AllianceBernstein®

Keeping Cool in Volatile Markets

The Upside of Defensive Equity Strategies

In a world of macroeconomic and market uncertainty, the fear of losing money may deter investors from seeking to capture equity return potential. Is there a way to stay confident when volatility strikes? Equity strategies that target downside-risk reduction can help. By seeking to reduce losses in downturns, these portfolios have less ground to regain when the market recovers. Over time, this gentler return pattern can deliver surprisingly resilient returns, helping investors stay in the market through bouts of turbulence.

SEPTEMBER 2025

Kent Hargis
Chief Investment Officer—
Strategic Core Equities

AB Strategic Core Equities Team

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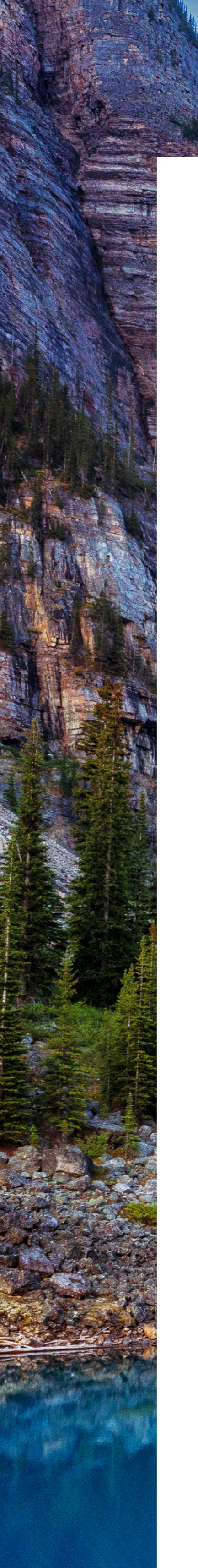


It's a deeply ingrained investing maxim that risk and return go hand in hand: to get more return, you must accept more risk. So some investors may find it counterintuitive that the opposite is also true: you can take less risk and still beat the market over time. It's a different way of defining investment success that leans on downside defenses in the pursuit of long-term goals.

Meeting investment objectives today requires a fresh mindset. Investors are facing an uncertain future, as US tariff policies shake up global trade, add risks to the global economy and stir market volatility. This follows several turbulent market episodes in recent years, from the COVID-19 economic shutdown in 2020 to the post-pandemic inflation spike in 2022. Meanwhile, equity market risks have been augmented by extreme US market concentration caused by the dominance of the US mega-cap stocks. Uncertainty often spurs unstable market conditions, which may deter investors from taking more risk to capture return potential.

That creates a conundrum for many investors. Whether an individual saving for retirement, a pension plan facing funding gaps or an insurance company dealing with stiffer capital requirements and asset/liability–matching challenges, investors can't tolerate wild market swings, let alone the prospect of losing money. They need their investments to go the distance.

Contributors

Brian Holland, Portfolio Manager and Senior Research Analyst—International Strategic Core Equities
James Russo, Senior Research Analyst
Peter Chocian, Senior Quantitative Research Analyst
Ian McNaugher, Research Coordinator (US) and Senior Research Analyst—Strategic Core Equities
Jayme Lisiewski, Senior Research Analyst
Ilyse Bender, Research Analyst
Jack Chen, Research Analyst
Austin Frey, Senior Quantitative Research Analyst
Richard Gairdner, Research Analyst
Teresa Keane, Senior Investment Strategist—Equities
Chris Marx, Senior Investment Strategist—Equities
David Wong, Senior Investment Strategist and Global Co-Head—Equity Business Development

Generating a Gentler Pattern of Returns

Strategies that expressly target downside-risk reduction can address many of these needs. These solutions get their performance power from the simple mathematics of lower risk drag and compounding. Stocks that lose less in market downturns have less ground to regain when the market recovers, so they're better positioned to compound off those higher returns in subsequent rallies. Over time, this gentler return pattern can end up ahead of the market.

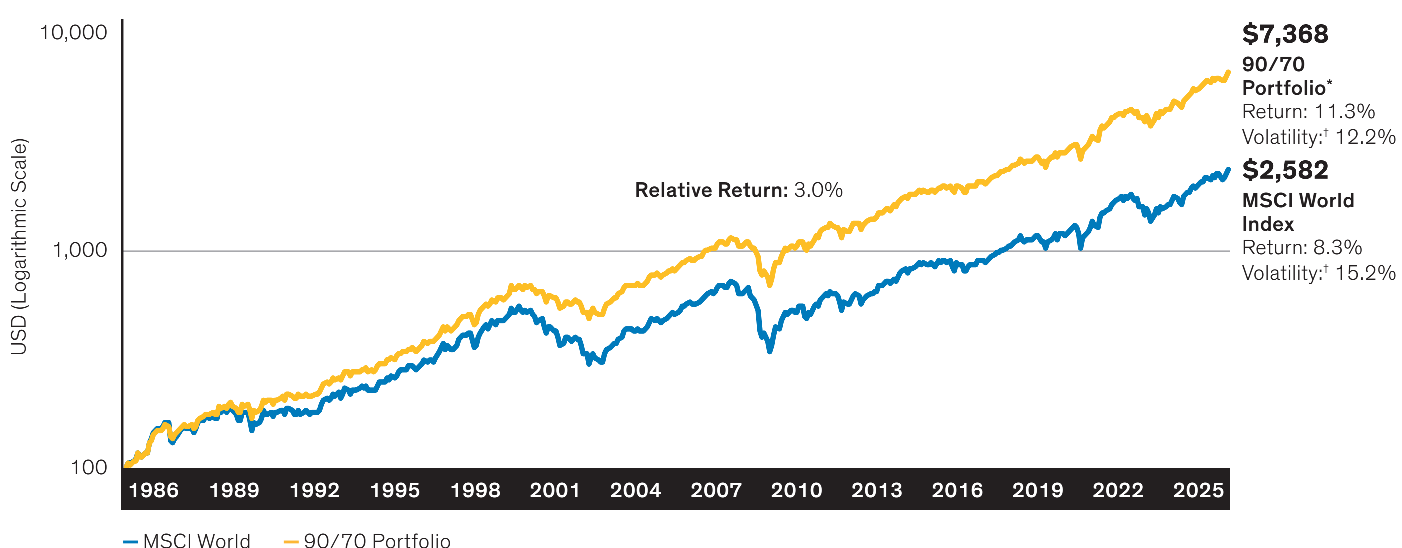
A measure known as upside/downside capture helps explain how preserving capital in the near term can actually drive outperformance over the long term. Imagine a hypothetical global stock portfolio that captured 90% of every market rally and fell only 70% as much as the market during every sell-off. What would the long-term returns of this portfolio look like?

