



Tom Slefinger
Market Strategist

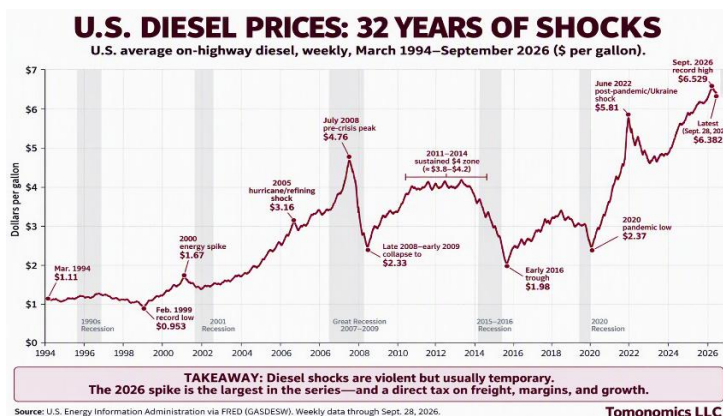
Weekly Relative Value

WEEK OF OCTOBER 5, 2026

The Fed Can't Print Diesel

Executive Summary: Markets are trapped between an energy shock, a tightening Fed and an economy already losing momentum. Diesel near \$6.50 will squeeze consumers and margins, but history says energy spikes create inflation noise — not lasting core inflation. Treasury yields above 5% are breaking housing and exposing credit stress, even as they finally offer real value. Stocks remain expensive and dangerously narrow, while housing outcomes depend almost entirely on local supply.

Diesel prices are near a record \$6.50 per gallon — up 70% since the war began. That tax will eventually hit growth, margins and consumers. It is reason enough to trim risk.



Diesel matters because it is a business cost. It flows through trucking, farming, construction and distribution, but freight remains a small share of most retail prices. Even a major diesel spike adds surprisingly little to the final price of most goods.

History agrees. Across six diesel shocks over 30 years, the one-year-lagged correlation with core inflation was just 29%. Core inflation peaked at only 2.4% on average. 2022 was the exception because diesel collided with stimulus, supply-chain failures, a hot labor market and surging housing costs.

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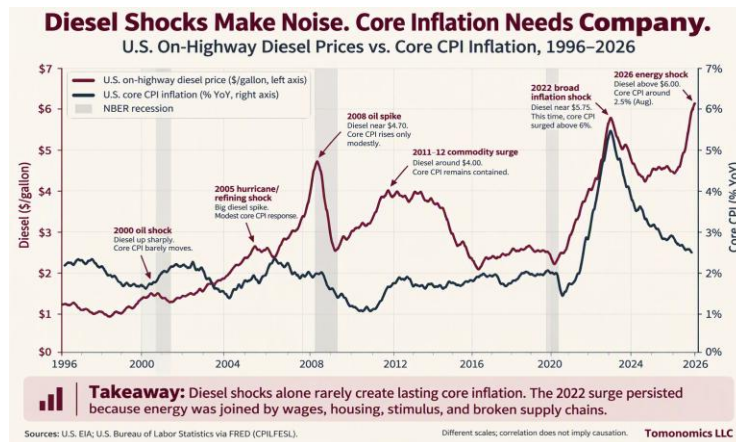
SUBORDINATED DEBT: (SIMPLIFIED)

Partnership has its perks.
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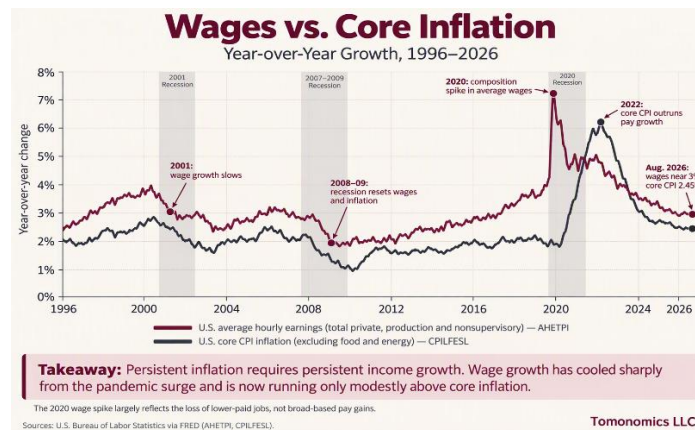


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The pattern is clear: Diesel creates inflation noise, not lasting core inflation.

The lasting inflation risk is wages. Diesel can reverse; wage gains usually stick and drive services inflation. If wage growth stays stable or slows, repeated rate hikes make little sense. Watch labor costs — not the diesel headline.



The Fed is hiking on expected pass-through, not evidence. Energy inflation hits first; demand destruction arrives later. The Fed is reacting to the headline just as higher real rates begin hurting housing, construction and jobs.

Rate hikes cannot produce diesel. They can only crush demand elsewhere. Core goods inflation is already below 0.7%, a 14-month low, while real-time housing measures suggest inflation is much closer to target than the official data show.

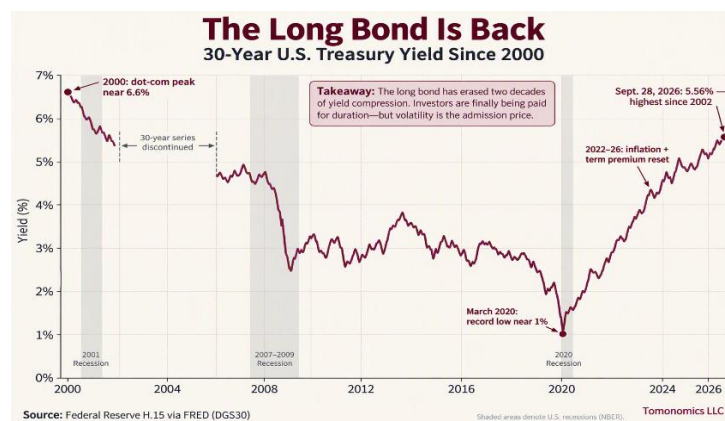
Bottom line: Diesel at \$6.50 is a serious tax on consumers, margins and growth — but history says energy shocks create inflation headlines, not lasting core inflation. The real danger is sticky wage growth, while housing and demand are already weakening. The Fed cannot produce more diesel by hiking rates; it can only crush the rest of the economy. Watch wages, not the pump.

