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THE FIRST GREEN SHOOTS OF SPRING P2

MARKET RECOVERIES
DON'T WAIT FOR GOOD NEWS P3

TUNE UP YOUR PORTFOLIO BC

Breaking Open Frozen Credit Markets

Government programs that encourage lending by Wall Street investors are designed to help consumers cope with the lingering financial crisis.

The credit crisis hit home for many people last year when they went to buy a car at their local dealership—and found themselves turned down for a loan. Others came face to face with frozen lending markets when they wanted to buy a home.

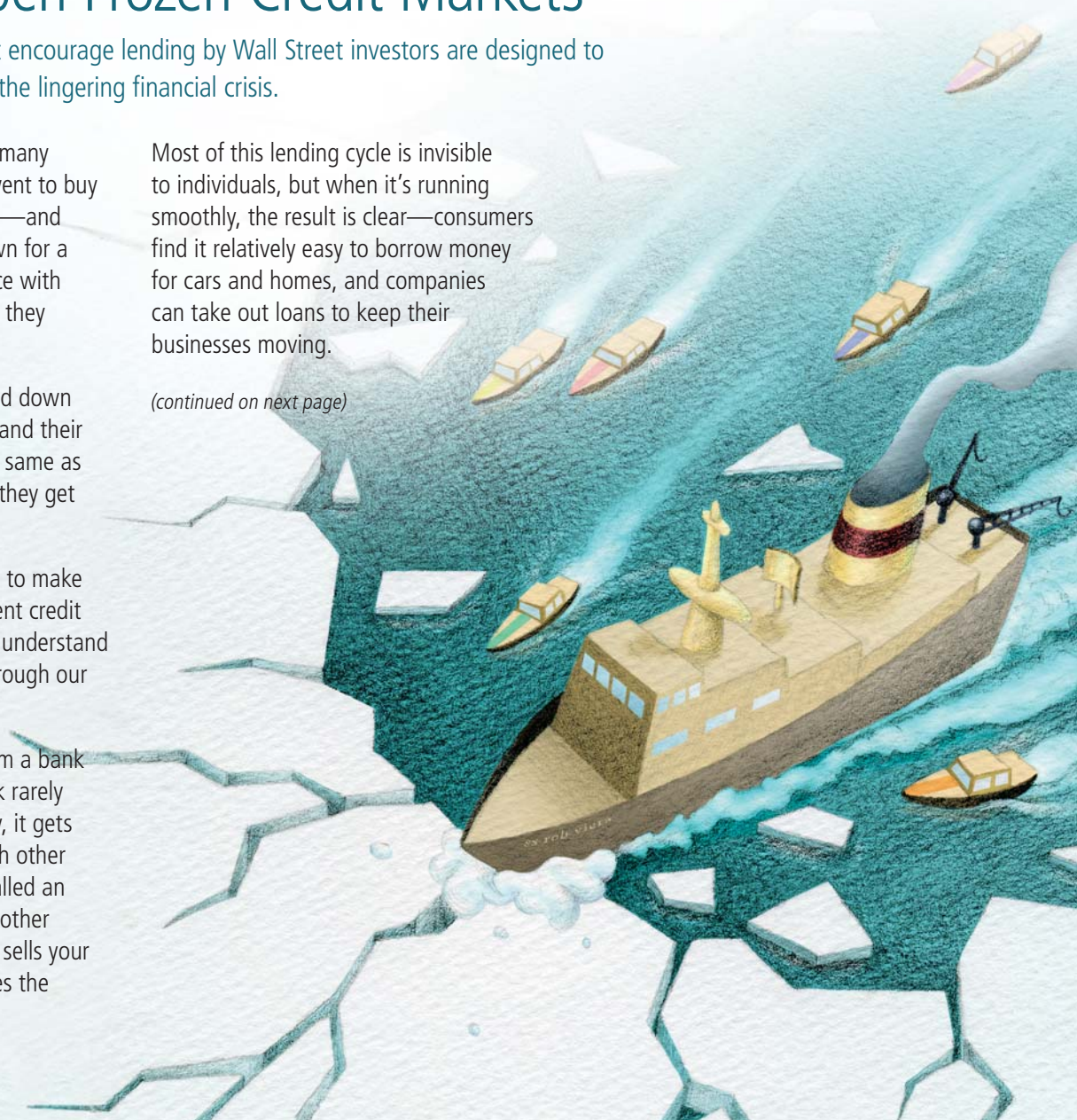
If the people who were turned down were still gainfully employed and their credit ratings were about the same as they had been, why couldn't they get a loan?