You might think it would underperform; it wouldn't. As *Display 1* illustrates, $100 invested in this portfolio in 1986 would have built up $7,368 in capital through June 2025 with reduced volatility. That's almost three times more capital than that generated by the MSCI World Index.

It's not easy to build a portfolio that can capture more upside during market rallies than it loses during downturns over time. In our experience, the secret to delivering on the 90%/70% potential lies in finding high-quality stocks with stable trading patterns and attractive prices (what we call "QSP," which stands for quality, stability and price).[1] It also requires the ability to nimbly adjust exposures as insights into fundamental attractiveness and risks change.

DISPLAY 1: CAN INVESTORS REDUCE LOSSES IN DOWNTURNS AND STILL BEAT THE MARKET?

Growth of $100



Past performance does not guarantee future results. Returns shown are for illustrative purposes and are not representative of any AB fund. It is not possible to invest in an index.

*Performance calculated by multiplying all positive monthly returns (0% or greater) of the MSCI World Index by 90% and all negative returns (less than 0%) by 70%; shown in logarithmic scale

†Annualized standard deviation

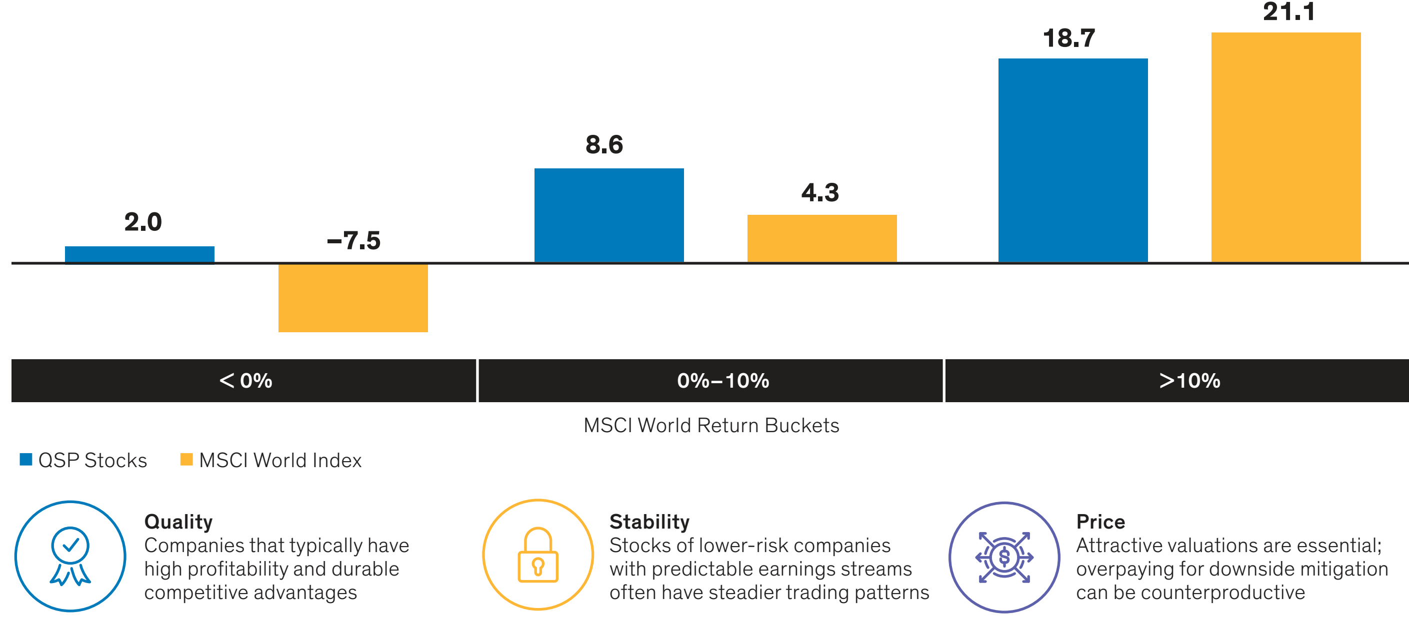
Data from March 31, 1986 (inception date of MSCI World Index), through June 30, 2025

Source: MSCI and AB

1 **Note on methodology:** Our analysis of QSP stocks in this paper uses two methodologies. The Strategic Core Edge methodology, as described in the footnote of *Display 2*, is used for analysis back to 1990. For longer-term analyses that begin before 1990, we use the AB QSP score, as described in the footnote of *Display 5*. Since some of the factors used in Strategic Core Edge do not have a history before 1990, we created the AB QSP score using proxies for factors that are not available for longer-term datasets.

DISPLAY 2: IN A VOLATILE WORLD, THE PATTERN OF RETURNS MATTERS MORE

Global Stocks with Attractive Quality, Stability and Price (QSP) Features vs. MSCI World
Average Rolling 12-Month Returns: Jul 2015–Jun 2025 (Percent)



Past performance does not guarantee future results.

QSP returns are for the quintile of developed global stocks with the highest Strategic Core Edge. Strategic Core Edge is the expected return from a proprietary model combining a number of quality, stability and price factors, with a ratio of approximately one-third for each quality, stability and price component.

Return buckets are based on returns for the MSCI World Index.

As of June 30, 2025 | **Source:** MSCI and AB

Stocks like these can help investors capture equity potential while navigating turbulent markets. In fact, our universe of global stocks with attractive QSP characteristics delivered returns of 2.0% on average in falling markets over the last decade, when the MSCI World Index fell by 7.5% on average (*Display 2*). In modestly rising market environments, QSP stocks advanced by 8.6%—double the broader market's gains.

When carefully selected, stocks like these have the potential to create a portfolio with resilience in down markets and solid growth potential in up markets. This type of portfolio can give investors the confidence to maintain a core strategic allocation to equities through turbulent times, which improves the chances of meeting their long-term goals.

Volatility isn't going away any time soon. Market volatility in the first half of 2025 reflected heightened uncertainty about the potential effects of US tariffs on business models, corporate earnings and equity returns, and macroeconomic growth. Even if the trade war deescalates, we believe investors must adjust to this profound regime change in global markets.

