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US Exceptionalism, AI and Towards the Total Portfolio

Perspectives on Markets, Strategic Allocation and the Investment Industry's Future

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EXECUTIVE SUMMARY

Introduction

In these books our aim is to present a narrative that connects the strategic outlook to portfolio allocation, and how this may need to evolve. Forces such as deglobalization and AI have accelerated over the last year, while others such as demographic change, public debt and climate change remain ever present. A specific theme linked to these forces is the question of whether the US is still exceptional from an equity and a currency perspective. In this book we outline an affirmative answer to the former, but negative to the latter. Likewise, AI spawns multiple investment questions. The ones that we grapple with here are the most strategic or macro in nature. We show that the AI productivity question is bound up with demographics and the future of labor in a number of ways.

This raises questions of investment praxis. The consequence of these megaforces is that investor behavior at large still needs to adapt to an investment paradigm that is likely different from recent decades. We discuss not only what this means for the asset-management industry but also what this specifically means for investment methodology. We think that this strengthens the case for the total portfolio approach, and it is with that end point in mind that we structure the narrative of this book.

A discussion of the strategic outlook has to be framed by the huge forces that are likely to determine the path of key financial variables such as growth, inflation and risk premia in coming years. We see these as:

AI: There have been rapid developments over the last year, but we still have a high degree of uncertainty as to what this means for aggregate productivity, labor markets, societal inequality and market valuations—let alone larger questions of epistemology and political philosophy that AI raises.

Deglobalization: The Iran war has provided yet another leg to the idea that the world is deglobalizing.

Debt: Public debt is at its highest level relative to GDP since WWII for G7 nations. US debt service cost now exceeds the defense budget, while there have been brief episodes in the last year when attempts have been made to price in sovereign risk for the UK, France and Japan. We believe that the likely strategic outcome is risk of higher inflation as a mechanism for debt monetization.

Demographics: The working-age population is shrinking in most developed economies and China. A harsh immigration policy would also imply slight shrinkage

in the US as well. The last five years have also seen a pronounced fall in birth rates, which further intensifies the long-term implications of this. If productivity is constant (*pace* AI) this implies lower growth. We also argue that, contrary to Japan's example, it is likely inflationary.

Climate: The alarming rapid increase in projected power demand in just the last 18 months, as a function of AI, makes an energy transition an even more distant goal. We think this cannot occur in the 2050 time frame. Hence, we expect a more than two-degree temperature increase, lowering growth rates, increasing inflation volatility and introducing more path uncertainty in forecasts.

We discuss the trade-off between these forces in this book. In concert, they imply a higher-equilibrium level of inflation. The extra aggregate growth due to AI is very much open to debate, but our central assumption is that the aggregate impact of all these forces is for lower global growth, not higher.

In our meetings with investors around the world, we find very little opposition to the proposition that equilibrium inflation will be higher, albeit with disagreement as to how much higher. However, asset allocation does not appear to have moved to match this. This dichotomy is shown in the sharp contrast between the evolution of market-based expectations of inflation versus precious metals over the last 18 months. Expectations of inflation over the next decade have not moved, yet gold is up 70% (*Display 1, page 3*). Both of these views, we suggest, cannot really hold in the long term.

This narrative builds on our recent books. We laid out the case for these megaforces in *A Preliminary Language for a Post-Global World*[1], while *Instability: Debt, Inflation and AI's Impact on Investing*[2] laid out the impact of several of these forces on particular areas of the market. The end point of this book, on the total portfolio approach, continues the broader case we made for the importance of process and methodology in finance in *Are We Human or Are We Dancer?*[3]

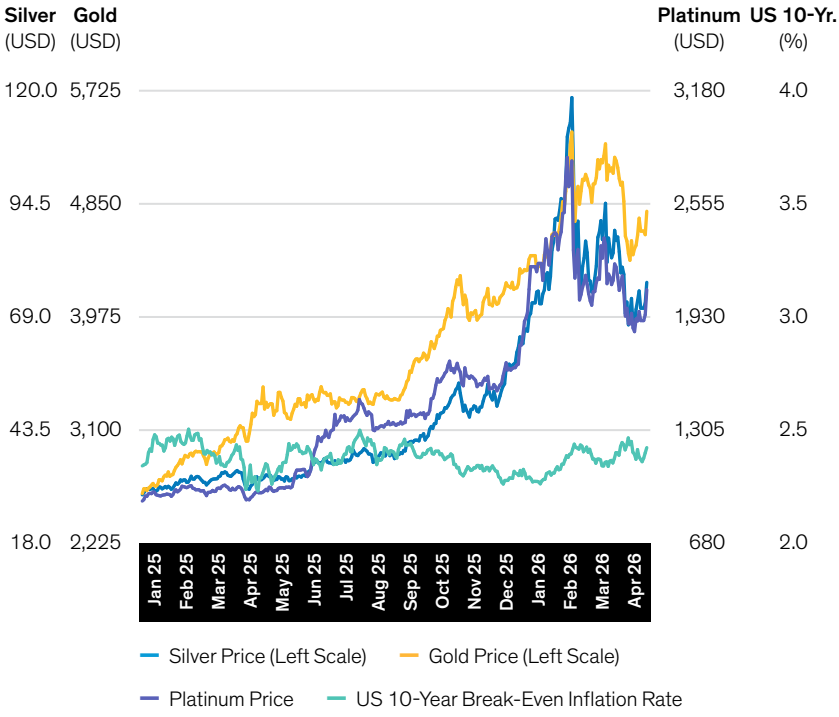
One force not explicitly included in the above list is geopolitics; however, no one can afford to be dismissive of it. Since the current US administration took office in early 2025, geopolitics has seen the most pronounced change of all the things that can be

1 Inigo Fraser Jenkins, Alla Harmsworth, Robertas Stancikas, Harjaspreet Mand and Maureen Hughes, *A Preliminary Language for a Post-Global World*, AllianceBernstein, May 2024, https://www.alliancebernstein.com/americas/en/institutions/capabilities/the-book-a-preliminary-language-for-a-post-global-world.html.