NO LOVE FOR BONDS...YET

If the Fed insists on fighting diesel with rate hikes, the bond market will keep taking the punishment — until oil cools or something breaks.



The long bond is flashing both danger and opportunity. The 30-year Treasury yield has climbed to 5.61%, its highest yield since the dotcom bust. The 10-year is at 5.25%, its highest since 2007.

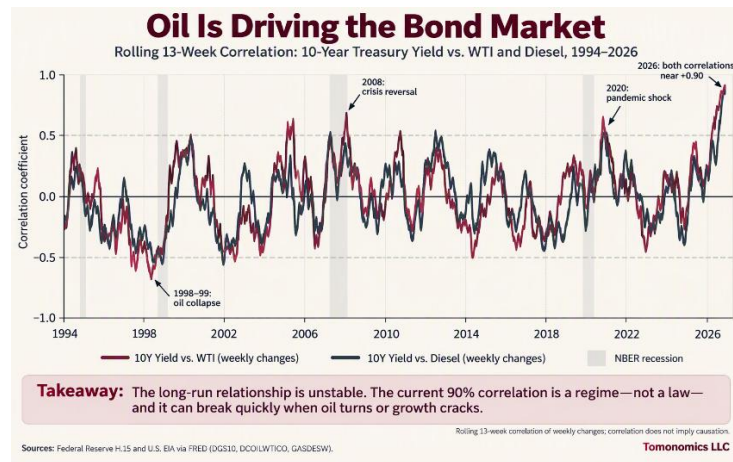


The Fed hiked rates to bring inflation down but the bond market doesn't believe it's going to work, so long-term rates keep climbing anyway. Mortgages crossed 7.3% this week, up from 6.3% a year ago. On a \$400,000 loan that's \$250 more per month for the same house.

For bonds, the immediate enemy is oil — and the Fed's reaction to it. The 10-year Treasury yield's long-run correlation with WTI was about +30%, but over the past three months it has surged to 90%. That does not prove oil alone is driving yields, but it shows how tightly the bond market is trading with the energy shock. Last June, hopes for a U.S.-Iran deal briefly pushed WTI below \$70 and pulled the 10-year yield back to 4.4%. Get crude there again, and bonds can finally breathe.

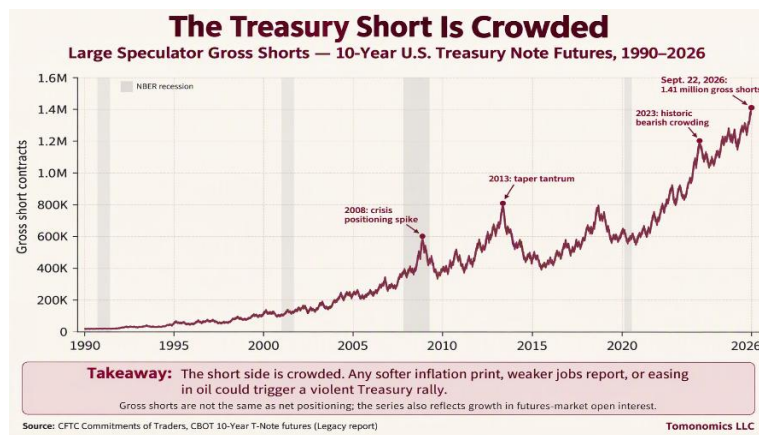
Warsh pretends he is not giving forward guidance, but he has made the message clear: Headline personal consumption expenditures (PCE) is all that matters. Translation: He is targeting diesel. That is why bonds cannot rally. Warsh has already declared the economy healthy and the labor market resilient, so the data only work one way — firm numbers

trigger a selloff; weak numbers get ignored. Under this regime, the economy is background noise. It is a one-variable Fed, and that variable is diesel.



Bond pessimism is nearing capitulation. Rates rising for decades is now a mainstream view — exactly the kind of thinking seen near turning points.

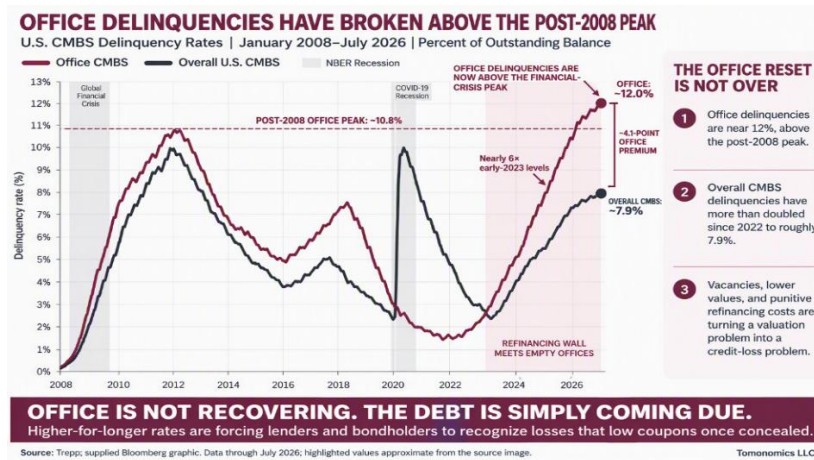
Positioning is just as extreme. Traders added bearish 10-year bets in twelve of thirteen sessions as open interest surged. The yield is stretched above its 50-day trendline to late-2024 levels, which preceded a 50-basis-point rally. In the week of September 22 alone, asset managers added more than 100,000 net shorts — one of the biggest bearish moves since yields peaked in late 2023. The trade is crowded. One good headline could trigger a violent squeeze.



