Tom Slefinger
Market Strategist

Weekly Relative Value

WEEK OF MAY 27, 2025

One Big Beautiful Debt Bomb

*“**I’d love to stand here and tell the American people, we can cut your taxes and we can increase spending and everything’s going to be just fine.** But I can’t do that because **I’m here to deliver a dose of reality**.”*

*“This **bill dramatically increases deficits in the near term, but promises our government will be fiscally responsible five years from now**. Where have we heard that before? How do you bind a future Congress to these promises? T**his bill is a debt bomb ticking.**”*

“Congress can do funny math, fantasy math, if it wants… But bond investors don’t…. We’re not rearranging deck chairs on the Titanic tonight. We’re putting coal in the boiler and setting a course for the iceberg.”
– Congressman Thomas Massie (R-KY)

The majority of Republicans in Congress, taking their marching orders from President Donald Trump, passed the Big, Beautiful Bill (BBB) last week.

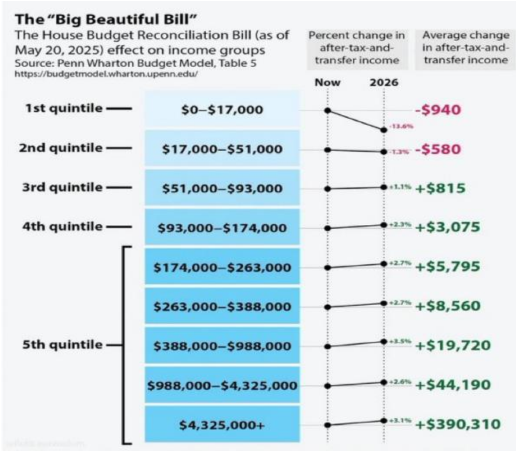
Here are the key highlights:

- The plan will raise the nation’s debt ceiling by $4 trillion.
- The nonpartisan Congressional Budget Office (CBO) finds that the bill will lead to over $3 trillion in new red ink over the next decade.
- The BBB included a higher state and local tax deduction of $40,000 annually in the package, up from the current annual deduction of $10,000.
- The no tax on tips and overtime provisions exclude “highly compensated employees” who fall above certain thresholds.
- The child tax credit goes to $2,500 from the current $2,000 level.
- The standard deduction goes from $15,000 to $16,000 for single filers.

THIS WEEK

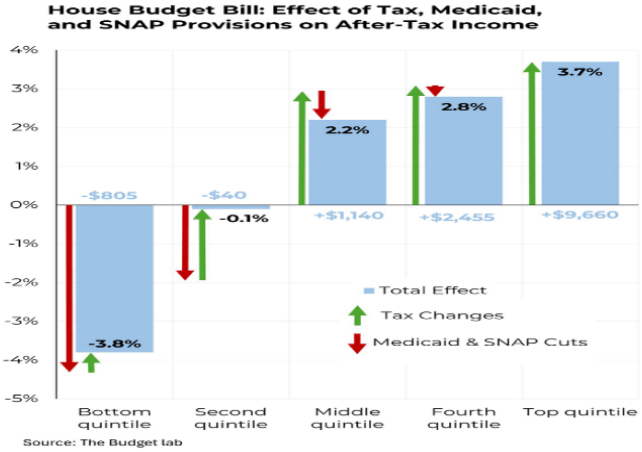
SUBSCRIBE

The image below shows who would be the primary beneficiary of the BBB. Not surprising, the lowest incomes lose ~13.6% while the ultra-wealthy gain ~$390,000.



Source: CBO

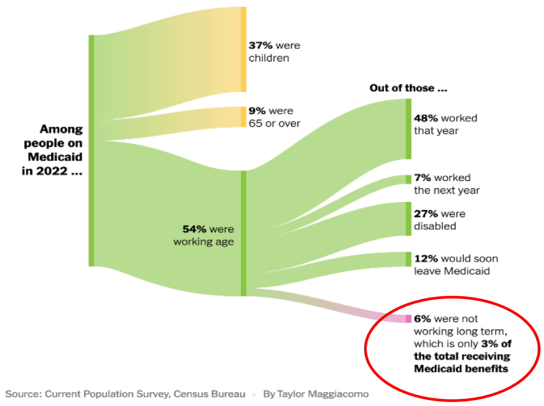
The big tax giveaways to the wealthy combined with cruel cuts in programs (especially Medicaid) that serve lower-income Americans will cause hardship to the bottom 4% of Americans, especially the poorest fifth. The nonpartisan Yale Budget Lab believes the bottom two quintiles will see a reduction of after-tax income (including Medicaid and SNAP cuts) while the top three quintiles will see gains of 2.2% to 3.7%.