Pick Your Poison:
Relative vs. Absolute Risk

Risk is a slippery concept. It means different things to different people. Yet for decades, equity risk has largely been defined in relative terms versus a market capitalization–weighted index, such as the S&P 500 or the MSCI World Index. This is how most investors are taught to define success.

Investors view relative risk through the lens of the information ratio—defined as relative returns divided by their volatility, or tracking error. This statistic gives investors an easy way to gauge portfolio performance and the skills of their asset managers.

But the preoccupation with relative risk is problematic. Since risk-taking is measured versus a benchmark, active managers have a strong incentive to stick closely to that benchmark. Growing investor frustration with paying high fees for benchmark-like or worse performance has fueled the popularity of low-cost, passive, cap-weighted index-tracking approaches.

In recent years, extreme US market concentration has sharpened this question. When US equity markets are dominated by the mega-cap stocks, deviating from large benchmark weights in a small group of stocks dramatically increases relative risk.

Going passive solves the relative-risk issue, but it raises other challenges. Many passive indices organize their holdings based on market capitalization, weighting each stock based on the total value of shares outstanding. So if sentiment turns agains the Magnificent Seven, passive investors could be exposed. And there may be more compelling reasons than size for choosing one stock over another, such as earnings growth, low valuation or price momentum. Active and passive benchmark-hugging portfolios can become overexposed to the benchmark's riskier excesses—and to the full magnitude of the inevitable market downdrafts.

Benchmarks are also backward-looking. So a portfolio that's tethered too closely to a benchmark will also be tethered too closely to yesterday's winners.

But, in our view, the biggest flaw in focusing on relative risk is that it doesn't solve the real problem: having enough money to meet your long-term goals. You can't spend relative performance.

The Advantages of Defensive Strategies

Defensive equity strategies can help investors strategically prepare for a more volatile future by offering the following advantages:

- They help investors stay the course in equities, preventing the tendency to buy high when markets boom and sell too quickly when they slump—thus missing out on future recoveries.
- They help shield against the corrosive effects of risk drag, which is particularly important for investors who need to start spending their money or for retirement plans that rely on their investment portfolio to meet payment obligations.
- They provide flexibility in budgeting portfolio risk and allow for increased allocations to return-seeking strategies.

Given these characteristics, we view strategies that aim to deliver reduced volatility as attractive choices for a core equity allocation. An active approach combining built-in downside-risk defenses with high fundamental quality and attractive valuation is an effective way to achieve more stable return patterns. Investors can use these strategies to help drive better long-term outcomes.

The Risk That Really Hurts

Market meltdowns are particularly damaging for investors in the post-accumulation phase—retirees living off their nest eggs and defined benefit plans in the runoff stage—especially if these sell-offs happen in the early withdrawal stage.

The return of inflation in recent years has raised hurdles for reaching investment goals. Many public and corporate pension plans are rethinking how they fill large funding gaps, while insurance companies are grappling with stiffer regulatory and asset/liability-matching challenges. In our view, generating real returns that can beat inflation over time will be the next big challenge for investors of all types. And many investors continue to evaluate performance based on relative returns versus a benchmark, rather than evaluating performance based on absolute returns (see "Pick Your Poison: Relative vs. Absolute Risk," left). We think this is the wrong prism through which to evaluate risk, particularly for investors focused on reducing volatility and generating positive real returns.

In our view, creating a portfolio that can consistently cushion downside losses and beat the market over time requires a disciplined focus on identifying stocks with QSP characteristics. The starting point for investors is to develop a clear definition of each component and broaden their perspective on how to source stocks with strong QSP credentials.

Quality: Durable Businesses Are Everywhere

For equity investors, quality is often associated with technology stocks or other high-octane growth companies. But in fact, standout business models can be found in an array of industries, among profitable companies that reinvest effectively and offer defensive features for an equity portfolio.

So what are some examples of resilient business models? Look for companies that enjoy well-defended competitive advantages, which enable them to maintain high and predictable profitability for longer than the market expects. Sources of this sustainable profitability can range from an entrenched network effect to a difficult-to-replicate service, a beloved brand or a low-cost production process. Innovation and a talented workforce also create quality advantages.

Standout business models can be found in an array of industries, among profitable companies that reinvest effectively and offer defensive features for an equity portfolio."

These types of business advantages are particularly important when inflation is high. Rising prices pressure companies on both the cost and income side of their businesses. In a world of higher inflation, the advantages of quality are greater than usual. Companies with pricing power, which may derive from their intellectual capital or brand, are well placed to overcome inflationary pressures. While companies can't control inflation, some business areas give them more control over their fates than their rivals have.

We believe that high-quality companies that are good stewards of capital, with strong and consistent cash flows, have more ways to protect their margins even as input costs increase. Pricing power—an important quality feature in any market—is an essential attribute: it allows companies to pass rising costs through to their customers without worrying about taking a hit to demand.

Measures of profitability, such as return on assets or return on invested capital, are important quality indicators and strong predictors of future earnings power. Similarly, companies that demonstrate capital discipline will be prized in an environment of higher interest rates.

AutoZone, a US retailer of car parts and accessories, is a good example of a quality business with defensive features. The company has a highly profitable business that has posted healthy growth in key segments of auto parts, including both DIFM ("do it for me") and DIY ("do it yourself"). AutoZone also tends to do well during tougher economic times when Americans drive their cars more frequently. That's because, when your car breaks down, you need to fix it, regardless of economic conditions.

Stability: Lower Beta Adds a Safety Net

Investors can also offset slowing growth with stability. Stable companies have a cushion on the downside because they typically have lower beta—lower sensitivity to the broader market—than traditional growth firms. Fundamental research can unearth companies with hallmarks of stability across a broad array of sectors, not only in traditionally defensive areas such as utilities and consumer staples, but also within more cyclically oriented industries such as financials, industrials and information technology.

In finance textbooks, the value of an asset is defined as a function of its future cash flows and the discount rate, which itself is a function of interest rates. It's also affected by the perceived variability of a company's cash-flow potential; greater uncertainty around cash flows will raise the discount rate and lower a stock's valuation. So, anything that can provoke uncertainty around cash flows may become a source of volatility, whether derived from a company's business model, its debt position (or leverage) or its sensitivity to exogenous shocks from the macroeconomy or geopolitics (see "Trade Wars and Turbulence: A Case Study in Defensive Investing," page 5).

We believe that shares of companies with more predictable earnings patterns than others tend to offer stability, even in times of limited visibility. Our research suggests that companies like these tend to outperform the market over time, with better risk characteristics, which lends stability to a portfolio and improves Sharpe ratios, a key measure of risk-adjusted returns.