Bottom line: Bonds still have an oil problem and a Fed problem, so the rally may have to wait. But yields above 5%, brutal sentiment and historically crowded shorts are finally creating real value. Stay patient, favor the two-year for income and protection and be ready to add duration when oil cracks or the economy does.

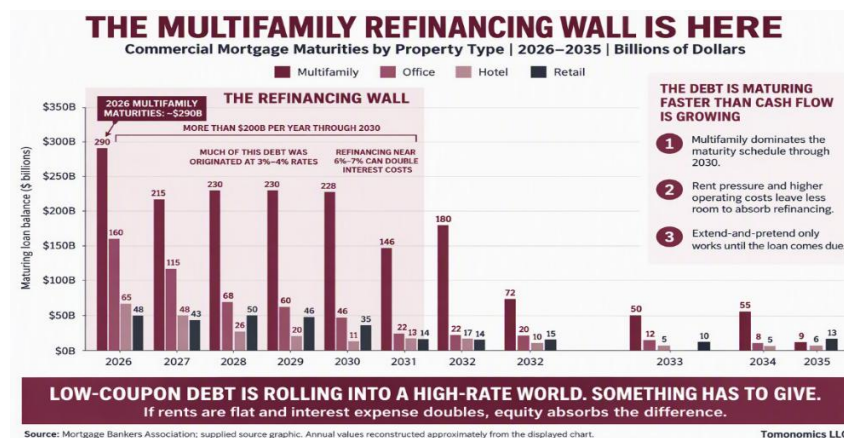
COMMERCIAL REAL ESTATE CREDIT CRACKS

Higher-for-longer rates are already breaking commercial real estate. Office commercial mortgage-backed securities (CMBS) delinquencies hit 12.0% in August, the second highest on record and six times early-2023 levels — above the 10.8% post-2008 peak. Overall, U.S. CMBS delinquencies have more than doubled since 2022 to 7.9%, the highest since early 2021 and, excluding the pandemic, a 13-year high.



Apartment distress is nearing 2008-09 levels. Borrowers who financed at 3%-4% now face 6%-7% refinancing rates their cash flows cannot support.

Mortgage Bankers Association data show at least \$200 billion in multifamily loans maturing annually through 2030. Most carry five- to ten-year terms and were originated when rates were far lower. Refinancing could double interest costs just as rental revenue weakens.



Many lenders adopted an “extend and pretend” strategy after rates rose because they did not want to foreclose. Four years into higher-for-longer rates, that patience is wearing thin. At some point, the underlying collateral — the apartment buildings — must generate enough cash to service the debt.

Lenders are turning more aggressive, and Bain's head of real estate warns that turbulence is coming.

"Lenders have gotten a lot more aggressive... That could lead to some real turbulence as you see distress start to manifest." — Ryan Cotton, Bain Capital

Distressed transactions now account for 4.7% of apartment sales, more than four times the pre-pandemic norm, according to MSCI. That share could rise sharply as more developers refinance into higher-cost debt.

This will show up most in the markets where rents are dropping, and down the most from pre-pandemic trend. The reality is that a major re-pricing is needed for apartment properties across the U.S. with the current interest rate and rent environment. 20-30% discounts would be a good start. In some markets, they might need to be even bigger.

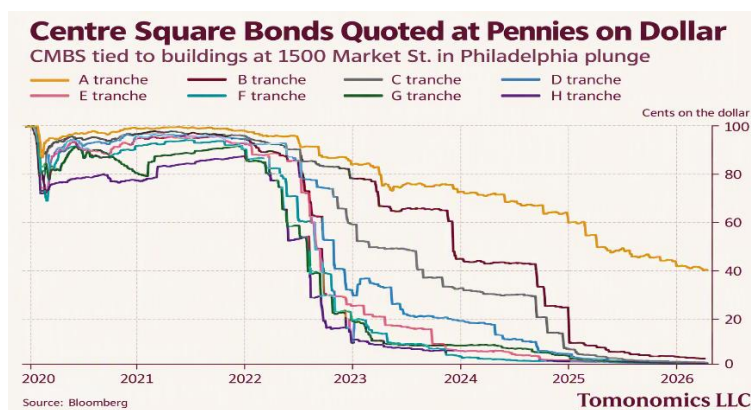
Bottom line: Commercial real estate is not recovering, it is repricing. Office delinquencies are already above the financial-crisis peak, apartment loans face a brutal refinancing wall, and lenders are running out of patience. Values need to fall, losses need to be recognized and the cleanup is just beginning.

WHEN AAA ISN'T AAA

And if anyone still thinks the AAA label makes this credit stress someone else's problem, Philadelphia just supplied the reality check.

A two-tower office complex in downtown Philadelphia was appraised at \$471 million in 2019. A judge just approved its sale for \$70 million. The 85% decline means even the AAA-rated bonds backed by the property will take losses, only the third time that's happened since the 2008 financial crisis.

Pimco, one of the largest bond managers in the world, holds roughly \$58 million across the deal and faces over \$35 million in losses. The building was 93% leased in 2020. It's 28% leased today. Over 30 other top-rated single-asset CMBS deals are now below 85 cents on the dollar, per Bloomberg.



AAA is supposed to mean you always get paid. Pimco bought that rating and is about to recover 44 cents on the dollar. The building lost 65 points of occupancy in six years, and the agencies didn't downgrade the bonds fast enough for it to matter. The ratings were wrong in 2008 on housing, and they were wrong here on offices.

Wall Street loved these single-asset deals: one building, one loan and a AAA label on top. KBRA called them “binary” — everything pays or everything defaults. The rating hides the risk until the exit is gone. Bank of America says this is only the beginning: Chicago, Denver, Portland and downtown LA remain impaired, with loans maturing over the next two years. At a 5.13% 10-year yield, nobody refinances a half-empty tower. Owners walk, bondholders eat the loss and AAA means what it meant in 2008.

