OCTOBER 2017

BERNSTEIN

50 YEARS OF INVESTMENT MANAGEMENT & RESEARCH

BROADEN YOUR HORIZONS

While it's been very rewarding to own US equities in recent years, now is the time to ensure that you have an adequate allocation to developed international and emerging markets stocks.

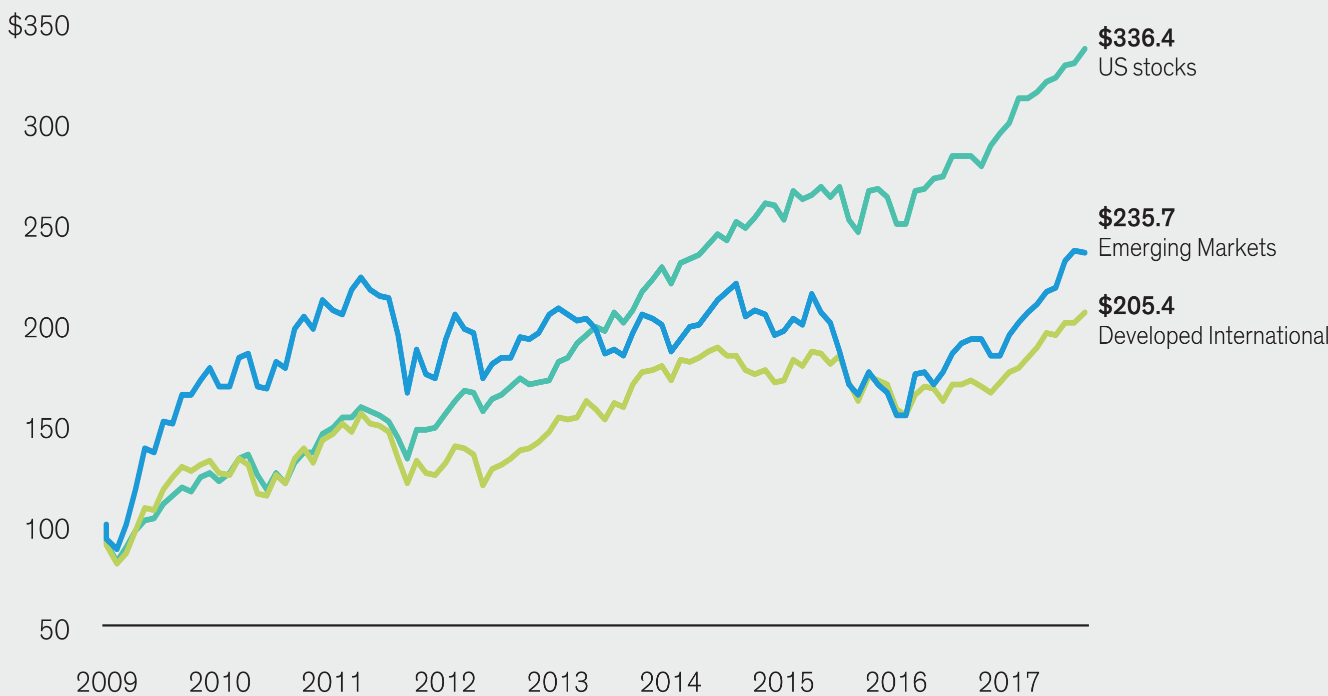
FIRST-MOVER ADVANTAGE GOES TO US

The US stock market has been the best place to invest since 2009 (*Display 1*). Why? Following the Great Financial Crisis of 2008 ("GFC"), US authorities moved swiftly to stabilize the banking system and stimulate the economy with historically low interest rates. US companies also took action to improve operating efficiencies and balance sheets; earnings, and then stock valuations, rose.

Other regions were not only slower to act, they were beset by additional challenges in the ensuing years. For instance, Europe was rocked by a series of debt crises in 2010–2011 that crippled economic growth. In Japan, Abenomics initially boosted Japanese equities, but given its failure to address deflation, proved to be a false dawn. China faced challenges as it grappled with how much freedom to allow the markets and private business. Meanwhile, other emerging economies struggled with the demise of the commodity supercycle.

DISPLAY 1: SINCE 2009, THE US HAS BEEN OUTPERFORMING NON-US REGIONS

Growth of $100, Jan 2009–Sep 2017



Through September 30, 2017

Past performance is not necessarily indicative of future results. US stocks are represented by the S&P 500 Index, emerging markets by the MSCI Emerging Markets Index, and developed international by the MSCI EAFE Index. An investor cannot invest in an index. These figures do not reflect the deduction of management fees and other expenses an investor would incur when investing in a fund or separately managed portfolio.

