



A Note from the AB Fixed Income Trading Desk

Thoughts from Our Senior Portfolio Managers

Limbo—Actively Managing Uncertainty

“It is not the strongest of the species that survives, not the most intelligent, but the one most responsive to change.” —Charles Darwin

If you closed your eyes in April and opened them in May, you might think not much had changed. Yet beneath the surface, it was one of the most volatile months in recent memory. Uncertainty now stretches from Main Street to Wall Street, from boardrooms to kitchen tables, and from Fed officials to foreign governments. Confidence is fragile, conviction is scarce, and markets have nearly round-tripped to their pre-Liberation Day levels—masking the underlying volatility tied to tariffs, trade and policy drift.

That leaves investors and decision-makers across the economic landscape in limbo. As we enter a new phase of potential trade negotiations, investors, corporations and central bankers alike are left waiting for confirmation on the direction of policy, growth and inflation. Until then, the market may remain range bound—but restless. That’s why, just as price levels remain largely unchanged, so does our guidance: manage to a wide range of outcomes and lean into active managers who can navigate dislocations, not just endure them.

Key Takeaways

- Despite recent volatility in sentiment and macro headlines, major asset classes have largely returned to their previous levels—masking meaningful divergence between soft and hard data.
- Uncertainty favors active flexibility. Markets are showing signs of correlation breakdowns and pricing in outcomes without supporting evidence. Active managers are best positioned to navigate these dislocations with discipline and selectivity.
- Investors don’t need to stretch for return. High-quality duration and short-duration high yield offer compelling income with relatively lower volatility—allowing investors to play offense and defense without taking excessive risk.

What Happened

Markets remain caught in a state of limbo. Over the past two weeks, incoming data has revealed a growing divergence between what the hard numbers say and how businesses, consumers and policymakers are responding (*Display 1*). The economy continues to show signs of resilience, but confidence has slipped. The Fed is on hold. Consumers are more cautious. Businesses are hesitant to commit. The result is a market environment driven by rising uncertainty.

The most closely watched release over the period was first-quarter US GDP, which contracted by 0.3%—the first negative print since early 2022. The headline decline was driven primarily by a surge in imports (*Display 2*) as firms and consumers pulled forward purchases in anticipation of tariffs. While this widened the trade deficit and dragged on overall growth, it also reflected strong domestic demand. Consumer spending and business investment held up well, underscoring a still-healthy economy prior to trade-related disruptions.

The labor market showed similar resilience. April’s nonfarm payrolls increased by 177,000—broadly in line with the trailing average—while the unemployment rate held steady at 4.2% (*Display 3*). Job growth was widespread across sectors, suggesting continued equilibrium in the labor market.

Sentiment indicators, however, told a different story. Consumer confidence fell sharply, with the Conference Board’s index dropping to 86.0—the lowest reading since May 2020—and marked by the largest drop in future expectations since the Global Financial Crisis (*Display 4*). Manufacturing sentiment slipped again, with the Institute for Supply Management index falling to 48.7%, while services activity held up slightly better but still reflected a cautious tone.

At last week’s Federal Open Market Committee meeting, the Fed left policy unchanged, as expected. Chair Powell offered little new guidance, repeatedly emphasizing a wait-and-see approach. “We don’t know what the right response to the data will be until we see more data,” he said—echoing the broader mood of strategic patience across markets.

Abroad, the Bank of England lowered its policy rate by 25 basis points (bps), continuing its gradual easing cycle amid global trade uncertainty. Meanwhile, the Taiwanese dollar experienced its most volatile trading week in decades—appreciating nearly 10% in just two sessions—as capital flows and trade exposures were repriced (*Display 5*).

Despite the noise, market performance remained stable. The S&P 500 ended the last two weeks up nearly 2.5%, bringing the year-to-date figure to -3.7%. High-yield credit spreads have tightened back to 343, but yield levels remain compelling at 7.7%. The headlines may have been loud, but price action suggests that many investors—like policymakers and business leaders—remain in a holding pattern, waiting for greater clarity before making their next move.

