AllianceBernstein

August 2026

A Note from the AB Fixed Income Trading Desk

Thoughts from Our Portfolio Management Team

The Midyear Review

"The bamboo that bends is stronger than the oak that resists"—ancient Japanese proverb

At the start of the year, we argued that investors did not need a perfect forecast to earn attractive fixed-income returns; they needed balance, flexibility and the ability to adapt as markets evolved. That advice proved especially valuable during the first half of 2026.

Markets navigated an unusual combination of events: conflict in the Middle East, an inflation resurgence, a sharp repricing in global interest-rate expectations and one of the largest corporate investment cycles in modern history. Yet, despite these headwinds, both the global economy and financial markets proved remarkably resilient.

The defining story of the first half of the year was not simply AI—it was AI's ability to offset many of the macro headwinds investors expected would derail growth. Higher oil prices, rising real yields and a more hawkish central bank backdrop created volatility, but investors increasingly focused on resilient earnings, record capital investment and improving productivity expectations.

As we enter the second half, we believe investors should focus less on forecasting headlines and more on understanding the structural forces driving growth, interest rates and credit markets. This month we take the opportunity to grade the expectations we had at the start of the year and to look ahead to the remainder of 2026.

What Changed in the First Half

Economic Resilience Surprised to the Upside. Entering 2026, hiring had slowed, manufacturing remained weak and GDP had ended 2025 well below trend. The first half of the year was notably stronger: The labor market stabilized (*Display 1*), manufacturing returned to expansion and equities delivered their strongest quarterly gains in years.

More importantly, the economy demonstrated an ability to absorb higher oil prices and a meaningful repricing of global interest-rate expectations without a material deterioration in financial conditions or corporate credit fundamentals. That resilience, however, became increasingly concentrated. AI investment and higher-income consumer spending carried much of the economy, while lower-income households continued to face pressure from elevated living costs.

Question for 2H 2026: Can growth broaden beyond AI investment and affluent consumers?

AI Became the Dominant Market Driver. No development possibly influenced financial markets more than AI. Rather than slowing in response to higher financing costs or geopolitical uncertainty, hyperscalers accelerated investment, driving one of the largest financing cycles the investment-grade market has experienced in years. By the second quarter, attention had refocused on the scale of AI investment, as hyperscalers issued nearly $200 billion of investment-grade debt across a wide range of currencies through the first half of 2026 to support a record pace of capital expenditure (*Display 2*).

From a credit perspective, our concern is not deteriorating balance sheets. Most hyperscalers remain exceptionally strong borrowers. Instead, the investment debate has shifted toward whether today's extraordinary pace of capital spending ultimately produces the productivity and earnings necessary to justify those investments.

Question for 2H 2026: Is today's investment cycle the beginning of a durable productivity boom or are expectations moving ahead of fundamentals?

Markets Repriced Rates—Not Credit. The Middle East conflict initially reignited inflation concerns, but the largest market adjustment occurred in interest-rate expectations, not credit markets. Investors moved from pricing additional rate cuts to considering future rate hikes, while the Federal Reserve's reduced reliance on forward guidance placed greater emphasis on incoming economic data. Risk-free rates have broadly shifted higher, with some key benchmarks, such as the 30-year Treasury, reaching yields not seen since before the global financial crisis (*Display 3*). The biggest moves in curves, though, have been in the front end as more hawkish expectations have driven front-end yields higher. The curve is now significantly flatter than it was to start the year (*Display 4*)

Perhaps what is most notable is what didn't happen. Credit spreads finished the first half of the year remarkably close to where they began (*Display 5*), funding markets remained orderly and public credit issuance continued uninterrupted. At the same time, oil prices retraced much of their geopolitical spike, allowing long-term inflation expectations to remain relatively well anchored.

Question for 2H 2026: Will inflation moderate as energy markets stabilize or broaden into more persistent price pressures?

Our Midyear Scorecard

Economic Growth: Correct
Resilient consumer spending and AI investment proved stronger than expected, offsetting geopolitical headwinds and supporting above-consensus growth.

