Special Equity Update from Bob Doll

BLACKROCK

22 September 2008

Last week featured intense equity market volatility, both to the downside and the upside, but a look at the numbers showed that U.S. markets ended the week largely where they began. Overall, the Dow Jones Industrial Average lost 0.3% to close at 11,388; the S&P 500® Index advanced 0.3% to 1,255; and the Nasdaq® Composite rose 0.6% to 2,273. Non-U.S. stocks performed similarly. The MSCI EAFE® Index moved in dramatic fashion but ended the week down just 0.11%. Over the course of the week, the Dow moved more than 2,000 points in all, evidencing the dramatic volatility.

Global equities dropped sharply during the first few days of trading following the announcement of the Lehman Brothers bankruptcy, the Merrill Lynch/Bank of America transaction, and the AIG rescue plan. Equity prices turned in the middle of last week, however, on the heels of major changes in global central bank practices, and news of pending government action. China loosened its reserve requirements for the second time in the current cycle, and the Federal Reserve worked closely with the Bank of Japan, the European Central Bank and other central banks to inject liquidity. Additionally, news began to circulate regarding the U.S. government's plans to create some sort of large-scale entity to help deal with the crisis — possibly modeled after the Resolution Trust Corporation (RTC) that was formed during the S&L crisis. From the trough on Thursday to the peak on Friday, the Dow, S&P, Nasdaq, and MSCI EAFE all recorded double-digit percentage gains.

Other asset classes also experienced extreme volatility last week as credit borrowing and lending, the basic functions of finance on which the economy rests, came close to breaking down. U.S. Treasury yields fell in the middle of the week to near-record lows, gold prices saw their biggest weekly increase since 1980, and oil dropped sharply, testing the $90 per barrel level, before moving back into triple-digits on news of reduced inventories, the effects of Hurricane Ike and unrest in Nigeria.

The financial system did come close to a meltdown last week, forcing the U.S. government to throw all it could at the situation. The broad outlines for the proposed policy measures — from money market fund insurance to the RTC-like funding of distressed mortgage securities — match the seriousness of the crisis, contain the hope of solving the core problems, and send a message that the U.S. government will do anything at any cost to prevent a large-scale financial meltdown for the simple reason that the alternatives would be even more expensive.

How the proposals will affect the economy and financial markets will, as always, depend on the plans' details, which remain somewhat murky. As details become available, investors will try to make assessments based on answers to some of the basic questions, including how prices of currently illiquid mortgage securities will be determined, who will be able to sell their assets to gain relief, and which mortgage securities will be eligible. In any case, capitalism as we know it cannot function without a working banking system that requires banks to trust one another and markets to operate smoothly. This past week, intense market disorder prompted a touch of systemic failure. In our opinion, such systemic failure requires a system-wide solution. Bailing out institutions one at a time has not, and will not, stabilize the environment, which has prompted such large-scale U.S. government action. Eventually, we expect the banking system and financial markets to once again be based on fundamentals, but for the time being, disorderly markets are likely to continue.

About BlackRock

BlackRock is a premier provider of global investment management, risk management, and advisory services. As of 30 June 2008, the firm manages US$1.43 trillion across equity, fixed income, real estate, liquidity, and alternative strategies. Clients include corporate, public, and union pension plans, insurance companies, mutual funds, endowments, foundations, charities, corporations, official institutions, and individuals worldwide.

Through BlackRock Solutions®, the firm offers risk management and advisory services that combine capital markets expertise with proprietarily-developed systems and technology. BlackRock Solutions provides risk management and enterprise investment services for US$7 trillion in assets.

BlackRock serves clients in North and South America, Europe, Asia, Australia, Africa, and the Middle East. Headquartered in New York, the firm maintains offices in 19 countries around the world.

Bob Doll is a Vice Chairman and a member of the BlackRock Board of Directors. He is also the Global Chief Investment Officer of Equities, a member of the BlackRock Executive Committee, and head of the US Large Cap Series equity team. Prior to joining BlackRock, Mr. Doll was President and Chief Investment Officer of Merrill Lynch Investment Managers.

What, then, are the investment implications? Our view is that investors will continue to face a highly complex and dangerous backdrop in terms of setting strategy. Economic activity is weakening worldwide, raising the possibility that some economies have entered a recession. Global equity markets appear to be oversold, even after Thursday's and Friday's explosive rallies. While additional policy action could help to extend that momentum, it is difficult to determine how long such a rally could last. The recent sell-off was triggered by a collapse in confidence and, therefore, a decisive rescue package from government authorities should bring us closer to the end of the bear market.

In our opinion, it will be critical to avoid a deep recession that would weaken areas of the market that have remained resilient. For example, U.S. non-financial sectors have weathered a slowing but not receding economy quite well. However, should the economy turn sharply downward, even those sectors would likely suffer heavy losses. In any case, not all signs are negative. The recent drop in oil prices is a net positive for equities, and U.S. manufacturing activity continues to hold up reasonably well on the back of a weak U.S. dollar, despite its recent rise.

Looking ahead, additional aggressive and coordinated central bank action, including rate cuts by the European Central Bank, may be necessary to continue to quell the fear and trepidation that so dominate market sentiment. The extreme problems in the credit markets and banking system have prompted the government to take some decisive action, which does represent a positive for risk assets. A relief rally does appear to be under way, but a strong bull market is far from assured. In all likelihood, investors will continue to be wary until it is clear that the U.S. government's efforts are working.

Sources: BlackRock, Bank Credit Analyst

BLACKROCK