

VOLUME VII, NO. 1 | SUMMER 2009

BERNSTEIN JOURNAL

PERSPECTIVES ON INVESTING AND WEALTH MANAGEMENT

- > Jump In or Go Slow?
Strategies for Entering the Market
- > Does Research Work in Difficult Markets?
- > How Safe Are Municipal Bonds Today?
- > Investment Planning in Turbulent Times:
Defining a Course of Action
- > Putting the Recession in Perspective:
Sobering (and Hopeful) Lessons of History



PERMISSION TO REPRINT MATERIALS FROM THE *BERNSTEIN JOURNAL*

With the exception of fair dealing for the purposes of research or private study, or criticism or review, no part of the *Bernstein Journal* may be reproduced, stored, or transmitted in any form or by any means without prior permission. To obtain permission to reprint any material from this or prior issues, please call 212.969.6724.

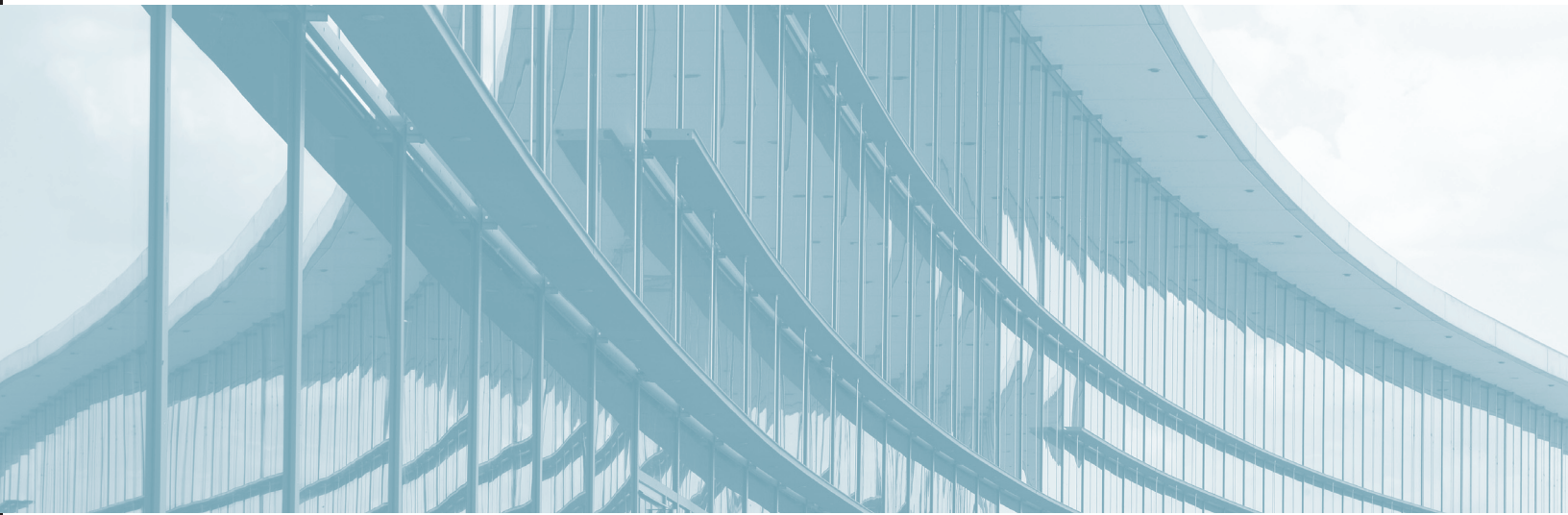
© Copyright July 2009, AllianceBernstein L.P. All rights reserved.

This publication is for use only with the private client business of Bernstein Global Wealth Management, a unit of AllianceBernstein L.P.

Bernstein does not provide tax, legal, or accounting advice. In considering this material, you should discuss your individual circumstances with professionals in those areas before making any decisions.

TABLE OF CONTENTS

> Jump In or Go Slow? Strategies for Entering the Market	1
> Does Research Work in Difficult Markets?	7
> How Safe Are Municipal Bonds Today?	13
> Investment Planning in Turbulent Times: Defining a Course of Action	21
> Putting the Recession in Perspective: Sobering (and Hopeful) Lessons of History	28



JUMP IN OR GO SLOW?

STRATEGIES FOR ENTERING THE MARKET

In the aftermath of 2008, investors may be holding on to cash, fearful of another market downturn. Many intend to reinvest once the markets show clear signs of improvement. But what is the best way to reenter? History suggests that a staged approach may be preferable to an extended stint on the sidelines. Careful analysis can help make the choice easier.

The study of behavioral finance tells us that people's fear of financial loss exceeds their desire for gain. The fierce bear market has sharpened the edge of investor anxiety, and many investors today are holding large cash positions with the intent of entering the market when it seems "safe" again. Yet they are caught in an excruciating situation: On the one hand, staying in cash would clearly have been profitable during 2008, but staying in cash during the early part of 2009 has actually been costly, and over the long term it will almost certainly result in less wealth than investing in a diversified portfolio of stocks and bonds.

A strategy of staging investments over time—known as "dollar cost averaging"—has long been viewed as an emotional aid in such times. This practice involves making investments of a fixed amount of money at regular intervals. The intended benefit is to limit an investor's exposure to downturns while providing a way to take advantage of market weakness. However, there is a risk to dollar cost averaging: If the market rises while you are "averaging in," you miss out on potential gains. And those forgone gains could be substantial: Market rallies, especially coming out of bear markets, have often been rapid, with the bulk of gains occurring in a short time frame. Missing gains like that could have a substantial impact on your wealth if you are investing for the long term.

Bernstein recently completed a study of dollar cost averaging in the stock market, aimed at answering:

- > How does this strategy compare with investing all at once, in terms of wealth creation and risk reduction?
- > Considering the possibility of extreme downturns like that of the recent past, how does dollar cost averaging fare versus investing all at once during poor markets?

Our conclusion is that any strategy for getting invested is likely to be far better at realizing long-term investment goals than remaining in cash. Further, while dollar cost averaging can help protect wealth in a falling market, it comes with a cost in typical or better markets. Investors should assess the trade-offs between the potential benefits of dollar cost averaging and the long-term potential costs.

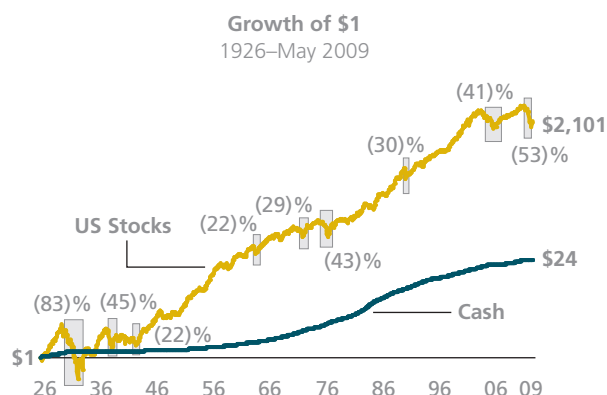
What Has Been the Best Long-Term Strategy?

The appeal of stock investing as a wealth-creation vehicle is easy to see if you compare the growth in portfolio values over the period from 1926 through May 2009—thus reflecting the ride through both good and tough times (*Display 1, following page*). One dollar invested in US stocks at the start of 1926 would have grown to \$2,101 by the end of May of 2009; a dollar invested in cash would have grown to \$24 over the same period. But *Display 1* also

reveals just how severe market downturns can be and why investors gravitate to strategies like dollar cost averaging. US stock declines in excess of 20% from peak to trough are highlighted, although there have been many smaller downturns along the way.

Display 1

Stocks have created wealth over time despite severe periodic downturns



Past performance does not guarantee future results.

US Stocks are represented by Ibbotson through 1974 and by the S&P 500 thereafter; Cash is represented by three-month T-bills. The display uses a logarithmic scale.

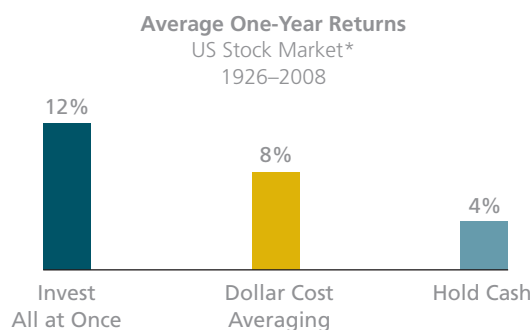
Source: Compustat; Roger G. Ibbotson and Rex A. Sinquefeld, "Stocks, Bonds, Bills, and Inflation: Year-by-Year Historical Returns," University of Chicago Press *Journal of Business* (January 1976); Standard & Poor's; and AllianceBernstein

Dollar cost averaging is appealing as an insurance against these downturns. So how has it performed versus investing all at once or holding cash? To quantify the trade-offs involved, we compared the strategies in a historical analysis of the US stock market since 1926, the point at which reliable data begin. We measured the average 12-month return generated by a strategy of averaging in to the US stock market during every rolling 12-month period. This encompasses approximately 1,000 different entry points across a wide range of market environments, from the Great Depression to the raging bull markets of the 1980s and 1990s to the worst of 2008. The results were illuminating.

On average, investing all at once has been the best strategy for maximizing returns. In *Display 2*, we show the average gain of the stock market and cash in all the rolling 12-month periods since 1926. Not surprisingly, the strategy of dollar cost averaging came in at the middle: 8%. That means that an investor who chose to make fixed monthly investments for a year would have, once fully invested, a portfolio that had grown about four percentage points less than someone who invested all at once at the start of the year, but at twice the rate of the investor who stayed in cash.

Display 2

For highest potential returns, invest all at once



Past performance does not guarantee future results.

Invest All at Once represents the return for the S&P 500; Dollar Cost Averaging assumes level investments for 12 months; Hold Cash represents the return for T-bills.

*Based on rolling 12-month US stock market returns from January 1926 through November 2008, represented by Ibbotson through 1974 and by the S&P 500 thereafter.

Source: FactSet; Roger G. Ibbotson and Rex A. Sinquefeld, "Stocks, Bonds, Bills, and Inflation: Year-by-Year Historical Returns," University of Chicago Press *Journal of Business* (January 1976); Standard & Poor's; and AllianceBernstein

Recent Results Amplify the Pattern

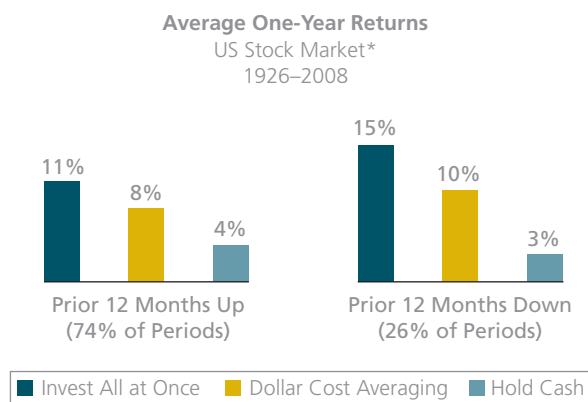
Of course, the average results are only modestly informative to an investor deciding whether or not to enter the market right now. The individual investor doesn't have 1,000 market entry points, as our study did. And in today's environment of heightened stock market volatility, the risk of further losses is higher than usual. Although we can't predict the path of returns over the coming several months, we can

look to history for some guideposts. Does the pattern portrayed in Display 2 change when we focus only on bear market periods?

We shifted our analysis to show one-year returns for the three strategies following 12-month periods in which US stocks gained and after 12-month periods in which they declined. As *Display 3* shows, regardless of how one enters the stock market, the average one-year returns were better in years following a negative 12-month period than in years following a positive 12-month period. The strategy of investing all at once generated returns of 11% on average after a positive year (positive years occurred in 74% of our study periods), but 15% after a negative year (negative years occurred in 26% of the periods we analyzed). And dollar cost averaging chalked up returns of 8% on average after a positive year, but 10% after a negative year. The reason for this is quite simple: Because the stock market has tended to revert to its mean

Display 3

The benefit of investing via either strategy over cash has been even greater following bear markets



Past performance does not guarantee future results.

Invest All at Once represents the return for the S&P 500; Dollar Cost Averaging assumes level investments for 12 months; Hold Cash represents the return for T-bills.
 *Based on rolling 12-month US stock market returns from January 1926 through November 2008, represented by Ibbotson through 1974 and by the S&P 500 thereafter.
 Source: FactSet; Roger G. Ibbotson and Rex A. Sinquefeld, "Stocks, Bonds, Bills, and Inflation: Year-by-Year Historical Returns," University of Chicago Press *Journal of Business* (January 1976); Standard & Poor's; and AllianceBernstein

KEY CONCEPTS

- > On average, entering the market all at once has proven to be a better strategy for wealth creation than either entering the market in stages—called "dollar cost averaging"—or holding cash for extended periods.
- > Dollar cost averaging is, however, a reasonable "insurance policy" against poor markets, paid for by giving up potential gains in typical or better markets.
- > If you decide to average in to the market, the optimal balance between cost and benefit occurs over a period of six months. Beyond that, the cost starts to outweigh the benefit, and after 18 months, the cost increases without added benefit.
- > A systematic, monthly program of dollar cost averaging works best. Trying to boost the strategy's effectiveness by buying only on dips or in rising markets is less effective.

growth rate (unusually strong growth tends to slow, and unusually poor results tend to improve), the likelihood of a strong 12-month period was greater if the market had lost ground in the previous 12 months.

Holding cash—that is, not investing—did not come close to the returns of the stock market in either case, but was especially detrimental to returns after a negative year in the market: Remaining in cash yielded only 3% in the periods following a down year.

However, just because the statistics favor investing immediately doesn't make it the best strategy for all investors. There is a trade-off between the potential reward of stock market gains and the risk that the market might drop after you've invested. Because everyone has a different tolerance for risk, we've developed a framework to help assess the trade-offs.

What Price Does Protection Carry?

To compare the cost and benefit of averaging in over different market environments, we arrayed all of the 12-month periods in our study by stock market returns, from the strongest to the weakest, and then broke those into five subsets, or quintiles. The bottom quintile included markets as bad as those of 2008, while the top quintile included markets like 1954, when the S&P 500 rose 53%.

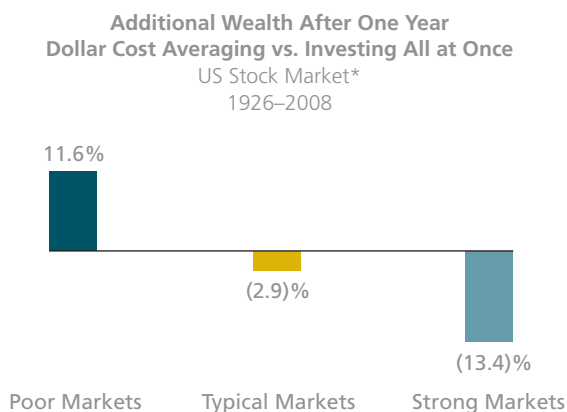
Display 4 shows that averaging in during poor markets (the bottom quintile of performance) helped preserve capital, resulting in 11.6% more wealth on average at the end of the 12-month periods than investing all at once. In typical markets (the middle quintile of performance), however, averaging in resulted

in 2.9% less wealth. But in strong markets (the top quintile of performance), dollar cost averaging detracted significantly from returns: The average wealth after one year was 13.4% less than investing all at once.