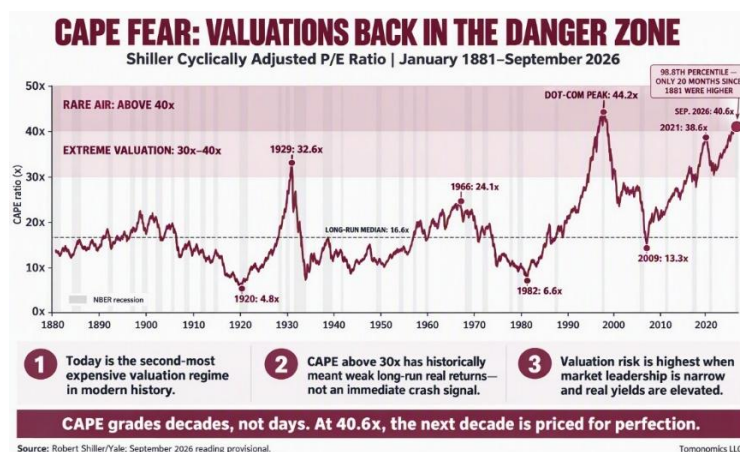
Bottom line: The AAA label did not eliminate risk — it merely delayed its recognition. Collapsing office occupancy, looming maturities and punitive refinancing costs mean more highly rated CMBS losses are likely ahead.

CAPE FEAR

Credit markets are already proving that labels can hide ugly risks. Equities are making the same bet at a much larger scale.

If you're looking for a capitulation signal in fixed income, this is about as subtle as a brick. Stocks offer a 1% dividend yield. T-bills pay 4.2%. At some point, even equity investors will notice.

This has been and still is the second most expensive market in modern history. The smoothed cyclically adjusted price-to-earnings (CAPE) multiple, in September, has now topped 40x for the fifth month running — only having done so before in the past in the summer and fall of 2000.



The S&P 500 is near its high, but the average stock is down more than 20% and yet everyone thinks the stock market has become invincible and bullet proof to the bond market shock. Twenty mega-caps are carrying the market. Tech is masking a market that is steadily deteriorating. Strip out chips and AI, and there is not much holding this market together. That kind of narrow leadership is not strength. It is a warning. With the 10-year Treasury above 5% and the Fed still tightening, the leaders are more likely to catch down than the laggards are to catch up. Stay braced.

S&P 500 MARKET BREADTH: THE AVERAGE STOCK IS HURTING Distance from 52-week highs	
Measure	Reading
Average drawdown from 52-week high	-20.52%
Median drawdown from 52-week high	-17.31%
Stocks at a new 52-week high	0
Stocks within 5% of 52-week high	31 (6.2% of index)
Stocks more than 20% below 52-week high	204 (40.5% of index)
Stocks more than 40% below 52-week high	41 (8.1% of index)
TAKEAWAY: The index may look healthy, but breadth is badly broken. More than 40% of stocks are already in bear-market territory, while none are at a new 52-week high.	
Tomonomics LLC	

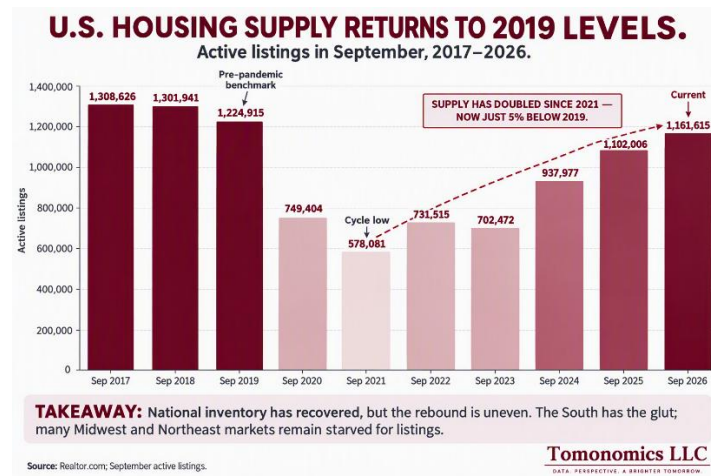
Bottom line: A CAPE above 40x, narrow market leadership and a 10-year yield above 5% leave stocks priced for perfection with little room for error. The risk is not that valuations look expensive — it is that the few stocks holding up the index finally catch down.

A TALE OF TWO HOUSING MARKETS

“There is no national housing market. Every single city and every single street across the country has its own unique housing market.” — Ali Wolf, Chief Economist, Zonda

The Fed’s rate shock is crushing housing. The 30-year mortgage is now 7.28%, up from 6.34% a year ago and 25 basis points in one week. Existing- and new-home sales are now below their 27-year average and below the level recorded during the 2007 financial crisis. New-purchase applications are down 14% year over year; refinancing has collapsed 56%. Homebuilder stocks are down 23% year over year and 35% from the peak.

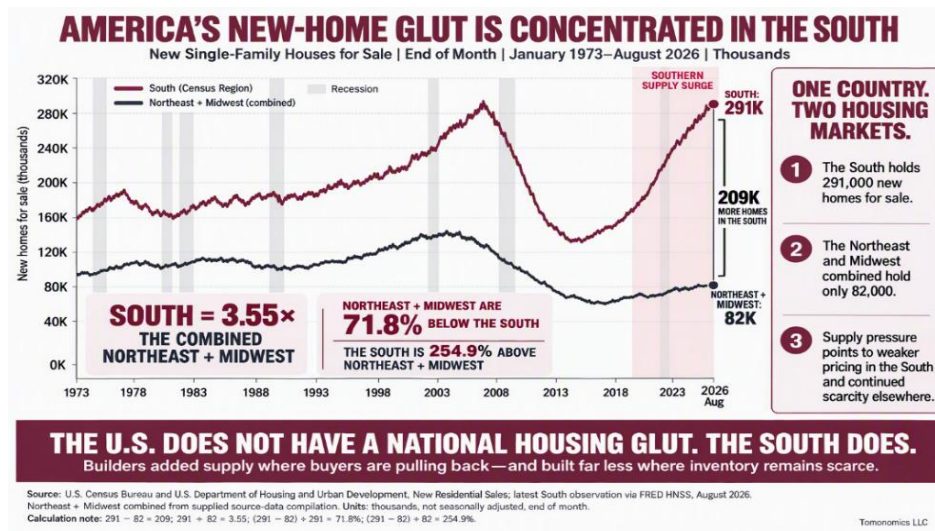
The good news: Housing supply is back. September had 1.16 million listings, just 5% below pre-pandemic levels and up 101% in five years. The national housing shortage is over. Much of the country now has too much inventory, and more is coming in 2027 as mortgage lock-in fades. That is good news for buyers — and bad news for prices.



