

BlackRock Investment Directions

Asset Allocation Overview

With the fourth quarter 2010 milestones of the Federal Reserve's quantitative easing program (QE2) and Congressional passage of the Bush-era tax cuts extension, economic growth expectations have shifted upward. While fixed income markets experienced a late-quarter rate rise (supporting our view of choosing fixed income securities carefully), we believe equities have further upside potential given strong corporate balance sheets and the reduction in downside risk.

Investment Themes

- ▶ **Overweight equities:** With strong corporate cash positions and higher economic growth expectations, equities are well positioned to benefit. We believe a focus on high quality can be balanced with cyclical opportunities.
- ▶ **Be selective with fixed income credit:** While the recent rise in Treasury rates has shown that interest rate risk exists, we continue to believe that selectivity is key and credit-sensitive spread sectors offer a compelling yield and return profile.
- ▶ **Credit concerns remain, but the municipal story is still compelling:** Despite state and local fiscal woes and the expiration of the Build America Bond program, munis still offer attractive relative yield and some degree of capital appreciation potential.



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Asset Allocation Views

Key ○ = previous quarter ● = current quarter

		Strength of Preference						
Current Outlook		Strong	◀ Neutral ▶	Strong				
Asset Allocation	Improving expectations and healthy levels of corporate cash benefit equities	Bonds	○	○	○	●	○	Stocks
Equities								
Region	US stocks show more upside potential	US	○	●	○	○	○	Int'l
	Improved visibility on developed countries	Developed	○	○	●	○	○	Emerging
Market Cap	With stronger growth, small caps benefit	Small	○	●	○	○	○	Large
Style	Broadly neutral	Value	○	○	●	○	○	Growth
Fixed Income								
Duration	Remain neutral given rate volatility and Fed actions	Short	○	○	●	○	○	Long
Quality	Recent Fed and fiscal actions support spread sectors in similar way to equities	High	○	○	○	●	○	Low
Regional	US pace of recovery greater than other markets	US	○	●	○	○	○	Int'l
Commodities & Currencies								
Commodities	Improving economic outlook should benefit commodities	Underweight	○	○	○	●	○	Overweight
Currencies	US dollar stronger than other developed market currencies, but weaker than emerging markets currencies	US	○	○	○	●	○	Foreign

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“From a sector perspective, telecommunications remains a favorite, while energy and industrials also have become more compelling.”

Equity Market Outlook

Equities finished 2010 in a position of significant strength thanks in part to improved economic expectations, improving jobs growth news, and the capital markets-friendly combination of QE2 and Congressional passage of the Bush tax cuts with some fiscal sweeteners. In this context, with risks to the downside reduced, we believe there are opportunities for investors in risk assets, and in stocks in particular.

With the strong fourth quarter of stock market gains behind us, investors will be assessing whether the upswing will continue. The strong technical backdrop of the likely shift of investor flows into equities, the probability of continuing strong corporate earnings, and our belief that the unemployment rate could begin to notch down contribute to our positive view. However, downside risk does exist in the continued weak housing market, the potential for negative state and municipal credit events, and impacts from European crisis and emerging markets rate tightening.

Strong balance sheets and income statements with healthy free cash flow will likely lead to considerable increases in dividends, share buybacks, merger and acquisition (M&A) activity and business reinvestment. In this context, we see higher quality economic growth (more from demand, less from stimulus) and resultant higher gross domestic product (GDP). Combined with improved business and consumer confidence and a less hostile capital markets attitude from Washington, DC, we are forecasting another reasonably good year for risk assets.

Equity Views

- ▶ With the improved economic outlook and strong corporate earnings and likelihood for improving flows into equities, investors should consider incorporating both high quality and cyclical opportunities into their portfolios. While there continues to be downside potential, we believe the upside possibilities outweigh the downside risks.
- ▶ From a sector perspective, telecommunications remains a favorite, while energy and industrials also have become more compelling. Healthcare continues to show promise, but we believe consumer discretionary may end its significant outperformance. Our outlook for financials continues to show headwinds and we believe the fundamentals of consumer staples have declined to neutral.

