



Tom Slefinger
Market Strategist

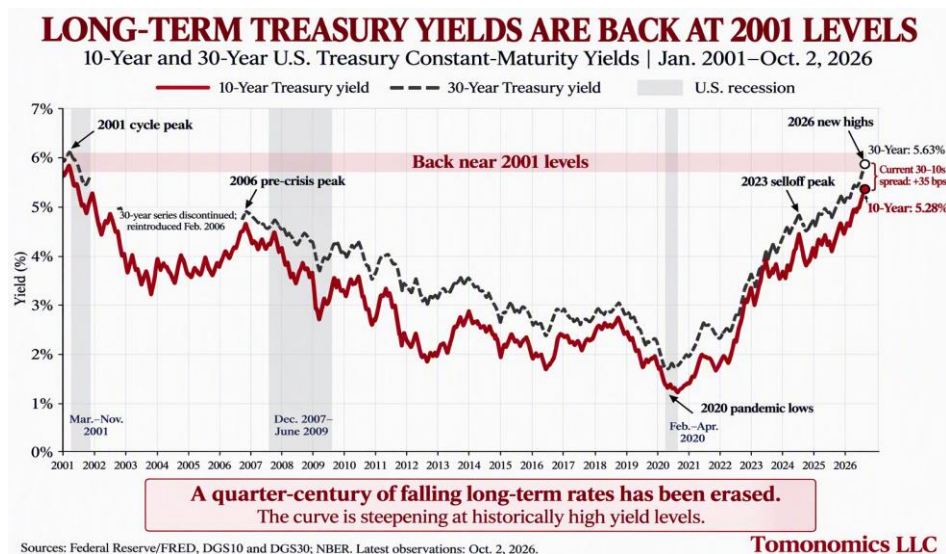
Weekly Relative Value

WEEK OF OCTOBER 13, 2026

Drunken Sailors and Bond Bears

Executive Summary: The economy is weaker than the headlines suggest. AI borrowing and Treasury supply are driving yields higher while 10 tech stocks carry 42% of the market on a trillion-dollar bet that still lacks paying customers. Consumers are spending down savings, missing loan payments, driving older cars and getting crushed by mortgage and credit-card rates. Hiring and wages are slowing, housing is frozen and tariffs have widened — not fixed — the trade deficit. That pressure will eventually break growth or asset prices. Meanwhile, Treasury yields are near 25-year highs, investors are heavily underweight and history shows bond bears usually overstay. Long Treasuries now offer meaningful income and strong upside if rates fall. Stay overweight duration.

The 10-year Treasury yield is up 130 basis points since February and is back to levels seen in 2001, but this latest yield spike is NOT about inflation. Not one basis point. About 75 basis points — nearly 60% of the increase — came from a massive Fed repricing: The market went from expecting two cuts to pricing four hikes, plus the hike already delivered. Another 33 basis points came from a higher term premium as fiscal and inflation uncertainty push long-term rates higher.



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THIS WEEK

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- MARKET OUTLOOK AND PORTFOLIO STRATEGY

SUBORDINATED DEBT: (SIMPLIFIED)

Partnership has its perks.
Hand over the hard parts.

TELL ME MORE!

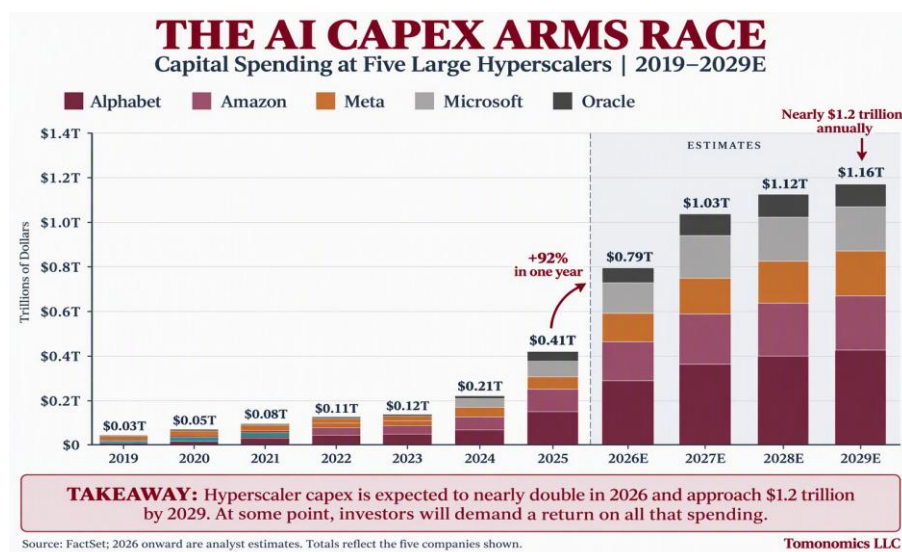


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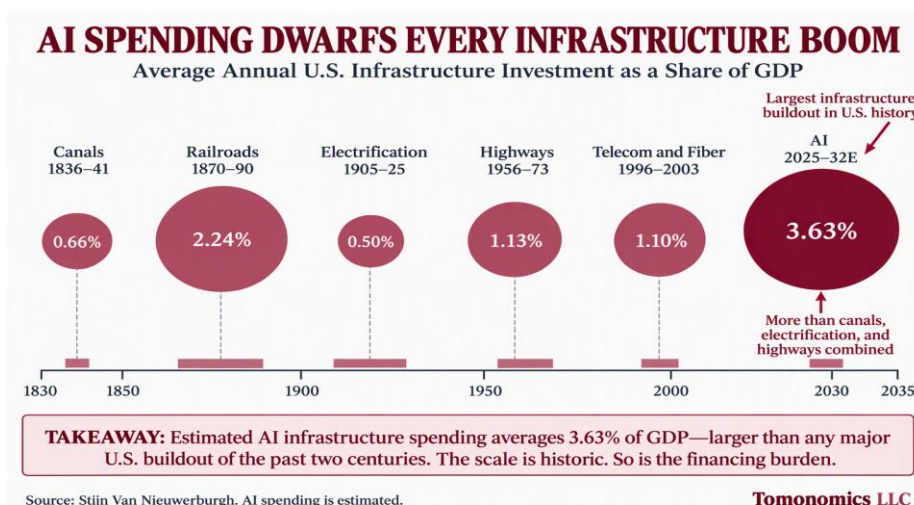
The latest yield spike has another culprit: mega-cap tech's historic debt binge to fund AI. Higher rates do not matter when investors still believe the growth story, or should I say fairy tale?

Goldman expects Alphabet, Amazon, Meta, Microsoft and Oracle to nearly double capital expenditures (capex) from \$412 billion in 2025 to \$789 billion in 2026. The latest estimates from Morgan Stanley put the external financing requirements of the AI infrastructure buildout by 2029 at \$1.2 trillion, which is a clear-cut sign that the mega caps are showing no signs of slowing down their tapping of the markets' pockets in a binge to finance their AI race.

The hidden exposure may be even bigger. Morgan Stanley estimates more than \$3.1 trillion in off-balance-sheet commitments and credit support across seven hyperscalers and chipmakers.

