



ALLIANCEBERNSTEIN

APRIL 2019

RESPONSIBLE RETURNS

BETTER STOCKS FOR A BETTER WORLD

Dan Roarty, Chief Investment Officer—Thematic and Sustainable Equities

IN THIS PAPER: Many equity investors want to help create social benefits while generating strong returns. Achieving these twin goals requires a coherent investment approach. In this paper, we outline a process designed to effectively integrate environmental, social and governance factors in a sustainable equity strategy. Using stock examples, we demonstrate how to identify companies that support the UN Sustainable Development Goals (SDGs) and offer sources of long-term return potential. Our research also shows that a sustainable investing approach doesn't restrict a portfolio to a narrow subset of the market and can be applied to a much broader universe of global equities than widely perceived.



Daniel C. Roarty
Chief Investment Officer –
Thematic & Sustainable Equities

Daniel C. Roarty was appointed Chief Investment Officer of AB's Thematic & Sustainable Equities team in 2013. He joined the firm in May 2011 as global technology sector head on the Global/International Research Growth team, and was named team leader for that team in early 2012. Dan previously spent nine years at Nuveen Investments, where he co-managed both a large-cap and a multi-cap growth strategy. His research experience includes coverage of technology, industrials and financials stocks at Morgan Stanley and Goldman Sachs. Dan holds a BS in finance from Fairfield University and an MBA from the Wharton School at the University of Pennsylvania. He is based in New York and is a CFA charterholder.

In the dusty outskirts of Lucknow in rural Uttar Pradesh, northern India, modern healthcare that could change lives and increase lifespans is finally arriving. Where India's public healthcare system has failed to deliver, Apollo Hospitals Enterprise Limited has helped fill the gap in one of the poorest corners of the planet. For responsible investors, the company is a great example of an opportunity to help create social benefits while also generating profits.

Apollo operates the largest chain of private hospitals and pharmacies in India. With one of the country's most trusted healthcare brands, the company is benefiting from rising demand for hospital beds. Its innovative business model includes a telemedicine command center to connect rural clinics with doctors in larger cities. Our research in 2017—including a “grassroots” meeting with consumers—gave us confidence that Apollo was poised for sustainable revenue and earnings growth.

A BLUEPRINT FOR RESPONSIBLE EQUITY INVESTMENT

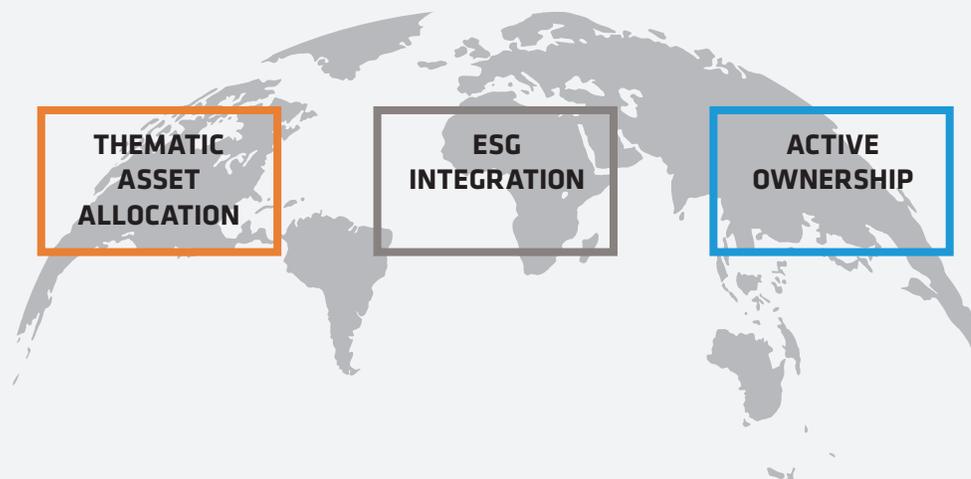
Finding companies like Apollo is no easy task. It requires a thorough process that can sift through thousands of global firms to identify those that are really making a difference on environmental, social and governance (ESG) issues. Equally important, it requires disciplined financial analysis to make sure that an ESG-focused target company is a good long-term investment.

In this paper, we explain why equities matter in a responsible investing (RI) agenda and how investors can effectively integrate ESG factors in an equity portfolio. Investing in stocks is important for responsible outcomes because publicly traded companies are massive. They employ the most people around the world, consume the most natural resources, generate the most pollution and have a large impact on political systems because of their lobbying efforts and financial muscle. As a result, what they do has a profound effect on countries, societies and sustainability in general. Shareholders who deploy a coherent approach to both making investments and wielding influence can make a big difference.

