
+ [GREETING]
+ Thank you for joining me today. Over the next half hour or so, I'll offer AB's assessment of the global economic and capital markets landscape. I'll also offer our insights on the opportunities and risks we see globally.
+ If we start with the 30,000-foot view, we've seen continued positive momentum throughout 2017.
+ That should continue, but we'll look at the various stories within the story, because once you scratch the surface, you start to see issues that could change the direction or the force in economies and markets—both globally and locally.
+ There are questions about further monetary tightening, and when or if that may reach a point of changing the current course of the markets.
+ And while the global growth theme is one of broad improvement—both developed and emerging—possible stress points are always just under the surface.
+ The issue for investors now is where to find growth, but without going too far out on a limb. It's been a long time since we've had a notable correction, so it's important for investors to determine how to participate <u>and</u> also defend.
+ With that in mind, let's take a look at how markets finished 2017.

## 2017 Returns Recap: Everything Is Awesome

Returns in US Dollars


As of December 31, 2017

Past performance does not guarantee future results.

Global corporates and Japan and euro-area government bonds in hedged USD terms. All other non-US returns in unhedged USD terms. An investor cannot invest directly in an index, and its performance does not reflect the performance of any AllianceBernstein (AB) portfolio. The unmanaged index does not reflect the fees and expenses associated with the active management of a portfolio.

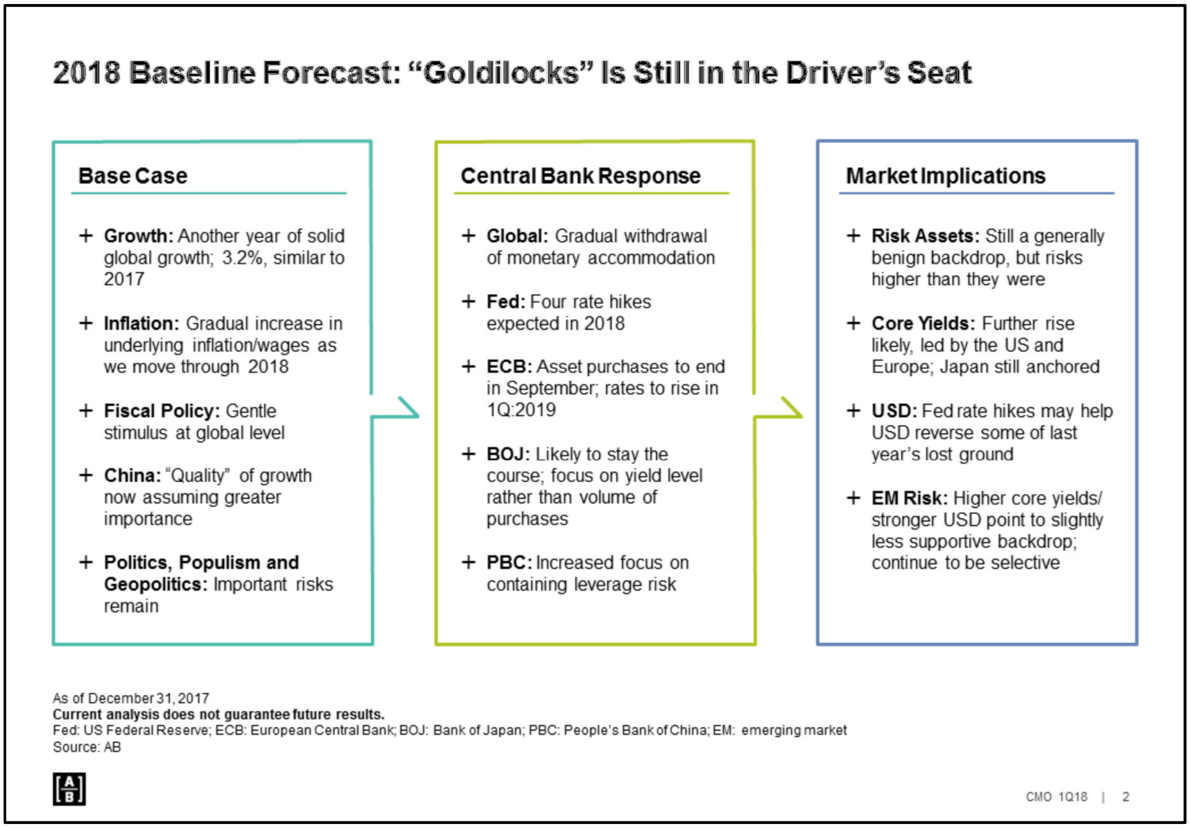
*Europe, Australasia and the Far East

†Returns reflect Morningstar US open-end fund category averages.

Source: Bloomberg Barclays, Morningstar, MSCI, S&P and AB



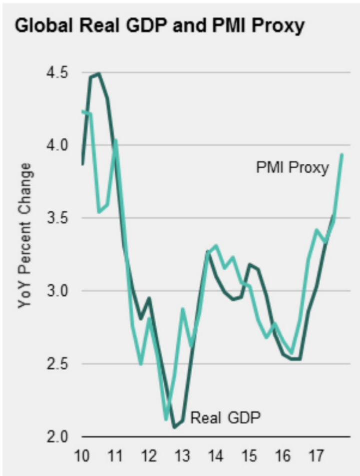
+ Across the board, we saw very strong returns—even for government bonds. The US 10-year Treasury basically returned its current yield. And it's interesting to note that 2018 (while only just a few days in), marks the 11th consecutive year that the 10-year Treasury has crossed through roughly the 2.45 level.
+ In equities, there was a continuation of strength that's been going on for some time, with double-digit returns globally, with emerging market returns strongest.
+ And the major fixed income indices are all positive, with munis having the strongest showing. Also, alternatives have generally done better than 2016, notably long-short equity.
+ 2018 looks set to be a strong year from a macro standpoint, with strengthening global growth, low inflation, and still broadly accommodative policy setting a benign backdrop for risk assets (but with far more modest return expectations than in 2017). Let's take a look at our 2018 Goldilocks base case…




+ Global growth remains strong, and seems to be gaining strength and breadth as the trade cycle shifts to a higher gear. Our Base Case calls for global growth of 3.2%, similar to 2017.
+ As capacity use tightens further, we expect to see global inflation and wage growth gradually start to rise. So we're calling for a base case of a gradual increase in underlying inflation and wages as we move through 2018. At the same time, there are several structural forces that should apply upward pressure to inflation in coming years, including demographics, populist policies and monetary regime shift - we will review these shortly.
+ Fiscal policy should see a gentle stimulus effect at the global level, and we expect that in China, the quality of growth will assume greater importance.
+ Among the important risk factors: politics, populism and geopolitical risks.
+ We see the response from Central Banks on a global level will be a gradual withdrawal of monetary accommodation. There's still net bond purchases in aggregate until sometime late in 2019-mid 2020. In the US, we're forecasting 4 rate hikes in 2018—one more than consensus (one increase per quarter). But the timing and number of hikes will be dependent upon how 2018 progresses, notably in the area of wage growth and inflation. We believe the European Central Bank will end its asset purchases in September and rates will likely begin to rise in the 1st quarter of 2019. The Bank of Japan will probably stay the course, focusing on yield level rather than volume of purchases. For the People's Bank of China, we expect an increased focus on containing leverage risk.
+ What are the implications for Markets? This is all still a generally benign backdrop for risk assets, but risks have moved higher. Core yields will likely rise, led by the US and Europe. And the Fed rate hikes should help the US dollar reverse much of last year's lost ground. We see Emerging Market risks have risen. Higher core yields and the stronger USD point to a slightly less supportive backdrop. So we believe there's a continuing need to be selective here, although EM growth is still stronger than in developed markets.
+ Broadly though, the key point as we enter 2018 is the continued improvement in global growth.

## Global Cyclical Outlook: The Recovery Gains Strength and Breadth

Trade Cycle Shifts to Higher Gear






As of December 31, 2017

Historical analysis does not guarantee future results.

*Standard deviation from mean

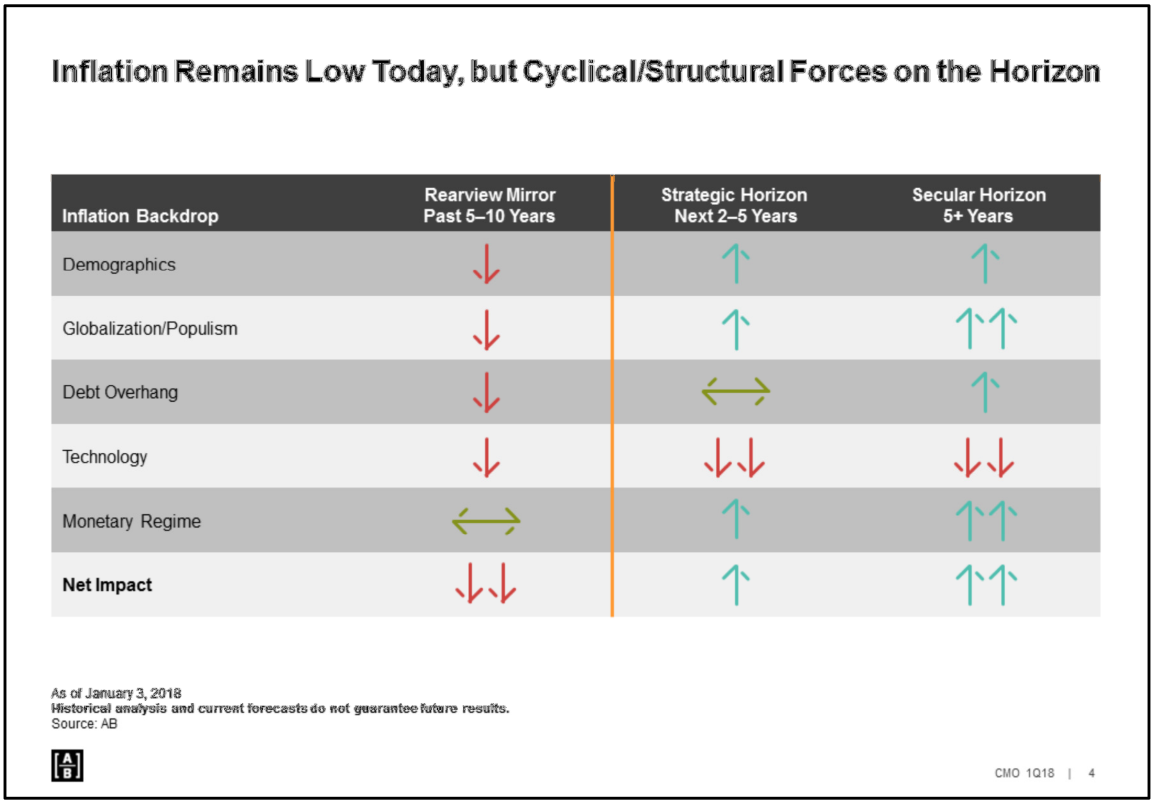
†DM: developed markets

‡EM: emerging markets

Source: Haver Analytics and IHS Markit



+ Let's look at what's driving global growth today.
+ Over the years, the Purchasing Managers Indexes have tracked quite tightly to GDP, so they're a good proxy for global growth.
+ The middle chart shows that when we look at how high PMIs around the world are relative to history, we're seeing PMIs in the developed world running on average over one full standard deviation above their historical norms, with Europe (led by Germany) running nearly two standard deviations above average.
+ In the right-hand chart, trade among nations further underscores the current strength, with world trade surging… another historical cohort of industrial production doing quite well.
+ At the same time, developed central banks enter 2018 with the same riddle…strong global growth and employment, but modest wage gains and still benign inflation. But we believe that will change over time, if not cyclically, then structurally.



## Inflation Remains Low Today, but Cyclical/Structural Forces on the Horizon

| Inflation Backdrop | Rearview Mirror<br>Past 5–10 Years | Strategic Horizon<br>Next 2–5 Years | Secular Horizon<br>5+ Years |
|---|---|---|---|
| Demographics | ↓ | ↑ | ↑ |
| Globalization/Populism | ↓ | ↑ | ↑↑ |
| Debt Overhang | ↓ | ↔ | ↑ |
| Technology | ↓ | ↓↓ | ↓↓ |
| Monetary Regime | ↔ | ↑ | ↑↑ |
| **Net Impact** | ↓↓ | ↑ | ↑↑ |

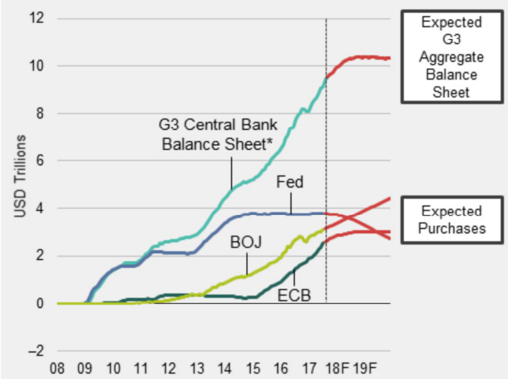
As of January 3, 2018
**Historical analysis and current forecasts do not guarantee future results.**
Source: AB

CMO 1Q18 | 4

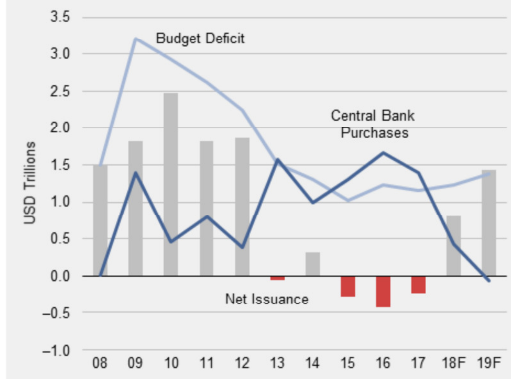
+ One key issue for the coming year is the big question mark of today's continued low inflation.
+ Inflation has trended sideways for some time and is likely to continue doing so in 2018. However, we don't believe that the Phillips curve—the relationship between employment and inflation—is broken. That relationship should come back to norm eventually. But when is a big question mark.
+ If you look at the key issues that impact inflation, you see a strikingly different story between the last 5-10 years (the left column) and the forward 5-10 years (the right column).
+ Demographics of aging Baby Boomers will push for higher demand for social services. Those Boomers will also be saving less and spending more. And income inequality will trend higher (with technology as an ongoing catalyst to labor market changes), which will likely increase populist movements and voters pushing for more help from government.
+ The debt overhang will also be a force pushing inflation higher (policy push to inflate away some of the debt, but keeping in mind savers, aka most of the voters, will have something to say about that!), whereas continued technological innovations will continue to have a dampening effect on inflationary trends.
+ Overall, however, we do see many factors contributing to an eventual rise in inflation, and we'll talk a bit more about monetary regime going forward.

