AllianceBernstein®
Investment Research and Management

On Our Website:
www.alliancebernstein.com

Posted August 2005


Muni Bond Update: Improved Finances Drive Strong Quarter

By **David Dowden,** Senior Portfolio Manager, and
Terrance T. Hults, Senior Portfolio Manager

Second-Quarter 2005 Investment Summary

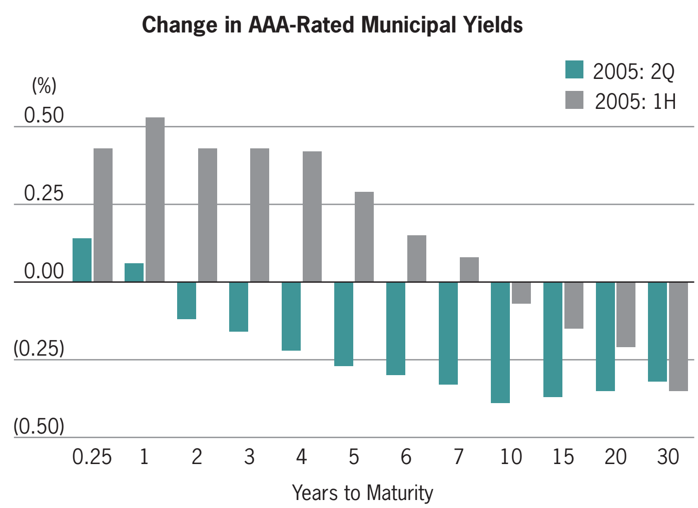
- Money-market rates rose as the Federal Reserve raised official short-term rates twice during the quarter, but most bond yields fell, with long-term rates declining the most.
- Issuers took advantage of declining rates by selling a record amount of municipal bonds, causing weakness in municipal bonds versus taxable bonds; municipals are now historically inexpensive.
- Municipal bonds posted a strong second quarter but fell short of taxable bond returns at longer maturities.
- Lower-rated bonds were the strongest performers due to the combination of high demand for income and limited supply of high-yield municipal bonds.
- Tax revenues continue to beat forecasts, improving the financial condition of state and local issuers; we anticipate upgrades in this sector.
- We have increased our credit rating for California bonds and have a positive outlook for New York City and the State of New York.
- We expect economic growth to remain strong and the Fed to continue to tighten monetary policy at a measured pace, so we're maintaining our shorter-than-benchmark duration.

Market Review

Interest rates fell despite continued monetary-policy tightening by the Federal Reserve. The targeted short-term Federal Funds interest rate now stands at 3.25%, after two additional 25-basis-point rate hikes in the second quarter. All told, the Federal Reserve has raised the Federal Funds rate by 2.25% since June 2004.

In our view, falling interest rates are primarily the result of complacency about inflation pressures and the sustained buying of U.S. Treasuries and other taxable bonds by foreign investors. Municipal bond yields also declined (*Display 1*), but without the same demand from foreign investors, they didn't fall as far as taxable bond yields.

Display 1
Municipal Bond Yields Fell in Second Quarter



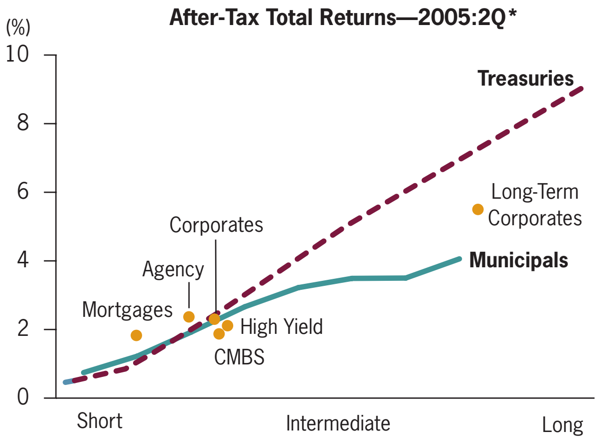
Source: Municipal Market Data Corp. and AllianceBernstein

There is no guarantee that any forecasts or opinions in this material will be realized.
Information should not be construed as investment advice.

With yields declining, municipal bonds posted strong returns in the second quarter but fell short of taxable bond returns at the longest maturities (*Display 2*). As a result, municipal bonds are now historically inexpensive in relation to taxable bonds.

