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January 13, 2026

A Note from the AB Fixed Income Trading Desk

Thoughts from Our Senior Portfolio Managers

Policy, Politics and Geopolitics

"Plans are worthless, but planning is everything." —Dwight D. Eisenhower

The year 2025 was explosive, but 2026 opened with a literal bang. US forces bombed Caracas, Venezuela, and arrested President Nicolás Maduro on allegations of sponsored narcoterrorism—and markets barely flinched. That reaction is telling. Markets are not ignoring risk, they are simply ranking it. Investors appear anchored in fundamentals and are pricing headlines through the variables that drive fixed-income outcomes, like growth, inflation and the policy mix across the monetary, administrative and fiscal landscape. The question now is how these inputs evolve and what they mean for the path of rates, the shape of the curve and whether investors are being paid enough to take credit risk. In this note, we look through the noise and lay out the 2026 themes most likely to matter for investors.

Recent Market Events and Data Releases (December 1, 2025–January 9, 2025)

December is usually a quieter stretch as investors mark books, take vacations and look ahead to the new year. However, the end of 2025 was marked by a renewed flow of data. With government agencies reopening after the October–November shutdown, the market finally started getting information again, beginning with the delayed labor-market read-through. Here's what mattered most since our last note:

Jobs: The US economy added 50,000 jobs in December, lower than the previous month and lower than expected, and there were downward revisions to hiring data for both October and November. The moving average of hiring over the past three months is now negative 22,000, reflecting net layoffs. The unemployment rate, however, fell by a 10th, to 4.4%, due to a drop in the number of workforce participants (*Display 1*).

CPI: The shutdown period also complicated data collection and interpretation, so the Consumer Price Index (CPI) story is a bit more opaque than usual. Even so, the broader trend still looks consistent with gradual disinflation, with core CPI falling to 2.6% year over year and prices rising just 0.2% over the full two-month period (*Display 2*).

GDP: On growth, the data continue to be noisy but kept the US resilience narrative alive, with 3Q GDP printing 4.3% on an annualized basis. That said, trade-related distortions contributed meaningfully to the headline number. While personal consumption was also elevated, it was predominantly driven by higher healthcare expenditures (*Display 3*).

Fed Policy: The Fed cut for the third and final time in 2025 at the December meeting, bringing the benchmark policy rate to the 3.50%–3.75% range. Current market pricing suggests the Fed will cut approximately two times in 2026, while we are forecasting two–three cuts (*Display 4*).

Business Sector: Institute for Supply Management business sentiment indices continued to show a divide between manufacturing and services. Manufacturing dipped further and below consensus, printing 47.9, indicating continued contraction. Services rebounded strongly and well exceeded expectations at 54.4. The composition was also strong, with increases in business activity, new orders and employment (*Display 5*).

Consumer Sentiment: The University of Michigan Consumer Sentiment Survey continued its improvement trend for the third straight month, printing above consensus at 54.0, versus the 53.5 consensus expectation.

Portfolio-Manager Perspectives

Elevated geopolitical risks, ground wars and regime changes in emerging-market countries have not translated into material risks for the global economy in the last few years. From a market's perspective, that means looking through the noise and staying focused on what is most likely to influence the factors that drive fixed-income returns, as well as the catalysts that could still upend risk assets.

Base Case (75% Probability): Our base case for the US is broadly in line with the consensus, and for good reason. We expect growth to improve but remain moderate, as trade-related frictions abate, capex investment accelerates, consumers continue to spend and a gradually softening labor market keeps growth tempered. Alongside this, the disinflation process should continue, allowing the Fed to stay on course toward normalizing policy. This setup argues for another year of positive cross-asset returns, albeit at a more moderate rate than those in the prior three years.

Bull Case (20% Probability): The same factors expected to drive higher growth may ultimately exceed our forecasts. Looking ahead, investment incentives from the One Big Beautiful Bill Act, record-breaking consumer tax benefits, easier financial conditions, growing demand for AI-related investment and a fading policy uncertainty drag could deliver a strong pace of consumption and capex growth in 2026. If these dynamics catalyze increased hiring and a re-acceleration in the labor market, the economy could perform much better than expected and we may end the year talking about rate hikes instead of rate cuts.