Note that the results are asymmetrical. The benefit of dollar cost averaging in poor markets is less than its cost in strong markets. Further, this cost has an enduring impact on an investor's long-term wealth: At the end of one year, both strategies will be fully invested—but the portfolio that used dollar cost averaging is more likely to be starting in a hole. If we take two portfolios that are identical—except for the fact that one was funded using dollar cost averaging and the other all at once—and track them side by side for 20 years, the portfolio that began with a 13.4% reduction from dollar cost averaging is always worth 13.4% less than the portfolio that began invested all at once.

Display 4

Averaging in can protect in poor markets, but can be costly in good ones



Past performance does not guarantee future results.

Dollar Cost Averaging assumes level investments for 12 months. Poor Markets represent the bottom 20%, Typical Markets the middle 20%, and Strong Markets the top 20%.

*Based on rolling 12-month US stock market returns from January 1926 through November 2008, represented by Ibbotson through 1974 and by the S&P 500 thereafter.

Source: FactSet; Roger G. Ibbotson and Rex A. Sinquefeld, "Stocks, Bonds, Bills, and Inflation: Year-by-Year Historical Returns," University of Chicago Press *Journal of Business* (January 1976); Standard & Poor's; and AllianceBernstein

Of course, dollar cost averaging also has a nonmonetary value: It can help a nervous investor sleep at night. So one way to think of the strategy is as an insurance policy against stock market losses. The cost of this policy in typical markets is 2.9% of one's holdings. An investor thinking about dollar cost averaging should consider whether the potential benefits match the cost.

The Question of Timing the Averaging

Assuming one is going to average in to the stock market, is there an optimal period? After all, a very nervous investor might want to ease in over years, while a more confident investor might be comfortable with a time frame of several months.

Display 5 shows the cost and benefit of averaging in over different time periods, from six months to two years. We measured the cost (shown on the horizontal axis) as the amount of potential gain given up by averaging in during typical markets, and the benefit (shown on the vertical axis) as the amount protected by averaging in during poor markets. For example, the 12-month point on the display shows the wealth cost of 2.9% mentioned above—if markets are typical—mapped against an 11.6% advantage if markets turn out to be poor.

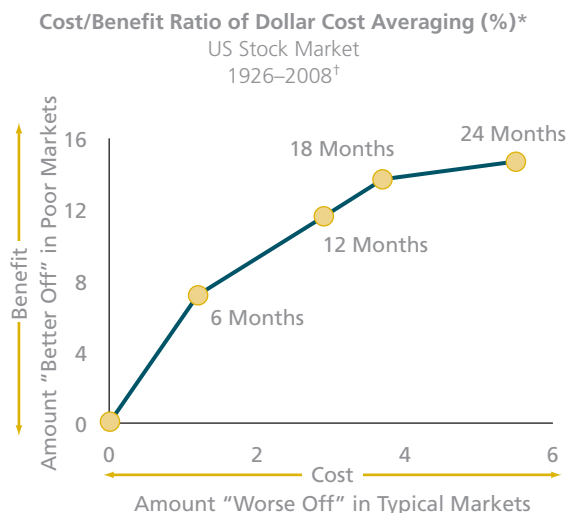
This analysis demonstrates that the longer one takes to average in, the higher the cost and the greater the potential benefit, but they don't rise equally. Between zero and six months, the

slope of the line is favorably steep: roughly 7% protection for a cost of about 1%. Between six and 18 months, the trade-off between cost and benefit moderates, and after 18 months, the slope becomes almost flat, indicating little increased benefit for much higher cost.

Our conclusion is that averaging in for a period of six months or less offers the best trade-off between cost and benefit. However, for those risk-averse investors who are willing to effectively pay an increased premium, the strategy can be extended for as long as 18 months. But beyond 18 months, averaging in doesn't make financial sense—unless it is part of a program like payroll deduction, in which the money becomes available incrementally over time.

Display 5

After 18 months, the benefit of averaging in doesn't keep pace with the cost



Past performance does not guarantee future results.

Dollar cost averaging assumes level investments for 12 months.

*As of the end of the averaging period

†Based on rolling 12-month US stock market returns from January 1926 through November 2008, represented by Ibbotson through 1974 and by the S&P 500 thereafter.

Source: FactSet; Roger G. Ibbotson and Rex A. Sinquefeld, "Stocks, Bonds, Bills, and Inflation: Year-by-Year Historical Returns," University of Chicago Press *Journal of Business* (January 1976); Standard & Poor's; and AllianceBernstein

The Markets Don't Send Signals

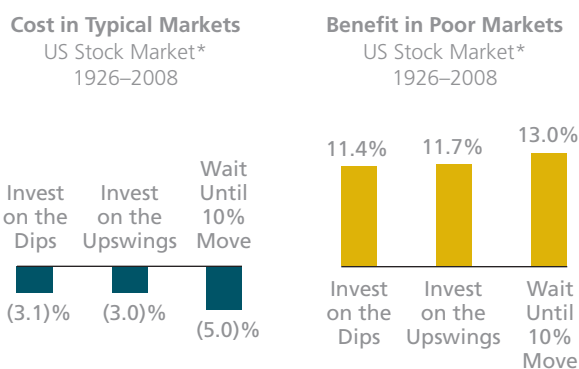
Some investors have tried to improve on the dollar cost averaging strategy with a tactical approach—either by watching market signals carefully to attempt investing before an upturn, or by investing only on market "dips." We analyzed these approaches to see if they can boost results.

Using the same rolling 12-month periods, we modeled three strategies. In the first, we invested in six equal installments, investing each installment only after a down month—in order to invest on the dips. In the second strategy, we invested in six equal installments, only after an up month—in order to capture "momentum." And in the third strategy, we invested all at once after the market had moved up by 10%.

The result: In typical markets, almost none of the strategies created an improvement over the simple strategy of level monthly investments

Display 6

Tweaking the formula makes little difference



Past performance does not guarantee future results.

Dollar cost averaging assumes level investments for 12 months.
*Based on rolling 12-month US stock market returns from January 1926 through November 2008, represented by Ibbotson through 1974 and by the S&P 500 thereafter.

Source: FactSet; Roger G. Ibbotson and Rex A. Sinquefeld, “Stocks, Bonds, Bills, and Inflation: Year-by-Year Historical Returns,” University of Chicago Press *Journal of Business* (January 1976); Standard & Poor’s; and AllianceBernstein

(Display 6). Only waiting for a 10% move off a trough showed a slight benefit, although its result of 13.0% greater wealth in poor markets was not much better than the 11.6% result of regular monthly dollar cost averaging (as seen in Display 4), and its cost in typical markets was high—5.0%—compared with the cost of regular monthly dollar cost averaging, 2.9% (as also seen in Display 4). In essence, what these strategies do is extend the averaging in period—in many cases over 12 months and longer—which, as we’ve seen, is not cost-effective.

Strategies that prolong the market entry time period also open the door to another risk: that if poor markets ensue, you will lose your nerve and stop investing altogether. The biggest risk to a staged investment plan is the temptation to second-guess the market and continue to wait in cash, which can lead to substantial erosion in long-term wealth.

Finding the Right Balance

Investors today understandably are struggling to balance their desire for capital preservation with the need to achieve growth in their portfolios. It is a difficult dilemma with no single answer that fits everyone. However, our analysis of dollar cost averaging provides some objective guidelines for finding a balance.

Our research shows that if you have a sum of money to invest for the long term, entering the market all at once will usually prove to be a better strategy than dollar cost averaging. The odds are in your favor that you will reap greater wealth in the end.

However, dollar cost averaging is a reasonable “insurance policy” against the risk of investing into a falling market. If the market declines, your losses will be less than if you were fully invested. But if the markets are typical or strong, the cost of that protection may be a significant portion of your invested wealth.

When choosing to dollar cost average, a time period of up to six months is the most efficient strategy; between six and 18 months offers a reasonable cost/benefit trade-off; periods over 18 months come at a high price.

Finally, if you decide to average in, it is essential that you choose a systematic method and time frame and stick to them. The alternative invites emotions to rule your investment decisions, which is likely to erode your wealth over the long term. ■

DOES RESEARCH WORK IN DIFFICULT MARKETS?

Investment research is designed to identify the stocks with the highest return potential at any given time, but it may prove ineffective in extreme market cycles. Still, in our judgment it remains the best route to investment success. Indeed, amid mixed signals that we may have seen the trough of the latest severe bear market, research may be especially powerful.

The damage in the worldwide stock markets in 2008 was devastating (*Display 1*). The S&P 500 fell almost 40% in the calendar year, the international markets fared worse, and the losses affected both value and growth stocks. Further, no sector and few individual stocks were spared. *Display 2, following page*, charts the correlation of returns within the S&P 500; the higher the correlation, the more its constituent stocks behaved similarly. And the correlation spike in 2008 (almost 0.7 out of a maximum of 1.0) was so far above its average that in recent years it was rivaled only by the short-lived October 1987 crash. Indeed, with 95% of the companies in the

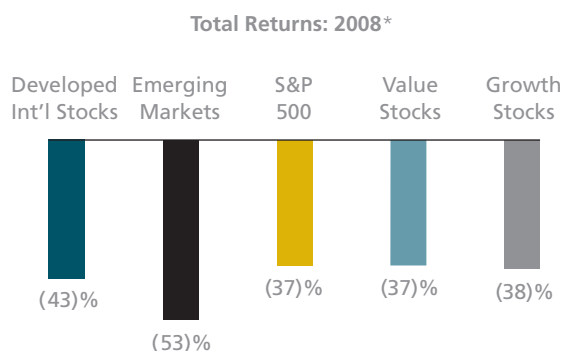
S&P 500 posting negative returns, 2008 was one of the worst years on record since the 1920s. The pattern was similar in markets worldwide.

Research Failed—for a Short While

With investor fear so intense and pervasive, the characteristics that have traditionally spelled success for both the value and growth investment styles proved useless, or worse. The bargain-priced value stocks that usually outperform the market lagged dramatically, and investors paid no attention to positive earnings “surprises” among growth stocks (*Display 3, following page*). Finding almost all stocks unattractive, investors were interested only in the locked-in safety of government bonds.

Display 1

The markets fell virtually in unison in the latest downturn



Past performance may not be indicative of future results.

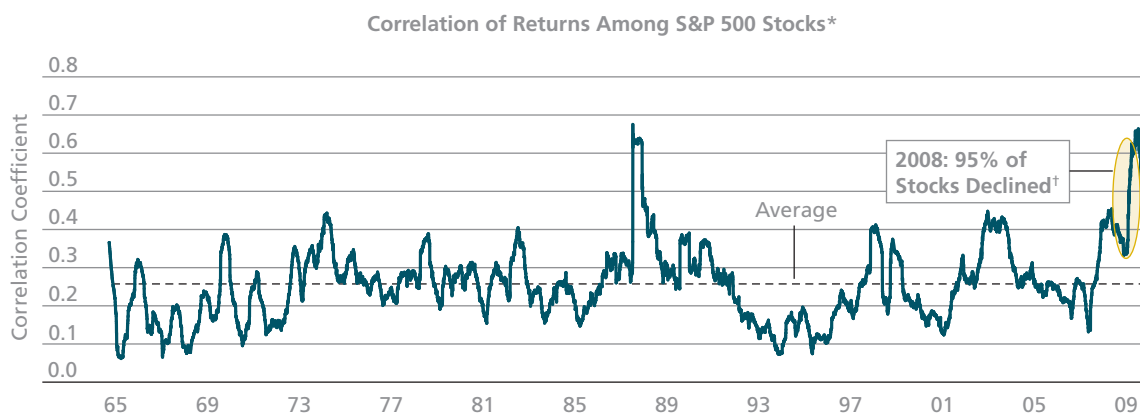
*Developed International Stocks are represented by the Morgan Stanley Capital International (MSCI) capitalization-weighted index of major markets in Europe, Australasia, and the Far East; Emerging Markets by the MSCI Emerging Markets Index; Value Stocks by the Russell 1000 Value Index; and Growth Stocks by the Russell 1000 Growth Index. Source: Morgan Stanley Capital International, Russell Investments, and Standard & Poor's

However, we're confident that these research indicators have not lost their long-term predictive power; indeed, as of early summer 2009, signs continue to emerge that research markers are once again pointing in the right directions. For one, as *Display 2* shows, correlations among S&P 500 stocks fell dramatically in early 2009—not yet to normal levels, but enough to suggest that investors were once again discriminating among stocks.

With stock selection beginning to count again, buy and sell decisions were being made in line with traditional value and growth metrics; in other words, research may be beginning to work once again. This is not surprising,

Display 2

Almost all stocks moved in tandem last year—downward—but marched less in lockstep by mid-2009



*Through May 31, 2009; correlations based on daily returns over six-month rolling periods

†Reflects the 465 companies that were in the S&P 500 for the entirety of 2008

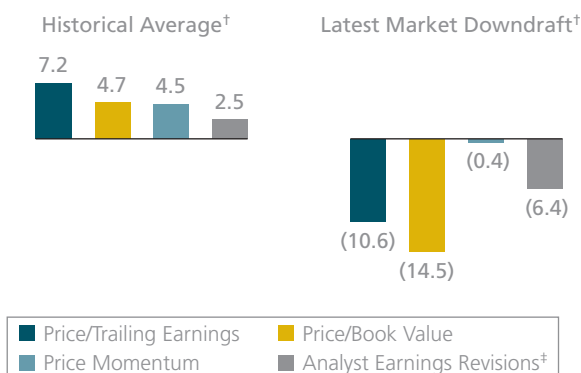
Source: Compustat and AllianceBernstein

because extremes always breed countervailing forces. Although economic signals remained mixed in the first half of 2009, evidence of improvement registered in certain credit, consumer, and inventory indicators, and even in some manufacturing and housing numbers.

Display 3

Both value and growth factors failed in the crisis

Relative Returns by Traditional Valuation Metrics*
(Percentage Points)



*The difference in return of the top 20% of stocks in Bernstein’s US large-capitalization universe versus the universe as a whole

†Historical Average covers the period from January 1971 through October 2008; Latest Market Downturn is the period from November 2007 through October 2008.

‡Data begin in 1988.

Source: AllianceBernstein

Meanwhile, signs—admittedly tentative—emerged that some of the companies most damaged in the financial crisis might be healing. We see the groundwork laid for recovery in the global economy in the latter half of 2009, albeit not robust growth. But after the meltdown of 2008, even a slower rate of decline in key indicators may be enough to give investors some courage (see “Is the Payoff Under Way?” on page 12).

