



Tom Slefinger
Market Strategist

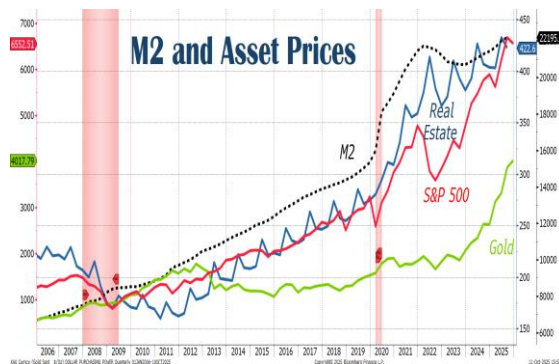
Weekly Relative Value

WEEK OF OCTOBER 14, 2025

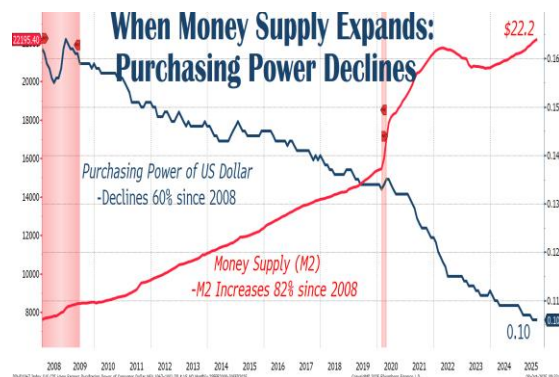
The K-Shaped Economy

"If you are on the other side of the K, then doing what you've always done and waiting for a macro recovery is a bad strategy." – Dan Furman, Inc. Magazine

The policy of the “establishment” is, and has been, to expand the money supply in ways that inflates the value of financial and real assets. These policies overwhelmingly benefit the wealthy who already own assets while eroding the purchasing power of everyone else. As shown below, if you own assets, you have done well. If you do not own assets, you are barely getting by. Since 2020, the S&P 500 has risen 102%, gold has gained 166% and residential real estate has appreciated 51%.



As asset prices have soared, the purchasing power of the U.S. dollar has steadily declined as the Fed has turbo charged its money printing operation. And right now, money supply (M2) is reaccelerating at the fastest pace since 2022.



THIS WEEK

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SUBORDINATED DEBT: (SIMPLIFIED)

Partnership has its perks.
Hand over the hard parts.

TELL ME MORE!



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This in turn leads to:

- More debt.
- More fiat currency.
- More liquidity funneled into asset markets.

History may not repeat, but it sure rhymes. When money supply expands, purchasing power contracts. History doesn't lie!

The last word goes to the Oracle:

“The natural course of government is to make the currency worth less over time...They devalue it at rates that are breathtaking.” – Warren Buffet

HIGHER ASSET PRICES DRIVE CONSUMPTION

As the establishment drives asset price higher, the rising stock market valuations continue to drive consumer spending in America, with the Top 10% of U.S. households by income now driving nearly 50% of consumer spending.

The following graph from Bloomberg shows how much the situation in spending has changed from the 1990s. Back then, the top 10% households by income only accounted for 36% of consumer spending. Today it's 50%, meaning the U.S. economy is becoming increasingly reliant on a small share of consumers to support it.

Wallets Open

High-income Americans are behind roughly half of all US consumer spending, up from about a third in the early 1990s

✓ Share of Spending By Consumers in Top 10% of Income Distribution



Source: Moody's Analytics review of Federal Reserve data

Now, one might ask, what is driving the increasing spending share of the top 10% of households by income?

Is it the fact that they are doing better in their jobs, and that the lower 90% is doing worse? Possibly.

However, the real drivers of the shifting distribution of spending appear to be related to generational factors, specifically stock market wealth accumulation.

