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Weekly Relative Value

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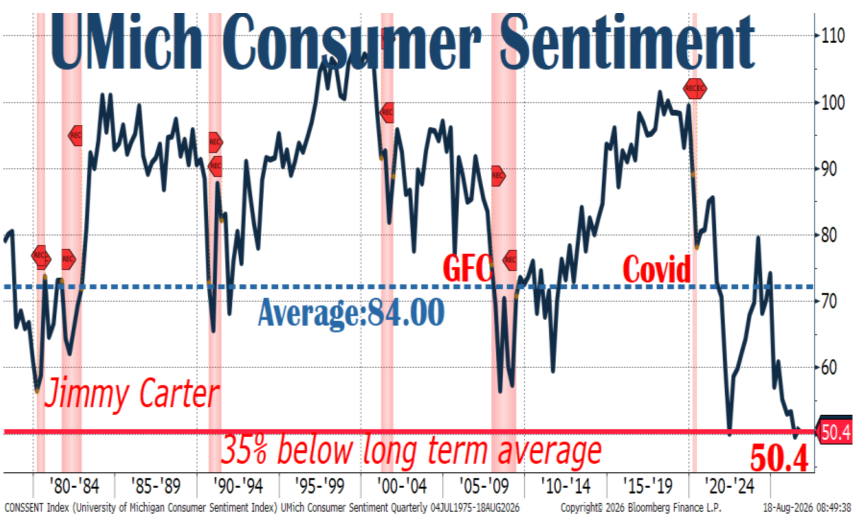
WEEK OF AUGUST 24, 2026

Wall Street Versus Main Street

Based on the stock market, you'd think everything is just peachy. Main Street, oddly enough, disagrees. **A new Financial Times poll shows 53% of Americans feel worse off financially than when President Trump returned to office in January 2025, including 57% of independents.** Nearly two-thirds of registered voters say the economy is heading in the wrong direction — a slight mismatch with institutional investors pricing recession odds at a heroic 2%. The Financial Times poll, however, confirms that Main Street has a slightly different opinion as did the horrible reading on the August version of consumer sentiment from the University of Michigan.



A lot of the economic angst Americans feel comes down to a simple question: Who is getting the pie?

For decades after World War II, labor received roughly two-thirds of national income, while capital — business owners, investors and asset holders — received the other third. That balance has been steadily collapsing. Globalization, China's rise, the financial crisis, the pandemic and the asset-price boom that followed all pushed labor further onto its back foot.

This year, workers received just over half of total U.S. economic output — the smallest labor share in nearly 80 years. While measurement issues can be debated, the direction cannot. More of the pie is going to corporations, investors and people who make money from assets rather than paychecks.

THIS WEEK

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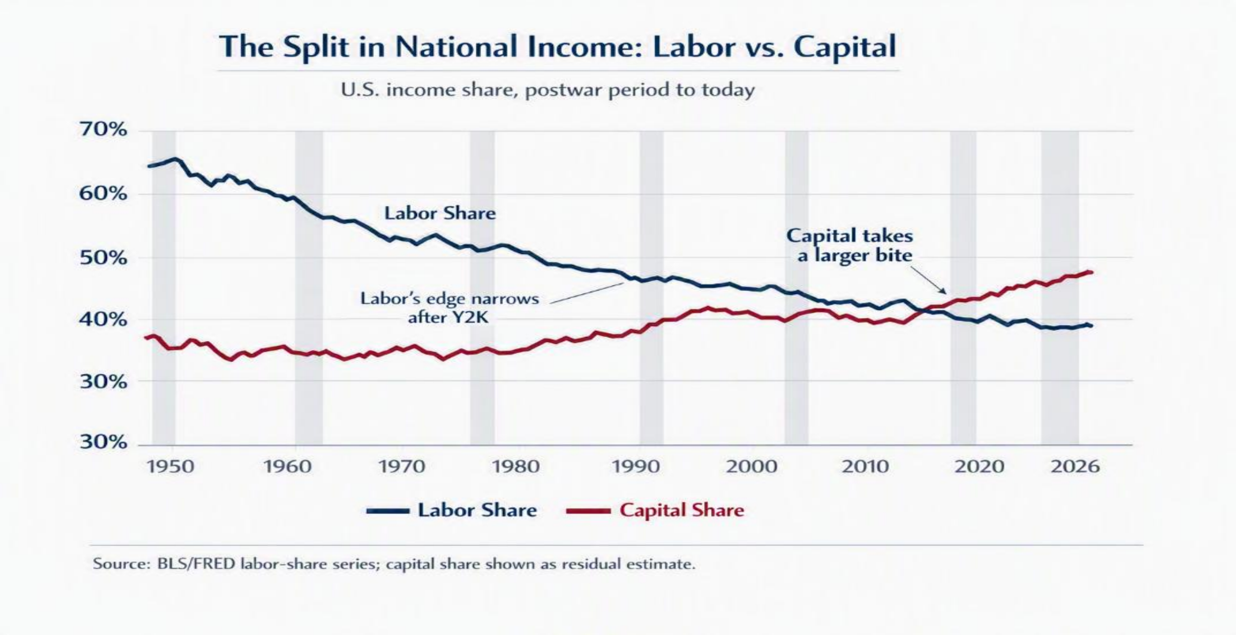


Now add artificial intelligence (AI). It's not hard to imagine AI supercharging this trend. Many Americans fear it will. The biggest beneficiaries so far are asset owners, thanks to an AI-driven stock market rally. And because the top 20% of U.S. households own nearly 90% of stock-market wealth, the gains are landing at the top. Rising portfolios (aka "wealth effect") make affluent households feel richer, and they spend accordingly. Everyone else gets to watch their paycheck rise with inflation. Indeed, AI is driving the spending train and the broader economic train.

AI may create many more billionaires and reduce the real incomes of many households (as automation did for blue-collar workers). This widens the divide between the country's economic winners and losers.

"When wealth concentrates and disaffection spreads, booms end badly." — Bridgewater Associates

If AI lands on top of already extreme income gaps, record asset concentration and a deeply pessimistic public, the result may be less "shared prosperity" and more gasoline on the K-shaped economy. In other words, AI may make the economy bigger. The real question is who gets to eat.

