

BLACKROCK

Week in View - 21 February 2011

Latest market views across all asset classes from the BlackRock Multi-Asset Client Solutions Group (BMACS)

Risk assets had yet another week of gains, with equities in the US and Europe up around 1%. Asian markets were stronger as the Nikkei rose 1.5% and Hong Kong was up over 3%. Bond markets were only marginally stronger on the whole, following the previous week's losses. The big story in currency markets was the rebound of the euro and sterling compared to the dollar.

UK Economy

Global investors watched events in the UK closely this week for a range of news about inflation and interest rates. Tuesday saw the release of January's inflation data, with headline CPI hitting the 4% mark, and even core inflation (which excludes food and energy costs) above the Bank of England's target at 3%. The Bank had chance to respond later in the week at the press conference following the Monetary Policy Committee meeting and with the publication of its quarterly Inflation Report.

The reason for the global interest is that the UK is the only one of the major western economies to be facing clear inflation problems even though unemployment remains high and the pace of recovery sluggish. The general tenor of western monetary policy relies on weak economies to keep inflation under control and prevent the need to tighten policy. However, if the UK experience suggests these assumptions are flawed, investors will have to take cover.

As highlighted, current measures of inflation are well above the target levels set by The Bank of England. There have been various special factors which have influenced these high levels; the 25% decline in sterling, repeated VAT increases and global increases in food and energy prices all had a part to play. However, there has not been a clear consensus that these factors alone are distorting an otherwise benign picture. In addition, it is unclear that the expectations which agents use to negotiate wages and prices can be kept immune from higher living costs, even if the causes are temporary.

This last point in particular has gathered increasing attention from members of the MPC and led to a small but striking change of emphasis in Governor King's

comments at the press conference. Anticipating the Inflation Report, he noted that assuming interest rates move in line with market expectations, the Bank forecast a balanced probability of inflation being either side of the target in a couple of years. Put another way, if interest rates begin to rise from Q2 onwards, then on average inflation could be expected to be around target. This seems to give the Bank a distinct tightening bias for the months to come.

Market Movements*

Markets	18 Feb 2011	% Change
S&P 500	1343.01	1.04
NASDAQ	2833.95	0.87
TSE 1st Section	973.6	2.85
FTSE S&P World Europe	348.11	0.64
FTSE All-Share	3154.10	0.32
DAX	7426.81	0.75
Hang Seng	23595.24	3.36
Citi World Govt Bond Index All Mats	570.098	0.15
Bonds**	18 Feb 2011	11 Feb 2011
US	3.59	3.64
Japan	1.29	1.30
Germany	3.22	3.28
UK	3.89	3.95
Currencies	18 Feb 2011	11 Feb 2011
USD/Euro	1.36	1.36
GBP/Euro	0.84	0.85
JPY/USD	83.35	83.39
USD/GBP	1.62	1.60
JPY/GBP	135.10	133.43
Commodities	18 Feb 2011	% Change
Oil (Brent Crude)	102.16	2.17
Commodity Futures (CRB) Index	657.32	0.50

Gold	1366.40	1.36
------	---------	------

Global Monetary Policy

Do we see this as the start of a global battle by central bankers to shore up inflation-fighting credibility with early rate rises? It is worth noting that the case in the US and the euro area is much less urgent as core inflation is well under control and there are tougher challenges in terms of regional unemployment. Even in the UK, while we have an insight into what the Bank may do if the economy remains on the current path, that is not to say we know the economy will do so. The UK still has to contend with meaningful pressure on the labour market as a result of the austerity programme. To be in a position of tightening both fiscal and monetary policy at the same time would be both unique and unwanted. Inflation pressures may ease as global food shortages are relieved after the poor harvests of 2010, which further makes the UK rate outlook less certain.

Monetary tightening was also a theme in China, with the announcement of yet another hike in the required reserve ratio for banks to 19.5% after the market close on Friday. Encouragingly, there was little adverse reaction to the news in early trading on Monday, perhaps suggesting that investors are getting used to the idea of tighter policy. However, the real test for sentiment will be the first signs of moderation in the pace of economic activity, which have not yet arrived.

Corporate Strength in US and Europe

Corporate reporting has continued in the US and Europe and remains generally supportive of the market rally. Around 400 of the S&P500 have reported in the US, with over 70% beating earnings forecasts and revenues. European companies are also seeing more positive surprises than negative, though not to the same extent as the US. Looking ahead, we believe that corporate confidence is justified and will itself support growth through hiring and capital spending. This should mean that western equities remain supported through the first half of the year.

