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2013 Outlook from the BlackRock Investment Institute:

WORLD TO SURPASS (LOW) EXPECTATIONS IN 2013

**US, Emerging Economies Poised to Outperform –
US's Prospects Hinge on Bridging "Fiscal Cliff"**

**Policy Remains Key Driver of Markets, Asset Values;
If US Fed Changes Track, "Vast Store" of Cash Could Empty into Equities**

**Eurozone Could Beat (Very Low) Expectations for Growth
By "Spreading the Pain" of Fiscal Tightening**

**Caution Is the Watchword for 2013:
Fixed Income Investors Especially Must Look Out**

London, December 12, 2012 – Prospects are improving for a positive albeit gradual turn next year in global economic and investment conditions, according to the BlackRock (**NYSE: BLK**) Investment Institute's 2013 investment outlook, released today and entitled: "[Slow Turn Ahead?](#)" ([Click here to read the Outlook](#))

Investors need to keep a close eye on the impact of government policy – first and foremost, the urgent effort to avoid the looming "fiscal cliff" in the US, which will drive the direction of both the US and global economies in 2013, according to the BlackRock Investment Institute (BII).

"Our big questions for 2013 are whether the wave of ultra-loose monetary policies and quantitative easing has crested and if private sector credit can stage a modest recovery," said Ewen Cameron Watt, BII's Chief Investment Strategist. "Trillions of dollars in monetary stimulus and record low interest rates have failed to spur much credit growth and economic activity so far. But what if this changes?"

“Policy - fiscal, monetary and regulatory - drove markets in 2012 and will remain central to 2013 outcomes,” he said.

With central banks apparently refocusing monetary stimulus away from preventing a financial sector collapse and towards targeting economic growth, next steps by the US Federal Reserve will merit particularly close attention, according to the report.

“We do not expect the Fed to raise rates any time soon. But it could take its foot off the monetary accelerator on signs of quickening job growth in the second half of 2013,” Cameron Watt noted. “Markets need only a whiff of a Fed preparing to slow its QE programmes because of improving employment to empty some of the vast store of investor money in cash and low-yielding fixed income assets, and put it into equities.”

Yet, in the US, much hinges on efforts to avoid the fiscal cliff, a set of tax hikes and spending cuts set to go into effect on 1 January. “The United States may turn the corner on growth – if Washington can avoid falling off the fiscal cliff and negotiate a long-term budget reduction plan,” according to the report.

Regulation remains an important focus too, whether it be financial sector reform in the developed world or social security and welfare reforms in emerging economies. Politics also will play a role again in 2013 with elections in, among other nations, Italy, Germany and Israel, alongside US budget reform.

The BlackRock Investment Institute is a global platform launched in 2011 that leverages the firm’s expertise in markets, asset classes and investor segments to generate investment insights. In addition to Cameron Watt, its 2013 Investment Outlook, “Slow Turn Ahead?”, was authored by:

Nigel Bolton, Head of European Equities, BlackRock Alpha Strategies; Peter Fisher, Head of BlackRock Fixed Income Portfolio Management; Philipp Hildebrand, BlackRock Vice Chairman; Russ Koesterich, BlackRock Chief Investment Strategist; Rick Rieder, Chief Investment Officer, BlackRock Fundamental Fixed Income; Andrew Swan, Head of Asian Equities, BlackRock Alpha Strategies; and Richard Urwin, Head of Investments, BlackRock Solutions Fiduciary Mandates.

An "Age of Separatism" Next Year, As US and Emerging Economies Advance

For its 2013 outlook, the BII has updated several potential investment scenarios originally developed at the beginning of 2012, and revised further at mid-year. The year-end updates reflect a generally more positive global view.

“Generally speaking, we are more upbeat about markets than when we last reviewed our outlook in July 2012,” said Richard Urwin, Head of Investments, BlackRock Solutions Fiduciary Mandates. “Many key indicators for growth and risk appetite are perking up

going into 2013 – albeit from a low base and low expectations. It also lays the groundwork for positive surprises. On balance, we see the world moving toward ‘good things’ albeit slowly, given on-going deleveraging pressures in parts of the developed world.”

At mid-year, the BII gave highest odds – 40 to 45 per cent – to a “stagnation” scenario of sluggish global economic growth, with the US and emerging economies losing steam. At year end, however, the BII has dropped the odds of this scenario – which it labels “Stop ‘n Go” – to 30 per cent.

Instead, the BII’s favoured scenario is an “Age of Separatism” (35 per cent odds) under which the United States outpaces the rest of the developed world, and emerging economies – and assets – outperform. In this “Age of Separatism,” Europe would continue to recover at a snail’s pace while China’s economy re-accelerates.