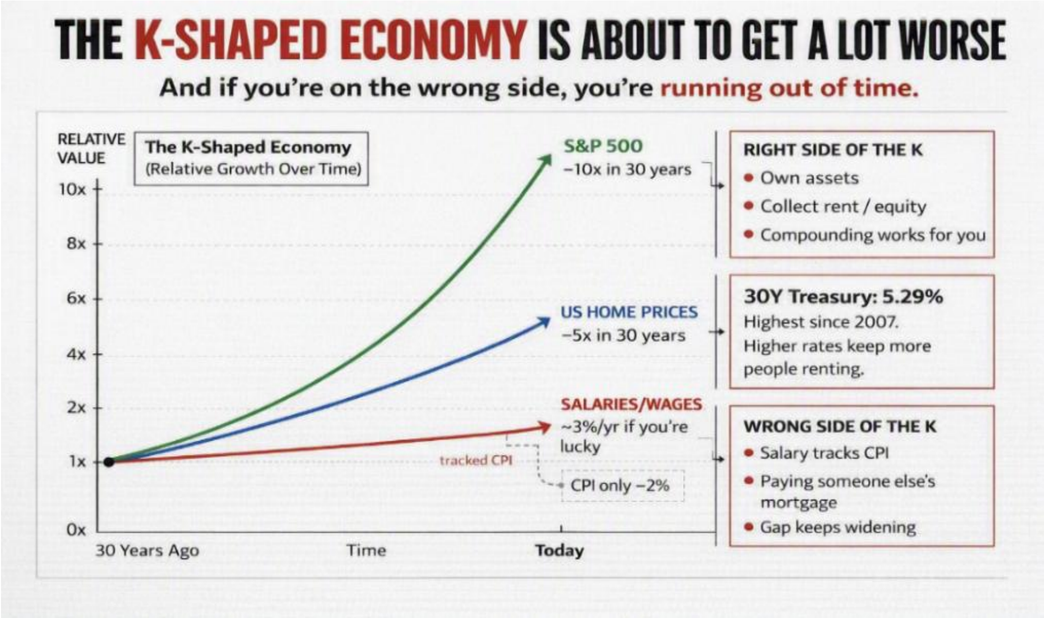
Bottom line: The stock market may be partying like everything is fine, but Main Street is not buying it. Americans feel worse off because the economy's gains are increasingly flowing to capital, corporations and asset owners rather than workers, whose share of national income has fallen to its lowest level in nearly 80 years.

The danger is that AI makes the economy bigger but not broader — creating more billionaires, weakening parts of the labor market and hardening an already K-shaped economy.

That brings us to the next pressure point: If AI is widening the gap through asset prices and spending power, higher rates and housing affordability are where that divide shows up most painfully in everyday life.

THE K-SHAPED ECONOMY MAY GET A LOT WORSE

Over the last 30 years, the Consumer Price Index (CPI) doubled. Houses went up fivefold. The S&P went up tenfold. Meanwhile, your salary tracks the CPI. Everything you wanted tracked the other two. That's 30 years of the finish line moving away from you while they told you inflation was running at 2%.



The 30-year Treasury just hit 5.29%, the highest since 2007. Mortgage rates track it almost directly. Every month rates sit up here, more people who were nearly buyers stop being buyers and they end up paying the mortgage of somebody who already owns. That's the K. One side collects rent; the other side pays it.

Wages don't compound either. You get 3% a year if you're lucky and it's a straight line. Assets compound. As the graph above, those two curves separate and they DON'T COME BACK TOGETHER.

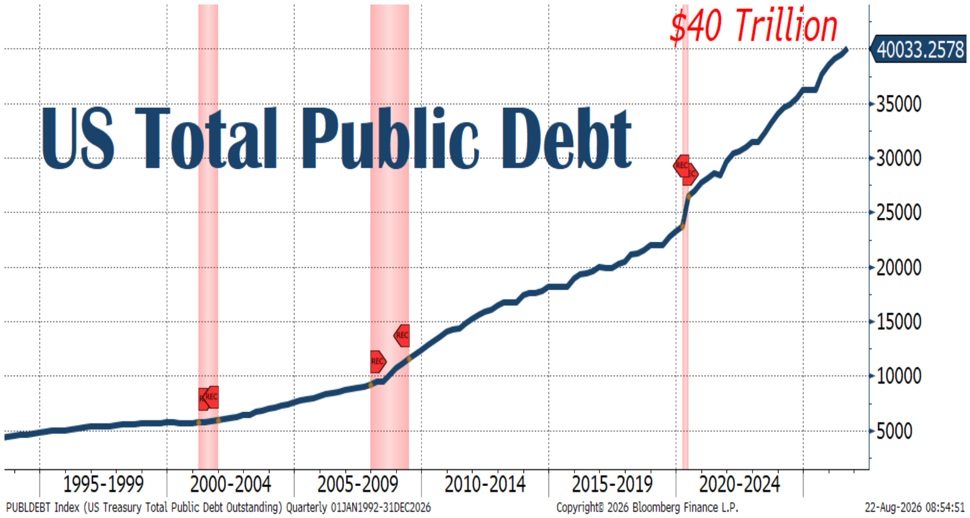
Bottom line: The K-shaped economy is widening because the things people need most — homes and assets — have dramatically outpaced wages. Over the past 30 years, CPI doubled, home prices rose roughly fivefold and the S&P 500 climbed tenfold, while paychecks mostly tracked official inflation.

Now, with the 30-year Treasury near its highest level since 2007 and mortgage rates following it higher, would-be buyers are getting pushed back into renting, effectively paying the mortgage of those who already own. That is the K in real life: Asset owners collect, non-owners pay and because assets compound while wages don't, the gap keeps widening — and it rarely closes on its own.