Display 2

Long-Term Municipal Bonds Trailed Taxable Bonds



*Assumes 35% federal tax rate
Source: Lehman Brothers and AllianceBernstein

Record new issuance of municipal bonds in the first half of the year was one factor that impeded the market's performance. The decline in long-term interest rates prompted a 57% increase in issuance for refunding purposes versus the comparable period last year. Meanwhile, issuance for new money purposes actually declined.

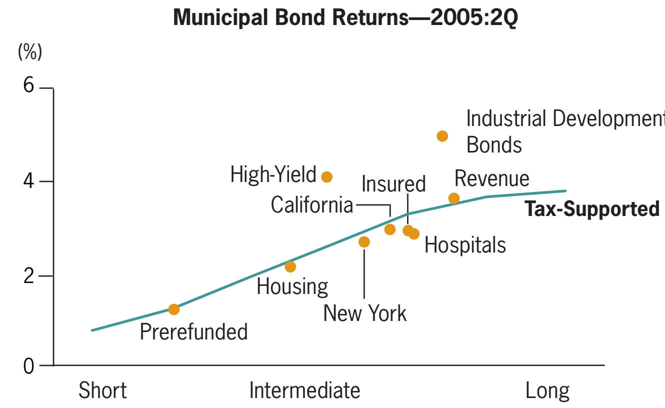
Investors were clearly rewarded for taking additional risk in the second quarter: The best performers in the municipal market were securities offering higher relative yields. Tobacco-backed bonds, which are part of the industrial-development-bond sector, and high-yield municipal bonds performed very well (*Display 3*) as investors clamored for income.

The strong returns of municipal high-yield bonds stood in sharp contrast to the taxable high-yield corporate bond market, where demand was weak. Yield spreads on high-yield corporate bonds widened sharply during the quarter, reflecting a rising risk premium, while high-yield municipal bond spreads continued to narrow.

Although high-yield municipal bond yield spreads have historically been lower and more stable than high-yield corporate spreads, we think it's likely that municipal high-yield spreads will eventually rise—causing underperformance—if investors continue to demand greater yield spreads for corporate high-yield bonds.

Display 3

Municipal Bond Investors Were Rewarded for Taking Risk



Source: Lehman Brothers

Limited supply also helped to boost returns of lower-rated municipal bonds. Issuance has lately been dominated by insured bonds, which reached a record 60% of total municipal issuance this year. Insured issuers are typically rated A or BBB, but the presence of insurance raises their ratings to AAA. A greater issuance of insured bonds therefore reduces the relative volume of lower-rated bonds in the municipal market by increasing the volume of higher-rated securities.

Portfolio Strategies

Overweighting the Tax-Supported Sector

Strong economic growth has allowed state and local governments to enjoy continued broad-based revenue growth. Most states are exceeding their revenue projections for personal and corporate income taxes and are on target to meet sales-tax projections. Strong growth in new construction and home-price appreciation are also contributing to property-tax growth at the local level. This has had a beneficial effect on the credit ratings of state and local governments.

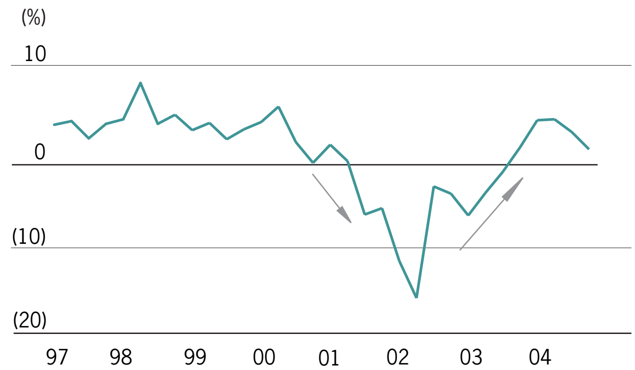
In 2004, for example, upgrades for tax-supported bonds outnumbered downgrades by 490 to 138—a trend that has continued into 2005. We have overweighted the tax-supported sector in our intermediate portfolios in an effort to benefit from these upgrades; we continue to purchase tax-supported bonds in our long-term portfolios on an opportunistic basis.

