



A Note from the AB Fixed Income Trading Desk

Thoughts from Our Senior Portfolio Managers

The AI and K-Shaped Economy

"We always overestimate the change that will occur in the next two years and underestimate the change that will occur in the next 10."
—Bill Gates

It's outlook season, and the debate has narrowed to a familiar triad: the artificial intelligence (AI) revolution, a softening labor market and a widening gap between lower- and higher-income households. As investors weigh how these forces intersect, alongside forecast risk and stretched valuations, we're trying to separate the hype cycle from the credit cycle. For advisors, the practical question is simple: what actually compounds from here—productivity, profits or just promises—and how should portfolios be sized if the answer takes time?

In our final note of the year, we consider three questions: Is AI a bonanza or a bubble (or a bit of both)? How is the labor market likely to evolve as policy normalizes? And does the K-shaped economy point to a broader macro vulnerability between the haves and the have-yachts? We'll frame what matters for fixed income—and where we think portfolios should be calibrated now.

Key Takeaways

- Key market economic data has resumed with labor market data on the softer side.
- The AI narrative that has fueled equity markets has different implications for credit.
- The K-shaped economy is being observed from both top-down and bottom-up measures.

Recent Market Events and Data Releases (November 17, 2025–November 28, 2025)

With the headlines shifting from "what might print" to "what actually did," here's what crossed the tape:

Resumed data flow: With agencies reopening, the Bureau of Labor Statistics (BLS) released the delayed September employment report. The print was mixed: headline payroll gains came in above expectations but were offset by downward revisions, and the unemployment rate rose to 4.4%, reinforcing the theme of a gradually softening labor backdrop (*Display 1*). The BLS also confirmed it will not publish an October employment report.

Other labor data: In lieu of an October jobs report, ADP updates pointed to moderate private-sector gains and a slower hiring pace than earlier in the year, consistent with cooling momentum (*Display 2*).

Fed minutes: Federal Open Market Committee minutes and public remarks emphasized flexibility and data dependence. Policymakers acknowledged softer labor dynamics, kept December "live" and avoided precommitments on the pace of easing. Governor Christopher Waller reiterated the recent cooling in labor conditions and the need to remain nimble rather than precommitted.

Consumer sentiment: The Conference Board Consumer Confidence Index declined in November, with the Expectations Index lagging the Present Situation Index. The University of Michigan final reading also dipped, and near-term inflation expectations edged higher—together signaling a more cautious consumer tone (*Display 3*).

Retail pulse: Retail sales (September, delayed) pointed to modest cooling in consumer spending, with headline sales up 0.2% MoM versus a stronger gain expected, and down from 0.6% MoM in August. Beneath the surface, the more "core" spending gauge was softer, reinforcing the view that demand is becoming more selective as the labor backdrop cools (*Display 4*).

Portfolio Manager Perspectives

AI implications: AI has officially graduated from idea to invoice. Behind the demos is a very unglamorous shopping list—land, power, substations, cooling, servers—and a growing bill to build, connect and maintain it all. In other words: AI runs on electricity and concrete, not adjectives. That's why we're steering clear of the two lazy extremes (golden age versus imminent bust) and sticking with a more

useful fixed-income filter: separate the hype cycle from the credit cycle—who's funding the build-out, on what terms and with what margin for error.

So far, this still looks more like “infrastructure plus strong balance sheets” than classic late-cycle behavior. The spend is flowing through the picks and shovels of the ecosystem—data centers, grid upgrades, networks and compute—where cash flows can be more contractual than the headlines suggest. And while a lot has been funded internally, the bond market has clearly been pulled back into the story: issuance has reaccelerated, deal sizes have been meaningfully larger than normal and the forward read still points to elevated capex into 2026 (even if the rate of increase slows). That means supply and spread sensitivity matter—without automatically implying widespread credit deterioration at the top of the stack.

