

Hedging Strategies

Presented at the NAECP 43rd Annual Conference

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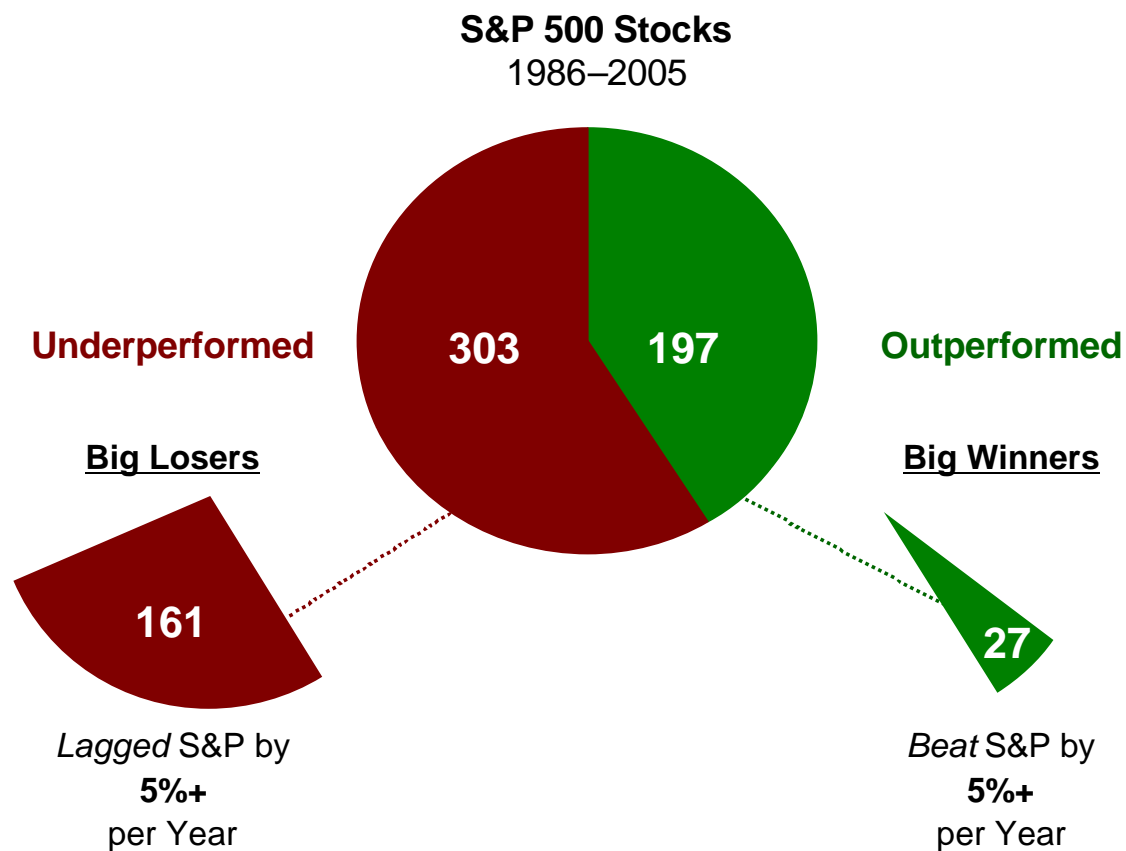
Director, Wealth Management Group

A Concentrated Portfolio Can Be Rewarding...

	Annual Growth Rate 1986–2005	Growth of \$1 Mil. 1986–2005
Dell Computer	39%	\$307 Mil.*
Microsoft	34	313*
Phillip Morris	22	50
Lowe's	21	49
Intel	21	43
Wrigley	20	39
Walgreen	19	32
Apple	18	29
S&P 500	12%	\$10 Mil.

*Growth from from first full month since inception of public trading: Dell: June 1988; Microsoft: March 1986
Source: CRSP, Standard & Poor's, and Bernstein

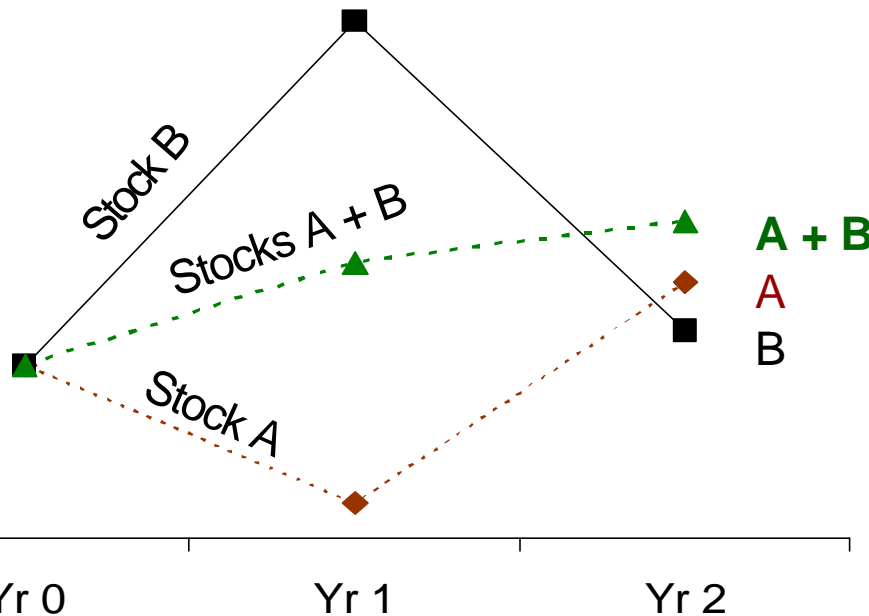
...But the Odds Are Against a Single Stock



The Problem Is Volatility

Hypothetical Returns

Stock	Year 1	Year 2	Average
A	(20)%	40%	= 10%
B	50	(30)	= 10
A + B	15	5	= 10



	Growth of \$1	Compound Growth	Risk Drag*
A + B	\$1.21	9.9%	(0.1)%
A	\$1.12	5.8	(4.2)
B	\$1.05	2.5	(7.5)

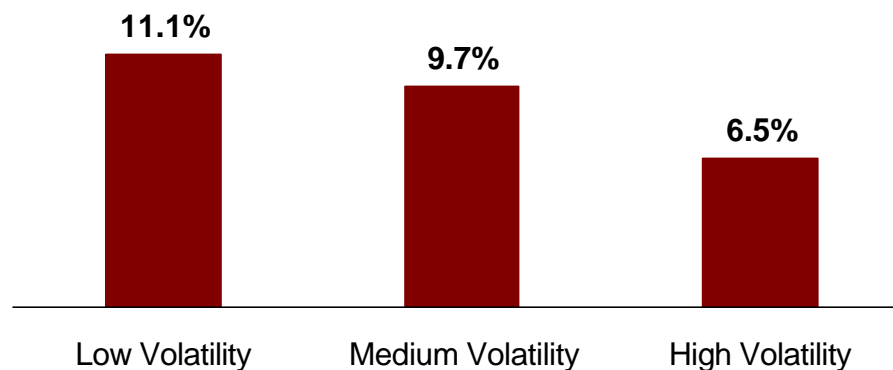
*The degree to which the compound return lags the average return over time, owing to volatility

Volatility Headwind: Lower Growth

1986–2005 Annualized

	Arithmetic Avg. Return	Risk Drag	Compound Annual Return
S&P 500	13.2 %	(1.3) %	11.9%
Avg. Single Stock	13.8	(4.5)	9.3

Compound Annual Return by Volatility Grouping



* Stocks are grouped based on volatility during the prior five years (1981–1985). Low-volatility stocks represented 25% of index and had volatilities less than 23.5%; average-volatility stocks represented 50% of index and had volatilities ranging from 23.5–33.75%; high-volatility stocks represented 25% of index and had volatilities in excess of 33.75%. S&P 500 volatility was 15.4%; all volatility figures are based on the annualized standard deviation of quarterly returns.

Source: CRSP, Standard & Poor's, and Bernstein

Are You Holding Too Much Company Stock?

1970s	Peak-to-Trough Decline
Penn Central	(98)%
Mattel Inc.	(94)
Columbia Pictures	(92)
TWA	(91)
Holiday Inn	(90)

1980s	
Coleco Industries	(99)%
First Republic Bank	(97)
Singer Inc.	(90)
Chrysler	(88)
Schlitz Brewing	(88)

1990s	Peak-to-Trough Decline
Pan Am	(100)%
Prime Motor Inns	(100)
Wang Laboratories	(99)
Zenith Radio	(99)
U.S. Home Corp.	(99)

2000s	
Conseco	(100)%
Global Crossing	(100)
WorldCom	(100)
Enron	(100)
Polaroid	(99)

Are You Holding Too Much Company Stock?

Top 10 on the *Fortune* “Most Admired” List 2000

Company	Bear Market Return Mar 31, 2000–Sep 30, 2002
Lucent	(98)%
Cisco	(86)
Intel	(79)
Home Depot	(59)
Microsoft	(59)
Dell	(56)
General Electric	(50)
S&P 500	(44)
Wal-Mart	(12)
Southwest Airlines	(6)
Berkshire Hathaway	29

Hedging Strategies: How Well Do They Work?

Pros

- Taxes deferred... *since not selling stock*
- Downside protected...*for stock price*
- Upside retained...*for stock price*
- Maintain current dividend* & voting rights...*on the underlying stock position*
- Diversification possible...*if borrow against the hedged stock or use a PVF*
- Can retain stock by settling with cash...*pay the option obligation off with cash and keep stock*

Hedging can be beneficial over the short-term...

Cons

- ...but not eliminated *Options will expire, then what do you do with stock?*
- ...temporarily *as long as hedge is in place*
- ...but is usually limited *to the call strike price*
- ...but dividend does not qualify for 15% rate *according to Tax Code*
- ...though sometimes limited *in the amount released* and usually costly
- ...which raises the specter of tax/cash-flow problems *mismatch of capital gain/loss treatment on the options*

...but is likely to lose its effectiveness over time

*In many hedging transactions, the investor is able to maintain his or her current dividend, but relinquishes any future growth in the dividend.