Consider equity ownership by generation:

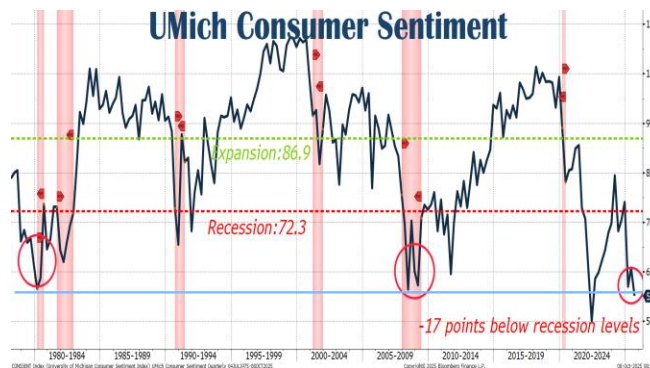
- Baby Boomers: 54%

- Gen X: 21.9%.
- Silent Generation (older than Baby Boomers): 16.1%.
- Millennials: 8.5%.
- Gen-Z: 0%.

By income distribution, the stock ownership is even more concentrated:

- Top 1%: 38.6% of stocks.
- Top 20%: 86.9%.
- Bottom 40%: 2.6%

This helps explain the bifurcated feeling in the current economy, where aggregate consumer sentiment is extremely poor, and most households feel constrained and unhappy with their economic situation. The reality is the vast majority don't own stocks and thus aren't getting "good vibes" from checking their portfolio each day.



FROM INFLATION TO INEQUALITY

"The stock market's been appreciating; home prices have been appreciating. The vast majority of Americans don't have much of that, and the benefits are very concentrated."

– Aaron Sojourner, Labor Economist and Professor, The University of Minnesota

The U.S. economy is K-shaped. If you are on the upward sloping line of the K, you are lifted by asset price inflation — your portfolio rises, your wealth compounds, and inflation isn't a threat but a tailwind. In fact, the top 10% by household wealth are in the best financial positions of their lives: They own 72% of financial assets while the stock market is trading near all-time highs, and they own 63% of homes, which are not far off their peak values.



If you are on the downward sloping line of the K-shaped economy, inflation is a squeeze. Young adults who don't own assets and are facing rising costs are in trouble. Their future increasingly depends on two choices: relying on family support or taking on substantial debt just to stay afloat.

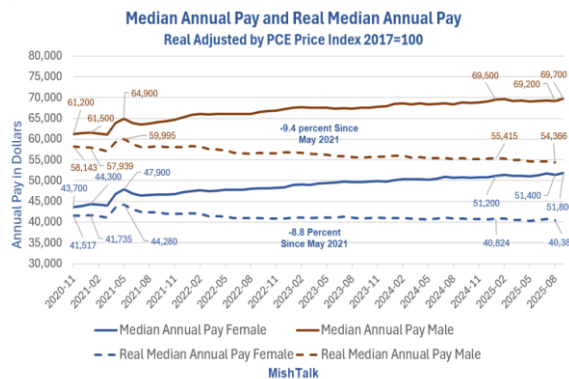
Today, half of American parents now provide regular financial support to adult children for basics like groceries and rent.

But if your family does not have the means to step in? You're on your own, caught in the downward slope of the K where wages lag, costs soar and the dream of asset ownership drifts further and further from reach.

WHY ARE VOTERS ANGRY?

Powell points to month-over-month declines, claiming "inflation is down." But inflation **compounds**. Just as gaining ten pounds one year and three more the next doesn't mean you're healthier, inflation stacks year after year, leaving households without assets suffocating.

The graph below, provided by Mish Talk, shows nominal and real wage change (adjusted by the Personal Consumption Expenditures (PCE) Index) since May 2021.



Here is the data summary:

Male

- Nominal Income: +6.6% to \$69,200
- Real Income: -9.4% to \$54,366.

Female

- Nominal Income: +7.3 % to \$51,400.
- Female Real Income: -8.8% to \$40,382.

Clearly, wages are not keeping up with inflation, keeping the middle and lower classes stuck paycheck-to-paycheck with no capital left to invest in. The system is designed so that the only way forward is to own assets (stocks, real estate, precious metals, crypto). If you don't, you're swimming in an endless pool where the water's current — **inflation** — only drags you backward.