Source: FactSet, MSCI, and AB

By 2016, the dominance of the US stock market had become particularly pronounced. The S&P 500 rose 12% for the year versus a mere 1% for developed markets stocks (as represented by the MSCI EAFE index), principally due to a burst of enthusiasm surrounding President Trump's election. In particular, investors bid up US stocks poised to benefit from potential pro-growth policy changes aimed at tax reform and deregulation.

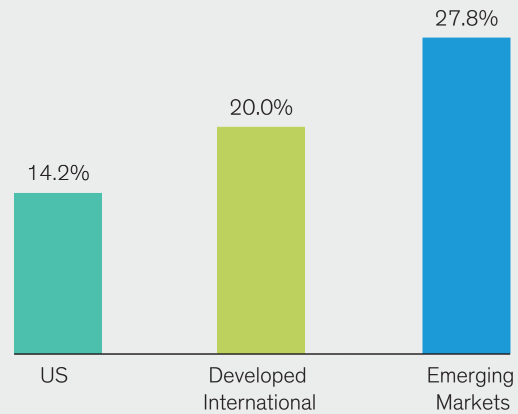
STARS AND STRIPES...FOREVER?

That all changed in 2017. For the year to date through September 30, returns on developed international stocks of 20% and emerging markets stocks of 27.8% have outpaced the 14.2% returns of the S&P 500 (*Display 2*).

The reasons for this abrupt shift make sense. Earnings growth in the US has been quite robust this year, but it's been even stronger in non-US markets—a trend we expect to continue. Plus, after years of underperformance, valuations of non-US stocks are significantly cheaper than those in the US (*Display 3*). At the same time, expectations for significant US policy changes have begun to wane and this year's 9% decline in the US dollar has boosted the returns on non-US stocks when converted back into dollars.

DISPLAY 2: THIS YEAR, THE TABLES TURNED WITH NON-US MARKETS BEATING THE US

YTD Total Return

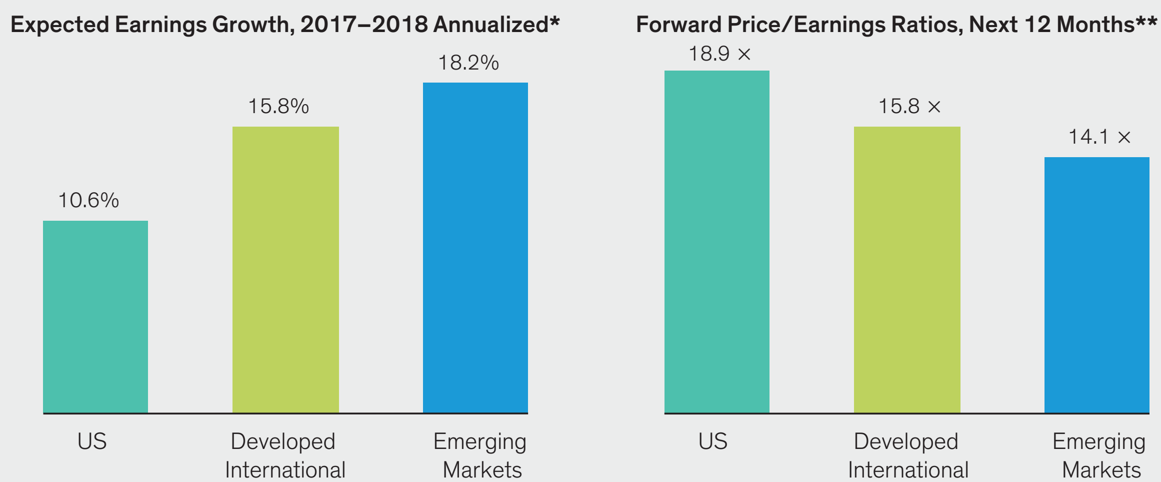


As of September 30, 2017

Past performance is not necessarily indicative of future results. US stocks are represented by the S&P 500 Index, emerging markets by the MSCI Emerging Markets Index, and developed international by the MSCI EAFE Index. An investor cannot invest in an index. These figures do not reflect the deduction of management fees and other expenses an investor would incur when investing in a fund or separately managed portfolio.

Source: FactSet, MSCI, S&P, and AB

DISPLAY 3: NON-US EARNINGS GROWTH AND VALUATIONS LOOK RELATIVELY ATTRACTIVE



As of September 30, 2017, unless otherwise noted.

*Earnings growth for the S&P 500 Index, MSCI EAFE Index, and MSCI Emerging Market Index was calculated by annualizing the total growth between 2018 expected earnings and 2016 actual earnings. **There is no guarantee that any estimates or forecasts will be realized**. US stocks are represented by the S&P 500 Index, developed international by the MSCI EAFE Index, and emerging markets by the MSCI Emerging Markets Index.

