

AB EMERGING MARKETS MULTI-ASSET PORTFOLIO

MARKET OVERVIEW

Emerging-market (EM) stocks surged in July despite an uneven start. The MSCI Emerging Markets Index advanced 5.96%, bringing year-to-date returns to 25.49% (in US dollar terms). The path of returns among different regions—emerging-market EMEA (Europe, the Middle East and Africa), the BRICs (Brazil, Russia, India and China) collectively and Latin America ex Brazil—appeared somewhat correlated, though the BRICs outperformed slightly by month's end.

Emerging-market equities looked past geopolitics to secure their seventh consecutive month of gains. Markets embraced dovish overtones from global central bankers, tangible signs of global economic acceleration and solid earnings announcements. The US dollar declined to a 13-month low, and oil prices rose to the highest level in almost two months.

From an individual country perspective, Chinese equities soared on stronger-than-expected June trade data and upbeat earnings reports. Brazilian shares also posted significant gains, buoyed by a commodities rally, the passage of labor reform legislation by the Senate and a third interest-rate cut. In contrast, Russian stocks retreated amid an escalating diplomatic row between the Kremlin and the United States. President Vladimir Putin ordered the expulsion of hundreds of US diplomatic staff from Russia in retaliation

for additional sanctions imposed by the US.

Sector results varied. Real estate shares led owing to favorable fundamentals, while the materials sector also outperformed, because of strengthening prices in commodities. In contrast, the more defensive healthcare and consumer staples sectors trailed versus other sectors.

PORTFOLIO PERFORMANCE AND POSITIONING

The Portfolio underperformed the emerging-market equity index in July. With EM bonds underperforming the equity index by more than 5%, the allocation to bonds was the greatest weight on relative returns. Security selection detracted marginally, with bonds outperforming bond indices but equities lagging the equity index somewhat. Currency selection detracted marginally from relative returns, largely because of the Argentine peso, which depreciated.

Electronics manufacturer Skyworth Digital Technology was the leading detractor for July, after announcing that the company's total TV sales volume declined 31% year on year in June.

Air China detracted in July after the transportation services company reported that passenger traffic rose year on year in June but declined compared with May numbers. Shares of Indian consumer

goods marketer ITC detracted after the government raised a tax on cigarettes. ITC reported a 7.4% rise in quarterly profit, which was aided by sales from its cigarettes segment.

Chinese investment holding company Yangzijiang Shipbuilding contributed in July. The company announced that it secured new contracts that brought year-to-date orders up to US\$450 million.

Laminates manufacturer Kingboard Chemical contributed after the company invested in Cathay Pacific Airways, to turn the ailing Asian international airline around. South Korea-based financial company Hana Financial contributed during the month, after reporting earnings that were helped by cost-cutting and improvement in net interest margins.

Our fixed-income holdings detracted from performance relative to the broad emerging equity market, but they outperformed fixed-income benchmarks.

OUTLOOK

Fundamentals, valuations and technicals for emerging equity and debt remain supportive. Across emerging-market equities, earnings growth expectations revised up steadily over the quarter, supported by accelerating economic and export growth. Despite rapid earnings growth, price multiples for EM stocks have remained stable, leaving a large discount to developed markets. As risk's have

declined, credit spreads on EM debt have declined but still remain wide compared with similarly rated US corporates.

Market leadership has been relatively narrow, led by mobile/internet companies, in both EM and developed markets, which are seen as having unassailably stable growth prospects. We think the next leg of the market rise will include companies in a broader set of industries that are also delivering good growth and are now trading at significant discounts.

Recent market concerns about the implications of higher rates, a stronger dollar and potential trade policy changes from the US have moderated, and market volatility has begun to stabilize. Consistent with this positive view, and with declining yields on EM debt reducing potential future returns on bonds, we have increased the equity allocation in the Portfolio to 83% from 73% during the month.

We like the balance of exposure to EM equity and debt that we now have in the Portfolio. If economic growth does not accelerate significantly from here, earnings growth to support EM equity

capital appreciation will be more modest, though low multiples leave some room for expansion, particularly when compared with developed-market valuations. On the other hand, we are still able to find selective EM bonds for which credit spreads are high in relation to the yield on comparably rated US credit, which has historically been a signal for strong future relative returns. As credit spreads have tightened across EM, it has become more important to be selective. Moreover, to the extent that the global economy remains in a muddle-through growth mode, EM debt could generate returns comparable to equity with considerably less volatility. The bonds we select are generally either higher-yielding securities with equity-like return potential or higher-quality securities that trade more in sync with Treasuries and that should therefore offer significant diversification from equities, and downside protection.

EM equities trade at about 13.2 times estimated 2017 earnings, versus 19.5 times for the US and 16.7 times for Japan. Consensus earnings growth for EM is 20.8% this year versus 12.9% for global. As earnings growth materializes, we believe that EM price-to-earnings multiples

could expand in the direction of developed-market levels, which underpin very strong returns.

However, the path is far from certain. This is precisely why we believe that the Emerging Markets Multi-Asset Portfolio is a great way to get exposure to EM right now. Our goal is to smooth out the inherent volatility of EM and participate in the upside as EM recovers. If it takes longer than anticipated, our aim is still to generate a positive yield.

As a reminder, EMMA isn't simply an asset-allocation strategy. We build the Portfolio in an integrated process as a single team, drawing on the best EM investment ideas from across the firm. Ultimately, much of the success will be driven by how our research into companies and countries surfaces opportunities that are different from standard benchmarks.

Thank you for your support,

Morgan Harting

Please see overleaf for important disclosures.

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