

December 2023

BlackRock

2024 Global outlook

Grabbing the wheel: putting money to work

BlackRock
Investment
Institute

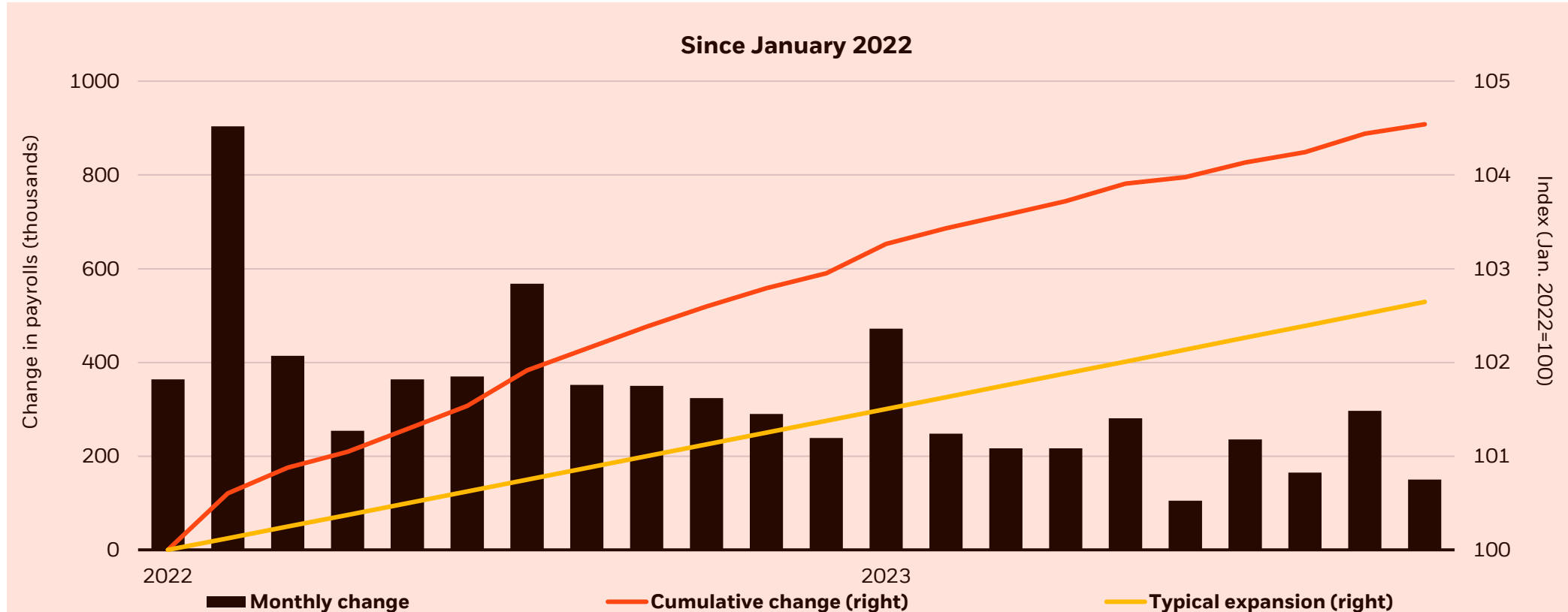
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Context is everything

A seemingly strong U.S. economy is fueling hopes of a soft landing – job growth since 2022 has outpaced what’s typically seen in an economic expansion.