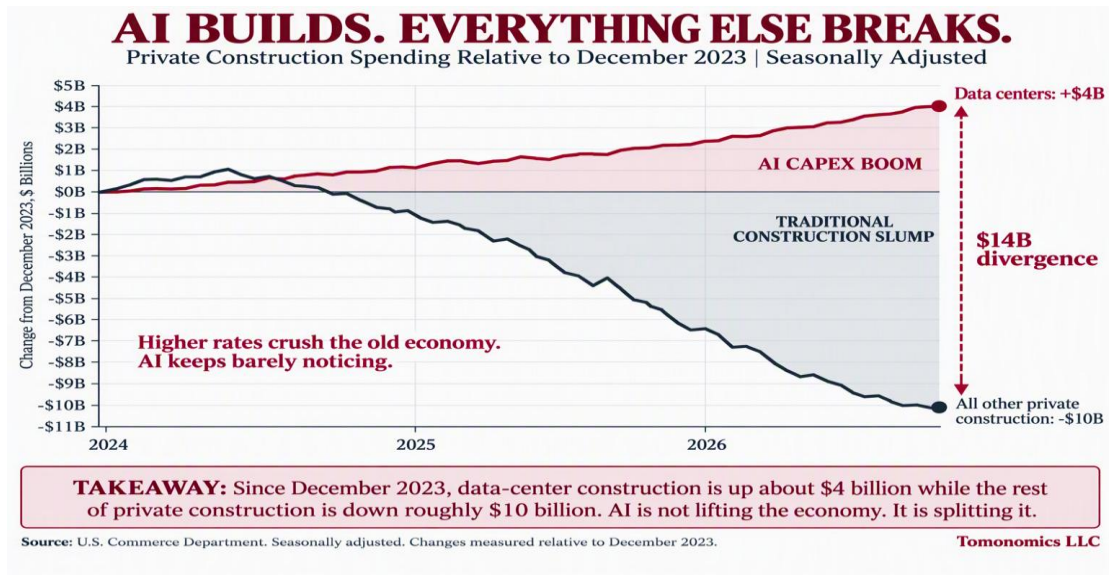


Have a look at the image below. AI infrastructure spending is projected to average 3.6% of U.S. gross domestic product (GDP). That is bigger than the canal boom, the railroad buildout and electrification — combined. This is not another investment cycle. It is the largest capital-spending experiment in American history.



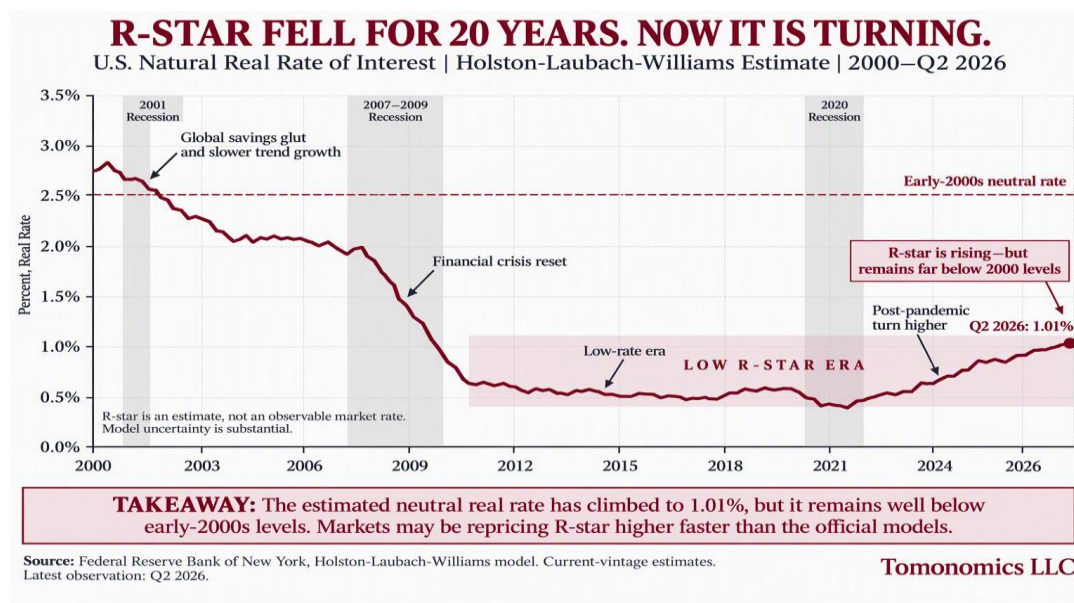
AI VERSUS THE OLD ECONOMY

At the same time, higher rates are crushing traditional construction. AI does not care. Since December 2023, data-center spending is up \$4 billion. Everything else is down \$10 billion. AI is not lifting the economy. It is splitting it.



Meanwhile, Washington keeps flooding the market with debt. Federal debt is above 120% of GDP, so Treasury supply keeps coming. U.S. Treasury Secretary Bessent is also losing credibility, which is not helping.

The market is resetting R-star (long term neutral rate) higher because public and private demand for capital is overwhelming supply. Translation: The price of money is moving into a higher range — until something breaks.



Bottom line: Inflation is not driving this yield spike. The real pressure is a historic collision between AI borrowing and relentless Treasury supply. Too much capital is chasing too little money, pushing the neutral rate — and the cost of borrowing — higher until demand breaks.

THE MAGNIFICENT SEVEN ARE THE MARKET

“There’s a new story in stock markets: If you aren’t touched by AI, good luck. AI is sucking in capital and squeezing the rest of the market, where stocks face higher interest rates and oil prices without a sexy technology story to sell.”
— James Mackintosh, *“AI Is Squeezing Out the Rest of the Stock Market,”* The Wall Street Journal

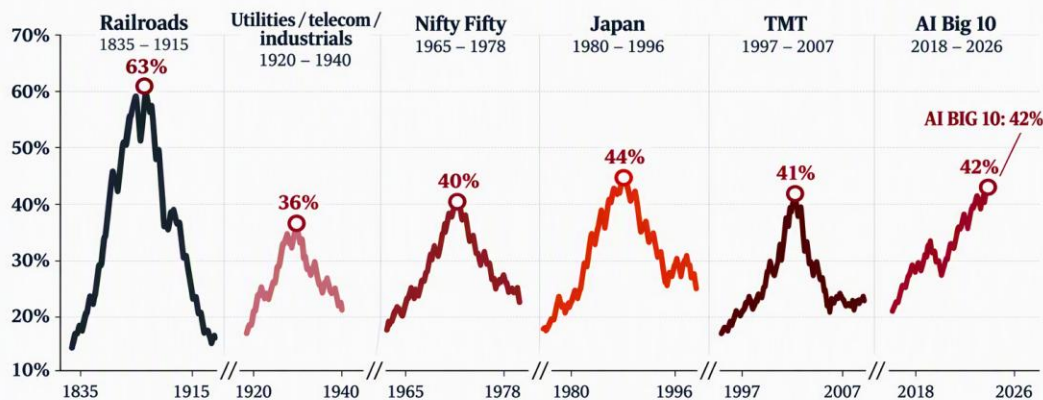
Since August 13, nearly three-quarters of industry groups have fallen. The equal-weight S&P 500 is down 5%, while banks and real estate are already in correction territory, off more than 10%. In Q3, Microsoft, Nvidia, Apple and Meta added roughly 300 points to the index — three times the S&P 500’s actual gain. The other 496 stocks subtracted 150 points.

The AI Big 10 — Magnificent Seven plus Broadcom, AMD and Micron — now own a record 42% of the U.S. stock market. Their share has more than doubled since the 2022 bear-market low. That already tops the Nifty Fifty’s 40% peak and the dot-com bubble’s 41%. Japan reached 44% in the 1980s. Only railroads were more extreme, peaking at 63% of U.S. market cap.

Translation: Every \$100 invested in U.S. stocks puts roughly \$42 into ten companies riding the same AI bet. If you own a 401(k), you are probably making that wager whether you meant to or not.

TODAY’S AI CONCENTRATION ALREADY LOOKS LIKE A BUBBLE

Peak concentration levels in major market bubbles | Share of relevant market capitalization



TAKEAWAY: Today’s AI leaders already control 42% of the market—above the peak concentration of the Nifty Fifty and the dot-com bubble. Only the railroad mania was more extreme.

Source: BofA Global Investment Strategy; GFD Finacon; Bloomberg.
AI Big 10 = Magnificent Seven + Broadcom, AMD, and Micron.

Tomonomics LLC

Let me be blunt: This is one of the biggest bubbles in financial history. Bubbles can last, but they all pop. Valuations, sentiment, concentration and positioning are off the charts. This time is not different. It is simply bigger. When it breaks, the debt remains.