We're more alert at the edge of the ecosystem—where the business model only works if adoption stays “perfect” and where leverage can hide in the plumbing. Oversupply shows up as underutilization and repricing; technology shifts can shorten asset lives; and if monetization lags the narrative, the market's patience thins and capex plans get stress tested. That's why our internal underwriting is deliberately more conservative than the headline narrative: we pay close attention to leasing, special-purpose-vehicle-style structures and embedded guarantees—places where risk can migrate off balance sheet and where public investment-grade paper can become the “sell-first” liquidity valve when markets wobble.

Labor market: The labor market is softening in a way that's getting harder to shrug off. Layoff notices are rising, job-cut tallies are drifting back toward ranges that have historically shown up in recessionary environments and sentiment is turning fragile—exactly the mix that can light the classic labor-to-spending spiral if confidence cracks and households start to retrench. For now, spending is still holding up, which is why we're not racing to call the worst-case outcome. But the direction of travel isn't comforting: the margin for error is thinner, risks are skewed down and a lot needs to go right—or at least not go wrong—to keep the slowdown from feeding on itself.

K-shaped consumer: A natural extension of that caution is showing up in the consumer. Even as the backdrop cools, aggregate spending is still holding up—but it's being carried disproportionately by the top end. Higher-income households, supported by stronger balance sheets and steadier employment, continue to spend, while lower-income cohorts are becoming more price and rate sensitive, trading down and showing more strain as buffers thin. This phenomenon is also highlighted in retailer performance. For example, Walmart continues to post solid results and share gains across income cohorts, with the strongest gains coming from upper-income households (highlighting a value-focused consumer across all income levels). Meanwhile, off-price retailers have been standout performers as value-seeking behavior broadens. In the middle, spending looks choppy and increasingly promo driven, with shoppers clustering around deals and event-led bursts rather than sustaining a smooth weekly cadence.

The risk isn't just inequality—it's fragility. When growth depends on a narrower slice of consumers, the cycle becomes more vulnerable to shocks that hit confidence, asset values or employment. Housing-linked categories tell the same story: Home Depot and Lowe's describe fewer trips and weak big-ticket projects, offset by steadier small repairs and more resilient pro demand—more “maintain” than “upgrade.” The takeaway is that the K-shape can keep the expansion alive longer than expected, but it also raises the odds that a modest deterioration in labor or sentiment creates a bigger-than-expected air pocket in demand.

Investment Implications

So, where does all this leave investors as we head into year-end? What risks are worth taking, and where is the market still paying you to stay disciplined?

- **AI (separate the equity story from the credit story):** Equity markets are pricing a lot of future perfection, and valuations don't leave much room for delays in monetization or a normal capex payback curve. Credit is a different exercise. The core of the ecosystem is still dominated by cash-rich issuers with meaningful capacity to service debt through the cycle—even if free cash flow is temporarily pressured by elevated spend. Where the opportunity set is expanding, particularly in high yield, is in the “real-asset” layer of the build-out: recent data-center financings are increasingly structured as secured, asset-backed exposure (power, land, buildings) where returns are tied to tangible infrastructure rather than AI model-cycle hype. The underwriting, however, lives and dies on counterparty quality and contractual backstops—especially the durability of leases once facilities deliver—plus disciplined execution through construction.
- **Duration (lean into the belly):** With labor-market momentum cooling and downside risks building, we still think the shape of the curve matters as much as the level of rates. We continue to prefer adding interest-rate exposure in the belly, where carry and roll remain attractive and where duration tends to benefit if growth softens further. Stated differently: even if the path is bumpy, the belly still looks like the cleanest way to express “slower growth” without taking uncompensated risk at the long end.
- **Consumer (stay higher-quality; pick spots):** In a K-shaped consumption backdrop, we prefer to keep exposure to discretionary retail light across investment grade and high yield and focus on businesses with clear value propositions and resilient traffic. Where we do want exposure, we'd bias toward off-price models that tend to gain share in trade-down environments. Home improvement remains a mixed picture near term—big-ticket demand is softer—but the longer-term fundamentals are still intact, and higher-quality investment-grade retail has generally seen muted spread volatility. In high yield, we maintain a structural underweight, with a selective willingness to engage in stressed situations only when there is a clear, financeable catalyst and a realistic path to improved fundamentals.

