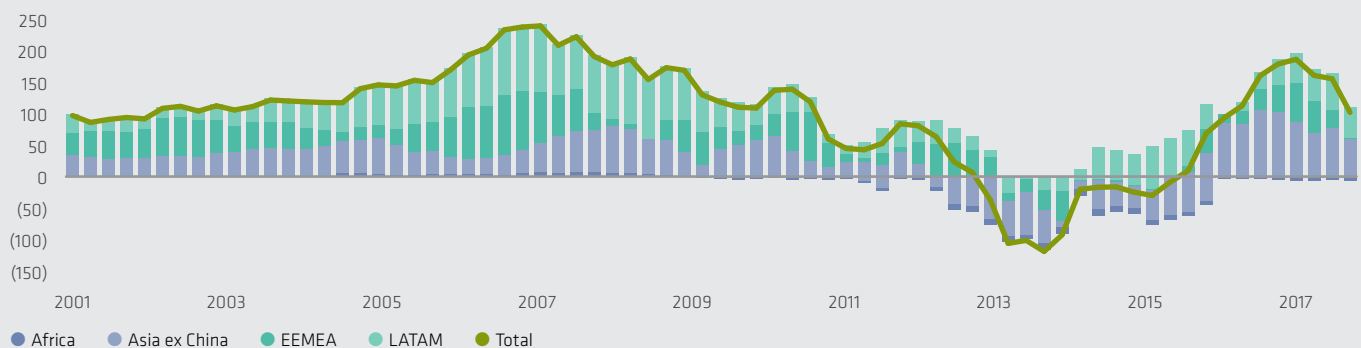

ALLIANCEBERNSTEIN®

EMERGING-MARKET DEBT (EMD) UPDATE: EXPECT VOLATILITY—AND OPPORTUNITY

Emerging-market (EM) bonds have struggled so far this year as global financial conditions have tightened and the US dollar has rallied. But unlike in years past, we think many EM countries today are strong enough to weather the storm. That means there are still opportunities for selective long-term investors.

DISPLAY 1: EM NOT AS VULNERABLE TO EXTERNAL SHOCKS

Basic Balance (USD Billions)*



Through September 30, 2017

* Basic balance includes current account position plus foreign direct investment; Venezuela and Peru data not available for 2017

Source: Haver Analytics and AB

As we noted in our 2018 outlook, emerging markets have cleaned up their act in recent years. They have done this by reducing their current account deficits, embracing more responsible fiscal and monetary policies and bringing inflation broadly under control—even as it starts to rise in developed markets.

At the same time, we warned investors to be prepared for volatility, pointing out that EMD's biggest challenge in 2018 would likely come from monetary policy changes in developed markets and a faster-than-expected rise in US interest rates.

It didn't take long for volatility to flare up. US Treasury yields began drifting higher in

January, and the 10-year yield had touched 3.11% by mid-May, some 70 basis points above where it began the year. That caused the US dollar to rally against EM currencies and provoked a broad sell-off in EMD assets—dollar-denominated bonds as well as local debt and currencies.

BROAD SELLING CREATES OPPORTUNITIES

In times of market stress, investors don't always make distinctions within asset classes, and that holds true for EMD. Despite the differences in economic health and governance among borrowers, the asset class is sometimes subject to indiscriminate

buying and selling, which leads asset prices to overshoot in both directions. Supply/demand imbalances also contribute; a surge in new issuance coincided with the sharp rise in Treasury yields in early 2018, increasing pressure on the asset class.

Broad moves across EMD can obscure the differences between countries, companies and individual securities. We think that many EM countries are much better positioned today to withstand sudden outflows.

That's not to say there aren't risks on the horizon or that investors should settle for passive exposure to the entire EMD universe. Economic and political risk varies, so country

and sector selection still matter. That's why reducing EM currency risk and overall beta—or market exposure—and taking a more tactical approach that focuses on attractive opportunities in specific countries and companies makes sense.

