

# BlackRock Investment Directions

SECOND QUARTER 2010



## Asset Allocation Overview

We remain comfortable with the view we initiated in the third quarter of 2009 to overweight equities as they have performed better relative to fixed income in the past six months. While we believe the economic recovery has gained ground, structural headwinds warrant maintaining a center of gravity around high-quality equities. At the same time, investors should look to opportunistically add lower-quality assets as buying opportunities emerge.

## Investment Themes

- **Focus on higher-quality equities:** As the economy continues to recover slowly, equity markets should continue to grind higher, albeit with some volatility along the way. In this environment, higher-quality equities should continue to outperform.
- **Prefer US & Emerging Markets:** The economic recovery has been strongest in emerging markets and the United States, and we continue to favor those regions.
- **Spread Assets Look Attractive:** Attractive opportunities can be found in fixed income spread sectors against the backdrop of an ongoing economic recovery, strong demand for higher-yielding assets and subdued levels of credit creation.



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Asset Allocation Views		Strength of Preference						
	Current Outlook		Strong	◀ Neutral ▶	Strong			
Asset Allocation	Still prefer equities to bonds; add to both during market pullbacks	Bonds	○	○	○	●	○	Equities
Equities		Strength of Preference						
	Current Outlook		Strong	◀ Neutral ▶	Strong			
Regional Allocation	Continued preference for the US over other developed markets	US	○	●	○	○	○	Int'l
	Retain preference for emerging markets	Developed	○	○	○	●	○	Emerging
Market Cap	Broadly neutral (extremely slight preference for large cap)	Small	○	○	●	○	○	Large
Style Allocation	Broadly neutral (extremely slight preference for growth)	Value	○	○	●	○	○	Growth
Fixed Income		Strength of Preference						
	Current Outlook		Strong	◀ Neutral ▶	Strong			
Duration	Improving economic picture largely priced into current rates	Short	○	○	●	○	○	Long
Quality	Fundamentals and technicals favor higher yielding spread assets	High	○	○	○	●	○	Low
Regional	Valuation change prompts move to neutral	US	○	○	●	○	○	Int'l
Commodities & Currencies		Strength of Preference						
	Current Outlook		Strong	◀ Neutral ▶	Strong			
Commodities	Bias toward economically-sensitive sectors	Underweight	○	○	○	●	○	Overweight
Currencies	US dollar has been showing strength	US	○	○	●	○	○	Foreign

▶ This sort of back-and-forth action is typical for a maturing bull market, and investors should prepare themselves for ongoing volatility.

▶ In all, we expect a prevailing equity-friendly environment will help stock prices continue to rise over the long term.

▶ A focus on high-quality investments continues to make sense in the current environment.

## Equity Market Outlook

Stocks traded somewhat unevenly in the early part of the first quarter, but since that point some better-than-expected economic data helped spark a turnaround. This sort of back-and-forth action is typical for a maturing bull market, and investors should prepare themselves for ongoing volatility.

In our view, the odds point to 2010 as a positive year for equities and other risk assets. However, equity markets do continue to face some risks. In addition to the prevailing economic uncertainty, investors are concerned about the prospects of premature policy tightening and ongoing credit-related problems. Additionally, in the short term, the recent run-up in stock prices has caused sentiment and some technical factors to become stretched.

On balance, we continue to believe that the positive factors outweigh the negatives. Credit conditions are improving, we expect employment to increase, the Fed remains accommodative, inflation threats are absent and corporations are ramping up merger and acquisition activity. In all, we expect a prevailing equity-friendly environment will help stock prices continue to rise over the long term.

## Equity Views

- A focus on high-quality investments continues to make sense in the current environment. This view leads us to favor US stocks over other developed markets, since the economic recovery in the United States has taken root more firmly. Additionally, we continue to favor emerging markets over developed markets.
- Regarding market sectors, telecommunications services look particularly attractive, as do industrials and information technology. The elimination of the uncertainty over healthcare has made this sector more fairly valued, but it is still benefiting from good fundamentals. We continue to believe underweights to the financial sector make sense.

Sector Outlook		Strength of Preference				
Sector	Current Outlook	Underweight	◀ Neutral ▶	Overweight		
Telecom Services	Good cash flows and high dividends	○	○	○	◐	●
Industrials	Positive on defense and select machinery companies	○	○	○	●	○
Information Technology	New products, further market penetration	○	○	○	●	◐
Healthcare	The healthcare reform cloud has lifted, good fundamentals	○	○	○	●	◐
Consumer Staples	Moderately attractive with mixed valuations	○	○	●	◐	○
Materials	Benefiting from recovery, but already priced in	○	◐	●	○	○
Energy	Excess inventories; oil prices have advanced	○	○	●	○	○
Consumer Discretionary	Consumers slowly increasing spending	○	○	●	○	○
Utilities	Facing some regulatory risks and cost issues	○	●	○	○	○
Financials	Further balance sheet repair; regulatory uncertainty	◐	●	○	○	○

Invest Key ○ = last quarter ● = current quarter

## Fixed Income Market Outlook

It is our view that the economy will continue to improve over the next several months as pent-up demand, rising confidence and better employment data will help sustain the recovery. However, the structural impediments to growth, including continued deleveraging, the prospects for higher taxes and reduced government stimulus will dampen the recovery. As a result, we believe that growth will be sub-par relative to previous recoveries and that inflation will be contained.

We believe increasing investor demand for higher returns in fixed income portfolios and a moderate supply of higher-yielding assets will continue to provide a favorable backdrop for solid performance across the various spread sectors. Specifically, we continue to favor non-Agency mortgage-backed securities as many investors are avoiding the sector given the more complex nature of the assets and real estate fundamentals that are still slow to recover. Within corporate credit, given improving economic fundamentals we believe better value can be found in higher quality high-yield issuers than exists in the more fully valued investment-grade bond market.

Turning to municipals, negative headlines continue to dominate the space, but for the most part states are proactively cutting expenses, increasingly at the local level, and raising taxes in an effort to reduce their significant budget gaps. Even though the current backup in the intermediate part of the curve may be a near-term buying opportunity, we believe the municipal market will continue to face pressure from negative headlines.

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## Fixed Income Views

- Investors searching for yield combined with a moderate supply of higher-yielding assets should continue to drive solid performance across all spread sectors of the market.
- Although state and local governments are proactively trying to reduce their budget gaps, the municipal market will continue to face pressures. This coupled with seasonal weakness from increased supply warrants maintaining a neutral stance.

Sector Outlook		Strength of Preference				
Sector	Current Outlook	Underweight	◀ Neutral ▶	Overweight		
Securitized Assets	Favor non-Agency MBS over CMBS and ABS	○	○	○	●	○
High Yield	Continue to see value in select high-quality names	○	○	●	●	○
Non-US Dollar	Reduced non-dollar holdings as valuations are less attractive	○	○	●	○	○
Inflation Protected	Appropriate to retain as an inflation hedge	○	○	●	○	○
Municipals	Seasonal weakness from increased supply warrants neutral stance	○	○	●	○	○
Treasury/Agency	Better valuations; most appropriate for liquidity conscious investors	○	○	●	○	○
Emerging Markets	Improving balance sheets; monitoring domestic inflation	○	○	●	○	○
Corporates	Reduce exposure as offset to high yield allocation	○	●	○	○	○
Agency Mortgages	Withdrawal of Fed purchases should modestly weaken sector	○	●	○	○	○

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