



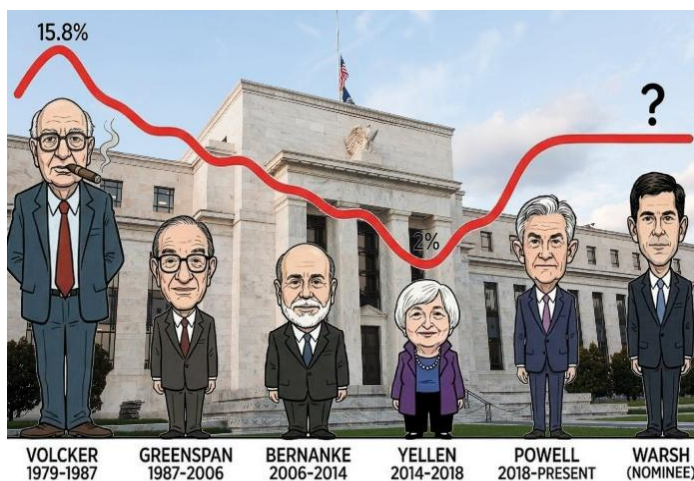
Tom Slefinger
Market Strategist

Weekly Relative Value

WEEK OF MAY 4, 2026

Regime Change?

Kevin Warsh, President Donald Trump’s nominee to be the next chair of the Federal Reserve, won the backing of the Senate Banking Committee last week on a 13-11 party-line vote, putting him on track to be confirmed by the full Senate before Jerome Powell’s term ends May 15.



Powell’s term as a governor of the Federal Reserve Board of Governors expires in January 2028. In the past, when the Fed chair term expired, Fed chairs also resigned from their governor slots and departed the Fed entirely, thereby making room for a new governor — in this case, Kevin Warsh.

But not this time.

“I will leave when I think it’s appropriate to do so.” — Jerome Powell

Powell announced during the press conference following the Federal Open Market Committee (FOMC) meeting that after his term as chair ends on May 15, he would not resign from his position as governor on the Board **“for a period of time”** until the investigation into the cost overruns on the Fed building by the Department of Justice (DOJ) **“is well and truly over with transparency and finality,”** adding... **“the things that have**

PLEASE NOTE: The views and opinions expressed herein are those of the author and do not necessarily reflect the views of Alloya Corporate Federal Credit Union, Alloya Investment Services (a division of Alloya Solutions, LLC), its affiliates, or its employees.

THIS WEEK

- DISSENT IS THE WORD
- THE AI MIRAGE
- WHERE WILL THE JOBS BE?
- UNCHARTED TERRITORY
- WILL AI LOWER LABOR COSTS?
- DEFLATION IN HOUSING
- LOWEST IN 70 YEARS!
- SPENDING WHAT THEY DON'T HAVE
- LEADING ECONOMIC INDICATORS (LEI) AT 12-YEAR LOW
- MARKET OUTLOOK AND PORTFOLIO STRATEGY



Credit Union Leadership
SYMPOSIUM
September 9-11, 2026
Nashville, TN

REGISTER NOW



SUBSCRIBE

happened really in the last three months left me no choice but to stay until I see them through at least that long.” He promised **“to keep a low profile”** and support the new chair.

At issue is the Fed’s independence, which has come under attack and is now getting fought over in the courts, including the Supreme Court.

Treasury Secretary Scott Bessent criticized Powell for his decision to stay on the Federal Reserve Board after he steps down as the U.S. central bank’s chair. Bessent said the move amounted to an “insult” to Warsh and Governors Michelle Bowman and Christopher Waller, who were also picked by Trump. Meanwhile, if Trump tries to fire Powell (which he has threatened to do), then Powell may dig his heels in and stay on the Fed until January 2028.

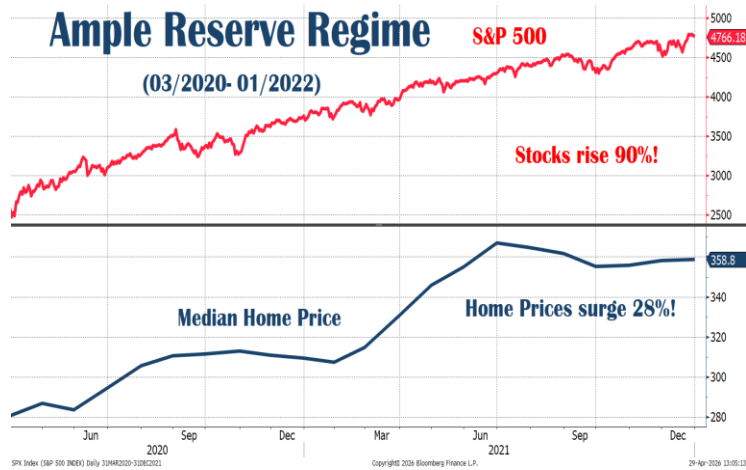
While this might make for good theater, it does not make for good policy.

Given that the Fed Taj Mahal was started before Powell’s term, and as many government contracts were woefully underbid, it is not shocking that there were cost overruns, especially in a highly inflationary construction environment. And it cannot be constructive to have Powell on the board even if he does vote with Warsh. In the interest of moving on quickly, I believe the DOJ should officially drop the case, declare Powell not at fault, and Powell should leave.

The bigger picture is that once we move beyond this soap opera, it looks like big change could be coming to the Federal Reserve. This is why. Powell was the architect of mega Quantitative Easing (QE) from March 2020 through early 2022, whereby the Fed purchased \$3 trillion in Treasury securities and mortgage-backed securities (MBS) in March, April and May 2020, and then continued buying these securities at a rapid pace, thereby driving down the 10-year Treasury yield below 1% and 30-year fixed mortgage rates below 3%, triggering a massive asset-price explosion, including the home-price explosion from mid-2020 through mid-2022, even as inflation began raging in early 2021.

He was also the architect of the “ample reserves regime,” which the Fed normalized in 2019 where banks hold large amounts of reserves, exceeding minimum requirement even when there is no crisis. This framework allows the Fed to manage policy efficiently without needing to manage the precise amount of reserves in the banking system, which was standard practice before the 2008 financial crisis. Critics of the “ample reserve regime” argue it subsidizes banks (via interest on large reserves), expands the Fed’s role unnecessarily and risks fiscal dominance. Proponents highlight smoother operations and resilience.

