Weekly Relative Value

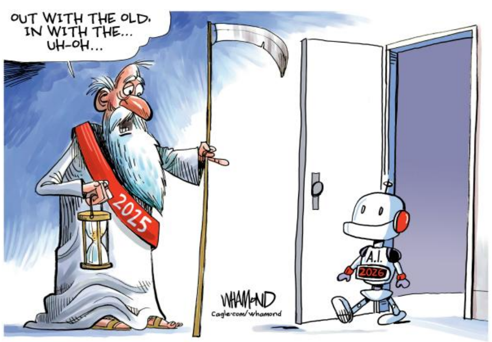
Tom Slefinger
Market Strategist

WEEK OF JANUARY 5, 2026

Goodbye 2025 and Hello 2026!

"The concentration of economic gains in AI has left the economy looking better on paper than it feels to most Americans."
– Dianne Swonk, Chief Economist and Managing Director, KPMG U.S.

What a year 2025 was! Over the past 12 months, the U.S. has seen every norm of economic policy — trade, fiscal, monetary, immigration — tossed aside. At the same time, the U.S. economy stands at the precipice of an artificial intelligence (AI) revolution just as tectonic as the transition from farming to manufacturing, or manufacturing to services. The difference is that the AI revolution could happen a lot faster. Or maybe the hype has far exceeded reality.



According to Gartner, global spending on AI in 2025 was ~$1.5 trillion in the U.S. Big Tech hyperscalers (e.g., Microsoft, Amazon, Google/Alphabet, Meta, Oracle) led the surge, with combined AI-related capital expenditures estimated at $350-$405 billion, which is counted in gross domestic product (GDP). In fact, AI spending accounted for ~92% of GDP growth in the first half of 2025. Without the AI/data centers, growth was ~0.1%.

If you are looking at just how the economic imbalances and strains are intensifying from the AI spending bubble, it was front and center in the *Financial Times* article titled "Data Centres Turn to Aircraft Engines to Avoid Grid Connection Delays" and in the *Wall Street Journal* story, "Caterpillar's Surging Stock Is Fueled by AI, Not Yellow Excavators."

The pressures on the energy grid have hit such epic levels that data center developers are turning to aircraft engines and fossil fuel generators to power the AI boom. Manufacturers

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of aeroderivative turbines and diesel generators have reported soaring demand; ditto for the consumption of generators fueled by diesel and gas. To wit: Cummins has practically doubled its capacity this year.

Things have reached such a nutty point that Caterpillar's power and energy business has overtaken everything else the manufacturer does in terms of sales growth across all divisions. Heck, who needs to build excavators when power generation from power-hungry AI projects is all the rage.

Bottom line: Suffice it to say, if this AI trade ever does reverse course, there will be reverberations across virtually every area of the market. And if the economy crashes this year, there will be far too many causes to choose from. But then again, maybe the economy won't crash, and AI will deliver the earnings and productivity boom so many pundits have proclaimed. While anything can happen, I would posit that everybody who claims to "know" is either lying or deluded. The truth is, nobody knows.

AI AND THE MARKET

What we do know is that in the wake of Liberation Day and the largest drop (-20%) in the S&P since 2020, the S&P 500 logged in its third straight double-digit gain, up ~16% for the year. Meanwhile, the Dow clocked in with a 13% gain, and the Nasdaq rose over 19%. AI was credited with the strong market returns as the top 10 companies (primarily tech) accounted for 50% to 60% of the returns of the S&P 500 Index.

And as usual, Wall Street is unanimously bullish in the year ahead, too!

To wit:

"The pessimists have just been wrong for so long that people are kind of tired of that shtick."
— Financial Post, "Bulls Only: Every Wall Street Analyst Is Predicting a Stock Rally", December 30, 2025

Then again, maybe it's time to pay heed to the investing legend Bob Farrell, who penned the "Top 10 Rules for Investing."

What seems like the most appropriate in the current environment is Rule Number Nine:

"When all the experts and forecasts agree — something else is going to happen."

Another rule that rings true is Rule Number Four:

"Exponential rapidly rising or falling markets usually go further than you think, but they do not correct by going sideways."

Finally, with the "Magnificent Seven" responsible for an estimated 54% of the S&P 500's total price gains by the end of 2025, Rule Number Seven is worth pondering:

“Markets are strongest when they are broad and weakest when they narrow to a handful of blue-chip names.”

