2018

BERNSTEIN

THE CASE FOR INTEGRATED WEALTH MANAGEMENT

Investor dissatisfaction with poor performance, high fees, and conflicts of interest is driving the wealth-management industry in two seemingly different directions. We think there's a better way.

THE CHALLENGE

Private wealth comes with a challenge: How best to manage it? There is a dizzying array of strategies, brands, and people to choose from, yet to most investors, they all look the same.

In the pages that follow, we attempt to demystify how wealth managers work and to explain how Bernstein's *integrated* approach is not just different but structurally advantaged versus the *outsourced* approach that prevails among advisors, consultants, and wealth offices serving affluent families. We also discuss the trade-offs between active and passive investing, which are more complex than conventional wisdom suggests.

For more than 50 years, Bernstein's business has focused exclusively on investment research and management. Today our relationships include multigenerational families, executives, entrepreneurs, entertainers, and not-for-profit organizations.

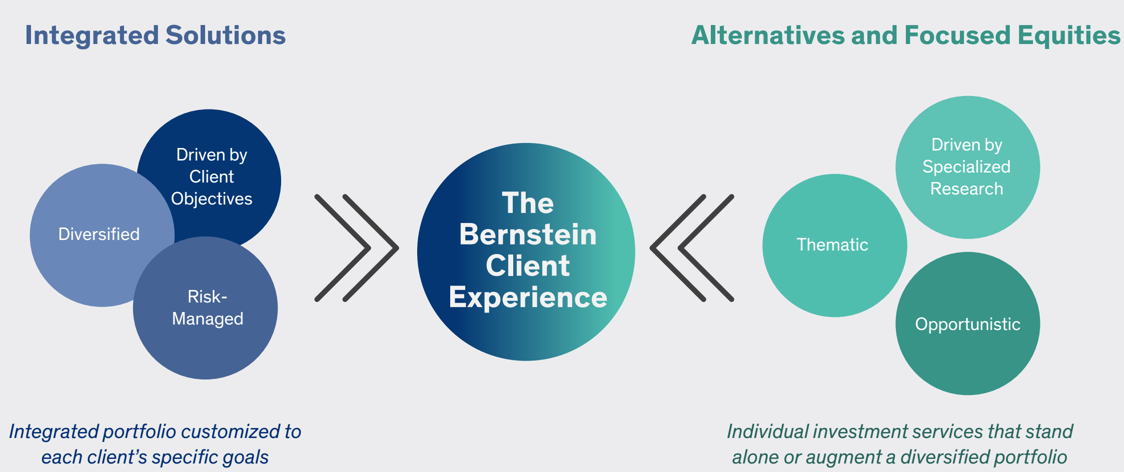
We approach each client differently depending on their needs. For many, we deliver solutions tailored to their broad financial goals, taking into consideration the full scope of their assets, business interests, and liabilities. For others, we provide distinctive alternatives and focused equities in which they invest directly alongside institutions from around the world (*Display 1*).

However a client chooses to work with us, we aim to stand out on the merits of aligned interests, accountability for results, and transparency.

WHY BERNSTEIN?

What makes Bernstein different is straightforward: We are an investment manager. The simplicity of this response often surprises people who assume that all wealth advisory firms are the same—if not in skill, then at least in structure. This important misperception is at the heart of why wealth managers often disappoint their clients.

DISPLAY 1: HOW WE WORK WITH OUR CLIENTS



For illustrative purposes only.
Source: AB

Let's start with some background: The industry that serves wealthy families is highly fragmented, clustered around two types of firms and one approach to investing. Using a process often referred to as *open*, most wealth advisors don't actually invest their clients' money. Instead, they are middlemen who outsource investment management to third parties. (We will examine this in more detail in the next section.)

At one end of the wealth-management industry spectrum are large banks, brokers, and insurance companies. The size and resources of these firms convey a feeling of stability and safety that some find appealing. The competing client interests inherent in firms with multiple lines of business, however, are not well understood.

These conflicts were plainly evident in remarks by the chief executive of a leading global investment bank at a conference in 2015. He described wealth management as the "ballast" of his company and the securities business (underwriting stocks and bonds and creating structured products) as "the engine room." "We are in the business of facilitating capital flows between issuers (companies) and investors," he added, describing the firm's wealth-management division as a "distribution (sales) platform" for products created on behalf of corporate clients.[1]

At the opposite end of the spectrum are small, independent wealth advisory firms and family offices. This part of the industry has seen significant growth in the wake of the financial crisis, which tarnished the reputations of many larger banks. But independence often brings deficits in scale, scope, and expertise.