But the way we see it, the broad-based decline in prices creates an opportunity to add exposure to countries and companies with strong fundamentals that have been unfairly punished.

PUTTING THE DOLLAR'S STRENGTH INTO PERSPECTIVE

Technical supply/demand factors aside, the sudden strengthening of the US dollar has set off the loudest alarm bells for EM investors this year. Conventional wisdom suggests that a stronger dollar is a problem because it makes it harder for EM borrowers to repay dollar-denominated debt. Some worry, too, that today's dollar rally indicates a tightening of global liquidity and a waning of investor risk appetite, a challenge for EM assets in general.

These are fair points. Rising yields and dollar strength are headwinds. But they're not necessarily game changers. Let's look at liquidity pressure first. We think this may be overstated. While liquidity may be tightening at the margin globally, investors should bear in mind that the move is starting from very loose levels. Most major central banks are widely expected to keep their accommodative policies in place, at least for the rest of 2018. That should keep the global economy humming along for a while yet.

The abrupt rise in Treasury yields this year also implies that the market's rate expectations are now more closely aligned with the Federal Reserve's. If so, the pace of yield and dollar gains should slow in the second half.

As for the dollar, it's still trading about 8% lower against other major currencies than it was at its peak in early 2017, and it remains in line with its five-year average. We think the exchange-rate pressure on EM borrowers is manageable.

But perhaps more importantly, currency moves may not matter as much today for EM countries and companies as they once did. For example, many countries have reduced their current account deficits in recent years. That makes them less dependent on capricious portfolio inflows. At the same time, foreign direct investment (FDI)—a more stable source

of funding because it tends to be long term in nature—has increased. Over the past few years, we've seen EM basic balances, which combine current account position and FDI flows, improve in every region of the globe. While the basic balance for all emerging markets (minus China) declined somewhat in late 2017, it remains much healthier than it was before the 2013 taper tantrum (*Display 1, page 1*).

There are exceptions. Rising rates and a stronger dollar are certainly concerns for the most highly indebted EM borrowers. But that doesn't mean they will have the same effect on every country. Take Argentina and Turkey, whose external financing needs are higher than for many other EM countries. The dollar's rise hit both countries hard, sparking a run on the peso and the lira. But the similarities end there.

Argentina's central bank moved swiftly to stabilize the peso by hiking interest rates to 40%, while the government lined up a financing deal with the International Monetary Fund and even managed to sell \$3 billion in new peso-denominated debt. Turkey's central bank, which has faced sharp criticism from President Recep Tayyip Erdoğan for keeping interest rates too high, waited weeks before acting, increasing investor concern about the bank's independence.

Put another way, policymaking and government effectiveness clearly differs across EM countries. That's why it's so important for investors to be selective and deliberate about where they invest.