To make the case for equities in an RI plan, investors can start with the Principles for Responsible Investment (PRI), an independent network supported by the United Nations and endorsed by more than 1,800 signatories across the global financial industry. In a report published in October 2017, the PRI outlined three pillars of RI practices: integration, active ownership and thematic asset allocation (*Display 1*). We offer a blueprint for using these three pillars to translate ESG words into action via equity investing.

DISPLAY 1: THE THREE PILLARS: HOW RESPONSIBLE INVESTORS CONTRIBUTE TO POSITIVE SOCIAL OUTCOMES

Primary Mechanisms Identified by the PRI*



*PRI stands for Principles for Responsible Investment.

Source: Principles for Responsible Investment, "The SDG Investment Case", October 2017

THREE PILLARS OF RESPONSIBLE INVESTING

RI and ESG are big buzzwords in the investing industry today. As people around the world pay closer attention to how their money is deployed in investment portfolios, the asset management industry has responded with an endless array of responsible portfolios. But it can be hard for investors to really know how an investment strategy's process and positioning delivers on ESG ambitions, or if it does at all.

The UN has made big efforts to advance the development of RI. After the PRI was launched in 2006, the UN introduced the Sustainable Development Goals (SDGs) in 2015. The SDGs represent an aspirational view of what the world could look like by 2030 and include consideration of the role that the private sector must play to achieve them.

The 17 goals and 169 specific targets address areas of critical importance to humanity, including eliminating poverty and hunger, improving access to education and healthcare, and addressing the negative impact of climate change (*Display 2*). Crafted and agreed to by 193 nations, the SDGs attempt to build on the earlier Millennium Development Goals by broadening the focus beyond developing markets and explicitly considering a role for the private sector. These important changes make the SDGs a more useful tool for equity investors.



Fulfilling these goals will require about US\$90 trillion of investment over 15 years, according to the UN. That's a very tall order. Philanthropy and government spending will play an important role, but won't be enough to get the job done. The private sector—and equity investors—must be the biggest part of the solution, in our view.

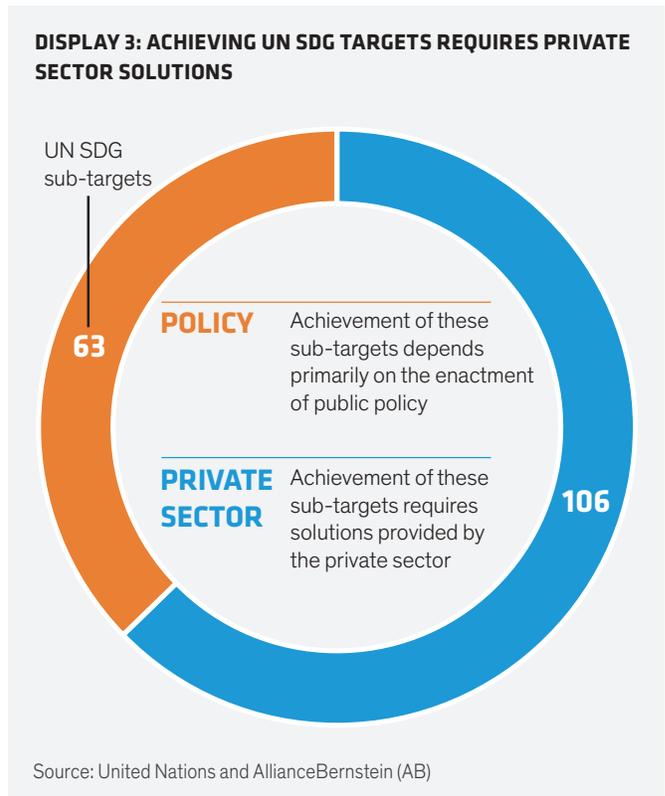
In their 2017 article on the SDGs, the PRI aimed to guide investors toward action that can lead to tangible results by outlining its three mechanisms for “positive outcomes”, or tangible real-world change. Now the onus is on investors to demonstrate how they incorporate these mechanisms in their day-to-day portfolio management. We've developed a disciplined process over several years that is consistent with the three pillars, designed to find stocks that can make a difference, and deliver long-term returns, in a focused sustainable portfolio.

PILLAR ONE: THEMATIC ASSET ALLOCATION IDENTIFIES INVESTIBLE OPPORTUNITIES

The UN SDGs are an ambitious program—with a massive scope. It would be impractical for an investor to try to focus equally on all 17 goals because the investing opportunities for the private sector aren't spread equally across the SDGs. Instead, we believe the best way to use the SDGs is to identify those that offer the best investible opportunities and to target those specific areas. This thematic approach also allows an investor to develop expertise that can support effective allocation of capital.