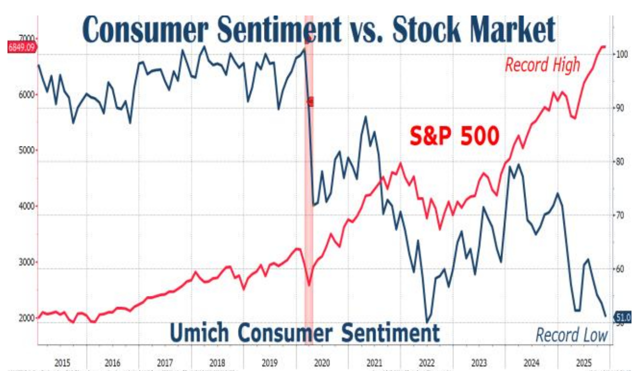
Meanwhile, Market Vane bullish sentiment, pressing against 70%, is near the very high end of the historical band. This index is a daily poll of futures trading advisors, indicating the percentage who are bullish on a particular market. A high reading (typically above 70%) often suggests an overbought market and potential for reversal (a contrarian signal), while a low reading (below 25%) indicates an oversold market and potential bottom. Today, everybody is all in and all at the same time as we move into 2026, save for Warren Buffett (sitting on cash) and Jamie Dimon (buying bonds).

Source: Haver Analytics

Bottom line: With valuations at extremely stretched levels and with everyone being bullish of more gains ahead, don’t be shocked to see the market disappoint in the coming year.

THE STOCK MARKET IS THE ECONOMY

How the stock market performs this year hinges critically on what the economy ends up doing, to an extent that we have not seen before. As the chart below illustrates, the gap between University of Michigan consumer sentiment (close to record lows) and the stock market (near all-time highs) has never before been as wide as it is currently.



The reason the stock market is key to the economy is because consumer spending is now heavily concentrated among the wealthy. The top 10% of earners account for 50% of all spending. Meanwhile, the bottom 20% contributes just 9% of total spending. This matters because consumer spending drives about 70% of U.S. GDP.

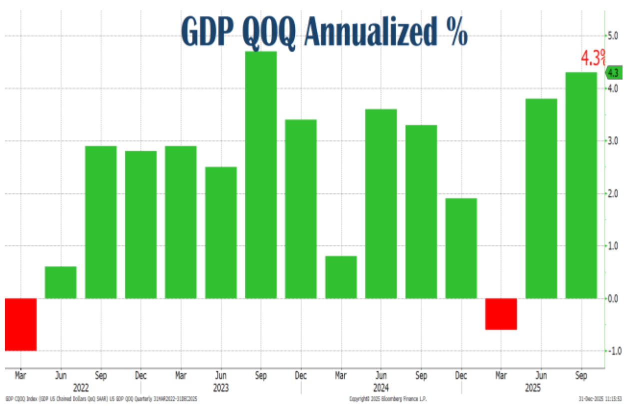
When that spending is concentrated among high income households, the economy becomes fragile. If something hits wealthy households hard, a market crash, recession, or rising rates, the entire consumer economy could contract sharply since there's no broad middle class spending base to cushion the blow.

The root cause is simple: Wages stagnated for most workers while asset prices soared. High income households own most financial assets and benefited from a decade of low rates and asset price inflation. Lower income households depend on wages that haven't kept up with inflation, so the wealth gap widened dramatically.

Bottom line: The practical risk is that high-income spending is sensitive to market performance. When stock markets drop, wealthy households cut back on discretionary purchases like vehicles. Since they drive the majority of consumer demand, a sharp market correction could trigger a significant spending pullback across the entire economy.

SCRATCHING BELOW THE SURFACE

While Wall Street is utterly bullish over the latest GDP report showing a growth rate of 4.3%, I keep finding myself having to contain my laughter on the so-called economic boom.



After digging into the latest Q3 GDP report, over 84% of that headline +4.3% GDP figure came from four sources:

Deconstructing the Q3 Real GDP Report (basis point contribution):

1. Savings decline and the equity "wealth effect" on spending contributed +240 basis points. Remember that real personal disposable income stagnated.
2. Goods imports decline: +84 basis points.
3. AI-related spending: +46 basis points.
4. Government sector: +39 basis points. See What happened to the Department of Government Efficiency (DOGE)? See "How Did DOGE Disrupt So Much While Saving So Little?"

But there's more. Going unreported was a burst of health care spending with a huge +6.8% surge in Q3. That alone added a further +76 basis points to that headline real GDP number. However, this has nothing to do with how the economy is doing and more to do with the low-end consumer prepping for the end of their Affordable Care Act subsidies. Net of that, the economy is contracting.

To highlight the uneven nature of the Q3 GDP report, there were contractions in housing, non-residential construction, consumer expenditures on appliances/furniture, the auto sector as well as business spending on industrial and transportation equipment. These items declined collectively at a -4.9% annual rate in Q3, and that marks the third consecutive retrenchment.