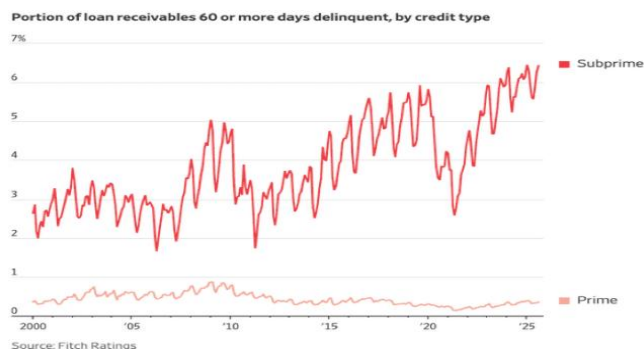
Bottom line: There are only two ways to fight inflation. Your wage grows faster than inflation. Or you own assets that inflate faster than inflation.

Owning assets is the only long-term solution.

THE NUMBERS TELL THE STORY

The K-shaped reality of 2025 reminds us that surface-level growth metrics don't tell the full story." – Equifax

Stress is accelerating with Q3 bank earnings starting October 14. Tricolor Holdings collapsed last month on weak used car sales. Credit card denial rates for subprime borrowers hit 29% versus 12% for prime. Subprime auto delinquencies have reached a new record high. The cracks in consumer credit are spreading from the bottom up.



According to Equifax, subprime borrowers (credit scores below 620) face denial rates two times higher than prime borrowers. They are two times more likely to use payday loans, and 40% have applied for buy now, pay later (BNPL) services versus 27% of prime borrowers. When people desperate for credit turn to increasingly expensive alternatives, that is the debt spiral beginning.

Here is what worries me most: Subprime consumers are over three times more likely than prime borrowers to want new credit cards. They are using credit strategically, with 21% making essential purchases specifically to raise credit scores. This determination to "move up the financial ladder" while already stretched creates systemic risk. They are borrowing at higher rates to prove creditworthiness for more borrowing. Read that again!

Bottom line: The so called "resilience" narrative is masking deterioration. When subprime borrowers turn to payday loans and BNPL while desperately trying to qualify for credit cards, that's not resilience; it's desperation.

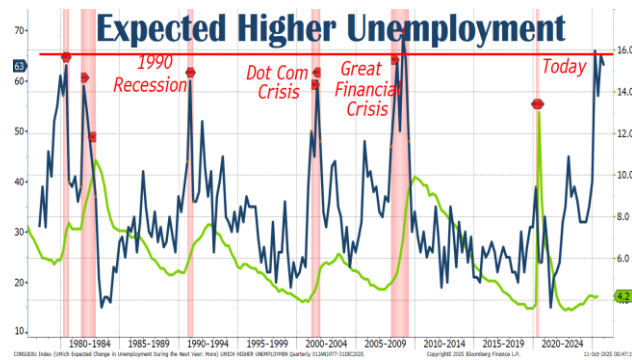
Consumer credit stress always starts at the bottom and works up. We are watching that progression in real-time.

MORE CONSUMER SEDIMENT

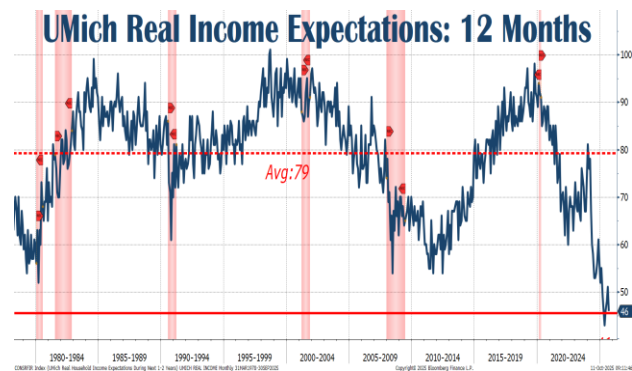
The University of Michigan Consumer Sentiment Index stayed flat at 55, showing people aren't feeling optimistic despite recent market rallies.

