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Reducing Factor Risk in Core Equity Portfolios

Global equity market patterns have been shifting dramatically, challenging active managers to deliver consistent performance. So how can investors be sure that their portfolio managers really have the skill to deliver long-term results as market conditions change?

In recent years, global equities have rallied sharply, generating significant returns for investors who have simply accessed cheap market beta. But today, with heightened equity valuations and diminished return opportunities across asset classes, finding dependable sources of alpha is the key to investment success.

Factor Returns Have Been Volatile

That's easier said than done. Equity return factors are often very inconsistent, as we've seen over the last 18 months. And many investors aren't even aware how their core equity portfolios may be exposed to factor risk.

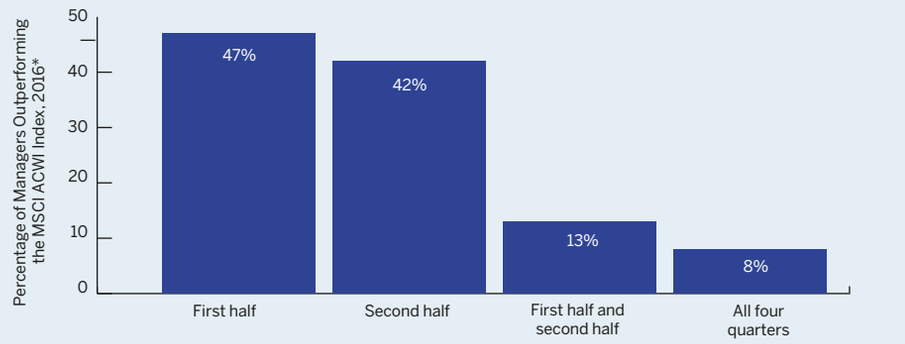
Last year, equity factor returns were extremely volatile. Safer stocks with lower-volatility characteristics or higher dividend yields outperformed in the first half and underperformed in the second half. And, in the first six months of 2017, growth stocks have surged while value stocks have underperformed—a sharp reversal of trading patterns in the second half of last year.

Inconsistent Returns in Core Equities

Core equity portfolios were also under pressure. Less than 50% of global core equity strategies outperformed the MSCI ACWI in either the first or second half of 2016. Only 13% outperformed in both the first and second half of 2016, and only 8% beat their benchmarks in all four quarters.

Why the challenged performance? We believe many core equity managers have biases to different equity factors that they may not be aware of. Of course, equity factors can be good guides to sources of long-term returns in style-oriented portfolios that deploy careful stock selection and diligent risk control. Core equity portfolios, however, aren't meant to be heavily weighted toward specific style factors.

Core equity managers' performance has been inconsistent



Source: eVestment, MSCI and AB
*As of December 31, 2016. Manager returns represented by 245 strategies in the eVestment Global All Cap Core Equity universe relative to MSCI ACWI

Yet, in practice, groups of stocks chosen in a core equity portfolio may inadvertently create a bias toward a particular factor or style.

Validating Stock-Picking Skill

So it's important to verify that the key contributors to an active core equity manager's excess returns aren't unintentionally or unduly influenced by style factors. And ensure that you're paying for a skill that truly can't be mechanistically replicated for a lower cost through a factor-investing or smart beta approach.

Successful stockpicking focuses on the fundamental characteristics of companies, such as cash-flow trends and business dynamics, that will drive long-term stock returns. By doing so, investors in core equity portfolios can mitigate the impact of erratic factor performance and enjoy more consistent long-term return patterns.

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AllianceBernstein (AB) Global Core Equity Portfolio has consistently delivered results in various market conditions by generating returns through idiosyncratic stock selection. The strategy is managed to avoid generating returns from factor exposures. We believe that this approach can help investors achieve strong risk-adjusted returns through global equities over the long term in today's low-return world.

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