



A Note from the AB Fixed Income Trading Desk

Thoughts from Our Senior Portfolio Managers

Icy Hot

"The test of a first-rate intelligence is the ability to hold two opposed ideas in the mind at the same time and still retain the ability to function." —F. Scott Fitzgerald

As the polar vortex tightens across the US and atmospheric rivers soak parts of Europe, markets have kept a surprisingly warm tone: equities near highs, credit spreads near tight and rates largely range-bound. The World Economic Forum Annual Meeting 2026 in Davos underscored the same paradox, with optimism around AI and productivity set against a more fragmented global backdrop, even as 2026 forecasts have firmed on expectations of fiscal support, fading tariff pressures, easier monetary policy and continued capex investment.

Meanwhile, the headline tape has been anything but quiet. Japan's snap elections have investors revisiting fiscal risk, and renewed US rhetoric about taking control of Greenland is a reminder that geopolitics can move from fringe to front page quickly. Perhaps the only thing that has felt relatively lukewarm is the Fed, sticking to a data-dependent, dual-mandate framework rather than chasing narratives. That was of course, until President Donald Trump nominated former board governor Kevin Warsh to become the next chair of the Federal Reserve. Warsh has historically leaned hawkish when attempting to ice inflation but has taken a more dovish stance lately, which should heat up the labor market.

In this note, we focus on what is most likely to drive portfolios in a carry-first market, where staying warm is easy and getting burned is still possible.

Recent Market Events and Data Releases (January 12, 2026–January 30, 2026)

Even without extreme winter weather across the US and Europe, market participants had plenty to dig their way out of.

Fed Chair Nominated. If confirmed by the Senate, Kevin Warsh would take the open governor's seat and remain as a governor until Powell's term ends, at which point he would become the chair in May. Warsh has long been thought of as a potential candidate, so this was not a shock to market participants.

Central Banks Largely Stayed the Course. The Fed left policy unchanged at its January meeting, while the Bank of Japan (BoJ) also held steady, keeping its policy rate at 0.75%. The Bank of Canada delivered its January rate decision alongside its quarterly monetary policy report, keeping global policy attention focused more on messaging and forecasts than on dramatic policy shifts (*Display 1*).

Japan Briefly Roiled Markets. Prime Minister Sanae Takaichi called a February 8 snap election, and the market quickly latched on to the fiscal implications and the monetary pickle the BoJ may be in. Long-end JGB yields jumped, with the 40-year yield briefly pushing above the 4% level. The move spilled into global rates and triggered a short-lived wobble in risk assets before conditions steadied (*Display 2*).

Global Headlines and the World Economic Forum. Davos ran January 19–23 under the theme "A Spirit of Dialogue," with conversations clustering around AI deployment and governance, productivity, energy security trade-offs and geopolitical risk management. Trade also moved back into focus as India and the EU announced they had finalized a major free trade agreement, featuring broad tariff reductions across most goods while formal approvals remain ahead. Separately, President Trump reiterated his push for US control of Greenland and then backed down, underscoring how geopolitical narratives can reenter the market conversation quickly.

Earnings Season Opened with Banks, and the early read through was firm. US banks reported solid 4Q earnings with beats from most large banks. Asset quality remains benign, as net charge-offs generally trended lower, provisions came in lighter than expected and delinquency metrics improved. Expense trends were mixed, as some banks saw unexpected upticks and elevated guidance for FY 2026. Management teams struck an optimistic tone on accelerating loan growth, expanding net interest margins and robust investment banking pipelines while downplaying the likelihood of a 10% APR cap, given its potential negative impact on the broader economy (*Display 3*).

Macro Data Leaned Steady, with a sharper hit to confidence. December CPI continued to show progress on inflation, with core CPI running at 2.6% year over year. November demand data remained resilient: retail sales rose 0.6% and personal consumption expenditures increased 0.5%. Confidence, however, softened materially. Conference Board consumer confidence fell to 84.5 in January, its lowest level since 2014, highlighting a widening gap between sturdy hard data and a more cautious household mood (*Display 4*).