2 Inigo Fraser Jenkins, Alla Harmsworth, Robertas Stancikas, Harjaspreet Mand and Maureen Hughes, *Instability: Debt, Inflation and AI's Impact on Investing*, AllianceBernstein, June 2025, https://www.alliancebernstein.com/americas/en/institutions/capabilities/the-book-2025/the-book-2025-perspectives-on-markets-strategic-allocation-and-the-investment-industrys-future.html.

3 Inigo Fraser Jenkins, Alla Harmsworth, Robertas Stancikas, Harjaspreet Mand and Maureen Hughes, *Are We Human or Are We Dancer?*, AllianceBernstein, July 2021, https://www.alliancebernstein.com/content/dam/global/insights/insights-whitepapers/are-we-human-or-are-we-dancer.PDF.

DISPLAY 1: A PAINFUL JUXTAPOSITION? PRECIOUS METALS VS. MARKET PRICING OF INFLATION

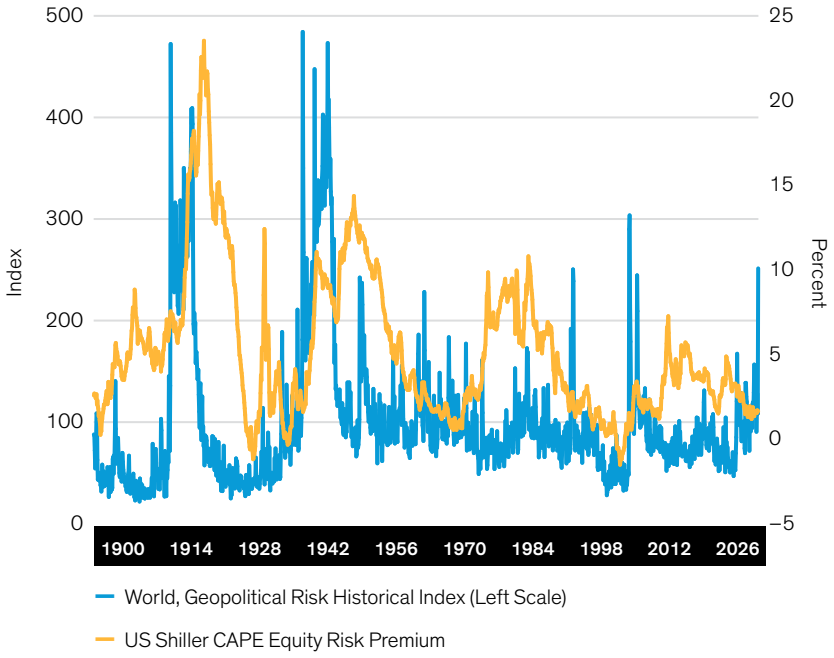


Past performance does not guarantee future results.

As of April 8, 2026 | **Source:** Macrobond and AllianceBernstein (AB)

said to frame the outlook for investing and markets. We would argue that this change is more significant and long-lasting than anything to do with the global economy, tariffs or other macro issues, barring AI and climate. What has occurred is a significant unwinding of the post-war US-led order. The Iran war has rightly dominated headlines, but the standoff over Greenland probably was also a step change with, at face value, the threat of the US to take by force the territory of a fellow North Atlantic Treaty Organization (NATO) member. Likewise, the downgrading of multilateral institutions such as the United Nations, the apparent normalization of "decapitation strikes" against heads of state and the break from prior views of the desirability of following even a fig leaf of international law are all seismic changes.

DISPLAY 2: GEOPOLITICAL RISK INDEX AND EQUITY RISK PREMIUM



Past performance does not guarantee future results.

CAPE: cyclically adjusted P/E ratio

As of April 8, 2026 | **Source:** Dario Caldara and Matteo Iacoviello, "Measuring Geopolitical Risk," *American Economic Review* 112, no. 4 (April 2022): 1194–1225, https://www.aeaweb.org/articles?id=10.1257/aer.20191823; Macrobond; Robert Shiller's database, S&P and AB

Nobody has a model for pricing in the end of NATO. Moreover, markets tend to be bad at pricing in geopolitical risks ex ante. Over the last 150 years, shifts in geopolitical risk have tended not to be priced ex ante by a rising risk premium, and instead tend to be priced when something "breaks" (*Display 2*). As the timing and scale of such impacts are very large, we think it is wrong to include them in return forecasts, a point we discuss in the equity section below. Investors should also prepare for a less "technocratic" approach, not only to trade, but also to supply chains for critical materials and commodities. This is a change that we think is here to stay.

Role of the US, and of US assets

The focus of the first two chapters of this book is the role of US assets in global portfolios. Whether either US equities or the US dollar are exceptional is not only a profoundly important thematic conversation that crops up in countless client meetings, but this also touches on several of the major forces that we outlined above: AI and the ability of it to raise productivity, debt and whether inflation is a necessary consequence, and demographic differences between nations.

The role and weighting of US assets in portfolios has consumed a huge amount of time in meetings over the last year. The start of 2025 saw a near-unanimous pro-US positioning by global investors. This was shattered by "liberation day," and the somewhat capricious policy announcements since then have raised profound questions of trust in the US. That unanimity of positive investor views of early 2025 no longer holds. Instead, we find a very broad range of views on the US. Those who are nervous about US equities usually cite the concentration of the market, the attack on US institutions or market valuation. Yet, underweighting US equities consumes so much of the risk budget of a portfolio that we find many investors are unwilling to do it. Our view, laid out in chapter 1, is that, in fact, it is right to overweight the US within global equities from a strategic point of view. That view comes down to growth and the likelihood that US earnings growth will be superior to the rest of the world. There are a number of factors that point in this direction: An essentially flat profile of the working-age population, while less positive than the last 40 years in absolute terms, compares favorably to other key markets and implies relatively better GDP growth. Whatever one thinks about the productivity gain of AI, this is likely to be better exploited by US firms. There is also the ugly side of US exceptionalism, which is the recognition that US firms have achieved a degree of regulatory capture, as seen in the near-monotonic decline in the effective corporate tax rate for decades. There has to be a limit to how high the profit share of GDP goes (or else there would presumably be a revolution), but in a change in our view in recent years, we have given up assuming that there is a mean reversion in US profit share of GDP anytime soon. For some reason, the American electorate seems not to care. We can also cite the size of the home market and relative geographic security of supply chains. All this supports our view to overweight US equities compared to their already large weight in benchmarks.