In a world where investment opportunities are becoming more global and markets increasingly complex, skill and capability gaps are more costly. Simply put, what independent teams can promise in personal touch is overshadowed by their need to rely on others to do just about everything else.

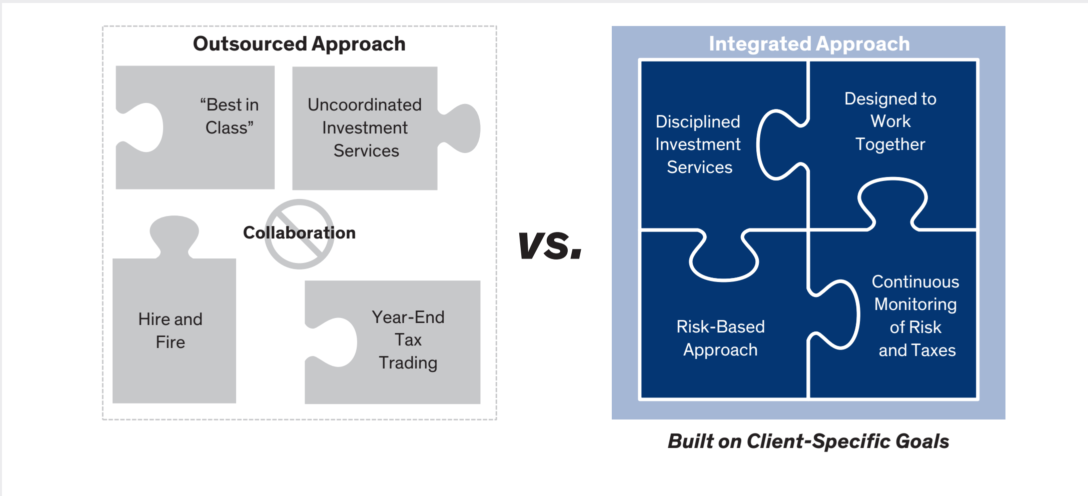
[Our integrated approach… makes us better.]

In a crowded, mostly commoditized business, what makes Bernstein different makes us better. Unlike big banks, the single focus of our business aligns our interests with our clients,' and we are fully accountable for the outcomes. Unlike smaller firms, we have the resources to develop sophisticated wealth strategies based on each of our clients' unique objectives. The effectiveness of seamlessly tying wealth goals to the efficiency of direct investment implementation with continuous tax and risk management defines Bernstein's *integrated* approach and sets us apart from the rest of the wealth-management industry. (*Display 2, page 4*).

Bernstein is part of AB, one of the world's leading research and investment firms. Our clients benefit from the skill and experience of the firm's entire global research and investment complex: nearly 3,500 employees in more than 20 countries around the world. We may all play different roles, but everyone at our firm is devoted to achieving successful investment outcomes for our clients and making every client feel like our only client. (See "Aiming for Outcomes: The Destination," on page 8.)

1 *"DealBook Conference 2015: Venture Capital and Where It's Going," The New York Times Conferences, November 3, 2015.*

DISPLAY 2: CHOICE IN PARTNERING WITH A WEALTH MANAGER



Source: AB

WHY NOT OUTSOURCE?

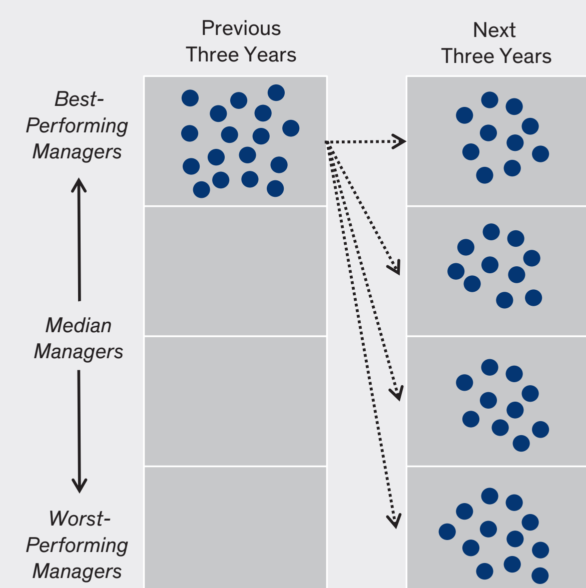
Outsourcing investment management is compelling in principle, but in practice its structural flaws become apparent and often lead to disappointing outcomes. The allure of outsourcing is twofold: access to investment managers' strong recent track records; and the flexibility to fire underperformers. While this sounds good in theory, in practice, outsourced portfolios hold too many securities, are insufficiently diversified with high concentration risk, and are prone to poor timing decisions.[2]

Consider an allocation to large-cap US stocks benchmarked to the S&P 500. With diversification in mind, an outsourced investment process would typically distribute a client's capital among at least four different managers who employ strategies such as growth, value, core, and low volatility. All the investment managers would be chosen for their stellar recent track records, of course, since few wealth advisors ever recommend strategies with recent poor performance that may be poised to recover (*Display 3*).

