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Weekly Relative Value

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WEEK OF SEPTEMBER 21, 2026

The Mad Hatter Economy

"There's nothing magic about the $40 trillion number. And we can grow our way out of that."
— Scott Bessent, Treasury Secretary, CNBC's Squawk on the Street (August 20, 2026)

EXECUTIVE SUMMARY

The economy is sending two conflicting signals. Bond yields, housing, consumer confidence and real borrowing costs warn that growth is weakening. Retail sales and AI investment say otherwise. My view is that the apparent strength is narrow, expensive and increasingly dependent on debt, wealthy consumers and technology spending. That leaves the economy more vulnerable than the headline numbers suggest — and makes today's elevated bond yields increasingly attractive.

For the last two years, markets assumed rates would eventually fall and everything built on cheap debt would survive until they did. That assumption is cracking. Long-term yields are rising, real borrowing costs are climbing and the debt-sensitive parts of the economy are already weakening.

Long-term yields have reached their highest levels in decades. The 10-year Treasury topped 5% for the first time since 2007, rising roughly half a percentage point in two months and nearly tripling from its 2022 low. The 30-year yield reached 5.32%, its highest level since 2001.

A 5% 10-year Treasury yield is not historically extreme — unless you use the financially repressed quantitative easing (QE) and zero interest rate policy (ZIRP) era as the benchmark. What is extreme is the debt load. Federal debt has exploded since 2009, making today's 5% far more painful than it was when Washington owed a fraction of the current total. The rate may look ordinary. The interest bill will not.

The 10-year Treasury yield is more than 80 basis points above the Congressional Budget Office (CBO) baseline. That baseline is not a prediction carved in stone; it is the government's benchmark for debt and interest costs under current law. If rates stay higher, the interest bill will overshoot. With more than $30 trillion of debt to finance and

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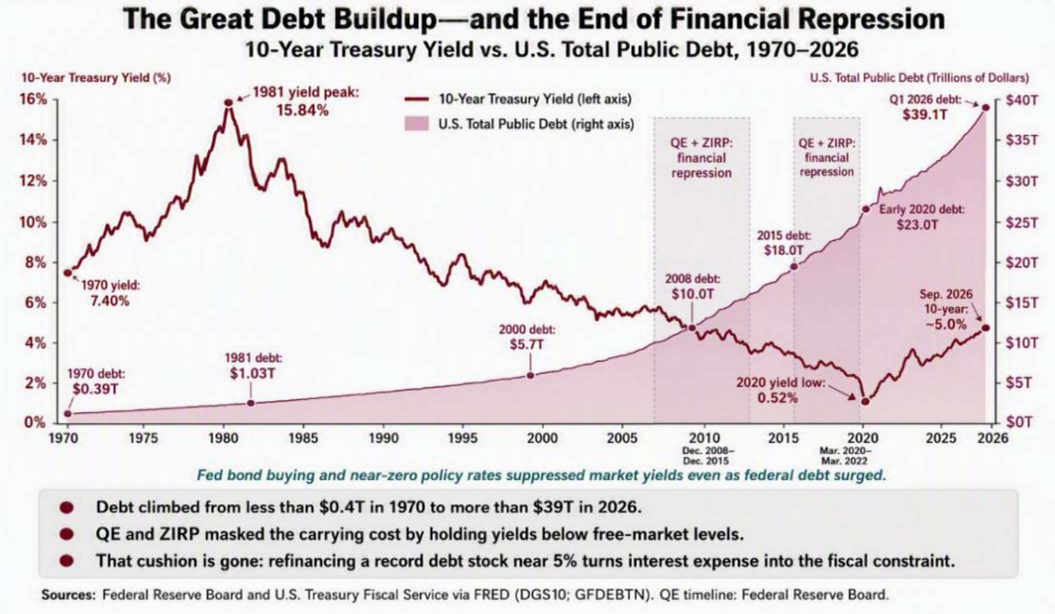
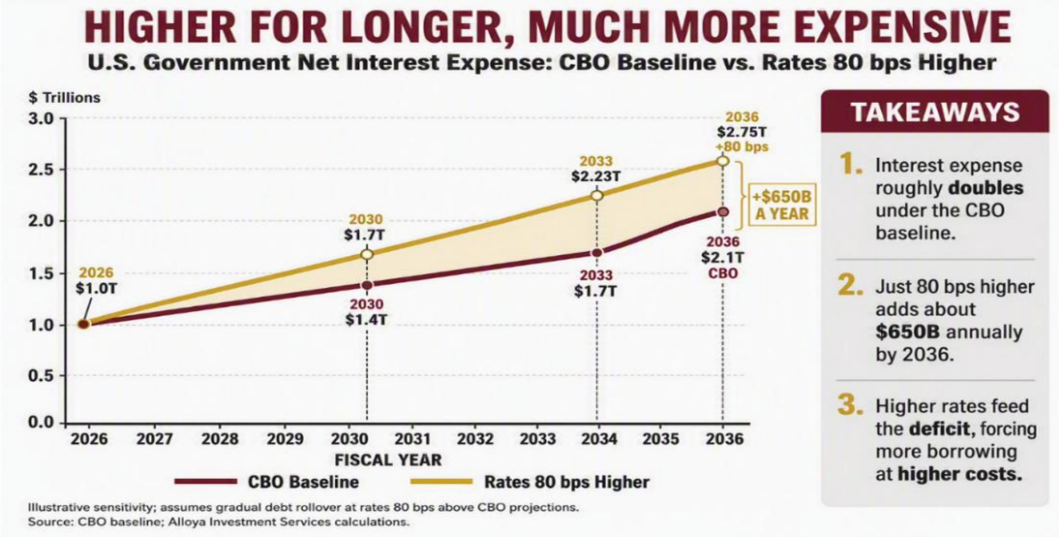
refinance, even a small rate miss can become hundreds of billions of dollars. The baseline matters because it shows how quickly the budget math breaks when borrowing costs are wrong.



Per the nonpartisan Committee for a Responsible Federal Budget (CRFB), if rates remain more than 80 basis points above projections, annual interest costs could reach $2.7 trillion by the end of the decade. At that point, interest would cost more than Medicare or Social Security retirement benefits. We would not be borrowing to build the future; we would be borrowing to pay for yesterday's borrowing.



Ordinary Americans don't escape the fiscal mess. New home buyers are paying around 7% on mortgages, while car loans, credit cards and business financing cost even more. Higher borrowing costs discourage investment, slow growth and leave households poorer. But at least the government got to spend the money first.

High debt pushes rates higher, and higher rates create even more debt — a financial treadmill that keeps speeding up while Congress argues over who is to blame. Last year, the federal government spent nearly $1 trillion on interest, about three times the 2020-2021 level and more than the defense budget. With rates still elevated, that tab is ready for liftoff.

All of this is happening in what the President Trump calls a "booming" economy. Pray tell, what happens if the U.S. economy falls into a recession? This is what Jeffrey Gundlach (AKA The Bond King) had to say:

"If there's a recession, there's going to be incredible attention paid to the fiscal situation… "You would have the budget deficit go easily to 12% of GDP. That would create $3 trillion of interest expense probably per year, and you just can't do it."

Meanwhile, in the *Ripley's Believe It or Not* category, Treasury Secretary Scott Bessent joined House Speaker Mike Johnson in backing President Donald Trump's proposal to send every adult a $5,000 dividend — provided Republicans sweep the midterms. If the economy needs stimulus, tying it to an election result makes the policy look less like economics and more like campaign strategy.

"If the Republicans win, you win with us and you get $5,000." — President Donald Trump

A new Tax Foundation analysis estimates Trump's proposed $5,000 payments would cost roughly $1.25 trillion if paid to 250 million adults. Yet the president's new tariffs are projected to generate only about $125 billion in net federal revenue next year — enough to cover roughly one-tenth of the checks.