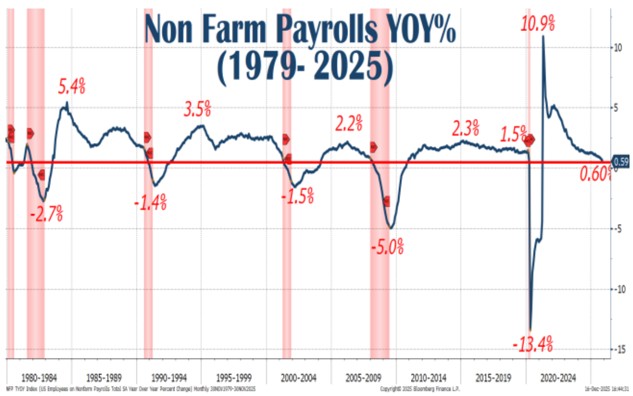
Bottom line: In a nutshell, FOUR small items in the GDP report accounted for 95% of all the economic growth in the last quarter. Strip out all four, and the economy is essentially flat (+0.2% annualized).

Sometimes you have to scratch below the surface to find the truth.

LABOR PAINS

Meanwhile, Wall Street is all a glitter and is focused on the +4.3% headline growth figure in Q3 real GDP. My concern is the shape of the labor market, which is plagued by high levels of economic uncertainty, a clouded outlook for aggregate demand, and the disruptions from AI.

Over the past year, the total number of jobs in the U.S. increased by 0.6%, the slowest growth rate since March 2021. Guess what? On average, the year-over-year trajectory for the first month of recession was +2.2% and the median was +1.8%. Not once was it +0.6%. In the past 50 years, this type of weakness in the labor market has preceded a recession and a spike in the unemployment rate 100% of the time. This is a fact, not an opinion.



This is one of those signals that's uncomfortable because it has such a clean history. A 0.6% year-over-year gain in payrolls means hiring is barely keeping up with population growth. In past cycles, that wasn't the cause of recessions, but it reliably showed when momentum had already broken. Labor rolls over late, then unemployment follows.
What happens historically is that when the year-over-year job creation pace softens to become as microscopic as +0.6%, the bottom is not turned in until the trend swings much lower to -2.7%, the mean outside of the pandemic recession.

The problem is that the Fed only springs into action once that trend removes its plus sign and turns negative. To get to the classic low, we typically see payroll growth after crossing the Rubicon of a +0.6% year-over-year trend, so we are talking about a future of a -four million employment decline ahead. In my mind, the weakening labor markets will be the dominant theme for the economy in 2026.

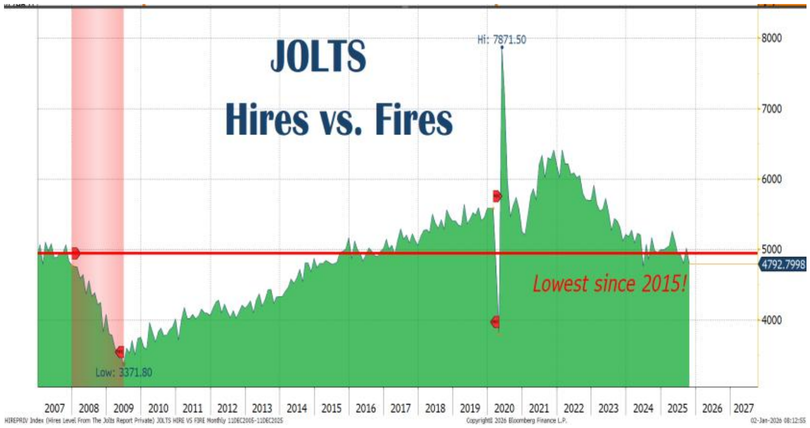
THE NO HIRE ECONOMY

"It's like an insider-outsider thing…where outsiders that need jobs are struggling to get their foot in, even as insiders are insulated by what up until now is a low-layoff environment."
– Guy Berger, Head of Research, The Burning Glass Institute

Throughout the year, hiring was downright recessionary overall. As shown below, the hiring rate for private companies of 3.5% is now well below pre-pandemic levels and is consistent with the hiring level seen during the Great Financial Crisis in 2007-2009.

My big concern is what is happening with the hiring rate and firing rate, which are now pointing to outright declines in non-farm payrolls. Note: This has already been happening for the past four months in the small business sector, which is a leading indicator.