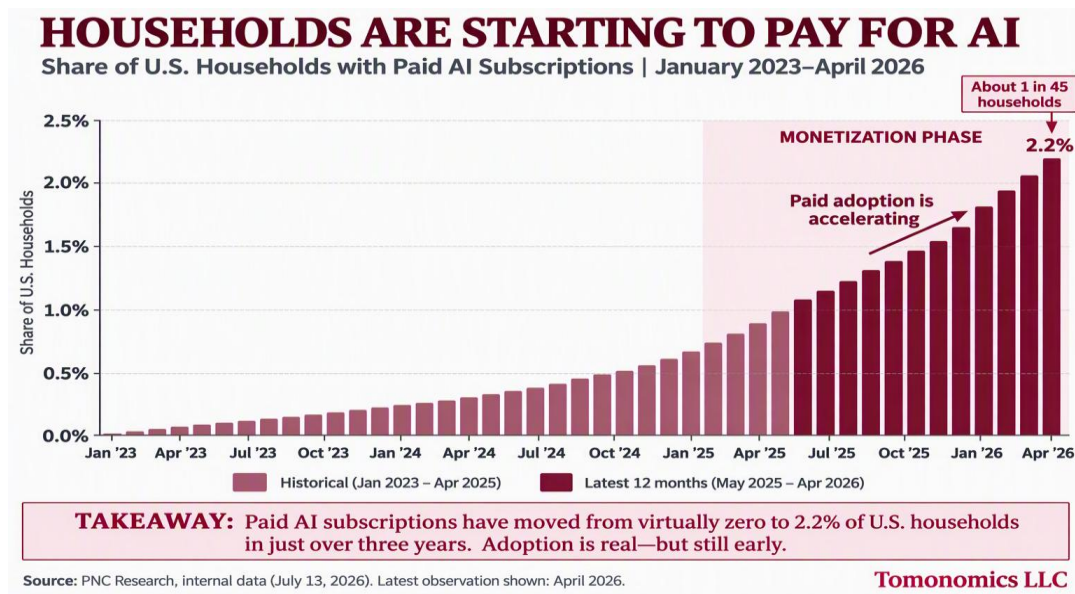
Yes, AI will change the economy. Railroads and the internet changed America too. Investors still lost their shirts because the companies borrowed ahead of demand. AI may end better. I would just prefer ten companies not carry nearly half the market.

Bottom line: The index looks strong because seven AI giants are doing the lifting. Breadth is weak, the leadership is crowded, and the rest of the market is already struggling. If mega-cap tech cracks, the headline index has nowhere to hide.

AI'S ONE TRILLION-DOLLAR LEAP OF FAITH

Trump and Big AI have fused their futures around an enormous bet that trillions poured into chips, data centers and power will create a productivity engine powerful enough to fuel a new industrial revolution. The promise sold by Trump and his tech allies is a new era of growth and abundance. The risk is a historic misallocation of capital on a scale few industries have ever seen.

The five largest players plan to spend \$725 billion on infrastructure this year. OpenAI lost \$21 billion on \$13 billion of revenue. After all that spending, PNC Bank's credit-card data shows just 2% of U.S. households pay for AI — roughly three million out of 131 million.



Most pay \$20 a month and cancel within seven months. The seven-month cancellation rate is the real warning. People try AI, use it and quit. Netflix replaced cable and saved consumers money. AI has not found that killer use yet. It is useful — but most people still cannot say what it replaces.

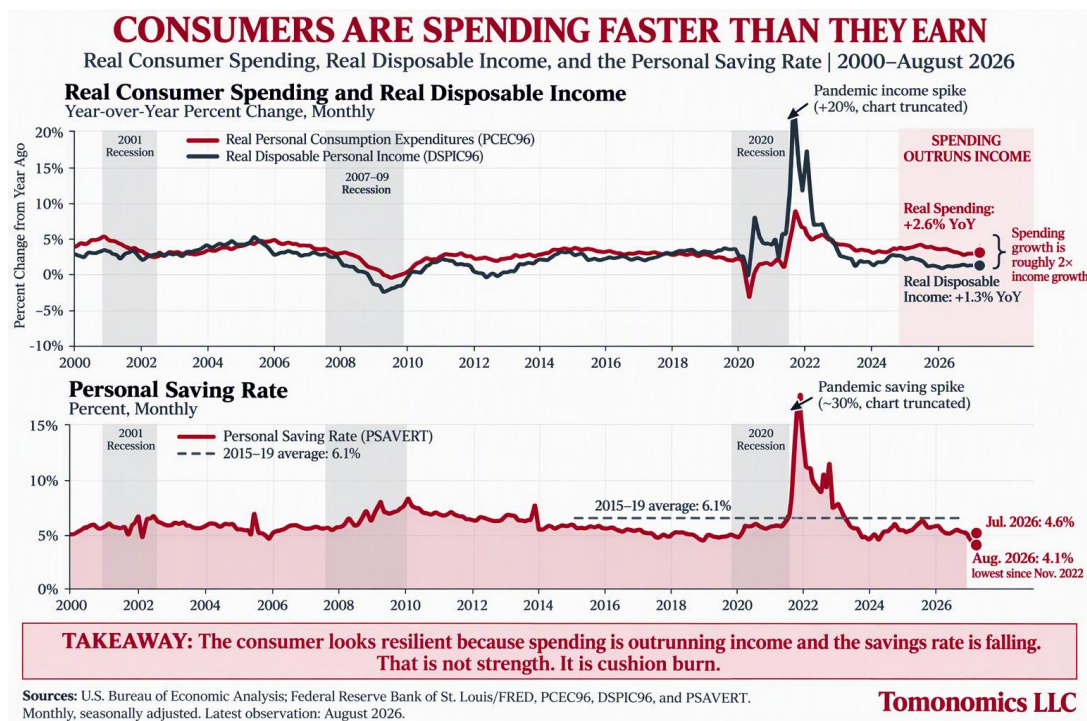
Investors will soon demand a return on these massive investments. The math is still brutal: The sector needs roughly \$300 billion in annual AI revenue just to justify the capex already committed.

Bottom line: Silicon Valley is spending nearly a trillion dollars to build a product most households still will not pay \$20 a month to use. Free AI is popular; paid AI is not. Until adoption and revenue catch up, this is less a business model than a leap of faith.

THE RESILIENT CONSUMER MYTH

“We don’t expect the consumer to suddenly be in a much better place in the next 12 to 18 months.”
— Ramon Laguarta, Chief Executive Officer, PepsiCo

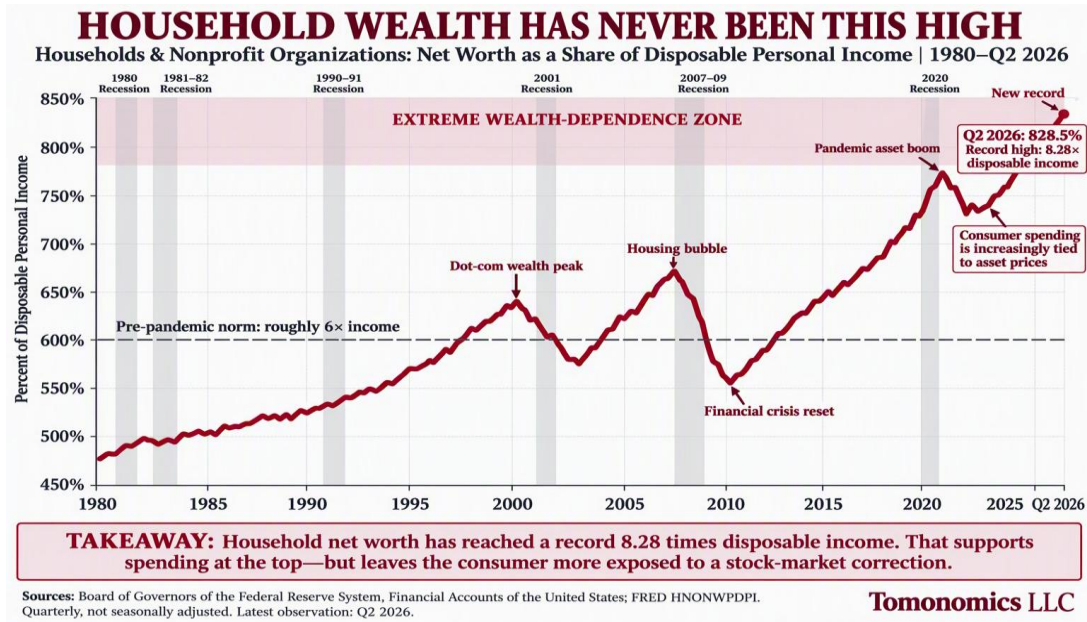
The consensus says the consumer is “solid” and “resilient.” The headlines agree. The details do not. Q2 real spending surged at a 3.8% annual rate while real disposable income slipped. August was more of the same. The savings rate fell from 4.6% in July to 4.1% — the lowest since November 2022. Back then, households still had pandemic cash. Now they do not. Real disposable income is up just 1.3% over the past year, roughly half the pace of real spending. The consumer looks strong because the consumer is spending the cushion.



