



BERNSTEIN

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Five Themes for '25 and Their SAA Implications for US Equities, TIPS, and Crypto

This note outlines five investment themes for 2025. These are not necessarily trades for the coming year, but rather issues that asset owners need to think about—even if some implications are longer-term. They are topics that we believe necessitate a change in investors' expectations and in their asset allocations.

The key allocation conclusions of this note are as follows. We maintain our overweight recommendation on global equities, and within that we have shifted to be explicitly overweight the US. We think exposure to private assets has more room to increase (although not private equity). We explicitly overweight Treasury Inflation Protected Securities (TIPS) versus a strategic underweight on duration via nominal government bonds. We were already positive on gold, and now add a strategic position in crypto in our strategic asset allocation.

In our view, expectations of medium-to-long-term inflation need to rise, and we suspect that questions of fiscal sustainability are likely to be a constant refrain in upcoming meetings. The broad investor tilt toward real assets has further to go. Tactically, we think that equities will deliver positive returns over the coming year.

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This note outlines five investment themes for 2025. We are not trying to specify a series of trades for the next 12 months; instead, we address issues that investors and allocators will need to think about in 2025, even if some of the implications are longer-term. We think that these topics will form key talking points in our meetings with clients over the coming year and represent areas where there may need to be a change in investors' asset allocations.

The strategic backdrop that we have laid out in previous research is one of higher-equilibrium inflation and lower real-growth rates, requiring a reallocation by investors into a higher weight for real assets. The underlying motivation for this view is that the large structural forces that drove a decline in yields in the decades prior to the pandemic have run their course—and, in some cases, are now acting in reverse. These forces are demographic change, globalization evolving into deglobalization, and the energy transition and climate change. AI could possibly temper this decline in growth somewhat, but we think that it is unlikely to fully offset the downward forces on growth.

A key topic that investors need to address in their forecasts and positioning for 2025 is the effect of the new US administration under president-elect Donald Trump. We are writing this before we have full clarity on the policy agenda; but in the near term, we see expansionary and regulation-cutting policies as pro-growth. However, over the medium to long term, we think that a Trump administration accelerates a shift to an investment regime of higher equilibrium inflation and ongoing concern about fiscal sustainability.

The fiscal-sustainability issue already came up in a large number of our meetings with investors over the last year, and we don't think it will go away. The question is: What are the implications of this for portfolios? There is the possibility of markets pricing in a higher-term premium, which we discuss later in this note. But we think the more likely impact is a change to long-term inflation expectations. We outline our strategic asset-allocation (SAA) recommendations in *Display 1*.

Display 1: Strategic Asset-Class Views

Asset Class	Recommendation vs. 60:40	Comment
Development Equities	Overweight	
US Large-Cap	+	A real asset; attractive long-term returns; US "exceptionalism", potential for higher nominal growth and margins under Trump; risks from valuations and market concentration
US Small-/Mid-Cap	+	Trump win a tailwind for domestically oriented businesses; historically an area of strong alpha generation by active managers
International Developed	Neutral	Attractive valuations but greater drag on growth from demographics and deglobalization than US; Trump win negative for euro-area outlook
UK	+	Attractive valuations and sector composition offering defensive/stable growth
Japan	+	Positive inflation dynamic; corporate reform boosting corporate earnings and improving long-term fundamentals and shareholder returns; attractive valuations; diversification benefits
Euro Zone	-	A more challenged growth outlook, Trump win negative for eurozone (defense, geopolitics, tariffs); lack of tech/AI exposure
EM Equities	Underweight	
Emerging Markets ex China	Neutral	Positive growth premium over developed markets; better demographics (India, Africa); structural sentiment measures supportive; deglobalization to improve the diversification role of emerging markets; geopolitics and policy are risks in some countries; Trump poses increased risks to outlook (protectionism, higher USD)
China	-	Poor demographics; policy and geopolitical risks to outlook (Trump) despite cheap valuations
Style Premium		
US Growth	+*	Expensive but structural tailwinds (greater persistence of ROE; tech and AI theme exposure)

US Value	+	Potential for higher inflation and rates favors value as long as accompanied by strong growth outlook
EAFE Quality	+	Attractive valuations; defensive properties and volatility reduction for a less robust strategic outlook outside the US
EAFE Dividend Yield	+	Attractive valuations; defensive properties and volatility reduction for a less robust strategic outlook outside the US; attractive source of income
Duration	Underweight	
US Government Long	-	Structural risks; low-term premium, inflation volatility; diminishing diversification; prospect of excess issuance relative to demand for bonds
US Gvt. Intermediate	Neutral/Overweight	
US Gvt. Short	+	Better compensation for (lower) risk than long bonds
Euro Gvt. Bonds	Neutral	Yields attractive vs. history; stronger fiscal position than US; nearer-term more favorable policy outlook; balanced against this is geopolitical and domestic political risk.
Real Assets	Overweight*	
REITs	+	Real asset with positive correlation to inflation and positive real returns in all inflation regimes; structural risks include climate change (higher insurance costs) and policy risk of rent control in residential real estate; case to be selective within the space
Natural Resources Assets	+	Strategic inflation hedge and provider of real return; diversifying asset for equity risk even at higher levels of inflation (unlike bonds); key example of sustainable asset that is also an inflation hedge; possible risks include climate change (e.g., risk of timber destruction by fire).
US TIPS	+	Attractive long-term returns; inflation protection
Private Assets	Overweight*	
Private Equity	-	Expect zero multiple expansion in aggregate; higher cost of debt than most of its history; many investors already overweight; high fee and liquidity concerns
Private Debt	+	Attractive current and prospective yield; floating-rate nature provides inflation protection; beneficiary of retrenchment by traditional credit providers
Infrastructure	+	Inflation protection by offering positive long-term real return in moderate- and high-inflation environments; beneficiary of energy transition
Non-Fiat	Overweight*	
Gold and Crypto	+	Zero-duration non-fiat assets; protection against debasement risk for G7 currencies

Current analysis and forecasts do not guarantee future results.

*Asset has small or no benchmark allocation.

Source: AllianceBernstein (AB)

1. The Case for Higher-Equilibrium Inflation

Inflation should once again be a central issue in questions of allocation. In fact, it never really went away. In 2024, we saw the establishment of a strong disinflationary trend, as highlighted by central banks cutting rates and reductions in market-based expectations of inflation. However, we think it is critical to avoid confounding cyclical and structural inflation. Central banks have been highly effective at addressing the cyclical aspect, but it's not clear that they can be as effective with the structural dimension, especially in the presence of restrictions on growth. We expect 5y/5y inflation swaps and 10-year inflation break-even rates to move higher in the years ahead. This trend should have two consequences for strategic allocation: First, one needs to consider which return streams are effective for return and diversification purposes at moderately higher levels of inflation. Second, it prompts questions of governance, forcing greater consideration of the risk of any loss of purchasing power in contradistinction to risk couched in the language of volatility of returns.

What is notable about the case for higher-equilibrium inflation is that the driving forces at work are very diverse in nature:

- Deglobalization: fragmenting supply chains and labor markets
- Demographics: a smaller labor force driving up wage-bargaining power and rising cost of care, which is hard to automate, for a larger cohort of elderly people

- A slower energy transition than the investment industry seems to expect, which implies severe weather shocks and increased inflation volatility
- Risk of debt monetization (at some point)

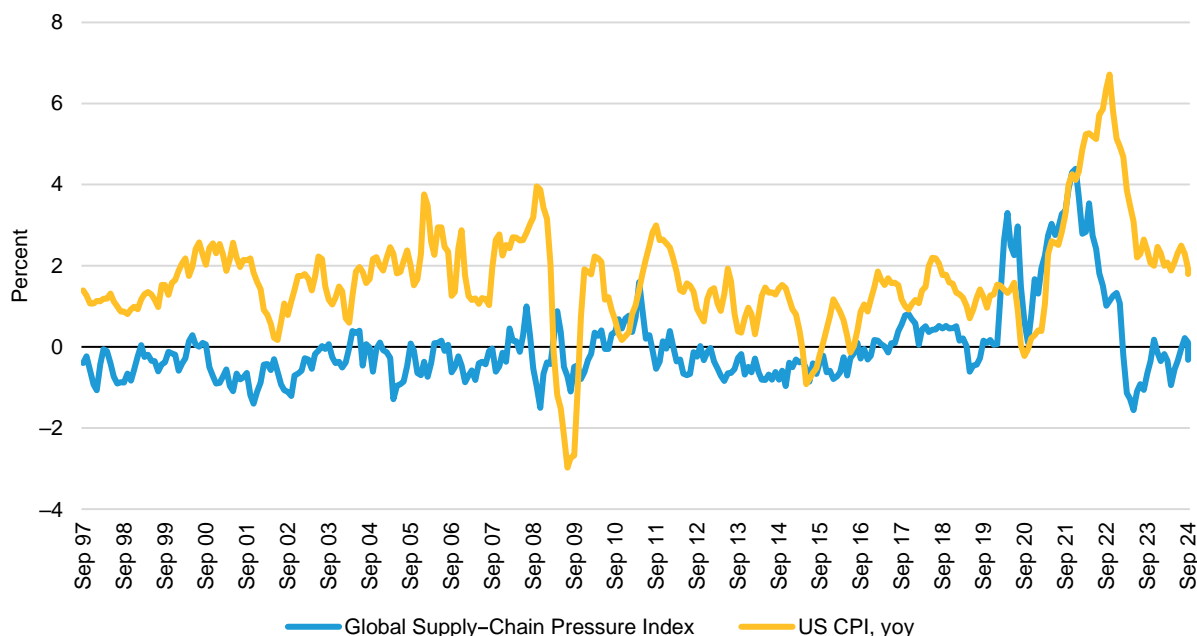
These are long-term forces. How could the new US administration change them? At the time of writing, we do not know exactly what the new policies will look like. Tariffs of some level are highly likely. One could argue ad nauseam about whether they constitute inflation or a one-off increase in prices. Either way, they prompt a need to rethink supply chains and labor sourcing; it is that restitching of supply chains that adds potential costs. Broadly, we see tariffs as adding extra costs.

Another topic that has been the subject of much discussion is the outlook for immigration in the US. The significant increase in the number of foreign-born workers over the last four years has likely created more slack in the labor market than would have existed otherwise, likely contributing to inflation being lower than it might otherwise have been. The inflow of new immigrants has already slowed, so these measures might have less marginal effect than over the last two years, although immigration is still running at a significant 150,000 per month.¹ Trump has said that he would like to also repatriate workers; it is unclear at this stage if this will happen. Thus, depending on the actual path of adopted policy, we see this aspect as at least neutral for inflation, but with an upside risk.

The final aspect of the new US administration that is relevant for inflation is fiscal sustainability. We cover this topic in more detail in a separate section below. The budget deficit would be an issue no matter who had won the election, but the potential for higher spending plans and questions of long-term central-bank independence are arguably now more pressing.

Adding detail to the longer-term forces, the key point about deglobalization is that China had acted as a deflationary impetus since Deng Xiaoping's reforms of the early 1980s—and especially since gaining World Trade Organization access in 2001. That process is now over, and is now a potential route for inflation in developed markets via both wages and goods. For example, Jaravel and Sager (2019) find that a 1-percentage-point increase in import penetration from China caused a 1.9% decline in consumer prices. But the restitching of supply chains also plausibly increased the volatility of inflation. *Display 2* shows the changes in the Federal Reserve's measure of supply-chain pressure overlaid on Consumer Price Index (CPI) changes. Shocks to supply chains are a plausible link to greater volatility of inflation.

Display 2: The Link Between Supply Chains and Inflation



Current analysis and forecasts do not guarantee future results.

As of October 31, 2024

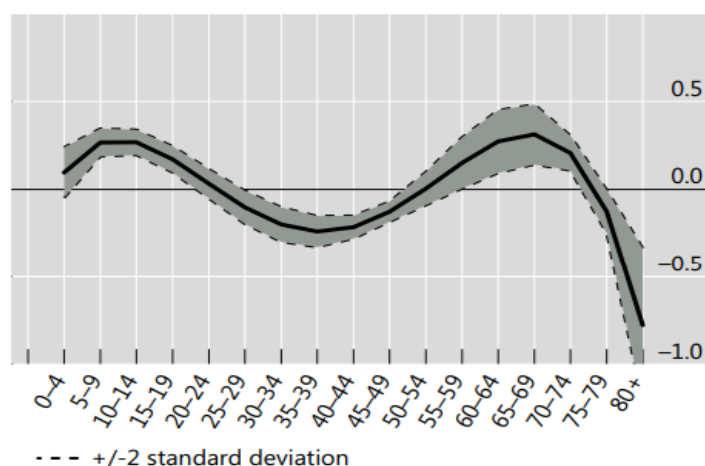
Source: Bloomberg and AB

¹ <https://www.cbp.gov/newsroom/stats>.

We think that demographic change is also inflationary. When we state this view in meetings, we sometimes see puzzled looks. The response: Wasn't this what happened in Japan, and wasn't that trend significantly deflationary there? We think that the shrinking working-age population for developed markets and China is different. First, it is happening simultaneously in many markets. Second, Japan's aging was taking place when there were still very large disinflationary forces at work elsewhere.