Bernstein does not provide tax, legal, or accounting advice. In considering this material, investors should discuss their individual circumstances with professionals in those areas before making any decisions.

Source: Bernstein

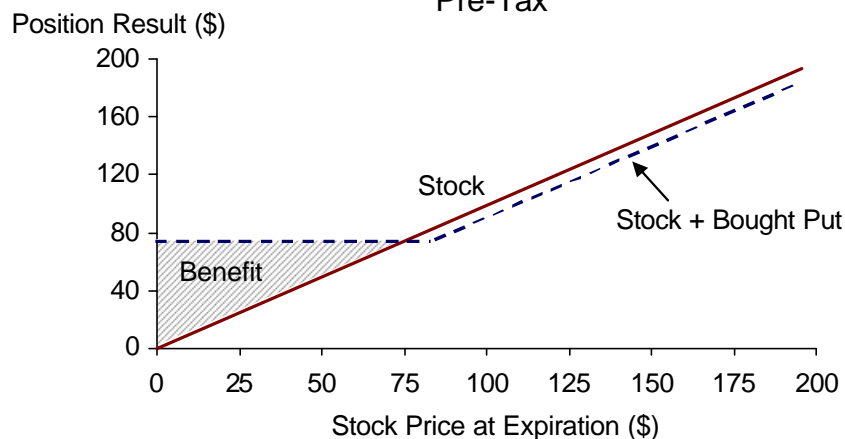
Buy a Put to Hedge an Existing Position

- Investor pays premium to sell one share of stock at \$85 three years out.

Assumptions

Stock Price	\$100
Put Strike	\$85
Premium (Up-front Payment Made)	\$10**
Time to Expiration	3 Years

Put Payoff Diagram Pre-Tax*



Pros

- Downside price protection at put strike
- Retain full upside potential of stock
- May defer tax on stock and preserve potential step-up
- Maintain some dividends and voting rights

Cons

- Premium paid can be significant (10% in example)
- Tax-straddle rules may apply
- Cash-flow complications at expiration may necessitate sale and gain recognition
- Dividend may not qualify for 15% tax rate
- Counterparty credit risk (Will the put seller be able to pay the put buyer for the obligation?)

*Tax-straddle rules may have a significant negative impact on after-tax results.

**Put pricing is for illustrative purposes only.

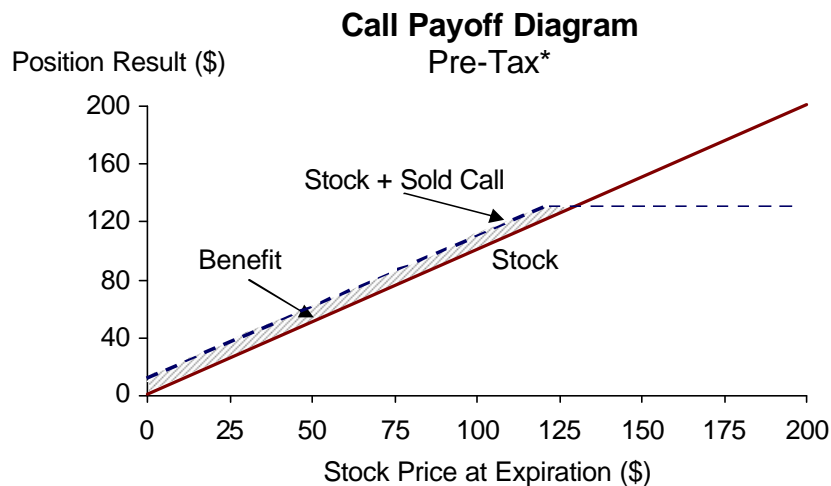
Source: Bernstein

Sell a Call to Generate Extra Income

- Investor receives premium in exchange for granting counterparty the right to buy one share of stock at \$85 three years out.

Assumptions

Stock Price	\$100
Call Strike	\$120
Premium (Up-front Payment Received)	\$10**
Time to Expiration	3 Years



Pros

- Generates up-front cash payment
- Upside potential up to call strike
- May defer tax on stock and preserve potential step-up
- Maintain some dividends and voting rights

Cons

- No downside protection (except for \$10 in premium received)
- Appreciation limited to call strike

*Tax-straddle rules may have a significant negative impact on after-tax results.

**Call pricing is for illustrative purposes only
Source: Bernstein

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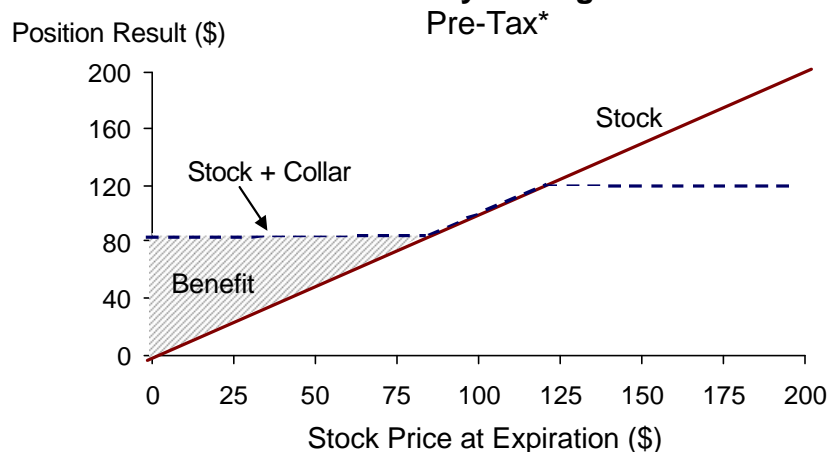
Use a Cashless Collar (Sell a Call to Pay for the Put)

- Combination of purchased put and sold call that is often structured as “cashless,” requiring no up-front payment.

Assumptions

Stock Price	\$100
Put Strike	\$85
Call Strike	\$120
Premium (Up-front Payment Received)	None: Cashless (\$10 offset)
Time to Expiration	3 Years

Collar Payoff Diagram



Pros

- Downside price protection at and below put strike
- Upside potential up to call strike
- “Cashless” structure avoids up-front cost
- May defer tax on stock and preserve potential step-up
- Maintain some dividends and voting rights
- May cash-settle if wish to retain shares
- Supports limited borrowing (50% of stock price) to diversify

Cons

- Appreciation limited to call strike
- Tax-straddle rules may apply
- Sufficient exposure to stock-price movement needed for collar not to be considered a sale for tax purposes
- Dividend may not qualify for 15% tax rate
- Counterparty credit risk (on the put side)

*Tax-straddle rules may have a significant negative impact on after-tax results.
Source: Bernstein

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Hedge through a Prepaid Variable Forward Sale

- Investor receives up-front payment (typically 80–90% of value) in exchange for delivery of variable amount of **shares or cash** in the future
- Up-front payment limits effect of stock decline for the investor and provides funds that may be used to diversify. Obtaining a tax-deferred minimum sale price for a stock position can be viewed as a hedge.
- Investor can further participate in stock appreciation between designated minimum and maximum stock prices (“floor” and “cap” collared position.)

By accepting a discounted payment for the stock today, the investor gets:



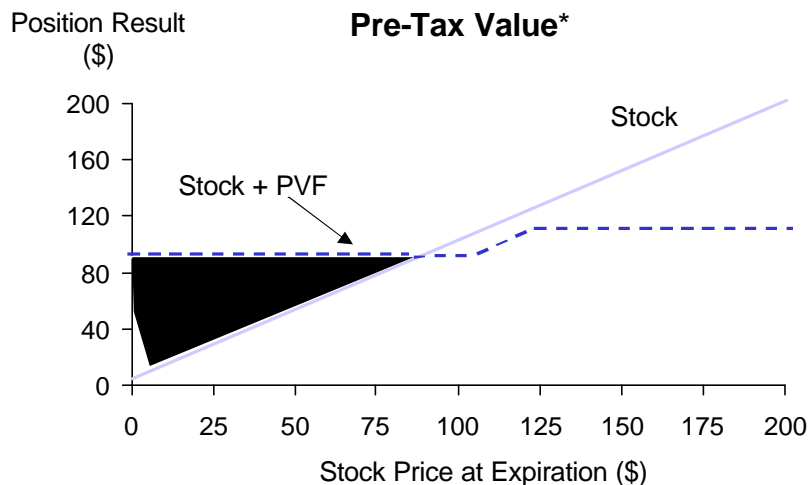
*Dividend is typically restricted to its current quarterly value for the term of the contract.

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Source: Bernstein

Prepaid Variable Forward Sale Payoff Results

Assumptions	
Stock Price	\$100
Cap Price	\$120
Floor Price	\$100
Up-Front Payment Received	\$85.80
Dividend	\$1.70
Time to Expiration	3 Years



If the stock closes at or below the floor, the investor must deliver all his original share position. If the stock closes above the floor, he delivers all his original share position less the value of any stock price move from \$100 to \$120 (i.e. he keeps the appreciation from the floor to the cap.)

*Assumes no reinvestment return for up-front payment. The PVF would be positively or negatively affected if the up-front payment were reinvested, as is often the case. Tax-straddle rules may have a significant negative impact on after-tax results.
Source: Bernstein

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Prepaid Variable Forward Sale Payoff Results

PVF Terms

? Initial Stock Price: \$100	? Floor Price: 100% (\$100)	? Up-Front Payment: 85.8% (\$85.80)
? Dividend: \$1.70/yr.	? Cap Price: 120% (\$120)	? Term: 3 yrs.

