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Weekly Relative Value

WEEK OF DECEMBER 15, 2025

Fade the Fed Dots

It's very difficult to estimate job growth in real time. They don't count everybody. They have a survey. And there's been something of a systematic overcount... we think that that has persisted... And it will be corrected."

"... Unemployment is now up three-tenths from June through September, payroll jobs averaging 40,000 per month since April. We think there's an overstatement in these numbers by about 60,000, so that would be negative-20,000 per month."

"... it's a complicated, unusual, and difficult situation, where the labor market is also under pressure, where job creation may actually be negative. Now, supply of workers has also gone way down, so the unemployment rate hasn't moved that much. But, you know, it's a labor market that seems to have significant downside risks."

— Jerome Powell, Chair, Federal Reserve



As expected, the Federal Reserve voted 9-3 Wednesday to cut its benchmark rate by a quarter point to a range between 3.5% and 3.75%. There were multiple dissents. Two voters favored no cut, and one preferred a larger reduction. It was the first time since 2019 that three policymakers had formally dissented.

THIS WEEK

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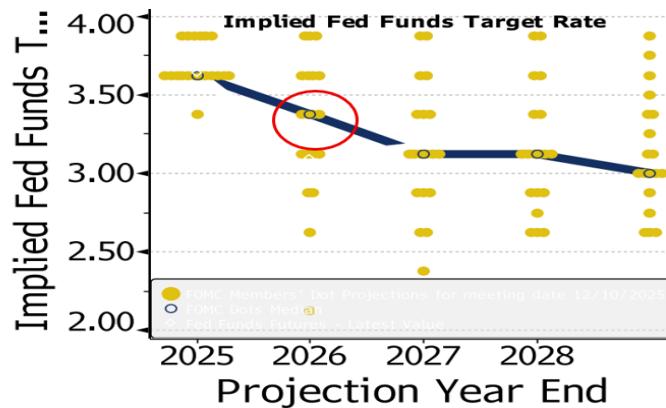


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Recent divisions reflect a dilemma the Fed hasn't faced in more than 15 years: stubborn inflation that calls for higher rates paired with a softening job market that suggests a need for lower rates.

"So what do you do?...You've got one tool. You can't do two things at once."
– Jerome Powell, Chair, Federal Reserve

The fabled but meaningless “dot plot” settled on one rate cut next year, and Fed Chair Powell described the current stance as being within a “neutral” range.



I give very little credence to the Federal Open Market Committee (FOMC) median forecasts of anything — or the dot plots, either. I say fade the Fed and the dots.

This is why:

First, Powell said that non-farm payrolls, instead of adding about +40,000 per month, the latest evidence shows that the economy has been shedding -20,000 per month since April. That means that around -120,000 jobs have been lost over the past six months. Over a six-month stretch, such a pattern has never happened without the economy heading into a recession. The Fed realizes that employment is not cooling at all but is contracting. I sense this will continue into 2026.

One more point. If we don't head into recession this time around it likely is because the stock market gains have fattened the high-end consumer so much that the equity wealth effect on spending has saved the day. This is why it is incredibly important, for the sake of the K-shaped economy, that the stock market never dares to enter into a bear phase.

Indeed, Powell talked about the K-shaped economy and the stresses that the low- and middle-income household sector is facing, and openly questioned the sustainability of the high-end continuing to bear the burden of keeping the economy in expansion mode.

Also, the top 10% may well account for 50% of all the spending, but let's keep in mind that there are 27 million American households that reside in the bottom 20% of the income scale. That is over one-fifth of the country, so I wouldn't exactly consider this number to be trivial.

“... If you listen to the earnings reports for consumer-facing companies that tend to deal with low- and moderate-income people, they'll all say that we're seeing people, you know, tightening their belts, you know, changing products that they buy, buying less, and that sort of thing. And so it's clearly a thing. It's also clearly a thing that, you know, asset values — housing values and securities values are high, and they tend to be owned by people more at the higher end of the income and wealth.