With up to 100 holdings typically found in each of the four outsourced portfolios, the client account ends up with 300 to 400 securities, versus 500 in the benchmark. Whatever might make each strategy individually compelling becomes diluted in

2 *For more on this topic, see Seth J. Masters, Joseph G. Paul, and Stuart C. Rae, "Conviction and Consistency," Bernstein, 2016.*

DISPLAY 3: PAST PERFORMANCE DOES NOT PREDICT FUTURE MANAGER RESULTS



For illustrative purposes only but based on research that showed that most top-quartile investment managers did not remain in the top quartile in subsequent years.
Source: AB

Outsourcing often results in portfolios that hold too many securities, are insufficiently diversified, and are prone to poor timing decisions.

aggregate, resembling something closer to the index than an actively managed strategy. But to beat a benchmark after fees, an investment portfolio needs to differ from its benchmark. Outsourcing to several large, diversified portfolios works against this.

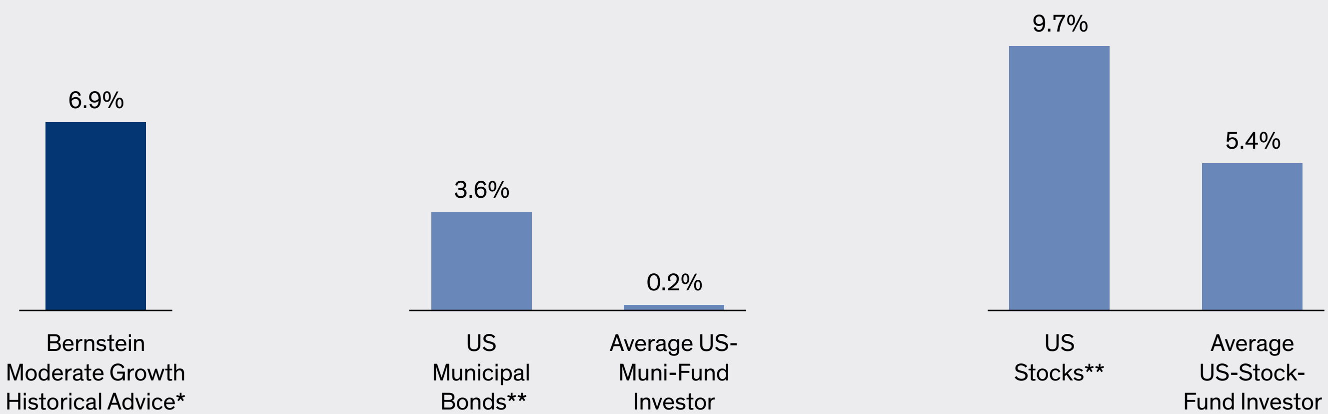
Despite holding many securities, outsourced portfolios often provide less diversification than meets the eye. While the four different investment strategies are intended to provide broad exposure, strong recent track records can often be explained by a common characteristic, or factor. When this common factor falls out of favor, the promise of diversification doesn't just fail: it can backfire.

Because advisors also tend to remove third-party managers in the wake of disappointing results, and add new managers after a strong run, they tend to make hire/fire decisions at precisely the wrong time. In analyzing fund flows, it is clear that timing decisions have hurt returns. Flow-weighted returns over the last 25 years for the average investor in US muni bond or stock funds are far below those of the comparable time-weighted indices (*Display 4*).

The reason is simple. Pinpointing market tops and bottoms is difficult for everyone, but it's almost impossible for third-party wealth advisors to deeply understand an external investment manager's process and how much of its recent success (or