Our View

Like the Fed, we don't know exactly how trade policy or the economic outlook will evolve—and that's the point. Uncertainty isn't a passing phase; it's becoming a defining feature of the current market regime. A lot can change with a tweet or the stroke of a pen. Recent discussions with China are a prime example of a near-term catalyst for positive sentiment. However, catalysts can also shift sentiment in the opposite direction. Positioning, which had recently flipped from exuberant expectations of deregulation, tax cuts and an M&A bonanza, has now swung the other way—toward pessimism around tariffs, growth and capital flows. In that context, the “pain trade” from here may actually be higher—not lower—risk-asset prices, unless the macro narrative deteriorates further.

Growth: The most probable outcome—ours and the consensus—is that the economy slows from here. Consumers are increasingly cautious, businesses are hesitant to deploy capital, and outside of modest fiscal support in Europe and China, most developed markets show little appetite for new stimulus. That said, we are not advocating complacency on the outlook. A renewed policy shock—particularly a growth shock—remains firmly within the range of plausible scenarios. Still, it's worth acknowledging that a material de-escalation in trade tensions or regulatory clarity could offer modest upside. The right response is to prepare for dispersion and build portfolios that are adaptive across that full range of outcomes.

Policy: The Fed remains cautious. Powell's comments underscored the committee's desire to wait for more clarity before making any moves. While survey data may inform the discussion, policymakers are unlikely to act without confirmation in the hard data—especially signs of labor market deterioration. The Fed has also intentionally withheld forward guidance to avoid premature commitments. However, if conditions shift—particularly in employment—they are likely to respond swiftly to support growth.

Volatility: Volatility isn't going away—and importantly, it's not just a one-way risk. While softening growth could continue to pressure risk assets, any meaningful progress on trade, regulatory clarity or geopolitical tensions could spark an outsize relief rally. In an environment where positioning is already defensive and sentiment is skewed, the market is vulnerable to both negative shocks and positive surprises.

We're also seeing signs of structural dislocation. For example, during the recent risk-off episode, nearly 3% of the investment-grade bond universe traded through BB-level yields—despite stronger fundamentals—highlighting how far sentiment can detach from value. Correlations across asset classes are showing signs of strain, and markets have begun pricing in scenarios, such as a foreign buyer strike in Treasuries, without confirming evidence. These types of mispricing create fertile ground for active investors who can differentiate signal from noise and reposition with precision. In this kind of environment, flexibility and security selection matter more than ever—and that's where active management has a clear edge.

Rates: We continue to favor short-to-intermediate duration. Forwards are not fully pricing downside growth risks or rising unemployment, while breakeven inflation remains well anchored. The short end may remain sensitive to shifting price pressures from trade policy, while long-end uncertainty around US deficits, dollar dynamics and global flows reinforces our call to avoid overextending duration.

Credit: Corporates have offered little to no forward guidance this cycle, highlighting their own uncertainty. Downgrades and defaults are likely to pick up gradually, particularly as cost pressures mount. Still, the structural case for credit resilience remains strong: leverage is low, coverage ratios are healthy, and all-in yields provide significant cushion. The March–April spread correction was modest—and ultimately faded as buyers returned quickly to capitalize on dislocation. This is strong evidence of a theme we have highlighted all year.

Investment Implications

While markets continue to wrestle with uncertainty, we remain focused on areas of greater conviction—and are doing the same in our own portfolios. A disciplined, actively managed approach is not just preferred in this environment—it's essential. Investors don't need to stretch for returns. Instead, they need to stay agile, risk-aware and aligned with strategies that can adapt to an evolving macro backdrop.

Today's regime presents a rare opportunity to generate attractive income without excessive risk-taking. This dynamic favors both high-quality income strategies and selectively deployed credit risk. The key is knowing when to lean in—and having the flexibility to adjust when the facts change.