Display 3 shows the impact of age cohorts on inflation. Having more workers is deflationary, as they produce more than they consume. Having more dependents tends to be inflationary. Applying the United Nations population forecasts implies that there will be a smaller number of workers and a larger number of retirees ahead. The implied effect of this is to raise the baseline level of inflation by the order of 3 percentage points.

Display 3: Age Cohort Effect on Inflation (1870-2016)



For illustrative purposes only

Source: Mikael Juselius and Előd Takáts (2018): “The Enduring Link Between Demography and Inflation” (BIS working paper no. 722), <https://www.bis.org/publ/work722.pd> and AB

It is notable that the very oldest people tend to be deflationary, but we think that there is a case that their required spending is also set to increase. Conditions such as dementia are likely to become more common because age is a critical risk factor. The largest projected part of the increase in associated costs for such conditions is care, since it is hard to automate. This point is also relevant for the labor market. We have shown in previous research² that the number of US care workers has tended to be a relatively constant function of the number of people over 75 years old. As the size of that cohort rises, it implies that more people have to leave other productive sectors of the economy to engage in care work, putting upward pressure on competition for labor in those other sectors.

We covered in detail the debate about whether the energy transition is inflationary or deflationary in our recent note on the topic.³ Leaving the question of how the transition itself affects inflation aside in this note, our view is that the energy transition will take longer than many in the investment industry are expecting. The consequence is that climate outcomes, while highly uncertain, will likely be worse. This point implies a greater frequency of severe weather events. In our recent note on the energy transition,⁴ we presented the range of academic research on this point that implies an impact on global headline inflation on the order of 0.8–0.9 percentage points per annum.

Before someone jumps to the conclusion that we are advocating unanchored inflation, there are disinflationary forces at work, too. Lower growth rates, other things equal, likely have a downward force on inflation. Automation is a significant downward force. While large parts of the CPI basket, such as real estate costs and the cost of care, are hard to automate, automation can be a downward force on prices of other services. Moreover, in societies such as the US and the UK, where the responsibility of saving for retirement has been shifted to individuals, the combination of lower

² [A Triumvirate of Macro Mega-Forces.](#)

³ [Can the Energy Transition Happen?.](#)

⁴ Ibid.

expected real returns and greater longevity implies that savings have to increase, too. We get that this will take a long time and may require coercion. But it could put a downward force on the velocity of money.

Thus, our call is for moderately higher inflation rather than unanchored inflation. Our working assumption is that the long-term inflation rate that investors need to target to ensure that they generate real returns will be in the range of 3%.

Display 4: Deflationary as Well as Inflationary Forces Are at Work over Strategic Horizons

Deflationary Forces	Inflationary Forces
<ul style="list-style-type: none"> Lower long-term growth expectations imply lower inflation. Technology and automation have been deflationary for years. Does AI revolutionize this and undercut the case for inflation? Once pent-up spending ebbs, customers' realization that nominal-savings returns are down and that inflation is up will imply the need to save more, which lowers money's long-term velocity. 	<ul style="list-style-type: none"> Over strategic horizons, inflation is driven by: <ul style="list-style-type: none"> Deglobalization (supply/labor cost impact) Demographics (shrinking labor force and care costs) Labor bargaining power? (smaller supply of labor vs. AI impact) Energy transition and climate: Is the transition inflationary or deflationary? What's the impact of severe weather on inflation volatility? Monetization of debt? Debt/GDP is at its highest level since WWII. Is inflation the only way out?

Current analysis does not guarantee future results.

Source: AB

We see two key dimensions to consider when choosing assets to hedge against inflation: the short-term correlation with inflation; and the ability to generate long-term positive real investment returns. Assets that might not have a high inflation beta in the short term are still crucial for investors with a long time horizon. In the periods of moderate inflation, which we define as a yearly US CPI of less than 4%, equities have been a key part of a portfolio allocation that seeks long-term real returns (*Display 5*). Other effective long-term inflation hedges include real estate, farmland and timberland, and infrastructure. Meanwhile, commodities such as oil and gold as well as broad commodities have historically been closely linked with short-term inflation spikes and thus useful for investors who need to hedge inflation over shorter horizons. On the fixed-income side, TIPS and short-duration government bonds have been effective short-term hedges.

In periods with greater than 4% inflation, real assets, such as real estate, farmland and timberland, and infrastructure, have become much more important in achieving a positive long-term real return. And in the shortterm, commodities as well as TIPS and T-bills remain effective inflation hedges.

Display 5: What Counts as an Inflation Hedge? Long-Term Investors Need Real Return Rather than a Correlation With Inflation

Moderate Inflation		High Inflation	
Long-Term Investors: Real Return	Short-Term Investors: High Inflation Beta	Long-Term Investors: Real Return	Short Term Investors: High Inflation Beta
Real Estate	Broad Commodity Index	Real Estate	Oil
Equities	Oil	Farmland, Timberland	Gold
Farmland, Timberland	Gold	Equity Income, Free-Cash-Flow Yield	Broad Commodity Index
Value Equity	Commodity Equities	Infrastructure	Commodity Equities
Infrastructure	Equity Momentum		Momentum (Cross-Asset)
	Renewables/Power Delivery		TIPS
	TIPS		T-Bills
	T-Bills		

For illustrative purposes only

Source: AB

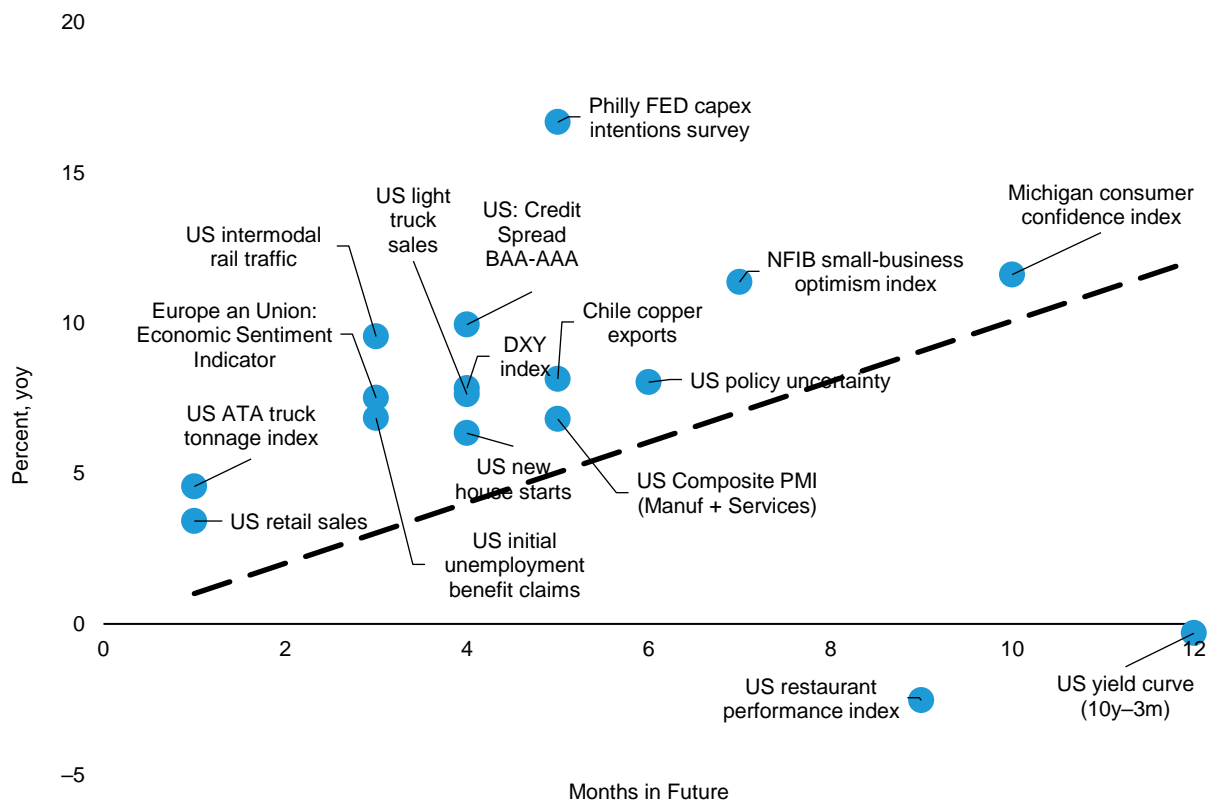
2. The Tactical Case for Risk Assets

Most of this note is concerned with the need to reassess longer-term positioning, but an outlook for 2025 needs to be tactical as well. On that point, we are positive on global equities over the next 12 months.

The core part of this positive view stems from the observation that, for all the fraught debate during 2024 about whether the US faces a soft landing, hard landing, or no landing, the growth outlook remains strong. We model the 12-month forward corporate-earnings growth that is most consistent with the cross-section of activity stats that have been most effective at forecasting earnings over the subsequent year. This model indicates that earnings-per-share (EPS) growth will be 12.1% over the next 12 months. That amounts to a very soft landing—indeed, it would barely qualify as a landing at all.

This level of growth does not count as a surprise versus bottom-up consensus, which stands at more than 14%, especially when the error bars for such forecasts are taken into account. Nevertheless, this is in the context of the Fed still cutting rates. The central bank has not been cutting rates with no recession in sight since 1995, so this is supportive.

Display 6: US Tactical Earnings Indicator: Current Forecast 12.1%



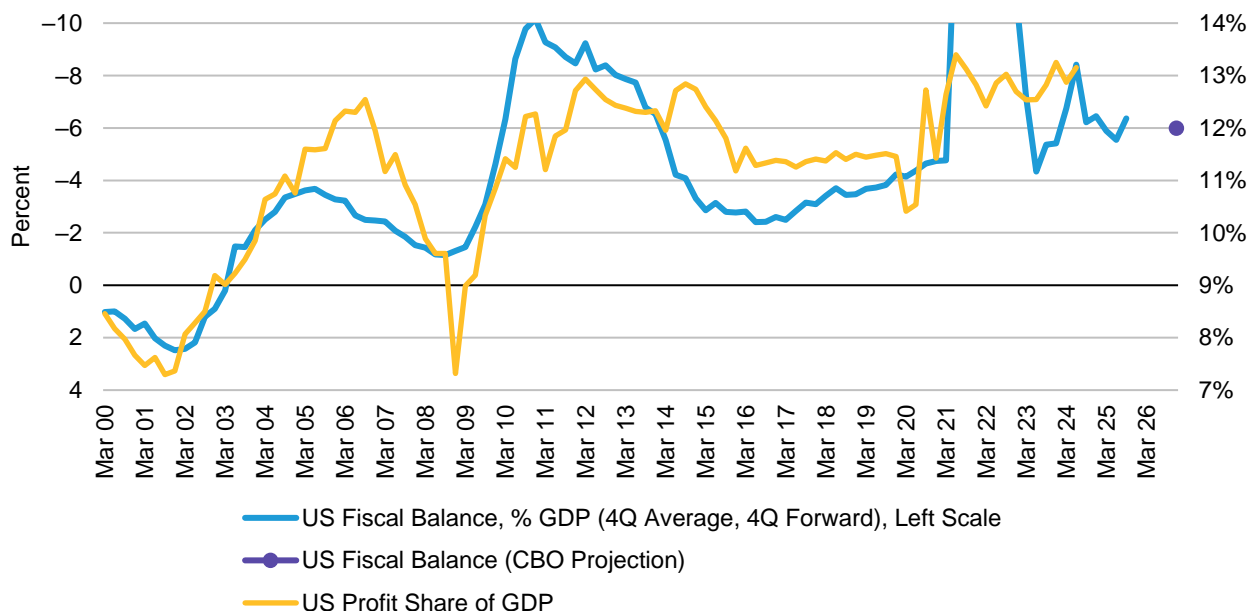
Current analysis and forecasts do not guarantee future results.

As of November 15, 2024

Source: Bloomberg, FRED, Thomson Reuters Datastream, and AB

In addition to the case for earnings growth, there are reasons to be positive on margins. A relevant strategic question is: How long can the extraordinarily high margin levels in the US be maintained? One would have thought that at some point they would be deemed socially unacceptable. That prospect has now changed. We think that a Trump administration will enable high corporate margins to last longer. An environment of loosening regulation and a lighter touch for mega-cap companies will help. Moreover, expansionary fiscal policy also implies a support for margins over the next one to two years (*Display 7*). Margin pressure in the US has to come one day, but as with Augustine’s wish to be chaste, just not yet.

Display 7: US Corporate Profitability Supported by Fiscal Stimulus



Current analysis and forecasts do not guarantee future results.