U.S. payroll changes vs. typical expansion

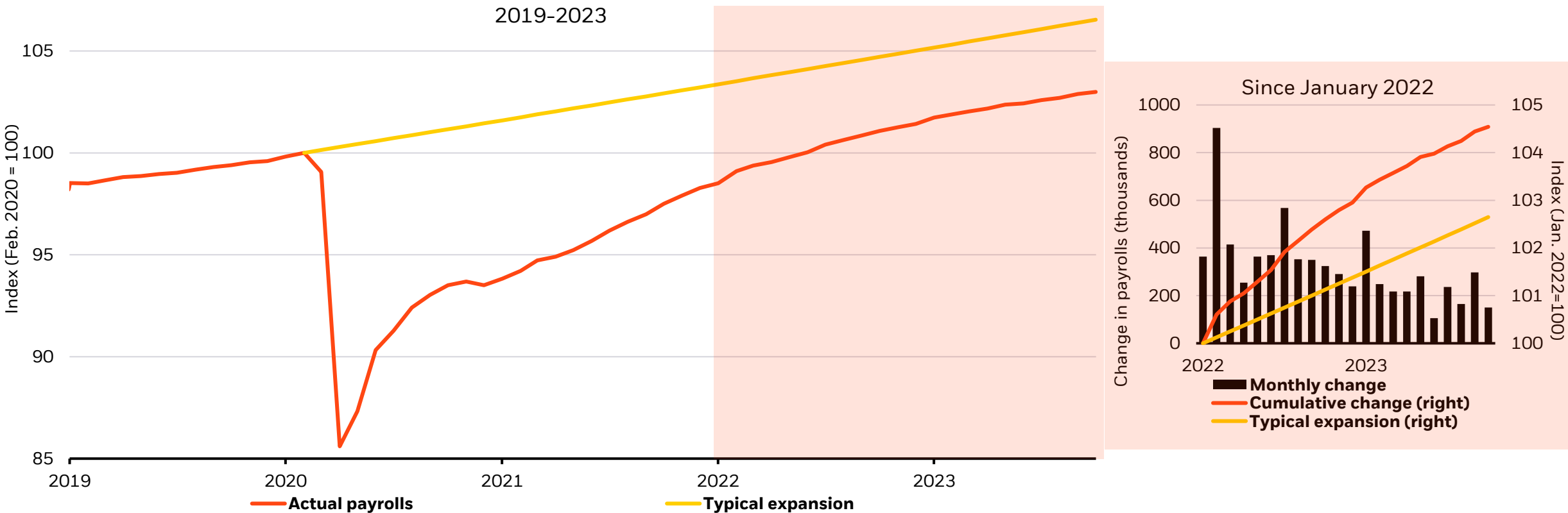


Source: BlackRock Investment Institute, U.S. Bureau of Labor Statistics, with data from Haver Analytics, December 2023. Notes: The chart shows U.S. nonfarm payrolls. The red lines show the actual level of total nonfarm payroll employment indexed to January 2022=100. The yellow line shows hypothetical payroll employment as if the economy had continued to grow at the average rate observed during U.S. post-1945 expansions. The black bars show actual monthly payroll gains (in millions) since January 2022.

Context is everything

But zooming out shows the economy is just climbing out of a pandemic hole.

U.S. payroll changes vs. typical expansion



Source: BlackRock Investment Institute, U.S. Bureau of Labor Statistics, with data from Haver Analytics, December 2023. Notes: The charts show U.S. nonfarm payrolls. The red lines show the actual level of total nonfarm payroll employment indexed to two different start dates: in the left chart, February 2020=100 and in the right chart January 2022=100. The yellow lines in both charts show hypothetical payroll employment as if the economy had continued to grow at the average rate observed during U.S. post-1945 expansions. The black bars in the right chart show actual monthly payroll gains (in millions) since January 2022.

Grabbing the wheel

1.

Managing macro risk

What matters in the new regime: Structurally higher interest rates and tougher financial conditions. Markets are still adjusting to this environment – and that’s why context is key in managing macro risk.

2.

Steering portfolio outcomes

We think investors need to grab the investment wheel and take a more dynamic approach to their portfolios with both indexing and alpha-seeking strategies while staying selective.