Income is about to weaken further. September payrolls rose just 29,000, earlier months were revised lower and unemployment climbed to 4.2%. Weekly earnings eked out a 0.1% gain, while September Consumer Price Index (CPI) is expected to jump 0.6%. That would produce the steepest drop in real work income since March and push the year-over-

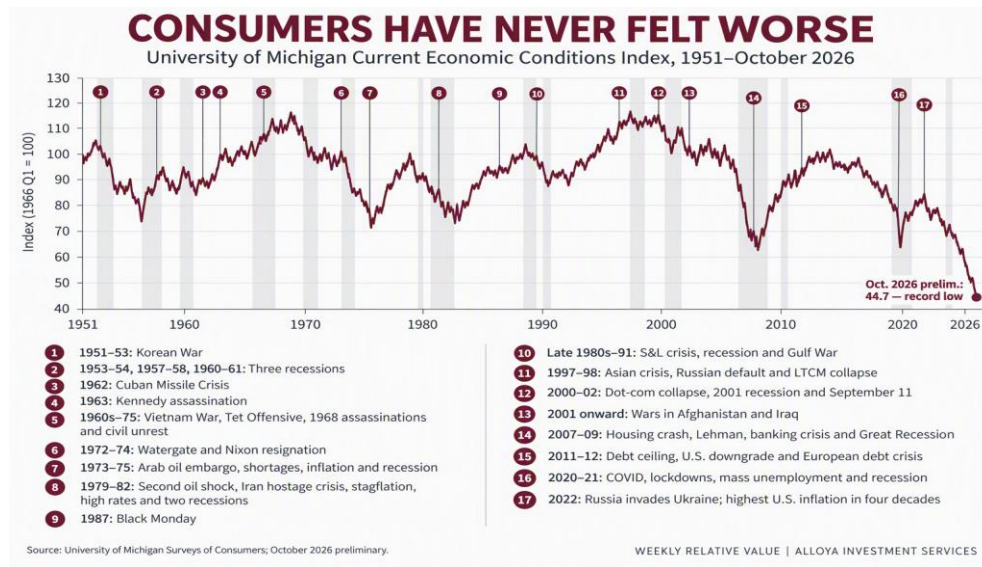
year trend negative. Employment-services payrolls fell 14,300 for a third straight month — a clear warning that hiring is slowing. Weak hiring means weak income, just as spending is outrunning both.

The other prop is the stock market. Net wealth relative to income is at a record, and JPMorgan Chase says investment-account withdrawals now fund nearly 7% of spending — nearly double the 2019 share.

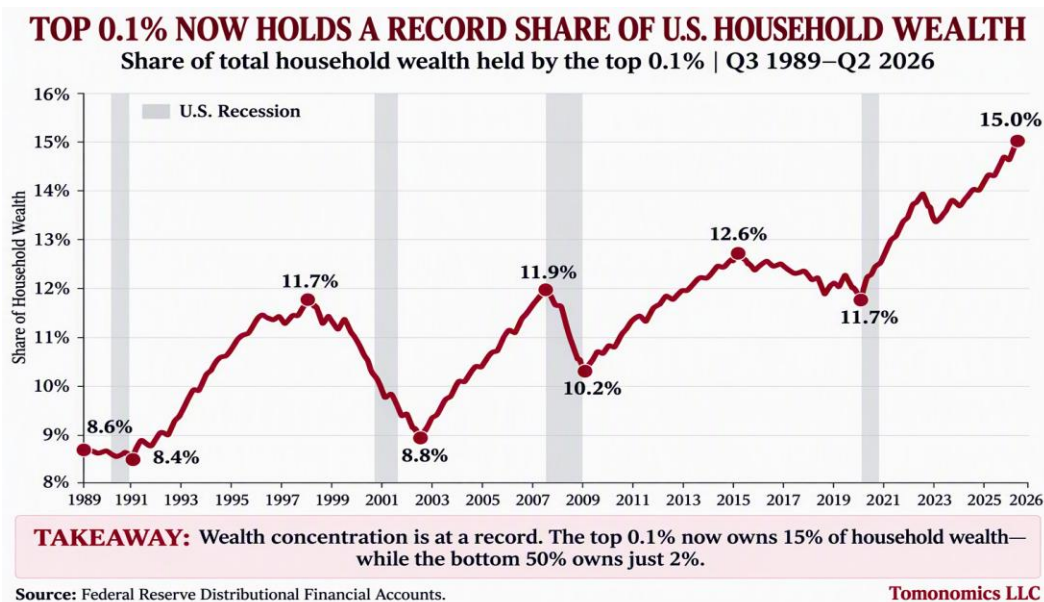


That money is concentrated among older, wealthier households. The top 0.1% of U.S. households now own 15% of all household wealth, a record high. Meanwhile, the bottom 50% own just 2%. The wealth gap has never been wider.

Meanwhile, the University of Michigan's Current Economic Conditions Index, which dates back to 1951, hit an all-time low in October's preliminary survey. Trump claims credit for creating the strongest economy in American history. Yet consumers' assessment of their finances and buying conditions is more negative now than during any of the crises listed below.



Why it matters: The consumer looks strong because the richest households own the market — and keep spending the gains. If stocks crack, the wealth effect disappears fast, exposing how weak the rest of the consumer really is.

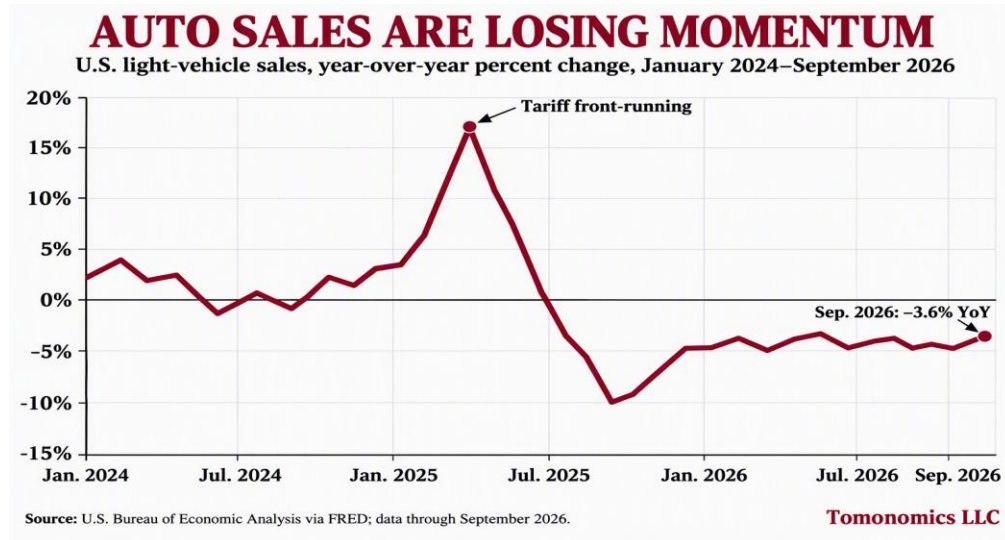


Two things are holding up spending — a falling savings rate and stock-market wealth at the top. One correction can hit both. Most S&P 500 stocks are already down, leaving the index — and the consumer — leaning on AI mega-caps. If the leaders crack, the myth of the resilient consumer goes with them.