To map out a framework that connects the SDGs with the private sector, it's important to dig deeper than the 17 SDGs themselves. While the SDGs offer simplicity, we think they aren't detailed enough to serve as an investment foundation. Instead, we evaluated the 169 SDG sub-targets that exist underneath the 17 SDGs. These sub-targets are much more detailed and, in our view, are key to unlocking the investment potential of the SDGs.

After carefully evaluating each individual sub-target, the next step is to classify each into one of two categories: policy or private sector. Our research found that 106 of the targets presented opportunities



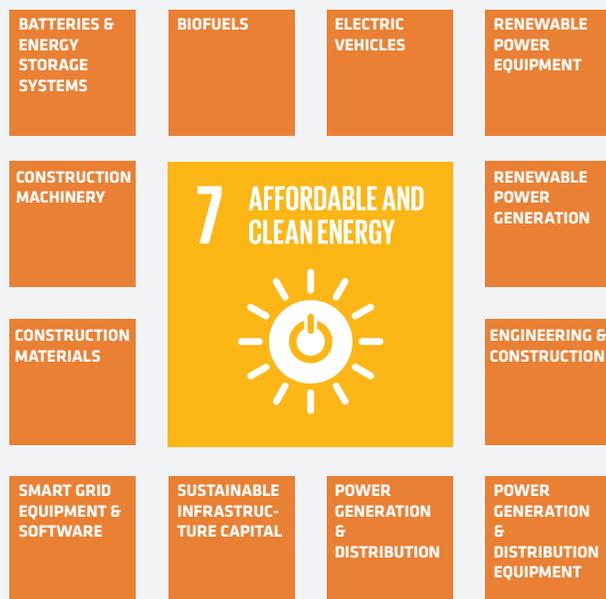
for the private sector, with the remainder more purely in the domain of policymakers (*Display 3*).

For those in the private sector group, we then identified the specific products and services that contribute to the achievement of these sub-targets. This requires thoughtful and rigorous analysis, yet it is critical to developing an investment strategy.

UN SDG target 7.2, for example, calls for increasing the use of renewable energy globally. We outlined 12 diverse groups of products including batteries, construction materials and power generation equipment that all contribute toward reaching this goal (*Display 4, next page*).

DISPLAY 4: IDENTIFYING PRODUCTS ALIGNED WITH SDGS SHAPES AN INVESTMENT STRATEGY

UN SDG Target 7.2: Renewable Energy



Source: AB

This step also facilitates another important plank of a sustainable investing plan: exclusions. It allows investors to identify products that aren't aligned with the SDGs in industries such as tobacco, weapons, pornography or gambling. Generally, such products will be automatically excluded from a sustainable portfolio.

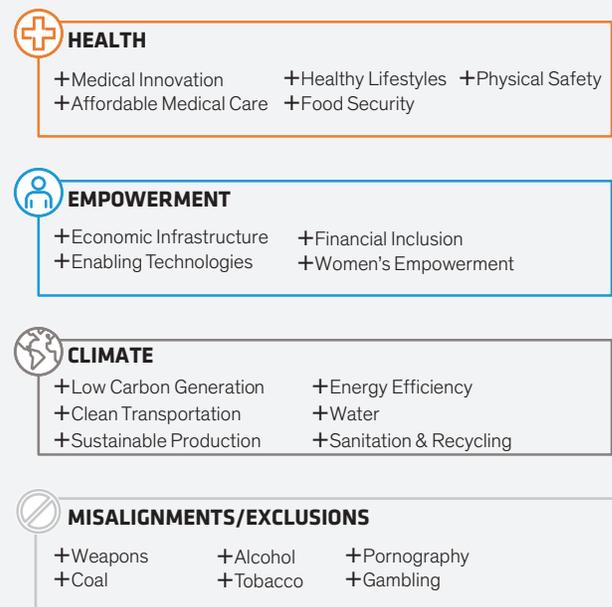
From Products to Investment Themes

Once we establish which products are relevant to the achievement of the SDGs, we can then logically group those products into more understandable themes. Themes can form an organizing structure for conducting ongoing research, can be used in portfolio construction, and can also facilitate client communication.

To simplify the investment agenda, we developed three primary themes: health, empowerment and climate (*Display 5*). We also identified 15 sub-themes within each of those categories to further clarify the investment opportunities represented by the UN SDGs. Sub-themes within climate include, for example, low carbon energy generation, energy efficiency and clean transportation.

