AllianceBernstein

Global Balanced Portfolio

Market Overview

Global stock markets initially greeted the new year with a continuation of late 2009's rally, but the advance ran into selling pressure before long. As January progressed, investors became unsettled by the prospect of policy changes that could be harmful to capital markets. For the month, the MSCI World Index fell 4.1% in US dollar terms.

Meanwhile, global bonds advanced in the month, as investors became more risk-averse despite evidence of a sustainable economic recovery. The Barclays Global Aggregate hedged into US dollars rose 1.02%.

News that China hiked its reserve requirement ratio (RRR) for banks, signaling the beginning of a new monetary tightening cycle, sent equity and credit markets lower mid-month, on worries that this could stifle economic growth.

Mixed news releases did little to bolster global sentiment. US gross domestic product jumped by 5.7% in the December quarter (annualized rate), with most of the increase due to a slower drawdown in business inventories. Though the unemployment rate remained unchanged at 10%, data showed the US economy added jobs for the first time since the recession began in 2007. On the other hand, retail sales unexpectedly fell in December.

Portfolio Performance

The Portfolio underperformed its benchmark, the 40% Barclays Capital Global Aggregate Bond Index/60% MSCI World Index, during the month.

Country and yield curve positioning was the main driver of the performance this month in the fixed-income portfolio. Our underweight to Japanese government bonds was beneficial to the Portfolio as the country's economy continued to struggle through the downturn and had its sovereign rating cut to negative by credit ratings agency Standard & Poor's. An overweight to euro-area governments was also a positive.

Both euro-area and US corporate credits had a weaker month than the previous as increased risk aversion caused investors to move to the safety of government bonds. Despite the weaker month for corporate credits, our corporate security selection generated positive returns as our choice in holdings outperformed the general corporate indices. Our overweight to commercial mortgage-backed securities was also a positive as the sector continued to show signs of improvement.

In the equity portfolio, detractors in the finance sector included Industrial & Commercial Bank and Goldman Sachs. In the consumer cyclicals sector, media company News Corp. moved lower as investors grew concerned about the sustainability of the recovery in advertising spending and whether the company would return accumulated cash to shareholders or invest it unwisely.

In the health care sector, large-cap pharmaceutical companies, including Portfolio holding Merck, outperformed after the Democratic Party lost its supermajority in the US Senate. As a result, health care reform legislation that passes, if any, is unlikely to be as aggressive as previously feared by some investors. A broker upgrade lifted building materials company Wolseley. Investors also reacted favorably to management changes. Finally, Japanese leasing company ORIX continued to outperform as it announced plans to invest 300 billion yen in China over the next three years, buoying investor sentiment.

Outlook

We expect the global economy to grow 3.5% in 2010, returning to its long-term average, with emerging market economies continuing to lead the recovery.

While we believe that the economic recovery now appears to be sustainable, continued uncertainty surrounding the outlook for fiscal and monetary policy is likely to keep many investors anxious. The upside of this anxiety is that it generates opportunities for active managers. We continue to see opportunities for equity managers to generate returns through stock selection, and for fixed-income managers to take advantage of attractive return potential in the credit sector.

The fixed-income portfolio has adopted an underweight exposure to mortgage pass-through securities, instead preferring US commercial mortgage-backed securities. It is invested neutral in terms of interest-rate exposure. We have our biggest overweight exposure in Europe. We remain underweight Japan, UK and overweight the US dollar. We continue to be largely overweight investment-grade corporate credits.

We think the medium-term outlook for company earnings the value portfolio invests in is improving. We continue to take advantage of attractive valuations across a wide range of sectors while continuing to invest in companies with strong balance sheets and clearer earnings visibility. With the economy and banking system on firmer footing, we continue to increase the value portfolio's exposure to economically-sensitive companies that look undervalued relative to their earnings power under more normal business conditions. Our research has also identified stocks that currently offer a rare combination of attractive valuations and resilient cash flows.

With regard to the growth portfolio, we believe that the opportunity for growth and for our research-driven approach to stock selection appears exceptional. We will continue to apply our growth investment discipline to identifying dynamic gap opportunities as the market recalibrates after the upheaval of the past two years.