Walking the Line

Still, we’re not calling an economic or market bottom. While we’re hopeful, we remain cautious. Indeed, we’ve adjusted our research disciplines to pay even more attention to risk. For example, as we consider the global array of value and growth opportunities we’re seeing among drug and biotech companies, we’re modeling the implications of significant failures in their R&D pipelines and a negative impact from government healthcare reform. For insurance companies, which are large bondholders, we’re stress-testing the earnings effects of corporate bond default levels that haven’t been seen since the Great Depression.

We're adding to our worldwide bank holdings when we find them very cheap relative to long-term earnings power, but we're paying extra attention to their capital strength. And for all economically sensitive industries, we're building into our forecasts unemployment rates above today's high levels.

We've also broadened our cross-industry research, since, in the current environment, trouble in one industry may signal trouble in another in ways we haven't seen historically. Further, we've enriched our tools for timing when we exit positions, which can be just as important as when we buy in, especially for growth stocks: We don't want to hold a company after its outperformance potential has begun to fade.

And so in both the US and internationally, and in both the value and growth domains, we're using research to identify companies that in our judgment have the resilience to withstand hard times if recovery winds up being delayed. Many are in industries that traditionally are less affected by the economy, such as pharmaceuticals and consumer staples like food and household products—items that need to be purchased at all times.

But gradually, we're also buying more stocks with appealing cyclical characteristics—sensitivity to the economy—at a time when economic recovery may arrive sooner rather than later. In fact, in the first six months of 2009, most of the large gain in the global stock markets was posted by cyclical sectors such as materials, technology, and energy.

Strong Balance Sheets, Good Cash Flow

But we still regard our first research task as testing for resiliency. One of the most important signs of strength, particularly in the value domain—which was hardest hit

KEY CONCEPTS

- > The efficacy of research came under fire in the latest vicious bear market, and for good reason: When the great majority of stocks do poorly, identifying attractive investments is impeded by a headwind that is almost impossible to overcome.
- > But periods of extreme distress don't invalidate essential research insights—and indeed tend to sow the seeds of outsized recovery.
- > We're still cautious about the markets and the economy, but we do see some encouraging signs that traditional research metrics may be working again.
- > In an unclear environment, we're balancing our portfolios between companies with the resilience to weather the possibility of further trouble and cyclical companies poised to participate in the eventual turnaround.

in the bear market—is balance-sheet solidity. In the current environment we're reviewing the terms and conditions of each component of a company's debt. We're examining its funding sources for liquidity needs, preferring to see long-maturity obligations rather than short. We're also assessing pension funding, which has become a critical issue. These days, a cash reserve counts for a great deal.

Consider *Display 4, following page*, which compares the average cash and debt positions of each of the five largest sectors in our US Strategic Value portfolio as of the end of the first quarter versus the broad market's. In four of the five sectors, the ratio of cash to debt was much higher than the S&P 500 average. In two sectors, energy and healthcare, our average holding had almost as much cash as debt, and in one, technology, cash overwhelmed debt. Even where cash is usually in plentiful

supply—tech, for example—these ratios are remarkable in the current market. A substantial cash cushion erases or reduces refinancing risk—a key consideration with credit still tight—and provides companies with notable liquidity, which we want in a nervous market.

Display 4

Our holdings tend to have stronger balance sheets than the market as a whole

US Strategic Value: Five Largest Sectors*

Sector	Avg. Cash	Avg. Debt	Cash as % of Debt
Energy	\$ 11.3 Bil.	\$ 13.1 Bil.	86%
Healthcare	10.1	10.5	96
Financials	140.1	233.1	60
Consumer Cyclicals	2.5	13.2	19
Technology	5.3	3.2	166
S&P 500 (Avg.)	\$ 17.9	\$ 42.3	42%

As of March 31, 2009

*Cash and debt averages weighted by position size in the portfolio; sectors are as delineated by the Global Industry Classification Standard. Source: FactSet and AllianceBernstein

But our value strategies are not simply defensive; we've actively responded to events and to stock valuations. For example, at the end of May, the energy sector—whose fortunes have bounced around as oil prices fluctuated—accounted for 18% of our average Strategic Value portfolio. The economic downturn caused the sharpest drop in oil demand in 25 years, but OPEC was quick to react by cutting production. And so while oil fell to about \$35 a barrel at its recent low point, in 2009 to date, prices have moved generally upward—but in a volatile pattern. As of mid-July, oil was in the \$60s. In response to these rapidly shifting sands, our research led us to balance our holdings between integrated oil companies, like ExxonMobil and Chevron, and companies

more directly focused on exploration and production, like Occidental and Devon Energy.

In technology and telecom, which are facing challenges because companies and consumers are loath to spend, our research suggested that investors were underestimating the staying power of dominant players like Nokia in handsets (a 40% market share), Corning in liquid crystal displays (a 56% share), and Symantec in security and storage software, which owns 60% of the market. Nevertheless, our Strategic Value tech holdings were selling at a price/book-value ratio of 2.0x at the end of the first quarter—versus a 10-year average of 7.4x. Extremes like these are untenable; they usually lead to outperformance when they unravel, and it looks as though that process may be beginning to unfold.

One more word: In this unusually volatile and unpredictable market, we're not necessarily emphasizing the very cheapest stocks in our value portfolios. In some cases, we're taking a pass on a seeming bargain if our analysts are concerned about risk; instead, we'll choose a stock that's not quite as compellingly cheap but comes with less potential uncertainty attached. We'll stick with that stance until we're more convinced that the cycle has truly turned.

Opportunities High Across the Board

In the growth domain, there are certain company attributes that can signal resiliency. Often, growth companies do best when the economy turns down, since they may provide products and services that are not as exposed to boom-and-bust fluctuations. In other cases, companies are building market share or expanding globally, or are well positioned to benefit early on from the massive

The specific securities identified and described herein do not represent all of the securities purchased, sold, or recommended for the strategy or the portfolio, and it should not be assumed that investments in the securities identified were or will be profitable. Please note that the specific securities discussed herein may no longer be held within the strategy or portfolio after the date of this publication.

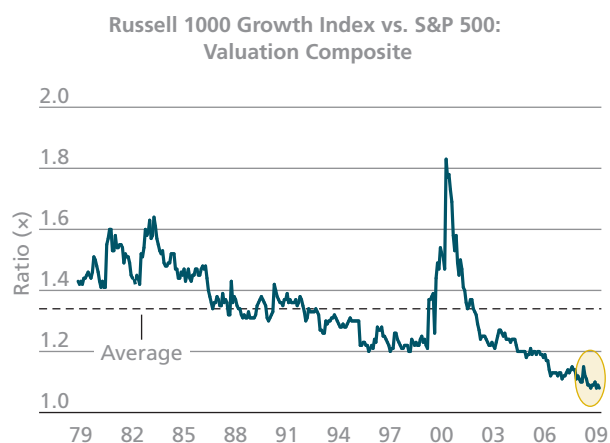
government stimulus programs. The common denominator among all these companies is the wherewithal to keep growing earnings, or to resume growth quickly. In fact, even companies whose earnings *contract less* than the consensus expects are likely to get rewarded—if not immediately, then over time. And just as in value, we’re straddling the fence on the economy, maintaining exposure to both cyclical and relatively insulated industries.

Further, not only does growth often do well in difficult markets, but research, both fundamental and quantitative, can loom even larger—because investor behavior tends to be enmeshed in biases when times are tough. We rely on research to avoid those “emotional traps” as we seek companies that will surprise the market on the upside. Our research has underscored that many household-name growth companies with premier franchises have remained strong in the recent downturn—and are showing signs of getting stronger. Some have traditionally been more stable, in such industries as consumer staples; increasingly, others, in sectors like retail, energy, and even some industrials, are more exposed to economic ups and downs. A number of our companies straddle that divide.

In early 2009, most of these companies shared another characteristic, rare for growth stocks: They’re unusually cheap—not that bargain pricing is our primary criterion for buying growth. But when the US growth universe is barely selling at a premium to the S&P 500 based on a trio of traditional valuation measures (*Display 5*)—even after the market run-up in early 2009—it’s an extra advantage and an indication of the magnitude of the opportunity. Premier growth names have been battered down in price, a phenomenon we don’t often see, and one that bodes well for growth stock returns.

Display 5

Growth stocks are priced at historically low levels



As of May 31, 2009

Composite comprises one-third price to cash flow, one-third forward price to earnings, and one-third price to sales.

Source: Russell Investments, Standard & Poor’s, Thomson First Call, Thomson I/B/E/S, and AllianceBernstein

Putting It All Together: A Global Mix

Armed with this research strength, we’re finding the characteristics we seek in an array of companies around the world. In fact, through these most uncertain of markets we’ve only reinforced, not abandoned, our research and buy/sell disciplines. But we’re looking in two directions at once. The size of the global opportunity suggests embracing *risk*, but the uncertain current environment suggests *restraint*.

Our solution is to invest in high-quality companies across a diverse array of industries and sectors, with a slowly increasing tilt toward cyclicals. Indeed, in financials, especially in the US, we’ve been induced to buy back some of the large names we sold in the downturn, as our analysis convinced us that they’ve negotiated the shoals and are becoming stronger as a result. And we’ve not been afraid to trade somewhat more frequently than usual, as opportunities have emerged quickly worldwide. *Display 6*, following page, details how our approach has played out in a typical global allocation, in both its value and growth components.

Display 6

Our global equity portfolio focuses on both stability and growth

Bernstein Global Stock Portfolio: Top Five Sectors 70% US/25% Developed International/5% Emerging Markets*

Sector	Value Themes	Growth Themes
Financials	Diversified among stable insurance companies and well-capitalized banks and investment banks, all still extremely cheap due to investor anxiety	Building exposure to dominant companies benefiting from increased capital markets activity at a time when weaker competitors have fallen away
Technology	Strong balance sheets; segment leaders	Dominant share driven by product innovation
Energy	With oil prices volatile, resilient integrated energy companies and exploration/production specialists	Oil-services companies positioned to benefit from economic recovery
Healthcare	Pharmaceuticals: cash-rich; stock prices low even after factoring in industry pressures	Biotech: pricing power, strong cash flow, cutting-edge technology
Consumer Discretionary (Nonessential Products)	Very depressed stock prices understate earnings power of industry leaders	Emphasis on companies gaining market share during downturn, hence well positioned whether recovery comes early or later

As of June 30, 2009

*Global Stock Portfolio is represented by 35% US Strategic Value, 35% US Strategic Growth, 25% Bernstein Tax-Managed International, and 5% Bernstein Emerging Markets. Based on an average US Strategic Value and a representative US Strategic Growth account; individual accounts may vary. Holdings of the Bernstein Tax-Managed International and Bernstein Emerging Markets asset classes are pooled investment vehicles organized under the Investment Company Act of 1940, as amended, managed by AllianceBernstein L.P.

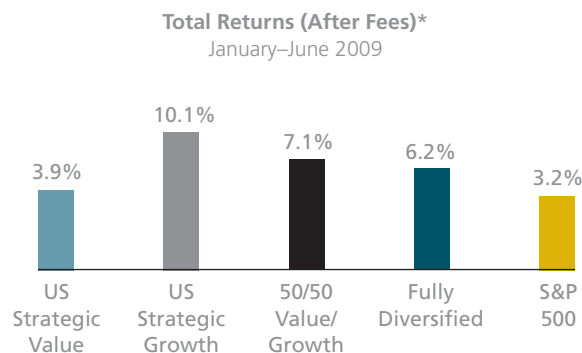
Source: AllianceBernstein

Is the Payoff Under Way?

In fact, after a calamitous market in 2008, we're encouraged that our fundamental investing approach may have started to bear fruit in 2009, as key portfolios outperformed the broad market over the first half of the year (*Display 7*). We're aware that six months of returns tell us little. But the economy appears to be doing better, most earnings are beating today's low consensus expectations, and the capital markets are showing some signs of thawing as investors take on more risk. Still, signals are mixed, and improvements are coming in fits and starts. Research, more than ever, is the necessary partner for investing success. ■

Display 7

Have the clouds lifted? We're cautious—but encouraged by results so far this year



Past performance does not guarantee future results.

*The performance of the 50/50 US Strategic Value/US Strategic Growth Blended Simulation and of the Fully Diversified Simulation (for taxable accounts) is presented for illustrative purposes only. The results shown are hypothetical because they do not represent the performance of actual managed accounts, and may not reflect the impact that certain material economic and market factors may have had on actual decision making. No representation is being made that an investor will or is likely to achieve results similar to those shown. The Fully Diversified Simulation comprises 55% global growth and value stocks, 35% municipal bonds, and 10% real estate investment trusts (REITs). See Notes on Performance Statistics on pages 34–35 for additional information.

Source: Standard & Poor's and AllianceBernstein

HOW SAFE ARE MUNICIPAL BONDS TODAY?

One of the key functions of a municipal bond allocation is to preserve capital. But the current difficult economic environment may mean lower state tax revenues for some time—and many are worried about the safety of these investments. We analyzed how municipalities have negotiated both up and down economic cycles in the past for perspective on the safety of municipal bonds.

June 30 marked the end of most state and local governments' fiscal year, and almost all of them had to struggle to balance their budgets. Although many made midyear budget adjustments last winter in an effort to close the gaps, since then the economy has contracted further, creating significant shortfalls for the 2009 fiscal year and widening budget gaps for years to come.

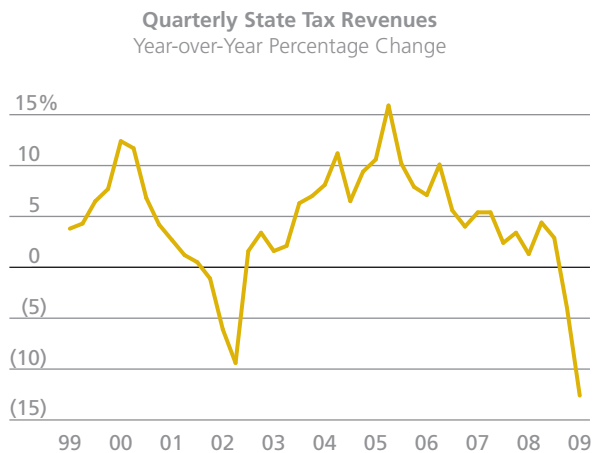
Nominal GDP shrank at an annual rate of 3.5% during the first three months of 2009. Not surprisingly, state tax revenues also fell sharply: Personal income tax receipts dropped an average of 15.8%, according to the Rockefeller Institute, while corporate and sales tax receipts fell 16.2% and 7.6%, respectively. Since January, state treasuries have taken in millions less than expected, and today, collectively, the finances of state and local governments are the worst they've been since the Great Depression (*Display 1*).

Reserves Are the First Line of Defense

Although the extent of the shortfall is unusual, shortfalls are not unprecedented—tax revenues have always fluctuated along with swings in the economic cycle. In response, budget officials have traditionally built up reserves, or rainy-day funds, during boom times to help get through the lean years.

