- [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.
- If we start with the 30,000-foot view, we'd have to say it's quite nice to have had a second quarter that seemed to build on the positive momentum of the first quarter.
- But today, we'll look at the various stories within the story, because once you scratch the surface, you start to see issues that could change the direction or the force in economies and markets—both globally and locally.
- In the US, we've seen an unwind of the Trump trade, even as markets, in general, continued to do well. But there are questions as to when fiscal policy may step in, and if and when further monetary tightening may reach a point of changing the current course of the markets.
- And while economic recovery is in its earlier stages in other markets and economies—both developed and emerging—possible stress points are always just under the surface.
- With that in mind, let's take a look at how markets did in the second quarter.

Strong Returns Continued in the Second Quarter...but with Differences

Returns in US Dollars

Past performance does not guarantee future results.
As of June 30, 2017
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 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, Standard & Poor's (S&P) and AB

CMO 3Q 2017 | 1

+ Returns in the second quarter were very good, with solid to strongly positive performance generally across the board. In equities, there was a continuation of strength that's been going on for some time. But there's an extremely important story within the story that relates to a change in the composition and drivers of performance.

After the Beta Trade Meets Trumponomics: The First 180 Days

After the Beta Trade Landscape

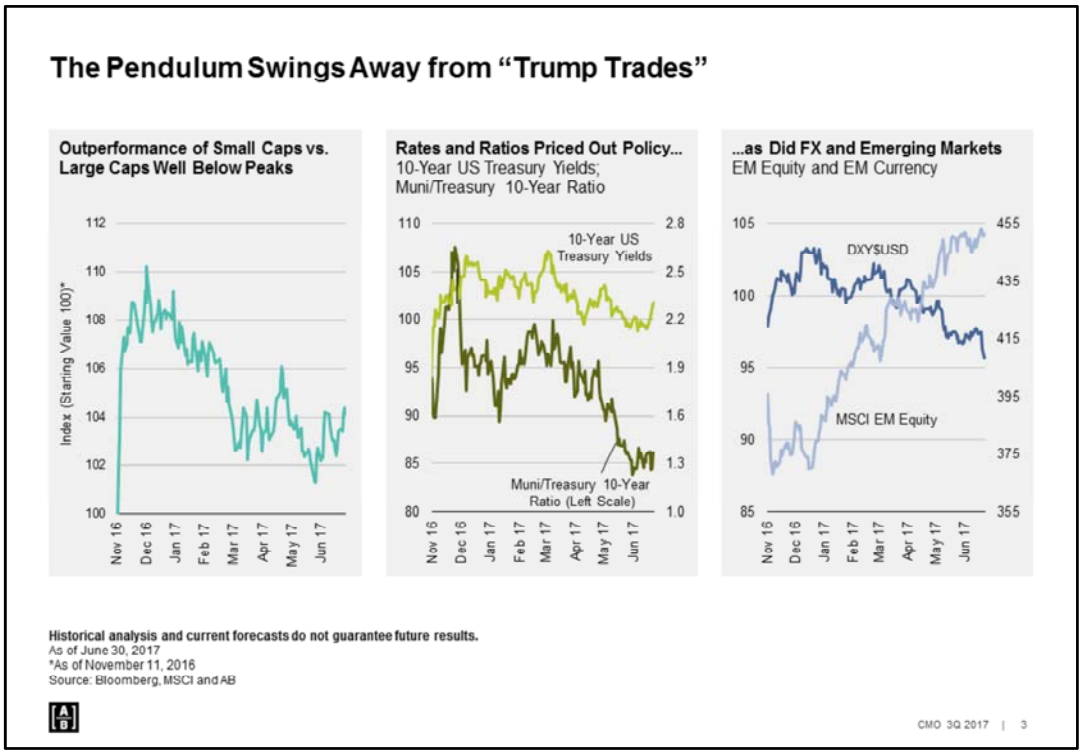
- Moderate Growth/ Low Inflation
- Accommodative monetary policy
  - Yields rise on a "low and slow" path
  - Eventual balance sheet reduction
- Lower expected returns
  - Elevated valuations
  - Lack of top-line sales growth
  - Net margin gains limited
- Higher volatility/ More dispersion
  - More alpha potential
  - More downside potential

Post-Election Recap

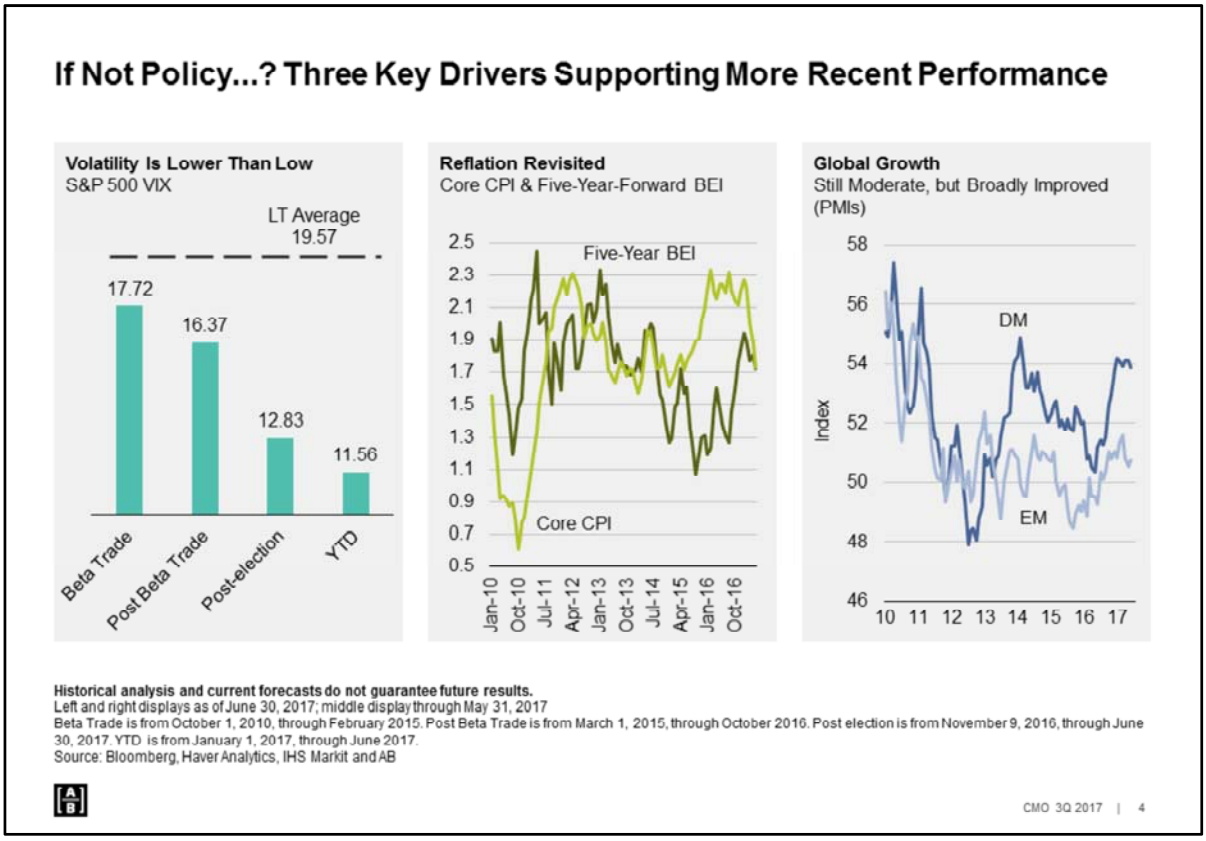
- Yields rose sharply
  - Real yields/ Inflation expectations rose
  - Curve steepened
  - Muni/Treasury ratio fell
- Dividend yielders underperformed
- Financials, cyclicals outperformed
- Small caps beat large caps
- Higher-tax co's beat lower-tax co's

Past performance and current assessment and forecasts do not guarantee future results.
As of June 30, 2017
After the Beta Trade is from March 1, 2015, to the present. Post election recap is from November 9, 2016, through June 30, 2017.
Source: Bloomberg and AB

- As a reminder, for some time we've spoken about after the beta trade – a period of moderate, below-trend but improving global growth, low levels of global inflation, highly accommodative monetary policy including QE, and an expected low and slow path of rate increases. From a market perspective, returns were expected to be more muted going forward as a result of elevated valuations, lower gains from net margins and low interest rates/bond yields.
- As you can see on the right, for "after the beta trade" period – starting around Feb 2015 through the November election, during that period we saw exactly that. Despite a lot of price movement, the price levels in the S&P 500, yields on the US Agg, spreads on high yield (not shown), were all roughly in the same place on the day of the election as they were 21 months earlier.
- However, following the election, the market reacted to the potential impact of proposed policy initiatives from the incoming Trump administration on the economy and market performance rather than the prevailing fundamental backdrop (and in some cases in opposition to it). At a broad level equities surged higher and so did Treasury yields, with expected winners and losers pricing in expected policies.
- Many of those impacts largely peaked in mid-December, with some beginning to unwind then. Then in mid-March, following perceived challenges to policy implementation, many of those trades, in whole of large part, unwound their relative gains – and with that the realities of the post-beta trade economic/market conditions came back to the fore investor's minds. The markets began to price out the euphoria of potential policy. And in its place, began to look more closely for where and how economic growth was going to be translated into market growth.



- So small cap stocks – one of the prime beneficiaries of corporate tax cuts—initially surged relative to large cap stocks, outperforming at the peak by over 10 percent cumulatively. But that small cap surge began to unwind those relative gains as investors took a less hopeful picture of when corporate tax policy might actually change, and prior to a June upswing, had given up almost all of the relative outperformance to large caps.
- In the absence of expected growth and inflation, treasury yields fall. In the absence of expected personal income tax reductions, munis, and the corresponding muni/Treasury ratio, which had been punished directly after the election, not only regained their pre-election levels – the muni/Treasury ratio is now lower than pre-election.
- Along with this, EM initially reacted to the protectionist trade policies that were proposed, leading to dollar strength versus other developed currencies. But those priced in expected changes didn't last long, as the fundamental/valuation, and technical case for EM (which we will review later), "trumped" potential policies which had already begun to look much watered down within weeks of the election. Likewise, developed currencies like the euro – particularly due to US policy, and partly given improved local growth and commentary from key central banks -in particular the ECB- that they might begin to withdraw stimulus and or raise rates.
- So if potential fiscal policy changes weren't actually driving the markets over the past few months, what was, for example, sending domestic equities higher?



