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INVESTMENT SERVICES

Weekly Relative Value

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Market Strategist

WEEK OF OCTOBER 26, 2026

AI: The Bill Is Coming Due

"The market's waking up to the fact that there is potentially a mismatch between the money they have to commit today and borrow today and the ability to generate revenues down the road."— David Munves, Head of Credit Strategy, AIR Platforms

Executive Summary

- **AI financing:** Buildout delays and revenue shortfalls threaten borrowers and lenders.
- **Equity portfolios:** Crowded positions leave little cushion for a reversal.
- **Housing:** Weak construction and sales signal slower hiring and a weaker economy.
- **Household debt:** Auto debt strains budgets. Student-loan collections could add pressure in 2027; timing remains uncertain.
- **Inflation:** Slower inflation doesn't mean lower prices. Tightening won't fix energy shortages and risks weaker growth.
- **Treasuries:** Coupons cushion returns; falling yields could create equity like returns.

AI infrastructure spending is on pace for $1 trillion this year — double 2025 and 20% above early projections. Looking further out, some estimates exceed $10 trillion over the seven years through 2032. The four major AI companies (Microsoft, Amazon, Alphabet and Meta) are expected to be about half of that. Anthropic and OpenAI and SpaceX are all making massive investments.

That seven-year estimate averages 3.6% of annual gross domestic product (GDP), roughly three-quarters of the expected yearly increase in economic activity. By that comparison, the spending dwarfs the railroad, electricity, transistor and internet investment booms.

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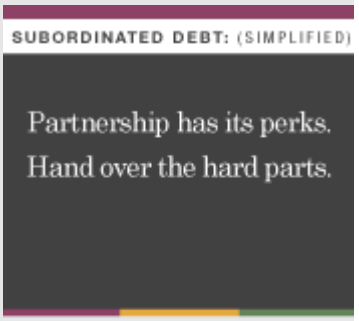
THIS WEEK

- AI: ONE BIG BET. A LOT OF DOMINOS.
- HOUSING IS ON FIRE
- PENDING HOME SALES COLLAPSE TO RECORD LOWS
- PRICED OUT OF A CAR
- STUDENT LOANS: THE NEXT PAYMENT SQUEEZE
- WHAT INFLATION IS…AND ISN'T
- MARKET OUTLOOK AND PORTFOLIO STRATEGY



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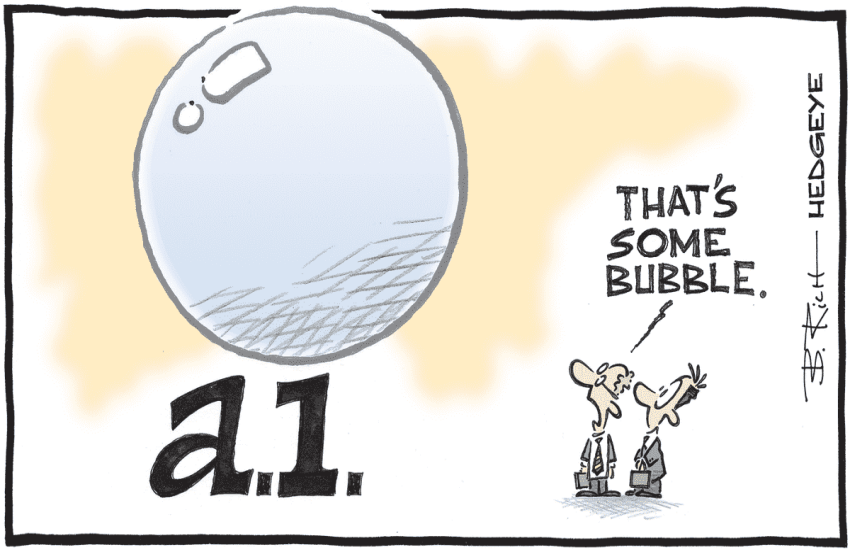
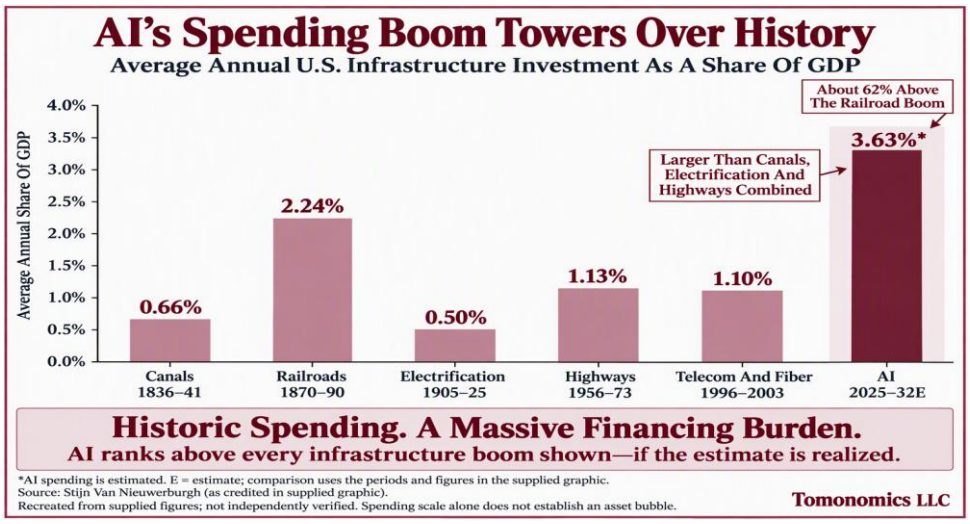
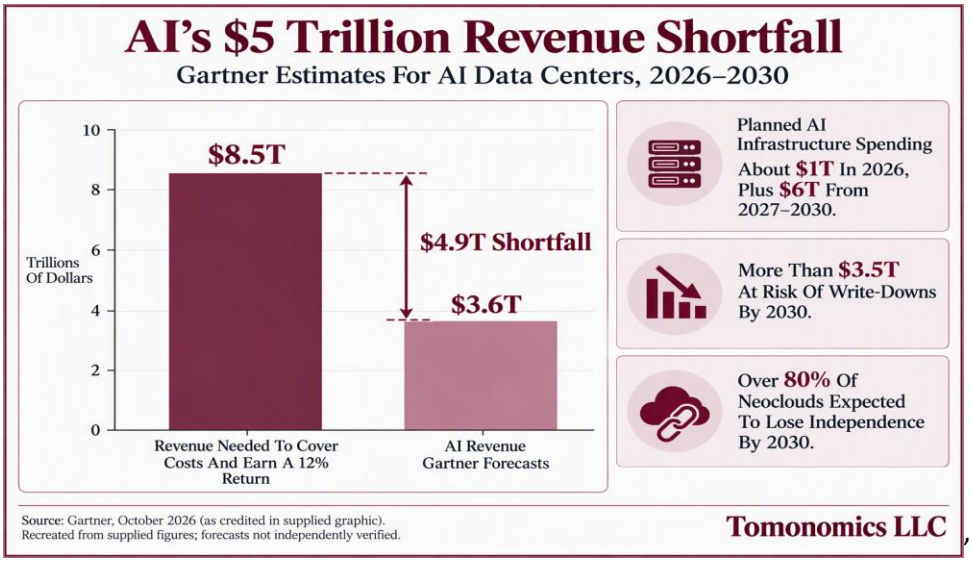


Bernstein estimates only about 35% of planned data-center expansion is viable. Unlike the internet buildout, there's also the issue of not enough power for all these planned data centers, and that may be what triggers the hyperscalers to slow the build out.