Inflation and Central Banks: Mixed
The energy shock delayed continuation of the easing cycle. While underlying inflation continued to improve, central banks understandably adopted a more cautious stance.

Duration: Too Early/Wrong
Our recommendation to gradually move away from cash and floating-rate exposure detracted from performance in the near term as higher real yields challenged our duration view. However, today's higher real yields have created a considerably more attractive starting point for long-term income investors.

Credit: Correct
Credit generated positive returns despite elevated volatility. Increasing dispersion across issuers and sectors reinforced the value of active management and security selection, particularly as AI has continued to reshape industry fundamentals.

Global Diversification: Correct
As central bank policies and economic cycles diverge, we believe global flexibility has become an increasingly valuable source of both opportunity and risk management.

The Playbook for the Second Half

The first half of the year reinforced that markets are increasingly driven by structural trends rather than a single macro forecast. In our view, successful portfolios should emphasize flexibility, diversification and active risk management as policy paths, growth trajectories and credit opportunities continue to diverge.

- **Global Bond Exposure Hedged to USD:** Diverging monetary policy is creating one of the broadest opportunity sets across global government bond markets in years. A hedged global approach allows investors to benefit from those differences while maintaining a high-quality core fixed-income allocation. Active global credit selection allows us to allocate across US, European and emerging-market opportunities, emphasizing the most attractive risk-adjusted income while avoiding sectors where valuations no longer adequately compensate investors.
- **Globally Diversified High Yield:** Credit fundamentals remain generally supportive, but opportunities are becoming increasingly dispersed across regions and sectors. A global approach broadens the investable universe while reducing dependence on any single economy or credit cycle. Active global credit selection allows us to allocate across US, European and emerging-market opportunities, emphasizing the most attractive risk-adjusted income while avoiding sectors where valuations no longer adequately compensate investors.
- **Higher-Quality, Shorter-Duration High Yield:** With government yields already elevated and credit spreads near historical averages, we believe investors can continue earning attractive income while limiting exposure to the two largest sources of high-yield volatility: lower-quality issuers and longer-duration bonds. Active security selection seeks to maximize income while managing downside risk through disciplined issuer selection, fundamental credit research and thoughtful duration management.

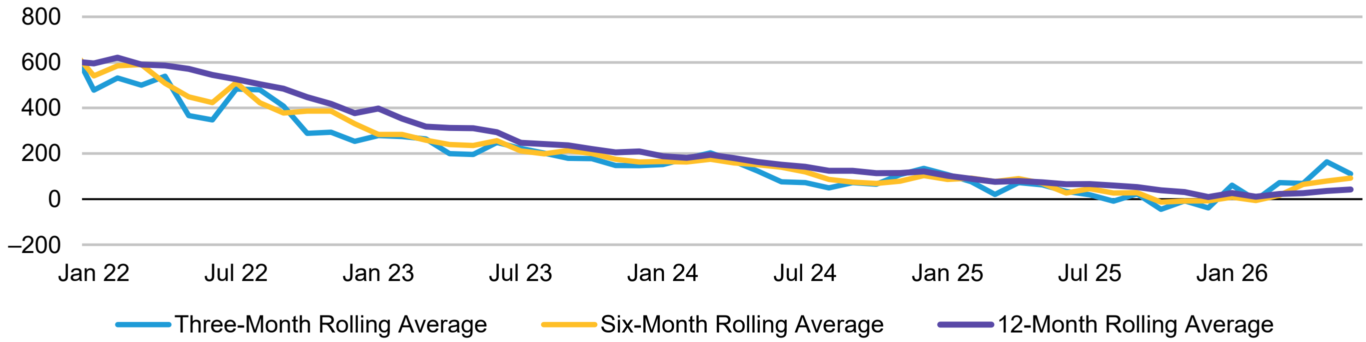
Bottom Line: The first half of 2026 demonstrated that financial markets can withstand significant geopolitical and macroeconomic shocks when supported by resilient economic activity and powerful structural investment trends. Looking ahead, the key question is no longer whether AI will influence markets—it already does. The more important question is whether today's unprecedented investment ultimately translates into lasting productivity, earnings growth and economic expansion. In an environment where economies, central banks and credit markets are becoming increasingly differentiated, we believe **active management, global flexibility and disciplined risk allocation** will remain essential to helping investors navigate the opportunities, and uncertainties, that lie ahead.

