 Developed-market stocks continued rising in November. The S&P 500 was up 3% for the month, after reaching several new highs. The EAFE index of the developed international markets gained a more muted 0.8%. Year-to-date through November, the US-market gains approached 30%, while EAFE was up more than 20%, so stocks in the developed markets are enjoying a robust year. After a couple of very strong months, emerging-market stocks fell back into the red in November, to end the 11-month period with a small loss of about 1%. Bonds also slipped last month—albeit not markedly so—as interest rates resumed rising, though year-to-date losses were modest (Display 1). Our portfolios benefited from the notable year-to-date performance in developed-market equities, resulting in strong stock and balanced-account returns.

Despite the robust rally, we believe that global stocks remain fairly valued. While the headlines focused on the US market reaching new highs, the level of the market, divorced from its valuations, doesn’t mean too much. Since 1900, the S&P 500 has been within 5% of its prior peak (plus or minus) in almost half of all months—not surprising, considering that the market goes up over time, along with corporate earnings and the economy. (The US economy is continuing to grow at a moderate pace, and more strongly in some niches, including the construction and goods sectors.) And investing when the market level was close to a prior peak has historically not detracted from subsequent short- or long-term returns, on average. On the other hand, buying at high valuations did.

Today, at 18.7 times trailing-12-month earnings,* the S&P 500 valuation is at the high end of its average range, but doesn’t suggest an overly expensive market (Display 2). Meanwhile, the MSCI World Index of global stocks remains close to its long-term average valuation. And with interest rates still near historical lows, stocks in general remain extremely attractive relative to bonds. At the same time, there’s always the risk of a market correction—hence our continuous focus on risk management.

Investors may be getting the message about equities, as fund flows turn positive for the first time since 2009. After years of progressively larger net outflows from US-domiciled stock funds and large inflows into bond funds, fueled by the crash and its aftermath, the trend appears to be reversing in 2013 (Display 3, next page). The reversal is still in its early stages, and hence has a way to go, in our estimation.

US corporate fundamentals remain solid, with room for further improvement. Company balance sheets are strong, in the main, featuring healthy earnings and low debt ratios. And our

Display 1
More of the Same: Higher Stock Returns, Challenged Bonds

Market Indexes: Total Returns, Jan–Nov 2013

<table>
<thead>
<tr>
<th>Index</th>
<th>Total Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>US Stocks</td>
<td>29.1%</td>
</tr>
<tr>
<td>Developed-Market Int’l Stocks</td>
<td>21.0%</td>
</tr>
<tr>
<td>Emerging-Market Stocks</td>
<td>1.2%</td>
</tr>
<tr>
<td>Alternative Investments</td>
<td>6.4%*</td>
</tr>
<tr>
<td>Municipal Bonds</td>
<td>0.2%</td>
</tr>
<tr>
<td>Taxable Bonds</td>
<td>1.5%</td>
</tr>
</tbody>
</table>

Past performance is not necessarily indicative of future results.

US stocks are represented by the S&P 500 Index; developed-market international stocks by the Morgan Stanley Capital International (MSCI) EAFE Index of developed markets in Europe, Australasia, and the Far East; emerging-market stocks by the MSCI Emerging Markets Index; alternative investments by the Hedge Fund Research, Inc.’s (HFRI’s) Fund of Funds Composite Index; municipal bonds by the Barclays 1-10 Year Municipal Bond Index; and taxable bonds by the Barclays US Aggregate Bond Index. See Information About MSCI at the end of this report.

*As of October 31, 2013
Source: Barclays, HFRI, MSCI, and Standard & Poor’s

Display 2
US Stocks Are Somewhat Expensive vs. Earnings, but Very Cheap vs. Bonds

Here and elsewhere in this report, historical analysis and forecasts are not necessarily indicative of future results.

Period covered is 1970 through November 1, 2013. Earnings yield is defined as earnings divided by price, minus the 10-year Treasury yield.