Technology research firm Gartner says $8.5 trillion is needed to cover costs and earn the expected 12% return. Its revenue forecast is just $3.6 trillion — less than half what's needed. Gartner puts more than $3.5 trillion of spending at risk of write-downs.



First off, there are several types of AI companies. Some use computer power, some build it and rent it out, some are hyperscalers and cloud providers, some are enormous and some are startups. Their needs and long-term viability are completely different.

The trillion-dollar hyperscalers like Microsoft, Amazon, Meta or Google are not going to have problems raising money. Their debt is investment grade, and they generate collectively $380 billion in free cash flow per year. They are taking that and investing it into AI capital expenditures (capex) and borrowing additional money as well. This may impair their future profits for a period, but these are massive companies, and they can take a "short-term" hit.

Then there are the "neoclouds." Fancy name. Simple business: Rent out AI computing power. Unlike traditional cloud providers, they're built specifically for AI, packing powerful chips, fast storage and high-speed connections into data centers for businesses, AI developers and tech giants.

But here's the catch: Gartner says less than half of AI revenue reaches the hardware owners. The apps collect customer payments and shop around for cheap computing. The infrastructure owners get a thin slice of revenue — and keep the debt.

GPU rentals must cover operating costs and borrowing. Falling rates or idle machines shrink revenue — not debt payments. Missed AI revenue targets threaten the infrastructure's interest coverage.

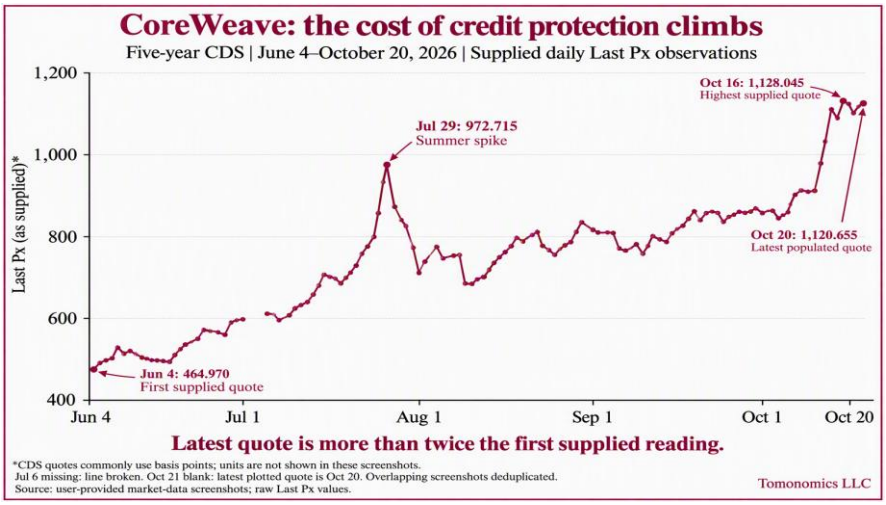
Gartner expects more than 80% of neoclouds to lose their independence by 2030. Big borrowing. Small revenue slice. Not exactly a comfortable setup.

A slow unwind could mean cheap acquisitions. A funding freeze could mean bankruptcies and losses for bondholders and private credit.

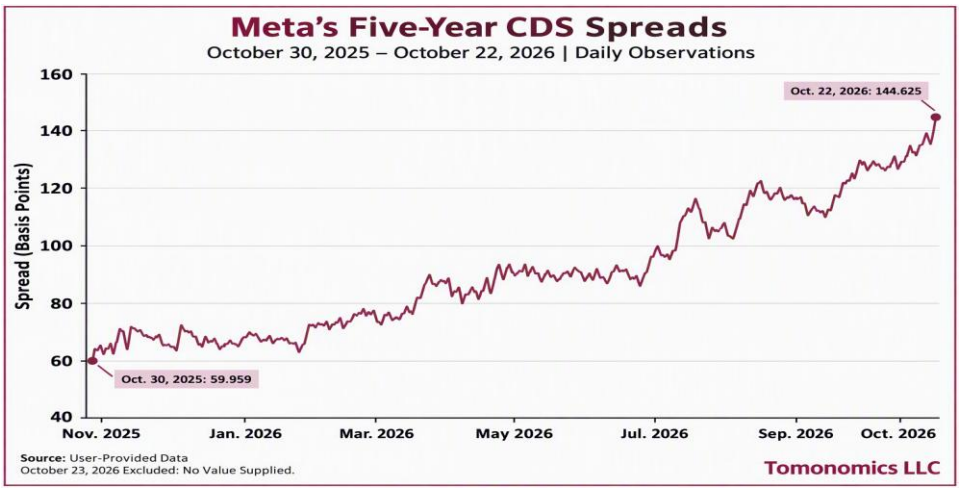
Meanwhile, credit warnings are mounting. Highly leverage CoreWeave's default swaps hit distress levels last week; some debt yields approach 15%. Some investment-grade data-center bonds are trading like junk.

Right now, **five-year contract and 40% recovery, that implies roughly a 60% market-implied probability of default over five years.** Basically, if you want to lend money to CoreWeave and hedge it, you must spend $6 million to hedge your $10 million loan over five years. That, of course, makes the interest rate that CoreWeave pays go through the roof. They are now basically junk bonds.

