unions cannot be faulted for shifting even further towards the front-end for a similar +4% total return on the 2-year Treasury note to help protect against any hiccups in interest rates along the way.

MORE INFORMATION

For more information about credit union investment strategy, portfolio allocation and security selection, please contact the author at **tom.slefinger@alloyacorp.org** or (630) 276-2753.

As Alloya's Market Strategist, **Tom Slefinger** leverages nearly 40 years of investment strategy expertise to deliver insightful commentary on the economy and market events to optimize balance sheet performance at the credit union level. With thousands of subscribers, Tom's daily and weekly publications are widely read amongst credit union executives.

Prior to becoming the corporate's Market Strategist, Tom served as the Senior Vice President of Institutional Fixed Income Sales at Alloya Investment Services, a division of Alloya Solutions, LLC. In this role, Tom developed and managed operations associated with institutional fixed income sales in addition to developing investment portfolio strategies, identifying appropriate sectors and securities, and optimizing portfolio performance at the credit union level.

Tom holds a B.S. in business administration from the University of Maine. In addition, he holds a Series 7 and 63 through ISI.

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