Display 1

States and municipalities face plunging revenues



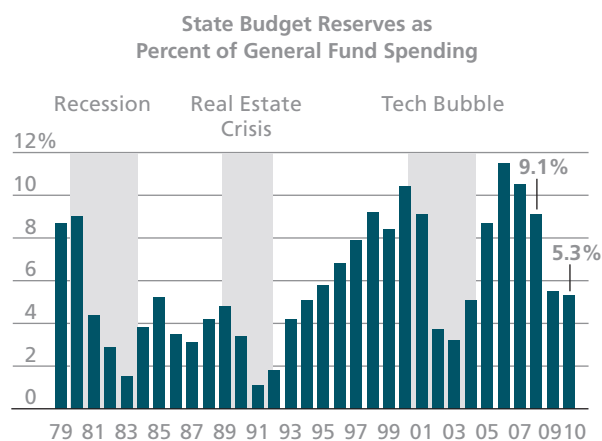
Through March 31, 2009

Nominal percentage change for personal income, sales, and corporate income taxes; first quarter 2009 data are preliminary.

Source: Nelson A. Rockefeller Institute of Government and AllianceBernstein

As of summer 2008, average state reserves were 9.1% of general fund spending—which is relatively high historically (*Display 2, following page*). States have had high reserves coming into previous downturns—like the bursting of the Internet bubble in the early part of this decade—and turned to these reserves as their first line of defense to remedy shortfalls. Today, once again states have been tapping their rainy-day funds to get by, although most states have substantially depleted their reserve funds at this point, and reserve spending represents only 5.3% of projected budgets for 2010.

States will draw on their reserve funds



Data for fiscal year 2009 are estimates, and data for fiscal year 2010 reflect proposed budgets.

Source: National Association of State Budget Officers and AllianceBernstein

Budgets Will Be Balanced (with a Little Help from Washington)

Almost all state and local governments are required by their constitutions or charters to pass balanced budgets, and just as the magnitude of municipalities’ problems varies, so do the solutions. While reserves are indeed a critical part of the tool kit available to municipal issuers, state and local government officials have recourse to other actions to address their imbalances.

Many states and municipalities are raising taxes—whether sales, corporate, income, property, or excise taxes—to help cover their shortfalls. New Jersey increased income taxes, and Massachusetts increased its sales tax; New York City increased property and sales taxes. States are also taking steps to rein in spending: The average projected budgeted state expenditures for fiscal year 2009 declined 2.2%, the first decrease in 25 years; spending is expected to decline again in 2010. Cities and states are not only cutting services such as libraries, sanitation pickup, and recreation programs, they’re also reducing their workforces and employee

costs through wage and salary freezes and benefit reductions. In addition, many are raising fees and taxes: Parking permit fees in Chicago and animal-shelter fees in Los Angeles will go up, and 16 states are raising cigarette taxes.

Further, states are receiving help via the American Recovery and Reinvestment Act of 2009. Although much of the \$787 billion stimulus package will support federal tax cuts, infrastructure funding, and other aid that will not directly subsidize the budgets of state and local governments, we estimate that \$177 billion of the overall total will go toward operating aid, which will directly help close state and local governments’ budget gaps.

The bulk of the operating support is made up of two major funding programs: \$87 billion over nine quarterly time periods will assist states with Medicaid funding, and \$54 billion is earmarked for “state fiscal stabilization” funding, of which \$45 billion is allocated for education and \$9 billion for flexible assistance. An additional \$25 billion is slated for education, \$4 billion for crime prevention, and \$7 billion for miscellaneous programs.

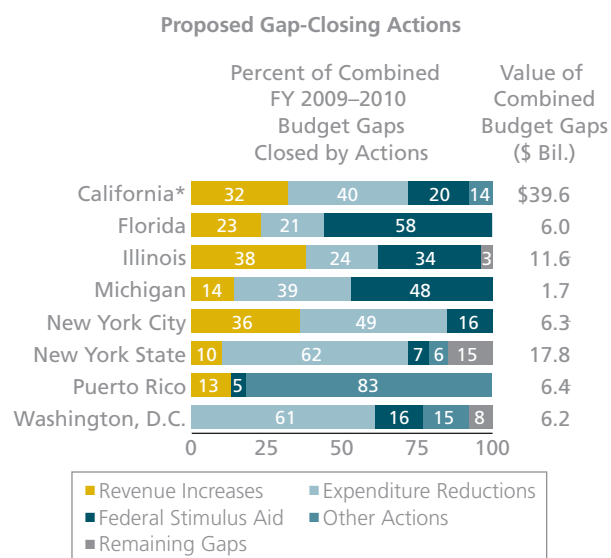
Although the act does not provide sufficient aid to completely remedy the budget shortfalls of state and local governments, it goes a long way toward eliminating some of the spending cuts and tax increases that would have been necessary to balance state and local budgets. For example, the state of California, which faced a midyear \$42 billion budget gap and then another \$26 billion gap for fiscal year 2010, will receive approximately \$17 billion in Medicaid and fiscal stabilization funding under the act. New York State, which confronted a \$17.9 billion shortfall for fiscal year 2010, should be receiving approximately \$10.6 billion of direct aid between fiscal years 2009 and 2011 (although a portion of New York State’s Medicaid aid must be shared with

New York counties since they contribute to Medicaid funding). Puerto Rico, which faced a \$3.2 billion structural budget gap, is slated to receive almost \$800 million in assistance.

Compelled by the current crisis, elected officials have been taking the necessary steps to deal with their financial obligations proactively. As shown in *Display 3*, key cities and states are making use of a range of plans that, in most cases, should close 100% of their combined fiscal years 2009–2010 budget gaps.

Display 3

Municipalities are taking corrective action



As of March 27, 2009; sums may exceed 100% due to rounding.
 *The sum of California percentages exceeds 100% because the state took action to create a large reserve in addition to closing the projected budget gap.
 Source: Nelson A. Rockefeller Institute of Government and AllianceBernstein

Municipal Bonds Rarely Default

History bears out the fact that most municipalities have successfully met their obligations. We analyzed municipal bond default rates from 1970 through 2006, focusing specifically on the percentage of bonds that defaulted at least once over any 10-year period, and found that the 10-year cumulative default rate is a

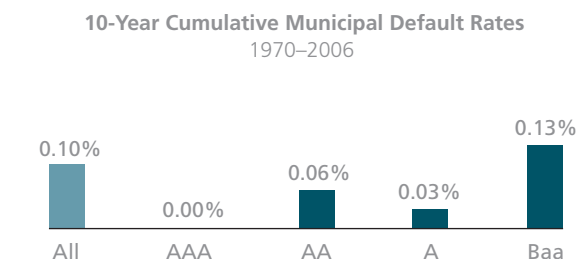
KEY CONCEPTS

- > States and municipalities are facing difficulties, but they are taking corrective actions to balance their budgets.
- > The federal government’s stimulus package is providing support, giving states and municipalities time to adjust their plans.
- > History has shown that municipal bonds rarely default, and we believe they are sound investments today.

meager 0.10% (*Display 4*). And if we look only at municipal bonds rated A or higher, the default rate is minuscule. Municipal bonds almost never default.

Display 4

Municipal bonds rarely default

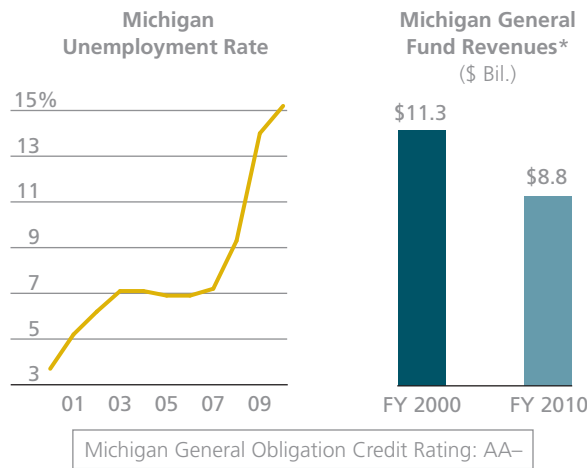


Source: Moody’s Investors Service and AllianceBernstein

The case of Michigan—a state that has faced protracted financial difficulties but has never defaulted on a municipal bond—helps illustrate why such defaults are so very rare. Michigan has lost more than 400,000 jobs since the beginning of the decade, and its unemployment rate has risen from 3.7% in 2000 to approximately 15.2% as of June (*Display 5, following page*). Personal income growth is among the lowest in the country, and home foreclosures are among the highest, particularly in the Detroit metropolitan area, where one in every 66 homes is in foreclosure and where

Display 5

Michigan has remained solvent, despite the odds



*FY 2000 budget is inflated to today's dollars using the US Bureau of Labor Statistics Consumer Price Index Inflation Calculator.
 Source: Michigan Labor Market Information, Michigan Office of the State Budget—Executive Budgets, US Bureau of Labor Statistics, and AllianceBernstein

homeowners are unlikely to have experienced any market appreciation unless they bought their homes more than 10 years ago.

Stagnant revenue reinforces the generally bleak economic picture. From fiscal year 2000 to fiscal year 2010, after adjusting for inflation, general fund revenues fell 22%, according to the Michigan Office of the State Budget and our estimates. Nevertheless—and this is the key point—Michigan balanced its budget every year and is rated double-A minus today. The state has diligently responded to forecasted revenue declines by controlling spending growth and raising taxes when necessary. Balancing budgets is difficult during deep recessions, but Michigan has shown that it can be done.

Recovery Rates Were High in the Great Depression

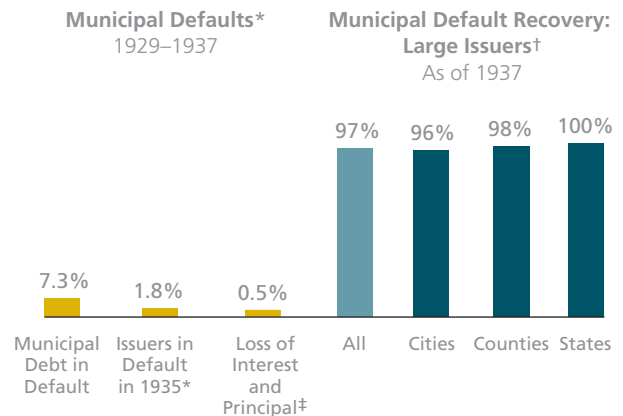
Although municipals have been safe over the last 40 years, the last 20 months have shown that the unexpected can occur. What if the economic recovery happens very slowly or the

economy suddenly gets much worse? We turned to the most stressful economic climate of the past 80 years—the Great Depression—for perspective on how difficult things could get.

Even during the Great Depression (1929–1937), municipalities maintained a remarkable record of paying their debt. Just 7.3% of all the municipal bonds outstanding technically defaulted—meaning they didn't make interest payments and repay principal *on time* (Display 6). And in the worst year for municipal defaults—1935—only 1.8% of municipalities were in default. But technical default doesn't mean investors never got their money back.

Display 6

During the Depression, municipal defaults were low and recovery rates were high



*Although total debt of defaulted issuers is calculated to be 15.3%, that percentage reflects the entire debt of any issuer in default, even if only a portion of a given issuer's debt was actually in default. Municipal Debt in Default reflects only those portions of all issuers' debt that were in default.
 †Cities, school districts, and other districts with over 25,000 in population and counties with over 100,000 in population
 ‡These data reflect debt from 1929 through 1937 as the percent of average debt outstanding over that period.
 Source: George H. Hempel, "The Postwar Quality of Municipal Bonds" (doctoral dissertation, University of Michigan, 1964) and AllianceBernstein

Since cities and states don't just disappear, they eventually address their budget problems. And as they do, they begin to pay investors back. By 1937, practically all the defaults had been

cured, and the average recovery rate at that point was 97% (stated conversely, a 3% loss). In fact, what investors actually lost turned out to be quite small: With 7.3% of the bonds outstanding in default over the whole period and an average loss of 3% in each default, the payments that were never recovered during the Great Depression represented only 0.48% of all outstanding municipal debt. Thus, even during the Great Depression, municipal bonds turned out to be a safe investment. The few issuers that remained in default continued to work on curing their defaults well into the 1940s.

Municipals Performed Well During the Depression

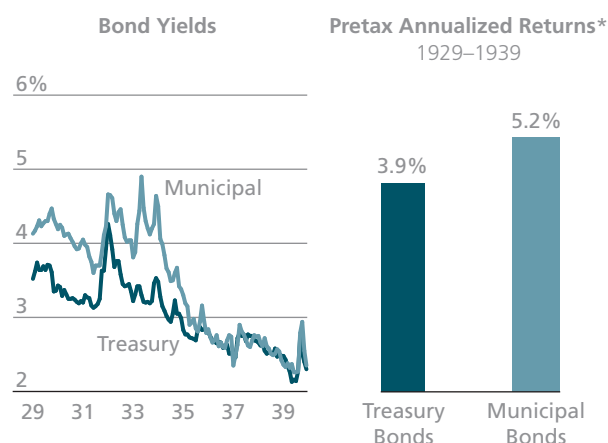
The Depression era establishes another reference point: municipal bond returns. As has recently been the case, municipal yields were higher than Treasury yields, presumably because investors wanted the safety of Treasuries (*Display 7, left*). This was particularly the case from 1931 through 1933, when municipal finances were in disarray and defaults were on the rise. But municipal bonds outperformed Treasuries during the Depression by a considerable amount (*Display 7, right*), even before taxes! Further, this calculation takes into account losses due to municipal defaults.

We learned three key lessons from our study of the Great Depression, and we've applied them to the current management of our bond portfolios:

- > No specific type of municipal issuer was immune to budget problems, although large issuers fared better because they had more resources to address their shortfalls and were able to cure defaults more quickly.
- > Issuers with low debt ratios fared best.
- > All municipal issuers had financial trouble, so investors were wise to diversify their municipal holdings.

Display 7

Municipals performed well during the Depression era



*Municipal returns are calculated from yield estimates for 20-year bonds with a Aa credit rating.

Source: *The Bond Buyer*; George H. Hempel, "The Postwar Quality of Municipal Bonds" (doctoral dissertation, University of Michigan, 1964); US Treasury Department; and AllianceBernstein

Municipal Bonds Have Weathered Severe Storms

The record of history shows that state and local governments have been very resourceful in addressing their fiscal difficulties. As a result, there have been very few defaults in the municipal market. And when traditional municipal issuers have defaulted, the recovery rate has been extremely high.

Municipal issuers today are facing tough times, but state and local governments have the resources to confront them. Although governors and legislators have been forced to make difficult decisions in crafting their austerity budgets this year, most budgets have been passed. Our research team will be analyzing the assumptions that were used to achieve balance to see if they are reasonable. Further, if the economy recovers later this year, the financial positions of many state and local governments are likely to improve. And it's possible they could improve significantly, since most municipal issuers will have balanced their budgets using conservative assumptions concerning economic growth in fiscal year 2010.

