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Key points

1 Rising U.S.-China rivalry is elevating concerns about disruption to global corporate supply chains, our recent field trip found.

2 Federal Reserve Chair Jerome Powell highlighted a readiness to respond to heightened downside risks with new easing measures.

3 Two oil market reports this week may give some hints on next policy moves of the Organization of the Petroleum Exporting Countries (OPEC).

The BlackRock Investment Institute (BII) leverages the firm's expertise to provide insights on the global economy, markets, geopolitics and long-term asset allocation – all to help our clients and portfolio managers navigate financial markets. As a unique center of excellence, BII offers strategic and tactical market views, publications and digital tools that are underpinned by proprietary research.

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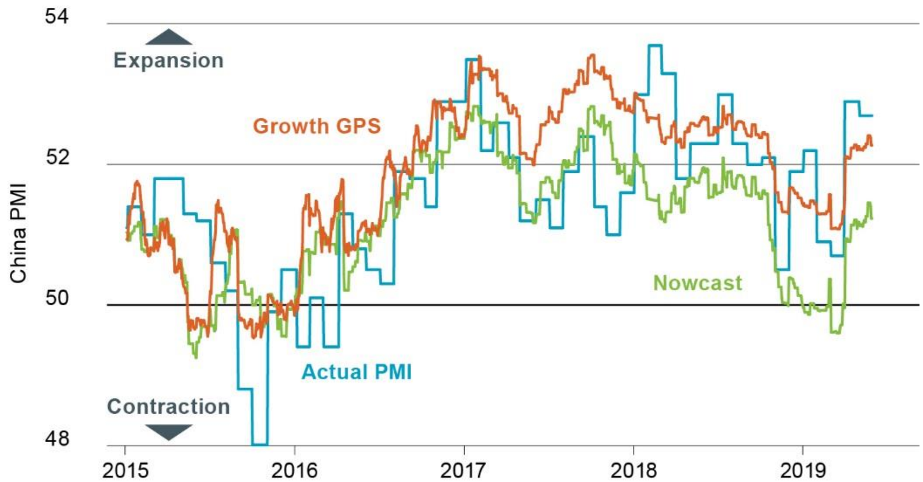
1 Postcards from China

Rising trade disputes and U.S.-China strategic tensions are increasingly weighing on global risk assets. How are the frictions playing out on the ground in China? A group of our senior investors recently went on a trip to the mainland to take the pulse on corporate sentiment and potential impacts on global manufacturing supply chains.

Chart of the week

China Growth GPS vs. composite PMI, 2015-2019



Sources: BlackRock Investment Institute and Markit, May 2019. Notes: The China GPS and nowcast are BlackRock estimates of where the Caixin composite PMI, compiled by Markit, may stand in three months' time. The nowcast is updated daily and captures a broad array of traditional economic data, such as industrial production and retail sales. The GPS adds big data signals to the nowcast, including text mining of earnings guidance by Chinese companies. Forward-looking estimates may not come to pass.

The rising U.S.-China rivalry is casting a cloud over China's growth outlook. Selling of Chinese equities by foreign investors hit record highs in April and May, with the greatest outflow of foreign capital since the launch five years ago of the "stock connect" program that gave global investors access to Chinese shares through Hong Kong. For now, the Chinese economy appears to be holding steady, thanks to policy support. See the BlackRock Growth GPS in the chart above, which provides a three-month look ahead on the Caixin composite PMI, a popular gauge of China's economic activity. We see limited direct economic impact of a "no deal" scenario in the ongoing trade negotiations in which U.S. tariffs would be fully applied to all Chinese exports. China likely has the tools to cushion the impact. The more pressing concern is what the escalating tensions imply for the sustainability of global supply chains – and for both Chinese and global companies that rely on them.

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The supply chain conundrum

China has evolved from the world's factory of cheap consumer goods to an integral part of global supply chains for a wide range of products, including sophisticated tech products. The deeply intertwined nature of global supply chains and other mutual interests have contained full-blown escalation between the U.S. and China so far. Yet earnings downgrades across the entire tech supply chain in Asia, particularly in South Korea, Taiwan and Japan, underline investor worries about the long-term disruption brought by rapidly escalating tensions.

Some global companies with large supply chains in China are not going to wait for the next turn in U.S.-China trade negotiations. A sign of the migration already underway: Dramatic wage increases in neighboring, poorer Vietnam as manufacturing jobs relocate there. Yet labor costs are not the only factor when companies consider relocating production facilities. One example: A basic requirement for large-scale manufacturing is a reliable supply of electricity, and many of China's emerging market rivals fall short in this regard. Adjusting supply chains is a costly affair that companies may have to grapple with for years ahead, in our view. In addition, U.S. firms supplying to Chinese customers face a potential loss of revenues. We also see China's move toward greater self-reliance – from the tech sector to energy and food production – as likely to accelerate.

