AB Sustainable International Thematic Fund

Advisor Class: AWPYX

International markets, as measured by the MSCI All Country World Index (ACWI) ex US, increased by 9.75% during the fourth quarter, bringing full-year returns to 15.62%. During the quarter, fear of higher-for-longer interest rates was replaced by the prospect of easing of financial conditions in what is widely viewed as a “Fed pivot” on the back of disinflation forces.

Similar to 2022, interest rates were once again the dominant driver of equity returns in 2023, but in the other direction. Investors entered the year with anxiety over if, and when, inflation might be tamed, but finished 2023 with the view that global economies are firmly experiencing disinflation and will be able to exit the rate hike cycle without slipping into a recession—achieving a “soft landing.”

The recovery in equity markets this past year was particularly concentrated in the fourth quarter amid greater signs of global disinflation. Eurozone core inflation decelerated further to 3.4% year over year in December, against a backdrop of subdued economic conditions. Purchasing managers’ indices for December softened further into the contractionary territory, and German Ifo Business Climate Survey results were also weak. With the eurozone at risk of another quarter of real gross domestic product (GDP) contraction in the fourth quarter, further tightening from the European Central Bank seems unlikely.

Turning to Asia, Japan continues to enjoy a supportive economic backdrop with positive nominal GDP growth driven by wage growth, benign (but positive) inflation and still loose monetary policy. In China, economic conditions remain weak with no meaningful improvement thus far to the domestic property market. Despite efforts from the central government to signal greater policy support for growth, already depressed investor sentiment took another dip in December when draconian draft rules on video games were published, raising concerns that the government will once again intervene in the country’s technology sector. Although government officials acted swiftly to reassure the market, their inconsistent messaging meant that despite increasing stimulus support global investors have little incentive to step further back into Chinese equities.

Fund Performance

Over the fourth quarter, the AB Sustainable International Thematic Fund increased in absolute terms and outperformed its benchmark, the MSCI ACWI ex US. For the full year, the Fund delivered positive absolute returns but underperformed its benchmark. During the quarter, both stock and sector selection contributed to overall returns. Stock selection within healthcare and an overweight to the technology sector contributed the most. In contrast, an overweight to healthcare and selection within consumer discretionary detracted.

Experian, a global data-services specialist from our Empowerment theme, contributed after shares originally weakened ahead of interim results on the back of a negative surprise from industry peer TransUnion. However, Experian's half-year results and reiterated guidance were welcomed by the market. Experian’s combination of cyclical and countercyclical businesses continued to deliver consistent growth despite a rising interest-rate environment and accompanying uncertainty, which resulted in credit bureau underperformance in 2023.

Chr. Hansen, a leader in the specialty ingredients space (including bacteria cultures, probiotics and enzymes), from our Health theme, contributed amid a strong earnings report driven by volume growth, continued price increases and stable operating expenses. The company experienced meaningful share gains in the quarter and raised its outlook.

Infineon Technologies, a power-management semiconductor company from our Climate theme, contributed. The company offered a resilient growth outlook into 2024, driven by secular tailwinds (renewables and electric vehicles [EVs]) in the face of increased investor skepticism. The company has extensive exposure to EVs in China, which continue to exhibit strong market adoption.

BYD, an EV manufacturer from our Climate theme, detracted. Shares declined along with Chinese EV peers on recent pricing promotions into the end of the calendar year as the company looks to shed some inventory, which has been slightly above average. We remain optimistic on BYD's growth and profitability profile given its well-documented cost advantage and the increasing contribution from its premium brands and exports.

Alcon, an eye-care product maker from our Health theme, detracted after the company reported mixed earnings results and trimmed the high end of its guidance, citing foreign exchange headwinds and weaker surgical segment results.

Unilever, a personal care company from our Health theme, detracted as volume remained soft while price growth also slowed. In response, the company's new CEO presented a 10-point action plan to improve performance and the stock's total shareholder return, with a particular focus on intensely supporting fewer big brands. We believe this strategy should lead to better execution and are optimistic on the name going forward.

Thematic Check: "Alive and Well"

Amid all the noise, our themes continue to move forward as broad shifts in the global economy run their course. Global challenges such as access to healthcare and infrastructure needs are not solved overnight. Entering the year with a more defensive mindset did not help; however, our core thematic exposures continue to offer robust growth potential.