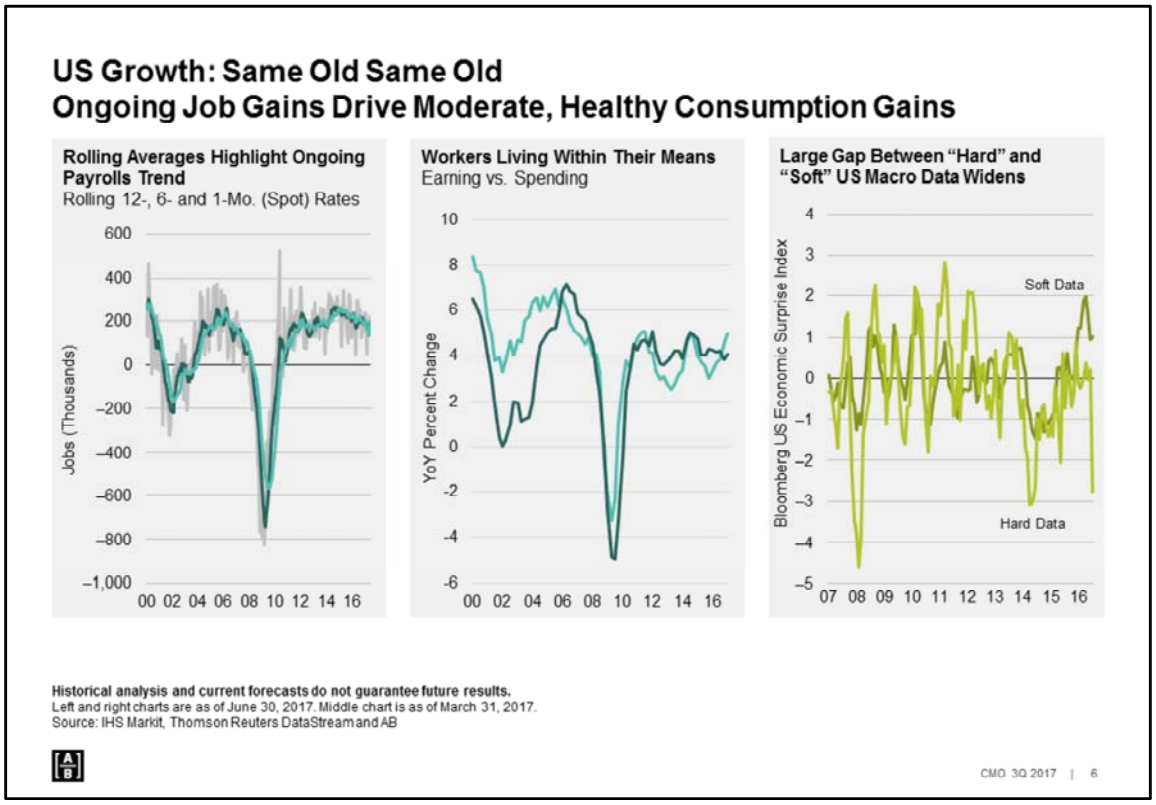
- Volatility, which had been low for some time, actually started to trend even lower in the last few months. Inflation expectations – particularly core – continued to be very subdued, and headline inflation expectations in the intermediate term have turned down. Both of which, among other things, feeds through to the idea that central banks can be more patient in withdrawing accommodation. This further benefits markets. And lastly, global growth has modestly improved and more synchronized around the globe. Developed and emerging markets – Europe, Japan, US, emerging markets generally stable and improving.
- There is a difference between improved…and strong. We're seeing moderate improvement, but we are seeing signs of life in various developed spots around the globe as well as EM.
- And the markets have benefited from the extended spell of low volatility. The bottom line is the more uncertainty you take out of the market, the better the market performance.

Global Growth Projections

Country/ Region	GDP (%) 2017	GDP (%) 2018	Inflation (%) 2017	Inflation (%) 2018	Expected Policy Rate Path	FX Change* (%)	FX Forecast	The Latest
Global	2.9	2.8	2.4	2.5	—	—	—	Solid growth; risks tilted in more positive direction but probability of significant fiscal boost has fallen; global headline inflation softer with focus now on core inflation
Developed Countries	2.1	1.8	1.5	1.7	—	—	—	Gradual withdrawal of monetary accommodation; however, the Bank of Japan likely to lag the US and Europe; modest inflation
Emerging Countries	4.2	4.5	3.9	3.7	—	—	—	Growth has stabilized overall; inflation mostly benign (with some exceptions); many countries have room to ease monetary policy
US	2.1	1.8	1.8	2.1	↑	—	—	Expectations of moderate growth with subdued inflation; one more increase in official rates likely in 2017; gradual reduction in the Fed's balance sheet expected later this year
UK	1.5	1.5	2.7	2.2	↔	–2.2	↓	Political uncertainty likely to weigh on growth; higher inflation but the Bank of England is likely to resist near-term pressure for higher rates
Euro Area	2.1	2.0	1.4	1.3	↑	+2.9	↑	Growth is improving, while inflation is subdued; the European Central Bank is likely to announce and possibly begin tapering of its asset purchases by year-end
Japan	1.5	1.3	0.4	0.9	↔	–8.2	↓	Continued yield curve control leading to weaker JPY; less focus on volume of purchases
China	6.4	5.9	1.5	2.2	↑	–2.0	↓	Economy is expected to slow; clear desire to contain leverage risk, but supporting growth a priority
Brazil	0.6	2.1	3.8	4.1	↓	–2.9	↑	Reforms are expected to stay on course though slowed due to political risks; monetary easing likely to continue as inflation stabilized

Historical and current analyses and forecasts do not guarantee future results.
As of June 30, 2017. GDP represents forecast year-over-year change in real terms. Inflation represents forecast year-over-year change in Consumer Price Index. Expectations for monetary policy are through end of 2017. *FX change is currency spot return for last 12 months vs. US dollar. FX forecast is AB economists' return projections for next six months vs. US dollar. †Quantitative and qualitative easing
Source: Bloomberg and AB

+ But there are still idiosyncratic growth and inflation pockets relating to countries and regions. [read text from "the Latest" to Audience]
+ Front and center in discussions about growth, the US reflects many of the things we're talking about.



- These themes have been in place for some time, and we discussed them last quarter, but in short:
- Job growth continues to be solid, which feeds through to increased consumption. That consumption, while not stellar, is healthy, as consumption levels largely reflect current earnings (rather than a consumer that is dissaving or levering). That translates through to healthy, but not rapid growth – therefore not runaway growth.
- Lastly, there continues to be a large gap between hard and soft economic data (and in particular hard data has turned down recently as measured by the economic surprise index). Typically, soft data tends to be "more right", and hard data tends to move towards it. However, a couple of important points. That is typically true when there is and economic driver underpinning surveys. In this case, many of the large moves up in sentiment occurred shortly after the election, and sentiment surveys are dominated by political affiliation, with sentiment being much higher among the incumbent party, and much lower among others. It will important to watch the trend of both over the coming months, but of course the pendulum will continue to swing both ways between after the beta trade.

The 2017 YTD Performance Tale of the Tape

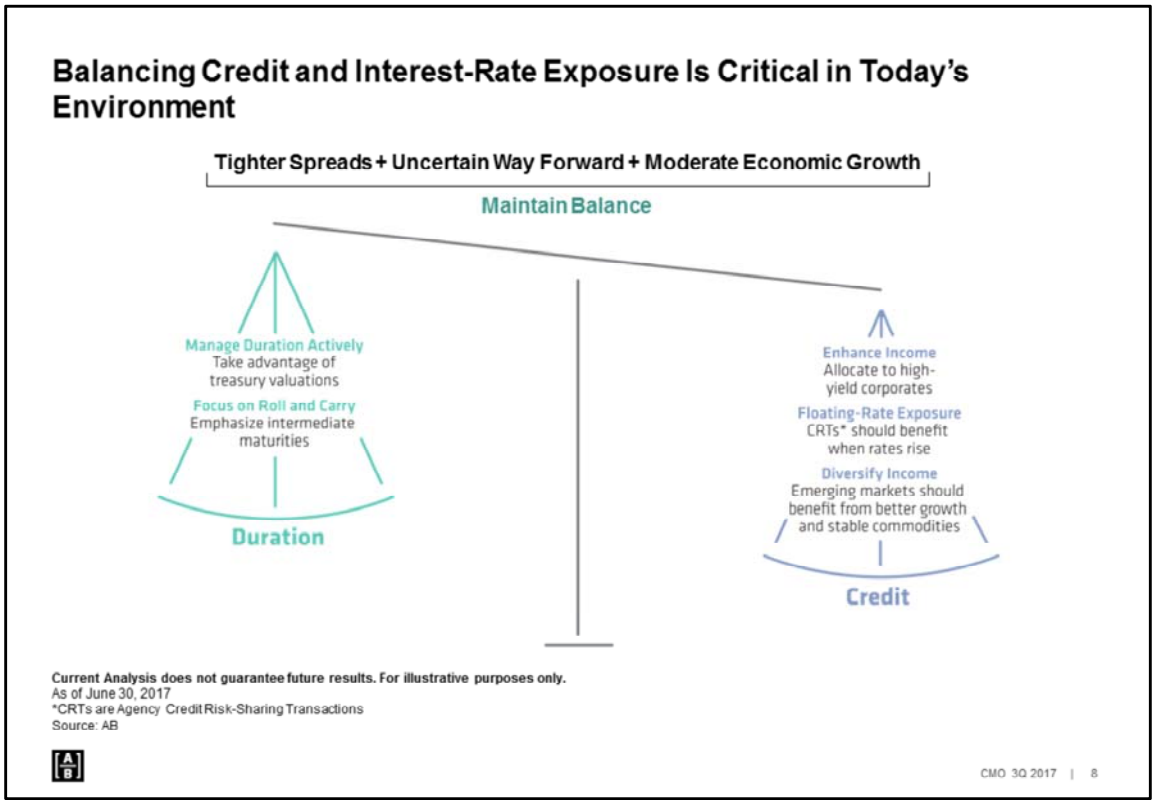
Equity Winners/Losers During First 180 Days
Percent