## Central Banks (Ever So Slowly) Beginning to Remove the Punch Bowl...

**Aggregated DM Central Bank Balance Sheet and Flow of Purchases**



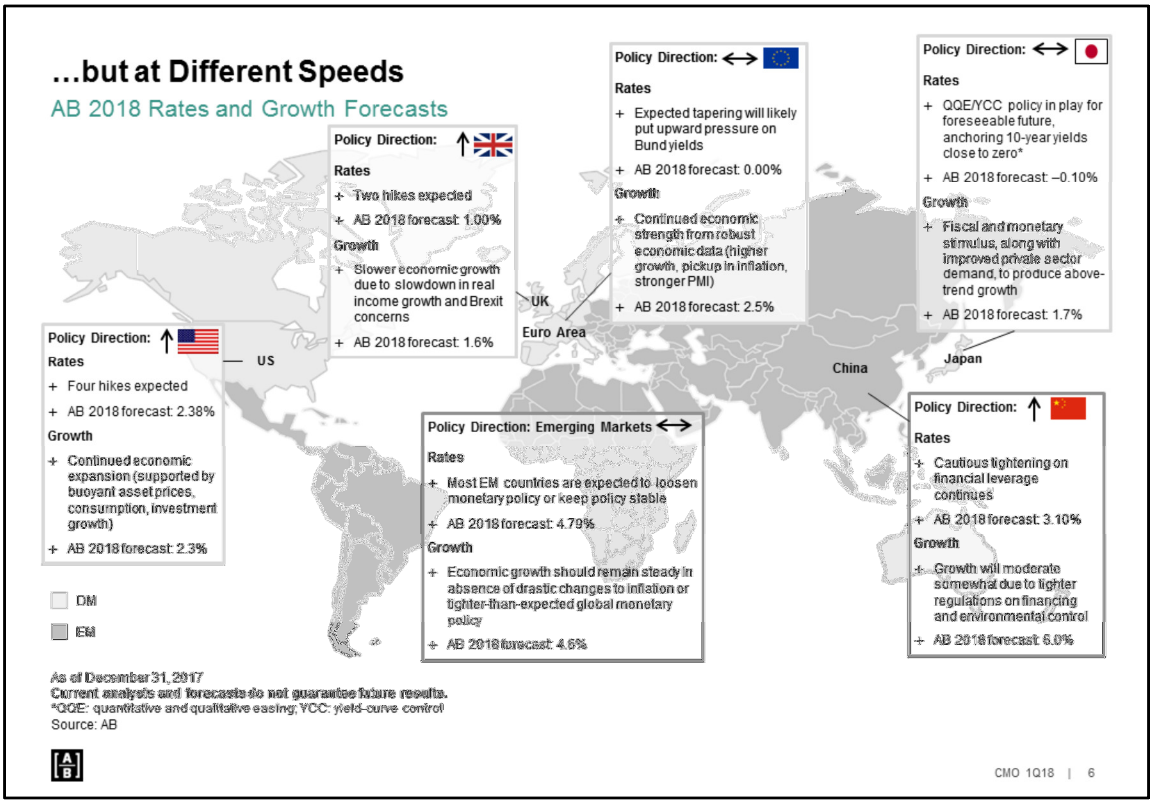

**G3 Net Issuance**




As of September 30, 2017
**Historical analysis and current forecasts do not guarantee future results.**
*G3 is the US, euro area and Japan.
Source: Bloomberg, International Monetary Fund and AB

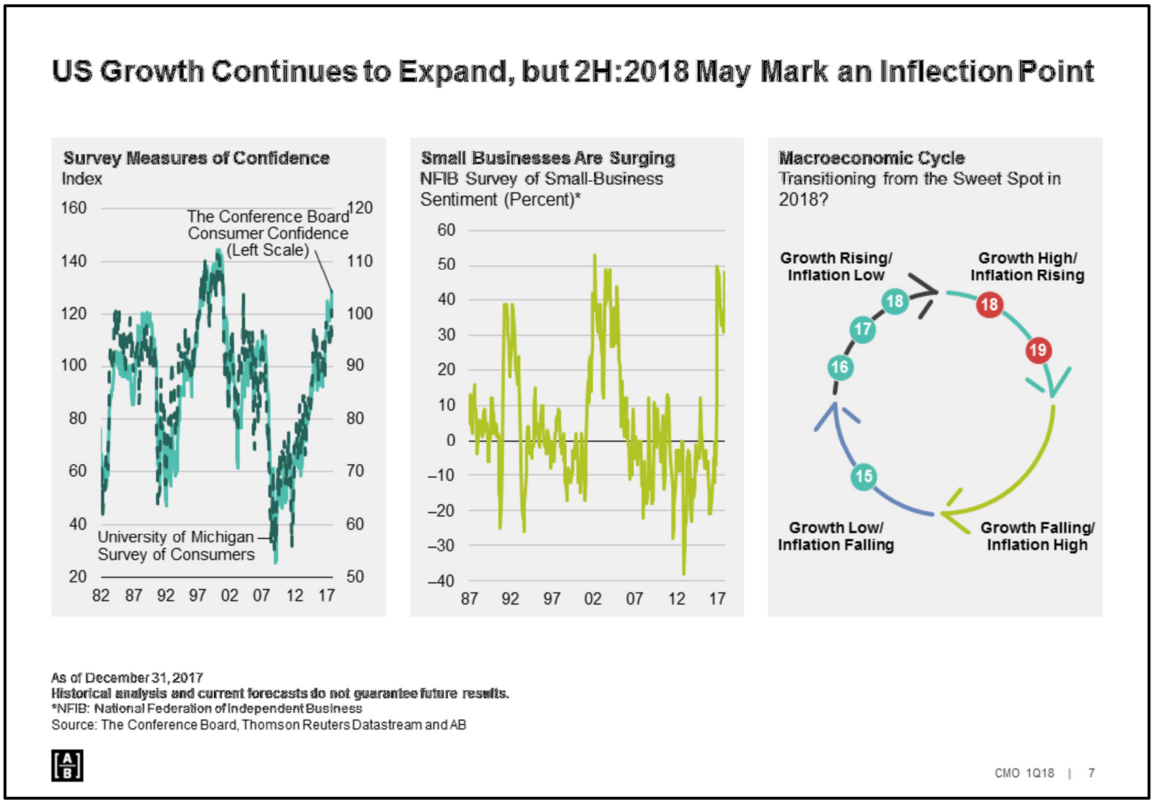


+ Yes, the Fed has begun the process of reducing its balance sheet, but we expect the impact of global QE to last for a couple more years as the ECB and BoJ continue to add to the overall stock of bonds held by central banks.
+ Netting the Fed’s sales and ECB/BOJ purchases, 2018 will still see a total net purchase of roughly USD 430 billion. It takes until the end of 2019 to begin to see net sales and reductions in the stock of central bank holdings.
+ But as central bank purchases/reinvestments decline, we’ll see increased supply that markets will need to digest, which all else being equal will put upward pressure on rates.
+ While at a broad level, monetary policy in developed markets have begun the tightening process, the actual timing, level, and mix will vary by country/region…




+ Policy changes will happen at different speeds around the globe.

+ Again, keep in mind that broadly, on a relative basis, for both the developed and emerging markets growth is good and getting better; inflation is moderate and below trend, but expected to increase over time. In the developed markets, that's generally translating into neutral to tightening policy; but in EM, on the back of improved balance sheets and high real yields (in aggregate) it's translating into neutral to easing policy.
+
+ So on our map:
+ In the UK, we're expecting the Bank of England to issue 2 rate hikes, reaching an interest-rate level of 1.00%. Economic growth will likely be slower due to a slowdown in real income growth and Brexit concerns, so our GDP forecast is 1.6%.
+ In the euro area, expected tapering by the ECB will likely put upward pressure on Bund yields. Our 2018 rate forecast is that rates remain at 0%, but as previously noted the ECB will take steps on the balance sheet. Economic growth should continue to be strong, we're seeing robust economic data—higher growth, a pick-up in inflation and stronger PMI readings. Altogether our GDP forecast is 2.5%
+ Japan's monetary policy should continue for the foreseeable future, anchoring 10-year yields close to zero, and our rate forecast is –0.10%. Fiscal and monetary stimulus, along with improved private sector demand, will produce above-trend growth of 1.7% in our forecast.
+ China, will likely continue their cautious tightening on financial leverage, and we see a likely rate level of 3.10%. Growth will moderate somewhat, due to tighter regulations on financing and environmental control. Our growth forecast for 2018 is 6.0%.
+ Most emerging market countries are expected to loosen monetary policy or keep policy stable, resulting in our aggregate rate forecast of 4.79%. Economic growth should remain steady in absence of drastic changes to inflation or tighter-than-expected global monetary policy, with EM expected to be a beneficiary of ongoing improvements in global trade/growth. On average, our EM GDP forecast is 4.6%.
+ Last, in the US, as we mentioned before, we're call for four rate hikes and our 2018 Fed Funds forecast is 2.38%. With economic growth, we see continued expansion supported by buoyant asset prices, consumption and investment growth (and about 25 bps from the tax plan). This should result in a 2018 GDP of 2.3%, and inflation of 2.1% (each about 20 bps off from consensus, with growth our growth expectations below, and inflation above, respectively). Let's dig in a bit more on the US.



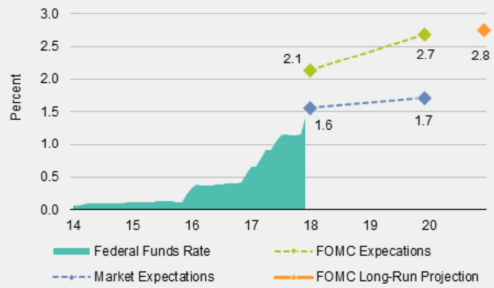

- Let's take a closer look at the US. More employment gains, above-trend growth, increased consumer spending and even some wage growth has both Consumer Confidence and consumption rising, as we're showing in the left-hand chart.
- And the confidence of small businesses is pretty much at a very high level, due in large part to expectations of lower regulations, tax cuts and the general strength of the economy.
- But let's put the US macroeconomic cycle in perspective of the past several years. The right-hand chart represents a stylized look at the cycle, shown in effect like a clock. The last few years are represented in the circles, with 2018 possibly sitting on either side of "noon". Our base case is that we will end 2018 on the "right-side" of 12. AB's growth forecast is for 2.3%, whereas consensus is a bit higher at 2.5%. Our slightly lower expectations are mostly concentrated in the second half of the year. As we move through the year we will likely have had further rate hikes with inflation starting to rise (as our base case) that will start to impact growth and take a bit of the steam out of it (alongside potential impact from expected further increases in asset valuations). So both of these factors may probably temper overall GDP. However, we view that as a healthy positive rather than presaging an economic downturn- at current run rates coming out of 2017, US growth is running above trend, so that slight reining in on growth toward long-run potential growth rates would be viewed by us generally as a positive. Inflation is a key lynchpin here though, and more sideways movements in core levels could leave us sitting to the left of 12 throughout 2018, adding to the Fed's growth/inflation riddle.
- And speaking of which, let's talk about the Fed…

## US Monetary Policy: Tightening Sails On…

...but with a Largely New Crew

**Federal Funds Rate Expectations**

FOMC and Market Expectations for the Fed Funds Rate*

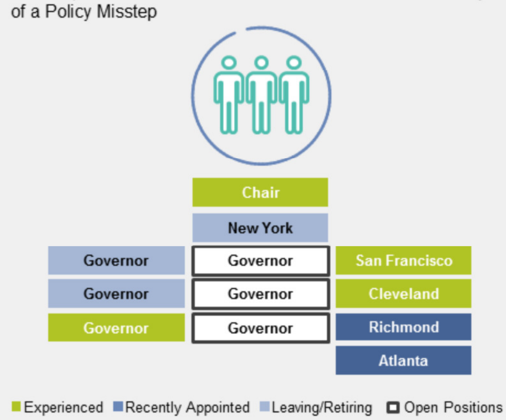



**FOMC September 2017 Forecasts**

| | 2017 | 2018 | 2019 | 2020 | Long Run |
|---|---|---|---|---|---|
| Change in real GDP, 4Q to 4Q | 2.4 | 2.1 | 2.0 | 1.8 | 1.8 |
| Unemployment rate, 4Q | 4.3 | 4.1 | 4.1 | 4.2 | 4.6 |
| PCE Inflation, 4Q to 4Q† | 1.6 | 1.9 | 2.0 | 2.0 | 2.0 |

**A Whole New Fed: FOMC**

Less Experienced Hands at the Helm Increase the Possibility of a Policy Misstep




As of December 31, 2017

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*FOMC: Federal Open Market Committee; market expectations are the federal funds rate priced into the Fed future market as of September 20, 2017 FOMC meeting date.