DISPLAY 5: FOCUSING ON SPECIFIC THEMES SHARPENS AN INVESTMENT STRATEGY

Three Primary Themes Reflect Our UN SDG Alignment Methodology



As of December 31, 2018
Source: AB

After identifying products that are aligned with the SDGs, investors can look for publicly listed companies that generate revenue from these products. This is the key link between the SDGs and equity investing. By doing so, investors can sharpen their focus to those companies that support the SDGs and are key catalysts for positive real-world change.

Identifying a universe of UN SDG-aligned companies also allows investors to better understand the financial implications of investing sustainably and dispel some common myths. The characteristics of these companies can be compared against other companies and benchmarks. Our research highlights, for instance, that sustainable companies are found in every economic sector and geographic region—counter to the myth that sustainable strategies are overly restrictive (*see Measuring Sustainability in Equity Portfolios, next page*).

MEASURING SUSTAINABILITY IN EQUITY PORTFOLIOS

Many investors think sustainable investing limits a portfolio to a very narrow subset of the broader equity market. Our research shows the opposite: many companies across a wide range of industries and countries are, in fact, aligned with the SDGs (*Displays below*).

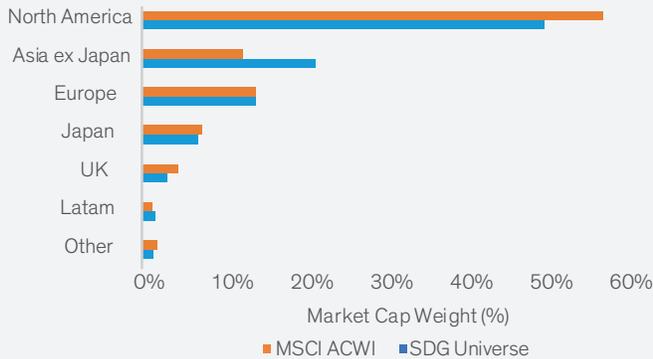
We identified companies with at least US\$1 billion in market capitalization that generate some portion of their revenues from the sale of SDG-aligned products and services. Identifying and researching these companies allows us to better understand the implications of sustainable investing, report portfolio and benchmark performance and alignment with the SDGs, while

dispelling some common misperceptions about sustainable investing.

Among companies that we surveyed around the world, 1,408 are aligned with the SDGs and 976 of them are included in the MSCI ACWI Index. Together, these companies represent 51% of the benchmark's market capitalization. These companies exist in all sectors and all geographies, which means there is ample opportunity to construct well-diversified global or regional portfolios using a sustainable investing lens. For example, we found 418 US companies that are aligned with the SDGs, including 197 in the S&P 500 Index, representing 56% of the benchmark's weight.

REGIONAL EXPOSURES

SDG Universe & MSCI ACWI (Cap-Weighted)



Current analyses do not guarantee future results

As of January 31, 2019

*Sector weightings will vary over time.

Source: Bloomberg, MSCI and AB

SECTOR EXPOSURES*

SDG Universe & MSCI ACWI (Cap-Weighted)

Sectors	SDG-Aligned Universe	MSCI ACWI Index
Technology	18.8%	14.8%
Healthcare	18.1%	11.8%
Telecom	15.4%	8.9%
Financials	12.8%	17.3%
Consumer Discretionary	10.9%	10.8%
Industrials	9.9%	10.4%
Consumer Staples	6.0%	8.2%
Utilities	3.8%	3.3%
Materials	3.1%	4.9%
Real Estate	0.8%	3.3%
Energy	0.4%	6.3%
Total	100.0%	100%

Many clients also assume that they must sacrifice financial returns to invest sustainably. We disagree.

Sustainable investing is not about passively excluding a few industries from a portfolio. It's an active approach that selects securities from a large universe of companies with attractive fundamental characteristics and powerful secular drivers. What's more, comprehensive sustainable investing involves consideration of additional ESG variables, which can help reduce risk. On the surface, then, we think there is no reason to expect that this group of companies must underperform non-sustainable strategies over time.

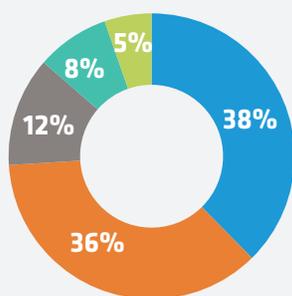
WATCH OUT FOR THE TILT

Still, sustainable investing portfolios tend to tilt toward some factors and sectors (*Displays below*). Our research shows that sustainable strategies may have more exposure to quality growth factors, such as profitability and earnings quality. At the same time, they're likely to be underexposed to value (cheapness), balance-sheet leverage and cyclical. In terms of sectors, sustainable strategies tilt towards technology and healthcare and away from financials and basic materials.

