- 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.
- The markets have been in state of free gains for a long time and a perception that these pillars that we've talked about for years, stronger growth, lower levels of inflation, accommodative policy, macro economy turning toward positive for whole world from synchronized perspective – that was all great and supportive. And it is.
- But as we've also talked about for a long time with the Beta Trade and After the Beta Trade, there's also this juxtaposition against a world that's been driven by the low level of volatility and the belief by markets that things would be sort of smooth sailing.
- So whenever the market has to adjust to that way of thinking, that volatility is going to be real. That maybe the pace of rate increases will be faster than they think. That's going to flow through directly to markets.

1Q 2018 Returns Recap: Goldilocks Challenged?

Returns in US Dollars

As of March 31, 2018

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.

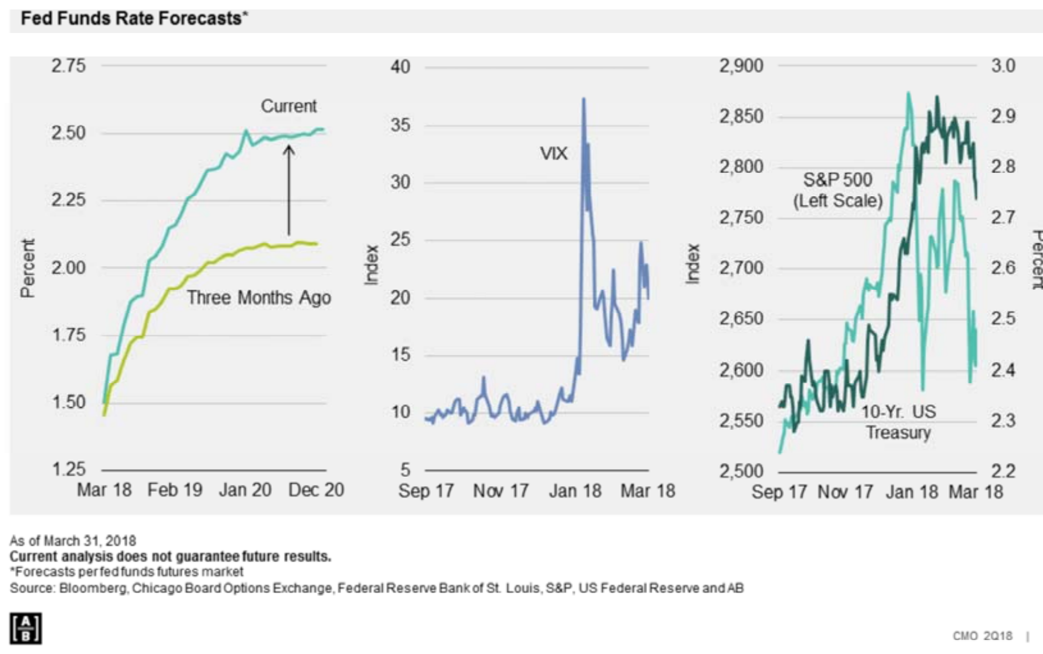
*Europe, Australasia and the Far East

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

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

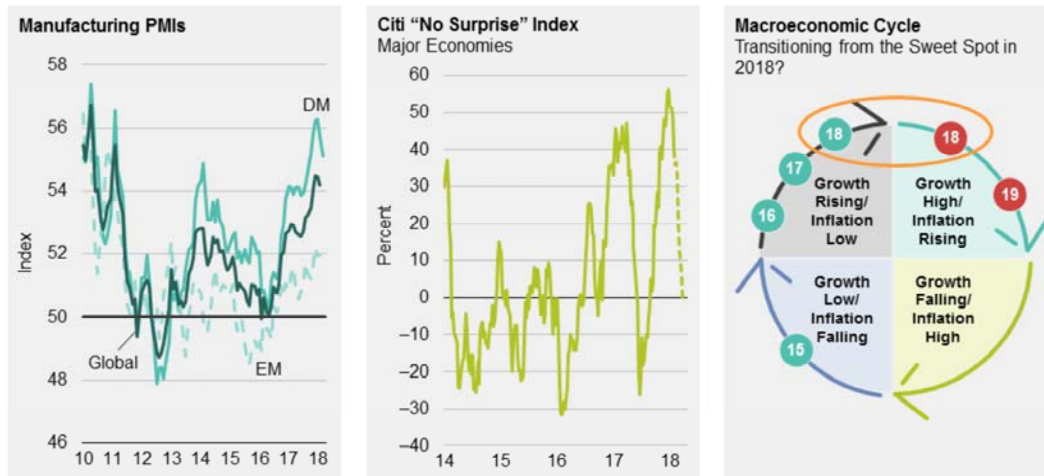
- From a broad performance perspective, we know that risk assets in much of the world were negative in the first quarter in much of the developed world. You can see emerging markets were positive and likewise in the United States with yield increases, high grade was also negative.
- We've been talking a lot about tariffs and policy in the backend of the quarter, into the second quarter. But really, the catalyst was a wage revision that leads to the expectation that inflation can rise more quickly, which leads to the idea that the Fed might have to raise rates more quickly, which then causes volatility to rise, which in turn nuked a bunch of the short VIX strategies and also obviously flows through to difficulties in markets.

When Markets Adjust to the Fed's Way of Thinking



- What this slide is saying is when the market hits had to adjust to the Fed's way of thinking, we've gotten volatility and challenge markets.
- And again that's because so much of the Beta Trade was driven by policy that the idea that it might be removed faster or become less accommodative more quickly is what really tends to drive things.
- So we see on slide two a change over a three-month period in the market's expectation of the path of the Fed funds rates. You can see that big jump. And yes, the catalyst might have been a higher wage number because everybody's had their inflation. But inflation really flows through to what's the path of rates.
- Going along with that increase in expectations for rates, and we see the big jump in VIX. We see the challenges in the S&P 500. And keep in mind treasury yields did have a pop in the first part this year.
- But the increase in 10-year Treasury yields has really been a post-tax plan passage development that this more or less continued. So you can see the roots of the increase in yields and treasuries going back to a time when the S&P continued to climb in the face of a tax cut. So that's an important thing to note from a fiscal perspective.
- So let's revisit the pillar of growth and inflation.

Growth Strong (if Peaking), but Also Consensus; Inflation Is the Variable

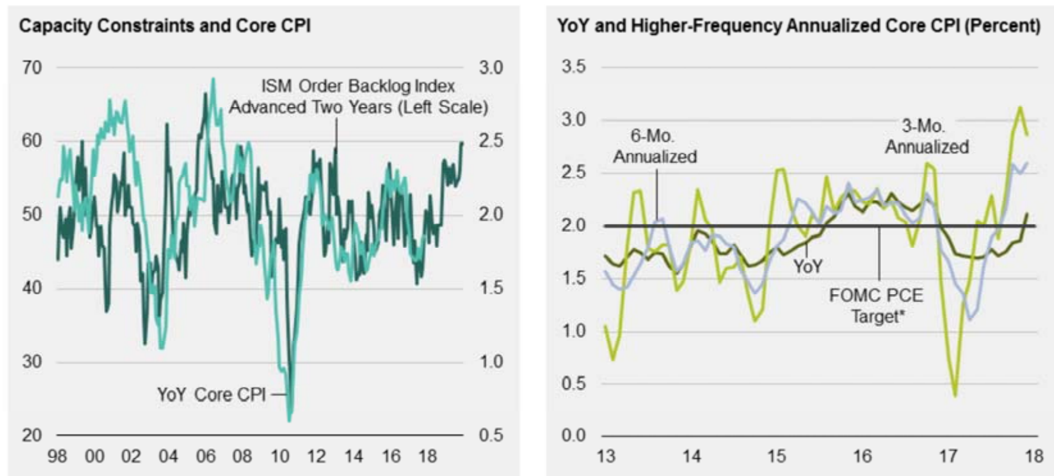


Left and right displays as of March 31, 2018; middle display as of March 23, 2018
Historical analysis and current forecasts do not guarantee future results.
DM: developed markets. EM: emerging markets
Source: Citigroup, Haver Analytics, IHS Markit and AB

CMO 2Q18 | 3

- Growth continues to be solid. And manufacturing PMIs have come down a little bit but still remain strongly in expansive territory.
- And that leads to the idea that the economies of the world in – particularly in developed markets - continue to be strong but somewhat peaking.
- So maybe one way to look at that and something that our economics team has shown is the Citi Surprise Index. Basically, this is an index that shows when results in major economic are stronger or weaker than consensus. So positive surprises tend to bode well for markets. Negative surprises tend to be negative for markets. So we call it jokingly the "no surprise" index because basically what this is saying is that consensus is winning right now.
- If you look in the right chart, for lack of a better term "moving the clock from before midnight to after midnight" isn't about growth. Notice that growth rising and growth high are both there on the green '18 and the red '18. What changes is the level of inflation. That continues to be the lynchpin.
- So we can keep having solid growth. But what we're flagging and what much of the market is very much aware of is what's the path of inflation, which in turn is a path of rates.

Inflation Remains Low Today, but Is Rising...



