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Thoughts on the Market

Investments in Heartland Housing

MARKET COMMENTARY

A hawkish Fed chair, and a settling yield curve

The S&P 500 closed August at 7,686.14, up 2.6% on the month and 12.3% year to date. Equities spent three weeks climbing and the last three days absorbing messaging from an important speech by Fed chair Warsh. The Nasdaq rose 3.5% to 26,370.89.

The war with Iran reopened on the final weekend of the month as the U.S. struck Iranian rocket launchers poised to re-mine the Strait of Hormuz and Tehran retaliated against American bases in Jordan and the UAE. Oil moved back above $90, and the S&P gave up 0.33% on the month's last trading session.

Warsh's speech at Jackson Hole was closely watched, as the Kansas City Fed's symposium has historically been the one venue where chairs are more open about their views. Since taking the chair, Warsh has been tight lipped, strongly favoring a less communicative posture with little forward guidance. This was the first time he described his own standard.

He said the summer's inflation readings, better than expected as they were, do not tell him underlying trends have meaningfully improved. He noted that he must be convinced that inflation is moving to the target clearly and at sufficient speed. Otherwise, in his words, the Committee "has work to do." He added that financial conditions are not restraining the economy and called interest rates his predominant tool.

Markets repriced immediately. Odds of a September hike stood at 35.4% the day before the speech and 57.5% the day after. The Committee meets September 15 and 16, and they will receive one more inflation print before the meeting.

EXHIBIT 1 Market benchmarks

Levels and change · through August 2026

	LEVEL			1-MONTH CHANGE		CHANGE FROM YE	
Benchmark	YE-2025	Jul-26	Aug-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%	3.71%	**3.68%**	-0.02%	-0.60%	0.00%	-0.11%
10-Yr Treasury	4.16%	4.74%	**4.76%**	+0.02%	+0.42%	+0.60%	+14.34%
S&P 500	6,845.50	7,489.72	**7,686.14**	+196.42	+2.62%	+840.64	+12.28%
REIT Index[1]	125.39	140.32	**137.82**	(2.50)	-1.78%	+12.43	+9.91%
VIX	14.76	15.99	**14.92**	(1.07)	-6.69%	+0.16	+1.08%

1. Vanguard Real Estate Index Fund (VGSLX), 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.

His position is supported by the inflation data. Headline CPI eased to 3.4% in July and core to 2.5%, back to its pre-conflict pace. Core PCE has been less obliging, printing 3.3% in April, 3.4% in May, and 3.3% in both June and July. Four months have produced no progress on the measure the Committee watches most closely.

The labor data continues to support the narrative of weakness and a "low hire, low fire" environment. July payrolls fell 23,000 against expectations of an 83,000 gain, and May and June were revised down by a combined 103,000. Unemployment declined to 4.1%, but only because people stopped looking. The share of Americans holding a job fell to its lowest level since 2014. Wages rose 3.2% over the past year, trailing inflation for a fourth consecutive month.

Warsh attributed the hiring slowdown to a shrinking pool of available workers rather than to weakening demand. He did not say why the pool is shrinking although net immigration fell sharply from 2024 into 2025 and is projected lower again this year, with some measures showing net migration at or below zero. Total employment has fallen by 833,000 since January even as the unemployment rate declined.

Long rates had been climbing since June, and on August 17 the 30-year reached 5.31%, its highest since 2007. Treasury Secretary Scott Bessent intervened two days later, announcing that Treasury would at least double its repurchases of long-dated bonds. Yields fell briefly on that announcement but by the next afternoon the 30-year was back to where it started. The market treated the intervention as an admission rather than a remedy. Treasury pays for these repurchases by issuing short-term bills, which makes inflation harder to bring down and gives the Fed more reason to hold rates high.

One additional problem is that Treasury is no longer the main seller of long-term debt. Pensions and insurers have a fixed appetite for thirty-year paper, and technology companies are now competing for it. Amazon, Alphabet, Meta and Oracle sold roughly $194 billion of bonds through early July, 79% more than the four issued in all of 2025, most of it to build data centers, and Goldman expects the largest of them to borrow $250 billion this year. Bank of America estimates corporate borrowing has added about 30 basis points to the 10-year, roughly half its rise since January. Buying back a few billion dollars of bonds does not move a market being reshaped at that scale.