"The proposed $5,000 payments would cost roughly 10 times the revenue we estimate would be raised by tariffs on net next year…It would increase the national debt and create inflationary pressures."
— Erica York, Senior Economist at the Tax Foundation's Center for Federal Tax Policy

The nonpartisan CRFB, a think tank, separately estimates the checks would cost more than $1.2 trillion. A onetime payout would more than double the projected 2027 primary deficit from $780 billion to about $2 trillion and push the total federal deficit to roughly $3.1 trillion.

Maya MacGuineas, the think tank's president, had this to say:

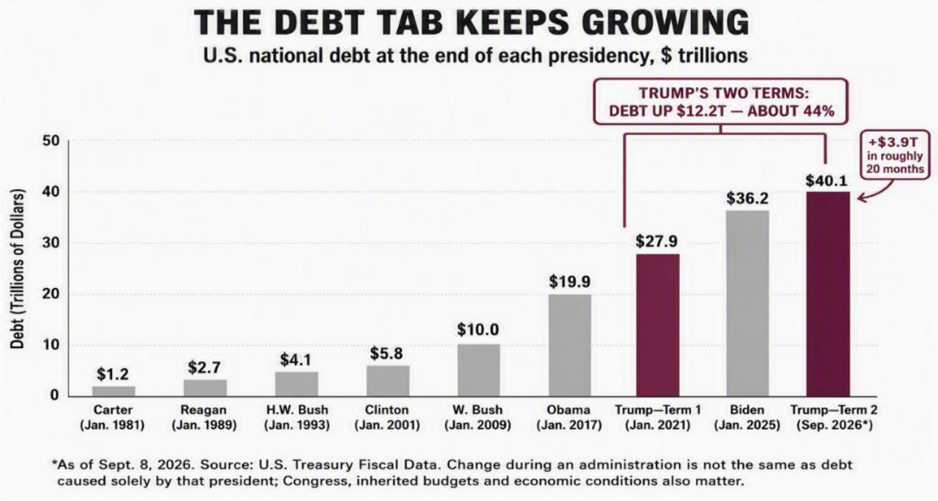
"This proposal is fiscally dangerous, economically backwards and fundamentally unserious."

The proposal is even harder to square with Bessent's recent concern about the bond market. Just weeks ago, the Treasury Secretary expanded buybacks of longer-dated debt and publicly pressured the Fed not to raise rates. Now he is backing a $1 trillion giveaway that would boost growth and widen the deficit. Apparently, Washington wants more stimulus, more debt, and lower interest rates — all at the same time. Can't make this stuff up.

The president has also suggested he may not need Congress to make it happen. But consider what you would do if a private company borrowed money to fund a dividend. Would that be a stock you wanted to own — or short?

The real danger is a debt spiral: Interest creates more debt, more debt creates more interest and eventually the math starts running the government instead of the other way around. A fiscal crisis once seemed unthinkable. Washington has worked hard to make it thinkable.

"I am the king of debt. I do love debt. I love debt and I love playing with it, but of course now you're talking about something that's very, very fragile, and it has to be handled very, very carefully."
— President Donald Trump, CNBC, May 2016



Bottom line: The Mad Hatter appears to be running economic and fiscal policy, and if a 5% 10-year Treasury yield is not a wake-up call, I don't know what is.

Policymakers need to start reducing the deficit. Bringing deficits toward 3% of gross domestic product (GDP) would put the debt on a more sustainable path and show markets that Washington is serious about fiscal discipline.

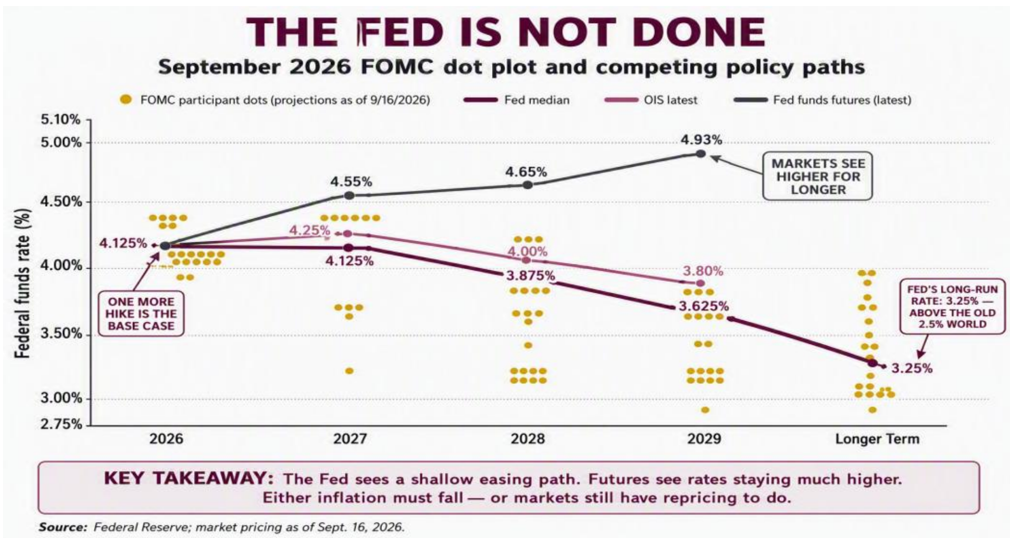
Is that too much to hope for?

WARSH DEFIES TRUMP

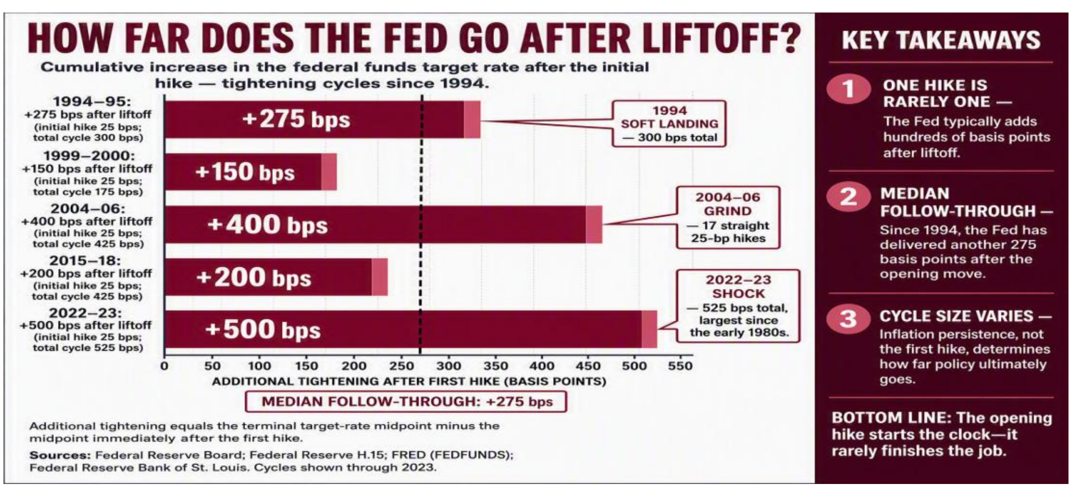
Last week's Federal Open Market Committee (FOMC) rate hike itself was no surprise, with markets pricing in a 90% probability prior to the meeting. The surprise was the sudden unity. Six weeks after voting to hold, the dovish majority joined the hawks in raising rates — and backed another hike by year-end. What has changed since late July? And why signal another increase next year when visibility that far out is little more than guesswork? After all, the Fed's July projections still called for a cut in 2027.