Wishing you success in your continued investment journey,

The AllianceBernstein Fixed Income Team

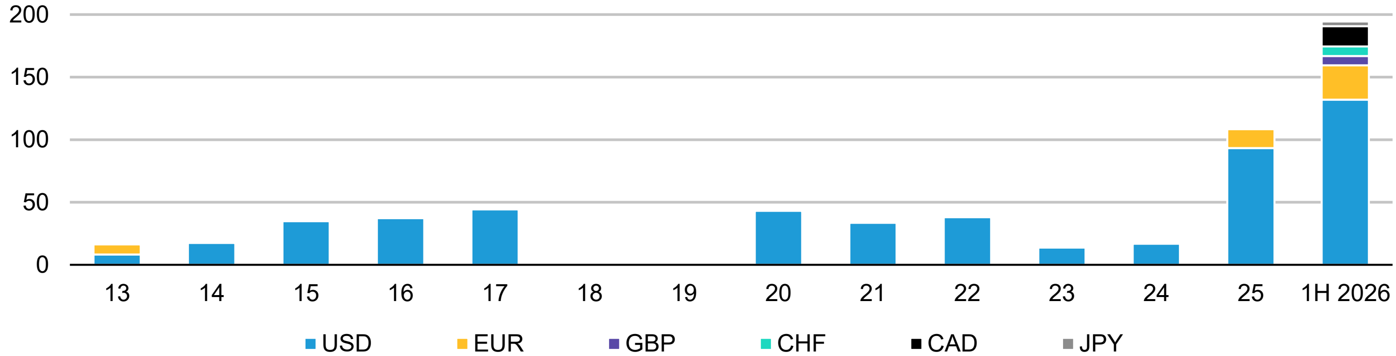
To learn more about AB's fixed-income solutions and access other market insights, visit [Fixed-Income Investments | AB](#).

Display 1: The Pace in Hiring Has Accelerated in 2026 After Decelerating in Recent Years
Change in Nonfarm Payroll (Thousands)



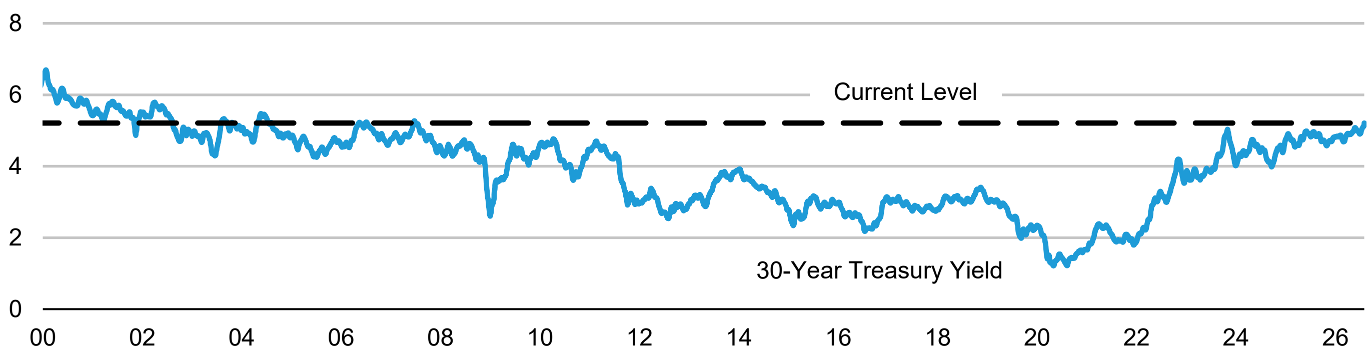
As of July 31, 2026
Source: Bloomberg and AllianceBernstein (AB)

Display 2: Hyperscaler Issuance in Credit Markets Has Exponentially Increased This Year
Investment-Grade Debt Issuance (USD Billions)



