

June 2006

Capital Markets Outlook: A Time to Rebalance

With this outlook, we apply our global research effort to identify and explain important market developments and investment opportunities. By doing so, we hope to help you become better informed and, as important, remain invested in the face of any uncertainty you may feel.

Japan and Europe Picking Up the Economic Baton

By some measures, the global economic growth story could not be more balanced. We forecast that global economic growth (expressed in terms of gross domestic product, or GDP) will stay on track in 2006 and should grow 3.4%, slightly better than in 2005 (see Display 1).

The U.S. will likely be less of a force on a global level than it has been for some time. We expect the U.S. growth rate to be 2.9%, which is healthy but below our projected global average.

So where will global growth come from? We think it'll be the emerging markets, particularly in Asia and Eastern Europe, as well as stepped-up activity in Japan and Developed Europe.

Corporate Sector to Drive the U.S. Economy

As economic growth remains intact on a global level, we see the underpinning of U.S. growth shifting from free-spending consumers to the corporate sector.

Consumer spending accounts for around 70% of U.S. GDP and has been a major contributor to economic growth in recent years. Now it's slowing down due to rising energy prices and interest costs, which are at their highest levels as a percentage of disposable income in over 10 years.

The consumer has much less cash available to spend, and the U.S. economy will feel the impact. But while the consumer is fully extended, we expect the corporate sector to pick up much of the slack. Corporate cash flow and operating profits are reaching new highs. In addition to using this as an opportunity to return money to shareholders through dividends and stock buybacks, many companies are substantially increasing their capital expenditures.

Rebalancing into U.S. Growth Stocks: Still a Strategic Imperative

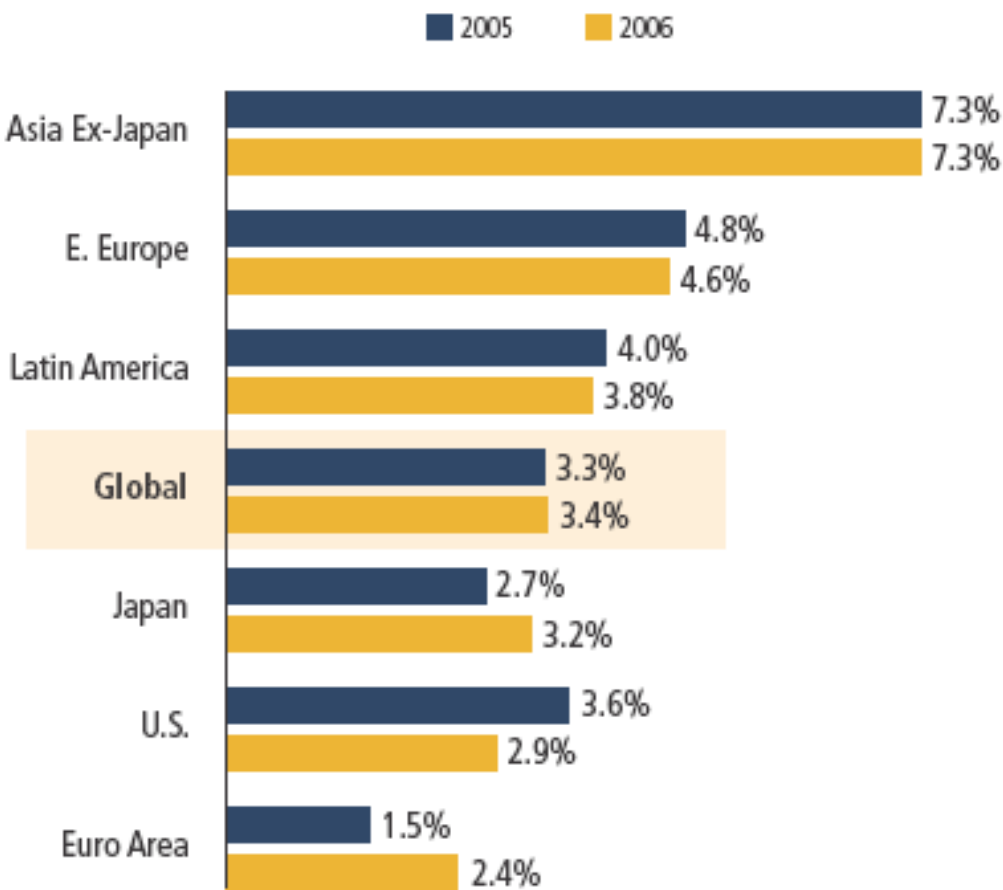
Our belief is that value stocks won't stay on top forever. We've been making the case for rebalancing into growth since 2004, and we remain confident that the days of growth's underperformance are in the process of ending.

Our own fundamental view is that investors should take a strategic, longterm investing approach, which is why we advocate equal allocations within stocks to value and growth as the right approach at all times.

Display 1

U.S. Growth Slows as Japan and Europe Recover

Global Real Economic Growth Forecast Percent Average Annual Rate



Current estimates do not guarantee future results.

As of March 15, 2006

Source: AllianceBernstein

We therefore urge investors to consider rebalancing their portfolios so that value is not out of proportion and growth is well positioned to gain as the style cycle changes.