**P/E ratios for the MSCI EAFE Index and MSCI Emerging Market Index are as of September 28, 2017.

Source: FactSet, MSCI, S&P, and AB

THE LONG-TERM CASE

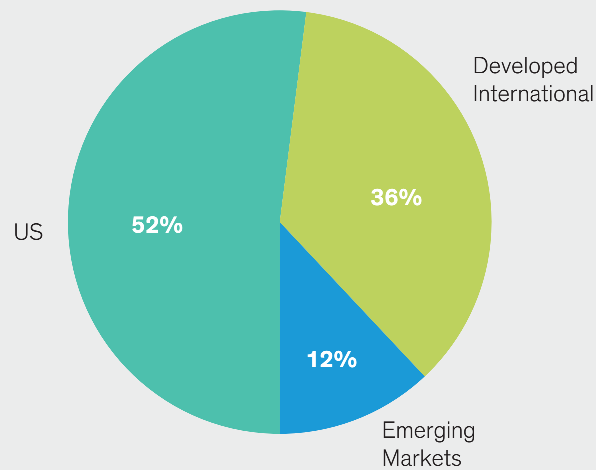
Clearly, returns this year show that investors recognize the current appeal of non-US stocks. But our recommendation for increased non-US exposure hinges upon a longer-term rationale.

> International investing is vital in expanding the available universe.

First, international investing opens up a world of opportunity. Currently, non-US companies across both developed and emerging markets together comprise 48% of the global stock market (*Display 4*)—a figure that is more likely to trend up over time than down. Further, innovation knows no boundaries, so neither should your investments. As a percent of GDP, expenditures on research and development are 50% higher in countries like Israel and South Korea compared to the US. In some regions, consumers are adopting technology more rapidly, too. For example, US online penetration in retail lags that of the UK, China, and South Korea (*Display 5*). In this instance, US retailers can learn from the experiences of their overseas peers, not the other way around.

DISPLAY 4: NEARLY HALF THE WORLD'S STOCK MARKET CAPITALIZATION IS OUTSIDE THE US

Market Cap of the Global Stock Market

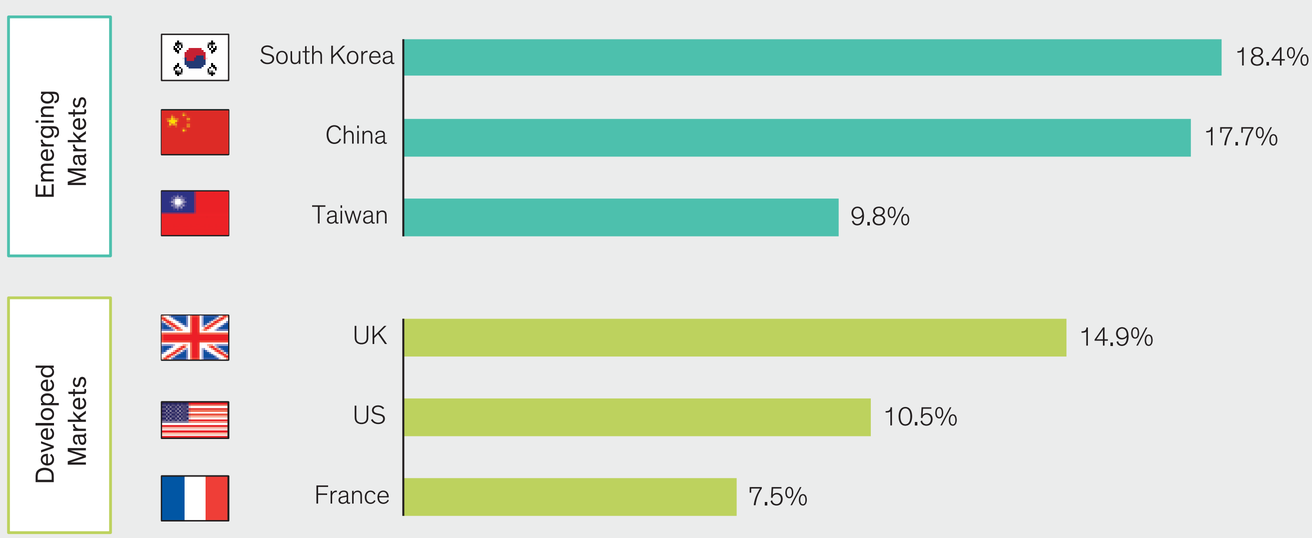


As of September 30, 2017

Source: FactSet, MSCI, S&P, and AB

DISPLAY 5: EMERGING ECONOMIES OUTPACE DEVELOPED IN E-COMMERCE ADOPTION

Online Retail Penetration



As of February 28, 2017

Past performance and current analysis do not guarantee future results. Retail value (excluding sales tax) of merchandise transacted online.

