AllianceBernstein®

October 7, 2025

A Note from the AB Fixed Income Trading Desk

Thoughts from Our Senior Portfolio Managers

From No Jobs–To No Jobs Data

"The signal is the truth. The noise is what distracts us from the truth."—Nate Silver

As parts of the federal government shut down, investors are left to determine what—if anything—the economic impact will be. While there are few positives in a shutdown, the near-term growth hit should be relatively muted. The bigger challenge is the **delay of critical Tier 1 economic data**—and the potential quality issues that may follow in the weeks ahead. The Federal Reserve and market participants have been especially focused on employment trends, as the labor market has softened this year. So, what's an investor to do without the usual inputs we rely on for capital-allocation decisions?

Key Takeaways

- The government shutdown delayed Tier 1 releases (including payrolls), and the available data skewed softer.
- Risks are two-sided but modestly skewed to the downside; our base case remains "recession avoided," with the Fed proceeding in a risk-management cadence.
- We favor balanced positioning—Core Plus to blend rates and credit, Active Global Bond for diversification and relative value, and Short-Duration High Yield to harvest carry with resilient downside behavior.

Recent Market Events and Data Releases (September 22, 2025–October 3, 2025)

Despite the shutdown—and the delay of the most sought-after labor release (nonfarm payrolls)—there was still meaningful information for markets to digest.

GDP Revision: Usually a snoozefest, but not this time—2Q GDP was revised up to 3.8% from 3.3%, with personal consumption revised up to 2.5% from 1.7%—another reminder of the US consumer's willingness to spend.

Core PCE: The Fed's preferred inflation gauge ticked up to 2.9%, reflecting firmer goods prices linked to tariff pass-through, while shelter continues to cool only gradually.

Sentiment: Households and businesses turned more cautious. The University of Michigan Consumer Sentiment Survey fell to 55.1, which is its second-lowest level since inception. The Conference Board index also slipped to 94.2, with softer forward expectations on inflation and employment. The ISM Manufacturing PMI improved modestly to 49.1 but remained contractionary, while the ISM Services PMI dipped to 50.0 from 51.5.

Labor Pulse: The Job Openings and Labor Turnover Survey showed continued stagnation in openings—little changed on the month—consistent with slower hiring. With the US Bureau of Labor Statistics payroll report delayed, the ADP release drew unusual focus and showed a 32,000 decline in private payrolls for September.

Portfolio Manager Perspectives

We've said for years: don't get hung up on a single print. That advice matters even more now. With the shutdown, some Tier 1 releases are delayed—and October data published in November may be less reliable (collection/backlog effects). That complicates—but doesn't derail—the Fed's path; we expect a risk-management cadence rather than a preset timetable. In the meantime, we're focused on the trajectory (not one-offs) and on near-term catalysts, weighing a cooling but broadly balanced economy against the range of valuations offered across asset classes.

Base Case: Watch What Consumers Do, Not What They Say. Plus, a Little Capex…

The biggest surprise of this cycle remains the resilience of the US consumer. Despite higher rates, softer growth and a slower hiring pulse, spending through the summer exceeded expectations. If that pattern persists, growth can stay positive and a recession should be avoided.

On the business side of things, one would ordinarily expect tariff-driven cost pressures to cool corporate capex. This is because higher costs of production usually mean management teams curb their pet projects until margins improve. However, as firms race to expand artificial intelligence infrastructure, capex among the "hyperscalers" rose roughly 66% in 2024 to about $210 billion. Some Wall Street forecasts project spending could reach **~$500 billion by 2026**. That momentum has kept investment running well ahead of what top-down models would imply.

At the same time, policy is turning more supportive. The One Big Beautiful Bill Act (H.R. 1) restores 100% bonus depreciation through 2028—allowing companies to immediately expense new equipment and structures instead of depreciating them over time. That effectively lowers the after-tax cost of investment, providing additional incentive for firms to keep building even amid tariff uncertainty. Combined with stronger household cash flows from expanded deductions, these measures should reinforce corporate and consumer resilience alike.

Taken together, we believe the worst of tariff effects should wane by year-end, with growth modestly re-accelerating into 2026 and the Fed continuing to normalize policy at a measured pace—always subject to incoming data. **This backdrop is modestly positive for duration and supportive for credit.** We'd expect rates to rally modestly as policy normalizes, while credit spreads grind slowly tighter, and investors let carry do more of the work in portfolios as they carry on clipping their coupons.

What Could Go Wrong: Cooling Continues at Accelerating Speed…Something We're Watching Closely

The most obvious downside risk is a labor shift from "not hiring" to "firing." This would drive a further decline in sentiment, drag on consumer spending and reduce corporate earnings. As earnings decline, unemployment potentially ticks higher. A second risk is a larger-than-expected tariff pass-through that bites more on prices and real incomes, prompting consumers to pull back even without layoffs.