As of March 31, 2018

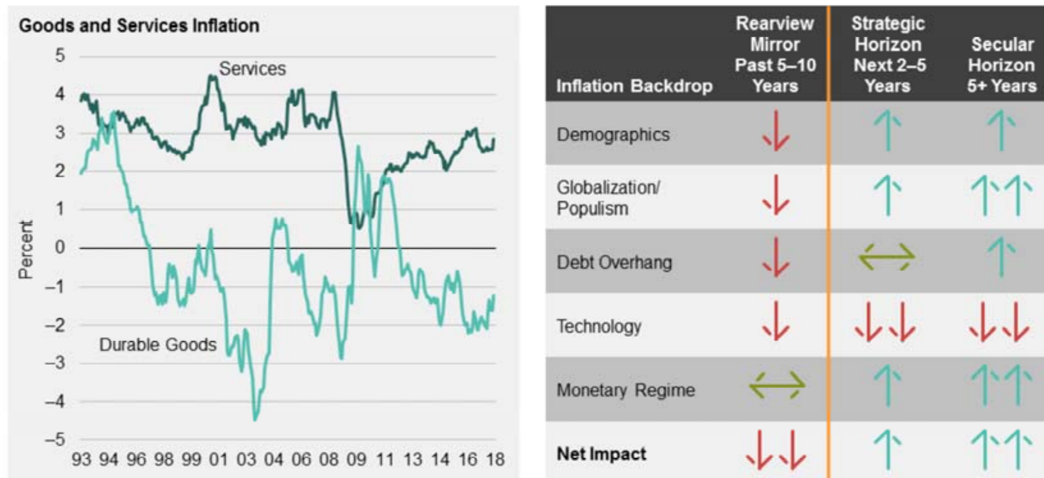
Historical analysis and current forecasts do not guarantee future results.

*FOMC: Federal Open Market Committee; PCE: personal consumption expenditures

Source: Haver Analytics, IHS Markit, Institute for Supply Management, Thomson Reuters Datastream, US Federal Reserve and AB

+ There are some fundamental drivers of inflation. And then there are some policy-based drivers of inflation, one of which we talked quite a bit about last quarter. First, fundamental.
+ We talked about PMI being really solid in the world and solid in United States. But as reminder, the PMI is a diffusion index, so when you see a number of 50, it means roughly neutral. The diffusion index tells you directionality, but it doesn't show magnitude. But it's extremely helpful as a leading indicator for growth and for other things because there are subcomponents in the ISM. And a couple of them are nice harbingers of inflationary pressures.
+ One of them is supplier delivery and another example is the order backlog index. And both of those have a pretty good relationship to core CPI, which you see on the left side chart. So we're seeing that with the order backlog index little above 60, and the supplier side as well is sitting right around 60. So both of those tell you that there is difficulty getting to product. And that tends to flow through the core CPI.
+ We're already seeing the fruits of that if you will, because for first time in some time, 3 months, 6 months and 12 months annualized core inflation are running above two, which you can see on the right side chart. This is not core PCE, which is the Fed's preferred measure, which is still running a little bit below two. But it does speak again to the idea that those inflationary pressures the Fed spoken about fundamentally are evidencing themselves. And that's going to flow through to policy.

...and Geopolitical/Structural Forces Are Present

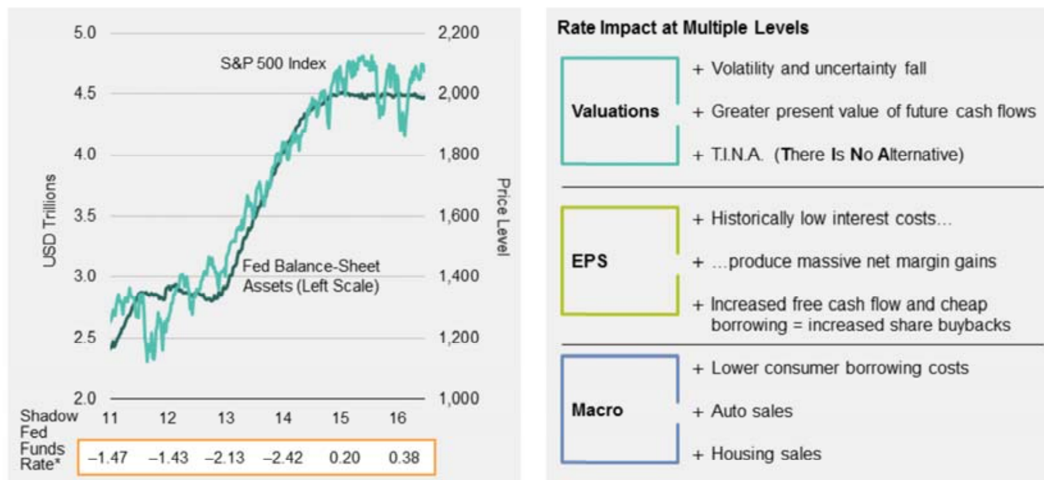


As of March 31, 2018
Historical analysis and current forecasts do not guarantee future results.
Source: Haver Analytics, IHS Markit, Thomson Reuters Datastream and AB

- From a not so fundamental but more policy perspective, this slide reminds us that there are other drivers of inflation. Another way to cut inflation is whether it’s coming from services or durable goods. And remember, most of the U.S. economy is services.
- Inflation has been running about or just under [what?] for a little while. But durable goods is the area where we’ve had deflation. And that speaks a little bit to the right side visual around technological deflation and globalization and the other pressures that keep prices low.
- But then you want to ask yourself “what happens if tariffs come into play?” They do become more meaningful. And we get into something that resembles a trade war because it’s the durable good side that’s been dragging in terms of inflation that would get hit by any change in trade policy and by anything as far as the impact of tariffs.
- So we have to keep a look from a policy perspective on what that will do to durable goods prices, which again thus far have been disinflationary to deflationary.
- The right hand chart displays the present and future pressures. They’re going to come from things like demographics, globalization, populism and trade policy. Tariffs are just one example of that. And we see the tide shifting to upward pressure on inflation because of policy, because of the demographic backdrop. In other words, today, we have to think about fundamental pressures, but we also have to keep an eye on policy pressures today and in the future as we move through the coming years.

Great Beta Trade Was Dominated by Rates…

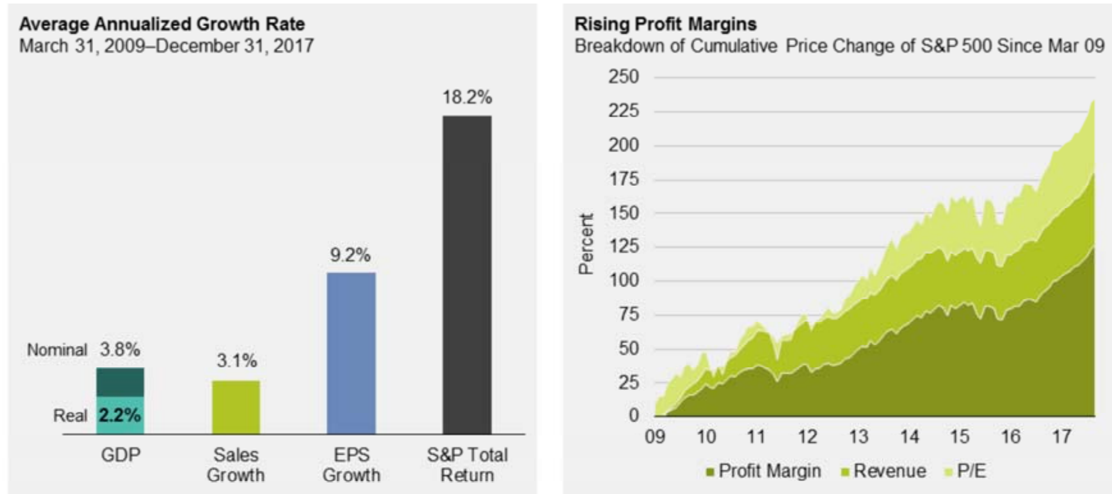
...and the Asset Purchases Used to Create Them



Left display from October 1, 2011 through June 15, 2016; right display as of March 31, 2018
Past performance and historical analysis does not guarantee future results. For illustrative purposes only
*Shadow fed funds rate as of year-end
Source: Bloomberg, Federal Reserve Bank of Atlanta, Federal Reserve Bank of St. Louis and S&P

+ The left hand chart is a reminder that inflation in many respects is just an indicator of the directionality of Fed policy or other central bank policy in rates. When central bank balance sheets explode, it's going to drive markets up all things being equal.
+ On the bottom, we have the shadow Fed funds rate, which was something put out by a central back writer to try to take not just the Fed funds rate, which was sitting at zero, but also add to that the effect of rate impact of all of that balance sheet activity. And what they found was that the effective Fed funds rate was significantly negative. You can see it climbing until basically we start to taper or stop purchasing bonds. So when you have a negative effect Fed funds rate, you're going to drive all sorts of fascinating things. And all of it ends up being because of rates.
+ Nearly everything that we've seen over the past decade or so in markets and macroeconomics is because of rates. And on the right, we capture some of those.
+ So again, if you take rates down to historically low levels you're going to drop volatility, you're going to drop uncertainty, the present value of cash flow goes up. And finally, you wipe out the competition to equity risk premiums, create a big gap between them, and you get TINA (There Is No Alternative).
+ From an earnings perspective, incredibly low interest cost produced massive net margin gains almost primary driven through corporate refi. So you get massive net margin gains. And then of course from all that free cash flow produced by massive net margin gains because rates are low, you get free cash flow. Also, you've got cheap borrowing because rates are low. And that flows through to that story of increased share buyback.
+ And then in the macro economy: Drop rates and you're going to lower the cost of borrowing. You can spur economic activity. And we saw that in the way of auto sales and housing activity.
+ All of these things meaningfully impact markets.

