

ACM Managed Income 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 driven 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 for 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.

In the case of the ACM Managed Income portfolio, the objective is to provide investors with a high level of total return by seeking both high current income and capital appreciation. This objective implies a generally higher level of risk than a portfolio which seeks a more conservative objective, such as capital preservation or safety of capital. In pursuing this objective, we construct the portfolio as a "credit barbell". This means that higher quality investment grade securities are balanced with below investment grade securities (up to a maximum of 50% of assets). A credit barbell diversifies the primary source of risk between interest rate risk (high grade issues), and credit risk (high yield issues).

As such, levels of risk are adjusted within the high grade portion of the ACM Managed Income portfolio by increasing or decreasing exposure to interest rate risk, by choosing high grade alternatives to US Treasuries, such as US Agency securities and mortgage-backed securities; and within the high yield allocation, and the portfolio as a whole, by increasing or decreasing holdings of high yield securities, as well as the relative credit quality of those securities.

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 and actual leverage utilized is often a function of portfolio specific factors, such as the investment guidelines/ allowable investment universe of the portfolio. In the ACM Managed Income portfolio, the type of leverage employed is preferred shares. The primary reason for this is the holdings within Managed Income- a large percentage of the portfolio is invested in High Yield

securities. The nature of the High Yield securities within Managed Income is that they do not lend themselves to "reverse repurchase agreements".

The portfolio's philosophy on use of leverage comes from our own research. It indicates that within a multi-sector portfolio, leverage should generally be maintained at a higher level as there always exists an area of relative outperformance where leverage should be employed. For example, in falling rate environments, interest rate-sensitive securities tend to perform well, whereas high yield securities tend to underperform on a relative basis as falling rate environments tend to be indicative of a weak/weakening economy, which adversely affects credit-sensitive securities. However, rising rate environments, while adversely affecting interest rate-sensitive securities, tend to be indicative of a strong/strengthening economy, which positively impacts the relative performance of credit-sensitive securities. This concept (which is also the investment rationale behind the use of a credit barbell), illustrates the availability of relative opportunities within a multi-sector portfolio that in turn supports the consistent use of a relatively higher level of leverage.

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

As we believe that high yield will outperform less risky asset classes over time, we will often be closer to our maximum (50% of the portfolio for Managed Income) weighting in HY. Recently however, our sector models have been forecasting negative excess returns for high yield due primarily to the flat/inverted yield curve and tight spreads. As such, we have been reducing the High Yield weighting toward the lower range of what we expect over market cycles. The amount of leverage, consistent with our philosophy on multi-sector portfolios noted above, has historically been at a relatively high level.

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

US Governments

We expect Treasuries to trade in a tight range given the pause in Fed policy and the 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%.

High Yield

Credit fundamentals are currently quite strong as low rates and tight spreads have allowed many companies to extend their debt maturities at very attractive rates. While we expect the default rate within high yield to remain low over the next 6-12 months, we are becoming a little more concerned over the longer-term. The recent trend toward leveraged buyouts with minimal equity contributions and employing high degrees of leverage is troubling and could hurt the market should the economy weaken.

We are somewhat cautious on the near-term performance potential for the High Yield Credit markets. Our quantitative analysts have identified several factors that are relevant in predicting future excess returns in High Yield including shape of the yield curve and spread level. The

flatness of today's yield curve along with narrow spreads indicates that investors are not getting paid for extending down the credit curve.

As such, we are modestly underweight High Yield exposure and are also positioned more conservatively relative to the index. Although this involves a modest give-up in yield, we remain confident that this is the right strategy in the current environment and will look to get more aggressive at a time where the market better compensates us for taking risk.

Our security specific expected return model continues to indicate that opportunities are few and far between. As such, we are maintaining a highly diversified portfolio and are keeping our tracking error from credit selection at the bottom of our long-term expected range.