Bear Case (5% Probability): There is also a chance that the economy slips into a hard-landing scenario. We see two potential catalysts. First, market sentiment fades (particularly around AI-related exuberance), leading to a correction in historically rich equity valuations. A weaker wealth effect would likely weigh on higher-end consumers, who have carried a meaningful share of recent spending, and consumption could soften. Second, persistently weak sentiment and a pullback in spending could slow top-line growth and accelerate the cooling in labor markets. Either path could produce a lower-growth, higher-unemployment environment and lead to rate cuts well beyond the terminal rate priced today.

Rates: This range of outcomes favors a carry-and-roll environment. We expect intermediate-term yields to remain range bound, with a lower ceiling than in recent years. The floor for short-term yields, however, has greater asymmetry, which favors steepening expressions in the belly of the curve. As the curve normalizes, all-in yield and carry become central to fixed-income portfolio construction again.

Credit: A moderate macro backdrop and lower yields suggest a continuation of what we have seen in credit markets. We expect a modest softening in fundamentals at the margin, but overall quality metrics should remain healthy. Defaults and Liabilities Management Exercise (LMEs) are likely to rise for the weakest issuers but should remain low by historical standards. Consensus expects spreads to widen modestly from historical tights, but in an expansionary environment, there is also reason to expect spreads to remain within the tight ranges we have seen over the last few years. We also expect rising animal spirits and continued M&A activity to drive shifts in the composition of the investment-grade and high-yield universes, creating opportunities for integrated managers.

Investment Implications

So where does that leave investors as we move into 2026? In our view, this is a year to stay disciplined, get paid for taking risk and avoid confusing a noisy backdrop with a broken one.

- **Carry and Curve:** A range-bound, gradually normalizing yield curve argues for a traditional carry-and-roll posture. Practically, that means extending duration away from cash, very short maturities and floating-rate exposure, and into the belly of the curve. The objective is straightforward: earn income, benefit from roll-down where it is still attractive and maintain a meaningful hedge if the growth outlook deteriorates.
- **Active Credit:** Taken together, we have a benign outlook and late-stage credit-cycle dynamics, with spreads likely to remain range bound even if fundamentals soften at the margin. That backdrop still supports an allocation to credit, with an emphasis on yield and risk-efficient income. But defaults and idiosyncratic tail risks are rising at the weaker end of the market, which we believe keeps an advantage to active managers who can manage downside risk, take advantage of periodic dislocations and add value through security selection.
- **Global Diversification:** Conditions abroad remain less optimistic than in the US, and policy paths are increasingly divergent. The Fed is still easing, the Bank of Japan is tightening, and many other developed-market central banks appear closer to the end of their cycles. Layer in geopolitics, uneven inflation progress and trade-policy cross-currents, and the opportunity set broadens meaningfully. This argues for a global multi-sector tilt, particularly on a currency-hedged basis, where investors can pursue relative value with lower FX-driven volatility.

Best of luck in 2026—we'll be watching the data closely and will keep you posted as the opportunity set evolves.

On behalf of the team,

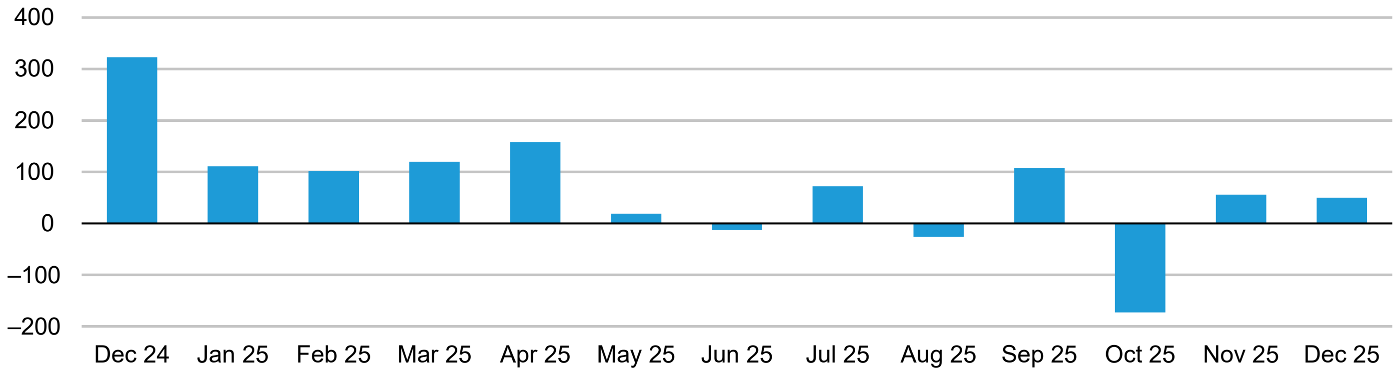
Scott DiMaggio, Gershon Distenfeld, Matt Sheridan, Fahd Malik, Will Smith, John Taylor, Serena Zhou, Tim Kurpis, Christian DiClementi, Sonam Dorji and AJ Rivers