Portfolio Manager Perspectives

When Things Are Balanced, Carry Is King. The tone in the data has shifted from cooling to stabilizing, with pockets beginning to warm at the margin. Growth expectations have firmed on supportive fiscal dynamics and a continued AI-driven capex cycle, while inflation has continued to improve, and the direction of policy is gradually becoming less restrictive as rates move closer to neutral. Together, that keeps the market in a familiar equilibrium: enough momentum to support risk assets, enough uncertainty to keep volatility episodic and geopolitics as a persistent source of headline risk. In that setup, income and roll-down tend to do more of the heavy lifting than heroic timing. The right posture is balanced. Stay invested, get paid and avoid chasing the tape.

Rates: Policy is close to neutral and the path forward looks measured. With policy much closer to its destination than its starting point, the Fed can remain anchored to a data-dependent, dual-mandate framework. Our base case is two cuts this year toward a neutral rate we now think sits around 3%. That backdrop should keep intermediate rates largely range-bound as the curve continues its slow normalization. Practically, that supports modest duration extension, particularly in the belly, while recognizing the long end can remain the most term-premium and headline-sensitive part of the curve. Importantly, high-quality duration remains one of the most reliable hedges when risk assets reprice.

With rates likely contained, the question becomes how much spread risk investors are being paid to own.

Credit: Fundamentals and technicals still support tight spreads, but dispersion still matters. Some modest spread-softening would not be surprising, but the underlying backdrop remains constructive. Corporate fundamentals are still in decent shape, credit quality is historically strong and high-yield duration remains unusually short (*Display 5*), meaning less exposure to rate volatility and a greater share of return coming from carry. Supportive technicals also remain in place, with steady demand for income and limited near-term refinancing pressure. In that context, it is easy to see how spreads can remain tight for longer than many expect. Absent a material equity drawdown and a clear softening in labor, sustained, meaningful widening looks less likely. And even in a benign tape, weak companies and poor management teams will still default. That is why we continue to favor active credit exposure and downside protection when beta looks calm but idiosyncratic risk can still do real damage.

Investment Implications

Bottom line: This still looks like a carry-first environment. The goal is to maximize income without turning portfolios into a one-way bet on perfect conditions. To us, that translates into three practical moves.

- **Duration:** With policy near neutral, we still expect rates to remain largely range-bound, which keeps the case intact for modest duration extension, particularly in the belly of the curve. Just as important, high-quality duration remains one of the most effective hedges in a risk-off move, and today you are being paid well to own that hedge through carry and roll-down. Implementationwise, this is a good moment to rebalance some cash and floating-rate exposure toward core intermediate allocations where income can work harder.
- **Credit:** We still like high yield, but we prefer balance and selectivity. Blend investment-grade and high-yield risk and lean into crossover, where you can often buy income without buying fragility. For dedicated high-yield allocations, put manager selection at the center of the decision. Favor teams with a repeatable process and a track record of avoiding defaults and permanent impairment in tail events, and stay mindful of liquidity when spreads leave little room for error.
- **Global Multi-Sector:** Tight spreads and range-bound US rates raise the value of diversification and relative value across global rates and credit. Currency-hedged global allocations can broaden opportunity sets and improve risk-adjusted income without importing the full volatility of unhedged FX. Use global as a diversifier first and a yield enhancer second.

What We Are Watching: labor market softening, equity drawdowns and term premium shocks tied to fiscal policy and geopolitics.

In an icy-hot market, it is easy to confuse calm prices with low risk. We would stay focused on being paid to own the right exposures, keeping hedges in place and letting carry do the compounding while the path ahead comes into focus.

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

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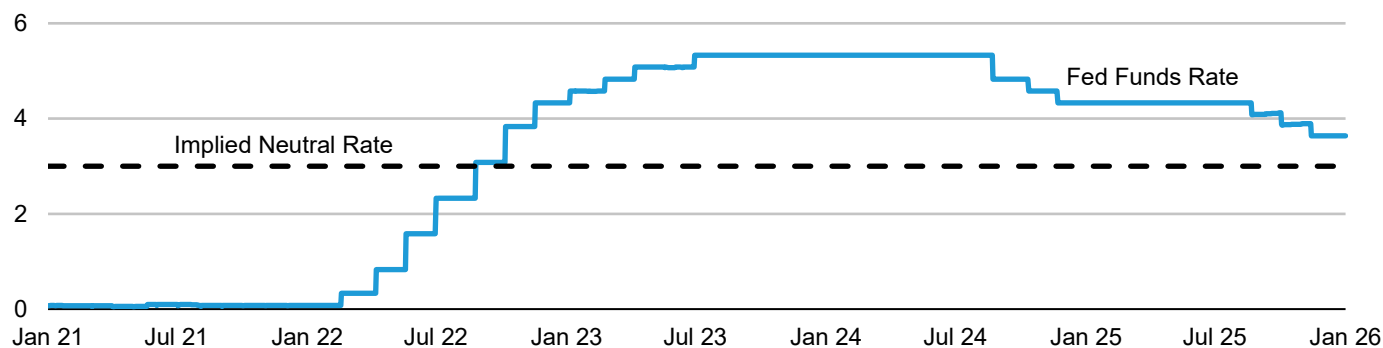
US Economic Scenarios