†PCE: personal consumption expenditures

Source: Bloomberg, Federal Reserve and AB

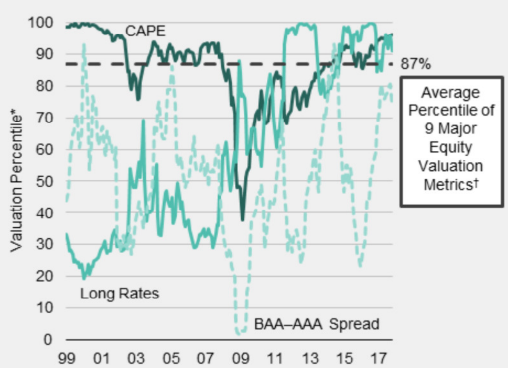
CMO 1Q18 | 8

- Here's a more detailed look at Fed Funds rate expectations. Current Fed funds rate is 1.38%, and market expectations see that going from 1.56% in 2018 to 1.71% by 2020. The FOMC, is calling for 2018 to get to 2.13% and then to 2.69% by 2020. Our forecast is the Fed Funds Rate to end 2018 at 2.38. In short, the market thinks 1-2 hikes in 2018 and the Fed says 3. For some years, the market has expected much slower movements in rates than the Fed, and for much of that time the market was right. In the more recent past however, Fed expectations have been closer to what transpired than market expectations. And the Fed's long-run projection (the so-called terminal value) is to reach 2.75%.
- We're calling for rates to be at 2.38% by the end of 2018 (four hikes), which is closer to the Fed's forecast than it is to market expectations. We believe that the Fed continues to follow its path in 2018, and will hike roughly quarterly throughout the year (but again that will be data dependent- inflation will be key).
- One very important thing to keep in mind with the Fed however, is that there will be a much different composition of governors on the FOMC guiding that policy, with a very high proportion of members by the end of 2018 having very little experience in the role. While Chair Powell is expected to continue the policies of Yellen, he is new to the leadership role and there are currently 3 empty seats on the seven-member board of governors alone, including the Vice Chair. Yellen's departure would make 4 (there is some sense that she is expected to stay another governor is appointed so that they can have a quorum, but that is not guaranteed). And there's a risk that Brainard could leave as well. This would leave very little institutional history on the board should problems develop. And among the remaining 5 voting members of the FOMC in 2018, 3 are or will be new (Atlanta joined 6/2017, Richmond 1/2018, NY TBD: Dudley to retire mid-2018).
- We know that there will inevitably be an economic crisis in the years to come. Less experienced hands at the helm increases the possibility of a policy misstep when that challenge hits.

## The Investor's Conundrum

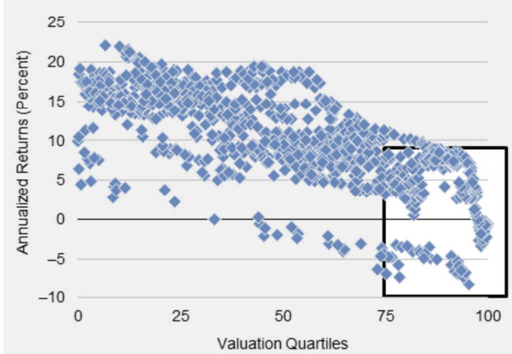
Strong Growth and Low Inflation vs. High Valuations and Low/Rising Yields

**Valuation Frustration: Both Bonds and Equities Appear Expensive**




**High Valuations, Modest Returns‡**

After Periods of Top-Quartile Valuations, Large-Cap Stocks Delivered Single-Digit/Negative Returns 99% of the Time




As of December 1, 2017

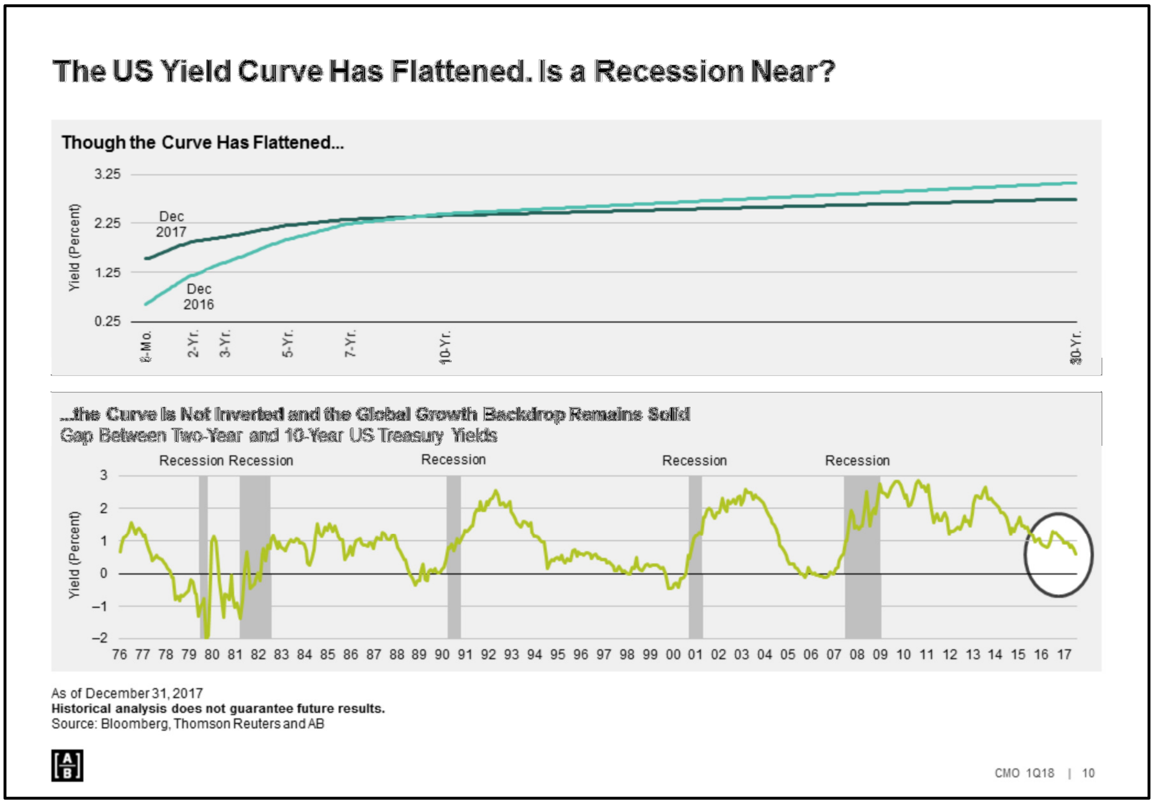
**Historical analysis does not guarantee future results.**

*Since 1900 for S&P 500 and 1919 for credit spreads. †Equity valuation metrics are: price/earnings, cyclically-adjusted price/earnings (CAPE), price/EBITDA, price/free cash flow, price/sales, forward P/E (best), enterprise value/EBITDA and price/book. ‡Subsequent 10-year annualized S&P 500 returns and S&P 500 valuation percentile levels for the cyclically-adjusted price-to-earnings (CAPE) ratio are calculated from December 30, 1927, the inception date of the S&P 500 Price Index. The bracketed area reflects the top-quartile (75%–100%).

Source: Bloomberg, Goldman Sachs, Robert J. Shiller and AB

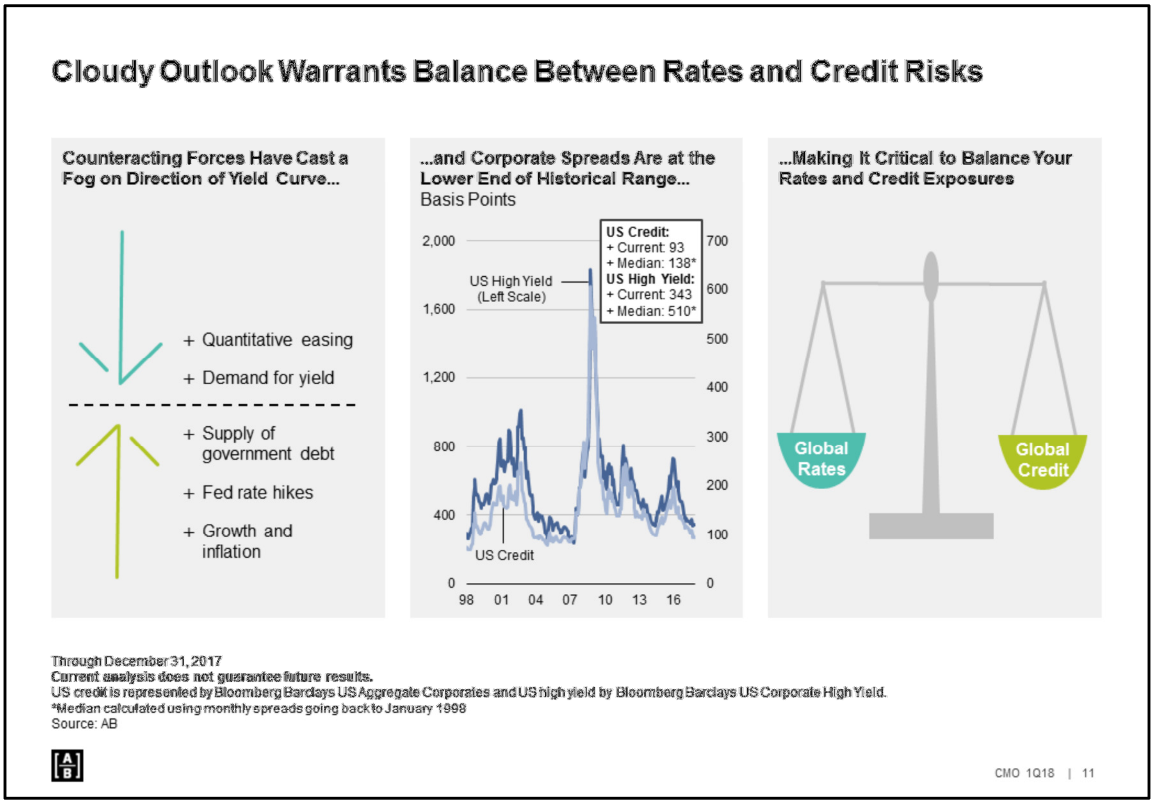
CMO 1Q18 | 9

- So, investors face the challenge of investing where there's strong growth and low inflation, but also high valuations and low yields that are starting to rise. The left hand chart shows that valuations are high, whether it's equities or it's bonds. In fact, today's valuations (nine different equity valuations' percentile ranks are averaged here) are near the top of the historical range we've calculated going back about 100 years or more.
- The right-hand chart shows that, historically over the last 45 years, when you've got top quartile valuations in the S&P 500, in the ten years that followed, you've had single-digit or lower returns 99% of the time over the following ten years. And we would expect that to be the case going forward. We've estimated that equity returns will likely be in the 5 ½ – 6 ½ percent range on average over the next 5 years.
- Ultimately the devil is in the details. As an investor, it is a matter of managing rates as QE gets taken away and, as rates move up. It will also mean managing equity choices as valuations are elevated and we expect returns to be modest but positive, and in the US, against a backdrop of the impact of the tax package on growth and market performance. This will give lots of opportunities, but those opportunities will likely be on a stock-by-stock basis—investors will need to find those idiosyncratic opportunities to drive performance in a world where valuations are elevated.
- In a rates world, where rates and spreads are generally low, the task is to find pockets of opportunity and combine them to produce a portfolio that can navigate this environment
- And amidst Goldilocks scenarios, it is critical to remember that there are always bears lurking. The lack of corrections, hidden volatility, and ever present tail risks means that we want to capture opportunities, but balanced against downside protection —**in other words to be able to participate and defend.**
- Altogether, to participate and defend in the current market conditions, we still suggest that investors need a solid foundation as their starting point – and we believe this Evergreen Advice makes for a good foundation:
  - Keep a focus on ways to improve your up/down capture
  - Keep a balance to non-correlated assets
  - Be selective!