While the national data is downright ugly there some geographical regions are faring better. That is because housing is local. Rates are national, but supply drives the outcome.

The South has nearly 300,000 new homes for sale — close to 2006 levels and 3.5 times the Northeast and Midwest’s combined 82,000. Southern builders have a glut, so prices are getting cut.

That supply gap matters. Southern builders are still adding homes into a correction, so price cuts and deflation should continue.



Many Northeast and Midwest markets remain starved for listings, which keeps competition and bidding wars alive.

Chicago is a perfect example. Listings are down 62.3% from 2019, the largest inventory contraction among major U.S. metros. Buyers are competing for a dramatically smaller pool of homes.



Bottom line: Housing is not one national market. Mortgage rates may be the same nationwide, but local supply determines the outcome — too many homes drive prices down, while too few keep prices firm. Same rate. Opposite markets.

THE MOOD IS GETTING UGLY

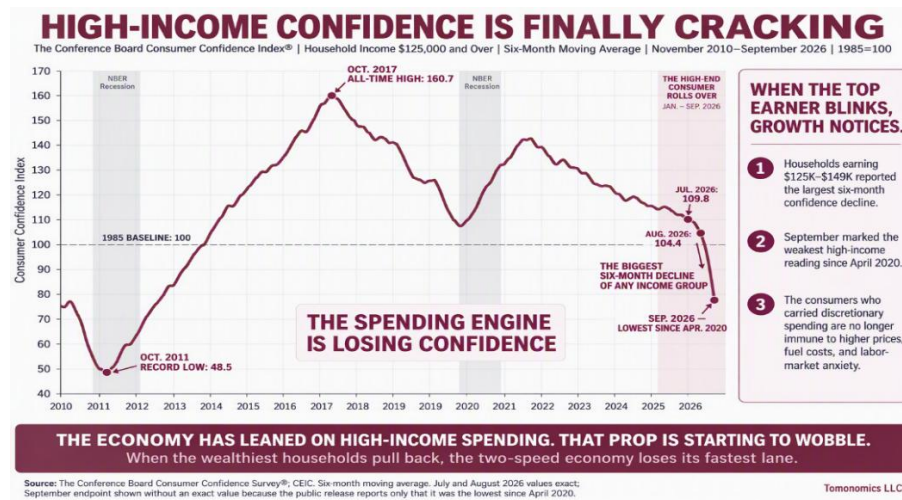
Housing may be splitting by region, but consumers everywhere are feeling the squeeze. Confidence plunged to 81.9 in September from 88.6 in August, badly missing the 89.0 consensus. Both the present-situation index, at 109.3 from 117.2, and expectations, at 63.6 from 69.5, undershot forecasts.

Confidence is now at a 12-year low, and it is interesting that it undercut the pandemic recession trough in 2020 and is right in line with the onset of the Great Recession, which began in late 2007.



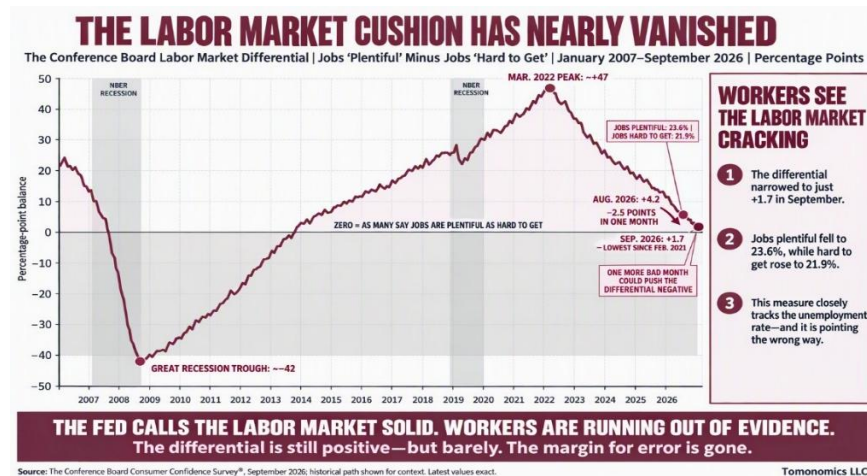
Confidence weakened across nearly every region, age group and income bracket. High-income households led the decline, posting their lowest reading since April 2020. That matters because affluent consumers — along with the AI

spending boom — have carried much of the economy over the past year. Both supports now look shakier than the headline data suggest.

