AllianceBernstein®

Quarterly Attribution **4Q** 2025

Global Strategic Core Equities

Market Overview

Global equities posted strong gains again in 2025, with the MSCI World Index advancing 3.12% in 4Q:25 and 21.09% for the year in US-dollar terms. The S&P 500 rose 17.88% for the year, trailing Europe, emerging markets and Japan, although most of this was driven by a weaker US dollar.

Equity volatility was driven by uncertainty around US tariff policy and its potential impact on global growth, as well as concerns that generative AI spending may be forming a bubble. But volatile market episodes and geopolitical instability didn't derail global equities or economic growth last year.

In 2025 globally, quality, minimum volatility and price underperformed at the same time for the first time in 30 years, as growth and speculative stocks lead the market. Quality and minimum volatility underperformed across US and Europe, Australasia and the Far East. However, stocks diverged, with growth continuing to lead in the US, while value led outside the US. Quality stocks underperformed by more than 10% outside the US and by approximately 4% within the US, the worst globally in over 20 years. Speculative growth stocks outperformed, benefiting from the AI trade and from expectations of US interest-rate cuts.

AI investment continued to accelerate, driving upside for AI infrastructure companies, while AI software and service companies lagged. Communication services, financials and technology led global sector returns, while consumer sectors—energy and healthcare underperformed. Many quality companies, particularly in software, along with business and information services, were viewed as more vulnerable to disruption from emerging generative AI solutions.

Downside fears of the Trump administration tariff and fiscal policies were not realized, with growth remaining strong and inflation not accelerating. Outside the US, growth remained muted; however, most economies maintained manageable inflation, resilient labor markets and supportive policy rates. With many central banks near neutral policy rates, there are fewer levers available to stimulate growth.

Portfolio Performance

Our Strategic Core Equity Portfolios seek to provide less volatility, with downside risk mitigation driving long-term outperformance. The Global Strategic Core Equity Portfolio rose in absolute terms but underperformed the MSCI World during the quarter and for the year, net of fees. During the quarter, security selection detracted from relative returns while sector selection contributed. Security selection within industrials and technology detracted the most, while an overweight to healthcare and selection in communication services contributed.

Top detractors for 4Q:25 included Wolters Kluwer, AutoZone, and RELX Group. Wolters Kluwer underperformed on generative AI disruption fears and continued headwinds from US dollar weakness. Wolters began commercializing its UpToDate medical AI product in October, which gave competitor OpenEvidence a lead in the market and escalated investor concerns.

AutoZone declined due to margin pressures from a sharp step-up in operating expenses tied to growth initiatives. Investors were concerned over how quickly these investments will translate into profits. AutoZone shares were also pressured after peer O'Reilly Automotive's earnings included commentary on weakness in do-it-yourself demand.

RELX also detracted on generative AI disruption fears and continued headwinds from US dollar weakness. The market debated whether large language models could erode RELX's data moats in legal, risk and scientific, technical and medical segments, and sentiment worsened after ChatGPT tools gained traction.

Leading contributors for 4Q:25 included Merck, OCBC Bank and Inditex. Merck outperformed throughout the quarter due to earnings beating expectations, pipeline wins, favorable policy development and a market rotation into defensive pharma names. Early in the quarter, the White House granted a three-year reprieve from proposed pharma tariffs, alleviating an overhang for the sector. Merck also has positive pipeline results that demonstrated a clearer earnings path post-Keytruda loss of exclusivity, including results in its phase study on one of its cardiac medications.

OCBC Bank rose after reporting 3Q:25 results that beat expectations driven by strong fee and trading income. Wealth management fee income rose 53.5% year over year continuing strong momentum from 2Q:25. Asset quality metrics were benign, and cost-to-income ratio was in line with expectations as the bank continued to exercise cost discipline. OCBC also reiterated its commitment to the announced two-year buyback plan, which is 12% executed so far.

Inditex contributed after reporting fiscal 3Q:25 results that beat expectations. Revenue growth and earnings were well ahead of consensus. The print put to bed concerns over Inditex's growth, which was also impacted by weather earlier in the fiscal year. Gross margins are at the upper end of guidance and sourcing gains are coming through.

Portfolio Changes

Portfolio changes during the quarter focused on three areas. First, we added to high-quality companies, with successful business models and strong cash-flow generation. Second, we reduced names with greater risk. Finally, we focused on valuation, taking profits in more expensive names, increasing exposure to businesses that offer compelling valuations.