As of September 30, 2024

Source: Thomson Reuters Datastream and AB

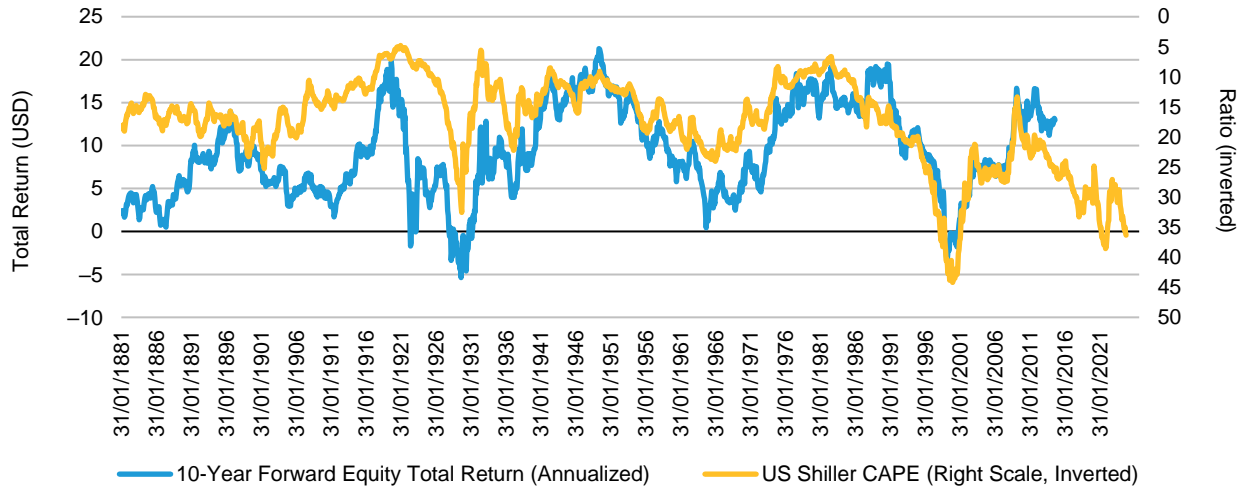
Valuation is the principal equity constraint. We need to be clear on that and not beat about the bush—the global equity market is expensive. But let's also be clear about the implications of that statement. It does not mean that the market has to fall. It's almost too obvious to state, but someone who had followed a valuation signal for equity positioning would have monumentally underperformed for many years. At any rate, all asset classes are expensive. We think that statement applies to bonds, credit, and private equity as well. However, one doesn't get to make an absolute call when it comes to asset allocation (usually).

The most negative take on this assertion would be the Shiller PE (price divided by 10-year inflation-adjusted earnings). Taken at face value, this implies a zero nominal return on US equities even in total-return terms (*Display 8*). One cannot totally shrug off such a state of affairs, but there are mitigating and framing factors. First of all, the time frame for valuation is that it is only a strong signal for the long term. One can never know when mean-reversion takes place. The Shiller PE has been one of the most effective valuation metrics when applied to data over the last 150 years, but only in forming 10-year forward views. Earnings (discussed above) and sentiment (more on this below) matter much more in the near term.

Moreover, we believe that there are good reasons for real yields to remain low in a low-growth world. In addition, an outlook of moderately higher inflation implies ongoing structural investor demand for real assets in the form of equities—in addition to continuing corporate demand via buybacks. Taken together, this means that valuations do not need to mean-revert to a long-term average.

One cannot completely dismiss high valuations, but our strong conclusion is that they imply a higher level of volatility than that of the last year, not that the market has to fall.

Display 8: US Shiller PE and 10-Year Forward Equity Return



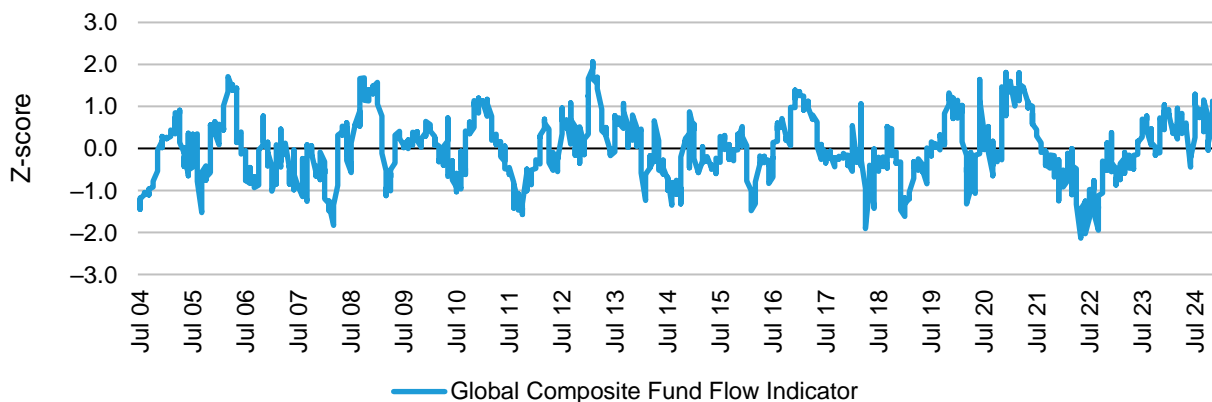
Current analysis and forecasts do not guarantee future results.

As of October 30, 2024

Source: Robert Shiller’s database, Thomson Reuters Datastream, and AB

The more sensitive point tactically is sentiment. There has been a flow of over \$620 billion into global equities since the start of 2024. Flows into the US have been particularly strong, with only Europe seeing outflows. As a consequence of this, our indicator of investor sentiment based on flows is at levels that imply weakness, or, at the very least, heightened volatility over the next three months (*Display 9*). However, this note is concerned about the outlook for 2025 as a whole, so while these sentiment readings are consistent with a high degree of tactical volatility, they do not change our expectation that global equities will deliver a positive return over the next year.

Display 9: Global Composite Fund-Flow Indicator Shows Elevated Investor Sentiment



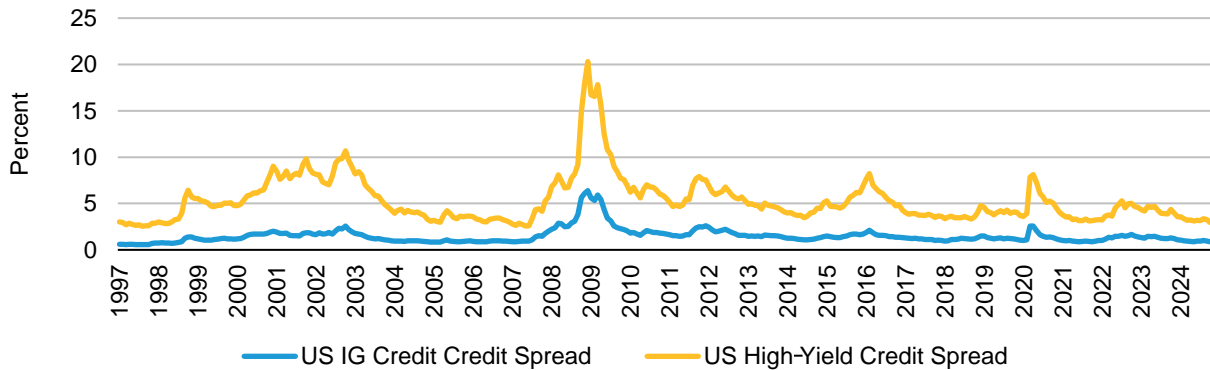
Current analysis and forecasts do not guarantee future results.

As of November 20, 2024

Source: EPFR, Thomson Reuters Datastream, and AB

What is the near-term role of credit in an allocation to risk assets? Meetings with investors on this topic have often led to disagreements about the importance of spreads versus overall yields. Yes, yields are attractive, but spreads are tight, as is widely recognized (*Display 10*). There are good reasons that justify spreads being tight (low levels of corporate leverage, a terming out of debt and an avoidance of recession), but it is hard to make a near-term valuation case.

Display 10: Credit Spreads Are Very Tight

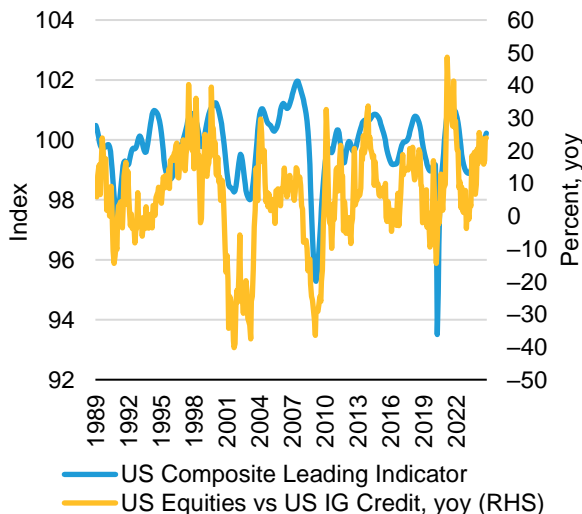


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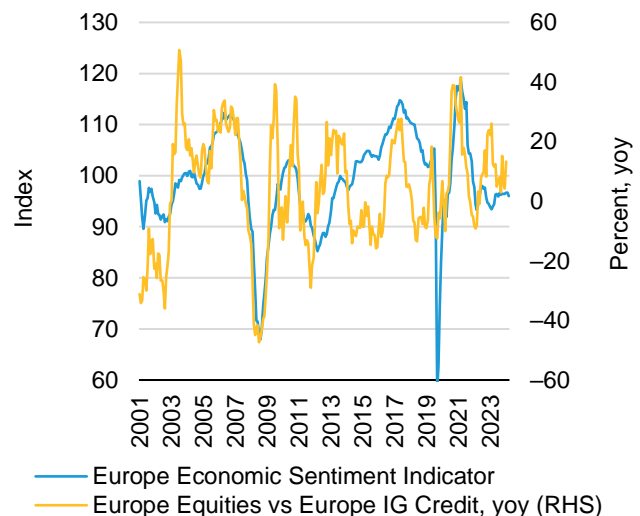
As of October 31, 2024
Source: FRED and AB

More important for making a near-term equities-versus-credit call is the prognosis for growth. We show in *Displays 11* and *12* that both in the US and Europe, the outperformance of credit is linked to periods of significant slowdown in growth. Given that we do not see a case for such a call at present, we favor equities over credit.

Display 11: US Equities and IG Credit Performance During Economic Cycles



Display 12: European Equities and IG Credit Performance During Economic Cycles



Current analysis and forecasts do not guarantee future results.

IG: investment-grade
As of October 31, 2024
Source: FRED, Thomson Reuters Datastream, and AB

3. Postelection Strategic Asset-Allocation Changes

What are the strategic asset-allocation (SAA) implications of the US election? In a nutshell, directionally our key strategic bets remain largely the same. However, the Trump win has increased our conviction in certain areas—specifically, our view that inflation will be higher and more volatile over the medium to long term and that Treasury yields will be pushed up over time as investors seek more compensation for the risk of holding government bonds. We remain overweight equities and underweight duration, preferring medium-term maturities and exposure to high-quality credit for income generation.

Within equities, we make some adjustments to our regional positioning. We increase our exposure to the US to a modest overweight, at the expense of exposure to the euro zone (underweight) and to EM ex China, which we move

from overweight to a neutral position. Despite the eurozone's attractive valuations, which should provide a favorable backdrop for the market, we find it hard to see a catalyst for sustained outperformance. There is rising geopolitical uncertainty, the likely need to increase already-surgeing defense spending, and a lack of a tech sector to provide an engine for growth. Emerging markets could face strategic headwinds associated with the stronger US dollar and the potential protectionist policies of the Trump administration. We remain overweight the UK and Japan and retain our underweight in China. Displays 28–39 in the Appendix illustrate some of the key valuation and fundamental drivers motivating our positioning.

As is well documented, the key areas of change include fiscal policy, trade, immigration, energy, regulation, and—of course—changes to foreign policy, although there is much uncertainty surrounding the timing and specifics of the implementation of all these changes. On taxes, Trump is likely to extend the expiring Tax Cuts and Jobs Act provisions and to propose new cuts, potentially including corporate taxes. This would likely mean persistent budget deficits—one factor that we think will push up long-term Treasury yields and that underscores our already-negative position on long-duration government bonds.

On trade, Trump has proposed a wide range of tariffs, including 60% on China and 10%–20% universal tariffs. While implementation is highly uncertain, this could exacerbate the geopolitical and economic fragmentation, or deglobalization, which is a structural factor that we already position for and see keeping inflation higher in the medium term. A reduction in legal immigration could affect the labor market, similarly increasing inflationary pressure and adding to other factors such as supply constraints from the aging workforce.

Deregulation, including the rollback of banking regulations and of the antitrust focus on Big Tech as well as measures to boost energy production, expand energy infrastructure, and scale back parts of the Inflation Reduction Act are also on the agenda. These measures could benefit equity sectors such as energy, financials, and tech. This potential re-underwrites our existing strategic tilt to US growth, but at the same time improves the prospects for US value. We also think that US small-cap stocks could benefit from the more domestic-business-friendly environment of the new administration, and we recommend considering this exposure as part of the SAA. In EAFE, we think exposure to the more defensive dividend-yield factor—which is trading at low multiples versus history and offers attractive yield relative to the market—makes sense with the more difficult outlook for the region.