Equity Gains Driven by Beta Trade, Not Top-Line or Economic Growth



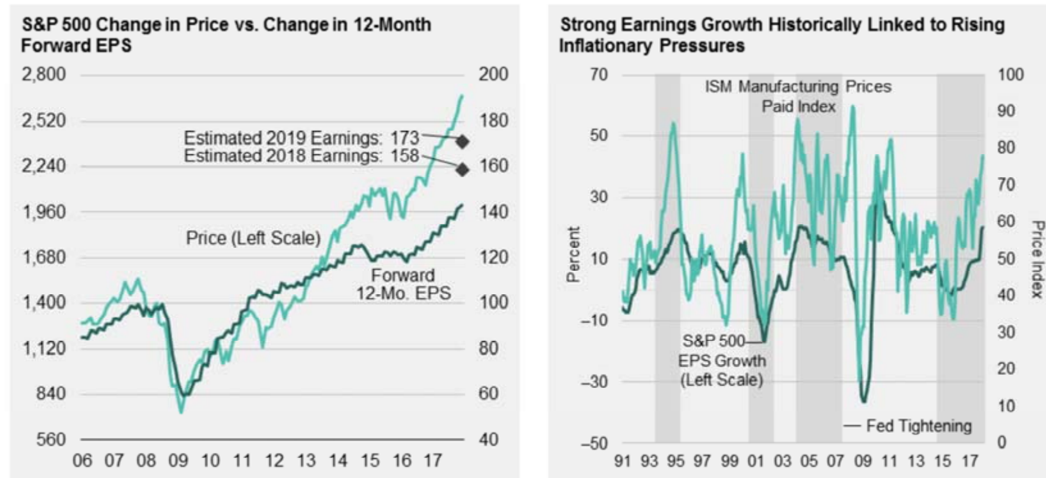
As of December 31, 2017

Current analysis does not guarantee future results.

Source: Bloomberg, Bureau of Economic Analysis, FactSet, Federal Reserve Bank of St. Louis, S&P, Wall Street Journal and AB

+ What it means in terms of categorizing or quantifying the impact is that you've got real GDP running in the low twos, and nominally about four.
+ Sales growth, which historically has been the driver of earnings growth in the United States, has also been around four.
+ But look at EPS growth running about 450 basis points higher per year for almost a decade.
+ And then valuations show up in the further gap in the return of the S&P 500.
+ The chart on the right first appeared in "The Wall Street Journal." We have borrowed that. And you can see that it's net margin gains and valuations that drove almost the entirety of gains in the S&P 500.
+ So going forward, it's got to be about topline growth. And this is why: This is a way to quantify how significant the impact of rates on driving things like net margins and valuations has been.

Lower Equity Prices/Higher Earnings Estimates Have Improved Valuations...



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, Cornerstone Macro, FactSet, Goldman Sachs, Institute for Supply Management, Robert J. Shiller, S&P and AB

CMO 2Q18 | 8

- We've talked about the Beta Trade in effect prepaying you market returns in the present on a promise of returns in the future.
- The chart on the left relates the price level of the S&P to forward earnings. What we've got is the lines run through 12/31 and then we've added in the 3/31 diamonds of the 2018 and 2019 earnings estimates, very strong earnings estimates. The S&P is not that far off from where it was at the end of December 31st.
- Price to earnings is getting better. Valuations are getting more reasonable, not so much on the back of big drops in the S&P. We've just seen a modest decline. But really it's the drive at earnings and a lot of that coming from the boost that the tax plan is giving. But you still have a reasonable gap between the level of prices and earnings.
- Now, there's a "be careful what you wish for" element on the right side chart, which is historically, at a corporate level, if you've got strong earnings growth, then that shows up in manufacturing prices paid, another part of the ISM survey that we've talked about earlier.
- So historically, you get great earnings growth. Not surprisingly, you should also tend to see inflationary pressures. And with that, you should also see Fed tightening. And you see a little bit of that in the shaded bars. But an easier way to look at is the next slide.

...but Rising Rates Have Historically Reduced Valuations

Rising Inflationary Pressures Have Led to Fed Tightening and P/E Contraction

Period	1/31/94–2/28/95	5/31/99–5/31/00	5/31/00–7/31/06	12/16/15–3/31/18
Begin	14.9×	23.5×	16.5×	17.6×
End	12.6×	22.2×	14.0×	16.9×
Change	**–2.3**	**–1.3**	**–2.5**	**–0.7**

Average change in P/E over the last four Fed tightening cycles: **1.7 P/E Points**

P/Es have actually declined in **8 of the past 8** Fed tightening cycles

P/E Multiples and Interest Rates Since 1978*

As of March 31, 2018

Past performance, historical analysis and current forecasts do not guarantee future results.

*Forward P/E multiples represent earnings estimates for the next 12 months. Display trend line is for January 1, 1978 through December 31, 2007.

Source: Bloomberg, Cornerstone Macro, FactSet, MSCI, S&P and AB

- The key point is that valuation metric again, valuations in the index.
- And historically, as we get into stronger earnings and then we get rising inflationary pressures and then you get Fed tightening, you do to get contraction in multiples. And you should expect that.
- Just as the Beta Trade takes rates low and helps to maximize valuations, a reversal with fortunes should have the opposite impact on valuations. And that's what it has meant historically. And it's not just about the Fed rate levels, not just about policy rates.
- On the right hand side, we show 10-year Treasury yields and the relationship between increasing rates and valuations. And again, the picture is as rates rise. So let's get away from inflation. Let's get away from policy rates and simply say it this way: As rates go up, historically, it tends to compress valuations. And so again, that's something we have to watch in markets against the backdrop of stronger earnings growth. And earnings growth, of course, is supposed to relate to economic growth. So let's talk about growth.

2018–2019 DM Macro View: Reduced Growth and Higher Inflation/Rates

Federal Funds Rate Expectations

FOMC and Market Expectations for the Fed Funds Rate*

FOMC March 2018 Forecasts

	2018	2019	2020	Long Run
Change in real GDP, 4Q to 4Q	2.7	2.4	2.0	1.8
Unemployment rate, 4Q	3.8	3.6	3.6	4.5
PCE Inflation, 4Q to 4Q†	1.9	2.0	2.1	2.0

AB Global Economic Forecast: April 2018

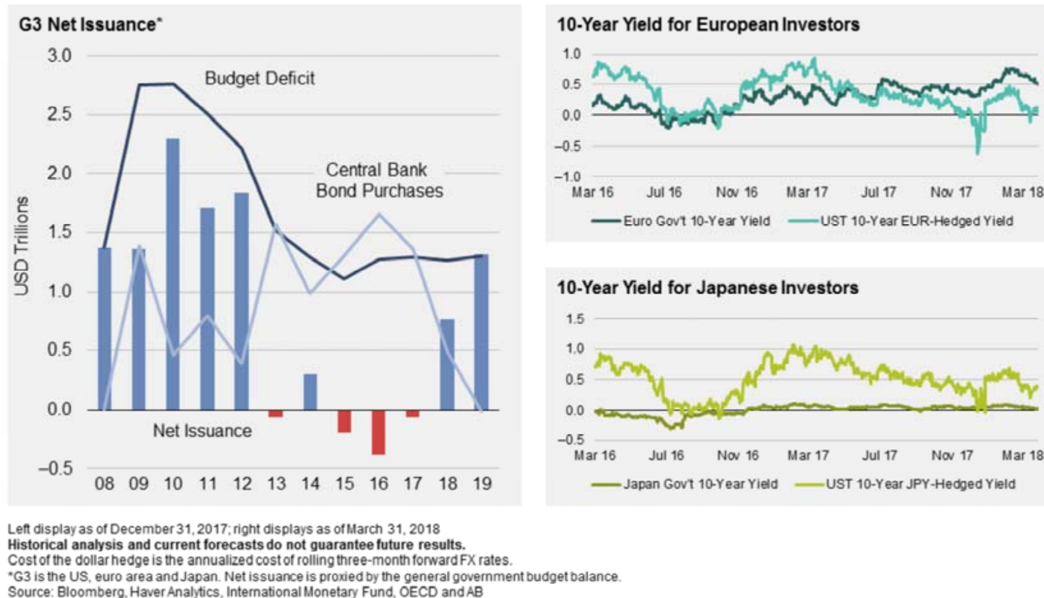
	Real Growth (%)		Inflation (%)		Official Rates (%)		Long Rates (%)	
	18F	19F	18F	19F	18F	19F	18F	19F
Global	3.3	3.1	2.6	2.7	2.5	2.8	3.5	3.8
Industrial Countries	2.4	2.0	1.9	2.0	1.3	1.7	2.3	2.7
Emerging Countries	4.9	4.8	3.9	3.8	4.8	4.9	5.8	5.8
US	2.3	1.8	2.3	2.3	2.4	2.9	3.3	3.5
Euro Area	2.8	2.5	1.4	1.8	0.0	0.5	1.5	2.3
UK	1.8	1.5	2.3	2.0	1.0	1.3	2.3	2.8
Japan	1.6	1.4	1.4	1.8	-0.1	0.0	0.1	0.3
China	6.5	6.3	2.3	2.6	3.1	3.2	4.0	4.2