The decision to raise the policy rate, despite opposition from the White House, strengthens the Fed's credibility when it otherwise might've been severely strained. That said, if inflation is trending too high, a quarter-point hike — removing, as Warsh put it, a "dose of accommodation" — is unlikely to suffice. But how much higher, as things stand, would the rate need to be?

Investors now want to know what happens next. Attention has shifted to the Fed's new dot plot — in which, as many analysts put it, policymakers have "penciled in" at least one more rate increase in the coming months because Warsh declines to take part in the dot-plot exercise and strongly objects to "forward guidance."



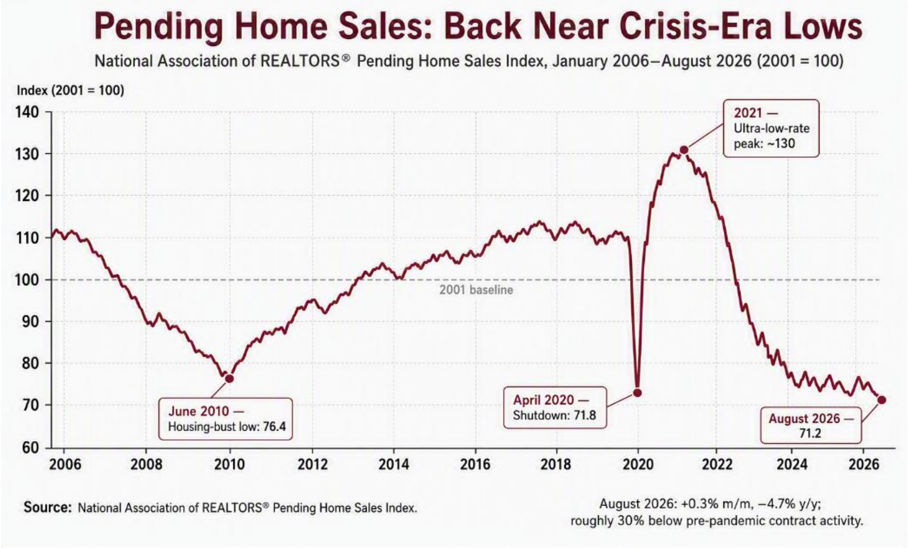
Historically, the Fed almost never hikes once and stops. The lone exception was 1997, when Asia, Long-Term Capital Management and Russia blew up — and the next three moves were cuts. In the other five cycles, rates rose an average 335 basis points to 5.25%. Starting at 3.625% means less tightening is needed today. But another 150 basis points could still trigger a recession. This time, there is no fiscal rescue package.



I also found Warsh's parade of adjectives about the economy — "resilient," "strong," "solid" and "robust" — to be over the top. Read the statement and you might think the economy was booming. Tell that to the homebuilders and home buyers/sellers.

Housing starts are down -10.3% annualized over the last six months and building permits are down -18.1% annualized over the same period, as higher mortgage rates continue to bite.

In the same vein, the Pending Home Sales Index sits at 71.2. For context, this is below the June 2010 cycle low of 76.4 and even below the April 2020 level of 71.8, when the whole economy shut down for a month. Sales were bad in all regions. But mortgage rates in August were still quite a bit lower than now. Pending sales are a leading indicator: Most signed contracts turn into existing home sales within one or two months. No wonder the S&P 500 Homebuilder Index is down -17% since the start of the U.S.-Iran conflict.

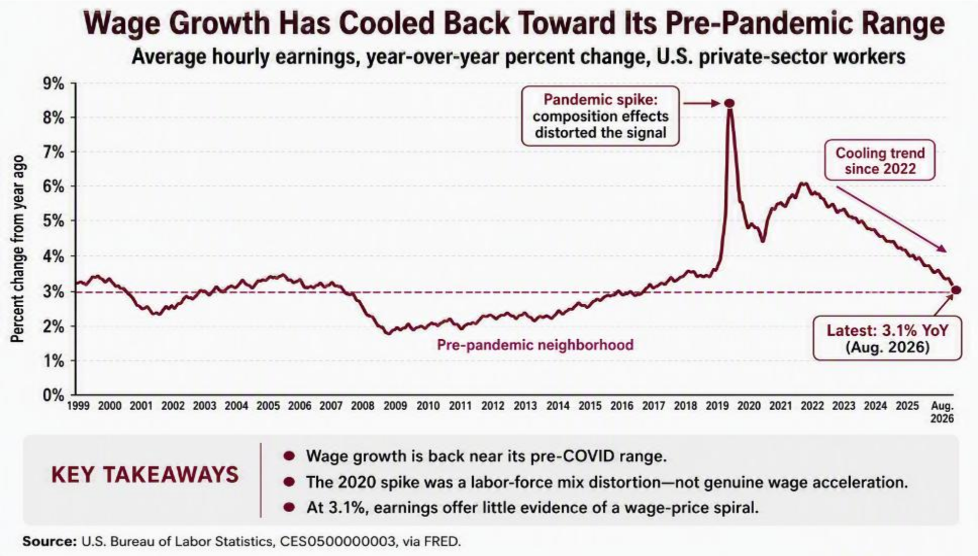


“Raising interest rates is specifically intended to deter spending. So the pain that the consumer is feeling if they’re obligated to pay more on a home, or a car loan, or on a student loan, is intentional.”
— Thierry Wizman, Strategist on Global Fixed Income and Rates Strategist, Macquarie Group

Warsh’s description of a “strong” and “robust” economy also looks detached from the latest Beige Book. The Fed said activity increased only modestly, with ten of twelve Districts reporting growth in the slight-to-moderate range and two reporting no growth at all. Consumer spending rose only slightly, residential construction declined and employment increased very little. Businesses remained cautious amid higher energy prices, policy uncertainty and international conflict. That is an economy still expanding — but hardly one begging for tighter policy. So, why spend the time and money on the Beige Book if policymakers are going to ignore it?

Regardless, Warsh’s implicit message was clear: Unless oil prices fall quickly, reaching the 2% inflation target will require demand destruction. Because the inflation shock is supply-driven, the Fed can offset it only by weakening demand enough to compensate for lost supply, in other words, engineering a recession. Warsh did not say that outright; doing so would likely provoke President Trump. Instead, he sold the economy as strong enough to withstand this monetary-policy experiment.

I do not set monetary policy. Warsh does — and the FOMC is now marching behind him. But logic still deserves a hard look. If inflation expectations were breaking loose and wages were accelerating, I would understand the move. They are not. Wage growth is 3.1%, down from 4.0% a year ago and roughly half the 2022 peak. There is no wage-price spiral. Warsh is buying insurance against a second-round inflation problem his own data says does NOT exist. The Fed is supposed to wait for spillover into wages, core inflation and expectations — not create the recession first and ask questions later.



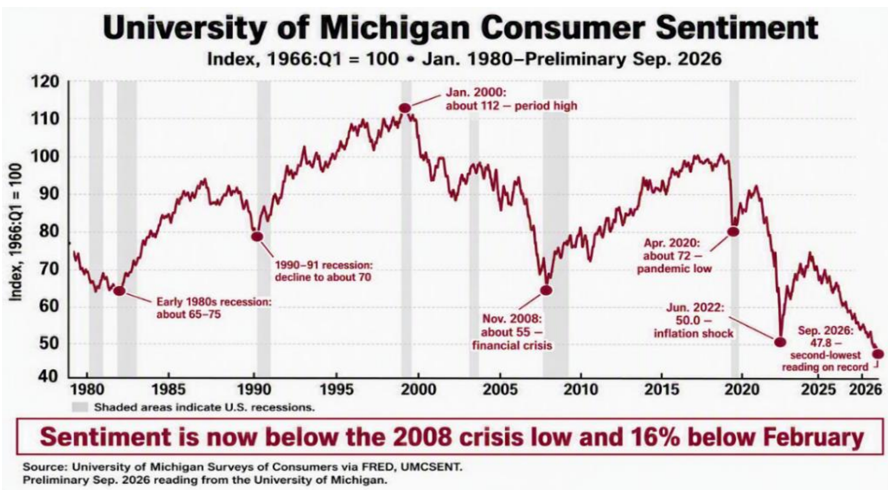
Bottom line: Warsh is treating an oil-driven supply shock like a demand boom even though wage growth is cooling and inflation expectations remain contained. The Fed is buying insurance against a fire that has not started — and may burn down the economy in the process.