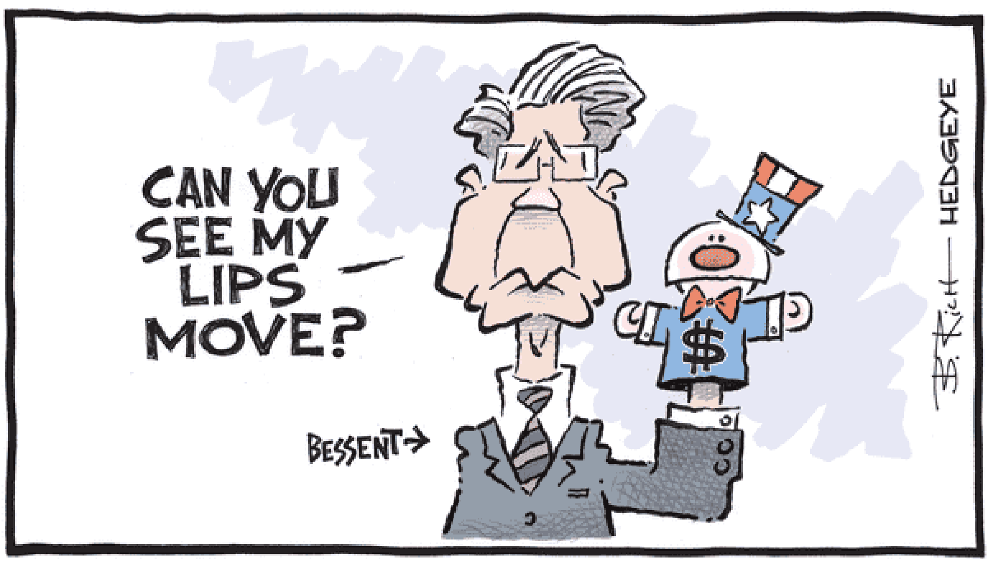
DON'T SWEAT IT!

"I love debt. I love playing with it…I'm the king of debt. I'm great with debt. Nobody knows debt better than me… I've made a fortune by using debt, and if things don't work out I renegotiate the debt." — President Donald Trump

U.S. public debt has crossed the **$40 trillion** mark, and the response from once fiscally conservative Republican-controlled White House and Congress was met with little more than a shrug.



The only meaningful official gesture so far has been Treasury Secretary Scott Bessent's doubling the amount of bonds he can purchase in a buyback under the Treasury's program to $4 billion from $2 billion. For some perspective, at peak quantitative easing after the pandemic, the Fed was buying $120 billion per month. In other words, this is peanuts.



Yields dropped on the announcement, but a day later, yields were back above where they were before the announcement. The 30-year hit 5.25% while the 10-year reached 4.71%. The buyback bought about 18 hours of relief.

As Jean Ergas of Tigress Financial Partners puts it, the move **"smacked of desperation"** while the market response was **"a vote of no-confidence"** in the Treasury and the administration.

Bessent went on CNBC today promising spending cuts are coming. The bond market has heard that from every Treasury Secretary for the last 20 years. Meanwhile, the July deficit was $432 billion, the highest monthly total since March 2021, and interest payments on the debt have hit $1.2 trillion this fiscal year. Bessent is trying to manage yields with a tool that amounts to less than 1% of quarterly borrowing, and yields are already back where they started.

When that failed to soothe investors, the message from the Treasury was essentially, "Don't sweat it."

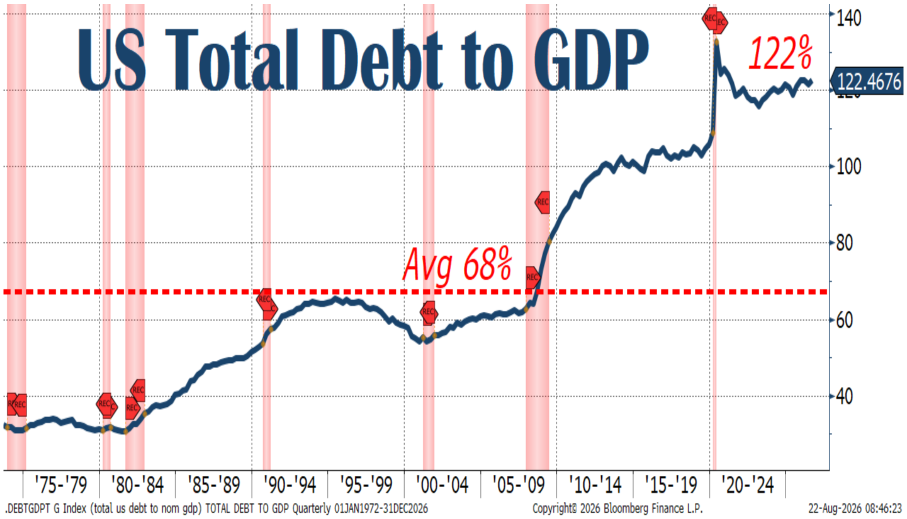
To wit:

"Well, I mean, look Sara, there's nothing magic about the $40 trillion number, and we can grow our way out of that." — Scott Bessent to Sara Eisen, Co-Host of "Squawk on the Street" on CNBC

The president then joined the chorus, demanding lower interest rates and wondering why countries like Switzerland can borrow more cheaply than the United States.

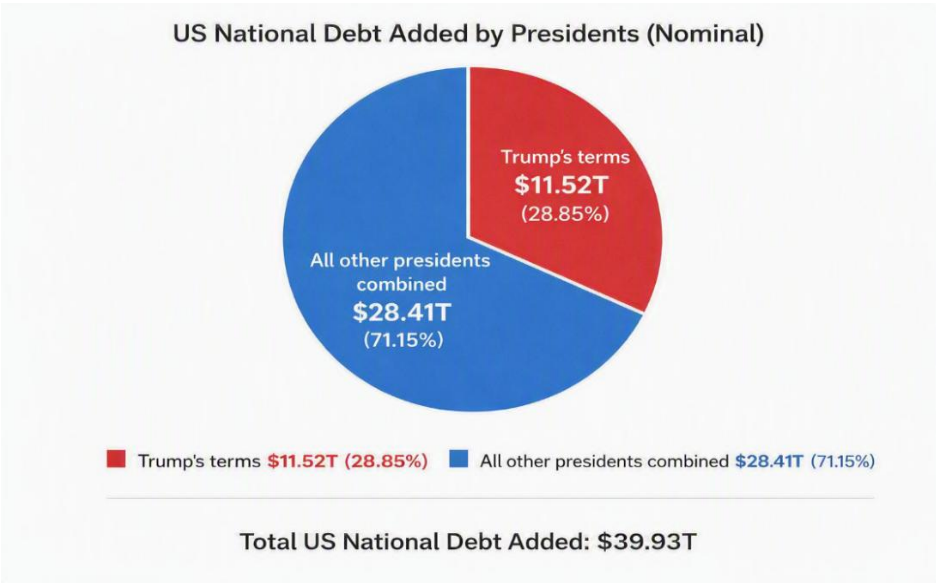
"We should pay the lowest interest rates….I see countries like Switzerland where they're the number one lowest interest rates, a half a percent, and we pay three and a half percent."