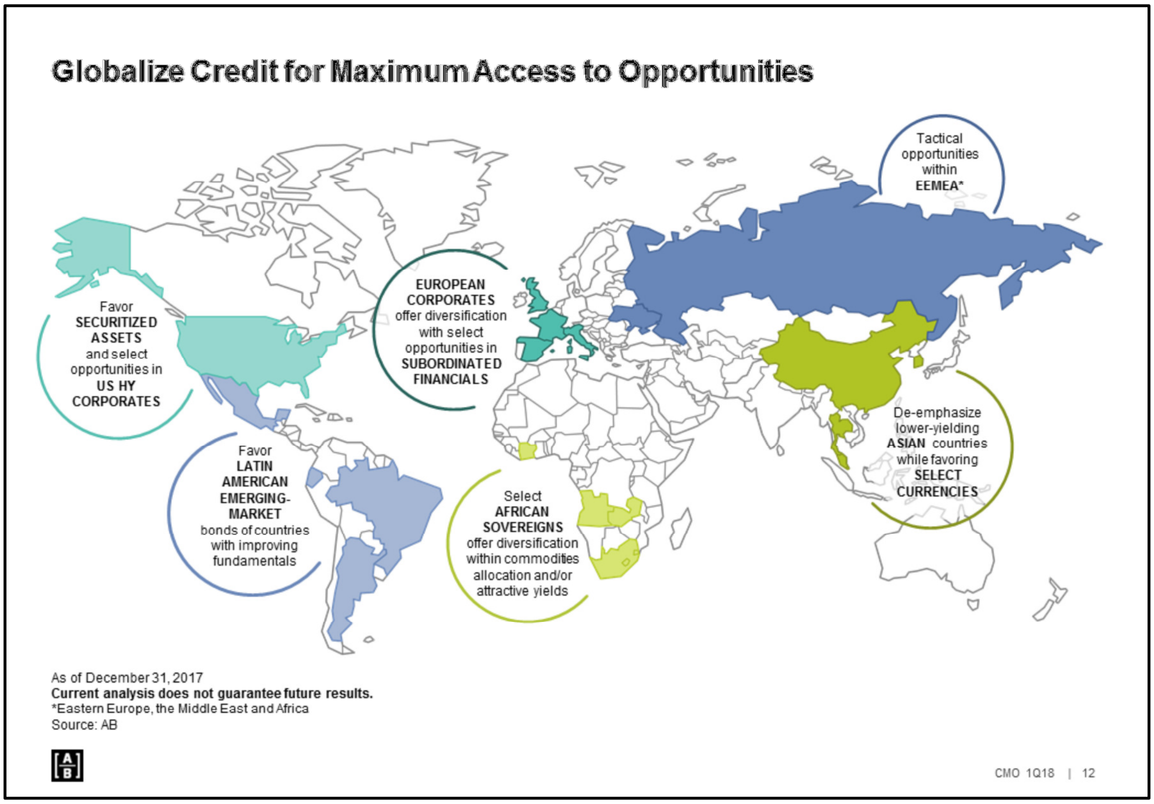



+ 2017 was supposed to be the year that shook up the status quo of modest growth, tepid inflation and low bond yields. The Fed did its part by raising interest rates and starting to reverse the asset purchases that created trillions of dollars of liquidity after the financial crisis. But the rates market didn't stick to the script. Risk assets such as equities and high-yield bonds have continued to rise and the US dollar has been falling.
+ Meanwhile, long-term US Treasury yields have declined. The top chart shows that the yield curve, which plots the gap between two- and 10-year yields, has become flatter than it was two years ago. In other words, financial conditions eased substantially—the opposite of what the Fed intended.
+ **Why is the Yield Curve Flattening?** A flattening yield curve is typically seen as a warning sign for markets—suggesting that growth is slowing and a recession may be near. The bottom chart shows that over the past 40 years, when the gap between the 2- and 10-year yields has fallen below zero (or when the yield curve is inverted), a recession has followed in the next 12–23 months. Given that the yield curve still has ways to go before inversion and our global economic backdrop remains supportive, we don't forecast a recession in the near-term.
+ If a recession were just around the corner, it would mean that the Fed has been tightening policy too quickly. But if that were the case, you'd expect to see equity valuations take a hit and economic data deteriorate. What's more, the Fed's benchmark interest rate—in nominal and real, or inflation-adjusted, terms—is still low and the curve is steeper than it was in the run-up to previous recessions.
+ We think a more likely explanation for today's low long-term yields is that there's still a tremendous amount of liquidity in the financial system. During and after the financial crisis, the Fed flooded the economy and markets with money and kept long-term rates low by buying trillions of dollars of bonds. That distorted many market signals. By letting some of the bonds on its balance sheet mature, the Fed has slowly started to drain that excess liquidity. But it has a long way to go.
+ At the same time, the Bank of Japan and European Central Bank are still buying bonds and other financial assets, which helps to offset the Fed's modest tightening.
+ Even so, a flatter yield curve can't be dismissed outright. We think caution is warranted.
+ Of course, none of this means yields will remain low forever. With the economy operating at full capacity, the Fed is widely expected to raise rates several times in 2018. The new US tax law changes may boost growth and inflation, and the Fed may be forced to tighten even more aggressively. This action would likely increase volatility and have implications for various sectors of the bond market. That's why investors will have to be careful about how they manage their exposure to the market's two primary risks—interest rates and credit.

- Normally, return-seeking credit assets such as high-yield corporate bonds do well when growth accelerates and interest rates rise. Treasuries and other high-quality bonds—we like to call them risk-reducing assets—struggle in these conditions because higher rates and rising inflation reduce these securities' market value.
- In such circumstances, investors may be tempted to reduce their interest-rate risk—or duration—and increase their credit risk.

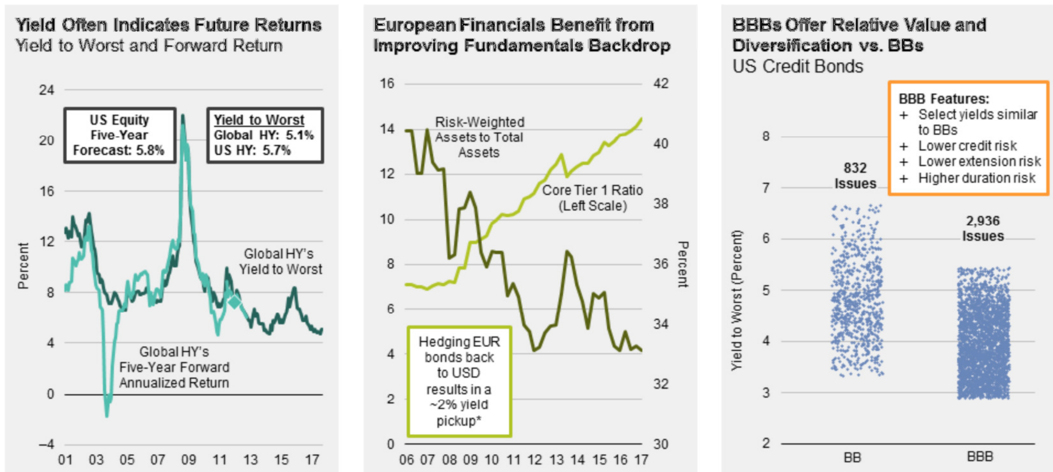



+ But these aren't normal times. There are forces pushing yields in both directions
+ On the one hand, both QE and investors' continued hunt for yield has pushed yields lower. However, as growth and inflation accelerate, as global central banks continue to gradually tighten monetary policy, and with positive net government debt issuance, this should exert upward pressure on yields. Inflation is a key variable—if inflation were to surprise to the upside, the Fed might have to raise rates more aggressively. Net-net we think developed market yields need to move modestly higher in the year ahead.
+ When it comes to the credit markets, spreads, both investment-grade and high yield, have continued to narrow. Years of central bank asset purchases and low rates encouraged global investors to crowd into the same high-yielding credit assets. That's raised valuations and compressed yield spreads—the extra yield they offer over comparable government bonds—causing corporate yield to finish 2017 at the lower end of their historical ranges, as the middle chart shows. And while there are certainly still opportunities with credit markets, we think investors should think twice about taking on too much credit risk, given current prices and conditions.
+ A better approach, in our view, would be to pair government bonds and other interest-rate-sensitive assets with growth-sensitive credit assets in the form of a credit barbell. Because the returns from the two types of assets are generally negatively correlated, strong returns on one side of the barbell can outweigh weakness on the other.
+ US Treasuries, of course, will struggle over the short term if tighter Fed policy eventually causes the curve to steepen. But even in rising-rate environments, these assets provide crucial stability, diversification and income.
+ Exposure there can also keep your bond portfolio liquid. Eventually, higher rates *will* slow growth and put an end to the credit cycle. In these periods, Treasuries tend to beat assets such as high-yield bonds.
+ The key to success, in our view, is having the ability to actively adjust your interest rate and credit weightings as conditions and valuations change. If markets do get more volatile in 2018, balance will be more important than ever.
+ With the interest-rate-sensitive portion of your bond portfolio, now is a good time to be flexible with your duration exposure while pursuing market opportunities. Intermediate maturities still present the most attractive opportunities, where you can take advantage of the power of roll—the natural price gain a bond experiences as it moves closer to maturity, assuming interest rates don't change. Roll varies considerably based on where you are on the curve, with the intermediate maturity range affording better roll potential. Adding global high-quality bonds (on a currency-hedged basis) is also an easy way to maintain defensive bond characteristics, by diversifying exposure to the US rates market. And as mentioned above, we believe it's still prudent to balance high grade bonds with credit exposure to generate income and lower rate sensitivity. Within the credit component, we suggest combining sectors such as high-yield corporates, securitized assets and emerging market debt that have been benefiting from better growth and more stable commodity pricings.
+ More than simply keeping this balanced exposure to both credit and interest-rate sensitive bonds, it's important to monitor the interplay between these two segments and to be flexible in managing the dynamics between them. Today we would be more diversified in the credit allocation, let's take a look at the opportunities...




+ Here we’re showing some credit opportunities around the globe where investors can potentially derive incrementally higher value.
+ In the US, we’re favoring securitized assets, like CRTs, but also some US high-yield corporates as well as select BBB-rated credit.
+ European corporates offer some good diversification, particularly with select opportunities in subordinated financials, which we’ll discuss later in more detail.
+ Within EM, we see opportunities in Latin American bonds, in those countries with improving fundamentals. Meanwhile, select African sovereigns can help to diversify investors’ commodity allocation while providing attractive yields. And although we’re underweight Asian bonds in general, there are some individual countries presenting appealing currency opportunities—such as the Indonesian rupiah.
+ Now let’s take a closer look at High Yield.

## Selectivity Within Corporate Credit Remains Critical




Left and right displays as of December 31, 2017 (except equity forecast as of June 30, 2017); middle display through September 30, 2017

**Historical analysis does not guarantee future results.** Global high yield is represented by Bloomberg Barclays Global Corporate High Yield (USD Hedged); US high yield by Bloomberg Barclays US Corporate High Yield; BBB by Bloomberg Barclays US Aggregate BBB Corporates and BB by Bloomberg Barclays US High Yield Corporates BB. Core Tier 1 ratios provided by Morgan Stanley European credit strategy research on western European banks. *Annualized hedging benefit uses one-month currency forwards. An investor cannot invest directly in an index, and its performance does not reflect the performance of any AB portfolio. The unmanaged index does not reflect the fees and expenses associated with the active management of a portfolio.

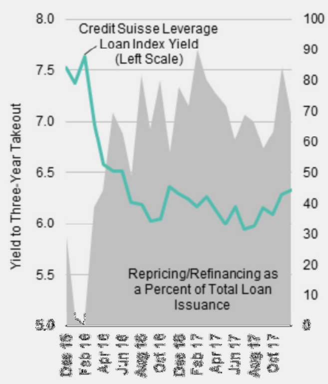
Source: Bloomberg Barclays, Morgan Stanley and AB

CMO 1Q18 | 13

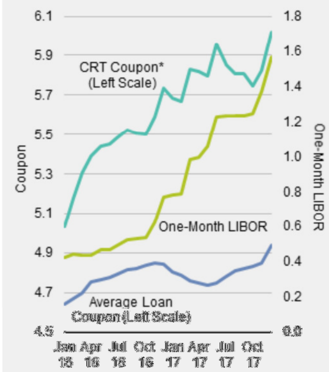
+ While high yield spreads and yields continue to grind tighter, they still look quite good relative to passive equities, because they offer a similar return forecast but with less volatility.
+ The left-hand chart shows the Global High Yield Corporate index yield-to-worst, which is a metric used to evaluate the lowest possible yield an investor might receive on a bond (incorporating provisions like call options), provided the issuer doesn't default. It's been a pretty reliable indicator of the type of annualized returns you can expect over the next five years. And currently, US Corporate High Yield is about 5.7% and Global is roughly 5.1%. That's compelling relative to our forecasted returns for passive equities which are around 5.8% for US equities, especially as high yield exhibits significantly lower volatility…but you need to be selective in the high yield space as valuations have shifted.
+ The middle chart shows one area where we see appealing opportunities: in Financials, and more specifically European Financials, where these banks are moving to a more solid recovery point in the credit cycle and balance sheet fundamentals have improved significantly. This is reflected in the middle display by the higher Core Tier-1 Capital ratios, which compares the bank's financial strength based on its equity and earnings to the bank's risk-weighted assets (credit risk), which have also steadily declined. This means that the higher the Core T1 ratio, the stronger the bank's fundamentals. Moreover, US-dollar based investors can generate a roughly 2% yield pick-up when hedging the Euro denominated bonds into their domestic currency.
+ We also recommend looking outside of a typical high-yield benchmark for corporate opportunities. For example, today's BB-rated bonds are looking rather expensive. However, we do see value in select BBB-rated bonds. The right-hand display shows that there is a significant overlap in yields offered by BBB- and BB-rated bonds, but BBB issuers have lower credit and extension risk, which we will address shortly. On the flip side, BBB bonds have higher duration, which can be viewed as either a positive or negative factor depending on the rest of the portfolio.
+ The higher extension risk of BBs is worth addressing in more detail as it makes these bonds more vulnerable in rising rate environments—like today. At low yield levels, many callable bonds trade at a price/yield that assumes they will be called; as rates rise, an issuer may decide not to call its bonds since doing so could result in refinancing at higher yields. In that scenario, investors would see the duration on their bonds grow at the worst possible time—we call this extension risk. In contrast, BBB rated bonds typically do not have a call provision—adding to their attractiveness today.

## Floating-Rate Exposure? Try Credit Risk–Transfer Securities (CRTs)

**Demand Has Pushed Bank Loan Yields Lower, Incentivizing Refinancing**




**Loans Have Not Benefited from LIBOR Rising but CRTs Have**




**CRTs Have More Attractive Features than Loans...**

+ Both have a *floating-rate structure* but CRTs offer:
  + Better liquidity
  + Better fundamentals
  + Better portfolio diversification

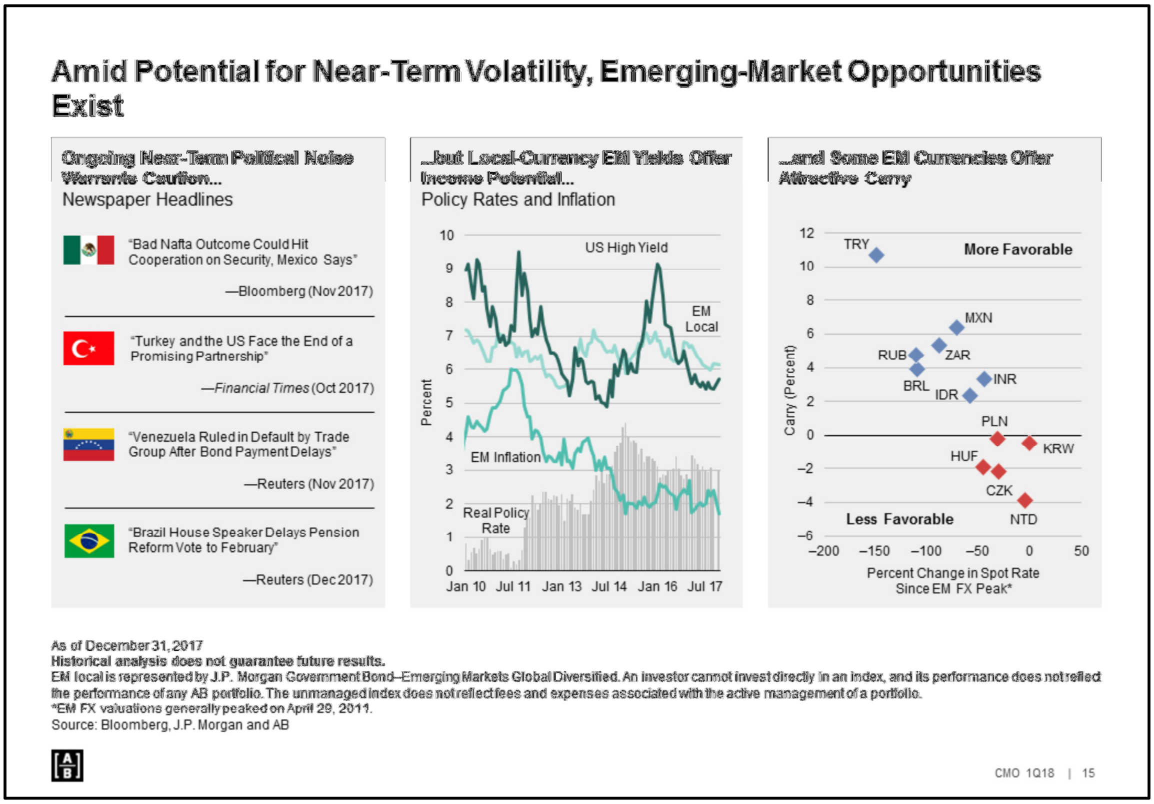
**...and Comparable Yields**

| Asset | Approximate Loss-Adjusted Yield (Percent) |
|---|---|
| CRTs | 2.5–6.0 |
| Bank Loans | 4.0–14.0 |