A VOTE OF NO CONFIDENCE

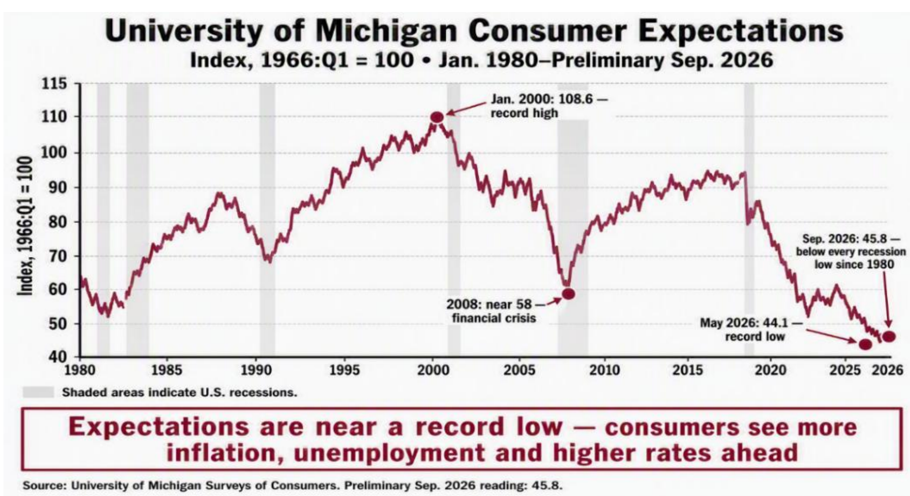
“This is the golden age of America.” — President Donald Trump, State of the Union, February 2026

The University of Michigan Consumer Sentiment Index is a monthly snapshot of how Americans feel about their finances, jobs, inflation and the economy. It matters because nervous consumers tend to pull back — especially on homes, cars and other major purchases. When confidence drops to unusually low levels, it can signal that the economy is starting to lose momentum.

The preliminary University of Michigan Consumer Sentiment Index was punky in September, faltering to a four-month low of 47.8 from 51.7 in August and sharply undercutting the consensus forecast of 51.0.

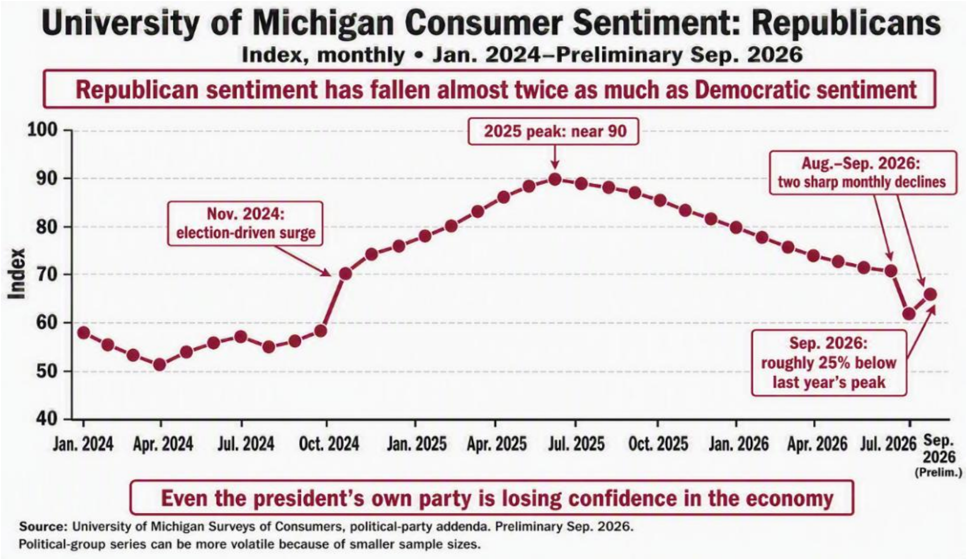


As for the economy, the “expectations” component led the decline, with a big drop to 45.8 from 51.5 in August and 55.4 in July — at or below all of the past eleven recessions over the past seven decades.

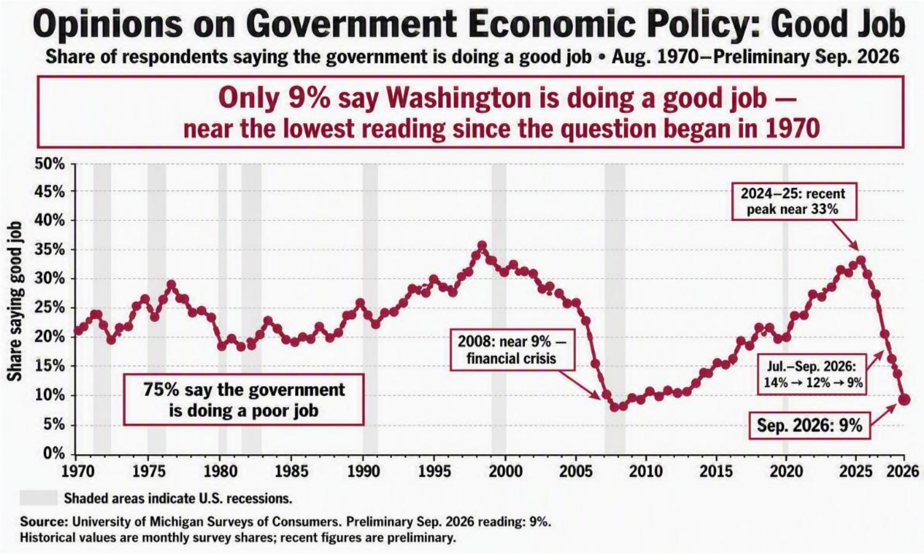


This was the second-lowest confidence reading since the survey began in 1952 — and worse than the 2022 inflation shock. Sentiment bottomed at 50.0 then, when inflation hit 9.1% and the Fed was already hiking. Today, confidence is below 48 with inflation at 3.4% and tightening barely underway. The difference? No stimulus checks cushioning the blow. The weakness was broad. Confidence dropped across nearly every age, income and education group.

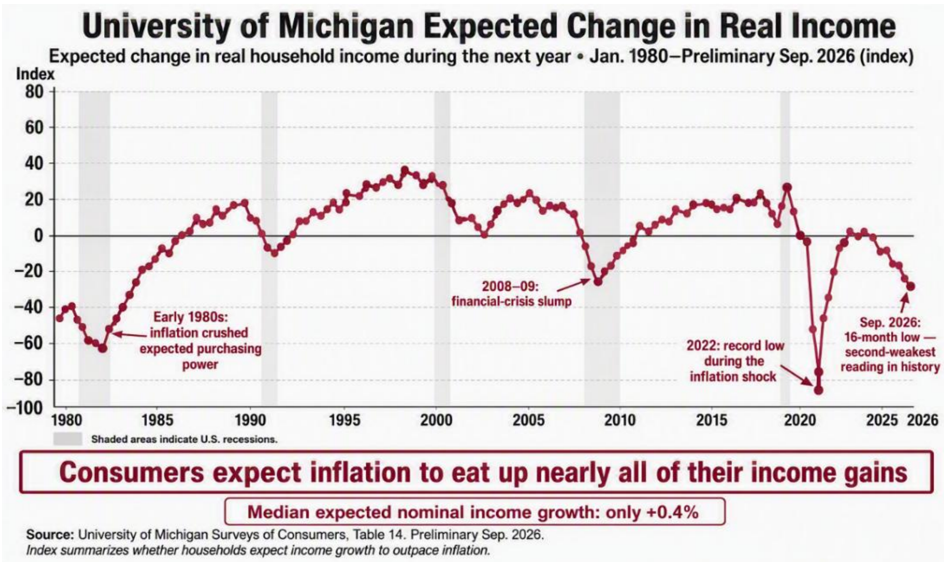
Both parties turned gloomier, but Republican confidence fell nearly twice as much as Democratic confidence. It is now back near the November 2024 election level and roughly 25% below last year's peak. With the midterms approaching, that is not exactly a campaign slogan.