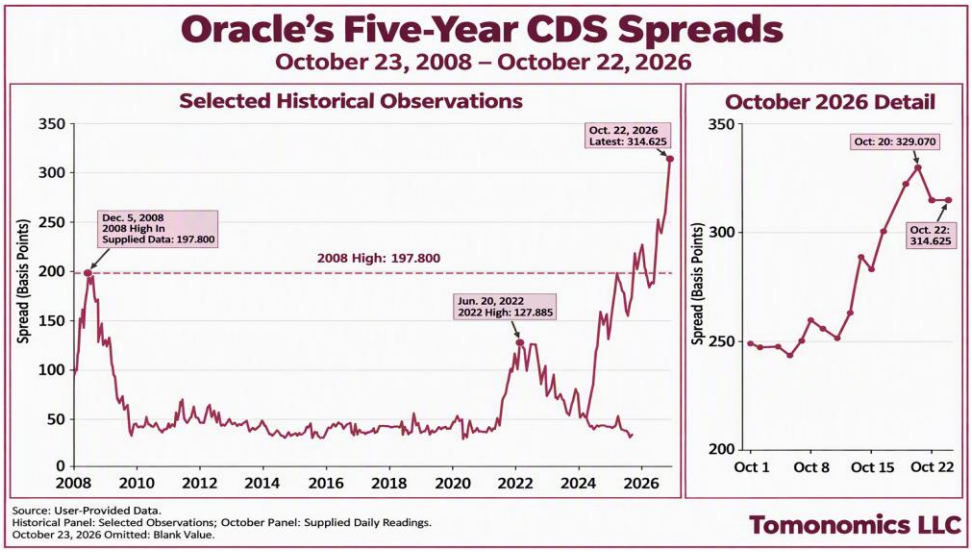
CoreWeave will need to raise $113 billion just to meet its current commitments. How can they make a profit if they are paying 15% interest rates annually?



It's not Just neoclouds. Weekly trading in credit default swaps — protection against bond defaults — linked to Oracle, SpaceX, Alphabet, Amazon, Meta, Broadcom and Nvidia topped $9 billion in September, up from $2 billion in July. Protection costs for many AI names hit records over the past month.



Oracle's default-insurance costs exceed the 2008 crisis high shown in the supplied history. Its credit default swap (CDS) spread of about 315 basis points trades closer to BB/B credit than its current BBB agency rating, while its near-7% yield is in line with the average BB-rated corporate bond yield.



The risk spreads beyond the builders. Turbine suppliers and banks are tied in, too. AI-related global investment banking fees are projected at $8.5 billion this year, versus $3.5 billion in 2025.

As Jamie Dimon warned a year ago, there's rarely just one cockroach. New Century Financial cracked in early 2007, before Countrywide fell and the debt-heavy housing boom unraveled. One weak borrower can expose a bigger problem.

Bottom line: Buildout constraints and inadequate revenue threaten debt-heavy AI operators. Rental income can fall; debt payments don't. Buyouts, bankruptcies and lender losses could ripple through chipmakers, suppliers, banks and private credit.

AI: ONE BIG BET. A LOT OF DOMINOS.

"What we learn from history is that people don't learn from history." — Warren Buffett

Data centers, computers, software, networking equipment and R&D accounted for 100% of business-investment growth over the past year. Five companies will spend $750 billion on capex this year.

Tech manias rarely end in soft landings — for markets or the economy. Investors overpay for the promise. Companies overbuild for demand that may never arrive.

The Internet buildout offers a warning: $1 trillion spent from 1996 to 2001; 25%-30% of capital raised impaired by 2002; telecom high-yield defaults ultimately at 30%. Overbuilding left write-downs and defaults. AI faces the same risk of falling prices.

After the Panic of 1873 and the depression that followed, **89 out of 364 railroads failed— roughly one in four**. The tracks still had value.

Look at the early auto industry. From just before 1900 through 1920, roughly 3,000 to 3,300 manufacturers launched. By 1920, just 98 remained. By 1930, only 44. Some merged. Plenty simply went under.

The internet changed everything. Useful technology and a lousy investment can coexist.

AI faces the same shakeout. Hundreds of startups are chasing different parts of the market, often competing for the same customers. Not all will survive.

I remain positive on the AI outlook. I just don't know which companies would be the real winners. There are going to be powerful winners. Some will rise faster than others, but I think some AI companies will be like Amazon. And others, like pets.com, will disappear. The technology can win without every company surviving.

> *"The bad news is that, from the canal mania of 1790s England, the British railway bubble of the 1840s, its American equivalent in the 1880s, electrification, radio, television and up to the fiber build-out of the dot-com bubble, investors were sorely disappointed. It took too long for the benefits to be realized, profits were smaller and came later than hoped or competition meant excess profits flowed to the users of the new technology, not its owners. AI is vulnerable to each of these. Investors really need this time to be different."*
> *— James Mackintosh, "The AI Stock Market Wobble Is a Reminder: This Time Isn't Different"*

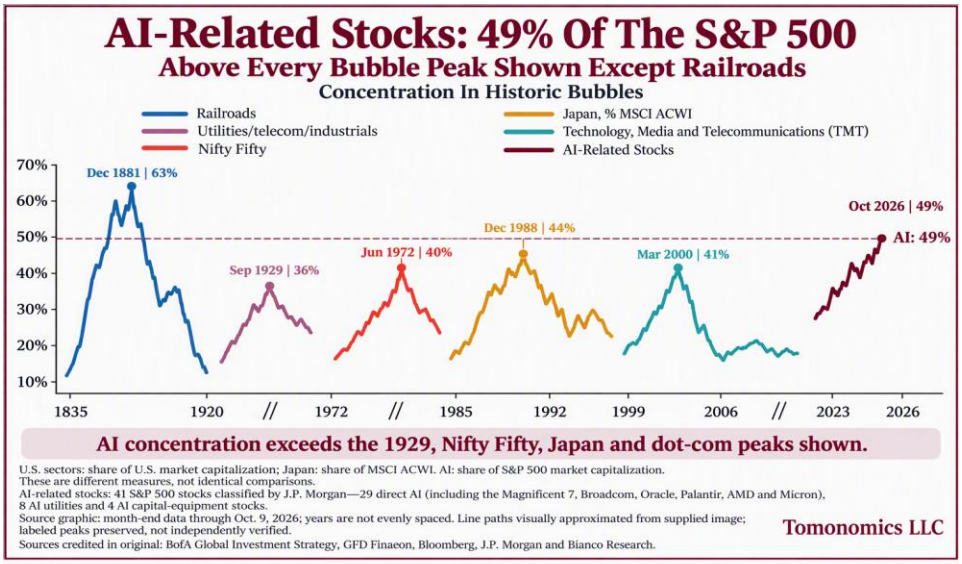
Does anyone believe profit will support the money being spent?

How likely is that?

