

Reflexivity and the K-shaped Economy

Hani Redha, CAIA, Global Multi-Asset Portfolio Manager

The US economy is exhibiting a pronounced K-shaped bifurcation that has garnered increasing attention and even calls for collapse and chaos. Yet while these dynamics could create vulnerabilities to shocks and related volatility, we think fears of a meltdown are overblown.

The K-shape certainly exists, not only across households but increasingly across corporations as well, with large companies and small businesses following markedly different trajectories in consumption and asset pricing. Household net worth has reached a record high, propelled by equity gains and concentrated among higher earners, with the S&P 500 showing 20%-plus surges in recent years. Wealth concentration amplifies this, as the top 10% of earners account for roughly 50% of total consumer spending.

The higher-rate environment has reinforced the corporate K-shape. More than 90% of S&P 500 debt is fixed-rate with long maturities, leaving large firms well insulated from rising rates and enabling them to earn higher interest income on their high cash balances. Small businesses, by contrast, lack cash on their balance sheets, rely on floating-rate credit, and face all-in borrowing costs of 9%-11%, pressuring net margins.

Yet is this a new phenomenon? While the K-shaped dynamic has reaccelerated, it certainly is not new. One way to measure this phenomenon is to track the ratio of mean-to-median incomes over time: a rising ratio would indicate that earnings at the higher income brackets are rising at a faster pace. The fact is that in the US economy, this ratio has been rising for several decades, so the K-shaped economy is certainly not a new characteristic. While the period immediately after the pandemic saw a reversal of this trend as lower incomes rose more rapidly due to shortages of labor in certain sectors, it proved to be a temporary counter-trend that has since reversed.

Although the K-shaped economy is not a new phenomenon, the dynamic has strengthened dramatically since the global financial crisis of 2008 as a result of policies that propelled asset markets more than they supported the economy. Quantitative easing combined with fiscal austerity led to a glut of liquidity flowing into asset markets without generating commensurate economic growth. As a result, asset owners – particularly owners of equities and residential housing – have benefited the most, and far more than those who lack assets and rely on income from labor.

The result today is that the US market and economy are highly intertwined in a reflexive relationship. Booming stock and/or housing markets add significantly to incomes for the highest-quintile earners, which in turn supports economic growth; yet the reverse can also play out, leading to an amplification of negative economic outcomes if markets tumble for any reason at all. Investors need to be increasingly cognizant of this dynamic and factor it into their modeling of the modern US economy.

Outside the US, this dynamic is less pronounced. In Europe, a K-shaped pattern is visible at the industry level, particularly with energy-intensive sectors suffering substantially compared to lower-energy industries. European households hold wealth predominantly in housing rather than equities, and Europe's social safety nets, pensions, and stable labor market participation have cushioned income disparities more effectively than in the US. Consequently, household income at the lower end has fallen less sharply in

December
2025

About This Report

PineBridge believes that not only do differences of opinion make markets, but they also foreshadow substantial moves ahead as these differences are resolved. Once a month, investment leaders from our global multi-asset, equities, and fixed income teams meet to share their diverse viewpoints. This report reflects those discussions and debates by providing insight on the topic of the month along with snapshots of our asset class views and convictions across the firm.

Europe compared to the US, and European savings rates have not experienced the same dramatic decline. Overall, Europe shows more industry-specific divergence rather than the broad K-shape defining America's economic landscape.

Overall, the K-shaped dynamic has been a key feature of the US economy for a long time; growth is increasingly driven by high-income consumption and mega-cap corporate dominance. This concentration also creates fragility, as momentum rests on markets and affluent consumers while lower-income households and smaller firms lack meaningful buffers. While our base case remains a soft landing and renewed growth in 2026, this bifurcation leaves the economy more vulnerable to shocks and periods of heightened volatility. Heading into 2026, we favor buying on such volatility-driven dips.

Conviction Score (CS) and Investment Views

The Conviction Scores shown below reflect the investment team's views on how portfolios should be positioned for the next six to nine months. 1=bullish, 5=bearish, and the change from the prior month is indicated in parentheses.

Global Macro

Sam McDonald
Sovereign Analyst, Emerging
Markets Fixed Income

CS 3.25 (unchanged)

With the US government now reopened, the release of data delayed by the shutdown should give the Federal Reserve and markets a better understanding of the US economy's current footing. Alternative data still point to a muddled picture on the pulse of the economy. Several Federal Open Market Committee (FOMC) members, including Chair Powell, have pushed back against the idea of a December cut being a forgone conclusion; the market recently has been pricing only a 40% probability of a cut. The near-term outlook remains soft, but tailwinds in early 2026 should provide a more supportive backdrop, assuming the labor market does not rapidly deteriorate from here.

