

Weekly Investment Commentary

Markets Will Look Past Debt Issues, But Not Yet

August 1, 2011

Equities markets dropped sharply last week in the face of continuing gridlock in Washington over debt and deficit issues, some renewed problems for euro-area sovereigns and a very weak gross domestic product report. For the week, the Dow Jones Industrial Average lost 4.2% to 12,143, the S&P 500 Index dropped 3.9% to 1,292 and the Nasdaq Composite fell 3.6% to 2,756.

The parties in Washington worked through the weekend, and by Sunday night a framework for a deficit and debt deal was reached. As of the time of this writing, the final voting on the deal has not yet occurred, but it is looking like the multi-part agreement will be passed. The debt deal will raise the debt ceiling, will provide a set of spending cuts over the next ten years and would be enough to remove the specter of a US debt default.

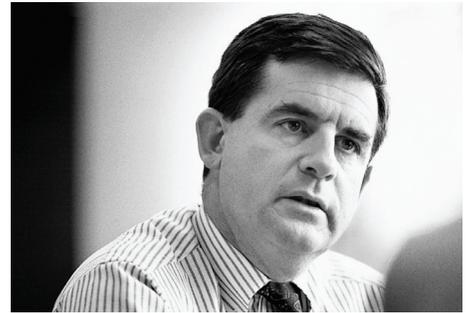
Even with the immediate risk of the debt ceiling issue likely fading for now, however, there remains a risk that one or more of the credit ratings agencies could downgrade the credit rating of the United States. It is unclear whether any agreement on long-term debt issues will reverse the trend of debt growing faster than GDP — an issue on which the ratings agencies remain highly focused.

Financial market volatility has increased as the debate has escalated, but at this point, it is very unclear how markets would react to any sort of credit downgrade. Investors loathe uncertainty and the fixation over the debate in Washington has been enough to disrupt markets. For politicians, however, ambiguity and last-minute compromise have become standard tools of the trade.

The circus in Washington has taken attention away from economic and earnings data. Friday's GDP report showed that second quarter growth came in at a lower-than-expected 1.3% rate. Furthermore, first-quarter growth was revised downward sharply to 0.4% from an original reported rate of 1.9%. While this report certainly confirms that the economy has slowed, there has also been some positive news. Initial unemployment claims fell in July to their lowest level in several months, suggesting that we should be seeing some labor market improvements.

Corporate earnings have also continued to show resilience. At this point, approximately two-thirds of companies have reported second-quarter earnings, and over 70% have delivered results that were ahead of expectations.

Over the past several months, stocks have been stuck in a fairly narrow trading range, with strong earnings pushing prices higher and macro risks and the growth slowdown acting as counterweights. Once the debt and deficit pictures become more clear and once investors are able to price in the effects of the final deals, markets may be able to again focus on fundamentals.



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.

From an economic perspective, the US economy remains vulnerable, which is not a comfortable backdrop for risk assets, but we continue to believe that the probability of recession remains low and that economic data should improve in the coming months. To us, all of this suggests that the positive forces for the markets should win out, but for that to happen additional clarity is key.

[For additional information, or to subscribe to weekly updates to this piece, please visit www.blackrock.com.](http://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 August 1, 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
--