Proceeds to Investor*

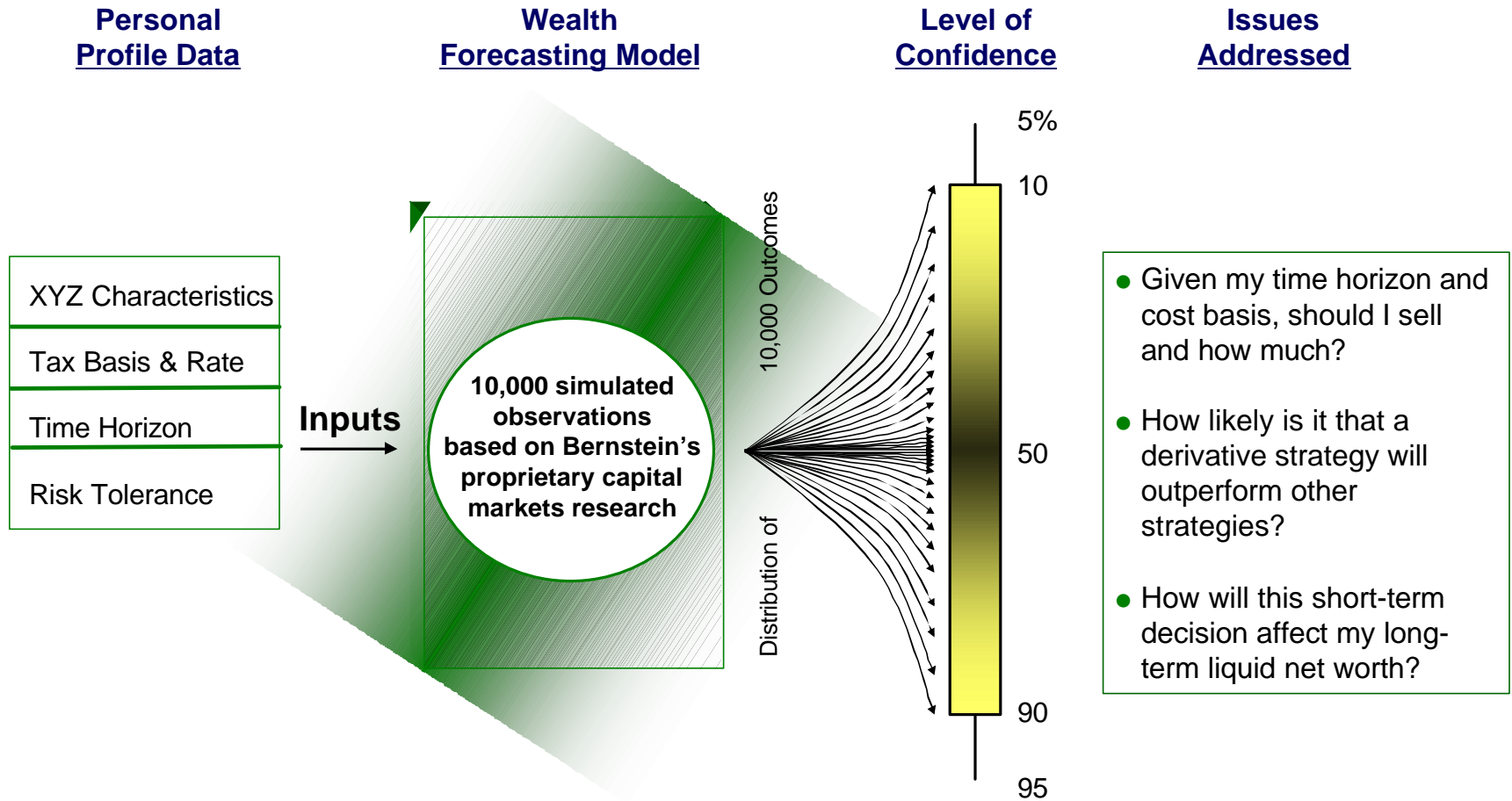
Stock Price At PVF Expiration	Up-Front Payment	Any Appreciation Between \$100–\$120**	Current Dividend	PVF Stock Sale \$ Pre-tax
\$90	\$85.80	0	\$5.10	\$90.90
110	85.80	10	5.10	100.90
130	85.80	20	5.10	110.90

- *Pre-tax proceeds from outright immediate sale = \$100*
- *Hence, for PVF strategy to outperform up-front stock sale, single stock must perform well*

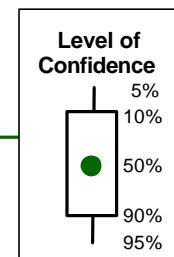
*Also see chart on previous page.

**If the stock price ends up between this range at the expiration of the PVF, the investor is able to retain shares of equivalent value.

Bernstein's Wealth Forecasting Process



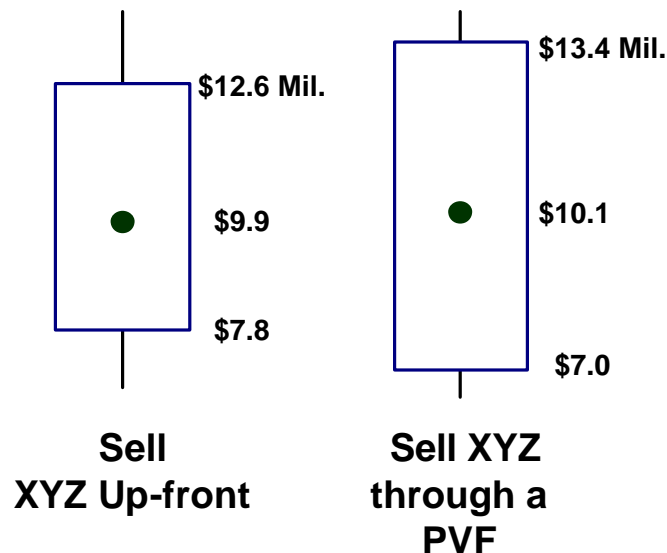
Analysis Shows that PVF Benefits are Often Limited



PVF Terms

- Initial Stock Price: \$100
- Floor Price: 100% (or \$100)
- Cap Price: 120% (or \$120)
- Up-Front Payment:* 85.8% (or \$85.80)
- Term: 3 years

\$10 Mil. in XYZ Stock—Year 3 After Taxes, Including Reinvestment In Diversified Equities**



*Available for immediate reinvestment

**Equity allocation is assumed to be globally diversified (35% U.S. growth, 35% U.S. value, 25% developed international, 5% emerging markets). Based on Bernstein's estimates of the range of returns for the applicable capital markets over the next three years. Data do not represent any past performance and are not a promise of actual future results.

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Hedging Eligibility with Over-the-Counter Contracts

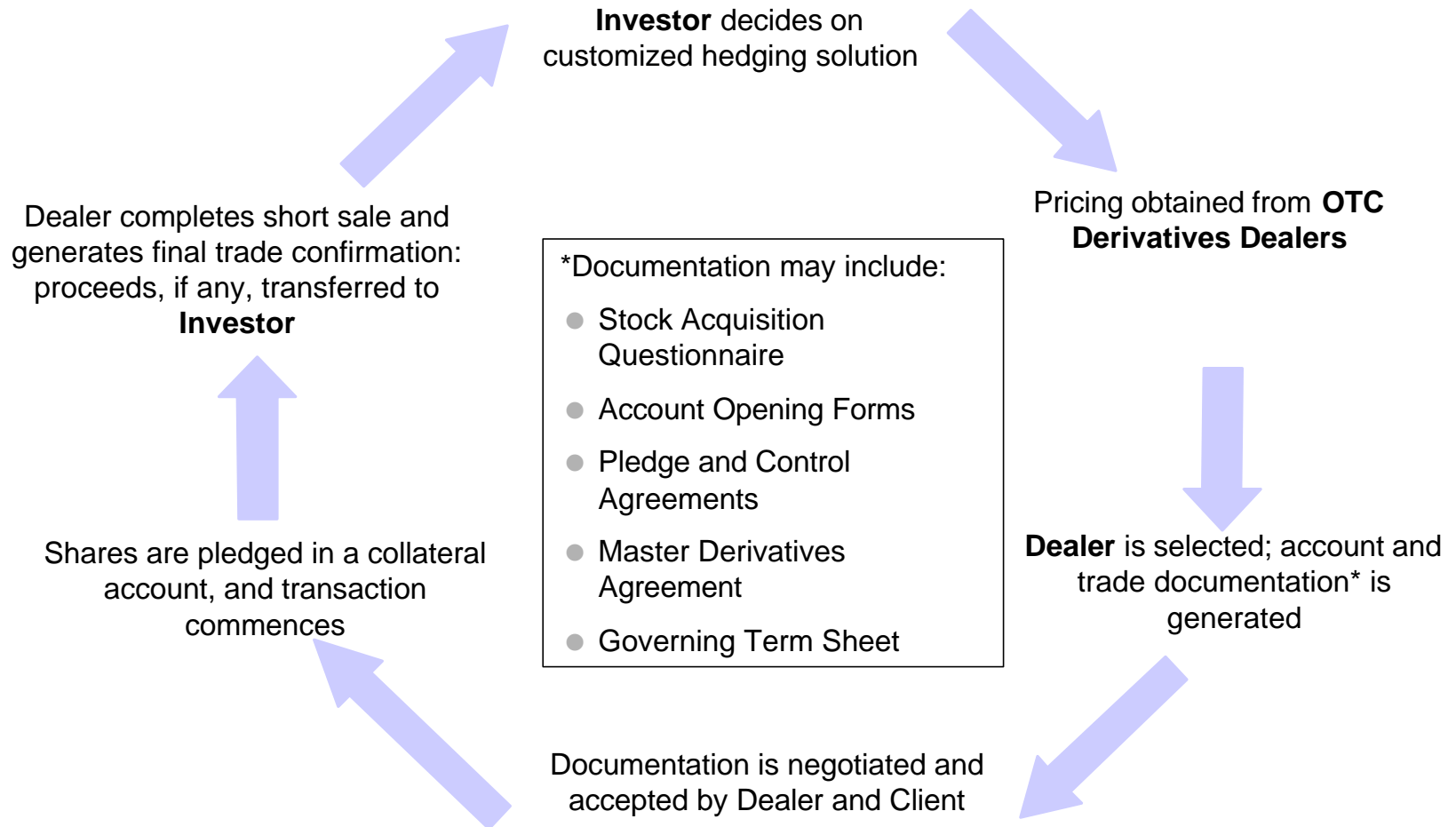
- Rule of thumb: amount that can be hedged may be limited to two times stock's average daily trading value
- Minimum dollar amount to hedge may be \$1,000,000
- Shares should be readily available for borrowing, to cover the dealer's short*
- High dividend-yielding stocks typically have less favorable hedging prices

* A derivatives dealer typically must sell a certain amount of shares "short" prior to completing a hedging transaction.