The labor market prior to the shutdown was softening, and data thereafter have pointed to further weakening, although the magnitude remains unclear. ADP data showed a gain of 42,000 jobs in October, but weekly data fell by only 11,000. Similarly, Indeed New Job Postings continue to suggest hiring weakness, but data from the latest Small Business Hiring Plans survey from the National Federation of Independent Business continues to move sideways. On layoffs, Challenger reported that job cuts increased to their highest level in two decades but were concentrated in tech and warehousing and only represent announcements, rather than registered job cuts. However, aggregating state data for initial jobless claims points to a labor market that has stalled. October's non-farm payrolls would have been affected by DOGE early resignations (about 100,000 jobs) and distortions to other data points due to the shutdown.

Several regional Fed officials have pushed back against a December cut, given ongoing concerns about inflation and a belief that the US economy is holding up despite softness in the labor market. The upcoming deluge of data will be a critical factor heading into the December FOMC meeting.

Credit card data and consumer surveys point to a spending rebound in October, following a temporary pullback in September. On inflation, October looks to be flat, although no official Consumer Price Index (CPI) readings for the month are expected to be released due to furloughs of data collection agents during the normal survey period. Prices paid in the October purchasing managers' index (PMI) showed a step downward.

Purchasing manager data from the Institute for Supply Management still point to a resilient backdrop, particularly in services, despite the labor market softness.

Looking into 2026, with the increases in tariffs largely behind us and the impact of the immigration cuts already under way, the growth outlook appears to be marginally stronger, though not at the exceptional levels we have seen over recent years, as some supporting factors are being weakened.

Rates

Henry Huang

Portfolio Manager, Developed
Markets Investment Grade

CS 4.00 (unchanged)

We remain bearish. The US 10-year note is at the low end of our range. We expect the remainder of the fourth quarter to be more volatile and higher in yield, a situation not helped by the shutdown-induced absence of US economic data.

Minutes from the recent Fed meeting showed dissent among members about its next move: “Many” saw a December cut as likely to be inappropriate, but “several” said it “could well be appropriate” while “most” thought further cuts could add to inflation risk.

It seems to us that the economic data missing as a result of the shutdown may need to be worse than expected for the Fed to cut rates at its 10 December meeting. Bad news, therefore, would be good news for a cut. The Fed has cut rates twice this year, but longer-term rates have not responded well. Before the first cut, the 10-year was 4.02% and the 30-year was 4.65%. After two 50-basis-point cuts in a row, both longer-term securities are higher in yield.

With inflation running above the Fed’s target while the labor market appears weaker, the US central bank’s next cut-or-not-cut decision on rates won’t be easy.

Credit

Steven Oh, CFA

Global Head of Credit
and Fixed Income

CS 3.25 (unchanged)

Credit markets were less volatile than equity markets in November, although spreads widened from their late-October tightness. While credit correlation with equities will continue, the growing dominance of tech and AI on equity markets should result in lower correlations overall relative to historical levels. However, particularly for the investment grade market, we anticipate that the increasing share of future issuance related to the tech sector could shift industry weightings.

The government shutdown had a limited effect on market sentiment despite reaching a record length; the ultimate resolution should contain any economic damage. Fed statements have become more divided on additional near-term rate cuts despite indications that employment trends could be deteriorating. A key factor determining the market direction over the next year will be the level of stimulus that is anticipated to emerge in 2026 from tax cuts, refunds, and other fiscal measures intended to reverse some of the declining trends.

Valuations remain tight but are not too far off the lower end of fair-value range within a low-but-positive economic growth scenario, which is typically supportive for credit. As we head into the final month of the year, spreads are generally near levels seen at the beginning of year, with returns driven by carry and the yield curve impact.

Currency (USD Perspective)

Sam McDonald

Sovereign Analyst, Emerging
Markets Fixed Income

CS 2.75 (unchanged)

Sometimes what doesn’t happen is more telling than what does. Consider the US Treasury market’s reaction (or, more accurately, its lack of reaction) in November to rising concerns over weakness in the US labor market and Fed monetary policy easing. In a world where official data were absent, the inability of the US 10-year rate to close below 4.00% on a weekly basis reveals more about what the market is really thinking than any Fed speech. The market clearly believes the risk of recession is overestimated, which bodes well for the US economy and the US dollar in 2026.