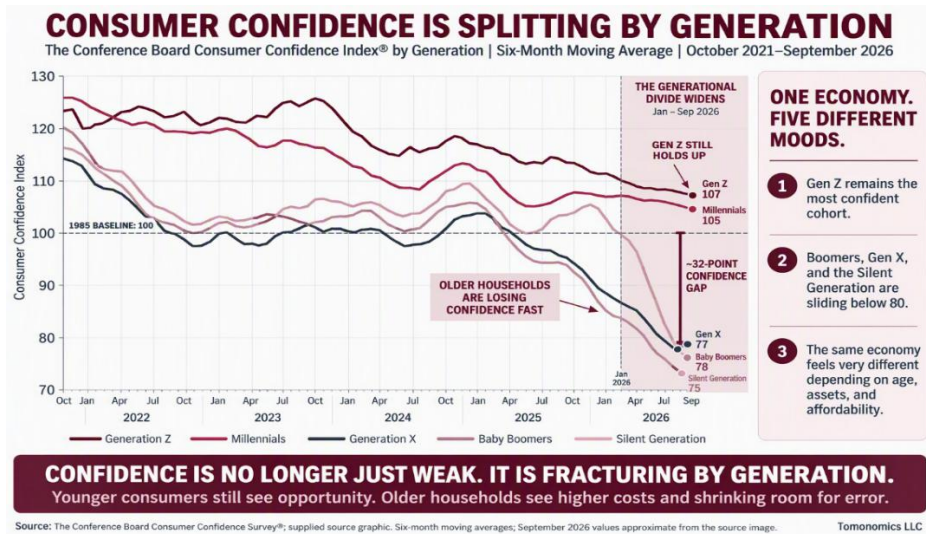


Workers are not buying the “solid labor market” story. “Jobs plentiful” fell to 23.6% from 24.5%, while “jobs hard to get” rose to 21.9% from 20.3%. The differential collapsed to 1.7 points — the weakest since February 2021, when unemployment was 6.2%. Workers see the cracks. The Fed apparently sees “resilience.”

So what exactly is the Warsh Fed watching?



The generational split is striking. Despite strong equity markets and concentrated household wealth, confidence has fallen across Baby Boomers, Generation X and Gen Z. The Silent Generation has recorded the steepest decline, falling from above 100 to below 80 in 2026.

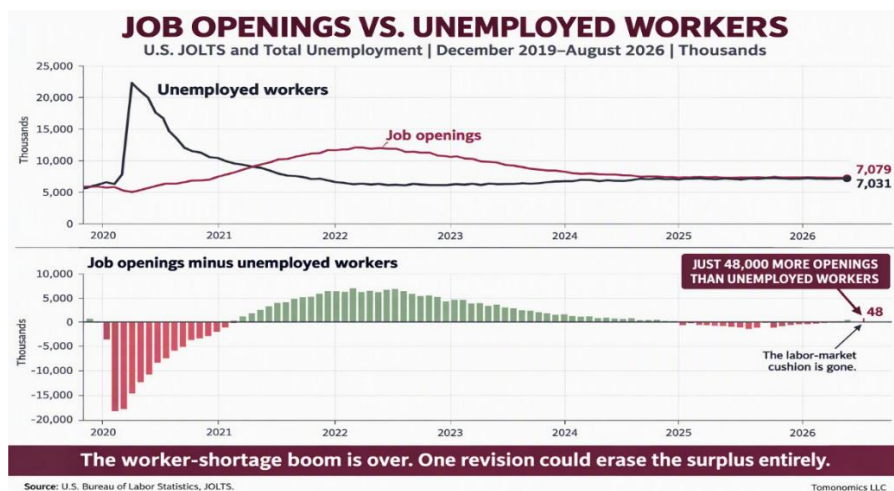


Bottom line: Consumer confidence is not merely soft — it is flashing recession-level stress. Affluent households are pulling back, workers see the job market deteriorating and expectations keep sliding. The consumer is losing faith long before the Fed is willing to admit the economy is losing momentum.

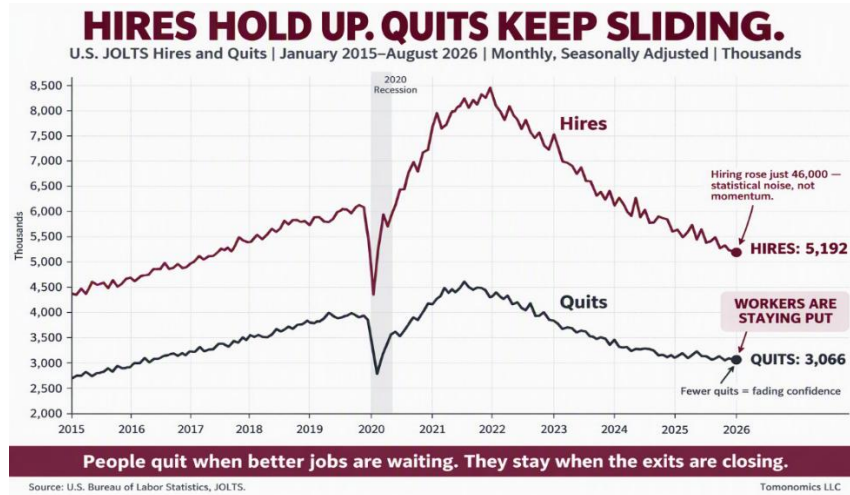
NO LAND FOR REALTORS

Consumers are losing confidence, and rate-sensitive real estate shows why.

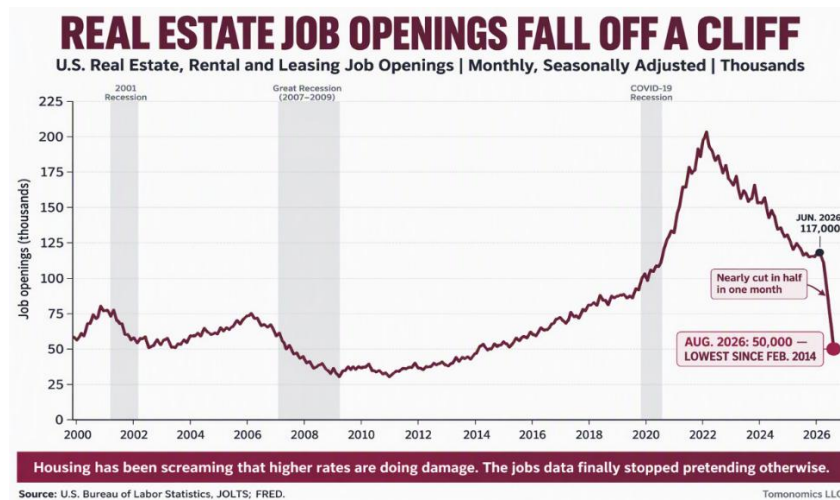
The headline still shows 7.1 million openings. Underneath, the cushion between job openings and unemployed workers is basically gone. The surplus collapsed to just 48,000 in August from 419,000 a month earlier. After four months of modest improvement, the labor market is one revision away from having more unemployed workers than available jobs. “Firing on all cylinders” this is not.