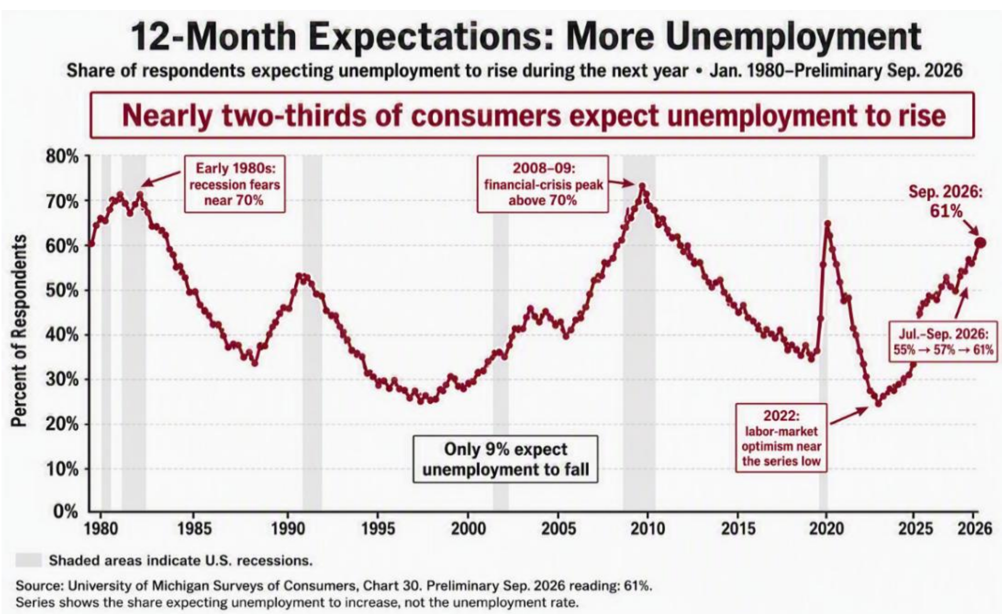
Only 9% say Washington is doing a good job, down from 14% in July. Meanwhile, 75% say it is doing a poor job — nearly as bad as 2008 and worse than almost any reading since the question began in 1970. Washington has managed to make Nixon look popular.



Income expectations are scraping the bottom. Fewer than 40% expect a raise, and the typical gain is just 0.4%. After inflation, income expectations fell to a 16-month low — the second-worst reading on record. Gas prices are rising. Paychecks are not.



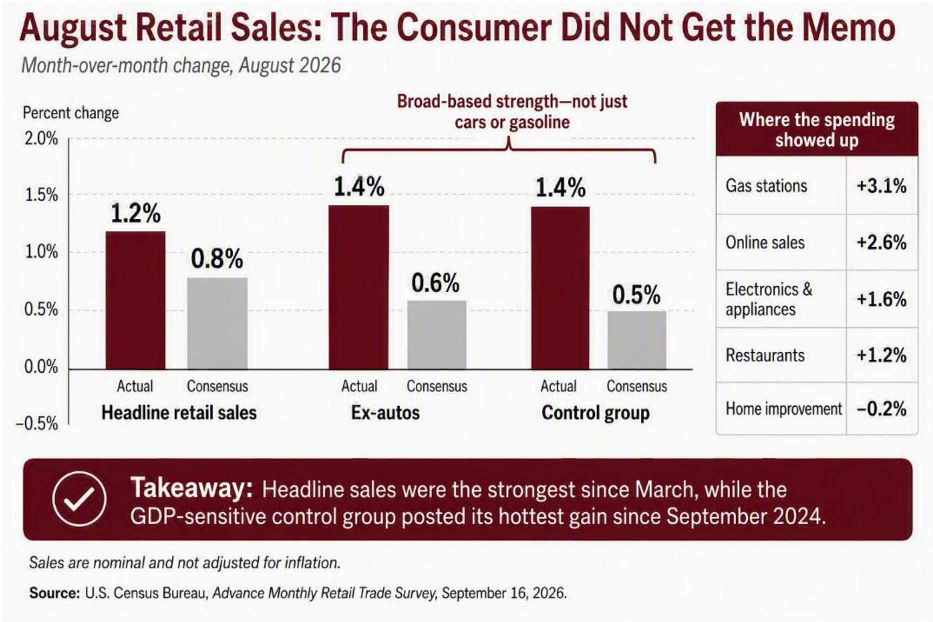
The jobs mood is getting darker. A full 61% expect unemployment to rise, up from 57%, while just 9% see it falling. People are preparing for layoffs, not a hiring boom.



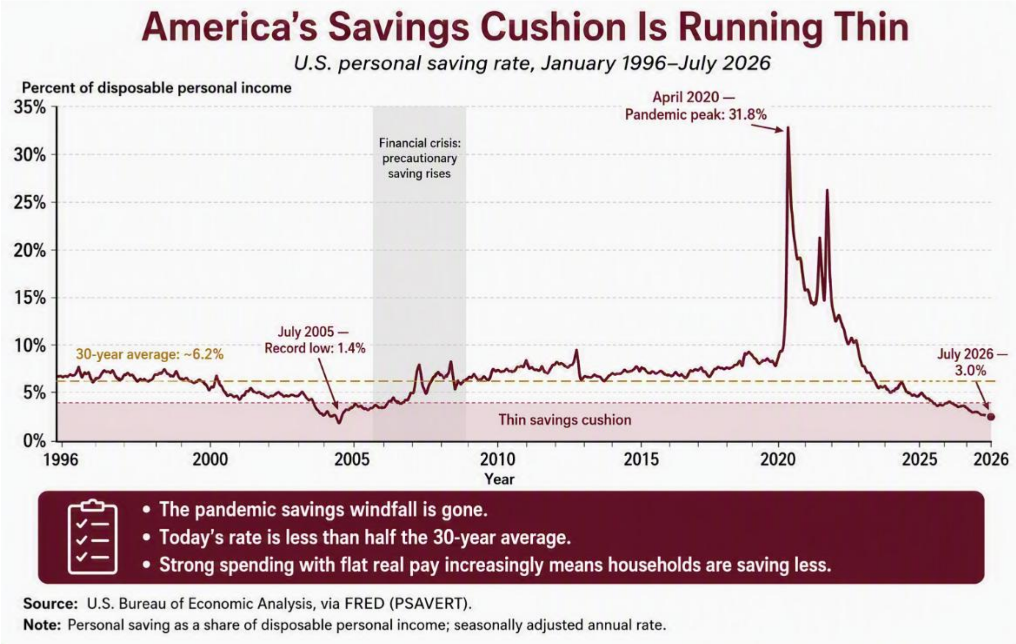
Bottom line: The president is cheering, but consumers are waving a white flag. Confidence is near a record low, job fears are rising, paychecks are shrinking after inflation and Washington is getting the blame. This is not a soft-landing mood. It is a vote of no confidence.