DISPLAY 4: THE INTEGRATED APPROACH HAS RESULTED IN DEMONSTRABLY BETTER OUTCOMES

Annualized Returns
1993–2017

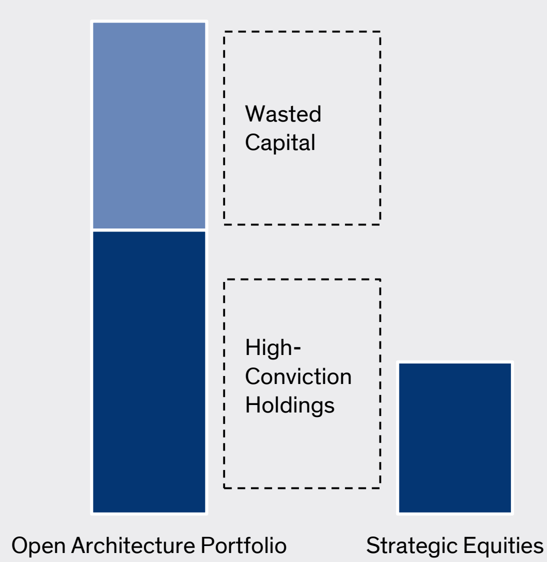


Past performance is not necessarily indicative of future results. There is no guarantee that any estimates or forecasts will be realized.
An investor cannot invest in an index. Index figures do not reflect the deduction of management fees and other expenses an investor would incur when investing in a fund or separately managed portfolio.
*The performance of the taxable Bernstein Moderate Growth Historical Advice (after fees) is presented for illustrative purposes only. The performance shown is simulated to reflect the annualized, net-of-fee returns of Bernstein's recommended asset allocation for clients with a moderate growth profile using Bernstein investment services. No representation is being made that an investor will, or is likely to, achieve a return similar to the result shown here. See Notes on Performance Statistics at the end of this presentation for additional information.
**US municipal bonds are represented by the Lipper Short/Intermediate Blended Municipal Fund Average; US stocks, by the S&P 500. The average US-stock-fund investor captures investors in US-registered stock funds, which may include funds that invest in whole or in part in non-US stocks.
There can be no assurance that working with a financial advisor will improve investment results. Investors cannot invest directly in indexes. The results for the average US-muni-fund and US-stock-fund investors are in the Dalbar study "Quantitative Analysis of Investor Behavior" (QAIB), 2018. QAIB calculates investor returns as the change in mutual fund assets after excluding sales, redemptions, and exchanges. This method of calculation captures realized and unrealized capital gains, dividends, interest, trading costs, sales charges, fees, expenses, and any other costs, annualized over the period.
Source: Dalbar, Lipper, S&P, and AB

failure) is a product of luck, skill, or just momentary timing. In fact, academic studies show that terminated managers end up outperforming the ones that replaced them in the years that follow.[3]

Unlike outsourced portfolios with hundreds of uncoordinated stock holdings, a typical large-cap US equity allocation in a Bernstein account has about 75 stocks, avoiding the excessive diversification that wastes capital (*Display 5*). Research insights from our firm's industry-leading analysts inform stock selection, and portfolios are constructed integrating factor-based characteristics such as quality, value, growth, and momentum. This results in investment strategies that are high-conviction and diversified, without being diluted. Far from getting a closet index,[4] Bernstein clients get the active management they expect.

DISPLAY 5: OPEN ARCHITECTURE TENDS TO OVERDIVERSIFY, WASTING CAPITAL
Capital Allocation: All Holdings



For illustrative purposes only.
Source: AB

Our clients pay a single, fully transparent fee that generally results in lower costs.

Our *integrated* approach also enables us to efficiently manage volatility and taxes in real time (see "Aiming for Outcomes: The Journey," on page 9). And because there is no middleman, our clients pay a single, fully transparent fee that generally results in lower costs.[5] Outsourced approaches have two fees: one for the wealth advisor; and another, less transparent, set of fees for the third-party investment managers.

No firm gets everything right all the time, but Bernstein's vast research resources, disciplined investment process, and full transparency provide a distinctive structural foundation on which long-term success can be built.

WHY BOTHER WITH ACTIVE?

Over the last several years, disappointing active-manager returns, especially in outsourced portfolios burdened with layers of fees, prompted a decisive shift toward passive index strategies, such as exchange-traded funds (ETFs). While passive investments can play an important role in some wealth strategies, we believe that their rising popularity reflects near-ideal investment conditions in recent years, as well as a marketing message that understates their complexity and risk.

The conventional wisdom supporting passive strategies focuses on three main ideas.

"Active managers can't beat the market." A recent study by Vanguard[6] reported that over the past 20 years, just 29% of active US mutual funds outperformed their stated benchmarks, net of fees and expenses. This seems low, until you consider that passive index funds *never* outperform their benchmarks after fees in any time frame. The key point, however, is that not all active managers are the same.

3 *Amit Goyal and Sunil Wahal, "The Selection and Termination of Investment Management Firms by Plan Sponsors,"* The Journal of Finance*, 2008.*
4 *Closet indexers are investment managers with low active share and high fees.*
5 *Bernstein fees are calculated based on specific asset allocations and the total value of assets under management. Our fee schedule is available on request.*
6 *Daniel W. Wallick, Brian R. Wimmer, CFA, and James Balsamo, "Keys to Improving the Odds of Active Management Success," Vanguard.com, 2015.*

The costs associated with active management make it mathematically impossible to beat a benchmark if the underlying investments don't differ sufficiently from the benchmark. But many supposedly active managers are prone to hugging an index. Simple measures like "active share" offer investors a straightforward way to identify "closet indexers" from those that are making active bets.