Given the likelihood of strategically higher and more volatile inflation, we also reiterate the importance of exposure to real assets/inflation-sensitive assets such as TIPS, REITs, and commodities. However, the prospect of higher bond yields, a stronger US dollar, and the potential rollback of climate transition efforts means that exposure to REITs and commodities would need to be more nuanced and selective going forward. We will follow up with more detailed thoughts on this.

What are the implications of the Trump win for market structure and active management? Our research has shown that stock correlations, valuation spreads, and market concentration all act as important drivers of active managers' returns. The first two of these forces remain supportive: valuation spreads are wide across and within markets and sectors, and stock correlations remain low. By contrast, high market concentration makes it more difficult for many active managers to outperform—and, if anything, the timing of any unwinding of concentration is now harder to call. While we do expect earnings delivery to broaden into 2025, Big Tech is now likely to benefit from a more favorable US domestic regulatory backdrop, which can continue to drive a concentrated market—rich valuations remain a risk, though, and may pull in the other direction.

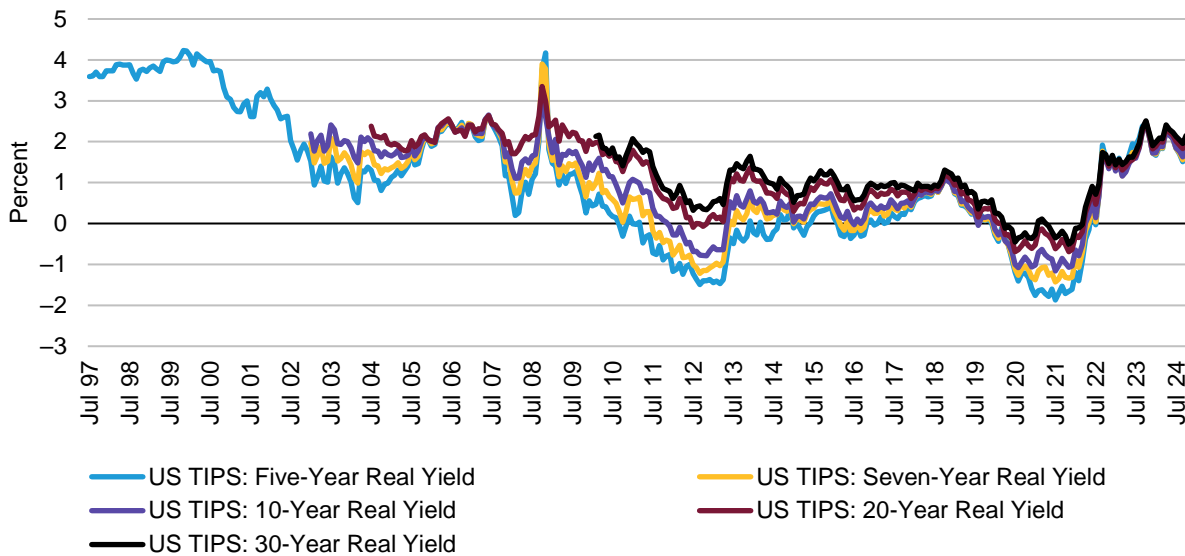
At the same time, better prospects for value could bring about some mean-reversion in valuation spreads and create greater opportunities for value managers, as well as core/blended approaches, systematic/quantitative managers and other strategies that use valuations as an input into their investment process.

4. The Case for TIPS, Gold ... and Crypto

Much of our more strategically oriented research in recent years has been concerned with the idea of higher-equilibrium inflation and what investors should do about it. The heightening of investor concerns about fiscal sustainability adds an extra, and related, issue that demands a response in terms of asset allocation. The implication is that, when considering overall portfolio risk, the risk of higher inflation and depreciating G7 currencies has to be taken into account. What makes this even more pressing is that the ability of bonds to diversify equity risk is likely to be suppressed in such an environment.

The yield on offer from inflation-protected securities such as TIPS stands in seemingly stark contrast to these observations. The increase in yield on US 10-year TIPS now puts their real yield at the top end of the range since 2010. This shift has been directionally the same across other markets with inflation-protected securities and across other maturities (*Display 13 and 14*)

Display 13: TIPS Yields by Maturity

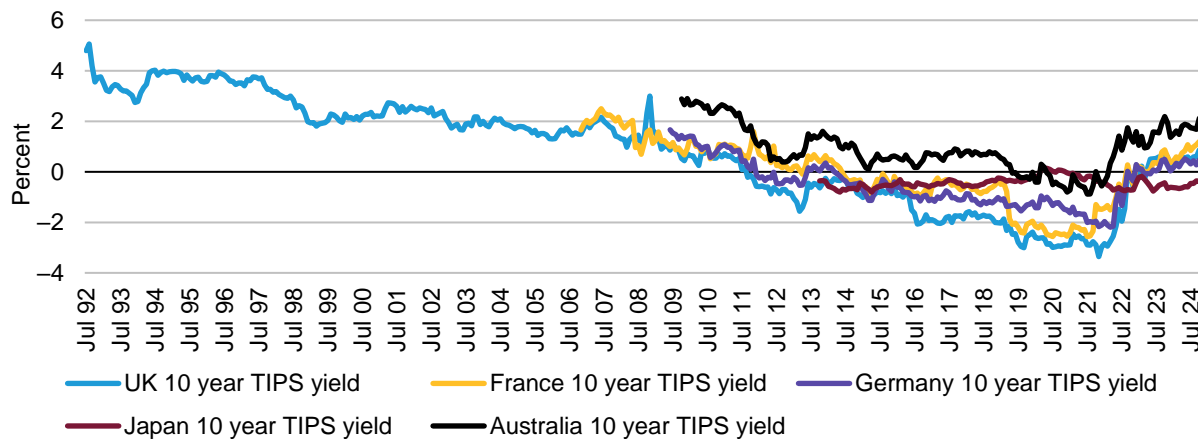


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Source: Thomson Reuters Datastream and AB

Display 14: 10-Year Inflation-Protected Yields by Country



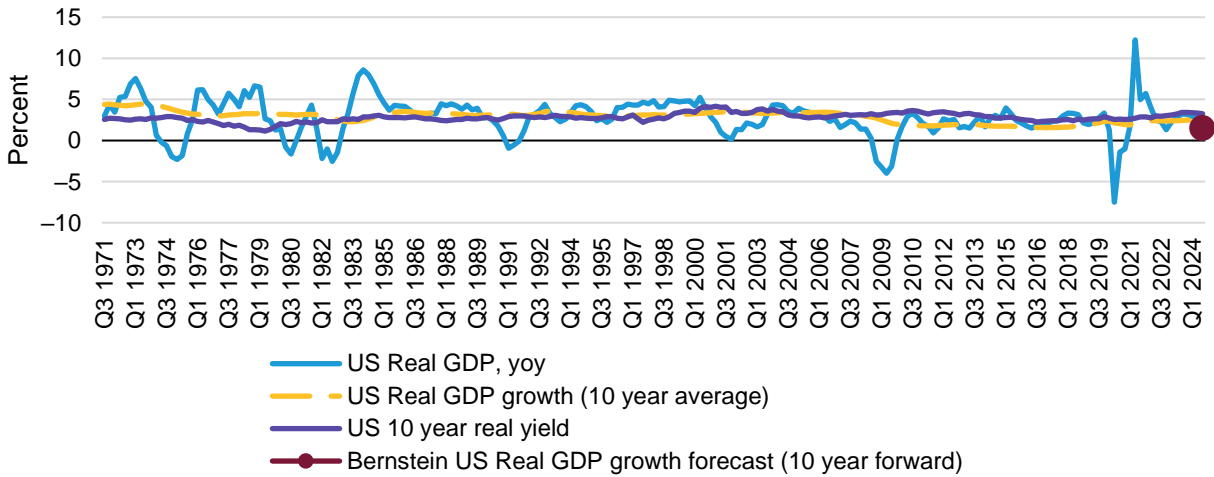
Current analysis and forecasts do not guarantee future results.

As of October 31, 2024

Source: Bloomberg and AB

How should one think about what level of yield on TIPS is attractive? One possible starting point is to relate the yield on TIPS to trend real-growth rates. Over the history of TIPS existing in the US, these investments have had a yield below the real-growth rate of gross domestic product (GDP) for nearly the entire period. The only exceptions have been brief episodes during recessions. While the expansionary shift under the new US administration tactically improves the growth outlook, demographics, deglobalization, and climate all imply a lower trend rate of growth over strategic horizons. In the context of that lower long-run trend rate, the current high level of TIPS yields looks anomalous and hence an attractive opportunity.

Display 15: TIPS Yields Look Attractive Compared with Trend Growth



Current analysis and forecasts do not guarantee future results.

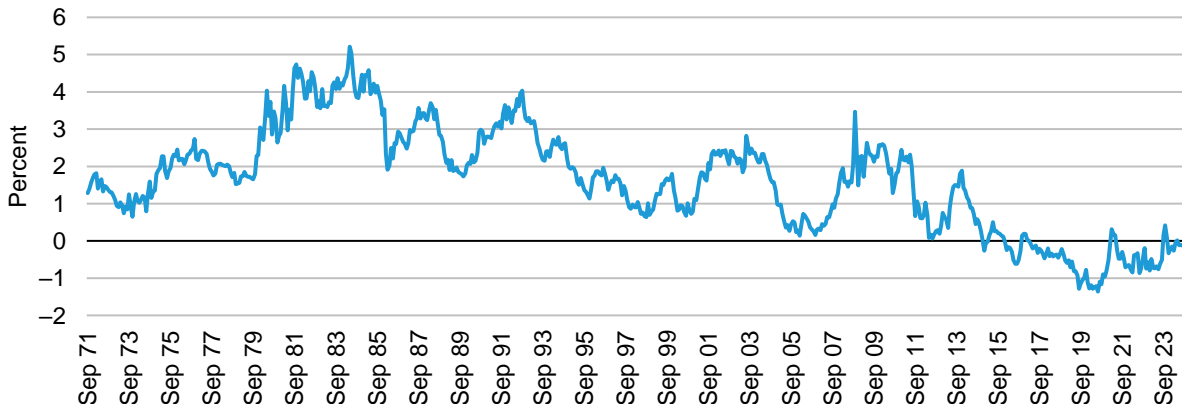
As of September 30, 2024

Source: Thomson Reuters Datastream and AB

The yield on TIPS does not need to have a directly proportional relationship to growth. We would argue that the yield on TIPS should reflect long-term potential growth plus the net increase/decrease in demand for savings plus a term premium. Models usually also impose a liquidity premium, given the relative size of TIPS markets versus nominal bonds, though one wonders to what degree that persists in a world of high public debt. This decomposition allows one to consider: What could be wrong with this pro-TIPS call? The main risk is that the term premium or sovereign risk is more aggressively priced. In fact, we were asked by clients in the month running up to the US election whether the increase in TIPS yield was the beginning of the pricing in of a term premium.

We think that a term premium should be more aggressively priced in. We show in *Display 16* that there has been something of an upward trend to estimates of the term premium since COVID-19. However, the timing of changes to the term premium will always be very uncertain. Moreover, we think it much more likely that G7 countries choose to inflate their way out of their current debt than actually default on it. So for investors who can hold the assets to maturity, this is less of a concern.

Display 16: US 10-Year Term Premium Estimate



Current analysis and forecasts do not guarantee future results.

Note: The term premium estimate is based on Tobias Adrian, Richard K. Crump, and Emanuel Moench, "Pricing the Term Structure with Linear Regressions," *Journal of Financial Economics*, October 2013.