We wish everyone a strong finish to 2025—and we'll see you again in 2026.

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

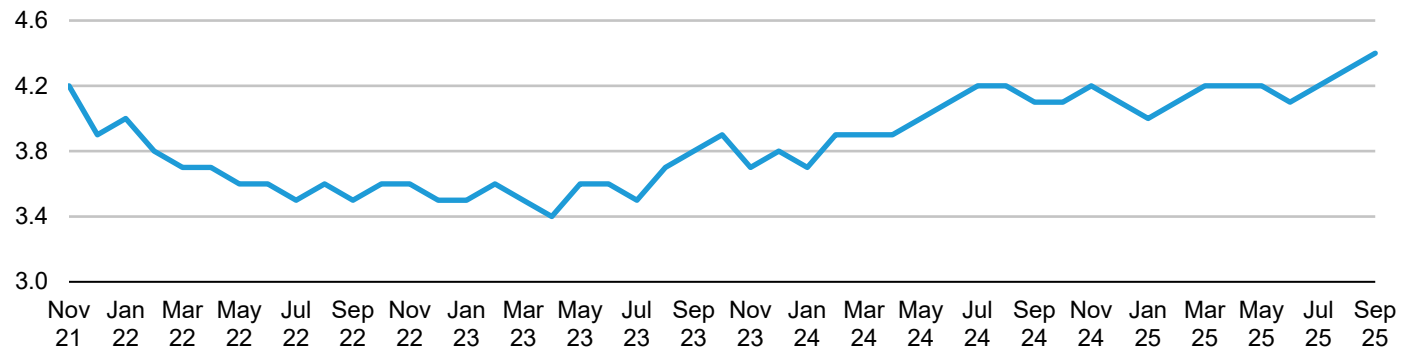
2025 Forecasts	Counterfactual No Tariffs at All (Percent)	Upside No Universal Tariffs (Percent)	Current Situation 10% Universal Tariffs (Percent)	April 2–9 20% Universal Tariffs (Percent)	Downside 30% Universal Tariffs (Percent)
Growth (YoY)	1.10	0.80	0.06	0.30	–0.60
Inflation (Annual)	2.00	1.80	1.60	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 with 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: Unemployment Has Risen to the Highest Level Since the Pandemic