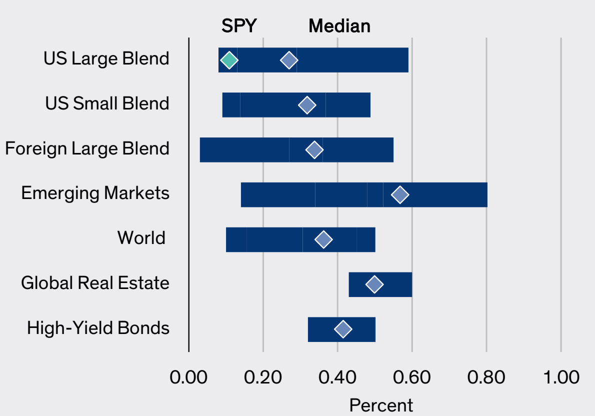
Active share is measured on a scale of zero to 100, where zero is exactly like an index, and 100 is entirely different. One academic study[7] found that the investment industry's aggregate active share is just 30%. It's no wonder the average active fund struggles to add value, net of fees, for its investors!

But averages can be misleading. The investment portfolios commonly held in Bernstein client accounts have active share values that start at 70% and go up to nearly 100%. In conjunction with our factor-driven portfolio construction process, our research-backed, high-conviction security selection gives Bernstein clients reason to expect above-average performance over the course of an investment cycle.

We believe the rising popularity of passive investments reflects near-ideal investment conditions for them in recent years.

DISPLAY 6: SOME ETFs ARE LOW-COST…BUT NOT ALL

Annual Range of Reported Net Expense Ratio



As of December 31, 2017

Select Morningstar US-domiciled passive ETF categories with greater than $20 billion in assets under management (AUM). Bars represent the middle 80% of expense ratios for all passive ETFs in the category and exclude the lowest and highest 10%. SPY is the ticker symbol for the SPDR S&P 500 ETF Trust.

Source: Morningstar and AB

"ETFs are cheap." While most large-cap stock index ETFs can be purchased for considerably less than their actively managed counterparts, there is a wide price range in each category. As index strategies move away from tracking broad benchmarks toward specific investment themes, sectors, or regions, the more expensive they tend to be. Moreover, the index the ETF is tracking isn't always clear (*Display 6*). For example, only three out of roughly 100 US large-cap blend ETFs track the S&P 500. The rest track a variety of indices. There's no disputing that many ETFs have delivered strong absolute returns in the years following the 2008 global financial crisis, fueling their recent popularity.[8] Their success from 2009 to 2014 was not just a product of low fees. The post-crisis period was a highly unusual investment environment during which stock market returns compounded at an above-average rate, with historically low volatility, especially in the latter years. Generally speaking, these conditions are the product of extreme market sentiment—either fear or greed[9]—and tend to under-reward active security selection for a period of time.

Unfortunately, asset values can't go straight up forever. Historically, more typical periods for returns and volatility have rewarded research-driven active managers, who tend to outperform with superior stock selection.

(continued on page 10)

7 *Martijn Cremers and Antti Petajisto, "How Active Is Your Fund Manager? A New Measure That Predicts Performance" (March 31, 2009). AFA 2007 Chicago Meetings Paper; EFA 2007 Ljubljana Meetings Paper; Yale ICF Working Paper No. 06-14. Available at SSRN: https://ssrn.com/abstract=891719 or http://dx.doi.org/10.2139/ssrn.891719.*

8 *The S&P 500 compounded at an annual rate of 15.5% for the five-year period ending December 31, 2014, compared with the average of 11.3%+ for the 20 years ending on the same date.*

9 *For more on this topic, see David Barnard, "Greed, Fear, and the Creation of Opportunity," Bernstein, 2015.*

AIMING FOR OUTCOMES: THE DESTINATION

It's human nature to assess progress. With this idea in mind, Bernstein allocates client capital on risk-based principles. In single-investment strategies and in portfolios that span asset classes, our goal is always the same: the most efficient trade-off of risk and return.