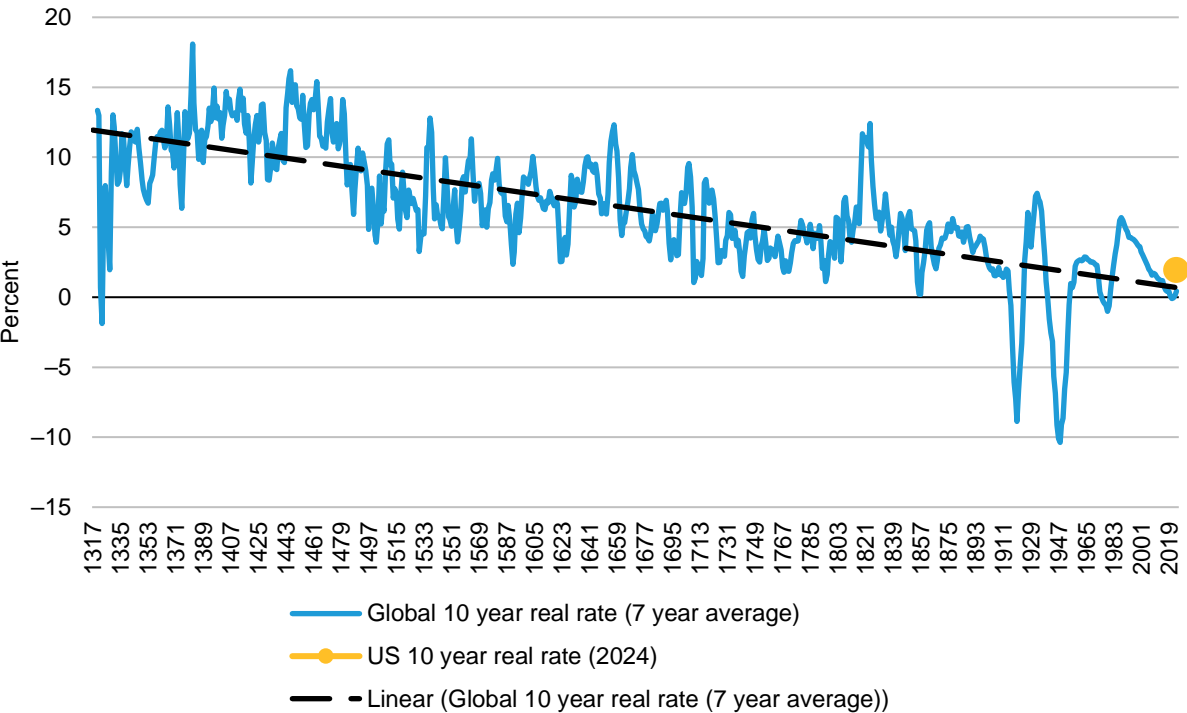
As of October 31, 2024

Source: NY FED and AB

We should also acknowledge another way that this pro-TIPS narrative could be wrong, which would be an outlook of plentiful growth. The long-term growth rate is a function of the number of workers and productivity. The working-age population in the US is still likely to grow, but not at the same level as in recent decades, at least not without massive immigration. Thus, the high-growth narrative is the techno-optimist route of AI delivering large productivity gains. The GDP/TIPS charts above imply that this could lead to a higher-equilibrium level of real yields. Moreover, this would point to a growth solution to the problem of government debt rather than having to inflate out of it. However, as we have explained elsewhere,⁵ we are doubtful that the productivity gains from AI will be sufficiently large to completely offset the other large downward forces on growth.

The volatility of real yields in the last two years will have given investors reason to pause. But in a relative trade-off between nominal and inflation-linked debt, we strongly favor the latter in a low-growth, higher-inflation regime. We also note that over strategic horizons, there has been a strong downward long-term trend for the level of real yields (*Display 17*).

Display 17: 700 Years of Global Real Interest Rates



Current analysis and forecasts do not guarantee future results.

Real rates are shown for a global universe until 2018. From 2018 to 2024, it is spliced with a US 10-year real rate. As of November 18, 2024

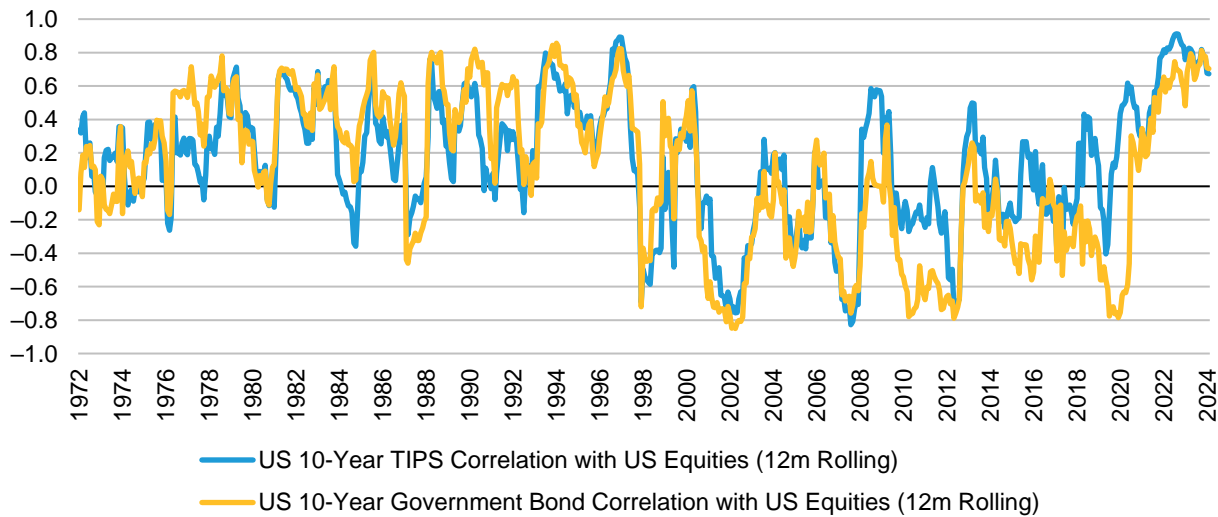
Source: Schmelzing (2019), <https://www.bankofengland.co.uk/working-paper/2020/eight-centuries-of-global-real-interest-rates-r-g-and-the-suprasecular-decline-1311-2018>, and AB

One area where TIPS don't help is in diversifying equity risk. One of the key challenges of portfolio construction is, we think, the need to find assets that can diversify equity risk in an environment when the level and volatility of inflation are higher. Nominal bonds are not effective diversifiers in such an environment, but inflation-linked bonds don't help either, it turns out (*Display 18*). This leads to the next asset that we consider.

⁵ [A Preliminary Language for a Post-Global World.](#)

Display 18: Neither TIPs nor Nominal Bonds Are Likely to Diversify Equity Return

US TIPs and Government Bond Correlation with Equities



Past performance does not guarantee future results.

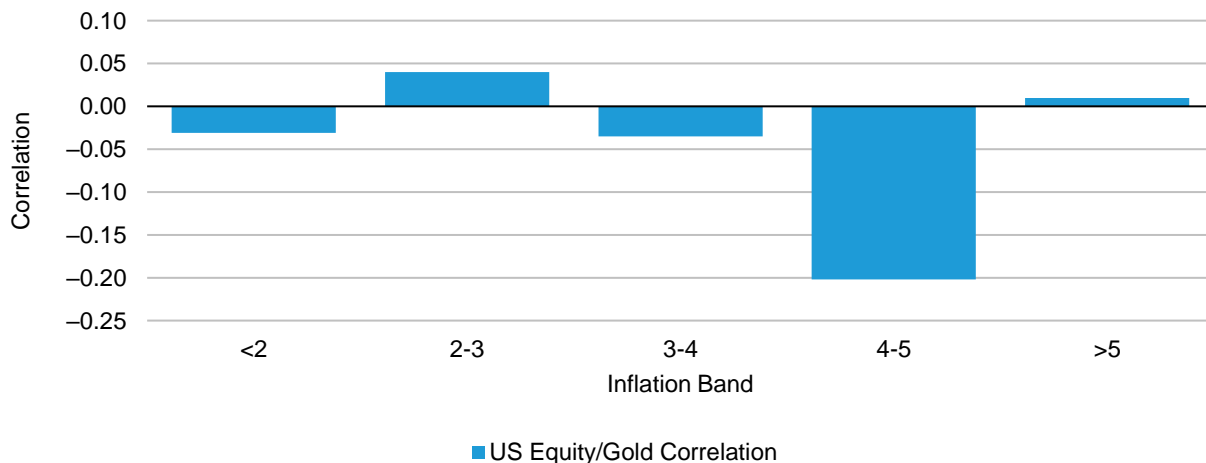
As of October 31, 2024

Source: Datastream and AB

Gold

The need to diversify equity exposure is a key reason for us to remain strategically overweight gold. Yes, both gold and equities have rallied strongly over the past year. However, a key attraction of gold is that over long horizons, its correlation with equities has tended to be close to zero and for that relationship to be invariant to the inflation level, an observation that is not true of nominal bonds (*Display 19*).

Display 19: Gold and Equity Correlation in Different Inflation Regimes



Current analysis does not guarantee future results.

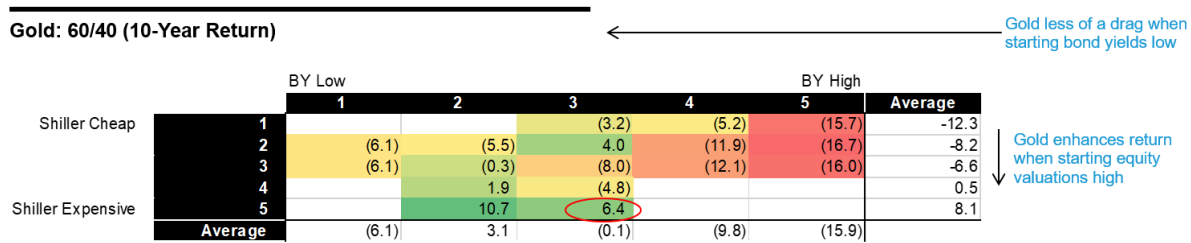
Note: The chart shows 12m rolling correlation from January 1969 through October 2024 bucketed by inflation band.

Source: Datastream, Global Financial Data, and AB

Granted, the return prospects of gold are not high. Over the last 170 years, its real return has been close to zero at +0.2% annualized. But we see its role in a portfolio as a diversifier rather than for return per se. Arguably, the return SHOULD be close to zero for an asset that produces no income, is not strictly needed aside from a small number of industrial uses, and has value only by virtue of a social agreement that it does.

The very strong gold rally over the last year, with the asset outperforming global equities, might put off investors. To that, our main response is that the reason to buy it is for diversification rather than for near-term returns. Our second response is that it also has to be seen in the context of an environment when most assets are, we would argue, expensive. One famously can't value gold, but one can value (nearly) everything else. From today's level of starting Shiller PE and today's 10-year bond yield, based on history, gold would be expected to outperform the 60:40 portfolio 10 years forward (*Display 20*). To be consistent with our equity view, we don't think that a full mean-reversion of Shiller PE levels is likely. However, even ignoring equity valuations and conditioning on bond yields alone, we would expect gold to perform in line with the 60:40 (*Display 20*, bottom row).

Display 20: Gold vs. 60:40: Average (Annualized) Return Conditioned on Equity Valuation and Bond Yield

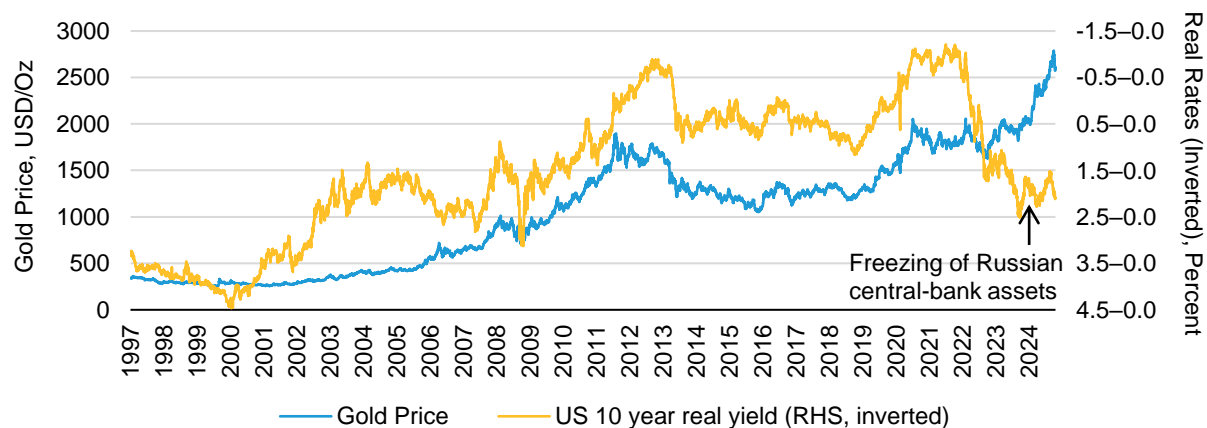


Past performance does not guarantee future results.

Data from January 1972 through April 30, 2020
 Source: Robert Shiller's database, Thomson Reuters Datastream, and AB

The other support for gold is central-bank buying. The driver here is the attempt at de-dollarization by countries that view the weaponization of the US dollar as strategically harmful to them. We do not think that it will be possible to de-dollarize in the near term because China would be unwilling to make its currency fully convertible, and there is not enough gold to act as an alternative. Nevertheless, this strategic imperative makes it highly likely that central banks will continue to be significant buyers of gold. The impact of that buying is perhaps made most clear by *Display 21*, which shows that the normal negative correlation between real yields and gold broke down at the same time as the Russian invasion of Ukraine prompted the US to restrict access to the US dollar.

Display 21: Weaponization of Us Dollar Access Changed the Correlation of Gold To Real Yields



Current analysis does not guarantee future results.

