INVESTOR SUMMIT KEY TAKE-A-WAYS

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Stepping back for a bit of perspective

Rick Rieder
Managing Director,
Global Chief Investment
Officer of Fixed Income

Thanks to technology and the highly disruptive social and traditional media universe it has enabled, investors today are bombarded with information more quickly and in higher volume than ever before in history. Yet Rick Rieder, CIO, Global Fixed Income, BlackRock, urged attendees at the recent Canada Investor Summit to focus on the trends and forces that will affect markets over the longer term. "I think there is a lot of noise, a dynamic on social media and focus on the news of the day," said Rieder. "But there are some huge secular trends at play." And, he argued, they will have long-term implications for fixed income markets.

The demographic cap and long-term rate trends

One of those trends: population growth around the world is declining, which over the longer term will constrain economic growth. "We can't grow like we did in the 1970s," Rieder said. "You can grow cyclically, but then you have to come back to the demographic curve." The global economy, and the U.S. in particular, is now in the midst of a growth spurt, which Rieder expects will last through 2019. After that, however, he anticipates a slowdown, and perhaps a recession.

As well, he noted that nearly a decade of ultra-low rates have supported very high leverage among developed market governments, creating a latent pressure to keep rates low. That's especially the case, Rieder contended, in Europe and Japan, lower-growth/high-leverage economies that he expects will be very slow to reverse quantitative easing and normalize interest rates.

"We're going to live in a historically low rate environment," he added, "because central banks can't let it go."

The Fed and rates

In the short term, Rieder's outlook for rates is different for the U.S., thanks in large part to the federal stimulus package, which will "pull forward" a lot of economic growth in 2018/2019. Wages are likely to rise – Rieder estimates by as much as 3.25 percent annualized – as will inflation, but he expects the latter to be muted, owing to demographics and the deflationary effects of technology. Still, he anticipates the Federal Reserve to continue removing accommodation – by simultaneously increasing the funds rates while reducing the money supply through the unwind of its balance sheet – until the middle of 2019.

Until then, rates are bound to rise, probably once every quarter, he said. One reason: the sheer volume of U.S. government debt issuance to fund fiscal stimulus, especially on the short end of the yield curve.

"The markets simply can't absorb that much," Rieder said. "Rates have to go up because there's too much debt."

The re-pricing of risk

For fixed-income investors, this is a radically altered landscape. During the era of low rates/bond-buying, Rieder noted, investors were "pushed out" of risk-free assets, and "pushed into" riskier assets. Now, however, the reverse is taking hold, as QE unwinds and the U.S. Treasury flooding the short end of the bond market with cash flow. Investors in 2018 are being pushed towards risk-free assets, from which they can realize returns while taking on less duration and credit risk. In short, the risk-free rate has risen, which means investors can seek income in their portfolios without having to stretch to take risk. It also suggests that volatility in riskier assets will rise because of declining demand.

In this unprecedented environment, volatility has spiked and long-held macro-market correlations are getting weaker, Reider said, noting for example that equities and bond yields have been moving together.

"It's harder to hedge," he added, "so it's a harder environment to take on risk."

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