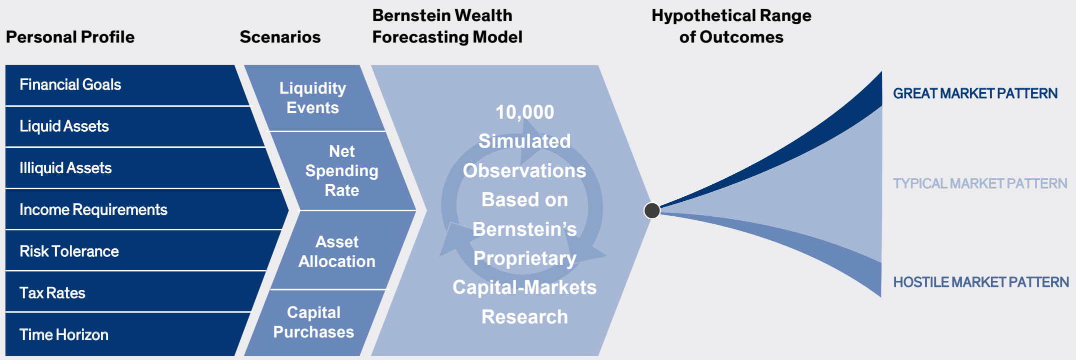
[The client's desired outcome is the benchmark that matters most.]

For many of our clients, this endeavor begins with a core-capital analysis, using our Wealth Forecasting System (*Display 7*). The objective is to provide a foundation for informed investment decision making by modeling outcomes and probabilities of loss under a variety of scenarios.

For individuals and families, we apply the concept of core capital to day-to-day cash-flow needs, which determines the amount of surplus capital available for generational transfer, philanthropy, or investment in assets with a different risk profile. For endowments and foundations, we apply the concept to distributions and spending. This core-capital analysis guides investment decision making and provides a basis for evaluating future progress.[10]

In the end, the client's desired outcome is the benchmark that matters most. This is why we show results relative to conventional indices, as well as to individual goals. When someone asks our clients about their results, our greatest hope is that they can respond (at a minimum!), "I'm on track."

DISPLAY 7: THE CORE OF YOUR RELATIONSHIP—TAILORED WEALTH FORECASTING



The Bernstein Wealth Forecasting System℠ is based upon our proprietary analysis of historical capital-market data over many decades. We look at variables such as past returns, volatility, valuations, and correlations to forecast a vast range of possible outcomes relating to market asset classes, not Bernstein portfolios. While there is no assurance that any specific outcome suggested by the model will actually come to pass, by quantifying the possibilities of achieving financial goals under changing, and sometimes extreme, capital-market conditions, the tool should help our clients make better choices.
Source: AB

10 *For more on this topic, see Seth J. Masters, "The Right End of the Telescope," Bernstein, 2015.*

AIMING FOR OUTCOMES: THE JOURNEY

Over the last 20 years, investors enjoyed close to a 6% return from a safe portfolio consisting of 100% taxable bonds. Over the next 20 years, we expect a 50% allocation to stocks will be required to achieve that same outcome. This shift to equities will also cause a greater variability in short-term returns. With this in mind, one challenge we face today is connecting our clients' return goals with the level of volatility[11] they are willing to accept.

Bernstein's proprietary Dynamic Asset Allocation (DAA) service was created to manage and reduce portfolio volatility. DAA achieves this by tactically adjusting the weight of return-seeking or risk assets in a portfolio to achieve a specific range of volatility.

For the sake of simplicity, consider a strategic asset allocation of 60% stocks and 40% bonds. A client invested in this allocation is signing up for annualized volatility of 8% to 11% over the long run.

Recognizing that volatility can be higher or lower in the short run, DAA uses sophisticated volatility forecasting tools to increase or lower the portfolio allocation to return-seeking assets, such as stocks, keeping realized volatility within the target range.

[Smoothing the bumps along the way gives investors the confidence to stay invested and take the risk needed to achieve their goals.]

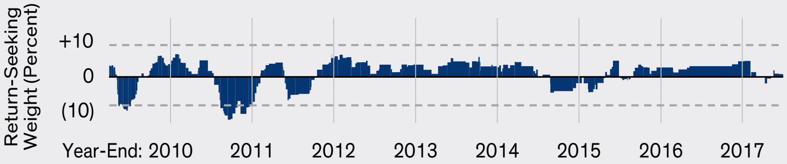
When the DAA team predicts low volatility, a normal 60/40 allocation might tick up to 65/35, with the idea that clients can take on a bit more risk and realize a greater return while remaining in their preferred volatility range. The same is true in reverse: If the DAA team expects higher volatility, it would adjust a portfolio to a more conservative asset mix—say, 55/45 (*Display 8*).

We've found that smoothing the bumps along the way not only improves long-run returns; it gives investors the confidence to stay invested and take the risk needed to achieve their goals.