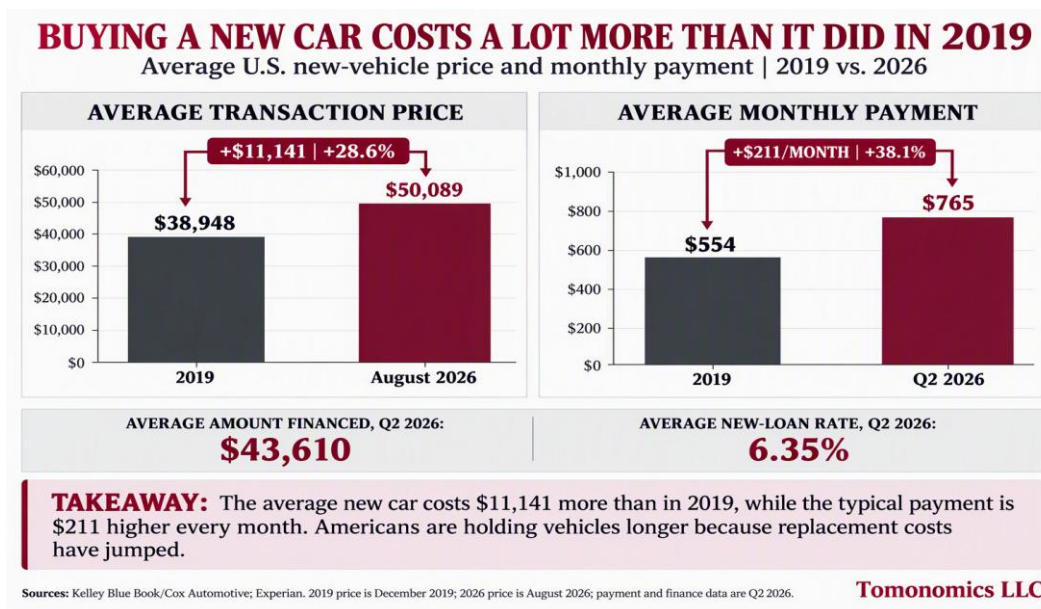
Bottom line: The consumer is not strong, it is spending down savings and cashing in stock-market gains. Income growth is weakening, the savings rate is falling and the high-end consumer is carrying the load. If stocks crack, the “resilient consumer” story cracks with them.

DRIVE IT TILL IT DIES

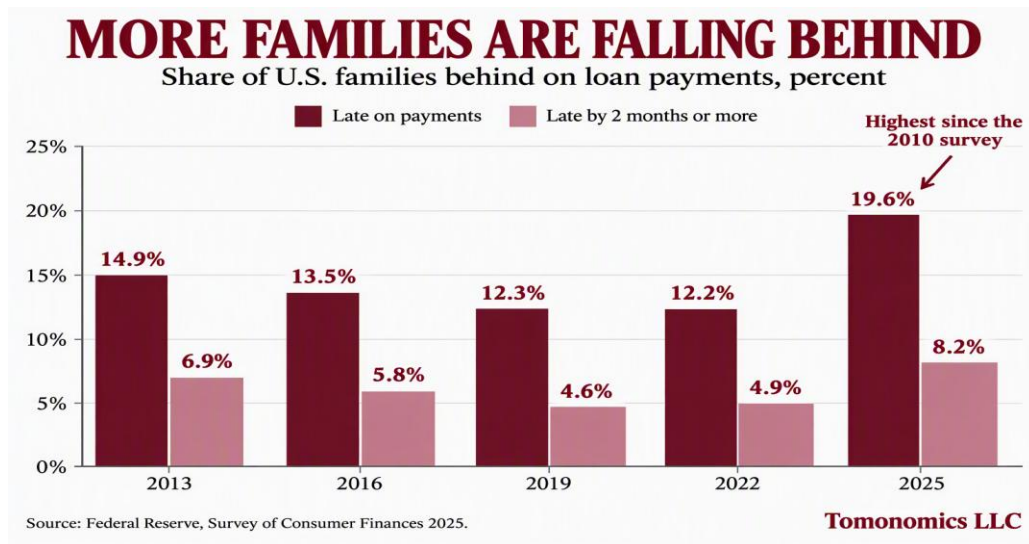
Since people rushed to buy autos ahead of the Trump tariffs, auto sales have slowed down significantly.



At the same time, the average car on the road in America is now nearly 13 years old, an all-time high. That's up more than 50% from 30 years ago (8.4 years). Why? Cars have gotten better. Or replacing them has gotten a lot more expensive?



Nearly 20% of American families missed a loan payment last year, up from 12% in 2022. That is the worst reading since 2010, just after the financial crisis. More than 8% were at least two months behind.



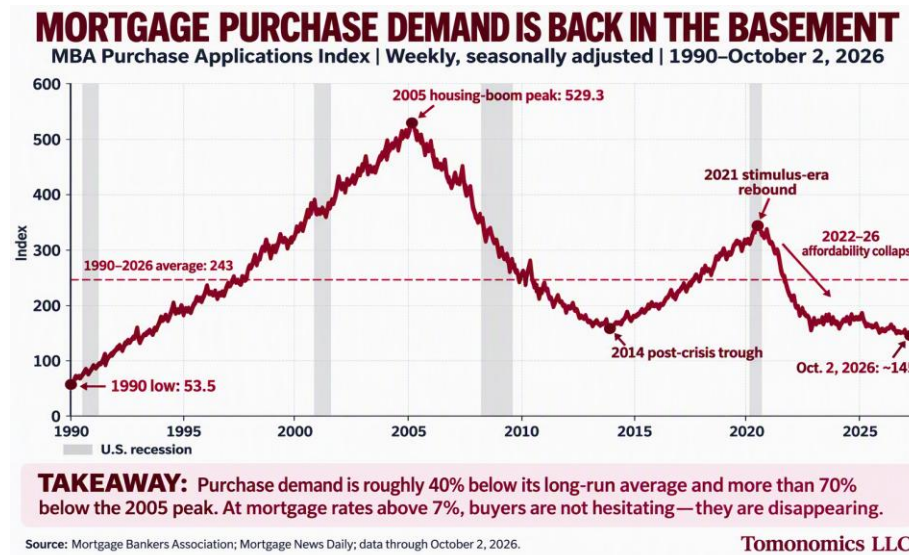
The median mortgage payment now eats one-third of family income — a record — mostly because rates surged. Credit cards charge more than 21%, and buy now, pay later use jumped to 12% from 7%. The survey predates this year's rise in long-term rates. The next one should look worse.

Bottom line: Americans are not buying cars. They are driving old ones, missing payments and leaning on expensive credit. That is not resilience. It is financial exhaustion.