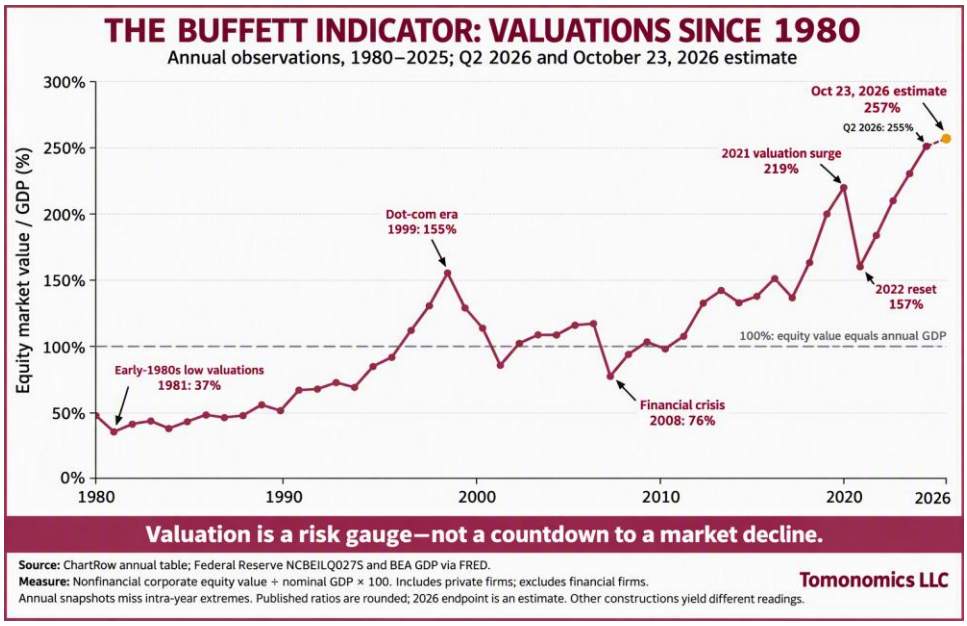
There is always overinvestment at the top, and it looks like AI is peaking as I write. But we'll see.

At the same time, AI is global portfolio managers' most concentrated long position, with tech positioning the most bullish in six years — even as 45% acknowledge a bubble. Go figure.

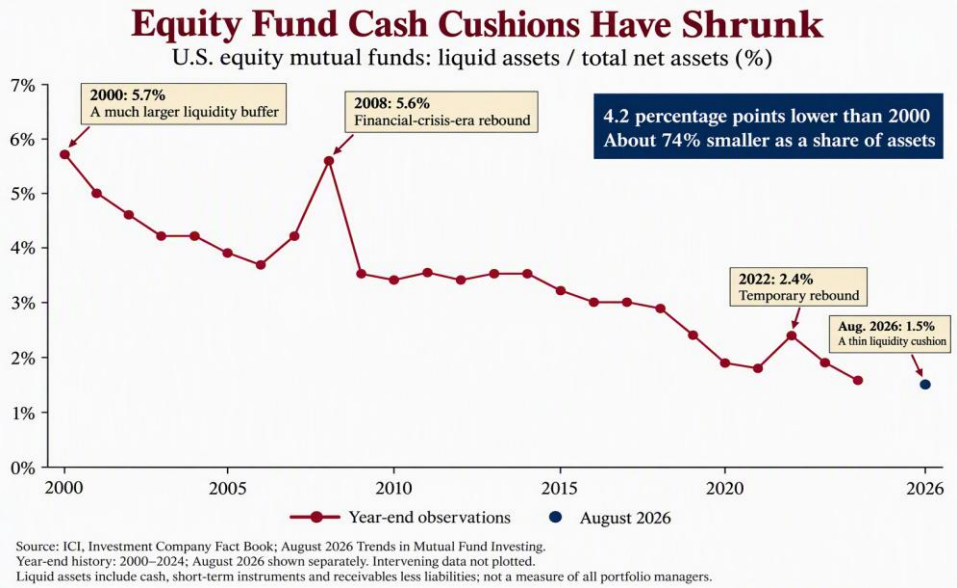
Retail investors face a double dose of concentration: Passive investing dominates well over half the S&P 500's market cap, and more than half the market is exposed to AI. An index fund doesn't remove that risk.



And valuations are at extreme record levels.

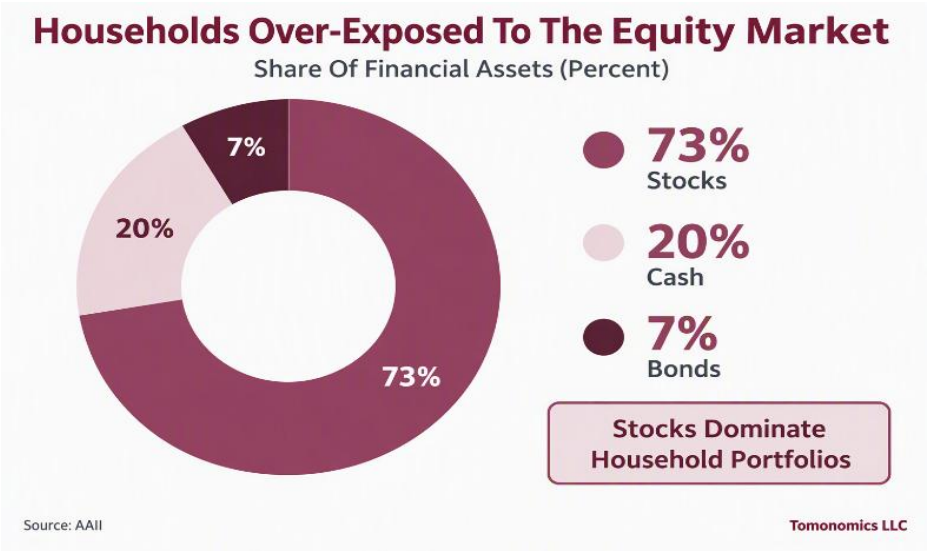


Professional investors' cash ratios are just 1%. Little cushion if the crowded trade reverses.



Retail bullishness persists despite mixed AI news and bubble warnings from Jeremy Grantham, Ray Dalio, Paul Tudor Jones and Jamie Dimon. I share those concerns.

According to the American Association of Individual Investors (AAII) figures, stock allocations have climbed to 72% — back to levels seen just before the tech bubble burst in 2000.



And let's face it — four years into this tech mania, there is very little evidence of any broadly-based productivity growth breakout. At this stage of the internet boom in the late 1990s, the productivity payoff was already rather clear (and still did not prevent a brutal three-year bear market).

"The four most dangerous words are: This time is different.
The five most dangerous words are: This time is never different." – Jeremy Grantham

High valuations, extreme debt and weak prospective returns over three to four years underpin my bubble view. A bust would bring business failures, investment losses and layoffs, as after the internet boom.

The question is timing. But what inning is this? Seventh, eighth or ninth? If you prefer to think in years, is it more like 1997 or March of 2000?

Bottom line: Useful and even transformative technology isn't automatically a profitable investment. Overbuilding and crowded portfolios could turn an AI reversal into economic dominos.