To answer that question, and to make sense of the recent government credit stimulus efforts, you need to understand the path that loans follow through our economy these days.

When you borrow money from a bank for a car or a house, the bank rarely holds on to that loan. Usually, it gets packaged and sold along with other loans in a new incarnation called an asset-backed security, which other investors buy. After the bank sells your loan, it pockets a fee and uses the money to make more loans.

Most of this lending cycle is invisible to individuals, but when it's running smoothly, the result is clear—consumers find it relatively easy to borrow money for cars and homes, and companies can take out loans to keep their businesses moving.

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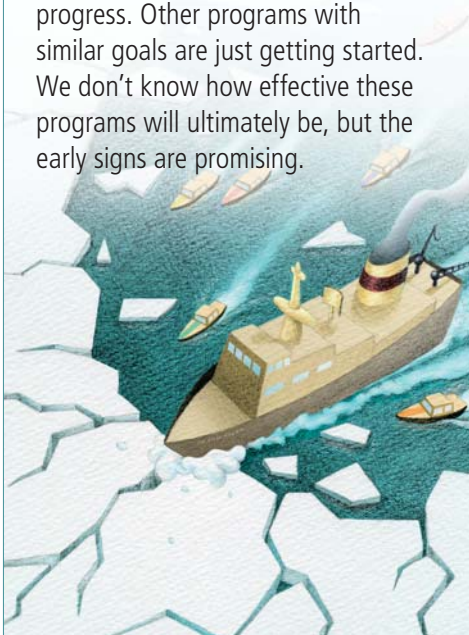
Breaking Open Frozen Credit Markets

(continued from cover)

The financial crisis changed all of that. By late 2008, the world's credit markets were almost frozen: large investors stopped buying asset-backed securities, so banks stopped lending. As global trade and industrial production collapsed, the economy nose-dived, and shaken consumers and businesses grew reluctant to borrow...even if they *could* get their hands on a loan.

Governments around the world stepped in with dozens of new programs to get credit flowing again. One US government program, the Term Asset-Backed Securities Loan Facility, or TALF, was designed to encourage big investors to start buying asset-backed securities again. The end goal is to restart the lending machine—and ultimately to lower the cost of borrowing for people and businesses.

Although it's still early in the game, TALF appears to be making some progress. Other programs with similar goals are just getting started. We don't know how effective these programs will ultimately be, but the early signs are promising.



The First Green Shoots of Spring

Although no one can predict the future, there are encouraging signs that conditions may be improving. Here are four signs that things might be headed in the right direction.

1 Companies are finding it easier to raise money

Most businesses need credit in order to grow. Financial institutions need it just to keep operating. When credit dried up last year, many financial institutions had to rely on government guarantees to issue the bonds they needed to survive.

Today, more financial companies are able to issue those bonds without government help, and that's a big step forward. Non-financial corporations are finding it easier, too. Companies raised \$425 billion in the first four months of this year—more than double the previous four months—and another \$95 billion in May.¹ Those numbers usually indicate that investors are feeling better about the future of the economy.

2 Money-market funds need fewer government guarantees

Money-market mutual funds help keep the credit cycle moving by investing in bonds, but they need the support of investors' capital to do it. During the panic of 2008, many investors grew wary of money-market funds. To prevent massive withdrawals, the funds had to pay the government a fee to guarantee investors' assets. Now that investors' fears have receded a bit, fewer money-market funds are using the guarantees.

3 Jobless claims are declining

Although the total number of unemployed people is still very high, it's important to keep an eye on the number of people filing new unemployment claims every week. If more people file claims than the previous week, it indicates that the economy is getting worse. But a decline in new jobless claims can indicate that recovery is on the horizon. In May, the pace of layoffs began to slow significantly. There's no guarantee they won't pick up again, but it's another sign the economy may be on the mend.

4 Consumer confidence is rising

The consumer sector accounts for more than two-thirds of US economic production, so the economy rises and falls based largely on consumers' willingness to spend. The Conference Board Consumer Confidence Index posted a slight increase in March, a larger increase in April and a sharp increase in May. Although confidence is still low by historical terms, it may indicate that consumers will be more likely to spend—and fuel a recovery.

¹ Bloomberg, JPMorgan Chase, Thomson Financial and AllianceBernstein

Market Recoveries Don't Wait for Good News

You're likely to miss the next market rebound if you wait for things to turn upbeat.

Everybody's looking forward to economic recovery, but much of the news these days is discouraging. How much attention should we pay to these forbidding headlines?

The simple answer: not much.

Stock markets usually recover before good news hits the headlines. In fact, most recoveries tend to occur when the news reports are generally awful.