Relative Winners	Return	Relative Losers	Return
Growth	13.7	Value	4.3
Large-Cap Growth	13.7	Small-Cap Value	0.5
Emerging Markets	18.9	US	9.6
Technology	16.2	Energy	–10.9
Healthcare	16.2	Telecom	–10.0

High Yield
Yields and Spreads Lower in 2Q

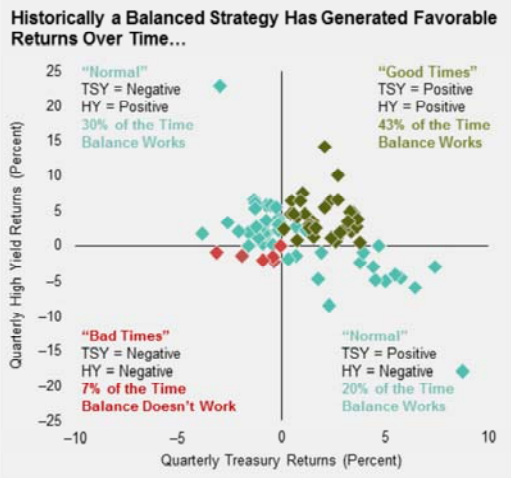
Historical analysis and current forecasts do not guarantee future results.
As of June 30, 2017
Growth is represented by Russell 3000 Growth; value by Russell 3000 Value; large-cap growth by Russell 1000 Growth; small-cap value by Russell 2000 Value; emerging markets by MSCI EM; US by S&P 500. An investor 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 and AB

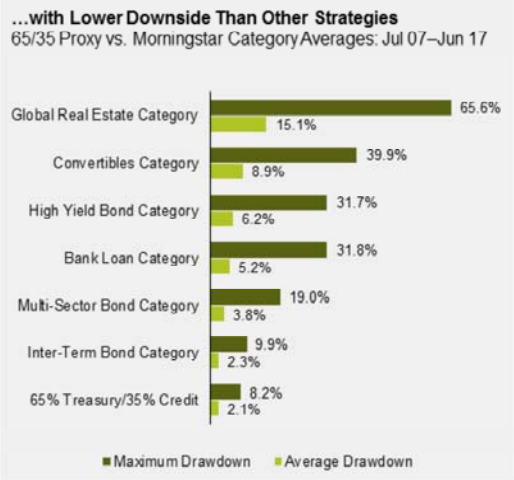
- As we take stock of the first 180 days of Trump, in the aggregate, here have been the winners:
- Beneficiaries of improved global growth – US multinationals
- Non-cyclical growers – those who can grow without economic growth (e.g., tech high fliers & healthcare)
- --- which is why only 10 stocks made up nearly 50% of the S&P 500 performance for most of the first half of the year.
- From a rates perspective (or income perspective) what you've seen is that high yield spreads, in the middle of an environment where growth
- High yield spreads have continued to compress regardless. So HY yield to worst has gotten tighter. Has continued to get tighter, but unlike the previous months leading to the 2nd q it has come from tighter yields but US treasury yields have also fallen – so spreads are tight, rates still a bit higher, but mostly because Fed fund rates have risen. So the curve has actually flattened back post the trump bump.
- The short end has gone up commensurate with the Fed funds rising, but the longer end has only moved up slightly. At the long-end there's more art in trying to price in longer term growth, inflation and other factors.
- With these two realities of after the beta trade and Trumponomics continuing to compete for market performance – this isn't going away – so how do markets and investors balance these dual realities of modest growth etc. and trump potential policy?
- This notion of balance as it relates to fixed income is about balancing exposure to rates and credit.
- So how should an investor think about working with lower rates and tighter spreads?



- Risk assets—like high yield and other credit markets—have been rallying for about a year. While sentiment remains positive, and the growth backdrop is positive—typically a good environment for risk assets—valuations are now less attractive as spreads have tightened. The looming political uncertainty could also disrupt the good mood and lead to higher volatility, especially if market participants begin to believe that President Trump may not be able to deliver on all of his campaign promises. In times like these, it's important to balance credit risk and interest-rate risk.
- With the interest-rate-sensitive portion of your bond portfolio, now is a good time to be flexible with your duration exposure while pursuing market opportunities. Intermediate maturities still present the most attractive opportunities, where you can take advantage of the power of roll—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, with the intermediate maturity range affording strong roll potential. Another addition to the high-quality portion might be a modest exposure to US Treasury Inflation-Protected securities (TIPS), which should perform well given current valuations, expectations of moderate US growth and anticipated inflationary fiscal spending. Finally, adding global high-quality bonds (on a currency-hedged basis) is also an easy way to maintain defensive bond characteristics, but diversify away from the US market. It is still prudent to balance high grade bonds with some credit exposure to generate some income and lower rate sensitivity. Within the credit component, we suggest combining sectors such as high-yield corporates, floating-rate Agency Credit Risk-Sharing Transactions(CRTs) and emerging market debt that has started benefiting from better growth and more stable commodity pricings.
- More than simply keeping this balanced exposure to both credit and interest-rate sensitive bonds, it's important to monitor the interplay between these two segments and to be flexible in managing the dynamics between them. Today we would be more diversified in the credit allocation, with more exposure to emerging markets and CRTs versus a year ago when corporate valuations were more attractive. Also, given expectations for solid growth we would recommend a tilt towards credit.

Balanced Strategies Improve Consistency of Returns and Limit Downside

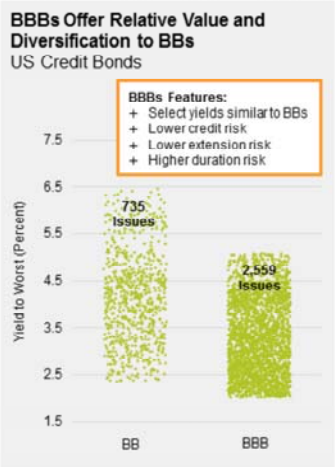




Historical analysis does not guarantee future results.
As of June 30, 2017
Treasury is represented by Bloomberg Barclays US Treasury; high yield by Bloomberg Barclays US Corporate High Yield.
Source: Bloomberg Barclays, Morningstar and AB

- This quarter, we've seen continued economic growth, sturdy employment numbers and inflation numbers that let the Fed feel comfortable raising rates again in March—the third 25-basis-point hike in the past 16 months. The market and the Federal Reserve's expectations for further official rate increases is still slow and steady, with the probability of another two modest increases this year, and a similar pace next year. There is a risk that if growth and inflation surprise on the upside (e.g., if an aggressive fiscal stimulus package is passed by the new Administration) the Fed could be forced to go faster. Nevertheless, today the markets are pricing in a further 50 basis points of hikes in 2017, which matches the median Fed expectations of two more increases, as the left-hand chart shows.
- But rising rates don't impact all parts of the fixed income market to the same degree, and don't have to mean disaster for bond portfolios. In the left-side display, we've calculated hypothetical returns for two bond indices assuming a range of interest rate and yield spread scenarios. These different scenarios allow investors to look at a range of possible outcomes, depending on their expectations for movement in Treasury yields and spreads, regardless of past correlations between the two. A 50 basis-point rise in the US Treasury yield curve doesn't derail the returns of the US Aggregate bond index over the next year, because of the power of income and roll (roll being the change in the price of a bond as it gets closer to maturity). A more dramatic spike would push return expectations into negative territory. While not the base case, it is possible rates could decline amid the many sources of risk and uncertainty today, in which case the US Aggregate return expectations are strong. That's a big reason why you need to keep some exposure to interest-rate sensitive bonds in your portfolio.
- If we turn to the high yield market, return expectations look attractive even under assumptions of rising rates and widening spreads—that's the power of the roll and carry in higher yielding bonds. Diversification, as always, is key to your bond portfolio, because bond sectors don't always move in sync. The right-hand chart shows the different degrees of correlation between US Treasuries and other bond sectors. While the US and Global Hedged Aggregates are closely correlated, municipals are only moderately so, and high yield—both US and global hedged—have historically demonstrated a negative correlation to Treasuries, which helps to explain why even in rising rate environments high-yield corporate bonds have generally delivered positive returns.
- So while rates may be rising, there's also a high level of uncertainty. To navigate uncertain waters, we highly recommend a balanced approach to your fixed income.

Credit: Opportunities Still Exist but Selectivity Is Key



High Extension Risk Makes BBs More Vulnerable to Rising Rates

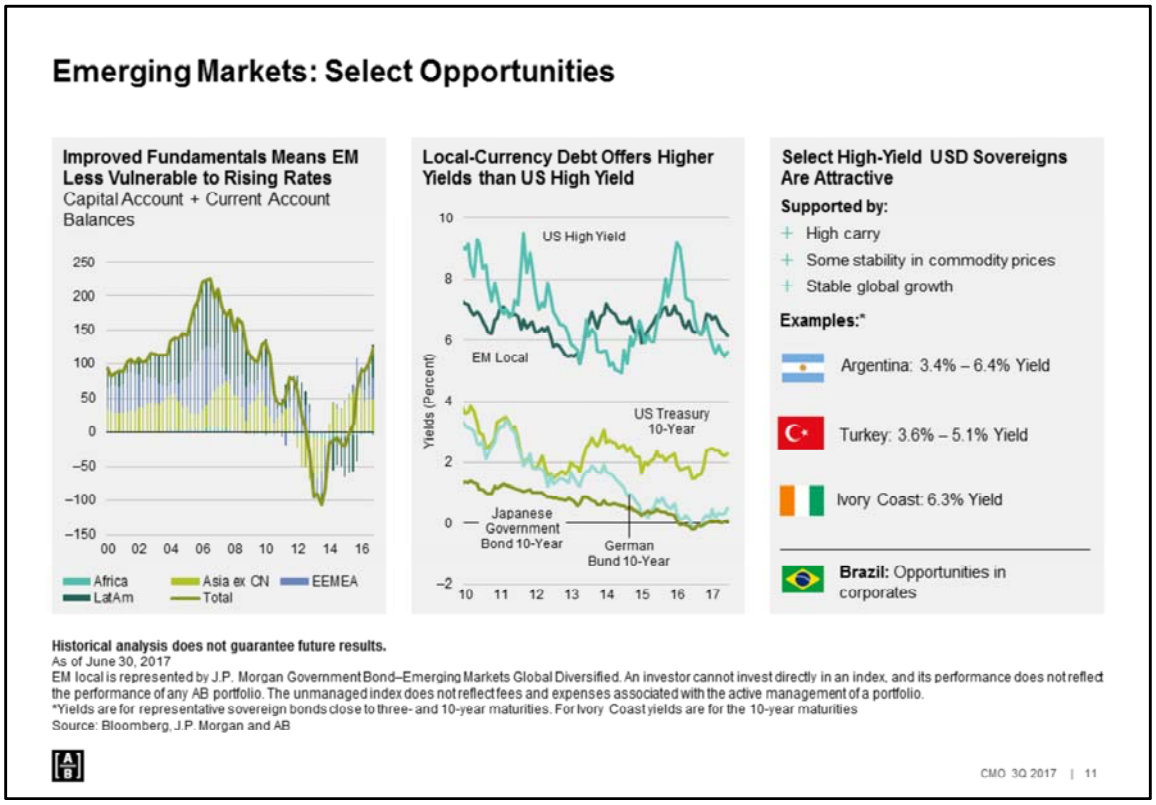
Segment	Percent Priced to Call	Yield to Worst (Percent)
BB	45.7	4.21
B	62.6	5.60
CCC	48.7	8.85