Source: Euromonitor International and AB

Investing in non-US stocks may also offer greater opportunity for stock selection. Why? Although far more efficient than in the past, non-US markets (especially emerging markets) are still less efficient than the US. Developed international and emerging markets combined host many more companies than the US, but there are far fewer earnings estimates available for the average company. This creates the potential for investors with on-the-ground expertise to benefit from an information advantage.

Finally, investing in non-US stocks provides diversification benefits. Not surprisingly, performance patterns vary across geographies, often reflecting different economic conditions and industry trends as well as the impact of interest rate movements and currency fluctuations. And, while foreign currency adds to volatility for non-US equities, geographic diversification has resulted in more stable returns over time (*see sidebar, page 8*).

For these reasons, we recommend moving non-US allocations toward a weighting in the 40% range, as the combination of risk and return in that range looks attractive for long-term investors (*Display 6*). Given that this is a long-term strategic recommendation, we've been advising clients to increase their allocations in a tax-sensitive manner. There is ample time to balance the tax costs of selling appreciated US stocks against the longer-term benefits of greater non-US exposure.

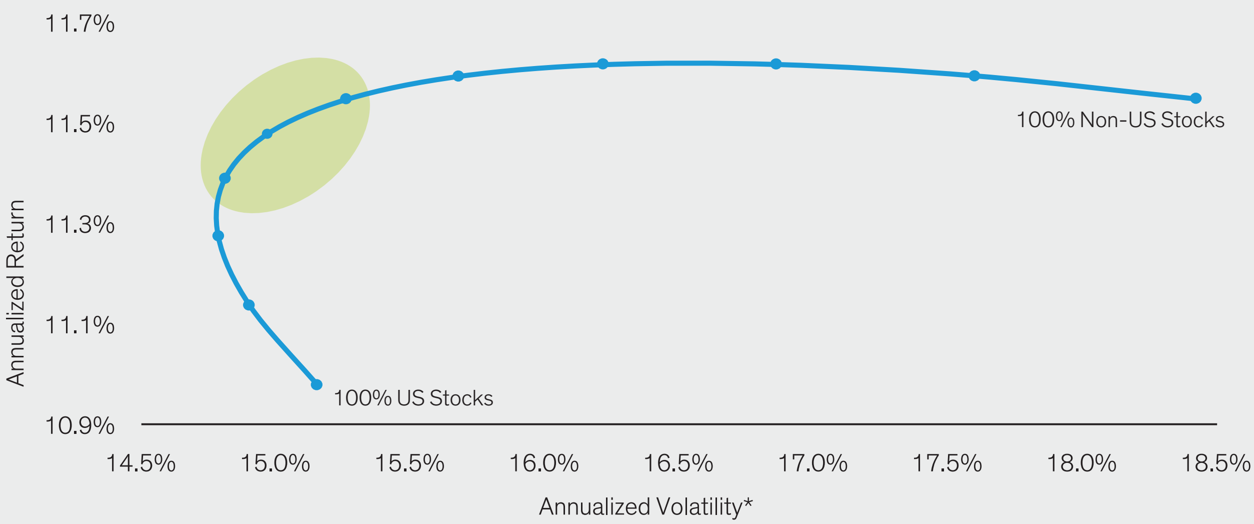
> This is an opportune time to increase exposure to non-US equities in a tax-sensitive manner.

THE NEAR-TERM CASE

While the long-term case for international investing remains compelling, so too does the near-term case, despite the strong performance of non-US stocks this year. That's why we consider this an opportune time to increase non-US allocations. Essentially, we see potential for non-US valuations to rise as investors become increasingly comfortable with the outlook for **earnings growth**, **political stability**, and **broad-based reforms** in overseas markets over the next several years.

DISPLAY 6: GEOGRAPHIC DIVERSIFICATION HAS ENHANCED RISK/RETURN TRADE-OFF OVER TIME

US and Non-US Efficient Frontier, Jan 1974–Sep 2017



Through September 30, 2017

Past performance is not necessarily indicative of future results. US stocks are represented by the S&P 500 Index. Non-US is represented by 100% MSCI EAFE Index from January 1, 1974 through December 31, 1987, and 80% MSCI EAFE Index/20% MSCI Emerging Markets Index thereafter. An investor cannot invest in an index. These figures do not reflect the deduction of management fees and other expenses an investor would incur when investing in a fund or separately managed portfolio.

*Annualized volatility is calculated based on the standard deviation of monthly returns for each allocation.

Source: FactSet, MSCI, S&P, and AB

For more on these three themes, we reached out to the senior investment officers of our core non-US strategies: Stuart Rae and Sammy Suzuki, who co-head our International Strategic Equities Portfolio, and Nelson Yu, who heads our Tax-Managed International Portfolio. A summary of their insights follows:

- **Earnings growth**

  We expect above-trend earnings growth in non-US markets to be supported by an improving macroeconomic backdrop. For instance, we expect Chinese GDP growth of about 6% in 2018—down a bit from recent years, but still impressive. And GDP in Japan and Europe are slowly recovering off a very low base. In fact, economic sentiment in the Eurozone just reached a 10-year high.[1] Inflation in most regions is generally stable to modestly rising. This results in higher nominal growth, which is a more important indicator than real growth for company profits and revenues. Measures of manufacturing activity and other sentiment indicators have been ticking upward, too (*Display 7*).