As a brief reminder, Medicaid provides health insurance program for low-income Americans who do not have any other way to pay for medical care. **In 2023, Medicaid covered 69 million Americans, far more than Medicare (which covers seniors), including 39% of children.**

Yes, there could be some fraud in Medicaid but the belief that many Americans receiving government support could and should be working but are choosing to be lazy is a ZOMBIE idea. This is the trickle-down theory where cutting taxes on the rich will unleash an economic miracle. It has been proved wrong by experience repeatedly.

The reality is that almost everyone on Medicaid is either a child, a senior, disabled or between jobs. Only 3% of Medicaid recipients were non-disabled working-age adults persistently not working.



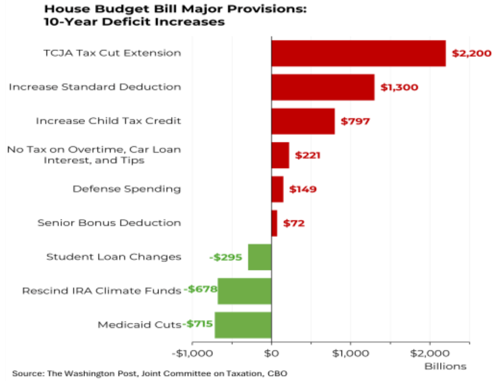
Bottom Line: The STIMULUS in this bill is NOT going to be IMPACTFUL**.** Poor people spend all the money they have back into the economy. The BBB cuts their after-tax income. On the other side, the AUSTERITY in this bill is going to be IMPACTFUL. Rich people invest all the excess money they have into financial assets. This doesn't lead to economic growth.

MR. BOND IS NOT HAPPY!

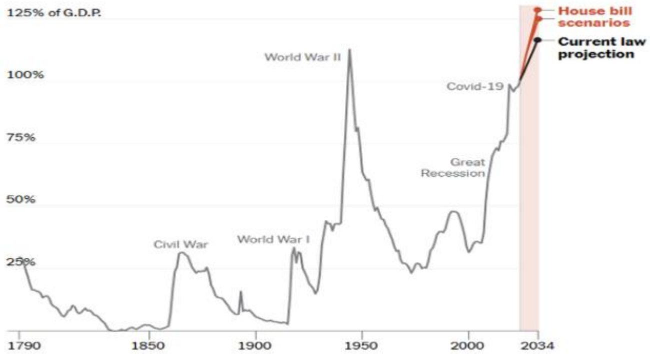
"The Big, Beautiful Bill not only won't make America Great Again, but it continues the destructive fiscal policies that contributed to our fall from greatness. Ironically, it may be the straw that breaks the camel's back, ushering in a long overdue dollar & sovereign debt crisis." – Peter Schiff, American Stockbroker

The BBB contains 1,116 pages, yet not a single page reduces future deficits. In fact, they make them larger. Only two House Republicans had the courage to vote against this monstrosity.

The BBB does cut some spending, but only in the out years because it is all delayed. In fact, spending will remain above 2024 levels for at least the next six years! In other words, this BBB does nothing to return the U.S. to a level of spending where it would even be possible to balance the budget.



After years of massive overspending, it should come as no surprise that fiscal worries are intensifying as the BBB adds +$3.3 trillion to the deficit over the next decade at a time when we already have over $36 trillion of debt outstanding. Moreover, if enacted, it would end up taking the U.S. debt-to-GDP ratio up an astonishing +25 % to 125% by the end of 2034 and to a new RECORD high going back to 1790! This does begin to resemble a Banana Republic.

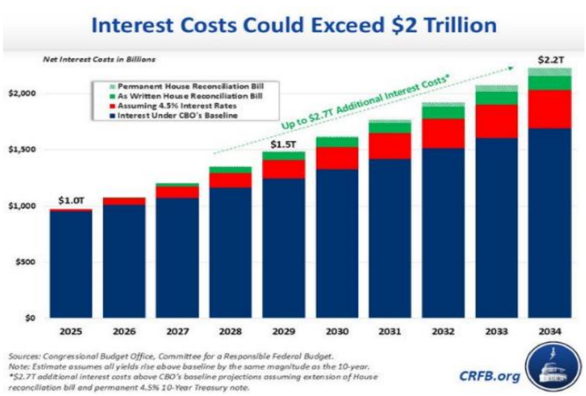


Source: Haver Analytics

While the White House has tried to convince everyone that the BBB will not add a dime to the deficit projection, the non-partisan Committee for a Responsible Federal Budget (CRFB) sees things very differently. They estimate that the BBB plan will increase the national debt by at least $3.3 trillion through to the end of 2034. Who do you believe?