With all due respect, that question answers itself. Switzerland has spent the past 45 years practicing something close to fiscal discipline: Public debt was roughly **40% of the gross domestic product (GDP)** in 1980 and remains slightly below that today. The U.S., by contrast, had public debt of about **29% of GDP** in 1980. Today, it is roughly **122%**.



"These ridiculous interest rates, they're ridiculous. Look, when our country is strong, interest rates should go down. When our country is weak, frankly they should go up. But this country is strong. They've never had, there's never been in history the kind of money coming into a country as we have right now." — President Donald Trump

I must admit the fact that President Trump whined that interest rates are "artificially high" was truly ridiculous. The fact is approximately $12 trillion of the national debt, or 30% of the total, has come under the president's watch since he began his first term in office in November 2016.



So far this year, the government has spent almost 40% more than it has taken in from revenues — more than double the historical norm. Imagine that had the U.S. government not run an unprecedented six years of 5%+ deficit/gross domestic product ratios, it is very likely that the fed funds rate would be near 2%.

And yet the president wonders why America pays higher rates. You really can't make this up.

Making matters worse, the truth is that the new **$40 trillion** debt milestone is not the end of the story. America's fiscal governance is broken, and Trump-O-Nomics only adds another layer of irresponsibility. At the same time, the promised "No More Wars/America First" foreign policy has given way to a path that points toward a **$1 trillion annual defense budget** and a bipartisan warfare state with no obvious appetite for restraint.

Under the Congressional Budget Office's (CBO) baseline, public debt is projected to reach nearly **172% of GDP by 2055**. In dollar terms, that means the national debt is on track to approach **$160 trillion! F**or reference, it stood at just **$1 trillion** in January 1981. That would be a roughly **160-fold increase** in well under a century.

And even that may be too generous. Under the CBO baseline, debt service alone is projected to consume **37% of federal revenue**s **by 2055**. With more realistic interest-rate assumptions, interest expense could eventually swallow the entire federal tax burden before a single dollar goes to defense, entitlements or Washington's endless pork barrel.

Bottom line: Crossing $40 trillion in U.S. public debt is not just another grim marker on the road to fiscal ruin. So, "Don't sweat it"? Please.

WHO'S CROWDING WHO?

"The AI borrowing is potentially crowding out long-end Treasury demand."
— Economists at Bank of America Corporation

The old "crowding out" theory says heavy government borrowing pushes up interest rates because it competes with companies for money. But now the AI boom may be flipping that idea around. Big tech companies are borrowing enormous sums to build data centers and AI infrastructure, and that flood of corporate debt is competing directly with U.S. Treasuries for investor dollars.

The government is still the main driver of higher rates because deficits remain huge. But AI borrowing is now large enough to matter. Nomura estimates tech borrowing equals about **25%** of Treasury bond issuance, up fivefold from last year. Bank of America estimates the AI debt surge has added about **0.3%** to the 10-year Treasury yield. Bond managers are selling Treasuries to buy higher-yielding AI-related corporate bonds instead.

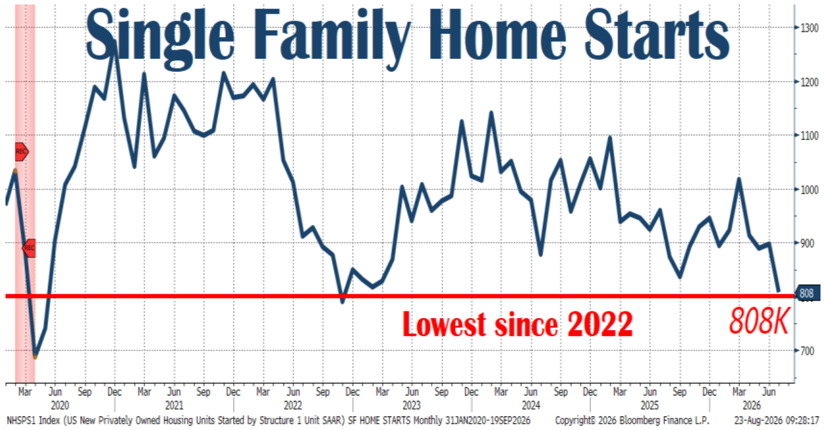
That matters because companies like Alphabet and Meta can offer long-term bonds yielding **6% to 7.5%**, while a 30-year Treasury pays closer to **5.2%**. Investors are following the higher yield. So, while the Fed may want rates lower, the market is being pulled the other way by a massive private-sector borrowing wave.

And this is just getting started. JPMorgan expects AI infrastructure spending to total roughly **$5.5 trillion** through 2030, much of it funded with debt. That borrowing raises the cost of money for everyone — the government, homebuyers, small businesses and consumers.

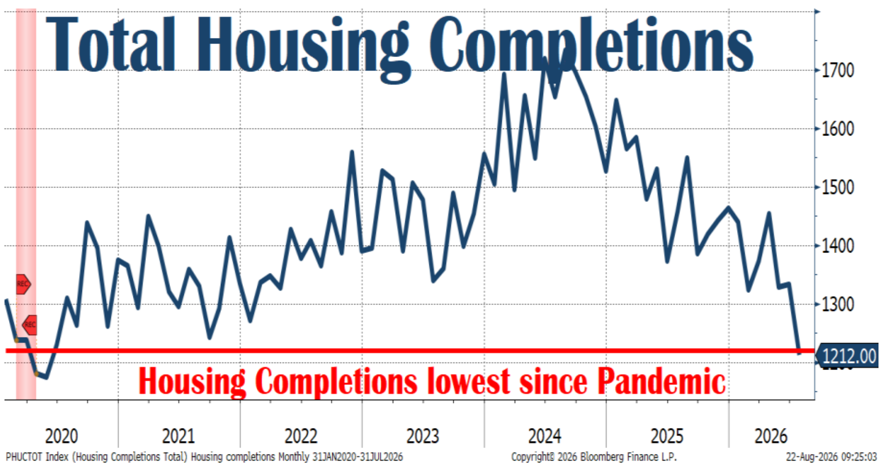
Bottom line: The AI borrowing boom is now large enough to matter for the entire bond market. Today Big Tech's data-center debt binge is competing directly with Treasuries for investor dollars, helping keep long-term rates elevated even as the Fed wants easier financial conditions. And if JPMorgan is right that AI infrastructure spending could reach $5.5 trillion by 2030, this is not a temporary sideshow — it is a private-sector borrowing wave big enough to raise the cost of money for the government, homebuyers, small businesses and consumers alike. The AI arms race is impacting more than stocks. It's becoming a bond market story, too.