STILL IN THE DOGHOUSE

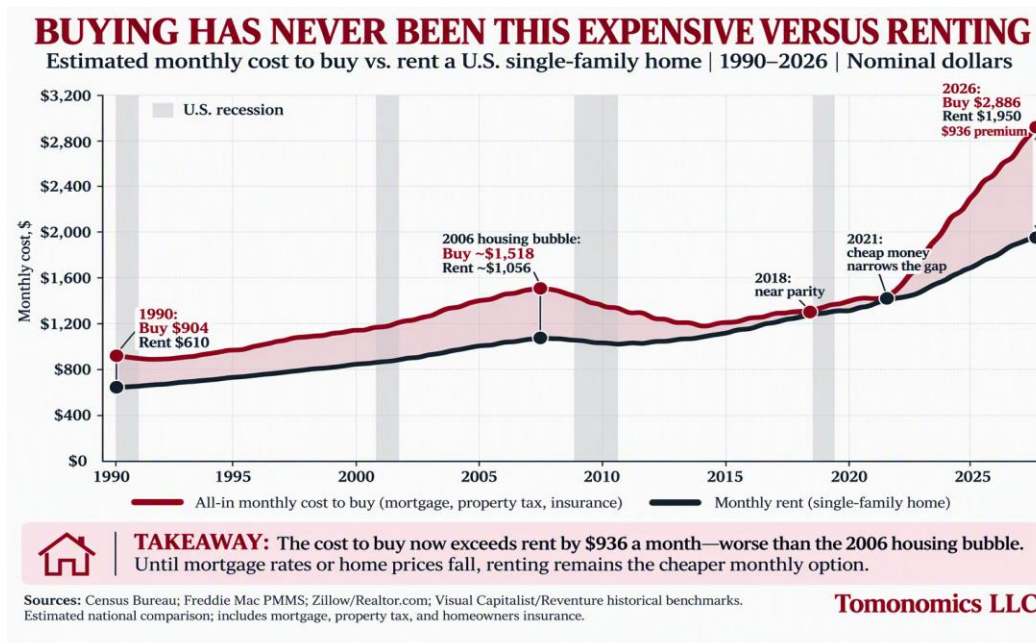
"We will drive down the mortgage rate so you will be able to pay 2% again, and we will be able to finance or refinance your homes drastically at much lower costs." — President Trump on the campaign trail, September 2024

When has the bond selloff gone too far? When it crushes housing. We are there. The 30-year mortgage rate has jumped 65 basis points in the past month to 7.6%. It started the year at 6.25%. That is a major shock. And housing demand is rolling over fast. In the week that ended October 2, purchase applications fell 2.1% — the fifth straight weekly decline — to their lowest level since February 2025. Applications are now down 15% from a year ago, a brutal reversal from the 21% gain in late April. Refinancing has been hit even harder, collapsing 56% year over year. The bond market is not just tightening financial conditions. It is breaking housing.



A \$400,000 loan over 30 years costs roughly \$1,127 MORE per month at 7.56% than at 3%, before taxes and insurance. An extra \$13,524 a year for the same loan. Over 30 years, a buyer would be paying approximately \$400,000 more interest.

Moreover, buying now costs \$2,886 a month, including the mortgage, taxes and insurance. Renting costs \$1,950. That \$936 buyer premium is one of the highest on record — worse than the 2006 housing bubble. As long as owning costs nearly \$1,000 more each month, buyers will stay on the sidelines. Renting is simply cheaper.



Bottom line: Housing is not slow — it is unaffordable. Mortgage rates above 7% have crushed purchase demand, and a \$400,000 loan now costs over \$1,100 more per month than it did at 3%. Until rates or home prices fall, buyers will stay in the doghouse.

TRADE DEFICIT BIGGEST IN HISTORY

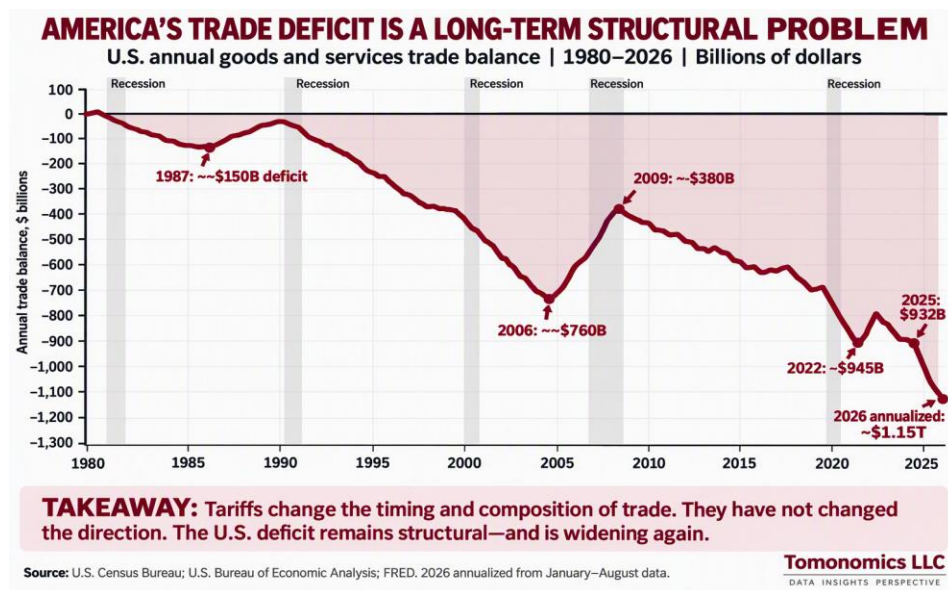
"It's a liberation day for our country because we're going to be getting back a lot of the wealth that we so foolishly gave up to other countries, including friend and foe." — President Trump, March 16, 2025, when explaining reciprocal tariffs on April 2, 2025, as "Liberation Day"

History shows tariffs raise costs and prices and lead to lasting economic harm, such as lower production and living standards, whether we keep importing goods or switch to domestic alternatives.

Yet, tariffs were pitched as a means to reduce the trade deficit, balance the budget, provide so much money we can eliminate the income tax and issue dividend checks to everyone.

Instead...over the last 20 months, the deficit didn't shrink. It increased 8%. The August trade deficit jumped 14% to \$106 billion, the widest gap since March 2025 when companies rushed to beat the Trump tariffs.

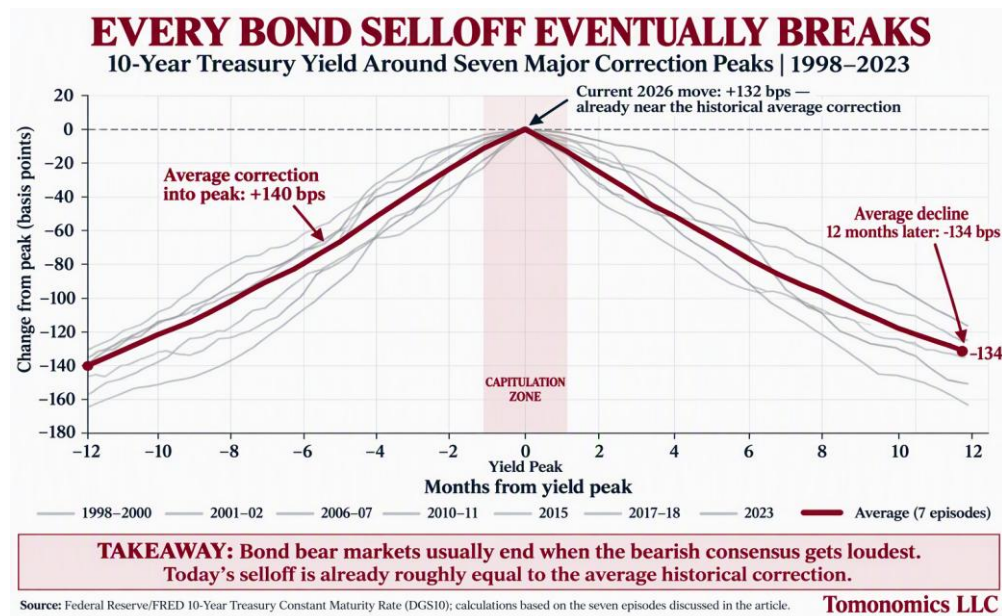
Excluding tariff front-running ahead of the Liberation Day announcement, the trade deficit is the highest in history.



Bottom line: Tariffs did not fix the trade deficit nor balance the budget. Trump did not issue dividend checks. Tariffs increased inflation and stressed small businesses.

BOND BEARS ALWAYS OVERSTAY

When stocks wobble, Wall Street says buy the dip. When bonds sell off, suddenly inflation is permanent and the secular bear market has arrived. Why? Stocks pay better. Bonds are boring. Hedge funds are massively short Treasuries, equity funds hold a record-low 1% cash and households have 73% in stocks versus just 7% in bonds. Everyone has a reason to sell the same story.



Every bond correction brings the same warning: Treasuries are finished and inflation has changed forever. It always sounds convincing. It is usually wrong. Bond selloffs end.