It's important to actively monitor companies for firm-specific risks that might threaten their fundamental stability and/or increase price volatility in the short term. This extra scrutiny helps weed out companies that may be headed for uncharacteristic periods of erratic stock performance. These risks could include an unexpected acquisition, a shift in top management or new regulatory requirements.

Wolters Kluwer, a Dutch information services company, is a good example of a business with stability features. The company has improved operating margins by transitioning from its traditional business of print journals and books to digital reference tools and software products, where it has built a strong market position. More than 80% of Wolters Kluwer's sales are derived from a recurring revenue model, the beating heart of steady cash flows through good and bad economic times.

Companies like Wolters are solutions providers, whose business models are underpinned by robust data and analytics. Since they are embedded in the workflow processes of their customers, it's very difficult to switch to competitors, which further adds to business stability.

Trade Wars and Turbulence: A Case Study in Defensive Investing

In early 2025, President Trump's sweeping tariff plans unsettled markets as companies and investors struggled to forecast earnings. However, reducing equity exposure when volatility strikes can be counterproductive.

Volatility moves in both directions—down and up. Investors who sold equities when US markets fell sharply after Trump's April 2 tariff announcement would have locked in losses and missed gains from the market rebound a week later. By quarter end, the S&P 500 had recovered all its losses and was touching record highs.

Timing market inflection points is challenging, especially when driven by unpredictable policy moves. And moments of extreme fear are often followed by strong equity rebounds. While the outcome of the current trade war is uncertain, we believe staying in the market offers the best chance to capture strong long-term equity returns.

Stay Focused on Fundamentals—Even in a Trade War

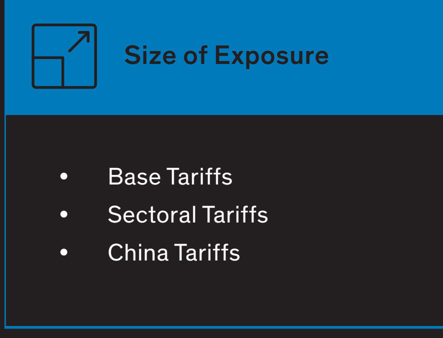
Of course, evaluating fundamentals is crucial for risk-aware equity investing and for a defensive strategy targeting high-quality businesses with strong cash-flow generation. We use a fundamental framework to evaluate the impact of tariffs on a company-by-company basis (*Display*). This includes estimating a company's revenue and input exposure to tariffs, evaluating the direct impact on profitability, and considering indirect impacts like economic cycles or inflation.

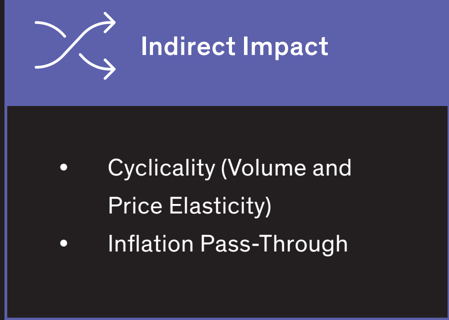
This framework is part of a broader research effort, including quantitative artificial intelligence (AI) tools, to find high-quality businesses with healthy balance sheets and skilled management teams. Shares of companies with strong QSP features can help form a solid defensive foundation.

Developing Defensive Diversification

Effective defensive diversification can be achieved by focusing on services-oriented companies rather than goods producers, which are more susceptible to tariffs. Internet-based travel services and select financial-services firms are also less affected by the trade war. In technology, software companies are less vulnerable to tariffs and offer opportunities to capture AI innovation, while semiconductor and hardware companies are more vulnerable. Even in sectors susceptible to tariffs, search for exceptions, such as industrial companies with US operations or digital publishers benefiting from global infrastructure spending.

FUNDAMENTAL FRAMEWORK FOR THE IMPACT OF TARIFFS





For illustrative purposes only.
There can be no assurance that any investment objective will be achieved.

Price: Valuation Underpins Defensive Potential

Market volatility in early 2025 provided a painful reminder of the importance of focusing on valuations. At the start of the year, many technology companies had become very expensive—in particular, the Magnificent Seven mega-cap stocks that have benefited from a wave of enthusiasm for artificial intelligence (AI) technology (see “How to Capture AI Innovation in a Defensive Equity Portfolio,” below).

When the market reversed, investors discovered that what goes up too high often comes down fast. In the first few months of 2025, most of the Magnificent Seven stocks fell sharply after the Chinese company DeepSeek unveiled an AI model developed at a fraction of the cost of traditional models. This suggested that the outlook for AI spending could be more modest than previously expected, which could challenge forecasts for the US mega-caps’ earnings growth potential. And the lofty valuations of the Magnificent Seven stocks at the beginning of the year were in part responsible for the sharp declines. While the US mega-caps include some great businesses, we believe they should be individually assessed and held at appropriate weights to a portfolio’s philosophy. And as with any stock, investors should always consider whether the valuation appears to be rooted in reality, even if the underlying business looks solid.

This principle is especially important when investing in defensive stocks. During times of stress, certain companies that are widely seen as having defensive characteristics may become popular—and expensive. Crowded trades form that could become very risky if the trend unwinds and investors rush for the exits all at once. In other words, investors could end up paying a hefty price for the insurance provided by a seemingly safer allocation, only to discover that its defensive features were a mirage.

That’s why we believe identifying high-quality, shock-resistant companies isn’t enough when building a defensive portfolio. To tilt the scale even more to the upside, the next step is to determine whether those characteristics are already being fully appreciated by the market or are trading at relatively attractive valuations. Staying alert to valuations is another way to improve return potential and avoid expensive, vulnerable pockets of the market.

How to Capture AI Innovation in a Defensive Equity Portfolio

Companies at the heart of the AI revolution are seen as expensive, fast-growing businesses that wouldn’t usually be held in a defensive portfolio. Yet select firms in the AI ecosystem can fit into a risk-aware equity allocation with an eye on quality growth and strategic portfolio construction.

Technology stocks aren’t usually seen as defensive. But avoiding the sector means missing out on AI, perhaps the most transformational technology cycle since the birth of the internet. The growth opportunities are real, but so are the risks—especially given the expensive share prices of many AI-related companies.

Is there a way to incorporate AI stocks in an equity portfolio focused on risk reduction? The key is to look for firms with high-quality business models, a degree of stability and relatively attractive valuations for the sector. For example, AI businesses with strong profitability, earnings prospects and capital discipline can capture growth potential and help a portfolio play defense.