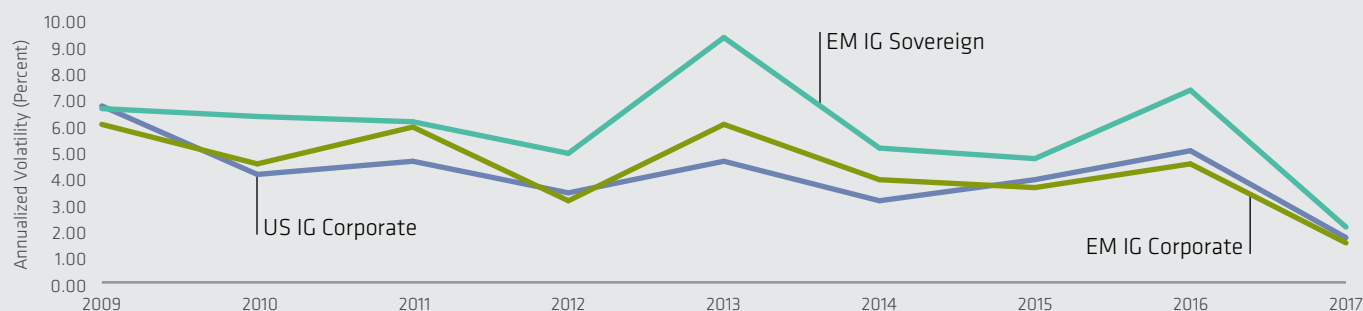
EM CORPORATES MORE RESILIENT

EM companies are less exposed to changes in the dollar than investors may realize, too. There are a few reasons for this. First, many EM companies that borrow in US dollars tend to do so because they have a natural affinity for the currency. For example, their export revenues may be denominated in dollars, which acts as a natural hedge against their dollar liabilities. For these types of firms, a rising dollar is good news because it boosts their margins, which leads to higher cash flow and creditworthiness.

Others keep their dollar liabilities manageable by hedging them back to their home currencies. Meanwhile, utilities or companies in other industries have tariff structures that enable them to pass higher currency costs on to consumers.

DISPLAY 2: SOME EM ASSETS ARE LESS VOLATILE THAN US ASSETS

Volatility of EM Investment-Grade Market



Through December 31, 2017

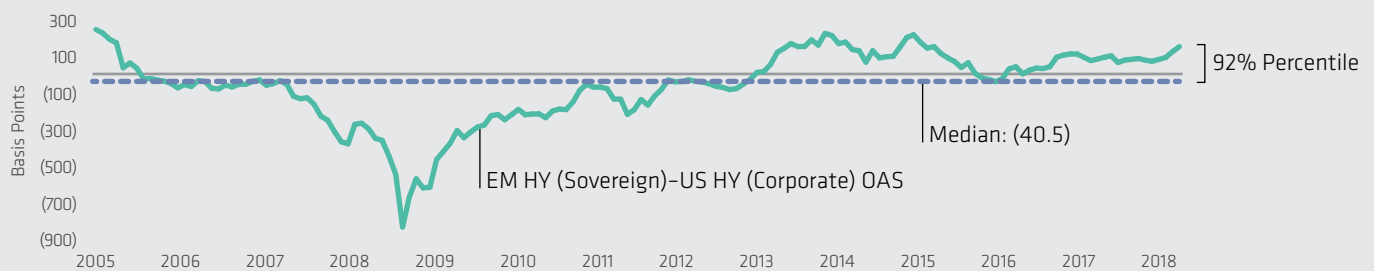
Historical and current analyses do not guarantee future results.

EM IG sovereign is represented by the J.P. Morgan EMBI Global Diversified, EM IG corporate is represented by the CEMBI Broad, and US IG corporate is represented by the J.P. Morgan US Liquid Index.

Source: J.P. Morgan and AB

DISPLAY 3: HARD-CURRENCY EM SOVEREIGNS UNUSUALLY CHEAP

J.P. Morgan EMBI (HY) vs. Bloomberg Barclays US Corporate HY Index (OAS*)



EM corporates with investment-grade ratings have also become much less volatile investments. In fact, over the past three years, high-grade EM corporates have been less volatile than their US counterparts (*Display 2, page 2*). This is partly because the buyer base has improved: these assets tend to attract large institutional investors with longer investment horizons.

Incidentally, investment-grade EMD—corporate and sovereign—has performed in line with US investment-grade corporate bonds so far this year (and has easily outpaced lower-credit-quality EMD).

DON'T OVERLOOK THE RISKS

As always, there are several broad risks that investors will have to monitor as we move into the second half of the year. Here are a few of the most pressing ones:

+ **Trump's Trade War:** The US administration has spent the year talking tough on trade. But so far, its bark appears to be worse than its bite. The pattern seems to be to start with a threat and then gradually move toward negotiation. So far, we've seen this play out in the NAFTA negotiations, the sweeping tariffs on Chinese goods and the Trans-Pacific Partnership (the administration withdrew last year but now says it may rejoin).