Odds of Global Growth Get a Boost

At the same time, the BII has boosted the odds of a “growth” scenario – which it labels “Go Growth” – to 20 per cent, compared with just 5 to 10 per cent at mid-year. Under this scenario, key economies such as the US, China and Europe grow faster than expected, and the global economy starts “weaning itself off” monetary stimulus. However, the chance of this growth scenario drops by 10 points, if the US goes off the fiscal cliff, the BII believes.

Among the things that could go right, the BII says, are an acceleration in credit creation, sell-offs in short-dated instruments such as bills and commercial paper, a grand US budget bargain that puts its fiscal house in order, and growth-boosting structural reforms in China, Brazil and India.

At this point, the BII sees reduced chances – 10 per cent, down from 15 to 20 per cent at mid-year – of a “Nemesis Redux” scenario involving a global recession, fire sale asset realisations, social upheaval and steep losses across asset classes. According to Urwin, “We see a smaller chance of Nemesis as risks of a Eurozone breakup have receded and China’s economic momentum looks to be strengthening. US and Middle East leaders hold the keys to Pandora’s Box now.” (This scenario was named after the Greek goddess who punishes the proud.) Yet, as with the BII’s growth scenario, the fiscal cliff is a major variable – the chance of a Nemesis scenario doubles, to 20 per cent, if the cliff is jumped.

In the BII’s view, there is an unchanged 5 per cent chance of an “Inflate Away” scenario, with high commodities prices and monetary easing driving up inflation around the world, effectively cutting the developed world’s debt load.

Around the Globe, Government Policy Will Drive Asset Returns; A Call to Compromise on Resolving Fiscal Cliff

Throughout 2013, changes in government policy will directly translate into changes in asset returns, the BII believes. “The legacies of the financial crisis – low economic growth, declining tax revenues, deleveraging, rising unemployment, record-low bond yields, and government transfers that prop up corporate profits – add up to a central role for policy,” said Rick Rieder, BlackRock’s Chief Investment Officer, Fundamental Fixed Income.

European policymakers are looking to “spread out the pain” of the Continent’s necessary fiscal tightening by extending deadlines for fiscal austerity – a positive development that may arrest Europe’s downward economic growth spiral. “Aided by tax cuts in Germany, this may cause the Eurozone to beat (extremely low) growth expectations in 2013, although ongoing deleveraging and the need for structural reforms make Europe’s potential recovery a multi-year event,” Rieder added.

In the US, market evidence suggests that investors are still not weighing heavily the potential impact of the fiscal cliff. “Short-term market volatility has been eerily low compared with political uncertainty that is at levels hit during the depths of the financial crisis in 2008,” said Russ Koesterich, BlackRock’s Chief Investment Strategist. “The answer may be easy monetary policy and liquidity. If financial markets are underwritten (albeit precariously) by central banks and governments, there is no need for asset prices to reflect any worries.”

The BII called on US political leaders to craft a compromise to avoid the crisis. “We hope politicians will rediscover the lost art of compromise. Businesses and voters have sent strong signals to Washington to work together. If politicians remain polarised, the fiscal cliff will turn into a fiscal cloud overhanging markets in 2013,” said Barbara Novick, BlackRock Vice Chair and Head of Government Relations, who co-authored recent BII reports on US Elections and a BII focus in June 2012 on housing: [In the Home Stretch? The US Housing Market Recovery](#).

On the Pacific Rim, Japan is unlikely to tighten further and may loosen monetary policy under a new political and central bank leadership. China is emerging from policy induced growth deceleration and a political handover, yet still faces long-term challenges, including shifting to a consumption society from an investment-driven command economy. “Change will come slowly but surely,” the BII says. “The new leadership is in place for a decade – and does not need to worry about re-election.”

Charting a Course Amid All the “Noise”: Caution Will Be Critical

With so much noise, it is difficult to invest with conviction, the BII notes.

“We generally like equities for 2013. But we are not enamoured.” US companies, which offer the best metrics globally, enjoy fat profit margins, and corporate profits as a percentage of GDP hit a post-WW II record of 11% this year, according to the Federal Reserve Bank of St. Louis. Entitlements and tax breaks have created demand for products and services without burdening companies with increased output costs. However, the BII cautions, this benefit reverses once fiscal tightening sets in.

Income remains a dominant, global investment theme; the BII notes that most investors – both institutional investors and retirees – are desperate for income to match their liabilities; a tall order in a world of record low yields and much longer lives.

“Some investors are sacrificing safety and liquidity just to gain a couple of basis points of yield,” the BII says. “Markets may pre-empt the Fed, and trigger a rush (out of fixed income) for the exit (to equities). Safe-haven fixed income assets may well provide disappointing returns from here.”

Quality businesses and dividend stocks would likely underperform leveraged companies as the flow out of income could result in a temporary “dash for trash,” the BII notes. “Casualties would be ‘safe’ assets such as government bonds of the US, UK, Germany and other Eurozone core countries. It takes just a miniscule rise in yield to trigger sizable bond price losses.”