HOUSING STARTS STOP

Housing starts rang in light at 1.239 million annualized units in July and off -12.4% from the prior month. Housing starts are now down in three of the past four months and -13.5% below year-ago levels. The real problem is not the headline starts number. It is that **single-family starts — the housing segment that actually moves the GDP needle — fell nearly 10% to 808,000 annualized units.** This is the lowest since November 2022, when the Fed was nine months into its aggressive tightening cycle. This time around, the mortgage market is doing the job on its own, with homeowner affordability some 20% more stretched than the historical norm.



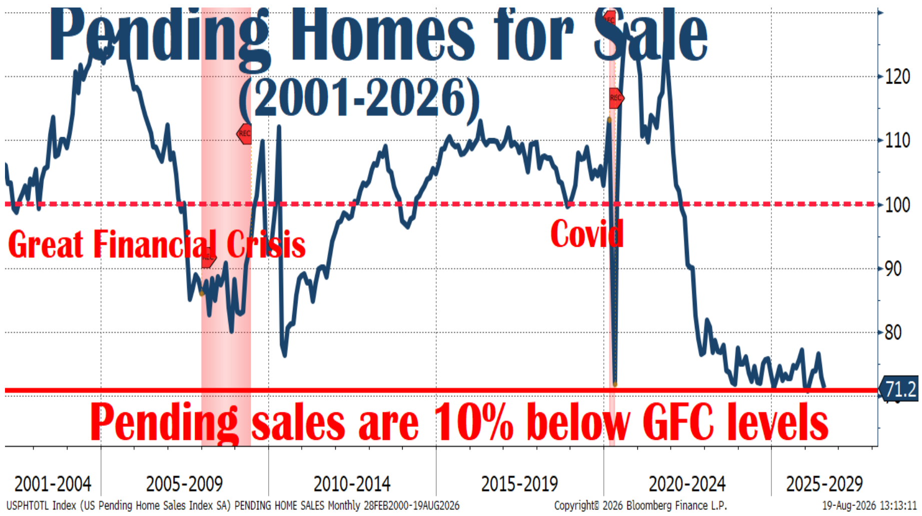
Housing completions, meanwhile, dropped -9.1% month over month and have plunged in two of the past three months. At 1.212 million units, they are now at the weakest level since May 2020, when we were crawling out of the pandemic crisis.



Bottom line: With two months to go in Q3, the "build in" for housing starts is -26% at an annual rate. You read that right. We have no growth in the index of aggregate hours worked and a slight drop in real retail sales. Inventories, meanwhile, continue to be shed by the business sector, especially in retail. It could well be that current-quarter real GDP growth ends up printing with a minus sign in front of it.

NOTHING PENDING

July pending home sales data sucked wind as well — down -2.3% month over month to the second lowest on record, a position shared with July 2024 and again, a surprise to a consensus looking for a flat result. This came on the heels of a -4.8% pullback in June and took the index down to a six-month low. Compared to 2020, pending sales have collapsed by 41%. Compared to July 2010 during the big bad housing crisis, sales are down by 9%.



Sales declined in all regions but plunged in the West to record lows and fell sharply in the South and Northeast.

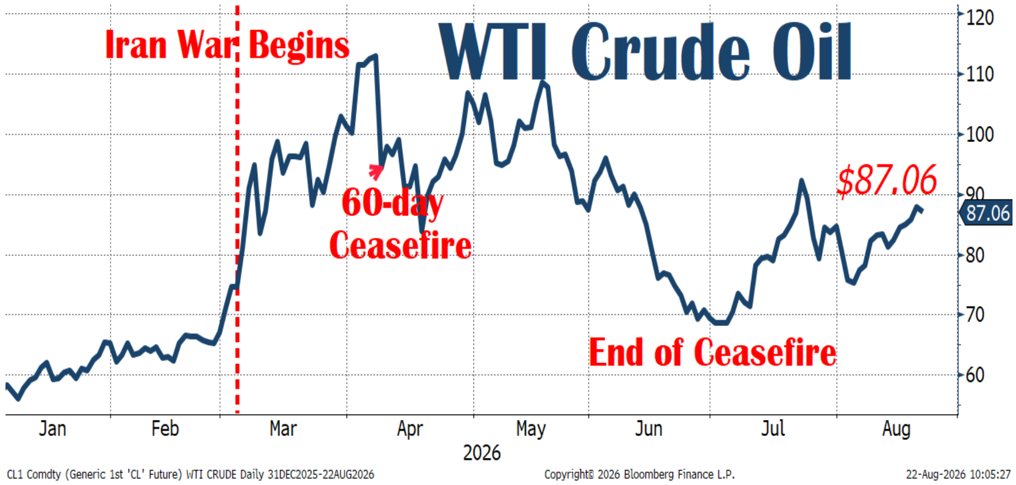
Bottom line: Pending home sales are sending another recessionary warning flare from housing. July's index dropped to the **second-lowest level on record**. The collapse is not just a month-to-month wobble: Pending sales are down more than 40% versus the stronger pre- and post-pandemic Julys and even sit below levels seen during the housing crisis. With declines across every region — and record weakness in the West — the leading indicators are saying the housing market is not stabilizing.