Furthermore, the situation has become "structural" because the high and rising interest expense on the debt (now more than $1 trillion annually) has doubled from where it was just five years ago and now exceeds what Uncle Sam spends on defense as well as on Medicare**.**

If the 10-year Treasury yield stays at 4.5% (and other yields maintain at respective levels), and if lawmakers pass and extend the House reconciliation bill, the CRFB estimates interest costs would more than double to $2.2 trillion in 2034. This would consume 29% of all revenue. I, for one, do not want to pay $2 trillion in interest. Do you?



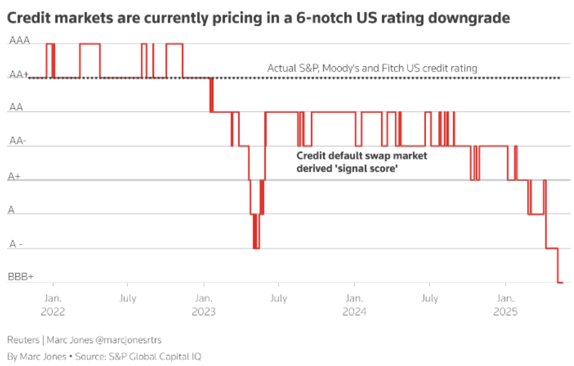
Due to Moody's rating downgrade, for the first time ever, the bonds of the world's reserve currency are no longer rated AAA by ANY major rating agency. Treasury Secretary Scott Bessent says, "who cares?"

But the problem with Bessent's "who cares?" argument is that it does not account for the fact that the market thinks the U.S. credit rating should be far lower.

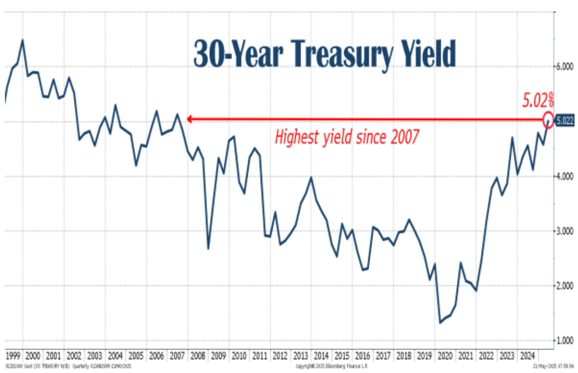
Not only does the U.S. have the weakest sovereign balance sheet of any other AA-rated countries on the planet, but the deficit and debt ratios are now practically the same as Egypt (rated B) and China (rated A+).

To highlight the credit concerns, just a day after the $3.8 trillion BBB was passed in the House of Representatives, the cost of U.S. credit default swaps (which pay off in the event of default) have astonishingly intersected with the price of Greece's credit default swaps.

Moreover, using credit default swaps pricing as an input, the S&P Global's Capital IQ model puts the U.S. sovereign credit rating six notches lower than its current grade… all the way down to BBB+. It is barely clinging to investment grade status, never mind AAA. Indeed, one of the most transformative aspects of the investment landscape today is the reclassification of Treasuries as a RISK ASSET.



Meanwhile, the Treasury market is telling the White House to cool its jets on the Trump desire to keep priming the fiscal pumps. Long-term interest rates are close to their highest level in nearly two decades. The surge in rates is mostly due to the surge in the term premium, reflecting ever-higher fiscal risk**.**



Soaring rates are extremely important because $9 trillion of U.S. government debt will need to be refinanced in next 12 months. This will worsen an already challenging situation in America.

Unlike Bessent, I think the fiscal recklessness is a big DEAL and the one "price" that recognizes this is the U.S. dollar index, which is slip sliding away yet again.

As shown in the graph below, the dollar, which rose after Trump's election, has now fallen sharply to three-year lows. It's a good thing there is not a replacement at the current time**.**

Meanwhile, foreign investors are clearly diversifying away from U.S. assets.

Bottom line: As the White House and the House of Representatives collude to take the federal debt-to-GDP ratio to record highs, breaking above any wartime peak levels of the past, we should all be very concerned. For bonds and for stocks, what is happening in Washington is kryptonite.

TRUMP'S LEGACY

Whatever happened to reducing the budget gap? Wasn't that part of the election campaign?

Trump is not going to run again. This means he had an excellent opportunity to ignore the midterms and do something right for the nation.