"Bad News" Stock Market Rebounds

Take 1932: The United States was mired in the Great Depression. Economic growth fell 23%, the top tax rate jumped from 25% to 63% and nearly a quarter of the workforce was unemployed.² The financial infrastructure was in disarray—thousands of banks had failed over the previous three years.

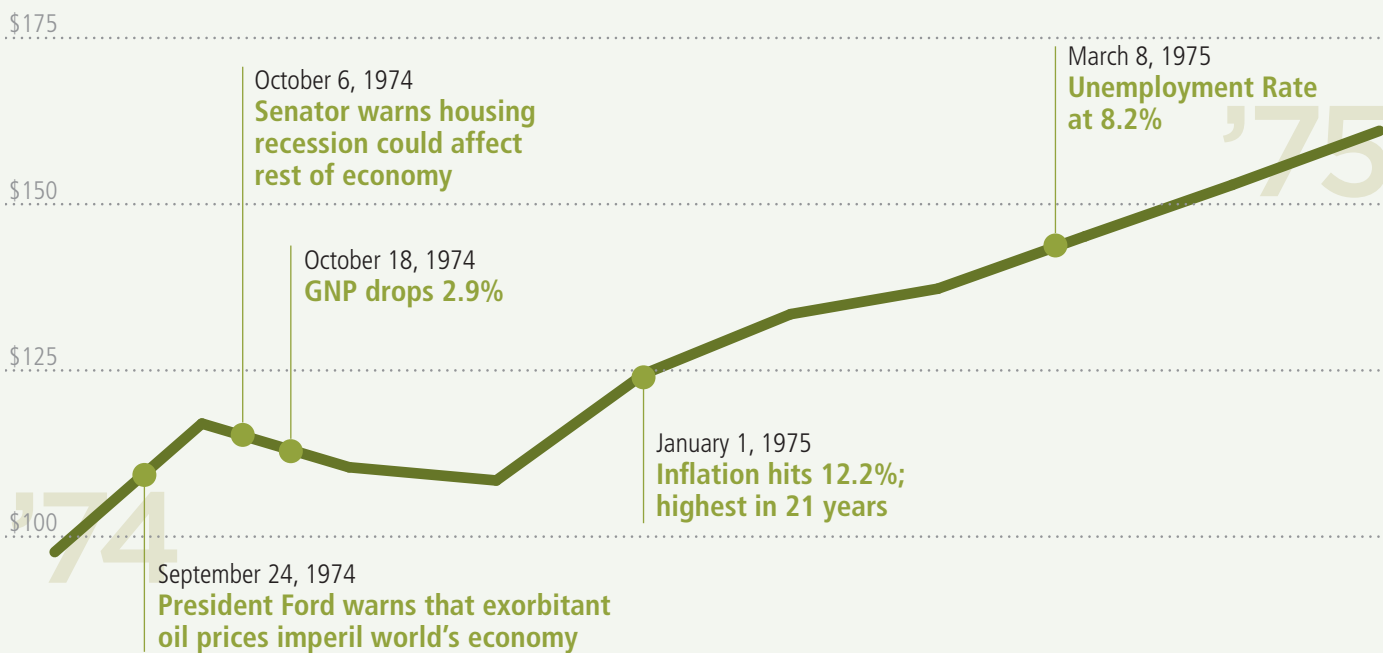
Still, stocks began to climb that year, and would eventually go on to recover fully and resume their long-term rise. The economic headlines might have said otherwise, but better times were ahead for equity markets.

The US struggled with another deep slowdown in 1974 and 1975: inflation soared, unemployment continued to climb, and a housing recession and high oil prices threatened the economy. Yet stocks found their footing and began to rally.

As these examples suggest, stock-market recoveries often start in the darkness before the dawn. That same darkness can also obscure the new opportunities that often emerge in the midst of bad economic times: the bad news of 1975 didn't prevent a certain college dropout from starting a company called Microsoft.³

Bad News Headlines Didn't Stop the Market Recovery in 1974 and 1975

Growth of \$100 Invested in US Stocks at Trough of '70s Recession



Past performance does not guarantee future results.

US stocks are represented by the S&P 500 Index, which includes 500 US stocks and is a common measure of the performance of the overall US stock market. This is a hypothetical example and does not indicate the results of any investment.

Individuals cannot invest directly in an index.

Source: Lipper Inc., The New York Times, Standard & Poor's and AllianceBernstein

² US Bureau of Economic Analysis, US Bureau of Labor Statistics, US Department of the Treasury

³ References to specific companies are not to be considered recommendations by AllianceBernstein to buy or sell those securities

Tune Up Your Portfolio

Your portfolio may look a lot different today. It may be time for a rebalancing act.