HOUSING IS ON FIRE

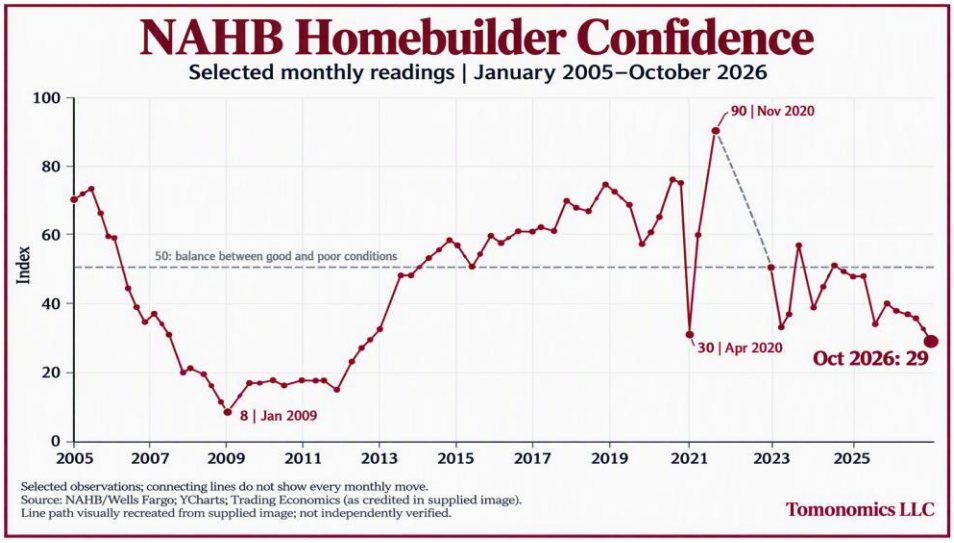
Keep on tightening Kevin.

Tightening into a global energy supply shock further pressures housing. September starts fell 5.2% monthly versus expectations for a 1.9% rise. Starts fell 7.4% yearly. Permits are down 3.0% yearly.

At 859,000 units, they are now at a twelve-month low and the second-lowest level of the past three-plus years. And the fact that single-family building permits receded -4.0% after a -1.6% August pullback portends further weakness ahead.

Not surprising, homebuilder confidence dropped to 29 in October. That's a 14-year low — even below April 2020. Below 50 means more builders see conditions as poor than good. At 29, it's not close.

The six-month sales outlook fell five points to 32. I expect weaker starts and hiring ahead a warning for 2027.



On the flipside, for anyone buying now, the market is looking better as 43% of builders cut prices in October, the highest share in data back to 2020; the average price cut was -6% for the seventh consecutive month. And the number is understated because 65% of the building community used sales incentives in October, the 19th consecutive month that at least 60% have done so.

Bottom line: Buyers are gaining leverage — not because housing is healthy, but because sellers are under pressure. Builder confidence is at a 14-year low; price cuts and incentives are widespread. That said, weaker construction and hiring remain risks for 2027.

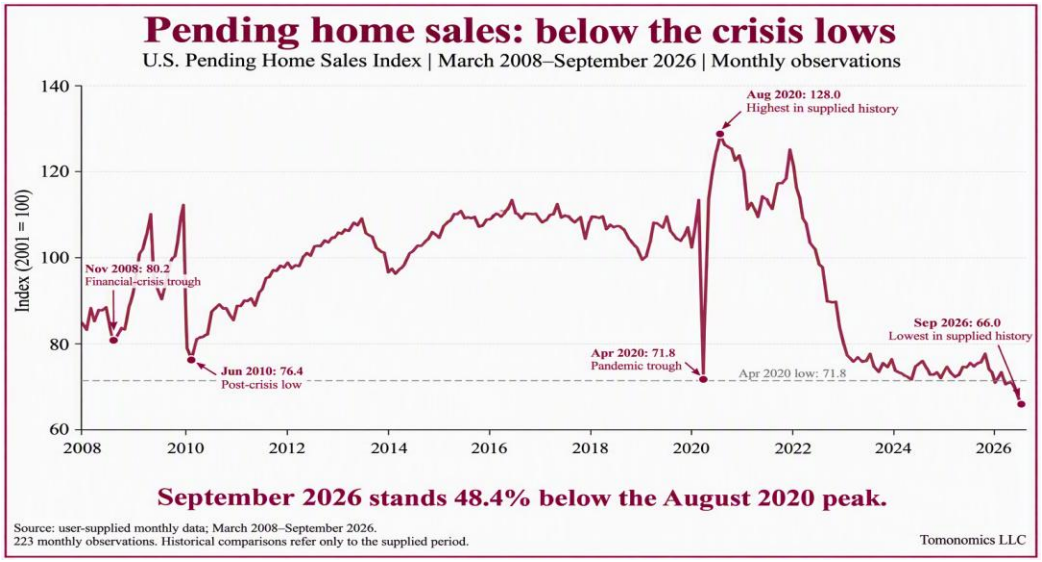
PENDING HOME SALES COLLAPSE TO RECORD LOWS

"We expect near-term housing activity to remain under pressure given the rate and broader macro backdrop." — Goldman Sachs Economists

September pending home sales fell 7.3% monthly versus an expected 3.9% decline, and 11% yearly. The National Association of Realtors' (NAR) index hit a record low 66.0. That's below April 2020's 71.8 and November 2008's 80.2.

The weakness was widespread as pending sales fell across every region in September. The West led the slide: down 9.2% from August and 15% year over year. The South fell 8.2% and 12%, respectively; the Midwest, 6.5% and 8.7%. The Northeast fell least for the month: down 4.2%, and 9.4% year over year.

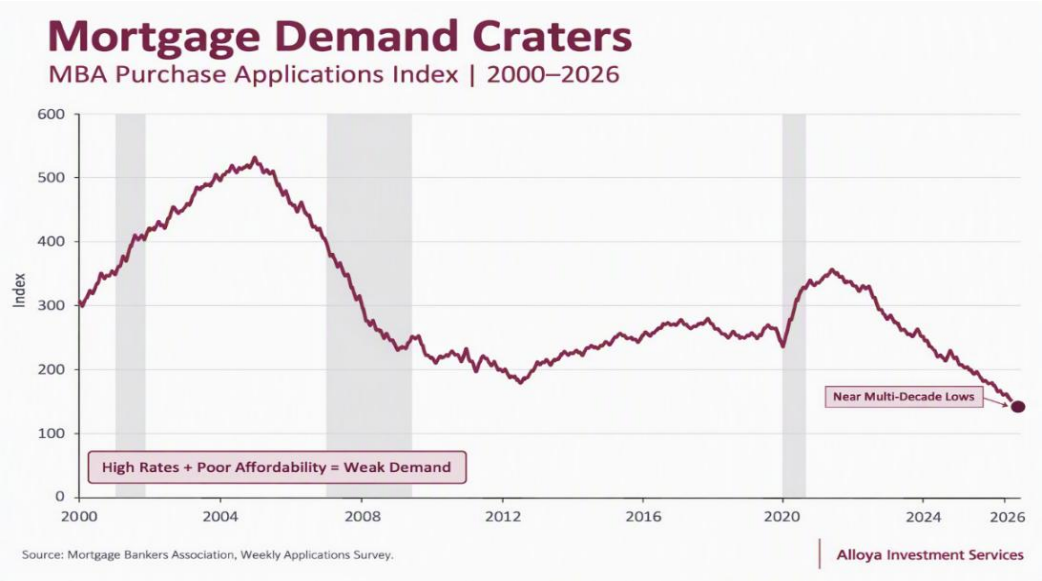
Pending sales measure signed contracts, typically one or two months before closing. They lead completed existing-home sales, but contracts can cancel — and cancellations have been elevated.