Weak labor data have raised market concerns about an imminent slowdown, and the Fed so far has been willing to accommodate the economy further, pointing to a shortfalls approach. Yet the 10-year US Treasury rate recognized the familiar pattern of exaggerated economic concerns and “bizarrely” failed to drop – the same way the guard dog in a Sherlock Holmes story did not bark because he knew the intruder. In short, the market has seen this movie before and reacted accordingly.

The rejection of the US 10-year at yields below 4.00%, together with the Fed’s hawkish cut in October, sets up the US Treasury market for a correction that moved yields higher. Additionally, since the October FOMC meeting, a chorus of Fed regional governors have aligned with Powell’s press message that a Fed cut in December is not a foregone conclusion. The next question is whether a December skip will turn into a pause and for how long; our “Stabilization” base case underpins our view of fewer Fed cuts over the next 12 months than what is being priced by the market, further underscoring our positive view on the US dollar based on the continuing rate differential.

While the end of the US government shutdown brings relief, we must all accustom ourselves to weeks of further data distortion, making it even more important to read the tea leaves of the financial markets. Implied foreign exchange (FX) volatility has dropped back below levels seen before US President Trump’s election victory last year, and we expect fewer economic and political swings in 2026 than in 2025. The fiscal impetus from the One Big Beautiful Bill Act (OBBBA) and easy financial conditions both point to firmer economic growth in the first half of 2026, supporting a stronger US dollar.

Emerging Markets Fixed Income

Joseph Cuthbertson
Sovereign Analyst, Global
Emerging Markets Fixed Income

USD EM (Sovereign and Corp.)
CS 2.75 (-0.25)

Local Markets (Sovereign)
CS 3.00 (unchanged)

Emerging market (EM) spreads remain supported by expectations of looser financial conditions, both domestically and externally, aligning with the “Stabilization” macroeconomic scenario. Having shaken off recent blips due to renewed trade tensions, equity selloffs, and soft alternative US labor market data, valuations are moving back to their tights. The geopolitical backdrop, particularly concerns with Venezuela and Ukraine, still adds uncertainty going into 2026, but EMs have demonstrated resilience throughout various shocks this year, and we expect that resilience to continue.

The domestic macro environment is favorable for most EMs, leading us to expect improved sovereign credit metrics going into 2026. Robust EM economic data and growing external buffers support policy easing in most countries. We anticipate credit rating agencies will upgrade several rising stars to investment grade, including Serbia and Morocco, and lift ratings out of the CCC bucket for Pakistan, Ghana, and Egypt. With a strong number of net upgrades in 2025, fewer upgrades are likely in 2026 because despite continued positive fundamentals, rating outlooks have now shifted more toward neutral. Nonetheless, longer-term reform stories, such as Argentina and Montenegro, remain in play as sovereigns look to capitalize from bilateral and multilateral anchors.

The mood at the recent IMF meetings was buoyant, with market participants believing the macro backdrop will remain supportive for EM and that improved fundamentals and deeper local markets across several countries have led to newfound “resilience.” Improved sentiment and supportive market conditions had led to market access for almost all sovereigns under our coverage, creating a positive feedback loop for the market. This also has been supported by positive events, with Argentina rallying on Javier Milei’s outperformance in the midterms, which has helped to maintain reform prospects.

We expect the upcoming corporate reporting period to be neutral within the context of a strong overall fundamental picture. While we have seen some idiosyncratic issues in Brazil, we continue to view these as credit-specific and not representative of wider Brazilian corporate fundamentals. Technicals for the assets class remain supportive, with inflows coming into the market.

Commodity markets are expected to stay in a favorable range for EM countries, while recently announced tariff levels remain manageable. External balances for many EMs have benefited from elevated gold and metals prices, with the trend largely expected to remain intact.

Multi-Asset

Deanne Nezas, CFA
Portfolio Manager,
Global Multi-Asset

CS 2.50 (-0.25)

The Federal Reserve delivered a widely expected 25-basis-point rate cut in its October meeting but struck a hawkish tone. In parallel, the Fed will end quantitative tightening on 1 December, a move that investors will likely welcome. Although US fiscal consolidation including tariffs has dampened growth to date, the OBBBA is set to inject fresh stimulus into both the corporate and household sectors. These developments position the US economy for a cyclical reacceleration – and its leadership in AI positions it for a secular acceleration.