Higher yield in Bs compensates us more adequately for extension risk

Though CCCs have higher yield, we remain very cautious here

Historical analysis does not guarantee future results.
Left display as of June 30, 2017, except equity forecast as of December 31, 2016; middle and right displays as of June 27, 2017
Global HY is represented by Bloomberg Barclays Global Corporate High Yield (USD Hedged); US HY by Bloomberg Barclays US Corporate High Yield; BBB by Bloomberg Barclays US Aggregate BBB; BB by Bloomberg Barclays US High Yield BB; and B by Bloomberg Barclays US High Yield B. 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 Barclays and AB

- While high yield spreads and yields are below average, they look quite good relative to passive equities, because they offer a similar return forecast but with less volatility.
- The left-hand chart shows the Global High Yield index yield-to-worst, which is a metric used to evaluate the lowest possible yield an investor might receive on a bond (incorporating provisions like call options), provided the issuer doesn't default. It's been a pretty reliable indicator of the type of annualized returns you can expect over the next five years. And currently, US Corporate High Yield is about 5.8% and Global is roughly 5.3%. That's compelling relative to our forecasted returns for passive equities which are around 5.9% for US equities, especially as high yield exhibits significantly lower volatility….but you need to be selective in the high yield space as valuations have shifted.
- For example, the middle chart shows that BB-rated bonds are looking rather expensive. In fact, when compared to BBB-rated bonds, BBs have rallied more—as you can see in the middle display showing the difference between the two market's spreads.
- And the high extension risk in BBs makes them more vulnerable in rising rate environments—like today. At low yield levels, many callable bonds trade at a price/yield that assumes they will be called; as rates rise, an issuer may decide not to call its bonds since doing so could result in refinancing at higher yields. In that scenario, investors would see the duration on their bonds grow at the worst possible time—we call this extension risk. in contrast, BBB rated bonds typically do not have a call provision – adding to their attractiveness today.
- As the right-hand chart shows, while there is also a large cohort of B-rated bonds that are trading to their call price, these bonds provide a higher yield, compensating us more adequately for that extension risk. And while CCCs have even higher yield, there's also much higher potential for default. So we remain very cautious over the risks here.

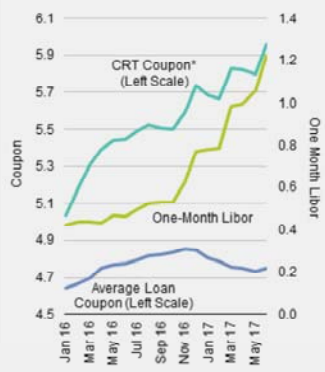


+ Diversifying a credit portfolio also means looking to the emerging markets.
+ We see value in emerging markets today due to their strong fundamentals and techncials and valuations that look compelling relative to other sectors.
+ One illustration of improving EM fundamentals (in the left-hand chart) is the “basic balance,” which gives a measure of money going into/out of a country. The basic balance is the combination of a country’s current account balance and capital account (which includes foreign direct investment [FDI]). For the four basic EM areas—Africa, emerging Europe and Middle East, Asia ex-China and Latin America—the “basic balance” has moved back into positive territory. The improved basic balance and increased FDI flows make the EM countries less vulnerable to potential capital outflows and more resistant in a rising rate environment.
+ Today we see opportunities in three different segments of emerging market debt; EM local bonds and currencies and EM hard currency sovereign debt, particularly of higher-yielding issuers..
+ The middle chart focuses on the appeal of local-currency sovereign debt today. EM local currency debt is significantly more attractive than government debt of developed market countries from a yield perspective. It also offers a modestly higher yield than US corporate high yield. What we like in this space are countries with improving fiscal balances, where inflation is stabilizing and monetary policy is either on hold or is expected to ease. Keeping some of the local bonds unhedged gives investors exposure to EM currencies as well. Generally, EM currencies are trading at discount to history. They also represent an easy and liquid way of gaining or reducing exposure, which makes them a great tool in efficiently managing the overall risk budget of the portfolios.
+ The right-hand chart gives several examples of appealing lower-rated US-dollar sovereigns, which are supported by more stable global growth and high carry. We show the examples of the yields on the shorter and intermediate maturities in select countries in the right graphic.
+ Argentina has some idiosyncratic factors leading to improving country fundamentals, while Ivory Coast is a commodity exporter. Turkey too offers a nice diversification to the portfolios given current yields.
+ We’re also highlighting Brazil for opportunities in some corporates.

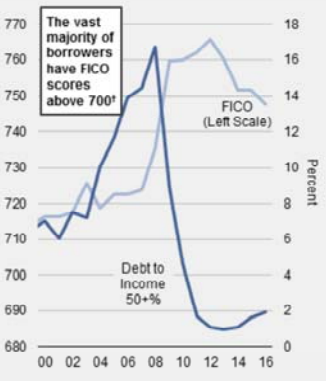
Floating Rate Exposure?

Try Agency Credit Risk-Transfer Securities (CRTs)

Loans Have Not Benefited from Libor Rising But CRTs Have



Residential Mortgage Market Is Still Early in the Cycle



CRTs Have More Attractive Features Than Loans...

- Both have a *floating rate structure* but CRTs offer:
  - Better liquidity
  - Better fundamentals
  - Better portfolio diversification

...and Have Comparable Yields:

Asset	Approximate Loss Adjusted Yield (Percent)
CRTs	3.5 – 7.0
Bank Loans	4.0 – 16.0

Historical analysis does not guarantee future results.
Left and right displays as of June 30, 2017; middle display as of December 31, 2016
*Last Cash Flow and Equity coupons.
†FICO score is a type of credit score that helps lenders assess borrower's credit risk. Typically, scores above 650 indicated a very good credit history. FICO scores and Debt to Income ratios is for borrowers with low Loan-to-Value ratios backed by Freddie Mac. Bank Loans are represented by Credit Suisse Leveraged Loans Index.
Source: Bloomberg, Credit Suisse, J.P. Morgan and AB

- With rates going up, many investors look to floating rate investments for protection. We see value in floating rate instruments, but investors have to exercise caution.
- For example, bank loans' floating-rate coupons are a big draw for this asset. But there are risks to the sector that must be kept in mind—namely credit risk, refinancing risk and liquidity risk. Bank loans are issued by below-investment-grade companies – and so investors must be mindful of default risks at this stage of the credit cycle.
- Refinancing risk is also a concern in bank loans. Bank loans have a feature that allow issuers to refinance them at any time. The refinancing has been significant in the past year as a substantial amount of them reach par, and overall yield levels remain low. Despite a rise in LIBOR rates, as we show in the left-hand chart, spreads have narrowed, keeping coupons low. Allowing companies to refinance their loans at **lower** rates defeats the whole idea of buying floating rate debt for rising yields.
- So if you want floating rate exposure, we feel an appealing alternative is the Agency Credit Risk-Sharing Transactions (CRTs) mortgage-backed bond market. The US real estate market is earlier in its credit cycle (vs corporates), and the middle chart shows that the fundamentals in the US real estate residential mortgage market are very strong. For example, current FICO scores—the creditworthiness scoring of the individual homeowners—have greatly improved over the last 10 years. And the job market is strong, with household net worth on the rise. This makes certain residential mortgage-backed securities look attractive, particularly since losses among mortgage borrowers have actually been coming in even less than we've expected. The loan-to-value ratios and the debt-to-income ratios are also at very healthy levels.
- Like bank loans, CRTS have floating rates, but CRTs offer better liquidity, since loans are relatively illiquid and typically require a few weeks to settle. CRTs also have better fundamentals as the middle chart shows. They provide attractive portfolio diversification—away from corporates to real estate, <u>and</u> offer a similar range of yields to bank loans.

Interest-Rate Exposure Is as Important as Ever, but Globalizing Is Key

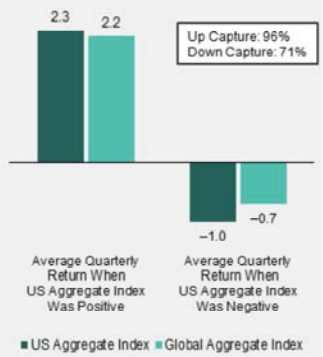
Rising Rates Don't Always Have to Derail Bonds*
Expected Total Returns (Percent)

US Aggregate		Change in US High Yield Spreads (b.p.)			
		−50	0	50	100
Change in US Treasury Yields (b.p.)	100	−1.4	−1.8	−2.1	−2.5
	50	0.9	0.6	0.2	−0.1
	0	3.2	2.9	2.5	2.2

US High Yield		Change in US High Yield Spreads (b.p.)			
		−50	0	50	100
Change in US Treasury Yields (b.p.)	100	5.5	4.0	2.4	0.9
	50	6.6	5.0	3.5	2.0
	0	7.6	6.1	4.5	3.0

Time Erases Pain of Rising Rates
24-Month Rolling Returns (Percent)

Global Outperforms When US Falls
Up vs. Down Capture
(March 1990–June 2017)



Past performance does not guarantee future results.
Left display as of June 27, 2017; middle and right displays as of June 30, 2017. *The scenario analysis assesses the potential impact of instantaneous changes in US High Yield spreads and a parallel shift in the US Treasury yield curve on the US Aggregate and US High Yield indices Bloomberg Barclay indices. Expected returns incorporate the impact of roll and carry over the subsequent 12 months. Bar height might differ due to rounding. Global bonds hedged is represented by Bloomberg Barclays Global Aggregate Hedged to USD; 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

- As we mentioned, given the risks to the macro outlook and less attractive credit valuations, you still need to maintain a balance between exposure to interest rates and credit in your fixed income portfolio. And we find global is the best route for rates.
- The left-hand chart shows that in periods when US 10-year yields have increased 100 basis points or more, hedged global core bonds typically outperform US core bonds.
- Even though investors can initially experience negative returns when yields rise, with bonds, times heals the pain of rising rates. The middle chart shows how it's important to stay invested, because over any two-year rolling period, the US and global hedged aggregate have never delivered a negative return—illustrating the power of roll and carry to offset the negative impact of rising rates over time.
- Again, though, a global approach is more attractive during rising rate environments: when the Fed hiked in 2005 and again when rates rose during the 2013 Taper Tantrum, the global hedged aggregate did better.
- Also, since inflation has been on the rise, consider including some inflation protection, because it's attractively valued today. The right-hand display shows that the breakeven inflation rate is about 1.9% right now, which is nowhere near core inflation. And our inflation expectation estimates are pointing to further increases from here. So we're likely to see outperformance by Treasury Inflation-Protected Securities (TIPS)—but we favor intermediate maturities so as not to take on too much interest rate risk.

