Investment Commentary Special Update

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Over the past several days, the financial news has been dominated by headlines concerning credit problems, specifically those associated with the subprime lending business. While this has been an ongoing issue for much of 2007, concerns have intensified over the past week, and global financial markets have been rattled. With all of the uncertainty surrounding the markets, we thought it would be useful to offer some perspective on what has been happening, and to share our thoughts on what investors might expect going forward.

What has been happening in the equity markets?

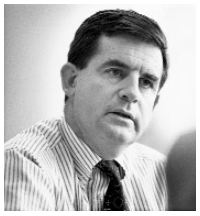
Following last week's equity market declines in the United States and around the world (U.S. stocks experienced their worst week since September 2002), stocks have continued to be volatile. Stocks around the world sold off on July 31 and August 1, with many Asian markets losing between 2% and 3%, losses in European markets approaching that range and U.S. markets trading in an uneven fashion, losing value on the 31st, but rallying the following day.

While this volatility is certainly enough to cause investors concern, we believe it is important to keep it in perspective. Stocks have been enjoying a bull market since October 2002, and over the past year, U.S. stocks are up 25%. What so far has been a roughly 5% correction (and may yet be a bit more) is best described as a "bull correction," a normal consolidation within a bull market.

What has changed recently?

The main catalyst for market declines has been what we would call the "July credit crunch." Subprime mortgages have been in a meltdown for several months, and related low-credit investments (including some hedge funds) have experienced a noticeable spillover effect. Over the past week, there have been some high-profile credit collapses (specifically, the stock of American Home Mortgage Investment Corporation lost 90% of its value on July 31) and many investors have been concerned that the credit contagion could continue to have a wider impact on the broader economy and other financial assets.

As a result of the July credit crunch, we have seen several changes. First, we have seen a drying up of the credit availability that has been helping to drive high levels of merger-and-acquisition and other corporate deal activity. Second, within fixed income markets, higher-quality bonds (specifically Treasury bonds) have gone up in price as investors have been moving to relatively "safe" assets, while bonds associated with housing and credit markets (such as asset-backed securities and commercial mortgage-backed securities) have experienced significant price declines. Lastly, expectations for Federal Reserve interest rate cuts have changed radically in recent weeks. On June 30, the fed funds futures curve was pricing in a nearly 0% chance that the Fed would cut rates in 2007. That number had moved up to 30% on July 20 and has since spiked to nearly 100% today.



Bob Doll is Vice Chairman and Global Chief Investment Officer of Equities at BlackRock, a premier provider of global investment management, risk management and advisory services. Bob also is Chairman of BlackRock's Private Client Operating Committee. Prior to the combination of BlackRock and Merrill Lynch Investment Managers in 2006, Bob served as President and Chief Investment Officer of Merrill Lynch Investment Managers. BlackRock has $1.23 trillion in assets under management as of June 30, 2007.

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What has not changed?

Despite the recent turmoil, much of the fundamental economic backdrop has not changed. We do not believe the current unrest in the credit markets will derail the prevailing macro trends that have been conducive to reasonably good global financial market performance. The U.S. economy continues to grow at a below-trend pace, with the main culprit being the residential real estate recession. Outside of the United States, growth remains robust, contributing to U.S. exports. Additionally, inflation and interest rates around the world remain relatively low. From a corporate earnings perspective, altough earnings growth levels have not been great, they have, for the most part, continued to beat expectations.

What are the remaining risks?

The main risk is that we do not believe we have seen the end of the credit crunch. We anticipate that credit availability will continue to shrink and that residential real estate will continue to experience problems. As a result, we will likely see a modestly negative impact on U.S. economic growth levels. The extent to which all of this will happen is open question, and is one that will continue to fuel uncertainty in the markets.

What should investors expect from here?

While the credit crunch may detract somewhat from U.S. economic growth levels, we believe the effects will be limited. The labor market has been resilient in the face of slowing growth, and sources of strength (most notably exports) should help to ensure that the U.S. economy does not sink into recession. Outside of the United States, we expect economic growth to remain robust.

Regarding the equity markets, the uncertainty in investors' minds will not be erased in the short-term, and we would not be surprised to see some additional corrective action in the coming weeks. From a price standpoint, we expect that the approximate 5% decline that we have already witnessed should mark more than half of any declines, but from a time perspective, we are probably less than halfway through this corrective phase. We would also note that we do not expect to see a "V" bottom, a scenario in which markets recover sharply, but instead expect a series of moderate rallies and failures until the dust settles.

From a longer-term perspective, our views remain unchanged. At the beginning of the year, when the S&P 500® Index was at 1,418, we had projected a year-end target of around 1,550 (as of the market close on August 1, the S&P was at 1,465). We believe this year-end number still seems reasonable, and would represent another double-digit year for equities (counting the effects of dividends). This would certainly fall into the range of what we have been calling a "reasonably constructive" year.

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