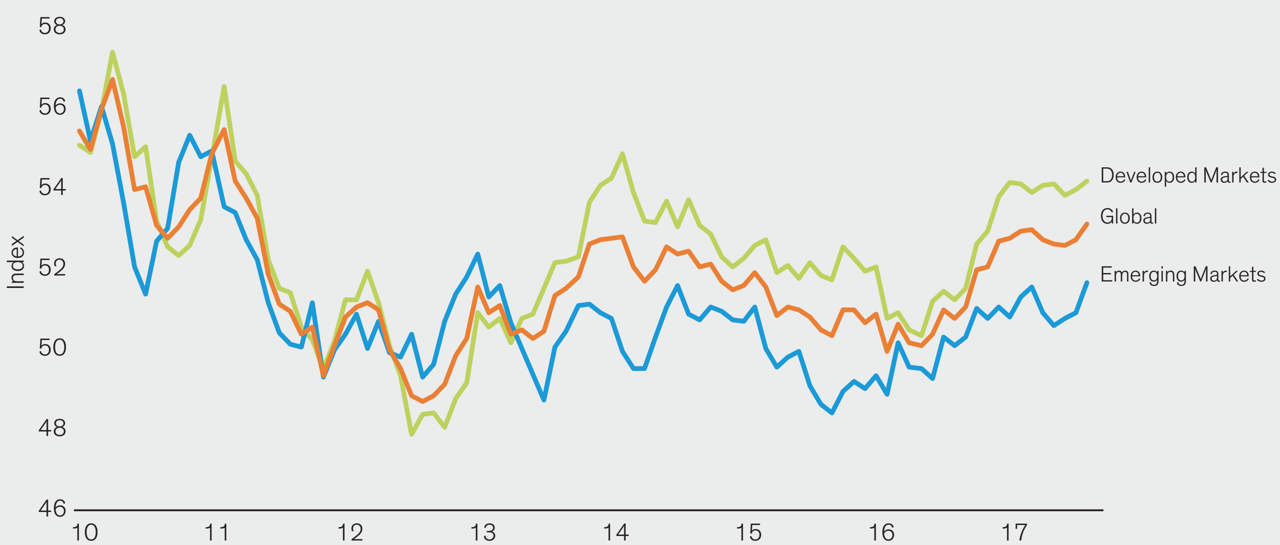
Despite US talk of tariffs and trade barriers, improvements in export growth around the globe represent another underpinning for earnings—especially for emerging markets, but also for Japanese and European industrial companies. Exports haven't revisited the robust levels of growth seen from 2003–07, but they are no longer a drag. And in some sectors, like technology, exports are particularly strong.

> We see a number of tailwinds supporting robust earnings growth in non-US markets.

Finally, stable and rising commodity prices should also give earnings a boost. Many associate improving commodity prices with benefits to emerging markets, but they help numerous developed-market industries, too. Strengthening commodity prices mean that upstream deflation no longer presents an issue. And for industries that "pass through" input costs, margins actually improve when costs rise.

DISPLAY 7: GLOBAL MANUFACTURING ACTIVITY IS GAINING STRENGTH

Manufacturing PMIs*



Through August 2017

*Purchasing Manager's Index, an indicator of economic health of the manufacturing sector.

Source: Haver Analytics and IHS Markit

[1]*As of August 30, 2017. Source: European Commission*

- **Political stability**

  Americans face daily evidence of political disunity in Washington. US stocks have done well nonetheless, because solid economic growth, still-low interest rates, and benign inflation have supported strong earnings growth. But corporate managers are dealing with more policy uncertainty than they have in years.

  In contrast, valuations of stocks in many overseas regions stand to benefit from *dwindling* political uncertainty. Consider the Eurozone. In France, markets welcomed centrist newcomer Emmanuel Macron. In Germany, although the anti-immigration party recently gained more votes than expected, Chancellor Angela Merkel is working to develop an effective centrist coalition government. Even peripherals like Greece and Italy have been marked by less turmoil, and talk of a Eurozone "break-up" seems like a bygone concern. And, while Brexit still looms on the horizon, as far as risks go it's fairly well known.

  In general, Asia also appears to be enjoying a period of relative political tranquility. Abe, the longest serving Japanese prime minister since Koizumi, has had a chance to implement his agenda over a number of years. Chinese leadership is also firmly in charge with President Xi about to head into his second five-year term. North Korea represents a notable exception, as tensions have continued to escalate on the Korean peninsula.