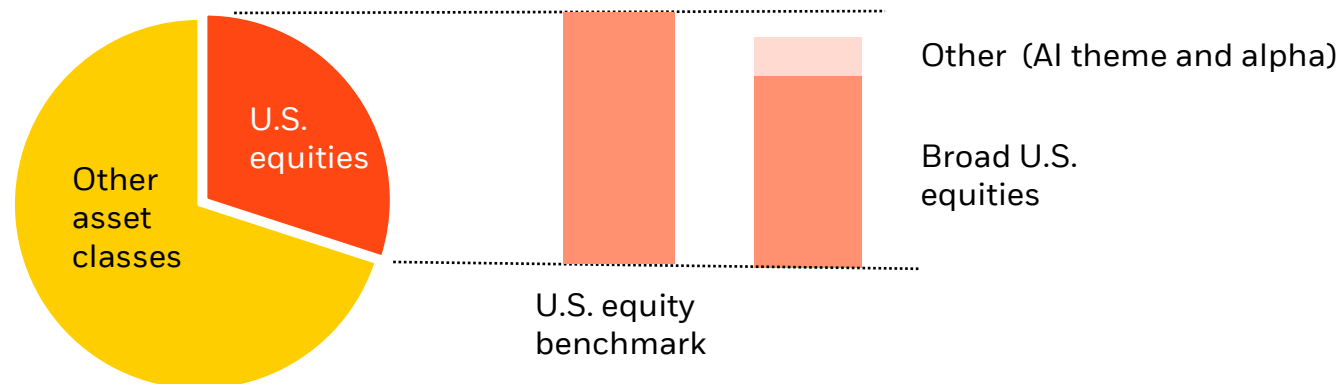
3.

Harnessing mega forces

Mega forces are another way to steer portfolios – and think about portfolio building blocks that transcend traditional asset classes, in our view.

Deep dive of including the mega force overweight on overall U.S. equity view

We are underweight broad U.S. equities. But our AI theme has taken us closer to neutral.

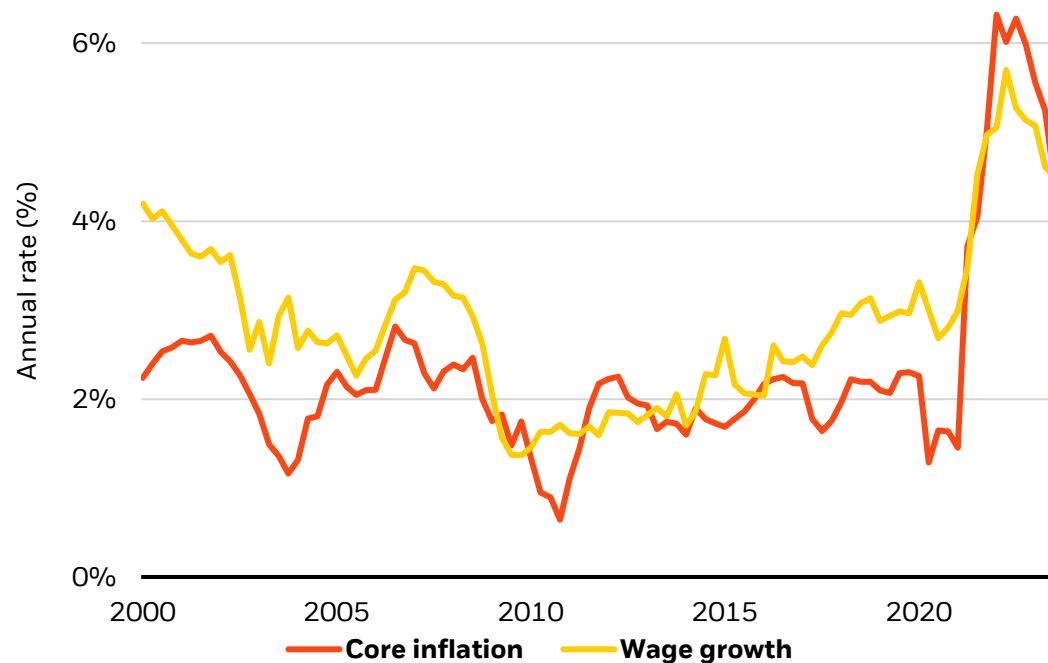


Note: Views are from a U.S. dollar perspective, December 2023. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice regarding any particular funds, strategy or security.