NO DOG DAYS FOR CONSUMERS

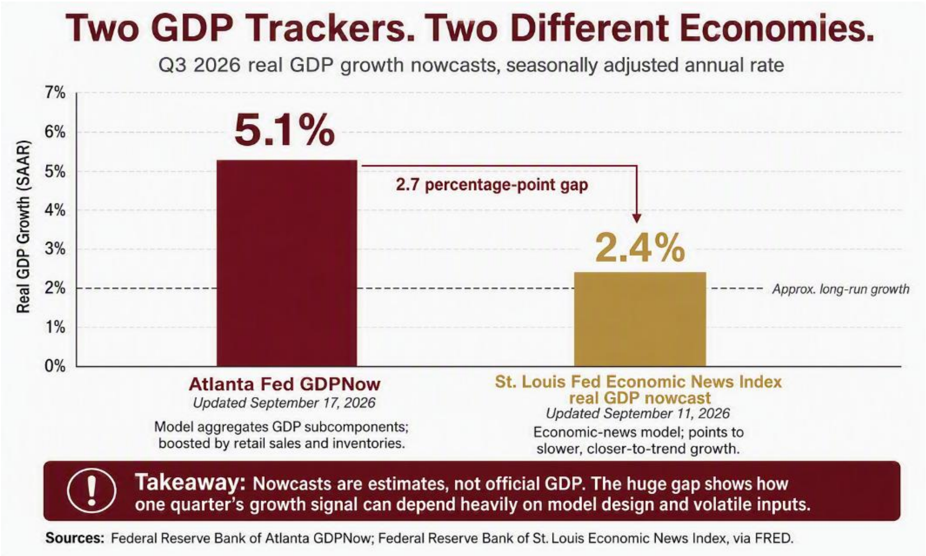
Despite collapsing consumer confidence, August retail sales beat expectations across nearly every major category. Home improvement was the lone exception, falling 0.2% for the second straight month.



This was not just inflation making the numbers look better. Sales volumes rose 0.8% and have increased in six of the past seven months. But real weekly pay has gone nowhere. So where is the money coming from? Most likely, consumers are saving less. The savings cushion was already thin. Now it is getting thinner.



The stronger retail report pushed the Atlanta Fed's current-quarter growth estimate to 5.1%, well above the St. Louis Fed's 2.4% nowcast. The gap is a reminder that these are models, not official GDP: Different inputs and methods can produce very different pictures of the same economy.



So, what's going on?

First, **the spending is K-shaped.** Higher-income households — helped by jobs, rising asset values and larger cash cushions — are driving much of the growth. Lower- and middle-income consumers can feel terrible without pulling the aggregate retail number down immediately.

Consumers are spending through the pain. Savings are thin, credit is easier than admitting defeat and households are cutting elsewhere to protect the purchases and experiences they value.

One more possibility is worth considering: Some younger households may be redirecting money once intended for a down payment. If homeownership feels permanently out of reach, part of that savings goal can become travel, restaurant, car or other discretionary spending. The idea is plausible, but retail-sales data alone cannot prove it. If it is happening, it supports spending today by weakening household wealth-building tomorrow.

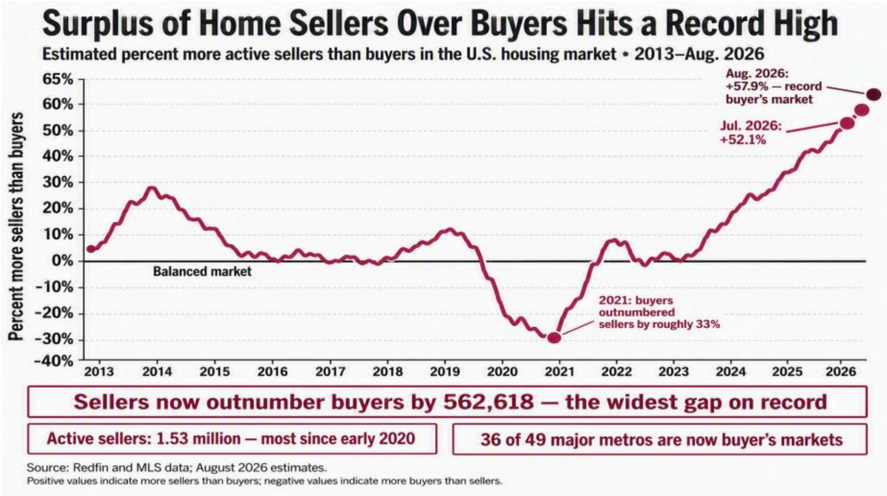
Bottom line: Consumers say they feel miserable, but they keep spending. August retail sales were broad and strong, supported by higher-income households, lower savings and continued use of credit. The spending boom may also reflect younger consumers redirecting money once intended for a home. The consumer is still moving — but the fuel tank is getting dangerously low.

THE SELLERS SHOWED UP. THE BUYERS DIDN'T.

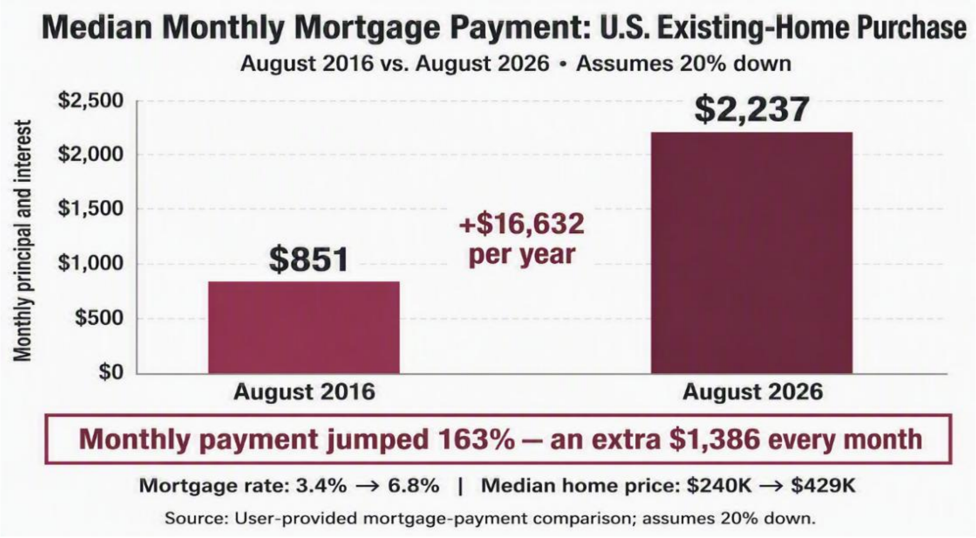
Remember when buyers outnumbered sellers? Those days are gone. In August, there were an estimated 57.9% more sellers than buyers, the largest gap on record and up from 52.1% in July. Active listings jumped by 57,958 in one month to 1,534,918 — the biggest monthly increase ever and the highest inventory since early 2020. Housing has not merely shifted toward buyers. It has flipped.

At the same time, there were ~972,300 active homebuyers, the second-lowest reading on record. This brings the gap between active sellers and homebuyers to a massive 562,618.

As a result, 36 of the 49 major U.S. metros are now buyers' markets, led by Nashville, Miami and Houston, where sellers outnumber buyers by more than TWO TO ONE.