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

US Economic Scenarios

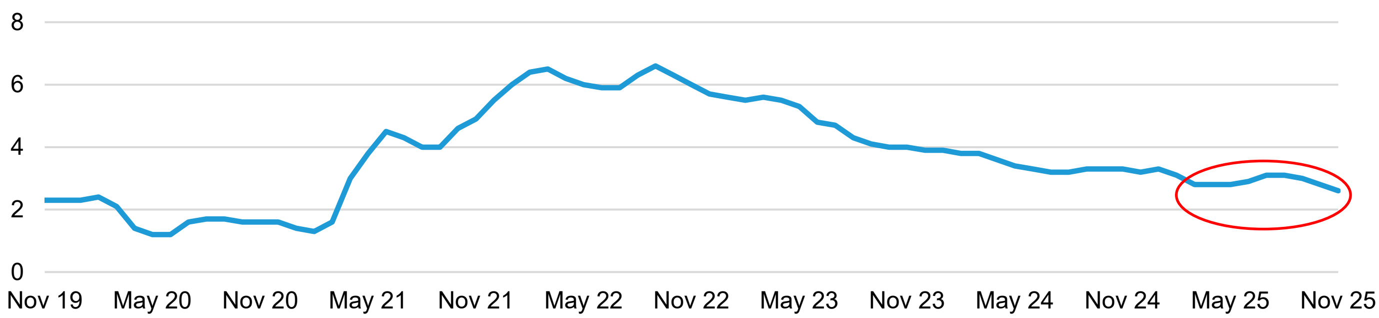
Economic Outcome	Description	Probability (Percent)
Hard Landing/Deep Contraction	Growth and the labor market collapse, and the Fed has to ease aggressively.	5
Soft Landing/Mild Contraction	The labor market slows enough and inflation comes down enough for the Fed to cut below neutral, but not so much as to signal an imminent recession.	40
Rebalancing	Growth and the labor market are stable and the Fed cuts +/– two times as inflation gradually declines.	35
Reacceleration	Growth picks up quickly and strongly, and hiring rebounds. Inflation starts to pick up and rate hikes come back on the table in H2:2026.	20

Display 1: Lower Number of December Jobs and Downward Revisions Reflect Net Layoffs
Job Openings and Labor Turnover Survey Data (Thousands)



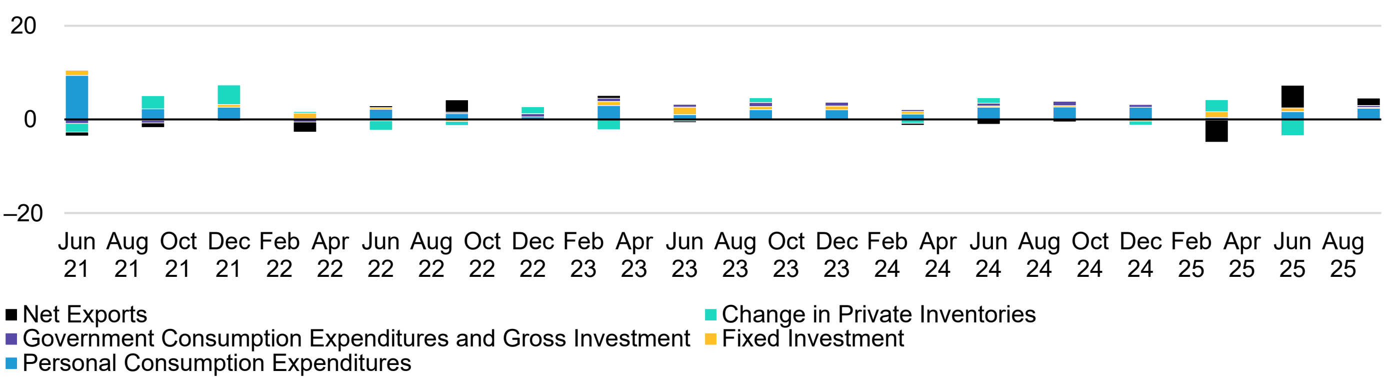
As of December 31, 2025
Source: Bloomberg and US Bureau of Labor Statistics

