AB AMERICAN INCOME PORTFOLIO

PORTFOLIO PERFORMANCE

In December, the American Income Portfolio (Class A) delivered positive absolute returns but underperformed its blended benchmark, the 50% Bloomberg Barclays US Government Bond Index/35% J.P. Morgan EMBI Global/15% Bloomberg Barclays US High-Yield 2% Constrained Index, which returned 0.42%. (Though, Portfolio management would like to note that the Portfolio's strategy is benchmark agnostic, meaning that it is not constrained by its benchmark). In 2017, the Portfolio increased in absolute terms but trailed the benchmark's returns of 5.50%.

The Portfolio posted positive absolute returns in December, as spreads tightened and Treasuries also delivered positive performance.

Relative to the custom benchmark, our underweight in the longer part of the curve detracted, as those yields fell (while shorter yields rose). However, our allocation to securitized assets—especially agency credit-risk transfer securities (CRTs) and commercial mortgage-backed securities (CMBS)—was a significant positive contributor. An allocation to inverse interest-only mortgages helped returns further.

MARKET REVIEW

Fixed-income markets generally ended the year on a positive note. In December, spread sectors outperformed most global treasuries, which had mixed returns as yields continued to flatten. Securitized assets performed well, particularly commercial real estate and non-guaranteed agency residential bonds. Emerging-market (EM) debt sectors benefited from both an increase in the price of oil after OPEC's decision to extend production cuts into late 2018 and overall positive market sentiment after the US passed the Tax Cuts and Jobs Act.

In December, US dollar-denominated debt rose, with the EMBI Global Index up 0.63%. EM corporates, as measured by the CEMBI Broad Diversified Index, were up 0.32%. The US High Yield Index posted positive absolute returns of 0.30%. Sector performance was largely positive, with energy leading the way (up 0.85%), within which the oil field services and independent energy subsectors rose 1.38% and 1.03%, respectively.

Progress was made on Brexit negotiations, as the UK and European Union agreed to move on to the second phase of negotiations. Even so, the British pound was one of the few developed currencies to weaken compared with the dollar. Meanwhile, the Bank of England and European Central Bank (ECB) leaving policy unchanged and the independence movement in the Catalonia region of Spain had limited impact on the euro, which performed well.

Reversing its recent losses, the South African rand was the best-performing currency in the month, as the country's president was pushed out of the ruling political party, clearing the way for an eventual successor. Markets reacted favorably to the decrease in political tail risk. The New Zealand and Canadian dollars outperformed on better-than-expected economic data and hawkish commentary from their respective central banks. The Australian dollar also moved higher, helped by strong employment numbers. The Argentine peso was a notable underperformer against the US dollar, as the central bank eased its inflation target, increasing the likelihood that monetary policy would follow suit. Investors had widely expected that the bank would maintain aggressive policies to keep inflation in check. The Mexican peso and the Brazilian real also weakened relative to the dollar.

OUTLOOK AND POSITIONING

The US economy ended 2017 on a high note, and we still think that it would take a very large shock to derail the momentum in the near term. As we look ahead to 2018, we expect the Federal Open Market Committee to tighten financial conditions gradually, with asset prices unlikely to perform as well this year as they have last year. The biggest economic risk on the horizon is higher inflation. Should price pressures accelerate, the accommodative financial conditions that boosted growth in 2017 may prove unsustainable. That said, a modest slowdown into the second half of 2018 is part of our base-case scenario for the US and should not be viewed as a negative outcome. With the economy growing above potential, a modest slowdown should serve to prevent overheating and limit financial market instability. The outlook in general is a good one, and we have revised our 2018 GDP growth for the country up to 2.3%.

We continue to move later in the credit cycle and valuations have tightened across sectors. This creates fewer attractive opportunities, and makes diversification of sources of risk and income critical. Within the American Income Portfolio, we hold allocations to emerging markets and securitized assets, which diversify our

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high-yield corporate exposure. In December, we maintained our balance between rates and credit with the tilt towards credit.

Also in the month, we reduced duration, as we believe that Treasury valuations have become more expensive given our expectations for strong economic growth. The Portfolio's duration is now close to the bottom of its historical range. We continue to focus on the intermediate part of the curve.

Within corporate credit, we modestly increased our energy allocation in December. We see some value in this space (relative to the broader high-yield market) and believe it should benefit from more stable oil prices. At current levels, we would expect most names left in the space to fare well. However, it is still critical to diversify our exposure, and certain EM countries (i.e., EM African sovereigns) allow us to do exactly that.

We have become cautious on the near-term EM outlook due to increased political risk in certain countries, expectations for further US rate increases and the stronger US dollar. Still, we remain constructive on the longer-term prospects for EM, and believe they should benefit from a strong global economy. In December, we maintained our well-diversified EM exposure, and continued to focus on the Latin American and African regions.

We continue to see value in CMBS and CRTs, and added to our positions in both during December. CMBS underwriting standards have deteriorated, leading us to prefer deals that originated between 2010 and 2014 with tighter underwriting standards and better loan-to-value ratios, which we have stress tested using very conservative assumptions. CRTs are floating-rate securitized bonds backed by residential mortgage payments, which should benefit if there is an increase in short-term rates, and also help us manage the Portfolio's duration exposure.

The Portfolio Management Team remains committed to the American Income Portfolio's credit barbell strategy, which has proven resilient through market stresses and dislocations over the last nearly 25 years.

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