Munis: Valuations Have Tightened, but Technicals Remain Supportive

Past performance does not guarantee future results.
Left and middle displays as of June 30, 2017; right display as of May 30, 2017
Source: The Bond Buyer, Federal Reserve Flow of Funds, Municipal Market Data, Siebert and AB

- Valuations in the municipal market have compressed, just like they have in the taxable market. But that does not mean that the opportunity is gone.
- As shown in the left display, the after-tax yield advantage over Treasury bonds has declined since its high in November of last year when Donald Trump won the US presidential elections. It is also below the 5-year average but a little above where it stood last August.
- However, while valuations have tightened, technicals in the sector remain supportive. 2016 saw a lot of issuance brought forward, with the issuers taking precautions before the presidential elections and refinancing their debt. As a result the refinancing volume has declined 40% this year. We don't expect this to change unless rates decline significantly. The middle display also shows that the new issue supply is expected to stay below last year's levels. At the same time flows picked up, reversing the outflows that we witnessed in the fourth quarter of last year. If we compound this with the record amount of bonds that are maturing, the technicals looks very favorable and should be supportive of the municipal market.

Balance Muni Intermediate Quality with Longer-Maturity Credit

+ **Shorter Bonds:** Consider short-maturity municipals vs. comparable-maturity taxable bonds
+ **Intermediate Bonds:** Focus on roll and carry from high-grade munis and crossover opportunities in Treasuries
+ **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

Historical analysis does not guarantee future results.
As of June 30, 2017
Nominal yields. A 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

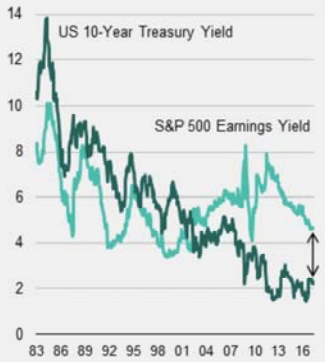
+ Today's muni opportunities balance intermediate high quality bonds with longer-maturity muni credit. In other words, adding income with muni credit exposure is a better approach than reaching for yield by buying longer-maturity high-grade munis. If inflation increases and yields rise—or if tax reform is passed—longer-maturity high-grade munis face the most downside risk.
+ 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.
+ We still see the "sweet spot" of the yield curve as intermediate maturities, in terms of combined yield and roll potential. For a 10-year A-rated muni bond, the combined potential of yield and roll amounts to about 3.7%. Yield plus roll is currently a bit higher for a 10-year bond than a 30-year bond, which carries significantly more interest rate risk and volatility! So we favor high quality municipals in the intermediate range.
+ But we're willing to buy longer-maturity bonds when dipping down in credit quality (which is where most of the lower-quality supply is). We still recommend some exposure to BBB-rated bonds, where investors get not only modest yield pickup, but lower interest rate sensitivity versus higher quality bonds. At the short end of the yield curve, we continue to favor short maturity municipals versus comparable maturity taxable bonds. But now let's explore the concerns and potential opportunities we're seeing in the equity markets.

Equities: Look to Earnings Growth, Not Multiple Expansion

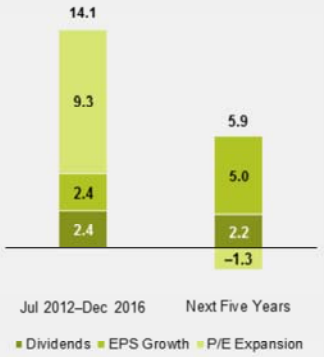
Equity Valuations Are Elevated…

Index	P/FE	20-Year Median
S&P 500	18.6×	16.3×
S&P Mid-Cap 400	20.5	18.1
S&P Small-Cap 600	22.0	18.8
MSCI EAFE	15.3	14.2
MSCI World	17.3	15.9
MSCI ACWI	16.7	15.1
MSCI EM	12.9	11.7

…Yet the Large Gap Between Stock and Bond Yields Persists
Stock Earnings Yields vs. Bond Yields (Percent)



Earnings: Critical Component of Forecasted Returns*
US Large Cap Annualized Returns (Percent)



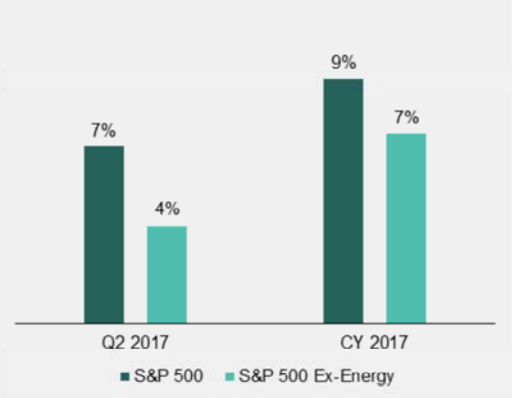
Historical analysis and past performance do not guarantee future results.
Left and middle displays as of June 30, 2017; right display as of December 31, 2016
The forecasted figures utilize book value and price-to-book valuations instead of earnings and price-to-earnings.
*Historical data are for the S&P 500 "Next Five Years" is the median AB proprietary forecast for a similar group of stocks.
Source: Bloomberg Barclays, FactSet, S&P and AB

- With equities, even though P/Es are pretty high, there are still some opportunities, but look for the "best in class" stories within each sector and capitalization. This is a market where you need to research and find the better topline growers, and watch out for the crowded trades of the stocks that basically act like bonds.
- Generally speaking, valuations look stretched—you can see that in the left-hand chart, where all US market caps as well as global developed and emerging markets are currently above the 20-year median for each.
- But despite the high valuation levels, equities are still attractive relative to bonds. The center chart compares the earnings yield of the S&P 500 (the aggregate earnings per share of the S&P 500 divided by the price level of the Index) to that of the 10-Year Treasury Note. The gap has narrowed a bit, but it still indicates opportunity for equities going forward.
- The composition of that opportunity, though, will be quite a bit different from the recent past.
- In the right-hand chart, most of the US large-cap gains during the Great Beta Trade came from multiple expansion. From July 2012 through the end of 2016, P/E Expansion produced the lion's share of the total returns.
- Over the next five years, multiple expansion will likely be a detractor to overall returns. And dividends will remain relatively the same. We're forecasting that overall returns will be much lower—roughly 6% annualized—and most of that gain will have to come from earnings.

Valuations Elevated, but Supported by Earnings Improvement

S&P 500 Bottom-up EPS Actuals and Estimates
Out of Stall Mode

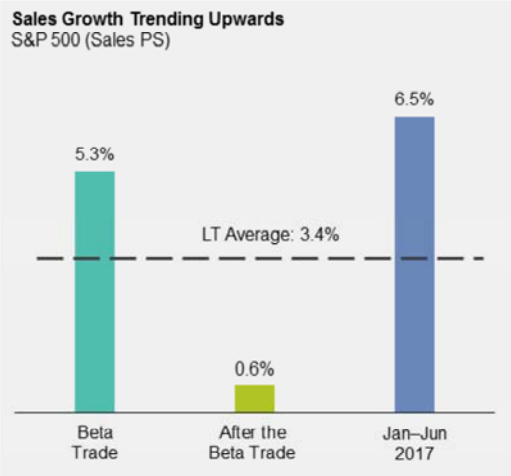
S&P 500 Estimates Earnings Growth
Even ex-Energy, a Healthy Picture

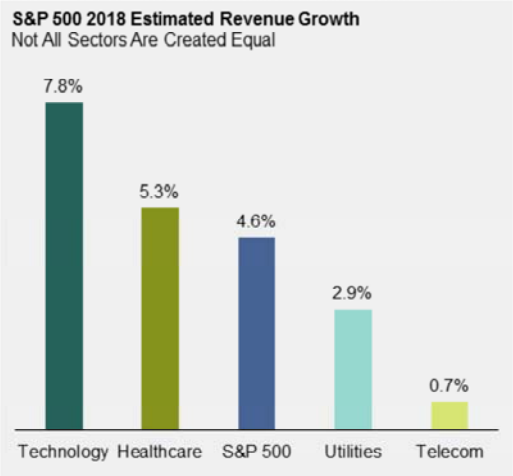


Past performance and historical analysis do not guarantee future results. Not all sectors perform the same.
As of June 30, 2017
EPS = earnings per share
Source: FactSet, S&P and AB

- Yes, returns will likely be lower, but we see these returns—grounded in earnings—as a healthier environment than returns driven by multiple expansion.
- In the past several years, earnings growth wasn't unhealthy, it just wasn't growing, as you see in the left-hand chart. But **consensus** forecasts point to a pickup for both this year and next.
- And that earnings growth isn't just forecast for energy stocks. The right chart shows that the S&P earnings estimates for the 2nd quarter and the full year 2017 are strong with energy, but they're still quite healthy even when you strip out energy.