With the following guidelines in mind, investors can identify AI stocks with the right balance of features for a risk-focused allocation:

- **Learn lessons from past technology cycles:** During the dot-com boom, innovation was led mostly by unprofitable companies with unproven business models targeting aggressive growth. Today, many firms building AI infrastructure are profitable, and some top innovators offer quality businesses with stability.
- **Distinguish among technology industries:** Much of the AI-driven surge to date has been led by semiconductor manufacturers and cloud infrastructure providers. We think software firms will play a bigger role in enabling efficiencies for companies and consumers, and some offer relatively attractive valuations and more defensive business models.
- **Be selective within the Magnificent Seven:** While the mega-caps are generally expensive, some offer high-quality business models that provide the flexibility to navigate short-term market stresses and longer-term challenges.

Finding AI companies with attractive QSP credentials can be challenging because technology sector valuations tend to be higher than the broad market.

The solution is to balance QSP features, both when analyzing individual holdings and in portfolio construction. Some AI-focused technology companies offer exceptionally high quality, particularly in software, where business models based on recurring revenue streams add stability to cash flows. Exposure to high quality and stability can offset some valuation risk. Investors should also target valuations that are relatively attractive compared to the broader technology industry, even if these may be somewhat pricier than other sectors.

By carefully selecting stocks of high-quality AI businesses, we think investors can benefit from a once-in-a-generation technological shift without destabilizing the lower-risk profile of a broad equity allocation.

Quality + Stability + Price (QSP): A Powerful Combination

Companies that embody the QSP sweet spot can be found across diverse sectors and industries, providing a portfolio with unexpected sources of defense and offense (*Display 3*).

Quality business models can provide companies with unexpected sources of defense. For example, technology companies aren't typically seen as defensive, yet platform-based businesses enjoy recurring sources of revenue, which can hold up well during tougher times.

For offense, think about companies that we call "quality compounders." These firms have successful business models and sustainable earnings, backed by good capital stewardship and, often, positive management behavior. Intangible assets, such as a company's brand, R&D and patents, are also valuable, particularly in times of stress. The effect of these features supports compound earnings gains from consistent growth drivers through market cycles, which translates to unexpected sources of offense for portfolios, even in sectors, like healthcare, typically seen as defensive.

We believe that sourcing a mix of defensive and offensive features in a broad range of companies can help create a portfolio with an attractive upside/downside-capture profile.

Healthcare stocks, for example, are typically seen as defensive holdings. But we see Eli Lilly as a surprising source of offense as well. The Indianapolis-based pharmaceutical company is well known for its diabetes treatments and is in advanced trials for an anti-obesity drug. It also has a strong pipeline of R&D and patents that should drive future growth.

Financial companies are less common in defensive portfolios, given the sector's vulnerability to macroeconomic ups and downs. Yet Visa has a resilient business model with recurring revenue streams, having transformed itself from a consumer payments network into a global payments and data services platform. Business segments such as cross-border B2B, remittances and real-time money movement now comprise over 30% of its revenue and are growing at more than 20% annually, providing stable cash flows.

DISPLAY 3: HOW HIGH-QUALITY BUSINESS MODELS SHAPE OFFENSE AND DEFENSE FOR INVESTORS

Unexpected Sources of Defense	Unexpected Sources of Offense
Platform with Network Effects	Innovation Patents/Research & Development
Recurring Stable Revenue	Secular Winners
Mission-Critical Expert Solutions Proprietary Data/Analytics	Brands

For illustrative purposes only.

Source: AB

Four Principles to Effectively Deploy Defensive Equities

Staying focused on QSP companies through volatile markets isn't easy. But following four principles can guide investors in creating defensive portfolios that may reduce volatility through changing conditions.

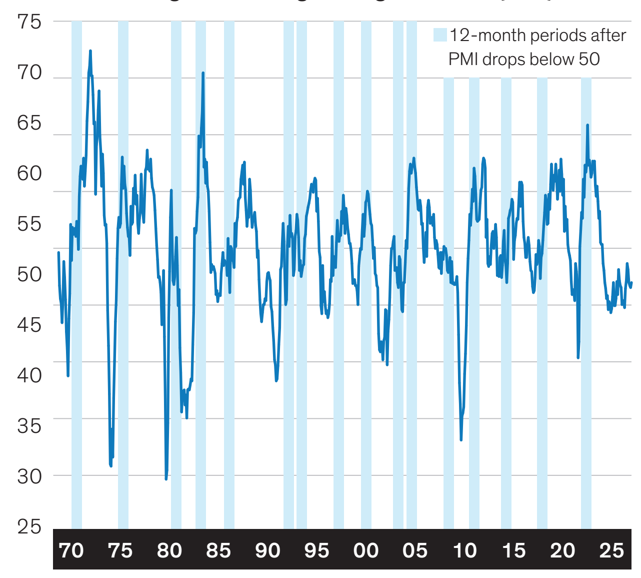
1. **Develop a Dynamic Defense**
   Every downturn is different, so the defensive script must change accordingly. When devising a defensive strategy, old playbooks may be obsolete. Consider current market behaviors, sensitivities and new forces of change that could redefine the essence of safety.
2. **Cast a Wider Net for Stable Companies**
   Preconceived notions of how to source stability can be restrictive. Companies in sectors such as utilities, consumer staples and healthcare have typically provided stability in volatile markets. But broadening the sources of stability can help diversify risk and return potential. We've found stable companies in industries ranging from industrials to technology, which aren't typically places investors search for safety.
3. **Steer Clear of Unpredictable Forces**
   Geopolitical risk and macroeconomic developments simply cannot be predicted with certainty. So it's not prudent to take a directional bet on them as part of a defensive equity-investing strategy. Tariff policy, election results and the Russia-Ukraine war are other examples of risks that can't be forecast. Of course, these events have a big impact on companies and markets. When researching a stock, investors should assess how significant the business's exposure is to an unpredictable risk—and avoid companies that appear to be especially vulnerable to things that can't be controlled.
4. **Don't Lose Your Nerve**
   When markets are falling and turbulent, it's easy to lose your nerve. Even the best-planned strategy may feel flimsy when losses are mounting. But selling equity positions in a falling market means locking in losses and forfeiting recovery potential. Since it's almost impossible to time market inflection points, investors who sell risk missing the best days of a rebound, which can dramatically impair long-term returns.