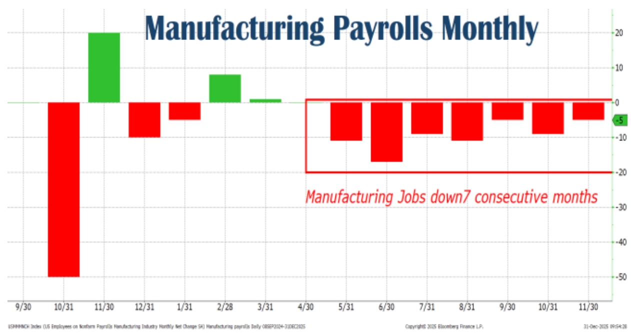
The Job Openings and Labor Turnover Survey (JOLTS) data points together suggest that we will soon be heading above 5.0% on the headline unemployment rate and possibly on our way to 6.0% by the end of 2026. Remember, the Fed believes the jobless rate has already peaked. (The median forecast is at 4.4% even though it sits at 4.6% at the moment.) Rising unemployment feeds into reduced wage growth and slower consumer spending trends. Ergo, I remain bullish on the bond markets and expect lower rates across the curve over the next year.



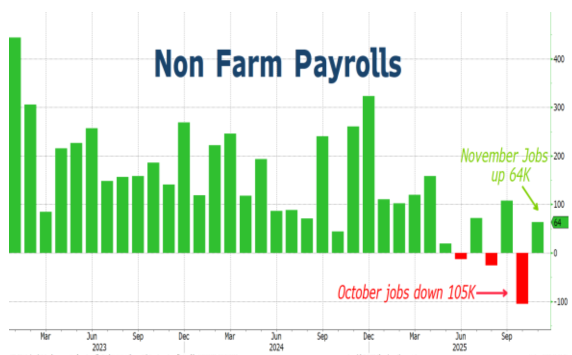
What job growth the U.S. did see was overwhelmingly concentrated in the health care and social assistance sector, which saw employment rise by 695,000 in 2025. Excluding that sector, overall employment in the U.S. declined this year!

On the other end of the spectrum, the manufacturing sector has shed jobs for seven straight months as the U.S. economy transitions from a factory to a hospital. Moreover, the Trumpian project of bringing “masculine” blue-collar jobs back is going badly. So, for all the talk about how the tariff wall was going to trigger a renaissance in the industrial sector, why is manufacturing employment down by -63,000 so far this year, to the lowest level since March 2022?

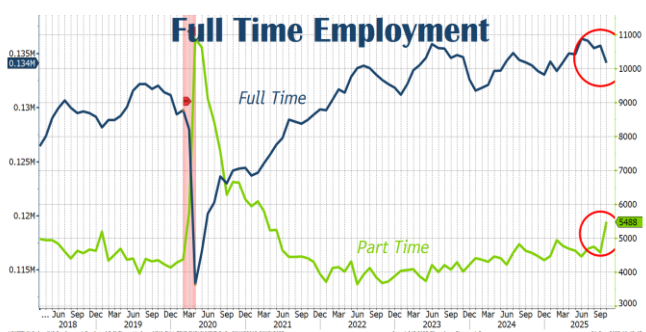
“We’re going to have a manufacturing boom… creating millions and millions of blue-collar jobs and jobs of every type.”
— President Donald Trump



The bigger picture shows that on a net basis, almost no jobs have been added since April.



Making matters worse, when digging below the headline numbers, one will find that there has been virtually no full-time job creation in 2025.

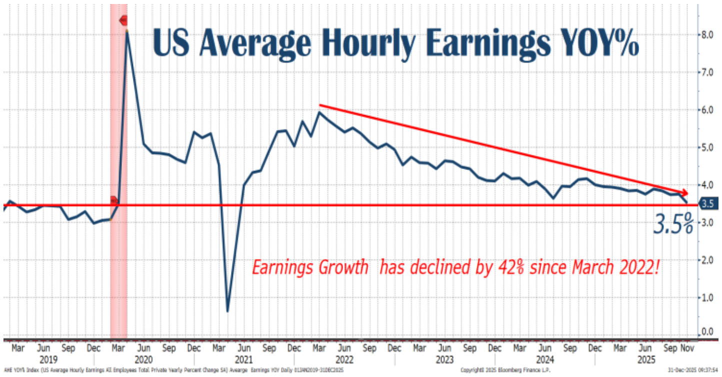


Here are a few more stats that clearly illustrate the weakness in the labor markets:

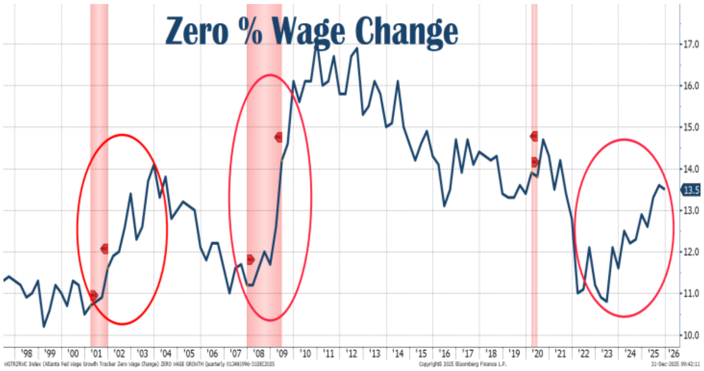
- The number of Americans working part-time because they can't find a full-time job has expanded +23% over the past year.
- The number of folks working at more than one job has jumped +8.4% in the past twelve months, which speaks to accelerating financial strains for those households who own little in the way of the stock market.
- The ranks of the self-employed have swelled by more than +4% (a contrarian indicator).
- The number of discouraged workers who have taken themselves out of the labor market has ballooned — get this — by 60% over the past year. Tell them how wonderful Q3 GDP was.

WAGES DECLINE

Those with jobs saw their wage gains cool. Measures including average hourly earnings and the Employment Cost Index are rising at the slowest paces since 2021. Question: On what planet is this inflationary?

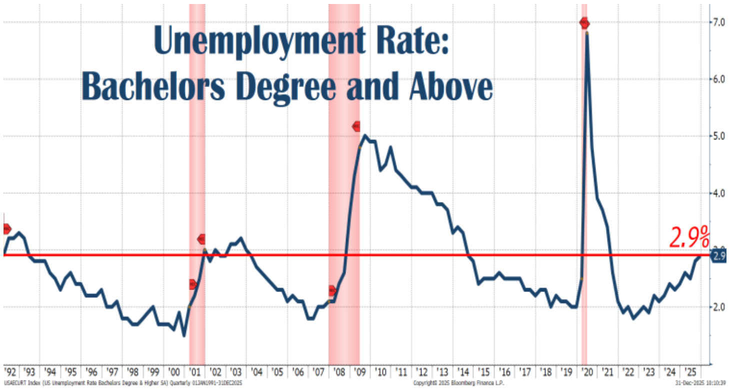


Per the Atlanta Fed, at least 13% of employed individuals saw no pay increase at all from a year earlier. Historically, such a sharp increase of employees getting no wage increase has indicated a recessionary environment.



Workers with four-year college degrees have been hit hard in the soft hiring environment. Their unemployment rate was 2.9% in November, comparatively still lower than many other demographics, but a level never before reached absent a recession.

As AI infiltrates the economy and labor markets, it is becoming apparent that young college-educated individuals no longer have the same kind of advantage in finding work over those with only high-school diplomas that they had in the past.



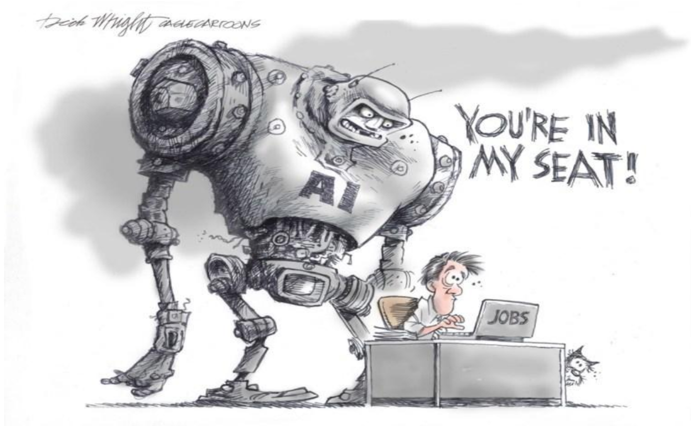
GROWTH WITH NO JOBS

"The question will really be one of meaning, of how – if a computer can do, and the robots can do everything better than you… does your life have meaning? That really will be the question in that benign scenario, and in the negative scenario, all bets are off where we're in deep trouble." – Elon Musk

The Wall Street Journal article "Companies Are Outlining Plans for 2026. Hiring Isn't One of Them", provided a key piece of economic information for the coming year.