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Source: Bernstein

Hedging Procedures With Over-the-Counter Contracts *



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Source: Bernstein

Potential Financial Requirements for Hedging with OTC Contracts

■ Accredited Investor

- Individual with net worth >\$1MM; or Income >\$200K (\$300K w/ spouse) in last 2 years
- A trust or business partnership with assets >\$5MM

■ Eligible Contract Participant

- Individual with assets >\$5MM and hedging intent
- A corporation, partnership, trust (or other entity) with net worth >\$1MM and hedging intent

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Source: Bernstein

Discussion

- When may hedging be a viable alternative?
- If an investor is worried about downside risk, should she sell the stock? If she is interested in upside potential, should she hold on? When, if ever, should she hedge?
- How do the federal and local capital gains tax rates play a role in the hedging decision?
- Are there estate planning opportunities in using hedging strategies?
- How would you compare the benefits of hedging with a prepaid variable forward sale versus using a collar?
- Why don't "hedgers" just buy puts and not limit their stock upside potential?
- * ■ What are the problems in hedging a low volatile, high yielding stock?

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Source: Bernstein

Hedging Low Basis Stock Positions

- You own a substantial amount of low basis XYZ stock
- You understand the need for diversification and seek to understand the impact of hedging alternatives to reduce risk:
 - Selling all or a portion of the security outright
 - Purchase Put
 - Sell Call
 - **Collar**
 - **Collar with margin**
 - **Prepaid Variable Forward Sale (PVF)**

Assumptions for Concentrated Wealth Analysis

■ Assumptions for Taxpayer:

- \$10,000,000 worth of XYZ stock (XYZ – 100,000 shares @ market price of \$100.00 per share as of 9/08/06)
- \$0.0 per share basis
- Time horizon alternatives:
 - ▶ 3 Years
 - ▶ 6 Years: rolling 2 PVFs, 2 collars
 - ▶ 9 Years: rolling 3 PVFs, 3 collars
- Federal Capital Gains tax rate of 15% through 2008, 20% thereafter
- No state tax
- Federal Qualified Dividend income is taxable at 15% through 2010, ordinary income thereafter
- Ordinary Federal Income rate is taxable at 35% through 2010, 39.6% thereafter

Assumptions for Concentrated Wealth Analysis

■ Assumptions for Diversified Portfolio:

- Reinvestment in personal portfolio - 100% diversified equities allocated as follows:
 - ▶ 35% US Value
 - ▶ 35% US Growth
 - ▶ 25% Developed International
 - ▶ 5% Emerging Markets

Alternative Solutions Analyzed *

1. Sell all \$10.0 million now
2. Collar - With Margin
 - ▶ 90%/120% range (\$9,000,000 / \$12,000,000)
 - ▶ 50% borrowing
 - ▶ variable interest rate: Libor + 100 basis points
3. Collar - Without Margin
 - ▶ 90%/120% range (\$9,000,000 / \$12,000,000)
4. Prepaid Variable Forward Sale
 - ▶ 100%/120% range (\$10,000,000 / \$12,000,000)
 - ▶ 87.0% up-front payment (\$8,700,000)
5. Hold all XYZ shares

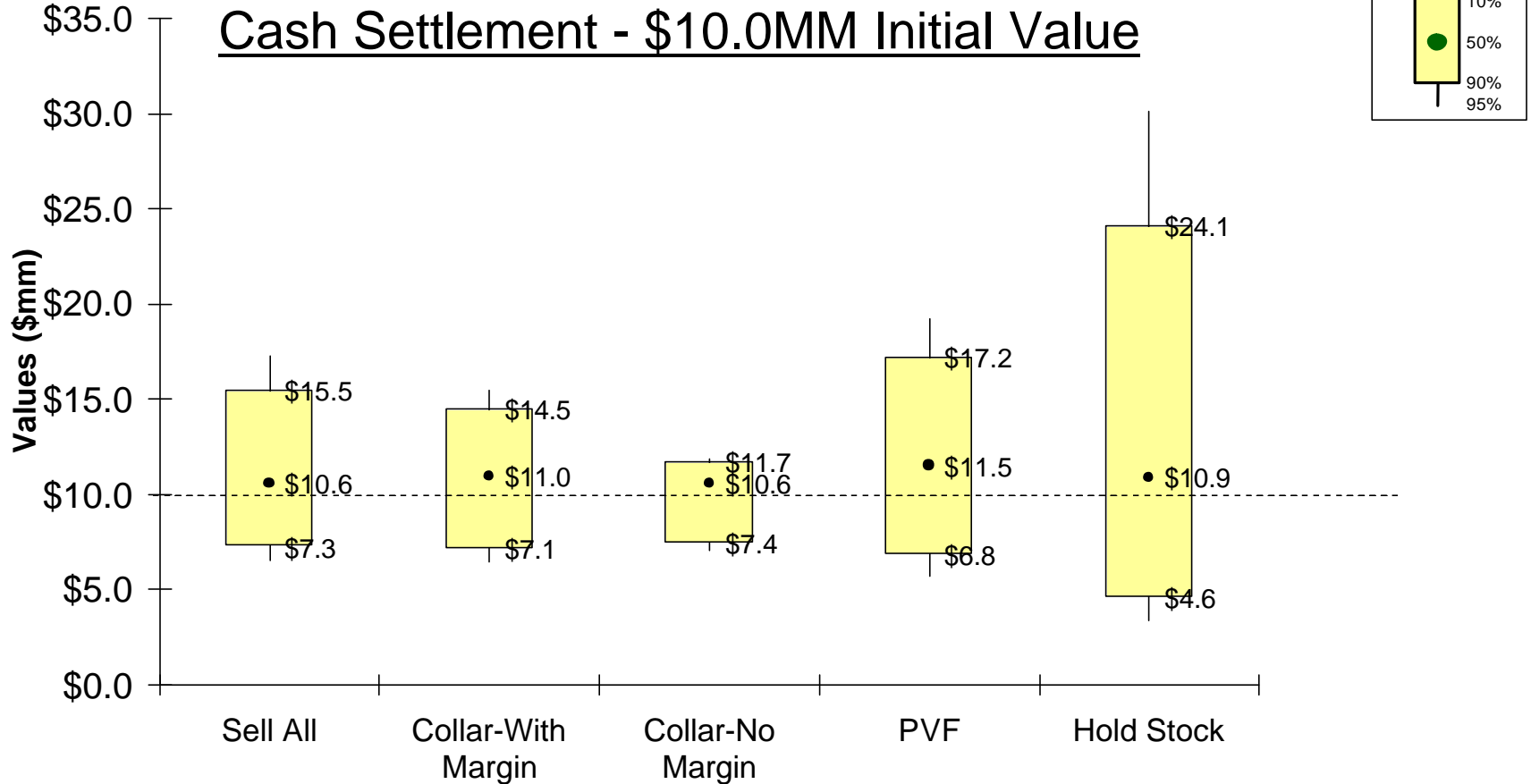
•Proceeds from stock sales and dividends are assured to be reinvested into a 60% Equity / 40% intermediate term municipal bond portfolio. The equity portfolio is allocated 35% US Value / 35% US Growth / 25% Developed International / 5% Emerging Markets. Derivative analyses assume gains on derivations are taxable at contract expiration as income, losses are assured to be long term and deferred until shares are sold.

Source: Bernstein

Assumptions for Dividends on Hedged Stock

- First 3 year contract price includes a maximum \$0.0 annual XYZ dividend.
- Dividend increases during a contract will be forfeited to investment bank.
- Future contracts (i.e. years 6 and 9) include changes to future dividends when contract is renewed.
- Liquidity needed to cash settle contracts are sourced sequentially from liquidity provided by a new contract, diversified portfolio liquidations, and XYZ share sales.
- Dividends of hedged XYZ stock assumed taxable as ordinary income

