

AllianceBernstein

## International Health Care Portfolio

### Market Overview

Health care stocks fell slightly in April, underperforming the overall market during a flat month for worldwide equities.

Within the health care sector, medical product and biotechnology stocks slightly outperformed, medical service stocks underperformed and pharmaceutical stocks were essentially in line. Corporate earnings results and commentary dominated the month's headlines.

Shares of Baxter fell sharply after the company significantly reduced its full-year outlook following its quarterly results. The company now expects 2010 underlying sales to grow just 1%-3%, with earnings increasing 3%-5%, down from a prior forecast for growth of 5%-7% and 11%-13%, respectively. The reduction in guidance was due primarily to deteriorating fundamentals in the company's key plasma products business, as reduced market demand and increased pricing pressures are being compounded by share losses.

Medco reported solid first-quarter results, which topped consensus revenue and earnings forecasts. Adjusted earnings per share (EPS) increased 15%, while sales rose 10%. The company reiterated full-year guidance that calls for adjusted earnings to grow by 16%-20%.

Shares of Gilead declined after the company reported disappointing first-quarter HIV-related sales and lowered guidance. Total sales and EPS growth of 36% and 51%, respectively, were better than expected, due largely to higher royalty revenues. However, sales in the company's key HIV franchise came in below expectations, as solid underlying demand was offset by currency swings and lower sales resulting from new US health care reform drug rebate provisions. This impact from health care reform also led the company to modestly lower its product sales and earnings guidance for the full year.

Celgene reported strong quarterly results. Sales grew 31% over the prior year's quarter, driven by very strong sales of the company's hallmark blood cancer drug Revlimid, whose sales rose 46%, exceeding expectations. EPS rose 43%, also beating estimates. In addition, the company raised revenue and earnings

guidance for the full year. The company now expects 2010 revenues and earnings to both increase by approximately 25%, driven by 30% growth in Revlimid sales.

Shire released very strong quarterly results, with both sales and earnings topping analyst consensus. Upside in the quarter was driven by good product sales and royalties, along with a solid gross margin. Importantly, management assuaged concerns around the impact of health care reform on the business, as they reiterated guidance for 2010 earnings to come in above the 2009 level and cited minimal impact from the changes in US Medicaid rebates.

ResMed's stock was up significantly after the company reported excellent results for its fiscal third quarter. Sales were up 22% as compared to last year's quarter, with broad-based strength and market share gains across product lines. EPS rose 23%, surpassing analyst estimates, as robust revenues were augmented by positive mix shift and disciplined cost control.

Allergan released good first-quarter results, with sales increasing 11% and EPS up a solid 18%, ahead of expectations. While overall sales were in line, several key, higher margin products were better than expected, including wrinkle drug Botox, eye drug Alphagan and the company's line of aesthetic products. Importantly, management was upbeat on the demand environment, noting improving growth in both the eye-care and elective procedure markets. Finally, following the quarterly beat, management raised the bottom end of its annual earnings guidance, which it now projects to increase 12%-13% for the year.

In non-earnings related news, a US federal court ruled that Medtronic's transcatheter valve infringed on Edwards Lifesciences' patent for its own transcatheter valve Sapien and awarded Edwards penalty fees. While neither valve is currently approved in the US, the ruling will likely prompt Edwards to seek an injunction against Medtronic, who plans to appeal the decision. If granted, an injunction could potentially delay Medtronic's ability to launch its valve in the US, lengthening Edwards' first-to-market advantage. Edwards hopes to receive US approval for the Sapien valve by the end of 2011.

## Portfolio Commentary

Trading in the Portfolio was active during the month, as we initiated and exited several positions, and traded around relative stock performance and earnings reports.

On the sell side, we eliminated positions in Baxter and Talecris after Baxter significantly lowered its guidance and cited softer fundamentals in the plasma products market. Talecris is also a major player in this market. We also exited small-cap device maker Masimo, owing to reduced conviction in the company's growth.

Other trims of note were Fresenius Medical, Hospira, Bristol Myers and Roche, as we managed position sizes and adjusted relative convictions.

On the buy side we started new positions in drug distributor McKesson and life science tools maker Thermo Fisher Scientific. McKesson should benefit from the oncoming wave of new generic drug launches. Thermo will benefit from health care-targeted stimulus spending by the US government, and it should see business fundamentals improve as hospital capital spending rebounds with the economy.

Contributing to returns in April were positions in Edwards, ResMed and Shire.

Detracting from returns were positions in Gilead, Baxter, and Medco.

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

## Outlook

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.

Furthermore, the uncertainty surrounding US healthcare reform has been a significant overhang for the sector for much of the past year. As a result, the healthcare space is attractively valued relative to the overall market. We believe that the recent resolution of the healthcare reform issue could serve as a positive catalyst for health care stocks and help drive multiple expansion for the sector going forward.

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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