Playing Defense: We continue to advocate for global diversification and positioning that emphasizes high quality and shorter-to-intermediate duration. This area of the curve provides balance—offering participation in favorable rate moves while helping defend against downside risks if growth softens or policy missteps occur. Global duration also presents a meaningful opportunity, particularly in

economies likely to ease faster than the US in response to softening growth. A weaker dollar further adds opportunity by enhancing the appeal of nondollar income streams and supporting returns from international bond exposures.

Playing Offense: High-yield credit—particularly in higher-quality, short-duration segments—offers an attractive way to add risk without taking on excessive volatility. With all-in yields still near 8%, the asset class provides equity-like return potential with far historically better downside protection. Active managers are uniquely positioned to avoid deteriorating credits, manage sector exposure and selectively lean into spread compression as sentiment improves. In our own portfolios, AB has re-underwritten every credit in coverage to incorporate downside risks from tariffs. This reinforces three key advantages:

1. Fundamentals remain remarkably strong—even under stressed scenarios,
2. We have greater visibility into where risks and opportunities are likely to emerge, and
3. AB's credit research and risk framework stand out among both active and passive peers.

Managing a Range of Outcomes: This is not a market for static allocations. We recommend implementing a flexible framework rooted in sound risk management—adding exposure during dislocations, trimming on strength and remaining prepared for abrupt changes in sentiment. Curve steepeners remain a tactical way to position for both inflation risk and growth slowdowns. If the curve steepens due to renewed Fed easing or term-premium buildup, this structure offers valuable asymmetry.

In markets like these, conviction must be paired with humility. Active management thrives in uncertain environments—not by chasing returns, but by seeking resilient, risk-adjusted outcomes. That's what today demands.

Wishing you continued success in your investment journey,

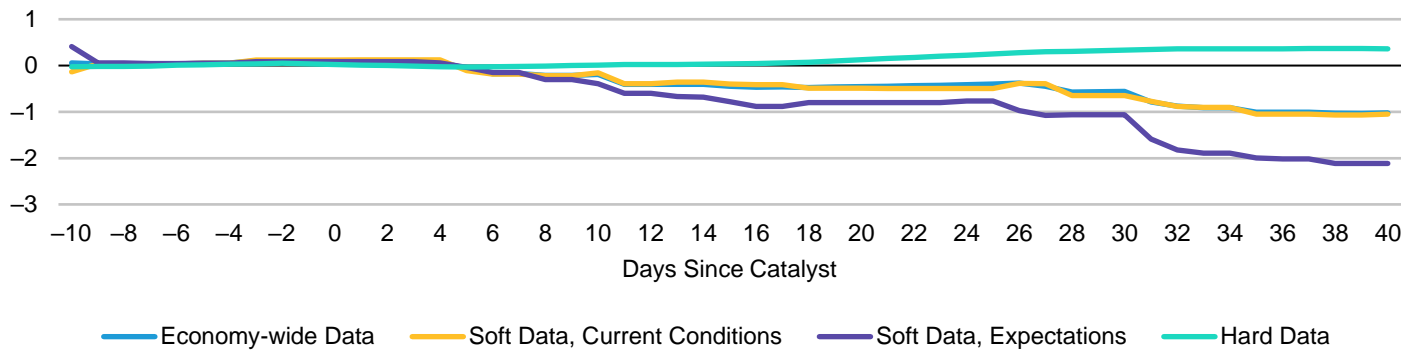
Scott DiMaggio, Gershon Distenfeld, Matt Sheridan, Fahd Malik, Will Smith, John Taylor, Serena Zhou, Tim Kurpis, Christian DiClementi, Sonam Dorji and AJ Rivers

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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.	25
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.	30
Rebalancing	Inflation and growth both approach trend levels only slowly, leaving the Fed comfortable easing policy slowly and remaining restrictive well into 2025: 25 bps cuts at some, but not all, meetings until the policy hits neutral in late 2025 or 2026.	30
Stagflation	The economy slows but inflation expectations rise, trapping the Fed between a rock and a hard place.	10
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: The Divergence Between Hard Data and Soft Data Continues to Grow