After coming off the worst National Association of Home Builders (NAHB) housing index in more than fourteen years, putrid pending sales and starts, the bad news keeps rolling in as mortgage applications cratered -7.3% last week to the lowest level since January 2025 and down -18% year over year (refinancing activity has collapsed by nearly -60%!).

These purchase mortgage applications are a forward-looking indicator of the direction of "pending" sales and then "closed" sales in October and November to be reported in November and later. Purchase mortgage applications show demand from buyers — or the lack thereof — who want to obtain a mortgage to fund their purchase.

This plunge in mortgage applications indicates that pending sales for October will be even worse than in September. Translation — this is terrible news building on an already ugly situation in the U.S. housing market.



Renting has become the far cheaper option monthly in many markets, given where home prices, mortgage rates, homeowners' insurance premiums, property taxes and HOA fees are. High home prices entail high carrying costs all around.

If homeowners want to sell their homes, there is a market and there is demand, but the price must be where the buyers are. That's what this says.

And home-price increases can no longer be taken for granted to bail out buyers with too-high carrying costs. Home prices have already been falling in many markets

As shown below, prices of mid-tier single-family homes have dropped by 11% to 26% in 16 bigger cities and counties through September, from their respective peaks in prior years. For 14 of them, those peaks occurred in mid-2022; for two of them, the peaks occurred in 2024.

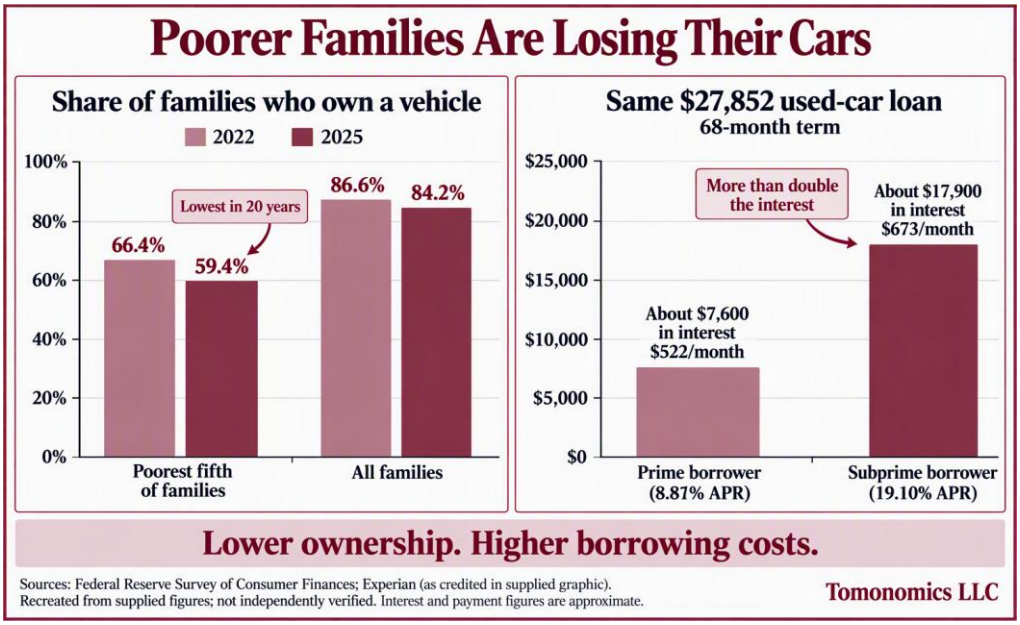
Bottom line: Debt-funded AI spending and higher rates leave housing squeezed. A booming data-center sector isn't a healthy housing market or healthy economy.

PRICED OUT OF A CAR

While buying a home is out of reach for many, lower income families are losing their wheels. Just 59.4% of the poorest fifth owned a vehicle in 2025, down from 66.4% in 2022 — a 20-year low, according to the Fed's Survey of Consumer Finances. The strain goes beyond cars: 19.6% of all families fell behind on a car loan, credit card, mortgage or student loan last year, up from 12.2% in 2022.

Overall car-loan defaults are rising slowly. That hides the squeeze at the bottom. Experian puts the average used-car loan near $27,850. A borrower with weaker credit paying 19.1%, versus 8.8% for a prime borrower, pays more than double the interest for the same car. Some lose it to repossession. Others can't afford to replace one that dies.

The federal interest deduction covers only new, U.S.-assembled vehicles, excluding used-car buyers. Qualifying buyers may deduct up to $10,000 yearly. Losing a car can restrict access to jobs, even when former borrowers disappear from lender data.



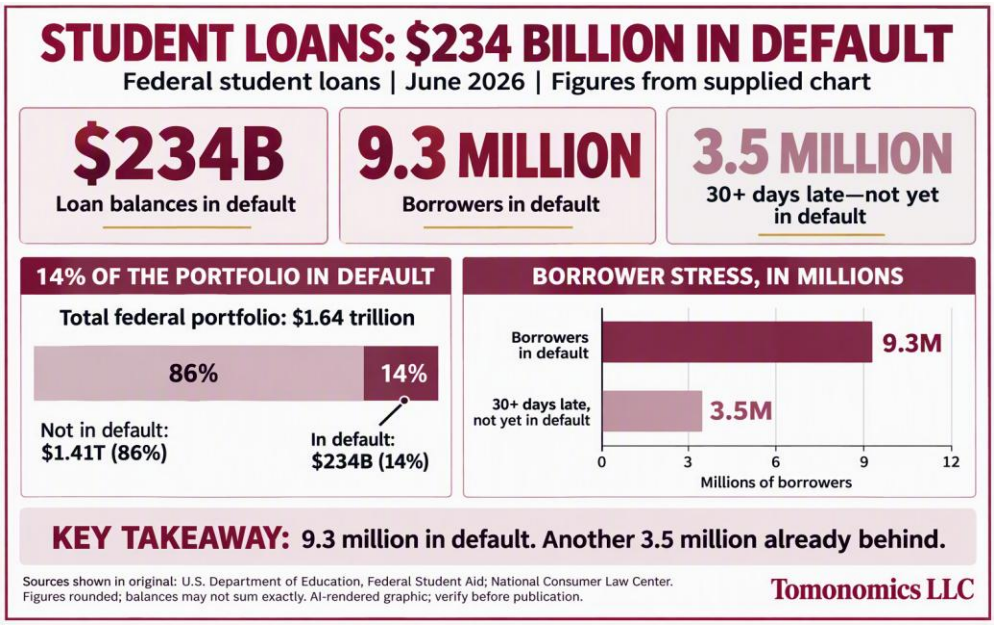
Bottom line: Expensive credit threatens vehicle ownership and access to work.

