



It's a Small World

International Discovery Portfolio

In the search for new sources of equity returns, investors are always seeking new horizons. International equities have long been a popular route for such diversification. Yet when doing so, investors have typically focused on the most visible large-capitalization stocks around the world. Small- and mid-caps—known together as SMID stocks—have often been overlooked.

We think it's time for investors to discover the benefits of investing in international SMID-cap stocks. In fact, SMID stocks outside the US form the largest pool of equities in the world, representing companies that generally march to a different beat. They tend to have much lower correlations with US equities than international large-caps. And since there are relatively few analysts covering these companies, we believe that active managers have a distinct advantage.

Of course, there are big questions about capturing the potential of smaller companies. How can a portfolio manager sift through so many stocks to build an effective portfolio? What are the risks? And what does it take to invest effectively in disparate, lower-profile companies around the world?

Big Universe for Smaller Stocks

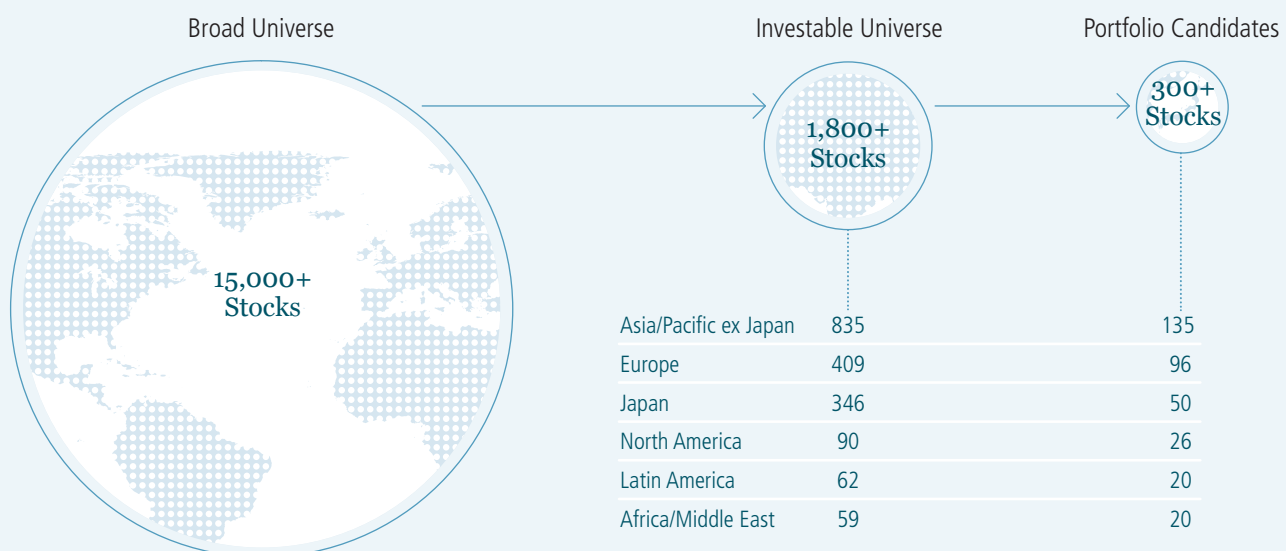
For equity investors, there is simply no bigger universe than international SMID stocks. According to MSCI classification, more than 15,000 SMID stocks are listed outside the US.

The choices are endless. So where does an investor begin? Our starting point is a pool of approximately 1,800 securities with a market cap below US\$7 billion, average trading volume of at least US\$5 million per day and sufficient financial data available to make meaningful analysis feasible. Next, we look at the fundamentals: our quantitative tools identify companies that look capable of delivering sustained earnings momentum and strong returns—and then, we hit the road.

We hold more than 700 meetings a year with management of companies around the world. This field research provides vital intelligence on a company's business model, strategy and financials, which helps us gain the conviction to invest.

Narrowing Down a Vast Pool of Stocks

International SMID-Cap Equities



As of May 31, 2014
Source: FactSet

In the SMID world, growth is abundant. For example, consumer and industrial companies account for 24% and 19%, respectively, of our primary benchmark, the MSCI ACWI ex US SMID Cap Index—significantly greater proportions than those of the MSCI ACWI ex US Large Cap Index. Companies in these sectors offer exposure to some of the most attractive secular growth opportunities, such as an increase in urbanization and broadening income distribution in emerging countries. These strong secular trends have historically driven much better earnings and sales growth for SMID companies versus their large-cap peers, a trend we expect to continue in the coming years (*Display 1*).

