

Weekly Investment Commentary

Risks Are Rising, but the Long-Term View Remains Positive

May 23, 2011

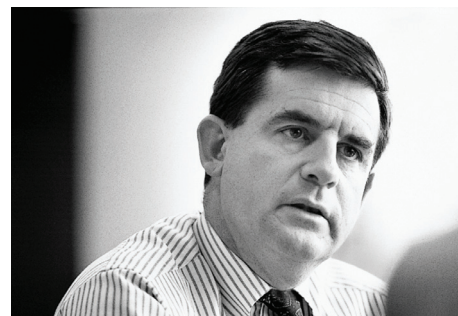
Stock markets endured a third consecutive week of flat-to-down returns as the sideways trading pattern continued. For the week, the Dow Jones Industrial Average lost 0.7% to 12,512, the S&P 500 Index declined 0.3% to 1,333 and the Nasdaq Composite fell 0.9% to 2,803. Our baseline assessment of the markets is that while the bull market remains intact, investors should expect continued near-term corrective activity as gains will be harder to come by.

To a large extent, the recently weaker tone in equity markets can be attributed to a broad slowdown in economic data that has been capturing the headlines of late. A longer-term retrospective view shows that the pace of economic growth has been gradually fading over the past several months. Some of the decline can be explained by seasonal factors (poor weather caused a disruption in growth in the first quarter) or factors that may prove to be temporary (the rise in energy prices, particularly gasoline, may have negatively impacted retail sales). In any case, however, at this juncture it appears that the recovery or acceleration phase of the business cycle may be ending. We believe the economy is now shifting into an expansion mode, and the question will become how long that expansion will last.

From an earnings perspective, corporations have continued to manage to grow their earnings at a pace faster than that of overall economic growth. At this point, nearly all of the S&P 500 companies have reported first-quarter earnings and the results have again been impressive. On average, companies exceeded earnings expectations by 6% and overall earnings are up 18% compared to year-ago levels. Strong corporate earnings should remain a meaningful tailwind for equity markets in the months ahead.

Outside of the United States, investors remain focused on the sovereign debt problems plaguing Europe. The International Monetary Fund has been advocating for a more comprehensive debt crisis plan and the European Union has recently taken some additional action, including calling for heightened austerity measures, increasing purchases of government bonds and providing banks with additional liquidity. The end game for the European debt crisis remains unknown, but will almost certainly require some combination of debt restructuring and debt forgiveness. At this point, we doubt we will see additional monetary tightening by the European Central Bank at any point soon, but regardless of what happens, the potential for additional debt problems remains worrisome for investors.

At present, stock markets appear balanced between the positive forces of strong corporate earnings, a still-friendly macro environment and attractive valuations, and the negative forces of a growing list of downside risks. There are a number of headwinds investors must contend with. The most obvious, of course, is the slowdown in economic data, but investors are also wary regarding the eventual need for a normalization in interest rates. Although we are not expecting the US Federal Reserve to raise rates any time soon, the



Bob Doll is Chief Equity Strategist for Fundamental Equities at BlackRock®, a premier provider of global investment management, risk management and advisory services. Mr. Doll is also Lead Portfolio Manager of BlackRock's Large Cap Series Funds. Prior to joining the firm, Mr. Doll was President and Chief Investment Officer of Merrill Lynch Investment Managers.

pending end of the QE2 program is highlighting the fact that the Fed is moving away from its “emergency” stance of ultra-easy policy. In addition to a potentially more troublesome economic and rates backdrop, investors are also rightfully concerned about ongoing debt issues and the potential for renewed energy price spikes.

From our perspective, we acknowledge that all of these downside risks are real ones, but we are not among those who are calling for an end to the bull market. Rather, we believe that the long-term uptrend in stock prices will continue, but at a more challenged pace than what we saw over the last two years. Since the nadir of the bear market in March 2009, stock prices have doubled, and that is obviously not a pace that can continue indefinitely. With the economy continuing to grow at a modest pace, inflationary pressures contained for now and corporate earnings growing at an impressive pace, we believe that markets should be able to make additional gains over the coming months and years, but we also expect to see near-term risks cause markets to remain range-bound for the time being.

For additional information, or to subscribe to weekly updates to this piece, please visit www.blackrock.com.

Sources: BlackRock; Bank Credit Analyst. This material is not intended to be relied upon as a forecast, research or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy. The opinions expressed are as of May 23, 2011, and may change as subsequent conditions vary. The information and opinions contained in this material are derived from proprietary and nonproprietary sources deemed by BlackRock to be reliable, are not necessarily all-inclusive and are not guaranteed as to accuracy. Past performance is no guarantee of future results. There is no guarantee that any forecasts made will come to pass. Reliance upon information in this material is at the sole discretion of the reader. Investment involves risks. International investing involves additional risks, including risks related to foreign currency, limited liquidity, less government regulation and the possibility of substantial volatility due to adverse political, economic or other developments. The two main risks related to fixed income investing are interest rate risk and credit risk. Typically, when interest rates rise, there is a corresponding decline in the market value of bonds. Credit risk refers to the possibility that the issuer of the bond will not be able to make principal and interest payments. Index performance is shown for illustrative purposes only. You cannot invest directly in an index.

FOR MORE INFORMATION: www.blackrock.com

BlackRock is a registered trademark of BlackRock, Inc. All other trademarks are the property of their respective owners.

Prepared by BlackRock Investments, LLC, member FINRA.

©2011 BlackRock, Inc. All Rights Reserved.

Not FDIC Insured • May Lose Value • No Bank Guarantee
--