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

Current analysis and forecasts do not guarantee future results.

Display 1: The Fed Kept Interest Rates Unchanged

Federal Funds Rate (Percent)

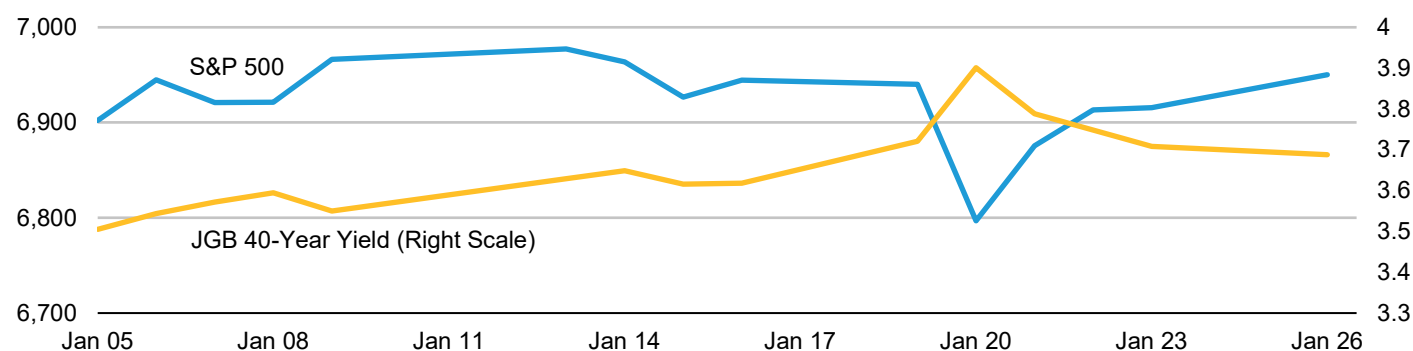


Through January 30, 2026

Source: Bloomberg and US Federal Reserve

Display 2: Japan Snap Elections Roiled Ultralong Bonds and Risk Assets

40-Year Japan Government Bond Yields and S&P 500

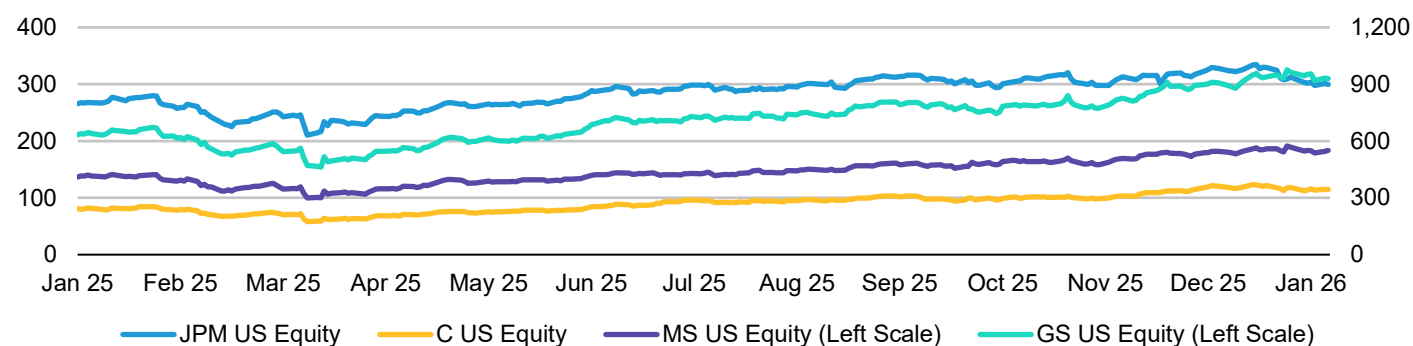


Through January 30, 2026

Source: Bloomberg and S&P

Display 3: Banks Kicked Off Earnings Season with a Decent Tone

Equity Prices (USD)



Past performance does not guarantee future results.