He had complete control of Congress, with cult like obedience to anything their leader tells them.

He could have simplified the tax code.

They could have frozen spending growth on entitlements for a decade.

They could have demanded the Pentagon pass budgets or accept automatic sequestration.

They could have come in and said taxes need to be modestly raised across the board to help pay back the years of profligate spending that everyone benefitted from.

They could have done all of this through legal routes, and most importantly through Congress to make it permanent.

But no.

Instead, Trump increased spending, increased deficits, decreased revenue, made the tax code more complex, made the tax code more unfair and raised taxes through tariffs (impacting small businesses and the lower income brackets the most). To add onto this, he wants a ridiculous "Golden Dome" defense system that will cost trillions of dollars and is not even in this budget analysis.

Bottom Line: This was a golden opportunity to take steps to change the trajectory of excess spending, debt and deficits. Sadly, if this BBB makes it through the Senate, just the opposite will occur.

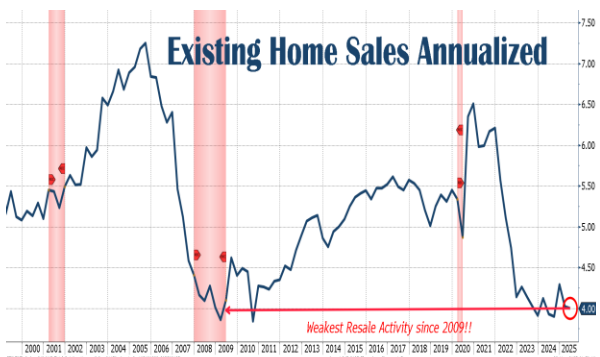
HOMESICK

"Home sales have been at 75% of normal or pre-pandemic activity for the past three years, even with seven million jobs added to the economy." – Lawrence Yun, Chief Economist, National Association of Realtors

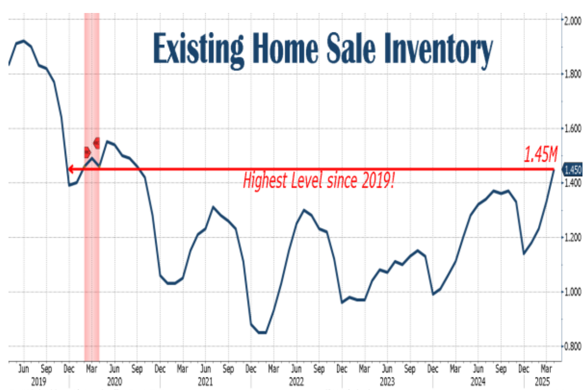
The existing home sales data for April showed that the hotly awaited spring selling season has fizzled.

Existing home sales dipped -0.5% month-over-month to a seven-month low of 4 million units at an annualized rate. It says a lot that home sales are lower today than they were in October 2008, the month after Lehman collapsed and when the economy was in an outright recession.

As depicted below, resale activity began collapsing in early 2022, after the median price had spiked by 50% in just three years. At the same time, mortgage rates were on their way to the 7% range. And demand destruction followed.

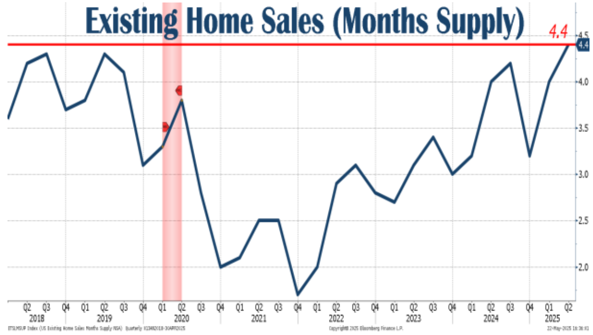


At first, in 2022, low inventories were blamed for the collapse in sales, but now supply has soared to the highest level in years, and sales have plunged even further. The inventory of existing homes for sale jumped by 9.0% in April from March, and by 21% year-over-year to 1.45 million listings, the most for any April since 2020.

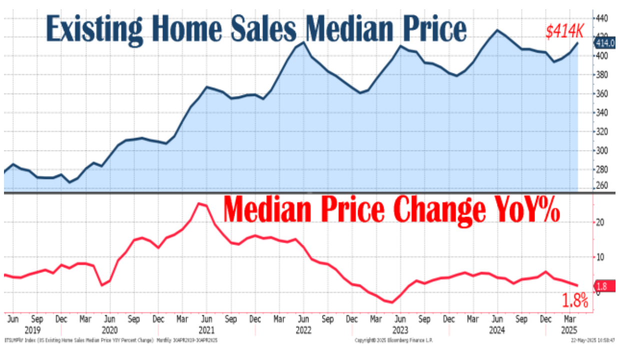


The unsold housing inventory backlog (measured in terms number of months) is a useful indicator of bearish pressure in the housing market. Unsold inventory sits at a 4.4-month supply at the current sales pace, up from 3.5 months in April 2024.

