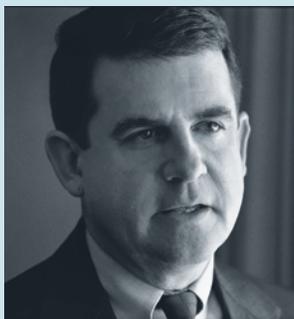


What's Ahead in 2012

An Investment Perspective: Spring Update

Executive Summary

- ▶ **The Economic Outlook:** While risks remain, the economy should be able to continue to grow modestly. *See page 2.*
- ▶ **Rising Bond Yields: How Much of a Worry?** We do not believe we are at the forefront of a bond bear market. *See pages 2–3.*
- ▶ **An Update on Our 10 Predictions for 2012:** At this point, our predictions generally appear on track. *See page 4.*
- ▶ **The Outlook:** Although the pace of gains should moderate, we think stocks have further room to run. *See page 6.*
- ▶ **So What Do I Do With My Money?™** Practical solutions to discuss with your financial professional (*see page 7 for more detail*):
 - Overweight stocks vs. bonds and cash.
 - Focus on the US market.
 - Look for free cash flow and dividend growth.
 - Expect further divergence of returns.



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The Economic and Market Backdrop



We continue to expect 2012 to deliver slow, but positive, levels of economic growth in the United States. The good news is that such a backdrop should be enough for continued outperformance of equities and other risk assets.

The Economy: We've Come a Long Way. Or Have We?

The overall economic environment feels quite different today than it did in the middle of last year, when the consensus was that the United States was on the verge of slipping back into recession. At that point, we were arguing that the economic backdrop was quite a bit better than was commonly perceived. We believed that economic growth would pick up to between 2% and 3%, but would struggle to accelerate beyond that level due to continued headwinds from deleveraging, fiscal restraint and the shockwaves emanating from Europe.

Despite the wild swing in sentiment that has occurred since that time and the surprisingly strong rally in equities that has accompanied it, very little has actually changed in terms of our view of the economy. Certainly, economic data has improved over the past several months, particularly with regard to the jobs market. Non-farm payrolls have grown by nearly 250,000 per month over the past three months (the best three-month period since the spring of 2010), and the unemployment rate has been slowly falling.

Below the surface, however, the details are not quite as reassuring. Productivity growth has been leveling off since late 2010 and the composition of real gross domestic product (GDP) growth leaves much to be desired. A significant percentage of the economic growth we have seen over the past six months can be attributed to the auto segment, and while we are not expecting auto production to fall, the current rate of expansion cannot be sustained, especially if gasoline prices keep moving higher.

Our core set of economic forecasts have not really changed: We continue to expect 2012 to deliver slow, but positive, levels of economic growth in the United States, with some quarters being better than others. The good news is that such a backdrop should be enough for continued outperformance of equities and other risk assets.

Rising Yields: How Much of a Worry?

The headline market story of the first quarter has been the spike in bond yields. The yield on the benchmark 10-year Treasury had been trading at around the 2.0% level for a period of several months before moving sharply higher as the quarter drew to a close. The sell off in bonds has caused some to wonder whether we are at the forefront of a bond bear market. Additionally, it raises questions about what yield movements mean for the stock market.

In our view, it seems extremely unlikely that we are at the forefront of a significant bond bear market. Typically, bond bear markets begin roughly six months before the Federal Reserve begins hiking interest rates. While the Fed has indicated that economic trends have been improving, there is almost no evidence to suggest the United States is entering into an inflationary environment.

Furthermore, the central bank has maintained its forward guidance that short-term interest rates are set to remain low for some time. Even when the Fed does begin to increase rates, it is likely to do so more gradually than it has in past tightening cycles, given the ongoing headwinds from fiscal restraint and household deleveraging.

We would not be surprised to see additional increases in yields in the months ahead and would expect that the yield on the 10-year Treasury could move somewhere between 2.5% and 3.0% before stabilizing. For yields to move beyond that, however, would require either a significant acceleration in economic growth or a marked increase in inflation expectations — neither of which appears likely in the near term. Additionally, we do not believe higher bond yields by themselves would act as an impediment to the stock market. While it is true that any sharp and sudden moves in yields have the potential to unnerve investors, such effects are likely to be temporary.

The First Quarter by the Numbers

The year started off strong for stocks and didn't turn back. Much of the gain in share prices can be attributed to improved economic data (particularly in terms of the labor market), but the absence of any "external shocks" also played a significant role. The European debt crisis has (so far) remained reasonably well contained, Chinese growth has held up, and although rising oil prices bear watching, the increase is significantly less than we saw during last year's price spike. As a result of this relatively benign environment, market volatility declined noticeably over the first quarter as stocks experienced multiple weeks of uninterrupted gains.