While economic growth remained robust in the third quarter, almost no new jobs were created. Entry-level jobs in particular seem to be bearing the brunt of flatlining in new job formation. Though large investments in datacenters, utilities, and reshoring are expected to create a meaningful number of construction jobs in the years ahead, rising delinquencies and stagnant employment are the current realities for lower-income consumers, highlighting a bumpy transition despite strong headline economic figures.

The recent meeting between presidents Trump and Xi marked a key step toward easing US-China trade tensions, with the leaders agreeing to a one-year truce. We’re upbeat on the constructive tone of the meeting, viewing the new reality as akin to the Cold War, where the potential for mutual harm keeps both sides within bounds. As such, we believe the agreement buys time for real progress, or delays further decoupling until both parties are more prepared, rendering the event less disruptive.

Overall, we expect a reacceleration of growth throughout 2026 and revised our CS to a more constructive 2.50.

Global Equity

Ken Ruskin, CFA
Director of Research
and Head of Sustainable
Investing, Equities

CS 3.00 (unchanged)

In the consumer segment, global consumer spending remains stable, though signs of strain are emerging among lower-income US households. Among financials, banks are well positioned in the near term, supported by strong net interest margins, potential regulatory relief, and healthy credit quality. More non-bank financial credit “cockroaches” haven’t appeared recently and shouldn’t be an issue provided unemployment remains stable.

Meanwhile, sentiment in the healthcare segment has improved from low levels, with more clarity on drug pricing agreements and tariffs that are viewed as manageable. Biotech, pharma, and life science tools companies are seen as the main beneficiaries of easing policy headwinds, lower interest rates, increased M&A, and re-shoring trends.

Among industrials, short-cycle industrial demand remains steady, while longer-cycle projects face headwinds from tariff uncertainty. Hyperscaler capex continues to be a key growth driver, and European construction activity is picking up while US residential remains weak. In the technology sector, while demand for AI infrastructure remains strong, investor sentiment has declined due to mounting concerns over OpenAI’s ability to fund its estimated \$1.5 trillion in long-term commitments. These concerns are further amplified by execution challenges, particularly power constraints that could limit scalability.

Global Emerging Markets Equity

Taras Shumelda
Portfolio Manager,
Global Equities

CS 3.25 (+0.25)

Our score remains unchanged, but we are beginning to see positive earnings revisions. Should these continue, we may review our score, especially if markets sell off.

The earnings season, which is nearing an end, has produced results moderately above expectations and resulted in a 1.8% index earnings upgrade in the past month. Emerging market companies so far have been adept at operating in the new tariff environment through a combination of cost-cutting, price increases, and redirection of supplies and suppliers.

In China, we saw strong results in the AI-related space, high-tech chain, and materials. In India, banks reported strong results. Korea delivered significant beats in many sectors, especially in tech, defense, and financials. Among global emerging markets, Taiwan has seen by far the strongest earnings reporting season.

In Latin America, results were better than expected in financials, some consumer discretionary companies, and the mining sector. Misses were in the discretionary sector, Mexico’s consumer staples, and in select financials.

In EMEA, the reporting season was also good, but not as uniformly as in other regions. Companies in various sectors in Poland and Turkey missed forecasts, while those in the Czech Republic, Hungary, and the Middle East beat their forecasts. The outcome has resulted in largely unchanged earnings projections for the EMEA segment.

Quantitative Research

Yang Qian
Fixed Income
Quantitative Strategist

Credit spreads barely moved in the face of the curve flattening by 5 basis points, resulting in a slight downtick in conviction.

Our global credit forecasts remain negative, with significant improvement in developed markets and slight improvement in emerging markets. In the developed market industries our model favors technology, banking, and industrials and dislikes utilities, basic industry, finance companies, and communications. Among EM industries, our model likes financials; technology, media, and telecommunications; and metals and mining. It dislikes real estate, industrials, and consumer goods.

Our global rates model forecasts higher yields for Switzerland, Japan, Denmark, and the UK and lower yields for Oceania, North America, and most European countries. The model forecasts a steeper curve in Switzerland, the US, and the UK and a flatter curve for Japan and most European countries.

The rates view expressed in our G10 Model portfolio is overweight global duration overall, being overweight France, Spain, New Zealand, and Canada and underweight the US, the UK, Japan, and Germany. Along the curve, it is overweight the six-month, 10-year, and 20-year and underweight the two-year, the five-year, the Japan Government Bond seven-year, and the 30-year.

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