The U.S. Capitalization Cycle Is Shifting to Large Stocks

As shown in Display 2, large caps and small caps have enjoyed successive periods of outperformance over the past decade. It's not surprising that small caps have done so well recently. The economic environment was ideal for them: the early stages of a strong expansion with low interest rates, low inflation and plenty of credit available for corporate borrowers.

Display 2

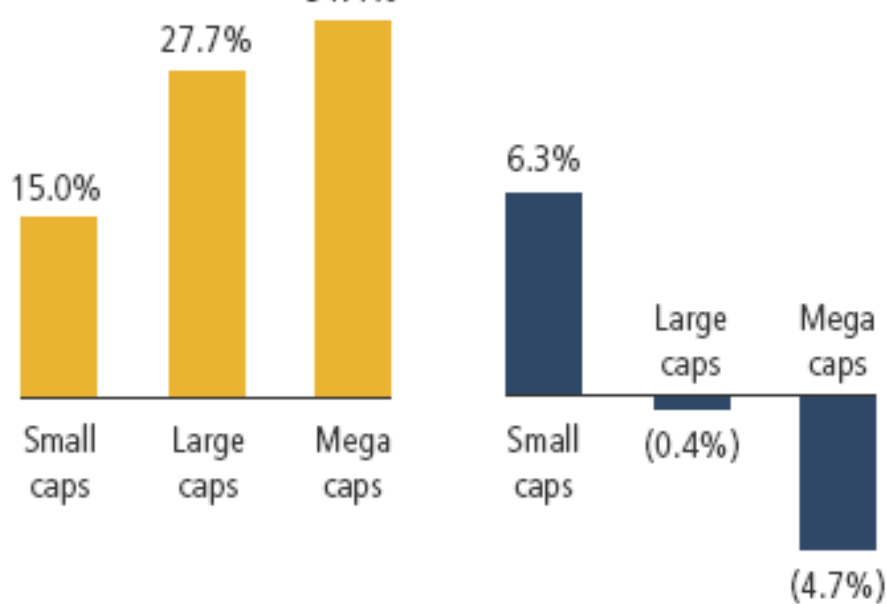
The Time for Large Caps Is Near

5-Year Annualized Returns

Large Caps Outperform
1995–2000

Small Caps Outperform
2000–2005

31.4%



Past performance is no guarantee of future results.

Sources: Russell Investment Group and Alliance-Bernstein

The following unmanaged indices are represented in the chart. None of the indices reflect fees and expenses associated with the active management of a mutual fund portfolio. Small-cap U.S. stocks: Russell 2000 Index—measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represent approximately 8% of the total market capitalization of the Russell 3000 Index; Large-cap U.S. stocks: Russell 1000 Index—measures the performance of the 1,000 largest companies in the Russell 3000 Index, which represent approximately 92% of the total market capitalization of the Russell 3000 Index; Mega-cap stocks: Russell Top 200 Index—measures the performance of the 200 largest companies in the Russell 1000 Index, which represents approximately 75% of the total market capitalization of the Russell 1000 Index. An investor cannot invest directly in an index or average, and their results are not indicative of the performance for any specific investment, including any AllianceBernstein mutual fund.

But today's economic environment--the later stages of the economic cycle featuring rising interest rates and decelerating growth--is when large caps have historically tended to perform best. This suggests to us that leadership may be set to rotate back to large caps. We see the present as a good opportunity to rebalance portfolios to bring large caps back up to their allocations relative to smaller-cap stocks.

The Case for International Stocks Remains Strong

We also feel that investors should maintain a long-term, strategic allocation to non-U.S. markets. The top three players (based on market capitalization) in banking, autos and household durables, for instance, are based outside the U.S., as are many other prominent companies.

The wider universe of opportunity in non-U.S. stocks is one of several good reasons for investing in them. Another is that profitability has been stronger among overseas companies than those in the U.S. Within the universe of non-U.S. stocks, we're optimistic about the prospects for emerging markets.

Interest Rates Should Stay Put, Bond Yields May Rise

Since the Federal Reserve (the "Fed") started its latest round of interest rate hikes in June 2004, annualized core inflation has hardly moved, going to 2.1% from 1.9%. Given what appears to be a well-entrenched and tame core inflation rate, we think the Fed would be wise to hold off on making any more rate hikes for the time being.

In general, we feel that a cautious stance on bonds is most appropriate. It's important to remember when discussing bonds that, regardless of the directional trend in interest rates at any given time, bonds should have a meaningful place in a well-diversified portfolio. They not only provide a solid source of income, but also act as an excellent portfolio stabilizer when combined with stocks and other assets.

Diversification Is the Key to Successful Long-Term Investing

All of the topics we've covered lead us inevitably to the conclusion that diversification by asset class and style remains the foundation of successful long-term investing.

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Summary

- > Global economic growth is well balanced and should remain intact in 2006.
- > It's a good time to rebalance portfolios by adding to U.S. growth and large-cap stocks.
- > The case for non-U.S. stocks is still strong, including emerging markets.
- > U.S. interest rates are unlikely to rise much further.
- > Portfolio diversification remains the key to successful long-term investing.

Courtesy of Alliance Bernstein Investments

"Diversification cannot ensure a profit or protect against a loss." and "International investing entails special risk considerations, including currency fluctuations, lower liquidity, economic and political risks, and differences in accounting methods. Past performance cannot guarantee future results."

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