One thing that stood out to me was the fact that 63% of respondents expect unemployment to rise next year, nearly double last year's level.

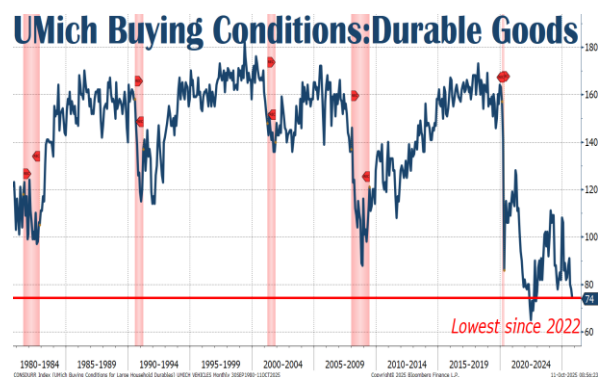
Historically, such negative sentiment has become self-fulfilling, leading to higher levels of unemployment. (See the green line in the graph below.)



Meanwhile, over two-thirds see inflation outpacing their income growth. Inflation expectations remain at 4.6% annually, well above the Fed's 2% target. When people expect both job losses and declining real wage, that creates a foundation for reduced spending regardless of current employment levels.



Indeed, buying conditions for durable goods dropped to the lowest level since 2022 due to tariff concerns. This tells me consumers are already factoring in higher costs from trade policies before they're even fully implemented, creating a preemptive drag on discretionary spending that could become self-fulfilling.



Bottom line: The flat sentiment amid market highs reveals that regular Americans are not feeling the wealth effect that typically drives consumer spending during bull markets. When people expect unemployment to rise and inflation to outpace wages while facing higher costs, consumer spending becomes vulnerable regardless of what current employment data shows. This sentiment-spending gap could become the economic reality that markets have not priced in yet.

THE AI BUBBLE

"[...] all the ingredients are in place for some kind of a blow off. History rhymes a lot, so I would think some version of it is going to happen again. If anything, now is so much more potentially explosive than 1999."

— Paul Tudor Jones, interview with CNBC's Squawk Box, October 6

The equity market rally has increasingly been driven by the Artificial Intelligence (AI) trade, which shows no sign yet of abating.

- The Magnificent Seven (Apple, Amazon, Alphabet, Meta, Microsoft, Nvidia, Tesla) represent approximately 35% of the S&P 500's total market capitalization as of mid-2025. NVDA equals 19% of that! The concentration of AI in the S&P 500 now exceeds the technology wave of the late 1990s.

The Magnificent Seven have also been the primary drivers of the S&P 500's performance in recent years, far outpacing the other 493 stocks due to their massive market caps and strong revenue and double-digit earnings growth rates.

Here is a summary of the latest performance:

- Year-to-date through August 2025: The group accounted for about 12% of the S&P 500's year-to-date return (S&P up ~9.7%, Magnificent Seven up ~12.1%).
- **2024:** They drove 55% of the S&P 500's total gains (S&P up ~24% overall).
- **2023:** They were responsible for 63% of the positive S&P 500 performance (S&P up 24.2% overall)

This concentration means the S&P 500's returns have been and remain heavily tied to these mega-caps. Without the AI gains, the index would have been flat in 2023–2024.

Yet, outside the AI and related areas of the market, earnings growth over the past year is running at a paltry +1.5% pace.

At this point, a slowdown in tech (e.g., AI hype fading) could pull the stock market down disproportionately.

Consider that the Shiller's cyclically adjusted price-to-earnings (CAPE) ratio is now at the second highest level ever.

Note: The Shiller CAPE index takes the 10-year earnings history of the S&P 500 and adjusts it for inflation to determine the stock market multiple.

This method has proved a very valid way of detecting bubbles in the past (1929, 1999), but today, many say it isn't valid anymore because it is "backward" looking.