Inflation is falling, but it's a structurally different world now

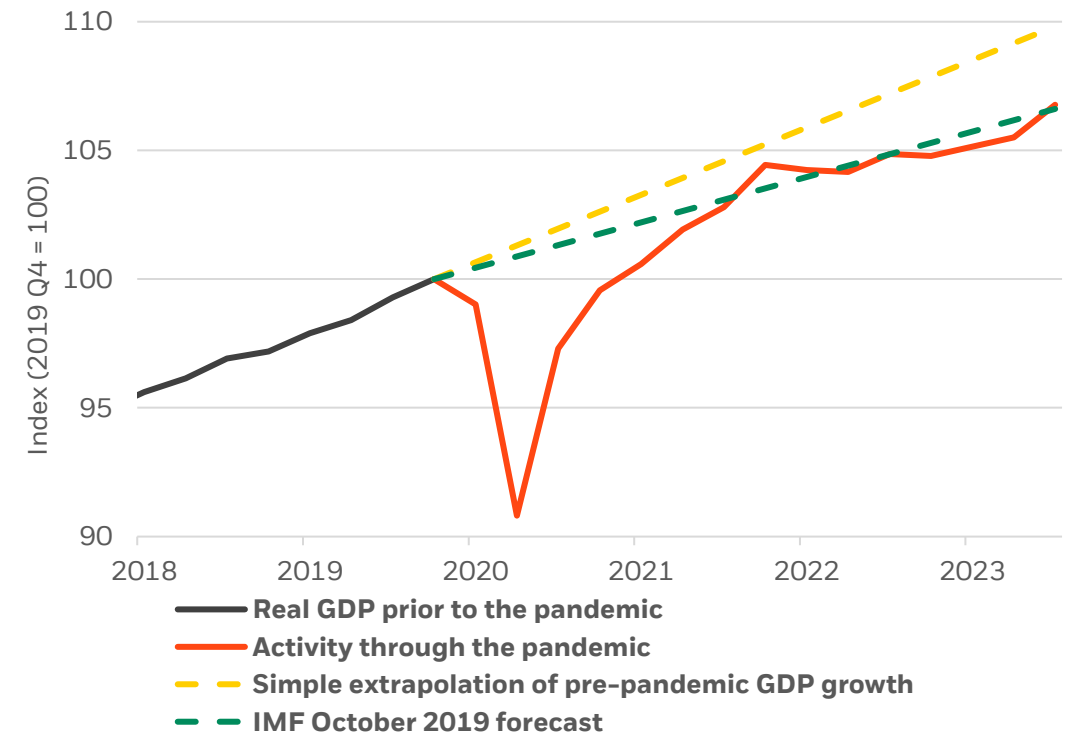
As the U.S. economy unwinds shocks from the pandemic – a sharp shift in spending towards goods and mismatches in job markets – the effects of an aging population on growth is becoming clearer.

Core CPI and wage inflation, 2000-2023



Source: BlackRock Investment Institute, with data from Haver Analytics, December 2023. Notes: The chart shows annual CPI inflation and ECI private sector wage inflation.