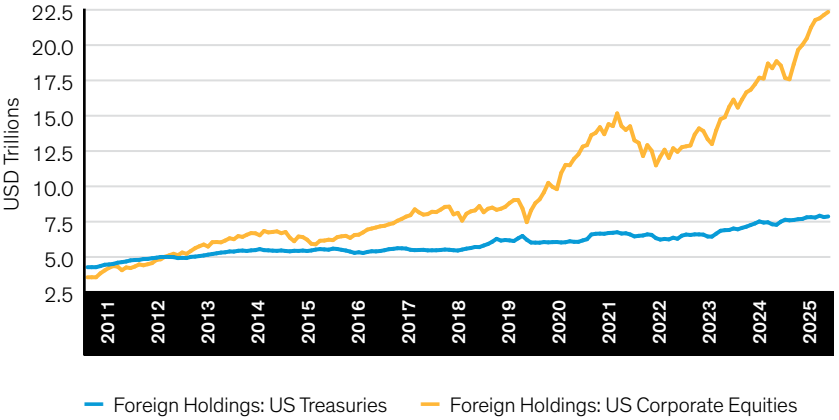
Where we think there is a clearer negative case to be made is against US bonds and the dollar. The recent positive performance of the dollar during the Iran war notwithstanding, we think that we have reached "peak dollar," not in an exchange-rate sense, but in terms of its share of international transactions and share of central bank reserves. The combination of questions of fiscal sustainability (which is really a G7 problem rather than being peculiar to the US), a geopolitical imperative for BRICS (Brazil, Russia, India, China and South Africa) nations to find dollar alternatives and a destruction of trust in the US, which is likely permanent, all point to the US dollar being less of a safe haven asset. Before people read too much into this, let's not

hold our breath. Changes in reserve currency status are slow—the last one took 20 years, through the 1920s and 30s—and there is no plausible alternative to the dollar. Moreover, the decision by the US to elevate stablecoins above other forms of digital money actually has created new demand for dollars. Our discussion on this in chapter 2 recommends that global investors should hedge more of their US-dollar exposure. We also do not think that US nominal long-duration bonds will play their role as a safe haven or (along with duration more generally) as a diversifier of equity risk.

Despite this, the glaring fact is that there has been no net selling of US bonds by global investors in recent years (*Display 3*). This is glaring, as it sits counter to the statements that we have heard, e.g., from some Asian and Northern European pension funds that they would consider divesting. So far, concerns about liquidity and existing rules of thumb have swamped any verbal statements about a wish to reposition.

Which brings us to gold, the subject of chapter 3. We retain a strategically positive recommendation on gold, as we have since 2019.[4] For us, this is not really an isolated

DISPLAY 3: FOREIGN HOLDINGS OF US TREASURIES AND EQUITIES



Past performance does not guarantee future results.

As of April 8, 2026 | **Source:** Macrobond, US Department of the Treasury and AB

4 Inigo Fraser Jenkins, Paul Gait and Alla Harmsworth, *Global Quantitative Strategy: A Strong Case for Holding Gold*, Bernstein Research, February 11, 2019.

call, as it sits very much alongside a positive strategic recommendation for equities. The primary reason for institutional investors to hold gold is the evidence that its correlation with equities remains zero at very different levels of inflation. A lack of correlation is not a sufficient reason for asset-allocation models to overweight it, however. As is often pointed out, it is hard to enunciate to a credible price target for gold. Investors used to link it to the yield on Treasury Inflation-Protected Securities, however that model broke down when Russia invaded Ukraine and, in our new geopolitical climate, we see no reason for that relationship to reassert itself. One could appeal to the very long run, 170-year real return on gold, which has averaged about 0.6% per annum. This is problematic, as the return has been highly episodic, and it might not sound sufficient for the basis of a strategic position. However, if one assumes that BRICS nations, especially China, have a geopolitical imperative to buy more gold (albeit with unknowable timing and quantity) then this implies a somewhat higher real return target. Yet another strategic reason comes from the prognosis for fiat currencies when levels of public debt are already very high. These together are sufficient to point toward a positive view on gold. We would augment this with other non-fiat assets that have somewhat different characteristics, such as silver and crypto, but it is very much a gold-first view.

We should comment on the apparent failure of gold as a safe haven during the Iran war in early 2026. Is this a problem for the strategic gold thesis? We think not. The forces that we outlined above are all very long term in nature and do not preclude tactical periods of underperformance. There was a highly significant buildup in investor demand for gold in 2025. Specifically, this led to investor demand for gold exceeding demand even from jewelry for four quarters, an occurrence not seen since the 1980s, and a demand for liquid assets and meeting margin calls created selling pressure for an asset that had performed so well.

Finally, and this may be a semantic detail, but we do not think that gold should be viewed as a commodity anymore. In this new paradigm it behaves more like money. The role of non-fiat assets in general is set, we think, to be greater if this paradigm thesis is correct.

AI

There are multiple distinct AI topics that are relevant for the strategic, cross-asset outlook.

- To what extent can AI raise aggregate productivity?
- Is the level of AI capex justified? And what does this mean for market valuation and sector rotation?
- AI is resource intensive. Should it be viewed as an extractive industry? And, if so, what does this mean for inflation and returns from investing in the tangible economy?

- Does AI necessarily create job insecurity? Or is this just another technology change like the others since the Industrial Revolution that have not raised structural unemployment? More fundamentally, does AI imply greater inequality?
- What does AI mean for epistemology and the meaning of truth? How damaging might be its social impact?
- Is AI compatible with democracy?

