



### Third Quarter 2010

#### GLOBAL CAPITAL MARKETS OUTLOOK

## The Recovery Experiences Growing Pains

**Risks have loomed larger and recent economic data have been less than inspiring. Markets have stumbled, but underlying conditions still support expansion and the global economic recovery continues.**

### Investors' Concerns Mount...

The atmosphere surrounding capital markets has been unsettled, as investors fret over the potential impact of the debt problems saddling parts of Europe. From its epicenter in Greece, contagion spread to other southern European countries, with concerns about mounting government debt extending as far as the UK and US.

Widespread anxiety reinforced the close connections between the world's markets and economies...and how worries leap borders with ease. Will nations pare their debt? How much will China's growth slow? How damaging will the Gulf of Mexico oil spill be? Is this merely a soft patch in the economic recovery...or something more severe?

\*Chicago Board of Options Exchange





### ...But the Economy Is Growing




Global stock markets rode a wave of worry to one of the largest post-recovery corrections in decades, with the MSCI World tumbling by 12.7% in the second quarter. And, the volatility index of the Chicago Board of Options Exchange (VIX), which measures expected market volatility and is widely referred to as the "fear gauge," surged from 17.6 to 34.5 by quarter-end.\*

Despite the market's substantial sell-off, conditions today are more supportive for both stocks and the economy than they were in the depths of the recession. And, even though key risks have asserted a stronger presence and some of the luster has come off of the global economic rebound, we still think chances are good for a sustainable expansion.

Stocks experienced a substantial correction in the second quarter  
Major Index Returns 2Q:10 (in USD)

Equities	Q2	YTD
MSCI World	-12.7% 	-9.8%
Emerging Markets	-8.4% 	-6.2%
Japan	-9.2% 	-2.5%
Europe	-11.4% 	-16.7%
US	-11.4% 	-6.7%

Credit	Q2	YTD
CMBS	2.8% 	12.1%
EM Debt	1.0% 	5.7%
Global Corp.	1.9% 	4.7%
Global High Yield	-0.3% 	5.0%

Government Bonds	Q2	YTD
US	4.7% 	5.9%
Japan	2.4% 	2.3%
Euro	0.1% 	2.4%

Past performance does not guarantee future results. Individuals cannot invest directly in an index. Please see the back cover for index definitions. Source: Barclays Capital, Bloomberg, Morgan Stanley Capital International (MSCI), Standard & Poor's, TOPIX and AllianceBernstein

## Growth Slows from a Jog to a Walk

**The pace of the world's economic expansion may be slightly less impressive than earlier, but our forecasts still call for growth to continue through 2011.**

### A Mix of Good News and Bad

The global economy has taken major steps forward from late 2008, when it was mired in recession, but a mix of good and bad news reminds investors that risks remain.

Leading economic indicators have moderated somewhat, and we've lowered our 2010 forecast for global growth slightly due to the headwinds in Europe—but we still expect a 3.9% increase this year. We've also lowered our 2010 forecasts for developed economies like the US, Euro Area and UK, while raising our forecasts for Japan and emerging markets, the latter of which we expect to grow by 7.6%.<sup>1</sup>

The manufacturing sector has provided an important source of momentum for the global recovery. Activity has been expanding for the past year; and, although a key global manufacturing index fell to 55 in June, it was still well above 50—the demarcation line between contraction and expansion.<sup>2</sup> Global trade flows are also growing, buoyed by recovering demand.

Of course, conditions aren't exactly rosy on all fronts. Unemployment is stubbornly high in many economies, weighing on the recovery. However, we've seen some encouraging signs recently. For example, Americans are working more hours than before: total hours worked in the second quarter rose at a 3.3% annualized rate, the strongest quarterly gain since 1997.<sup>3</sup> And the unemployment rate is falling in the US and other countries, including Australia, Canada and Brazil.