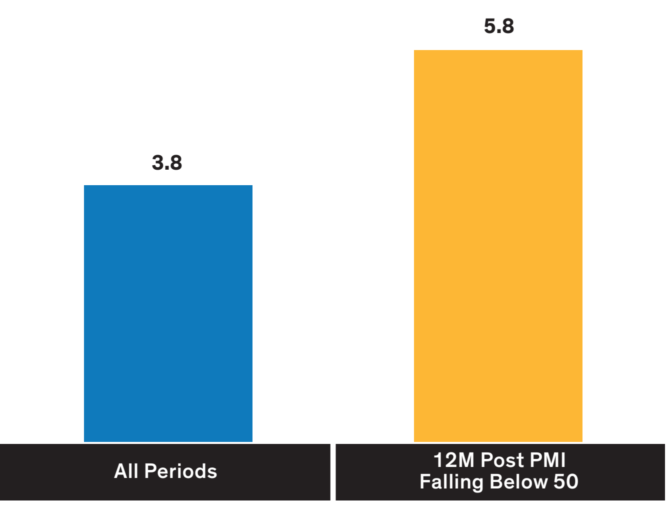
Putting QSP to the Test: Inflation and Recessions

To test the efficacy of our QSP approach, we conducted a historical analysis of performance during periods of macroeconomic stress.

We looked at how QSP stocks performed during different economic environments from 1970 to early 2025, based on the US Manufacturing PMI, a key leading indicator of economic growth. Our research found that QSP stocks outpaced the Russell 1000 Index by 5.8% during periods when the PMI fell below 50, which signals weakening growth (*Display 4*).

DISPLAY 4: QSP FORWARD RETURNS ARE TYPICALLY HIGHER IN WEAK GROWTH ENVIRONMENTS





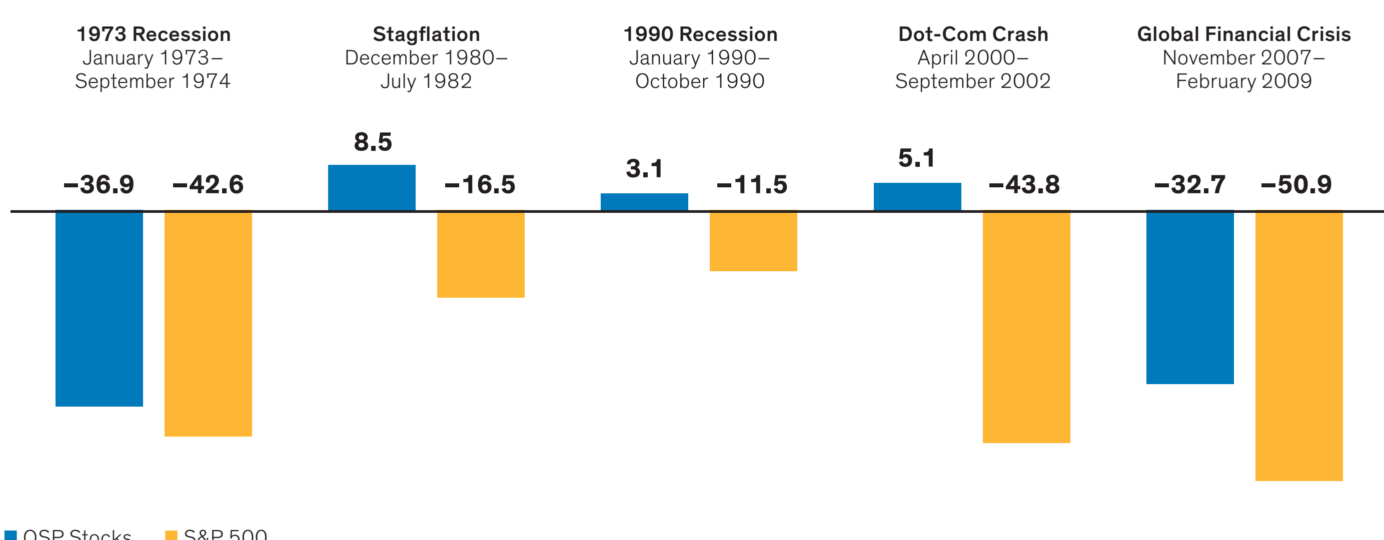
Past performance and current analysis do not guarantee future results.

Left display: Shows PMI for the period from January 1, 1970, through June 30, 2025, and 19 12-month periods after US Manufacturing PMI fell below 50. Right display: Average forward 12-month equally weighted USD returns of QSP stocks with a first-quintile AB QSP score at the start of each month, relative to the equally weighted returns of the universe. The AB QSP score is calculated as follows: [(1/3) Quality {return on assets z score} + (1/3) Stability {– AB Adaptive Beta z score} + (1/3) Price {earnings/price z score}]. Universe is the Russell 1000 (since its inception of January 1, 1984) and the largest 1,000 US stocks in the AB research universe prior to the Russell 1000 inception.
*Relative returns to Russell 1000

As of June 30, 2025 | **Source:** FactSet, IHS Markit, Russell Investments and AB

DISPLAY 5: A RECIPE FOR RISK REDUCTION IN DEEP RECESSION ENVIRONMENTS

Absolute Returns, USD Annualized (Percent)



Past performance does not guarantee future results.

Deep recessions are characterized by durations exceeding two quarters with GDP contractions exceeding 1.5% or a decline of more than 30% in the S&P 500 Index. By this definition, the short recession in 2020 triggered by the COVID-19 pandemic was not a deep recession.

For the period from January 1970 through June 30, 2025. Universe is the US large-cap universe. QSP returns are average cap-weighted returns for stocks with a first-quintile AB QSP score at the start of each month. The AB QSP score is calculated as follows: [(1/3) Quality {return on assets z score} + (1/3) Stability {– AB Adaptive Beta z score} + (1/3) Price {earnings/price z score}].

As of June 30, 2025 | **Source:** S&P Compustat and AB

Zooming in on specific recessions, we found that our universe of QSP stocks did well during different types of economic shocks (*Display 5*). For example, during the stagflation from 1980 to 1982, QSP stocks rose by 8.5% annualized while the S&P 500 fell by 16.5%. And in the global financial crisis, when US equities fell by nearly 51%, QSP stocks declined by 32.7%—cushioning losses during a catastrophic market collapse. We've observed similar trends in global stocks during economic slowdowns and recessions.

