



A Note from the AB Fixed Income Trading Desk

Thoughts from Our Senior Portfolio Managers

Midterm Marks and Market Lessons

"The only real mistake is the one from which we learn nothing."—Henry Ford

With markets reopening after the July 4 holiday, it's a good moment to take stock of how the first half of the year played out. At the start of 2025, we laid out a disciplined set of expectations for markets—and a clear view on the risks that could challenge them. We've modestly updated those assumptions as new information has emerged, but for the most part, our highest-conviction views have held firm.

That said, for a year characterized by "uncertainty," this hasn't been a market set for autopilot. Between geopolitical flare-ups, fiscal noise and policy uncertainty, markets have tested even the most thoughtful plans. But the lessons have been clear: conviction, humility and flexibility remain essential. This special-edition note serves as a scorecard, grading each of our original 2025 assumptions—not in order to take a victory lap, but as a reflection on what's worked, and what still needs to evolve.

Key Takeaways

- Most of our highest-conviction views have held firm—and performance has reflected that—despite a noisy backdrop of geopolitical and fiscal risk.
- We remain confident in our core macro assumptions, particularly around disinflation, slowing growth and the value of curve steepeners—but we're monitoring policy and sentiment shifts closely.
- This midyear scorecard reinforces the value of process over prediction—and, where the market has shifted, we'll sharpen our pencils accordingly.

Midyear Scorecard

Economic Growth: A

What we said: "We expect global growth to continue to slow, but remain positive, for the largest economic blocs. Both the US and eurozone should see below-trend growth, with Europe facing greater challenges than the US...Additionally, tariffs and aggressive trade policy may increase the risk of growth softening further than expected."

What happened: The data confirmed a gradual deceleration in global growth. In the US, personal consumption remains positive but is showing signs of fatigue—PCE registered its weakest quarter since 2023, and monthly retail sales have moderated. Labor markets are cooling in an orderly fashion, with job growth settling modestly above 100,000 per month. Importantly, recent headline GDP prints have been skewed by volatile trade and inventory flows, making underlying growth trends harder to read and likely to remain messy in upcoming quarters.

Europe continues to lag, weighed down by subdued private demand, restrictive policy and ongoing weakness in manufacturing. Our baseline is for eurozone GDP to rise just 0.3% in 2024 and 0.7% in 2025. However, as inflation recedes and the ECB eases policy, consumption could stabilize and modestly recover if external risks remain contained.

Inflation: A–

What we said: "We expect tariffs, geopolitical risks and continued budget deficits to potentially cause adverse price shocks and temporarily keep inflation expectations elevated...Hence, even though central banks continue to reiterate their inflation goals, we believe they will be comfortable with inflation levels that are slightly above target, especially if labor markets remain in equilibrium."

What happened: Four straight downside surprises in CPI and PPI reaffirmed the trend. US inflation is easing, with core CPI continuing to drift lower. Goods prices are flat to down, and while services—especially shelter—are still sticky, there are signs of softening. That said, tariffs are a clear upside risk: a 10-point increase in the effective rate could add about a point to inflation, especially in durables, and policy volatility could weigh on inflation expectations and complicate the path forward.

Rates: B+

What we said: "As economic conditions evolve, we believe that the pace of rate cuts is likely to vary more across central banks...In the US, we expect the Fed to cut four times (for a total of 100 basis points [bps]) in the coming year. We anticipate that the ECB will follow

a more front-loaded cutting cycle in 2025...expect that the Bank of England, much like the Fed, will take a more staggered approach to rate cuts this year."

What happened: Policy divergence has played out as expected, though the pace has been slower and more data dependent than we anticipated. The Fed remains on hold, with markets now pricing only one or two cuts this year, reflecting persistent strength in growth and employment data. The ECB has cut rates four times since June 2024—bringing its deposit rate to 2.0%—consistent with our projection of a front-loaded cycle. The Bank of England has delivered two quarter-point cuts, most recently to 4.25% in May, in line with a more staggered approach.

Overall, policy rate normalization has proceeded more cautiously than our original forecast. However, our view to maintain a modest overweight in duration across strategies has added value. Additionally, we expected the 10-year US Treasury to fluctuate within recent ranges and anticipated that range-trading duration would provide an additional source of alpha, which it has.

Curve Shape: A

What we said: "We prefer the short end of the yield curve and are positioned for curve steepening."

What happened: Yield curves have steepened modestly across developed markets, broadly in line with our outlook. In the US, 2s10s moved higher during the first half of the year—driven by renewed growth concerns and front-end repricing—while 5s30s steepened by roughly 60 bps, reflecting ongoing supply and term premium dynamics at the long end. Similar but less-pronounced patterns were seen in the UK and eurozone. Our preference for curve positioning over outright duration was validated by these measured market shifts.

Credit Spreads: A–

What we said: "Despite tight spreads, yields are generally the best predictor of future returns and current levels remain compelling from a historical context. There are still many pockets of credit that present attractive risk/reward profiles...We prefer investment grade and the higher-quality segments of the high-yield market."