When evaluating a sustainable equity portfolio, check whether the manager is actively drawing on a broad universe of SDG-aligned companies and not just the usual ESG suspects. And make sure that portfolio construction takes into account the potential factor and sector tilts, and how they might influence the pattern of returns.

SOURCES OF TRACKING ERROR

SDG Universe vs. MSCI ACWI*



■ Industry ■ Country ■ Stock-Specific ■ Factors ■ Currency

Current analyses do not guarantee future results

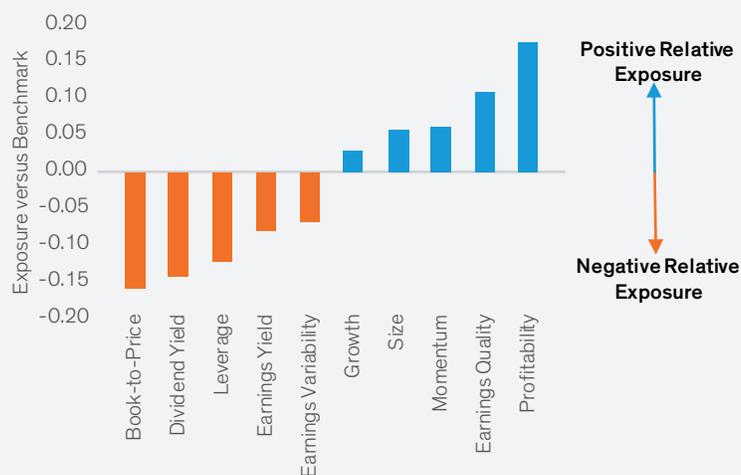
As of March 6, 2019

*Numbers may not sum to 100 due to rounding

Source: Barra, MSCI and AB

FACTOR EXPOSURES

SDG Universe vs. MSCI ACWI



PILLAR TWO: ESG INTEGRATION AS A DISCIPLINED APPROACH TO SUSTAINABLE RETURNS

With a thematic framework in place to help identify investment candidates, the stock selection process is next. Emphasizing companies with strong and/or improving ESG practices has been linked to positive social outcomes, superior financial performance and lower risk. So considering ESG factors at every step of an investment process is the key to building more effective sustainable portfolios.

When it comes to ESG assessments, data and ratings alone don't tell the full story. In our approach to sustainable thematic equities, we conduct independent fieldwork to develop a complete picture of corporate behavior. Investors engage with corporate management teams, visit individual facilities, speak with the employees and fully understand the ecosystem a firm operates in.

Such grassroots research can help investors develop a more complete investment picture—especially in emerging markets, where underlying trends may be harder to uncover from afar (see *Grassroots Research: Investing Insights from Real People*, next page). This means engaging directly with households and businesses on key environmental, social or economic issues and visiting consumers. Extensive in-home interviews with people across the socioeconomic spectrum and questionnaires tailored to the local market can generate important investment insights.

The intelligence gathered on these missions is a vital input into an investment process. Through grassroots research, investors learn more about the nuances of how sustainable investment themes might play out and how companies are having a direct impact on society. The visits also help clarify the challenges and risks to the investment case for a company, which allows us to develop an informed long-term outlook on a company's return potential.

Apollo Hospitals: Developing an Investment Thesis

Apollo Hospitals is an excellent example of how on-the-ground research insights can be combined with ESG analysis in fundamental research processes. The investment thesis begins with India's chronic shortage of hospital beds, well below other emerging-market countries and levels recommended by the World Health Organization (WHO) (*Display 6, left*). By steadily increasing the number of hospital beds available, Apollo is helping to address a serious deficiency in the country's healthcare system (*Display 6, right*). It clearly aligns with UN SDG number 3, aiming to achieve good health and well-being, as well as several sub-targets outlined in Display 5 earlier.

But is Apollo a good investment? To find out, we visited Apollo's operations in 2017 and discovered several advantages to the company's business model. For example, we found that the company had plans to invest in diagnostic labs, pharmacies and smaller clinics in smaller cities, to further improve access to care in India and to generate referrals for Apollo's larger hospitals. At the same time, our meetings with consumers affirmed the underappreciated drivers of demand for modern healthcare. These included better access to infrastructure and growing awareness of health issues through smartphone adoption.