So as to how sustainable it is, I don't know. Most of the consumption does happen by people who have more means. I think, you know, the top — the top third accounts for way more than a third of the consumption, for example. So it's a good question how sustainable that is.”

Second, Powell stated that the entire inflation overshoot from target is due to the tariffs, which he sees subsiding next quarter. He emphasized that core inflation is down to the “low 2's” absent the tariff effect, and he believes that the disinflation we are seeing in the services sector will persist. So, what are the hawks and bond bears so worked up about?

If the coming data confirm this, and the Fed seems to think so without saying so, there may be more cuts than the market is pricing, or the funds rate drops to 3.00%-3.25% sooner.

“The story with inflation, and, you know, we're well aware that this is a story at this point, is that if you get away from tariffs inflation is in the low twos, right?... So it's really tariffs that's causing most of the inflation overshoot.”

“Well, I think the risk in inflation is pretty clear to see, and that is, you know, we see higher inflation — as I mentioned, most of the inflation over target is from goods, and we think, we estimate, we expect — most of us — that that inflation will be a one-time price increase and then come down.”

He is bullish on the productivity outlook and talked about how this is transcending the artificial intelligence (AI) impact. The bottom line is that you cannot have an inflationary view when you believe that the labor market is cooling and productivity growth is accelerating.

“...we're definitely seeing higher productivity. I don't — I think it's a little quick to be saying it's generative AI, but I don't know. You know, the pandemic may have induced people to do more automation and do more things with computers to replace people, and that raises productivity — you know, output per hour.”

Third, Powell stated that the giddy upgrade in economic growth boiled down to the 2026 real gross domestic product (GDP) growth forecast to the timing effect of the government shutdown. Purely a statistical quirk. Real growth really goes to +2.1% next year, from +1.9% this year.

"I mentioned that the Summary of Economic Projections (SEP) meeting is 1.7% for this year growth, and 2.3% for next year. You actually — some of that is due to the shutdown. So you can take two tenths out of 2026 and put it in 2025. So it would really be 1.9% and 2.1%."

He acknowledged that while the funds rate is in the vicinity of “neutral,” it’s not really there yet.

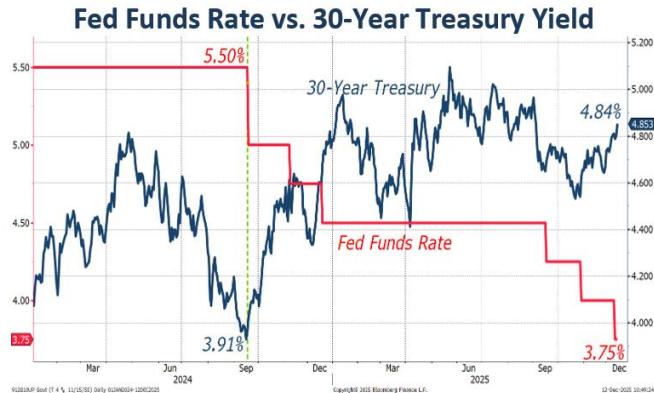
"... when they're (inflation and employment) are broadly equally threatened or equally at risk, you should be kind of neutral. Because if you're either accommodative or tight, you're favoring one or the other goal. And so we've been trying to — we've been sort of moving in the direction of neutral. Now we're in the range of neutral. We're in the high end of the range of neutral, I would say."

Plus, let's not overplay the extent of what the Fed has done this cycle. It may well have cut the funds rate by -175 basis points since September 2024, but the 10-year Treasury yield, which is what the economy is really priced off of, has risen by nearly +50 basis points. Historically, after the Fed has cut rates by 175 basis points the norm is for the 10-year yield to have fallen by more than -30 basis points. In fact, the backup in the 10-year Treasury yield during this easing cycle is unprecedented.



The same dynamics are on display when looking at the performance of the long bond versus fed funds. Since the Fed rate cut cycle began the yield on the 30-year Treasury bond has soared by 93 basis points.