Bottom line: We see the direct impact from a fallout in U.S.-China trade talks as limited. And we expect Chinese policymakers to provide support in the case of a downturn, yet are mindful that many policy tools could have unintentional side effects on the economy and markets. Our research on the ground still pointed to confidence in the resilience of the Chinese economy, despite trade talks grinding to a halt. One reason: The credit impulse to the economy is turning positive – a sea change from last year's clampdown on credit growth. Yet the heightening global trade conflict – including a U.S. threat of tariffs on Mexican goods – is a source of major macro uncertainty globally. This reinforces our call for portfolio resilience, including allocations to U.S. government bonds, which have historically played an important role in cushioning portfolios against bouts of volatility.

2 Week in review

- Global central banks sent strong dovish signals. Fed's Powell discussed the possibility escalating trade risks could lead to rate cuts at a closely-watched monetary policy conference in Chicago. The European Central Bank committed to leave rates unchanged through the first half of 2020 and has started to discuss additional steps. The Reserve Bank of Australia cut rates for the first time in three years.
- Global stocks rebounded from a 3-1/2-month low hit in the previous week, boosted by hopes for a Fed rate cut. U.S. tech stocks initially came under pressure on reports the U.S. government had launched its antitrust probes in a few large tech companies. Worries about global growth helped gold, a perceived safe-haven asset, rise to the highest level in more than three months.
- U.S. job growth slowed sharply and wage rose less than expected in May, suggesting weakening economic growth.

Global snapshot

Weekly and 12-month performance of selected assets

Equities	Week	YTD	12 Months	Div. Yield
U.S. Large Caps	4.5%	15.7%	5.8%	2.0%
U.S. Small Caps	3.4%	12.9%	-7.9%	1.7%
Non-U.S. World	2.7%	10.3%	-5.2%	3.2%
Non-U.S. Developed	3.2%	11.5%	-3.9%	3.4%
Japan	1.8%	5.9%	-9.2%	2.5%
Emerging	1.0%	5.3%	-9.8%	2.8%
Asia ex-Japan	0.8%	4.8%	-13.0%	2.6%

Bonds	Week	YTD	12 Months	Yield
U.S. Treasuries	0.3%	4.6%	7.2%	2.1%
U.S. TIPS	0.4%	5.7%	5.2%	2.2%
U.S. Investment Grade	0.5%	7.8%	8.7%	3.4%
U.S. High Yield	0.9%	8.5%	5.9%	6.2%
U.S. Municipals	0.2%	4.9%	6.7%	2.0%
Non-U.S. Developed	1.9%	3.9%	2.5%	0.7%
EM $ Bonds	1.5%	9.2%	9.4%	5.8%

Commodities	Week	YTD	12 Months	Level
Brent Crude Oil	-1.9%	17.6%	-18.2%	$ 63.29
Gold	2.7%	4.5%	3.4%	$ 1,341
Copper	-0.5%	-2.8%	-20.9%	$ 5,799

Currencies	Week	YTD	12 Months	Level
Euro/USD	1.5%	-1.2%	-3.9%	1.13
USD/Yen	-0.1%	-1.3%	-1.4%	108.20
Pound/USD	0.8%	-0.2%	-5.1%	1.27

Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index. Source: Thomson Reuters. As of June 7, 2019. Notes: Weekly data through Friday. Equity and bond performance are measured in total index returns in U.S. dollars. U.S. large caps are represented by the S&P 500 Index; U.S. small caps are represented by the Russell 2000 Index; Non-U.S. world equity by the MSCI ACWI ex U.S.; non-U.S. developed equity by the MSCI EAFE Index; Japan, Emerging and Asia ex-Japan by their respective MSCI Indexes; U.S. Treasuries by the Bloomberg Barclays U.S. Treasury Index; U.S. TIPS by the U.S. Treasury Inflation Notes Total Return Index; U.S. investment grade by the Bloomberg Barclays U.S. Corporate Index; U.S. high yield by the Bloomberg Barclays U.S. Corporate High Yield 2% Issuer Capped Index; U.S. municipals by the Bloomberg Barclays Municipal Bond Index; non-U.S. developed bonds by the Bloomberg Barclays Global Aggregate ex USD; and emerging market $ bonds by the JP Morgan EMBI Global Diversified Index. Brent crude oil prices are in U.S. dollars per barrel, gold prices are in U.S. dollar per troy ounce and copper prices are in U.S. dollar per metric ton. The Euro/USD level is represented by U.S. dollar per euro, USD/JPY by yen per U.S. dollar and Pound/USD by U.S. dollar per pound.