- **Broad-based reforms**

  Reform measures are another encouraging development that should bolster non-US valuations. Take China, for example, where controls on capital expenditures and restructuring of state-owned enterprises (SOEs) are boosting margins in key industries such as materials, energy, and infrastructure. Government-led initiatives are also shaking up the economic landscape in India as investors welcome demonetization, the introduction of a Goods and Services Tax (GST), and other policies introduced by Prime Minister Narendra Modi.

  > Overseas markets should benefit from increasing political stability and broad-based reforms.

  Developed markets are embracing change, too. In Japan, structural reform has made steady, if quiet, inroads over the past several years. For instance, a gradual improvement in corporate governance, which has made corporate management more focused on shareholders' interests, has contributed to a marked increase in shareholder returns in the form of stock buybacks and dividends. Then there's Europe, where Macron's ambitious reform agenda for France is designed to ease notoriously strict labor rules. While it's too early to forecast the chances of success—or how long such changes might take to unfold—the proposal provides concrete evidence of fresh thinking on the Continent.

Taken together, all these trends provide supportive conditions for international valuations, reinforcing our decision to increase non-US exposure now.

CURRENCY:
The Added Dimension

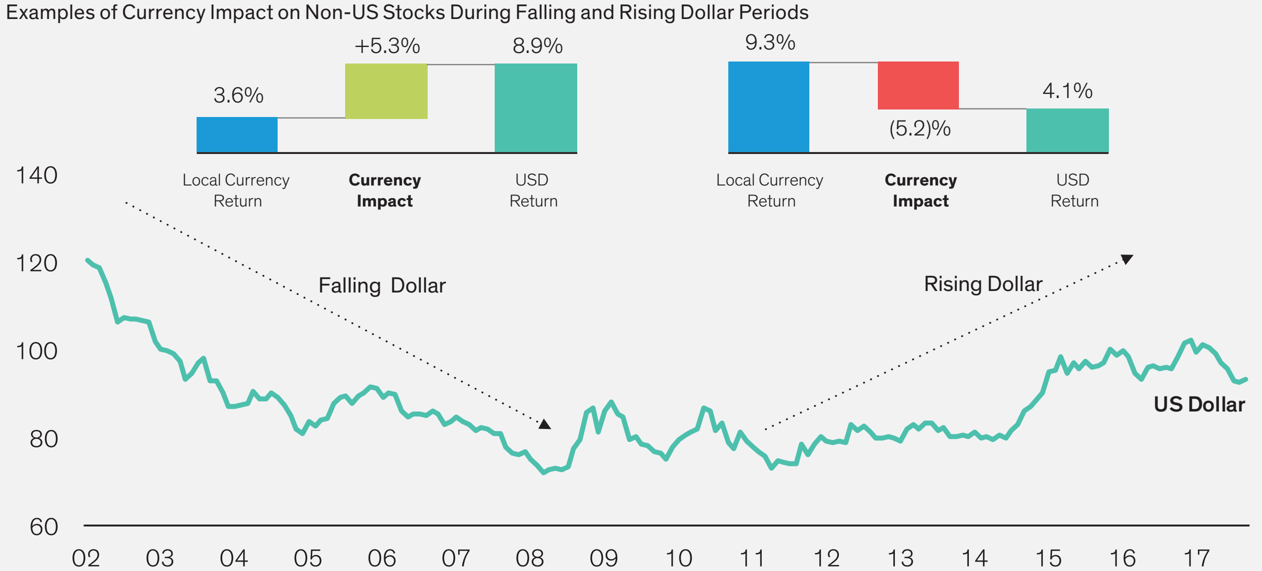
No discussion of international investing would be complete without touching upon the impact of currency. It's a complex topic, with many crosscurrents. For example, a falling dollar could benefit the revenues of a US exporter by making the company's products relatively inexpensive to those of competitors overseas. However, if that company's inputs are sourced from abroad, a weak dollar would make those inputs more expensive, potentially squeezing margins.

What's more, changes in currency directions can be difficult to forecast. Currencies rise or fall based on evolving expectations for relative economic growth and the direction of interest rates, among other factors. These influence sentiment, which can turn very quickly and is notoriously hard to predict.