Ending Period Wealth Values - Year 3



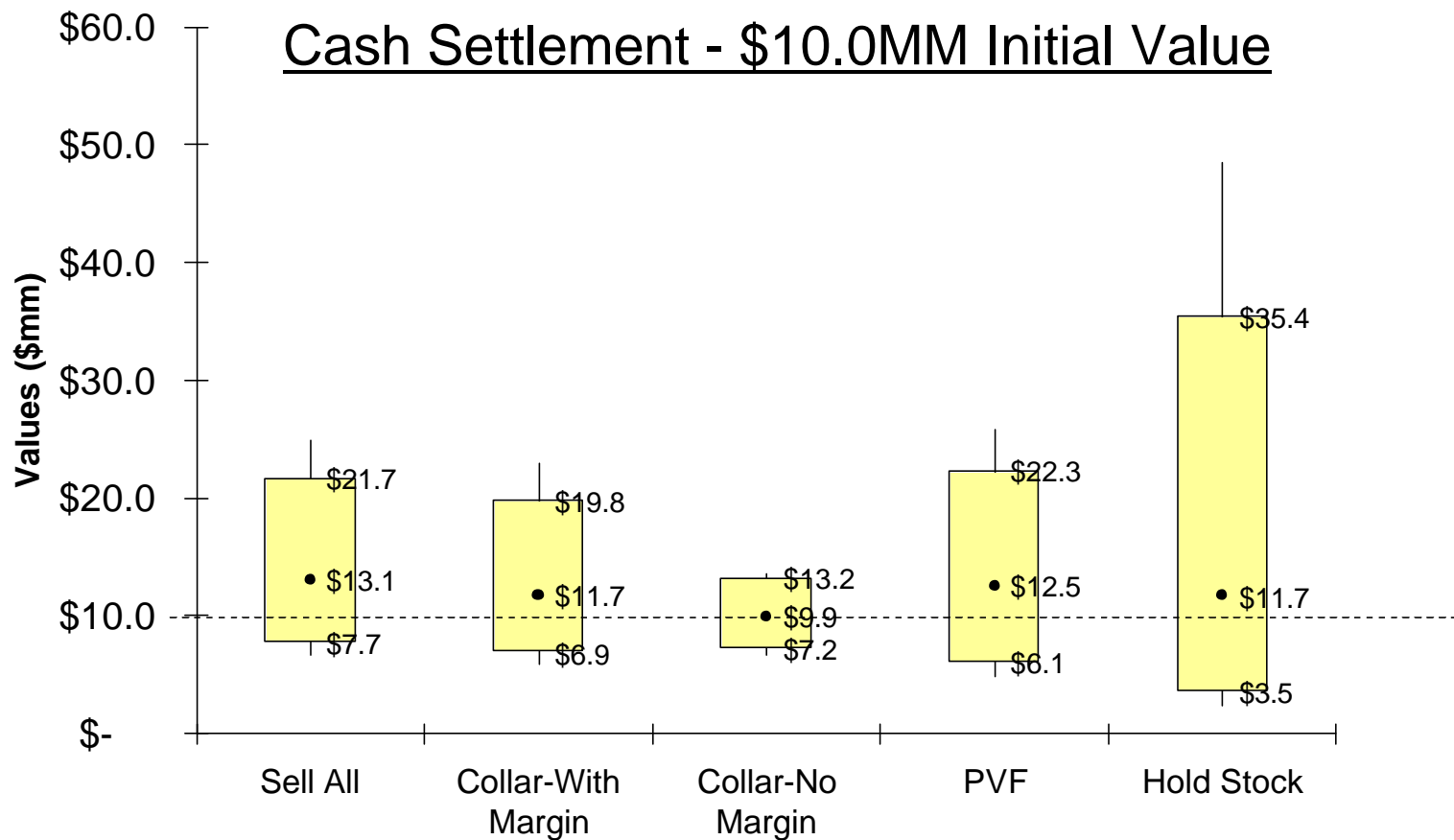
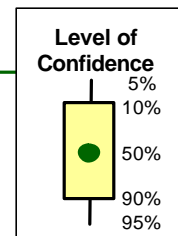
Based on Bernstein's estimates of the range of returns for the applicable capital markets over the next 3 years.

Data does not represent any past performance and is not a promise of actual future results.

Asset values represent the estimated market value; if the assets were liquidated, additional capital gains or losses would be realized that are not reflected here.

See Assumptions and Notes on Wealth Forecasting System in Appendix for further details.

Ending Period Wealth Values - Year 6



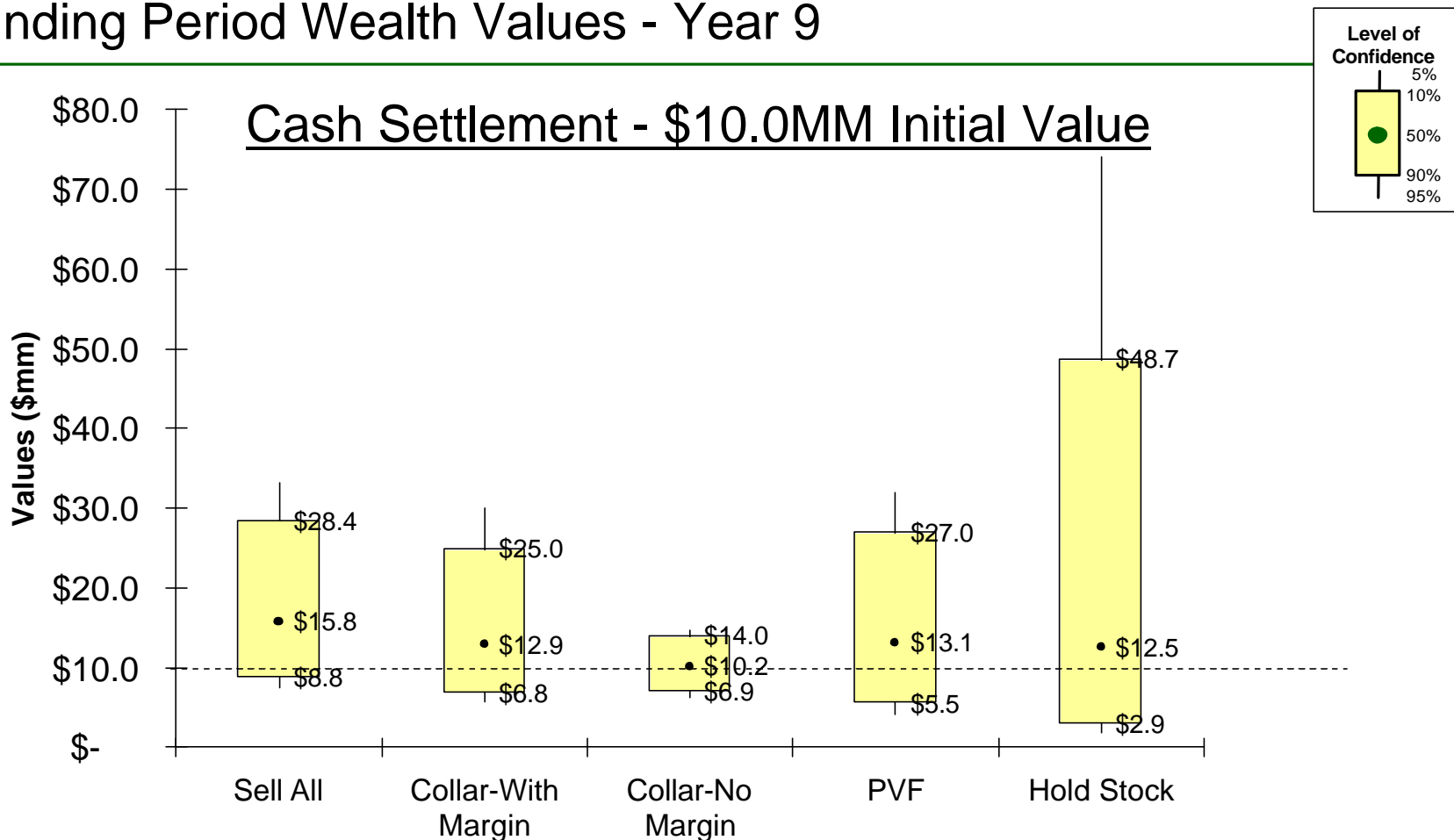
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Ending Period Wealth Values - Year 9



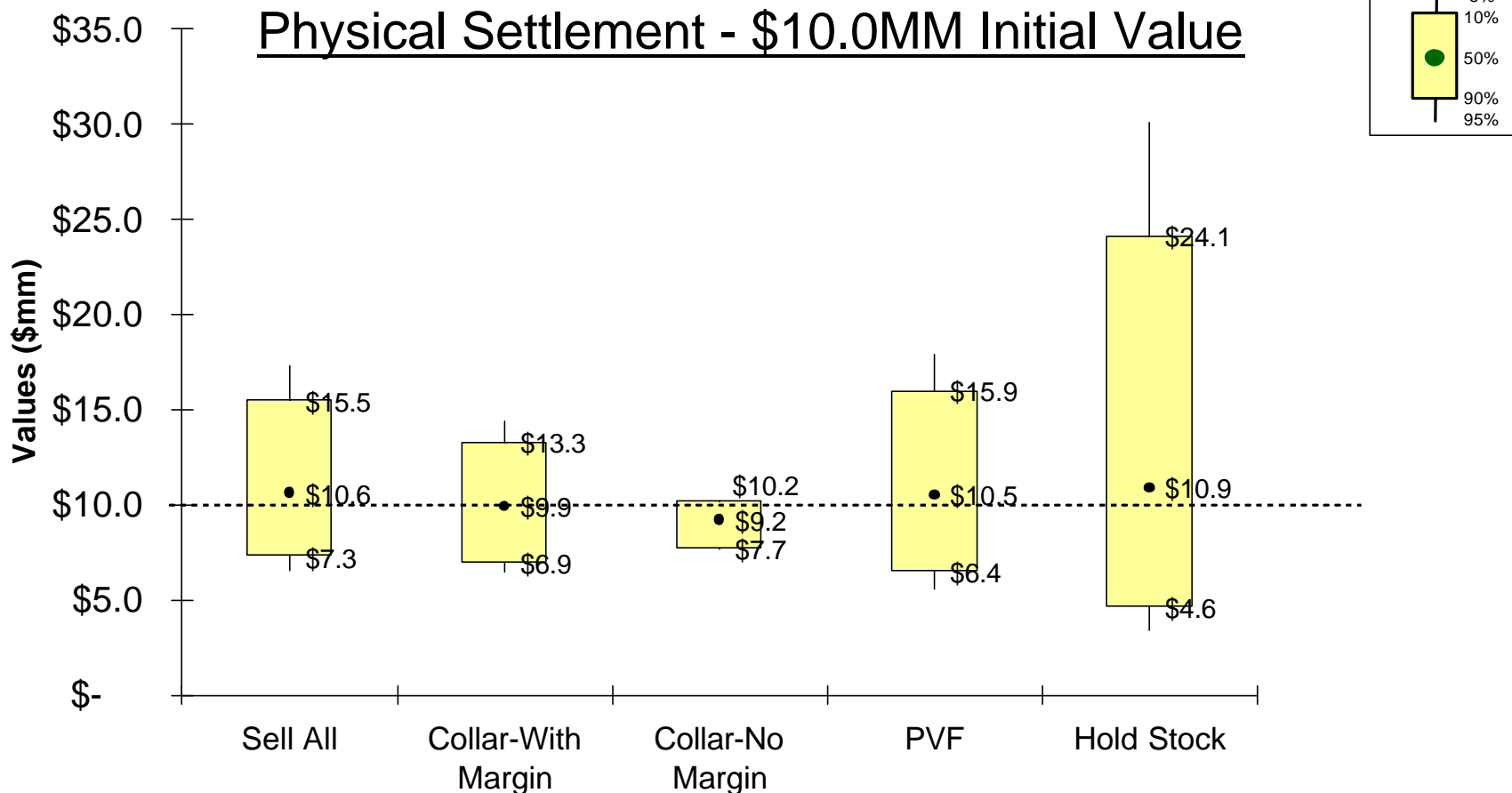
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Ending Period Wealth Values - Year 3