U.S. real GDP, 2018-2023

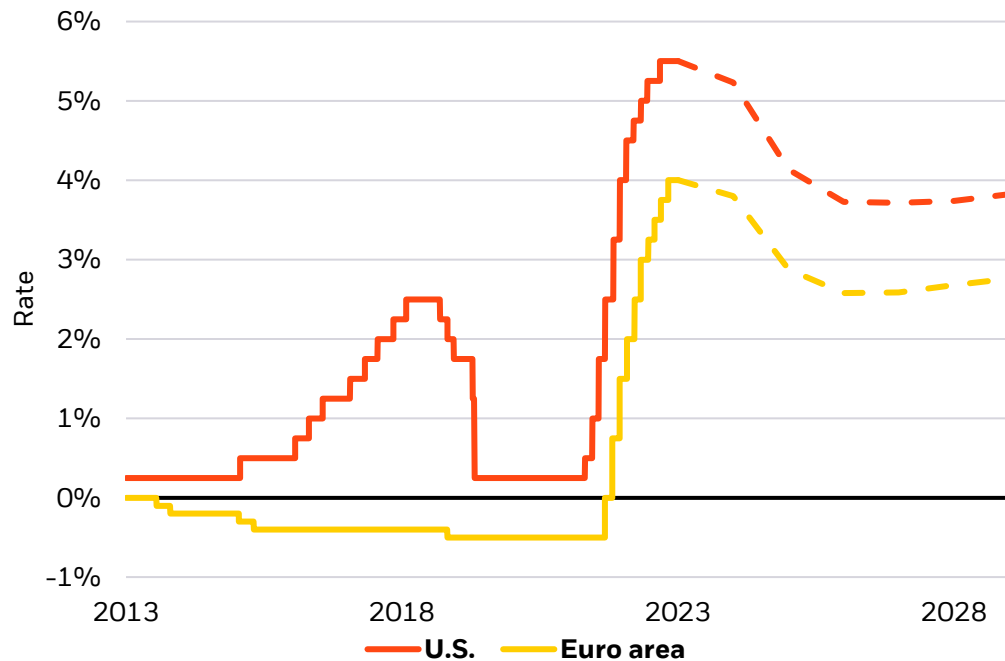


Source: BlackRock Investment Institute, U.S. Bureau of Economic Analysis, IMF with data from Haver Analytics, December 2023. Notes: The chart shows the level of real gross domestic product (GDP) in the U.S. The black line shows GDP before the pandemic and the yellow line assumes GDP kept growing at the same pace. The pink line shows the path of U.S. GDP forecast by the International Monetary Fund in its October 2019 World Economic Outlook. The red line shows actual activity through and since the pandemic.

We believe higher interest rates are here to stay

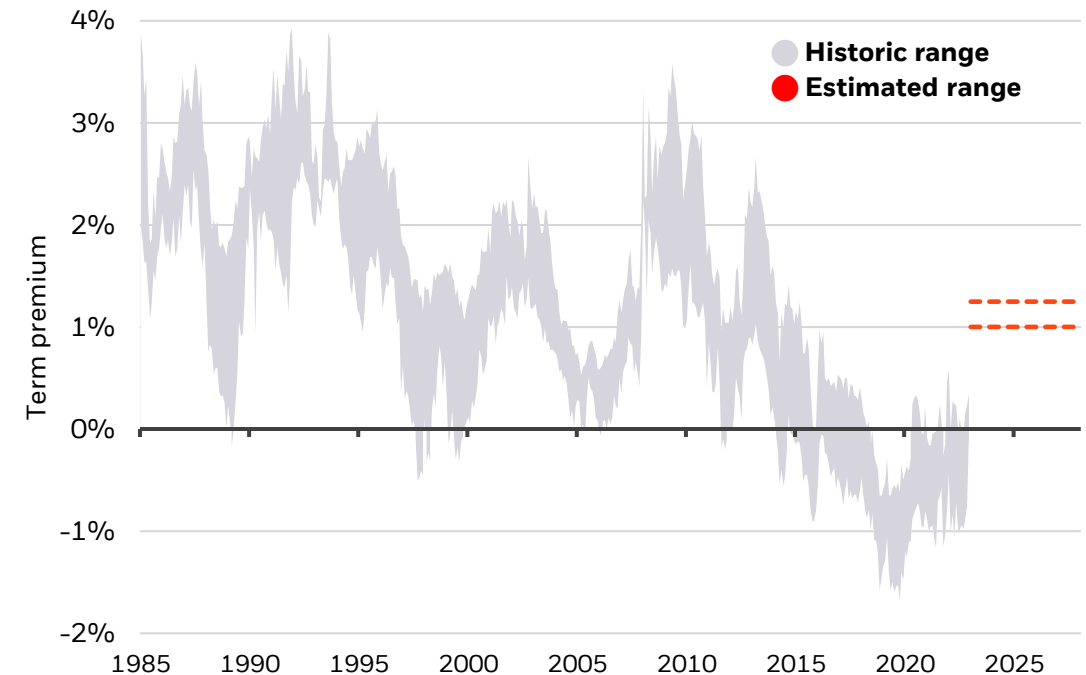
Structurally higher interest rates and tougher financial conditions are key parts of the new regime, in our view. We think long-term yields have more room to rise as investors demand more compensation for bond risk.