(continued, page 20)

A CLOSER LOOK: HURDLES ARE NOT INSURMOUNTABLE FOR SOME OF THE NATION'S LARGEST MUNICIPAL BOND ISSUERS

Amid Financial Difficulties, California Has Passed a Budget

Over the last 10 years, California's economy has been twice as volatile as the national economy due to its leading role in the technology and housing bubbles. Today, while almost every state has been experiencing some financial pressure, none approaches the magnitude of California's or the degree of difficulty in addressing those imbalances. On February 20, Governor Schwarzenegger signed a midyear budget plan to address a projected \$42 billion shortfall for what remained of fiscal year 2009 and for fiscal year 2010, which began July 1. But the state economy continued to deteriorate; in the May 19 special election, voters rejected the \$6 billion in budget measures aimed at keeping the state solvent, and a new budget gap totaling \$24 billion emerged. With a budget of \$92 billion, a gap of \$24 billion is a very large problem.

Both the governor and the legislative leaders have been fully aware of the magnitude of the state's financial problems and agreed that cuts were necessary; most of the \$24 billion in budget balancing solutions that Governor Schwarzenegger proposed were spending reductions. But those recommendations included eliminating programs that the Democratic-controlled legislature backed. As this goes to press, the governor and legislative leaders have agreed to a new budget; it relies on a combination of spending cuts, revenue enhancements, and a number of one-time measures. Although it will provide some immediate relief, it does not address the state's structural budget problems.

During the time that California was without a budget, the state controller started conserving the state's cash by issuing IOUs to ensure that sufficient monies remain available to make public education and debt service payments when due—the state's top two funding priorities under the state constitution. Conserving cash has in fact occurred on several occasions over the past 25 years, most recently earlier this year. Faced with a cash crunch in January and February, the state controller delayed income tax refunds and vendor payments and halted certain public works projects to conserve cash to pay public school aid and debt service.

The commitment to payment of debt is a point that state officials continue to make to investors. In addition, continued access to the public credit markets depends on a clean record of repayment of outstanding debt, and without market access, the state would be unable to obtain funding for its critical program of capital investments. The state has often demonstrated its commitment to honoring its debt obligations—even during periods of major budgetary and cash challenges—as it did in January and February. We believe that California will honor its debt obligations and continue to do whatever it takes to ensure timely debt repayment.

With another round of state aid cuts and payment deferrals, it will be a tough year for California schools, cities, and counties. And with their own revenues falling and their inability to easily raise taxes, they too have had to reformulate their budgets. A number of such entities are likely to see their bond ratings fall, especially if they can't reduce their expenses in

a timely way or don't have adequate reserves. Others have adequate reserves to tide them over and have shown a willingness to make needed budget cuts.

The state of California will continue to face significant financial challenges requiring further action. We don't expect any missed principal or coupon payments in the months ahead. However, maintaining a balanced budget in future years will continue to be a difficult, fractious process. Because of this, we have built California portfolios that are well insulated from California's financial challenges.

New York State and New York City Are Also Under Pressure

New York State has been hard-hit by the recession. For some time we have been concerned about the state's optimistic tax revenue assumptions and budget practices, which routinely allowed spending to exceed inflation. However, the enacted fiscal year 2010 budget effectively closes the gaps largely through a combination of spending reductions, federal stimulus aid, and tax increases. While the state's financial difficulties are considerable, it has weathered similar challenges before.

The carnage on Wall Street has presented New York City with a budget-balancing challenge as tax revenues decline and job losses mount. Fortunately, when city officials crafted the current budget, they anticipated a Wall Street slowdown and a declining housing market. Although these estimates were optimistic, the fact that the city had already forecast difficult times ahead put it in a better position to deal with the financial crisis.

Mayor Bloomberg has been aggressively addressing the rapidly declining economy. In September of 2008 he mandated \$1.5 billion in spending cuts—\$500 million for the current fiscal year and \$1 billion for next fiscal year.

Significant additional budget cuts were called for in November and December. The mayor and the city council repealed the 7% property tax rate reduction implemented last year, which raised revenues by \$576 million for fiscal year 2009 and \$1.2 billion for fiscal year 2010.

New York City's fiscal year 2010 budget, adopted in June, closed a \$6.9 billion budget gap through various measures, including spending reductions and revenue enhancements. However, some of the proposed budget solutions required state legislative approval, which caused them to be delayed for a month while the state senate was in gridlock. The delay in enacting the city's proposed 0.5% increase in the sales tax rate cost the city \$60 million in lost tax revenues. However, we expect that the city's \$879 million overall tax revenue package will be enacted.

Given the city's long track record of taking aggressive action to resolve its fiscal problems, its conservative budgeting, and its swift response to the turmoil on Wall Street, its willingness or ability to address the current challenges in a timely and effective manner is clear. This knowledge alone is enough to make us comfortable buying New York City general obligation bonds (GOs).

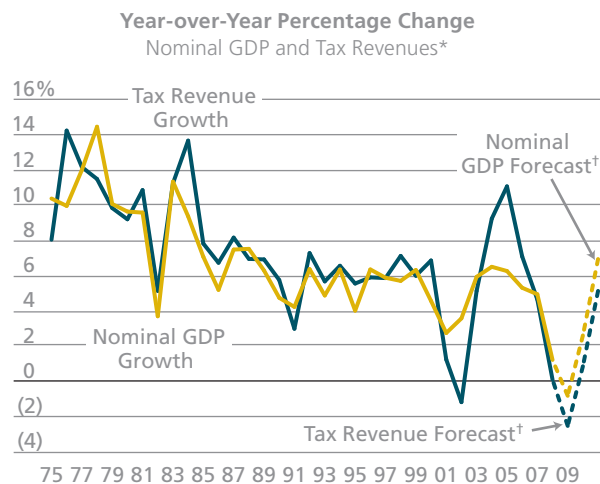
But, as with California, investors in New York City GOs are afforded some additional protections. In fact, a mechanism dating back to the fiscal crisis of the 1970s remains in place: Property taxes are diverted into a lockbox under the control of the New York State comptroller, who pays debt service on city general obligation bonds and only then returns any balance of these tax revenues to the city. The fact that property tax revenues are almost four times larger than debt service payments today virtually ensures continued payment of general obligation debt service.

As one would expect, tax receipts are highly correlated with economic growth (*Display 8*), and if we see an economic recovery, tax receipts should rebound as well.

We believe municipals remain a safe asset class, as the vast majority of issuers will pay their debts. Investors will recognize that fact eventually. But disruptions in the municipal markets—especially on the order of those that occurred last fall—have proven to be opportunities: At the end of December, municipal yields were higher than Treasury yields as investors sought out only the very safest bonds, a reversal of the normal relationship. In our view, those managers seeking to ensure the safety of their municipal portfolios must be well armed with research that can identify which issuers to value and which to avoid when building portfolios that are diverse and high quality. ■

Display 8

State and local tax revenues are closely linked to economic growth



*Nominal percentage change for state and local tax collections (excluding property taxes); data for 1Q:2009 through 2Q:2010 are forecasts. Forecasts may not be realized.

†AllianceBernstein forecasts

Source: Bureau of Economic Analysis and AllianceBernstein

INVESTMENT PLANNING IN TURBULENT TIMES: DEFINING A COURSE OF ACTION

Investment plans should last a lifetime and be built conservatively enough to endure extreme market swings—but plans should also be flexible so investors can adjust them. Having a clear, quantifiable view of the potential impact of any changes they’re considering is critical to making informed decisions.

Financial Planning After the 100-Year Flood

Two thousand eight will go down in the annals of investing as a historic year: Based on history, single-year market declines on the order of 40% have a mathematical likelihood of occurring just once a century. In the wake of this 100-year flood, many are rethinking their financial plans. Their questions include:

- > Should I go to cash?
- > Should I move to a more conservative allocation?
- > Do I need to cut spending?
- > Will I recover from this, and when?

We looked at answering some of these questions using our quantitative tool set, always with an eye to identifying the near- and longer-term implications any actions would likely have on an investor’s ability to achieve his full range of financial objectives. Our research showed that:

- > Historically, market rebounds have enabled portfolio values to climb back relatively quickly from prior losses, so it’s important to first assess where you stand today versus your original plan, as well as the consequences of any changes.

- > Going to cash or shifting to a more conservative allocation reduces portfolio volatility but will protract the time required to recover the plan’s forecasted wealth trajectory—and it could even preempt recovery altogether.
- > One interim step that can help provide some peace of mind without causing as much drag on a portfolio’s ability to grow toward recovery would be to set aside the equivalent of two years’ worth of spending in cash or short-term bonds, while keeping the remainder of the portfolio at its prior allocation.
- > For many investors, recovery could be accelerated by even a temporary cut in spending.

Investment plans are meant to last a lifetime, but they can be adjusted over time. In other words, investors have choices. In this analysis we examine those choices in light of historical example and against the modeled outcomes of our proprietary Wealth Forecasting System.¹

Core Capital and the Lifelong Portfolio

At Bernstein, our planning framework is built upon the notion of “core” capital. Core capital is the amount of money we estimate an investor will need at any point in the future to cover his personal spending for as long as he (and his spouse) may live. Since investors must meet their core needs even in dismal

¹ See page 36 for further information.

markets, we model their estimated core capital conservatively, stress-testing it against particularly difficult markets and high inflation and focusing on results at the 90% confidence level in our Wealth Forecasting System. We do this to ensure that an investor will be able to maintain his spending in real dollars—after inflation—and in bleak capital markets scenarios (see “Modeling with Confidence” on page 25).

The diagonally descending line in *Display 1* schematically represents an investor’s core capital. The line declines because, over time, the years of spending we need to support also decline. Having wealth greater than the estimated core portfolio at any point in time provides comfort—the investor has more than enough; having less may provoke anxiety. But the actual level of the portfolio over time will inevitably fluctuate above and below the core capital line, as markets shift. If the portfolio were to fall significantly below the core line and remain below it for an extended period of time, the investor would face a real risk of not achieving his goals. That’s why we emphasize regular reviews of the plan: Understanding where an investor’s actual wealth stands versus the plan at any point in time (and assessing the need for adjustments throughout the life of the plan) are critical to safeguarding the investor’s ability to meet his lifelong goals.

Display 1

Defining “core” capital is critical to charting a lifelong financial path

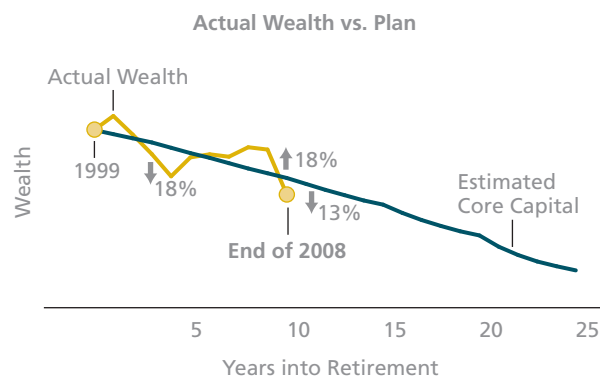


Source: AllianceBernstein

As an example, consider an investor who retired at the end of 1998 at 60 years of age with a core portfolio that was valued at exactly the level he required to support his needs over his expected 25-year time horizon. He had no surplus and no additional sources of income, so as 1999 dawned he began drawing from his portfolio, consisting of 60% equities and 40% bonds, to support his spending (*Display 2*).

Display 2

The path of actual wealth fluctuates around the projected core line



Past performance does not guarantee future results.

Core capital and actual results calculations are based on an allocation of 60% global stocks (35% US value, 35% US growth, 25% developed international, and 5% emerging markets) and 40% intermediate-duration municipal bonds. Analysis assumes spending is 4.1% of initial portfolio value, adjusted annually for inflation.

See Notes on Wealth Forecasting and Actual Results vs. Core Capital on page 36 for further details. Based on Bernstein’s estimates of the range of returns for the applicable capital markets over the periods analyzed.

Source: Lipper, Morgan Stanley Capital International (MSCI), Standard & Poor’s, US Bureau of Labor Statistics, and AllianceBernstein

After enjoying a brief tailwind, he pretty quickly encountered the bust in technology shares and the recession that followed. At that point, the portfolio was 18% below his original plan. Taking stock of that loss, he may have wondered, as many are wondering today, whether he could ever recover. Did he need to overhaul a plan that had been built to last his lifetime after just three years? Let’s say he decided not to make any changes—to either his allocation or his spending.

Well, robust equity returns during the next few years not only completely restored his portfolio but went on to add to it, exceeding his core needs and affording him a substantial degree of comfort nine years later. Then in a flash, the financial crisis drove the portfolio 13% below his core line as of the end of 2008.

Start with the Facts: Quantify Actual Wealth vs. Estimated Core Capital

This sort of variability in the relationship between actual and projected wealth over time is not unusual. But investors today all feel as though their long-term plans are at risk, and in response to this worry, many are considering making profound changes to their plans—changes that may not be necessary or that may actually be detrimental to their long-term objectives.

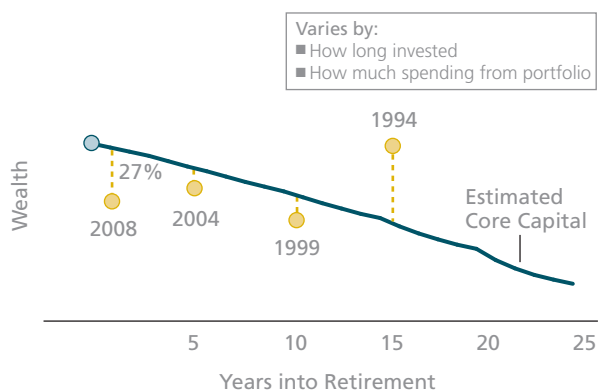
No two investors face the same situation. Where anyone stands relative to his plan's original trajectory is determined chiefly by the start date of the investment and by whether and how much the investor is drawing from his investment portfolio to support his spending (*Display 3*). In the most extreme case, someone who retired at the start of 2008 faces a difficult set of circumstances. He's about 27% below his needed core today and may feel the need to take some action now to regain confidence in his plan. A 2004 investor five years into retirement is quite close to plan and may feel secure enough to wait until a full market cycle has run its course before taking action. And someone who retired in 1994 is today dramatically ahead of his number, thanks to the bull markets of the 1990s, which lifted his wealth well above the level required to support his lifetime spending.

KEY CONCEPTS

- > Historically, market rebounds have enabled portfolio values to climb back relatively quickly from prior losses, so investors should first assess where they stand today versus their original plan, as well as the consequences of any changes.
- > Going to cash or shifting out of equities reduces portfolio volatility, but it also protracts and may even preempt recovery.
- > For many investors, recovery could be accelerated by even a temporary cut in spending.
- > In an environment of heightened volatility, investors need to find the right balance between their long-term return goals and their tolerance for risk.

Display 3

Each investor faces a different situation



Past performance does not guarantee future results.

Core capital and actual results calculations are based on an allocation of 60% global stocks (35% US value, 35% US growth, 25% developed international, and 5% emerging markets) and 40% intermediate-duration municipal bonds. Analysis assumes spending is 4.1% of initial portfolio value, adjusted annually for inflation.

See Notes on Wealth Forecasting and Actual Results vs. Core Capital on page 36 for further details. Based on Bernstein's estimates of the range of returns for the applicable capital markets over the periods analyzed.