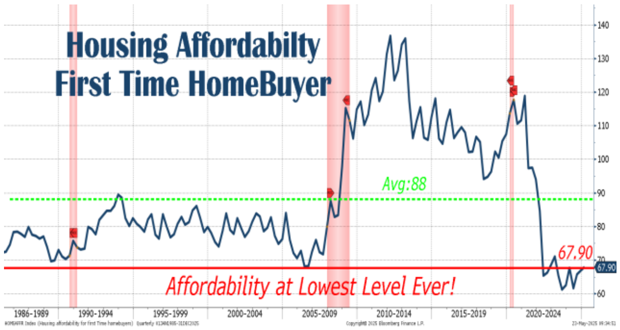
The supply-demand mix in favor of lower prices was last here in May 2020 and in September 2016.



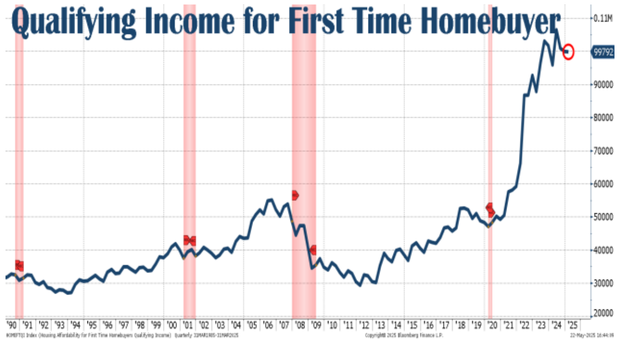
The median sales price climbed to $414,000, a record for the month of April. This reflected greater activity at the upper end of the price spectrum. That said, greater supply is beginning to bring prices down**.** The median sale prices dipped -0.4% month-over-month and have deflated now in each of the past four months. This is the longest losing streak in over 14 years. The year-over-year trend, which had been running at +5.4% a year ago, has cooled to +1.8%, the fourth month in a row of narrowing year-over-year increases.



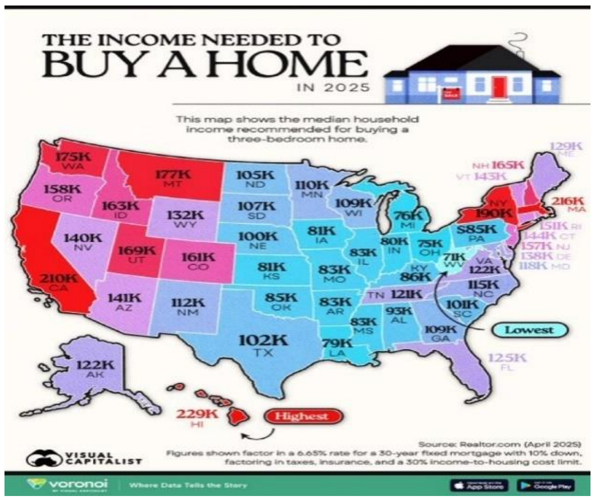
Home prices have more than doubled since 2011, jumping 143% in nominal terms. And with mortgage rates hovering around 7%, buyers today are facing the most expensive combination of prices and borrowing costs in modern history. As shown below, home affordability is at the lowest level EVER! This super-stretched homeowner affordability ratio will require at least a further -20% drop in nationwide real estate values from here.



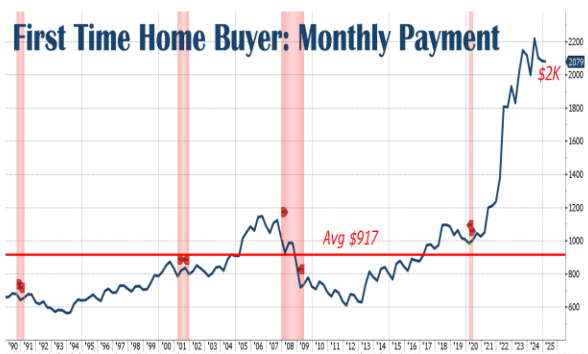
It still takes $100,000 of median first-time buyer income to qualify for a loan. This is twice what it took pre-pandemic. Needless to say, this is a bit of a problem from a potential purchaser standpoint since the actual median income for this group of homeowner wannabes sits below $68,000 or over a 30% gap.