Topline Growth Has Improved, but Dispersions Remain Wide





Past performance and historical analysis do not guarantee future results. Not all sectors perform the same.
As of June 30, 2017
Beta Trade period is calculated from September 30, 2010, through February 27, 2015; After the Beta Trade period is calculated from March 31, 2015, through June 30, 2017; LT Average period is calculated from April 30, 2002, through June 30, 2017
Source: Factset, S&P and AB

- Sales growth tells the same story. In the left-hand chart, revenue continues to grow, with sales per share rising.
- However, just as all companies are not created equal, the same applies to the topline growth they can generate.
- Note the revenue growth of the top two fastest growing sectors versus the lowest two topline growers (information technology, heath care, and utilities and telecom services, respectively).
- There's quite a difference between the two groups. And given the stage of the economic cycle we're in—coupled with the moderate economic growth we expect—those companies that can consistently deliver strong topline growth should be coveted by investors.
- So on a broad-based look at stocks, we're still seeing room to grow—with or without energy stocks. However, the story within the story calls for a more active and selective approach to today's equity markets.

RUST Stocks Expensive and Upside Likely Limited

Value for Your Money?
Price/Earnings Ratio

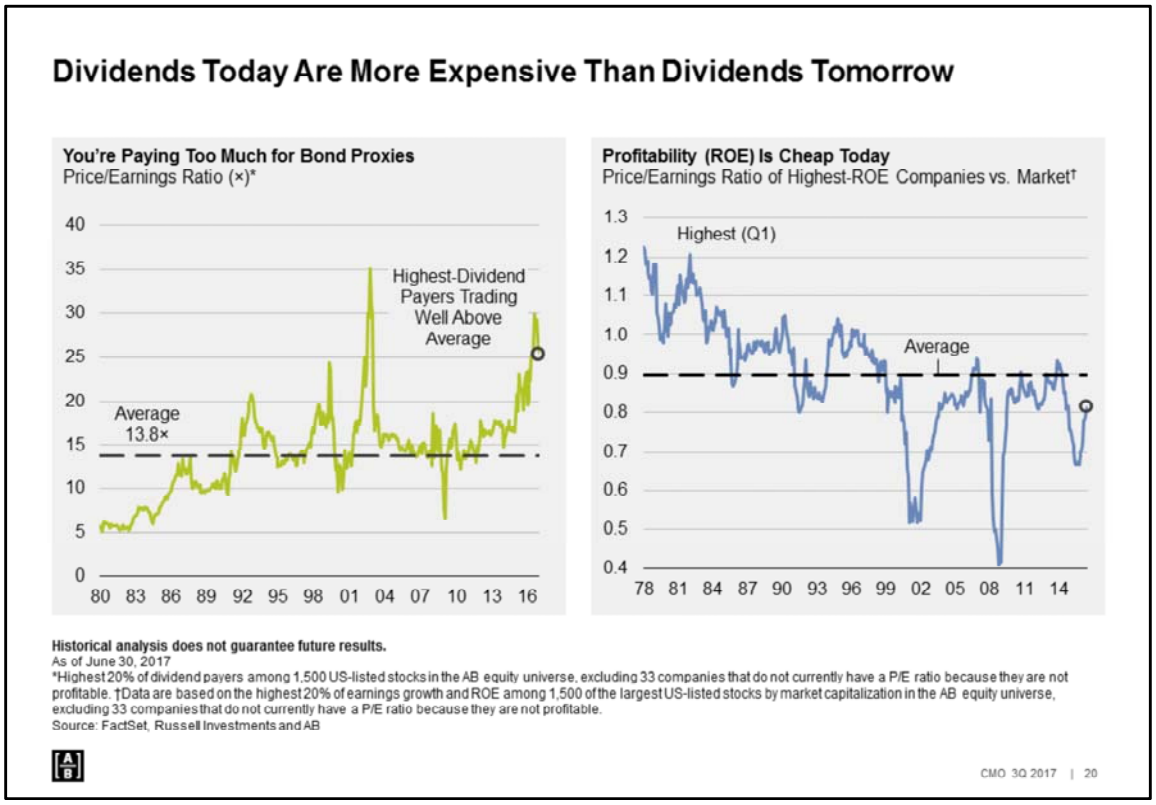
Sector	Forward P/E	Earnings Growth	PEG Ratio
Telecom	13.1×	3.0×	4.4×
Utilities	18.3	6.4	2.9
Consumer Staples	20.7	7.8	2.7
Real Estate	18.1	7.3	2.5
S&P 500	**17.7×**	**11.7×**	**1.5×**

RUST Sectors
Materially Lower Rates Required for Outperformance

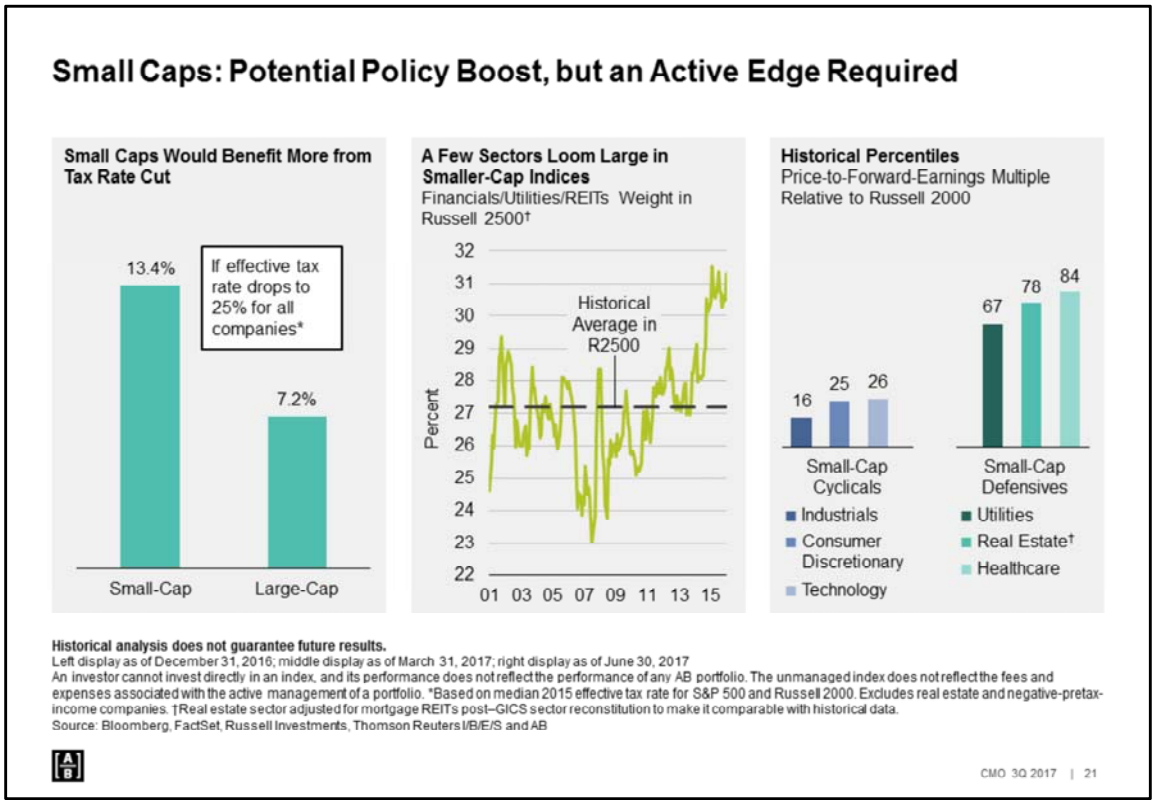
Year	S&P 500 Return	Change in RUST (%)	Change in 10-Year (b.p.)
2008	**–37.0**	**16.00**	**–166**
2009	26.46	–3.75	139
2010	15.06	3.56	–55
2011	**2.11**	**11.32**	**–147**
2012	16.00	–1.05	–19
2013	32.39	–14.22	118
2014	13.69	5.18	–83
2015	1.38	0.88	15
2016	11.96	–0.47	21

Past performance and historical analysis do not guarantee future results. Not all sectors perform the same.
Left display as of June 30, 2017; right display as of December 31, 2016
Source: Dow Jones Indices, FactSet, Federal Reserve Board, MSCI, Ned Davis Research, S&P and AB