So either there is a fiscal risk premium being embedded the further out you go across the yield curve, or investors are worried about duration because of the sense that President Trump will appoint (more like anoint) a Fed Chair who will be taking marching orders from the White House.

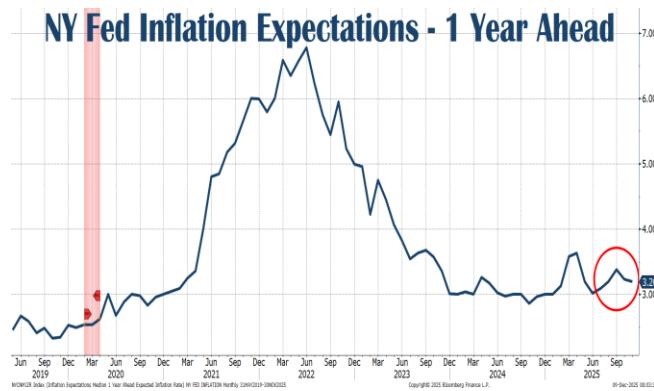


Bottom line: We are just rewinding the same movie. I say to fade the dot plots. Focus on the narrative. When you dig through the post-meeting Powell transcripts, it becomes clear that Powell was actually not the least bit hawkish. Let me also say, I really have no idea why Trump continues to insult Powell. Shouldn't he be attacking the two FOMC members who dissented in the way of no cut?

I think the Fed will be cutting, and that there will be far more cuts in 2026 than the markets and consensus believe. To repeat, employment, when measured accurately, is not slowing — it is contracting; and inflation, when adjusted for tariffs, is almost at target.

WHAT'S BUGGING BOND MARKETS?

There has been something bugging the bond market of late, but I don't believe it has anything to do with the incoming data releases. To wit: The New York Fed's monthly Survey of Consumer Expectations showed the one-year median inflation view dipping to a three-month low of 3.20% in November from 3.24% in October. The three-year expectation hung in at +3.00%, and the five-year expectation moved fractionally below 3.0% (2.98%). Measures of "inflation uncertainty" were also stable to lower.



The job market metrics remain worrying, with an assessed 42% probability of rising unemployment ahead versus 35% a year ago. Meanwhile, the prospect of finding a job within the next three months is ONLY 47.4%! This reading ranks in the bottom 10% of all time. To sum up, finding a new job after being terminated is no easy task today.

Meanwhile, nearly 40% claimed they are financially worse off now compared to a year ago, the highest in two years. This is more than double the share who state they are better off (a six-month low of 17.6%).

Bottom line: I believe the long end of the bond market has become disconnected from Fed policy over concerns about who President Trump will appoint as the next Fed Chairman and how much influence Trump will have in dictating policy and rates.

KEVIN!

"The two Kevins are great." – President Donald Trump

Added policy confusion has come from President Trump initially saying he was down to one choice for Powell's replacement to lead the Fed, to now being two (or maybe more). The announcement that he is not down to one choice has taken Kevin Hassett's market-based odds down to 50% from 75%, while Kevin Warsh's probability has tripled to 41% from 13%. Either way, it likely will be a Kevin, and a dedicated rate cutter, though Warsh is clearly the better choice since he is less politically tainted and, at least, has a modicum of central banking experience.



So, will it be Kevin Warsh or Kevin Hassett as the next Fed Chairman?

Hassett has been increasingly viewed as the front-runner after Trump repeatedly teased in recent weeks that he had settled on his choice to lead the Fed, but Trump's comments suggest Warsh remains solidly in contention.

According to *The Wall Street Journal*, during a meeting last week with Warsh at the White House, the president pressed Warsh on whether he could trust him to support interest-rate cuts if he were chosen to lead the central bank.

Trump said of Warsh:

"He thinks you have to lower interest rates...And so does everybody else that I've talked to."