As of December 31, 2017
**Historical analysis does not guarantee future results.**
*Last cash flow and equity coupons
Source: Bloomberg, Credit Suisse, J.P. Morgan and AB

CMO 1Q18 | 14

+ With rates going up, many investors look to floating rate investments for protection. We see value in floating rate instruments, but investors should exercise caution.
+ For example, the floating-rate coupons on bank loans are a big draw for this segment of the market. That demand, in turn, has pushed bank loan yields lower—dropping roughly 150 basis points in the past two years, as the left hand chart shows.
+ That also means that refinancing risk is a clear concern in this sector, as it can offset the benefits from rising rates. Bank loans have a feature that allow issuers to refinance them at any time. The refinancing has been significant in the past two years as a substantial amount of them reach par, and overall yield levels remain low.
+ The middle chart shows the story within the bank-loan story: Despite a rise in LIBOR rates, spreads have narrowed leading to a record wave of refinancings, keeping coupons low. Allowing companies to refinance their loans at **lower** rates defeats the whole idea of buying floating rate debt for rising yields.
+ The middle chart also shows what we feel is a more efficient alternative for investors wanting floating rate exposure—using Agency Credit Risk-Transfer Securities (CRTs) in the mortgage market. CRTs are floating rate mortgage securities that reset monthly (they are linked to 1-month LIBOR). And unlike bank loans, they're not callable and are therefore able to benefit from rising LIBOR rates.
+ Additionally, the US real estate market is earlier in its credit cycle (vs corporates). Also, the fundamentals have improved, such as current FICO scores—the creditworthiness scoring of the individual homeowners—and healthier levels of debt-to-income ratios. Plus, an improving labor market and solid economy further support this market.
+ CRTs also offer better liquidity and provide attractive portfolio diversification—away from corporates to real estate. They also offer a similar range of yields to bank loans.




+ Diversifying a credit portfolio also means looking to the emerging markets.
+ We are cautious on the near-term EM outlook due to politics (and the accompanying volatility). For instance, Mexico and the US are locking horns over Nafta; US–Turkey relations are strained; Venezuela has delayed some bond payments; and impeachment proceedings have begun against Jacob Zuma, president of South Africa—the most industrialized nation in Africa.
+ However, we remain constructive on the longer-term prospects of EM. Broadly speaking, their improved fundamentals, technicals, and solid global growth are supportive of the asset class.  Within EM, we see opportunities in three different segments of emerging market debt; EM local bonds, currencies, and EM hard currency sovereign debt, particularly of higher-yielding issuers.
+ The middle chart highlights the appeal of local-currency debt today. While valuations have tightened somewhat, EM local currency debt still offers a modestly higher yield than US corporate high yield. Also, over the last seven years or so inflation for EM markets in general has fallen and real policy rates have risen, offering potential for more attractive income in this area. Additionally, low levels of inflation leave room for central banks in these countries to ease monetary policy even as central banks in developed markets are beginning to withdraw monetary accommodation. This bodes well for their government bonds. We recommend focusing on countries with improving fiscal balances, where inflation is stabilizing and monetary policy is either on hold or is expected to ease. Keeping some of the local bonds unhedged gives investors exposure to EM currencies as well.
+ As displayed in the right-hand chart, EM currencies are generally trading at discount to history and some can offer attractive carry. They also represent an easy and liquid way of gaining or reducing exposure, which makes them a great tool in efficiently managing the overall risk budget of the portfolios.
+ While not displayed, select high-yielding EM USD sovereigns offer value and are supported by stable global growth.

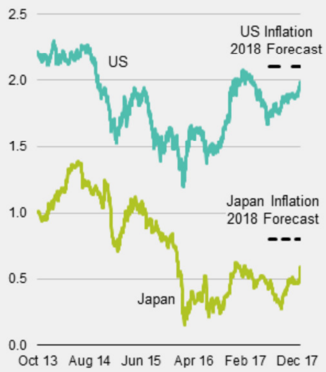
## Take a Worldview on Interest-Rate Exposure, Too

**Rising Rates Don't Always Have to Derail Bonds***
Expected Total Returns (Percent)

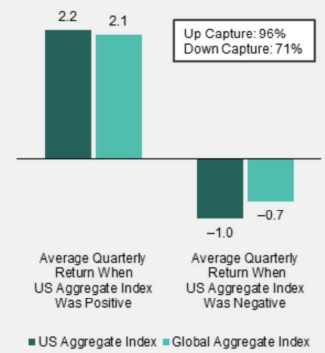
| US Aggregate | | Change in US High-Yield Spreads (b.p.) | | | |
|---|---|---|---|---|---|
| | | –50 | 0 | 50 | 100 |
| Change in US Treasury Yields (b.p.) | 100 | –1.4 | –1.8 | –2.1 | –2.4 |
| | 50 | 0.9 | 0.6 | 0.2 | –0.1 |
| | 0 | 3.2 | 2.9 | 2.6 | 2.2 |

| US High Yield | | Change in US High-Yield Spreads (b.p.) | | | |
|---|---|---|---|---|---|
| | | –50 | 0 | 50 | 100 |
| Change in US Treasury Yields (b.p.) | 100 | 5.3 | 3.8 | 2.2 | 0.6 |
| | 50 | 6.4 | 4.9 | 3.3 | 1.8 |
| | 0 | 7.5 | 6.0 | 4.4 | 2.9 |

**Japanese and US Inflation-Linked Bonds Offer Value**
B/E Inflation for 10-Year Rates (Percent)†




**Global Outperforms When US Falls**
Up vs. Down Capture‡
(March 1990–December 2017)



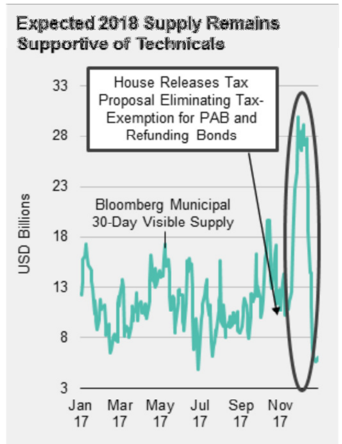

As of December 31, 2017
Past performance does not guarantee future results. *The scenario analysis assesses the potential impact of instantaneous changes in US high-yield spreads and a parallel shift in the US Treasury yield curve on the Bloomberg Barclays US Aggregate and US High Yield indices. Expected returns incorporate the impact of roll and carry over the subsequent 12 months. †B/E: break-even. ‡Bar height might differ due to rounding. Global bonds hedged is represented by Bloomberg Barclays Global Aggregate Hedged to USD and US bonds by Bloomberg Barclays US Aggregate. An investor cannot invest directly in an index, and its performance does not reflect the performance of any AB portfolio. The unmanaged index does not reflect fees and expenses associated with the active management of a portfolio.
Source: Bloomberg Barclays and AB

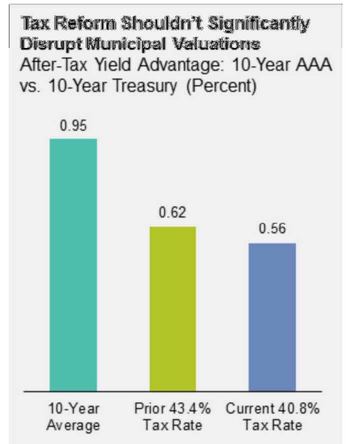


+ But while you're hunting for credit opportunities, don't abandon your exposure to interest rates.
+ The US raised rates another 25 basis points in December, and it's likely that the Fed will continue its slow and steady rate increases next year—a majority of FOMC members expect three hikes in 2018.
+ So it's not surprising that some investors are concerned about having exposure to fixed income today.
+ But rising rates don't impact all parts of the fixed income market to the same degree, and don't have to mean disaster for bond portfolios. In the left-side display, we've calculated hypothetical returns for two bond indices assuming a range of interest rate and yield spread scenarios. These different scenarios allow investors to look at a range of possible outcomes, depending on their expectations for movement in Treasury yields and spreads, regardless of past correlations between the two.
+ A 50 basis-point rise in the US Treasury yield curve doesn't derail the returns of the US Aggregate bond index over the next year, because of the power of income and roll (roll being the change in the price of a bond as it gets closer to maturity). A more dramatic spike would push return expectations into negative territory.
+ If we turn to the high yield market, return expectations look attractive under assumptions of moderately rising rates and widening spreads—that's the power of the roll and carry in higher yielding bonds.
+ But today, in many parts of the capital markets, it's important to both participate and defend. And one defensive move that's worth considering now is the inflation-linked bonds of Japan and the US. Despite currently low inflation rates, the 2018 inflation forecasts are higher, and those potential rises aren't yet reflected in the pricing of inflation-linked bonds.
+ But another strategy that helps your clients both participate and defend is adopting a global approach to your bond allocation. Global bonds provide an overall better upside / downside potential. In the right display, we've sorted quarterly returns over a roughly 25-year stretch into periods when the US Aggregate was positive and periods when it was negative. During those times when it was positive, it returned, on average, 2.2%. The hedged global aggregate performed almost as well during those same quarters, capturing 96% of that performance. That's the "up capture" part. But it's the "down capture" part where hedged global bonds excel. When the US aggregate was negative, it returned, on average –1.0%. While the hedged global aggregate was also negative, it did better and was down only –0.7% on average. That "down capture" represents just 71% of the US bond decline. This lower downside of global bonds will become even more important to investors as the Fed continues to hike.

## Tax Reform Should Not Thwart Municipal Market Outlook

| Tax Reform Element | Impact on the Municipal Market | |
|---|---|---|
| Elimination of Advance Refunding Bonds* | ↑ | Lower supply |
| Reduction in Personal Income Tax Rates | ↓ | Reduce after-tax yield advantage of municipals |
| Increase in AMT Exemption† | ↑ | Fewer people subject to AMT; PAB could see more demand‡ |
| Cap on SALT Deduction§ | ↑ | Increase in demand for in-state munis in high-tax states |
| Cut in Corporate Tax Rates | ↓ | Reduced demand from corporations |

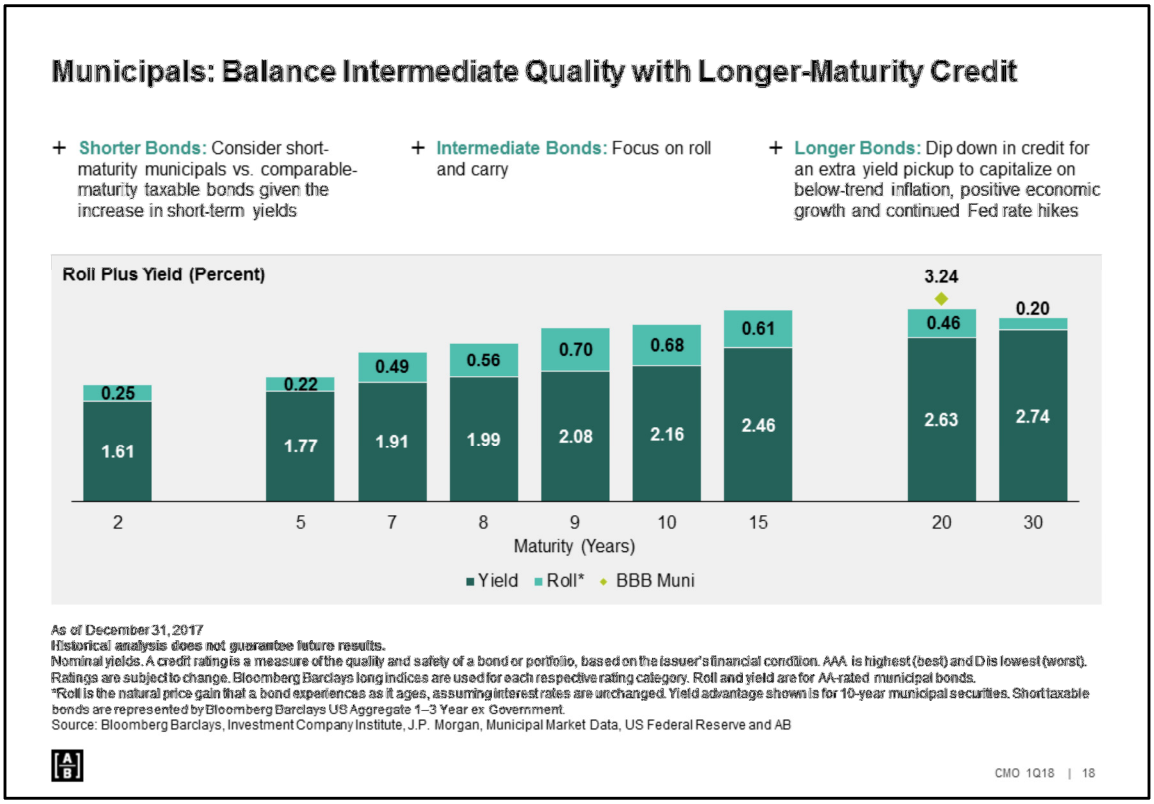



As of December 31, 2017
Past performance does not guarantee future results.
*Advance refunding bonds allow a municipal issuer to take advantage of lower interest rates when the outstanding bonds are not currently callable.
†AMT: alternative minimum tax
‡PAB: private activity bonds
§SALT: state and local tax
Source: Bloomberg and AB

