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# WEEKLY INVESTMENT COMMENTARY

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## Slow Growth and Low Rates Drive Markets Higher

### Markets Breathe a Sigh of Relief

With the government shutdown ended and the threat of debt default avoided (for now, at least), markets were able to digest corporate earnings releases and some delayed economic reports. While the tone of the data was less than upbeat, investors have been adopting a relatively optimistic stance and appear to be focusing on the likelihood that slow economic growth will mean the Federal Reserve will keep monetary policy accommodative for longer than previously expected.

This backdrop helped stocks rise for yet another week. For the week, the Dow Jones Industrial Average advanced 1.1% to 15,570, the S&P 500 Index rose 0.9% to 1,759 and the Nasdaq Composite climbed 0.7% to 3,943. In fixed income markets, Treasury yields continued to fall (as prices correspondingly rose), with the yield on the 10-year Treasury declining from 2.59% to 2.51%.

### U.S. Economy Remains Stuck in Second Gear

With government agencies back to work, a bottleneck of economic data was released, providing investors with some important clues as to how the U.S. economy will fare as we head into the final months of 2013. The summary conclusion that can be drawn from the data is that the U.S. still appears to be growing at a sluggish rate of around 2%, with little evidence that we'll be seeing a pickup any time soon.

The most important data set that was released was the delayed and long-awaited September jobs report. The headline numbers were a bit disappointing, as the U.S. created only 148,000 net new jobs, well below expectations and below the average of around 180,000 from the first nine months of the year. The other data included in the report also failed to show much in the way of improvement. Hourly earnings are still growing at around 2%, well below the long-term average, while labor force participation remains at 63.2%, a multi-decade low. The lone bright spot was the unemployment rate, which fell to 7.2%, its lowest level since late 2008.

Other measures of economic activity painted a similar picture of anemic growth. While durable goods orders for September saw a dramatic increase of nearly 4%, it was skewed by a sharp rise in aircraft orders. In many sectors, capital goods orders have been quite weak—a trend confirmed by last week's announcement by Caterpillar, the largest manufacturer of construction and mining equipment, that it was cutting its 2013 sales forecasts.

While the U.S. economy is not currently in danger of slipping back into recession, neither is it accelerating. The government shutdown and budget battles certainly

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 US Market Neutral Group. Prior to joining the firm in 2005, he was Chief North American Strategist for State Street Bank.

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did not help matters. The drama undermined business confidence, which in turn dampens hiring, and we also saw consumer confidence drop to a nine-month low.

### Fed Accommodation Likely to Persist

Interestingly, the trend of weak economic data does not appear to be bothering investors, who are continuing to bid stock prices higher. Flows into stock funds jumped last week, with significant inflows moving into U.S. funds.

As we alluded to earlier, much of this optimism can be attributed to the fact that investors are expecting the Federal Reserve to hold off on tightening monetary policy. Specifically, investors and economists are pushing back expectations for when the Fed will begin to taper (i.e., when the central bank will begin to reduce its asset purchases), as well as the likely date when the Fed will begin to increase short-term rates. This has also had the effect of reducing longer-term expectations for interest rates. As recently as a few months ago, many were expecting rates to rise dramatically late this year and early next year, but those expectations have since been softened.

### Stocks Can See Further Gains in a Slow Growth/Low Rates World

For investors, there are a couple of takeaways from all of this. The first is that interest rates are likely to remain range-bound for the coming months (or at least until economic data surprises to the upside). The second is that while a more benign rates environment should be good news for stocks, equity markets will have to manage a delicate balancing act. If the economy stalls further, corporate earnings estimates will likely be reduced, which would hurt stocks. In contrast, however, an acceleration in economic growth would reignite concerns over the potential for interest rate increases.

Put another way, for stocks to continue to make gains, we likely need to see a continuation of the not-too-hot, not-too-cold "Goldilocks" economy that provides for modest growth, high profit margins, and an accommodative Fed.

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