Fast forward to 2022, when the historical benefits of the QSP approach were seen during especially traumatic market conditions, as stocks in many regions fell by more than 20% during the year.

Quality on its own fared poorly in 2022, but quality stocks with stability and attractive valuations performed better, while also mitigating risk. This performance differential was particularly striking in the case of technology. Low-volatility strategies that sought to balance risk and return through bottom-up stock selection across traditional defensives—as well as sourcing stability from sectors such as technology, financials and energy—had more levers to pull to manage volatility. We believe dynamic defensive strategies will be especially important if market volatility becomes more prevalent in the coming years (*see* "Will the Future Be More Volatile for Equity Investors?," *page 10*).

Will the Future Be More Volatile for Equity Investors?

After the 2025 tariff shock and the COVID-19 crisis, it's hard to remember just how calm the equity markets were during the 2010s. From a historical perspective, that period looks like an anomaly. We think the fierce bursts of volatility seen between 2020 and 2025 are a sign of the times—and of more to come. That's why we believe strategies that help reduce downside risk should become integral to equity allocations for the future.

Yet even when taking into account the volatility of recent years, global equities have been less volatile in the past decade than they have been over the longer term (*Display*). Our research shows that over the last 10 years, the MSCI World Index has been down only 21% of the time versus 24% of the time from 1986 through 2025.

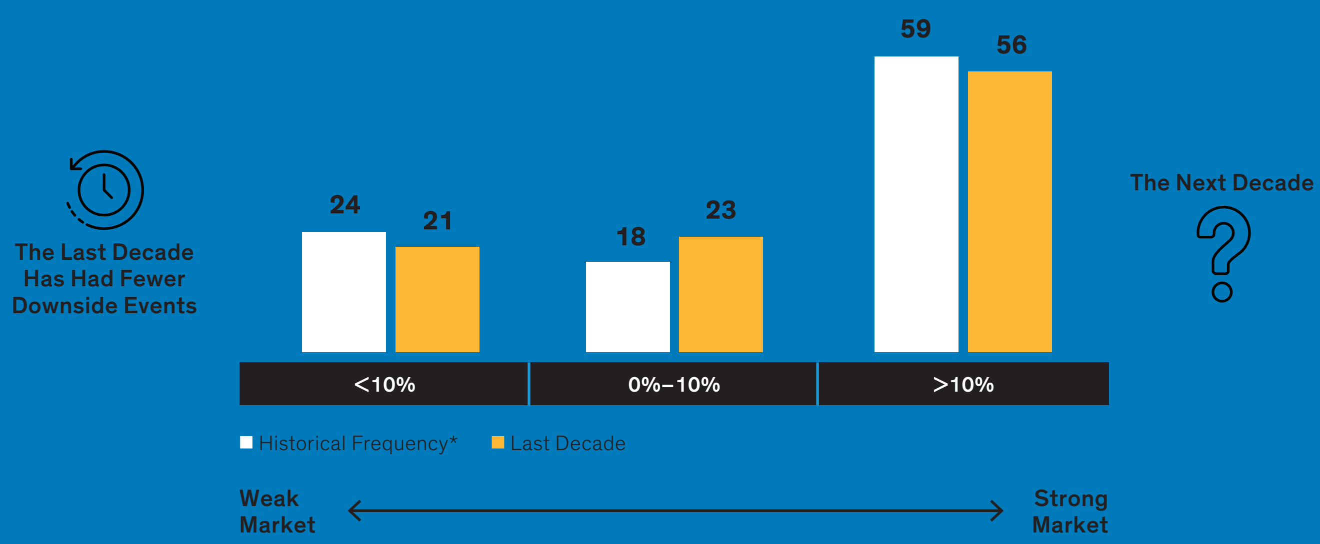
Periods of moderate gains have been practically a mirror image. Over the past decade, 23% of the time, equities have been up by as much as 10%—a historically strong run. Yet big rallies—with gains exceeding 10%—have been slightly less frequent over the past decade than over the longer term.

Nobody knows what the future holds. But given the current macroeconomic and geopolitical stress, it doesn't take a big stretch of the imagination to expect more volatility over the next 10 years than in the recent past—in line with longer-term trends.

EQUITY MARKETS HAVE BEEN RELATIVELY CALM IN RECENT YEARS

Global Stocks (MSCI World)

Frequency of Rolling 12-Month Returns (USD, Percent of Months)



Past performance does not guarantee future results.

Return buckets are based on returns for the MSCI World. Forward 12-month returns are calculated monthly, with the frequency calculated across all months in the period.

***From June 30, 1986 to June 30, 2025**

As of June 30, 2025 | **Source:** MSCI and AB

How to Use Risk Reduction to Lift Returns

In a world of more frequent and acute market volatility, equity strategies with less risk and more stable return patterns can help investors make better strategic decisions in two ways:

1. They prevent the counterproductive tendency of investors to time the market.
2. They free up risk budgets, allowing them to be used for reducing overall portfolio risk or boosting return potential.

Timing the Market Is a Dangerous Tactic

When markets turn unruly, investors may be tempted to rush for the exits. But history teaches us that this response (and most efforts to time the market) tends to be costly. Investors risk locking in losses and missing out on the market's eventual recovery.

That timeless lesson was reinforced in early 2025 (*Display 6*). First, global stocks fell in the first quarter after DeepSeek's AI breakthrough raised concerns about the technology mega-caps. Then, in early April, equities tumbled in response to President Trump's sweeping tariff plans, followed by a rapid recovery after a 90-day pause was announced a week later.