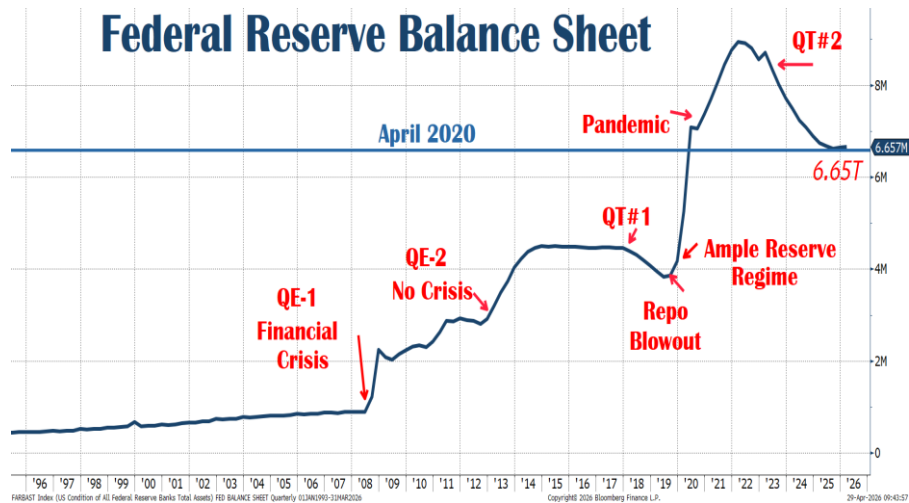
As I have written about time and time again, Powell’s QE was ONLY justified if your number one priority was to inflate asset prices out of the wazoo without rhyme or reason, including the home price explosion that is now causing such big problems.



Warsh and Bennet, who picked Warsh as one of the candidates, have publicly opposed these policies. Bessent did so in an essay last September that blasted the Fed for QE, its “perverse incentives” for fiscal “irresponsibility,” the Fed’s “wealth effect” policies and its failure to deal with inflation.

When Warsh was a governor on the Federal Reserve Board under Bernanke, he supported QE1 to get the financial crisis under control. But Bernanke pushed for QE2 despite a recovering economy and roaring markets, and against substantial opposition from some members on the FOMC, including Warsh and Thomas Hoenig. Bernanke persevered and announced QE2 in November 2010. In response, this is why Warsh left the FOMC in 2018.

Even during the selection process, during the Senate confirmation hearings, Warsh stuck to his guns: The Fed should have a smaller balance sheet than it has now. He has also been an inflation hawk, and he thinks reducing the balance sheet will make it easier to keep a lid on inflation. His hostility to “money printing” appears to be etched in stone, and Bessent is with him on this.



During the Senate hearings, Warsh called for a “regime change” at the Fed — a change of the policy regime — not the people. This might include ending the “ample reserves regime” that Powell concocted. Ending the ample reserves framework would likely involve deliberately reducing reserves further — into the scarce reserves zone — by continuing or accelerating balance sheet reduction (e.g., more aggressive Quantitative Tightening (QT) or outright sales) without

offsetting purchases. This would return the Fed to a pre-2008 corridor system, where it primarily influences the federal funds rate by adjusting reserve supply through open market operations.

If so, the Fed's holdings of securities (and thus its overall size) could shrink significantly — potentially by another \$1–2+ trillion or more, depending on how low reserves go. This would reduce the Fed's "footprint" in financial markets and its holdings of Treasuries, which some view as desirable for limiting political pressures or quasi-fiscal activities.

I should also highlight that banks and credit unions would hold fewer excess reserves, potentially increasing their reliance on interbank lending, the discount window or private repurchase agreement markets for liquidity management. Also, they would likely be impacted by reduced profitability from lower interest on reserve balances (IORB) income on reserves.

Bottom line: The prospect of a Warsh-led Fed promises to be the biggest shake up of the central bank in years. Having raised the prospect of "regime change" as part of his bid to win Trump's nomination, Warsh has promised to shrink the Fed's \$6.7 trillion balance sheet, establish a new framework for managing inflation and change how the central bank communicates with the public.

That said, currently, there is no indication of an imminent full reversal on ending the ample reserves regime. The exact outcomes would depend on how far reserves are reduced, regulatory changes, economic conditions and the Fed's tolerance for volatility. Whatever the case, the transition would need to be gradual and well-communicated to avoid disruptions.

DISSENT IS THE WORD

*"I am increasingly concerned about how long it will take inflation to return all the way to the FOMC's 2% target."
— Lorie Logan, President, Federal Reserve Bank of Dallas in explaining her dissent*

The parting gift to Jerome Powell for his last FOMC meeting as chairman was dissents. The Federal Reserve held rates steady at 3.5% to 3.75% in what will most likely be Jerome Powell's final meeting as chair, but the vote split 8-4, the most dissents since October 1992. Governor Stephen Miran wanted to cut rates, and the other three (Kashkari, Logan and Hammack — all hawks) voted against the de facto "easing bias" as they wanted a two-sided comment that the next move could well be a hike.

An 8-4 split is NOT a routine disagreement. Four dissents in the same meeting pulling in opposite directions describe a committee that has genuinely lost consensus on where policy should go. The conflict within the FOMC will make forward guidance harder to interpret and increase uncertainty for anyone making borrowing or investment decisions based on where rates are headed.

Bottom line: Markets are pricing in no cuts for the rest of 2026 and well into 2027. The broader challenge is that the Fed is caught between two real problems simultaneously.

The Iran war has pushed energy prices high enough and long enough that officials can no longer treat it as a temporary shock to look through, which argues for holding or tightening.

At the same time, the housing market is in a state of depression, the labor market is softening, and excluding artificial intelligence (AI) and healthcare, 75% of the economy is in recession, which argues for easing.

Also, Kevin Warsh has advocated for a closer relationship between the Fed and Treasury on debt issuance, which could complicate that already difficult balance if the incoming chair prioritizes coordination over price stability at a moment when inflation remains well above the 2% target.