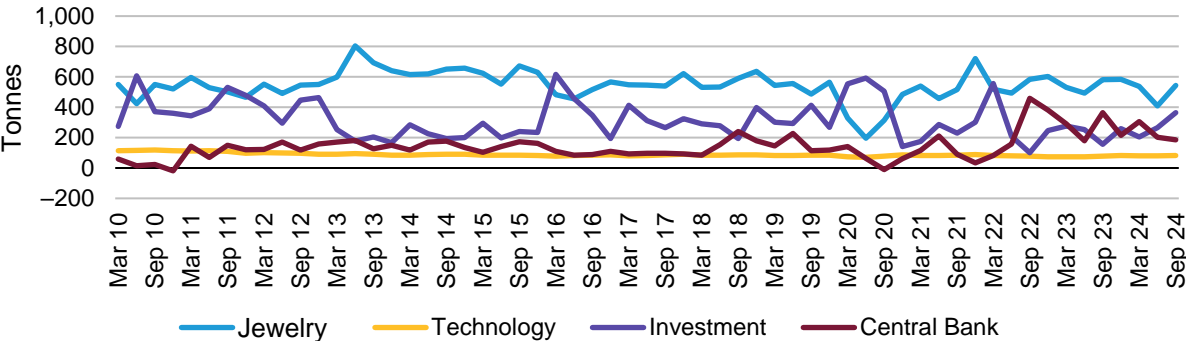
As of November 18, 2024
 Source: Thomson Reuters Datastream and AB

Central banks reached their highest share of gold buying in two decades in September 2022. The ensuing two years saw that share decline, in part because the extraordinary strong run in gold's price attracted a broader base of investor

buying (*Display 22*). With central-bank buying seemingly set to continue, any further rate cutting by the Fed that pushes real yields lower would be the tactical cherry on the cake in terms of the case for investors buying gold.

Taken together, TIPS and gold are the closest thing that investors have to “risk-free assets.” Even using the term makes us wince; we think that it represents some combination of recency bias and wishful thinking to simplify investment decisions. We have written before on why there is, really, no such thing as a risk-free asset.⁶

Display 22: Share of Gold Demand by Source



Current analysis does not guarantee future results.

As of September 30, 2024
 Source: World Gold Council, Thomson Reuters Datastream, and AB

Crypto as a Strategic Holding

Increased demand for gold, the risk of rising term premiums, and the likelihood of debasement of fiat currencies prompt the question of whether this creates enough demand that institutional investors should expand their holdings of other zero-duration non-fiat assets, i.e., crypto. We think they should.

We upgrade crypto, specifically bitcoin and ethereum, to a strategic overweight position in our SAA. We say “overweight,” but crypto does not appear in benchmarks used by institutional investors (yet). Thus, our view really amounts to a call for a non-zero strategic weight.

Our view on institutional holding of crypto has evolved. Pre-COVID, we did not think that it had a role to play in asset allocation. The expansion of central-bank balance sheets and fiscal policy during the pandemic led us to have a very public change of heart,⁷ that crypto was actually an asset worthy of consideration. More recently, we made the case that crypto could have a specific role as part of a diversification of debasement risk. However, regulatory uncertainty, the high share of retail involvement, and volatility meant that its role, while relevant, was only for a time in the future when regulatory clarity was more likely.⁸ Trump’s election victory prompts a reexamination of that position in two ways. First, it makes the question of fiscal sustainability and possible inflationary consequences more acute. Second, given Trump’s crypto-friendly statements on the campaign trail, it brings forward potential regulatory clarity.

Trump’s second term is expected to usher in the first expressly pro-crypto administration after he courted digital asset enthusiasts during the campaign and vowed to enact an array of industry-friendly changes. On Capitol Hill, crypto allies will likely be elevated to key committee leadership posts. Taken together, it all but ensures that Washington will soon overhaul an array of financial regulations in ways that align with the crypto industry’s biggest asks.

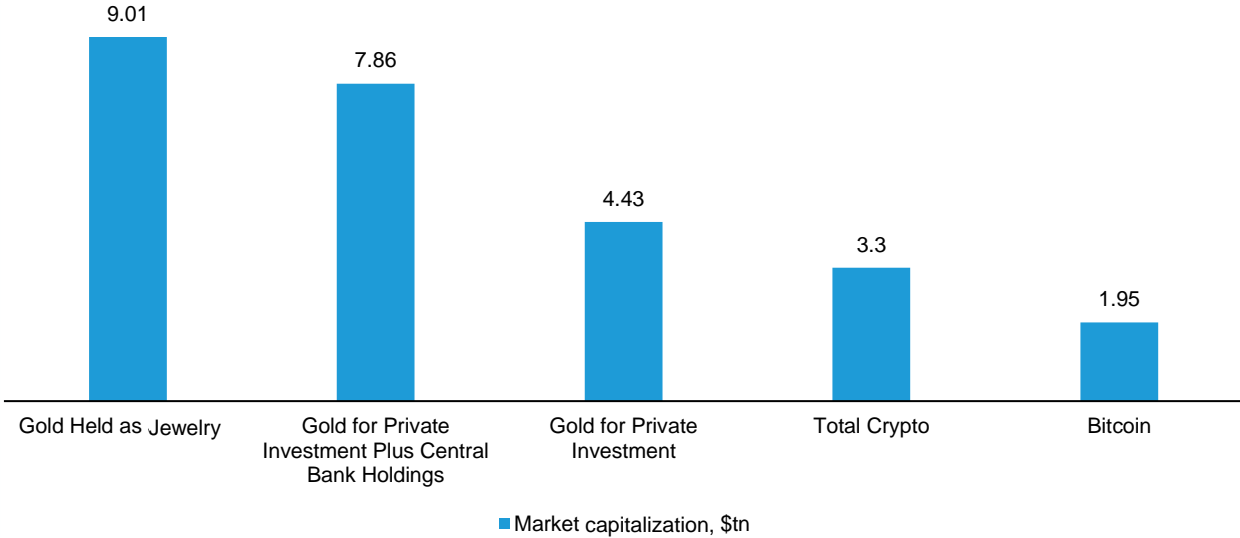
The industry’s wish list includes legislation that would carve out a bespoke path to legitimacy among regulators who have, for much of crypto’s existence, put a strong emphasis on reining in its potential risks to consumers and the financial system. A key target for the industry would be to change the influence of the Securities and Exchange Commission in this regard.

We do not believe that it is possible to value crypto, and we remain highly suspicious of any claims to be able to do so as the basis for an investment case. As opposed to valuing crypto, one can conduct a scaling exercise. In *Display 23*,

⁶ Inigo Fraser Jenkins et al., *Global Quantitative Strategy: The End of Pax Americana*, Bernstein Research, January 2019.
⁷ Inigo Fraser Jenkins et al., “Portfolio Strategy: Cryptocurrencies in Asset Allocation” – I have changed my mind!, Bernstein Research, November 30, 2020.
⁸ See Chapter 9: The Role of Digital Assets in Portfolios in [A Painful Epiphany](#).

we compare the size of gold held for investment and the total size of all crypto. There is no reason that one needs to be larger than the other (this is a topic that can be debated at length!); we merely make the point that as demand for zero-duration non-fiat assets rises and supply is limited, the value of both should rise in tandem. At current prices, the market cap of all crypto is still \$1 trillion less than the value of gold held for private investment—even before central-bank holdings are taken into account.

Display 23: Relative Scale of Gold and Crypto Assets
USD trillions



Current analysis does not guarantee future results.

Note: Gold statistics use end-of-2023 value for gold stocks and latest gold price.

As of November 21, 2024

Source: Thomson Reuters Datastream, World Gold Council, www.coinmarketcap.com, and AB

After a 120% rise over the last 12 months, including a 34% postelection rally for bitcoin, there rightly must be concerns about very short-term tactical exposure, especially given our belief that there is no valid valuation metric. However, because the holding of crypto in the portfolios of global asset owners that we speak with is negligible, we feel that it is right to move to an explicit overweight. If we shout about it enough now, maybe the allocations will start to happen in the next few years.

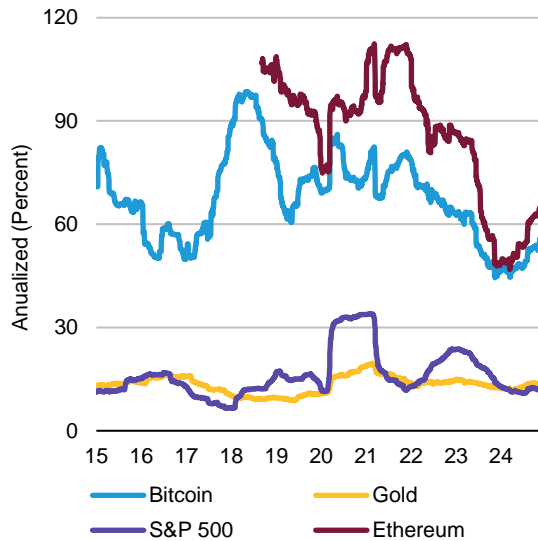
One concern about crypto is that while coins like bitcoin famously have a limited supply, new coins can be created with ease. Thus, the concern is that the total supply of crypto is not limited, prompting concerns about long-term value. We hear this concern, but we would assert that, for all practical purposes, the supply is limited because only a very small number of coins would actually be considered for institutional portfolios. Thus, we focus our overweight on bitcoin and ethereum. Bitcoin is by far the largest cryptocurrency, with a market cap of nearly \$2 trillion, and it is also the most established. Ethereum is the next largest crypto asset, with a market cap of over \$400 billion. It is also likely to be the main blockchain used for the development of tokenized real assets, for which there is a separate strong investment case not covered in this short note.

In September 2022, ethereum was moved from proof-of-work to proof-of-stake method, which reduced its direct power consumption and carbon impact by close to 100%. Thus, for investors worried about bitcoin’s large power consumption, ethereum could be a more attractive alternative. However, worries about power consumption seem lost on investors who have simply bought into a passive S&P Index whose rise over the last year has been propelled by the prospect of AI, which is set to reach a power demand over the next two years equivalent to Japan’s total power consumption. In this context, for investors to single out bitcoin’s power consumption seems somewhat hypocritical.

A problem with adding bitcoin and ethereum into portfolios is their high volatility and uncertain correlation with risk assets. We think volatility will continue to decline in step with regulatory clarity and greater institutional involvement. The standard deviation of bitcoin’s annualized daily price move over the last 12 months has been 55% (*Display 24*). By comparison, gold has had an average annualized volatility of daily returns over the last decade of less than 14%. That presents a lower possible floor for the volatility of bitcoin, but we think that it will remain well above that level of volatility for the medium to long term.

The correlation of crypto with other assets is more nuanced. To be clear, it has mainly behaved like a procyclical asset with a significantly positive correlation with equities over the post-COVID era (*Display 25*). There have been tentative signs that its correlation with equities is falling and its correlation with gold rising more recently.

Display 24: 12-Month Trailing Volatility of Crypto, Gold, and Equities

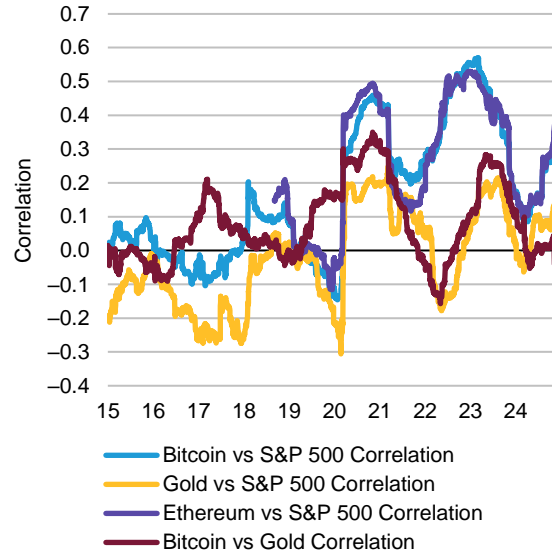


Past performance does not guarantee future results.

As of November 19, 2024

Source: S&P, Thomson Reuters Datastream and AB

Display 25: 12-Month Rolling Correlation of Crypto, Gold, and Equities



Past performance does not guarantee future results.

As of November 19, 2024

Source: S&P, Thomson Reuters Datastream and AB

The bottom line on this section is that we hold a strategic overweight in equities. In the portfolio that sits around that, TIPS, gold, and crypto perform slightly different, but complementary, roles. TIPS offer an attractive real yield and represent the segment of government bond holdings that is attractive. In addition, there is a need for zero-duration assets (gold and crypto) and assets with zero and stable correlation to equities (gold).

5. Private Asset Exposure Should Rise ... but Not Uniformly

The appropriate allocation to private versus public assets and the allocation within private assets will, we think, remain a key topic of discussion in 2025. We maintain our long-standing view that overall exposure to private assets should rise for most investors. However, we also remain skeptical of private equity and think that the outcomes will be a disappointment, compared with expectations. Thus, the marginal flows into private assets are set to go to areas other than private equity.

The key reason that we think that exposure to private assets will continue growing is the need for asset owners to find an attractive trade-off between real return and diversification. We are very clear that stale prices do not constitute diversification. Instead, the diversification of private assets derives from the ability to find return streams that are not available in public markets. Moreover, the way that capital is raised to fund growth in the contemporary economy is increasingly by private capital. The stock of public equity is shrinking in absolute terms (even if the price rises), and bank credit is shrinking as a share of total credit provision. There is no need for any individual investor to respond to this; but for asset owners in aggregate, their allocation is likely to match this shift in where capital is raised.