When asked where he wants interest rates to be a year from now, Trump said:

"1% and maybe lower than that...We should have the lowest rate in the world."

Trump is effectively asking to put the economy into emergency mode when we aren't actually in an emergency. By demanding interest rates drop to 1%, he wants to make borrowing money nearly free, which changes the entire game for investors.

When rates are that low, keeping cash in a savings account becomes pointless because it earns you nothing, so everyone is forced to take that cash and dump it into things like stocks, real estate and crypto to find a return.

However, if money becomes free again, cash becomes trash and the value of assets generally skyrockets because there is simply nowhere else for the capital to go. For your investment portfolio, it would likely trigger a massive melt-up where prices hit all-time highs, but for the actual economy, it's a huge risk.

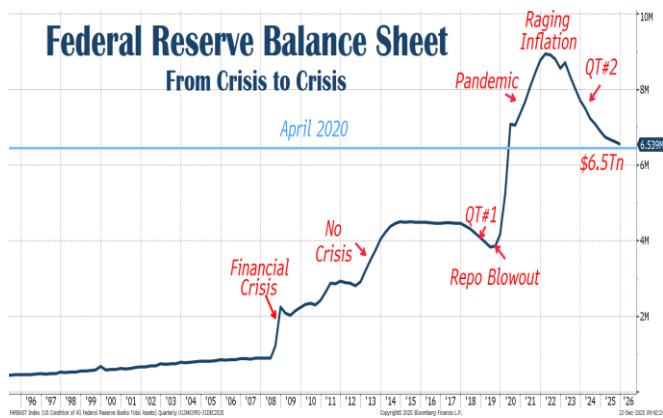
Rates of 1% are usually reserved for crises to keep the system alive, using them when the economy is stable is like injecting adrenaline into someone who is already running a marathon.

It creates a temporary boom that feels amazing, but it almost guarantees we see inflation spike back up for regular things like food and rent, eventually forcing the Fed to slam the brakes even harder later on.

Bottom line: Regardless of Trump's pick, there is only one requirement for the job, any job within the administration, and every Trump appointment is to bow down to the president regardless of economic consequences. Who will it be? Warsh is trying to convince Trump he is up to the task. I am sure Hassett is fully on board.

THE END OF QUANTITATIVE TIGHTENING

The Fed has finished a big multi-year cleanup of its balance sheet after the huge money printing during the pandemic but it stopped shrinking things while the balance sheet is still very large by historical standards. The Fed's quantitative tightening (QT) officially concluded: During its QT, the central bank reduced assets by -\$2.4 trillion, to \$6.5 trillion, the lowest since April 2020 but still far above the roughly \$4 trillion area before the pandemic.



The Fed did this by letting the bonds it owns mature without fully replacing them, which slowly pulled money out of the financial system and reversed a bit more than half of the emergency support it added in 2020–2021.

In beginner terms, you can think of the Fed's balance sheet as a big pool of money and bonds that helps determine how much cash is sloshing around in banks and markets.

During quantitative easing (QE), the Fed filled the pool by buying bonds, which pushed cash into the system and tended to support asset prices.

QT was the opposite: The Fed let that pool drain, which removed cash and made financial conditions tighter.

Now that QT has ended, the Fed is basically saying this is as small as we're comfortable going for now because they don't want to risk another problem like the 2019 repo spike where markets suddenly ran short of safe cash and short-term rates jumped.

The implications going forward are that one important source of tightening pressure is gone, but policy is still restrictive through interest rates. Markets no longer have to worry about the Fed being a constant, predictable seller of Treasuries and mortgage bonds, which is mildly supportive for stocks, credit and longer term bonds because there is less forced supply hitting the market every month.

At the same time, the Fed has kept the balance sheet big enough that banks still have a comfortable cushion of reserves, so it has more room to focus on deciding when to cut rates based on inflation and growth rather than on avoiding a liquidity accident.