Meanwhile, many corporations outside the financial sector entered the downturn with strong balance sheets. In fact, in 2009, free cash flow generated after capital expenditures was over USD 1 trillion.<sup>4</sup> Some of this surplus undoubtedly stems from memories of difficulties in obtaining financing during the credit crisis, but these cash stockpiles may translate to greater capital expenditures ahead, supporting the economy.

### A Supportive Landscape

Extremely low interest rates and a slackening of headwinds also offer encouraging signs for a continued expansion. Many of these factors have improved meaningfully from the darkest days of the global recession.

For example, global short-term interest rates stood around 4.6% when Lehman Brothers closed its doors in September 2008. Today, the rate is less than half that level at under 2.0%, encouraging banks to tap into cheap capital...and hopefully to begin lending it out.<sup>5</sup>

Oil prices have fallen substantially—from nearly USD 101 per barrel in September 2008 to about USD 76 per barrel by the end of the second quarter—reducing energy costs for both businesses and consumers.<sup>6</sup> Households in key developed markets are also in much better shape, having significantly lowered their financial burden. For instance, total US household financial obligations fell again in the first quarter to 17.36% of disposable income, the fifth straight decline and the lowest reading since mid-2000.<sup>7</sup> Reduced payments on financial obligations tend to free up household cash flow, which may then translate into increased consumer spending.

<sup>1</sup> AllianceBernstein GDP estimates as of June 2010. Forecasts may not be achieved.

<sup>2</sup> JPMorgan Global Manufacturing PMI Index as of June 2010. Please see back cover for index definitions.

<sup>3</sup> Bureau of Labor Statistics as of July 2, 2010.

<sup>4</sup> MSCI and AllianceBernstein

<sup>5</sup> ISI

<sup>6</sup> Bloomberg

<sup>7</sup> AllianceBernstein US Economic Weekly June 11, 2010

## Re-Mixing the Global Economy

The forces feeding global economic growth are being transformed, perhaps for many years to come, with much of it stemming from the ascendancy of emerging economies.

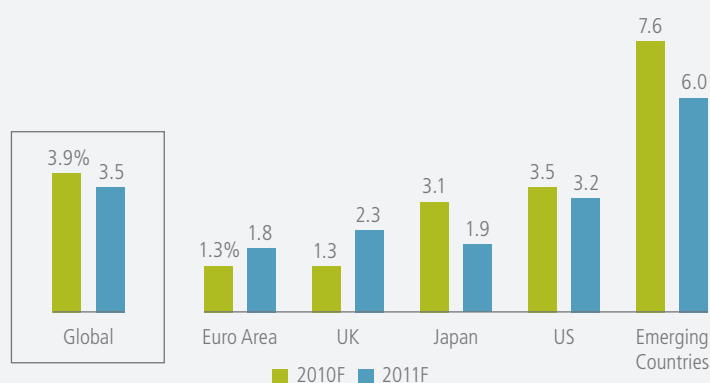
Historically, when the global economy stumbled, US demand was typically the catalyst to lead the world to recovery. But this pattern has changed dramatically. Between 1992 and 2009, the share of real global GDP accounted for by emerging markets nearly doubled. And in 2009, the global upturn began in emerging markets instead, with countries like China, India and Brazil leading the way well before most developed market countries were on their feet again.

There were good reasons why developing economies recovered first. Emerging-market banks dodged the worst of the credit crisis in 2007 and 2008, and the global recession failed to extinguish the internal domestic growth forces of many developing countries in Asia, Latin America and eastern Europe. These nations continued to benefit from a growing middle class consuming more goods and services. Major fiscal stimulus packages also helped with the ongoing development of key sectors and industries in these countries.

All of these factors have led to growth for the emerging markets that has exceeded that of the developed economies, and for the global economy in aggregate. And we expect that to continue throughout 2011.

