

AUGUST 12, 2013

## WEEKLY INVESTMENT COMMENTARY

**BLACKROCK®**

### Improvement in Europe and China: What it Means for Investors

#### Stocks Sink During a Quiet Trading Week

Markets were in a bit of a summer lull last week and trading volume was thin. Investor unease about the likelihood of the Federal Reserve paring back on its monetary easing appears to be growing, causing stocks to lose some ground. For the week, the Dow Jones Industrial Average fell 1.5% to 15,425, the S&P 500 Index dropped 1.7% to 1,691 and the Nasdaq Composite declined 0.8% to 3,660. In fixed income markets, Treasury yields were little changed, with the yield on the 10-year Treasury dropping from 2.60% to 2.58% (yields move in the opposite direction of prices).

#### US Mega-Cap Stocks and International Equities Warrant a Closer Look

In recent weeks, we have been talking about the importance of improving economic growth outside of the United States, and last week provided additional evidence that both Europe and China appear to be stabilizing. Better-than-expected growth in these regions is a positive for the global economy, which does have an impact on US investors. In addition to providing support for large US companies that derive significant revenue from overseas (such as exporters), improving global growth is also an argument for an increased focus on international equities—an asset class in which many US investors are underweight.

#### Signs of Stabilization from Europe and China

So what is the evidence that is pointing to better growth? Starting in Europe, we would cite the significant jump in the UK services sector, which suggests that the United Kingdom is recovering from its recent weakness. We also saw strong reports on factory orders and industrial production from Germany last week, both signs of improvement in that country's manufacturing sector. These developments are quite encouraging, especially since we are finally starting to see a pattern of positive surprises in Europe's economic data after months of disappointments.

The story from China is similar. Recent data is helping to confirm that the Chinese economy is stabilizing as well. Last month, Chinese industrial production rose by close to 10% on a year-over-year basis, a significant improvement over the prior month and better than economists had forecasted.



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WITH MY MONEY?**

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## Why it Matters for Investors

These signs of stabilization are important for a number of reasons. First is the sheer size of these markets—together, Europe and China represent more than one-third of global gross domestic product, so improvement in these regions is critical for the global economy to improve. Second, as we alluded to earlier, better global growth will be a boon for large and mega-cap US companies that do a great deal of business overseas.

Additionally, we would point out that while economic growth and stock market returns do not always go hand in hand, to the extent that investors have low expectations for Europe and China, positive surprises in the economic data should help support those markets. This sort of trend is one of the reasons that we have been encouraging US investors to take a closer look at international stocks. While we wouldn't say that valuations in the United States are stretched, stocks in most international markets are exceptionally cheap when compared to US equities. Non-US developed markets trade at a 20% discount to US stocks, while emerging market equities trade at more than a 40% discount.

There is at least some evidence that investors are beginning to recognize these improvements and sentiment is starting to shift, at least for Europe. For the past month and a half, we have seen strong inflows into equity funds. While the majority of these flows continue to pour into US stock funds, last week was the first time in months that we also saw significant inflows (approximately \$2 billion) into European funds. On the whole, we do expect to see continued volatility in international markets, but we firmly believe that they also offer solid long-term value.

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AC6641-0813 / USR-2631