ENERGY AND IRAN

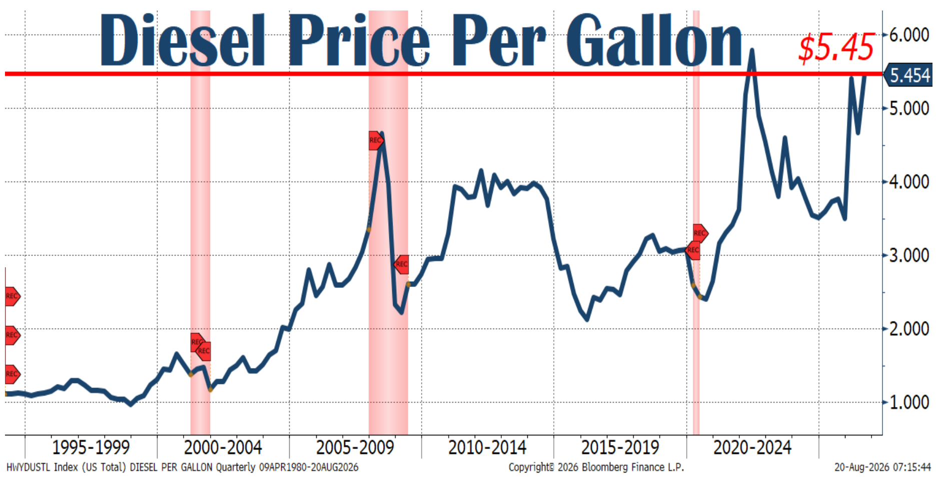
"I just think it's a great idea [declaring the Strait of Hormuz a U.S. territory]. We control it. We control it with the blockade. We have a blockade. And I like the idea of declaring it a territory. We have total control over the Strait."
— President Donald Trump, August 17, 2026

Energy prices are probably not coming down anytime soon. The U.S.-Iran conflict remains unresolved, and Iran is not giving up its leverage over the Strait of Hormuz. Traffic through the strait has slowed sharply, and while President Trump appears reluctant to escalate militarily, Iran is still testing the situation with occasional drones and missiles. Tehran may believe higher oil prices will eventually force the White House to back down, especially with the president's approval ratings weak ahead of the midterms.

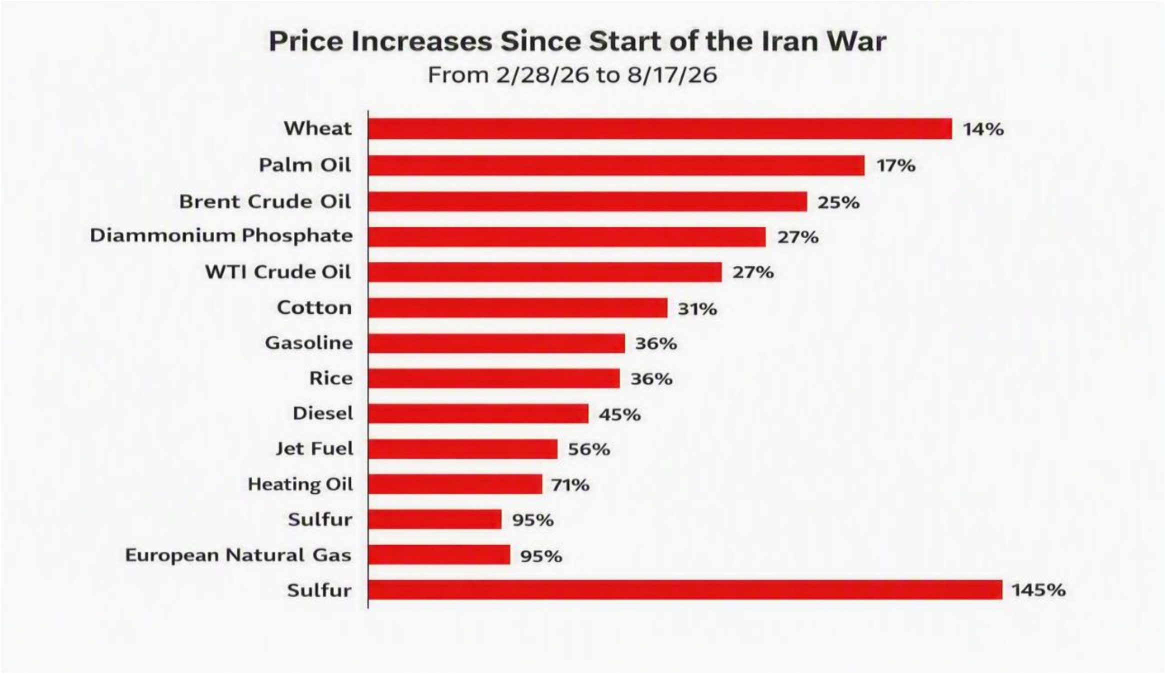
The problem is that Trump is fighting a political battle, while Iran's regime views this as a fight for survival. Oil jumped 6% last week because of the Iran conflict. Since this war with Iran started in late February, the oil price is up by nearly 30% ($87.60 per barrel for WTI). That is happening at a bad time: The economy is already weakening, July jobs were soft, retail sales posted their biggest drop in over a year and inflation cooled only slightly. Yet long-term bond yields are still rising anyway.



While WTI crude has not yet gone back up to the recent summertime highs, the price that matters most for U.S. industry is diesel, which has gone to nearly $5.50/gallon — jumping +8% in just the past month (fast approaching the wartime peak of $5.69/gallon). This is sure to ricochet through the economy before long. A quiet crisis is in the making.



And as shown below, it's not just energy prices that have risen because of the war.



Bottom line: Energy prices are becoming a slow-motion shock to an already weakening economy. The unresolved U.S.-Iran conflict has pushed WTI up nearly 30% since late February and diesel near $5.50 per gallon, close to wartime highs. That matters because diesel runs through everything — trucking, shipping, farming, construction and retail prices. With jobs softening, retail sales falling, inflation only cooling slightly and long-term yields still rising, the Iran conflict is no longer just a geopolitical headline. It is becoming another cost-of-living squeeze and a growth risk.