Source: FactSet, MSCI, Standard & Poor’s, and AllianceBernstein

*As of November 1, 2013
latest research on third-quarter earnings indicates that just about half of the S&P 500 companies, particularly in cyclical industries, currently have pricing power (the ability to raise prices, defined as year-over-year gross-margin expansion).

**We remain committed to our portfolio strategies in stocks and bonds.** In stocks we are emphasizing diversification by sector; investment style (value, growth, and stability); and geography, with a tilt toward cyclical shares—especially in consumer-discretionary industries. The strategy is consonant with generally improving economies. At the same time, particularly in the US, we are being very cautious about high-dividend-paying “safer” stocks, which remain overpriced, though investor appetite for these sectors has apparently begun to abate. Meanwhile, opportunities worldwide are plentiful at the individual-stock level.

In bonds, we are limiting our interest-rate exposure by maintaining short and intermediate durations. We also continue to favor credit: investment-grade corporate bonds over government issues in our tax-deferred portfolios, single- and double-A securities over triple-A in our municipal constructions—a strategy that increases income in a low-yielding environment. In addition, in both taxable and municipal portfolios, given how steep the yield curve is, we are emphasizing the incremental returns available by “roll”—selling before maturity to take advantage of extra yield.

Interest rates rose in November, are up considerably since the beginning of the year, and will probably continue rising until rates normalize several years down the road. But we see a fairly modest, gradual process unfolding from here on out. So far this year, our bond portfolios, and the bond market, have sustained small losses; eventually, the extra income from higher-yielding bonds will overwhelm capital losses.

**Our multi-manager fund of hedge funds was considerably ahead of the benchmark through October** (the latest date for which data are available), with a premium in excess of three percentage points. The extra return reflects both strategy selection and superior manager performance. As to strategies, we were helped by our commitment to long/short equity as well as our limited exposure to funds that have been underperforming this year, including those with a global-macroeconomic and short-only focus. Further, despite a down bond market, our credit-related funds posted gains. Our 10-month return of close to 10% net of fees is well in line with our goal of participating in equity bull markets, while also helping to protect in down cycles.

In our Dynamic Asset Allocation (DAA) service (right), we continued modestly overweighting international stocks while also maintaining our hedges in both equities and bonds. A summary of our latest DAA strategies is immediately below, followed by a detailed discussion.

**Dynamic Asset Allocation Summary**

- We are maintaining our overweight in return-seeking assets, focused on globally diversified stocks. We remain underweight bonds.

- Supporting this position are low levels of equity-market volatility, low interest rates, and global stock valuations that are in line with long-term averages.

- Geographic valuation disparities continue to exist, however: Non-US markets are more attractive than domestic markets, leading to our slight geographic tilt toward overseas equities.

- We are retaining our stock and interest-rate hedges on a small portion of the portfolio, to provide some protection against sharp, adverse moves in both the equity and bond markets.

Display 3

Investors Are Embracing More Stocks

<table>
<thead>
<tr>
<th>US Mutual-Fund Net Flows ($ Bil.)</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Equity</td>
<td>379.6</td>
<td>235.6</td>
<td>125.1</td>
<td>303.6</td>
<td>156.2</td>
</tr>
<tr>
<td>Total Bond</td>
<td>(1.8)</td>
<td>(23.4)</td>
<td>(128.3)</td>
<td>(153.1)</td>
<td>(54.8)</td>
</tr>
</tbody>
</table>

*Through November 20

Source: Investment Company Institute

**About Dynamic Asset Allocation**

We continuously follow the capital markets, using our extensive research capabilities, with the goal of making short-term allocation adjustments to the portfolios of clients who have signed up for our Dynamic Asset Allocation (DAA) service. Since the inception of DAA, we’ve met our objective of reducing volatility while maintaining return.

Display 4

We’re Maintaining a Modest Overweight in Risk Assets

**Current Positioning for Private Clients**

The recommended position for a 60/40 private-client investor remains approximately 64% to return-seeking assets (Display 4)—the same as it was at the end

*Based on the 85% of S&P 500 companies that reported detailed earnings data as of November 18
of October, albeit a modest increase from where we were at the end of the third quarter.