DISPLAY 8: DYNAMIC ASSET ALLOCATION—SAME RETURN, LOWER RISK

April 2010–June 2018

Adjustments Made Within DAA*



Performance Summary
Bernstein Fully Diversified Simulation (%)**

	Conservative	Moderate	Growth
Return Impact	(0.0)	(0.2)	(0.3)
Volatility Impact	(2.8)	(4.4)	(4.7)

Past performance is not necessarily indicative of future results. There is no guarantee that any estimates or forecasts will be realized.
As of June 30, 2018, unless otherwise noted. DAA inception is April 1, 2010.
*Adjustments are to the return-seeking exposure of a taxable moderate-growth portfolio.
**Fully diversified simulation is for a taxable account and excludes the Multi-Manager Alternatives Fund portfolio in order to more accurately capture the efficacy of Dynamic Asset Allocation. Return impact on the strategic equities portion of both with and without DAA portfolios is computed net of investment management fees of 40 basis points. Additional advisory fees are assessed, as provided in the Bernstein fee schedule applicable to the account. Please consult your Bernstein Advisor for additional information.
Return impact is measured as the difference in returns between the with and without DAA portfolios. Volatility impact is measured as the difference in volatilities between the with and without DAA portfolios in percentage terms of the volatility of the without DAA portfolio.
Source: AB

11 *Volatility measures the choppiness of a return pattern for a given asset. It can reflect the fundamental risk associated with an asset but also captures investor sentiment. Volatility is important to understand and manage because it can lead to poor timing decisions (buying high and selling low).*

While this environment favoring active management has started to play out, we believe that we are still in the early stages of this new investment setting (*Display 9*).

The more modest return environment we expect going forward will be particularly challenging for index investors who will get only what the market gives, with no hope of doing better. Worse, the most popular passive investments track capitalization-weighted indices that are heavy with stocks that recently outperformed and are at risk for a pullback. These strategies are also unable to take advantage of opportunities when volatility spikes and strong companies get cheap along with weaker ones. Sometimes you get what you pay for and still end up disappointed.

"ETFs are simple and low risk." We know that timing manager selection in outsourced investment approaches often fails, and it's nearly impossible for active managers with low active share to beat their benchmark, so it's no surprise that many investors see passive strategies as a comparatively simple way to avoid these pitfalls. But there is no free lunch with investing, and ETFs simply present different risks.

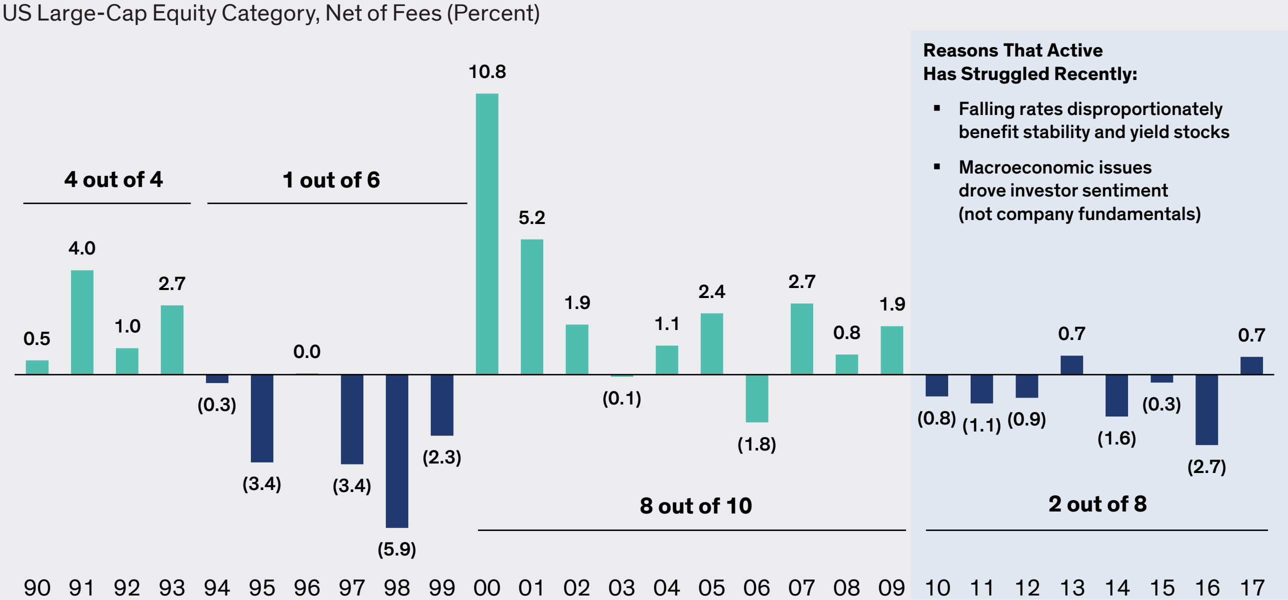
[Index ETFs are backward-looking. What makes them cheap also makes them susceptible to concentration risk.]