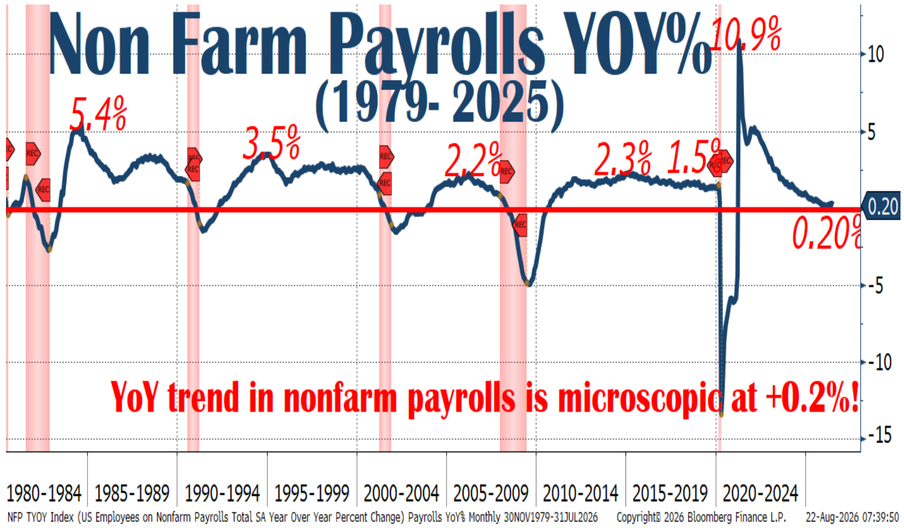
MARKET OUTLOOK AND PORTFOLIO STRATEGY

The U.S. economy is losing steam, though markets seem determined not to notice. Real GDP growth has slowed from +2.1% in Q1 to +1.5% in Q2, with essentially no momentum heading into Q3. Historically, this kind of slide toward stall speed has not ended with a soft landing. In the post-WWII era, it ended in recession every time. We do still have two months to go in Q3, but that is a pretty weak starting point.

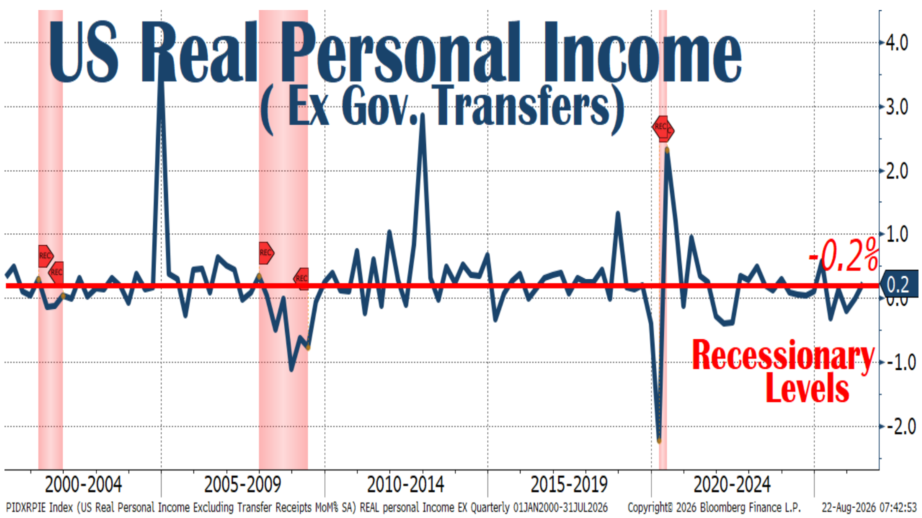
The market's counterargument is that this time is different because the economy dodged recession in 2022-2023 despite an inverted yield curve. Conveniently left out of that narrative is the roughly $2 trillion in pandemic-era stimulus still sloshing through the economy. Without it, 2022 GDP likely would have contracted.

More recently, households also got another assist from the One Big Beautiful Bill, which delivered roughly $100 billion annualized in reduced tax payments. Apparently, business-cycle resilience looks a lot better when Washington keeps writing checks.

The broader data are not exactly inspiring. **Employment is up just +0.2% over the past year.**



At the same time, real organic personal income — excluding government benefits — is up only +0.2%. Since 1960, whenever those two measures have converged near zero, recession followed nine times out of nine. No head fakes. No "new paradigm." Just the economy doing what economies tend to do.



Markets may keep pretending otherwise. Equity investors have a natural bullish bias and may continue their Wile E. Coyote routine — running across the canyon and declining to look down.

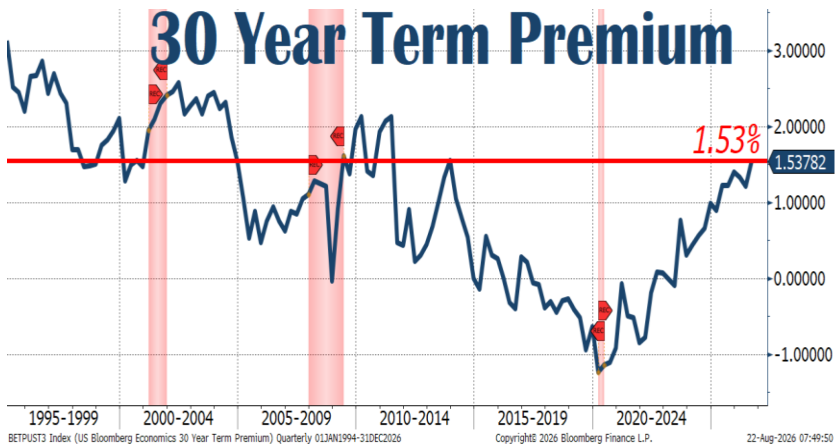
Bonds are more puzzling. The economy is cooling and long-term rates are still climbing. Normally weaker data brings yields down because the market expects rate cuts. Instead, the short end is falling while the long end pushes higher, which means bond investors see weaker growth ahead but don't believe inflation or the borrowing is going away. That's a bad combination for anyone with a mortgage or a car loan because the Fed can cut all it wants and your borrowing costs still go up.

The 10-year Treasury yield rose by another 5 basis points on Friday to 4.74%, having regained the entire drop on Wednesday, and is just 1 basis point short of July 31 (4.75%). So back to square one.

The bond market demanded higher yields to overcome their triple-fears: fears about future inflation which wipes out the purchasing power of long-term bonds; fears about the unsustainable trajectory of the fiscal deficits (made even worse by the war); and fears about the flood of new debt that **must** find buyers at an eyepopping rate of $1 trillion every three to five months, come hell or high water.

In addition, the government is now competing with the AI investment mania that is also trying to find investors for bonds with much higher yields and much bigger risks.