To prepare for such a day, it is important to identify areas of value in income investing – and pockets of overvaluation or risk, the BII says.

Above all, the BII notes, it will be critical to be cautious across the entire investment landscape in the year to come.

Conflicts in the Middle East have been the focus of global foreign policy for much of the new millennium, and have the potential to cause an oil price spike, or “energy shock.” Another risk is China’s territorial dispute with Japan and other nations over uninhabited but resource-rich islands in the South China Sea. A major terrorist attack is a third risk.

“Other risks include a North Korean provocation against South Korea or Japan, which may act up to (temporarily) regain the global spotlight and to test China’s new leadership,” the BII notes.

The BII says: “How about major policy mistakes that would throw the world back into recession? These worried us greatly a year ago. These risks appear to have receded now, or at least this is what most investors think. So perhaps there is a risk – the risk of complacency.”

BII’s Five-Point Summary for 2013

1. We have become more upbeat about the prospects for risk assets and stabilising economic growth (albeit at low levels). Low expectations = potential upside surprises.

2. The US economy should gain momentum and help boost global growth – IF Washington can avoid the “fiscal cliff” and compromise on a sustainable budget.
3. Many investors lack conviction in markets where risk taking is often punished and trends last a skinny minute. Rome – and confidence – was not built in a day.
4. The era of ultra-loose monetary policy may draw to a close, challenging “safe” fixed income assets and heralding a shift toward equities. Safety = new tail risk.
5. Income investing works in a zero-rate world – but the hunt for yield has narrowed valuations between top-quality and not-so great income assets. Take out the garbage.

So What Do I Do With My Money?™

Here is a summary of the BII’s investment recommendations for 2013:

Fixed Income: Danger in Safety

Prices of safe-haven government bonds and similar assets could plunge when yields start to rise. Low yield = high price risk. We like global high yield and US munis for income – but do not expect much capital appreciation. We favour emerging market debt. In Europe, we prefer Italian and Spanish bonds over debt of weaker core countries. We are bullish on commercial mortgage-backed securities and collateralised loan obligations.

Equities: Global Smorgasbord

We like global companies with strong balance sheets, steady cash flows and growing dividends. We favour high-quality US stocks, global energy and emerging markets. We are bullish on domestic consumption plays in Brazil and China, North Asian cyclical stocks, and Mexican banks and industrials. We like discounted exporters on Europe’s periphery and small “self-help” UK companies.

Commodities: Long View

We like metals with long-term supply gaps and agricultural commodities. China’s appetite is huge.

Currencies: Dollar Bulls

We are bullish on the US dollar due to the country’s energy boom and long-term growth prospects.

Good and Bad Income

Income investing remains our strategy of choice in a zero-rate world. The hunt for yield has created pockets of overheating and narrowed valuations between top-quality and less desirable income assets. The report details the state of play in fixed income, high yield, emerging market debt, municipal bonds, dividends, and real estate investment trusts.

Pain Trades

Our biggest contrarian idea is buying Japanese exporters while selling the yen. Other pain trades include selling “safe” tobacco stocks, buying US companies with cash piles abroad, and buying securities of European and US financials. We have warmed up to Indian equities after the country’s reforms on foreign investment.

The Gift of Insurance

Short-term implied volatility is eerily low whereas policy uncertainties are near financial crisis levels. Consider options to hedge downside and upside risks.

Volatility Reversal?

The fire hose of monetary liquidity and investor hunger for yield has depressed short-term volatility, so maybe a reversal will have the opposite effect.

About BlackRock

BlackRock is a leader in investment management, risk management and advisory services for institutional and retail clients worldwide. At September 30, 2012, BlackRock’s AUM was \$3.673 trillion. BlackRock offers products that span the risk spectrum to meet clients’ needs, including active, enhanced and index strategies across markets and asset classes. Products are offered in a variety of structures including separate accounts, mutual funds, *iShares*® (exchange traded funds), and other pooled investment vehicles. BlackRock also offers risk management, advisory and enterprise investment system services to a broad base of institutional investors through *BlackRock Solutions*®. Headquartered in New York City, as of September 30, 2012, the firm has approximately 10,400 employees in 29 countries and a major presence in key global markets, including North and South America, Europe, Asia, Australia and the Middle East and Africa. For additional information, please visit the Company’s website at www.blackrock.com.

About the BlackRock Investment Institute

The BlackRock Investment Institute leverages the firm’s expertise across asset classes, client groups and regions. The Institute’s goal is to produce information that makes BlackRock’s portfolio managers better investors and helps deliver positive investment results for clients.

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Investing For a New World Initiative

In February 2012, BlackRock launched a multi-faceted, global communications initiative – Investing For a New World™ – to provide guidance and practical advice to investors

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struggling to make sense of this new world of low yields, volatile markets and uncertain returns. See BlackRock's dedicated microsite, www.blackrock.com/newworld