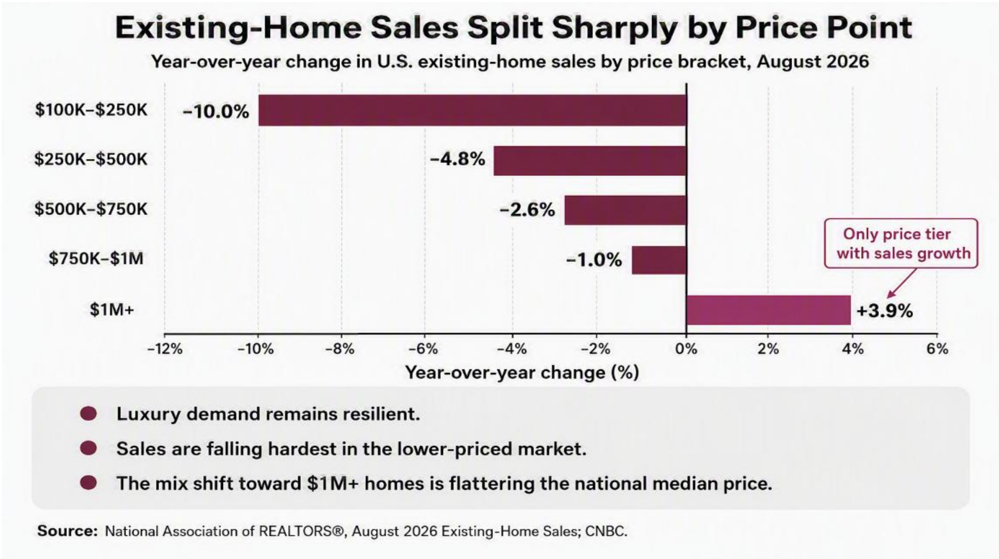
Buyers are walking away because homes have become far less affordable. Ten years ago, the average 30-year mortgage rate was 3.4% and the median existing home cost was about $240,000. Today, the mortgage rate is 7.22%, and the median price is $429,000. For a buyer putting 20% down, that means about $38,000 more upfront and a monthly principal-and-interest payment that has jumped 163% from $851 to $2,237. Same house. Same loan. An extra $16,632 a year. No wonder homeowners with 3% mortgages are staying put.



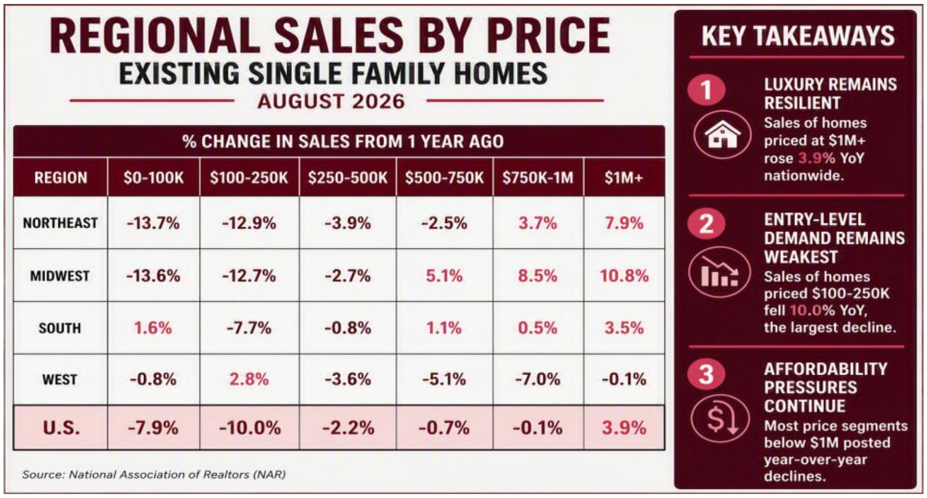
Bottom line: Housing has flipped from too few homes to too few buyers. Inventory is surging and sellers now outnumber buyers by a record margin. Buyers finally have leverage — mostly because mortgage rates and prices have driven them from the market.

K-SHAPED HOUSING MARKET

In terms of pricing, the U.S. is now officially in a K-shaped housing market. Sales volumes are still rising at the $1 million+ luxury price point (+3.9% year over year) but are collapsing everywhere else.



This shift in mix towards higher-end buyers is causing something interesting to happen. Sale prices are still rising, up 1.6% year over year. Not because prices are rising across the board. But because a higher share of the sales are happening in the luxury segment. It will be interesting to see what happens to sale prices once the buyer shift goes back to normal. And younger, more middle-income buyers start buying more. There could be a sudden shift in median and average sale prices.



REGION	$0-100K	$100-250K	$250-500K	$500-750K	$750K-1M	$1M+
NORTHEAST	-13.7%	-12.9%	-3.9%	-2.5%	3.7%	7.9%
MIDWEST	-13.6%	-12.7%	-2.7%	5.1%	8.5%	10.8%
SOUTH	1.6%	-7.7%	-0.8%	1.1%	0.5%	3.5%
WEST	-0.8%	2.8%	-3.6%	-5.1%	-7.0%	-0.1%
U.S.	-7.9%	-10.0%	-2.2%	-0.7%	-0.1%	3.9%

Source: National Association of Realtors (NAR)

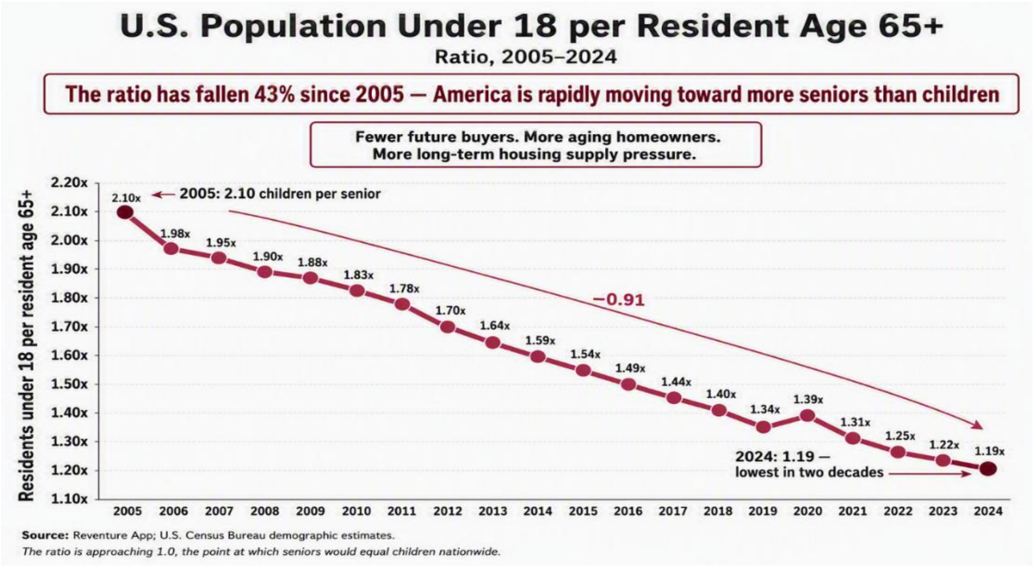
Bottom line: Luxury sales are keeping headline prices afloat while activity below $1 million weakens. The median can still rise even when most of the market is losing momentum because the mix of homes being sold has shifted toward the high end.

BOOMERS HAVE THE HOMES. WHO WILL BUY THEM?