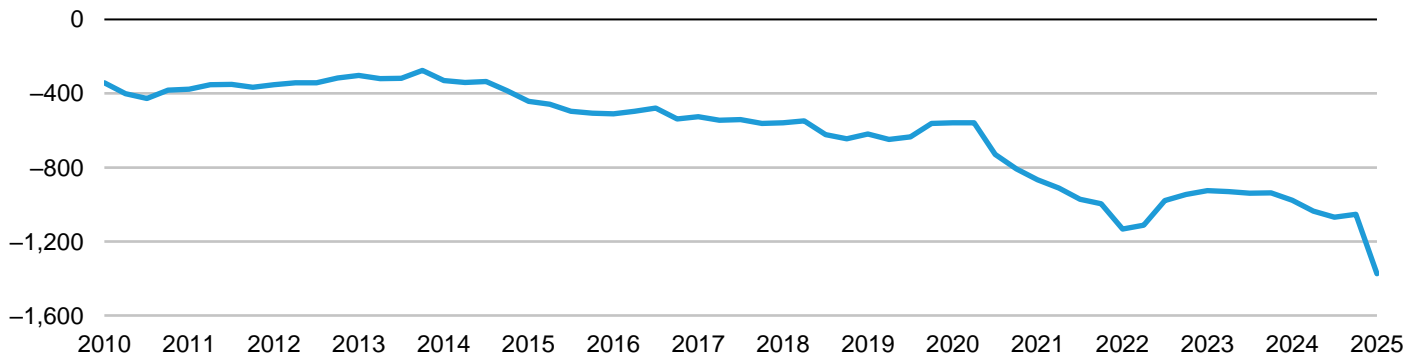
Goldman Sachs Index



As of May 9, 2025
Source: Goldman Sachs

Display 2: The Surge in Net Imports Caused Distortions in the GDP Data

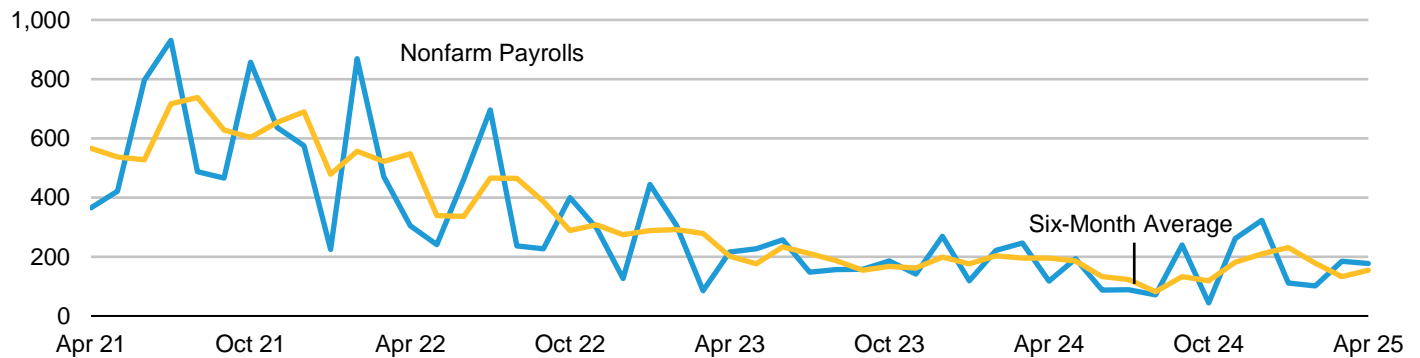
Total Net Exports (USD Billions)