Bottom line: If the economy and inflation keep cooling, this setup (no more QT plus eventual rate cuts) is supportive for risk assets. If inflation flares up again, the Fed can keep rates high for longer, but is less likely to quickly restart aggressive QT given how sensitive the system is to liquidity.

IS QUANTITATIVE EASING BACK?

Just as the Fed announced the end of QT, the Fed announced it will be buying T-bills "on an ongoing basis." Their cover story is that the Treasury General Account, (TGA) swells in April, so they need to start buying bills now (\$40 billion in January, more in February). For background, the TGA is the U.S. government's main checking account, held at the Federal Reserve, that handles all federal income (taxes, bond sales) and expenses (Social Security, payroll, interest). It acts like a giant bank account for the government, and its balance significantly impacts the overall liquidity in the financial system, essentially moving money in or out of the economy as the Treasury collects or spends funds.

The press conference message from Powell is that they are buying because the Fed wants money market rates set by policy, not managed through open market operations via the Standing Repurchase Agreement Facility (SRF).

The SRF is a permanent facility established by the Federal Open Market Committee (FOMC) in July 2021 to help control the federal funds rate and ensure smooth market functioning.

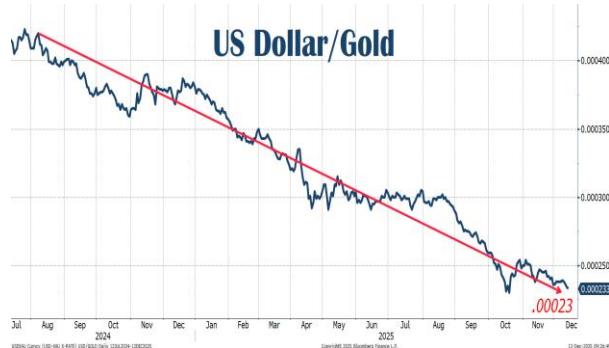
In truth, the return signals that the Fed is ensuring that Treasury spending will be financed without any rate hiccups. The Fed will smooth out the volatility and keep rates tied to the funds rate.

What Bessent and Trump want is cheap funding – flood the short end and starve the long end of issuance. Today, the Fed announced it will be there to buy the short end.

The day after the Fed resumed QE, precious metals, mining stocks and the dollar did what one would expect.

Gold and silver rose and the Dollar Index sank to a two-month low. As shown below, the U.S. Dollar/Gold ratio has continued to plumb new depths. When will the dollar's depreciation stop? The sad reality is it won't if the U.S. government continues to issue excessive debt while the Fed continues to print more fiat currency.

Got gold?



Given that long-term rates will rise on this inflationary policy shift, the question is who will but the long end of the curve?

The so-called “Bond King” Jeffrey Gundlach has stated that if Treasury yields reached 6%, it could prompt the Federal Reserve to intervene and start buying long-term bonds (QE) to control borrowing costs.

“I believe at 6%, the Fed will announce QE ... you will have to be very quick, and buy as much as you possibly could, because it'll be just like when they announced buying corporate bonds during COVID... bonds ripped”.

—Jeffrey Gundlach

Gundlach's comments are based on the idea that the current U.S. debt and deficit levels make the economy vulnerable to sustained high interest rates, which a 6% yield would represent.

I agree with the “King” but I believe the QE will start buying at much lower yield levels, say 5%.

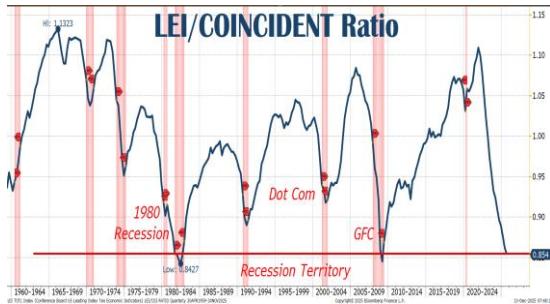
Bottom line: It won't be long before the Fed expands and extends QE to longer-dated maturities.