CMO 1Q18 | 17

+ The other big concern in the US is the new tax reforms and the impact they'll have on municipal bonds. The left-hand chart looks at some issues affecting munis.
+ The elimination of advance refunding bonds in 2018 would reduce the overall volume of muni bonds outstanding over time. And over the near term, their pending elimination has been driving heavy supply as issuers rush to take advantage of the closing issuance window.
+ While the reduction in personal income tax rates appears to lower the extent of the tax-free appeal of munis, the reductions in marginal rates aren't very large, so demand for municipals from individual investors should remain strong.
+ Elimination of the Alternative Minimum Tax for corporations and the reduction for individuals would benefit private activity bonds. Currently, AMT bonds offer investors a 0.20% yield advantage versus non-AMT-subject munis. This spread could narrow as these bonds rally, with investors reaching for extra yield.
+ The shrinking of state and local tax (SALT) deductions is likely to decrease the appeal of investing in out-of-state munis, but should increase demand for in-state munis—especially in high-tax states. Near-term, munis in high-tax states should perform relatively well. But longer term, the economies of these states may be negatively impacted, because the after-tax income of high-tax states with many high-income taxpayers may decline.
+ And lastly, the cut in corporate tax rates will reduce demand for munis by corporations such as banks and insurers. These institutions traditionally buy high-grade muni bonds and hold about 30% of outstanding muni debt.
+ All in all, tax reform shouldn't significantly disrupt muni valuations. In the middle chart, we're showing a variety of muni tax-advantages over US Treasuries. The 10-year average is about 0.95%, and at the current 43.4% top tax rate, the advantage is 0.62%. Even with the top tax rate lowered to 40.8%, that tax-advantage of municipals would still be 0.56%, which in today's yield starved environment, any advantage is a worthwhile advantage.
+ We continue to believe that municipal bonds are supported by strong technicals, as we're showing in the right-hand chart. As mentioned previously, the elimination of tax-exempt issuance for advance refunding purposes will reduce the overall supply of the muni market. Going back to 2006, refundings made up anywhere between 20% to 50% of overall annual supply and was what had driven the muni market to its highest gross issuance total ever in 2016. That said, while this represents a large portion of total issuance, refundings bonds currently make up 7% of the overall municipal market. Moreover, while tax-exempt financing for private activity and not-for-profit issuers remains intact, concerns that these would also be eliminated have also pushed issuance that otherwise would've been in 2018 forward—further dimming the supply outlook in the municipal market. (In fact, 20% of 2017's overall supply was issued in November and December alone—a sure sign that issuance has been pushed forward)



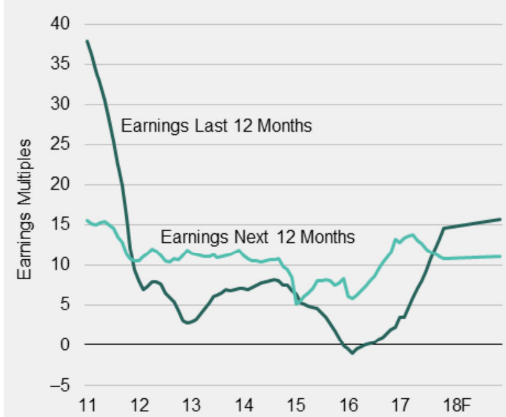

+ But positioning matters. Today's muni opportunities balance intermediate high quality bonds with longer-maturity muni credit. In other words, adding income with muni credit exposure is a better approach than reaching for yield by buying longer-maturity high-grade munis. If inflation increases and yields rise—along with the recent tax reforms—longer-maturity high-grade munis face the most downside risk.
+ In this display, we look at the combination of yield and roll for munis at different maturity ranges—grouped into short, intermediate and long-term. We've talked about the power of roll for some time. It's the natural price gain a bond experiences as it moves closer to maturity, assuming interest rates don't change. Roll varies considerably based on where you are on the curve.
+ We still see the "sweet spot" of the yield curve as intermediate maturities, in terms of combined yield and roll potential. For a 10-year AA-rated muni bond, the combined potential of yield and roll amounts to about 2.8%. Yield plus roll is currently only slightly lower for a 10-year bond than a 30-year bond, which carries significantly more interest rate risk and volatility! So we favor high quality municipals in the intermediate range.
+ But we're willing to buy longer-maturity bonds when dipping down in credit quality (which is where most of the lower-quality supply is). We still recommend some exposure to BBB-rated bonds, where investors get not only modest yield pickup, but lower interest rate sensitivity versus higher quality bonds. However, we also believe investors can diversify their exposure in this part of the curve with US treasury bonds with the purpose of reallocating the position to longer-maturity municipals once they cheapen and offer better value.
+ At the short end of the yield curve, we continue to favor short maturity municipals versus comparable maturity taxable bonds. But now let's explore the concerns and potential opportunities we're seeing in the equity markets.

## Valuations Elevated, but Earnings Bear Watching

**Equity Valuations Are Elevated**

| Index | P/FE | 20-Year Median |
|---|---|---|
| S&P 500 | 20.0× | 16.7× |
| S&P MidCap 400 | 22.1 | 18.3 |
| S&P SmallCap 600 | 25.1 | 19.0 |
| MSCI EAFE | 16.1 | 14.3 |
| MSCI World | 18.4 | 16.1 |
| MSCI ACWI | 17.8 | 15.3 |
| MSCI EM | 14.2 | 11.8 |

**MSCI ACWI Earnings Growth and Forward Estimates**

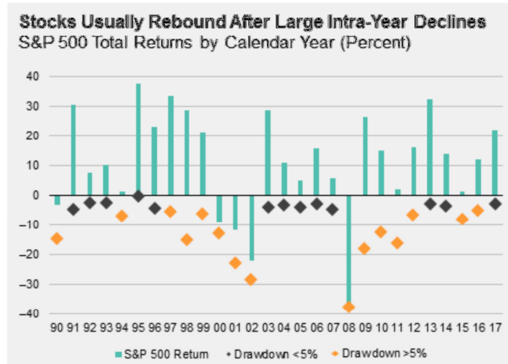



As of December 31, 2017
**Past performance, historical analysis and current forecasts do not guarantee future results.** Not all sectors perform the same.
An investor cannot invest directly in an index, and its performance does not reflect the performance of any AB portfolio. The unmanaged index does not reflect the fees and expenses associated with the active management of a portfolio.
Source: Bloomberg, FactSet, MSCI and S&P



+ As we noted earlier, the first issue we face with equity investing today is that equities have been climbing for a good eight years now, and equity valuations look stretched across the board. You can see that in the left-hand chart, where all US markets as well as global developed and emerging markets are currently above the 20-year median for each.
+ Those high valuations will make it difficult for equities to keep rising on multiple expansion as the indexes have generally enjoyed for the past several years. That makes it very likely that index returns will be lower over the next several years, but we see a market that will be far more grounded in individual company earnings. And that's a healthier environment than returns driven by multiple expansion.
+ Globally, earnings growth has generally ticked upward for the past two years. And while forward estimates appear to be tempering their prospects slightly, we still see pockets of opportunity—but with a healthy dose of caution that relies on selectivity and solid research.

## Worried About a Correction? Prepare Accordingly


| | Drawdown Count | Drawdown Depth | Length (Days) | Time to 50% Rebound (Days) | Time to 100% Rebound (Days) | Fwd. 3-Mo. Return Post-Drawdown | Fwd. 12-Mo. Return Post-Drawdown |
|---|---|---|---|---|---|---|---|
| S&P 500 | 39 | –8% | 17 | 7 | 69 | 11% | 16% |

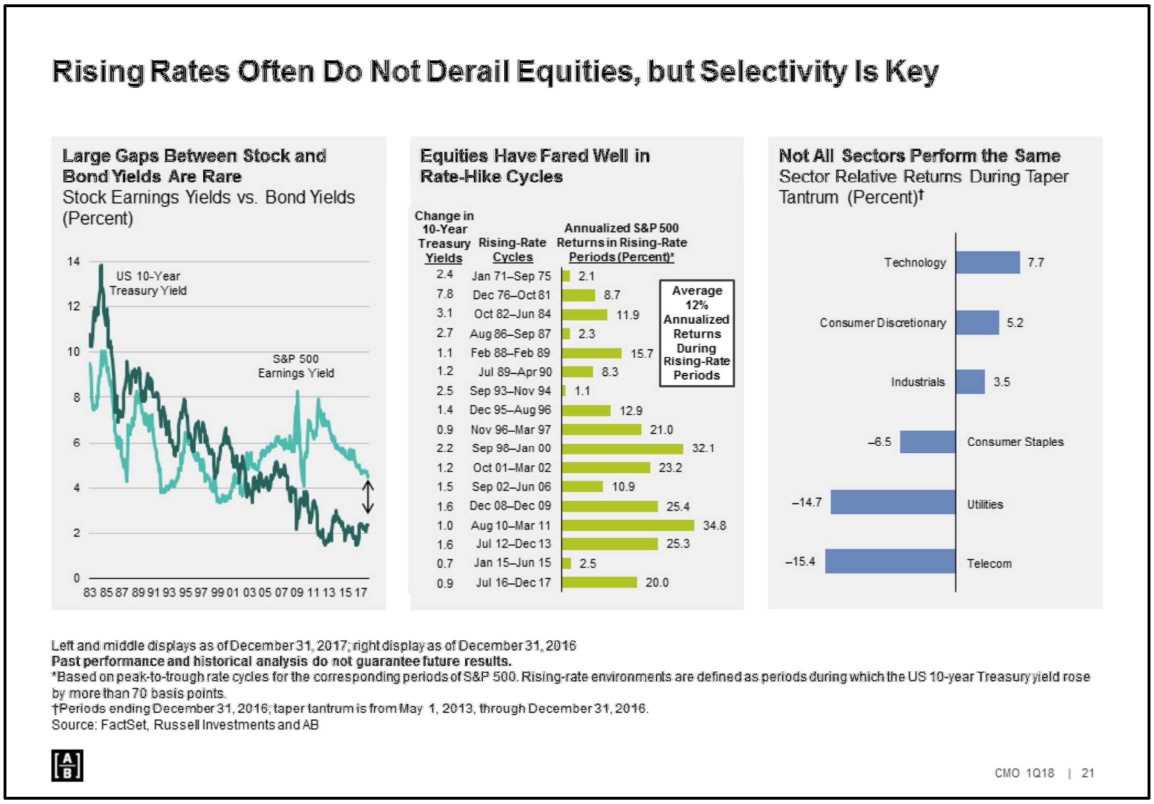
As of December 31, 2017

**Past performance and historical analysis do not guarantee future results.**

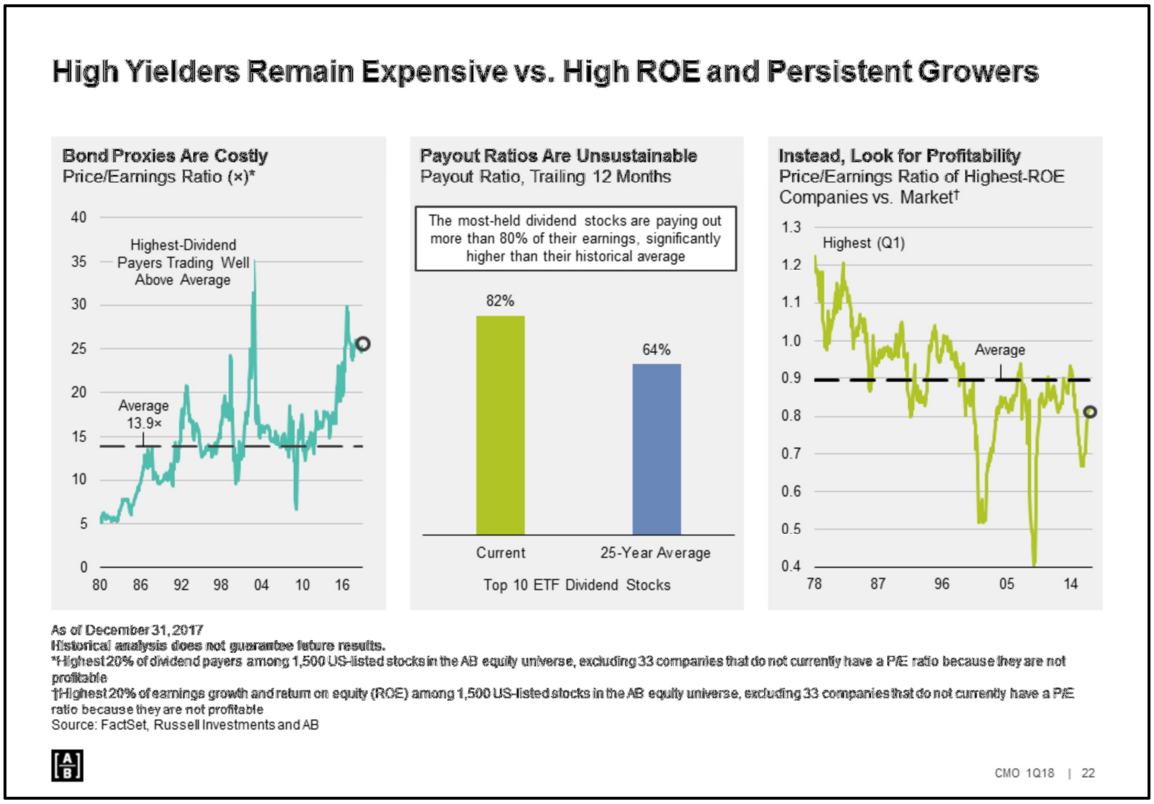
Source: Ned Davis Research, Northern Trust, S&P and AB