One thing we do know is that currency movements tend to run in multiyear cycles. In periods of dollar weakness, US investors stand to benefit from holding non-US stocks. In contrast, returns on non-US stocks are eroded when converted back to dollars in periods of dollar strength (*Display 8*). Over the long term, geographically diversified portfolios have generated returns that are comparable to, and smoother than, returns on US stocks alone. Over the 15-year period shown in the display, the different patterns of geographic returns resulted in a 7.4% annualized return for a globally diversified portfolio compared to 7.3% for a US-only strategy.[2]

DISPLAY 8: CURRENCY MOVEMENTS ADD ANOTHER DIMENSION TO INTERNATIONAL INVESTING

Examples of Currency Impact on Non-US Stocks During Falling and Rising Dollar Periods



Through September 30, 2017

Past performance is no guarantee of future results. US Dollar is represented by the DXY Index. Falling dollar is represented by the period January 2001–June 2008. Rising dollar is represented by the period May 2011—December 2016. Non-US stocks: 80% MSCI EAFE index, 20% MSCI EM Index. Returns for all periods greater than a year are annualized. An investor cannot invest in an index. These figures do not reflect the deduction of management fees and other expenses an investor would incur when investing in a fund or separately managed portfolio.

Source: FactSet, MSCI, and AB

[2] *As of September 30, 2017.* ***Past performance is no guarantee of future results****. Globally diversified portfolio is represented by 60% S&P 500 Index, 32% MSCI EAFE Index, and 8% MSCI Emerging Markets Index. US-only strategy is represented by 100% S&P 500 Index. An investor cannot invest in an index. These figures do not reflect the deduction of management fees and other expenses an investor would incur when investing in a fund or separately managed portfolio.*

Source: FactSet, MSCI, and AB

CAPITALIZING ON TODAY'S OPPORTUNITIES

We have been saying for some time that our outlook for equity returns for the next few years is muted, and that clients should expect more volatility as well. Of note—though not a guarantee—our 8% five-year forecast for non-US equity index returns exceeds the 6% index returns we expect for US markets. However, while international investing offers long-term benefits, it requires in-depth, local expertise to uncover the strongest companies and sectors that will drive outperformance.

With our on-the-ground research effort, we've identified a diverse array of appealing investment opportunities across styles, industries, and geographies. The examples highlighted here illustrate our prior assertion that innovators are plentiful overseas. Consider ASML. This leader in advanced manufacturing techniques for photolithography systems conducts the vast majority of its R&D and assembly in the Netherlands. Though it's located a world away from Silicon Valley, the company is instrumental in ensuring that silicon chips will double in speed, for the same or lower cost, roughly every two years.

Then there is Panasonic. Few realize this well-known Japanese manufacturer of electronic products is poised for strong earnings growth as the auto industry transforms. Why? Today it focuses on auto infotainment systems and car batteries and is the sole supplier to Tesla's GIGA factory.

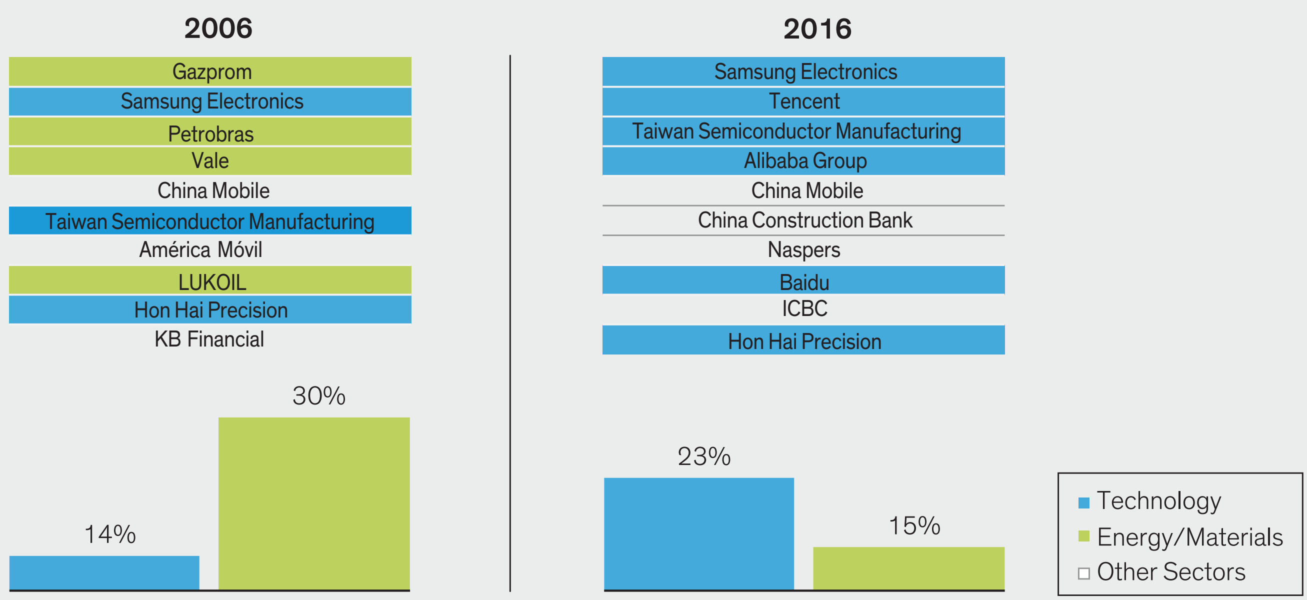
Australia's Cochlear, a world leader in hearing implant technology, or so-called "bionic ears," represents another quintessential innovator. Cochlear's latest processors can interact directly with smartphones—a key to their transition from a medical device company to more of a consumer-focused firm. We see overlooked growth potential for Cochlear in new markets (such as China and India) as well as in more lifestyle-oriented products in mature markets.