There is a clear relationship between municipal tax-revenue growth and changes in credit ratings for tax-backed issuers. Over the past five years, state-tax revenues have experienced a full cycle of decline and growth (*Display 4*). Revenues fell from 2001 through 2003, and then strengthened in 2004; credit ratings followed suit, with municipal issuers undergoing a cycle of downgrades followed by a cycle of upgrades as revenues improved (*Display 5*).

Display 4

State-Tax Revenues Continue to Strengthen...

Change in Quarterly State-Tax Revenues: Year-over-Year*



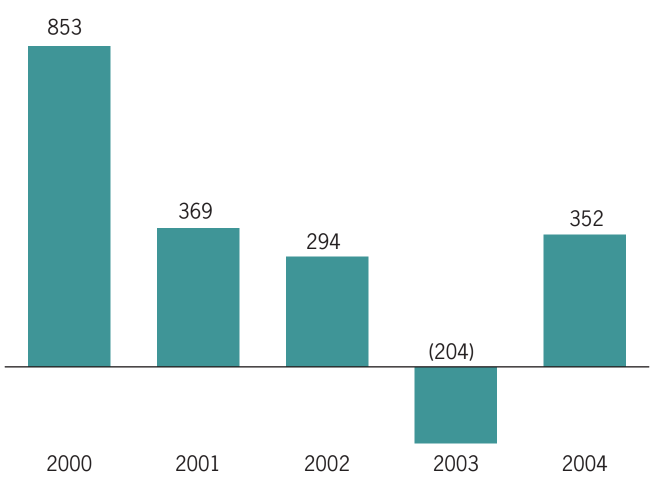
*Through fourth-quarter 2004

Source: National Association of State Budget Officers, Nelson A. Rockefeller Institute of Government and Alliance Capital

Display 5

... And Upgrades Usually Follow Strong Tax Revenues

Upgrades Minus Downgrades: Tax-Supported Bonds



Source: Standard & Poor's and AllianceBernstein

Of course, this relationship is far from perfect. For example, rating agencies were slow to downgrade issuers as tax revenues declined and caused fiscal distress. Still, the relationship is meaningful, and active municipal bond portfolio managers try to anticipate rating upgrades and downgrades, since the value of a bond typically increases when it is upgraded and decreases when it is downgraded.

The key to this strategy is identifying those tax-backed bonds that will be upgraded or downgraded, so credit research is a critical factor in our decision-making.

In 2000, we identified a substantial opportunity in tax-supported bonds that were poised for upgrades, and the market value of tax-supported bonds in the Intermediate Diversified Fund was almost twice that of revenue bonds.

By the end of 2002, when we perceived much less opportunity for tax-supported credit upgrades, the two segments were roughly equal in the portfolio. Today, in anticipation of upgrades to tax-backed municipals, the portfolio has more than twice as much invested in tax-supported bonds as in revenue bonds.

California

The California economy continues to improve, with continued job growth and low unemployment. The strengthening economy has resulted in stronger-than-expected revenue growth, which helped balance the fiscal-year 2006 budget that began July 1. The recently adopted budget reduces the state's reliance on borrowing, eliminates many questionable revenue sources and includes some one-time expenditure items. The projected 2007 budget gap has also shrunk.

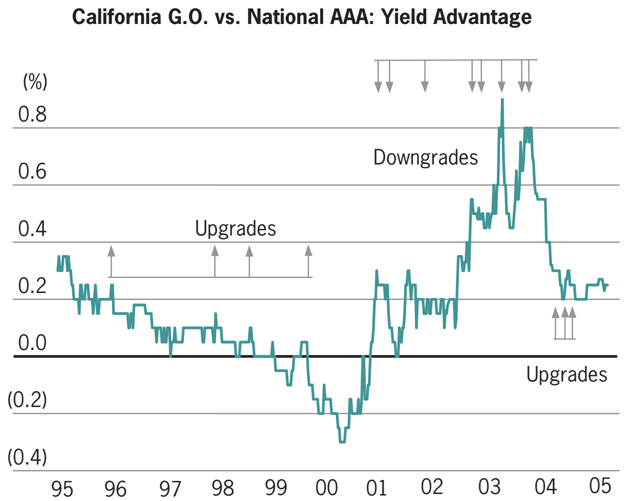
Uncertainty over the final budget has thus far kept the rating agencies from further upgrading the state's bond ratings, which continue to rank as the lowest among the 50 states. But we've raised our own credit rating on California's general-obligation bonds to A+, and we expect the rating agencies to soon follow suit. Indeed, the process has already begun. On July 11, Moody's raised its rating on California from A3 to A2 and maintained its positive outlook.