We believe a portfolio with high-quality companies on the right side of change, trading at reasonable valuations, provides a strong combination for the current market environment. Resilient fundamentals and narrow leadership in the market have created a powerful setup for a group of companies that fit this profile.

Within information, communication and technologies, the latest earnings results from a number of leaders like NVIDIA, AMD and the cloud providers demonstrate that society's move toward intelligent digital economies is leading to increased demand for bigger networks, more powerful and energy efficient data centers, and new consumption models. We continue to expect the key AI enablers—companies that facilitate the training and running of AI models in an energy-efficient way—and the adopters that successfully integrate AI in their applications will enjoy strong tailwinds in the near term.

Within transportation, secular shifts in automotives continue—EV global sales rose more than 50% through September 2023 versus 63% growth in 2022. EV adoption continues to grow, but it will not be a straight line. Additionally, automotive original equipment manufacturer (OEM) stocks are still in a discovery phase, learning what features have the greatest appeal with consumers. As with our other themes, our focus on the enablers of vehicle electrification is driving an earnings tailwind despite OEM-specific challenges. Every EV rolling off the line contains significantly more electronic content, benefiting suppliers in this ecosystem. We're also seeing a standardization of charging standards in the US, which should encourage further adoption.

In our Health theme, there have been a few dynamics at play in 2023. A lot of the diagnostic and testing companies benefited from robust demand during the early days of COVID. Lead time to get products significantly increased, so customers ordered more to ensure supply. In 2023, we saw the reverse as lead times decreased. We are going through a period of inventory digestion (for life sciences and diagnostic tools particularly) along with macroeconomic weakness in China—a double whammy of sorts for suppliers into this ecosystem. The underlying growth rate of their customers (biopharmaceutical production) remains in the double digits. The market enthusiasm around weight loss has also drawn investor attention and buying activity, further depressing valuations for companies outside this group. We expect 2024 should see an improvement in inventory profiles and growth rates for suppliers of medical innovation products as well.

As Ben Graham said, “In the short run, the market is a voting machine but in the long run it is a weighing machine.” Rather than chasing the market’s chosen few, our focus continues to be on identifying powerful themes and the companies best positioned to capitalize on these opportunities. This approach has delivered strong results for our clients over time and we are highly confident in its ability to do so in the future.

As always, thank you for your continued support.

Dan Roarty

Top Ten Holdings*	Fund %
Partners Group	3.75
BYD	3.46
Veralto	3.09
London Stock Exchange	2.94
Accenture	2.92
Danone	2.91
Deutsche Börse	2.79
ICON	2.79
SMC	2.64
Autoliv	2.61

Please refer to the following legal disclosures.

*Based on a representative account as of 12/31/23. Holdings, characteristics and weightings (which are equity only weightings and excluding cash) will vary over time. They are provided for informational purposes only and should not be deemed as a recommendation to buy or sell the securities mentioned.

A WORD ABOUT RISK

Market Risk: The market values of the portfolio's holdings rise and fall from day to day, so investments may lose value. **Foreign (Non-US) Risk:** Non-US securities may be more volatile because of political, regulatory, market and economic uncertainties associated with such securities. Fluctuations in currency exchange rates may negatively affect the value of the investment or reduce returns. These risks are magnified in emerging or developing markets. **Capitalization Size Risk (Small/Mid):** Small-and mid-cap stocks are often more volatile than large-cap stocks—smaller companies generally face higher risks due to their limited product lines, markets and financial resources. **Derivatives Risk:** Investing in derivative instruments such as options, futures, forwards or swaps can be riskier than traditional investments, and may be more volatile, especially in a down market. **ESG Risk:** Applying ESG and sustainability criteria to the investment process may exclude securities of certain issuers for nonfinancial reasons and, therefore, the Fund may forgo some market opportunities available to funds that do not use ESG or sustainability criteria.

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The Morgan Stanley Capital International All Country World ("MSCI ACWI") ex-USA Index is a free float-adjusted market capitalization composed of about 2,000 securities across 47 developed and emerging market country indices. The index measures equity market performance in the global developed and emerging markets..

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