Workers already understand what the headline writers do not. Quits fell another 23,000 to 3.066 million from 3.089 million. People quit when better jobs are waiting. They stay put when the exits are closing. Hires rose by just 46,000 to 5.192 million from 5.146 million. That is statistical noise, not momentum.



Real-estate openings nearly halved to 50,000, the lowest since February 2014. Housing warned that higher rates were doing damage. The jobs data finally caught up.



Bottom line: Add it up: Openings missed again, quits fell, and hiring went nowhere. The labor market is not falling off a cliff — yet. It is quietly losing altitude, which is how downturns usually begin before everyone agrees they have begun.

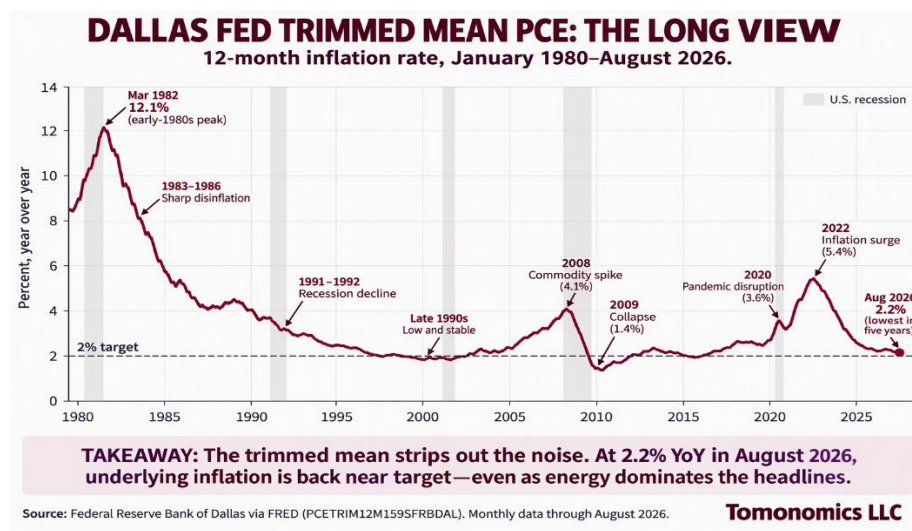
MARKET OUTLOOK AND PORTFOLIO STRATEGY

“My funds are yielding 7 plus percent with a three-year duration. I’ve waited four decades for the ability to do that.”
 — Rick Rieder, Chief Investment Officer for Global Fixed Income, BlackRock

The bond market is a mess. I watch it every day. Every rally gets sold. Every economic report becomes another excuse to dump Treasuries. Here is the latest example: Friday’s payroll report was weak (only 29,000 vs. expectations of 85,000), and prior months were revised lower. The headline number was bad, but the revisions were worse. August was revised down 29,000. July went negative. Combined, that’s 60,000 fewer jobs than previously reported across the prior two months. Bonds rallied at first. By the close, yields were higher. Same story. Every rally gets sold.

Despite the media headlines, this is not really about inflation. Inflation is near its 40-year average, and it is falling. The three-month trend says it is cooling fast. From May through August — including much of the energy shock — headline PCE ran at just a 1.0% annual rate. Core was 2.0%. But energy owns the narrative, so the numbers get ignored.

Even Warsh’s old favorite, the Dallas Fed trimmed mean, is flashing the same message. It ran at a 1.9% annual rate in August and stayed below 2% for three straight months, the first time since late 2020. The year-over-year rate fell to 2.2% from 2.3% in June and July and 2.9% a year ago — the lowest in five years.



Average hourly earnings are the inflation tell. Inflation does not last unless wages play along, and there is still no pass-through — just as with tariffs. Labor has little bargaining power, and workers know it. The voluntary quits rate fell to 10.5% from 13.1%, the lowest since May 2025. Quits lead wages. Warsh may dismiss that signal. Bernanke and Yellen did not. They were economists.

The data says inflation is cooling. Public perception says otherwise.



This is about two things...

First, credibility. Bessent, Warsh and Washington have a credibility problem. The market does not believe them. So far, it has been right. All hat. No cattle.

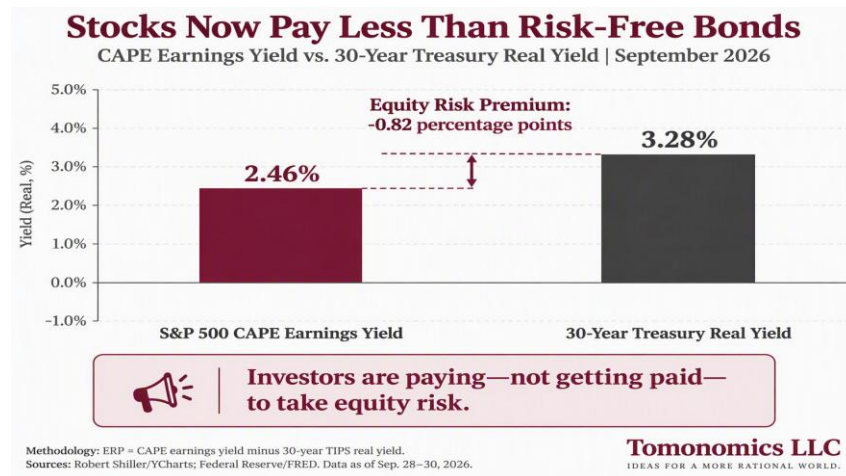
Second, hyperscalers are issuing hundreds of billions in bonds and barely care about the rate because the assumed AI return is infinite. That supply is crowding Treasury issuance and making the government's job harder.

