

The Case for US Stocks:

Market Views From the Large Cap Series Team

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Following the near-collapse of the global financial system in 2008, the global economy began to show signs of recovery in the first half of 2009 — with the rebound beginning in the developing world before broadening to include developed markets in the second half of the year. Compared to responses in other countries, the US government acted more quickly and more aggressively, and by mid-2009 a modest economic recovery had taken hold in the United States. While the United States continues to face a number of structural problems, we expect the benefits of cyclical stimulus will outweigh these challenges and expect US equities will continue to outperform the rest of the developed world over the course of the next year.

In this report, Bob Doll, BlackRock's Chief Equity Strategist for Fundamental Equities and head of the US Large Cap Series equity team, makes a threefold case for why US equities (and US multinationals in particular) offer compelling value for investors. First, the United States is in the midst of a strong cyclical recovery and is better positioned than other markets. Second, from a valuation perspective, US companies are attractively priced and offer stronger upside potential, particularly in the near term. And third, US multinationals offer exposure to fast-growing emerging markets with less potential risk than direct investments.

The US Cyclical Recovery Remains Stronger

In sum, our cyclical case for US stocks to outperform European and Japanese markets is based on our belief that the United States will experience more robust levels of economic growth driven by a variety of factors, including unprecedented stimulus levels, the unfolding of the inventory cycle, a bounce from depression-level spending, strong productivity, historically low interest rates and a tailwind from strength in emerging markets.

US GDP Growth Should Lead Among Developed Markets

GDP Growth (%)	2009	2010F	2011F
US	-2.4	3.5	3.0
Western Europe	-4.0	1.0	1.6
Japan	-5.5	2.0	1.7
Emerging Markets	2.9	6.5	6.9

Source: BlackRock forecasts.

One of the great strengths of the American capitalist model is its flexibility. When the markets faltered in 2008 and corporate top-line revenue growth stalled, US companies were quick to cut costs, unlike their European and Japanese counterparts. Now that the recovery has taken hold, businesses are rehiring, inventories are being replenished and consumers are starting to spend again. The rise in productivity has led to an increase in corporate profitability that should be long-lasting. We have already seen earnings surprise on the upside in 2010 and the outlook for 2011 remains strong.

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of the US Large Cap Series equity team, and has primary portfolio management responsibility for these products, which he has managed since their inception in December 1999. Mr. Doll's service with the firm dates back to 1999, including his years with Merrill Lynch Investment Managers (MLIM), which merged with BlackRock in 2006. At MLIM, he served as President and Chief Investment Officer, Senior Portfolio Manager and Team Leader. Mr. Doll holds a BA in accounting and a BS in economics from Lehigh University, and an MBA from the University of Pennsylvania.

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In contrast, European governments are grappling with more significant macro issues. The fiscal health of many European governments is in question, as many countries’ financial situations have been hampered by generous unemployment and social welfare benefits, regulatory and structural rigidities and widespread stimulus spending and rescue packages. The lack of currency flexibility has been a strain on governments, and the strength of the euro (until recently) has hampered export competitiveness. The recent events of the sovereign debt crisis in Greece and other peripheral-euro countries has highlighted several of these problems, and also reinforces the fact that Europe still has significant deflation issues.

Meanwhile, in Japan, the economic recovery is evident but the pace is much slower. Deflation remains a real concern, a strong yen has slowed exports and banks are under pressure. While the United States still faces a number of challenges, our analysis supports the view that Europe will see a lower-inflation, lower-growth recovery than that in the United States, and Japan will muddle along, risking yet another lost decade. These divergent trends, in our view, make US equities a more attractive investment option.

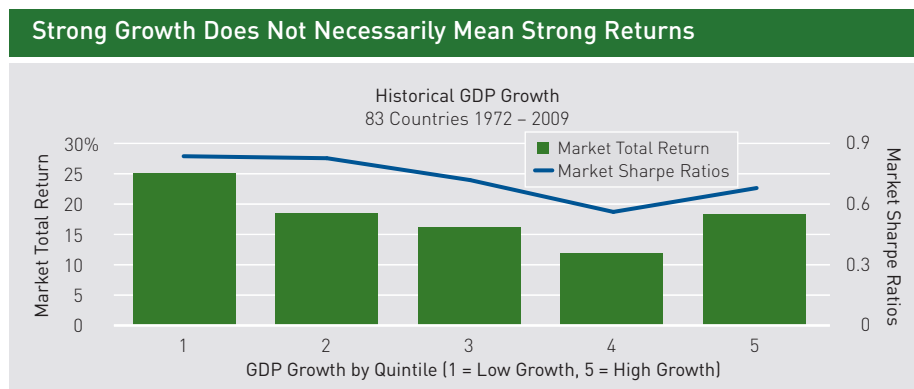
US Stocks: A True Value Play

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Although we do believe that US stocks are positioned to benefit from a more attractive macroeconomic backdrop, economic growth rates, by themselves, do not tell the complete story. While many other economies are growing faster than the United States, US companies have long had investment-friendly management practices that have driven (and, we believe, will continue to drive) better long-term returns. For this reason, under normal circumstances, US stocks merit a premium. At present, it appears to us that US corporations offer generally similar valuations when compared to companies in other markets, but represent structurally better businesses. Therefore, we believe that US stocks are attractively valued since we believe that the market is overly discounting the risks of longer-term US structural imbalances such as high deficit levels.