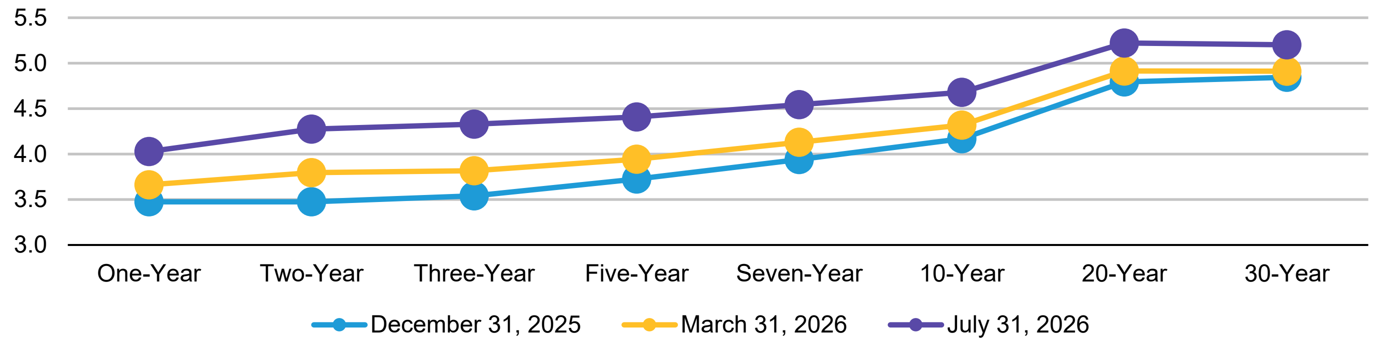
Hyperscalers defined as GOOGL, META, MSFT, AMZN, SPCX and ORCL
As of July 31, 2026
Source: Bloomberg, Goldman Sachs and AB

Display 3: The 30-Year Treasury Yield Has Risen Above 5% for the First Time Since 2007
Yield (Percent)



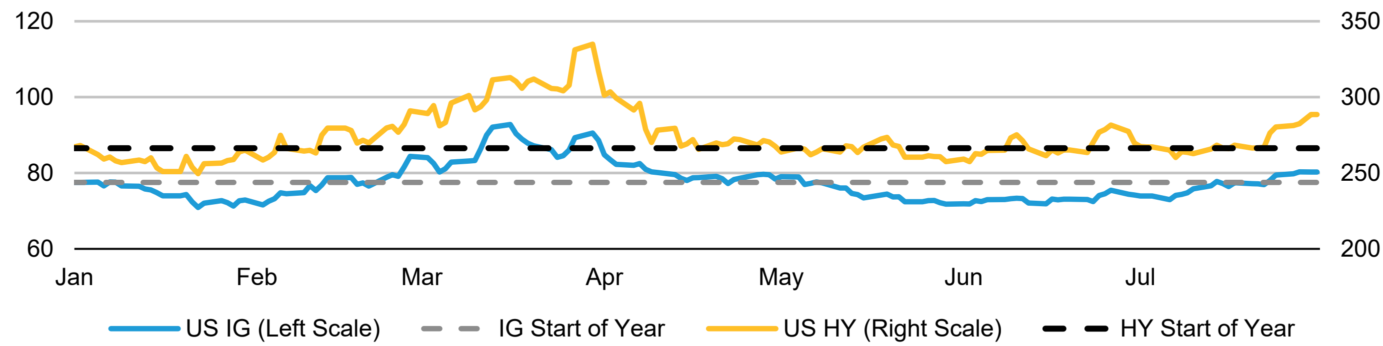
As of July 31, 2026
Source: Bloomberg and AB

Display 4: The Treasury Yield Curve Has Flattened Materially This Year
Yield (Percent)



As of July 31, 2026
Source: Bloomberg and AB

Display 5: Credit Spreads Are Only Modestly Above Where They Began the Year
Basis Points (Basis Points)



HY: high yield; IG: investment-grade
As of July 31, 2026
Source: Bloomberg and AB

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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