What fixes it?

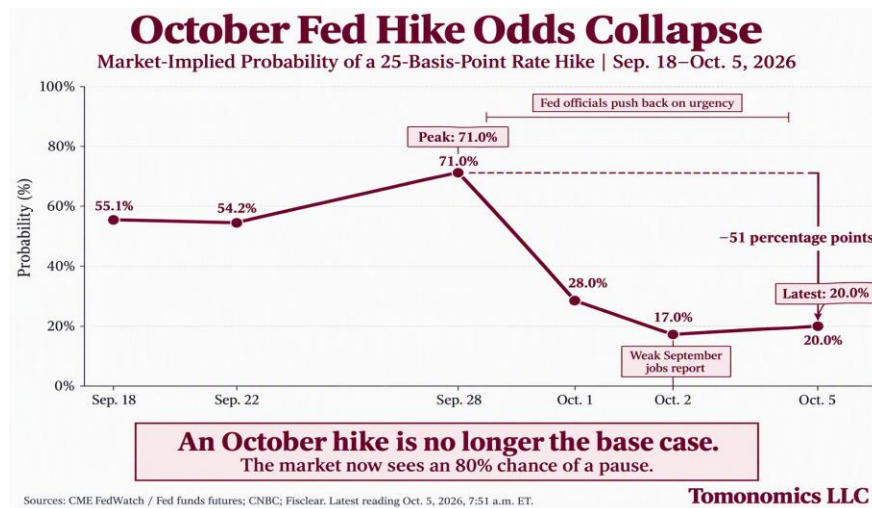
1. A bear market in stocks.
2. An end to the war and lower oil prices.
3. Yield-curve control.
4. A credible attempt to cut spending.

Any of these could help. A combination could finally break the cycle.

Meanwhile, Treasuries are offering a 5.25% risk-free nominal yield against 2.4% core inflation. That is attractive. Compare that with a 2.5% equity earnings yield based on the CAPE multiple and a 3.2% real yield at the long end of the Treasury curve. The equity risk premium is now negative 70 basis points. The question is simple: Do you want to get paid to take risk — or pay for the privilege?



Bond bears betting on four more Fed hikes should take notice. October hike odds have collapsed to around 20% from 70% earlier this week. Jefferson, Williams, Bowman, Cook and Logan all pushed back — some directly, others by what they did not say. Even the hawks see no urgency, and Logan says the bond market is already doing the Fed's work. The message is clear: The Fed is now leaning against aggressive rate-hike bets, just as it pushed back on rate-cut bets last winter. The tone has shifted. See ["Here's Why the Fed Is on Hold—Maybe for a While"](#) (*The Wall Street Journal*)

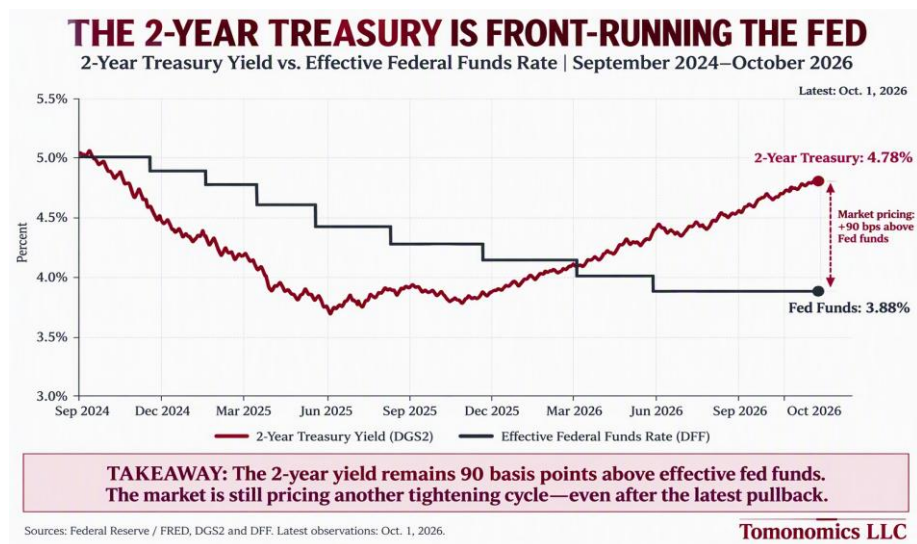


The jobs report killed an October hike. December is still priced at 84%, and futures still expect nearly four moves by next summer. The timing shifted. The 4.75% terminal rate did not. That is roughly 60 basis points above the Fed's median forecast, despite dovish signals from key Federal Open Market Committee (FOMC) members.

While yields may rise in the short term, I still believe that longer-term high-quality bonds still look mispriced and have an attractive risk return profile. Consider the 30-year zero-coupon Treasury bond now yields about 5.5% and trades for about 20 cents on the dollar, meaning that an investor will see a fivefold increase in value over 30 years with no risk.

Returns are also asymmetric in the investor's favor. A 30-year Treasury bond (coupon) should increase about 17% in price if rates fall one percentage point and drop 13% in price if rates rise one point and that drop will be partly offset by interest income.

That said, if you want safety and income at a reasonable price look at the two-year Treasury near 4.8%. The market has already priced in a full tightening cycle, leaving the note above the 4.8% fed funds rate expected by September 2027. Even if its yield rises another 100 basis points, the coupon cushion should still deliver roughly a 4% total return over the next 12 months, compared with an estimated -2% for the 10-year and -8% for the long bond. For investors focused on preserving capital and cash flow, that risk-return profile is hard to ignore.



Bottom line: Higher rates, expensive energy and tighter credit are squeezing the economy from every direction. The Fed may keep tightening until something breaks, but the bond selloff has finally created real value. Stay patient, keep liquidity and add duration gradually.

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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 over 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.

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