BLACKROCK
MERRILL LYNCH
INVESTMENT MANAGERS

# Week in View

## Market Review

Financial markets suffered heavy losses during the early part of the week, as conditions deteriorated amid a tighter credit environment and increased uncertainty, which instigated a re-pricing of credit risk. Something of a Wall Street recovery was inspired late on, as the **US Federal Reserve (Fed) stepped in with an emergency discount rate reduction**, admitting that financial markets had deteriorated to the point where "...downside risks to growth have increased appreciably". Despite the end-of-week rally, the S&P 500 ended 0.5% lower, while the Dow Jones declined by 1.2%.

**Market Movements**

| Markets | 17 Aug 2007 | % Change |
|---|---|---|
| S&P 500 | 1445.94 | -0.53 |
| NASDAQ | 2505.03 | -1.57 |
| TSE 1st Section | 1480.39 | -9.40 |
| FTSE/S&P World Europe | 415.31 | -0.49 |
| FTSE All-Share | 3128.97 | -0.02 |
| DAX | 7378.29 | 0.48 |
| Hang Seng | 20387.13 | -6.45 |
| Citi World Govt Bond Index All Mats | 495.35 | 0.70 |
| **Bonds*** | **17 Aug 2007** | **10 Aug 2007** |
| US | 4.67 | 4.78 |
| Japan | 1.59 | 1.72 |
| Germany | 4.28 | 4.35 |
| UK | 5.07 | 5.22 |
| **Currencies** | **17 Aug 2007** | **10 Aug 2007** |
| USD/Euro | 1.35 | 1.37 |
| GBP/Euro | 0.68 | 0.68 |
| JPY/USD | 113.81 | 117.79 |
| USD/GBP | 1.99 | 2.02 |
| JPY/GBP | 226.09 | 237.89 |
| **Commodities** | **17 Aug 2007** | **% Change** |
| Oil (Brent Crude) | 69.58 | -0.03 |
| Commodity Futures (CRB) Index | 403.72 | -2.91 |
| Gold | 656.75 | -2.67 |

The Tokyo market led heavy declines witnessed at the end of the week, after the **Nikkei 225 slumped to a new low for the year**. Friday's trading saw the index close down 874 points; its biggest point drop since the terrorist attacks of 2001.Exporters suffered as the yen continued to strengthen against high-yielding currencies and the dollar, on evidence of the unwinding of the carry trade.

Having fallen by more than 11% since mid-July, **European equity markets rebounded in response to Friday's US rate cut**, to reverse much of the week-to-date's losses. Germany's DAX actually ended 0.5% higher, while France's CAC-40 declined by 1.6%

After much turbulence, **London also benefited from the Fed's decision to cut bank-lending rates** by 0.5%, enabling the FTSE 100 to regain ground and close above the significant 6,000-point level. End-of-week gains left the index of larger UK companies with a rise of 0.4%.

**Asian stocks fell for the fourth-consecutive week** in a row, with some markets posting double-digit losses. To illustrate the pain, Korea and Hong Kong recorded their worst weeks since September 2001, while Indonesia and the Philippines had their worst weeks since the 1997 Asian crisis.

**Emerging markets also suffered** amid the global turmoil with the Latin American markets of Brazil (-7.8%), Argentina (-6.0%) and Mexico (-1.9%) all declining. Markets in emerging Europe also ended the week down.

**Investors continued dumping risky assets, such as equities and high-yielding currencies, preferring instead the safety of government bonds**. Markets began to price in the eventuality of Fed rate cuts in September, although we see this as far from certain.

In currency markets, a below-target reading on UK inflation saw **sterling weaker against the US dollar**.

**Commodities were broadly lower** over the week, with base metals suffering on fears of a US economic slowdown. Crude oil prices ended the week flat, however, on worries that hurricane Dean might disrupt oil and gas production in the Gulf of Mexico.

**Signs emerging that markets are bottoming**

It was another volatile week in equity markets, with US markets at one point down over 5% before rallying towards flat at the end of the week. While European markets were also flat, Asian markets did not benefit from Friday's news of Fed action and therefore locked in substantial losses for the week.

There were important signs that the focused concerns on the fallout from the US sub-prime market had broadened into full-blown panic for many investors. For example, weakness in Asia had little to do with concerns about dubious investments, and more to do with concerns that a US economic slowdown would be bad news for Asian companies, while volatility spilled over into other assets – notably currencies.

The key point remains that investors look for signs of panic, or capitulation, as important stages on the way to a bottoming of markets – and perhaps some of these signs are finally emerging. We expect an equity recovery but, in the short term, our stance remains cautious as jittery investors will be reluctant to commit before we hear more from financials about their credit exposures and see economic confirmation of the soft landing that we expect.