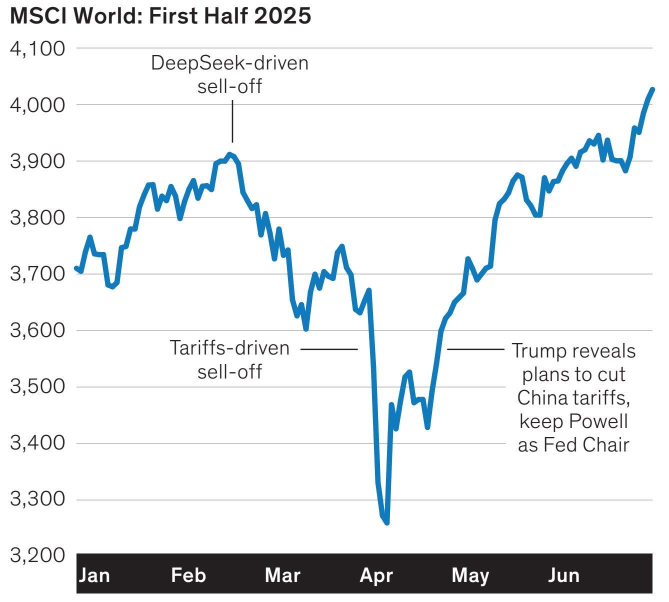
By quarter-end, equities touched record highs. However, excluding the five best days of the recovery, returns were dramatically impaired. For the S&P 500, missing the five best days in the first half of 2025 translated to a 12.1% loss compared with a 6.2% gain for the full period. For non-US stocks, the MSCI EAFE Index returned 2.0% in US-dollar terms, excluding the five best days, versus a 19.4% gain for those who remained invested. These trends echo long-term patterns observed over the last 20 years in equity markets, when missing just five days over each rolling three-year period significantly weakened returns. That's a big price to pay for trying to predict market inflection points, which is extremely difficult to do. With a portfolio that falls less than the market during downturns, the pain of losses during a downturn is reduced, making it easier to stick with an allocation through turbulence.

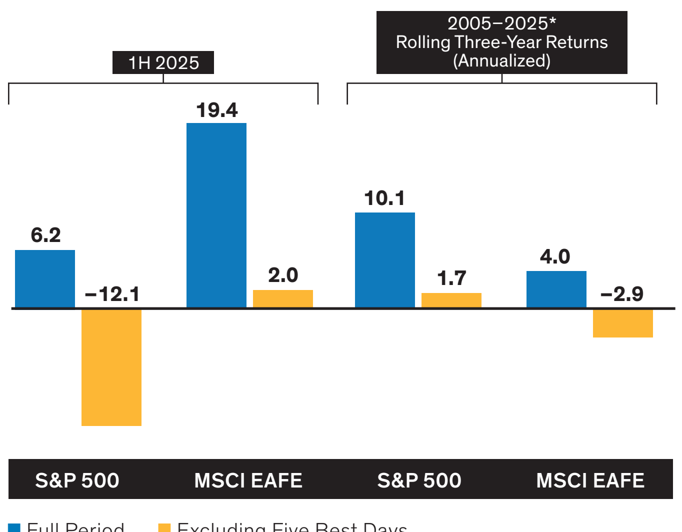
Freeing Up Risk Budgets

Being active doesn't always mean accepting higher risk. Because a QSP strategy tends to work best when other active approaches are less effective, it offers diversifying benefits that can be used as a source of uncorrelated alpha or for more efficient risk budgeting.

To diversify the equity bucket, investors can pair an active QSP-focused low-volatility equity portfolio with other equity strategies, such as a higher-beta, quality growth portfolio. This combination can potentially improve the risk/reward ratio for the overall allocation.

DISPLAY 6: MISSING THE FIVE STRONGEST DAYS IN A MARKET RALLY CAN RUIN RETURNS





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*****Annualized trailing three-year daily returns of the S&P 500 and MSCI EAFE and trailing three-year daily returns where the best five days are excluded are calculated every business day from January 2008 (so trailing three years goes back to January 2005) through the end of June 2025. The average of these returns is then calculated to give the results in the display. MSCI EAFE returns are shown in US-dollar terms.

As of June 30, 2025 | **Source:** FactSet, MSCI, S&P and AB

Investors seeking to reduce risk in their portfolios might be focused on their fixed-income or multi-asset allocations. But if they add a low-volatility equity portfolio to the mix, we believe investors can improve their overall return potential, with only a modest increase in risk. A low-volatility portfolio also offers a low correlation to bonds, which means the overall allocation is positioned to perform in changing market environments.

For many investors, anxiety about losing money is their primary concern after the recent market crises. Traditional diversification and equity-benchmark-sensitive strategies were less effective in limiting losses than investors expected during the 2022 market collapse, when almost all assets fell sharply. Today, with inflation running high and the need to take more risk to meet long-term goals, mitigating losses in falling markets takes on added importance.

Redefining Defense to Boost Confidence

Defensive equity strategies can help reduce volatility through an investment journey, which makes it easier to stay in equities. But they require clear parameters and processes for finding companies that can weather tough environments, along with an open mind to adapt to the changing conditions driving markets.

To harness the full benefits of this strategy, we believe investors must be willing to free themselves from the tyranny of benchmarks and adopt a new way of defining investment success that leans on absolute risk and return potential in the pursuit of long-term goals. In a fast-changing world, an active defensive equity allocation—rooted in research yet capable of adapting to new conditions—may provide investors with the confidence to stick with equities through volatile times and improve long-term outcomes.

Nashville
501 Commerce Street
Nashville, TN 37203
United States
(212) 969 1000

Tokyo
Hibiya Parkfront 14F
2-1-6 Uchisaiwaicho,
Chiyoda-ku
Tokyo, 100-0011, Japan
+81 3 5962 9000

New York
66 Hudson Boulevard East
New York, NY 10001
United States
(212) 969 1000

Toronto
200 Bay Street, North Tower
Suite 1203
Toronto, Ontario M5J 2J2
Canada
(647) 375 2803

London
60 London Wall
London EC2M 5SJ
United Kingdom
+44 20 7470 0100

Sydney
Level 32, Aurora Place
88 Phillip Street
Sydney NSW 2000
Australia
+61 02 9255 1200

Hong Kong
39th Floor, One Island East,
Taikoo Place
18 Westlands Road
Quarry Bay, Hong Kong
+852 2918 7888

Singapore
One Raffles Quay
#27-11 South Tower
Singapore 048583
+65 6230 4600

MSCI World Index: The MSCI World Index is a free float–adjusted market capitalization–weighted index that is designed to measure the equity market performance of developed markets. Since June 2007 the MSCI World Index has consisted of the following 23 developed-market country indices: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the United Kingdom and the United States. The index represents the unhedged performance of the constituent stocks, in US dollars.

MSCI EAFE Index: The MSCI EAFE (Morgan Stanley Capital International Europe, Australasia, Far East Index) is an unmanaged index of over 900 companies, and is a generally accepted benchmark for major overseas markets. Index weightings represent the relative capitalizations of the major overseas markets included in the index on a US dollar–adjusted basis.

S&P 500 Index: The S&P 500 Index is an unmanaged market index generally considered representative of the stock market as a whole. The index focuses on the large-cap segment of the US equities market. It is not possible to invest directly in an unmanaged index.

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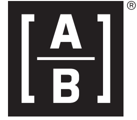

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