Source: Lipper, MSCI, Standard & Poor's, US Bureau of Labor Statistics, and AllianceBernstein

Taking Control: The Role of Spending

Only after quantifying where an investor stands relative to his plan can we properly evaluate what actions—if any—are appropriate to consider taking. One of the more efficacious steps that many are evaluating today is cutting spending. There is virtually no one who hasn't reassessed his expenses in this environment—it's evident in the global slowdown in consumer spending that is part of the current macro environment. Still, it can be a hard thing to do, even if the change in spending is temporary. However, it's the one variable that has a guaranteed impact on the pace of recovery. Therefore, obtaining a clear, quantifiable view of the impact spending changes can have is critical to making informed decisions—and to preventing an investor from making unnecessarily draconian changes.

For purposes of illustration, consider an investor with a \$1 million portfolio. (Note that the amount of money and the duration of the analysis can be scaled up or down to suit any individual situation, and the ending wealth values would scale along with it.) In this example we assume the investor has an annual spending rate of 5%, or \$50,000 per million dollars, grown with inflation over the next 20 years, and a portfolio diversified 60% in global stocks and 40% in bonds. Further, for the purpose of our analysis, we assume that all the spending is coming out of the investment portfolio—in other words, there are no other sources of income.

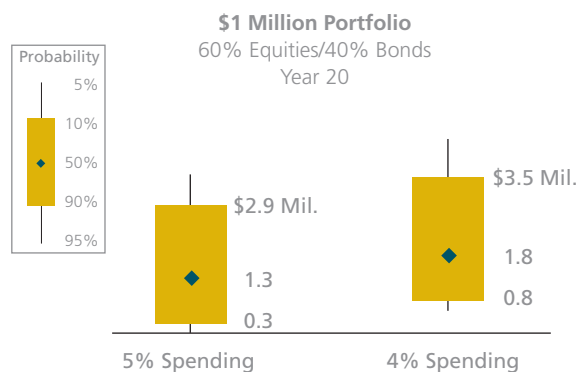
In *Display 4*, we illustrate how our quantitative model values this investor's core portfolio 20 years into the future under two different spending scenarios: maintaining 5% per year versus reducing the annual spending rate to 4% (or \$40,000). The diamond in the middle of each box represents the expected wealth outcome in typical markets. But remember,

we advise our clients to plan based on a more conservative estimate of future market results, and we therefore tend to focus on the bottom of the box. That's the 90th percentile result, illustrating the likely outcome if poor markets persist over the course of the plan. If the bottom of the box is above zero, the investor has been able to meet his annual spending goal for the next 20 years, even when poor market results are projected over that period.

As the display shows, there is a reasonable chance—the median result—that at the end of 20 years this investor's portfolio value would be higher than it is today under either spending scenario. But again, focus on the bottom of the box at the amount of money that would remain if difficult market conditions prevailed over the next 20 years. Spending 5% would likely result in an ending value of \$300,000, meaning the investor has successfully maintained his spending in each of the 20 years and still has some left over. Whether that is “enough” is

Display 4

A reduction in spending can accelerate the recovery to core



Returns are quoted in nominal terms, after taxes. Spending is grown with inflation. Based on Bernstein's estimates of the range of returns for the applicable capital markets over the periods analyzed and on simulations with capital markets conditions as of December 31, 2008. Data do not represent past performance and are not a promise of actual future results. See Notes on Wealth Forecasting and Actual Results vs. Core Capital on page 36 for further details. Equities are invested 35% US value, 35% US growth, 25% developed international, and 5% emerging markets. Bonds are intermediate-duration municipal bonds. Source: AllianceBernstein

Modeling with Confidence

Some may feel that applying a 90% confidence standard to gauge their core capital amount may not be conservative enough, particularly given last year's market decline. But there is an important trade-off between managing the risk of running out of money and the risk of unnecessarily crimping an investor's budget.

At Bernstein, we explore the implications of such trade-offs analytically through our Wealth Forecasting System, which projects the behavior of various asset classes over time based on their historical performance patterns. We use this modeling tool to evaluate how various asset allocations (and spending rates) may perform over different time horizons, generating projections for 10,000 market scenarios ranging from the superior (10% confidence) to the dismal (90% confidence).

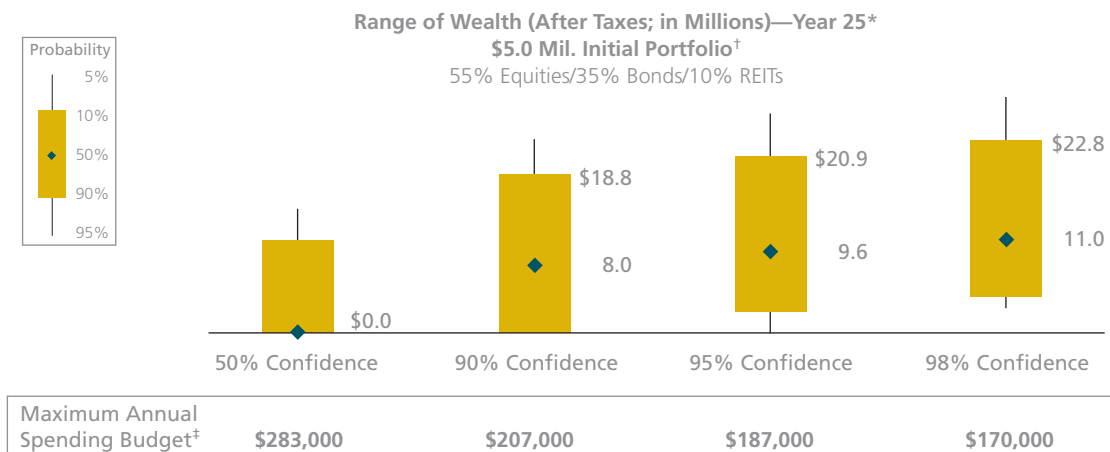
For example, let's look at the expected wealth 25 years into the future for a 60-year-old couple retiring with a \$5 million portfolio, along with a range of annual budgets determined by applying different planning standards. On the left, we built a plan based on a 50% confidence level in future markets. In this median case, the couple could sustain a spending rate of \$283,000 a year (grown with inflation) through year 25, at which point they would run out. But if we apply

a more conservative outlook to future market returns, using a 90% standard as the guideline, the planned spending becomes much more modest—\$207,000 annually (about 30% less). And there is an important side effect to spending at the 90% confidence level: If those typical market forecasts come true and median market returns are realized, the couple would also likely have an estate of \$8 million at the end of year 25.

We can be more conservative still in our planning: Applying an even stricter standard of 95% would dictate an annual budget of \$20,000 less each year, whereas a 98% threshold would permit a much more parsimonious annual budget of only \$170,000. Again, should median markets ensue, by year 25 the couple's remaining estate would have grown substantially.

While we believe it is reasonably conservative to model a family's spending along with the estimated core capital to support it at the 90% confidence level, the plan still needs to be reviewed regularly, because client circumstances—and market circumstances—change. The benefit of our quantitative approach is that it allows us to adjust a plan to any level of confidence that a client wishes, lay out the options, and help clients make the choice that's best for them.

90% confidence is a conservative planning standard



*Based on Bernstein's estimates of the range of long-term returns for the applicable capital markets and on simulations with capital markets conditions as of September 30, 2008. See Notes on Wealth Forecasting and Actual Results vs. Core Capital on page 36 for further details. Data do not represent past performance and are not a promise of actual results or a range of future results.

[†]Assumes clients are 60 years old with \$3.75 million in a taxable account and \$1.25 million in a traditional IRA

[‡]Assumes spending adjusted annually for inflation

Source: AllianceBernstein

contingent on whether the investor's life span falls within the 20-year period of our analysis or extends beyond it and what his legacy and other goals are. But if we reduce the spending from 5% to 4% of the portfolio, the remaining \$800,000 leaves a much larger cushion in poor markets and creates about 50% more wealth in typical or median markets.

The effect of a reduction in spending can be powerful, but the example here reflects a particularly arduous scenario. That's because we've reduced the investor's spending not just for a year or two, but for the full 20-year period of the analysis. It may not be necessary to make a reduction like this permanent. As we saw with the investor who retired in 1998 and never changed his plan, reasonably strong markets brought him back in line with his estimated core capital forecast long before 20 years had elapsed. But such a recovery depends on being able to tolerate the higher volatility in the markets today.

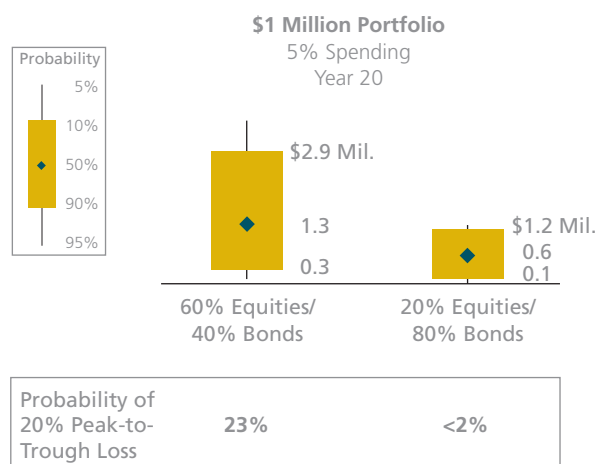
Seeking Shelter from the Storm: Reduce the Equity Allocation?

And that brings us to the next step in our analysis: the asset mix. Determining an asset allocation with a risk level one can tolerate is arguably the most important investment decision one can make. All of the scenarios we've reviewed assume a 60% allocation to global stocks—which has been a very difficult level of equity exposure to sustain of late. So what are the consequences of reducing the equity allocation?

Let's stay with the prior example of a \$1 million portfolio and a 5% spending rate, but now we will incorporate a measure of risk as well: the likelihood that this portfolio will experience a peak-to-trough loss of 20% or more at some point over the next 20 years. As *Display 5* shows, there's a one-in-four chance that this will happen at the current allocation.

Display 5

Shifting away from equities could lock in today's losses



Returns are quoted in nominal terms, after taxes. Spending is grown with inflation. Based on Bernstein's estimates of the range of returns for the applicable capital markets over the periods analyzed and on simulations with capital markets conditions as of December 31, 2008. Data do not represent past performance and are not a promise of actual future results. See Notes on Wealth Forecasting and Actual Results vs. Core Capital on page 36 for further details. Equities are invested 35% US value, 35% US growth, 25% developed international, and 5% emerging markets. Bonds are intermediate-duration municipal bonds. Source: AllianceBernstein

But having lived through the magnitude of the recent downturn, this investor's risk tolerance may have changed.

Shifting the stock allocation from 60% down to 20% will reduce the probability of a steep loss—to less than 2%. But that protection comes at a price: The growth potential of the portfolio also falls. As a result, median markets would leave a portfolio of \$600,000 come year 20, and in poor markets, the cushion would be far smaller: only \$100,000. Going entirely to cash would only further erode the portfolio's growth potential—dangerously so, for many. In short, downshifting to a lower-risk portfolio lessens the volatility, but it also locks in today's losses and limits the investor's ability to recover to his estimated core amount.

This decision can have significant consequences, raising the specter of a different sort of risk: that the investor will last longer than his portfolio does. Yet it's hard to resist the temptation to seek some shelter from the storm. For those facing this dilemma, one interim solution may provide some peace of mind in today's environment, without causing as much drag on the portfolio's ability to grow toward recovery: Set aside the equivalent of two years of spending in a separate cash or short-term bond portfolio, and keep the remainder of the portfolio at its prior allocation.

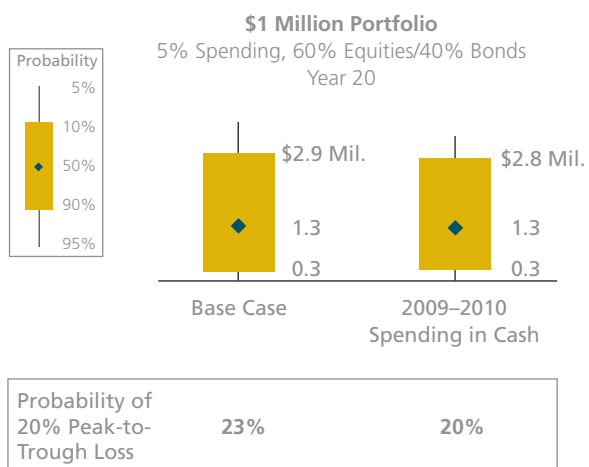
As you can see on the right of *Display 6*, such a plan does modestly reduce the risk to the portfolio, but has virtually no impact on the expected wealth outcome. For those who believe that a market recovery ultimately will come but are anxious about supporting their needs until that time, this approach may be one solution.

Lifetime Planning Requires Lifelong Vigilance

We construct investment plans to last a lifetime and build them conservatively so that they can endure extreme swings in the market, but they are flexible, and investors do have options. From time to time it is helpful to revisit the plan to see if it's on track, whether it will soon get back on track, or whether some adjustment is in order. All of the planning

Display 6

An interim solution: Stay allocated to equities, but set aside two years' worth of spending in cash



Returns are quoted in nominal terms, after taxes. Spending is grown with inflation. Based on Bernstein's estimates of the range of returns for the applicable capital markets over the periods analyzed and on simulations with capital markets conditions as of December 31, 2008. Data do not represent past performance and are not a promise of actual future results. See Notes on Wealth Forecasting and Actual Results vs. Core Capital on page 36 for further details. Equities are invested 35% US value, 35% US growth, 25% developed international, and 5% emerging markets. Bonds are intermediate-duration municipal bonds. Source: AllianceBernstein

options we've analyzed have both benefits and disadvantages, and there is no one right answer. Using Bernstein's wealth forecasting tools to help dimension the likely outcomes, we can help you chart a course of action through these turbulent times. ■

PUTTING THE RECESSION IN PERSPECTIVE: SOBERING (AND HOPEFUL) LESSONS OF HISTORY

The current recession is especially severe because it is the result of a global credit crisis. By analyzing past crises, we can gain insight into the process of recovery and better frame the risks and opportunities that exist in today's challenging environment.

The recession that began in 2008 and continued into 2009 has been unusually severe because it is the result of a credit crisis: Economic activity has slowed around the world due to a precipitous drop in lending, and it is not entirely clear what will get the global economy growing again. Given this uncertain outlook, securities markets have been plagued with volatility, while many investors have lost faith in stocks and bonds, seeking refuge in cash.