Combined with more traditional financial analysis, these insights underpinned our confidence in Apollo's long-term forecasts. When evaluating a portfolio candidate, we calculate a bottom-up internal rate of return (IRR) for the company, similar to the approach used by private equity funds (*Display 7, next page*). The IRR approximates the return potential for owners of the business, based on the current share price, cash flow over the next five years and a terminal value for the business, discounted back to today.

DISPLAY 6: APOLLO IS HELPING ALLEVIATE STRESS IN INDIA'S HEALTHCARE SYSTEM

Hospital Beds per 10,000 People*



Apollo Hospital Beds†



*Based on latest available data from World Health Organization data retrieved on 20 February 2019. Years vary by country.

Current analyses do not guarantee future results

†As of June 30, 2018

Source: Apollo Hospitals, CLSA, World Health Organization and AB

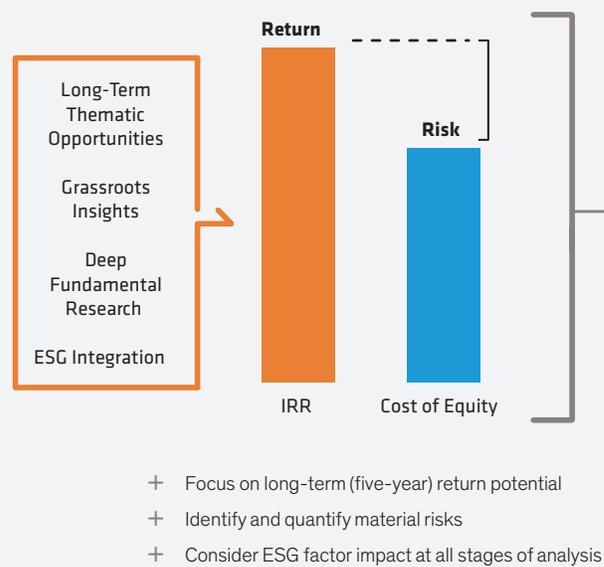
Our return forecasts are then compared with a cost of equity (COE), or risk, forecast. The spread between the return and the risk determines the degree of relative attractiveness of the stock. To calculate the COE, we evaluate various risks, and develop proprietary ESG risk scores. Higher risk scores result in a higher COE, reducing the return-risk spread and making the investment less attractive. Lower risk scores have the opposite effect. In Apollo's case, for example, we found that recruitment and retention was a top risk, and the company's need to maintain a staff of well-trained doctors was a high priority—and a key social risk.

Through engagement with company management, we gained deeper insight into Apollo's remuneration policy for doctors, including an extension of guaranteed salaries for the first year of a new hospital's operation. Management explained that this helps attract medical talent in the first year or two of a new hospital as patient volumes increase, after which doctors can rely on the traditional "fee for service" salary model for competitive compensation.

Without engaging with Apollo management, our COE analysis would be much less granular—and the inputs less informed. Employee retention is still a high-impact risk for Apollo, but a strong brand and efforts to retain and attract employees are offsetting factors that reduce this social-risk score in our analysis and give us confidence that we are being adequately compensated for the true risks of owning Apollo Hospital shares.

DISPLAY 7: BRINGING A PRIVATE EQUITY-LIKE MENTALITY TO SECURITY SELECTION

Disciplined Approach Drives Competitive Financial Returns



For informational purposes only. There can be no assurance that any investment objectives will be met.
Source: AB

GRASSROOTS RESEARCH INVESTING INSIGHTS FROM REAL PEOPLE

Sustainability is about real people, especially in emerging markets where poverty, and economic and ecological stress, are often most acute. That's why we believe grassroots research should be an integral part of an investment process aimed at finding companies that can change the world for the better.

Grassroots research seeks to understand the nuances of sustainable investment themes by directly engaging with local households and businesses on critical environmental, social and economic issues. On our grassroots research trips, we conduct extensive in-home interviews with people across the socioeconomic spectrum, using proprietary questionnaires tailored to each market. These trips generate invaluable insights into the big issues and can help identify investment opportunities.

ON THE ROAD: FROM MEXICO TO SOUTH AFRICA

Over the last five years, we've made 24 trips to 16 countries including China, Indonesia, Mexico and South Africa. In 2017, our trip to India led to research insights in sectors as diverse as financials, technology and healthcare, while supporting SDGs such as women's empowerment, inclusive finance and reduction of health risks.

In 2018, we travelled to Cape Town, South Africa, to learn more about how the city and its residents were coping with an acute water shortage that led to severe constraints on water consumption. This research was directly linked to several UN SDGs, including clean

water and sanitation (#6), sustainable cities and communities (#11) and responsible consumption and production (#12).