If you are wondering what the qualifying household income to buy a three-bedroom home is in your home state, have a look at the chart provided by Visual Capitalist.



On a national level, the combined mortgage and principal payment per month is $2,100 – well over double the historical norm. Moreover, with mortgage rates backing up and income growth slowing as the labor market takes on more slack, the American Dream truly is a DREAM.



Bottom Line: The median price exploded by 50% in the three years between June 2019 and June 2022, on top of the large price gains in the prior 10 years, driven by the Fed's interest-rate repression. Now, prices are simply way too high and do not make economic sense. Textbook demand destruction has ensued.

While lower rates would be welcomed, the real PROBLEM is the PRICE! Prices need to fall to restore housing affordability to normal levels. While not apparent at this juncture, I believe we are now in the early stages of a real estate deflation cycle. If so, consider the possible "wealth effect" hit on spending from an additional 20% hit to a $52 trillion asset on household balance sheets called "residential real estate." This would be roughly a $500 billion drain from consumer spending.

A TALE OF TWO LABOR MARKETS

There are still no warning signs being flashed by the headline initial jobless claims data, which came in a tad below expected, at +227,000, for the week of May 17. At face value, a layoff cycle has yet to take hold.

On the other side of the ledger, the fact that the backlog of continuing claims jumped by +36,000, for the lagged week of May 10, to 1.9 million highlights the increased difficulty that the ranks of the unemployed are having in terms of landing a job.

And while the U-3 unemployment rate languishes at a low 4.2% rate, beneath the surface you are seeing a big drop in labor demand, job openings, hiring rates and job hopping. Workers are far less confident than they were in 2021-2023. This is clear in surveys showing much higher fear of job loss and lower wage expectations.

Bottom Line: It's a different complexion to the job market today than it was pre-pandemic. Companies are hoarding their existing staff but have taken the "for hire" signs off the front door. Sclerosis. And what we know about hiring rates is that they are a leading economic indicator while firing rates tend to lag the cycle. It's not about the 4.2% lagging unemployment rate.

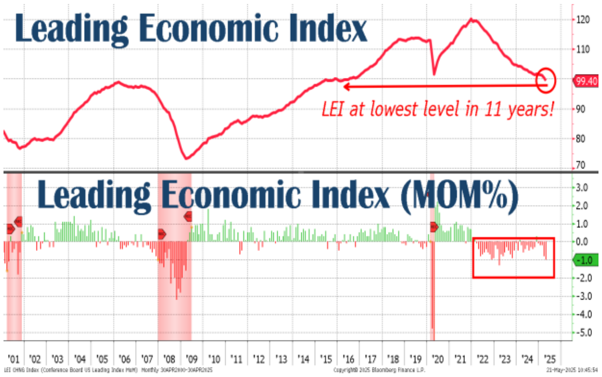
IT'S THE ECONOMY STUPID!

"It's the economy stupid" was a phrase coined by James Carville in 1992 when he was advising Bill Clinton in his run for the White House.

In a week bereft of top-tier economic data, the economic news out of the U.S. remained poor. All anyone needs to know is that Main Street is so freaked out by everything that Costco had to limit its gold bar sales to just one per customer so it would not run out of supplies too quickly.

As for the data, the Conference Board Leading Economic Index (LEI) - composed of ten indicators that cover a broad range of economic activity- offers a comprehensive view of the economy's future direction. Last week, the LEI tumbled -1.0% month-over-month in April after a -0.8% falloff in March. This was the FIFTH straight decline to the lowest level since March 2016. As shown below, the LEI is now at the lowest level in 11 YEARS. The drawdown since the peak has been ~17 %, the biggest since the Great Financial Crisis. Such a drop has never happened outside of recessions.

While fallible, the LEI has a history of peaking and declining before recessions. Historical analysis shows that it has successfully predicted all but two U.S. recessions in the last 60 years.



In the wake of the LEI, the Chicago Fed National Activity Index (NAI) for April was released. This index consists of 85 variables and is arguably the most comprehensive monthly economic update. Like the LEI, the NAI came in very weak in April at -0.25 after the +0.03 print in March. In other words, from stagnation to contraction in just the span of one month.

Every component of the Chicago Fed NAI was either flat or negative in April, from production to personal consumption to housing to sales/orders/inventories and finally employment.