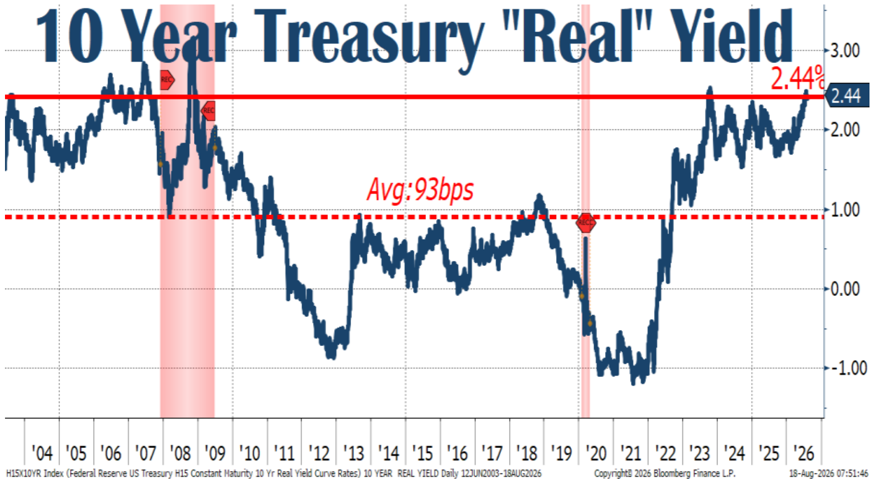
Barclays laid out what it would take for long-term rates to come down: slower AI borrowing, a fiscal surprise, a shift in how Treasury issues debt and sustained weak data, all at once. That's a high bar. AI companies are still flooding the bond market. The deficit is running 6% of GDP. And the Iran war keeps pushing oil higher.



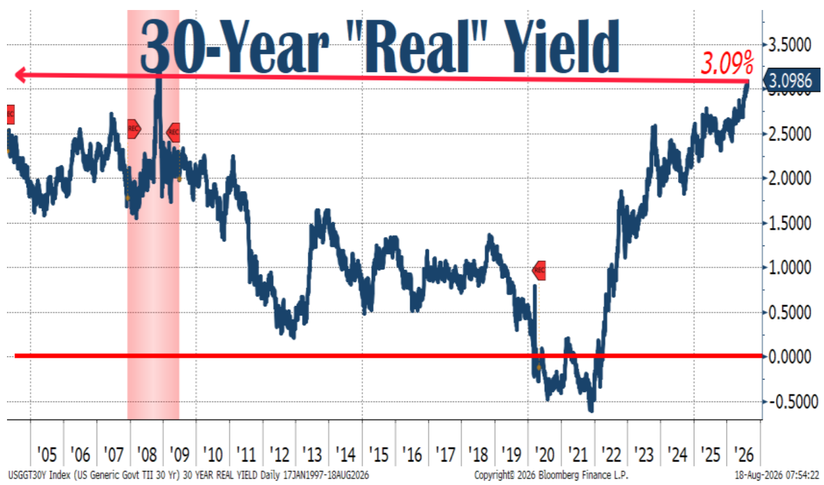
Right now, oil is the key variable. Historically, oil prices and Treasury yields have had about a 50% correlation. Over the past two months, that relationship has jumped to roughly 80%. That matters because the bond market needs oil to cool off.

Meanwhile, the bond market is effectively doing the Fed's work. Rate-hike expectations have fallen sharply — odds of a hike next month are down to about one-in-three from 75% in late July — but long-term yields are still rising. That is the definition of a bear steepener: Short-end rate expectations ease, while long-end yields climb because investors demand more compensation for inflation, supply and geopolitical risk.

Indeed, it has not been market-based inflation expectations that have driven nominal bond yields higher so far. It is all about the rising and elevated uncertainty that has taken the term premium higher. As shown below, the real rates on the 10-year have risen to 2.44%, back to 2007 levels.



Likewise, the real yield on long bond has risen to 3.09%.



The major point here is that rising real rates that are not accompanied by accelerating real economic growth are almost always a prescription for a stock market pullback.

On the consumer front, Walmart remains the best read on the U.S. household and have the weakest earnings in over six years. The message was crystal clear. Other retailers are telling the same story. Target has cut prices on roughly 10,000 items and is pushing more rollbacks, with most school supplies priced at or below last year's levels. Walmart has also expanded price cuts to 11,000 items, up from 7,200 three months ago. That sounds a lot more like retail deflation than tariff-driven inflation.

Meanwhile, households are still absorbing gasoline prices 38% above pre-war levels and diesel 48% higher, with no real growth in employment or real disposable income over the past year. Savings are depleted, tax refunds are gone and delinquencies remain elevated across consumer credit.

At the same time, core CPI has slowed to a 1.6% annualized pace over the past three months, hardly a 1970s rerun. Wage settlements are running near 3.5%, not the 6%+ pace seen during the last inflation scare.

The point is this is not a wage-price spiral. It is a supply-shock hangover. In a true inflation spiral, wages chase prices higher. Here, wage growth is cooling while prices remain elevated, meaning workers are taking the hit through squeezed real incomes. That is not demand-driven inflation.

These are facts that nobody wants to hear because everyone has inflation on the brain. What is most disappointing is that this includes many Fed officials who should know better, because there is no theory or practice where inflation is sustained without the price shocks feeding into wages. It's a basic premise that has become widely ignored.

Bottom line: President Trump has made plenty of things "great" if the stock market is the ONLY measuring stick. Most definitively, the president has not made the labor market great again. In fact, there has been zero net job creation over a twelve-month time span. Wage growth has failed to keep up with headline inflation in each of the past four months. At the same time, bonds have come unglued, housing is stuck in a deep funk and the consumer is clearly under pressure. We will see whether the S&P 500 is on the ballot on November 3.

Despite widespread negative sentiment, bonds still offer an attractive risk/reward tradeoff at these levels. Inflation looks less durable than advertised, the economy looks weaker than markets want to admit and the Fed risks tightening into a slowdown driven more by supply shocks, oil headlines and speculative excess than by genuine demand-led inflation.

Stay patient, stay liquid and use today's unusually hated bond market to add duration selectively before the Fed and the data force the market to rethink the path of policy.

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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.