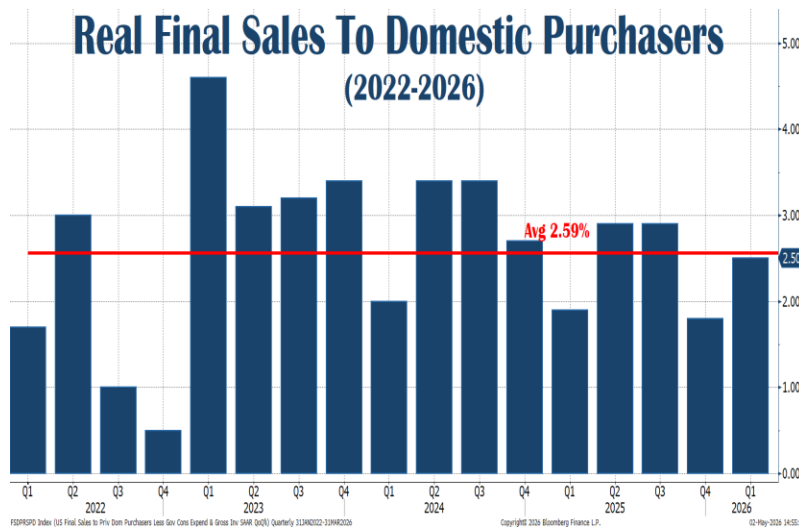
THE AI MIRAGE

Real gross domestic product (GDP) growth was +2.0% in Q1, up from a weak +0.5% in the previous quarter. Q1 2025 was impacted by front running tariffs (imports are negative for GDP). Then there was a large rebound as things balanced. The weaker 0.5% growth of Q4 2025 was almost entirely due to the government shutdown, and part of the 2% growth for Q1 2026 was catch-up from the government shutdown. It was helped greatly by the massive AI spending boom.

Here are the key takeaways:

- Real consumer spending rose 0.2% in March, but annualized growth slowed to 1.6% from 1.9% in Q4.
- Spending on goods was roughly unchanged, adjusted for inflation. Service spending stayed robust, mostly driven by a 4.5% annual increase in health care, which has grown every quarter since early 2022.
- Financial services experienced a notable increase, rising at a +4.6% annual rate, reflecting heightened activity among retail investors. Conversely, the restaurant and accommodation sector declined by -2.8% annually, following a -1.2% decrease in Q4 — marking its first recession in four years.
- Housing was a net subtraction (-8%) for the fifth quarter in a row, and for commercial construction (-6.7%), the losses have now accumulated for nine straight quarters.
- Tech-related capital expenditures (capex) soared at a +23.3% annual rate, and that was the strongest on record and followed a ripping +14.2% pace in last year’s fourth quarter. **Tech capex added +1.5% to the Q1 GDP growth headline, or 75% of the total.**

However, if you simply look at real final sales to private domestic purchasers (excludes government expenditures, government investment, exports, imports and changes in inventories), which Powell especially, and the Fed in general, like to talk about, annualized GDP for the quarter would have been 2.5% with AI driving well over 60% of the return.



Bottom line: Everybody and their mother seem to think the economy is rocking and rolling. We got that +2.0% real GDP growth rate for Q1, and three-quarters of that headline number was all tech capex. Consider that \$725 billion number

from the four mega-cap tech companies for this year — that bests the highest number we have ever seen in 80 years of data.

That said, the economy is so lopsided that net of AI capex, health care and financial services, the other 72% share of the economy contracted at a -1.1% annualized rate after a -1.8% falloff in Q4.

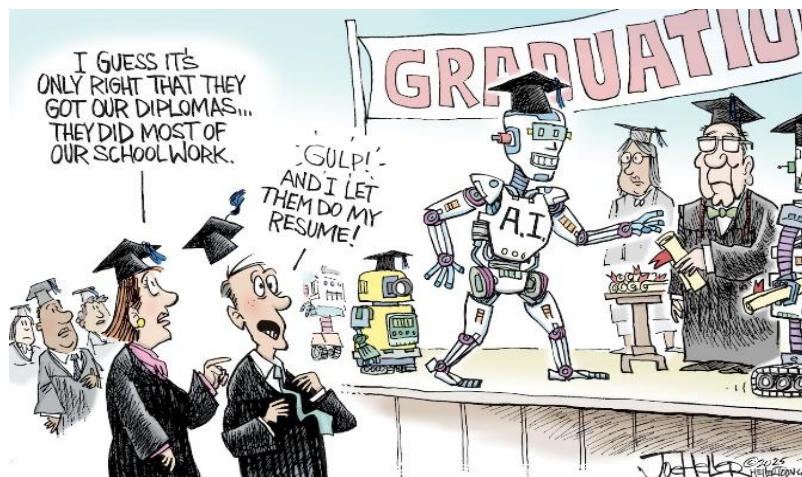
Let me repeat. **Nearly three-quarters of the U.S. economy is in recession**, and yet nary an asset class is remotely priced for this outcome nor does the Fed seem to have any such recognition, because I can see, based on the commentary, that the typical monetary policymaker, like the usual trader, doesn't take the time to look under the hood.

Ergo, the GDP mirage is mostly made up by the AI mirage.

WHERE WILL THE JOBS BE?

According to Harvard Kennedy School polling, approximately 70% of college students perceive AI as a threat to their future job prospects, prompting many to change majors in pursuit of careers perceived as less susceptible to automation. For example, one business analytics student transitioned to marketing to develop critical thinking and interpersonal skills. Another student (data science major) is considering a shift to studio art.

The students trying to navigate this AI environment don't have bad instincts. Critical thinking, relationship building and communication genuinely are harder to automate than statistical analysis and coding. The problem is that the same companies cutting data scientists and coders are also cutting marketing teams, communications roles and middle management. Simply put, there is no place to hide. There is no major AI-proof because the disruption isn't sector-specific. It's structural. Despite these uncertainties, institutions continue to charge between \$60,000 and \$80,000 per year for degrees whose future value is unknown.



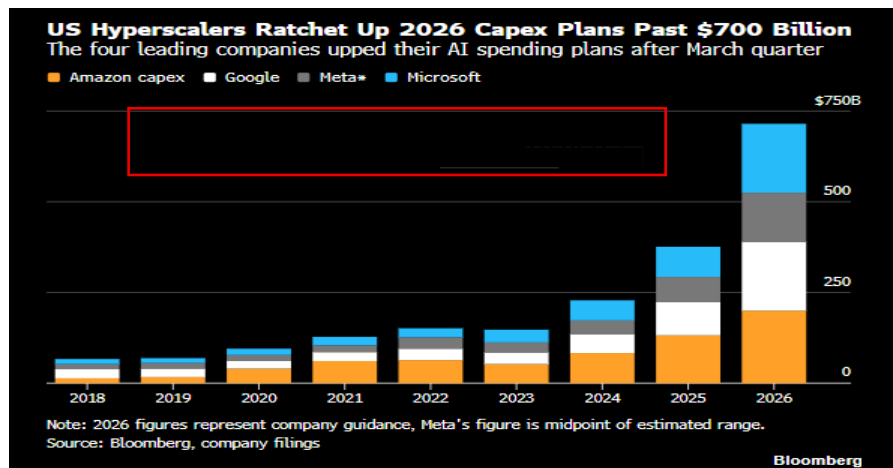
Bottom line: The graduating class of 2026 is entering a job market that looks nothing like when they started college, and AI is the reason. Over the next decade, the advances in AI will mean that many humans may no longer be needed for many jobs and professions.

