AllianceBernstein

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International Health Care Portfolio

Market Overview

Health care stocks rose slightly in June, outperforming the overall market during another volatile month for global equities. Within the health care sector, pharmaceutical stocks outperformed, while biotechnology, medical product and medical service stocks all underperformed. Clinical trial results and merger and acquisition activity garnered most of the month's major headlines.

Celgene reported strong data for its blockbuster cancer drug Revlimid at the annual American Society of Clinical Oncology (ASCO) meeting. Full results from two major studies evaluating Revlimid in the maintenance treatment of multiple myeloma patients, post-stem cell transplant, showed very good efficacy. Meanwhile, data from a third maintenance myeloma study provided further evidence of the drug's benefit in transplant ineligible patients. Together, the plethora of data supports the use of Revlimid for maintenance treatment and is expected to help drive significant adoption of the drug in this setting.

Also during the month, Celgene announced the acquisition of Abraxis BioScience for approximately USD2.9 billion in cash and stock. Through the purchase, Celgene will gain Abraxane, a chemotherapy drug currently approved to treat metastatic breast cancer. The drug is also being studied in the treatment of lung and pancreatic cancers. The deal, which is expected to close in Q4, is projected to be dilutive to Celgene's adjusted earnings in 2011 and accretive in 2012 and beyond, with no impact to 2010 results.

Bristol-Myers Squibb also had a month full of positive clinical results. At ASCO Bristol presented impressive pivotal data for its pipeline drug ipilimumab in second-line treatment of melanoma. The drug is the first compound to show an overall survival benefit in the indication and could pave the way for US approval at the end of the year. Bristol will also present data for first-line melanoma treatment later in 2010.

Additionally, Bristol and partner Pfizer announced that they had prematurely ended their Phase III trial for their blood thinner apixaban, after finding "clear evidence" that the drug was more effective than aspirin in reducing stroke risk in patients with an irregular heartbeat. With several other companies currently conducting trials for similar drugs, the results could provide Bristol with a competitive advantage, though the company will likely wait for the conclusion of its second Phase III trial in 2011 to file for regulatory approval.

Shares of Ipsen fell sharply after partner Roche announced it would delay filing of the compound taspoglutide—a once-weekly diabetes treatment—due to a higher-than-expected incidence of hypersensitivity reactions in its studies. Investors had expected the companies to file for approval of the drug in the coming months. The delay came on the heels of disappointing results from the drug's pivotal trial, which showed the drug to have worse tolerability compared to competitor compounds.

Shares of Amgen got a boost after the company announced it had received US Food and Drug Administration approval for its major pipeline drug Prolia for the treatment of post-menopausal osteoporosis. The approval, nearly two months ahead of schedule, came a week after similar approval in the EU and sets the stage for a product launch in the coming months for this indication.

Covidien agreed to buy mid-cap medical device company ev3 for USD2.6 billion. Covidien will tender for the outstanding shares of ev3 at a 19% premium to the prior day's close. Ev3's products focus on treating diseases of the vascular system, and, in particular, the acquisition will expand Covidien's presence in the peripheral vascular and neurovascular markets. The deal, which is expected to close by July 31, will be dilutive to earnings in fiscal years 2010 and 2011, becoming accretive thereafter.

Human Genome Sciences and partner GlaxoSmithKline presented detailed results from its second pivotal trial for Benlysta, its key drug for the treatment of lupus. While the longer-term data was less impressive than results from the companies' initial pivotal study, the drug continued to show clear efficacy and a good safety profile in a disease that hasn't seen a new drug approval in many years. Earlier in the month, Human Genome and Glaxo submitted the drug for regulatory approval in both the US and Europe. The companies hope to receive an accelerated review in the US, which would allow the drug to receive approval by year end.

Portfolio Performance

The Portfolio underperformed its benchmark for the month, but outperformed for the year to date.

Trading in the Portfolio was active during the month. In biotechnology, we added mid-cap names Amylin and Dendreon. In drugs, we added specialty pharma company Cephalon, Indian generics company Glenmark, and Japanese pharma company Mitsubishi Tanabe. In medical devices, we added Hill-Rom.

We exited Ipsen, due to the development delay for their key pipeline compound. We also exited Amgen, owing to potential further deterioration in their base business. Other noteworthy actions during the month included adding to Teva and trimming Bristol Myers and ResMed on relative strength.

Contributing to returns in June were positions in Edwards, Fresenius Medical and Amgen. Detracting from returns were positions in Ipsen, Teva and Express Scripts.

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