In the United States, stocks enjoyed their best first quarter in many years. The Dow Jones Industrial Average gained 8.8%, the S&P 500 Index rose 12.6% and the Nasdaq Composite jumped an impressive 19.0%. Small cap stocks, represented by the Russell 2000 Index, also notched solid gains, rising 12.4%. The results outside of the United States told a similar story, although the magnitude of gains generally trailed slightly. The MSCI World ex-US Index rose by 10.4%, with German stocks up 17.8%, UK equities up 4.8%, the Japanese market up 20.3% and Chinese stocks advancing 4.7% (returns expressed in local currencies). Emerging markets as a whole were a bright spot, with the MSCI Emerging Markets Index up 14.1%.

In contrast, fixed income markets struggled in the first quarter in the face of rising yields. The Barclays Capital US Aggregate Bond Index posted a meager gain of 0.3%, although credit-related sectors of the bond market, such as high yield, performed noticeably better. Cash investments, as represented by the 3-month Treasury bill, returned a minor fraction over 0% for the quarter, as short-term rates have been and remain very low.

We do not believe higher bond yields by themselves would act as an impediment to the stock market.

As a result of this relatively benign environment, market volatility declined noticeably over the first quarter as stocks experienced multiple weeks of uninterrupted gains.

10 Predictions for 2012:



The predictions business is always fraught with uncertainty, and although it is still very early in the year, the vast majority of our predictions so far appear to be on track. Nine months is a long time, however, so it is far too early to declare victory (or defeat) for any of our forecasts.

1

The European debt crisis begins to ease even as Europe experiences a recession.

After dominating economic headlines in 2011, an eerie calm appears to have descended over the eurozone. The growth outlook for Europe (especially peripheral Europe) remains bleak, but the debt crisis has been relatively well contained thus far. Still, the European credit crisis is far from over, and a number of scenarios (such as Greece failing to meet its budget targets) could throw the region back into crisis mode.

2

The US economy continues to muddle through yet again.

The employment data, along with other economic readings, suggest that the current economic expansion is becoming increasingly self-sustaining. The trend of accelerating jobs growth appears likely to continue, which should help to propel growth in the rest of the economy. At this point, we expect first quarter GDP growth to be decent, but would be surprised if it exceeded 3%, meaning it should be about the same as the fourth quarter of last year.

3

Despite slowing growth, China and India contribute more than half of the world's economic growth.

Both Chinese and Indian growth levels have been holding up. The question over China's growth pattern has been drawing particular attention and most forecasts predict growth will dip below 8% in the coming quarters. The evidence so far, however, is consistent with a soft landing for the Chinese economy.

4

US earnings grow moderately, but fail to exceed estimates for the first time since the Great Recession.

As of now, this prediction appears to be on track. Earnings results and forecasts have been positive, but the pace of gains looks like it will slow in 2012. Earnings and profits may have peaked for the current cycle, and we believe gains will be harder to come by.

5

Treasury rates rise and quality spreads fall.

Treasury rates spiked in the middle of March and although they have come down a bit since then, rates clearly appear to be on an upward trajectory. Additionally, investors have been moving into lower-quality bonds such as high yield, which has caused spreads versus higher-quality bonds to tighten.

Our Scorecard So Far

6

US equities experience a double-digit percentage return as multiples rise modestly for the first time since the Great Recession.

We have joked that the first quarter was a very good year for stocks, but there is some truth to that statement. Stocks have already advanced by double digits on a year-to-date basis, and while we do not expect the pace of gains to continue, we do expect equity markets to continue their march higher.

7

US stocks outperform non-US markets for the third year in a row.

Almost all markets experienced gains in the first quarter, but US stocks did slightly outperform non-US markets. Looking ahead, we expect this pattern will continue given relatively stronger economic growth in the United States.

8

Company dividends and share buybacks hit a record high.

The headline dividend story of the first quarter was, of course, Apple's announcement that it would initiate a \$45 billion dividend program over the next three years. Even outside of that banner news, corporate dividends and share buybacks have continued at a fast clip. Corporations continue to have a great deal of cash on their balance sheets and we expect they will continue to deploy that cash in a variety of shareholder-friendly ways.

9

Healthcare and energy outperform utilities and financials.

So far, we are on the wrong side of this prediction. Both the healthcare and energy sectors experienced modestly positive results in the first quarter and utilities, as the only sector of the market to produce negative returns, was a notable laggard. Financial stocks, however, were the runaway favorite during the quarter (up 22%).

