

Thoughts on the Market

Investments in Heartland Housing

MARKET COMMENTARY

Stocks buy the peace, bonds don't

The S&P 500 closed May at a record 7,580.06, up 5.1% on the month and roughly 10.7% year-to-date. It was the index's sixteenth record close of the year. Two months after the war and subsequent oil shock pushed the index down more than 5% in March, equities have not merely recovered. Markets are increasingly pricing a conclusion to the conflict and have resumed their AI-driven advance.

The equity rally did not extend into the bond market. Treasury yields ended the month higher across the curve, with the 10-year closing at 4.45% and the 30-year pressing 5%. Markets still assign close to even odds to a rate hike by December.

The United States and Iran reached agreement in principle on a 60-day memorandum to extend the ceasefire and begin reopening the Strait of Hormuz, though President Trump has not yet signed off and the strait remains effectively closed. That was enough to pull oil sharply lower, with Brent down almost 19% in May. Markets care less about resolution than direction, and for now the direction appears favorable. The gasoline surge that drove prices higher in March and April has begun to reverse, and although the conflict is far from resolved, its economic cost has fallen sharply.

April CPI, released May 12, rose 3.8% from a year earlier, the highest since May 2023, with core inflation at 2.8%. For the first time in three years, wages failed to keep pace with prices. The late-month PCE report offered

an encouraging sign, with core PCE up just 0.2% in April, the softest monthly reading in some time, even as the annual rate held at 3.3%. With oil now falling, summer inflation prints could ease further. If the peace holds, the inflation trajectory should begin to trend lower.

The May data added to the evidence that consumer stress is worsening. First-quarter GDP was revised down to 1.6% from an initial 2.0%, on weaker spending and investment, and real personal income has now fallen for two straight months. Consumer credit tells an even sharper story. The share of credit card balances at least 90 days delinquent reached 13.1% in the first quarter, the highest since 2011 and approaching the post-GFC peak. The pace of deterioration since 2022 has been remarkably rapid, exceeding much of the trajectory observed between 2007 and 2010. The stress is no longer confined to lower-income borrowers, as delinquency is slowly climbing in affluent zip codes. April payrolls rose 115,000 and unemployment held at 4.3%, but the low-hire, low-fire labor market continues to obscure underlying weakness.

EXHIBIT 1 Market benchmarks

Levels and change · through May 2026

Benchmark	LEVEL			1-MONTH CHANGE		CHANGE FROM YE	
	YE-2025	Apr-26	May-26	Δ	% Δ	Δ	% Δ
Fed Funds	3.63%	3.63%	3.63%	0.00%	0.00%	0.00%	0.00%
1-Month SOFR	3.69%	3.65%	3.62%	-0.03%	-0.76%	-0.07%	-1.82%
10-Yr Treasury	4.16%	4.39%	4.45%	+0.06%	+1.34%	+0.29%	+6.94%
S&P 500	6,845.50	7,208.97	7,580.06	+371.09	+5.15%	+734.56	+10.73%
REIT Index ¹	125.39	136.15	135.58	(0.57)	-0.42%	+10.19	+8.13%
VIX	14.76	16.89	15.32	(1.57)	-9.30%	+0.56	+3.79%

1. Vanguard Real Estate Index Fund (VGSIX), which tracks the MSCI U.S. REIT Index. Fed Funds shown at the effective rate; Treasury and SOFR at month-end. Source: Bloomberg, Federal Reserve, Caisson Capital Partners.

01 Warsh takes the chair

The Federal Reserve has a new chair. Kevin Warsh took office in May, ending a transition that had hung over markets since last summer. Though the leadership change attracted significant attention, it does not materially alter the balance of power within the Federal Open Market Committee. Powell remains on the Board of Governors, and the committee remains divided between officials focused on inflation and those increasingly concerned about slowing growth. For investors, the takeaway is that incoming economic data remains far more important than the name on the chair's door.

Warsh's policy views remain difficult to pin down. As a governor from 2006 to 2011, he was generally considered hawkish and later criticized the Fed's ultralow-rate policies following the pandemic. More recently, he has argued that artificial intelligence will raise productivity enough to support stronger growth without reigniting inflation, potentially creating room to cut rates. He has also advocated for a smaller balance sheet and less reliance on forward guidance. Whether those views ultimately shape pol-

icy will, however, depend less on Warsh himself and more on his ability to build consensus within a divided committee.

Powell's final meeting in April produced four dissents, the most since 1992, with one vote for a cut and three objections to language that pointed toward easing. One camp sees a slowing labor market and wants to cut. The other sees inflation stuck above target and wants the flexibility to hold rates higher for longer. Change at the top does not resolve that debate. The trajectory of inflation and employment will determine what happens far more than any personnel change.

Warsh will chair his first meeting on June 16 and 17. Markets expect no immediate policy change and still assign elevated odds of a hike by year-end. The central question that will define Warsh's early tenure is whether he can deliver the lower rates the administration expects against an inflationary backdrop, and whether he can do so without compromising the Fed's independence.

02 The end of extend and pretend

For more than three years, lenders extended troubled commercial real estate loans rather than recognize losses, deferring the reckoning in hopes that rates and values would recover. This frustrated many investors and operators, as delaying the inevitable did real damage to the underlying assets and certain submarkets. Recently, lenders are finally showing a willingness to take losses and clean up their books. MSCI counted nearly \$132 billion of distressed CRE debt in the first quarter, but for the first time since 2022, workouts of troubled loans outpaced new distress. Goldman Sachs and Deutsche Bank are among those now selling non-performing loans at steep discounts or taking the assets outright. Trepp reports that loans tied to properties already in foreclosure reached \$17 billion in March, up from \$7 billion in 2024 and the highest since the cleanup that followed the GFC. Office remains the epicenter, with distressed sales up 45% year over year, while multifamily's stress is narrower and concentrated in specific markets.

Ready Capital sold a pool of Sunbelt apartment loans at roughly a 30% discount and has moved to shed 60% of its legacy real estate book, including about \$1.5 billion of non-performing debt. We are seeing the same shift on the ground, where foreclosure and REO processes have accelerated and distressed assets are beginning to trade. Properties that are 15% to 40% occupied are changing hands well below their loan balances. At the bottom tier of quality, we have seen Class C assets print as low as \$30,000 a unit on effectively vacant buildings, with others marketed near that level.

Those numbers are less of a bargain than they appear. Bringing such an asset back online can take another \$30,000 to \$50,000 a unit in capital and interest reserves before stabilization, putting the all-in basis far above the headline price. Some of the worst of it does not pencil at any price. We have heard distressed product in markets like San Antonio described as "unsafe at any speed," effectively not worth the cost to demolish.

Importantly, this is the floor of the market and should not be misconstrued as indicative of broad conditions. The assets trading at salvage prices were purchased at the top of the market and have been mismanaged and capital starved for several years. They are largely concentrated in the oversupplied Sun Belt, and it could take some time for the lowest-quality assets to find the right clearing price.

This is ultimately healthy, as distressed sales restore the pricing benchmarks that have been missing since 2022, and transaction activity cannot recover until sellers accept them. Capital is already preparing for that turn, with the Mortgage Bankers Association projecting commercial mortgage originations up 27% this year to roughly \$805 billion.

We remain laser-focused on Class B housing in supply-constrained Heartland markets, where the tenant base is employed, new construction has thinned, and the entry basis carries a margin of safety that the current repricing is helping to define.

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