Multiple books could, and no doubt will, be written on all of these topics. In this book we focus on the intersection of a few of these topics, ultimately with a view on what this means for strategic returns and risk levels. The great hope for AI, of course,

DISPLAY 4: AI VS. DEMOGRAPHICS AND CLIMATE IMPACT ON GROWTH

US		Positive Outcome	Middle Ground	Negative Outcome
Demographics	Immigration continues at recent pace	−0.6		
	Middle ground		−0.8	
	Harsh immigration policy			−0.9
Climate	No impact on growth	0.0		
	Academic research average		−0.2	
	Network for Greening the Financial System			−0.6
Labor-Capital Share	Corporations take more share	0.1		
	Constant share		0.0	
	Labor claws back share			−0.1
AI	**Required boost from AI**	**0.5**	**1.0**	**1.6**
	Techno-optimist	2.5		
	Average of recent academic studies		1.0	
	Acemoglu, "The Simple Macroeconomics of AI"			0.1

Current analysis and forecasts do not guarantee future results.

As of September 15, 2025 | **Source:** Daron Acemoglu, "The Simple Macroeconomics of AI," *Economic Policy* 40, no. 121 (January 2025): 13–58; Network for Greening the Financial System; and AB

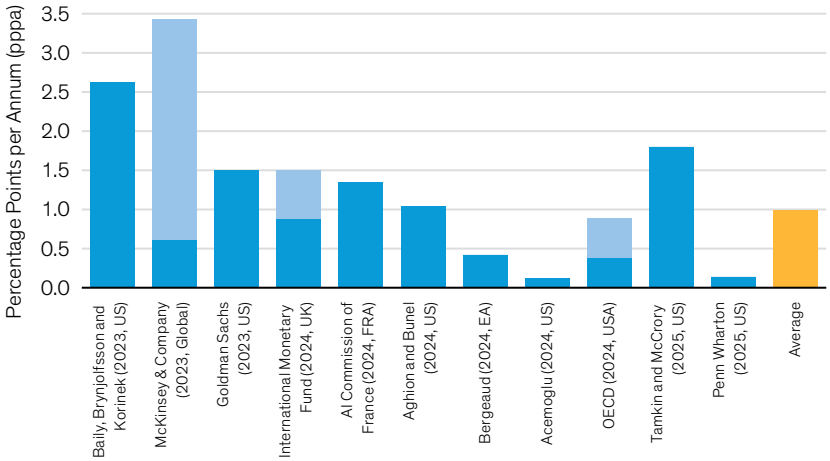
is that it potentially raises productivity. In our chapter "AI vs. Demographics," we point out that one has to be humble in making the claim that it raises productivity by a given amount. It is not obvious that big changes in aggregate productivity are inherently predictable. The last time that >1 percentage points per annum (pppa) changes in long-run assumptions were made about productivity was during the technology, media and telecom bubble of 2000, and those forecasts had to be subsequently unwound. Thus, we are suspicious of approaches to forecasting the outlook that commence with an assumption about aggregate productivity growth at the outset. Instead, our preference is to "reverse engineer" the process by estimating the negative impact on growth from the other megaforces and asking whether it is plausible that AI can compensate for this drop.

It is easiest to make these numbers "add up" for the US. Our central case for the change in the size of the working-age population and for climate change (two of the biggest drags on strategic growth rates), imply that AI would have to raise the growth rate of productivity by 1 pppa over the next decade to keep growth steady at the average run rate of the past 40 years (*Display 4, page 8*). So, the question is, is a sustainable 1 pppa productivity growth plausible?

One way to answer this is to turn to history. The introduction of the steam engine in the early nineteenth century saw the first sustained increase in productivity in modern human history and led to an increase in per capita growth rates in the UK by 0.8 pppa. So, if AI is as good as the steam engine, then it could offset a large part of the decline in growth. Separately, we also appeal to recent attempts by academics to make this forecast (*Display 5, page 10*). The first thing to point out about such forecasts is that the range is implausibly wide, from 0.1 pppa to 3.5 pppa! So, the error bars on such forecasts are not particularly helpful. Nevertheless, the average is 0.9 pppa, again implying that AI might be able to counteract most of the decline in growth. Despite this, this would only keep growth close to the levels that we have been used to in recent decades, not an expansion of growth rates. Moreover, this ignores the downsides of AI in terms of inequality, politics and geopolitics. Making this balance outside the US is generally harder, given worse demographic outlooks and likely more muted AI benefits.

Changes in productivity can come about in socially positive and negative ways. Forecasts of productivity growth tend to be coy about how much of any productivity gain originates from making a unit of labor more productive versus through making a unit of labor redundant and automating a task that was not previously automated. Despite 200 years of waves of fear about automation and job losses, there has been zero evidence that technological change has led to a sustained increase in structural unemployment, although that aggregate point masks periods of extreme hardship for segments of society, so the social impact requires an analysis of the cross section and not just the aggregate. The economic point really is that despite all the fears, in the past technology has led to new jobs being created.

DISPLAY 5: ACADEMIC FORECASTS OF AI PRODUCTIVITY INCREASE

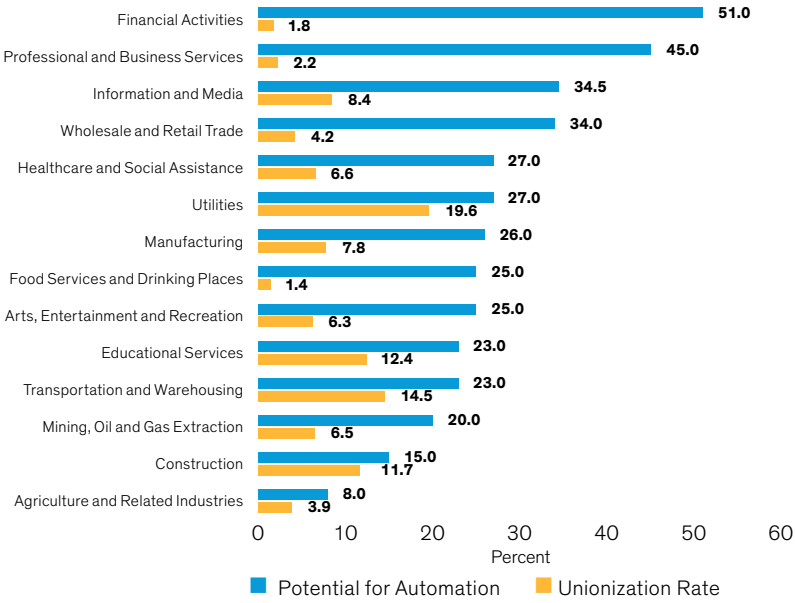


Current analysis does not guarantee future results.