10

Republicans capture the Senate, retain the House and defeat President Obama.

The political backdrop has evolved somewhat over the first three months of the year. The contentious and drawn out Republican primary season appears to have damaged the GOP brand and President Obama's approval ratings have moved higher as economic conditions have improved. As such, the President does appear better positioned than he did just a few months ago. In any case, we continue to believe the odds favor a Republican takeover of the Senate.

The Outlook

We never believed solid market performance would require a significant turnaround in global economic growth, but instead felt that a continued environment of modestly positive fundamentals should be “good enough” for stocks.

Although gains are likely to be uneven and realized at a slower pace than occurred in the first three months of 2012, we do believe prices will be higher at year-end than they are today.

Continued Equity Gains Are Likely, But Will Be Harder to Come By

The bears could pursue any number of angles to emphasize potential downside market risks. Should Treasury yields and/or oil prices rise dramatically, they would potentially derail the current bull market in equities. They might also point to economic and debt problems in Europe, concerns over growth in China, relatively modest levels of global economic growth, weakening trends in corporate profits and escalating geopolitical tension in the Middle East as sources of potential risk.

While all of these concerns are real, we would argue that the current strong run for equities has mostly been a result of receding macro risks. We argued just three short months ago that as long as fundamentals were at least decent, that should support risk assets. We never believed solid market performance would require a significant turnaround in global economic growth, but instead felt that a continued environment of modestly positive fundamentals should be “good enough” for stocks.

The macroeconomic and policy backdrop remains broadly supportive of risk assets. In the United States, we expect the labor market to continue to improve as the year progresses; even the long-beleaguered housing market has been showing increasing signs of life. Recent comments from Fed Chairman Ben Bernanke indicate that the central bank remains concerned about economic risks, and the Fed has made it very clear that it intends to keep interest rates at historic lows for the foreseeable future. Additionally, stock valuations appear at least reasonable, and while equities may not be particularly inexpensive in absolute terms, they are quite attractive relative to alternatives such as cash and bonds.

This is not to suggest that we expect the pattern of gains we saw in the first quarter to continue unabated. Stocks have advanced very far, very quickly and we would not be surprised to see some sort of consolidation or setback. The pace of gains has slowed in recent weeks, so we very well may be at the forefront of such a period. That said, we do not believe we have seen the market highs for this year yet. Although gains are likely to be uneven and realized at a slower pace than occurred in the first three months of 2012, we do believe prices will be higher at year-end than they are today.

So What Do I Do With My Money?

Markets have certainly improved over the past couple of months, although uncertainty remains high and many investors are unsure of how to position their portfolios. As always, we encourage investors to work with their financial professionals to focus on their long-term objectives and to find tactical investment strategies that work within the context of their long-term plans.

- ▶ **Stick With Stocks:** The table appears to be set for continued outperformance by equities. Decent economic growth, solid corporate earnings, reasonable valuations and low interest rates indicate to us that stocks should outperform cash and Treasuries over the coming months and years. Likewise, we expect other risk assets, including credit-related sectors of the fixed income market, will also perform well.
- ▶ **Focus on Free Cash Flow and Dividend Growth:** Our core investment theme for 2012 remains unchanged: Focus on ample free cash flow that would allow companies to engage in shareholder-friendly practices. Dividend-paying companies have long been a focus for many investors. It is critical to remember, however, that it is not dividend payments themselves that are attractive, but the quality of those dividends and the ability to grow them.
- ▶ **Factor in Geographic Strengths:** Among developed markets, we continue to favor a higher weighting to the United States, since US economic growth should be stronger and US stocks should continue to outperform. This is not to say that international equities should be avoided, since they continue to represent a valuable diversification tool, but simply that we see greater opportunities in US markets. At the same time, the long-term case for investments in emerging markets remains intact. We particularly advocate an emphasis on US multinational companies, which can benefit from growth trends in emerging markets.
- ▶ **Expect Falling Correlations:** As macro conditions appear to be improving and as investor sentiment is rising, we have been seeing less of a “risk-on/risk-off” trading pattern so far this year, and we believe that trend will continue. As such, correlations within and among different asset classes have been falling, suggesting that security selection is becoming increasingly important.

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Sources: BlackRock, Bank Credit Analyst. The opinions presented are those of the author on April 1, 2012, and may change as subsequent conditions vary. Individual portfolio managers for BlackRock may have opinions and/or make investment decisions that, in certain respects, may not be consistent with the information contained in this report. 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 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 does not guarantee 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.

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