**Favorable Climate for Stocks**

Overall conditions are supportive of stocks, given low interest rates and relatively low equity-market volatility. However, as the broad equity markets approach and surpass nominal highs, investor concern has shifted to whether equities still remain attractive. In our view, they do, on both an absolute-return basis and relative to other major asset classes, such as bonds.

On valuations, as discussed on page 1, global-stock indexes are not expensive and continue to trade at levels in line with their long-term averages on several metrics, including price to earnings. Looking more closely at the various geographies, the non-US markets are in line with their historical levels as well, with the US S&P 500 somewhat more expensive but still reasonably valued. Given these varied levels, the DAA team continues to believe that equities are broadly attractive, with the opportunity set favoring the non-US markets; hence our overweight in those geographies.

With valuations at reasonable levels, we turn next to earnings growth. On that front, consensus growth forecasts continue to improve, having climbed steadily since this year. The figure now stands above 9% for the S&P 500 over the next 12 months (Display 5). Furthermore, the ratio of positive analyst revisions to negative ones on a company-by-company basis is greater than one, implying a growing optimism from Wall Street on corporate profitability.

**Factoring in Downside Risk**

While we remain optimistic about stocks, we felt it was imperative to understand the risks to our expectations. To do so, we analyzed the worst quarterly declines in the S&P 500 since 1976 relative to the riskless (cash) return, and compared them to a subset of those declines when today’s prevailing conditions were present (Display 6). Our conclusion is that rarely does the market experience an extreme sell-off in an environment similar to today’s. Specifically, while extreme quarterly sell-offs averaged some eight percentage points below the cash return—and 10 points when earnings growth plummeted—the declines were considerably less pronounced when valuations were not expensive and earnings growth did not decelerate.

To help protect against a severe downturn—in either stocks or bonds—we have taken advantage of the current low volatility to implement hedges on our exposures, which would be negatively impacted if either or both markets were to falter.

**High Equity Risk Premium**

Finally, while market participants have been very focused on the Fed’s potential to “taper” quantitative easing, rates globally remain very low and policy is accommodative. In fact, the Fed continues to emphasize that any tapering will be data-dependent, meaning that a reduction of stimulus will occur only if economic improvement supports such a withdrawal. If data are positive for the economy, corporate profitability should also improve, which would be further supportive of equities.

At some point, however, better economic data will push interest rates higher, making bonds more competitive with stocks. However, the markets are not at that point yet. Specifically, the equity risk premium—the difference between the likely return on stocks and the return on bonds—remains attractive relative to recent history (since 2000). Whereas the premium that equity investors have tended to expect was 1.8 percentage points above bonds, the premium today is closer to 3.2 points, a result largely of the current low returns on bonds. As rates have risen throughout the year, the premium has become less pronounced, but it is not yet at levels close to average. We believe that this asset-class relationship, as well as the macro and policy backdrop, supports our somewhat greater allocation to return-seeking assets at the expense of fixed income.
Conclusion
The DAA team has positioned client portfolios to be slightly overweight in equities, as the conditions in our view are favorable for further appreciation in stocks and support a higher-than-normal risk premium relative to bonds. We have a modest tilt to non-US stocks owing to their more attractive valuations. However, to mitigate the impact of a market slide in equities, or a spike in interest rates, we have chosen to maintain hedges on both our equity and fixed-income exposure.

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Disclosure About Dynamic Asset Allocation
There is no guarantee that the goals of the Dynamic Asset Allocation (DAA) overlay service will be achieved. An account invested in DAA may cause the account’s overall exposure to equities, fixed income, real estate investment trusts (REITs), and other asset classes to vary significantly from the strategic long-term target allocations agreed upon for the account and may be different from information in this summary. Please read Bernstein’s Investment-Management Services and Policies manual and the Prospectus for the DAA overlay portfolios for additional information about DAA, including the principal risks of investing in the DAA overlay portfolios.

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