We added to high-quality names, such as Alphabet Inc., which continues to innovate, integrating search and generative AI, along with the removal of the Department of Justice antitrust overhang. We added to ASML, the leading semi-equipment maker as demand for its products is accelerating. We increased our weight in Mastercard, which has lagged the more speculative areas of the market. We also increased exposure to Toronto-Dominion Bank, a leading Canadian bank operating in a highly concentrated and rational market structure. We exited names we felt were less resilient to the AI threat in software and service, such as Salesforce and Amdocs.

We reduced names that exhibited higher risks. We exited Fiserv, as growth in its integrated payments offering Clover was revised down and firm guidance was reduced. Meta Platforms was trimmed, as generative AI investments continue to grow without a clear path to returns on those investments. We added to companies exposed to the growing need for water infrastructure, such as Stantec, and more defensive tech names like Cisco Systems and Motorola, as well as utilities such as NextEra Energy. We also added to Euronext, a fully integrated cross-border exchange, with accelerating growth and strong incremental margins.

NextEra Energy is positioned as America's largest renewable energy developer while maintaining one of the nation's largest regulated utility franchises. NextEra has an excellent execution track record with a 15-year streak of meeting expectations. The company has an unmatched competitive moat through scale advantages. Motorola Solutions supplies mission-critical communications, video security and public safety software. The company holds a dominant 75%–80% market share of the North American land mobile radio (LMR) market. The LMR market is distinctly moated with a protected network, importance of reliability and unsophisticated buyers willing to pay up for quality and brand network effects.

We adjusted Portfolio weights based on valuation, reducing weight in AI winners. We took profits in Oracle, exiting after the stock rallied based on increased demand for its cloud and semiconductor chips. We also reduced Singapore bank DBS Bank, on higher valuations.

Outlook

We continue to believe that the global economy will expand in the coming months and quarters. While that expansion may not be robust by historical standards, the risks around our relatively benign base case seem to us to be more balanced: the asymmetry may be more to the downside, but an acceleration is also possible. We also believe that stretched valuations mean that investors should be cautious in their return expectations, even if we are right that the economic outlook is a decent one. With a lot of good news already priced into markets, even the generally positive news we expect may not drive large asset price returns.

The downside risks for 2026 emanate from both policy and economic variables. From a policy perspective, the Fed faces sticky inflation and a slower labor market. The unemployment rate has risen consistently over the last few months, which means that demand is falling faster than supply. Any additional decrease in labor demand could mean a pivot away from slow hiring and into large-scale layoffs, which have a much more pernicious effect on the economy.

The labor market is in flux. Demand for workers has deteriorated as growth has slowed, but migration and deportation policy has reduced labor supply in parallel. That has left the labor market in a curious equilibrium in which slow hiring by historical standards may be sufficient to absorb the much slower growth rate of the available workforce. If sustained, this equilibrium would lead to lower growth over time.

Inflation is a mixed bag. Goods prices are clearly being impacted by tariffs and are moving higher, while shelter inflation continues to decelerate. Overall inflation is above the Fed's target and unlikely to fall to that level over a reasonable forecast horizon; how the Fed responds to that systematic miss will be a very interesting question in the years to come. All major central banks, save the Bank of Japan (BOJ), are easing monetary policy.

From an economic perspective, while AI holds the promise of boosting productivity, history suggests the boost comes with a significant lag. Financial markets may not be patient enough to wait for evidence—in the form of profits—to support the valuation of many AI-related assets. Tech-related investment was a significant contributor to growth in 2025 and seems likely to continue supporting growth in 2026.

And, of course, US financial markets benefited from AI optimism in 2025. If that optimism fades and financial market volatility increases, however, it could both slow growth in the sector and generate a negative wealth effect in which consumption slows in response to lower financial asset prices.

The case for an acceleration rests on three primary planks. The first is the accelerating adoption of AI. Investment in data centers boosted growth, especially in the US, in 2025 and if that investment pays off in the form of increased productivity across the economy, growth could pick up. The second plank is the adjustment of companies worldwide to the relatively more settled tariff regime. The third is the accumulated impact of monetary easing. Central banks around the world have cut rates significantly and we believe there is a bit more easing to come. As the rate cuts filter through to the real economy, they should support growth.

