

AllianceBernstein

International Health Care Portfolio

Market Overview

Health care stocks fell slightly in January, but outperformed the overall market.

Within the health care sector, biotechnology and medical service stocks outperformed, while pharmaceutical and medical product stocks underperformed. Corporate earnings and some merger news supplied the majority of headlines during the month.

Novartis announced it would exercise its option to purchase Nestlé's remaining 52% stake in Alcon at the predetermined cost of US\$180 a share, or US\$28.1 billion. The transaction, which is expected to close in the second half of 2010, marks the second stage of a two-part deal under which Novartis will obtain Nestlé's full 77% stake in Alcon.

Concurrent with this announcement, Novartis also proposed the purchase of the remaining 23% of Alcon held by minority shareholders through a direct merger under Swiss merger law. At the time of the announcement, the all-stock proposal represented an offer price of US\$153 per share, below Alcon's previous closing price. After review, Alcon's Independent Director Committee—established to protect the rights of minority shareholders—rejected the offer, calling the price and terms proposed by Novartis “grossly inadequate.” Novartis management has not yet responded to the statement from Alcon's Independent Director Committee.

Gilead shares moved higher after reporting robust fourth-quarter results, which exceeded estimates on both the top and bottom lines. Revenues were up 42% versus the prior year's quarter and earnings per share (EPS) grew 49%. The company also issued solid guidance for 2010, including product sales growth of 17% to 19%.

Teva hosted its annual strategic outlook meeting, where it provided bullish long-term forecasts for the business. Specifically, the company is projecting compounded annual sales growth of approximately 14% between 2009 and 2015, and compounded annual EPS growth of over 13%. Growth is expected to be even higher between 2009 and 2012. Going forward, the company expects approximately two-thirds of revenue growth will be organic, with the remainder

coming from acquisitions, and sees Europe and other international markets offering the best growth potential.

Covidien reported solid fiscal first-quarter results that meaningfully surpassed consensus expectations. Sales grew 7% in the quarter, with better-than-expected sales coming out of all three business segments. Meanwhile, EPS grew 10%, with significant upside resulting from better-than-anticipated sales and a very strong gross margin. For the full fiscal year 2010, management continues to expect sales to grow 6% to 9% (excluding the fiscal year 2009 benefit from long-acting OxyContin sales), and it now expects sales in its key Medical Device segment to increase 10% to 13%. The company raised its operating margin guidance for fiscal year 2010 to 21% to 22%, up from 20% to 21%.

Baxter reported solid fourth-quarter results, with sales rising 11% and earnings up 12.5% from the prior year, largely in-line with expectations. Revenues from each of the company's three main segments were slightly better than expected. The company also provided its initial guidance for 2010, with earnings expected to increase by 11% to 13% and organic revenues expected to go up 5% to 7%.

Amgen reported disappointing fourth-quarter results, which fell below consensus estimates on both the revenue and earnings lines. Sales in the quarter were up 2% and EPS was down 1% from the year prior. Meanwhile, management issued broad guidance for 2010 that bracketed analyst expectations, calling for sales growth of between 3% and 6% and EPS growth of between 3% and 7%. On the positive front, Amgen announced that it had submitted its response to the US Food and Drug Administration's (FDA) letter on key pipeline drug Prolia for osteoporosis, which could facilitate an approval for the drug in the coming months.

Shares of small-cap drugmaker AMAG Pharmaceuticals moved upwards after the company reported strong fourth-quarter sales. The results provided early signs that the launch of the company's intravenous iron compound, Feraheme, could be gaining momentum. The compound is indicated for the treatment of iron deficiency anemia in adult patients with chronic kidney disease.

Portfolio Commentary

Trading in the Portfolio was fairly active in January, though this mostly consisted of minor adds and trims around earnings results and stock movements.

Most notably, we exited Novo Nordisk on ongoing US regulatory and commercial uncertainty around its new diabetes drug. We used proceeds from the sale to build a position in Allergan, the US specialty pharmaceutical and aesthetics company. During the month we also continued to reduce our position in Celgene and increased our holding of Bristol-Myers.

Contributing to returns in January were positions in Gilead, Covidien and Merck

Detracting from returns were positions in Vertex, Human Genome Sciences and Alcon.

The Portfolio is overweight biotechnology, modestly overweight medical products, neutral to medical services and underweight pharmaceuticals.

Outlook

Although volatile markets may tempt investors to question their investment strategy, we believe it is best to stay the course and maintain a long-term investment approach.

Health care's traditionally defensive image and stable growth potential make it an appealing sector in the face of ongoing economic uncertainty. In addition, major

secular trends, particularly an aging global population, will continue to drive increased spending in many areas of health care for the foreseeable future. In this environment, cost-cutting is important, and we continue to emphasize several companies that should benefit from the significant wave of generic drug utilization. Finally, while US health care reform has been a significant overhang for the health care sector for much of the past year; concerns on this front have begun to diminish due to recent political events.

Over the long term, health care industries and stocks with consistent stable growth and solid fundamentals tend to demonstrate relative strength. We would continue to favor stocks that exhibit such criteria, particularly those that we believe will exceed consensus expectations.

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