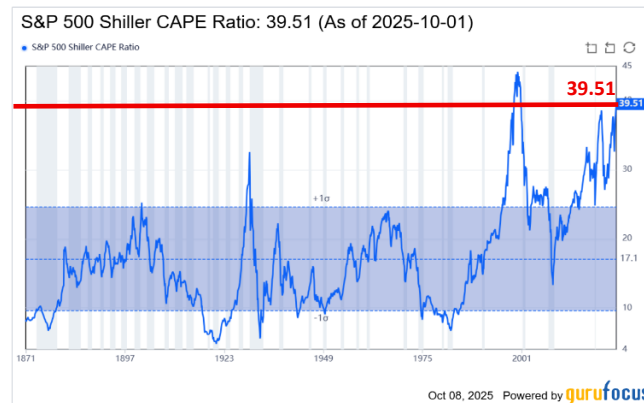
Not everyone agrees.

I'll let you decide if "this time is different." Here are the facts:

- Long-term average Shiller P/E Ratio of the S&P 500 is 17.8x.
- Today it is 39.5x.

This level exceeds every prior bubble peak in the past century outside of the unprecedented tech mania in the late 1990s and early 2000s. This compares to the 1929 bubble peak of 33x, the Nifty Fifty peak in the late 1960s of 24x, and the 1987 pre-crash peak of 18x.

The average bubble peak in this valuation metric is 26x. It is now pressing against 40x. The only time that stock market valuations were richer was in 1999.



AI is huge. But so is the mania of hype that caused stock prices to explode. And while everyone agrees that AI will be transformative, the question is whether we are expecting too much too soon. The dotcom bubble really wasn't that long ago, serving as an excellent reminder that extrapolating lofty assumptions into the future is fraught with risk.

Per a study from the Massachusetts Institute of Technology, 95% of the corporate sector has not seen positive returns on AI investments.

The AI bubble evidence is now overwhelming. NVIDIA's market cap is now just ~\$1 TRILLION below the Japanese stock market. As a reminder, Japan's market is the second largest in the world, after the U.S.

How is this sustainable?



While AI has been good for the stock market, the same is true within the economy because the AI spending boom has taken capital expenditures in this space to a 2.0% share of the gross domestic product (GDP), up from less than 0.1% in 2022. That is a 20x surge in just three years.

Because investment is one of the key components of GDP, building a data center creates economic activity. Indeed, AI-related investment has unquestionably helped raise current U.S. growth. However, without AI, the economy would have

grown at a measly 0.1% in 2025! In other words, the entire economy is being propped up by a few people in San Francisco.

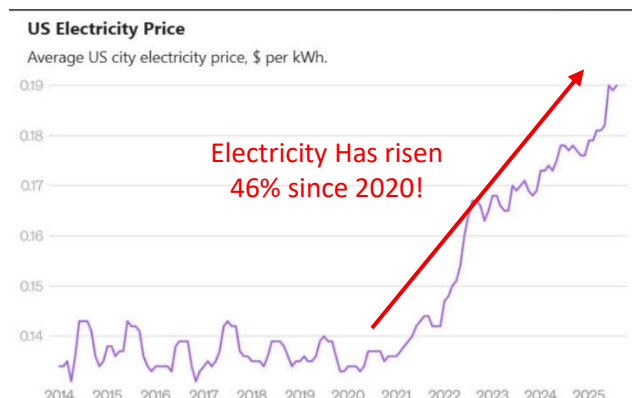


I should also mention that AI potentially lowers current growth by diverting resources. For example, research by McKinsey has shown that regional electricity prices can be pushed significantly higher by the power needs of data centers.

“AI compute is now the largest driver of incremental data center electricity demand. Goldman Sachs estimates that AI workloads alone could consume 3%-4% of total U.S. electricity by 2030, up from less than 1% today. More broadly, total U.S. data center demand — including AI, cloud, and enterprise computing — is projected to rise from 3.7% of U.S. grid demand in 2023 to 11.7% by 2030.” – McKinsey.

