Weekly commentary

BlackRock

April 8, 2024

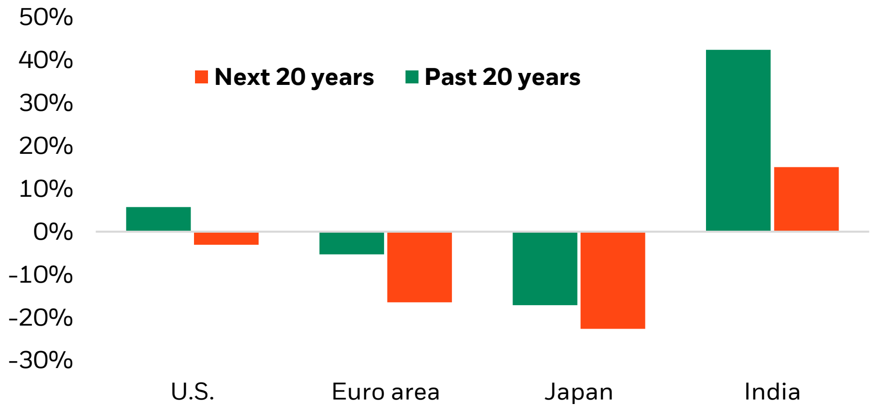
Playing demographic divergence now

- Working-age populations are declining in major economies. We favor countries that are better adapting and sectors set to benefit from spending shifts.
- U.S. yields jumped last week but U.S. stocks remain near all-time highs. The strong March U.S. jobs data supports our view of only two or three cuts this year.
- We eye this week's U.S. CPI. We see goods inflation pulling down overall inflation while services remain sticky. We watch for how soon the ECB will cut rates.

Working-age populations are shrinking across developed markets (DMs) but still growing in emerging markets (EMs). That hurts DM economic growth and favors EM growth – a divergence that is broadly reflected in asset prices, in our view. Yet we think the demographic mega force is also driving structural shifts in sectors – like healthcare and real estate – that are not priced in. We get selective, seeking EMs capitalizing on their younger populations and DMs better adapting to aging.

Mind the DM-EM gap

Change in domestic working-age population, next 20 years vs. past 20 years



Forward-looking estimates may not come to pass. Source: BlackRock Investment Institute, United Nations, with data from Haver Analytics, April 2024. Notes: The chart shows the percentage change in the domestic working-age population (aged 15-64), 2003-2023 vs. 2024-2044. The domestic working-age population is calculated by subtracting the UN's migration projections from the UN's population projections that include migration, assuming the overall age structure does not change.

Life expectancy is rising and birth rates are falling across the globe. In many DMs, that means the working-age population is set to shrink over the next 20 years. See the chart. That has vast macro implications. Fewer workers means slower growth. It is also inflationary, in our view. Retirees stop producing economic output, but do not typically spend less, historical data show. Plus, governments are likely to spend more on healthcare and pensions. The resulting inflationary pressure is one reason why we expect central bank policy rates to stay above pre-pandemic levels. Aging-related spending also threatens to push up government debt, with global public debt having already tripled since the mid-1970s to 92% of global GDP in 2022. And that debt is likely to be subject to higher interest costs. The economic picture looks quite different in EMs, like India, where the working-age population is still growing.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We think the broad growth impact of diverging population trends is well understood by markets. Yet as we outline in our new research paper, countries can respond differently – creating an uncertain outlook. We believe this will affect asset prices as markets adjust to how countries adapt. Within EMs, we seek those more likely to capitalize on their demographic advantage by bringing more working-age people into the workforce or that look to ramp up investment in productive capital, like public infrastructure. Growing populations consume more energy, so we expect rising spending on energy infrastructure in places like India and Indonesia. We think higher returns are likely in EMs with stronger growth and greater investment demand.

In DMs, we look for those that could better adapt and outperform the growth outlook markets have priced. DMs can mitigate the hit to growth by finding more workers – from other countries, or among women and other groups underrepresented in the workforce. Japan has somewhat lessened the impact of aging by substantially raising female participation. The recent immigration surge in the U.S., UK and Canada is boosting their workforces, as reflected in last week's bumper U.S. jobs report, but it would have to persist for years to fully offset working-age population declines – unlikely, in our view. We're monitoring how much artificial intelligence (AI) can boost the productivity of a smaller workforce.

Even less understood by markets, we believe, is the sectoral impact of mega forces – or big structural shifts driving returns. Older populations spend differently than younger ones. For example, healthcare spending rises with age. Real estate demand could change since older people typically move less frequently. Yet research shows even predictable spending shifts are not priced in until they hit. That was true for healthcare in Japan, where valuations have risen broadly in lockstep with the well-signposted growth of the country's retired population. That appears true now in the U.S. and Europe – one reason we like healthcare in both regions. We also think AI names will benefit from investment in automation to boost worker productivity.