CMO 1Q18 | 20

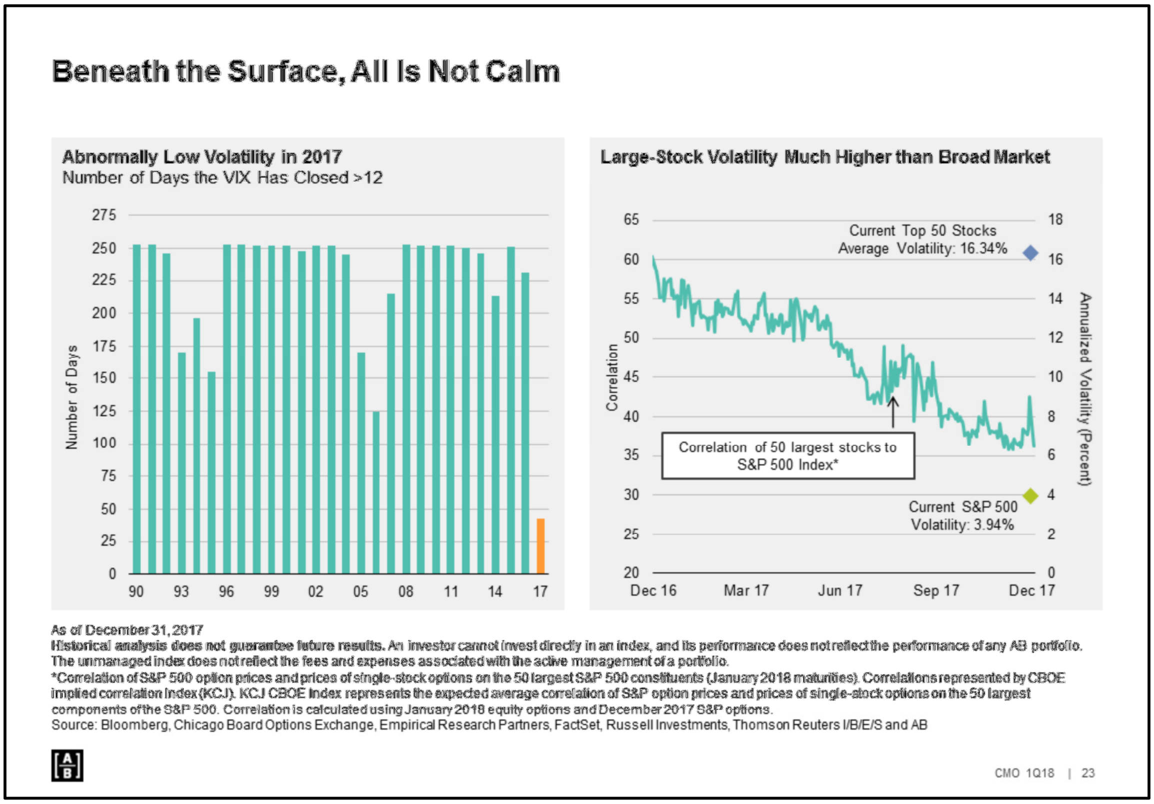
+ There are two parts to that caution and selectivity: first, it's unlikely that 2018 will see a rising tide lifting all boats, even with the generally favorable prospects of global economic growth. But another issue causing investors' concern today is whether we're due for a correction, simply based on the extraordinary length of the current streak for stocks. And to a certain extent, they're right to be concerned.
+ That's because over the last 90 years large-cap US stocks typically had a correction of some magnitude much more frequently. A 5% correction, on average, happens about once every ten weeks—but as of year-end 2017, we've gone 77 weeks since the last 5% correction. The frequency of a 10% correction has usually been about 33 weeks: we're at 96 weeks; and a 20% correction has, on average, occurred after about 127 weeks. We haven't had that size downturn for 445 weeks—not since early 2009.
+ But time alone can't predict the when, if, or the magnitude of a correction. And it is worth noting that stocks usually rebound pretty quickly after large intra-year declines, as we're showing in the right-hand chart. Since 1990, we've had 39 drawdowns of 5.6% or more. The average decline has been about 8% over a typical period of about 17 days. The time to a halfway recovery has averaged only 7 days, while a full rebound has on average taken 69 days—about 3 ½ months. The issue, though, is staying in the market through these downturns, because typically, the subsequent 3-month forward return has been about 11%, and the 12-month forward return has, on average, been 16%.
+ While there's concern over a possible correction, the economic backdrop still supports a picture of slow and steady growth. But now is a time to be selective. Even though equity valuations are pretty high, there are still some opportunities. Look for the "best in class" stories within each sector and capitalization. This is a market where you need to research and find the better topline growers, and watch out for the crowded trades of the stocks that basically act like bonds.



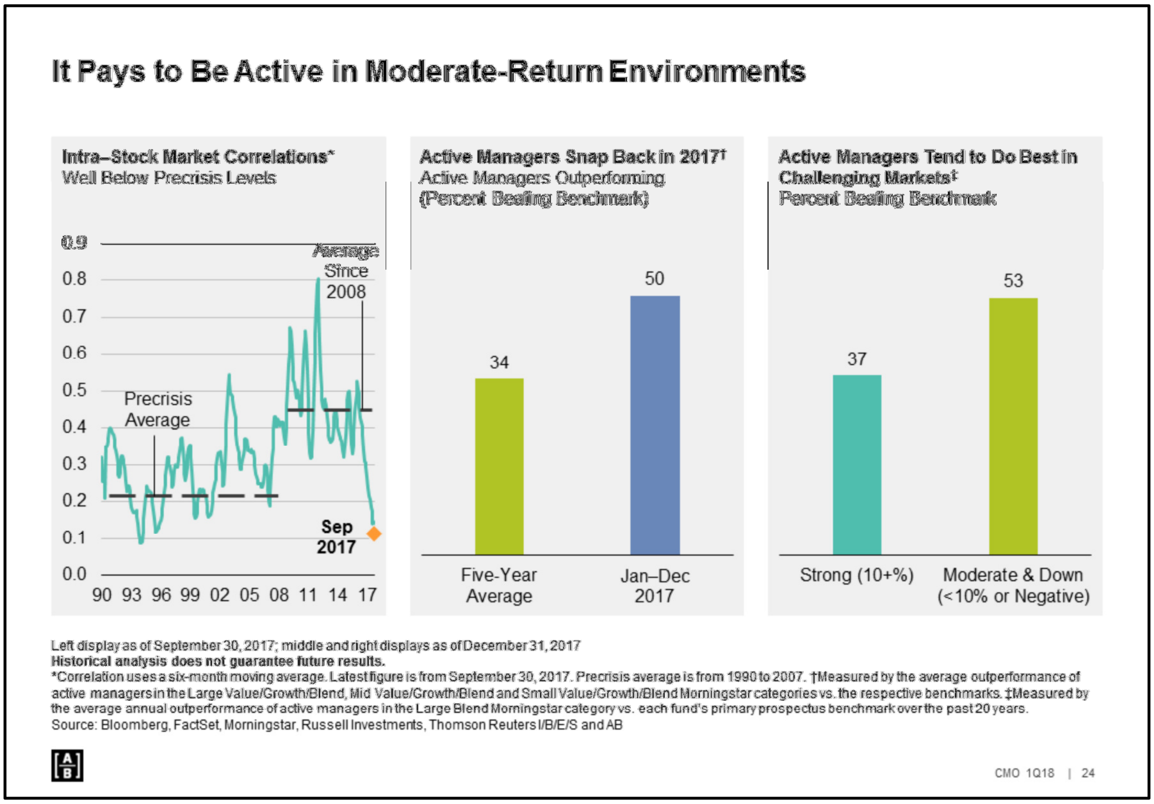

- Regardless of those concerns for high valuations and a possible correction on the horizon, we advise that investors not allow potential, short-term market volatility to override a sound, long-term plan. A component of such a good strategy is to be thoughtful regarding which equity investments make the most sense in today's climate. Our view remains that those companies that can deliver superior and persistent earnings growth will prove rewarding for investors.
- The good news is that equities are still attractive relative to bonds. The left-hand chart compares the earnings yield of the S&P 500 (the aggregate earnings per share of the S&P 500 divided by the price level of the Index) to that of the 10-Year Treasury Note. The gap has narrowed, but it still indicates opportunity for equities going forward.
- And even if interest rates rise, as we expect, equities have fared well during previous rate-hike cycles. Often, part of the reason is that rising rate cycles mean the economy is growing, companies are growing, and earnings per share are growing. As the middle chart shows, for nearly 50 years, equities have turned in an annualized average of 12% during rising rate cycles.
- But not all sectors perform the same when concerns of rising rates hit the markets. We saw that during the second half of 2013, following the Taper Tantrum. High dividend yielding stocks, like consumer staples, utilities and telecom dropped significantly. That's because these stocks tend to be highly sensitive to interest-rate risk, often because they are mature firms with high debt burdens. As a result, these stocks—and portfolios with outsized allocations to them—are likely to trade down with bonds when interest rates rise.
- A tilt to high-dividend-yielding stocks thus increases the correlation of stocks and bonds in a portfolio, reducing the diversification benefit that provides real protection. In today's market, we believe a selective, active approach, focused on valuation, profitability, dividend growers, and company fundamentals presents a more compelling opportunity set.



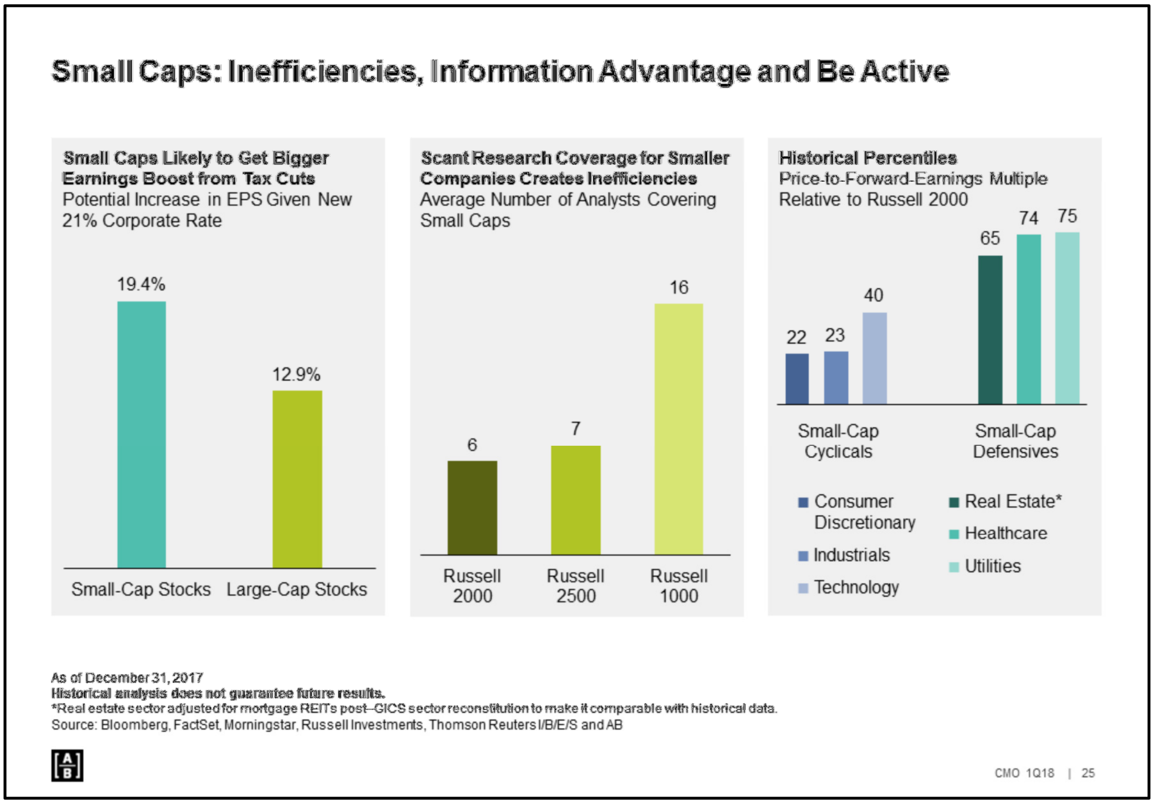

+ Let's take a closer look at those high dividend-yielding stocks. They've been favored by many investors for six or seven years now. The result is that those high yield-oriented equity sectors are currently trading far above their long-term historical average, as the left-hand chart shows.
+ Since the Taper Tantrum, these sectors have outperformed, yes, but they've also seen massive capital inflows that have inflated their valuations severely.
+ This cohort of equities is trading at roughly 23 times earnings—significantly higher than their average P/E ratio of 13.8. We think that's a hefty price tag for stocks that act a lot like bonds.
+ And dividend payers are straining: as shown in the middle display (which details the biggest stock holdings across the 10 largest dividend-focused exchange-traded funds), they're paying out almost 90% of their earnings. That leaves precious little to reinvest in the business in order to either fuel future earnings growth or increase future dividends. Also, earnings growth for this group of dividend yielders is projected to be about 30% lower than that of their growth counterparts. This situation seems unsustainable.
+ At the same time, companies that are actually "delivering the goods," are still underappreciated by the market. We like to look at companies with sustainable and solid levels of profitability.  But safety and current income is still dominant for investors today, so they're overlooking which companies have high profitability as we're showing in the right chart. These companies with the highest Return On Equity (ROE, which is a key measure of profitability) are still trading below their long-term average valuations.
+ Again, taking an active approach to equity investing can help investors avoid overweights in seemingly safe—but crowded-trade—sectors that have diminished potential for positive performance.