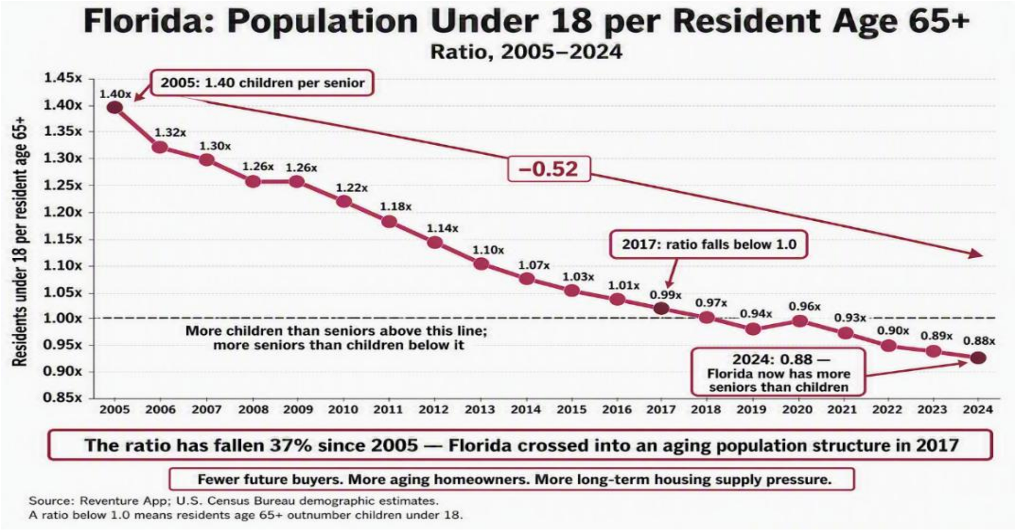
"Demography is destiny."

Most housing analysis still focuses on rates, prices and inventory. Demographics may be the slower-moving force that ultimately matters more.

America's housing market is approaching a major demographic turning point**.** In 2005, there were about 2.1 children under 18 for every American age 65 or older. Today, the ratio is closer to 1.2, and it could fall below 1.0 around 2030. In plain English, seniors may soon outnumber children nationwide.

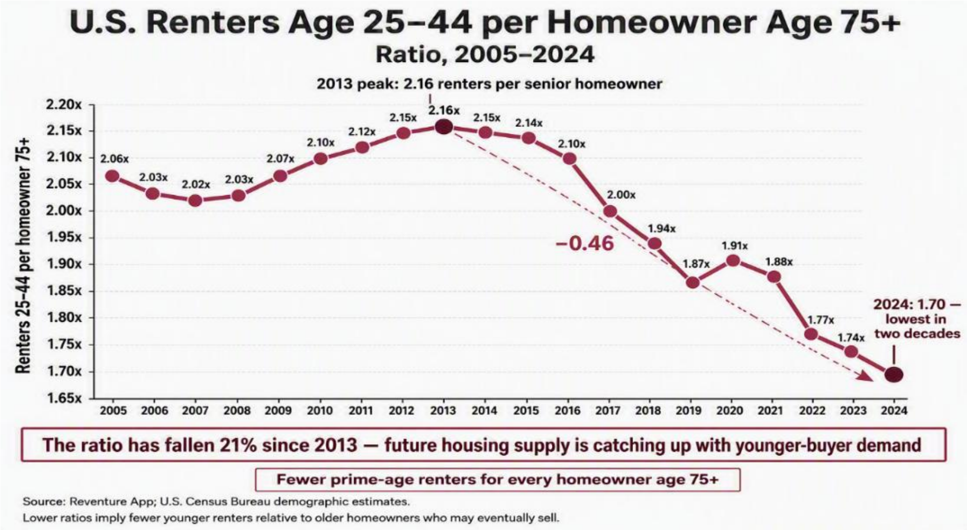


Housing needs young buyers, but fewer are coming while more Boomers prepare to sell. Over the next decade, that shift should create a gradual headwind for demand and add supply, especially in older, slower-growing markets. Immigration, household formation, job growth and housing shortages will still determine how strongly individual regions feel the pressure. Florida may offer an early warning: Its child-to-senior ratio has fallen 37% since 2005, leaving more seniors than children.



A telling housing measure is the ratio of renters ages 25-44 to homeowners 75 and older — the next buyers versus the next sellers. That ratio fell from 2.16 in 2013 to 1.70 in 2024, a two-decade low. Translation: Potential sellers are growing faster than potential buyers.

The millennial housing wave is also aging out. The oldest millennials are about 45, moving past their peak first-time-buying and frequent-moving years.



The implications are clear:
Demand: Fewer children and young adults mean fewer future first-time buyers and less need for family-sized homes.
Supply: As Baby Boomers downsize, move into care or pass homes to their estates, older households will gradually shift from net buyers to net sellers.
Prices: More supply and weaker demand should improve affordability, but this could also weigh on home prices and sales volumes, assuming inflation does not reaccelerate.

Bottom line: The 2010s had the perfect mix: Boomers retiring and millennials buying. That tailwind is now reversing. Fewer young buyers, more aging sellers and a shrinking child population point to a softer housing market ahead. Demographics move slowly — but they are destiny.

Footnote: Not every market is at the same point in this demographic cycle. Areas with more millennials, children and job growth should hold up better. Markets with older homeowners and weaker population growth will face the strongest pressure.

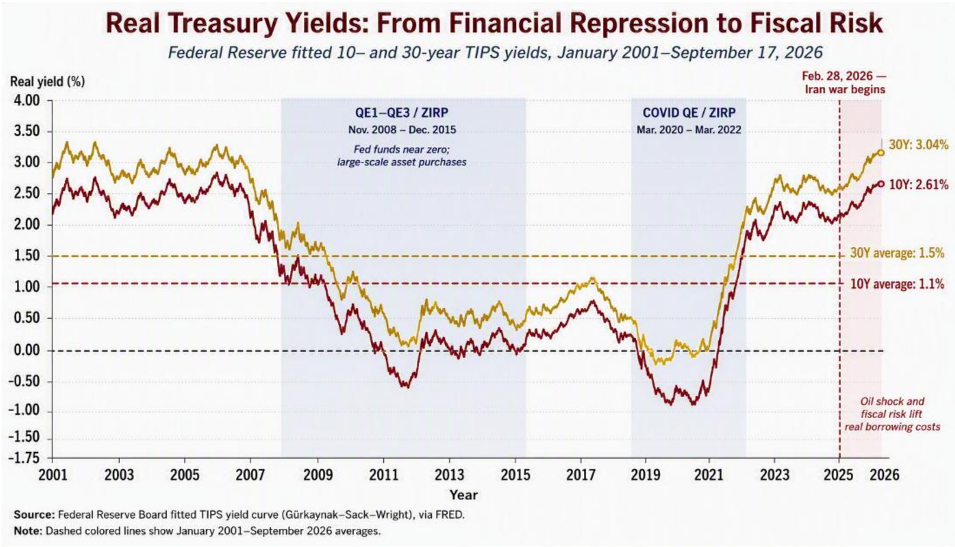
MARKET OUTLOOK AND PORTFOLIO STRATEGY

Rule #9: "When all the experts and forecasts agree, something else is going to happen." **— Bob Farrell**

The market now believes AI is the only trade, valuations no longer matter, the economy cannot slip into recession and bonds are dead. Fine. I will take the other side.

Bond yields are being driven more by rising real rates than by inflation expectations, which is exactly the wrong medicine for an economy already losing momentum.

High real rates punish borrowers, crush investment, weigh on asset prices and force more income toward interest payments. That may be manageable in a boom. In a slowing economy, it is how weakness becomes recession. The Fed is tightening into a slowdown.



At today's yields, bonds offer real value no matter what the Fed does next. Inflation may cool faster than feared, while the economy looks weaker than the market wants to admit. The bigger danger is the Fed tightening into a slowdown driven by oil, supply shocks and speculation — not runaway consumer demand.

Stay patient and keep liquidity. Add duration selectively while real yields remain well above their long-term averages and bonds remain deeply unpopular. If growth weakens and inflation cools, the Fed and the market will eventually have to rethink the policy path. By then, the easy entry point may be gone.

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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.