The historical record is clear:

Correction Period	10-Year Yield Move	One Year Later	What the Bears Missed
Apr. 5-Oct. 19, 2023	3.30% → 4.98%	4.08%	Not the 6% consensus predicted.
Sept. 7, 2017-Oct. 5, 2018	2.05% → 3.23%	1.52%	The selloff fully reversed.
Feb. 2-June 10, 2015	1.68% → 2.50%	1.64%	Back below the starting yield.
Oct. 6, 2010-Feb. 8, 2011	2.41% → 3.75%	2.01%	Back below the starting yield.
Dec. 4, 2006-June 12, 2007	4.43% → 5.26%	4.23%	Back below the starting yield.
Nov. 7, 2001-Apr. 1, 2002	4.22% → 5.44%	3.84%	Back below the starting yield.
Oct. 5, 1998-Jan. 20, 2000	4.16% → 6.79%	5.19%	Pundits called for 8%.

Across these seven corrections, the 10-year yield rose an average 140 basis points — about what we have seen this time. From the peak, yields then fell an average 134 basis points. Nobody rings a bell at the top, but bond bear markets usually end when the bearish crowd gets loudest. Get close to the peak, and the 10-year has delivered an average 15% total return over the next 12 months.

Rates are self-correcting. Push them high enough and the economy slows, credit spreads widen, stocks wobble and the Fed backs off. The cycle never changes. The 10-year has jumped from 3.97% on February 27 to 5.29% on September 30, and everyone is still loaded for bear. That looks less like the beginning — and more like capitulation.

Bottom line: Bond selloffs feel permanent near the peak. History says they are not. Today's correction is already near the historical average, positioning is crowded and the income cushion is finally meaningful. Nobody rings a bell at the top, but this is when patient buyers start getting paid.

THE ASYMMETRY OF LONG-TERM TREASURIES

"A 30-year Treasury should increase about 17% in price if rates fall one percentage point and drop 13% in price if rates rise one point based on Bloomberg data, and that drop will be partly offset by interest income. The risk/return on Treasury zeros is even better."

— Andrew Barry, *"Long-Term Treasuries Could Be a Good Contrarian Bet,"* Barron's

There is rate risk with 30-year Treasuries, and especially with long-term zeros, but both have a nice feature: Returns are asymmetric in the investor's favor.

Below I show a simple scenario chart comparing estimated 12-month outcomes for a current coupon 30-year Treasury and zero-coupon Treasury.

30-Year Coupon Treasury: Approximate 12- Month Outcomes			
Yield Change	Estimated Price Move	Approx. Coupon Income	Approx. 12-Month Total Return
−100 basis points	+17.0%	+5.5%	+22.5%
No change	0.0%	+5.5%	+5.5%
+100 basis points	−13.0%	+5.5%	−7.5%

Assumption: approximately 5.5% annual coupon income, with price returns based on the surrounding Bloomberg estimates. Figures are approximate and exclude reinvestment effects.

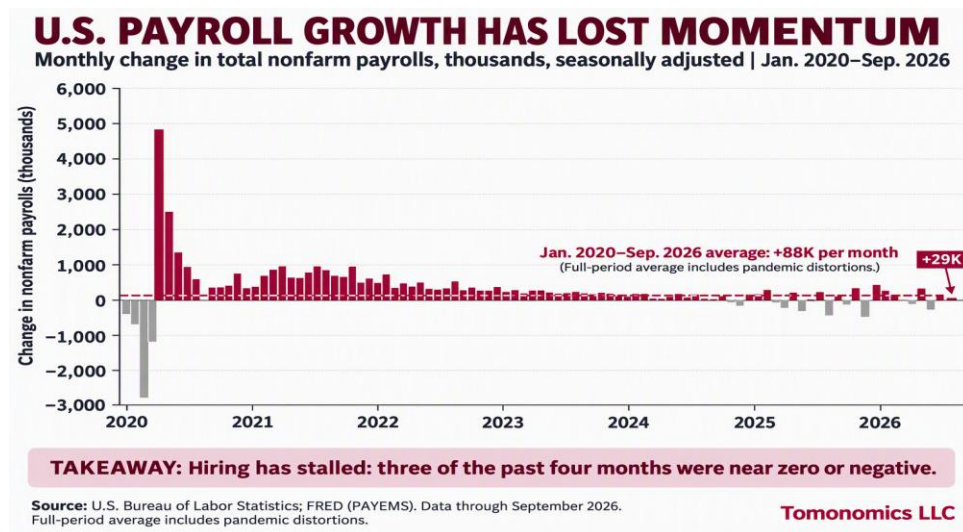
30-Year Zero-Coupon Treasury: Approximate 12-Month Outcomes			
Yield Change	Approx. Price After 12 Months	Coupon Income	Approx. 12-Month Total Return
−100 basis points	\$27.88	None	+39.0%
No change	\$21.15	None	+5.5%
+100 basis points	\$16.10	None	−19.7%

Assumption: a 30-year zero-coupon Treasury priced at approximately \$20.05 per \$100 of face value and yielding 5.5%. After 12 months, the bond has 29 years remaining. Returns reflect price accretion only because zero-coupon bonds pay no current income. Figures are approximate and exclude taxes and transaction costs.

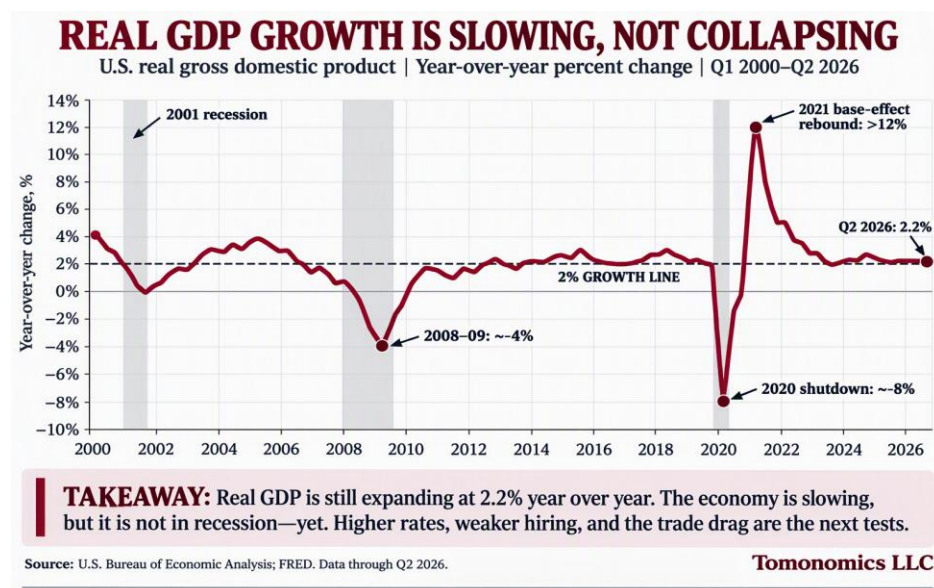
Bottom line: Long Treasuries finally offer real asymmetry. A 100-basis-point yield decline could produce roughly a 22.5% total return, including coupon income, while a 100-basis-point increase would cost about 7.5%. Duration still carries risk, but at today's yields, investors are finally getting paid to take it.

MARKET OUTLOOK AND PORTFOLIO STRATEGY

September payrolls were a horror show. Bad across the board. Three of the past four payroll reports have now been garbage. The market still does not care.



Meanwhile, despite the narrative from the Oval Office, growth is NOT booming. In fact, over the past 12 months, real GDP has been approximately 2%.



On the inflation front, had it not been for the major shocks below, core inflation would likely be well below 2% today.

- **Pandemic shutdowns and supply bottlenecks** — Factory closures, shipping disruptions and labor shortages constrained supply.
- **Massive fiscal and monetary stimulus** — Government checks, deficit spending and near-zero rates fueled demand while supply remained limited.
- **Russia's invasion of Ukraine** — Energy, food, fertilizer and commodity prices surged.
- **Trump tariffs** — Import taxes raised costs for businesses and consumers and disrupted trade flows.
- **The Iran war and oil shock** — Higher energy prices increased transportation, production and household costs.