As of March 31, 2018

Historical analysis and current forecasts do not guarantee future results. Expectations for federal funds rate are for December 2018 and December 2019. The projections for the federal funds rate are the value of the midpoint of the projected appropriate target range for the federal funds rate or the projected appropriate target level for the federal funds rate at the end of the specific calendar year or over the longer run. Long-run rates are 10-year yields unless otherwise noted. *FOMC: Federal Open Market Committee; market expectations are the federal funds rate priced into the Fed futures market as of March 21, 2018 FOMC meeting date. †PCE: personal consumption expenditures

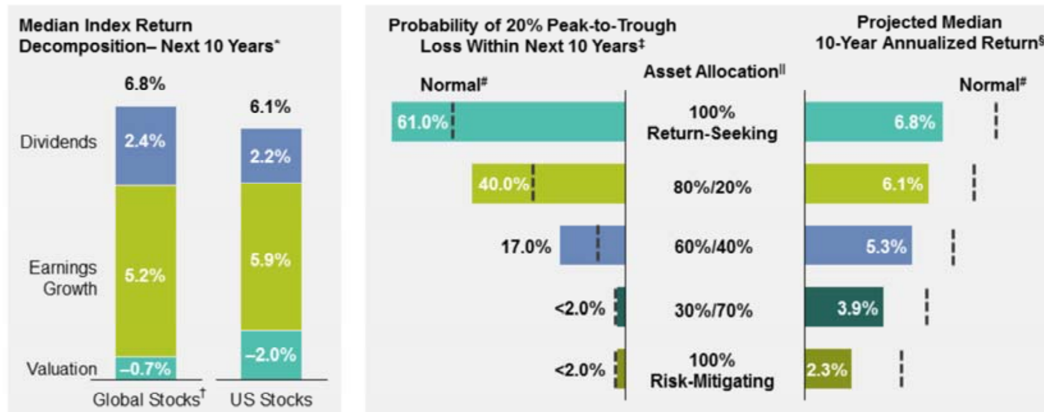
Source: Bloomberg, US Federal Reserve and AB

- On the left, we've revisited the path of rates. We've updated it with the FOMC's expectations. But I want to flag something here, and it goes back to this notion of solid growth but perhaps peaking through 2018.
- Look at the right side, at the industrial countries. Now imagine I said to you that the backdrop from a macro and policy perspective through 2018 and into 2019, the end of next year will be the following: growth will be weaker in developed countries, inflation will be higher, short rates will be higher and long rates will be higher. What would you think of in terms of the market backdrop? The idea is, of course, that again things are going to get a bit more challenged. And it does mean that it – driven from a macroeconomic perspective, we have to think in terms of idiosyncratic choices and thinking about the winners.
- So just as we talked about earlier, still good growth this year, still very solid growth expected next year. But a lot of economies are running hot in the developed world. They're running growth higher than their potential growth rate suggest that they should. And so we would view it as healthy that growth would normalize a bit and start to come back towards its averages.
- But again, from a market perspective, it's supportive from a growth perspective. We got higher inflation, we've got higher rates. And we've just talked about what rates do to valuations and generally what they can do to markets. And so again, it means we have to become far more selective.



+ Just to add a little bit to the concern, I talked about policy earlier and its impact on inflation. There are other factors that affect yields. It's not just about inflation goes up, yields in general go up.
+ It's also the idea that we've got supply demand factors. The Fed is reducing its balance sheet. We see this on the left hand chart: The effective amount of bond issue that the world will have to absorb when central banks are rising, positive for the first time in a handful of years, this year and growing more in 2019.
+ Add to that in the United States the budget deficit that's been moving upward because of the tax plan and the spending plan. And it means that not only will markets have to absorb the supply that central banks are not. But they're going to have to eat more of it.
+ And remember that these buyers are price sensitive. Central banks are not when they're trying to affect policy. The rate level will matter to a lot of buyers.
+ Speaking of rate level, the right side also speaks to supply and demand. If you're in Europe or you're in Japan, your yields are really low. You'll look to the U.S. where yields were higher. You buy a 10-year Treasury, but you don't want the currency risk. So you hedge it back to the euro or to the yen. And that still has left you with a pretty positive yield spread. So there's a lot of buying there.
+ But as rates have gone up in the U.S. the cost of hedging has increased. And as a cost of hedging has increased, the gap between hedged yields for European investor buying treasuries and simply buying bonds has compressed meaningful. Same thing for JGB investors or for traditional Japanese Government Bond investors versus buying treasuries. Translation, there is less fundamental reason for places like Europe and Japan to buy treasuries because of the yield gap. Now, there's still a bit of a yield gap. But remember they also have to factor in that the Feds are expected to keep going whereas Europe is expected to hold for some time longer.
+ So the supply/demand element and what that would mean for rates is also turning back against the U.S. So we have to be very mindful of what that means for rates in general and what it means for return.

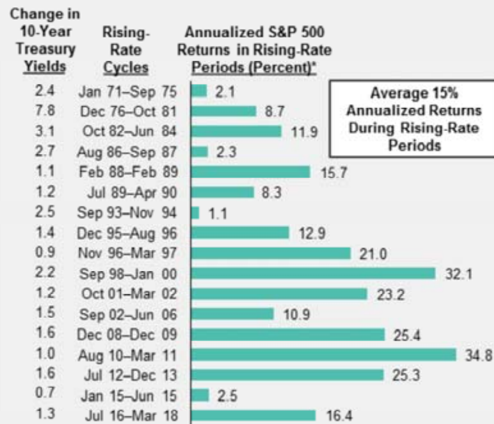
The Risk/Return Trade-Off Is More Important than Ever



Past performance is not necessarily indicative of future results. There is no guarantee that any estimates or forecasts will be realized.
Left display as of December 31, 2017; right display as of June 30, 2017. Based on AB's estimates of the range of returns for the applicable capital markets.
The forecasted figures in the left display utilize book-value growth and price-to-book valuations as representations of earnings growth and valuation. Data do not represent past performance and are not a promise of actual future results or a range of future results. Based on proprietary AB forecasting system. *Represents projected median compound annual growth rates over the next 10 years. †Global stocks are modeled as 18% US diversified, 18% US value, 18% US growth, 6% US small-/mid-cap, 30% developed international, and 10% emerging markets. ‡Probability of a 20% peak-to-trough decline in pretax, pre-cash-flow cumulative returns within the next 10 years. Because the AB system uses annual capital-market returns, the probability of peak-to-trough losses measured on a more frequent basis (such as daily or monthly) may be understated. The probabilities depicted above include an upward adjustment intended to account for the incidence of peak-to-trough losses that do not last an exact number of years. §Represents projected median compound annual growth rates over the next 10 years. ||100% risk-mitigating allocation is all bonds; 30%/70% allocation is 30% stocks/70% bonds; 60%/40% allocation is 60% stocks/40% bonds; 80%/20% allocation is 80% stocks/20% bonds; and 100% return-seeking allocation is all stocks. #Normal conditions reflect AB's estimates of equilibrium capital-market conditions, which are typically close to a very long-term historical average.
Source: AB

- In summary, this is why we talk so much about "Building a Better Path."
- You've heard us talk for a long time about 5.5-6.5% U.S. equity returns. This is our wealth forecasting of the capital markets engine, which takes a lot of fundamental inputs and puts them into an algorithm model and then spits out expected returns over a period of time in the future. Here's 10 years on the left, both global and U.S. stocks.
- Look at the U.S. on the right, good earnings growth, dividends being paid but valuations being reduced. Interestingly, it's close to that 2% compression number that we showed earlier. And that's right in the middle of that 5.5-6.5% that we've talked about for some time.
- Same phenomenon generally on the global stock side. But we have less of valuation impression, because of where valuations are in other parts of the world outside the United States. But it still puts us in that 5.5-6.5%, or 6-7% globally. And if you then look at the chart on the right hand side, now start adding bonds to create an 80-20 or 60-40 allocation.
- And what you'll notice is that the expected returns over the next 10 years are solid just as we've talked about but well below normal, again a consequence in large part because of a level of yields and the level of valuations and where we sort of see growth going forward and the limited ability of net margins to contribute.
- But the "Build a Better Path" side is really the left side of that chart. This is a probability of a 20% peak to trough loss within the next 10 years. And what you see again is that while expected returns are well below average, the probability of a big drop is way above average.
- So from a portfolio construction perspective, what all of this should add up to is that Goldilocks is challenged. We still got a good growth and low inflation. But growth is sort of peaking, expected to be lower next year. Inflation is rising. Rates are expected to be higher. And because of where we are with valuations and expectation for returns, you've got less upside relative to history and more downside relative to history. And so the choices we make idiosyncratically and the importance of controlling the path of returns is critical.