SHOULD YOU FOLLOW THE LEAD?

As far as the economic data goes, the Leading Economic Index (LEI) fell by -0.3% month over month in September after a like-sized decline in August and down to an eleven-year low. The year-over-year trend has been ensconced in negative territory each and every month since July 2022 (-3.3% presently), and that duration has never occurred outside of an outright recession.



What was noteworthy is that the Index of Coincident Indicators (COI) has basically sputtered since June. The Coincident Index reflects what's happening right now with jobs, incomes, production and consumer spending. The closely watched LEI to COI ratio has now declined for 31 straight months and is now at the third lowest level ever!



Bottom line: There was a time when the Conference Board's Index of Leading Economic Indicators was a closely watched metric, but having made the recession call — the downturn that never arrived — in 2022, nobody pays much attention to it anymore. But I do.

A HOAX REPORT

The other report that received a lot of press last week was the Job Openings and Labor Turnover Survey (JOLTS) data for October. Job openings rose to 7.67 million, which was up modestly from 7.658 million in September, and the highest reading since last May.



This openings number doesn't match what we're seeing everywhere else in the labor market. To wit:

- Small businesses just cut 120,000 jobs in November, the worst drop since pandemic lockdowns.
- October layoffs hit 153,074, the highest for that month in 22 years.

At the same time, hiring activity took a tumble, so either companies are testing the waters or can't find anyone to hire. The number of new hires collapsed by -218,000 in October and has declined now in five of the past six months (a cumulative slide of -466,000). Almost every sector outside of the government (what happened to the Department of Government Efficiency?) posted declines — **the overall 5.14 million new hires were the third lowest since April 2020!**

From 2010-2019, openings and hires moved together with gaps rarely exceeding 10%. In 2021-2022, openings spiked to 11 million, but hires remained at 6-7 million, with as many as 38% of postings going nowhere.

This explains a lot about why the labor market feels broken. When 30% of job postings never result in a hire, job seekers waste time applying to positions that don't exist. I think companies keep postings open for several reasons: building

candidate pools for future roles, showing investors they're growing, maintaining the appearance of expansion, or just forgetting to take them down. Some of the gap comes from legitimate labor shortages where companies can't find qualified candidates, but the scale suggests a lot of it is deliberate overposting.

Moreover, if a third of postings never turn into hires, the JOLTS data is giving policymakers a false picture of labor demand. The Fed uses job openings data to assess labor market health and make rate decisions. If millions of those openings are fake, they're easing or tightening based on inaccurate information. For job seekers, this is brutal. You're competing against hundreds of other applicants for positions that may not even be filled.



The number I focus on the most is new hires minus fires, and that differential fell in October to its lowest reading since March 2015 (excluding the pandemic recession). That pretty much is all you need to know.



Not just that, but the clearest sign of a decay in worker confidence showed up in the voluntary quits number — plunging by -187,000 in October and slipping in four of the past five months to 2.941 million, the lowest figure since August 2020.

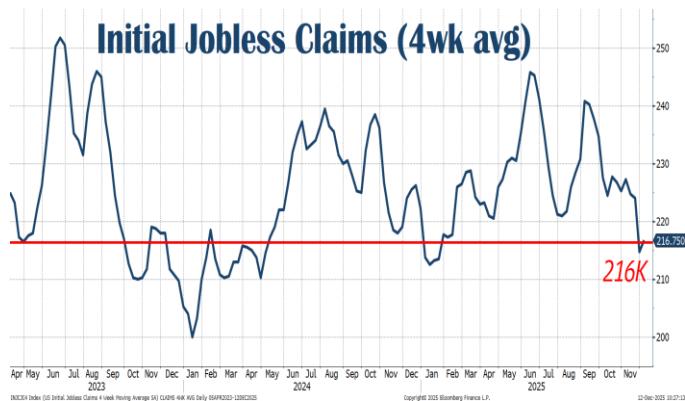


So how are job openings suddenly jumping to a five-month high? The fact that this data came in so far above what was expected, during a period when we know the labor market is weakening, makes me wonder what's really being measured. It feels like one of those situations where the headline number looks fine but the reality underneath is different.