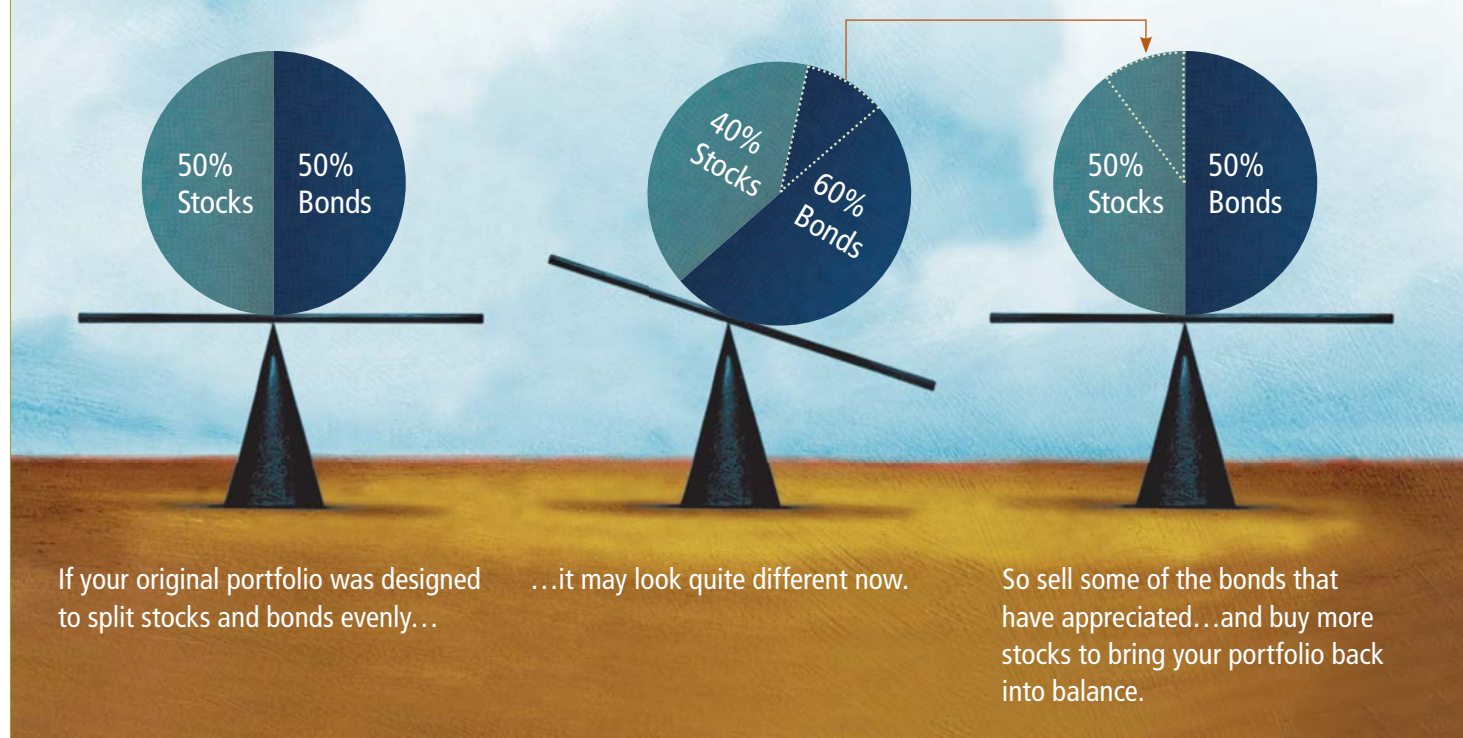
In these trying times, you may be tempted to simply leave your most recent statement unopened on the kitchen counter to avoid the pain of looking at what you've lost. However, there's one part of your statement you should be sure to check, and that's your asset allocation.

It's very possible that the intense market volatility disrupted your carefully designed balance between asset classes like stocks and bonds. For example, if you originally invested 50% of your assets in bonds and 50% in stocks at the beginning of 2008, your portfolio might have been closer to a 60/40 split of bonds and stocks less than a year later.

If that's the case, it's time to sell some bonds and invest the proceeds in stocks to keep your portfolio faithful to your original strategy. It may seem counterintuitive to sell assets that have appreciated in value to buy assets that have declined in value, but reallocating your investments forces you to sell high and buy low.

Review your investment strategy. Make sure you get your portfolio back into balance. Your ability to achieve your long-term financial goals may depend on it.

How to Stay True to Your Original Investment Strategy



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