UNCHARTED TERRITORY

“I’m starting to worry there’s so much spending right now on the AI physical boom — the buildout of data centers, chips, and so on — that if anyone decides to pause and ask, ‘What’s our real economic return here?’ it could be a big problem.” — Jim Chanos, American Investment Manager

Something’s been bugging me lately, and I think more people need to talk about it. Companies have committed \$2.5 trillion in global AI investment this year alone, up 44% from last year. Amazon, Google, Meta and Microsoft are set to blow through \$725 billion on AI, more than double what they spent two years ago. Historically, that kind of capital injection means one thing. Jobs, growth and prosperity.

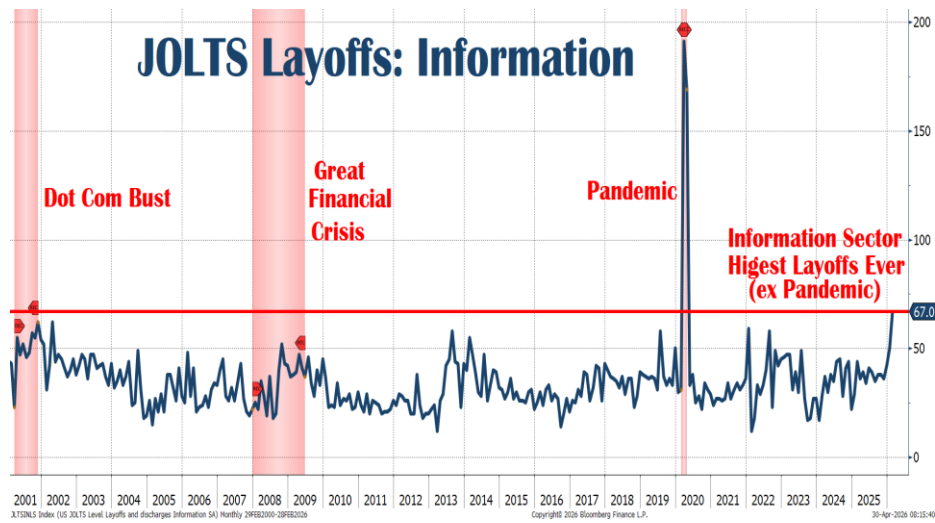
But this time, it doesn’t...because every dollar being deployed is designed to REPLACE the people who would normally benefit from it.



As discussed last week’s *WRV*, “In the Name of Efficiency,” Meta is cutting around 10% of its workforce (around 8,000 roles), while Microsoft is offering buyouts to roughly 7% of employees (around 8,000 roles eligible as well). Meta is not only reducing headcount but also scaling back hiring by closing around 6,000 open roles, signaling weaker labor demand at the margin.

The company plans to invest up to \$135 billion in AI infrastructure this year, marking a shift from labor-driven growth to capital investment, with productivity gains now focused on infrastructure over expanding staff.

The graph below shows that, even BEFORE this latest round of layoffs, the information sector (which includes information technology as well as publishing/broadcasting industries, libraries and other information services) was laying off workers at the highest rate ever (excluding the pandemic) — higher than the dot-com bust peak or during the Great Financial Crisis. This is likely evidence of AI-driven job displacement and will be major pressure on the job market throughout 2026.



We are heading for something that has NEVER existed before. Record investment and mass unemployment.

Here’s the chain reaction nobody wants to talk about: Jobs disappear, spending collapses, revenue dries up, tax receipts fall off a cliff. Governments already buried in debt have zero room to respond. Indeed, for the first time since World War II, U.S. debt has crossed 100% of GDP. With debt now above 100% of GDP and the annual deficit heading toward \$3 trillion, the pressure on whoever runs the Fed to accommodate Treasury borrowing rather than fight inflation is going to be significant. The Iran war is already pushing energy prices higher and tariff inflation is already in the pipeline. A Fed chair who prioritizes coordination with a Treasury financing \$39 trillion in debt at elevated interest rates, in an inflationary environment, is a combination that historically has not ended well.

Annual interest payments on U.S. public debt have officially surpassed \$1 trillion, driven by rising interest rates and a debt exceeding \$31 trillion, making it one of the fastest-growing federal budget components. As of 2026, this cost exceeds annual defense spending and represents over 14% of government spending, a figure projected to grow to over \$2 trillion by 2036. It has been pointed out by many that empires do not last when their interest costs are higher than their defense spending. We are there.

At some point the bond market will simply indicate to Congress that they have to make changes in the way they do business. Otherwise, long-term rates are going to continue to go up no matter what happens with short-term rates.



We are entering a period where monetary policy will no longer work as it has in the past. Just as we are seeing long-term rates rise around the world because of fiscal profligacy, the same will happen in the U.S. The real limiting factor on U.S. growth is not Federal Reserve policy but out-of-control spending and the bipartisan congressional commitment to spending growth.

Three forces are converging simultaneously for the first time in history:

- Record capital deployment
- Widespread job displacement
- Unsustainable government debt

The proposed solutions: automation taxes and universal basic income, are political non-starters that no one is seriously willing to touch. But the fact that they keep coming up tells you everything about where this is heading.

Bottom line: We are in uncharted territory. Massive change is coming and the old levers: rate cuts, stimulus and regulation, weren't designed for any of this.

WILL AI LOWER LABOR COSTS?

“There will come a point where no job is needed.” — Elon Musk, noting that individuals may only work for personal satisfaction or as a “hobby.”

What I find interesting is that equity investors are optimistic about AI reducing labor costs and inflation while the bond market and the Fed are fretting over inflation due to the rise of energy prices. However, the labor markets have had a much larger impact on inflation than the commodity market. To wit: worker shortages, higher quit rates and rising wages — played a far greater role in driving inflation to over 9% in summer 2022 than commodity prices did.

Over the past two years, combined productivity growth (~ approximately 2.5% annually) was the primary driver of GDP growth, while labor (aggregate hours worked) has been a two-bit player. In fact, 92% of the growth in output over the past two years has come from productivity gains — labor input added ONLY 8%.

For some perspective, in a normal year or cycle, the split is even between the two, and even after prior major shifts in the technology curve, including the Internet, the ratio was 70%-30% — NOT 90%-10%.