When the source presents a range of estimates as the main result, the lower and upper bounds are indicated by light blue areas. In cases where predictions are made for total factor productivity, predicted labor productivity gains are obtained by assuming a standard long-run multiplier of 1.5 regarding the adjustment of the capital stock (Acemoglu, Aghion and Bunel, Bergeaud, and OECD). The estimates refer to the countries shown in brackets.

As of December 18, 2025 | **Source:** AI Commission of France; Alex Tamkin and Peter McCrory, *Estimating AI Productivity Gains from Claude Conversations*, Anthropic, November 5, 2025; Alexander Arnon, *The Projected Impact of Generative AI on Future Productivity Growth*, Penn Wharton Budget Model, University of Pennsylvania, September 8, 2025; Antonin Bergeaud, "The Past, Present and Future of European Productivity," presentation, ECB Forum on Central Banking 2024: Monetary Policy in an Era of Transformation, Session 4: Euro Area Productivity in the Short and Long Run, Sintra, Portugal, July 3, 2024; Daron Acemoglu, "The Simple Macroeconomics of AI," *Economic Policy* 40, no. 121 (January 2025): 13–58; Francesco Filippucci, Peter Gal and Matthias Schief, "Miracle or Myth? Assessing the Macroeconomic Productivity Gains from Artificial Intelligence," working paper, *OECD Artificial Intelligence Papers*, No. 29, OECD Publishing, Organisation for Economic Co-operation and Development, Paris, France, 2024, https://doi.org/10.1787/b524a072-en; Jan Hatzius, Joseph Briggs, Devesh Kodnani and Giovanni Pierdomenico, *The Potentially Large Effects of Artificial Intelligence on Economic Growth* (Briggs/Kodnani), Global Economics Analyst, Goldman Sachs, March 26, 2023; Martin Neil Baily, Erik Brynjolfsson and Anton Korinek, *Machines of Mind: The Case for an AI-Powered Productivity Boom*, Brookings Institution, May 10, 2023, https://www.brookings.edu/articles/machines-of-mind-the-case-for-an-ai-powered-productivity-boom/; Mauro Cazzaniga, Florence Jaumotte, Longji Li, Giovanni Melina, Augustus J. Panton, Carlo Pizzinelli, Emma J. Rockall and Marina Mendes Tavares, "Gen-AI: Artificial Intelligence and the Future of Work," staff discussion notes, International Monetary Fund, January 13, 2024; McKinsey & Company; Philippe Aghion and Simon Bunel, *AI and Growth: Where Do We Stand?*, Federal Reserve Bank of San Francisco, June 2024; and AB

DISPLAY 6: AI EXPOSURE VS. UNIONIZATION



Current analysis does not guarantee future results.

As of June 29, 2023 | **Source:** Accenture, US Bureau of Labor Statistics, US Department of Labor and AB

Despite this backdrop, we would point out that the current wave of technology does at least appear to be different from the rounds of automation of heavy industry that have occurred in recent decades, in that there is a marked difference between the exposure of professions to AI and the level of unionization in those professions. At the very least this implies a shift in the balance of labor versus capital bargaining power in favor of the latter (*Display 6*). In this book, we present a model of the trade-off between productivity gain and job displacement. Of course, in these early days we do not know the proportion of productivity gain that is likely to come from labor displacement versus labor enhancement, but the model allows us to gauge the scale of the trade-off.

We choose to pair AI with demographics in this book, as these issues are strategically entangled for more than one reason. The very big picture point is that the decline in the size of the working-age population in developed markets and China is the most predictable force that points to a lower-growth future than the one that we have been

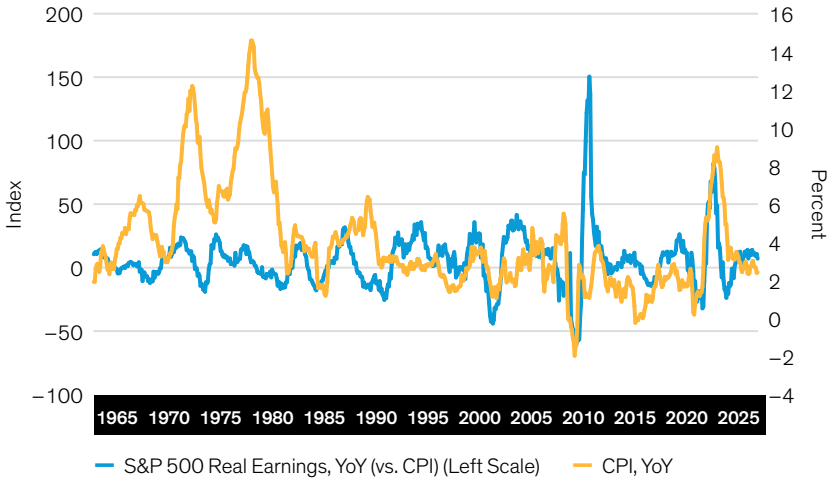
accustomed to for the last 40 years. If productivity is constant, then an approximately stable working-age population in the US and one that is set to decline by 1 pppa in China point to a material shift in starting assumptions about aggregate growth versus the post-1980 average. AI is the only force at scale that could counteract that (apart from mass immigration of course).

The other very different way to approach the interaction of these topics is via the question that has been asked: Do we need as many workers in the future? The fact that this question has been publicly aired and debated several times since the early nineteenth century, without ever being answered in the negative, makes us wary of the claim implicit in raising the question. Moreover, we are skeptical of the claim that automation from AI might balance out the reduction in the size of the working-age population. These are very different forces; and hence there is no need for them to be of the same order of magnitude. They are also likely to differ in their geographical and temporal impact (i.e., the likely slower impact on the demand for labor in Europe, where the working-age population is shrinking compared to the US).