Rising Rates Often Do Not Derail Equities, but Sectors Can Matter



Sector Relative Performance During Past Three Rising-Rate Tantrums (Percent)†

Sector	Taper Tantrum	Tightening Tantrum	Tax-Cut Tantrum
Financials	6.2	23.5	6.6
Cons. Disc.	5.5	(2.1)	5.3
Technology	3.7	11.6	6.1
Industrials	9.3	2.2	1.2
Telecom	–19.7	–18.4	–6.7
Cons. Staples	–10.1	–12.4	–11.1
Real Estate	–24.7	–20.2	–11.5
Utilities	–20.6	–15.6	–13.5
10-Year UST Note Yield Change	+138 b.p.	+125 b.p.	+70 b.p.

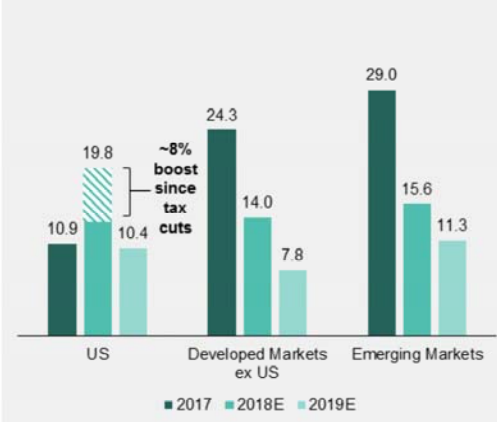
As of March 31, 2018
Past performance and historical analysis do not guarantee future results.
*Based on peak-to-trough rate cycles for the corresponding periods of S&P 500. Rising-rate environments are defined as periods during which the 10-year US Treasury yield rose by more than 70 basis points.
†Taper tantrum is from May 1, 2013, to December 31, 2013; tightening tantrum is from July 5, 2016, to March 13, 2017; tax-cut tantrum is from September 7, 2017 to March 31, 2018.
Source: Bloomberg, Bloomberg Barclays, Ned Davis Research, S&P and AB

- Moving on to equities, on the left hand side, we're showing various periods of time where you saw interest rates rising. And again, just because rates are rising, it doesn't mean that's debt to equities.
- True multiples are likely to be challenged. But with an improving economy, with rates going up, that means corporate profitability is going up. And if you could identify those companies that can deliver that, that's going to reward your investors over time.
- The right hand table is showing that not all sectors are created equal. Here, we took a different cut at this. We looked at three different tantrums: the taper tantrum, which is back in May of 2013 through the end of that year. The tightening tantrum, which goes from really where the tightening started in earnest about July in 2016 through March of last year. And then the tax cut tantrum, meaning that if we're going to cut taxes that should be economic growth and raise interest rates.
- And you can see that things such as financials to technology and industrials, the top four sectors, each one of those spaces on a percentage basis did pretty well in terms of their performance. The bottom four – including utilities, staples and telecom - didn't fare so well. And you can see in each column the 10-year note in terms of the yield change. The yields went up. And you can see the headwinds to those sectors.
- So again going back to that keyword, selective, not all these sectors are created equal.

Improved 2018 Earnings Outlook Supports Near-Term Valuation Picture

Equity Valuations More Reasonable

Index	P/FE 12/31/17	P/FE 3/31/18	20-Year Median
S&P 500	20.0×	**16.9×**	16.7×
S&P MidCap 400	22.1	**18.0**	18.1
S&P SmallCap 600	25.1	**19.1**	18.9
MSCI EAFE	16.1	**14.0**	14.3
MSCI World	18.4	**15.8**	16.0
MSCI ACWI	17.8	**15.3**	15.2
MSCI EM	14.2	**12.5**	11.9

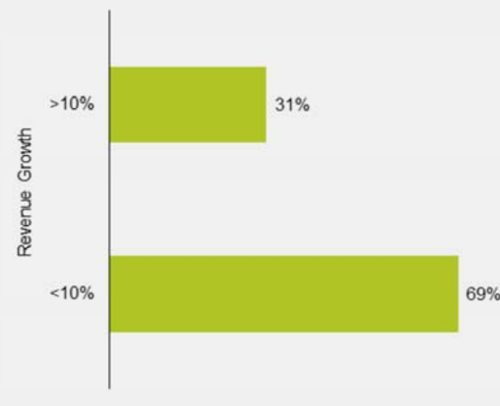


Left display as of March 31, 2018; right display as of December 31, 2017
An investor cannot invest directly in an index, and its performance does not reflect the performance of any AB portfolio. The unmanaged index does not reflect the fees and expenses associated with the active management of a portfolio.
Source: Bloomberg, FactSet, MSCI, S&P and AB

- Let's talk about a little bit of good news. We've seen valuations. If you look on the left hand side at the global indices, you can see that valuations have improved measurably. More of that has come from the fact that we've seen earnings go up, the denominator of the P/E ratio if you will. The E has gotten bigger.
- Clearly, we've seen a bit of a pullback this quarter. But if you look at the price of all earnings multiples in the bolded middle column relative their 20-year medians, you can see that they've gotten closer versus coming in to this year.
- So from a valuation backdrop, things have become more attractive. The key driver - if you look on the right hand side - is earnings. You can see that those have picked substantially. We break it out into 2017, '18 and '19.
- You can see in the U.S. roughly 8% of that list in earnings has come through corporate tax cuts. But it's a positive nonetheless. And there's a lot of good downstream implications from that.
- You can see it's fading a bit in 2019, but still growing at a healthy clip. So the good news is we have valuations that are better. Profitability is high. And as investors we'd want to seek those companies that have that.

High Profitability and Revenue Growth Scarce, but Likely to Be Rewarding

More than Half of the Index Has Single-Digit Revenue Growth…
S&P 500 (Percent of Companies Reporting)*

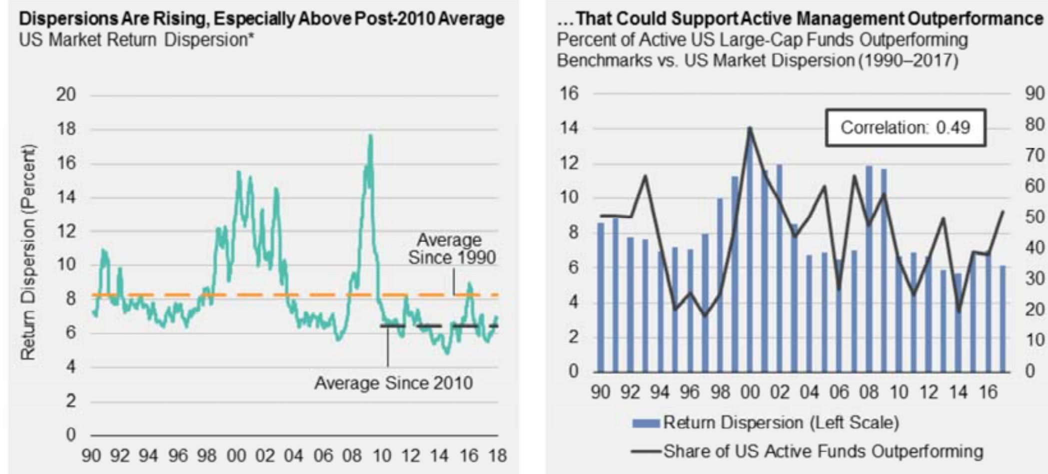


…yet the Returns of Highly Profitable US Stocks Have Lagged Earnings
Earnings per Share Growth and Total Return Differential

As of December 31, 2017. **Historical analysis does not guarantee future results.** High-profitability companies are the 20% of stocks in the S&P 500 Index with the highest return on assets. Calendar-year-end earnings per share growth indexed to 1 at January 2011. Forecast sales per share based on Bloomberg reported consensus. Calendar-year total return indexed to 1 at January 2011
*Based on 471 of 505 companies reporting earnings for the fourth quarter of 2017
Source: S&P and AB

- But not all of them do. Topline growth is key in terms of driving that profitability. If you look on the left hand chart, you can see that over 2/3 of the companies in the S&P 500 index had topline growth of 10% or less.
- Now, the good news is there's about 1/3 of them that do have favorable topline growth. And that is going to be key to profitability.
- If you look on the right hand side, very, very high profitability, high return on assets just as one particular proxy of that.
- If you look on the right hand side, you can see us going back to this Beta Trade phase, the horizontal axis goes from 2011 to 2017. We know that the S&P has been straight up. But if you look at that dashed green line, you can see the profit growth of the S&P. There's a big divergence there.
- If you contrast that with the companies that we deem to be the most highly profitable companies, you look at that solid teal line versus what the earnings growth is for those high profitability companies (the dashed line). They've lagged. In other words, there's a lot of pent-up demand if you will. Pent-up return potential is really the better way to phrase this.