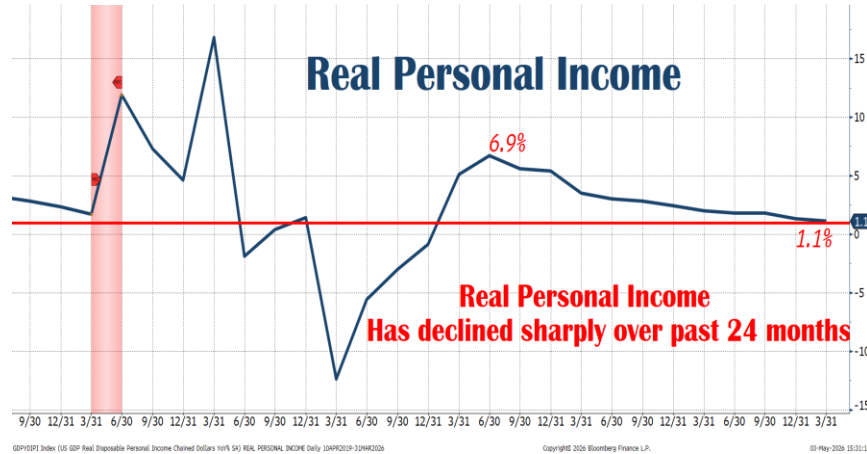
Note: GDP (or non-farm business output) growth = productivity growth plus growth in hours worked (labor input).

Overall, real GDP growth was 3% in 2024, and 2.1% in 2025. As seen in the table below, productivity has been the dominant driver, with labor input (employment/hours) contributing little after post-pandemic recovery.

Year	Labor Productivity (Output per hour)	Hours Worked	Output
2024	+3.0%	+0.0%	+2.9%
2025	+2.1%	+0.4%	+2.5%

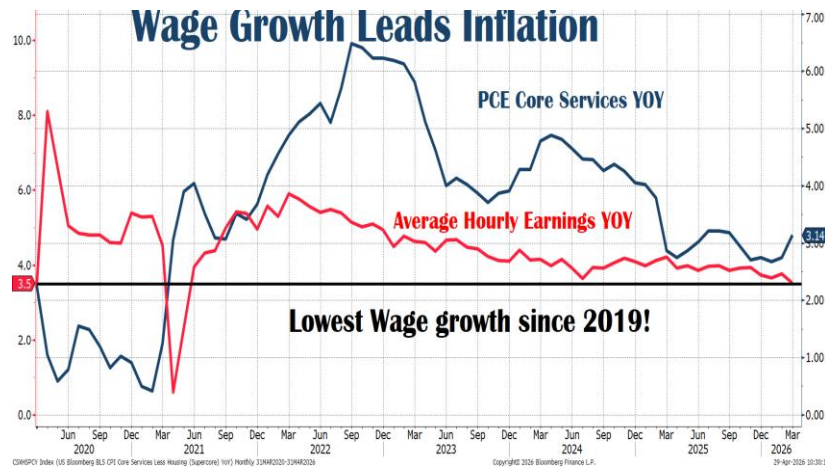
The impact that the AI wave is wielding on the labor market is unquestionable, and it is a dead-weight drag on wage growth now and going forward. That is primarily why I am not buying into the inflation narrative.

Since 2021, the relationship between wage growth and services inflation has been clear: Wages have consistently moved first, with Personal Consumption Expenditures (PCE) following with a lag. The graph below highlights this relationship, showing the peak in wage growth roughly a year prior to the peak core inflation in the aftermath of the pandemic. Currently, there’s no sign at all of any labor market strength in wages. Indeed, real wage growth has declined to a measly 1.1% over the past year.



Service sectors, particularly categories such as health care, education and hospitality, are highly labor-intensive, meaning that wages account for a large share of the input costs. As a result, changes in wage growth tend to feed into prices with a lag ranging from a few months to about a year, as firms gradually adjust pricing to reflect evolving labor costs.

So, if the historical relationship holds, the recent decline in short-term wage momentum should result in lower services inflation over the next few months. Thus, while services inflation has been slow to normalize, the leading indicator is already signaling that the next leg lower is still ahead.



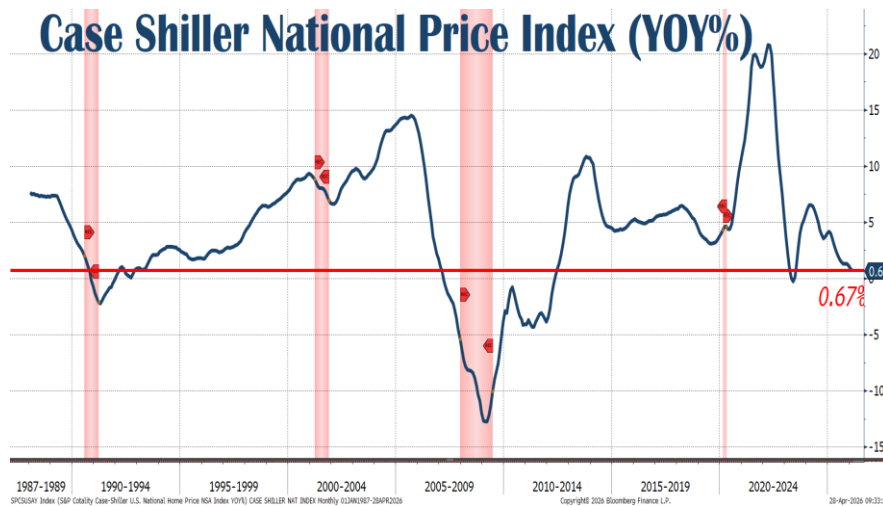
Bottom line: Higher monthly wage gains were a major factor driving the surge in services inflation through 2022-2023. Now, with AI productivity being a disinflationary force on the labor market, the opposite dynamic is in place: Cooler monthly prints are steadily feeding through into lower rates of services inflation.