Early in 2004, we increased our position in California general-obligation bonds with the view that the state's economy and finances were improving and that its bonds were significantly undervalued. We purchased the bonds at incremental yields of 55 to 70 basis points in excess of AAA municipal bonds. Since then, these spreads have narrowed to about 20 basis points (*Display 6*), placing California general obligations among our top performers over this period. However, any additional outperformance by these bonds is likely to be more modest, even if they are upgraded further by the rating agencies.

Although California is in better financial condition today, it still has credit weaknesses, but its prospects are strong enough that we're currently targeting a 7% position

Display 6

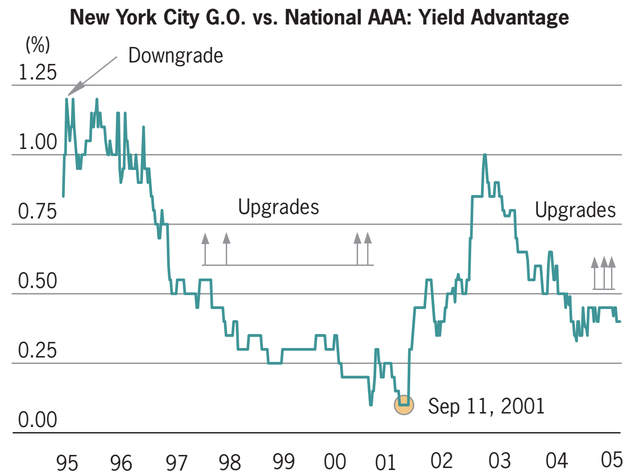
California is Under Pressure but Clearly Improving



Through June 30, 2005; 10-year par bonds
Source: AllianceBernstein

Display 7

New York City Is Also Improving



Through June 30, 2005; 10-year par bonds
Source: AllianceBernstein

in California general-obligation bonds in California portfolios, a 2% position in nationally diversified portfolios and a 1% position in most of our single-state portfolios.

New York City

New York City's economy continues to exhibit solid growth that has translated into strong financial performance. In the first quarter, for example, New York City outperformed the nation in the growth of payroll jobs and gross product. Other signs of strong economic growth can be found in improving commercial vacancy rates and rising personal-income-tax revenues.

The rating agencies have recognized the city's progress by raising their credit ratings to the highest levels ever. Nevertheless, investors have been slow to react, and New York City bonds still offer substantial incremental yield above what their rating and fiscal/economic strength would suggest (*Display 7*). We are targeting a 7% position in New York City general-obligation bonds in our New York portfolios and have recently increased our target position to 4.5% in nationally diversified portfolios.

New York State

New York State is also exhibiting signs of an improving economy, which is translating into strong revenue performance. The state ended its 2005 fiscal year with a $1.2 billion budget surplus—based largely on strong growth in personal-income-tax revenues—allowing it to start replenishing the reserve funds that were depleted over the past three years.

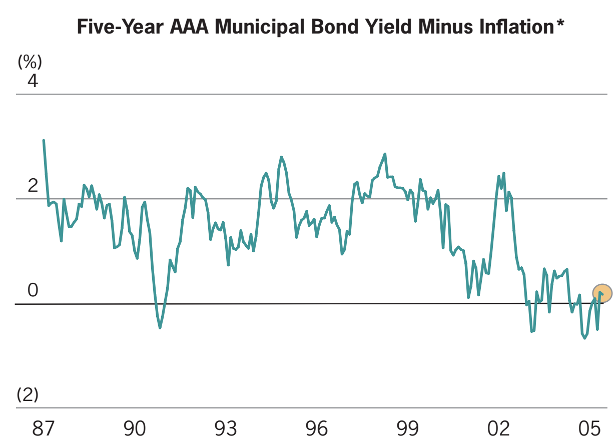
New York State bonds remain attractive, although we almost never buy the state's general-obligation bonds, which in our analysis are very expensive. Instead, we focus on other state bonds whose credit ratings are tied to the general-obligation rating. These bonds offer a higher yield than the state's general-obligation bonds, with a minimal increase in risk.