Finally, what many consider to be the most prominent Chinese stock, Alibaba. While many US investors recognize the name, fewer are likely to grasp the company's size and scope. As the dominant Chinese e-commerce company, Alibaba boasts nearly 500 million active users. The company has been exploring a number of new fronts, including electronic payments and financial services, cloud computing infrastructure, and various services mining its core e-commerce customer base. Expanding into new markets is also on the horizon, leading us to believe that the company's optionality and growth potential may be underappreciated.

Innovation is also taking hold more broadly in emerging markets as technology overtakes commodities as the engine for profits. Roughly a decade ago, four of the 10 largest companies by market capitalization in emerging markets (as represented by the MSCI Emerging Markets Index) were in the energy/materials sector (*Display 9*). Cumulatively, the sector represented nearly a third of the entire index—compared to just 14% for technology companies. Fast forward to today and those figures have reversed. Six of the 10 largest companies are in the technology sector, which now represents nearly one quarter of the index by market cap. Energy and materials make up just 15%.

DISPLAY 9: THE NEW FACE OF EMERGING MARKETS: MORE TECH AND LESS COMMODITIES

MSCI Emerging Markets Index: 10 Largest Holdings and Select Sector Weights



As of December 31, 2016

Historical analysis does not guarantee future results.

Top holdings for MSCI Emerging Markets Index are as of December 31, 2006 and December 31, 2016.

Source: MSCI and AB

CONCLUSION

We have long espoused the benefits of geographic diversification in equity investing, and see this as the optimal time to reinforce that message. Nearly a decade after the GFC, the evolution of global commerce, and its impact on markets, has come more fully into focus. The world grows more interconnected all the time, and technological innovation moves rapidly across industries regardless of borders. With our on-the-ground research, we are finding compelling opportunities in overseas markets that offer both diversification and return potential. Now, more than ever, optimal exposure to non-US stocks is a key part of a well-diversified long-term allocation. ■

BERNSTEIN OFFICES

ATLANTA
404.279.4900

BOSTON
617.788.3700

CHICAGO
312.696.7800

CLEVELAND
216.263.8090

DALLAS
214.860.5200

DENVER
303.292.7400

HOUSTON
832.366.2000

LOS ANGELES
310.286.6000

MIAMI
305.530.6200

MINNEAPOLIS
612.758.5000

NEW YORK
212.486.5800

PHILADELPHIA
215.430.5600

SAN DIEGO
858.812.2200

SAN FRANCISCO
415.217.8000

SEATTLE
206.342.1300

TAMPA
813.314.3300

TEL AVIV
+972 73 2844514

WASHINGTON, DC
202.261.6700

WEST PALM BEACH
561.820.2100

AB OFFICES WORLDWIDE

EMEA

AMSTERDAM
COPENHAGEN
FRANKFURT
GENEVA
LONDON
LUXEMBOURG
MANAMA
MILAN
MUNICH
PARIS
STOCKHOLM
TEL AVIV
ZURICH

ASIA-PACIFIC

HONG KONG
MELBOURNE
SEOUL
SINGAPORE CITY
SYDNEY
TAIPEI
TOKYO

OTHER AMERICAS

BUENOS AIRES
MEXICO CITY
SAN ANTONIO
SÃO PAULO
TORONTO

INFORMATION ABOUT MORGAN STANLEY CAPITAL INTERNATIONAL (MSCI)
MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indexes or any securities or financial products. This paper has not been approved, reviewed, or produced by MSCI.

NOTE TO ALL READERS
The information contained herein reflects the views of AllianceBernstein L.P. or its affiliates and sources it believes are reliable as of the date of this publication. AllianceBernstein L.P. makes no representations or warranties concerning the accuracy of any data. There is no guarantee that any projection, forecast, or opinion in this material will be realized. Past performance does not guarantee future results. The views expressed herein may change at any time after the date of this publication. This document is for informational purposes only and does not constitute investment advice. It does not take an investor's personal investment objectives or financial situation into account; investors should discuss their individual circumstances with appropriate professionals before making any decisions. AllianceBernstein L.P. does not provide tax, legal, or accounting advice. This information should not be construed as sales or marketing material or an offer or solicitation for the purchase or sale of any financial instrument, product, or service sponsored by AllianceBernstein or its affiliates.

BERNSTEIN