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Regarding relative growth rates, as the graph below shows, over the long term, investors have not automatically obtained excess returns by investing in higher GDP growth markets (typically emerging economies). Buying stocks in low-growth countries has equaled or exceeded the returns from buying stocks in the high-growth economies. Because developed markets are often underpriced relative to their high-growth emerging market cousins, these slower-growth economies have often delivered superior returns. Because of the cyclical recovery trends we described above, we believe that US stocks, in particular, offer better prospects, and are, in this sense, an attractive ‘value play’ for investors.

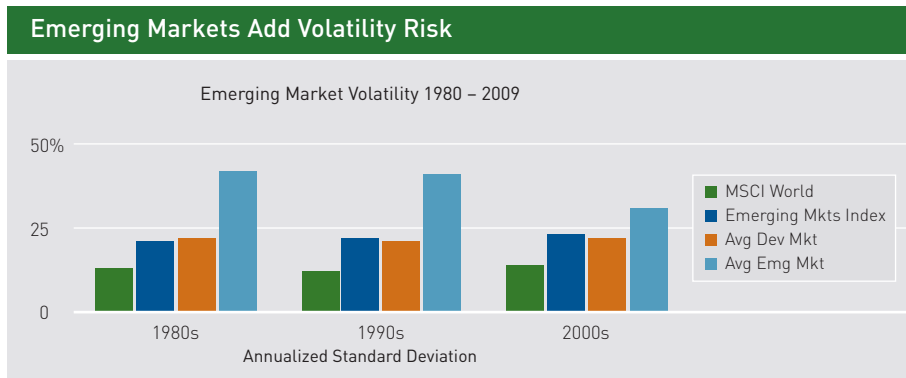


Source: Credit Suisse Yearbook, February 2010.

Opportunities in US-Based Multinationals

While emerging markets have been producing some impressive gains in the current bull market, there is an argument to be made that the return potential in emerging markets may not justify the increased risk potential. As the graph below shows, emerging markets are significantly more volatile than developed markets—the volatility of the average emerging market was 1.4x that of the average developing market. Particularly for those investors who are looking to reduce overall levels of risk in their portfolios, we would argue that exposure to US multinational companies provides many of the benefits of directly investing in emerging markets without adding the additional volatility risk.

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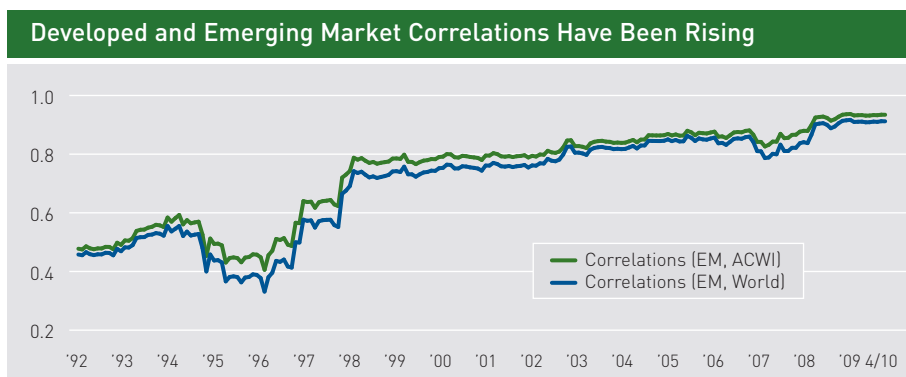


Source: Credit Suisse Yearbook, February 2010. The MSCI World and Emerging Markets Indices represent equal-weighted measure of volatility; the latter two bars represent price-weighted measures.

While the S&P 500 Index is typically thought of as a US stock market index, the companies within that index are increasingly global in nature. S&P 500 corporate profits are globally exposed, with 40% of profits (and 60% to 70% of incremental profits) coming from outside the United States, meaning that an investment in large, multinational US stocks is also a de-facto investment in global markets.

On a related point, we believe there is an argument to be made that some of the diversification benefits investors typically seek when investing internationally maybe somewhat overstated. The recent crisis showed that equity markets around the world remain highly correlated since all risk assets fell together. The crisis also reminded us that in times of stress or severe market declines, correlations between markets tend to increase. This is not to say that investors should ignore the benefits of diversification, but rather that they should be aware of how much potential risk reduction they are actually getting, particularly in the context of looking at US multinationals compared to emerging markets.

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Source: MSCI and BlackRock. Data reflects rolling 5-year monthly returns through April 30, 2010 of the MSCI Emerging Markets, World and All Country World Indices.

Compared to their counterparts in emerging economies, US companies offer several fundamental advantages from an investment perspective. US corporations are innovative; they have a record of effectively allocating capital; they operate under stronger corporate governance standards; and they have a greater shareholder orientation than most companies in the developing world. For all of these reasons, we believe that US multinationals represent a particularly attractive investment option.

Finding Opportunities in the Current Environment

“Within the Large Cap Series portfolios, we own a number of high-quality multinational companies across various industry groups, which we believe are attractive in both risk and return prospects relative to their international counterparts.”

Within the Large Cap Series portfolios, we own a number of high-quality multinational companies across various industry groups, which we believe are attractive in both risk and return prospects relative to their international counterparts. We believe that these holdings are an attractive means for achieving the benefits of exposure to the secular growth opportunities of emerging markets, and the diversification and global scale benefits of exposure to global developed markets.

These positions range across industry groups and sectors, from cyclical to defensive, branded franchises to commodity producers. What they have in common is a strong business position and exposure to the global economy at what we believe to be compelling valuations with good visibility for growth. We believe that this sort of positioning in our portfolios will be beneficial for our clients.

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