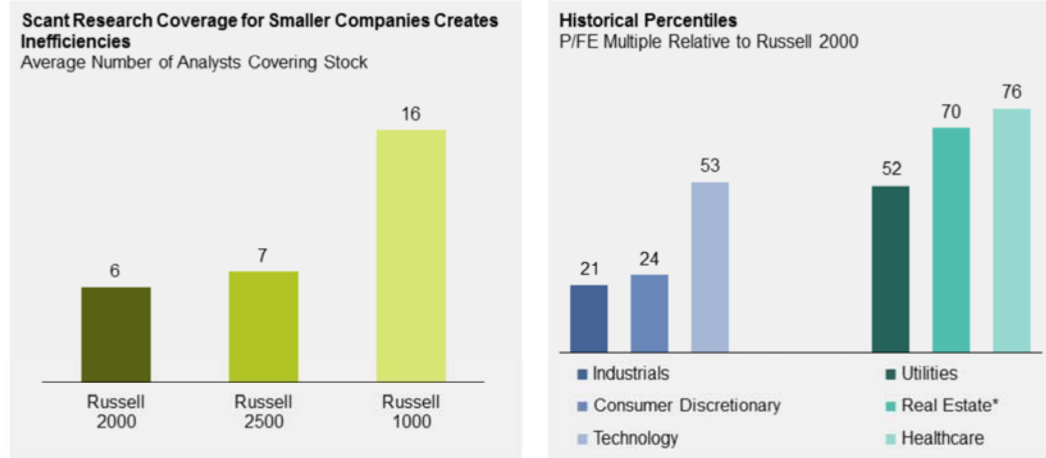
Dispersions Are Rising, Which Bodes Well for Active Managers



Through 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.
*Three-month trailing average historical monthly return dispersion; S&P 500 Stock Universe (1990–2017)
Source: S&P and AB

- If you look at the left hand side, what we're showing is dispersions are starting to rise. We took it back to 1990. And you can see that they're coming up. And it's certainly below that 1990 line with the lines rising.
- Then we broke it out in 2010. Why? Two reasons. One, that was the right, best one path of really starting take off in 2010. And think of that as the Great Beta Trade.
- You can see relative to that time period that – the beta trade and this rise of path if you're seeing dispersions going above that 2010 average. And we've seen this divergence where active managers have been having a better goal, that right in the last 18 months.
- On the right hand side where if you look at dispersion, when it's rising (that's the blue bars): when those blue bars are getting bigger, that black line, the percentage of active managers outperforming goes up.
- So if this trend persists as we expect it to do given some variables that we talked about, that's a good set-up for active managers.

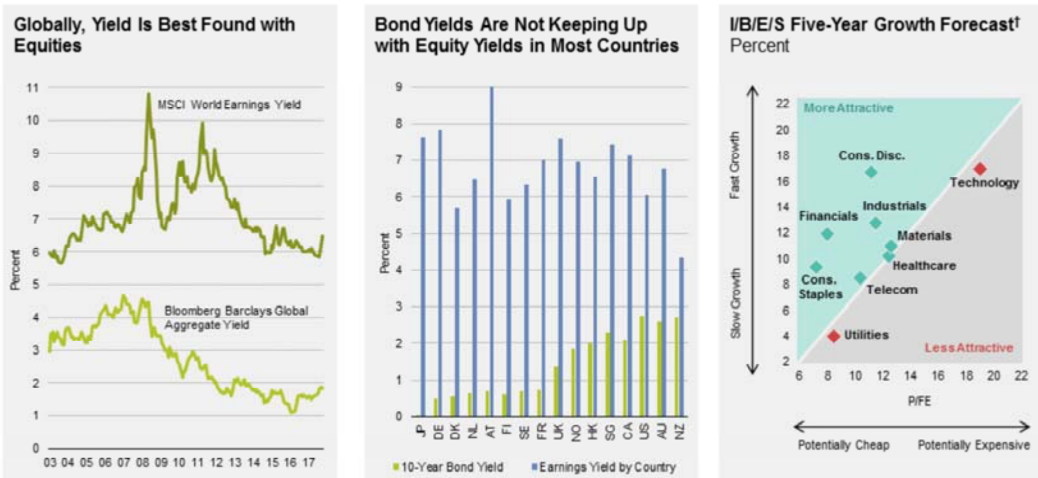
Small-Caps: Information Advantage and Be Active



Left display as of December 31, 2017; right display as of March 31, 2018
Historical analysis does not guarantee future results.
*Real estate sector adjusted for mortgage REITs post–GICS sector reconstitution to make it comparable with historical data.
Source: Bloomberg, FactSet, Russell Investments and AB

- Let's talk about small cap: You have an information advantage. A lot of this was driven just by trading regulations that were put in place, small caps at the smaller commission flow. Consequently, there is less sell side support or sponsorship for these companies.
- If you look at the Russell 1000 companies, you have 16 people on the sell side usually sponsoring the stocks where as you get the Russell 2500 and Russell 2000 it gets cut in below half that.
- If you look at the areas that we think are most attractive, it's going to be technology and industrials versus a lot of those RUST sectors that we talked about earlier, and healthcare.
- Technology's gone up a little higher if you will, but there are still select areas.

Large Gap Between Stock and Bond Yields Persists Globally; Be Selective



As of March 31, 2018

Past performance and historical analysis do not guarantee future results.

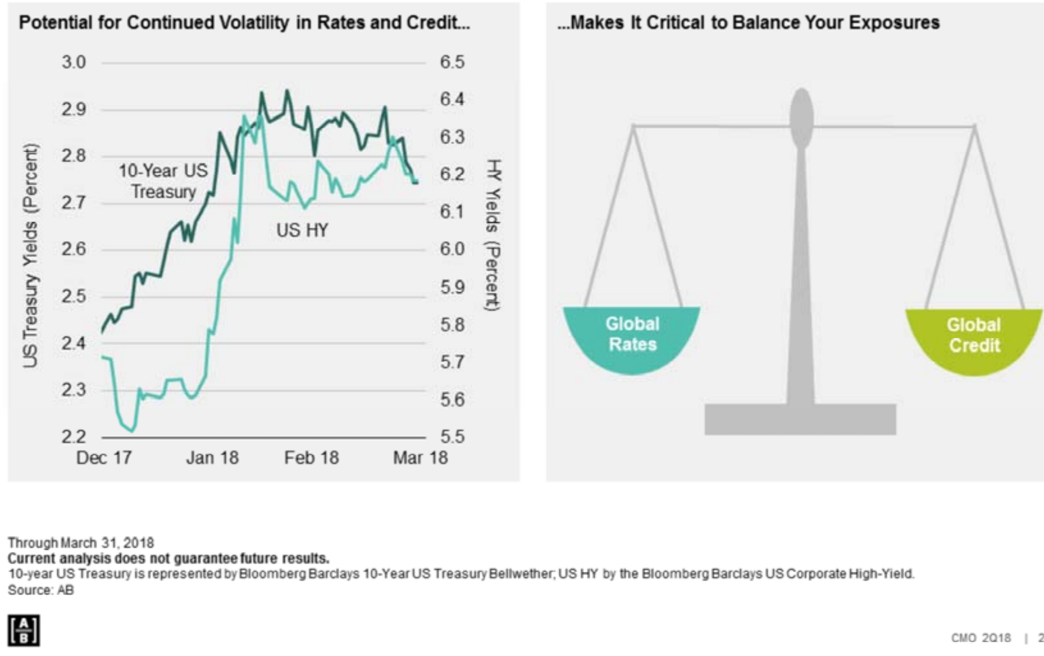
*MSCI World earnings yield calculated using reciprocal of the price/earnings ratio for the next 12 months. Indices are used for comparison purposes only. An investor generally cannot invest in an index.

†Excludes energy

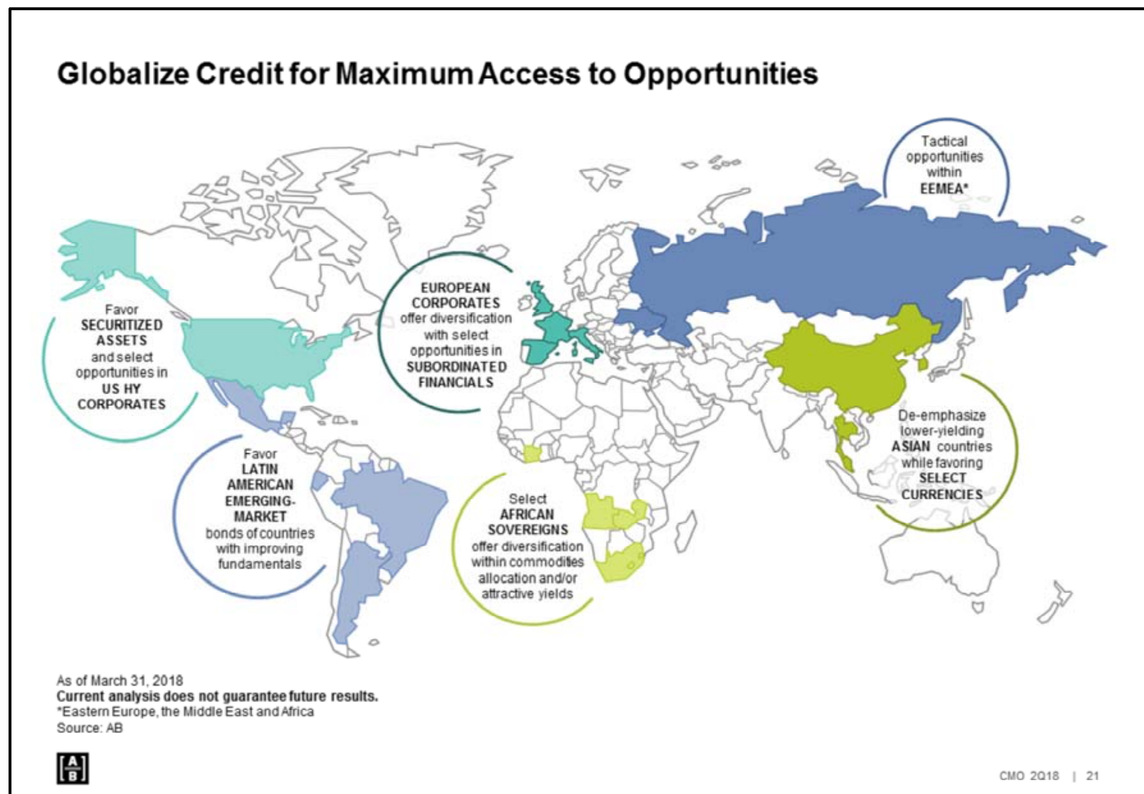
Source: Bloomberg Barclays, FactSet, MSCI, S&P Compustat, Thomson Reuters I/B/E/S, Worldscope and AB