In our second chapter on AI, "AI Capex: A Vertiginous Dialectic," we delve into the topic of whether the extraordinary capex expenditure related to AI can be justified. We present a range of possible paths for aggregate productivity increases, with assumptions about what proportion of such increases could be claimed as revenue by AI hyperscalers. The gains have to be large but are not inconceivable. Our conclusion is that it is possible to plausibly justify the valuation of the mega-cap tech names in the US; the bigger problem is that one is unlikely to have clarity about the revenue trajectory on a time horizon that is shorter than the depreciation cycle of the chips that consume the lion's share of capex budgets. While we have seen capex cycles in the past to rival the current one (the build-out of the railways, electrification, etc.), if we adjust for the depreciation of capex then this is possibly the most intense cycle of capex ever. This means that we will likely hit an "air pocket" at some point, where we simply do not have enough information about the earnings path. This is not bearish for the large-cap tech names, but it does imply that there is marked complacency about the level of volatility that should be expected. This leads to a need for defensive trades, which we discuss elsewhere in this book.

While AI is the only plausible force that can offset the structural downward forces on growth, we would point out that it is somewhat striking that the net impact on growth from AI is widely assumed to be positive. While our central forecast does not differ from this, we point out that this focuses on a specific set of assumptions about productivity improvements. Other possibilities are that AI is "too good" and aggressively displaces labor, hence undercutting demand; that it increases inequality, creating a social backlash; or that it proves very destabilizing to national politics or geopolitics.

DISPLAY 7: EQUITIES AS A REAL ASSET



Past performance does not guarantee future results.

YoY: year over year

From December 31, 1964, through January 31, 2026 | **Source:** FactSet, Macrobond , S&P and AB

Equities

A strategically positive view on equities is one result of the macro view articulated in this book, albeit a somewhat grudging one. Equities are "fully valued," so one cannot, with any sense of equanimity, include a multiple expansion in a forecast at any time horizon. The risk to growth is that it falls rather than rises. Moreover, markets are concentrated. Yet, despite this somewhat inauspicious set of characteristics, we think the key case for equities rests in the evidence that it constitutes a real asset, and a liquid one to boot. As equilibrium inflation likely rises this will force investors to focus on the ability to generate real returns, and equities need to be at the core of that.

The evidence that equities can behave like a real asset at moderately elevated levels of inflation is important for this. We can show that as long as equilibrium inflation is not greater than 4% then the equity market is a generator of robust real earnings growth (*Display 7*).

We cannot dismiss the valuation and concentration of the market. The concentration level, as measured by the weight of the top 10 stocks within the US market, is not unprecedented. We have been at this level before, in the 1960s and pre-WWI. Other markets outside the US have also routinely exceeded this level of concentration.

Nevertheless, it is high compared to history. Our research suggests that the combined effect of high valuation and concentration is that it implies volatility will be higher, rather than that the market needs to deliver negative returns. Therefore, within our strategic positive position on equities we find space for defensive trades, especially where there are extenuating thematic reasons to support them, of which more below.

One plausible response to the strategic outlook outlined in this book is that surely the world is more "risky," and hence this should be reflected in asset prices, specifically in risk premia. Asset pricing theory tells us that this should be the case. However, several things mitigate against this. First, one does not want to fall into the trap of saying "the future looks risky." Surely, one could have said this at any stage back through time. Having said that, a greater than two-degree temperature increase and AI do feel like different kinds of risk that we have not seen before, and there is a good case that both forces materially broaden the range of possible paths in any long-term forecast. Moreover, the greatest change in the last 18 months has been the rupture in the geopolitical order. As we suggested earlier, no one has a model for the price impact of the ending of the post-war US-led order or the risk that NATO comes to an end. Second, there is very little evidence that the equity risk premium anticipates risks of this nature, so it could be wrong for a long period to include such an assumption.

One can pore over the fine details of strategic equity forecasts. The fine points of changes in growth forecasts might move the forecast for annual equity returns up or down on a scale of about 50 basis points (bps). However, changes to the assumptions of the equilibrium equity risk premium (ERP) can easily shift the annual return assumption by 200 bps or more. This is a problem for any strategist. Changes in equilibrium ERP assumptions are always more art than science. What period of history constitutes a basis for an equilibrium assumption? With the Shiller price to earnings at 39×, the brute fact is that there isn't even room to increase the ERP if one wanted to. One would be left with a negative equity return forecast and a recommendation to strategically sell equities. That does not feel like a move that can be justified.

Maybe this sounds like an intellectual non sequitur, or the tail wagging the dog. Perhaps. But for long-horizon investors, we feel that the evidence that equities can deliver positive real returns is more important, even if those returns are substantially below those that investors have become accustomed to in recent decades. There are mitigating factors behind the high valuations: evidence that profitability has become more persistent, the observation that real rates do not need to mean revert higher and also the profit share of GDP moving higher. As we said before, there have to be limits to this, but there is no evidence that such a limit is approaching soon (however remarkable that may be from a social perspective).

The complacency about volatility means that we want to incorporate defensive trades, especially where there is a thematic element offering strategic support. One such area

is healthcare. We initiated a strategically positive view on the global sector in 2025, which we continue to maintain. We cover this in the chapter "US Healthcare: Attractive Valuation for a Structural Growth Opportunity." Healthcare fits with the structural macro themes outlined in this book in that it is likely to be a long-run beneficiary of the demographic evolution to an older population, and it is also likely to be a beneficiary of AI (both in drug development and in the care sector). The sector has outperformed but still trades on a valuation discount to its long-run average. Yes, it comes with near-term regulatory risks, but these are different from the risks elsewhere in a portfolio. Moreover, from the point of view of portfolio design, it gives exposure to an element of growth in the total portfolio that is not dependent on large-cap tech.

Positioning

The strategic outlook of elevated long-term equilibrium inflation, somewhat lower growth and high starting multiples implies a future of lower real returns and less diversification available from traditional sources of return. It is not, however, a bearish outlook, as we can make a case that the major asset classes do deliver positive real return. We show how our capital-market expectations differ from the average of the last 15 years in *Display 8, page 16*. The conclusion is that investors are able to access a smaller return/risk "space" than they were before.