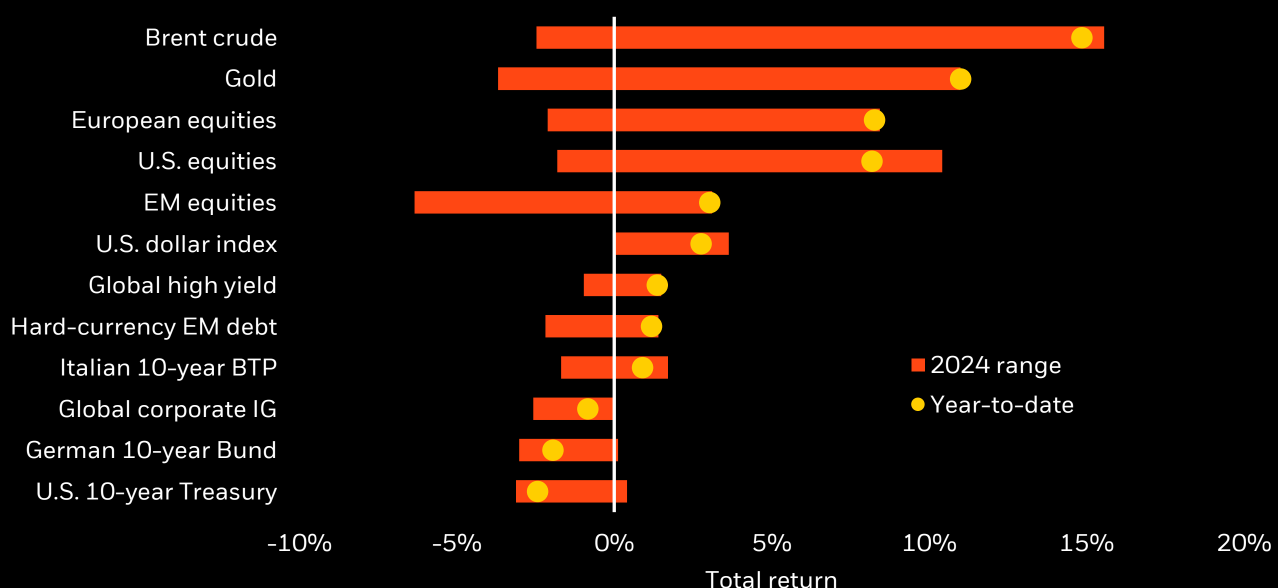
Bottom line: In EM, we favor countries best able to capitalize on their demographic advantage. We prefer DMs whose responses to aging could be underappreciated. We target sectors and firms poised to benefit from new spending patterns.

Market backdrop

The S&P 500 dipped 1% last week but was near a record high and 10-year Treasury yields jumped to their highs of the year near 4.40%. The March U.S. payrolls data showed job gains easily beating expectations. We think this reflects an unexpected surge in immigration helping expand the workforce. Markets are pricing in between two and three quarter-point Fed rate cuts this year. We think June is no longer a given for the Fed to start cutting rates – but see rate cuts coming as inflation falls.

Assets in review

Selected asset performance, year-to-date return and range



Past performance is not a reliable indicator of current or future results. Indexes are unmanaged and do not account for fees. It is not possible to invest directly in an index.

Sources: BlackRock Investment Institute, with data from LSEG Datastream as of April 4, 2024. Notes: The two ends of the bars show the lowest and highest returns at any point year to date, and the dots represent current year-to-date returns. Emerging market (EM), high yield and global corporate investment grade (IG) returns are denominated in U.S. dollars, and the rest in local currencies. Indexes or prices used are: spot Brent crude, ICE U.S. Dollar Index (DXY), spot gold, MSCI Emerging Markets Index, MSCI Europe Index, LSEG Datastream 10-year benchmark government bond index (U.S., Germany and Italy), Bank of America Merrill Lynch Global High Yield Index, J.P. Morgan EMBI Index, Bank of America Merrill Lynch Global Broad Corporate Index and MSCI USA Index.

Week ahead

April 10	U.S. CPI	**April 12**	University of Michigan consumer sentiment survey; China trade data; UK GDP
April 11	China CPI and PPI; European Central Bank policy decision	**April 10-17**	China total social financing

U.S. inflation data is in focus this week. We expect inflation to fall toward the Federal Reserve's 2% policy target this year as goods prices keep falling from pandemic highs. Yet we still see inflation on a rollercoaster back up in 2025, led by stubborn services inflation. We think core inflation will settle closer to 3% – higher than pre-pandemic levels. We watch for the European Central Bank (ECB) to give more clues on the timing of rate cuts at next week's policy meeting.

Big calls

Our highest conviction views on tactical (6-12 month) and strategic (long-term) horizons, April 2024

Tactical	**Reasons**
U.S. equities	• Our macro view has us neutral at the benchmark level. But the AI theme and its potential to generate alpha – or above-benchmark returns – push us to be overweight overall.
Income in fixed income	• The income cushion bonds provide has increased across the board in a higher rate environment. We like short-term bonds and are now neutral long-term U.S. Treasuries as we see two-way risks ahead.
Geographic granularity	• We favor getting granular by geography and like Japan equities in DM. Within EM, we like India and Mexico as beneficiaries of mega forces even as relative valuations appear rich.
Strategic	**Reasons**
Private credit	• We think private credit is going to earn lending share as banks retreat – and at attractive returns relative to public credit risk.
Inflation-linked bonds	• We see inflation staying closer to 3% in the new regime on a strategic horizon.
Short- and medium-term bonds	• We overall prefer short-term bonds over long term. That's due to more uncertain and volatile inflation, heightened bond market volatility and weaker investor demand.