Defensively Positioned Against Rising Rates

We continue to keep the interest-rate risk of our portfolios below that of their benchmarks, since our research indicates that interest rates are low relative to the rates of economic growth and inflation (*Display 8*).

Display 8

Real Interest Rates Remain Unusually Low



*Through June 30, 2005
Source: CPI data from Bureau of Labor Statistics, Municipal Market Data Corp.

For example, AAA-rated bonds maturing in five years normally offer a yield that's 1% greater than inflation, as measured by the Consumer Price Index. Today, they offer only 0.2% more, which is greater than the last two years but still low by historical standards. We expect all interest rates to trend higher over time and are seeking to preserve the principal of our portfolios by modestly reducing their interest-rate risk.

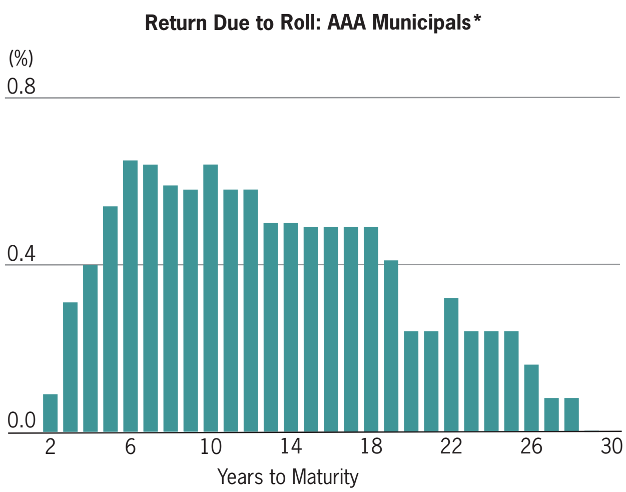
An Emphasis on Intermediate Maturities

One opportunity that remains, although at lower levels than in the past, is the potential to add value through managing yield-curve roll. Yield-curve roll is the tendency of a bond to increase in value over time as it "rolls" down an upwardly sloping yield curve; roll can influence returns just as yield can.

Roll requires two conditions: an upwardly sloping (or steep) yield curve and duration, which is the sensitivity of a bond's price to a given change in interest rates. Opportunities to capture roll are not prevalent in the short end of the yield curve because, while it is upward sloping, it lacks duration. Nor are they typically found at the long end of the yield curve, which has a lot of duration but lacks steepness. Only the intermediate part of the yield curve has both duration and steepness, which is why returns from roll are highest there (*Display 9*).

Display 9

"Roll" Opportunity Is Concentrated in Intermediate Bonds



As of June 30, 2005
*Insured callable bonds
Source: Municipal Market Data Corp. and AllianceBernstein

Given how much the yield curve has flattened over the past year, opportunities to capture roll have diminished. However, although roll is not as powerful as it has been in the past, it's still substantial. As such, we've concentrated a sizable portion of our intermediate-duration portfolios in intermediate maturities. Given the income needs of our longer-duration portfolios, those portfolios are primarily invested in bonds maturing more than 15 years from now. Our intermediate portfolios are not solely invested in intermediate bonds. There are opportunities, at times, along the entire yield curve.

Buying Premium-Coupon Callable Bonds

Our research shows that long-maturity callable bonds remain undervalued. These instruments bear coupons of at least 5%, which in the current low-yield environment are at least 50 basis points more than the bond's yield (a bond with a coupon higher than its yield is called a "premium-coupon" bond).

Because the bonds are callable, issuers have the right to buy them back in 10 years at a predetermined price, typically near par. Given the high coupon on the bonds, the market assumes they will be called, and their interest-rate risk, or duration, is similar to that of other bonds that mature near its call date. In this comparison, callable bonds yield approximately 55 basis points more than noncallable bonds of comparable duration.

The extra yield is intended to compensate investors for the risk that the bond's duration will increase as interest rates rise. One way to mitigate this risk is to own high-coupon bonds, which require interest rates to rise further before the bond's duration grows.

In our long-term portfolios, which hold primarily long-term callable bonds, appropriate coupon selection is essential to reducing risk. Another way of avoiding extension risk is to limit the portfolio's position in callable bonds: In intermediate portfolios, our target weight for long-term, premium-coupon callable bonds is 15%.