The real limit to private asset allocation is, we think, liquidity. As a consequence, it is investor-specific. However, the ongoing attempted pivot from quantitative easing (QE) to quantitative tightening (QT), the observation that investor portfolios have become more illiquid, and changes in market microstructure that make liquidity in public markets more fragile all point to a greater need for liquidity.

Display 1: The Case for and Against Private Assets

A Need for More Private Assets	Emerging Limits on Private Market Allocation
<p><u>Demand (from Investors)</u></p> <ul style="list-style-type: none">• Prospect of a lower nominal return on public markets• Need for diversification• Need for inflation protection• Exposure to sectors not represented in public markets• Need for active return streams <p><u>Supply</u></p> <ul style="list-style-type: none">• Dearth of young, high-growth companies coming to market• Buybacks have led to a shrinking stock of public equity.• Retrenchment of traditional providers of credit• Borrowers recognizing greater flexibility of private capital	<ul style="list-style-type: none">• Denominator effect: many funds are now overweight private assets versus target.• Liquidity is a greater concern:<ul style="list-style-type: none">◦ QE-to-QT attempted pivot◦ Asset-owner portfolios are more illiquid.◦ More fragile liquidity in public markets• Fees: private is now the lion's share of many fee budgets.

Current analysis and forecasts do not guarantee future results.

Source: AB

We remain relatively negative on private equity because of high buyout multiples and the impact that a higher cost of debt has on future returns versus those over the last 20 years of the industry's existence.⁹ Thus, we think that other areas of private assets will attract more of the marginal flow.

There are, however, legitimate concerns. In our meetings with clients over the last six months, the majority of investors who are allocating to private assets are still happy to add to this area, but there is also a greater sense of skepticism, and indeed this cannot be dismissed. However, we think that this needs to be seen in an overall area of asset allocation where there are no great choices. The core theme in our research over the last year has been that the range of real return and diversification available for investors is reduced, compared with recent decades.

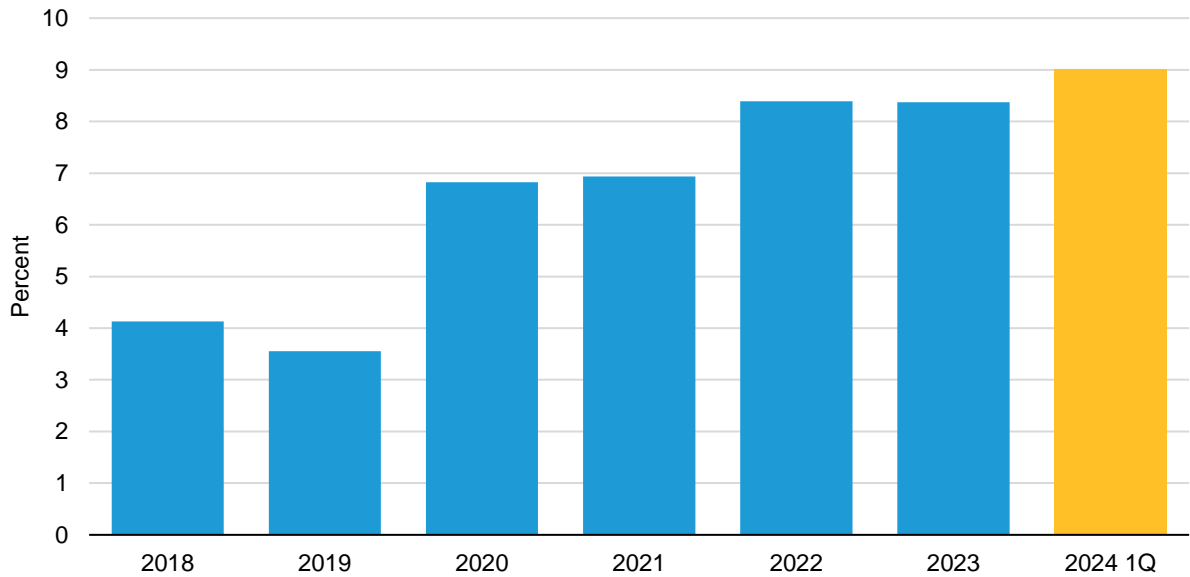
Fundamentally, this points to an underlying tension between risk measured as portfolio volatility versus the risk of a loss of purchasing power. In order to defer the greater problem posed by the latter, risk measured by volatility might have to rise. The pertinent question, really, is. What risks do investors want to take to do this? Greater equity risk, illiquidity risk, and active exposure are all possible responses.

Potential worries about private credit has been one specific area of concern that we have heard in meetings. Private credit has attracted significantly larger flows in recent years; as a result, this is likely to have tilted the bargaining power of investors versus borrowers. This tilt can show up in available yield or also in the quality of the terms of the paper. However, in contrast to private equity, at least one can observe the illiquidity premium ex ante and assess whether it is attractive.

Another concern is the rise of payments in kind, as opposed to cash. The International Monetary Fund recently showed that 9% of all income to listed private equity vehicles is now in the form of payment in kind, up from 4% in 2019.

⁹ Inigo Fraser Jenkins and Matthew D. Bass, "[The Role of Private Assets in Strategic Asset Allocation: A Macro Perspective](#)", AllianceBernstein, May 10, 2023".

Display 27: Payment-in-Kind Income as Share of Interest and Dividend Income of US BDCS



Current analysis does not guarantee future results.

As of March 30, 2024

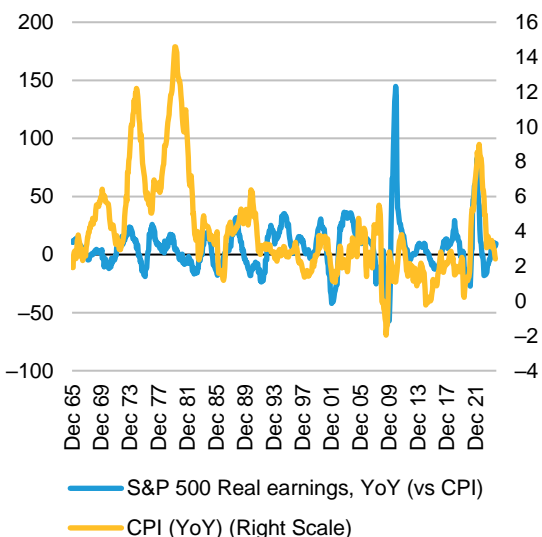
Source: IMF and AB

The floating-rate nature of private credit, which is a key attraction of the asset class as a potential part of the response to a higher-inflation world, makes the yields on offer less attractive as rates come down. On all these fronts, the asset class might be less attractive in absolute terms than it was 18 to 24 months ago. Nevertheless, compared with the other options available, we think it is attractive and fits alongside other allocations. Thus, we recommend an overweight.

We note that there is also the potential macro concern in the rise of shadow banks; regulators fret that they have less of a clear view of where problems might lie. It also represents a shift of where systemic risk sits in the system. Yes, that is a potential concern, and regulators will no doubt consider how to make this more transparent. However, in theory this shift could be positive, or at least benign. Having this risk sitting with unlevered long-horizon pension plans might be an improvement, compared with the risk of being with levered, cyclical, and listed banks.

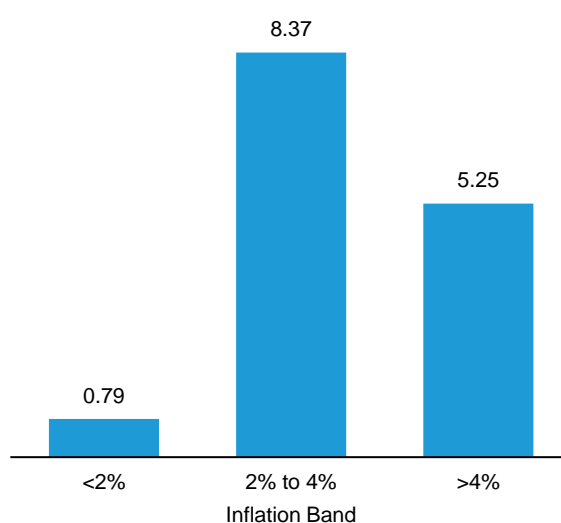
Appendix

Display 28: Real Growth in Total Earnings and Inflation



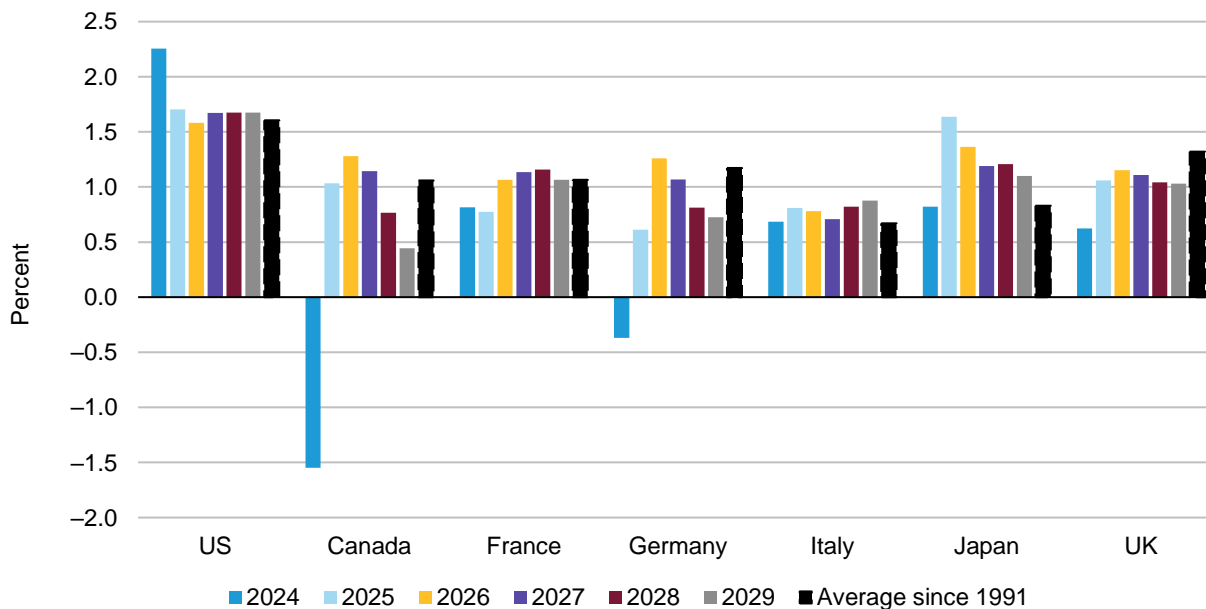
Past performance does not guarantee future results.
Data as of December 31, 1964, through October 30, 2024
Source: FactSet, S&P, Thompson Reuters Datastream, and AB

Display 29: Average Real Growth in Total Earnings by Inflation Band (Percent)



Past performance does not guarantee future results.
Data as of December 31, 1964, through October 30, 2024
Source: FactSet, Thompson Reuters Datastream, and AB

Display 30: Fundamentals—Expected GDP Growth Rates (IMF GDP Growth Forecast, Percent)

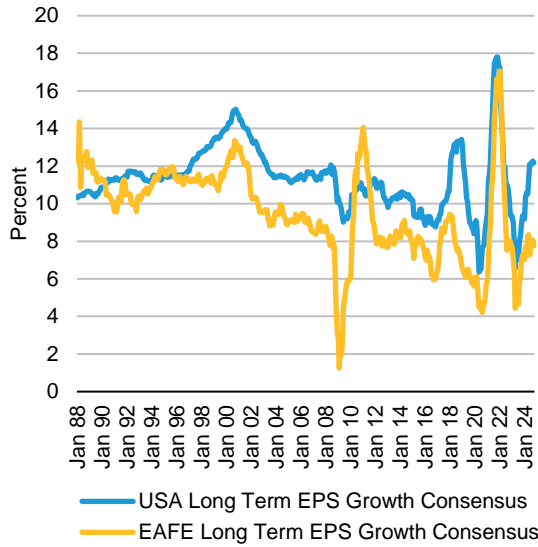


Current analysis and forecasts do not guarantee future results.

As of October 30, 2024

Source: IMF and AB

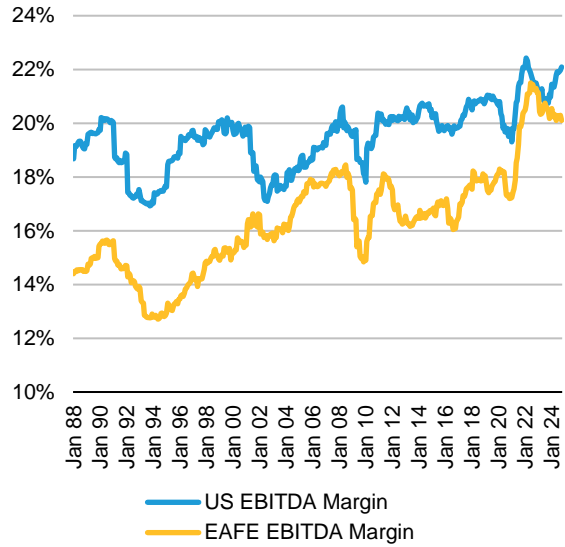
Display 31: Long-Term EPS Growth Consensus



Past performance does not guarantee future results.