Display 2: Gradual Trend Toward Disinflation
Consumer Price Index Data



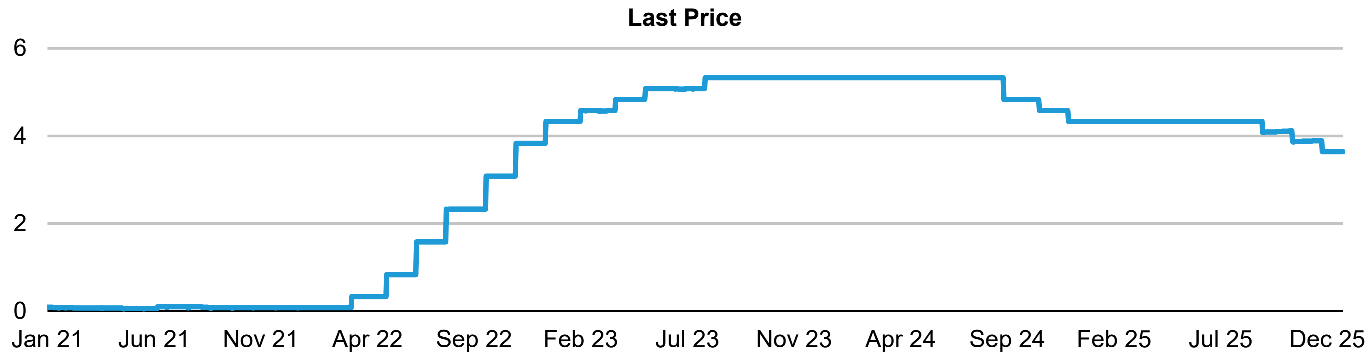
Through November 30, 2025
Source: Bloomberg and US Bureau of Labor Statistics

Display 3: US Resilience Remains, Though Trade-Related Activity Continues to Distort Headline Numbers
US GDP



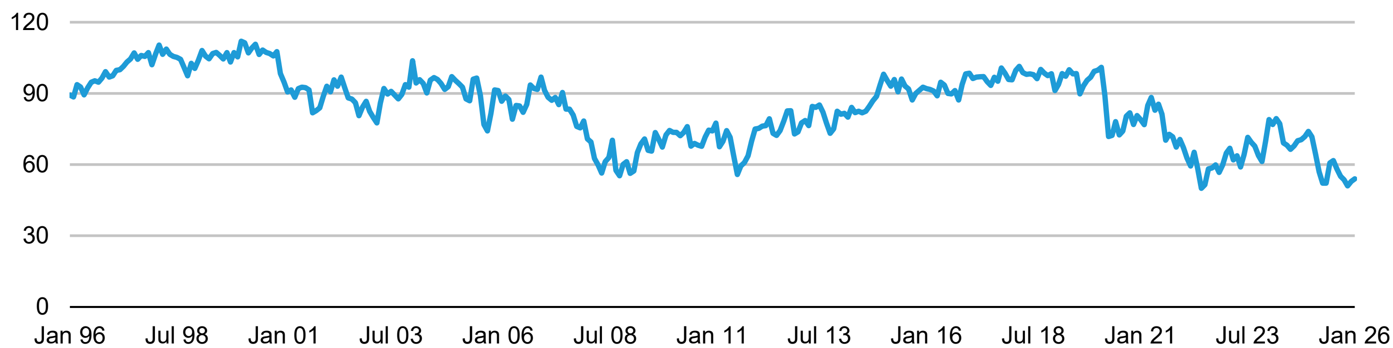
As of September 30, 2025
Source: Bloomberg

Display 4: Fed Ended the Year with a Cut of 25 Basis Points
Federal Funds Rate (Percent)



Through January 9, 2026
Source: Bloomberg

Display 5: ISM Services Rebounded
Institute for Supply Management Services Data



Through January 31, 2026
Source: Bloomberg and Institute for Supply Management

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

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