Bottom line: This was a HOAX of a report and the initial bond market selloff on the job openings alone looks way overdone.

MORE JOB DISTORTIONS

About the jobless claims data. As has been reported, the unexpected decline in the November 29 week in initial jobless claims was due to Thanksgiving, and we saw the same thing with the December 6 week, as claims jumped to 236,000 from 192,000. Given the noise, it's as always best to look at a four-week moving average, which smooths out the weekly distortions. As shown below, by this measure, claims remain relatively low.



Now, I realize that Rick Santelli got very excited on CNBC that the backlog of continuing claims plunged by nearly - 100,000 to 1.838 million, but that covered that late November week, and so was equally distorted.

"If there were big layoffs, you would expect continuing claims to go up. So, it's a little bit curious."
— Jerome Powell



Powell, on Wednesday, expressed confusion as to why all the layoffs have yet to result in higher claims. Powell really misses the mark here.

It may be because this is a white-collar jobs downturn, not a blue-collar development. Looking at the JOLTS data, you see that white collar firings are up more than +3% in the past year, while layoffs are down by -5% for the blue-collar workforce.

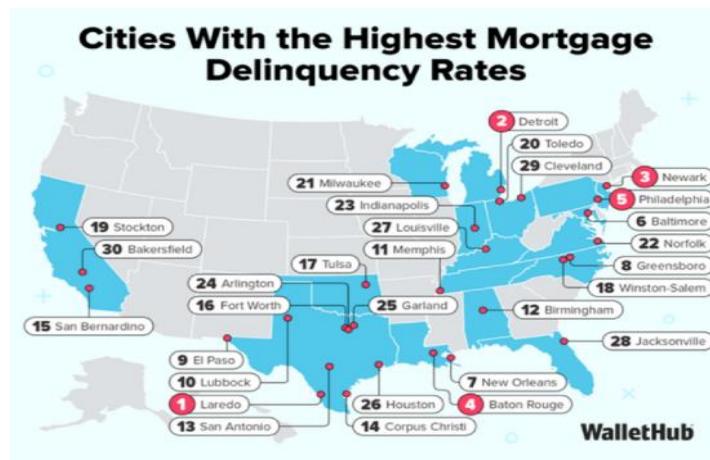
And white-collar workers tend to get severance packages on the way out the door (while blue-collar staff do not). It is also quite possible that the reason claims are not rising steeply is because people have exhausted all of their unemployment insurance benefits.

Bottom line: My advice is let's see what happens down the road, because there are instances when the jobless benefits get delayed. Looking at the jobless claims data alone provides a very distorted view on the state of the labor markets.

MORTGAGE DELINQUENCIES ON THE RISE

According to WalletHub, mortgage delinquency rates are worsening across most of the country, with rates ranging from 3% to nearly 24% depending on the city. The firm found 87 of the 100 largest U.S. cities saw delinquency rates rise between Q1 and Q2 2025 as elevated mortgage rates, high home prices and cost-of-living pressures strained household finances. To repeat: 87 out of 100 cities saw mortgage delinquencies rise in one quarter. That's not isolated stress, that's systemic.

Laredo, Texas posted an ~6% quarter-over-quarter increase in delinquencies to 24%. In other words, nearly one in four mortgages are delinquent. Detroit ranked second at nearly 19%, up 11% in the latest quarter shows, thus delinquencies are accelerating. Newark, New Jersey placed third at close to 17%, with a 9% quarter-to-quarter surge.



Bottom line: People prioritize keeping their house above everything else, so mortgage delinquency comes last. When it starts rising across 87 cities simultaneously, households have already exhausted every other option. This feeds directly into the housing market correction prediction where I expect home prices to drop significantly because the math doesn't work anymore.

