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Weekly Investment Commentary

More Market Choppiness Ahead, but Long-Term Outlook Remains Strong

October 15, 2012

Stocks Stuck in Consolidation Mode

Following several months of gains over the summer, stocks have been trading more-or-less in a sideways fashion for the last five weeks as investors have been engaging in some profit taking. Last week, there was little change in fundamentals, but stocks nonetheless experienced some declines. The Dow Jones Industrial Average fell 2.1% to 13,328, the S&P 500 Index declined 2.2% to 1,428 and the Nasdaq Composite dropped 2.9% to 3,044.

In other market news, we have seen a significant (and surprising) oil price decline in recent weeks. While some are attributing the decline to weakening demand, our view is that the fall in prices probably has more to do with some modest supply increases and perhaps a reduction in geopolitical risk levels. Regardless, should the decline persist, that would be good news for the global economy and for equities.

Focus on Election Intensifies

Investors are increasingly focusing their attention on the upcoming elections, as the results will have a significant impact on the future direction of fiscal and tax policies. At present, President Obama's approval rating is hovering around 50%, which is a positive sign for him. Governor Romney has enjoyed a strong bounce in the polls following the first debate and is currently tied or slightly ahead in most national polls. In the more important Electoral College, however, it still appears that President Obama has more paths to victory, and he remains ahead in several important swing states, including what looks to be the crucial state of Ohio.

Global Growth to Remain Modest

Over the last few months, the dominant economic story has been the actions taken by the world's central banks to promote reflation. The US Federal Reserve has been expanding its balance sheet further and has deepened its commitment to keeping short-term interest rates low. For its part, the European Central Bank has transitioned to a more open-ended commitment in its efforts to promote growth and ease some of Europe's debt woes.

Although reflation remains a powerful positive force, the global economy is still sluggish and there are signs of a trough in global activity. There is also a great deal of uncertainty and significant divergence in terms of regional performance. Parts of

Bob Doll is a Senior Advisor to BlackRock®, a premier provider of global investment management, risk management and advisory services. Mr. Doll also formerly served as Chief Equity Strategist for Fundamental Equities and Lead Portfolio Manager of BlackRock's Large Cap Series Funds. Prior to joining the firm, Mr. Doll was President and Chief Investment Officer of Merrill Lynch Investment Managers.

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Europe remain in a recession, Japan is stagnating, the United States is growing very slowly and many emerging markets remain in a bottoming phase. There are some possible catalysts that could jolt the world into a more solid growth trajectory, including a resolution to the US fiscal cliff, a continued easing of Europe's debt problems and a decisive turnaround in China. Each of these is a tall order, and even if we do see some sort of combination of the three, overall global economic growth is still likely to be somewhat weaker than what we saw over the last decade.

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Stocks Still Offer Promise

Despite what looks to be a modest-at-best growth environment, we would argue that equities still have potential to rally further. True, stocks appear to lack strong drivers at present. In the United States, we are at the start of the third-quarter earnings season and we would describe results so far as being "acceptable." Expectations have been reduced and companies have been meeting these lowered expectations so, at best, earnings are providing a small positive tailwind for stocks.

For some time now, risks have been skewed to the downside, pessimism has remained high and businesses have been extremely cautious in their spending and hiring plans. There is an argument to be made that if the world turns out to be less ugly than many fear and if the global economy is able to manage through some of the obvious obstacles and barriers to growth, then businesses would grow more aggressive and investors would be more willing to put some of their cash to work and re-enter the markets.

In our view, we expect to see further near-term choppiness in stock prices as investors continue to digest the gains of the last few months, but over the long-term, we still believe that stocks appear attractive.

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