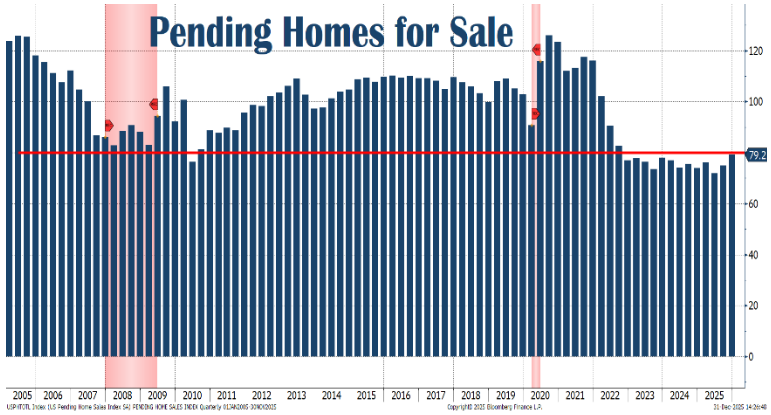
In fact, a recent survey of CEOs indicated that only a third (33%) of leaders plan to hire more workers in 2026. The remaining 66% plan to either reduce headcount or maintain the current team size, reflecting economic uncertainties and the growing influence of AI on staffing decisions.

What bothers me and is well worth pondering is that Goldman Sachs economists are warning about "jobless growth" becoming the new normal, where GDP expands while hiring stagnates.

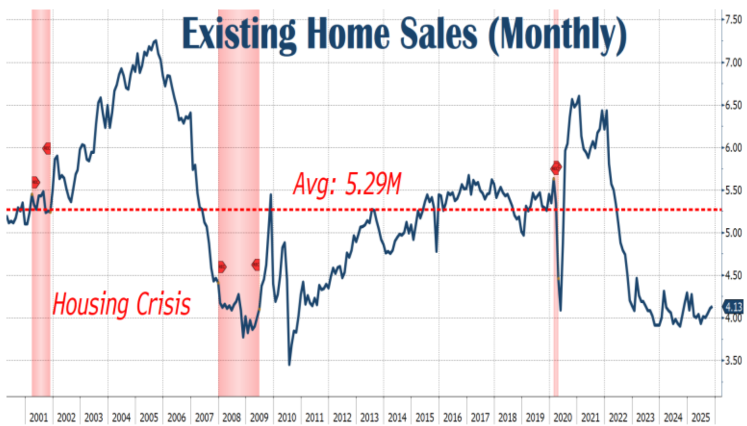


HOUSING REMAINS IN THE BASEMENT

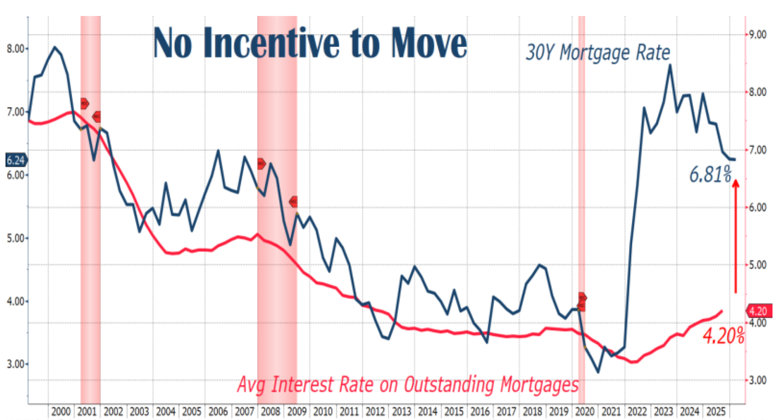
As we ended the year, America is heading into its fourth year of a real estate recession. As shown below, buyer demand plummeted in 2022 and has not recovered and is still down nearly 30% from pre-pandemic norms. In fact, today's buyer demand is worse than the lows experienced in the 2008-2011 downturn.



Existing home sales have been flat at roughly 4,000,000 annualized sales for three full years. Only price insensitive buyers have been buying.



Even though mortgage rates have declined by over 150 basis points, few are willing to trade a 3-4% mortgage for a 6% plus mortgage. And unlike the Great Recession with huge job losses, homeowners can just sit tight.



But the biggest reason why homebuyer demand is near the lowest level on record is horrendous affordability. The single-biggest determinant of mortgage costs is not mortgage rates. It's price. Prices going up 50% have crushed affordability more than rates going from 4% to 6%. This is the legacy of inept Fed policy twice. First, the Fed created a massive bubble of liar loans ahead of the Great Recession. Then the Fed slashed rates to zero during thepandemic, creating the current locked market.