Diverse Exposures Make a Difference

So what makes international SMID-cap companies different? First, their sales are tied more tightly to domestic markets than are those of their larger-cap peers (*Display 2*), which typically have operations beyond their borders. That means the performance of SMID-cap companies is driven much more explicitly by economic conditions at home, where they are often focused on smaller, niche markets. Whether it's an Indonesian consumer company, a Taiwanese functional fabricmaker or a European green-building-materials company, these companies are affected by a broad range of business and economic trends. As a result, investors get less common factor risk and more idiosyncratic risk than they do from large-caps, with returns that have a lower correlation with US equities.

However, liquidity is an important consideration. Smaller companies tend to trade with much lower volume. In fact, 58% of stocks with a market cap between US\$100 million and US\$1 billion have an average daily trading volume of less than US\$1 million. That's why it's important to have a SMID approach in international markets. In the SMID universe, the number of stocks with average daily volume

of at least US\$5 million doubles compared to the small-cap universe. Importantly, the additional companies offer similar fundamentals to small-cap stocks in terms of growth and profitability. So investors enjoy the benefits offered by smaller international companies, while mitigating liquidity risks. In our portfolio, the SMID focus provides the flexibility to capitalize on the success of smaller companies as they graduate to the next level.

More Insight from Less Coverage

Smaller stocks are usually not household names. Few investors will be familiar with the companies that comprise an international SMID portfolio. Yet because they are often not well known, investors who take a closer look can gain a competitive advantage. Most companies in the international SMID-cap universe are covered by a small number of analysts—if any (*Display 3, next page*). In fact, while a typical large-cap company is covered by 21 analysts, the average SMID-cap has only five. What's more, 45% of SMID-caps outside the US aren't covered by any analysts at all.

This is good news for investors who are willing to look under the hood of these companies. By researching stocks that have scant coverage elsewhere, active managers can unearth competitive advantages and growth potential not yet discovered by the market. As a result, the median outperformance generated by international SMID managers was 4.4% over the three-year period through March 31, 2014 (*Display 4, next page*)—nearly triple the outperformance in US small-caps and international (EAFE) large-cap stocks.

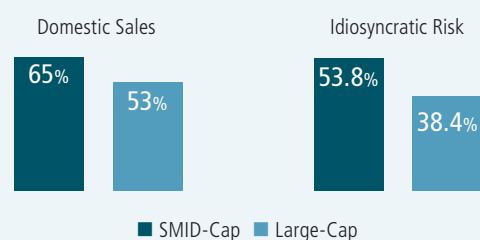
Still, relatively few active managers have ventured into the international SMID arena. In fact, by the end of 2013, there were only 36 institutional products available, of which only

Display 1: International SMID Has an Attractive Growth Profile

	EPS Growth 2013–2014E	EPS Growth 2014E–2015E
S&P 500	10.4%	12.1%
MSCI EAFE	9.5	11.7
MSCI EM	13.8	13.3
MSCI ACWI ex US SMID	14.2	16.2

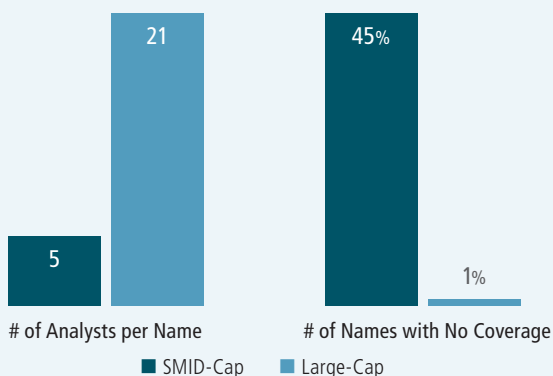
As of March 31, 2014
 MSCI EAFE represents international, developed-market stocks in Europe, the Far East and Asia. MSCI EM represents emerging-market stocks.
 Source: MSCI, S&P and AllianceBernstein

Display 2: Domestic Growth Drivers Add Diversification Benefits



Domestic sales are for fiscal year 2012. Idiosyncratic risk as of December 31, 2013.
 SMID-cap represented by MSCI ACWI ex US SMID Cap; large-cap represented by MSCI ACWI ex US Large Cap
 Data available for 79% and 73% of large-cap and SMID-cap universe, respectively, by index weight
 Source: Credit Suisse, MSCI Barra and AllianceBernstein