Guest Speaker Slot: BlackRock's Latin American Equities Team

Will Landers, head of the BlackRock Latin American Equities Team believes inflation concerns in Brazil are overblown and the fundamentals for investing in Latin America remain compelling.

Despite a tough beginning, we continue to believe that 2011 looks to be a strong year for Latin American equities. The region suffered earlier in January from fears regarding concerns around strengthening currencies. Chile essentially devalued their currency roughly 5% overnight when they announced a huge buyback of dollars to happen over the next few months. In Brazil, there were concerns potential changes to fiscal policy and capital controls to weaken the BRL. Like most emerging markets, Latin American economies are concerned about their currencies strengthening and the volatility we saw earlier in the month was the market trying to digest this noise.

There was some volatility in Brazil around the first interest rate hike of the current tightening cycle which aims to bring inflation expectations back to target. We think the inflation concerns in Brazil are overblown. The Brazilian Central Bank does not want to attract more capital by creating a larger interest rate differential (which would happen if rates went higher than the 150 bps total tightening we are expecting). We are not concerned that this tightening cycle will derail the domestic consumption story in the country. There are many supportive factors: employment is at all time highs, which means record low unemployment; wages are improving; record retail sales figures for Christmas in 2010 and strong demand for imported goods, which should help bring down inflation. Domestic consumption, led by a growing middle class with access to affordable credit and the strong pricing currently enjoyed by commodities companies should continue to drive growth.

The unrest in Egypt caused volatility in emerging markets as a whole. As Brazil is the largest and most liquid emerging market, it was, and continues to be, impacted by the increased investor risk aversion in emerging markets.

Elsewhere in the region, Mexico's dependency on the performance of the US market, security concerns and our expectation of continued political gridlock are sources of concern. Despite our view that President Piñera should succeed in growing Chile's economy 6% per annum during his presidency, valuations in Chile remain challenging. We do not see the same inflationary pressures in Mexico and Chile as we do in Brazil. Chile's inflation has been below the target since 2009 and Mexico is still working its way out of the US-caused recession. Therefore we do not anticipate a tightening cycle to start in either country in the near future. We expect Peru to lead the region in terms of economic growth this year. Despite feeling positive regarding President Santos' policies, valuations are not compelling enough to warrant an overweight in Colombia at the moment

Overall, the fundamentals for Latin America remain strong, valuations are compelling and earnings growth ranks among the best in the world. We are using the current volatility as a buying opportunity as we believe inflation concerns are overblown.

Highlights for the Week Ahead
(21 February- 25 February)

Economic Diary

Monday: PMI Flash manufacturing, services and composite for Germany, France and Euro area

Tuesday: US consumer confidence

Wednesday: US existing home sales, UK MPC minutes from Jan meeting

Thursday: EC consumer confidence, Germany GDP (final Q4 2010)

Friday: US Real GDP (Q4 2010, revision), Germany CPI data (6 states)

Corporate Diary

There will be continued focus on the UK banking sector as Standard Chartered, Royal Bank of Scotland and the Lloyds Banking Group publish results this week with particular attention on the recoveries of the two

government-backed banks. In retail we will see results from Hammerson, Walmart, Saks and Gap; in food and beverages, Rexam and Carlsberg are due to report and British American Tobacco from the tobacco industry. European telecomms companies, Deutsche Telekom, Telefonika and Telecom Italia all publish results at the end of the week.

*Equity, currency and bond markets measured over seven days, from previous Friday's close to Friday's close. All index returns in local currency terms. All equity index returns are price only. **Bonds: 10-year yield. Past performance is not a guide to future performance. The value of investments and the income from them can fall as well as rise and is not guaranteed. You may not get back the amount originally invested. Changes in the rates of exchange between currencies may cause the value of investments to diminish or increase. Levels and bases of taxation may change from time to time. Issued by BlackRock Investment Management (UK) Limited (authorised and regulated by the Financial Services Authority). Registered office: 33 King William Street, London, EC4R 9AS. Registered in England No. 2020394. Tel: 020 7743 3000. For your protection, telephone calls are usually recorded. BlackRock is a trading name of BlackRock Investment Management (UK) Limited. Issued in Switzerland by the representative office, BlackRock Investment Management (UK) Limited (London), Zurich Branch, Claridenstrasse 25, Postfach 2118 CH-8022 Zürich. In Singapore, this information is issued by BlackRock Investment Management (Singapore) Limited. The offer which is the subject of this information memorandum is not allowed to be made to the retail public. The views expressed herein are as of 25.01.11, and do not constitute investment or any other advice; the views are subject to change and do not necessarily reflect the views of BlackRock as a whole or any part thereof.