JUNE 2019

AllianceBernstein

Q&A

GENERATING STABLE RETURNS IN UNCERTAIN TIMES

Global Dynamic Bond Portfolio manager **John Taylor** is co-head of European Fixed Income at AllianceBernstein (AB), with 18 years' experience at the firm. In this Q-&-A John discusses how the current market environment is driving positioning in the Fund. He shows how a nimble risk-aware approach, dynamic management and the application of new technology are key to meeting the challenges of today's bond markets, and to generating stable returns.

KEY FUND FACTS:

Why AB Global Dynamic Bond Fund?
Our fund aims to deliver:

+ Consistent Returns
+ Stability and Downside Protection
+ Low Correlation

Portfolio Inception Date
16/01/2007

Fund Net Assets: 723.33 mil
(as of 10/04/2019

Base Currency: GPB

ISIN: LU1005411068

Management Team

+ **John Taylor**
+ **Scott DiMaggio, CFA**
+ **Douglas J. Peebles**

1. What are the key challenges facing bond investors over the next 12–24 months?

Low yields will continue to be a tough challenge. The big question is, how will central bank intervention play out? Quantitative easing (QE) buoyed up asset prices and created gains for investors. Coming into 2019, markets expected continuing strong growth and further rate rises in the US, together with continuing steady recovery in the euro area. These conditions would likely support the reversal of QE and a secular shift to a quantitative tightening (QT) stance. Now growth and inflation expectations have moderated, and the appetite globally for further tightening has diminished, for the time being at least. But investors should expect higher volatility—and probably lower returns—from the traditional parts of the market that are no longer benefiting from central banks making net new bond purchases.

2. Where do you see the key opportunities for the asset class over the next 12 months?

The sell-off in the latter half of 2018 gave us a great opportunity to buy credit at attractive prices. Credit spreads had widened on increased supply and fears of the start of QT in Europe. Now that QT has receded, credit spreads have tightened quite nicely.

We still see scope to increase credit exposures—but with economic growth forecasts continuing to ratchet down, we want to make sure we're buying the issuers who are well set to weather a turndown in the global economy.

3. What about the risks over the next 12 months?

A slowing economy and higher leverage in bond markets mean potential credit-rating downgrades ahead. The part of the market that investors are most concerned about is BBB, the lowest-rated tier of investment grade. Since the financial crisis, the size of the US bond market has more than doubled, and over that period, the proportion of BBB-rated securities has gone from one-third, up to 50%. So the concern is that there could be downgrades to a very large volume of fixed-income assets.

Now, if we look at our own internal forecasts, we currently assume that maybe 3%–4% of that BBB market is already priced in line with lower-rated high yield (HY)—so the downside will be limited if downgrades occur. But in a worst-case scenario, perhaps 15%–20% of BBB bonds are going to be downgraded to HY, which will hit prices hard. HY markets might struggle to cope with a lot of new supply in the form of downgraded former investment-grade bonds—particularly because these would typically have longer maturities than HY investors are used to. Even so, we think it's important to keep this outlier risk in perspective—the more likely outcome is that the downside risk is more modest, and that careful credit analysis will uncover attractive opportunities in BBB bonds that have become oversold and undervalued.

4. What is your market outlook for Fixed Income?

The rally in markets earlier this year has more than recovered all of 2018's losses, leaving valuations quite stretched. That means investors will need to be selective in the months ahead and avoid over-concentration in any one sector or region. So a fully global, dynamically managed approach will be very important.

In the longer term, higher inflation is a potential problem for fixed-income investors. We think the rising tide of populism is changing the political landscape, and that governments will need to respond by redressing the imbalance that has grown up between the owners of capital and workers. We feel that populist policies will likely lead to wage inflation through time, and higher inflation in general. In this scenario, a focus on shorter-dated bonds and a nimble risk-aware approach will help.

AB Global Dynamic Bond Fund is a portfolio of AB SICAV I, an open-ended investment company with variable capital (société d'investissement à capital variable) incorporated under the laws of the Grand Duchy of Luxembourg.

5. Are there any particularly important trends which you are focusing on, as a portfolio manager?

Harnessing new technology and machine learning is critical to our success at AB. We've developed our own trading platform, called Alpha, which aggregates all the data from different trading platforms in the various bond markets. This information advantage gives us a real edge. It means we can find the bonds that we want and trade them quickly, in what are becoming increasingly fast-moving and less liquid markets.

We've also introduced a digital assistant into our investment process, a chatbot called Abbie. Abbie's first job was to improve our speed in order-building, which was previously a time-consuming manual process. But as Abbie has learned new skills, she is now able to access all our different research inputs, and to make trade suggestions too. We are continuing to help Abbie develop new skills, and at each stage of her development she is making us much faster and more efficient in originating and executing ideas.

6. How is the AB GDB portfolio positioned to face a more challenging market environment?

Currently, we like: high quality bonds that will be resilient even in a slowing economy; bonds with very low sensitivity to interest rates; short-dated high quality credit instruments; and cash and cash proxies that we can use very quickly to buy credit bonds when setback periods create opportunities.

We believe that changes in government and central bank policies will drive volatility higher, triggering episodes where credit spreads spike. That's the sort of environment where dynamic management and a disciplined investment approach can really pay off.

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INVESTMENT RISKS TO CONSIDER

Investment in the Portfolio entails certain risks. Investment returns and principal value of the Portfolio will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Some of the principal risks of investing in the Portfolio include:

Derivatives Risk: The Portfolio may include financial derivative instruments. These may be used to obtain, increase or reduce exposure to underlying assets and may create gearing; their use may result in greater fluctuations of the net asset value.

Emerging-Markets Risk: Where the Portfolio invests in emerging markets, these assets are generally smaller and more sensitive to economic and political factors, and may be less easily traded, which could cause a loss to the Portfolio.

Lower-Rated and Unrated Instruments Risk: These securities are subject to a greater risk of loss of capital and interest, and are usually less liquid and more volatile. Some investments may be in high-yielding fixed-income securities, so the risk of depreciation and capital losses may be unavoidable.

Other Risks Include: Portfolio Turnover Risk, Smaller Capitalization Companies Risk, OTC Derivatives Counterparty Risk, Fixed-Income Securities Risk, Sovereign Debt Obligations Risk, Corporate Debt Obligations Risk.

These and other risks are described in the Portfolio's prospectus.

IMPORTANT INFORMATION

Prior to 31 October 2018, the Portfolio was named AB Diversified Yield Plus Portfolio. All data prior to 31 October 2018 relates to the AB Diversified Yield Plus Portfolio.

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