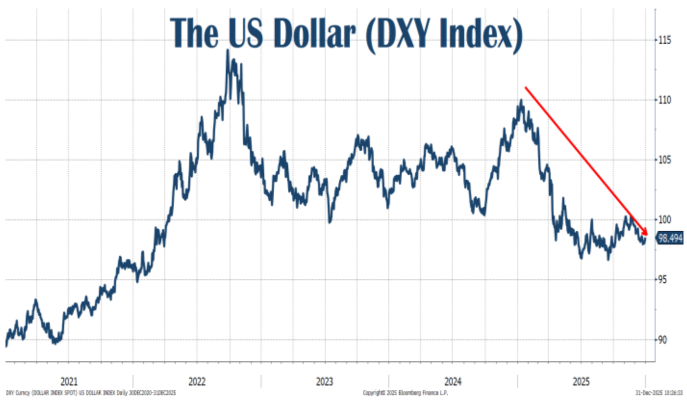
Right now, U.S. homebuyers need to pay ~40% of their gross income to afford to buy a house. And obviously, no one wants to do that. As a result, demand has plummeted to the lowest level in 40 years (only 4.7% of occupied homes sold in 2025, the lowest since 1982).

Bottom line: Buyers don't care about rates. After seven rate cuts, you would think people in real estate would have learned this by now. They care about prices. And so long as prices stay high, demand will likely stay low.

GOLD AND SILVER SURGE

*"I want my new Fed Chairman to lower Interest Rates if the Market is doing well, not destroy the Market for no reason whatsoever. I want to have a Market the likes of which we haven't had in many decades**. Anybody that disagrees with me will never be the Fed Chairman!"** — President Donald Trump*

One of the biggest themes throughout 2025 was the meteoric rise in precious metals, and the worst performance in the dollar over five years. The quote above is all one needs to know why the U.S. Dollar (DXY Index) ended the year lower by ~8%.

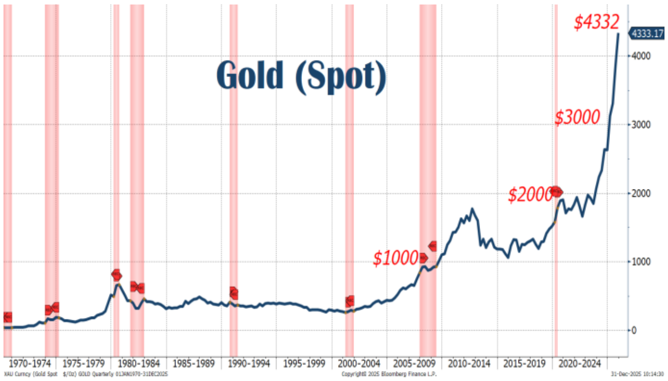


Investors say more declines are coming if the next Federal Reserve chief opts for deeper interest-rate cuts as expected. Thus, for now, it's all about the Fed and who steps into replacing Jerome Powell, whose term as chair is set to end in early 2026.

"And it's not just the meetings in January and March, but who will be the Fed Chair after Jerome Powell ends his term." – Yusuke Miyairi, Foreign-Exchange Strategist, Nomura.

Concerns over Fed independence led to epic rallies in precious metals as a hedge against the U.S. dollar debasement.

Indeed, gold enjoyed its best year in two generations. Not to be outdone, the price of silver more than doubled.



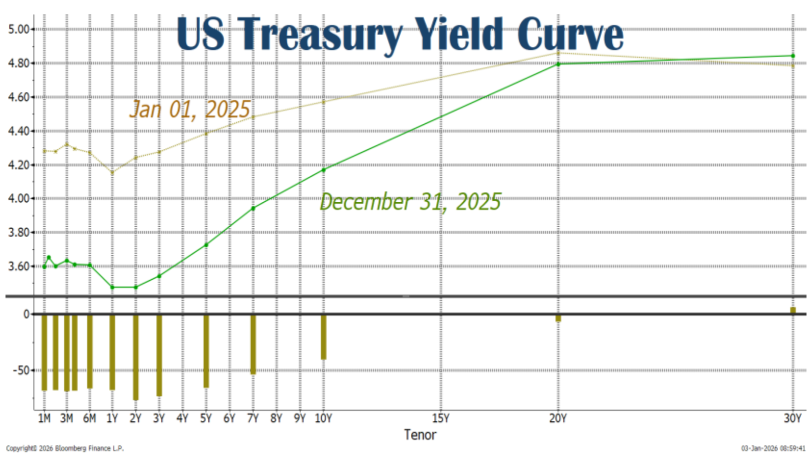
MARKET OUTLOOK AND PORTFLIO STRATEGY

Regarding Fed monetary policy, the Fed after reducing the fed funds rate by 100 basis points in 2024 restarted its easing cycle in lowering the fed funds rate by an additional 75 basis points in 2025 to 3.75%. In total, the Fed has cut rates by 175 basis points since beginning the easing cycle in September 2024.