Consumers who must spend more on electricity will have less money to spend on other goods and services, reducing demand. Energy-intensive businesses will face higher costs.

Weaker demand and higher costs may cause some otherwise productive businesses to close. That risks creating a gap in the economic growth story, if businesses that are economically productive today close to allow the building of a sector that may be economically productive only in the future.



Bottom line: We are in the stratosphere. This is indubitably a bubble. While no one can time it, the higher they go, the harder they fall; if anything cannot last forever, it shall not. Exponentially rapidly rising markets may go further than you think, but every bull market has its peak (just as bear markets have their lows).

If the AI bubble bursts and the stock market declines, the rich will pull back on spending and the economy will stall because the rest of America is broke or living paycheck to paycheck.

IT'S ROUGH OUT THERE

"Consumer spending is built on the strength of the labor market."
 — Mary Daly, President, Federal Reserve Bank of San Francisco

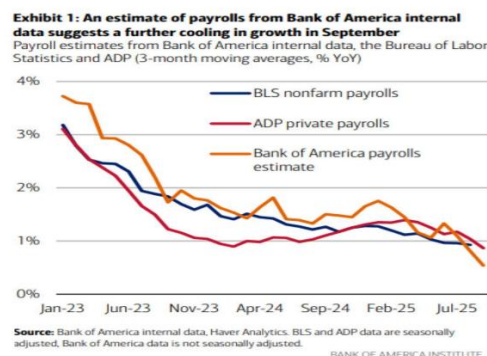
I hope the government shutdown ends soon so we can start chewing on the data again. Especially the employment numbers. But this is where the labor markets stand today:

- Unemployment rate (4.3%, the highest since October 2021)
- Hiring rate (3.2%, tied for the lowest since April 2020)
- Firing rate (1.1% — at the low end of the historical range)
- Quits rate (1.9% — tied for the lowest level since May 2020)
- Ratio of job vacancies to unemployment (0.98 — the lowest since April 2021)
- Share of unemployed who are finding a job (24.2%, the lowest since November 2024)
- Youth unemployment rate (10.5% for the 16 to 24-year-old group, the highest since April 2021).

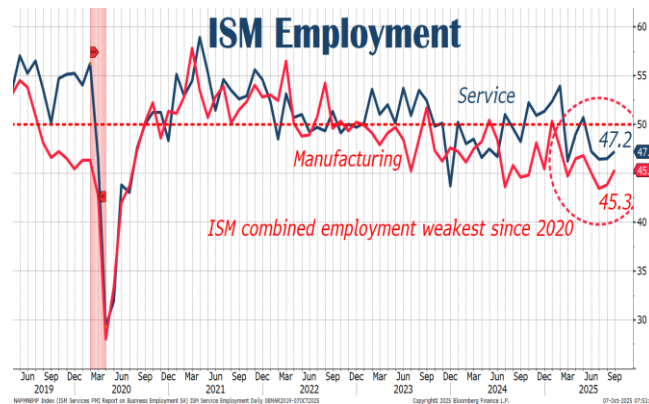
Except for the firing rate, all these statistics are at levels we have not seen for some time. Every single measure of demand for labor is in the sick bay, and if these are the indicators the Fed is looking at, it is a mystery as to why anyone would have had a problem cutting rates at the last meeting or even the next one.

Meanwhile a host of “alternative” jobs data from Wall Street are pointing in the same direction:

- Private-equity company Carlyle Group, extrapolating from companies in which it owns stakes, estimates that just 17,000 jobs were created in September. The 17,000 jobs estimate, if accurate, means we're adding jobs at 1980s recession levels.
- Goldman Sachs said its measure of labor-market tightness fell last month back to levels seen in 2015.
- Bank of America found a “further softening in job growth in September and a 10% rise in unemployment payments in October compared with a year ago.”



- The Institute for Supply Management (ISM) found that over the past few months, the combined ISM jobs indices were the weakest since the summer of 2020, and the only other times we were around these contractionary levels for several months were in the 2001 and 2008-2009 recessions.