Our economic outlook is for moderate growth driven mainly by emerging markets

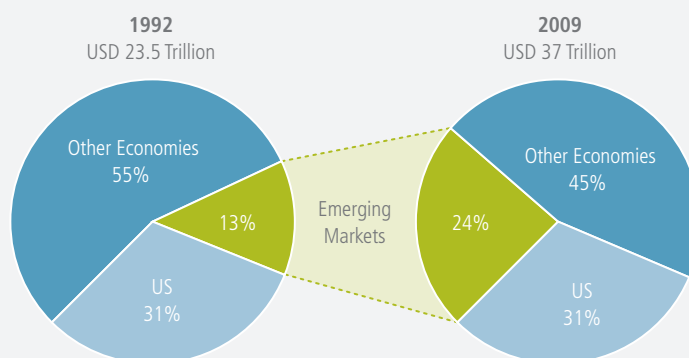
AllianceBernstein Real GDP Forecasts



Current estimates and forecasts may not be attained.  
As of 1 July 2010  
Source: AllianceBernstein

Emerging markets are playing a much larger role in the global economy

Real Global GDP



Historical analysis does not guarantee future results.  
As of 31 December 2009. Data are subject to change.  
Source: Haver Analytics and International Monetary Fund

## Potential in Stocks...But with Risks

**Equity valuations appear attractive, but volatility is higher than normal. Our investment teams are pursuing opportunities, but also considering the implications of elevated risk.**

### Corporate Profits Rising

Surveying equity markets in mid-2010 and looking forward, we believe stock valuations are likely to become more attractive, as an expanding economy translates into better corporate earnings. During the downturn, profits fell well below their long-term trend. But they've begun to recover, and the market expects double-digit profit growth in both 2010 and 2011.

Based on current prices and expectations for rising earnings, stocks could become a more compelling proposition. The evidence can be seen in the price-to-earnings ratio for global stocks, which indicates how much investors must pay for a given amount of expected stock earnings. Based on current expectations for 2010 and 2011, P/E ratios become increasingly appealing. Of course, not every stock will prosper...and some will stumble.

### Research Points the Way to Good Stocks

In our view, effective research is vital in telling the difference between winners and losers. As our growth team surveys the market, it expects the incredible pace of positive corporate earnings surprises to lose some steam. This slowing should benefit companies that continue to exceed expectations—for example, technology companies that provide data storage and management services.

Our value team, meanwhile, has been shifting some of its emphasis to companies with the attributes to weather a turbulent market: stable cash flows, stronger balance sheets and key competitive advantages. For example, the team is finding value among regional banks that seem better positioned to benefit from improving credit trends...and that offer a clearer path to earnings recovery than the market recognizes.

### Risk Is Part of the Equation

In capital markets, risk goes hand-in-hand with opportunity. Investors should give careful thought not only to the return they expect a stock, sector or asset class to produce, but also to how much that return might vary from what's expected—for better or worse.

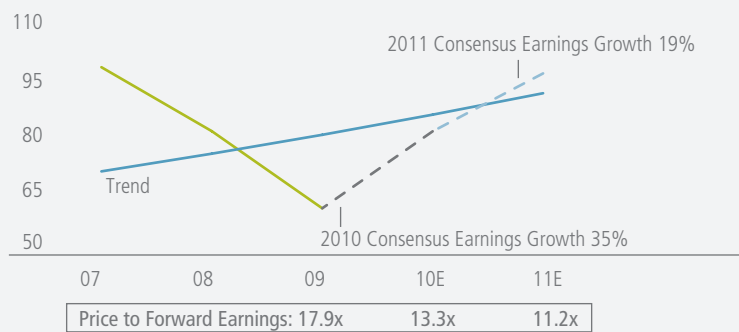
Fortunately, our research indicates that while returns are very hard to forecast, volatility is less so. Volatility is "sticky"—it spends periods of time both above normal and below normal, and it tends to move away from those extremes and back toward equilibrium at a gradual pace. This makes sense, since markets are influenced heavily by optimism and pessimism—and these attitudes don't always change overnight.

Based on our assessment, return potential for global stocks is above normal, but so is volatility; the opposite is true for global bonds. It may make sense to consider a moderate reduction in your equity exposure in favor of bonds when equity volatility is higher.