DEFLATION IN HOUSING

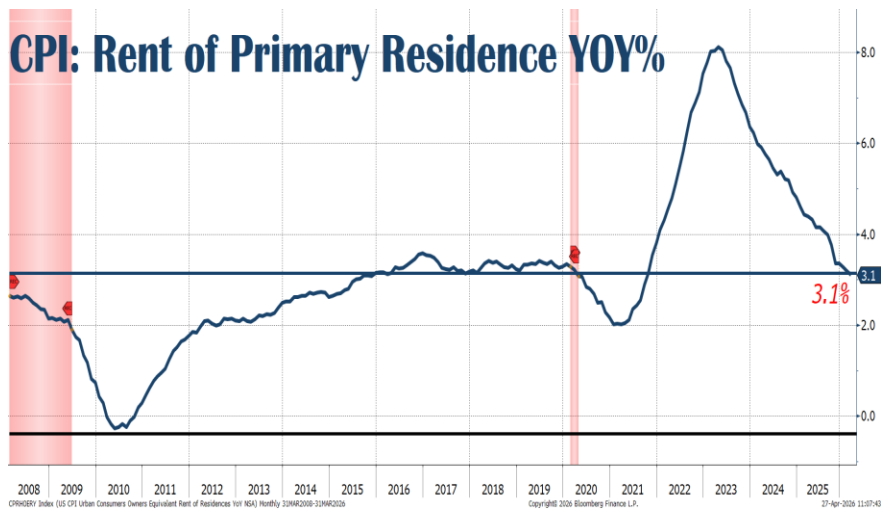
As higher energy and related prices obviously run the risk of triggering some nasty headline inflation prints in the months ahead, let’s not lose sight of the importance of the deflation that has crept into the U.S. housing market. **Energy may command a 7% share of the Consumer Price Index (CPI), but housing represents more than 30% (and about 40% for the core).**

The S&P Case-Shiller 20-city Home Price Index dipped -0.1% month over month in February for the first decline since last June.

The national year-over-year trend cooled to below +0.7% from +0.8% in February — this represents a -2.6% trend in real or inflation-adjusted terms — and that compares to a +4.0% nominal pace a year ago (close to a three-year low).



Because CPI measures shelter with a lag — particularly through owners’ equivalent rent (OER), which adjusts slowly, I expect this decline to persist through 2026. The year-over-year trend in rent is down to just +3.1% (the lowest since September 2021 as well) and has also been declining or flat for two consecutive years. The pace is below the levels that were typical in the 2016-2019 pre-pandemic period.



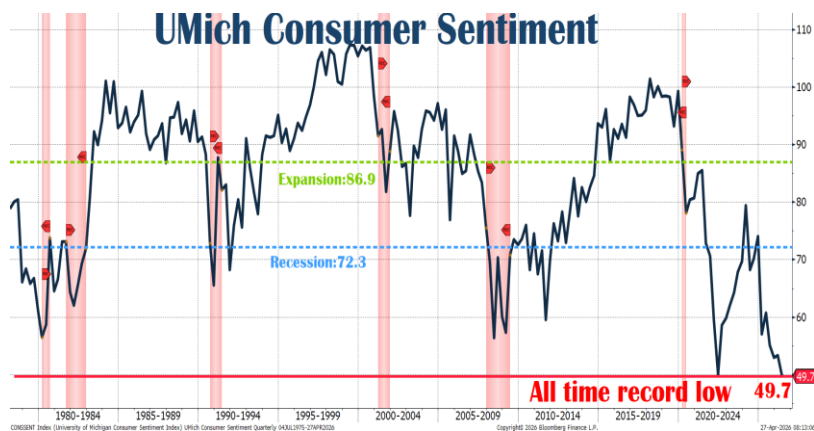
Amid concerns about inflation and the Iran conflict's impact on energy markets, it's important to consider underlying trends. While food and energy are volatile, services and shelter inflation generally reflect their respective labor and housing markets. Currently, both markets are oversupplied, which is contributing to disinflation.

The combination of easing wage pressures and falling shelter inflation suggests that underlying inflation is already on a sustained downward path. While near-term volatility may persist because of the spike in energy prices, the underlying trends are stronger and will reassert themselves by the summer.

For investors, this is a major reason to be bullish on the front end of the bond curve. With the pace of hiring low, unemployment is likely to tick up this year, and a moderate trend in core inflation will push the Fed towards a cut, not a hike.

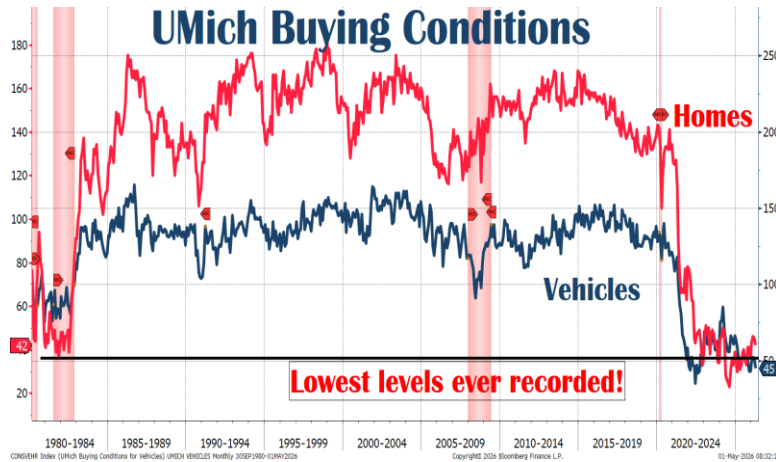
LOWEST IN 70 YEARS!

Long forgotten was the fact that the University of Michigan measure of consumer sentiment fell to 49.8 in April, its lowest level in the 70-plus years the university has been regularly polling American consumers. Consumer sentiment in April declined across all segments of society — by income group, by wealth, cohorts and across all ages, education attainment, regions and even party affiliation.

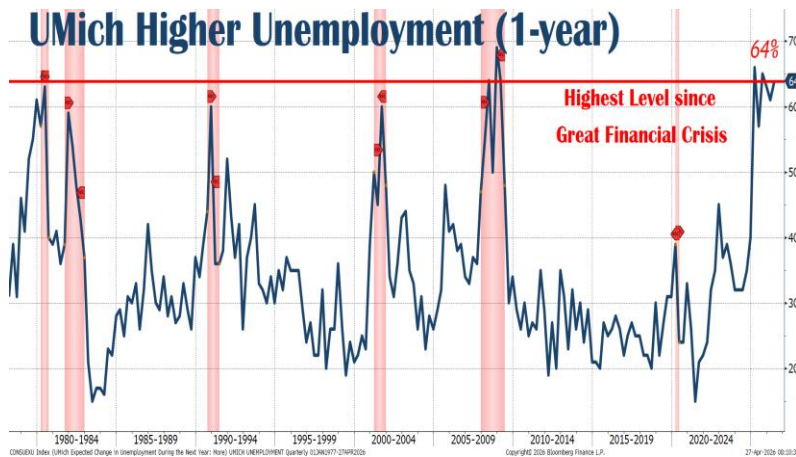


I went back through history books to find out the last time consumer sentiment fell in a month across all segments: Income, wealth, education status, age, region and gender, and it happened just 5% of the time. Everything pretty well lines up at best as the worst ~10% prints of all time, or basically across-the-board.

