JANUARY 22, 2013

WEEKLY INVESTMENT COMMENTARY

BLACKROCK®

Economic Backdrop Supports Stocks, Credit Sectors and Munis

Stocks Strong Start to 2013 Persists

Thanks to solid earnings, some decent (if mixed) economic news and indications that the debt ceiling debate may be delayed slightly, stocks posted additional gains last week, continuing their strong start to 2013. For the week, the Dow Jones Industrial Average climbed 1.2% to 13,649, the S&P 500 Index advanced 1.0% to 1,485 and the Nasdaq Composite rose 0.3% to 3,134. Bonds have remained relatively steady, with the 10-year US Treasury closing the week at a yield of 1.84%, two one-hundredths lower than the previous Friday close.

Economic News: The Good, the Slightly Bad and the Somewhat Ugly

There were a number of economic data releases last week and while the tone of the data was relatively mixed, the overall picture suggests the United States will continue to progress through a slow, uneven recovery with low inflation. While the economic landscape is not ideal, as long as the United States stays out of recession, the environment should be decent for both stocks and credit-related fixed income sectors.

Starting with the good economic news, we would point to the silver lining of slow growth: low inflation. December's consumer price index (CPI) fell to 1.7% and core CPI (which removes the volatile food and energy components) remained steady at 1.9%. The reality is that outside of a few commodities-related areas, significant inflation does not exist. We also continued to see some good news from the housing market. Housing starts surged in December to their highest level since the middle of 2008. While investors were cheered by this news, housing permits (which we believe are a better indicator of future activity) remained in line with where they have been for the past several months, suggesting that housing starts may moderate in the near term.

Moving to the "slightly bad" category of economic data brings us to US retail sales. The headline number from December showed that retail sales rose 0.5% compared to the prior month, but much of this improvement can be attributed to just one sector: auto sales. In fact, stripping out autos and food shows that retail sales have been relatively flat for the past several months. This should not be surprising given that consumers are struggling with high debt levels and insufficient income. Disposable income is currently growing at a 3.2% annual rate, which is down from 6.5% two years ago and below the long-term average of around 7%. For hourly workers, the situation is even worse since hourly wage increases are barely keeping

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.

While the economic landscape is not ideal, as long as the United States stays out of recession, the environment should be decent for both stocks and credit-related fixed income sectors.

pace with inflation. All of this, of course, will be compounded with another headwind: higher payroll taxes, which should act as a further drag on consumer spending.

This brings us to the "somewhat ugly" segment of the economy: consumer confidence. The fiscal soap opera that has been dominating the news since November, combined with the reality of higher taxes, is having a negative impact on confidence levels. One indicator is the University of Michigan's Consumer Sentiment Index released last week that came in lower than anticipated. Additionally, the expectations component of the index showed its lowest level since November 2011, when we were in the midst of the European debt crisis. The bottom line of all of this is that we expect the weakness in consumer spending and the drop in confidence to help produce relatively soft levels of growth for the first quarter of 2013.

While the economic landscape is not ideal, as long as the United States stays out of recession, the environment should be decent for both stocks and credit-related fixed income sectors.

Stocks, Fixed Income Credit Sectors and Muni Bonds Still Look Attractive

Notwithstanding some of the negatives, investors have continued to bid stocks higher in recent weeks. US equities are up around 4% so far for the year, as are markets in Europe and much of Asia. Some of this can be attributed to temporary enthusiasm and seasonal strength and we do expect stocks to experience tougher going in February. That said, a continuation of 2% economic growth combined with low inflation is not a bad environment for stocks. Equity valuations remain reasonable (particularly outside the United States), so we would view any near-term volatility as a potential buying opportunity.

Similarly, slow growth and low inflation is a decent environment for fixed income credit sectors (including high yield and bank loans). While gains are unlikely to match the pace of those seen in 2012, a slow and steady recovery should keep default rates low and should support this area of the market. The story is pretty much the same for municipal bonds. Last year was a strong one for munis, and while it would be a mistake to expect this year's gains to match last year's pace, municipal bonds look fundamentally attractive when compared to Treasuries, particularly on an after-tax basis.

Visit www.blackrock.com

For additional information, or to subscribe to weekly updates to this piece.

BLACKROCK®

iShares® BLACKROCK SOLUTIONS®