If that feedback loop takes hold, the pattern is familiar: labor softens → confidence falls → spending slows → margins compress → defaults pick up → risk assets reprice → layoffs rise—until the standard recession playbook of joint monetary and fiscal stimulus restores credit and economic activity.

In that scenario, rates tend to perform best on a risk-adjusted basis, especially in the belly of the curve (intermediate duration), while credit spreads widen. Even so, high-quality credit has historically outperformed equities through downturns, continuing to pay income while taking less drawdown risk. We would expect that relationship to continue.

Investment Implications

When the economy is in balance and risks are two-sided, favor positioning that can hold up across a range of outcomes if the scales tip. Cut through the noise, focus on the signal and balance portfolios accordingly. In practice, that points to three strategies:

- **Core Plus Bond:** When the economy is in balance, choose a strategy that balances rates and credit. Rates tend to perform best when growth softens, credit tends to lead when growth firms—and both can do well as Fed policy normalizes. Core Plus also delivers high, diversified income and has historically provided strong risk mitigation to multi-asset portfolios if a tail-risk event reappears.

- **Active Global Bond:** With US fiscal pressures still elevated, global growth cooling, institutional uncertainty heightened and the dollar on its back foot, we expect a gradual reallocation of capital outside the US. That creates opportunities across yield curves, credit sectors and select currencies. An active, currency-hedged global bond approach can capture those relative-value dislocations and offers broader diversification versus a domestic-only intermediate core sleeve—while picking up yield and dampening volatility.

- **Short-Duration High Yield:** Our base case supports continued constructive credit with a subdued default cycle versus long-term averages. Short-duration high yield earns attractive all-in yields (above cycle averages) while limiting price volatility and mitigating downside in drawdowns. In the March–April sell-off, equities declined roughly ~20% while short-duration high yield fell only ~1%–2%; we would expect similar down-capture if equities correct again.

Bottom line: In a world shrouded in uncertainty and saturated with noise, these three strategies are designed to fare well across the likely paths ahead—keeping portfolios balanced, liquid and ready to lean either way as the evidence becomes clear.

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.