The home buying plan segments are close to the lowest levels ever recorded. Ditto for vehicles.



Consumer sentiment was low in 2022, but now workers are even more pessimistic about the job market. Currently, 64% of University of Michigan survey respondents expect higher unemployment next year, compared to 32% at the height of inflation concerns in mid-2022. Notably, this level of unemployment expectation has never occurred without a recession following.



Bottom line: Not everything is coming up smelling like roses. If the economy was truly “good,” would consumer sentiment be at an all-time low?

SPENDING WHAT THEY DON'T HAVE

It is very interesting, don't you think, that for the first time since 2009, that consumer spending surpassed the level of “organic” personal income? Real personal income (excluding government benefits) is now down -0.1% on a year-over-year basis (was +2.1% a year earlier).

Inflation-adjusted incomes are now down in three of the past four months and in four of the past six. Over the past twelve months, the year-over-year trend has melted to +0.2% from +2.8%. Yet, because of the equity wealth effect on spending and the rising usage of credit cards, real consumer spending is now running at 10 times the pace of real incomes at just over a +2.0% pace.

Even with rising delinquency rates to levels matching or exceeding the pandemic crisis peaks, consumer debt rose \$10 billion in February, which has taken the increase over the past three months to \$33 billion (and nearly \$60 billion over the past six months). That is going to buy a whole lot of laptops no matter what your job status or income is.

We also have tax refunds, which created a positive skew to household cash flow from March 2025, and that is precisely the increase in retail sales last month. All the refunds are being spent, just as was the case with those massive pandemic stimulus checks four and five years ago.

All the while, in the past two months, the personal savings rate dropped from 4.5% to 3.6%, compared to 5.1% a year ago. In other words, if consumers were compelled to live within their means, real consumer spending right now would be in a borderline recessionary state.



Bottom line: So far, most of the serious cracks in the consumer economy are surfacing among lower- and middle-income Americans. Traditional savings, which boomed during the pandemic, are now slightly below average. Consumption is being buoyed by affluent baby boomers spending retirement savings that have appreciated dramatically due to soaring financial markets. Here's the catch. Now that consumer behavior and rising wealth levels have become highly correlated, what happens if we start to see a significant drop in the stock market.

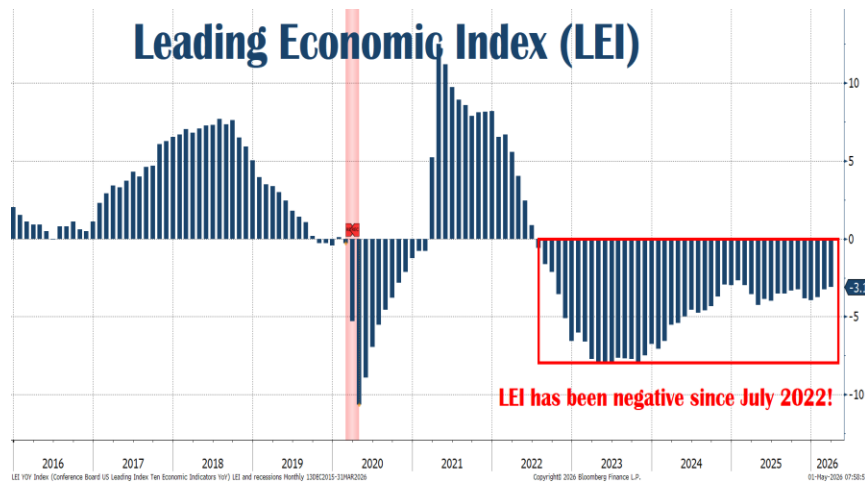
LEADING ECONOMIC INDICATORS (LEI) AT 12-YEAR LOW

The Conference Board's composite index of leading economic indicators (LEI) fell -0.6% in March, as the uncertainty from the Iran conflict started to bite. That takes the index to 97.3, the lowest level since November 2014, with the largest decline since Liberation Day a year ago.

There were declines in the manufacturing workweek, the ISM new orders index, building permits, the S&P 500 and consumer expectations. Of these, building permits were the biggest factor, with the most negative contribution since the depth of the pandemic in April 2020.



As shown below, the LEI has been negative since July 2022!



Bottom line: Rarely does the media focus on the LEI. Apparently, it no longer matters. However, history tells a different story. Whenever this index has been at such a low level, recessions have followed.

MARKET OUTLOOK AND PORTFOLIO STRATEGY

"We should have the lowest interest rate in the world." — President Donald Trump

What comes next? In 2024, it was the CPI reading and the Fed’s “higher for longer” rate expectations. Last year, it was the big tariff shock and Trump’s approach to existing trade agreements. This year, it is one of the most severe oil supply shocks, combined with extremely high geopolitical volatility.

What happens in May will depend heavily on whether the tense Middle East gridlock persists. The latest headlines point to efforts to hold another round of talks, and markets are already buying into that hope. The longer the war in Iran goes on, the more likely the risk of a global recession becomes.

Moreover, many market strategists could be underestimating the “ripple effects” of the conflict, which is already showing up in everything from diesel and fertilizer prices to the cost of helium, which is used to make semiconductors. It probably won't be much longer before we see problems.

As discussed, despite the uncertainty and high volatility the economy keeps on truckin'. Real Final Sales to Domestic Purchases for Q1 was 2.5%, essentially the same level we have experienced over the past three years. Even though much of the latest growth is attributable to AI investments, which is a solid number and does not exactly scream for immediate rate cuts.

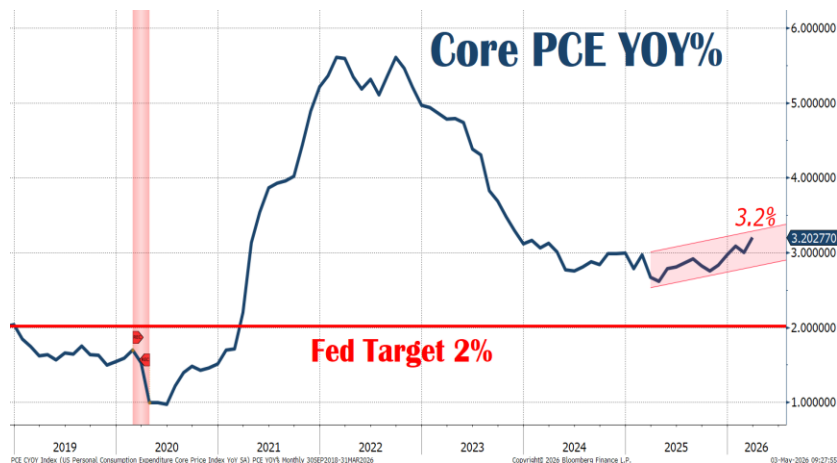
On the other hand, the economy is so out of balance that nearly three-quarters of the U.S. economy is in recession.