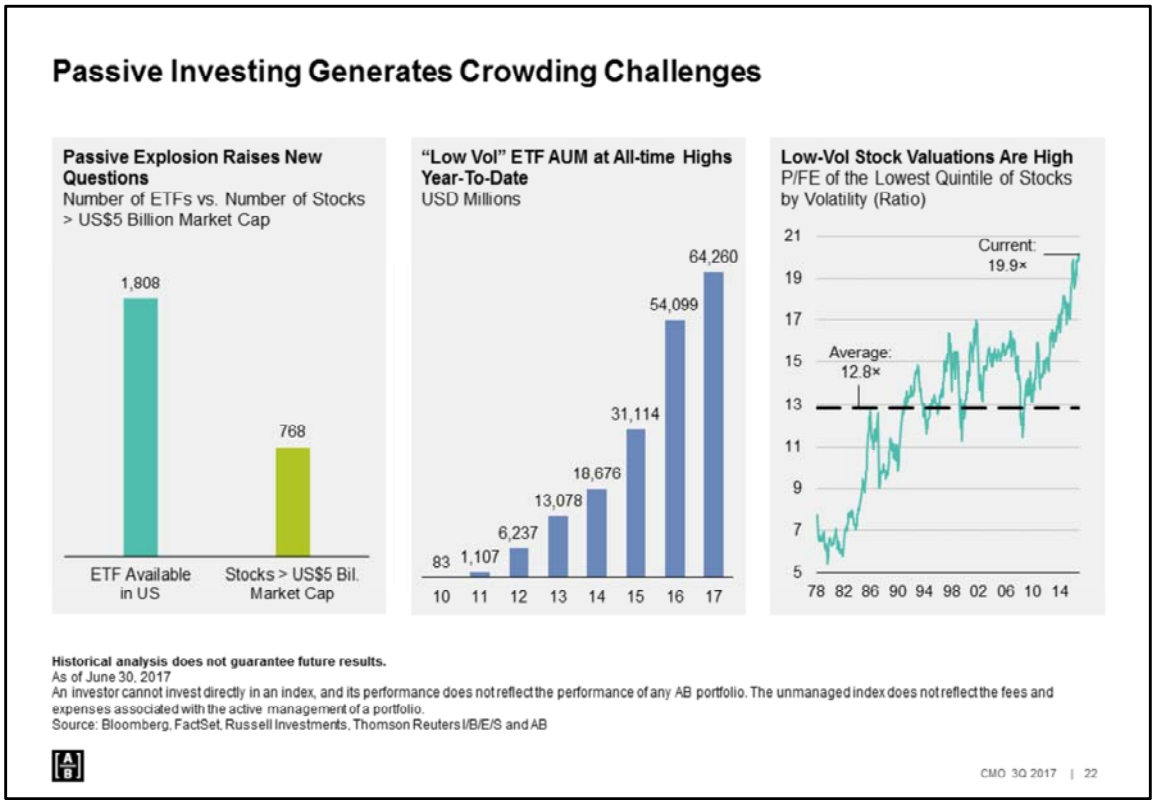
- In general, with valuations on the high side, you really do have to be selective. Indexing can't help you sift through sectors and stocks to limit downside risk or to identify the companies that have respectable growth prospects.
- There's a wide difference among sectors as to their future growth prospects, especially when high dividend yield sectors are examined. And we can see that with the PEG ratios shown in the left-hand chart for the RUST (REITs, Utilities, Consumer Staples, And Telecom) sectors.
- PEG ratios give you a good indication of the price you're paying per unit of earnings growth. And generally, you want that ratio to be lower.
- These high-dividend paying sectors—bond proxies—are not only saddled with some very high PEG ratios, they're also facing the difficult hurdle of a rising interest-rate environment.
- Historically speaking, high-dividend-yielding stocks tend to hold up better in crises, when investors seek near-term safety, because they garner more of their return up front through dividend payments, rather than from future growth. But they also tend to be highly sensitive to interest-rate risk, often because they are mature firms with high debt burdens. As a result, these stocks—and portfolios with outsized allocations to them—are likely to trade down with bonds if interest rates rise.
- And while PEG ratios for sectors such as technology and health care are in line, or slightly higher than the broad market, companies that can deliver persistent fundamental strength, and that do a great job of converting the promise of growth into the reality of growth should be worth a higher price tag than the average stock in the market.
- So, factors such as a company's competitive positioning, its business returns and how its growth is funded need to be taken into account, and that requires a lot of fundamental work, a discerning eye and a long-term horizon.
- The chart on the right tells an interesting story about the RUST sectors. The only years of the past decade when they've had a meaningful uptick in performance have been when the yield on 10-Year Treasuries fell more than 50 basis points. And as a group, they've only outperformed the broader S&P 500 in the two years when the "flight to safety" brought major drops to Treasury yields. All in all, this doesn't bode well for the RUST sectors.
- In today's market, we believe a selective, active approach, focused on valuation, profitability, dividend growers, and company fundamentals presents a more compelling opportunity set.



- Another concern with those high yield-oriented equity sectors is that they're currently trading high above their long-term historical average, as the left-hand chart shows.
- Since the Taper Tantrum, these sectors have outperformed, yes, but they've also seen massive capital inflows that have inflated their valuations severely.
- This cohort of equities is trading at roughly 28 times earnings—significantly higher than their average P/E ratio of 13.7. We think that's a hefty price tag for stocks that act a lot like bonds.
- We believe that crowded trades like these are very risky. If rates continue to rise in 2017, investors with balanced stock/bond portfolios who are overweight in high-yielding equity sectors might not be as diversified—or safe—as they think.
- At the same time, companies that are actually "delivering the goods," are still underappreciated by the market. We like to look at companies with sustainable and solid levels of profitability. But safety and current income is still dominant for investors today, so they're overlooking which companies have high profitability as we're showing in the right chart. These companies with the highest Return On Equity (ROE, which is a key measure of profitability) are still trading below their long-term average valuations.
- Again, taking an active approach to equity investing can help investors avoid overweights in seemingly safe—but crowded-trade—sectors that have diminished potential for positive performance.

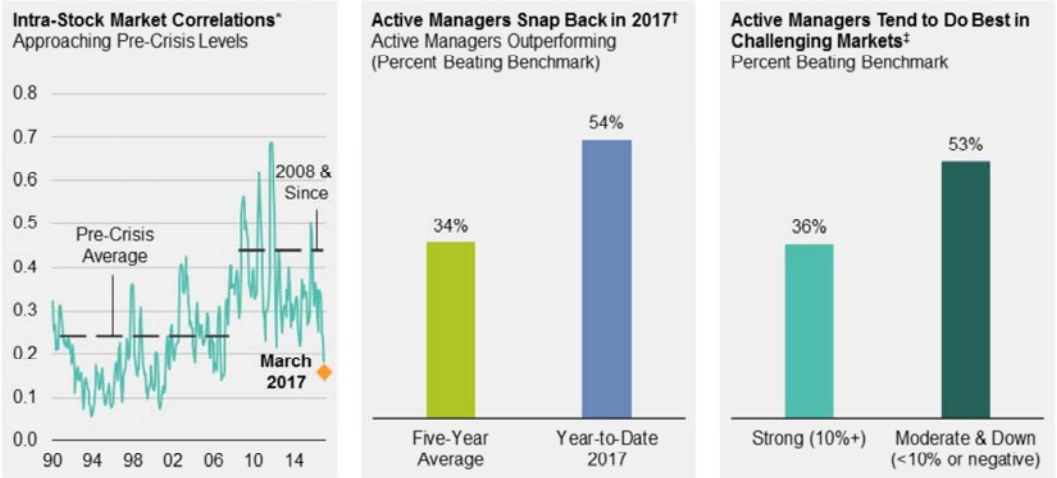


- Small-cap stocks are another good case in point for highlighting the advantages of active management.
- Small caps soared in 2016—returning over 21% [21.31%] versus the large-cap average of nearly 12% [11.96%]. And small-caps may fare better than larger companies if the Trump administration's proposals to cut taxes and relax regulations make it into policy. That's because smaller companies are more domestically oriented, pay higher taxes and face disproportionately stiffer regulatory burdens than the larger firms.
- Over the last month or two, expectations have dimmed significantly for many of those proposals to become legislation any time soon. Most recently, the scuffles with any healthcare bill have reinforced that point. But a cut in corporate tax rates might stand a better chance.
- If the effective corporate tax rate drops to 25% for all companies, the potential earnings per share increase for small caps will be nearly double that of large companies. And some smaller companies that pay close to the full current corporate rate—such as regional banks and some consumer and industrial companies—could see earnings rise by 10%–20% if the rate falls as proposed.
- Even so, while we remain positive on small stocks, we believe investors should be selective in how they get exposure. For example, rising rates are good for bank shares, but bad for interest-rate sensitive REITs and utilities. Those three sectors now make up a much larger portion of small-cap index, as we show in the middle chart, making them riskier for passive, index investors.
- Small-cap market gains over the past five years have been heavily skewed to stable-earners and high-dividend payers in healthcare, real estate, consumer staples and utilities. Cyclical, globally oriented technology, industrials and consumer discretionary stocks have trailed. The hunt for income and safety also steered capital away from fast-growth companies, which are more likely to reinvest profits back into their businesses.
- As a result of these divergences, our right-hand chart shows that neglected small-cap cyclicals are trading at some of their lowest multiples relative to the index in nearly 30 years, while their defensive peers trade at some of their highest. Relative valuations for high-quality, secular growth stories also look extremely attractive. With the economy on a solid footing, this valuation gap creates rich pickings for active investors.
- In this environment, autopilot index-tracking approaches are at a big disadvantage, in our view. They can't interpret the varying ways that new policies and economic developments may impact individual sectors and companies, nor can they avoid risky concentrations in overvalued pockets of the market.



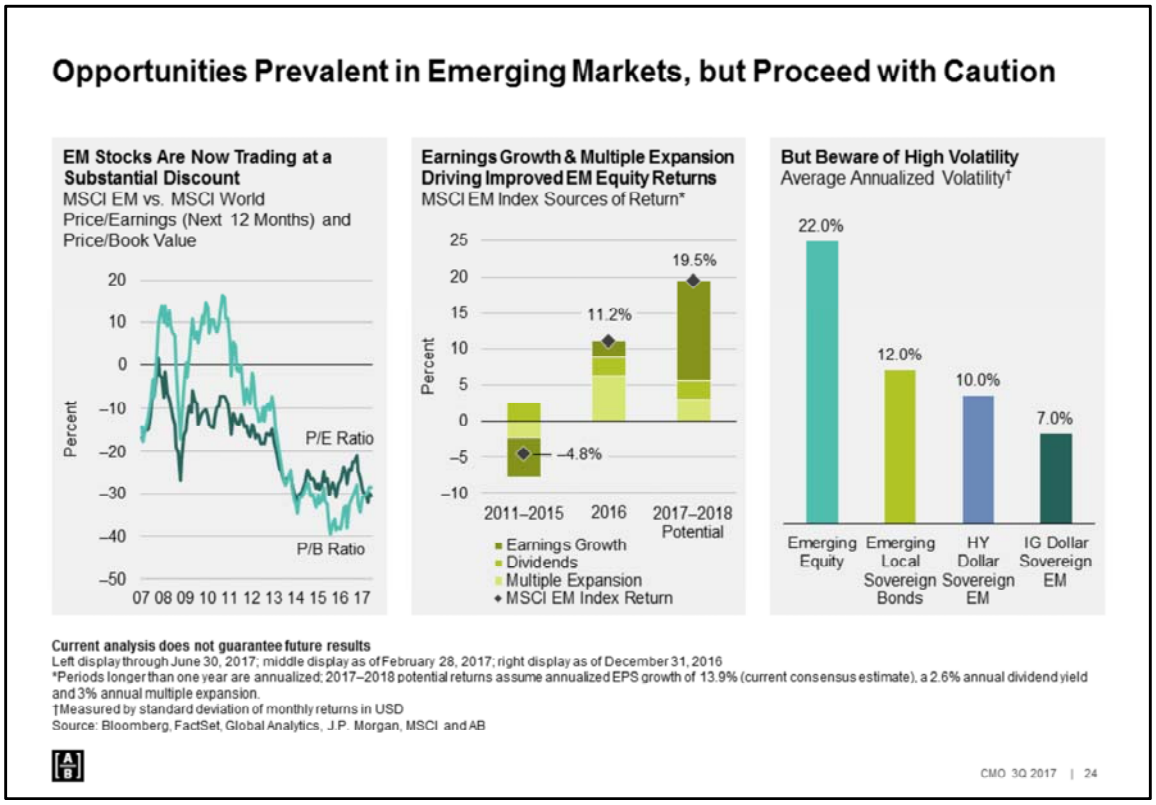
- In fact, we feel that a passive approach, such as today's trend toward ETFs, actually will be a problem in the coming years of lower market returns, in general. The left-hand chart shows that there's well over double the number of ETFS in relation to stocks with a market cap over $5 billion. More than double. What that means is that there are any number of ETFs that are just slightly masked variations of each other. And while you think you may be passively investing, in some cases you're making an active decision which could potentially overextend some of your risks.
- Let's take just one example of a stock investing approach—low volatility—and how ETFs have mushroomed massively in this space. The center display shows that this category didn't even exist seven years ago, and now it has over $54 billion in assets.
- To parallel that growth, valuations for these low volatility stocks are at a substantial premium. The right-hand chart shows that this cohort of equities has a price to forward earnings of 19.2x—that's about 30% higher than the historical average of 12.8x. And if those ETFs grew so quickly in assets, the possibility of a steep decline for those low-volatility stocks would be a massive problem for passive ETF investors.