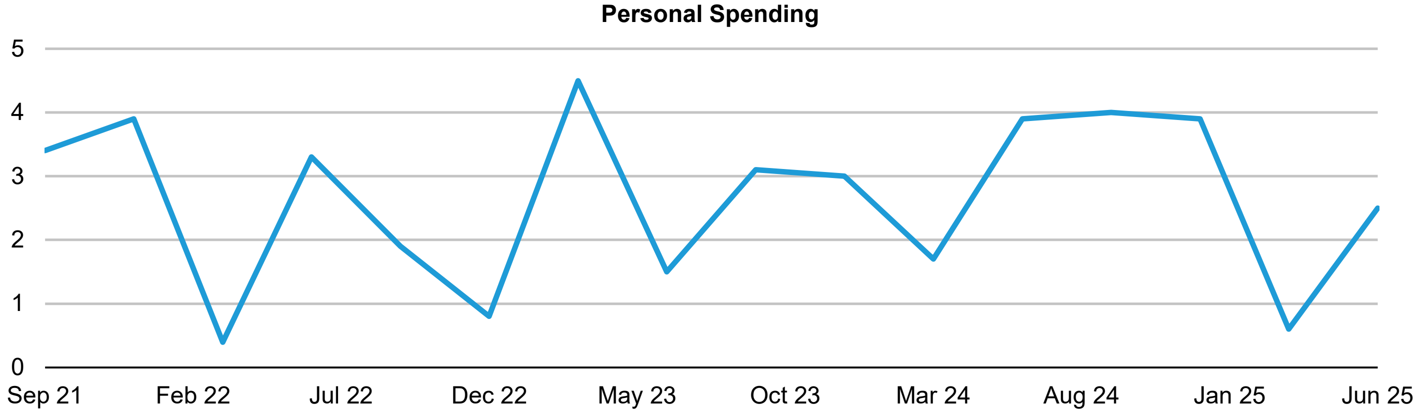
European Tariff Scenarios

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

US Economic Scenarios

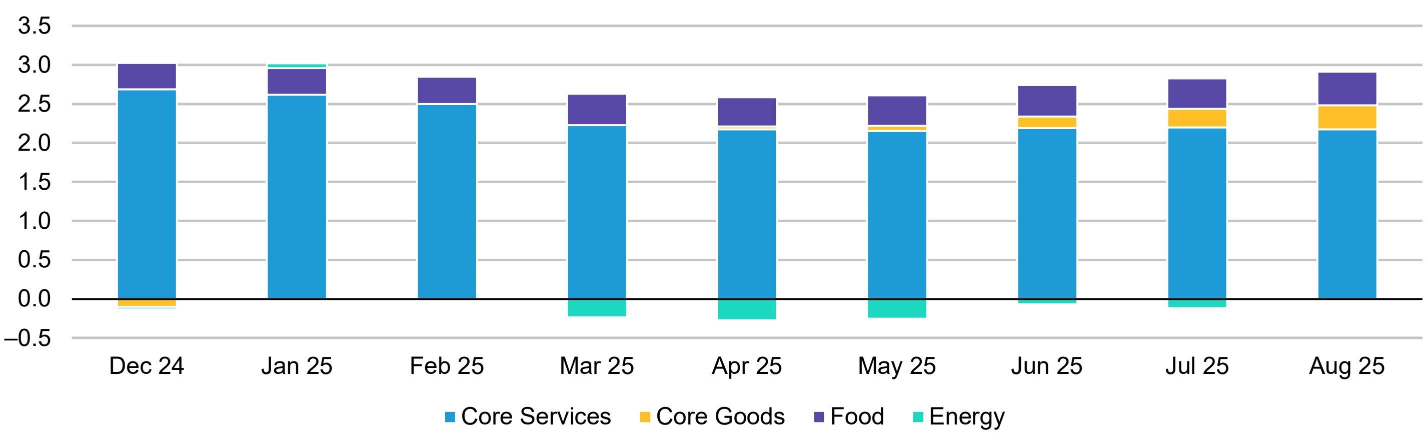
Economic Outcome	Description	Probability (Percent)
Hard Landing/Deep Contraction	Either an external shock occurs, or business-cycle dynamics deteriorate sharply. Growth slows rapidly and central banks have to act aggressively to support growth.	20
Soft Landing/Mild Contraction	Growth slows, labor markets 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 slowly, leaving the Fed comfortable easing policy slowly and remaining restrictive well into 2025, with cuts of 25 basis points 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

Display 1: GDP Was Revised Higher on the Back of Personal Consumption
Change in GDP US Personal Consumption in Chained Dollars from Previous Period (Percent)



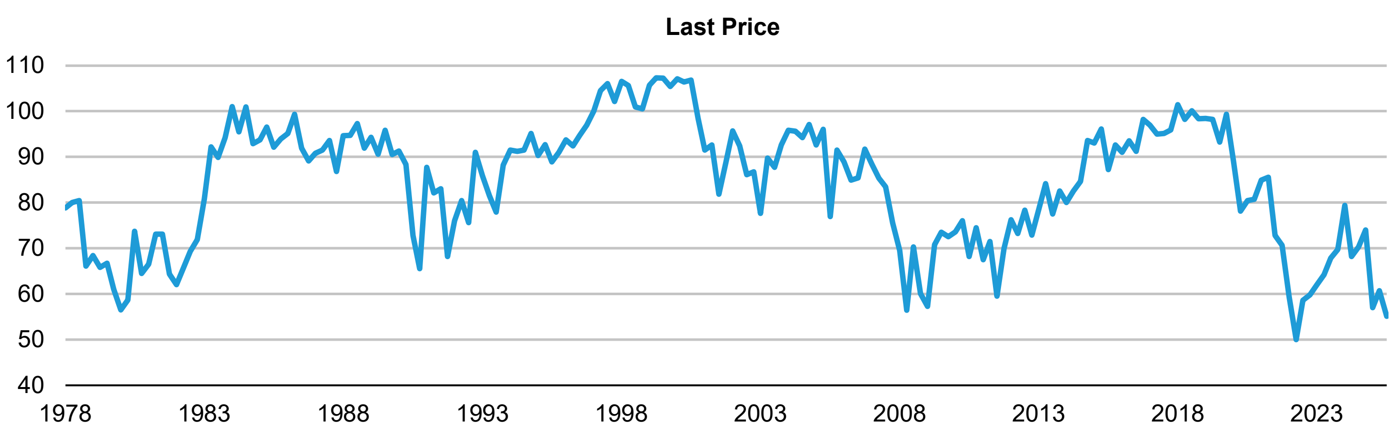
As of October 3, 2025
Source: Bloomberg and Bureau of Economic Analysis

Display 2: Goods Prices Continued to Tick Higher on Tariffs
US Personal Consumption Expenditure Core Price Index, YoY, Seasonally Adjusted (Percent Contribution)