Equity Sector Outlook		Key ○ = previous quarter ● = current quarter				
	Current Outlook	Strength of Preference				
		Underweight	◀	Neutral	▶	Overweight
Telecom Services	Good cash flows and high dividends	○	○	○	○	●
Healthcare	The healthcare reform cloud has lifted; stocks reasonably priced	○	○	○	●	○
Energy	Global economic growth; higher oil prices	○	●	○	●	○
Industrials	Global cyclical reacceleration and reasonable valuations	○	○	○	●	○
Consumer Discretionary	Shift to neutral outlook as sector outperformance might end	○	○	●	○	○
Consumer Staples	Neutral fundamentals with mixed valuations	○	○	●	○	○
Utilities	Mixed fundamental outlook; reasonably priced after weak 4Q	○	○	●	○	○
Information Technology	Inventory overhang contributes to continued mixed outlook	○	○	●	○	○
Materials	Should benefit from improving macro outlook	○	○	●	○	○
Financials	Slowly improving balance sheets; regulatory overhang; not expensive	○	●	○	○	○

Taxable Fixed Income Market Outlook

With economic growth expectations shifting upward, we believe investors should begin to review portfolio allocations. While economic indicators continue to demonstrate mixed messages such as an improvement in consumer and manufacturing sectors against an increase in unemployment and continued decline in housing, we believe an economic environment of low domestic inflation and slow-to-moderate growth will prevail. Against this backdrop, investors will continue to be challenged to balance the tailwinds of moderately improving economic expectations with the structural headwinds to US labor market growth, which is crucial to economic recovery.

We believe inflation will remain a non-issue as the late fourth quarter US Treasury rate backup was, we believe, a result of a rebound from overbought conditions and a response to European economic issues as well as improving US economic conditions. In this context, and with a complex global environment of European crises, emerging market rate tightening and US recovery dynamics, being nimble in sector selection and duration will be critical. We continue to see opportunities in high yield as growth improves and rates are held low. We also see agency mortgages and securitized sectors as attractively priced given the recent backup in rates.

“With positive supply/demand dynamics for fixed income assets, we continue to favor higher-quality spread sectors but have also begun to see opportunities in agency mortgages.”

Taxable Fixed Income Views

- ▶ We believe there are encouraging signs that QE2 and extension of Bush-era tax cuts have aided the recovery meaningfully and raised economic growth expectations.
- ▶ With positive supply/demand dynamics for fixed income assets, we continue to favor higher-quality spread sectors but have also begun to see opportunities in agency mortgages.

Taxable Fixed Income Sector Outlook		Key ○ = previous quarter ● = current quarter				
	Current Outlook	Strength of Preference				
		Underweight	◀	Neutral	▶	Overweight
High Yield	Supportive supply/demand dynamics and fundamentals warrant an overweight position	○	○	○	●	○
Securitized Assets	Constrained supply leads to strong technical backdrop	○	○	○	●	○
Corporates	Modestly overweight investment-grade corporates based on fundamental and technical factors	○	○	○	●	○
Non-US Dollar	Broadly neutral given volatile currency moves and sovereign headline risk concern us	○	○	●	○	○
Inflation Protected	Inflation-protected securities becoming increasingly attractive	○	○	○	○	○
Emerging Markets	Structural advantages versus developed nations support attractiveness of EM debt	○	○	○	○	○
Agency Mortgages	Given recent backup in yields, we see some attractive opportunities	○	○	○	○	○
Treasury/Agency	We are underweight Treasuries and neutral on agency securities as better relative value can be found in spread sectors	○	○	○	○	○

Municipal Markets Outlook

While state and local governments have clearly been hard hit by the fiscal challenges and the expiration of the Build America Bond program, we believe munis still offer attractive relative yield and some degree of capital appreciation potential. We believe there is a substantial margin of safety between credit deterioration and potential insolvency and believe that states and localities will continue to make timely and full payments on their general obligation debt. While a decline in direct federal aid

is a threat, the improvements in revenue collections and exercise of powers to balance budgets and restore fiscal integrity bode well for future health. We believe the fourth quarter technical conditions of significant mutual fund outflows amplified an already weak seasonal period for munis marked by increased supply, and that the first quarter brings a more constructive outlook.

“We believe munis still offer attractive relative yield and some degree of capital appreciation potential.”

Municipal Markets Views

- ▶ We continue to favor state tax-backed and essential service bonds, particularly the Southwest, Plains and Southeast regions. We also like dedicated-tax bonds and housing issues.
- ▶ We continue to have a less favorable view toward land-secured bonds, senior living bonds, bond insurers, student loans, pre-refunded bonds and local tax-backed issues.

Municipal Market Positioning

		Key ○ = previous quarter ● = current quarter						
		Strength of Preference						
		Strong	◀	Neutral	▶	Strong		
Duration	Move to neutral duration	Short	○	○	●	○	○	Long
Yield Curve	Favor intermediate maturities	Short	○	○	●	○	○	Long

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