In Europe, fiscal policy looks set to be the major issue for 2026. Germany's plan for additional spending was the major upside economic surprise in 2025; now it is time for the plan to come to fruition. Should fiscal plans proceed as expected, it would provide important support for growth in 2026. Surging imports from China have pushed prices lower. The UK is in a different situation. The damage done to UK fiscal credibility over the last few years has lingered, causing persistently higher borrowing costs in what is already a sluggish economy. As long as fiscal policy remains responsible enough, we expect the Bank of England to deliver additional rate cuts.

While investment should improve further through expansive fiscal policy and disbursement of the recovery funds, this might take longer to be felt. Specifically, Germany is set to frontload its infrastructure spending in 2026–2027 but the pace remains uncertain. So far, implementation is limited, but governmental decisions in the next few months will likely set the stage and provide clarity. Growth is resilient, and inflation is on target, which makes the ECB satisfied and "in a good place" with its policy rates.

Japan remains idiosyncratic among the world's largest economies, with policy rates that are going up rather than down. While the BOJ has been cautious about raising rates after so many years of sluggish demand and price pressures, the recent strong performance of inflation and the weakening of the yen have paved the way for modest rate increases. In China, the impact of tariffs has added to what is already a challenging economic situation. Domestic demand remains sluggish and nominal GDP—growth unadjusted for inflation—is at its lowest growth rate in decades. China is exporting deflation to other countries in order to preserve production capacity at home. For now, the best the economy seems able to do for the time being is to muddle through.

How do these developments frame our equity strategy for 2026? In an environment of unprecedented underperformance of quality and minimum volatility stocks, AI-driven market dynamics with growing risk of a capex bubble, and sluggish macroeconomic growth and US policy uncertainty, we are focused on three areas.

First, focus on quality. Don't give up on resilient companies that can sustain profitability. Quality companies with consistent profitability and resilient business models tend to outperform over time. High-quality companies can also sustain earnings growth independent of macro conditions. Short-term lapses in quality stock performance don't signal a fundamental erosion of long-term potential. In our view, earnings and cash flows are still the best predictor of equity returns over long-term horizons.

In 2026, we believe quality stocks could become even more valuable in a portfolio. Our historical analysis suggests that periods of pronounced quality underperformance have typically been followed by quality outperformance in the subsequent market cycle. We believe this is an attractive point to increase exposure to high-quality franchises with compelling return profiles and valuations.

Second, focus on managing AI volatility, while keeping exposure for long-term returns. Complacency about volatility is a risk following a strong year for equities. US market dynamics and AI controversies could provoke turbulence in 2026. For example, the mega caps will face heightened scrutiny, and any AI-related disappointments may prompt equity declines. In 2025, the S&P 500's relative volatility versus non-US markets reached a record high for the 21st century.

AI's rapid growth may unlock productivity gains and return potential, but transformational technology comes with considerable risks. Today, as the hyperscalers pour hundreds of billions of dollars into infrastructure capex, more questions are being asked about their future return on investment and whether we're in an AI bubble.

Given the scale of spending, bubble fears are understandable. That said, capex in public markets is mostly being financed from free cash flow rather than debt, which should help alleviate potential stresses. However, the next phase of AI is being financed by less stable sources, including circular deals between large players and private-credit structures that could be more vulnerable.

We are finding opportunities in oversold software and information services companies. We believe companies will need to invest in AI through these companies to support the current high levels of capex. Opportunities will also emerge among a broader range of companies that will become consumers and beneficiaries of AI.

Third, cast a wider net for long-term return potential. US equities remain expensive versus global peers. Regional diversification isn't just a risk-control tool—it's a source of differentiated returns to help fight concentrated leadership. Capital discipline in Europe and corporate governance reform in Japan can add uncorrelated sources of returns.

We think investors should have diversified exposure across business models, industries and regions. Remember that the early winners in the dot-com boom don't rule the web today and expand the search for companies that could become tomorrow's leaders. We continue to look for companies that offer a combination of quality and stability at attractive prices; these three core elements underpin our investment philosophy and are key to navigating the current market environment. Quality, stable companies can cushion on the downside across a broad array of sectors and industries.

We believe that equity portfolios designed to smooth volatility are especially appealing in the current market environment. For long-term, outcome-oriented investors, we believe that companies with these features are best positioned to deliver strong returns through changing environments.

Thank you for your support,

Kent Hargis

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