Note: Views are from a U.S. dollar perspective, April 2024. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice regarding any particular funds, strategy or security.

Tracking five mega forces

Mega forces are big, structural changes that affect investing now – and far in the future. As key drivers of the new regime of greater macroeconomic and market volatility, they change the long-term growth and inflation outlook and are poised to create big shifts in profitability across economies and sectors. This creates major opportunities – and risks – for investors. See our web hub for our research and related content on each mega force.

1. **Demographic divergence:** The world is split between aging advanced economies and younger emerging markets – with different implications.
2. **Digital disruption and artificial intelligence (AI):** Technologies that are transforming how we live and work.
3. **Geopolitical fragmentation and economic competition:** Globalization is being rewired as the world splits into competing blocs.
4. **Future of finance:** A fast-evolving financial architecture is changing how households and companies use cash, borrow, transact and seek returns.
5. **Transition to a low-carbon economy:** The transition is set to spur a massive capital reallocation as energy systems are rewired.

Granular views

Six- to 12-month tactical views on selected assets vs. broad global asset classes by level of conviction, April 2024

Our approach is to first determine asset allocations based on our macro outlook – and what's in the price. **The table below reflects this and, importantly, leaves aside the opportunity for alpha, or the potential to generate above-benchmark returns.** The new regime is not conducive to static exposures to broad asset classes, in our view, but is creating more space for alpha**.**

Underweight | **Neutral** | **Overweight** | ● Previous view

	Asset		View	Commentary
Equities	**Developed markets**			
	United States	Benchmark	Neutral	We are neutral in our largest portfolio allocation. Falling inflation and coming Fed rate cuts can underpin the rally's momentum. We are ready to pivot once the market narrative shifts.
		Overall	+1	We are overweight overall when incorporating our U.S.-centric positive view on artificial intelligence (AI). We think AI beneficiaries can still gain while earnings growth looks robust.
	Europe		-1	We are underweight. While valuations look fair to us, we think the near-term growth and earnings outlook remain less attractive than in the U.S. and Japan – our preferred markets.
	UK		Neutral	We are neutral. We find attractive valuations better reflect the weak growth outlook and the Bank of England's sharp rate hikes to fight sticky inflation.
	Japan		+2	We are overweight. Mild inflation, strong earnings growth and shareholder-friendly reforms are all positives. We see the BOJ policy shift as a normalization, not a shift to tightening.
	Emerging markets		Neutral	We are neutral. We see growth on a weaker trajectory and see only limited policy stimulus from China. We prefer EM debt over equity.
	China		Neutral	We are neutral. Modest policy stimulus may help stabilize activity, and valuations have come down. Structural challenges such as an aging population and geopolitical risks persist.
Fixed Income	Short U.S. Treasuries		+1	We are overweight. We prefer short-term government bonds for income as interest rates stay higher for longer
	Long U.S. Treasuries		Neutral	We are neutral. The yield surge driven by expected policy rates has likely peaked. We now see about equal odds that long-term yields swing in either direction.
	U.S. inflation-linked bonds		Neutral	We are neutral. We see higher medium-term inflation, but cooling inflation and growth may matter more near term.
	Euro area inflation-linked bonds		Neutral	We are neutral. Market expectations for persistent inflation in the euro area have come down.
	Euro area govt bonds		Neutral	We are neutral. Market pricing reflects policy rates in line with our expectations and 10-year yields are off their highs. Widening peripheral bond spreads remain a risk.
	UK gilts		Neutral	We are neutral. Gilt yields have compressed relative to U.S. Treasuries. Markets are pricing in Bank of England policy rates closer to our expectations.
	Japanese govt bonds		-2	We are underweight. We find more attractive returns in equities. We see some of the least attractive returns in Japanese government bonds, so we use them as a funding source.
	China govt bonds		Neutral	We are neutral. Bonds are supported by looser policy. Yet we find yields more attractive in short-term DM paper.
	U.S. agency MBS		Neutral	We are neutral. We see agency MBS as a high-quality exposure in a diversified bond allocation and prefer it to IG.
	Global IG credit		-1	We are underweight. Tight spreads don't compensate for the expected hit to corporate balance sheets from rate hikes, in our view. We prefer Europe over the U.S.
	Global high yield		Neutral	We are neutral. Spreads are tight, but we like its high total yield and potential near-term rallies. We prefer Europe.
	Asia credit		Neutral	We are neutral. We don't find valuations compelling enough to turn more positive.
	Emerging hard currency		+1	We are overweight. We prefer EM hard currency debt due to its relative value and quality. It is also cushioned from weakening local currencies as EM central banks cut policy rates.
	Emerging local currency		Neutral	We are neutral. Yields have fallen closer to U.S. Treasury yields. Central bank rate cuts could hurt EM currencies, dragging on potential returns.

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