

## Market Overview

Equity and credit markets sold off sharply during the fourth quarter as the ongoing U.S./China trade dispute and concerns about potential policy mistakes by the U.S. Federal Reserve led investors to reduce risk exposure. Exacerbating the move lower were indications that China's and Europe's respective economies were weakening further and the potential negative impacts that such a scenario would have on future earnings of U.S. companies. The magnitude of the declines appeared outsized in our opinion, perhaps driven by algorithmic trading and a seasonal lull in liquidity, as the fundamentals of the U.S. economy (low unemployment, resilient consumer spending, and neutral-to-accommodative fiscal and monetary policy) still point to Gross Domestic Product (GDP) growth in 2019.

Convertibles, as measured by the ICE BofA/Merrill Lynch All US Convertibles Index (the "Convertibles Index") were not immune to the weakness, retreating (-9.31%) during the quarter. The declines were fairly broad-based with every sector except utilities registering losses. The two worst performing sectors were energy and materials, where investors fretted about oversupply amidst a global slowing of economic activity. The underlying equities of the Convertibles Index fell (17.52%) during the quarter, approximating the midpoint of the S&P 500®'s and the Russell 2000®'s performance. For the year, convertibles outperformed equities and credit, a product of the asset class's unique convexity as well as the composition of the underlying issuers.

Growth convertibles slightly underperformed value convertibles during the quarter. The fact that both growth and value convertibles exhibited similar declines is indicative of the indiscriminate selling observed in December. Similarly, while large-cap convertibles outperformed both mid- and small-cap convertibles during the quarter, all three segments were similarly weak. Interestingly enough, the performance of convertibles did not mirror the outsized outperformance of the larger capitalization S&P 500® vis-à-vis the smaller capitalization Russell 2000®.

Despite the market turmoil, the convertible primary market continued to be active. During the fourth quarter, convertible new issuance totaled 18 issues raising \$5.4 billion. Even during the month of December, when the high yield primary market was essentially closed with no new high yield issues being priced (the first time that has occurred since November 2008, during the midst of a financial crisis!), the convertible new issue market remained open, pricing two new issues and raising \$0.4 billion. For the year, the convertible primary market raised \$52.7 billion of proceeds, or growth year-over-year of +41%.

## Fund Overview

The 1290 Convertible Securities Fund pursues its investment objective by investing at least 80% of its net assets, plus borrowings for investment purposes, in a diversified portfolio of convertible securities.

Source: Palisade Capital Management

A dramatic investor shift to a risk-off mentality in the fourth quarter negatively affected the Fund's performance. The combination of the equity market selloff and widening credit spreads more than offset the tailwind of moderating interest rates. The Fund was positioned for continued economic growth with the U.S. posting solid GDP growth through most of the year. However, this positive trend was unable to offset negative sentiment surrounding the continuing trade spat with China and its potential to derail positive economic momentum. Defensive sectors such as utilities and consumer staples, which the Fund was underweight, were the best performing sectors in the quarter and a relative drag on performance. The Fund's positioning in more cyclical sectors such as industrials and energy were also a headwind to performance as the market's risk appetite faltered.

While the subadvisor remains positively predisposed in their market outlook, they acknowledge that policy uncertainty has affected investor sentiment more than expected and points to a continued volatile trading environment for 2019. As such, they are moderating their market expectations as the U.S. policy environment, especially with the shift in Congress, and its impact on the economy, remains hard to predict. Based on current conditions, their base case is for continued, though slightly slower, economic expansion, stable credit fundamentals and a supportive interest rate environment. They continue to favor companies that they believe will provide above average growth over the long run, but look to bias our holdings to higher quality and less speculative names to better navigate potential volatility. The subadvisor continues to believe that convertibles remain an attractive alternative to help investors mitigate their downside risks while maintaining the potential for upside gains in a period of uncertainty.

## Fund Highlights

### What helped performance during the quarter?

- The Fund benefitted from a lack of exposure to the poorly performing telecommunications sector.
- An underweight to the media sector also contributed to returns during the quarter. Lack of exposure to the World Wrestling Entertainment, Inc. 3.375% (0.00%\*) convert, which fell -21.32%, was additive.
- The Fund also outperformed in the materials sector, where our position in Cemex Sab De 3.72% (0.00%\*), a non benchmark holding, handily outperformed the index sector return.

### What hurt performance during the quarter?

- The largest detractor to returns in the quarter was unfavorable security selection in the industrials sector. In particular, our exposure to the poorly performing Belden Inc. 6.750% (0.52%\*) and Patrick Industries, Inc. 1.0% (0.67%\*) held back results.
- Energy represented our second largest detractor to returns in the fourth quarter as our position in a Nabors Industries 6% (0.27%\*) preferred, which fell dramatically in part due to the steep decline in oil prices, contributed to our underperformance in energy.
- Our underperformance in financials was attributable to our lack of exposure to the Real Estate Investment Trust (REIT) industry as this defensive industry held up relatively well during the quarter.
- Similarly, our lack of exposure to the defensive utilities sector detracted from returns.

\* % of total market value of the Fund's portfolio holdings as of 12/31/18. Subject to change.

Current and future Fund holdings are subject to risk.

An investor should consider the investment objectives, risks, charges and expenses of the Fund carefully before investing. To obtain a prospectus containing this and other information, please call 1-888-310-0416 or download the file from [www.1290funds.com](http://www.1290funds.com). Read the prospectus carefully before you invest.

1290 Convertible Securities Fund seeks to achieve a high level of total return. Performance may be affected by one or more of the following risks. The value of convertible securities fluctuates in relation to changes in interest rates and the credit quality of the issuer and, in addition, fluctuates in relation to the underlying common stock. A convertible security may be subject to redemption at the option of the issuer at a price established in the convertible security's governing instrument, which may be different than the current market price of the security. If a convertible security held by the Fund is called for redemption, the Fund will be required to permit the issuer to redeem the security, convert it into underlying common stock or sell it to a third party. Convertible securities are subject to equity risk, interest rate risk and credit risk and are often lower quality securities. Lower quality may lead to greater volatility in the price of a security and may negatively affect a security's liquidity. Since it derives a portion of its value from the common stock into which it may be converted, a convertible security is also subject to the same types of market and issuer-specific risks that apply to the underlying common stock.

**Past performance is no guarantee of future performance.**

**ICE BofA/ML All U.S. Convertibles Index** (the "Index") consists of U.S. dollar denominated investment grade and non-investment grade convertible securities sold into the U.S. market and publicly traded in the United States. The Index constituents are market value weighted based on the convertible securities prices and outstanding shares, and the underlying index is rebalanced daily. Individuals cannot invest directly in an index.

**Russell 2000® Index** is an unmanaged index which measures the performance of approximately 2000 of the smallest companies in the Russell 3000® Index, which represents approximately 10% of the total market capitalization of the Russell 3000® Index. It is market-capitalization weighted.

**S&P 500® Index** is an unmanaged weighted index of common stocks of 500 of the largest U.S. companies, deemed by Standard & Poor's to be representative of the larger capitalization portion of the United States stock market.

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(AXA000723) (exp. 6/30/19)