

NOVEMBER 19, 2012

WEEKLY INVESTMENT COMMENTARY

BLACKROCK®

“Cliff” Avoidance Remains Key to a Brighter Outlook

Stocks Again Falter on Fiscal Cliff Fears

Equities slipped yet again last week as investors remain focused on the upcoming fiscal cliff set to take effect at the beginning of 2013. Of course, some softer economic data and rising concerns over conflict in the Middle East did not help matters. For the week, the Dow Jones Industrial Average fell 1.8% to 12,588, the S&P 500 Index declined 1.5% to 1,359 and the Nasdaq Composite dropped 1.8% to 2,853. Since the US election on November 6, the S&P 500 has slid 5%, indicating that investors remain highly anxious about the path forward.

Chances for an 11th-Hour Solution?

The question of whether or not the fiscal cliff will be avoided is impossible to answer with any degree of certainty, but the political reality does indicate that some sort of compromise may be possible. Both the election results and current polls suggest Republicans are more likely to be blamed if no deal is reached. At the same time, it is clearly in President Obama's interests to reach a resolution. As such, most politicians appear motivated to find some sort of middle ground. The two sides still appear to be quite far apart on some important issues (particularly regarding a potential tax increase for higher-income Americans), but the parties are at least attempting to avoid brinksmanship.

Our best guess as to the outcome is that, at the 11th (or 12th) hour, President Obama and Congress will agree to some type of compromise deal that includes a short extension of at least most of the Bush-era tax cuts, some sort of tax increase on upper-income households and a delay of most of the scheduled spending cuts.

Any such deal also is likely to include provisions that launch the process of more comprehensive deficit reduction and tax and entitlement reform. Should this come to pass, our assessment is that the size of the tax increases and spending cuts would be reduced to the point that they would cause about a 1.5% hit on US economic growth, less than the currently forecasted more-than-4% impact, but still significant. It is important to remember that the risks are still heavily skewed to the downside, and until we see some sort of fiscal cliff resolution, equity markets are likely to remain choppy.

Despite Risks, Stocks Still Attractively Positioned

Investors are understandably focused on the near-term risks of the fiscal cliff, weakness in the global economy and escalating geopolitical conflict, all of which



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are driving volatility higher. However, we continue to believe that, from a fundamental perspective, stocks remain attractive. The combination of decent valuations, easy monetary policy, low inflation and still-positive economic growth suggests stocks will continue to outperform bonds over the next 12 months.

Passing the Baton

As many of you are aware, I'm retiring from BlackRock. Working here has been a great experience for me, and one of the aspects of this job I have enjoyed the most was talking about the markets, offering my opinions and predictions and suggesting ways that BlackRock's clients can position their portfolios. I know that these communications are important for our regular readers as well, and I want to let everyone know that, starting next week, BlackRock's weekly investment commentary will be authored by Russ Koesterich. I've had many opportunities to work with Russ and I have found his opinions and ideas to be insightful and thought-provoking—I have full confidence that you will as well.

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Introducing BlackRock's Chief Investment Strategist: Russ Koesterich

We are pleased to let you know that Russ Koesterich has been named BlackRock's Global Chief Investment Strategist and, starting next week, will be authoring BlackRock's weekly investment commentaries. Russ is a prolific commentator on the markets and can regularly be seen on CNBC, Fox Business News and Bloomberg TV, and is often quoted in the print media, including the Wall Street Journal, USA Today and Barron's.



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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