Research Excellence
The Source of Competitive Advantage

By Lewis A. Sanders, Chairman and CEO, AllianceBernstein L.P.

Introduction
I’m often asked to describe AllianceBernstein’s business strategy. Most expect a long and complex answer. Yet our strategy can be summarized in just two words—research excellence. It is the basis of our ability to properly manage the assets under our care. It is the source of our competitive advantage. But before describing what we mean by research excellence, let me tell you a little about who we are at AllianceBernstein.

We are a firm of 4,200 people responsible for managing some $618 billion of client assets. We serve a broad range of clients, including mutual fund investors, high-net-worth private investors and institutional investors in the corporate, government and philanthropic sectors. (Display 1)

We are in every sense of the word a global firm. Our investment platforms in growth and value equities and in fixed income are all global in design. Country and regional services are derivatives of integrated global investment processes. Our client-facing units all have global charters.

The intellectual capital of the firm spans the world, with research resources in the U.S., Brazil, the U.K., Japan, Australia, New Zealand, Russia, Mainland China, Hong Kong, Taiwan, Singapore, India and South Africa.

More than 50% of total assets under management are currently deployed in global and international services, with a high penetration of such mandates in all of our investment platforms. (Display 2) These mandates are far and away the fastest-growing parts of our service array, rising by more than 50% over the last 12 months.

About 40% of assets under management derive from clients who are domiciled outside the U.S., an element of the firm that has also been growing strongly.
During the last 12 months, assets under management, ex-cash management services, grew by 22%, with all investment platforms contributing to growth. Organic growth contributed about seven points of the total. (Display 3)

AllianceBernstein is a client-focused firm. In our view, competitive advantage derives exclusively from factors that bear on achieving investment success for clients. This, in turn, is about knowledge—having more of it and using it better than market participants at large. We believe, too, that sharing knowledge with clients is crucial to sustained success. Educating clients, informing clients through content-rich communication, positions them to make better choices, especially during volatile times. Thus, when we think about strategy, we think primarily about initiatives directed at widening our lead when it comes to knowledge...that is the essence of research excellence!

Consistent with this vision, we have established one of the largest commitments to industry and company research in the investment-management industry; a total of 209 analysts organized into distinct teams to support our global growth, value and fixed-income investment platforms. These teams are supplemented by another 105 research analysts in the Bernstein institutional research unit and a eight-member team of economists. (Display 4)

But despite this very large resource base, we continue to invest in new research initiatives that we think can translate to better investment performance. A review of these initiatives is instructive, as they make clear the path the firm is on:

**Research on China**

In response to the growing importance of China, we have recently established an on-the-ground research team in Shanghai to provide insight on how developments in key industries in that country will influence—perhaps even control—industry performance elsewhere. The list of industries where China looms large is growing, either as a consumer or a competitor. Therefore, having a local research presence in the country has become a strategic imperative.

Among the current projects on this research group’s agenda are a comprehensive study of China’s property and construction markets as a driver of global demand for industrial commodities, an analysis of the structural shifts in China’s steel industry and a study of selected companies with disruptive potential outside China, focused first in the telecommunications-equipment sector. (Display 5, Page 3)

**Display 5 Creating a Knowledge-Based Advantage Through Research**

- Property/Construction
- Disruptive Companies
- Pharmacogenomics
- Mobile Media
- Alternative Energy
- Nanotechnology
- Mobile Broadband
- Hybrid Power

**Research on Strategic Change**

In that investment controversies are often about issues as opposed to industries, we have formed another specialized research unit, called “Research on Strategic Change.” The group has already completed several important studies, the most recent of which analyzes the significance of de-verticalized business models, a powerful phenomenon that promises to spawn profound change in a number of industries. This work provides a road map that enables our industry analysts to effectively capture this trend in their forecasts.

The group’s attention has now turned to new areas such as:

- The significance of mobile broadband as a new multimedia communications channel;
• The impact of hybrid powertrains on the auto, oil and electric-power industries, including an assessment of high-energy-density batteries, are advances that could make hybrids truly game-changing in character.

The investment payoff of such major cross-industry issues can be very large, and assessing them is the raison d’être of this research group.

**Research on Early-Stage Growth**

In the same spirit, we have formed another research unit focused exclusively on uncovering innovation that looks as if it can translate to great commercial success—a search with no industry or geographic boundaries. While industry analysts are supposed to be on the lookout for such developments, as a practical matter most aren't because they are preoccupied with incumbent coverage. The agenda here includes:

• An exploration of opportunities in pharmacogenomics;
• Opportunities in services and content that will be enabled by mobile broadband;
• Opportunities in non-fossil fuel energy production;
• Studies of the early applications of nanotechnology.

This is heroic research, it is expensive research, and it is inherently speculative in character; but it’s the kind of research that we think we need to pursue to fulfill our commitment to clients and to truly distinguish the firm.

