AllianceBernstein

MAY 2019

Q&A

FIVE QUESTIONS FOR FIVE YEARS

Equity markets have been through plenty of challenges in the five years since AllianceBernstein launched its Concentrated Global Equity Portfolio. In this Q&A, **CIO Mark Phelps** explains how he's steering the portfolio through tricky conditions in 2019.

Mark Phelps is Chief Investment Officer of Concentrated Global Equity at AllianceBernstein (AB). Before joining AB in 2013, he was CEO and managing director of Global Investments at W.P. Stewart & Co. Prior to that, Mark held senior positions with Kleinwort Benson/Dresdner Bank in London and San Francisco, including CIO for Global Equities.

KEY FUND FACTS:

(As at 30/04/2019)

Why AB Concentrated Global Equity?

+ Focused portfolio of roughly 35 stocks with underappreciated long-term growth potential
+ Uses intensive, bottom-up research to identify companies growing in excess of 10%
+ Emphasises quality firms with strong management

Fund Launch date: 23.12.2013

Net Assets: US$239 million

Total Number of holdings: 32

Morningstar Rating:

Class I USD Shares

★★★★★

Rated against 746 funds in the Global Large-Cap Growth Equity Category, based on risk-adjusted returns.

ISIN I: LU1011997464

Portfolio management & experience

+ **Mark Phelps**: 32 years
+ **Dev Chakrabarti**: 18 years

1. Many investors are worried about earnings growth in 2019. How do you view the threats to global profits ?

Mark Phelps (MP): Earnings are facing many hurdles, including the escalating US-China trade war, growing concerns about monetary policy tightening and fears of a global economic slowdown. But the outlook itself may not be as bad as widely perceived. It's true that the pace of earnings growth is slowing—particularly in the US, as the boost from last year's tax reform fades. Yet companies are generally still increasing profits across most sectors globally, which is a positive environment for stocks. We expect global earnings growth to range between 5% and 8% this year. So growth is slowing but not disappearing, and the balance between the US and other markets should be supportive of a more consistent return across markets.*

2. For the first time in some while, we saw interest rates rise in the US during 2018. What are the greatest risks/opportunities for your portfolios in a rising-rates environment?

MP: The key issue of rising rates is why they are going up. If they are just normalizing then we should think about the degree to which higher capital costs will impact margins. Potentially you would favour strong balance-sheet and cash-flow businesses, over those that are highly indebted.

If interest rates are rising because inflation is becoming a real concern for central banks, then further rate rises may be undertaken to curtail economic activity. This will slow growth and clearly have a negative impact on corporate profitability. In this environment we expect to see a compression of price/earnings multiples. This tends to have a greater impact on more expensive stocks with higher multiples.

However, with growth stabilizing at a slower pace in the US and China in 2019, then rate expectations may already be priced into the market. That means stocks of companies with genuine growth and strong balance sheets—like the ones we target in our portfolio—could see their multiples expand.

3. In the last year, we have seen volatility come back to markets. How are you positioning your portfolio to protect or take advantage of more volatile markets?

MP: Volatility is not necessarily a bad thing; it is really a fact of life in markets. In recent years, investors have become accustomed to exceptionally low levels of volatility; and, in many ways, the return of volatility implies that normal conditions are beginning to return to markets after a decade of support from exceptionally loose monetary policy globally. In fact, historically, equity markets correct by 10% on average about every eight months—as they did in February and October of 2018.*

For skilled, long-term investors, volatility often provides opportunities, and does not necessarily reduce returns. More turbulence should be expected as we move away from quantitative easing and an environment of very cheap money. We are not trying to time markets, but are happy to hold cash of up to 10% to find attractive entry points in stocks of high quality companies with solid long-term fundamentals.

* Source: Bloomberg, S&P and AllianceBernstein (AB)

4. What types of companies are you looking for in the current market environment?

MP: We are carefully scrutinizing input cost inflation to avoid companies that may deliver negative earnings surprises. Companies with strong pricing power could potentially offset inflationary pressures, so this is factored strongly into our models. That said, the best investing strategy is to find great secular growth businesses that can deliver growth in almost any environment. And the correction in late 2018 gave us the opportunity to modestly reposition our portfolio toward the most predictable growers at reasonable prices.

Our investing philosophy aims to target companies that have the potential to generate earnings growth of 10% or more per year over the next five years. Even in the best of times, very few companies can do this—but those that do tend to outperform the market over time. In today's market, we believe that identifying companies with the potential to deliver consistent earnings growth amid trade tensions and continued uncertainty in global equity markets is a recipe for long-term success.

In the long run, we continue to believe our portfolio can generate returns broadly in line with the earnings growth achieved. In that respect, if the journey is going to be a positive one, how we get there shouldn't matter, so long as we are able to stay the course. Volatility is rising, but that can be an opportunity as well as a challenge.

5. Has anything changed in the way you manage the portfolio over the last five years?

MP: The world around us has changed dramatically in the last five years. But when markets get a bit crazy, it's all the more important to stay disciplined as investors.

To find companies that can grow earnings consistently over time, we still look for superior businesses, typically industry leaders with predictable, recurring revenue streams. People often ask me: what do you mean by "high quality growth"? For us, it's all about finding companies with strong management, volume growth drivers, dominant franchises and high barriers to entry. We prefer businesses with low cyclicality, low customer concentration and low regulatory risk. To qualify for our portfolio, companies must demonstrate an ability to maintain capital discipline, as indicated by strong balance sheets.

Our team's approach is based on years of experience, developed well before the current fund was launched. Yet we're always fine-tuning our investment process and risk management tools as the markets change. And the essence of our goal remains the same: to tap into sources of underappreciated growth potential in a small number of select companies that we believe can deliver long-term returns for our clients through changing markets.

Mark's Five Top Stock Picks for 2019

Amphenol (US)-the second-largest player in the US$50 billion global connector industry, Amphenol continues to benefit as the electronics revolution creates demand for new equipment, functionalities and applications. The company's diversified presence in high-growth markets bolsters its long-term earnings growth potential.

Abbot Laboratories (US)—manufacturer of a range of healthcare products including diagnostics, nutrition, pharmaceuticals and medical technologies. Each franchise enjoys unique investment themes that contribute to durable growth and diversified revenues for the group. A strong management team underpins the company's strategic advantages and earnings growth potential.

Treasury Wine Estates (Australia)—formerly the wine division of international brewing company Foster's Group, this company has a global winemaking and distribution business. Treasury has also penetrated China, a rapidly growing strategic market, where competition is relatively scarce.

Tencent Holdings Ltd. (China)—an international holding company that provides Internet value-added services and online advertising services with an emphasis on China and Hong Kong. Tencent's array of smartphone games generates massive revenue streams, while its powerful and popular "We Chat" app has more than one billion users and better profit margins than WhatsApp.

Eurofins Scientific SE (Belgium)—an international group of laboratories headquartered in Brussels, providing testing and support services to various industries and governments. The company specializes in lab testing for food companies and pharmaceuticals. The food industry is a niche market where we believe Eurofins has a first-mover advantage with large manufacturers.