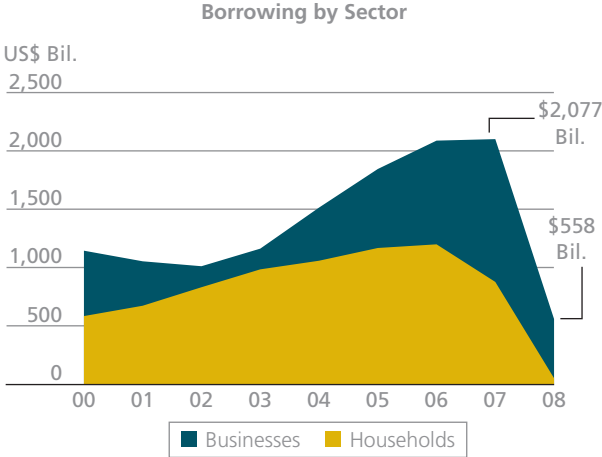
How long might we have to wait for a sustained recovery, both in the economy and in the financial markets? Bernstein recently completed an analysis aimed at providing perspective on this question. While no one can forecast an exact timetable for recovery, a comparison of the current situation to previous similar crises leads us to conclude that although this recession is likely to inflict more pain, central banks around the world are taking reasonable steps toward facilitating recovery. Moreover, while the risks of investing remain higher than usual, the decline in asset values has been so great that the potential for outsized investment returns over the recovery cycle is significant.

Understanding the Nature of the Crisis

Before we can assess what the prospects are for recovery, we must first understand the challenge confronting us: A full-blown credit crisis that started in the US subprime housing market spread globally last year to infect all aspects of lending, from consumer finance to

the letters of credit that grease the wheels of world trade. In the US, borrowing by businesses and consumers spiked from about \$1 trillion in 2002 to \$2 trillion by 2007, only to drop like a rock to just \$558 billion in 2008 (*Display 1*). This massive plunge sent shock waves throughout the global economy.

Display 1
A credit shutdown triggered the crisis



Annual borrowing through 2008; businesses include nonfinancial corporate, nonfarm noncorporate, and farm. Data are as of March 12, 2009. Source: Federal Reserve and AllianceBernstein

It is this credit contraction that distinguishes today's recession from the typical business-cycle-related recessions and bear markets of the last several decades. Credit is critical to the functioning of the economy. Businesses rely on credit to finance their operations, and consumers count on mortgages and loans to

maintain their lifestyles. In typical recessions, banks can speed recovery simply by lowering interest rates. But in a credit contraction, banks are less willing (or able) to lend, and their customers are less willing (or able) to borrow. In a worst-case scenario, a credit contraction can lead to a self-perpetuating downward spiral in which economic distress causes banks to rein in lending, which creates further economic distress, and so on.

Indeed, banks have been at the center of the storm, as the credit crisis spun into a financial-system crisis as well. Banks around the world have been forced to realize losses on their investments and on loans that have become non-performing, which has constrained their capital and driven them to tighten their lending flow.

Further, the near-shutdown of the so-called shadow banking system—businesses and institutions that essentially acted like banks but did so beneath the radar of banking regulators—intensified the trauma. Applying securitization, leverage, and financial derivatives, the shadow banking system had enabled an enormous run-up in lending. We estimate that there was \$5.7 trillion in debt outstanding in the shadow banking system by the first quarter of 2008 in the US alone—more than 20% of outstanding debt owed by households and nonfinancial businesses.

Faced with the sudden constriction of credit and uncertain about the extent of its potential damage, investors reacted with panic. From the start of 2008 through the first quarter of 2009, stock markets around the world dropped some 50%–60%, resulting in the first negative 10-year rolling returns since the 1930s (*Display 2*).

To put the crisis in perspective and gain insight into possible sources of resolution, we analyzed systemic banking crises across the globe. Because today's downturn is the worst in post-World War II US history, we wanted

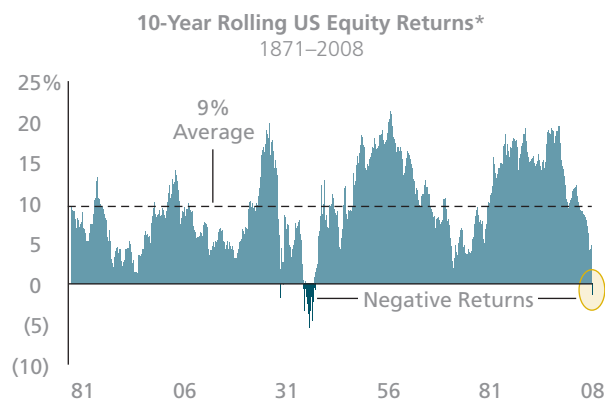
KEY CONCEPTS

- > Recessions driven by credit crises are particularly severe, but an analysis of past crises provides insight into the process of recovery.
- > Lasting economic recovery depends on the credit markets returning to normal, and the massive array of government programs aims at speeding this process.
- > Stock market recoveries have historically occurred well before any "all clear" bell.

to cast a wide net, so we went back more than 130 years. After identifying 200 that we believe share important similarities with the current situation, we selected for in-depth analysis 15 that appear most relevant to today, as measured by factors such as the wealth of the countries involved and the maturity of their banking systems. Among these 15 are five major prewar crises, including the Great Depression.

Display 2

"Lost decades" are extremely rare



Past performance does not guarantee future results.

*US equities are represented by Global Financial Data's S&P 500 Total Return Index extension from 1871 through 1925, by Ibbotson from 1926 through 1974, and by the S&P 500 thereafter.

Source: Global Financial Data; Roger G. Ibbotson and Rex A. Sinquefeld, "Stocks, Bonds, Bills, and Inflation: Year-by-Year Historical Returns," University of Chicago Press *Journal of Business* (January 1976); Standard & Poor's; and AllianceBernstein

Credit Crises by the Numbers

In the midst of a credit expansion, systemic risk may seem manageable because the economy is growing. But each of the crises in our analysis exhibited a classic pattern of boom and bust. Tempted by cheap credit terms, borrowers took on more and more risk. Banks and other lenders in turn became increasingly aggressive in their lending, lowering their standards in order to remain competitive. Ultimately, each boom resulted in a collapse of lending.

While the events that trigger credit crises differ, the outcome is the same: Overextended borrowers get into trouble because they can't refinance, so they sell any assets they can, which has the perverse effect of driving down the prices of the highest-quality assets because sellers can't find buyers for lower-quality assets. Meanwhile, banks, struggling with an increasing number of bad loans, tighten lending standards, which further constricts credit throughout the economy. Not surprisingly, the economy and the stock market suffer commensurately.

The degree to which credit crises have affected the economy and the capital markets has varied widely, but there are common patterns. *Display 3* shows the average effect of the 15 credit crises we selected, organized by developed markets, emerging markets, and pre-World War II developed markets. We show the Great Depression separately, both because it is a statistical outlier and because many investors are using it as a gauge of recent events.

A few salient points: The average peak-to-trough stock market drop of 52% of all the crises is roughly in line with our recent experience. Does this imply that we have seen the bottom of the market's decline? Not necessarily, but it does suggest that the decline of 2008 and early 2009 was "typical" compared to past credit crises. It is unnerving, then, to look at other bottom-line numbers like the average 10% drop in GDP and the 7.2 percentage-point increase in the unemployment rate. Despite the severity of the current recession, we are still a long way from that kind of pain.¹ Could the economy fall that far? We can seek

Display 3

Measuring the impacts of credit crises in history

	Averages Across the Universe of Crises					
	Real Economy			Real Equity Price		
	Corporate Earnings (EPS)	GDP*	Unemployment (Percentage Points)	Peak-to-Trough Drop	Peak-to-Trough (Yrs.)	Years to Regain Peak
Developed	(137)%	(4.4)%	Up 5.6	(53)%	4.1 Yrs.	7.0 Yrs.
Emerging	(213)	(11.6)	Up 4.5	(60)	1.0	5.4
Pre-WW II (Developed)	(42)	(15.1)	Up 11.4	(45)	2.8	15.2
Great Depression†	(67)	(30.8)	Up 21.0	(81)	2.8	26.5
All	(130)%	(10.0)%	Up 7.2	(52)%	2.6 Yrs.	9.2 Yrs.

Past performance may not be indicative of future results.

*Real, per capita, annualized

†Great Depression data are also included in the Pre-World War II row above.

Source: Global Financial Data, International Monetary Fund, Morgan Stanley Capital International, National Bureau of Economic Research, Organisation for Economic Co-operation and Development, and AllianceBernstein

¹ Through the first quarter of 2009 (the most recent data available), annual real GDP (full, four-quarter) had declined by less than 1% from its peak in the third quarter of 2008. The June 2009 unemployment rate of 9.5% represented an increase of 4.6 percentage points from the start of the recession.

the answer by digging deeper into the causes of the crisis and possible resolutions.

Mapping the Road to Recovery

Every credit crisis is ultimately about over-leveraging (excessive debt), and the road to recovery is a process of deleveraging (shedding debt). For credit to start flowing again, banks must rid themselves of exposure to bad loans, and borrowers must have manageable debt levels. Practically speaking, the process of deleveraging comprises some combination of debt repayment, bankruptcies, and write-downs or write-offs through restructuring. While this is almost always painful, it need not be catastrophic.

Our research shows that the amount of deleveraging that took place in past credit crises was roughly equal to the amount of credit expansion experienced in the final three years of the upswing in lending, some of which was reckless. (Anecdotal examples of three-year climactic lending “blowouts” include Japanese banks accepting artwork as loan collateral in the late 1980s and US lenders issuing NINJA—No Income, No Job, No Assets—mortgages during the recent cycle.) We estimate that lending in the US grew by 20% between early 2005 and early 2008; this relationship suggests we could experience about a 20% decline in credit outstanding over an undetermined number of years.

We also found that the deleveraging process has a statistically significant relationship to stock market performance. This reflects the fact that deleveraging results in slower economic growth, lower profit margins, and hence lower stock prices. Indeed, credit contracted 45% during the Great Depression, the second-highest amount in any of the 15 credit crises we studied, coinciding with the worst stock market decline—81%. In contrast, a

20% credit contraction in today’s US economy would imply a stock market decline of about 50%—almost exactly the amount the S&P 500 fell from its October 2007 peak to its March 2009 low point, and strikingly close to the average noted earlier in Display 3.

Interestingly, we found that deleveraging in post–World War II developed countries had a notably smaller impact on the economy than in emerging markets or pre–World War II economies. This, we hypothesize, is because government fiscal and monetary authorities have learned to respond more quickly to financial emergencies. In fact, a number of financial leaders have studied the lessons of the Great Depression, and that, in part, is why we are seeing the massive government intervention efforts around the world today.

Fostering the Flow of Credit

The scale and scope of the global intervention to restore the flow of credit and reestablish economic solid ground are unprecedented. Central banks around the world have slashed their interest rates to near zero, and some, including those of the US and UK, are flooding economies with cash by buying securities in the open market—a technique known as “quantitative easing.” As *Display 4, following page*, shows, massive fiscal programs are being implemented to support economic growth, with more than \$900 billion being injected into national economies this year. In the US alone, \$280 billion is proposed, or 2% of the GDP.

Through a slew of new and innovative programs, trillions of dollars have been committed to loosen credit markets and relieve banks of toxic assets. The government has been creative in supporting the shadow banking system with the creation of programs such as TALF, which has shown early success in supporting the asset-backed lending market.

Display 4

Record levels of fiscal stimulus will be applied in 2009

Fiscal Stimulus Proposals for 2009*		
Country/Region	US\$ (Bil.)	Percent of GDP
United States	\$280.0	2.0%
Europe	127.7	0.9
Japan	147.1	2.9
Asia ex Japan	277.7	2.9
Latin America	35.0	1.2
Eastern Europe	69.4	2.8
Global Stimulus	\$968.8	2.0%

As of May 1, 2009

*Fiscal Stimulus Proposals include increases in federal spending and tax cuts for individuals and businesses. Direct aid to specific firms or sectors is not included. Fiscal stimulus proposals for 2009 are subject to change. Global Stimulus includes additional countries/regions.

Source: Haver Analytics and AllianceBernstein

We have seen the virtual nationalization of Fannie Mae and Freddie Mac to keep the mortgage industry afloat. There is also the controversial TARP initiative, which helped prop up the largest banks and lent stability to the financial markets at their weakest moments in 2008.

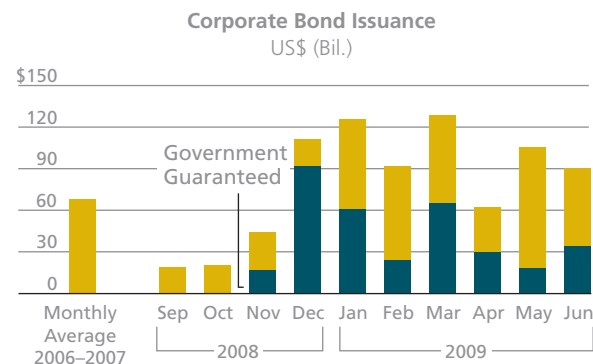
The private sector, too, has a role to play in the recovery process. Corporations are leaner and better poised for an eventual recovery. While falling home prices have certainly hurt household wealth, the combination of lower prices and attractive mortgage rates has made homeownership less expensive.

What will signal economic recovery? While there will never be an “all clear” bell, we are watching key credit indicators that would show confidence returning to credit markets. These include an increase in debt issuance without government backing; a reemergence of securitized lending; and shrinking risk premiums in the marketplace.

Some encouraging signs are emerging on all these fronts. High-quality companies have been successfully tapping the bond market: As *Display 5* shows, from January through June of 2009, the dollar value of investment-grade corporate bond issuance averaged \$104 billion, well above the monthly average seen during the halcyon times of 2006 and 2007. The amount of these issues that was guaranteed by the government is shrinking, and nonguaranteed issuance by financial firms has increased. Securitized lending is also reemerging, albeit slowly, under the TALF program, with almost \$40 billion in TALF-related issuance as of the end of June. Last but not least, a key measure of credit risk, the so-called TED² spread—which measures banks’ willingness to lend to each other—has fallen back to historically normal levels of around 40 basis points, after hitting a panic level of 464 basis points in October of 2008.

Display 5

High-quality corporations are now able to issue debt



Measures all investment-grade corporate bonds issued globally, in US dollars, regardless of the issuer’s home country

Source: Bloomberg, JPMorgan Chase, Thomson Financial, and AllianceBernstein

The Trouble with Predictions

Even as signs emerge of improvement in the credit markets, no one can predict when a lasting recovery in the stock market will begin.

² The acronym is formed from *Treasury bills* and the ticker symbol for the Eurodollar futures contract.

As of this writing, stocks have rallied from a new low in March of 2009 to regain the levels seen at year-end 2008. But volatility remains high, and economic indicators remain mixed at best.

Calling a market turn is virtually impossible, and this time is no different. On the one hand, the global economy faces serious challenges, and it is hard to make a case for robust economic recovery anytime soon. Yet recoveries in the stock market have almost always preceded the end of recessions. In fact, stock market recoveries sometimes have begun when the economic climate seemed bleakest. As *Display 6* shows, in the two worst periods for the stock market in the twentieth century, stocks began their recovery when economic news was grim. During the Great Depression, by 1932 GDP had plummeted 23%, one-fourth of the nation’s workers couldn’t find a job, 10,000 banks had failed—and the stock market began to rise. In 1974, inflation was running at a fever pitch of 12%, unemployment was rising toward its peak in 1975, oil

prices had increased 400% over two years, the president of the United States was forced to resign—and the stock market began to rise.