We witnessed the dire water shortage at the largest dam in Cape Town's supply system and found out how the city and its residents of all income levels were working together to drastically conserve and stockpile potable water. "It's everyone's responsibility to resolve this crisis," said Akhona, a 36-year-old service consultant at a call centre. She told us about her own efforts to conserve water by taking short showers and cleaning the floor with reused water, as well as her frustration with the government for failing to develop a strategic plan that could have averted the water crisis.

SEEING THE CHALLENGES UP CLOSE

Ultimately, interactions with people like Akhona provided important research insights that fed into fundamental analysis of equity investment targets in companies addressing sustainable goals. For investors seeking to make a difference in the world, it simply isn't enough to conduct research from a distance by poring over spreadsheets and financial reports. In our view, seeing the challenges to sustainability first-hand provides a substantial advantage in the search for companies that are truly contributing to efficient and effective solutions for some of the world's most pressing problems.

PILLAR THREE: ACTIVE OWNERSHIP AND ENGAGEMENT

Engaging with management is an essential ingredient in active portfolio management. As the Apollo case shows, our discussions with the company's management were instrumental in developing conviction in its profitability path. More broadly, engagement is essential to help persuade companies to make changes to their practices, which ultimately can enhance shareholder returns and improve social outcomes.

There are many ways for shareholders to engage with companies. News headlines often focus on aggressive, public activism, in which shareholders engage in personal, public debates or proxy fights over matters of corporate policy. We prefer a more civil discourse, by introducing outside perspectives to the company, based on thoughtful research findings, aimed at fostering improvements that are in the best long-term interests of both the company and its shareholders.

Many issues are subject to engagement, from corporate strategy and capital allocation to ESG practices. According to the PRI, the goal of engagement is to improve, or identify the need to influence, ESG practices and/or disclosure. "It involves a structured process that includes dialogue and continuously improving or monitoring companies," the PRI said in an article in October 2018. This approach is in line with our view that constructive activism requires a productive and respectful dialogue with management to be effective.

XYLEM: ENGAGING WITH A WATER TECHNOLOGY PROVIDER

Our engagement with Xylem illustrates how we work with management to promote ESG issues in a company that fits our thematic focus. Xylem, based in Rye Brook, New York, is a water technology provider that is addressing important sustainable goals.

According to a UN report in 2018, about half the world's population experiences water scarcity during at least one month each year. More than two billion people lack access to clean drinking water. UNICEF reported in 2016 that women and children spend more than 200 million hours every day collecting water. And, globally, available freshwater per capita has declined by 26% over the last 25 years, according to the Union of Concerned Scientists.

Clean water and sanitation is the sixth UN SDG. But companies that tackle water issues are also addressing several other SDGs including reducing poverty, eliminating hunger, promoting good health and supporting sustainable cities and communities. Cities, communities, utilities and industries are on the prowl for innovative solutions to water challenges. In many cases, technology and data will play a key role in addressing water issues.

Enter Xylem, which provides a broad suite of solutions for water transportation, treatment, recycling and efficiency of use.

In Cape Town, South Africa, which has faced an acute water shortage, Xylem is providing smart meters for more efficient water use by industrial and residential customers. In California, the City of Los Angeles commissioned Xylem to develop a unique water purification and reuse system that will enable the city to treat wastewater from 130,000 residents and 100 business, to help recharge the stressed drinking water aquifers. And in Ecuador, Xylem is supplying pumps and water infrastructure, enabling the irrigation of 7,700 hectares of previously unreliable agricultural land as well as drinking water needs for 85,000 residents.

Clearly, Xylem's core activities support ESG goals. But how does the company itself score on ESG performance in its day-to-day activities? In our discussions with management, we asked about one important aspect: whether ESG performance is tied to the company's executive compensation plans. We learned that Xylem applies ESG metrics to compensation and has targets for reducing greenhouse gas emissions, water use and waste generation, which are incorporated into performance goals for some managers and executives.

However, we felt these targets were subjective, and asked the company to move toward more explicit weight settings, and better disclosure, of ESG metrics in executive compensation. In our view, linking ESG targets more concretely to executive compensation would be an opportunity for Xylem to demonstrate ESG leadership in its industry and beyond. Management responded positively to the feedback and said it would consider the concerns.

Governance issues also require scrutiny from engaged investors, through direct engagement as well as proxy voting. In a respectful dialogue, we pressed Xylem's management to reduce the threshold for the right to call a special meeting from 25% of share ownership to 10%, and we voted in favor of a shareholder proposal on the issue. We explained that, since the top four investors collectively own 27% of the company, they would effectively have more power than smaller investors to invoke this right at a 25% threshold. In this case, management did not accept our suggestions; however, we will continue to monitor the issue.

