

AllianceBernstein

Global Conservative Portfolio

Market Overview

Sovereign debt risks in Europe, regulatory uncertainties and moderating growth expectations in China renewed risk aversion and triggered a flight to quality among fixed-income investors in May.

The price of the 10-year Treasury note rose, lowering yields the most since the US Federal Reserve dropped interest rates to a record low in December 2008 to spur the economy. Consumer spending in the US unexpectedly stalled in April after a 0.6% gain in March, and the US economy grew 3% in the first quarter, slightly less than the 3.2% initially calculated, Commerce Department data showed.

Spain's credit grade was reduced to AA+ from AAA by Fitch Ratings. The company said the "process of adjustment to a lower level of private sector and external indebtedness will materially reduce the rate of growth of the Spanish economy over the medium term."

The euro fell 7.7% against the US dollar in May as investors fled riskier assets denominated in the currency.

Portfolio Commentary

The Portfolio underperformed its benchmark, the 30% MSCI World Index/35% Barclays Capital Global Aggregate Bond Index/35% Barclays Capital 1-3 Year Government Credit Index during the month and for the year-to-date period.

The short duration portfolio modestly underperformed its benchmark for the month due to exposure to investment-grade corporates, which underperformed. The sleeve's yield curve structure was relatively flat. We generally maintained our spread product exposure given attractive valuations. The portfolio's duration exposure was modestly longer than the benchmark.

The main cause of the underperformance of the fixed-income portfolio in May was sector allocation. An overweight position to investment-grade credit cost the Portfolio performance as both US and European credits came under pressure following international risk aversion. European sovereign concern weighed on sentiment and prompted investors to move into the safety of the highest quality government bonds. An overweight to commercial mortgage-backed securities

was a modest negative as a lack of risk appetite caused the sector to underperform.

An overweight to the Australian dollar was also a detractor to performance. Global contagion from the European sovereign woes caused investors to move to the safety of the US dollar.

Our country and yield-curve positioning was a positive this month and enabled the portfolio to recover some performance lost from the other areas. The flight to quality caused both US and core European treasury yields to fall across the curve, and so our overweight positioning was positive. With global yields falling considerably in the five- to 10-year area, our overweight in this part of the yield curve benefited the portfolio. An underweight position to Japanese Treasuries also contributed.

The fixed-income portfolio does not hold any government securities in Greece, Spain, Portugal, Italy or Ireland.

For the month, detractors in the equity portfolio included media company News Corp. and financials Wells Fargo and Orix. News Corp. projected a rise in operating fiscal-year income over its prior guidance, but below what investors had hoped for. The outlook and downgrade overshadowed News Corp.'s stronger-than-expected fiscal third-quarter results, which were buoyed by an improving advertising market and the success of its 3D epic film *Avatar*. Financial services stocks trailed as investors de-risked amid the market volatility. In addition, a mid-term growth outlook announced by Orix management was not as aggressive as some market participants had expected.

Contributing to returns were positions in Sprint Nextel, Delta Airlines and German auto maker BMW. In the telecommunications sector, Sprint reported first-quarter results at the end of April slightly ahead of rising expectations. Subscriber losses and margins showed signs of continued improvement. Our position in Delta Air Lines was a strong performer as rivals United and Continental announced a long-rumored merger. If the deal is approved by regulators, it is likely to lead to improved industry capacity and pricing discipline. Luxury car maker BMW posted first-quarter results

that beat analyst expectations. The company benefited from a rapid rebound in luxury car sales, especially in China.

Outlook

Our 2010 real US GDP growth forecast has been revised to 3.7%, down from our prior estimate of 4.0%. The downward revision is primarily the result of a weaker than expected first-quarter GDP performance, which now stands at 3%, a bit below the initial estimate of 3.2%. We still anticipate relatively strong real GDP growth (+4% annualized) over the remaining quarters of 2010.

The US economic forecast is not without risk, however. Fiscal sustainability issues in Europe have triggered a sharp risk aversion trade in the global financial markets over the past two months, sending global equity prices sharply lower and triggering a sharp correction in the value of the euro. We do not think the fiscal issues in Europe as well as the recent appreciation of the USD versus the euro will materially affect the US growth cycle, but the events of the past several weeks will force the Federal Reserve to delay their official rate hikes until later in the year, at least a quarter or so later than we initially thought. As a result, we have lowered the year-end 2010 fed funds target to 0.75%, down from the 1.5% target one month ago. We continue to take advantage of the attractive return potential in the credit sector. While spreads have tightened significantly, the economic recovery continues to provide support for spread sectors.

The fixed-income portfolio is invested neutral in terms of interest-rate exposure. We have our biggest overweight exposure in USD and have moved to neutral Europe following the ongoing turmoil in this region. The Portfolio remains underweight Japan and neutral the UK. We continue to be overweight investment-grade corporate credits.

Apprehension about the future is producing abundant opportunities for investors willing to take a long-term view. Corporate profitability is still extremely low. But history and our experience tell us that it won't stay this way for long. We are already seeing signs of the cycle's self-correcting forces taking hold. As the process unfolds, the value team continues to take advantage of attractive valuations across a wide range of sectors while investing in companies with strong balance sheets and clearer earnings visibility. Our research has also identified stocks that currently offer a favorable 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.

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