- Lastly, let's look at the equity risk premium. If you look at the earnings yield versus what you get on sovereign 10-year Treasury yields globally, you could see that that chasm is quite big.
- So there's still fertile ground. There's still a lot of opportunity there in terms of what we're finding on the global side.
- If you look on the far right hand side, it's areas like discretionary financials and industrials that seem to be the most attractive from a risk reward standpoint in terms of their valuation versus where they're trading right now in their growth rate.

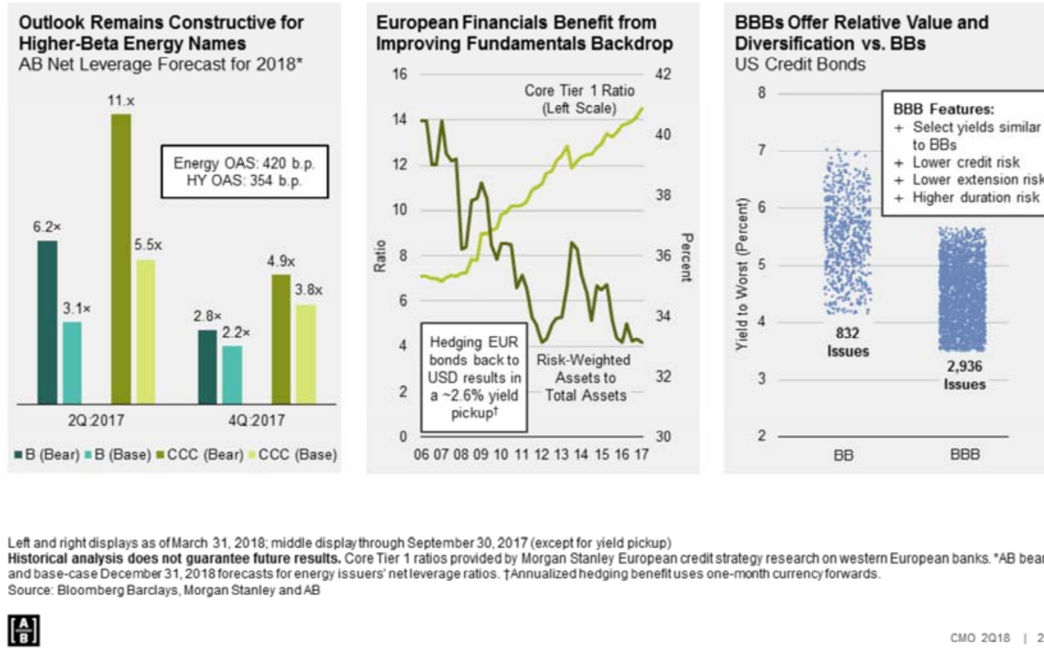
+ I'd like to start the fixed income section with continuing the theme of rising rates, because especially early this year it was something that scared a lot of investors.
+ To put this into context, we looked at historical monthly changes in the 10-year Treasury yield to see how often we actually get big spikes like that. It turns out not that often. Historically, about only 11% of the time, we have the 10-year that moves up by a significant amount. And when it does happen, yes, interest rate sensitive strategies can have negative return. But what is even more important is the returns during the next six months, which are actually positive. And in high yield, of course, we get positive returns even when government yield's rise. There's a negative correlation.
+ But that's the past. What about the future? Our expectations for returns in high yield and U.S. are on the right hand side. They are depending on different scenarios, different spreads, different movement in spreads or in rates. You can see that even if the 10-year was to move up by 100 basis point, we can get positive returns in high yield. In U.S. high yield, yes, the returns would be negative, positive or modestly positive if the movement is 50 basis points.
+ But bigger rates, bigger changes, yes, negative returns. But keep in mind that so much of this movement has already happened, just during the first two months. So if you think about our forecast of 325 by year end, we're at 283 today. We've already covered more ground in January and February than we have remaining until the end of the year.



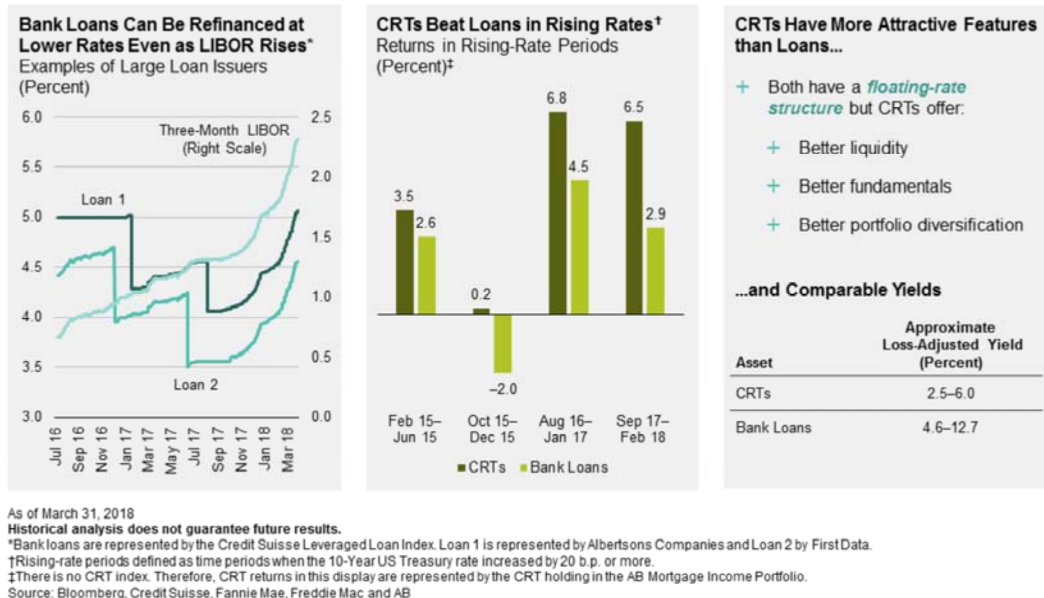
- And so now, we're left with (populations) that are somewhat more attractive. And so yield on government bonds can provide you better cushion than what we were getting at the (U.S) quarter.
- And so if we do have that offset, if we have this risk covered, then we have more of an offset here. And if you think about the environment, yes, ever source the Barbell.
- Think about today's environment. It's not all about valuations and government bonds. It's also Trump Twitters, headlines around trade wars and so forth. All of that means that we could have some risk aversion, some risk selloff, which means you should have a well-rounded portfolio.
- Diversify your allocation. Diversify it across sectors, across credit cycles, across regions.



- So, yes, we somewhat like high yield corporates.
- But we're also looking to Europe for European financials, they're earlier in the cycle than let's say U.S. industrials.
- We like mortgages, so we look into securitized assets.
- We diversify our exposure with EM. Some countries in Africa can provide great diversification to commodity exposure that we're getting in the corporate space.
- So it's about keeping your options open.



- Let's talk about the corporate space.
- We have become a little bit more optimistic about the valuations in that space. Yields on high yield are a little over 6%, which is somewhat what we're expecting returns to be over the next few years. And if you remember the slide we showed a little earlier on, that's the expected path of equities as well.
- The sectors that we favor are energy and financials. We've been talking about financials for a while.
- Energy has been something that was more silent, but the overall industry has become better. The quality has improved so much. We had about 20 percent of energy is sure that defaulted until the ones that are still left are – input their balance sheet, then to so some asset. So they're better positioned to withstand current oil prices, which we think will remain stable. So our expectation for leverage has actually improved.
- And then financials: if you invest in Europe, in addition to attractive fundamentals, you also get the yield pickup from hedging. That's about 2.5% today.
- Outside of high yield, BBBs offer similar yield as BBs, in some instances with better credit quality and low extension risk.



- And we can't talk about credit without talking about bank loans.
- I would imagine that your conversation about bank loans have become a little bit more challenging, because bank loans have held up pretty well this year.
- But I can tell you that about 70% of the market is trading above par. And that means that many of these loans are now subject to be refinanced. And the left graphic shows you what happens when loans are refinanced.
- Notice how these coupons were set with the LIBOR rate until the point when the issue where as it holds the loan and then you end up with a lower coupon than where you started.
- Now, for those who are little bit more skeptical, it turns out that we haven't seen a drop in the coupon recently. So we haven't seen that refinancing in these two specific examples. But to me, that just means that we'll probably get refinancing soon.
- So if you want floating rate exposure, which we think is critical, we think CRTs are a much better, more efficient way of being in that. And they have actually outperformed every time when yields grow, which you can see in the middle chart including the most recent time period.
- From September of last year to February of this year, the 10-year moved up by 75 basis point. And notice how much CRTs sets in that (grown).
- CRTs have better fundamentals and they provide diversification.
- Another way to get diversification is through emerging markets.

