

JANUARY 27, 2014

WEEKLY INVESTMENT COMMENTARY

BLACKROCK®

Expect Higher Volatility to Persist

Stocks Sink and Bonds Rise as Investor Anxiety Increases

After a rocky first few weeks of the year, equity markets succumbed to rising negative sentiment last week and experienced sharp declines. Most of the media coverage attributed the selloff to market turmoil in emerging markets (EMs), but there were multiple culprits, as we describe below. For the week, the Dow Jones Industrial Average lost 3.5% to close at 15,879, the S&P 500 Index declined 2.6% to 1,790 and the Nasdaq Composite fell 1.6% to 4,128. As stock prices fell, bond prices rose as investors appeared to be seeking out some safe havens. The yield on the 10-year Treasury fell from 2.82% to 2.72% last week (prices move in the opposite direction of yields).

Behind the Selloff: EM Issues, Stretched Valuations and Mediocre Earnings

Some issues coming from emerging markets helped contribute to the broader decline in stocks last week. China reported some surprisingly weak economic data, and financial turmoil in Argentina and Turkey led to a selloff in EM currencies.

While that volatility was a factor, we believe the decline in U.S. stocks also can be attributed to issues closer to home. We have discussed previously that last year's gains were powered primarily by multiple expansion, meaning prices were rising faster than underlying corporate earnings. In fact, 2013 saw the largest single-year increase in market valuations since 1998. As stocks grew more expensive over the last year, bonds became less so. As a result, we have been seeing some investors (notably large institutional investors) shifting more assets into bonds over the past few weeks. This helps explain why bond yields have been declining since the start of the year.

On a related point, corporate earnings so far have been less than stellar for the current reporting cycle. Last year's rally was, to a large extent, based on an act of faith that the economy and corporate earnings would improve, which would, in turn, justify higher stock prices. While the economy does appear to be mending, improvements are modest and so far are not evident in corporate earnings reports.

It is still relatively early in the fourth-quarter reporting season, and to date, the results have been respectable, but hardly inspiring. The percentage of companies that are reporting better-than-expected results is actually below the four-year average, which appears to be frustrating investors. We're seeing this frustration in the form of fund flows: U.S. equity funds have been seeing outflows, while European and global equity funds have been attracting assets.



Russ Koesterich, Managing Director, is BlackRock's Global Chief Investment Strategist, as well as Global Chief Investment Strategist for BlackRock's iShares business. Mr. Koesterich was previously Global Head of Investment Strategy for active equities and a senior portfolio manager in the U.S. Market Neutral Group. Prior to joining the firm in 2005, he was Chief North American Strategist for State Street Bank.

While we still think stocks will post gains this year, those gains will be accompanied by more ups and downs.

**SO WHAT DO I DO
WITH MY MONEY?®**

It's the question on everyone's mind. And fortunately, there are answers. Visit blackrock.com for more information.

Expect Higher Levels of Volatility; Diversify Internationally

Market volatility in 2013 was unusually low, thanks in large part to the Federal Reserve's extraordinary monetary policies. As the central bank begins its tapering process and is starting to move away from its ultra-easy approach to policy, we expect market volatility to climb to levels that are closer to long-term averages. While we still think stocks will post gains this year, those gains will be accompanied by more ups and downs.

In this environment, we'll echo an investment recommendation we have been making for some time: Diversify into international stocks. We'll point out that during a week where most of the news was negative, Europe surprised to the upside with a surge in manufacturing data. For those investors who have been overly focused on U.S. stocks, we would suggest increasing exposures to international equities—specifically to the other large developed markets of Europe and Japan. In fact, we would recommend overweight positions to both of those regions.

For those investors who have been overly focused on U.S. stocks, we would suggest increasing exposures to international equities—specifically to the other large developed markets of Europe and Japan.

Visit www.blackrock.com

For additional information, or to subscribe to weekly updates to this piece.

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 January 27, 2014, 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

©2014 BlackRock, Inc. All Rights Reserved. **BLACKROCK**, **BLACKROCK SOLUTIONS**, **iSHARES**, and **SO WHAT DO I DO WITH MY MONEY** are registered trademarks of BlackRock, Inc. or its subsidiaries in the United States and elsewhere. All other trademarks are those of their respective owners.

Prepared by BlackRock Investments, LLC, member FINRA.

Not FDIC Insured • May Lose Value • No Bank Guarantee

393A-AC-0114 / USR-3382

