AllianceBernstein

AllianceBernstein
International Health Care Portfolio

Market Overview

World equity markets posted their largest monthly gains of 2013 in July, as investors were optimistic about the outlook for the current global monetary-easing cycle.

Capital markets received a boost on indications that the aggressive reflationary policies of key central banks would remain in place, at least in the near term. Of particular significance was US Federal Reserve Chairman Ben Bernanke's July announcement that the Fed would not wind down its massive bond-buying program until the American economy was stronger.

The market upturn was further bolstered when the European Central Bank and the Bank of Japan reaffirmed their commitment to their respective stimulus programs amid data suggesting that the economic health of both regions was gradually improving. Also, China's central bank moved to allay fears of another credit squeeze in China, the world's second-largest economy, by injecting funds into local money markets for the first time since February.

Against this backdrop, the MSCI World Index advanced 5.3% in July, its largest monthly gain since October 2011. In the first seven months of the year, the index appreciated 14.1%. (All returns are in US-dollar terms.)

Healthcare stocks outperformed the broader market, advancing 5.7% for the month, bringing the year to date gain to 24.0%. Biotechnology stocks led performance, while pharmaceutical stocks lagged.

Portfolio Performance

The Portfolio underperformed its benchmark, the MSCI World Health Care Index, in July and for the year to date. Stock selection in the health care equipment sector detracted, while an overweight to the biotechnology sector contributed.

In the US, shares of surgical-robotics maker Intuitive Surgical detracted after the company reported lower-than-expected second-quarter earnings due to slowing sales of its signature da Vinci robotic surgery machines. Intuitive also lowered its full-year revenue forecast. Our investment thesis is that the company offers disruptive technology for surgical procedures with no near-term competition. It also has significant room for earnings growth through procedure growth and geographic expansion, coupled with good free-cash-flow generation, a strong return profile and a clean balance sheet.

Also in the US, shares of drugmaker Bristol-Myers Squibb detracted after the company reported a decline in second-quarter profits due to ongoing pressure from the loss of patent protection for its top-selling heart drugs. The company also issued a negative full-year guidance revision on expectations of lower sales. Our positive stance is premised on the company's strong pipeline of potential blockbuster drugs, most notably the anticoagulant Eliquis and the melanoma drug YERVOY. Moreover, Bristol-Myers Squibb has a strong track record of acquiring companies when necessary in order to fortify its pipeline, and it has deepened its footprint in emerging markets.

Across the Atlantic, shares of Swiss pharmaceutical giant Roche detracted on profit-taking after strong price appreciation, which was highlighted when the company reported that first-half 2013 profits had surged by nearly 40%. Our investment thesis is that Roche's long-term earnings growth potential is biased toward the upside, based on the company's lucrative oncology franchise and diagnostics business. While each segment is attractive in its own right, the combination supports efficient research, development and utilization addressing large, currently unmet medical needs.

Contributors included several of the Portfolio's biotechnology stocks, including Alexion Pharmaceuticals, Celldex Therapuetics and Synageva Biopharma. All three firms are currently developing or marketing orphan drugs, which are used to treat rare medical conditions and carry an ultrahigh price.

Alexion markets an orphan drug called Soliris, which treats both a genetic and a blood disorder. Soliris is Alexion's sole product, and it's being tested in five other clinical studies to evaluate its ability to treat other rare diseases. Shares rose at month end after reports of a takeover by Roche emerged.

Celldex, the first antibody-based immunotherapy company, has a strong pipeline of products in clinical trial stages. The recent upsurge in Celldex is partly due to an announcement of the first the dosing of a patient in a pilot study of one of its orphan drugs for a rare kidney disease.

Synageva also rose during the month. The company's balance sheet remains strong, allowing for a robust effort to increase physician awareness of debilitating and rare lysosomal storage disorders.

Outlook

Healthcare is a defensive sector that has historically underperformed in rising markets. Our strategy is to maintain a focus on companies that we believe will deliver value in the long term, irrespective of market conditions. We do this by identifying companies that are attracting healthcare dollars, generally through the introduction on new treatment and therapies or offering customers cost reduction opportunities.

The Portfolio is currently modestly overweight the US and underweight Europe and Japan. Biotechnology and managed care stocks are the largest industry overweights. Pharmaceuticals remain an underweight but less than the average over the past year. The Portfolio has largely eliminated its healthcare-related consumer exposures.

We believe the Portfolio is well balanced between growth and value stocks with an underlying fundamental emphasis on market share winners. Although the sector overall should continue to benefit in the face of an uncertain macro environment, we believe the Portfolio is positioned in high quality companies that should perform well irrespective of the macro environment.

The performance discussed in this commentary is net of fees and expenses, but does not account for the potential sales charges that may apply to certain share classes of the fund.

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