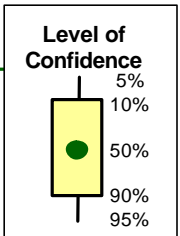
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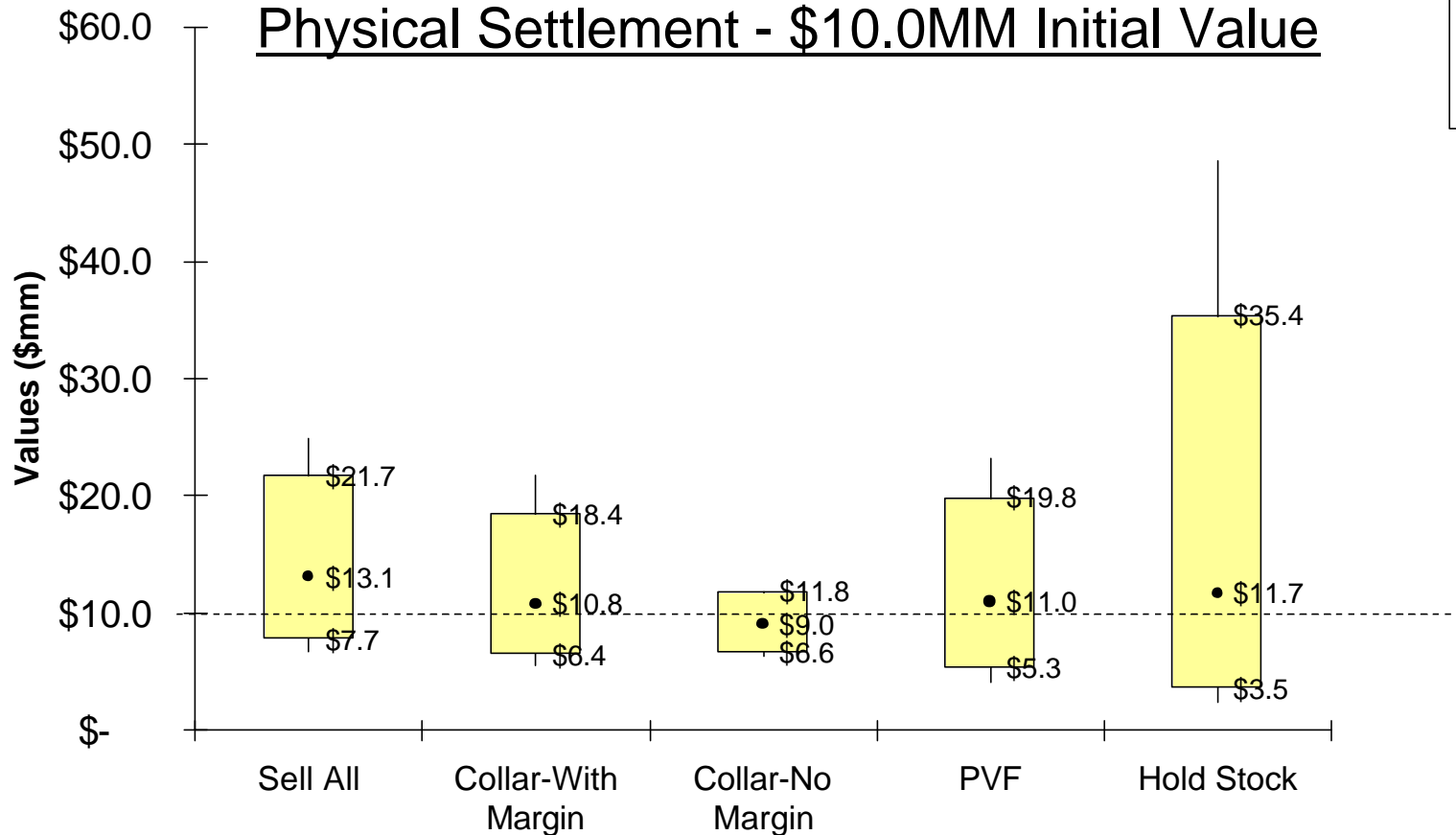
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Ending Period Wealth Values - Year 6