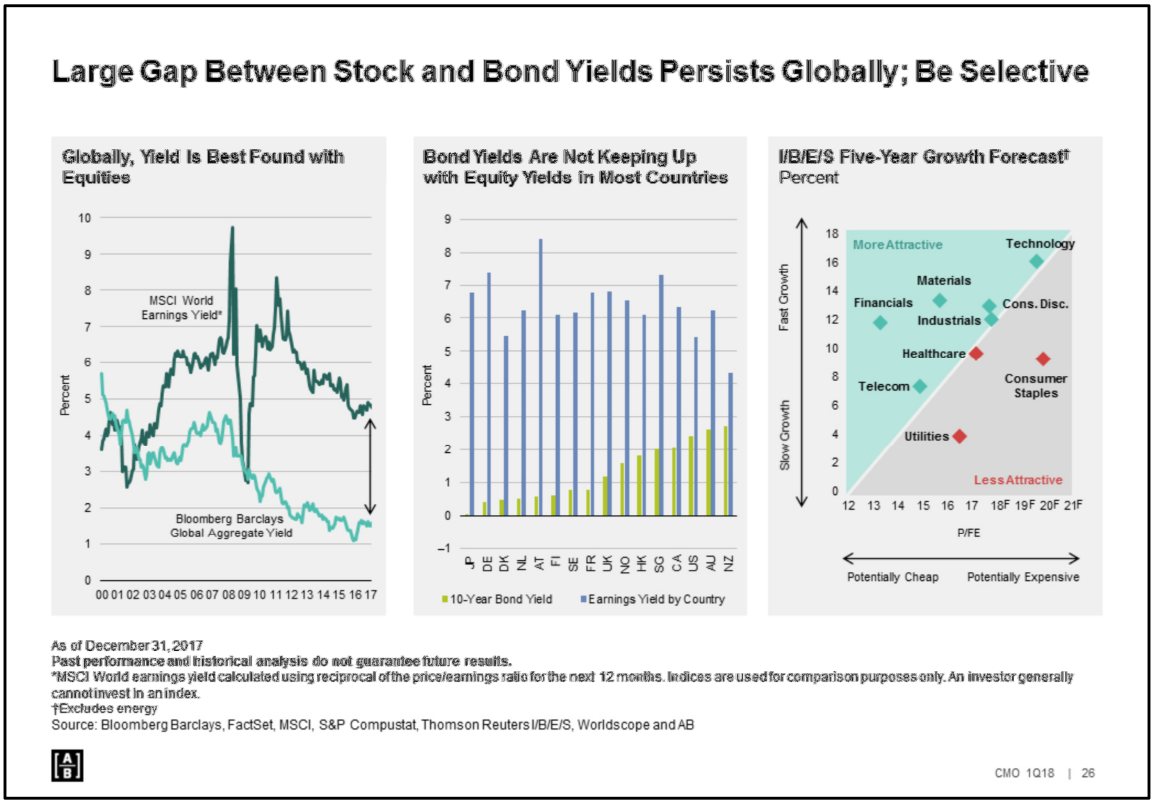

+ Something that has gone hand in hand with the dominance of high-dividend yielders, crowded trades and the dominance of passive approaches to the equity markets is the incredible drop in volatility—at least on the surface. Despite high valuations and concerns over a possible correction, volatility remains well below the average of the past decade. As a red flag of investor complacency, and possible troubles on the horizon, the volatility index is pretty much asleep. The left-hand chart shows just how much of an outlier 2017 was for low volatility—with only about 40 days even nudging the needle of volatility. We haven't seen anything like that in the past 28 years!
+ But while overall volatility for the S&P 500 index looks like a duck gliding smoothly across the surface of a lake, that duck is paddling like crazy underneath the surface! You can see that in the right hand chart. The top-50 largest stocks—one-tenth of the total index—is registering three times the volatility of the total index year-to-date. The reason for this is falling correlation—as the correlation between these largest equities and the overall market has declined in a meaningful way.
+ And when there's low volatility—at least on the surface—that misleading picture induces complacency, which can create market imbalances that snap back violently. Extremely low volatility may make investors think that risky assets are less risky than they really are. This misperception fuels an inflation of prices that may result in a sharp correction.




+ We think it pays to be active when you're in any environment where the correlations among stocks are low—exactly where we are today, as the left-hand chart shows.
+ That intra-stock correlation has declined noticeably as the Fed continues to normalize short-term interest rates. It's much different than the last several years, when stocks moved more in lock step with each other over what had been extremely high levels.
+ Now, with that drop in correlation, the middle display shows a notable increase in active managers outperforming the benchmark in 2017. The fact that not all stocks are moving in lock step, is allowing good research to be rewarded for those managers with a more discerning lens.
+ And if we are correct that future stock market returns will moderate from their recent pattern, the chart on the right shows that during periods when the S&P 500 Index has returned 10% or less over the past 20 years, active managers have posted favorable results.
+ We feel an active approach is more suitable for the environment we foresee for equities; namely lower returns and higher volatility. This coupled with the fact that the Fed is in a tightening phase, warrants a more selective approach.
+ And we believe that approach to long-term investing will return to favor as investors start to feel the restraints and risks of passive strategies, and should stock market returns moderate over time.




+ Small-cap stocks are a good case in point for highlighting the advantages of active management.
+ First, the new tax code should provide a greater boost for small-cap companies than large-caps. That’s because smaller companies are more domestically oriented, pay higher taxes and face disproportionately stiffer regulatory burdens than the larger firms. With the corporate tax rate dropping from 35% down to 21% for all companies, the potential earnings per share increase for small caps will be nearly double that of large companies. And some smaller companies that pay close to the full current corporate rate—such as regional banks and some consumer and industrial companies—could see earnings rise by 10%–20%.
+ Also, there is an informational advantage in the small cap space, given there’s a lot less coverage by analysts here than for large-cap stocks—about two-thirds less coverage.
+ Another advantage of active investing in small caps is the ability to steer away from overpriced sectors and take advantage of better opportunities. For example, small-cap market gains over the past five years have been heavily skewed to stable-earners and high-dividend payers in healthcare, real estate, consumer staples and utilities. Cyclical, globally oriented technology, industrials and consumer discretionary stocks have trailed. The hunt for income and safety also steered capital away from fast-growth companies, which are more likely to reinvest profits back into their businesses.
+ As a result of these divergences, neglected small-cap cyclicals are trading at some of their lowest multiples relative to the index in nearly 30 years, while their defensive peers trade at some of their highest. Relative valuations for high-quality, secular growth stories also look extremely attractive. With the economy on a solid footing, this valuation gap creates rich pickings for active investors.
+ In this environment, autopilot index-tracking approaches are at a big disadvantage, in our view. They can’t interpret the varying ways that new policies and economic developments may impact individual sectors and companies, nor can they avoid risky concentrations in overvalued pockets of the market.




+ But such an approach, we believe has appeal beyond the US, as many opportunities exist in global equities. At an even higher level compared to US stocks, for the level of risk involved, global equity earnings overall, are providing more attractive yields relative to the global bond index yields.
+ The middle chart gives a more specific country-by-country comparison. In countries like Switzerland and Japan, bond yields are almost flat to negative.
+ As you move across Europe most yields are below 1%—UK and Norway slightly higher at roughly 1.5%—but all of them lower than the US (a little over 2%)
+ Parts of Asia are comparable to the US, around 2%. But the equity risk premium across them all is, at minimum, a good 3%–4% more than the bond yields.
+ While global equities do reward you handsomely for the risks you're taking, we firmly believe that selectivity is warranted going forward. The right-hand chart reaffirms our US story—where some of the more yield-centric sectors offer less growth opportunities, but charge higher premiums.
+ That's why we're remaining selective and active in our research and stock selection process. Looking for companies with attractive valuations and compelling growth opportunities.
+ The watchword is don't over extend yourself in areas of the market where the surface-level picture doesn't truly reflect all the risks.
+ Thanks for your time – I'm happy to take your questions.

# A Word About Risk

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**Important Risk Information Related to Investing in Equity and Short Strategies**

All investments involve risk. Equity securities may rise and decline in value due to both real and perceived market and economic factors as well as general industry conditions.

A short strategy may not always be able to close out a short position on favorable terms. Short sales involve the risk of loss by subsequently buying a security at a higher price than the price at which it sold the security short. The amount of such loss is theoretically unlimited (since it is limited only by the increase in value of the security sold short). In contrast, the risk of loss from a long position is limited to the investment in the long position, since its value cannot fall below zero. Short selling is a form of leverage. To mitigate leverage risk, a strategy will always hold liquid assets (including its long positions) at least equal to its short position exposure, marked to market daily.

**Important Risk Information Related to Investing in Emerging Markets and Foreign Currencies**

Investing in emerging-market debt poses risks, including those generally associated with fixed-income investments. Fixed-income securities may lose value due to market fluctuations or changes in interest rates. Longer-maturity bonds are more vulnerable to rising interest rates. A bond issuer's credit rating may be lowered due to deteriorating financial condition; this may result in losses and potentially default, or failure to meet payment obligations. The default probability is higher in bonds with lower, noninvestment-grade ratings (commonly known as "junk bonds").

There are other potential risks when investing in emerging-market debt. Non-US securities may be more volatile because of the associated political, regulatory, market and economic uncertainties; these risks can be magnified in emerging-market securities. Emerging-market bonds may also be exposed to fluctuating currency values. If a bond's currency weakens against the US dollar, this can negatively affect its value when translated back into US-dollar terms.

**Bond Ratings Definition**

A measure of the quality and safety of a bond or portfolio, based on the issuer's financial condition, and not based on the financial condition of the fund itself. AAA is highest (best) and D is lowest (worst). Ratings are subject to change. Investment-grade securities are those rated BBB and above. If applicable, the Pre-Refunded category includes bonds which are secured by US government securities and therefore are deemed high-quality investment grade by the advisor.



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## Index Definitions

Following are definitions of the indices referred to in this presentation. It is important to recognize that all indices are unmanaged and do not reflect fees and expenses associated with the active management of a mutual fund portfolio. Investors cannot invest directly in an index, and its performance does not reflect the performance of any AB mutual fund.

+ **Bloomberg Barclays Global Aggregate Bond Index:** Measure of global investment-grade debt from 24 local currency markets and includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed- and emerging-markets issuers.
+ **Bloomberg Barclays Global Aggregate Corporate Bond Index:** Tracks the performance of investment-grade corporate bonds publicly issued in the global market and found in the Global Aggregate. (Represents global corporate on slide 1.)
+ **Bloomberg Barclays Global High-Yield Bond Index:** Provides a broad-based measure of the global high-yield fixed-income markets. It represents the union of the US High Yield, Pan-European High Yield, US Emerging Markets High Yield, CMBS High Yield and Pan-European Emerging Markets High Yield indices.
+ **Bloomberg Barclays Global High-Yield Corporate Index:** A multi-currency measure of the global high yield corporate debt market. The index represents the union of the US High Yield, the Pan-European High Yield, and the corporate sector of the Emerging Markets (EM) Hard Currency High Yield Indices. The high yield and emerging markets sub-components are mutually exclusive. The Global High Yield Corporate Index is a component of the Global High Yield Index and subsequently a component of the Multiverse Index, along with the Global Aggregate, Euro Treasury High Yield and EM Local Currency Government Indices.
+ **Bloomberg Barclays Global Treasury: Euro Bond Index:** Includes fixed-rate, local-currency sovereign debt that makes up the Euro Area Treasury sector of the Global Aggregate Index. (Represents euro-area government bonds on slide 1.)
+ **Bloomberg Barclays Global Treasury: Japan Bond Index:** Includes fixed-rate, local-currency sovereign debt that makes up the Japanese Treasury sector of the Global Aggregate Index. (Represents Japan government bonds on slide 1.)
+ **Bloomberg Barclays Municipal Bond Index:** A rules-based, market value–weighted index engineered for the long-term tax-exempt bond market. (Represents municipals on slide 1.)
+ **Bloomberg Barclays US Aggregate Bond Index:** A broad-based benchmark that measures the investment-grade, US dollar–denominated, fixed-rate, taxable bond market, including US Treasuries, government-related and corporate securities, mortgage-backed securities (MBS [agency fixed-rate and hybrid ARM pass-throughs]), asset-backed securities (ABS), and commercial mortgage-backed securities (CMBS).
+ **Bloomberg Barclays US Corporate High-Yield Bond Index:** Represents the corporate component of the Bloomberg Barclays US High Yield Index. (Represents US high yield on slide 1.) Bloomberg Barclays US Corporate Bond Index: Measures the investment-grade, fixed-rate, taxable corporate bond market and includes USD-denominated securities publicly issued by US and non-US industrial, utility and financial issuers.



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## Index Definitions (continued)

- **Bloomberg Barclays US Treasury Index:** Includes fixed-rate, local-currency sovereign debt that makes up the US Treasury sector of the Global Aggregate Index. (Represents US government bonds on slide 1.)
- **Bloomberg Barclays US Treasury Inflation-Linked Bond Index:** Measures the performance of the US Treasury Inflation-Protected Securities market.
- **J.P. Morgan Emerging Market Bond Index Global:** A benchmark index for measuring the total return performance of government bonds issued by emerging-market countries that are considered sovereign (issued in something other than local currency) and that meet specific liquidity and structural requirements. In order to qualify for index membership, the debt must be more than one year to maturity, have more than $500 million outstanding, and meet stringent trading guidelines to ensure that pricing inefficiencies don't affect the index. (Represents emerging-market debt on slide 1.)
- **J.P. Morgan Government Bond-Emerging Markets Global Diversified Index:** A comprehensive global emerging markets index of local government bond debt. To qualify, a country's gross national income (GNI) per capita must be below the GNI per capita level that is adjusted yearly by the growth rate of the world GNI per capita, provided by the World Bank, for three consecutive years.
- **MSCI All Country World Index:** A market capitalization weighted index designed to provide a broad measure of equity-market performance throughout the world.
- **MSCI EAFE Index:** A free float–adjusted, market capitalization–weighted index designed to measure developed-market equity performance, excluding the US and Canada. It consists of 22 developed-market country indices. (Represents EAFE on slide 1.)
- **MSCI Emerging Markets Index:** A free float–adjusted, market capitalization–weighted index designed to measure equity market performance in the global emerging markets. It consists of 21 emerging-market country indices. (Represents emerging markets on slide 1.)
- **MSCI World Index:** A market capitalization–weighted index that measures the performance of stock markets in 24 countries.
- **Russell 2500 Index:** A broad index featuring 2,500 stocks that cover the small and mid cap market capitalizations. The Russell 2500 is a market cap weighted index that includes the smallest 2,500 companies covered in the Russell 3000 universe of United States-based listed equities.
- **S&P 500 Index:** Includes a representative sample of 500 leading companies in leading industries of the US economy. (Represents US large-cap on slide 1.)
- **S&P MidCap 400 Index:** Provides investors with a benchmark for mid-sized companies. The index measures the performance of mid-sized companies, reflecting the distinctive risk and return characteristics of this market segment.
- **S&P SmallCap 600 Index:** Measures the small-cap segment of the U.S. equity market. The index is designed to track companies that meet specific inclusion criteria to ensure that they are liquid and financially viable.





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