At this point, we doubt that a NAFTA rewrite or the US-China trade disputes will metastasize into a full-blown trade war that threatens the global economy. But with governments negotiating trade agreements in public, investors should be prepared for trade-related headlines to provoke more volatility.

+ **Slower Chinese Growth:** The world's second biggest economy has been slowing as Chinese authorities try to balance the pace of overall economic growth with the quality of that growth.

Does that spell trouble for EM growth at large? We don't think so, and here's why: China's slowdown hasn't had much of an effect on commodity prices, which have been rising steadily in 2018. This is partly because supply has been the biggest driver of commodity prices this year. For instance, China and other countries have been scaling back metals mining for environmental reasons, while major oil producers have been cutting supply to support prices.

Global growth also remains strong, which should provide more support for commodity prices and the broad universe of EM countries, many of which are net exporters of commodities.

+ **Local Politics:** Several EM countries will hold elections this year, including Turkey and Mexico, where polls suggest that the anti-market presidential candidates are favorites to win. If so, that will likely boost volatility across EM assets. But with volatility come opportunities.

Political change can also lead to positive outcomes—we've seen this repeatedly in the developing world in countries such as Brazil, South Africa, Colombia and Argentina, where elected officials and policymakers have taken steps to shore up finances, tackle corruption and embrace centrist economic policies.

It's also important to remember that political risk isn't unique to EM countries and assets. Trump's election victory, Britain's decision to leave the European Union, and big wins for anti-establishment parties across Europe (including the two that formed Italy's new government in May) have all injected a new layer of risk into markets and investment decisions. But in most cases, investors in developed-market assets aren't being compensated for that risk.

EM investors are. For example, dollar-denominated high-yield EM sovereign debt has rarely been cheaper. As of June 8, it offered a yield pickup of about 1.65% over US high-yield corporate bonds, according to J.P. Morgan data (*Display 3*). The spread between the two has been that high less than 10% of the time. For careful investors, this may present an attractive relative-value opportunity.

SUMMING IT UP

We still think robust global growth, prudent policymaking and smaller deficits will help fortify many key EM countries against external shocks, and we still see value across EMD assets. In particular, investment-grade EM corporate bonds have been remarkably steady in today's volatile markets and may be appealing to investors who want to boost their bond portfolio's return and income potential without taking on undue risk.

With volatility likely to stay high this year, it's important to carefully manage overall portfolio risk and to pinpoint tactical opportunities. That means staying active and taking advantage of broad downturns to pick up assets at attractive prices. For long-term investors with the luxury of long time horizons, today's conditions present an opportunity to add value in one of the most rapidly growing sectors in the global fixed-income market.

NEW YORK

1345 Avenue of the Americas
New York, NY 10105
(212) 969 1000

LONDON

50 Berkeley Street
London W1J 8HA
United Kingdom
+44 20 7470 0100

SYDNEY

Level 32, Aurora Place
88 Phillip Street
Sydney NSW 2000, Australia
+61 02 9255 1299

TORONTO

Brookfield Place
161 Bay Street, 27th Floor
Toronto, Ontario M5J 2S1
(416) 572 2534

TOKYO

Marunouchi Trust Tower Main 17F
1-8-3, Marunouchi, Chiyoda-ku
Tokyo 100-0005, Japan
+81 3 5962 9000

HONG KONG

39th Floor, One Island East
Taikoo Place
18 Westlands Road
Quarry Bay, Hong Kong
+852 2918 7888

SINGAPORE

One Raffles Quay
#27-11 South Tower
Singapore 048583
+65 6230 4600

Past performance, historical and current analyses, and expectations do not guarantee future results. There can be no assurance that any investment objectives will be achieved.