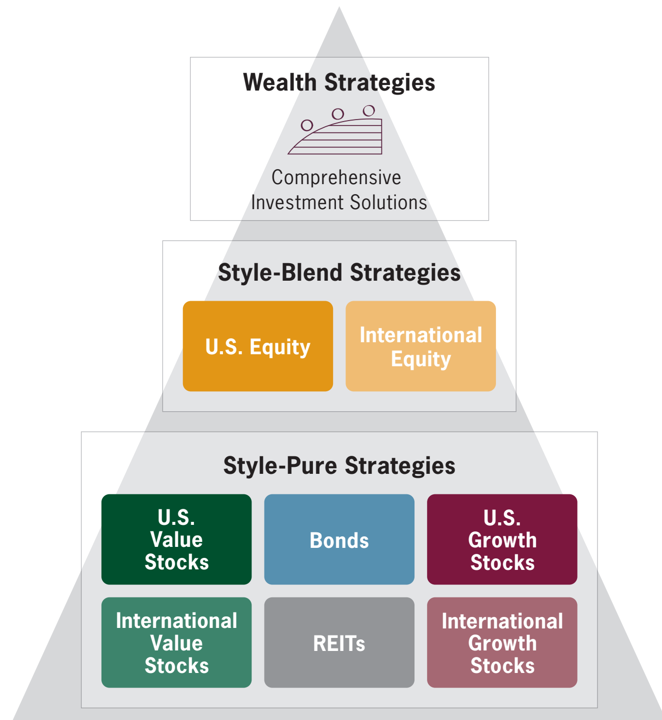
Investment Strategies for Every Investor

For over 35 years, AllianceBernstein has provided investment services to a diverse group of clients, including some of the largest institutional investors in the world. Our primary business goal is to design diversified investment solutions that help our clients build and preserve wealth.

Our mutual fund portfolios include wealth, style-blend and style-pure strategies. These investment strategies, together with our global, innovative research and our disciplined, principled investment processes, make AllianceBernstein one of the most powerful investment organizations in the industry.

Our investment services come in a variety of platforms to suit individual needs, including:

- Mutual Funds
- CollegeBound*fund*®
  (our section 529 college savings program)
- Retirement Services
- Separately Managed Accounts
- Subadvisory Services



Our Firm, Our Mission

Building and preserving investor wealth through:

- A sole focus on asset management
- Global, innovative research
- Disciplined, principled investment processes
- Investment strategies geared to client needs
- Competitive performance at a good value

Delivered by our most important assets...

Our People

Price fluctuation in any AllianceBernstein municipal bond fund's portfolio of securities may be caused by changes in the general level of interest rates or changes in bond credit quality ratings. Please note that as interest rates rise, existing bond prices fall, which can cause the value of your investment in the Funds to decline. Changes in interest rates have a greater negative effect on bonds with longer maturities than on those with shorter maturities. Investments in the municipal bond funds are not guaranteed because of fluctuation in the net asset value of the underlying fixed-income related investments. Similar to direct bond ownership, bond funds have the same interest rate, inflation, and credit risks that are associated with the underlying bonds owned by the fund. Municipal bond fund purchasers should understand that, in contrast to owning individual bonds, there are ongoing fees and expenses associated with owning shares of bond funds. While the AllianceBernstein municipal bond funds invest principally in bonds and other fixed-income securities in order to achieve their investment objectives, some funds may at times use certain types of investment derivatives, such as options, futures, forwards and swaps. These instruments involve risks different from, and in certain cases greater than, the risks presented by more traditional investments. These risks are fully discussed in our individual municipal bond fund prospectuses.

Past performance does not guarantee future results. You should consider the investment objectives, risks, and charges and expenses of the AllianceBernstein family of municipal bond funds carefully before investing. For a free copy of any of our municipal fund prospectuses, which contain this and other information, visit our website at www.alliancebernstein.com, or call your financial advisor or Alliance at (800) 227-4618. Please read the prospectus carefully before you invest.

MUNIQTRCKUPDATE0605

AllianceBernstein®
Investment Research and Management

1345 Avenue of the Americas
New York, NY 10105
1.800.227.4618

www.alliancebernstein.com