Of course, it's imperative to work with a financial advisor to choose a longterm mix of stocks and bonds that makes sense for you. But it's also worth considering making modest adjustments to that mix—not to chase returns, but to cushion against volatility. Over the long haul, this type of attentive approach may reduce portfolio volatility without sacrificing long-term returns.

### If earnings recover as expected, stock valuations may seem more compelling

MSCI World Operating Earnings per Share (US Dollars)



Historical analysis and current estimates do not guarantee future results.

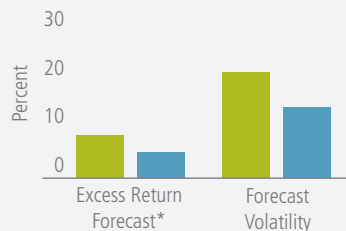
Trend line reflects growth from 1948 through 2009. Actual earnings are shown through 31 December 2009; 2010–2011 consensus estimates are as of 30 June 2010. Individuals cannot invest directly in an index. Please see the back cover for index definitions.

Source: FactSet, MSCI, Thomson I/B/E/S and AllianceBernstein

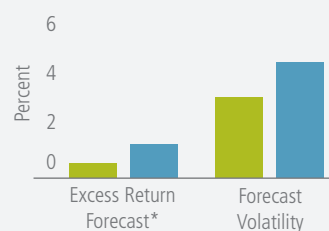
### We expect global stocks to have higher potential, but also more risk

■ Today  
■ Normal

**Stocks**  
Our forecast returns are elevated,  
but so is risk



**Bonds**  
Our forecast returns are lower  
than normal, as is risk



Forecasts may not be achieved.

12 month forecast, as of 30 June 2010. The above analysis is based on AllianceBernstein's proprietary model. Normal is AllianceBernstein's proprietary forecast of asset class returns and risks when markets are in long-run equilibrium.

\*Over US cash

Source: AllianceBernstein

### Solid Fundamentals in Corporate Bonds

Recent market volatility has highlighted the importance of research and security selection—whether investing in corporate bonds or even government bonds. Markets wobbled as risk aversion rose, with investors nervously eyeing southern Europe’s sovereign-debt crisis and the debate over US financial regulatory reform.

Acknowledging this unsettled environment, we’re paring risk in our fixed-income portfolios by slightly reducing our overweight to corporate bonds and increasing our diversification within this sector, while keeping positioned for a continued economic recovery.

Overall, the fundamental condition of corporate balance sheets is solid, particularly outside of the financial sector, although we have some concerns about certain European issuers. We still see adequate compensation in the expected returns of investment-grade bonds: the yield that these securities provide over and above government bonds remains above average. Corporate bond prices might gain further support from a slowdown in new issuance compared to recent years. With demand still robust, relatively limited supply provides stronger support for bond prices.

Finally, we continue to find select opportunities in global high yield, where careful research can help uncover bonds that offer greater return potential for an incrementally higher amount of risk.

### Fiscal Issues at the Fore

We’ve gradually reinvested some of the proceeds from our reduced investment-grade corporate exposure by adding to our government debt holdings. Specifically, we’ve favored US bonds, because their yields are higher than Japan and the euro area. Meanwhile, the risks facing “peripheral” European nations like Greece and Italy have led us to avoid them.

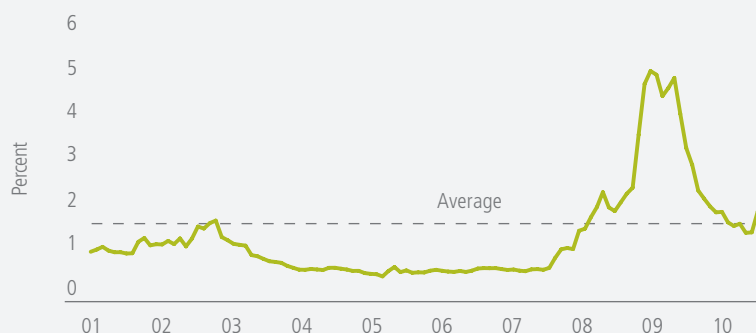
To be sure, several euro-area countries face significant challenges in refinancing their debt in coming years. But so far, policy actions have helped stem the threat of contagion to global financial markets. For example, in early May, euro-area governments and the International Monetary Fund unveiled a €110 billion support plan for Greece and, just days later, a €750 billion

rescue package to aid other troubled euro-area countries. In addition, the European Central Bank pledged to purchase euro-area public and private securities in the secondary markets to help preserve liquidity.