- The Federal Reserve Bank of New York found that respondents put the odds of finding a job in the next three months at 47.4% last month, well below the trailing 12-month average of 51%.
- Payroll processor ADP said last week that U.S. employers shed private-sector jobs last month.

Bottom line: When private equity starts publishing economic data because government can't, we have reached peak dysfunction.

Regardless, hiring intentions are falling off a cliff. Add that to more than 100,000 federal jobs being cut, and it is clear the labor market is losing steam fast. Companies are not hiring; the government's trimming headcount and wage growth is already rolling over. Things are not looking too hot.

Let me end by saying it will be interesting to see how bad the next few non-farm payroll reports are going to look once they are released. Hundreds of thousands of federal civil servants who had been forced to retire early have yet to show up in the data, and now we have the White House saying on Friday that it began conducting mass layoffs of federal employees in response to the government shutdown (an unprecedented step).

WHY I REMAIN BULLISH ON BONDS

There's anecdotal evidence that companies have been absorbing the tariff on durable goods and auto firms have been delaying inevitable price increases, as they want to avoid raising prices and then lowering them later if tariffs are removed or struck down by the Supreme Court. That should change soon.

In addition to the tariff effect, a major increase in health insurance premiums (about 18%) is expected in 2026. The planned expiry of tax credits because of the One Big Beautiful Bill Act is a major factor in the jump in insurance costs.

Here is the good news for bond bulls: Health insurance only has about 0.8% weight in the headline Consumer Price Index (CPI) basket.

In addition to this, there are incoming changes in the electricity market. Electricity has a 2.5% weight in the headline CPI basket. Electricity demand from data centers is a major theme for the 2020s going forward, and most estimate that electricity prices will rise by 4-6% per year for a number of years.

But the good news for the bond markets is that shelter and services excluding shelter are two of the largest components of CPI, and they are strongly driven by new rents and wages acting on predictable lags.

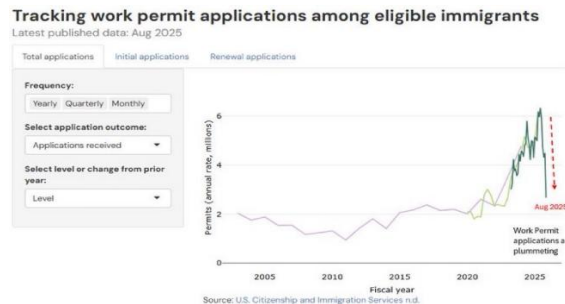
Here's a quick update on what has happened with apartment rents over the last three years.

- Austin: -18.3% rent drop.
- Fort Myers: -15.3%.
- Colorado Springs: -12.5%.

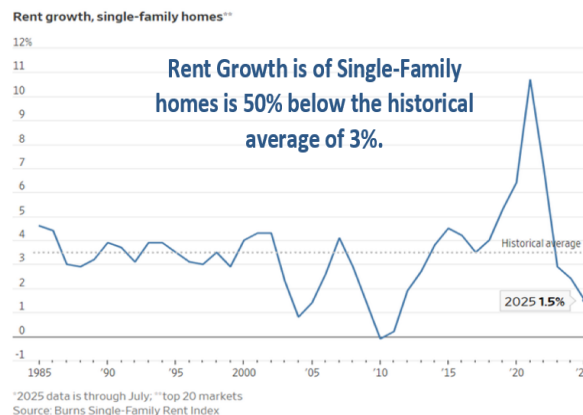
The reason apartment rents are dropping in these markets is due to a large post-pandemic construction pipeline that has led to many new units hitting the market. In some cases, the vacancy rates in these markets are going over 10%, which is resulting in landlords aggressively cutting rents.

One angle to this story is immigration, particularly, the big decline in immigration in 2025. Lower immigration is starting to bleed over into reduced demand for rentals in the second half of 2025, which will cause muted rent growth moving forward.