Consumer spending slowed to 1.6% real growth, but as long as the stock market doesn't crash, it is seemingly in the American DNA to keep on consuming. Again, nothing in this data suggests the need for a rate cut now.

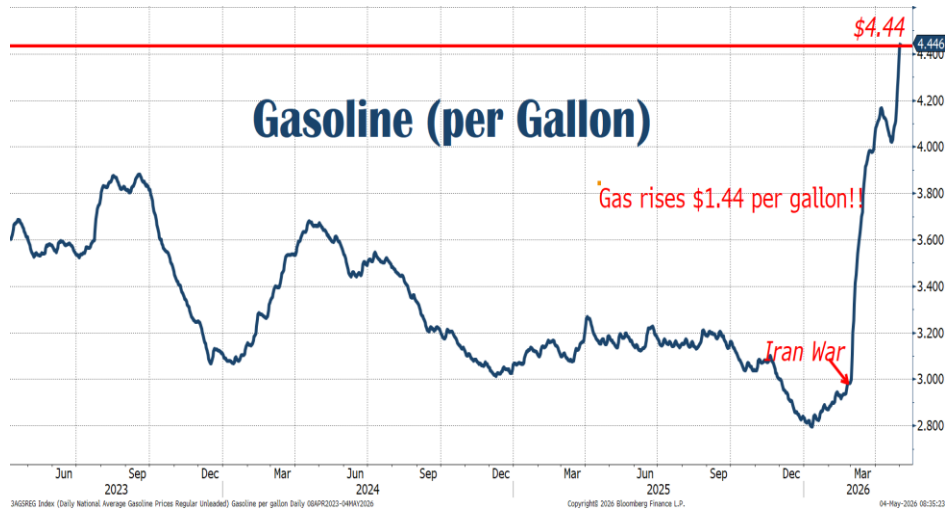
Unemployment is solid at 4.3%. While job openings are decreasing and most of the job growth has come from health care and education, 4.4% is still a solid number. Again, the case for lower rates is not obvious with this number.



Inflation has been rising since mid-2025. The core PCE price index (the Fed's preferred inflation metric) has reached 3.2%, the highest level since May 2023, and as shown below, has moved further from the Fed's 2.0% target for the past ten months. Nothing here suggests the Fed should be cutting rates now.



In fact, there were multiple press clippings over the weekend strongly suggesting that it is just a matter of when — in terms of the Fed signaling rate hikes. Why these journalists believe the Fed can combat an energy shock with the funds rate is a legitimate question. It is like trying to fight a sales tax increase, which is what this shock really amounts to. It is nutty the way some people treat this situation, and that includes these three vocal dissenters on the FOMC.



Moving on. Kevin Warsh’s first meeting as Chair will be June 16-17, and he has a dilemma. President Trump expects a rate cut. Yet the data at this point doesn’t call for one. The market is assuming Warsh will not cut rates.

As for the Treasury market, six months ago, the 10-year yield was 3.98%. Today it is 4.39%. The 10-year benchmark, to a significant degree, reflects the inflation expectation outlook. Lowering the Federal Reserve rates without lower inflation will not reduce the mortgage rate, no matter how much we would like it to. In fact, it might have the perverse effect of making the bond market believe that the Federal Reserve is not serious about inflation.

Furthermore, long-term rates are being negatively impacted by the U.S. government’s fiscal profligacy and causing the “term premium” to widen. As shown below the Fed, starting in September 2024, has lowered the fed funds rate by 150 basis points from 5.5% to 3.75%. Yet the 30-year Treasury yield has risen by over 100 basis points from 3.91% to 4.96%.



The Treasury market remains, at best, range-bound, but it is doing so at a yield that is some +40 basis points above the pre-war level. Near term, the bond market is being hit by concerns over inflation and reckless government spending.

From a longer-term perspective, I remain bond-bullish, as I believe the Fed will be compelled to eventually cut rates by more than what is priced in as the slack in the labor market continues to build.

Also, despite the near-term energy price shock, my base case is that bonds will benefit from the major disinflation in the pipeline from reduced wage pressure and a sustained slowdown in residential rents. At the same time, the tariff impact should subside.

While I remain bond-bullish, I would continue to overweight the front end of the curve due to concerns over fiscal recklessness and a rising term premium on the long end of the curve.

WHY SUBSCRIBE TO THE WRV?

The financial world and social media are often crowded with opinions and commentary about the markets and economy. I focus on filtering out the usual noise, rhetoric and optimism that tend to emphasize potential rewards but often overlook related risks — a recurring issue in Wall Street research. My analysis strives to move beyond misleading narratives, critically evaluate headlines and deliver comprehensive reviews of financial market movements and economic realities. While some may consider this approach too cautious, I see it as similar to a mechanic double-checking all safety features — recognizing and understanding risk is vital and must not be ignored. This dedication sets the *Weekly Relative Value (WRV)* publication apart. Subscribers receive timely updates on important trends in the economy and markets, as well as key risks. To get future issues of *WRV* sent straight to your inbox, please 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.

The views and opinions expressed herein are those of the author and do not necessarily reflect the views of Alloya Corporate Federal Credit Union, Alloya Investment Services (a division of Alloya Solutions, LLC), its affiliates, or its employees. The information set forth herein has been obtained or derived from sources believed by the author to be reliable. However, the author does not make any representation or warranty, express or implied, as to the information's accuracy or completeness, nor does the author recommend that the attached information serve as the basis of any

investment decision and it has been provided to you solely for informational purposes only and does not constitute an offer or solicitation of an offer, or any advice or recommendation, to purchase any securities or other financial instruments, and may not be construed as such.

*Information is prepared by ISI Registered Representatives for general circulation and is distributed for general information only. This information does not consider the specific investment objectives, financial situations or needs of any specific individual or organization that may receive this report. Neither the information nor any opinion expressed constitutes an offer, or an invitation to make an offer, to buy or sell any securities. All opinions, prices, and yields contained herein are subject to change without notice. Investors should understand that statements regarding prospects might not be realized. Please contact **Alloya Investment Services*** to discuss your specific situation and goals.*