We have made the case in previous books that for investors who need to defend purchasing power over other objectives, which is the vast majority of investors, that inflation should be a benchmark. This implies a need to strategically overweight real assets, with equities being the largest real asset.[5] We remain underweight nominal duration and continue to advocate positions in private assets, factors and non-fiat assets (*Display 9, pages 17–18*).

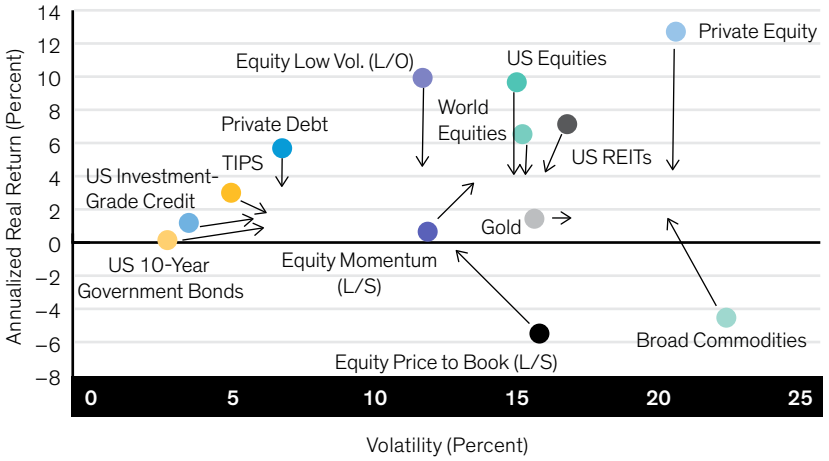
Praxis

The latter part of this book considers the process of investing and what the strategic outlook implies for changes to the design of portfolios. Rather than only opining about the strategic outlook and the prognosis for asset-class returns, we think that a shift in investment paradigm is sufficient to change *how* people invest.

We think that this points to greater interest in the total portfolio approach (TPA) as a logical response to a changed investment paradigm. The idea has been around for over a decade, yet we have seen a marked increase in the number of questions that we have about the approach from clients. There are two reasons for this: First, investors, in some form, agree with our view of lower returns and less available

5 Inigo Fraser Jenkins, Alla Harmsworth, Robertas Stancikas, Harjaspreet Mand and Maureen Hughes, *Instability: Debt, Inflation and AI's Impact on Investing*, AllianceBernstein, June 2025, https://www.alliancebernstein.com/americas/en/institutions/capabilities/the-book-2025/the-book-2025-perspectives-on-markets-strategic-allocation-and-the-investment-industrys-future.html.

DISPLAY 8: CAPITAL-MARKETS EXPECTATIONS SCATTER



Historical analysis and current forecasts do not guarantee future results.

L/O: long-only; L/S: long/short; REITs: real estate investment trusts; TIPS: Treasury Inflation-Protected Securities. The circles represent real returns and volatility from January 2010 to December 2022 for the major return streams investors can buy. The arrows represent the AB Institutional Solutions team's forecasts for the next five to 10 years. Private equity return data are from the US Private Equity Index from Cambridge Associates, compiled from 1,562 funds, including fully liquidated partnerships, formed between 1986 and 2019. All returns are net of fees, expenses and carried interest. Data are provided at no cost to managers. Private equity volatility is estimated from MSCI US Small Cap Value Index, with 15% leverage. For private debt, historical and future volatility is expressed as volatility of public US investment-grade credit. The number is between the historic volatility of public US high-yield fixed income and the Preqin Direct Lending Return Index. Factor future volatility is assumed to be in line with the post-1950 historical average.

As of October 5, 2023 | **Source:** BlackRock, Cambridge Associates, FactSet, Federal Reserve Bank of St. Louis, Kenneth R. French Data Library, MSCI, Preqin and AB

diversification. Second, investors see TPA as a route to integrating investments in public and private assets in portfolios.

Our chapter "Portfolio Design as Gesamtkunstwerk: The Total Portfolio Approach" explains why we think interest in TPA will continue to grow, what it is and what it means for asset allocation. At its heart, TPA is about removing silos from investing. An example of this is not to allocate assets in a manner predicated primarily by asset class, but instead to consider the portfolio as a set of return streams that could represent asset classes, factors or strategies. While most adopters of the approach would probably agree on this as a definition, what this means in practice is very

DISPLAY 9: STRATEGIC ASSET-CLASS VIEWS

Asset Class	Recommendation vs. 60/40	Comment
Developed Equities	**Overweight**	
US Large-Cap	+	Real asset; attractive long-term returns; "US exceptionalism" still holds. Valuation and market concentration are sources of risk
US Small-/Mid-Cap	+	Historically an area of strong alpha generation by active managers
International Developed	Neutral	Attractive valuations but greater drag on growth from demographics and deglobalization than US
Japan	+	Positive inflation dynamic; corporate reform boosting corporate earnings and improving long-term fundamentals and shareholder returns; attractive valuations; diversification benefits
Europe	Neutral	The challenge is lack of growth drivers; the recent increase in infrastructure and defense spending might help. Valuation not enough, but also prevents being underweight
EM Equities	**Underweight**	
EM ex China	Neutral	Positive growth premium over developed markets; better demographics (India, Africa); structural sentiment measures supportive; deglobalization to improve the diversification role of EM; geopolitics and policy are risks in some countries; President Trump poses increased risks to outlook (protectionism, higher USD)
China	–	Poor demographics, real estate overhang; policy and geopolitical risks to outlook despite cheap valuations
Style Premia		
US Growth	+*	Expensive but structural tailwinds (greater persistency of ROE; tech and AI theme exposure)
EAFE Dividend Yield	+*	Attractive valuations; defensive properties and volatility reduction for a less robust strategic outlook outside of the US; attractive source of income
Duration	**Underweight**	
US Government: Long	–	Structural risks: fiscal sustainability, de-dollarization; inflation volatility; diminishing diversification role
US Government: Short	+	Better compensation for (lower) risk than long bonds
Euro Government Bonds	–	Yields attractive vs. history; balanced against this is geopolitical and domestic political risk