Note to All Readers: The information contained here reflects the views of AllianceBernstein L.P. or its affiliates and sources it believes are reliable as of the date of this publication. AllianceBernstein L.P. makes no representations or warranties concerning the accuracy of any data. There is no guarantee that any projection, forecast or opinion in this material will be realized. Past performance does not guarantee future results. The views expressed here may change at any time after the date of this publication. This document is for informational purposes only and does not constitute investment advice. AllianceBernstein L.P. does not provide tax, legal or accounting advice. It does not take an investor's personal investment objectives or financial situation into account; investors should discuss their individual circumstances with appropriate professionals before making any decisions. This information should not be construed as sales or marketing material or an offer or solicitation for the purchase or sale of any financial instrument, product or service sponsored by AB or its affiliates. **Note to Canadian Readers:** This publication has been provided by AB Canada, Inc. or Sanford C. Bernstein & Co., LLC and is for general information purposes only. It should not be construed as advice as to the investing in or the buying or selling of securities, or as an activity in furtherance of a trade in securities. Neither AB Institutional Investments nor AB L.P. provides investment advice or deals in securities in Canada. **Note to European Readers:** This information is issued by AllianceBernstein Limited, a company registered in England under company number 2551144. AllianceBernstein Limited is authorised and regulated in the UK by the Financial Conduct Authority (FCA—Reference Number 147956). **Note to Readers in Japan:** This document has been provided by AllianceBernstein Japan Ltd. AllianceBernstein Japan Ltd. is a registered investment-management company (registration number: Kanto Local Financial Bureau no. 303). It is also a member of the Japan Investment Advisers Association; the Investment Trusts Association, Japan; the Japan Securities Dealers Association; and the Type II Financial Instruments Firms Association. The product/service may not be offered or sold in Japan; this document is not made to solicit investment. **Note to Australian Readers:** This document has been issued by AllianceBernstein Australia Limited (ABN 53 095 022 718 and AFSL 230698). Information in this document is intended only for persons who qualify as "wholesale clients," as defined in the Corporations Act 2001 (Cth of Australia), and should not be construed as advice. **Note to Singapore Readers:** This document has been issued by AllianceBernstein (Singapore) Ltd. ("ABSL", Company Registration No. 199703364C). ABSL is a holder of a Capital Markets Services Licence issued by the Monetary Authority of Singapore (MAS) to conduct regulated activity in fund management and dealing in securities. AllianceBernstein (Luxembourg) S.à r.l. is the management company of the portfolio and has appointed ABSL as its agent for service of process and as its Singapore representative. This document has not been reviewed by the MAS. **Note to Hong Kong Readers:** This document is issued in Hong Kong by AllianceBernstein Hong Kong Limited (聯博香港有限公司), a licensed entity regulated by the Hong Kong Securities and Futures Commission. This document has not been reviewed by the Hong Kong Securities and Futures Commission. **Note to Readers in Vietnam, the Philippines, Brunei, Thailand, Indonesia, China, Taiwan and India:** This document is provided solely for the informational purposes of institutional investors and is not investment advice, nor is it intended to be an offer or solicitation, and does not pertain to the specific investment objectives, financial situation or particular needs of any person to whom it is sent. This document is not an advertisement and is not intended for public use or additional distribution. AB is not licensed to, and does not purport to, conduct any business or offer any services in any of the above countries. **Note to Readers in Malaysia:** Nothing in this document should be construed as an invitation or offer to subscribe to or purchase any securities, nor is it an offering of fund-management services, advice, analysis or a report concerning securities. AB is not licensed to, and does not purport to, conduct any business or offer any services in Malaysia. Without prejudice to the generality of the foregoing, AB does not hold a capital-markets services license under the Capital Markets & Services Act 2007 of Malaysia and does not, nor does it purport to, deal in securities, trade in futures contracts, manage funds, offer corporate finance or investment advice, or provide financial-planning services in Malaysia.

Important Note for UK and EU Readers: For professional client or investment professional use only. Not for inspection by, distribution or quotation to, the general public.

The [A/B] logo is a registered service mark of AllianceBernstein and AllianceBernstein® is a registered service mark used by permission of the owner, AllianceBernstein L.P.

© 2018 AllianceBernstein L.P., 1345 Avenue of the Americas, New York, NY 10105