As of October 31, 2024
Source: FactSet and AB

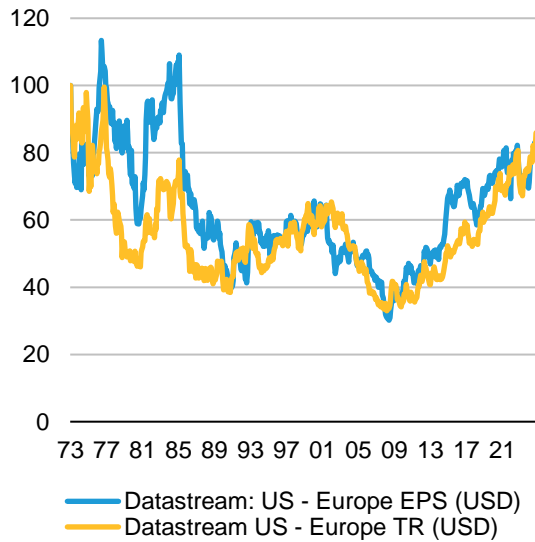
Display 32: EBITDA Margin



Past performance does not guarantee future results.

As of October 31, 2024
Source: FactSet and AB

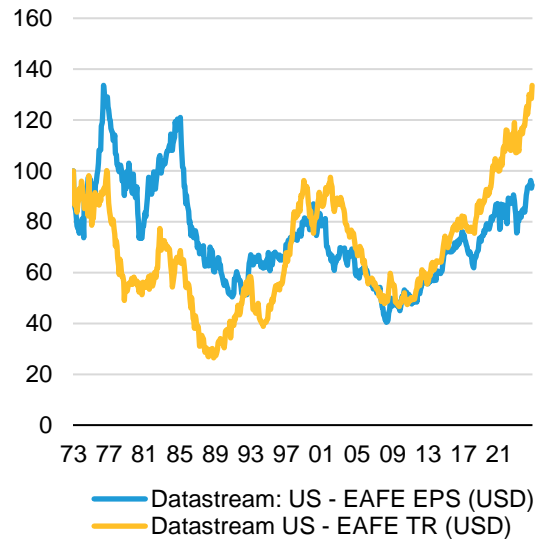
Display 33: US vs. Europe Relative Earnings Growth and Relative Returns (USD)



Past performance does not guarantee future results.

Relative EPS growth and relative total returns
As of October 30, 2024
Source: Thompson Reuters Datastream and AB

Display 34: US vs. EAFE Relative Earnings Growth and Relative Returns (USD)



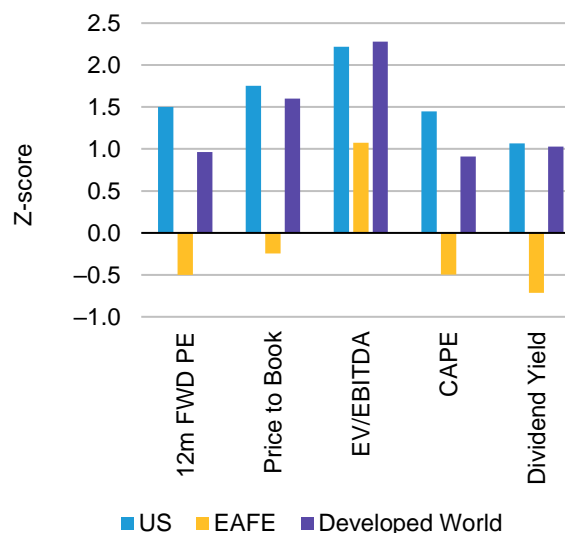
Past performance does not guarantee future results.

Relative EPS growth and relative total returns
As of October 30, 2024
Source: Thompson Reuters Datastream and AB

Display 35: Current Valuations vs. Historical Averages

Z-Score	US	EAFE	Developed World
12M FWD PE	1.50	-0.50	0.96
Price/Book	1.75	-0.24	1.60
EV/EBITDA	2.22	1.07	2.28
CAPE	1.45	-0.50	0.91
Dividend Yield	1.07	-0.71	1.03

Display 36: Current Valuations vs. Historical Averages



Past performance does not guarantee future results.

As of October 31, 2024

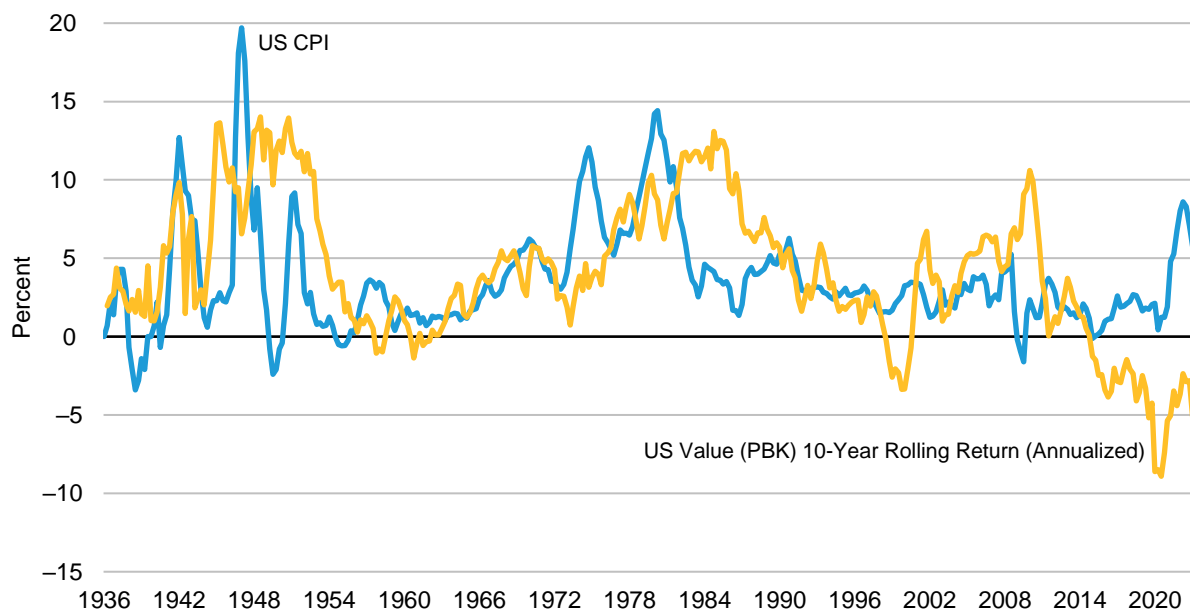
Source: FactSet, Thomson Reuters Datastream, and AB

Past performance does not guarantee future results.

As of October 31, 2024

Source: FactSet, Thomson Reuters Datastream, and AB

Display 37: 90 Years of Inflation and Value: Is Inflation All That Was Missing? US Consumer Price Inflation and US Value Returns



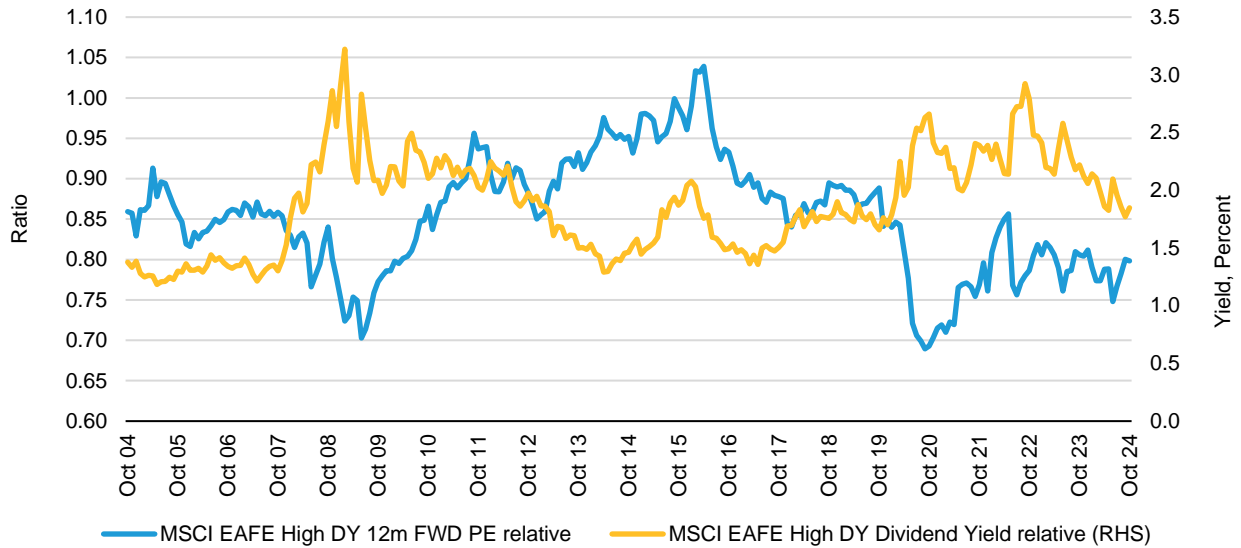
Current analysis does not guarantee future results.

The chart shows annualized 10-year rolling return for Ken French's value factor portfolio using the top quintile of cheapest stocks by price to book vs. the most expensive quintile. Inflation is proxied by the change in the US CPI index.

Data from January 1, 1936, through March 31, 2024

Source: Ken French Data Library, Thomson Reuters Datastream, and AB

Display 38: 90 EAFE High-Dividend Yield Factor Valuations

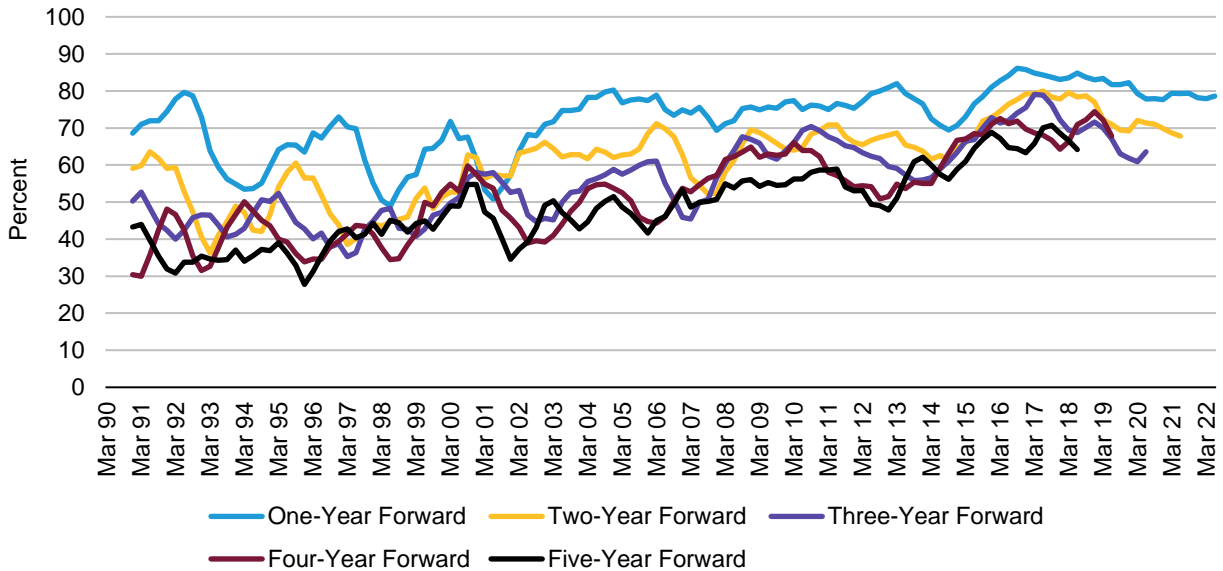


Current analysis does not guarantee future results.

As of October 31, 2024

Source: MSCI, Thomson Reuters Datastream, and AB

Display 39: High-Profitability US Companies Are Staying That Way for Longer Percentage of High-Return-on-Equity Decile US Stocks That Remain in the Top Two Deciles 1–5 Years Later



Current analysis does not guarantee future results.

In each quarter since 1990, we split the stocks in the MSCI USA Index into groups by ROE deciles (within sectors) and calculated the percentage of stocks in the high ROE decile at a specific point in time in the highest two deciles over the next 1–5 years. A four-quarter smoothing is applied to the quarterly percentages.

Data from January 1, 1990, through June 30, 2023

Source: FactSet, MSCI, and AB

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Tokyo Hibiya Parkfront 14F 2-1-6 Uchisaiwaicho, Chiyoda-ku Tokyo, 100-0011, Japan +81 3 5962 9000	Toronto 200 Bay Street, North Tower Suite 1203 Toronto, Ontario M5J 2J2, Canada (647) 375 2803	Sydney Level 32, Aurora Place 88 Phillip Street Sydney NSW 2000 Australia +61 02 9255 1200	Hong Kong 39th Floor, One Island East, Taikoo Place 18 Westlands Road Quarry Bay, Hong Kong +852 2918 7888

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