This was not an official data point, but it may as well have been. Target sales in the three months to May 3 fell -3.8%, reflecting both lower foot traffic and less money spent per visit. Compared to Walmart, Target relies much less on staples like groceries and far more on discretionary goods such as electronics.

One other article that speaks to a consumer recession that may already be staring us right in the face was contained in the *Wall Street Journal* article, "**Europe Is Out. Road Trips Are In. Welcome to the Scaled-Back Vacation.**"

Here's an excerpt from the article:

"Summer vacation is getting a makeover. Americans are planning to take time off this summer, but their concerns about the economy are prompting them to swap air travel and extravagant holidays for road trips and shorter vacations."

Bottom line: Consumer-led recessions begin with this sort of shift in consumer behavior – it shows up in the "hard data" when it is already too late for investors to respond. Keep your eye on the ball; try and peek at what lies around the bend.

TRADE WAR RESUMES

Not sure this is well understood, but the EU bloc is America's biggest trading partner. The U.S. exported more than $350 billion of goods to the 27-nation bloc in recent years and imported $550 billion worth of goods.

Trump has repeatedly attacked the EU, calling it "in many ways, nastier than China." In a post on his Truth Social platform, Trump wrote that he *was* "recommending a straight 50% Tariff on the EU, starting on June 1, 2025." Note that two days later, Trump extended the deadline to July 9. Regardless, that rate would be higher than the 39% Trump promised to hit the bloc with on April 2's so-called Liberation Day.

Speaking after Trump's social media posts, Chicago Federal Reserve President Austan Goolsbee noted:

"10% was going to be the highest tariff rate that we had on the world in 90 years. To go to 50% is a completely different order of magnitude."

Just minutes earlier, Trump had also threatened Apple with a 25% tariff if it does not start producing iPhones in the U.S.

Most analysts, including yours truly, do not believe this will happen due to the higher costs consumers would pay for their phone.

"The concept of Apple producing iPhones in the U.S. is a fairy tale,"
– Daniel Ives, Senior Equity Research Analyst, Wedbush Securities

Bottom line: We've gone from the President assuring us that they had "200" deals done and countries "kissing his butt" to make deals to new threats of returning to reciprocal tariffs if countries don't make deals. Moreover, suffice it to say, putting 50% tariffs on your largest trading partner is downright stupid. Moreover, forcing a company to manufacture their product in the U.S. is equally stupid. I'm old enough to remember when we had free trade.

MAGA MAOISM

Meanwhile, the way to generate economic confidence is definitely NOT to interfere in private business. The President targeting Walmart crossed a line *(*"EAT THE TARIFFS"*),* not unlike how the Democrats last year threatened the food retailers. However, in this case, it is about targeting a specific company whose responsibility is to its shareholders.

Is the White House aware that the retailers, even the largest ones, operate on ultra-thin margins? And would it really be better for the economy if companies like Walmart preserve their margins by laying people off?

Finally, when Trump was a real estate mogul, did anyone from the government tell him where to set his hotel rates?

My recommendation to the White House is to read *The Social Responsibility of Business is to Increase Its Profits* penned by Milton Freidman. Read it and reread it.

There is nothing unethical about Walmart preserving its slim margins (approximately 2%) and maximizing profits for its shareholders in a very competitive retail environment.

Frankly, I am stunned there has not been a greater pushback on this in the business media. Is capitalism being put on trial?

Bottom line: Trump seems awfully fond of the command-economy playbook, in which the central government calls the shots and sets the prices. This dovetails with what some critics have labeled "MAGA Maoism," which is rattling businesses, consumers, and investors while throwing global markets into turmoil.

TRAVEL TO U.S. PLUMMETS!

The decline in Canadian tourism, as a de facto boycott fueled by nationalism (and anger), has pushed Canadian visits down. But it’s not just Canada. The latest data on European business travel suggest this is a worldwide phenomenon.

As reported by POLITICO, data from Hotel Hub find that business travel from Europe to the U.S. were down -26% year-over-year in April when compared to April 2024. On the surface, it suggests that businesses are prioritizing more stable, non-U.S., destinations for travel.

What is interesting is that this is not travel by the potentially more fickle consumer – it is travel from business passengers. This data not only hit at U.S. GDP directly but could be a canary in the coal mine. Less business travel now means fewer deals, less investment and fewer joint ventures in the years to come.

Bottom Line: The world may start to pass on by and don’t be surprised to see more bilateral travel and dealings among Europe, the U.K., Japan and China.