STUDENT LOANS: THE NEXT PAYMENT SQUEEZE

About 9.3 million federal student loan borrowers are in default, owing $234 billion, according to the Education Department's latest data. The Washington Sun reports that the Treasury may start hiring private debt collectors as soon as November, with wage garnishment and tax refund seizures likely in 2027. The government can take up to 15% of a defaulted borrower's paycheck without going to court.

Collections have been delayed before, so 2027 remains uncertain. Another 3.5 million borrowers are over 30 days late. Damaged credit can mean nearly 19% used-car financing, with gas already a third costlier than last year.

Money garnished from a paycheck comes straight out of rent, car payments and groceries. I expect subprime auto delinquencies to climb and discount retailers to feel it in 2027. Anyone in default should look into rehabilitation now, because nine on-time payments can bring the loan back to good standing and clear the default from a credit report



Bottom line: A possible 2027 restart would squeeze household spending and could worsen auto delinquencies and discount retailer sales.

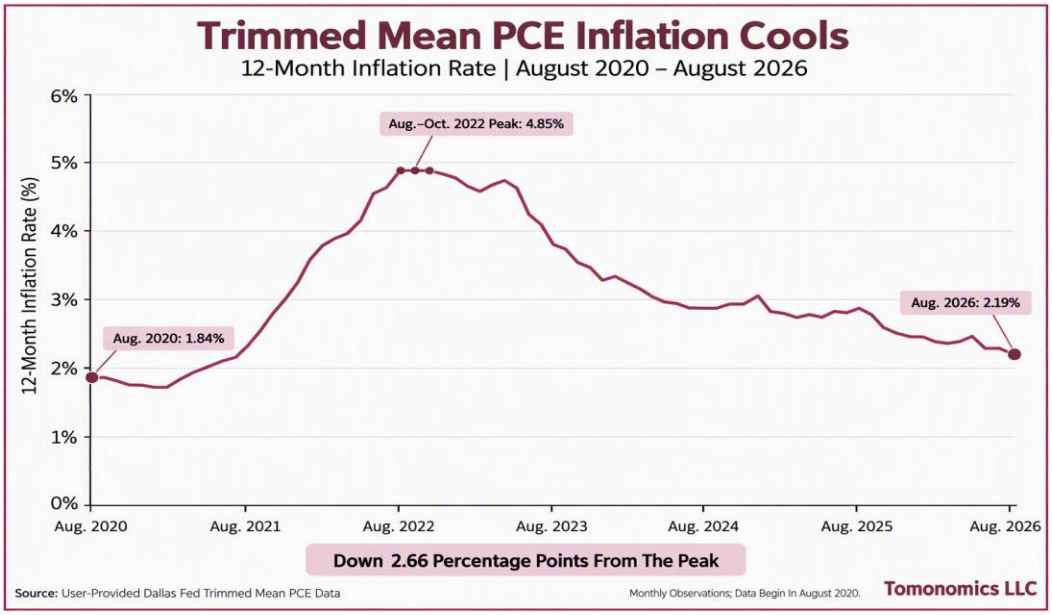
WHAT INFLATION IS… AND ISN'T

I keep making the same point: the cost of living and inflation are different things. The cost of living is the price level. Inflation is how fast it changes. Slower inflation doesn't mean lower prices. Prices rose 55% during Volcker's 1979-1987 Fed tenure, after 90% in the prior decade. He slowed inflation, not the price level. Broad deflation, as in the early 1930s or 2008-2009, carries its own damage.

Volcker reduced double-digit inflation to low single digits. He was considered the inflation slayer. Core inflation was 4.0% when he left in August 1987, versus 2.6% today.

Warsh's favorite inflation metric is (believe it or not) approaching the 2% target and a five-year low. The Dallas Fed's 12-month trimmed mean Personal Consumption Expenditures (PCE) inflation rate was 2.19% in August 2026, approaching 2% and near a five-year low.

Yes, the price level is at a record high. It was when Volcker left, too.



Bottom line: Easing inflation slows price increases; it does not restore yesterday's prices.

MARKET OUTLOOK AND PORTFOLIO STRATEGY

"The past week brought a lively and very useful dress rehearsal for what a bursting of the AI bubble in markets might look like […] the good news for investors who struggle to shake the feeling that we are overdue for a big pullback in the runaway AI trade is that the classic safe retreat — developed-market government debt — is deep in the bargain basement."— Katie Martin, Financial Times

As everyone clamors for rate hikes, I need to stress that hikes won't produce more oil. They can squeeze an economy already absorbing an energy tax.

The Fed began hiking on September 16 with real GDP growth at 2.2%. Apparently, 2% now qualifies as a boom. The historical record puts recessions after tightening into bubble peaks and supply shocks at 85%. That's hardly reassuring.

And growth had plenty of help: stock-market wealth, AI capex, data-center construction and tax stimulus. Corporate receipts fell $70 billion instead of rising at least $30 billion absent accelerated depreciation — a $100 billion fiscal swing. Unlike 2022-2023, there isn't $2 trillion in pandemic checks cushioning the slowdown.

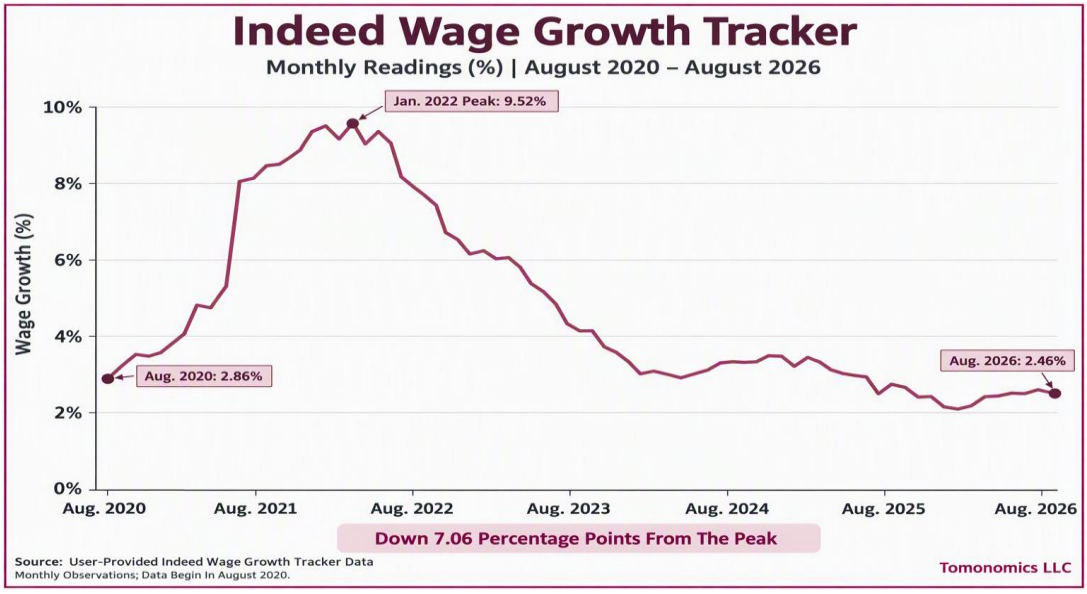
As for the consumer, all anyone needs to do is read the Fed's Beige Book from last week:

"Most Districts reported little or no change in overall consumer spending […] Most Districts described little or no net change in overall employment levels."