Physical Settlement - \$10.0MM Initial Value



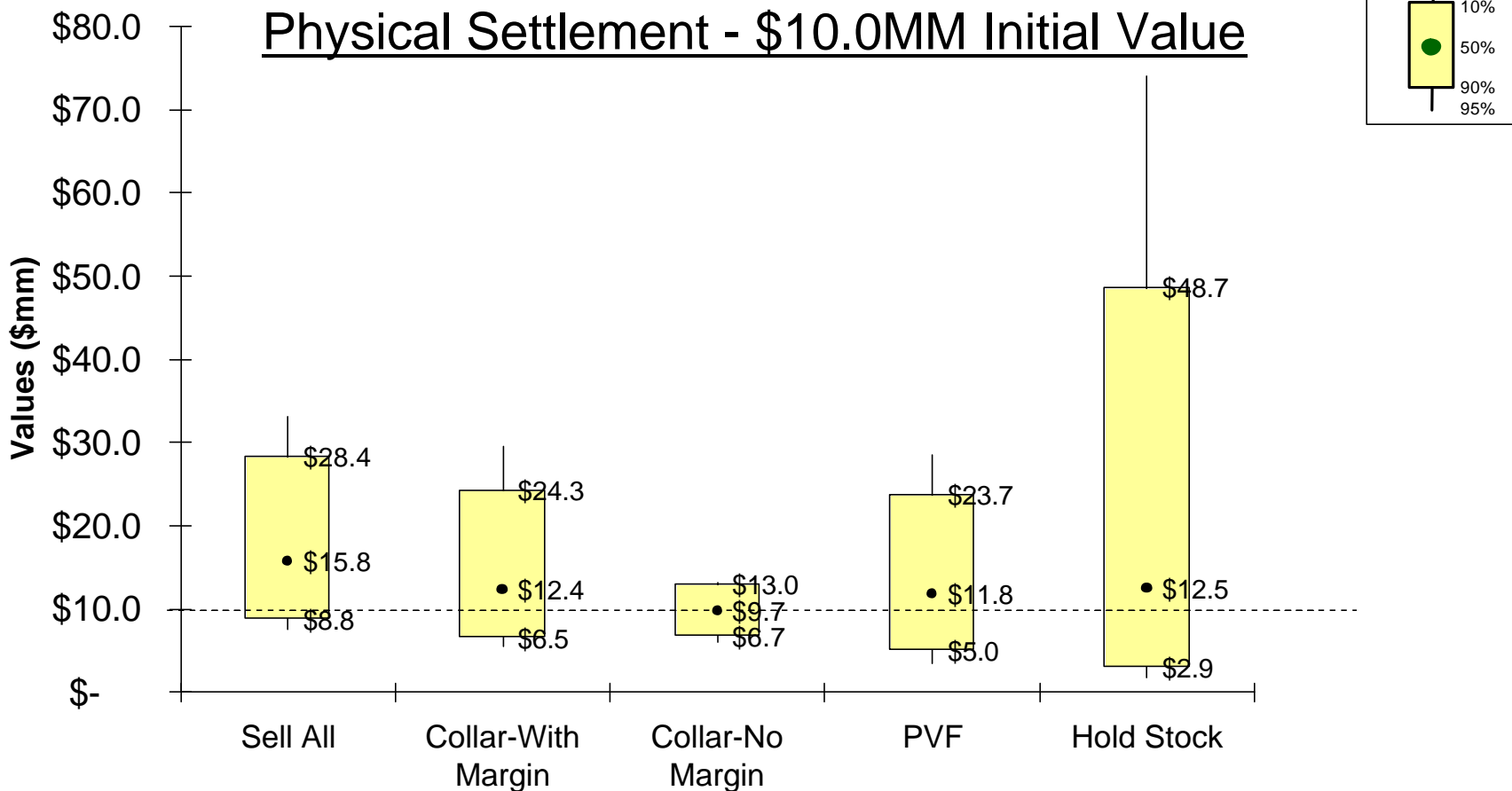
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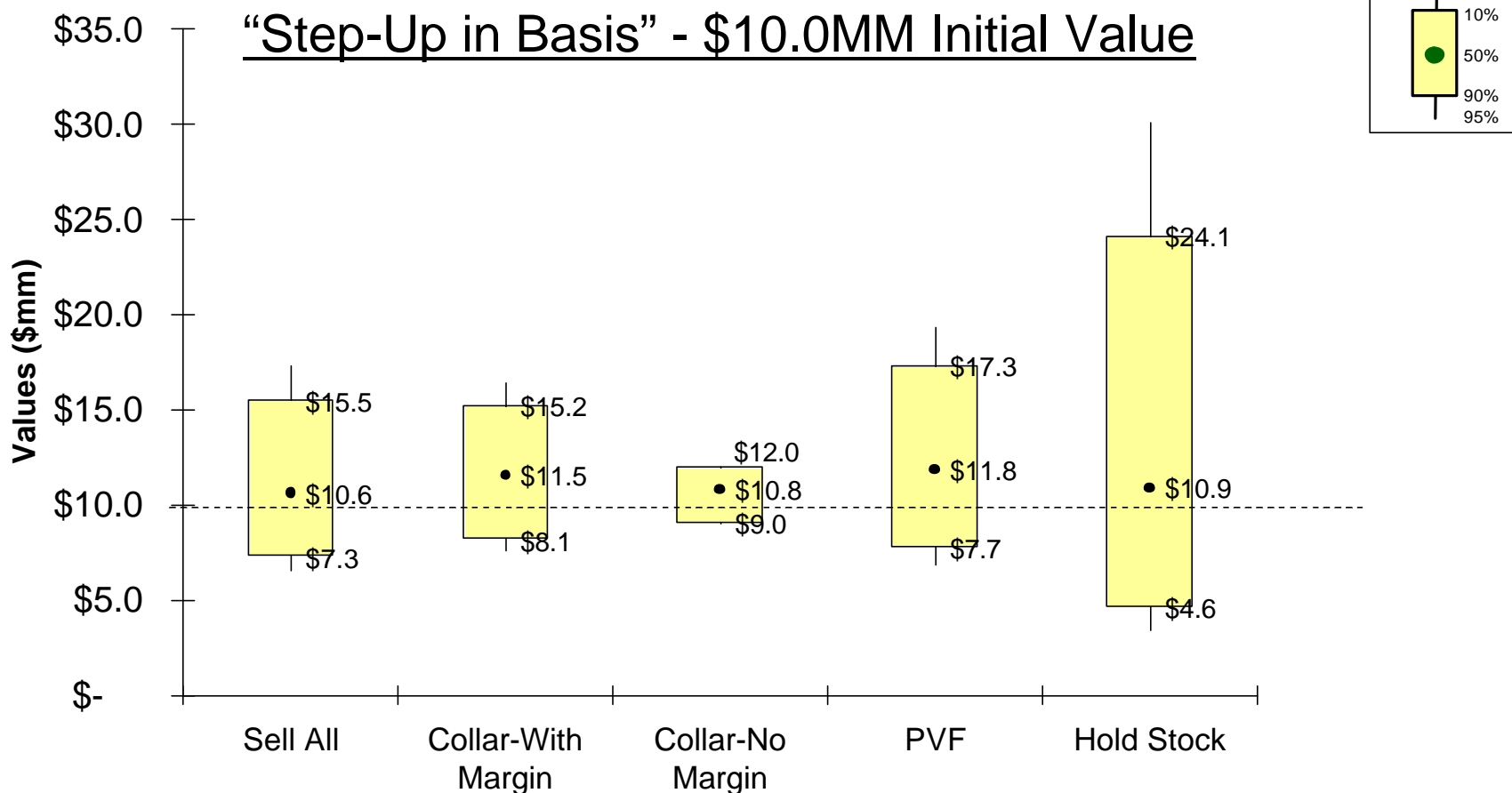
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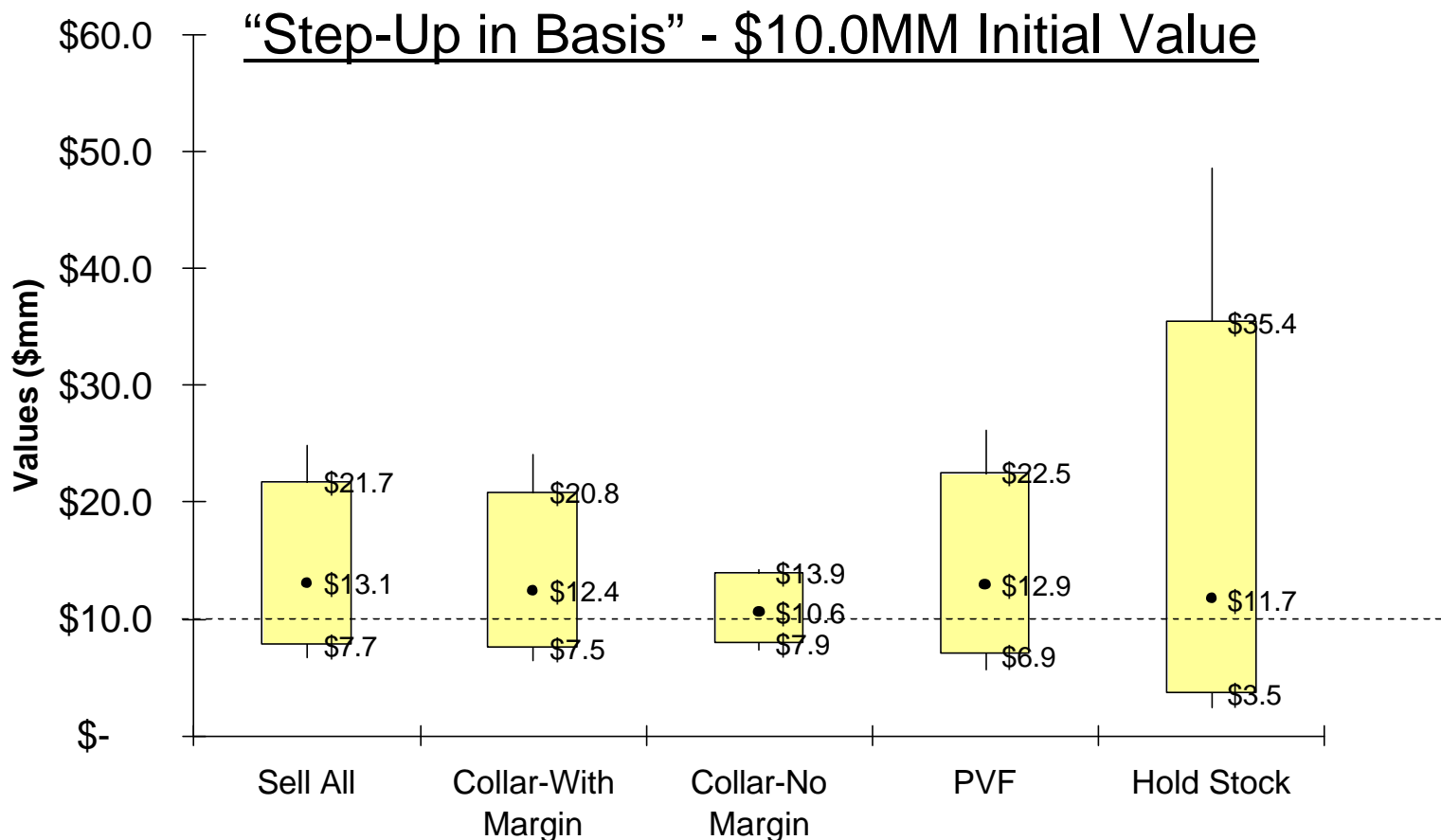
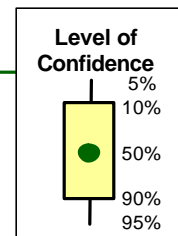
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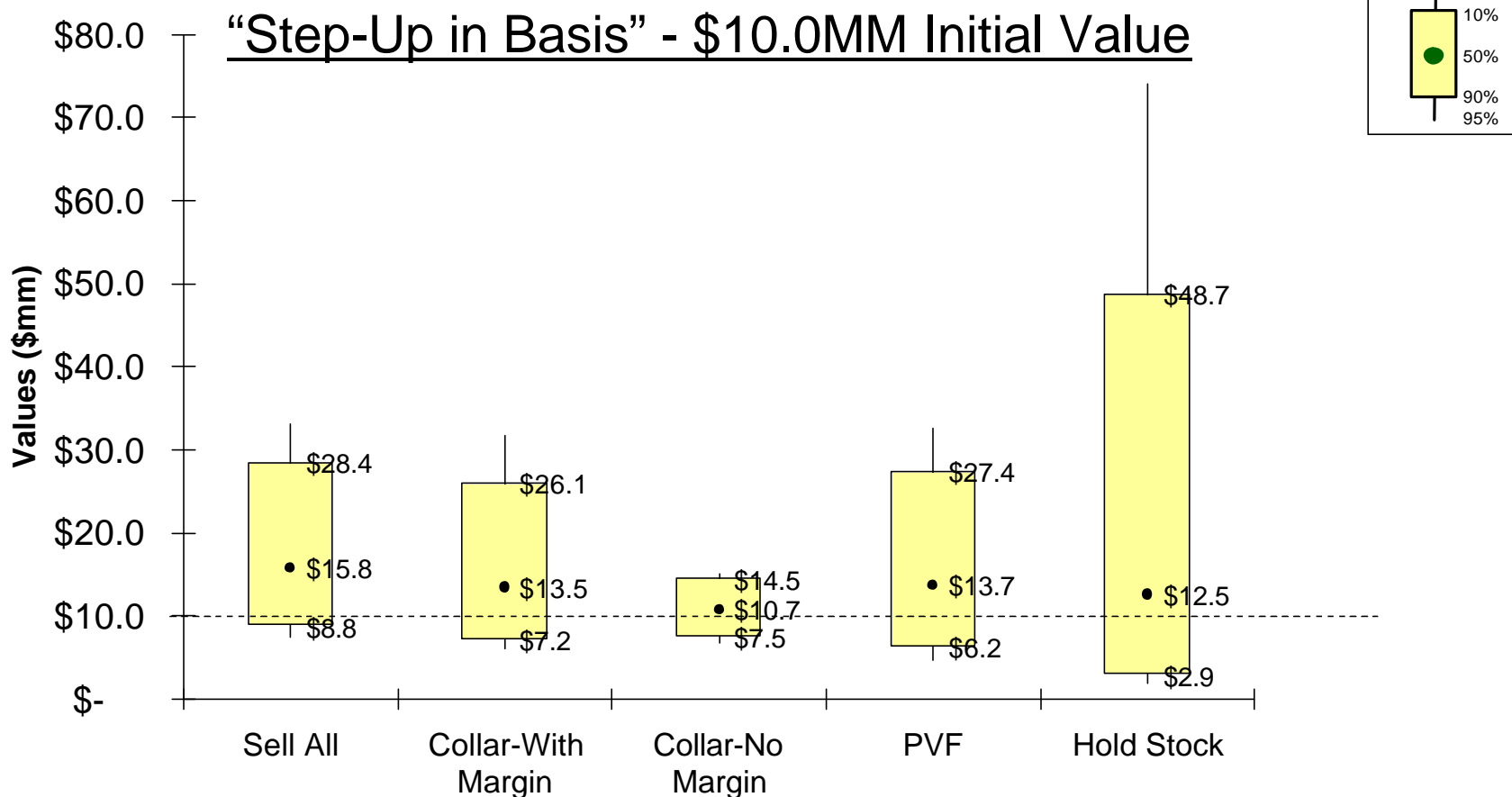
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CAPITAL MARKETS PROJECTIONS