**Quantitative Methods**

In addition to seeking informational advantages through innovative fundamental research, the firm has one of the largest commitments to quantitative methods in the industry. We see the disciplines developed out of this research—which falls into the domain of using knowledge better—as accomplishing three critical things:

• Driving superior relative investment performance through improved analyst accuracy;
• Driving superior portfolio construction through technologies that improve the calibration of risk with return, especially in complex cross-border portfolios;
• Helping us craft effective investment solutions for clients, especially those with unusually complex wealth-management issues involving taxation, single-stock concentration, intergenerational wealth transfer and charitable giving.

**Growth: The Dynamic Gap**

Apropos of the first of these objectives, we have just completed the development of a new framework that is effective in predicting corporate growth-rate acceleration, persistency and decay—a technology we have dubbed the “dynamic gap.” Taken together with valuation tools, this framework’s ability to discriminate between winning and losing stocks in the growth domain is impressive.

As such, it will serve as an important means to prioritize the growth research, pointing to opportunities we have not yet pursued, and just as important, highlighting areas of increasing vulnerability in existing positions that we should consider exiting.

We believe that this framework has the potential to improve analyst accuracy and thus lead to better relative performance.

We have chosen to publish this research to call attention to it in the consulting community and other constituencies. We believe it will do much to distinguish our firm from the competition in this investment style.

**Yield-Curve Shape and Sector Spreads**

Impressive advances have also been made in tools that predict shifts in yield-curve level and shape, as well as changes in sector spreads. Taken together with advances in credit scoring, these tools hold the promise of improving the firm’s position in fixed-income investing, an area of intense focus.

**Currency-Management Framework**

On yet another front, we have recently implemented a major upgrade to our currency-modeling technology, an area where the firm has considerable intellectual capital and a long and highly successful track record as an embedded part of our global value and fixed-income services.

Given our prowess in this area, we have decided to form a new product group to offer stand-alone currency-management services to institutional clients. This is a business with considerable potential and one where we think we possess demonstrable competitive advantages. If all goes well, we should be positioned to enter the market by the second half of 2006 with a service designed to generate excess return, which could be configured in a portable form. We will follow shortly thereafter with overlay services to control portfolio risk.

**Asset Allocation**

I want to specifically highlight our work in asset allocation. Here, we have taken our well-developed investment planning know-how for high-net-worth clients and applied it to creating retirement solutions for 401(k) and IRA investors. Based on this work, we have recently launched a series of target-date retirement funds, rounding out a family of multi-asset class
offerings we call “Investment Strategies for Life.” We believe the design of our target-date Retirement Strategies offering substantially advances the state of the art for such strategies. At the risk of sounding bold, we think we have a chance to change the industry’s thinking about the asset classes that should be included in such funds and how exposure to each asset should be managed over their clients’ lives.

We have also brought innovation to implementation. Our target-date retirement funds are drawn from an underlying series of style-pure portfolios covering the full range of the firm’s services in U.S. equities—in growth and value, large and small cap, international (developed and emerging markets), fixed income and REITs. These same style-pure portfolios are shared with our other blended services, including Wealth and Education Strategies, thereby lowering administrative and transaction costs for all. (Display 6)

Display 6
**Investment Strategies for Life**

**Wealth Strategies**
- U.S. Large Cap Value
- U.S. Large Cap Growth
- U.S. Small/Mid-Cap Value
- U.S. Small/Mid-Cap Growth
- International Value
- International Growth
- High Yield Bonds
- Inflation-Protected Securities
- Intermediate Duration Bonds
- Short Duration Bonds
- REITs

**Retirement Strategies**

**Education Strategies**

On the Research Agenda for 2006

We believe that there is still more opportunity to use our asset/liability modeling skills in creative ways to meet client needs, the potential for which can be large. Consider that after just three years on the market, our style-blend services have reached $100 billion in AUM, benefitting from a feature set that neutralizes style risk—thereby producing high active premiums per unit of volatility, a function of negatively correlating sources of excess return from the growth and value components of these portfolios. Moreover, return is augmented by systematic rebalancing—turning style volatility into an opportunity as opposed to a threat.

In 2006, we plan to enlarge the mandate of the style-blend group to use our quantitative know-how to address other issues of interest to institutional plan sponsors, an undertaking you’ll hear more about over the course of next year. (Display 7)

Also on the research agenda for 2006 are initiatives to:

- Port our investment-planning tools to U.K.-domiciled private clients with a pound sterling currency reference, in preparation for our entry into that market late next year;
- Port our Investment Strategies for Life offerings to other major currency references as we roll out that product suite throughout the world;
- Broaden our quantitative and fundamental research capabilities in real estate on a global basis—an asset class that we plan to make a major focus of the firm for the longer term.

Research—the DNA of AllianceBernstein

What I hope comes through from this summary is that research, both fundamental and quantitative, is the DNA of AllianceBernstein. (Display 8) We are out to define the state of the art in this realm. We are out to turn the knowledge we thereby generate to the advantage of our clients and thus create competitive advantage for the firm.

Display 8
**The DNA of AllianceBernstein**

**Research Excellence**

- Know More
- Use Knowledge Better

The views expressed in this article may change at any time subsequent to the date of issue hereof. This article is provided for informational purposes only and under no circumstances may any information contained herein be construed as investment advice.