Lower Correlations and Muted Returns Have Favored an Active Approach



Historical analysis does not guarantee future results.
Left display as of March 31, 2017; middle display as of June 30, 2017; right display as of December 31, 2016. *Correlation uses a six-month moving average. Latest figure is from March 1, 2017. Pre-Crisis average is from 1990–2007. †Measured by the average outperformance of active managers in the Large Value/Growth/Blend, Mid Value/Growth/Blend and Value/Growth/Blend Morningstar categories vs. the respective benchmarks. ‡Measured by the average annual outperformance of active managers in the Large Blend Morningstar category versus each fund's primary prospectus benchmark over the past 20 years.
Source: Bloomberg, FactSet, Russell Investments, Thomson Reuters I/B/E/S and AB

- One variable that has witnessed a change in trend is correlations between stocks. We've seen correlations among stocks decline noticeably as the Fed has continued to normalize short-term interest rates. The left-hand chart points out the degree that stocks moved more in lock step with each other over what had been extremely higher levels looking back the last several years.
- Now, with that drop in correlation, the middle display shows a notable increase in active managers outperforming the benchmark so far in 2017. While these results are early, active managers' recent outperformance pattern is in line with history when returns for the broad market have resided in ranges similar to what has been posted so far this year.
- Accordingly, the chart on the right shows that during periods when the S&P 500 Index has returned 10% or less over the past 20 years, active managers have posted favorable results.
- We feel an active approach is more suitable for the environment we foresee for equities; namely lower returns and higher volatility. This coupled with the fact that the Fed is in a tightening phase, warrants a more selective approach.
- And we believe that approach to long-term investing will return to favor as investors start to feel the restraints and risks of passive strategies, and should stock market returns moderate over time.



- Another investment arena that's showing promise is emerging markets—both equities and bonds.
- Both EM equity and debt turned in strong full-year performances for 2016. And if we put some perspective on the risks facing emerging markets, we see opportunities in EM countries that have favorable domestic economic trends as well as with EM companies that are relatively immune to the potential trade challenges emanating from the US.
- The geopolitical order is shifting toward emerging powers, with developing countries also asserting their economic independence driven, in part, by improving domestic economic trends. There's also a growing trend among EM countries to tame inflation, and real interest rates are low enough to be a stimulating factor across many developing countries. With this, external balances have adjusted significantly, which has made EM economies generally less reliant on foreign capital—and therefore less vulnerable to rising interest rates in developed markets.
- Yet, as the left-hand chart shows, EM equities are currently cheaper than they were before 2008.
- The middle chart gives a snapshot of EM equities over the last half-dozen years. They had a difficult time prior to last year, and then delivered a solid 11% in 2016, mostly driven by higher valuations. But going forward, we expect that earnings will be the main driver of returns.
- However, there's still a great deal of uncertainty in emerging markets, and risks ranging from commodities, geopolitics, and just sustainability of growth remain. For these reasons and others, volatility is always a concern when investing in EM as risks are higher than developed markets, as we show in the right-hand chart. Due to this, we strongly recommend being active with your investments in this space.
- An active approach will be key in sorting out the sectors, companies and countries that can provide opportunities. And EM equities are an investment arena where active, research-driven investing is critical, because of the lack of available research information. In addition, if the risks of EM equities are too high, you may want to consider adding some EM debt to reduce these risks somewhat.
- Which leads to our key takeaway here: We're often asked our opinion on emerging market assets and how to approach them. Our response is that we see very solid opportunities, but given uncertainty**,** investors should consider investing across the capital structure. Good yields and an improving economic backdrop offer a "paid to wait" element, should challenging markets or increased volatility delay equity gains, without a significant drop in absolute return potential but with a lower volatility component. Meanwhile, strong potential growth, earnings, and good technicals such as potential flows are very supportive of equity return potential. Additionally, the diverse nature of developing countries' economic growth, inflation, and policy responses imply that in some countries or parts of the world, fixed income may be a more attractive option, while in others, it will be equities.

Investing Through the Pendulum Swings

Evergreen Advice	Environment			Suggested Actions	
		Growth	Inflation	Favor These…	…Over These
+ **Focus Portfolio Design on Better Up/Down Capture Generation** Better betas, efficient structures, targeted alpha + **Go Global** Economies/policies not moving in lockstep + **Stay Balanced** Amid uncertainty, don't overload + **Be Selective/Active** Security and sector dispersion on the rise	Heating Up	↑	↑	+ Small-cap equity + High yield + Inflation protection	+ Government bonds
	Questionable	↔	↔	+ Balanced rates & credit + Quality & growth equity	+ Inflation protection
	Surprise Slip	↓	↓	+ Hedged equities + Government bonds	+ High yield + Equity + Inflation protection

Current assessment does not guarantee future results.
As of March 31, 2017
Source: AB

+ So we're still seeing uncertainty now and on the horizon for economies and markets around the globe and particularly here in the US, where Trumponomics has lost some of its steam, but may still have an impact if and when policy proposals take shape as legislative realities.
+ In the meantime, there's enough indications of modest economic growth, low inflation and low volatility to keep the markets relatively healthy.
+ Even so, the sun is setting on multiple expansion driving equities in the US, and there's a need to be active and look carefully for companies that can create their own destinies, and create their own growth.
+ With your fixed income allocations, balance is the watchword—balance between duration and credit, and balance between US and global.
+ Altogether, we still suggest that investors need a solid foundation as their starting point – and we believe the Evergreen Advice on the left makes for a good foundation.
+ Keep a focus on ways to improve your up/down capture—that would include better betas, efficient structures, such as a barbell approach to balancing rate and credit risk, and targeted use of your risk budget for alpha.
+ Keep a balance to non-correlated assets—so, avoid having your equities mimic your bonds, and make use of alternative approaches that can provide an advantage during heightened uncertainty. And with your bonds, consider a balanced, barbell approach to your rate and credit risk.
+ Be selective! Find those areas where you can most gain from any informational advantage. For example, if you can find good research that produces earnings forecasts out beyond the 2-year horizon, that's where there's a large drop-off in analyst assessment, and it can provide a great advantage for selecting long-term winners. Small cap stocks also come to mind for an area of informational advantage, because there's far less coverage than in the large-cap arena.
+ And be active in those under-researched areas. Also emerging markets is an area to be active, again based on an informational advantage and because they have highly inefficient indices.
+ But along with that sound foundational approach, you still have to decide whether you think the coming environment will see one of the following three scenarios.
+ If you think that growth is heating up, then look to small-cap equities—small and mid-cap value, for instance, but not just a passive approach, because nearly 25% of the SMID index is made up of bond proxies. So be active. Also high yield will likely do well, and you should consider inflation protection which is still inexpensive. But avoid what will be most sensitive to rising rates – mainly government bonds.
+ If you think the future will be so-so, with moderate but unspectacular growth—basically a continuation of what we called "After the Beta Trade"—then high yield will likely still do well, and you want to focus on finding those better topline growers—the quality and growth equities. Again, government bonds will be challenged in this questionable growth environment as will the need for inflation protection.
+ And remember, it doesn't take much for markets to fall off. If there's a surprise slip, if Trump's proposals fall short—overpromising and under-delivering—then you do need the buffer to your portfolio of hedged equities and government bonds.
+ The Trump bump has been quite a bit of a rising tide for many boats. But when the waters get choppy, the best boats get rewarded while the worst boats sink.
+ Thanks, and I'll be taking your questions now.

A Word About Risk

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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 and includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed- and emerging-markets 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 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 US CMBS Investment-Grade Index:** Designed to mirror commercial mortgage-backed securities of investment-grade quality (Baa3/BBB–/BBB– or above) using Moody's, S&P and Fitch, respectively, with maturity of at least one year.
- **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.)

[Read to audience]

Index Definitions (continued)

- **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.
- **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 Corporate Emerging Markets Bond Index:** A global, corporate emerging-market benchmark that tracks USD-denominated corporate bonds issued by emerging-market entities.
- **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.
- **J.P. Morgan Emerging Market Currency Index:** A tradable benchmark for emerging-market currencies vs. the US dollar.
- **J.P. Morgan Government Bond Index–Emerging Markets:** Tracks local-currency bonds issued by emerging-market governments.
- **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-market debt on slide 1.)
- **MSCI World Index:** A market capitalization–weighted index that measures the performance of stock markets in 24 countries.

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Index Definitions (continued)

- **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 1000 Growth Index:** A market capitalization weighted index based on the Russell 1000 index. The Russell 1000 Growth Index includes mid-to large cap companies that display signs of above average growth. The index is used to provide a gauge of the performance of the largest growth stocks in the U.S.
- **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 2000 Value Index:** A market-capitalization weighted equity index maintained by the Russell Investment Group and based on the Russell 2000 Index, which measures how U.S. small-cap stocks in the equity value segment perform.
- **Russell 3000 Growth Index:** A market capitalization weighted index based on the Russell 3000 index. The Russell 3000 Growth Index includes companies that display signs of above average growth. The index is used to provide a gauge of the performance of growth stocks in the U.S.
- **Russell 3000 Value Index:** A market-capitalization weighted equity index maintained by the Russell Investment Group and based on the Russell 3000 Index, which measures how U.S. stocks in the equity value segment perform.
- **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-sized companies. The index measures the performance of mid-sized 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.

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