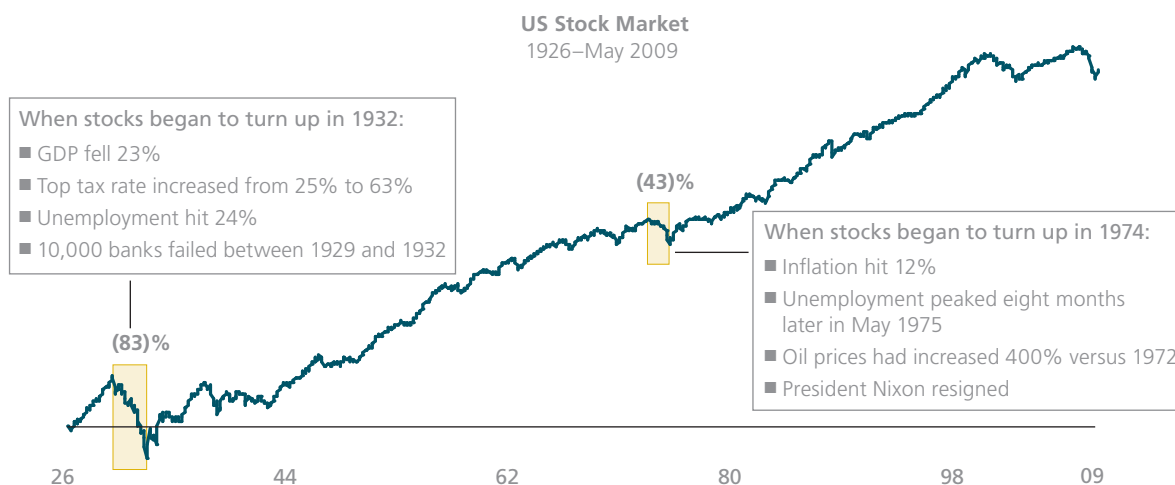
Assessing the Risks

Earlier this year, securities prices in both the stock and nongovernment bond markets had dropped to remarkably low levels, reflecting investors’ fears that the global economy is not going to recover soon. As of June, across an array of investments, the potential return available over and above “safe” government bonds remained well above normal levels, as measured by the so-called risk premium.

In ordinary times, the high risk premiums and high projected returns for securities today would be an unambiguous “buy” sign. But these are not ordinary times. Securities appear cheap because risk remains high. As the credit crisis plays itself out, we are striving to ensure that we assess risk appropriately, and we are stress-testing our holdings to reflect both the heightened risks and the opportunities we see. ■

Display 6

Stock market recoveries often begin without positive news



Past performance does not guarantee future results.

US stocks are represented by Ibbotson through 1974 and by the S&P 500 thereafter.

Source: Compustat; Roger G. Ibbotson and Rex A. Sinquefeld, “Stocks, Bonds, Bills, and Inflation: Year-by-Year Historical Returns,” University of Chicago Press *Journal of Business* (January 1976); Standard & Poor’s; and AllianceBernstein

Notes on Performance Statistics

1. General Note

Performance Statistics Are Not Financial Statements—
The data were compiled using the standards of performance measurement set forth below. Past performance does not guarantee future results. Your investment suffers losses as well as achieves gains.

2. Methodology

US STRATEGIC VALUE (ALL), US STRATEGIC GROWTH (ALL), 50/50 SIMULATION (ALL), INTERMEDIATE MUNICIPAL BOND COMPOSITE (ACCOUNTS OVER \$3 MILLION), AND FULLY DIVERSIFIED PORTFOLIO (SIMULATION)

Composites' Structure and Preparation of Data—Only fee-paying private and institutional discretionary accounts not subject to significant client-imposed restrictions are included in the Bernstein US Strategic Value (all accounts) composite beginning in 1993 and in the US Strategic Growth (all accounts) composite beginning in 2001. Prior to 1993, all private and institutional discretionary US Strategic Value accounts are included in the US Strategic Value composite. The US Strategic Growth composite's performance is calculated by geometrically linking the asset-weighted monthly returns of the Alliance US Large Cap Growth composite from 1978 through 2000 to those of Bernstein US Strategic Growth (all accounts) thereafter. These monthly returns are used to calculate cumulative and/or annualized "time-weighted" rates of return for various periods. Bernstein US Strategic Growth differs from Alliance US Large Cap Growth in that, among other things, it offers tax management and may contain fewer stocks. The Alliance US Large Cap Growth composite includes fee-paying discretionary tax-exempt accounts with assets over \$10 million not subject to significant client-imposed investment restrictions. In these equity portfolios, the asset-allocation mix is generally determined by client guidelines, with cash flows allocated accordingly.

Returns for the 50/50 Simulation ("50/50") were calculated by blending the actual returns of the Bernstein US Strategic Value and Bernstein US Strategic Growth composites in a 50/50 allocation. From January 1979 through December 1982, the summed quarterly returns for US Strategic Value and US Strategic Growth were divided by two. From January 1983 to the present, the methodology is the same, except monthly composite returns are used instead of quarterly returns (prior to 1983, only quarterly returns are available for US Strategic Value). These 50/50 quarterly and

monthly returns are geometrically linked, or compounded, to calculate cumulative and/or annualized returns for various time periods. This methodology assumes quarterly rebalancing from 1979 through 1982 and monthly rebalancing thereafter. Transaction costs associated with rebalancing are not considered in this simulation.

For the Intermediate Municipal Bond composite, quarterly returns for every separately managed account were added together and the sum divided by the total number of accounts in each quarter through 1992; beginning in 1993, quarterly performance for all accounts was weighted by their market value. These quarterly performance figures were then linked to produce a continuous-performance index. The continuous-performance index from inception was used to create point-to-point comparisons. Closed accounts are included for each full quarter prior to their closing. The minimum account sizes included in the composite's performance are: 1983–1987:3Q: \$250,000; 1987:4Q–1994: \$5 million; 1995 and thereafter: \$3 million.

Fully Diversified Portfolio: 60% Stock/40% Bond Mix: Returns for the Fully Diversified 60/40 Simulated Portfolio (the "Portfolio") were calculated by blending the actual net-of-fee returns of the following products: Bernstein US Strategic Value (all accounts), Bernstein US Strategic Growth (all accounts), Bernstein Intermediate Municipal Bonds (accounts over \$3 million), and pooled investment vehicles that invest in developed foreign markets, emerging markets, and global real estate, respectively. The Portfolio is rebalanced to a 60/40 allocation on a quarterly basis. Each quarter's return is calculated by multiplying the actual quarterly return of the product by its weight in the blend, then summing these weighted returns. These quarterly returns are then geometrically linked, or compounded, to calculate cumulative and/or annualized rates of return for various time periods. Although a 60/40 allocation is maintained over time, the specific blend of products in the Portfolio changes over time with the inception of new products on an ongoing basis. The specific allocations over time follow:

a. From January 1983 through June 1992: 30% Bernstein US Strategic Value (all accounts), 30% Bernstein US Strategic Growth (all accounts), 40% Bernstein Intermediate Municipal Bonds (accounts over \$3 million).

b. From July 1992 through December 1995: 21% Bernstein US Strategic Value (all accounts), 21% Bernstein US Strategic Growth (all accounts), 40% Bernstein Intermediate Municipal Bonds (accounts over \$3 million), 18% pooled investment vehicle that invests in developed foreign markets.

c. From January 1996 through June 2001: 21% Bernstein US Strategic Value (all accounts), 21% Bernstein US Strategic Growth (all accounts), 40% Bernstein Intermediate Municipal Bonds (accounts over \$3 million), 15% pooled investment vehicle that invests in developed foreign markets, 3% pooled investment vehicle that invests in emerging markets.

d. From July 2001 through March 2007: 18.5% Bernstein US Strategic Value (all accounts), 18.5% Bernstein US Strategic Growth (all accounts), 35% Bernstein Intermediate Municipal Bonds (accounts over \$3 million), 15% pooled investment vehicle that invests in developed foreign markets, 3% pooled investment vehicle that invests in emerging markets, 10% pooled investment vehicle that invests in global real estate.

e. From April 2007 to present: 19.2% Bernstein US Strategic Value (all accounts), 19.2% Bernstein US Strategic Growth (all accounts), 35% Bernstein Intermediate Municipal Bonds (accounts over \$3 million), 13.8% pooled investment vehicle that invests in developed foreign markets, 2.8% pooled investment vehicle that invests in emerging markets, 10% pooled investment vehicle that invests in global real estate.

Rate of Return—Performance returns for each US Strategic Value, US Strategic Growth, and Intermediate Municipal account are calculated monthly using trade-date accounting. Performance results for these composites are reported on a total-return basis, which includes all income from dividends and interest, and realized and unrealized gains or losses. For the US Strategic Value and US Strategic Growth composites, closed accounts are included in their respective composites for each full quarter prior to their closing.

Benchmarks—The benchmark for both the US Strategic Value and US Strategic Growth composites is the S&P 500 Index, which is widely regarded as the standard for measuring large-cap US stock market performance, and the benchmark for the Intermediate Municipal Bond composite is the Lipper Short/Intermediate Municipal Bond Fund Average.

Net-of-Fee Performance Figures—The composite's net-of-fee return is the asset-weighted average of the actual after-fee returns of each account in the composite. Net-of-fee performance figures reflect the compounding effect of such fees.

Net-of-Fee Returns—The US Strategic Value composite's net-of-fee returns for the past 10 years are: 1999: (0.2)%; 2000: 10.0%; 2001: 9.3%; 2002: (17.6)%; 2003: 32.0%; 2004: 13.5%; 2005: 8.6%; 2006: 20.1%; 2007: (1.4)%; 2008: (46.9)%. The US Strategic Growth composite's net-of-fee returns for the past 10 years are: 1999: 32.3%; 2000: (17.2)%; 2001: (18.5)%; 2002: (32.9)%; 2003: 21.2%; 2004: 4.1%; 2005: 11.5%; 2006: (2.5)%; 2007: 14.1%; 2008: (40.8)%.

The 50/50 Simulation's net-of-fee returns for the past 10 years are: 1999: 15.9%; 2000: (3.5)%; 2001: (4.8)%; 2002: (25.4)%; 2003: 26.6%; 2004: 8.8%; 2005: 10.1%; 2006: 8.3%; 2007: 6.1%; 2008: (43.8)%. The Fully Diversified Portfolio's (Simulation, All) net-of-fee returns for the past 10 years are: 1999: 12.3%; 2000: 0.2%; 2001: (1.5)%; 2002: (8.0)%; 2003: 22.7%; 2004: 11.4%; 2005: 8.5%; 2006: 12.1%; 2007: 5.3%; 2008: (31.1)%. The Intermediate Municipal Bond composite's net-of-fee returns for the past 10 years are: 1999: 0.3%; 2000: 8.2%; 2001: 5.2%; 2002: 7.1%; 2003: 3.8%; 2004: 2.7%; 2005: 1.5%; 2006: 3.3%; 2007: 4.5%; 2008: 3.4%.

Notes on Wealth Forecasting

Bernstein's Wealth Forecasting Analysis™ is designed to assist investors in making a range of key decisions, including setting their long-term allocation of financial assets. The WFA consists of a four-step process: (1) Client Profile Input: the client's asset allocation, income, expenses, cash withdrawals, tax rate, risk-tolerance goals, and other factors; (2) Client Scenarios: in effect, questions the client would like our guidance on, which may touch on issues such as which vehicles are best for intergenerational and philanthropic giving, what his/her cash-flow stream is likely to be, whether his/her portfolio can beat inflation long term, when to retire, and how different asset allocations might impact his/her long-term security; (3) The Capital Markets Engine: our proprietary model, which uses our research and historical data to create a vast range of market returns, taking into account the linkages within and among the capital markets (not Bernstein portfolios), as well as their unpredictability; and (4) A Probability Distribution of Outcomes: based on the assets invested pursuant to the stated asset allocation, 90% of the estimated returns and asset values the client could expect to experience, represented within a range established by the 5th and 95th percentiles of probability. However, outcomes outside this range are expected to occur 10% of the time; thus, the range does not establish the boundaries for all outcomes. Further, we often focus on the 10th, 50th, and 90th percentiles to represent the upside, median, and downside cases. Unless otherwise noted, asset-class projections used in this publication are derived from the following: US value stocks are represented by the S&P/Barra Value Index, based on simulations with capital markets conditions as of December 31, 2008; US growth stocks by the S&P/Barra Growth Index; developed international stocks by the Morgan Stanley Capital International (MSCI) EAFE Index of major markets in Europe, Australasia, and the Far East, with countries weighted by market capitalization and currency positions unhedged; emerging markets stocks by the MSCI Emerging Markets Index; taxable bonds by diversified securities with seven-year maturities; real

estate investment trusts (REITs) by the NAREIT Index; a single stock with a beta of 1.0, volatility of 30%, and a dividend yield of 0%; and inflation by the US Bureau of Labor Statistics' Consumer Price Index (CPI)—All Urban Consumers. Expected market returns on bonds are derived taking into account yield and other criteria. An important assumption is that stocks will, over time, outperform long-term bonds by a reasonable amount, although this is by no means a certainty. Moreover, actual future results may not be consonant with Bernstein's estimates of the range of market returns, as these returns are subject to a variety of economic, market, and other variables. Accordingly, this analysis should not be construed as a promise of actual future results, the actual range of future results, or the actual probability that these results will be realized.

Actual Results vs. Core Capital

Actual results assume that an investor holds 60% in globally diversified equities and 40% in municipal bonds and rebalances at the end of every year. Globally diversified equities are assumed to be 70% S&P 500 Index, 25% MSCI EAFE Index, and 5% MSCI Emerging Markets Index. Municipal bonds are represented by the Lipper Intermediate Municipal Bond Fund Average.

Annual spending from the portfolio is assumed to grow with inflation, as measured by the US Bureau of Labor Statistics' Consumer Price Index (CPI)—All Urban Consumers. All analyses assume that investors build plans with 4.1% spending, with the exception of 1999 investors, who build plans with 3.4% spending.

The core capital line assumes that an investor must sustain spending until age 90 and that the investor is subject to top marginal federal tax rates and 6% state and local income and capital gains taxes.

All results shown are adjusted for inflation.

Client-Centered Wealth Management Solutions

At Bernstein, we are dedicated to providing our clients with wealth management solutions tailored to their unique circumstances. We start with robust *planning*, to identify each client's needs for lifetime spending, retirement, multigenerational wealth transfer, and philanthropic pursuits. We then stress-test a range of investment strategies, including asset allocation approaches, to arrive at a plan for achieving these goals. We then implement the client's plan through our proprietary platform of investment services, each reliant upon dedicated research teams and managed by dedicated portfolio management teams. In *managing* a client's plan over time, we employ active management within each service, rebalancing to maintain the overall portfolio's profile, and tax management to mitigate the impact of taxes on a client's after-tax returns. We also place a high degree of emphasis on *informing* our clients, providing transparent and real-time performance reporting via our website, and having frequent discussions on portfolio strategy. Throughout, we aim to meet our clients' objectives...and their expectations.