US Unemployment Rate Total in Labor Force Seasonally Adjusted

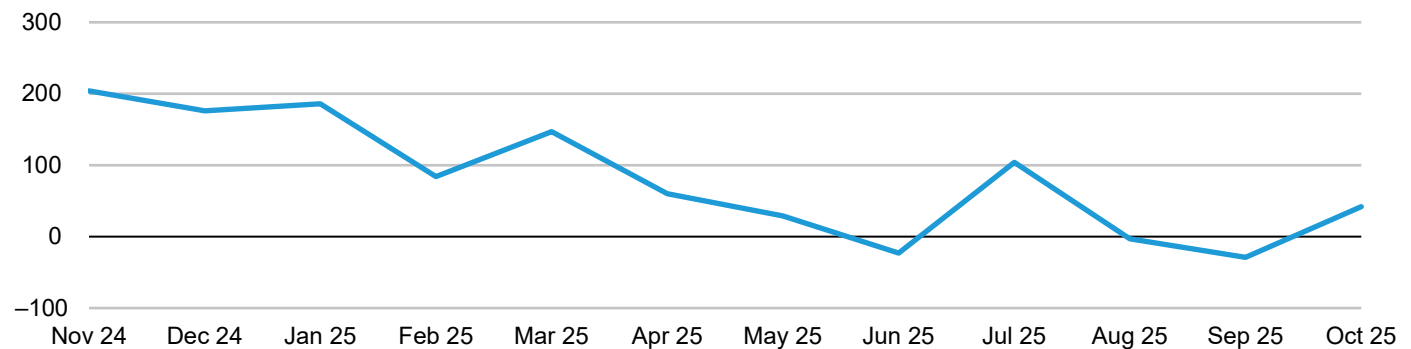


As of November 28, 2025

Source: Bloomberg, Bureau of Labor Statistics

Display 2: ADP Shows the Economy Averaging Just 25k Per Month Since April

ADP National Employment Report SA Private Nonfarm Level Change

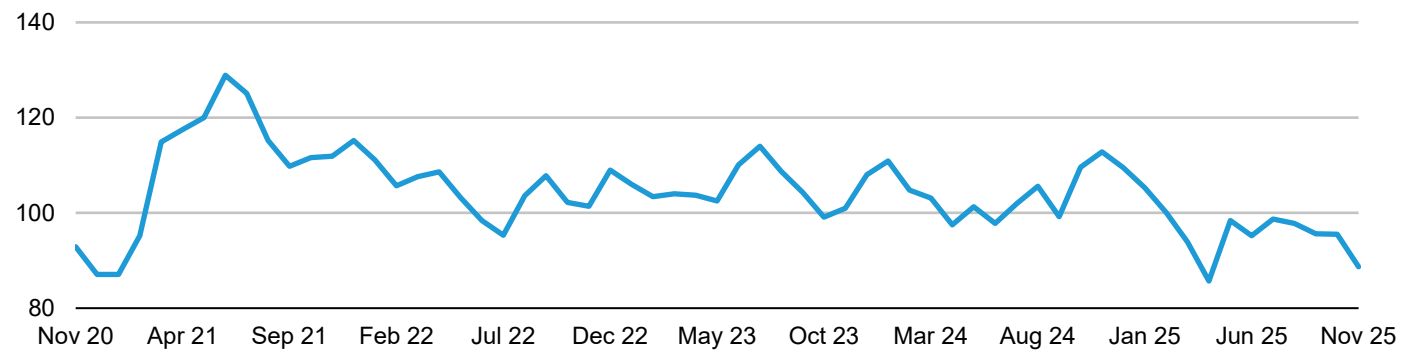


As of November 28, 2025

Source: Bloomberg, ADP

Display 3: Consumer Confidence Remains at Very Low Levels

Conference Board Consumer Confidence Index

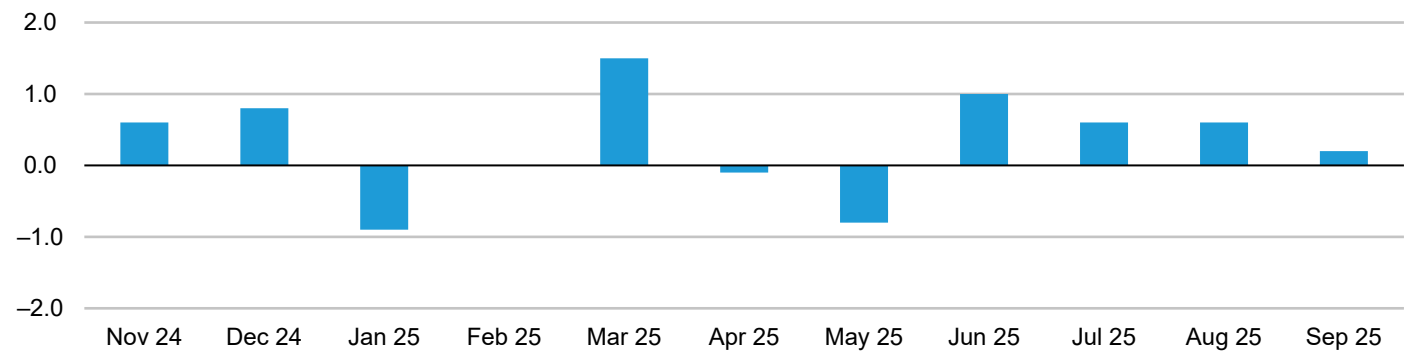


As of November 28, 2025

Source: Bloomberg, Conference Board

Display 4: Retail Sales Softened in September, Missing Analyst Estimates

Adjusted Retail and Food Services Sales



As of November 28, 2025

Source: Bloomberg, US Census Bureau

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.

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