Display 3: Less Research Creates Opportunities for Alpha



As of March 31, 2014
 Based on the number of estimates for the next fiscal year per company SMID-cap names as defined by the minimum and maximum market cap of the MSCI ACWI ex US SMID Cap as of last constitution
 Source: FactSet and AllianceBernstein

Display 4: Active Managers Have Thrived in International SMID

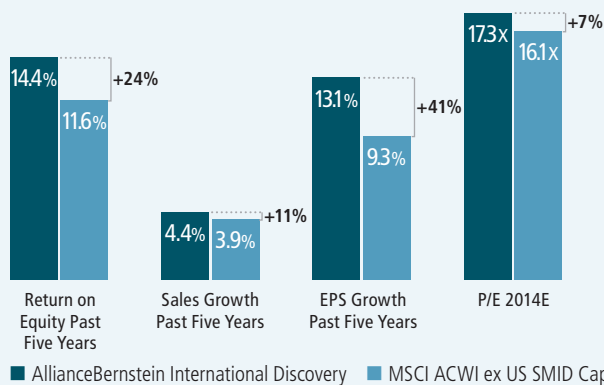
Median Alpha Generated

	3 yr.	5 yr.	10 yr.
US Large-Cap	(0.2)%	(0.3)%	1.0%
EAFE	1.6	1.8	1.2
EM	5.7	2.0	1.4
US Small-Cap	1.5	2.0	2.0
Intl. SMID	4.4	4.1	3.0

As of March 31, 2014
 Median alpha generated using manager-preferred benchmark
 Based on eVestment peer groups
 Source: eVestment

Display 5: International Discovery: Growth and Profitability at Attractive Valuations

Portfolio vs. Benchmark



As of March 31, 2014
 Based on a representative International Discovery Portfolio
 Source: MSCI, Thomson Reuters I/B/E/S, Worldscope and AllianceBernstein

27 had a track record of more than five years, according to eVestment. That's dwarfed by the number of offerings in the US small-cap space, where 576 managers had a track record of more than five years.

International Discovery Portfolio

In such a relatively unexplored niche, we believe that the recipe for success is a global approach, combined with proven stock-picking skills. These ingredients are at the heart of AllianceBernstein's International Discovery Portfolio, which draws on a global research platform across five continents, from São Paulo to Sydney, and an investment team with an average of 16 years' experience.






Our portfolio managers and analysts are dedicated to hunting for alpha across the vast SMID universe, anywhere in the world, including emerging markets, which account for about a quarter of the current portfolio. No matter where we look, our criteria for stock selection are the same—market-leading companies steered by experienced management teams who are capable of delivering strong growth and profitability. That's why the earnings growth and return on equity of our portfolio holdings have been consistently higher than the benchmark (*Display 5*).

This bottom-up process is the key to achieving our performance objectives. The International Discovery Portfolio aims to outperform its primary benchmark, the MSCI ACWI ex US SMID Cap, by at least three percentage points before fees, annualized over a full market cycle. Since its inception in 2008, the portfolio has consistently exceeded its investment objective on an annualized basis, with the vast majority of its alpha coming from stock selection.

We have decades of experience investing in smaller-cap markets and a rigorous investment process based on fundamental and quantitative analysis, aimed at identifying the most promising opportunities and capturing the attractive return potential of SMID-cap stocks around the world.

With the support of our global platform, we have on-the-ground research all over the world, from industry experts to macroeconomic specialists, who provide valuable insight into our investment process. And by taking the time to get to know companies, their financial history and their management, we can identify those most likely to deliver sustainable earnings growth momentum and strong profitability—even in the SMID world, where there is comparatively little information on many portfolio candidates. For investors seeking a new source of equity returns and diversification, AllianceBernstein's International Discovery Portfolio can turn a large universe of SMID companies into a small world of stocks with big performance potential.

Features and Benefits

Systematic Process...		...narrows down an international universe of 1,800 stocks to a portfolio of 100–150 stocks by using quantitative screening, management meetings, company visits and industry analysis to find those with the best growth prospects
Diversification Opportunity...		...provides low correlations with large- and small-cap US stocks and a focus on names with higher idiosyncratic risk versus large-cap stocks
Growth Focus...		...targets strong franchises and industry leaders, which are more likely to deliver sustainable growth and fundamental outperformance over the long term
Experienced Investment Team...		...builds on a long history of success in small- and mid-cap growth equities and draws upon the firm's global growth research team, including 28 fundamental analysts and three quantitative analysts across five continents, averaging 16 years of experience
Global Research Approach...		...generates on-the-ground real-time insight and benefits from global sector integration to gain perspective on trends driving companies in diverse industries

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