	Median 9-Year Growth Rate	Mean Annual Return	Mean Annual Income	1-Year Volatility	9-Year Annual Equivalent Volatility
U.S. Value	8.4	10.3	3.0	18.2	15.9
U.S. Growth	8.5	10.7	1.6	19.8	18.1
Developed International	7.9	10.8	3.2	21.7	17.7
Emerging Markets	5.9	10.8	3.5	27.3	23.5
Inflation	2.7	3.0	n/a	1.6	5.2
XYZ (A)	3.5	10.3	0.7	38.8	36.9

Based on 10,000 simulated trials each consisting of 9-year periods.

Reflects Bernstein's estimates, and the capital market conditions of June 30, 2006.

Does not represent any past performance and is not a guarantee of any future specific risk-levels or returns, or any specific range of risk-levels or returns.

PROJECTED CORRELATIONS

	U.S. Value	U.S. Growth	Developed International	Emerging Markets	Inflation
U.S. Value	1.0	0.9	0.7	0.6	(0.1)
U.S. Growth	0.9	1.0	0.7	0.6	(0.1)
Developed International	0.7	0.7	1.0	0.6	(0.1)
Emerging Markets	0.6	0.6	0.6	1.0	(0.1)
Inflation	(0.1)	(0.1)	(0.1)	(0.1)	1.0

Based on the first year of each of 10,000 simulated trials.

Reflects Bernstein's estimates, and the capital market conditions of June 30, 2006.

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NOTES ON WEALTH FORECASTING SYSTEM

1. Purpose and Description of Wealth Forecasting Analysis

Bernstein's Wealth Forecasting Analysis is designed to assist investors in making their long-term investment decisions as to their allocation of investments among categories of financial assets. Our new planning tool consists of a four-step process: (1) Client-Profile Input: the client's asset allocation, income, expenses, cash withdrawals, tax rate, risk-tolerance level, goals and other factors; (2) Client Scenarios: in effect, questions the client would like our guidance on, which may touch on issues such as when to retire, what his cash-flow stream is likely to be, whether his portfolio can beat inflation long-term, and how different asset allocations might impact his long-term security; (3) The Capital-Markets Engine: our proprietary model that uses our research and historical data to create a vast range of market returns, which takes into account the linkages within and among the capital markets, as well as their unpredictability; and finally (4) A Probability Distribution of Outcomes: based on the assets invested pursuant to the stated asset allocation, 90% of the estimated ranges of returns and asset values the client could expect to experience are represented within the range established by the 5th and 95th percentiles on "box- and- whiskers" graphs. However, outcomes outside this range are expected to occur 10% of the time; thus, the range does not establish the boundaries for all outcomes. Expected market returns on bonds are derived taking into account yield and other criteria. An important assumption is that stocks will, over time, outperform long bonds by a reasonable amount, although this is in no way a certainty. Moreover, actual future results may not meet Bernstein's estimates of the range of market returns, as these results are subject to a variety of economic, market and other variables. Accordingly, the analysis should not be construed as a promise of actual future results, the actual range of future results or the actual probability that these results will be realized.

2. Retirement Vehicles

Each retirement plan is modeled as one of the following vehicles: IRA, 401(k), 403(b) or Keogh. One of the significant differences among these vehicle types is the date at which mandatory distributions commence. For IRA vehicles, mandatory distributions are assumed to commence during the year in which the investor reaches the age of 70.5. For 401(k), 403(b), and Keogh vehicles, mandatory distributions are assumed to commence at the later of (i) the year in which the investor reaches the age of 70.5 and (ii) the year in which the investor retires. In the case of a married couple, these dates are based on the date of birth of the older spouse. The minimum mandatory withdrawal is estimated using the Minimum Distribution Incidental Benefit tables as published on www.irs.gov.

3. Rebalancing

Another important planning assumption is how the asset allocation varies over time. We attempt to model how the portfolio would actually be managed. Cash flows and cash generated from portfolio turnover are used to maintain the selected asset allocation between cash, bonds, stocks, REITs, and hedge funds over the period of the analysis. Where this is not sufficient, an optimization program is run to trade off the mismatch between the actual allocation and targets against the cost of trading to rebalance. In general, the portfolio will be maintained reasonably close to the target allocation. In addition, in later years, there may be contention between the total relationship's allocation and those of the separate portfolios. For example, suppose an investor (in the top marginal federal tax bracket) begins with an asset mix consisting entirely of municipal bonds in his personal portfolio and entirely of stocks in his retirement portfolio. If personal assets are spent, the mix between stocks and bonds will be pulled away from targets. We put primary weight on maintaining the overall allocation near target, which may result in an allocation to taxable bonds in the retirement portfolio as the personal assets decrease in value relative to the retirement portfolio's value.

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4. Expenses and Spending Plans (Withdrawals)

All results are generally shown after applicable taxes and after anticipated withdrawals and/or additions, unless otherwise noted. Liquidations may result in realized gains or losses which will have capital gains tax implications. See details on withdrawals in Cash-Flow Summary, if any.

5. Modeled Asset Classes

The following assets or indexes were used in this analysis to represent the various model classes:

Asset Class	Modeled As...	Annual Turnover Rate
U.S. Value	S & P / Barra Value Index	15%
U.S. Growth	S & P / Barra Growth Index	15%
Developed International	MSCI EAFE Unhedged	15%
Emerging Markets	MSCI Emerging Markets Free Index	20%
XYZ	Volatility: 40%; Dividend: \$0; Beta: 0.9	0%

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6. Volatility

Volatility is a measure of dispersion of expected returns around the average. The greater the volatility, the more likely it is that returns in any one period will be substantially above or below the expected result. The volatility for each asset class used in this analysis is listed on the Assumptions page. In general two-thirds of the returns will be within one standard deviation. For example, assuming that stocks are expected to return 8.0% on a compounded basis and the volatility of returns on stocks is 17.0%, in any one year it is likely that two-thirds of the projected returns will be between (8.9)% and 28.8%. But with intermediate government bonds, if the expected compound return is assumed to be 5.0% and the volatility is assumed to be 6.0%, two-thirds of the outcomes will typically be between (1.1)% and 11.5%. Bernstein's forecast of volatility is based on historical data and incorporates Bernstein's judgement that volatility of fixed-income assets is different for different time periods.

7. Technical Assumptions

Bernstein's Wealth Forecasting Analysis is based on a number of technical assumptions regarding the future behavior of financial markets. Bernstein's Capital Markets Engine is the module responsible for creating simulations of returns in the capital markets. These simulations are based on inputs which summarize the current condition of the capital markets as of June 30, 2006. Therefore, the first 12-month period of simulated returns represents the period from June 30, 2006 through June 30, 2007, and not necessarily the calendar year of 2006. A description of these technical assumptions is available on request.

8. Tax Implications

Before making any asset allocation decisions, an investor should review with his/her tax advisor the tax liabilities incurred by the different investment alternatives presented herein including any capital gains that would be incurred as a result of liquidating all or part of his/her portfolio, retirement-plan distributions, investments in municipal or taxable bonds, etc. Bernstein does not provide tax, legal, or accounting advice. In considering this material, you should discuss your individual circumstances with professionals in those areas before making any decisions.

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9. Tax Rates

Bernstein's Wealth Forecasting Analysis has used the following tax rates for this analysis:

Tax Payer	Scenario	Start Year	End Year	Federal Income Tax Rate	Federal Capital Gains Tax Rate	State Income Tax Rate	State Capital Gains Tax Rate	Tax Method Type
Sample Client	A	2006	2014	see below	see below	0.00%	0.00%	Top Marginal Rates

The federal income tax rate represents Bernstein's estimate of either the top marginal tax bracket or an "average" rate calculated based upon the marginal rate schedule. The federal capital gains tax rate is represented by the lesser of the top marginal income tax bracket or the current cap on capital gains for an individual or corporation, as applicable. Federal tax rates are blended with applicable state tax rates by including, among other things, federal deductions for state income and capital gains taxes. The state tax rate generally represents Bernstein's estimate of the top marginal rate, if applicable.

The Wealth Forecasting System uses the following top marginal tax rates: From now until 2010, federal income tax rate is 35%, and federal capital gains tax rate is 15%. For 2011 and beyond, federal income tax rate becomes 39.6%, and federal capital gains tax rate becomes 20%. The system uses the following AMT rates: From now until 2010, federal income tax rate is 28%, and federal capital gains tax rate is 15%. For 2011 and beyond, federal income tax rate becomes 28%, and federal capital gains tax rate becomes 20%.