The 10-year closed August at 4.76%, two basis points above July and sixty above year end, and the REIT Index fell 1.78% on the month while equities gained 2.62%. Warsh was right that financial conditions are not restraining the economy, and he was describing a curve that no longer answers to him. That level has held for eight months, through a war, a ceasefire, a change of chair and a negative payroll print. It is a cost of capital, not a move to wait out.

01 The last cycle in perspective

For forty-three consecutive years, apartments outperformed every other kind of commercial real estate. The streak ended in early 2021, when industrial passed them, and it has not resumed. Sam Lawhead's recent work in Housing + Markets, which sits outside our usual sources, is compelling. He argues that the industry has misread why performance has slowed. We think he is right about the cause and that he stops short on what it means.

Historically, the return engine for apartments was never appreciation. Across four decades, rental income never produced a negative year, including 2009, while appreciation swung from up 22% in 1980 to down 27% in the financial crisis and was several times as volatile throughout. Rent was the part you could underwrite. Appreciation was the part you hoped for.

That composition is what made the asset class defensive. Rent arrives regardless of what equities did last quarter. Appreciation comes from credit conditions and capital flows, the same forces that move every other risk asset. When rent is doing the work, apartments behave like housing. When appreciation is doing the work, they behave like a bet on cheap money.

The last decade reversed that order. Values rose so quickly that appreciation became the whole return, and apartments started behaving like the risk assets that appreciation tracks. The industry read that as strength. It was a change in what was actually being bought.

Four conditions arrived together and all four have since reversed:

1. Cap rates compressed to an all-time low near 3.4%.
2. The millennial cohort, the largest demographic in history, reached its peak renting years.
3. The GFC led to a decade of underbuilding.
4. Raising rents carried no political cost.

The most durable constraint is the one that gets discussed least. Adjusted for inflation, rents have grown at a fraction of a percent a year for 135 years, across every monetary regime in that span, because rent is paid out of wages and thus rent growth is bounded by wage growth. Real rents now sit about 30% above the long-run line, the widest gap in the record. The gap closes in one of three ways. Rents fall, wages catch up, or real rents stay flat for a decade while income grinds forward. The third is the likeliest, and it is the one that should discipline how anyone underwrites rent growth.

That gap, though, is a national figure, and it is not evenly distributed. Austin, Phoenix, Nashville and the Florida metros posted single-year rent increases above 25% during the COVID boom. Those markets borrowed from their own future and are now repaying it. Reading a national average as a national condition is how a market-specific hangover gets mistaken for an asset-class problem.

A counterexample is Kansas City. On the government's regional price index for housing, Kansas City sits at 87 against a national reading of 100, the only top-thirty metro below the national average. Denver sits at 147. That index measures rents adjusted for quality, which is exactly the thing wages constrain, and a market at 87 has no pulled-forward rent to give back.

The second-quarter data show the same division. The Midwest led the country in rent growth. Within individual markets, workforce housing is outgrowing luxury product by a wide margin, including in the metros that absorbed the heaviest deliveries. Demand is not weak. It has moved down the price ladder.

The distress numbers run the other way. Apartments accounted for nearly all of the commercial real estate loans that fell into distress in July. Almost all of that paper was written in 2021 and 2022, on floating rate debt, against underwriting that required those four conditions to hold. Operations are improving while capital structures fail. That is an investment-vintage problem rather than an asset problem, and confusing the two is how buyers talk themselves out of a good entry point.

We have never underwritten to cap rate compression, and we do not need rent growth above trend for a deal to work. But we would not want to leave the impression that the returns of the last forty years are simply waiting to be collected. That record was built when apartments traded at cap rates of eight to ten percent. The national index sits near five today, and at five the income business is thin.

Which is why the entry price is the whole argument rather than a discipline point. The asset we acquired in Overland Park in June went in at a 6.3% cap on in-place income, against local comparable sales in the mid-fives. That spread is not a rounding difference. It is the difference between owning the income business and owning a bet on what rates do next.

The trade of the last cycle is over. The business underneath it is the one that produced forty-three years of returns, and the return you earn in it now depends almost entirely on what you pay to get in.

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