Although Italy, Portugal, Ireland and Spain all faced higher borrowing costs at government bond auctions in late May, the debt offerings nevertheless attracted solid demand. Sustainable economic growth would greatly alleviate the pressures on government finances by boosting tax revenues, and we believe there are grounds for optimism on this front. Ultimately, however, governments around the world must address their structural deficits—the portion of budget shortfalls that won’t be cured by stronger economic growth.

Besides global high-yield, we also like investment-grade corporate bonds

Global Investment-Grade Corporates\*



Historical analysis does not guarantee future results.  
 Through 30 June 2010  
 \*Average is for the period shown  
 Source: Barclays Capital, Bloomberg and AllianceBernstein

# Volatility Can Unearth Opportunity

**It's not easy to stay steady when the ground is shaking, but stocks have been through unstable periods before. The key is to look for attractively valued investments amid the shifting landscape.**

## Europe's Debt Crisis Reverberates

Concerns over the heavy weight of government debt have pushed bond yields higher for some European nations, and many investors are wondering whether the global economy will fall back into recession. We think the likelihood of that is small, and the related drag on European economic growth has only slightly reduced our global forecast.

Other trouble spots may continue to emerge to join the ranks of Dubai and southern Europe, but this latest episode appears to be more an aftershock than a relapse. It also seems largely localized. For example, the TED spread, a global indicator of the perceived credit risk, has risen but is still well below its average prior to the global financial crisis.<sup>8</sup>

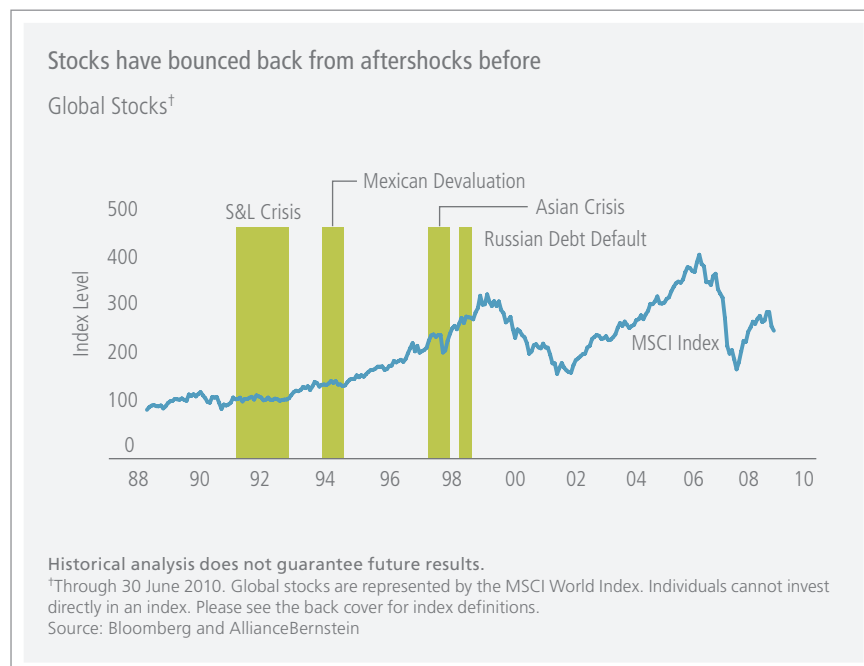
The pattern of recent events appears to have parallels in the aftermath of the US savings and loan crisis of the early 1990s. In the ensuing years, ultra-low interest rates unleashed speculative forces that eventually led to the devaluation of the Mexican peso in 1994, the Asian crisis in 1997 and the Russian debt crisis in 1998.