Asset Class	Recommendation vs. 60/40	Comment
Real Assets	**Overweight***	
REITs and Natural Resources Assets	Neutral	Real asset; strategic inflation hedge
US TIPS	+*	Attractive long-term returns; inflation protection
Infrastructure	+	Inflation protection in the form of offering positive long-term real return in both moderate- and high-inflation environments; beneficiary of energy transition
Private Assets		
Private Equity	Neutral	Expect zero multiple expansion in aggregate, higher cost of debt than most of its history; many investors are already overweight; high fee and liquidity concerns
Private Debt	+	Attractive current and prospective yield; floating nature provides inflation protection; beneficiary of retrenchment by traditional providers of credit
Non-Fiat		
Gold and Crypto	+	Hedge against debasement risk for G7 currencies; de-dollarization beneficiary

Historical analysis and current forecasts do not guarantee future results.

EAFE: Europe, Australasia and the Far East; EM: emerging-markets; REITs: real estate investment trusts; ROE: return on equity; TIPS: Treasury Inflation-Protected Securities

***Asset has a small or no benchmark allocation.

As of April 13, 2026 | **Source:** AB

different. This leads to a discussion of the hurdles to adopting a TPA approach, which are legion. Adopting TPA requires significant changes to governance structure and the definition of risk, the kinds of changes that need to be undertaken in a humble way. Moreover, it also likely implies organizational changes and career risk for those individuals steering the transition. Thus, adoption in its pure form will likely take considerable time, and we are likely to see many "halfway houses" adopted.

In this book we present our view of what constitutes TPA and show how it can differ from a traditional strategic asset allocation. The resulting portfolio ends up with a greater allocation to factor and active strategies, and also has more space for niche strategies that do not easily fit within traditional investment buckets. We think that greater adoption of TPA will also lead to changes in asset allocation in aggregate. For example, we think it would lead to a higher exposure to real and private assets, more investment in factor strategies, and likely a lower allocation to nominal bonds (as TPA encourages a broader set of vehicles to act as diversifiers of equity risk). We see this

as building on our previous work on the definition of idiosyncratic alpha, as identifying returns that have this characteristic is important for a TPA portfolio.[6] More generally, this fits our appeal for a greater focus on process in investment, an idea we explored at length in our book *Are We Human or Are We Dancer?*[7]

In "Chapter 8—The Future of Asset Management: The Macro Imperative," we go on to consider what a changed strategic investment outlook means for the asset-management industry more generally. The need to generate returns that can protect purchasing power and the likely ongoing increase in the role of private assets in portfolios imply that there is a continued increase in multi-asset investing, and also in OCIO (outsourced chief investment officer) mandates. Meanwhile, tie-ups between insurance companies and asset managers will probably increase as the role of insurance companies as providers of long-term capital becomes even more important in a world where more of the marginal raising of capital is happening in private markets.

One of the biggest investment challenges is the contemporary retirement problem of higher inflation, greater longevity (a nice problem to have of course), lower expected returns, reduced availability of defined benefit schemes, real value of state safety nets under threat, given debt levels and demographic challenges. This is primarily a social and political problem, and applies in many large economies. However, it is the role of the asset-management industry to help find solutions to this problem.

Yet another link between the future of the asset-management industry and macro forces lies in the role of digital assets. The initial focus on this is the role of crypto, and we continue to think that it has a role to play in a world where some non-fiat exposure becomes desirable in portfolios. However, the greater long-term role for the industry is likely to be in the tokenization of assets and the greater ease this allows in the inclusion of illiquid real assets in portfolios. Finally, in chapter 5, we consider the role of AI in investment and, in particular, the way that this likely changes the structural form of financial models. We are skeptical of the extent to which, in the near term, AI can automate investment decisions, in part because of the self-referential nature of financial markets.

Dystopia

The final chapter of this book takes the form of Galilean dialogue and is clearly fictional. However, despite the use of fiction, the topic is very serious. We discuss the twin features of modern investing: the dominance of passive cap-weighted indices

6 Inigo Fraser Jenkins, Alla Harmsworth, Robertas Stancikas, Harjaspreet Mand and Maureen Hughes, *A Preliminary Language for a Post-Global World*, AllianceBernstein, May 2024, https://www.alliancebernstein.com/americas/en/institutions/capabilities/the-book-a-preliminary-language-for-a-post-global-world.html.

7 Inigo Fraser Jenkins, Alla Harmsworth, Robertas Stancikas, Harjaspreet Mand and Maureen Hughes, *Are We Human or Are We Dancer?,* AllianceBernstein, July 2021, https://www.alliancebernstein.com/content/dam/global/insights/insights-whitepapers/are-we-human-or-are-we-dancer.PDF.

and the emergence of a small number of mega-cap companies. We do not suggest that either feature has caused the other, but they have become mutually entangled and represent a dystopian symbiosis. It is dystopian as the role of mega-cap companies stifles competition, and the degree of concentration in popular passive indices makes those "passive" investments riskier than they have been in the decades since they became so popular.

There is an argument to be had about what the emergence of mega-cap companies means for the state of competition and the functioning of capitalism. It could be claimed that they represent a triumph of capitalism. However, we are not so sure. Despite oligopolies potentially dampening competition, they also point to a shift in the bargaining power between corporates and the state, with the emergence of such large companies arguably pointing to lax antitrust enforcement and a process of regulatory capture. This is a dilemma for those who might want to enliven the functioning of a capitalist economy—a move to promote competition might imperil the returns to a concentrated market. The practical consequence is that there may be complacency about what volatility investors will experience.

The overall narrative of this book claims that there is a shift in the structural forces that ultimately underpin the returns of financial assets, which means investors should expect returns and the correlations between them to be different compared with what has proved to be a rather special period since the early 1980s. This is also bound up with questions of market structure and the power of corporates versus other stakeholders. The message is not bearish, but it does imply that investors should adapt their strategic asset allocation. We suggest that one possible response to this is to increase the focus on the total portfolio in a way that moves away from distinct asset-class silos.

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