One metric I am watching is work permit applications. This figure has collapsed in recent months and is down 60% from the beginning of the year. Historically, there is a relationship between immigration work permit applications and renter absorption. And the renter absorption in 2024 and early 2025 was quite high, aligning with the surge in work permit applications. But now that work permit applications are dropping, look out for renter absorption/demand to drop as well.



John Burns just reported that rental inflation for single-family homes in 2025 is down to only 1.5%, one of the lowest levels the index has recorded in the last three decades.



This slowdown in rent growth is being driven by an increase in rental listings from homeowners who cannot sell their houses. In addition, slowing population growth is now likely filtering its way into reduced rental demand.

Bottom line: Even with incoming upward shocks to the goods sector from tariffs to health insurance from higher premiums and electricity costs from AI demand, the inflation outlook is still disinflationary because I believe that both the Federal Reserve and much of the private sector are underplaying the predictable trends in the housing sector, despite the very strong historical lag relationships at work.

This disinflationary view is one of the largest reasons for my bullish bond call.

THE MINUTES

The Fed minutes from September revealed a central bank caught between conflicting pressures that could reshape markets heading into year-end. While officials voted for a quarter-point cut, the internal debate shows they're far from unified on the path forward.

What struck me most is that "a majority of participants emphasized upside risks to their outlooks for inflation" even as they cut rates. When I see Fed officials worried about inflation while simultaneously easing policy, that tells me they're feeling political and economic pressure to cut despite their own concerns about price stability.

Fed funds futures are pricing in cuts through December, but six of 19 Fed officials project one or no cuts in 2025. That's a massive disconnect between what markets expect and what policymakers think is appropriate.

The timing could not be worse. The ongoing shutdown has frozen key economic data releases just as the Fed needs clear information to make decisions. Making monetary policy in an information blackout while facing political pressure from Trump administration officials calling for immediate cuts creates a recipe for policy mistakes.

Bottom line: I see a Fed that is cutting rates because the labor markets clearly warrant it.

MARKET OUTLOOK AND PORTFOLIO STRATEGY

The U.S. government shutdown drags on, disrupting the major data releases. Thus, the CPI will not be released as previously scheduled (tentatively rescheduled to October 24, and still ahead of the October 28-29 Fed meeting), Import Prices, Retail Sales, and Industrial Production reports next week, leaving the markets flying blind and more reliant on alternative data than usual. The Fed's Beige Book, the New York and Philly Fed surveys and the earnings data coming this week will all loom larger in importance.

The AI-driven investment boom is becoming a head-scratcher even for the "this time is different" camp. Meanwhile, manufacturing executives describe "severe depression." The disconnect between hidden reality and market euphoria is historic.

Meanwhile, bond yields edge lower to reflect the growing risk that markets are pricing an overly optimistic growth path for next year and beyond. The benchmark 10-year Treasury yield is on the precipice of a major break lower.



At the front end the two-year Treasury yield has quietly declined to 3.47%, the lowest level in over three years!



In the near term, the earnings season will set the tone, and with so much priced to perfection, negative surprises will draw outsized reactions.

Fed speeches will include Powell on Tuesday, Miran on Wednesday and Thursday, and Waller on Thursday — with Powell’s speech likely to be watched for some guidance as to his thinking on the absence of timely CPI data.

Bottom line: Employment and wage growth are cooling off and credit usage is clearly softening. But here is what I hope the folks on the Federal Open Market Committee are aware of, which is that a weakening in the demand for credit *ipso facto* means that interest rates, or the price of credit, should be going down in tandem.

Selloffs should be viewed as an attractive entry point to position investment portfolios and balance sheets for a lower rate paradigm. As always, the most prudent approach is to build a risk-appropriate ladder strategy.

WHY SUBSCRIBE TO THE WRV?

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 point to the rewards without discussing the risks) that dominate Wall Street research and, most of all, try to 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 I focus on identifying them. It’s what makes the *Weekly Relative Value (WRV)* unique in the marketplace. By subscribing, you will always be up to date with the most relevant economic and market trends, and most importantly, you will be aware of the key risks. To receive future issues of *WRV* in your inbox, subscribe [here](#).

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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