Amid Potential for Near-Term Volatility, EM Opportunities Exist

EM Outlook Warrants Caution Despite Improved Long-Term Fundamentals

EM should be supported by:

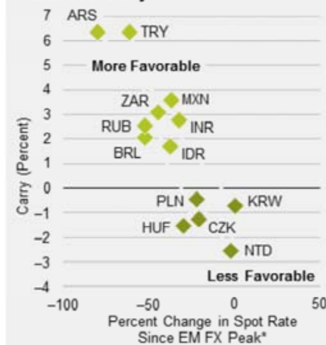
- Solid global growth
- Improved EM fundamentals
- Relative value vs. other asset classes

But there are reasons to be cautious and selective:

- Tighter valuations
- Rising rates in developed markets
- Increased political risk in select countries

Select Local-Currency EM Yields Offer Income Potential...

...and Some EM Currencies Offer Attractive Carry



As of March 31, 2018

Historical analysis does not guarantee future results.

EM local is represented by J.P. Morgan Government Bond–Emerging Markets Global Diversified, and yields are sourced from the index's sub-components. 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.

*EM FX valuations generally peaked on April 29, 2011.

Source: Bloomberg, J.P. Morgan and AB

- We still like emerging markets. We've seen big benefits from global growth. We think valuations are OK relative to some of the other sectors. They've improved their fundamentals quite a bit over the past few years. But we are being more selective because of geopolitical concerns, because valuations even though they may be OK relative to some of the other places in fixed income, they have contrast. So now, we're analyzing each country and making sure that we're being careful in the country that we invest in.
- Take a look at the valuation rate, U.S. high yield versus EM, similar yield on average. But there is also this big diversion in the end: you can get certain countries like Argentina where you have double-digit yield. That's one of the places where we're overweight.
- But at the same time, you have countries like Poland or Hungary, which give you yield similar to what you would get in the U.S., but they're emerging market. When we do get exposure to EM local, we leave a bunch of that ahead, because we want to get a yield pickup.
- The currency exposure, however, at this point is more of a carry way. We're not really expecting a huge appreciation in these currencies. But they do provide an nice carry. And they also give us a very quick and liquid way of managing our risk up and down.

Take a World View on Interest-Rate Exposure, Too

As of March 31, 2018

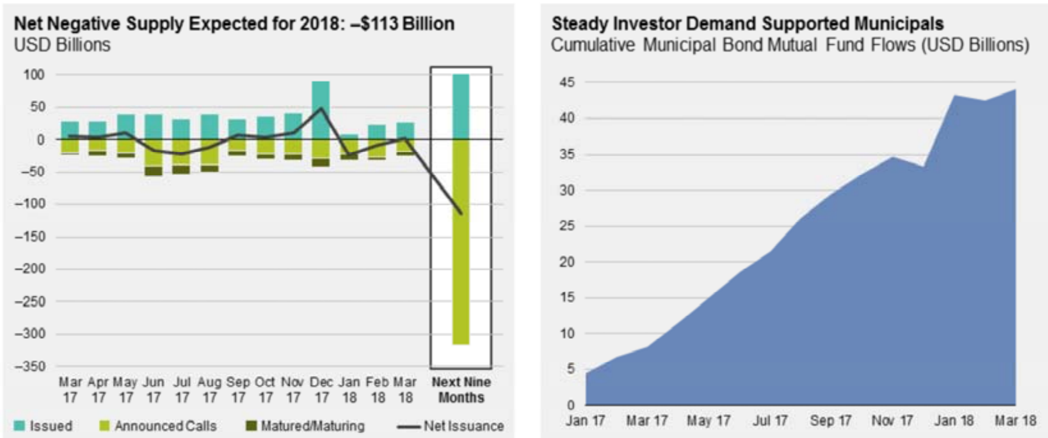
Past performance does not guarantee future results.

*B/E: break-even. †German yield is rebased so that Mario Draghi's Sintra speech (June 27, 2017) is aligned with Ben Bernanke's May 2013 speech in which he first mentioned tapering the Fed's bond purchases. ‡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

+ Let's talk about rates a little bit.
+ Of course, we always recommend global exposure because you can get access to the most attractive opportunities.
+ And so if you diversify your exposure globally, you could have exposure to points in (Clinkers) but not just in the U.S. but also in Japan. And we think valuations there are attractive.
+ One part of the market that we like is German bunds. The reason is because we expect quite a bit more volatility in German bunds or in the European market in general. In the U.S., what happened is after the taper tantrum or around the taper talk, yields actually caught up to what the Fed was trying to communicate. And so that middle chart shows the yield of the 10-year U.S. Treasury. And we highlighted some important periods, so Bernanke's taper talk and when they actually began to taper. After Bernanke started to communicate the possible changes in the monetary policy in the U.S. yields had more depth.
+ When you overlay the same or similar time period for German bunds, the ECB started to talk about tapering. They were actually tapering. They're going to finish tapering this year. But take a look at German bunds. They haven't really moved much, which means that their level is under what we believe is the fair value. And though we would expect volatility, we expect these yields to steady.
+ In the right display, we're addressing Up/Down Capture. 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". 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. This lower downside of global bonds will become even more important to investors as the Fed continues to hike.

Municipal Technicals Remain Supportive



As of March 31, 2018
Past performance does not guarantee future results.
Source: Bloomberg Barclays, Municipal Market Data and AB

- Finally, let's move on to munis.
- If taxes are a consideration, munis are still attractive.
- So our municipal team talks about technicals. Essentially, so much of the supply was dragged forward that this year, their expectation for supply is negative.
- And at the same time, we have seen some demand for inflows into munis, as you can see on the right hand side.

Municipals: Balance Intermediate Quality with Longer-Maturity Credit

+ **Shorter Bonds:** Consider short-maturity municipals vs. comparable-maturity taxable bonds given the increase in short-term yield
+ **Intermediate Bonds:** Focus on roll and carry, but manage yield-curve structure due to flattening
+ **Longer Bonds:** Dip down in credit for an extra yield pickup—avoid longer-maturity high-grades, which may remain volatile owing to possible changes to tax rates

As of March 31, 2018

Historical analysis does not guarantee future results.

Nominal yields. AA credit rating is a measure of the quality and safety of a bond or portfolio, based on the issuer's financial condition. AAA is highest (best) and D is lowest (worst). Ratings are subject to change. Bloomberg Barclays long indices are used for each respective rating category.

*Roll is the natural price gain that a bond experiences as it ages, assuming interest rates are unchanged. Yield advantage shown is for 10-year municipal securities. Short taxable bonds are represented by Bloomberg Barclays US Aggregate 1–3 Year ex Government.

Source: Bloomberg Barclays, Investment Company Institute, J.P. Morgan, Municipal Market Data, US Federal Reserve and AB

+ But the positioning matters.
+ 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.
+ Our team continues to overweight the intermediate part of the curve in the high grade muni space. They look for credit on the long end. And on the short end, they now have own munis, (elect) coverage and no treasury.

A Word About Risk

The information contained here reflects the views of AllianceBernstein L.P. or its affiliates and sources it believes are reliable as of the date of this publication. AllianceBernstein L.P. makes no representations or warranties concerning the accuracy of any data. There is no guarantee that any projection, forecast or opinion in this material will be realized. Past performance does not guarantee future results. The views expressed here may change at any time after the date of this publication. This document is for informational purposes only and does not constitute investment advice. AllianceBernstein L.P. does not provide tax, legal or accounting advice. It does not take an investor's personal investment objectives or financial situation into account; investors should discuss their individual circumstances with appropriate professionals before making any decisions. This information should not be construed as sales or marketing material or an offer or solicitation for the purchase or sale of any financial instrument, product or service sponsored by AllianceBernstein L.P. or its affiliates.

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.

[Read to audience]

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; includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed- and emerging-market 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-market 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.

[Read to audience]

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-market 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 1000 Index**: A stock market index that represents the highest-ranking 1,000 stocks in the Russell 3000 Index, representing about 90% of the total market capitalization of that index.
- **Russell 2000 Index:** Measures the performance of the small-cap segment of the US equity universe. It is a subset of the Russell 3000 Index, representing approximately 8% of the total market capitalization of that index. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership. (Represents US small-cap on slide 1.)
- **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 US-based listed equities.

[Read to audience]

Index Definitions (continued)

- **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-size companies. The index measures the performance of mid-size 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.

MSCI makes no express or implied warranties or representations, and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices, any securities or financial products. This report is not approved, reviewed or produced by MSCI.

[Read to audience]

ALLIANCEBERNSTEIN®

The [A/B] logo is a registered service mark of AllianceBernstein and AllianceBernstein® is a registered service mark used by permission of the owner, AllianceBernstein L.P.

© 2018 AllianceBernstein L.P. www.AllianceBernstein.com

180411183807