MARKET OUTLOOK AND PORTFOLIO STRATEGY

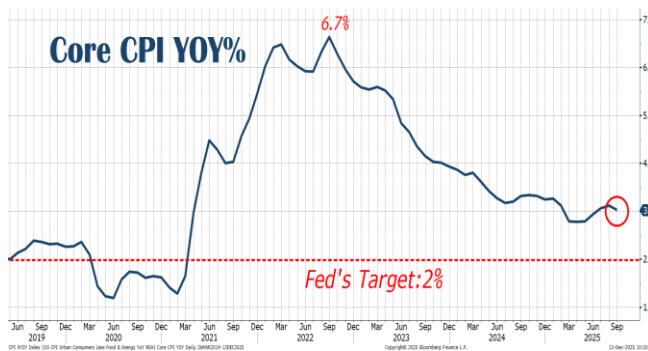
"Folks are going to get kicked off Medicaid, while the middle class are going to see their Obamacare premiums rise by quite painful amounts. Even if the aggregates rise and the size of GDP growth is positive, working and middle-class Americans may find themselves in a recession where their incomes are falling."

— Justin Wolfers, Economics Professor, The University of Michigan

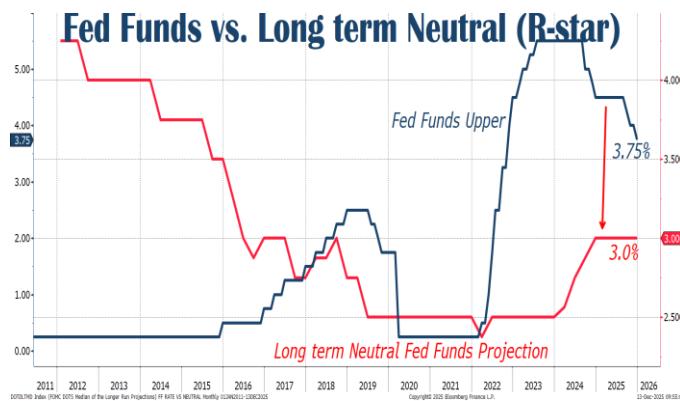
Data releases and central bank meetings will mark a busy pre-Christmas week.

The delayed November non-farm payrolls data on Tuesday and Consumer Price Index (CPI) on Thursday will dictate market action. If non-farm payrolls come in as light as the rolling ADP data suggest, we should see downward movement across the yield curve.

I also expect incoming data to support a further stabilization in price pressures with the core CPI coming in at 3% year over year.



Accordingly, I expect that over the coming months, the Fed will continue easing monetary policy at a cautious pace. As shown below, the current Fed Funds rate is still 75 basis points above the long-term neutral rate (R-Star).



With respect to the bond market, we are living through history. The 10-year Treasury yield has risen to 4.18% from 4.14% since the last Fed rate cut. Since the first easing in September 2024, it has risen by +50 basis points, which has never before happened at this juncture of any Fed rate-cutting cycle in the past. Normally, once the Fed has cut by a cumulative -175 basis points, the 10-year is down by an average of more than -40 basis points. This speaks to a market deeply suspicious of the administration's commitment to price stability because even with all the "dereg," the fiscal

largess being implemented and the tariff hikes have caused the term premium embedded in the Treasury market to firm back up.

On the fixed-income side, there is modest upward pressure on long-term yields across the curve, albeit with limited volatility for now. I expect steepening pressure to become a critical theme as early as January. Until then, the market appears to be navigating the year-end with a mix of caution and a quiet hope for peace and calm over the holiday period.

Bottom line: I expect the Fed to continue to lower rates towards neutral in the coming months. As such, any weakness in Treasuries provides an attractive entry point to invest excess cash reserves. As always, the most prudent approach is to build a risk-appropriate ladder strategy. **Strategically, the short to intermediate part of the yield curve is most attractive.**

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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 Alloyd'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 Alloyd Investment Services, a division of Alloyd 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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