September real wages and core control retail sales each fell 0.5%. Retail growth halved from Q2's 4% annualized pace in Q3, leaving near-zero Q4 momentum. Even higher-income households are turning frugal.

So much for the Kevin Warsh economic boom thesis, which is just a one-trick pony.

On the inflation front, had it not been for the self-inflicted tariff war and Iranian War, inflation would be likely already at or below the Fed's target of 2%. Moreover, how does one generate sustainable inflation when wages are declining?



Finally, there is something else for investors to contemplate which is that the political winds in the United States are shifting away from the Republicans and increasingly towards the Democrats. The just released New York Times/Siena poll shows the Dems pulling away when it comes to the November 3 midterms — leading nationally by +11 percentage points (52% to 41%). That is an enormous spread.

If the Democrats do sweep, history shows there is a 70% chance that they take it all in the 2028 national elections — as was the case with Clinton, Bush, Obama, Biden and Trump. And what that means is that the pro-market tax policies of Trump 1.0 and 2.0 will be reversed. I should add that gridlock is bad for equities but good for bonds.

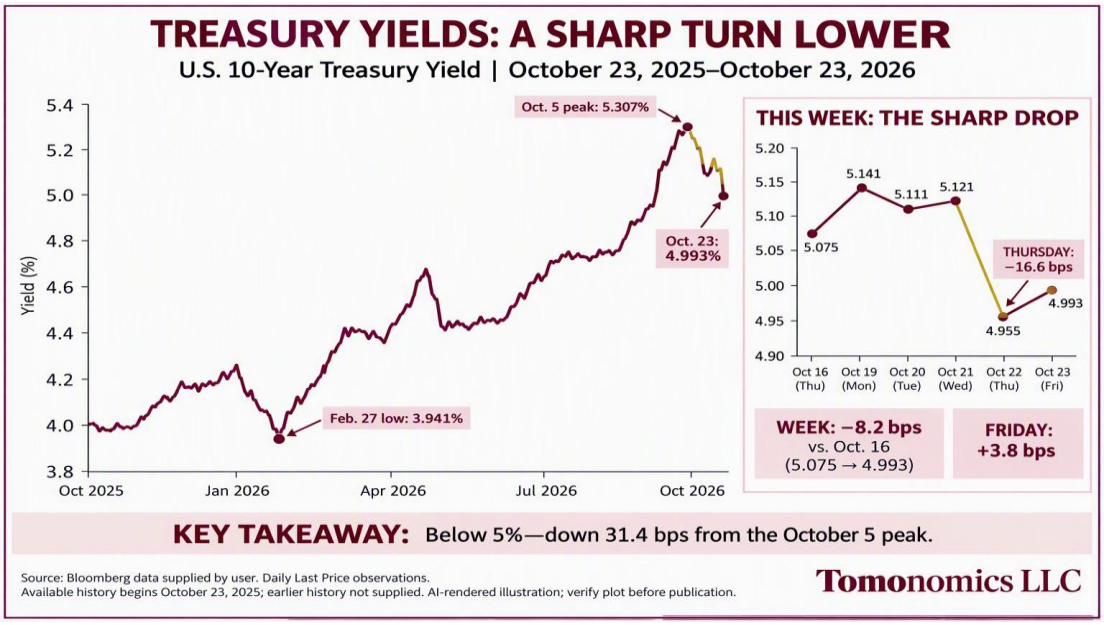
In terms of portfolio strategy, if you believe in the contrarian "front cover" effect, as in all the news is priced in when it makes it to the front page of the daily newspapers, bullish bond investors should like the column in the Wall Street Journal: **Economists surveyed by the Wall Street Journal now see higher bond yields for longer, firmer growth and eventual relief on inflation.** That is a widespread consensus view and one we heard often at prior yield peaks in 2000, 2007, 2018, and again in 2023.

The 30-year Treasury yield has plunged from around 5.7% to 5.315% in less than three weeks.

Last Thursday's 10-year Treasury yield decline of 17 basis points to 4.95% was the largest single day yield decline since March 10, 2023, which is the day Silicon Valley Bank failed.

Falling Treasury yields may be hiding a darker story about the AI boom.

If Treasury yields continue falling while corporate credit spreads widen, hiring weakens and investment contracts, it would suggest that existing economic deterioration is spreading.



Why do I still like Treasuries? In a word, math. The 10-year Treasury has so much coupon protection now that it would have to test 6% to not make any money (on a total return basis) where the yield was back in the summer of 2000. But if it can manage to just retreat to the 4.4% level it was sitting at when the Fed made the transition from neutral Powell to tight Warsh, the net positive return would top +12%. Equity-like returns in the bond market — quite doable. I like that risk-reward tradeoff.

Illustrative 12-Month Treasury Returns: Yields Rise 100 Basis Points

Initial maturity	Starting yield / coupon	Exit yield	Remaining maturity	Coupon income	Price change	Total return
2 years	4.79%	5.79%	1 year	+4.79%	−0.96%	**+3.83%**
5 years	4.94%	5.94%	4 years	+4.94%	−3.51%	**+1.43%**
10 years	5.12%	6.12%	9 years	+5.12%	−6.84%	**−1.72%**

Illustrative 12-Month Treasury Returns: Yields Decline 100 Basis Points

Initial maturity	Starting yield / coupon	Exit yield	Remaining maturity	Coupon income	Price change	Total return
2 years	4.79%	3.79%	1 year	+4.79%	+0.97%	**+5.76%**
5 years	4.94%	3.94%	4 years	+4.94%	+3.67%	**+8.61%**
10 years	5.12%	4.12%	9 years	+5.12%	+7.46%	**+12.58%**

Note: Illustrative scenario only — not a forecast.

WHY SUBSCRIBE TO THE WRV?

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MORE INFORMATION

For more information about credit union investment strategy, portfolio allocation and security selection, please contact the author at **tom.slefinger@alloyacorp.org** or (630) 276-2753.

As Alloya's Market Strategist, **Tom Slefinger** leverages 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.

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