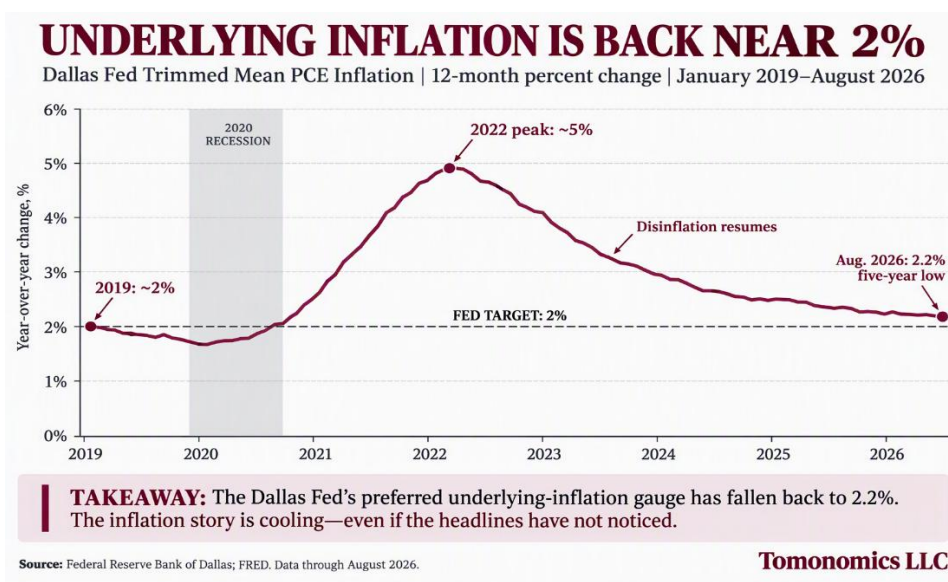
This is what Fed Chair Kevin Warsh said about inflation metrics at his April confirmation hearing.

*"The measures I prefer are looking at things that **are called trimmed averages... We take out all of the tail risks, all of the one-off items, and we ask ourselves whether the generalized change in prices is having second-order effects on the economy.**"*

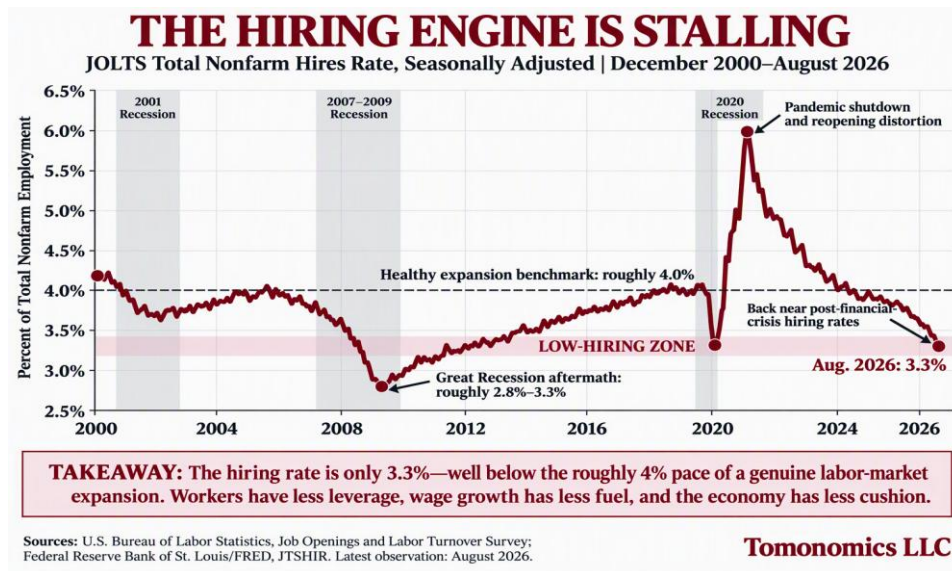
Warsh's point was that he wants to measure the **underlying inflation trend**, rather than temporary price shocks caused by geopolitics, energy, food or individual categories such as beef. He said the trimmed measures showed inflation was **"quite favorable"** and **"somewhat improving."**

Now, have a look at what Kevin Warsh's favorite metric — the Dallas Fed's Trimmed Personal Consumption Expenditures (PCE) Index — has done.

Question: Does this look INFLATIONARY to you?



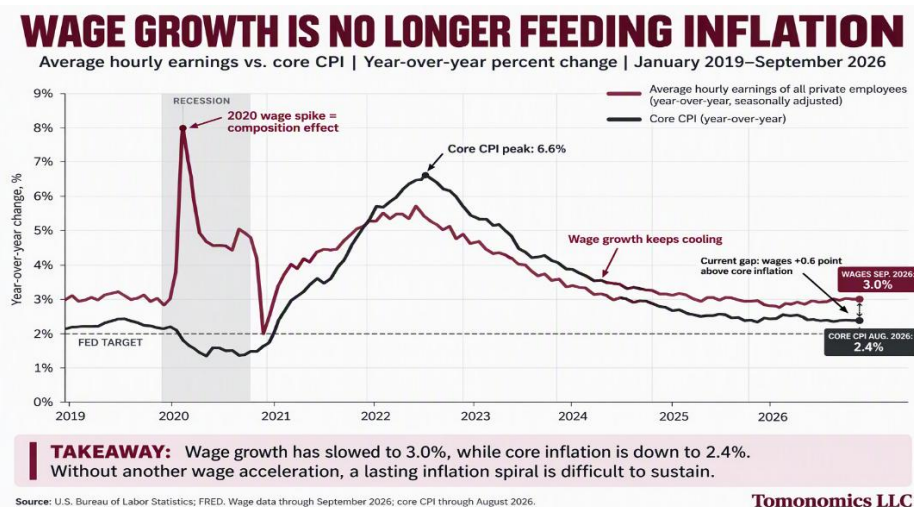
The hiring rate was just 3.3% in August, closer to 2009-10 than a boom. Add AI competition, and workers have little leverage to demand bigger raises.



Unless wage growth picks up, there is no sustainable path towards higher structural inflation. Wage growth matters because **labor is the largest cost for many businesses — especially service companies.**

Wages also support consumer spending. Bigger paychecks allow households to keep paying higher prices, making inflation more persistent. Workers may then demand another raise to recover lost purchasing power, creating the risk of a **wage-price spiral.**

Simply put, supply shocks can temporarily lift inflation, but sustained inflation usually needs strong wage growth to keep demand — and service-sector prices — rising. That is NOT happening.



Finally, with sentiment so bearish and investors grossly underweight bonds, it's time to expect the unexpected. Treasury Secretary Scott Bessent hired David Zervos and Judy Shelton. Those are not status-quo hires.

Zervos is a veteran bond strategist, former Jefferies chief market strategist and two-time Fed veteran. He joined Treasury in September 2026 as Bessent's counselor. His bias is clear: Expand long-bond buybacks and drive rates lower. Shelton is the monetary system disruptor. She favors sound money, gold-linked bonds and tighter limits on the Fed.

The message is obvious: Get long-term rates down.

The hires say Treasury is serious. Buybacks, less long-bond issuance, mortgage support or something more aggressive may be coming. You do not hire Zervos and Shelton to protect the status quo.

Even if rates stay higher for longer, the Fed may not deliver everything the market has priced in. If the economy cracks or the AI bubble bursts, the 10-year could fall to 4.5%, if not much lower, before it ever reaches the new 6% consensus target.

Yields are near 25-year highs, and investors remain grossly underweight. That gives Treasuries a very favorable risk-reward setup over the next 12 months.

Bottom line: Growth is slowing, hiring is weak, wage pressure is fading and the latest inflation surge reflects shocks — not a new wage-price spiral. Meanwhile, yields are near 25-year highs, investors are underweight and Treasury appears serious about pulling long-term rates lower. Stay overweight duration. The risk-reward in Treasuries is the best it has been in years.

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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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