GENERATING RESPONSIBLE RETURNS

Engagement is the best way to make sure that companies are actively devoted to improving their ESG practices. And good ESG practices make for good business. That's why, in our view, a sustainable investing agenda must be comprehensive. Companies that help to advance climate, health and empowerment issues by virtue of the products and services that they offer must also show that they are committed to strong ESG practices in their own operational routines. And investors who are dedicated to sustainability must proactively engage with management to reinforce best practices.

Equity investors can make a big difference by adopting a coherent sustainable agenda, in our view. Thematic asset allocation aligns a portfolio's target securities with the most important development issues flagged by the UN. ESG integration in research allows for more comprehensive financial forecasting and risk analysis at the security level. And active engagement helps promote positive change at companies, which can also be a driver of stronger investment returns. What's more, when equity investors support sustainable companies, their share prices rise, which helps reduce their cost of capital and enable continued investment in business activities that are generating positive outcomes.

Sustainable investing is more than a slogan. It requires identifying businesses that deliver goods and services to promote sustainability while also ensuring that the companies themselves live up to ESG standards in everything they do. Creating truly sustainable equity portfolios requires a comprehensive investment process built on knowledge and research skill—not platitudes. By following clear guidelines that systematically target the UN SDGs in portfolios, we believe investors can use their equity allocations to promote companies addressing some of the world's biggest ESG challenges while at the same time finding responsible sources of strong long-term investment returns.

CASE STUDY: ETSY

EMPOWERING WOMEN THROUGH SMALL BUSINESS

Women's empowerment is an important sustainable development goal. Our search for companies that address empowerment attracted us to Etsy, an online marketplace for one-of-a-kind products made almost exclusively by small businesses and women. Deploying the three-pillar agenda helped us identify Etsy as an attractive sustainable investment with promising return potential.

THEMATIC ALIGNMENT

The UN's eighth SDG advocates decent work and sustainable economic growth, with a particular emphasis on the development of small businesses. SDG #5 calls for gender equality. Etsy's business encourages entrepreneurship—especially for women—making it a natural fit for a sustainable thematic portfolio.

Etsy is a US-based online marketplace designed for specific types of products, such as crafts, handmade gifts and unique clothing. Most of its two million sellers are small- and medium-sized businesses, including many artists. This profile is especially attractive for women, who account for 87% of Etsy sellers. In fact, 97% of Etsy sellers run shops from their home and 28% live in rural areas.

After identifying the company's thematic fit, our team conducted a detailed analysis of Etsy's business and cash flows. The company has faced significant challenges, including pricing controversies, policy decisions related to acceptable sellers on its platform and competitive threats from an Amazon marketplace called Handmade. Etsy also made several strategic mistakes along the way.

But after new management was installed in May 2017, we believe the company started to turn the corner. Revenue growth has picked up, profitability has improved and Etsy is reinvesting in the business to expand the tools that it offers sellers.

ESG INTEGRATION

Based on our fundamental research, we apply the IRR methodology explained on pages 6-7. To do so, we assume a lower terminal stock multiple in five years, which helps us determine whether the company should be able to generate returns without help from the market.

IRR is only one side of the coin. We then calculate the stock's risk, by factoring in the risk-free interest rate, the equity market risk premium and the stock's beta. Since ESG is integrated into our fundamental analysis, we scrutinize environmental, social and governance risks that could affect the stock. As an e-commerce company, Etsy has little environmental risk. Yet social risks are acute because Etsy needs to hire and retain talent and must protect customer data. Governance risks were addressed during the company's restructuring, and Etsy now has an independent board, separation of CEO and chairman and four female board members. These and other risks are scored to create an adjustment factor that is applied to the stock's beta. The return-risk spread determines how attractive the investment is from a fundamental point of view, creating a clear figure that can be easily compared across different investment candidates.

ACTIVE OWNERSHIP

As shareholders, we believe engagement with management is a critical component of a sustainable investment strategy.

In November 2018, we engaged with Etsy's chief financial officer and its head of investor relations to discuss growth drivers as well as the company's continued efforts to offer additional services to help sellers. Ensuring that the company continues to roll out new offerings that improve the quality of service, buyer experience and ultimately gross merchandise volume will help Etsy increase the number of women sellers that it can empower with its platform, while also improving the chances of the stock delivering strong returns to investors over time.

The value of investments and the income from them can fall as well as rise and you may not get back the original amount invested.

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