Index ETFs are cheap because they are systematic strategies. That is, their approach to both security selection and construction is rule-based and requires little to no human intervention to execute. Unfortunately, this makes them susceptible to concentration risk when sectors or stocks become popular and trade at higher valuations than their fundamentals merit. Examples are Internet companies in the late 1990s, and energy companies more recently. In these cases, ETFs had to keep buying shares of these high-valuation companies when analytical insight or common sense might have suggested otherwise.

Another example of ETF risk was apparent on August 24, 2015, when the global markets plunged. That day, some ETFs reported trades down 30% to 45%, far below the value of their

DISPLAY 9: ACTIVE'S RECENT UNDERPERFORMANCE IS JUST THE LATEST IN A CYCLE

Median Excess Return vs. Benchmark, 1990–2017
US Large-Cap Equity Category, Net of Fees (Percent)



As of December 31, 2017

Past performance is not necessarily indicative of future results. There is no guarantee that any estimates or forecasts will be realized. Excess return is calculated as the median of excess returns in the eVestment US Large-Cap Equity category (includes value, growth, and core) versus the manager's preferred benchmark. Historical data include funds that are no longer active. In cases where the manager has not provided a benchmark, the S&P 500 was used as the default.

Source: eVestment and AB

underlying securities.[12] ETFs failed to deliver the liquidity they had promised. Some investors tried to trade and, fortunately, couldn't. Others were not as lucky. They traded successfully at prices that were massively disconnected from prices of the underlying components and suffered huge losses.

Passive strategies in assets such as high-yield bonds have also proved less rewarding than marketers would have you believe. Since inception, the largest high-yield benchmark has lagged the average active fund manager by 2%, annualized.[13]

Despite the pitfalls of investing in ETFs, Bernstein does see a role for certain passive investments, especially for investors with meaningful allocations to alternatives or shorter-term time horizons. However, we don't think that they are the simple, low-risk investment panacea that many people believe them to be.

THE BERNSTEIN ADVANTAGE

In a world where most investment managers look alike, Bernstein Private Wealth Management has evolved into an organization like no other. We have the resources of the largest global firms, but the service culture of a boutique. AB ranks among the leading investment management firms in the world with over $500 billion in assets under management. And, while many firms can point to a comparable worldwide footprint, few can lay claim to 50 years of serving private clients. Our resources are vast, but our relationships are personal and we aspire to make every client feel like they are our only client.

For our entire 50-year history, we have derived 100% of our business economics from investment research and management. Our focus and commitment to research excellence are some of the keys to our longevity. The hundreds of analysts that we employ—along with their tenure in the industry and at AB—stand as a testament to that commitment today.

Existing solely as an investment manager (and not a bank, insurance company, or brokerage operation) affords us the independence and financial strength to operate in our clients' best interests through all cycles. Unlike most competitors of similar size, we don't engage in proprietary trading or leverage our balance sheet to drive profit for the firm. We are a business that is uniquely aligned with our clients, offering them incomparable peace of mind. ■

12 *Source: Barron's, BlackRock, ETF.com, Forbes.com, Morningstar, USA Today, The Wall Street Journal, and AB.*
13 *For more on this topic, see Gershon Distenfeld, "No Contest: In High Yield, Active Funds Beat ETFs," CONTEXT/The AB Blog on Investing, August 17, 2015.*

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NOTES ON THE BERNSTEIN WEALTH FORECASTING SYSTEM

The Bernstein Wealth Forecasting System[SM] uses a Monte Carlo model that simulates 10,000 plausible paths of return for each asset class and inflation and produces a probability distribution of outcomes. The model does not draw randomly from a set of historical returns to produce estimates for the future. Instead, the forecasts: (1) are based on the building blocks of asset returns, such as inflation, yields, yield spreads, stock earnings, and price multiples; (2) incorporate the linkages that exist among the returns of various asset classes; (3) take into account current market conditions at the beginning of the analysis; and (4) factor in a reasonable degree of randomness and unpredictability.

NOTES ON PERFORMANCE STATISTICS

The performance shown for Bernstein Moderate Growth Historical Advice is a simulation intended to illustrate the investment experience of a Bernstein taxable client who was invested in a 60% equity/40% fixed-income (municipal bond) allocation of Bernstein investment services. The specific allocations have changed over time as new investment services were introduced, or as a result of changes in Bernstein's asset-allocation recommendation. This simulation is presented for illustrative purposes only, and no representation is made that an investor will, or is likely to, achieve profits or experience losses similar to those shown. The specific allocations beginning in January 1991 and additional information regarding the calculation of performance are available upon request.

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