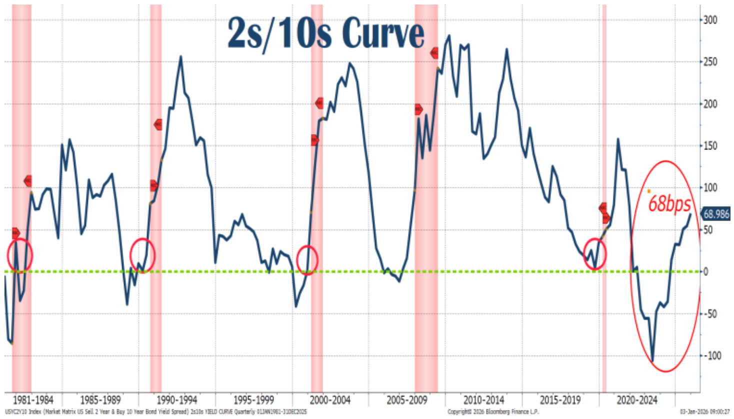
In terms of performance, the Treasury market in 2025 had its best year since 2020.

Yield declines were biggest for short maturities. The two-year yield declined 77 basis points from 4.24% to 3.47%. Likewise, the five-year Treasury yield fell 72 basis points from 4.46% to 3.74%.

At the long end of the curve the 10-year Treasury benchmark yield declined 40 basis points from 4.57% to 4.17%. The long bond (30-year) Treasury was the only part of the curve that did not participate in the rally with the yield rising six basis points from 4.78% to 4.84%.

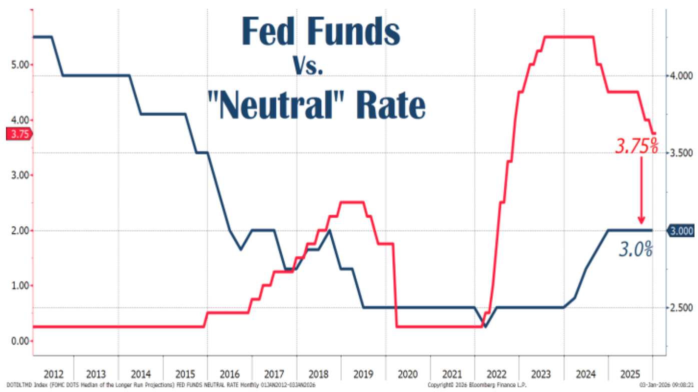


The sharp declines in short-term yields led to a dramatic steepening of the yield curve. As shown below, the 2s/10s at 68 basis points is now at the steepest level since 2019.



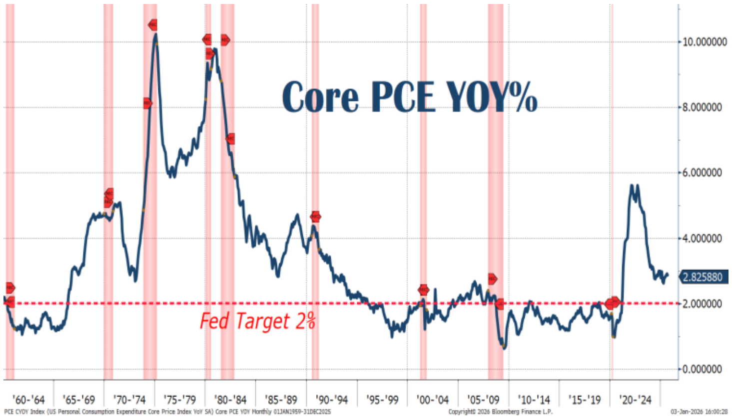
Looking forward, there are two rate cuts priced in 2026. This is consistent with my long-standing view that the Fed will continue to lower the Fed Funds Rate to its long-term neutral level (aka "r-star) – an estimate of where policy is not "stimulative" or "restrictive."

Currently, the Fed is projecting that the long-term neutral level is 3% although other estimates suggest the long-term neutral level is closer to 2%.



Moving on. While the narrative is currently focused on AI and the affordability crisis, I believe the focus will shift towards the quickly weakening jobs market in 2026 (as discussed above). To that point, this week there will be some key labor market data that will set the tone for 2026 growth expectations. JOLTS and ADP payrolls on Wednesday will be followed by December's non-farm payrolls on Friday (the consensus is expecting a +55,000 gain in employment and a drop in the unemployment rate from 4.6% to 4.5%). If the jobs data is weaker than expected, look for the bond market to price in more aggressive action by the Fed.

Moreover, although a contrarian view, don't be surprised to see inflation moving to and then likely through the Fed's 2% target in 2026 as the lagged costs of shelter filter into the real time data and overwhelm any impact from higher tariffs.



Bottom line: Due to a weakening labor market and expected disinflationary pressures from housing and shelter, 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.

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.

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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 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.