MARKET OUTLOOK AND PORTFOLIO STRATEGY

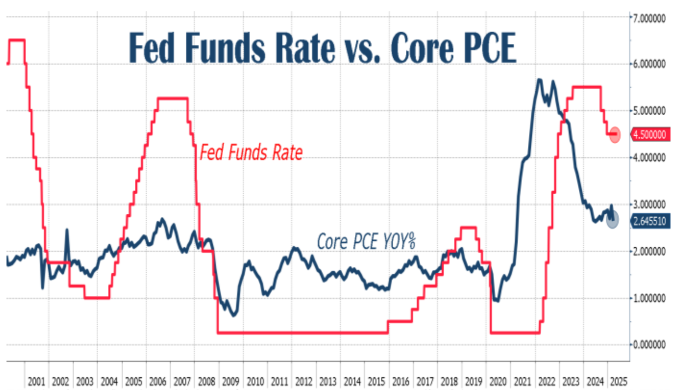
"Most firms I talk to, there's this kind of simple rule of thumb. You know, a third of it will be eaten by the supplier, a third of it will be eaten by the firm, and a third of it will be passed on. So if it's a 10% tariff, imports are 10% of the price index, so 10% on 10% is a 1% increase the price level. That means only a third of it is going to get passed through. So, instead of something like 2.5% you might see something like 2.8%, but that's it, and then inflation should start coming right back down…We're in a good position to kind of move with rate cuts through the second half of the year." – Federal Reserve Governor Christopher Waller

We have a trade shock and a fiscal shock.

Because of total fiscal irresponsibility displayed by Congress and Trump, plus tariff madness, the bond markets have now priced out rate cuts for June and July. A month ago, the odds of at least a quarter-point rate cut for July were over 98%. Today, the odds are 29%.

As for the Fed, the key message from pontification of speakers last week was "uncertainty". Uncertainty about policy, uncertainty about how companies and consumers would react to that uncertainty, uncertainty about second-round effects from tariffs, and so on. The result is a wait-and-see approach from the Fed. The risk is that a reactive policy may come too late to correct any economic damage from all the uncertainty.

Given that the current Fed funds rate is nearly 200 basis points higher than the Fed's preferred inflation metric (core PCE), the Fed has the requisite room to lower rates significantly. Sadly, if it were not for the UNCERTAINTY around the trade war and fiscal policy, the Fed would have continued its rate cutting strategy that commenced September 2024.



The UNCERTAINTY is reflected in the term premium (how much extra return is required to own longer term maturities), which has spiked +60 basis points since early April to the highest level in 11 years and is now over +100 basis points above the norm of the past decade. It would be one thing if inflation expectations were surging. It would be another if growth expectations were surging. Only 15 other times back to the early 1960s has the term premium surged this much over a one-year period and this coincided with economic recessions more than half the time. This sharp rise in the term premium is a major negative shock on the economy and will blunt the impact from the BBB.

Indeed because of the UNCERTAINTY surrounding trade and fiscal policy, Treasury yields are now significantly higher than when the Fed began its rate cutting cycle. Meanwhile, the President is blaming the Fed for keeping rates elevated. Yet, since the jumbo (50 basis point) policy easing on September 18, the 10-year Treasury yield has shot up by nearly +100 basis points. While the President does believe he knows more about interest rates than the Fed Chairman, the reality is that the central bank only controls the very front end of the bond curve. Treasury yields basically are determined by investors. Maybe they need a good talking to from the Oval Office.

In the meantime, the yield curve has steepened to the highest level in over FIVE years! While long-term rates could continue to rise from here given the current backdrop, there is no question that the risk/return of moving out the yield curve has improved significantly.

Bottom line: Unquestionably, in the current environment, the trade war creates inflationary fears. However, I continue to believe that the ongoing trade war will have a much more significant and negative impact on economic growth and employment than prices. In other words, this environment is more deflationary than inflationary. Even if prices are raised, it will be a one-time shock and not a long-lasting trend.

In this environment of extreme volatility, the only prudent thing to do is to stay on course. Continue to maintain a risk-appropriate ladder strategy while buying bonds on price dips.

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.

There is a lot of noise in the financial world and social media about the markets and the economy. I do what I always do, block out the noise, rhetoric and bullish biases that dominate Wall Street research and, most of all, keep investors out of trouble. This constant analysis goes through the noise, debunks misleading headlines and makes deep dives into the financial markets and economic reality.

Call me a "permabear" if you will, but I see myself more as the car mechanic who fixes your brake lights and makes sure your side-view mirrors are okay. Risks should never be ignored and identifying them is what I focus on. It's what makes this research unique in the marketplace**.**

By subscribing, you will always be up to date with what is relevant, and you will be aware of the key risks.

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.