As of May 9, 2025
Source: Bloomberg, Bureau of Economic Analysis

Display 3: Job Growth Remains Stable, Keeping the Unemployment Rate Steady

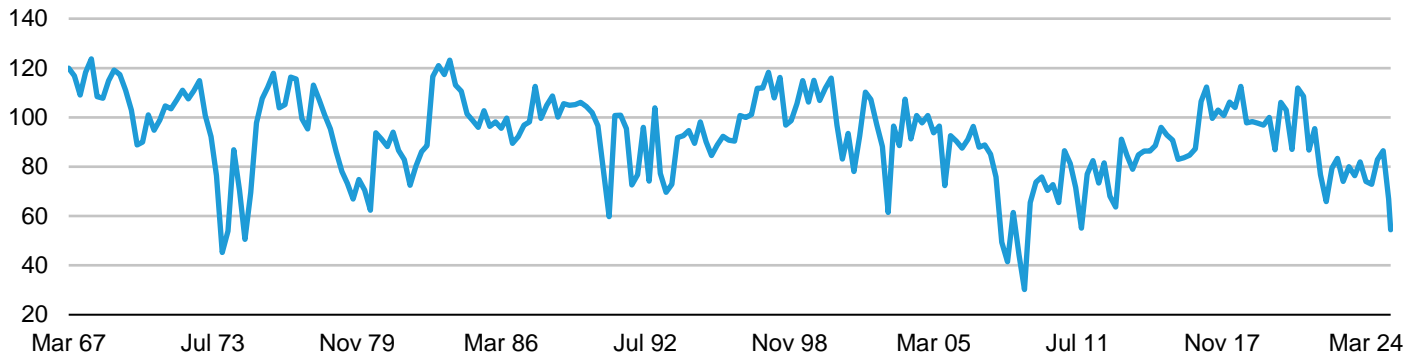
Nonfarm Payrolls



As of May 9, 2025
Source: Bloomberg, US Bureau of Labor Statistics

Display 4: Consumer Expectations of Future Conditions Are at Post-Financial Crisis Lows

Scores of the Conference Board, the Leading Index of US Consumer Expectations

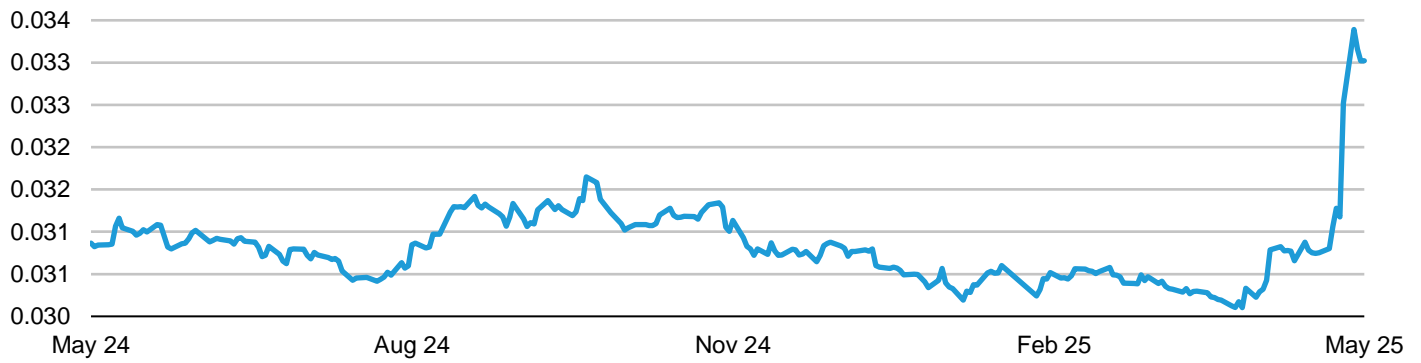


As of May 9, 2025

Source: Bloomberg, Conference Board

Display 5: Taiwan Dollar Posted the Largest Two-Day Surge in Decades

TWD/USD



As of May 9, 2025

Source: Bloomberg

Investment Risks to Consider

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