3 Week ahead

June 12 U.S. Consumer Price Index (CPI); China CPI, Producer Price Index (PPI)

June 13 Eurozone industrial production; OPEC monthly oil market report

June 14 China industrial production, fixed asset investment, retail sales; U.S. retail sales

The OPEC and the International Energy Agency (IEA) are due to each release their monthly oil market reports – ahead of a key OPEC meeting in late June. Crude oil has moved into a bear market after prices have fallen over 20% since the April peaks. An unexpected jump in U.S. crude inventories last week added to worries about waning demand caused by slower global economic growth. The two reports could shed light on the supply and demand dynamic in the oil market, and may provide some hints on OPEC's next policy moves.

Asset class views

Views from a U.S. dollar perspective over a three-month horizon

Asset class		View	Comments
Equities	U.S.	▲	A slowing but still growing economy underlies our positive view. We prefer quality companies with strong balance sheets in a late-cycle environment. Health care and technology are among our favored sectors.
	Europe	▼	Weak economic momentum and political risks are still challenges to earnings growth. A value bias makes Europe less attractive without a clear catalyst for value outperformance, such as a global growth rebound. We prefer higher-quality, globally oriented firms.
	Japan	—	Cheap valuations are supportive, along with shareholder-friendly corporate behavior, central bank stock buying and political stability. Earnings uncertainty is a key risk.
	EM	▲	Economic reforms and policy stimulus support EM stocks. Improved consumption and economic activity from Chinese stimulus could help offset any trade-related weakness. We see the greatest opportunities in EM Asia.
	Asia ex-Japan	▲	The economic backdrop is encouraging, with near-term resilience in China and solid corporate earnings. We like selected Southeast Asian markets but recognize a worse-than-expected Chinese slowdown or disruptions in global trade would pose risks to the entire region.
Fixed income	U.S. government bonds	—	We are cautious on U.S. Treasury valuations, but still see the bonds as important portfolio diversifiers. We see recent moves lower in yields as excessive and advocate patience before increasing exposure. We prefer shorter-dated and inflation-linked bonds and expect a gradual yield curve steepening, driven by still-solid U.S. growth and the Fed's stated willingness to tolerate temporary inflation overshoots.
	U.S. municipals	▲	We see coupon-like returns amid a benign interest rate backdrop and favorable supply-demand dynamics. New issuance is lagging the total amount of debt that is called, refunded or matures. The tax overhaul has made munis' tax-exempt status more attractive in many U.S. states, driving inflows.
	U.S. credit	—	Increased demand for income amid stable monetary policy, signs of more conservative corporate behavior and constrained supply remain supportive. We prefer an up-in-quality stance overall, but recent spread widening may also offer an attractive opportunity in BBB-rated credits. We favor bonds over loans in high yield.
	European sovereigns	▼	Low yields, European political risks, and the potential for a market reassessment of pessimistic euro area growth expectations all make us wary on European sovereigns, particularly peripherals. European sovereign bonds offer an attractive income opportunity for U.S.-dollar based investors on a currency-hedged basis.
	European credit	▼	"Low for longer" ECB policy should reduce market volatility and support credit as a source of income, yet valuations are relatively rich after a rally this year. We prefer high yield credits, supported by muted issuance and strong inflows. Euro high yield also offers a significant spread premium to its U.S. counterparts.
	EM debt	—	Prospects for a Chinese growth turnaround and a pause in U.S. dollar strength support both local- and hard-currency markets. Valuations are attractive despite the recent rally, with limited issuance adding to positives. Risks include worsening U.S.-China relations and slower global growth.
	Asia fixed income	—	We favor investment grade in India, China and parts of the Middle East, and high yield in Indonesia. Portfolio rebalancing could cause material capital inflows into China, as the country opens its markets to foreign capital.
Other	Commodities and currencies	*	A reversal of recent oversupply is likely to underpin oil prices. Any relaxation in trade tensions could boost industrial metal prices. We are neutral on the U.S. dollar. It has perceived "safe-haven" appeal but gains could be limited by a high valuation and a narrowing growth gap with the rest of the world.

▲ Overweight — Neutral ▼ Underweight *Given the breadth of this category, we do not offer a consolidated view.

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