What happened: After the sharp April sell-off in equities, credit markets demonstrated incredible resilience. This was something we continually emphasized throughout the year. We have highlighted repeatedly that credit would fare better than equities given macro stress, and it certainly did. During the equity market's ~20% peak-to-trough drawdown, high yield declined only about 1%. Spreads in both investment grade and high yield widened briefly but retraced quickly, closing the first half near the tightest levels of the cycle. Solid fundamentals and persistent demand, along with strong technicals, helped support the market and absorb new issuance. Our portfolios entered the year positioned up in quality and with ample flexibility; we used the volatility to selectively add risk—particularly in higher-quality high yield—while avoiding the weakest segments. As spreads have tightened again, portfolios are once more positioned with a tilt toward quality and liquidity, reflecting both the opportunities and ongoing macro risks.

Volatility: A+

What we said: "Despite our optimistic view, we continue to expect heightened volatility in 2025. Central banks remain focused on evolutions in economic data to drive policy. As a result, markets will continue to have knee-jerk reactions to data releases and economic surprises. Geopolitical concerns add another layer of complexity. Further transparency on US trade policy and budgetary concerns are also likely to drive outsize market reactions as new information is digested by market participants."

What happened: Exactly that.

Global Diversification: A

What we said: "While these broad trends provide a sense of stability, growing divergences across the global economy should create opportunities for active managers. Investors would be wise not to overweight the consensus view [on US exceptionalism] and to mind the gaps that could define the year ahead."

What happened: Global assets outperformed US-only portfolios in the first half, validating the value of diversification. Diverging policy cycles, regional yield-curve moves and sector dispersion provided multiple sources of excess return for fixed-income investors. Hedged currency exposures detracted in the near term due to broad dollar weakness but remain a source of income and stability as yield differentials persist and hedging continues to add yield while reducing risk.

AB's Active Management: A–

What we said: In a year defined by dispersion, volatility and shifting policy paths, we believed active management would be a differentiator—especially in fixed income.

What happened: Active strategies delivered mixed results in the first half. While our own portfolios performed well—particularly through curve positioning and credit selection—many managers across the industry struggled to consistently add value, with passive options outperforming the active peer groups by a modest margin. The environment favored nimbleness and selective risk-taking, but persistent flows into indexed products and challenging sector rotation made for a demanding backdrop. We continue to see opportunities for differentiated results as dispersion persists into the second half.

Looking Ahead

The first half of 2025 brought its fair share of validation—and plenty of reminders that markets (and policymakers) have minds of their own. While many of our core views held, new developments kept us on our toes and reinforced the importance of constantly reevaluating our assumptions—a discipline at the heart of our process.

We appreciate your partnership and feedback as we navigate what's next together. Look for a refreshed outlook and updated positioning themes in our next edition. In the meantime, we'll keep doing our part to deliver value and alpha for clients, no matter what the headlines bring.

On behalf of the team,

Scott DiMaggio, Gershon Distenfeld, Matt Sheridan, Fahd Malik, Will Smith, John Taylor, Serena Zhou, Tim Kurpis, Christian DiClementi, Sonam Dorji and AJ Rivers

To learn more about AB's fixed-income solutions and access other market insights, visit [Fixed-Income Investments | AB](#).

US Economic Scenarios

Economic Outcome	Description	Probability (Percent)
Hard Landing/Deep Contraction	Either an external shock occurs or business-cycle dynamics deteriorate sharply. Growth slows rapidly, and central banks have to act aggressively to support growth.	20
Soft Landing/Mild Contraction	Growth slows, labor markets weaken, and central banks hurry to get back to neutral. The magnitude of the slowdown defines the terminal rate, and inflation expectations determine the speed with which it is reached.	35
Rebalancing	Both inflation and growth approach trend levels only slowly, leaving the Fed comfortable easing policy slowly and remaining restrictive well into 2025: 25-basis points cuts at some, but not all, meetings until the policy hits neutral in late 2025 or 2026.	35
Stagflation	The economy slows, but inflation expectations rise, trapping the Fed between a rock and a hard place.	5
No Landing	The economy performs despite headwinds, and inflation stays elevated enough to keep the Fed on hold for some time to come.	5

European Tariff Scenarios

2025 Forecasts	Counterfactual No Tariffs at All (Percent)	Upside No Universal Tariffs (Percent)	Current Situation 10% Universal Tariffs (Percent)	April 2–9 20% Universal Tariffs (Percent)	Downside 30% Universal Tariffs (Percent)
Growth (YoY)	1.10	0.80	0.06	0.30	–0.60
Inflation (Annual)	2.00	1.80	1.60	1.70	1.40
ECB Deposit Rate (Year-End 2025)	2.00	1.75	1.75	1.75	1.00
Recession Probability	30.00	40.00	60.00	70.00	90.00

There is no guarantee that any estimates or forecasts will be realized.

Investment Risks to Consider

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