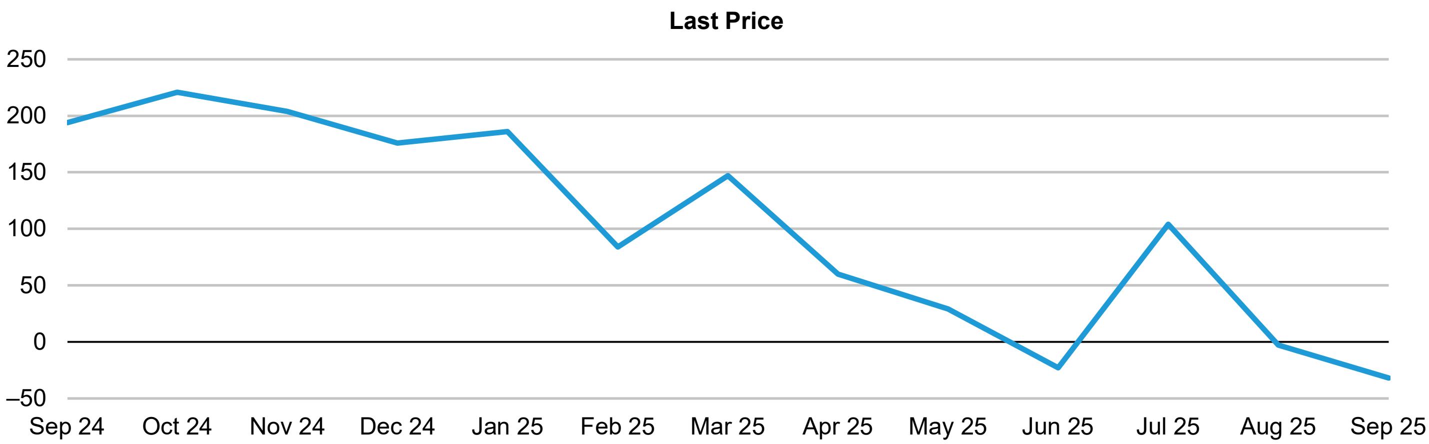
As of August 31, 2025
Source: Bloomberg and Bureau of Economic Analysis

Display 3: Consumer Sentiment Continues to Decline, Hitting One of the Lowest Levels Since Inception
University of Michigan Consumer Sentiment Survey



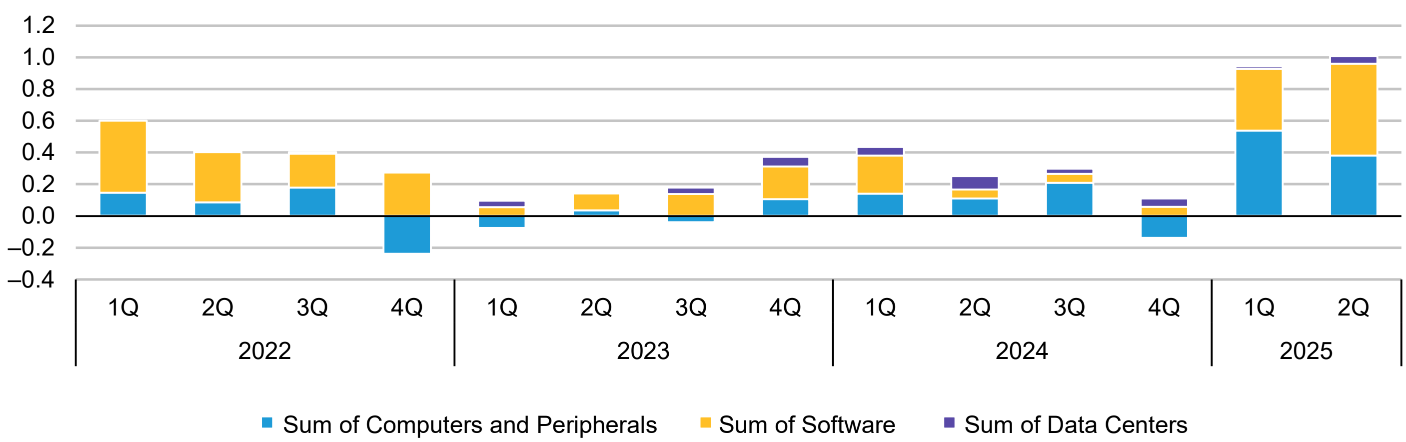
Through October 3, 2025
Source: Bloomberg and University of Michigan

Display 4: Private Payrolls Data Show a Further Hit to the Labor Market
ADP National Employment Report, Seasonally Adjusted, Private Nonfarm Level Change (Monthly, Thousands)



Through October 3, 2025
Source: Automatic Data Processing and Bloomberg

Display 5: AI Spending Continues to Surprise Against Top-Down Expectations of a Capex Decline
Expenditure Contribution to GDP Growth (Percent QoQ)



As of October 3, 2025
Source: Barclays

Investment Risks to Consider

The value of an investment can go down as well as up, and investors may not get back the full amount they invested. Capital is at risk. Past performance does not guarantee future results.

Important Information

IMA-814628-2025-10-06