## Opportunity Can Spring from Restless Markets

These disturbances rattled markets, but equities eventually resumed their upward path. One reason: these aftershocks spurred monetary authorities to ease their policies or prompted one or more nations to provide fiscal stimulus aimed at encouraging economic growth and stabilizing markets.

Market setbacks can be painful, but they also allow disciplined investors to capitalize on overreactions. For example, European budget woes have weakened the euro, but some European countries are likely to see their exports grow as they become more affordable to emerging markets such as China.

Every investor has to fit these opportunities into a portfolio framework whose overall strategy should align with long-term goals. Your financial advisor may recommend adjustments to that mix based on current market conditions. But within the major building blocks of your portfolio, such as stocks and bonds, effective research can always point to areas of opportunity.



<sup>8</sup> Represents the difference between the three-month London Interbank Offered Rate (LIBOR), a measure of interbank borrowing, and the three-month US Treasury-bill yield.

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- Helping investors overcome their emotions and keep their portfolios on track

- Defining the importance of investment planning and portfolio construction in determining investment success

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For the chart on page one, emerging market equities are represented by the MSCI Emerging Markets Index, European equities by the MSCI Europe Index, Japanese equities by the TOPIX Index and US equities by the S&P 500 Index. Global high yield is represented by the Barclays Capital Global High-Yield Index, US CMBS by the Barclays Capital Commercial Mortgage-Backed Securities (CMBS) Index, emerging market debt by the Barclays Capital US Dollar Emerging Markets Index and global corporate bonds by the Barclays Capital Global Corporate Bond Index. Euro, Japan and US government bonds are represented by the Barclays Capital Euro Treasury, Japan Treasury and US Treasury indices, respectively. Please see index definitions below for further description. MSCI makes no express or implied warranties or representations, and shall have no liability whatsoever with respect to any MSCI data

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Index Definitions: The **Standard & Poor's 500 Index** includes 500 US stocks and is a common measure of the performance of the overall US stock market. The **MSCI World Index** is a market capitalization-weighted index that measures the performance of stock markets in 23 countries. The **MSCI Emerging Markets Index** is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets. It consists of 26 emerging market country indices. The **MSCI Europe Index** is a free float-adjusted market capitalization index that is designed to measure developed market equity performance in Europe. The **Barclays Capital US Dollar Emerging Markets Index** includes USD-denominated debt from emerging markets in the following regions: Americas, Europe, Middle East, Africa and Asia. The **Barclays Capital Global High-Yield Index** provides a broad-based measure of the global high-yield fixed income markets. The **Global High-Yield Index** represents that union of the US High-Yield, Pan-European High-Yield, US Emerging Markets High-Yield, CMBS High-Yield and Pan-European Emerging Markets High-Yield Indices. The **Barclays Capital Commercial Mortgage-Backed Securities (CMBS) Index** tracks the performance of USD-denominated commercial mortgage-backed securities publicly issued in the US domestic market. The **Barclays Capital Global Corporate Bond Index** tracks the performance of investment-grade corporate bonds publicly issued in the global market. The **TOPIX Index** measures stock prices on the Tokyo Stock Exchange (TSE). The **Barclays Capital US Treasury Index** includes fixed-rate, local currency sovereign debt that makes up the US Treasury sector of the Global Aggregate Index. The **Barclays Capital Japan Treasury Index** includes fixed-rate, local currency sovereign debt that makes up the Japanese Treasury sector of the Global Aggregate Index. The **Barclays Capital Euro Treasury Index** includes fixed-rate, local currency sovereign debt that makes up the Euro Treasury sector of the Global Aggregate Index. The **Barclays Capital Global Treasury-UK Index** is the UK component of the Global Treasury Index. The **Barclays Capital Global Treasury-Canada Index** is the Canada component of the Global Treasury Index.

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