

ACM Government Opportunity Portfolio: Frequently Asked Questions

How do you decide which sectors, and in what proportion, to invest, and how do you determine the level of risk that is appropriate given market conditions?

For all Closed-End portfolios, the appropriate level of risk in the portfolio is determined through a process that combines AllianceBernstein's forward looking forecasts with current market conditions and opportunities. These conditions inform a key component of our investment process, namely Risk Budgeting. Risk Budgeting represents the aggregate level of risk to be undertaken in the portfolio given market conditions, and is performed primarily at two levels. One is at the portfolio level- a determination is made as to the aggregate level of risk to be taken. Another level of risk budgeting is done at a "Risk Factor" level. These factors are Country/Yield Curve, Sector, Issue, Currency, and Leverage. Research related to these factors answers the question of where and how to distribute the risk.

Generally, the level and composition of risk taken in the portfolio is a function of when, where, and how much the market is compensating risk taking. Our research has shown us that there are times when the market compensates investors more for taking a given level of risk than at other points in the market cycle. In short, when the market is paying investors well on a relative basis to take risk, we will generally increase risk exposure in the portfolio. Conversely, when it is compensating investors poorly on a relative basis we will generally look to reduce risk in the portfolio. The amount that we vary these risk exposures is dependent on the individual portfolio objectives and portfolio guidelines.

At a portfolio-specific level, the amount of risk taken is also a function of its objective and guidelines. In the case of the ACM Government Opportunities portfolio, the objective is to provide investors with high current income consistent with preservation of capital. This objective implies a generally lower level of risk than a portfolio which, for example, seeks a high level of income or total return without the additional objective of capital preservation or safety of capital. In order to deliver on this objective, the portfolio is constructed almost exclusively as a government portfolio, with a requirement that at least 65% of assets be invested specifically in U.S. Government securities. The remaining non-US Government investments are generally composed of emerging market debt (both U.S dollar and local currency denominated), which provides an additional investment opportunity set, as well as potential diversification benefits within the portfolio.

Given its objective and investment guidelines, levels of risk within the ACM Government Opportunities portfolio are adjusted by increasing or decreasing exposure to interest rate risk, and within the holdings of emerging market debt, and the portfolio as a whole, by increasing or decreasing the proportion of emerging market securities and the currency denomination of those securities, as well as the relative credit quality of those holdings.

What type of leverage does this portfolio use, and what specifically is your philosophy/approach to using leverage?

There are essentially two main ways to utilize leverage in a portfolio. They are: Investment Operations, through transactions such as reverse repurchase agreements, leverage is produced within a portfolio; and Borrowing, such as bank loans or the issuance of preferred shares.

The type of leverage utilized is often a function of portfolio specific factors, such as the investment guidelines/ allowable investment universe of the portfolio. In the ACM Government Opportunity portfolio, leverage is employed through investment operations. This is primarily due to the nature of the sovereign securities within Government Opportunity, which lend themselves

to "reverse repurchase agreements". A reverse repurchase agreement, which is not a practical technique for all asset classes, is generally a more cost-effective form of leverage than borrowing.

The portfolio's philosophy on the use of leverage derives from its sovereign denominated holdings, which in turn produces a portfolio with a dominant risk, namely interest rate risk. This interest rate risk is most commonly measured via a duration calculation. When leverage is employed, it may increase the portfolio's yield, but also magnify its risk. In the case of the ACM Government Opportunity portfolio, this therefore means magnifying exposure to interest rate risk. Because of this, the amount of leverage within the ACM Government Opportunity portfolio at any given time is a risk/return decision based upon current market conditions, and will vary over time.

How are the above responses reflected in what you have done historically?

- As mentioned in the previous question, the major risk measurement tool for this portfolio is interest rate duration. Duration is adjusted over time to reflect current market conditions. Over the past few years duration has averaged between 6 and 8 years.
- Consistent with the portfolio's philosophy on the use of leverage, leverage has varied considerably over time, ranging from relatively low to relatively high levels.

What is your current outlook for the fixed income markets and how have you positioned the portfolio as a result?

- We expect Treasuries to trade in a tight range given the pause in Fed policy and a likelihood of an extended pause as the market and the FOMC await growth and inflation data. The markets also seem to be tempered by the weakness in the housing market which is offsetting any concerns about continued robust inflation. Hence, we view 4.75%-5.25% as an appropriate range for the benchmark 10-year Treasury yield and will manage the Treasury exposure similar to that of the Lehman Government benchmark duration. Mortgage negative convexity presents support to a rallying Treasury market if 10-year yields trade below 4.7%.
- Our fundamental research remains bullish on the outlook for local currency markets in countries such as Brazil, Turkey, Mexico, Peru and Poland. Real interest rates in these countries are much higher than real interest rates in developed economies. We believe the market is under-estimating the underlying improvement in domestic macro-economic fundamentals in these countries. We expect real rates in these countries to converge to the levels of developed economies over the next few years.
- Current exposure to emerging market local currency bonds is 26%. About 9.5% of the currency exposure is hedged, leaving us with 16.5% currency exposure.
- Even with the inverted US yield curve we believe the recent increase in leverage is justified given our forecast for unchanged Fed policy and the investment opportunities available in mortgage-backed securities and emerging market debt.