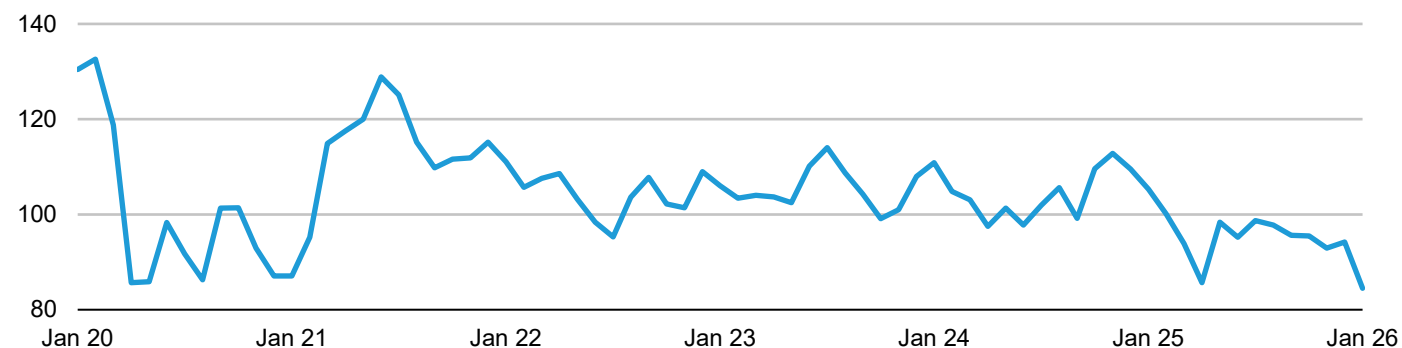
JPM: J.P. Morgan; C: Citigroup; MS: Morgan Stanley; GS: Goldman Sachs

Through January 30, 2026

Source: Bloomberg

Display 4: Survey Measures of Consumer Confidence Slipped Despite Strong Spending Backdrop

Conference Board Consumer Confidence Index

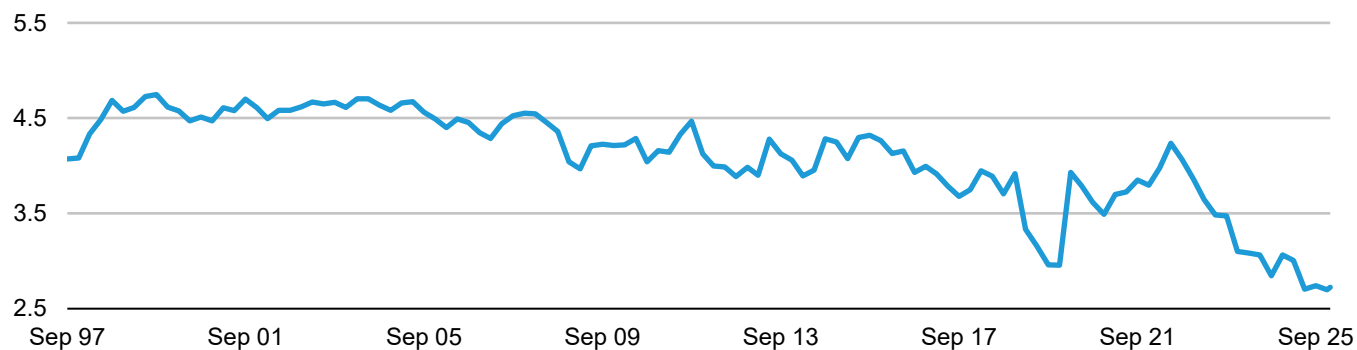


Through January 30, 2026

Source: Bloomberg and The Conference Board

Display 5: High-Yield Index Duration Remains Low from a Historical Perspective

Bloomberg High Yield Index Duration



As of January 30, 2026

Source: Bloomberg

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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