Actual and market implied policy rates, 2013-2029



Forward looking estimates may not come to pass. Source: BlackRock Investment Institute, with data from LSEG Datastream, December 2023. Notes: The chart shows the actual policy rate for the Federal Reserve (U.S.) and the European Central Bank (Euro area) along with the market expectations of future policy rates, based on interest rate swaps.

10-year term premium across U.S., Germany and UK

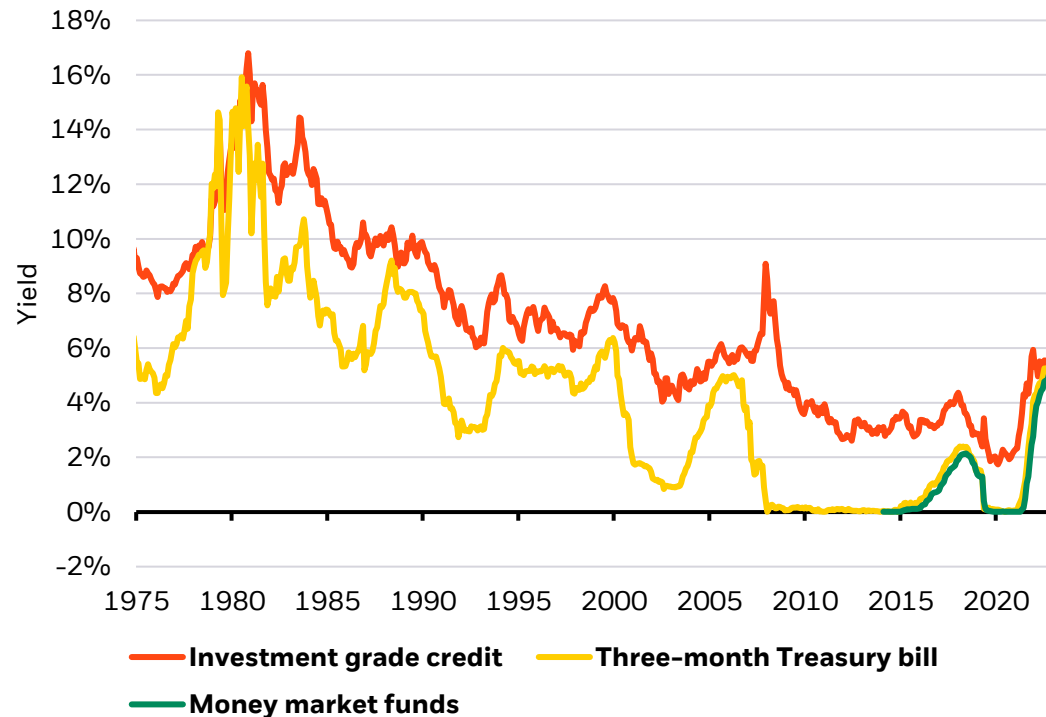


Forward looking estimates may not come to pass. Source: BlackRock Investment Institute, November 2023. Notes: The chart shows the historic and estimated term premium range. The range captures three regions: U.S., Germany, and UK. Term premium is defined as the compensation investors demand for the risk of holding long-term bonds. The estimates of term premium are based on the [Adrian, Crump and Moench \(2013\) "ACM" model](#). The ACM model is an arbitrage-free affine term structure model that provides an approach for extracting term premia from Treasury yields, described in detail here: [Pricing the Term Structure with Linear Regressions - FEDERAL RESERVE BANK of NEW YORK \(newyorkfed.org\)](#).

Competitive cash calls for selectivity: time to grab the wheel

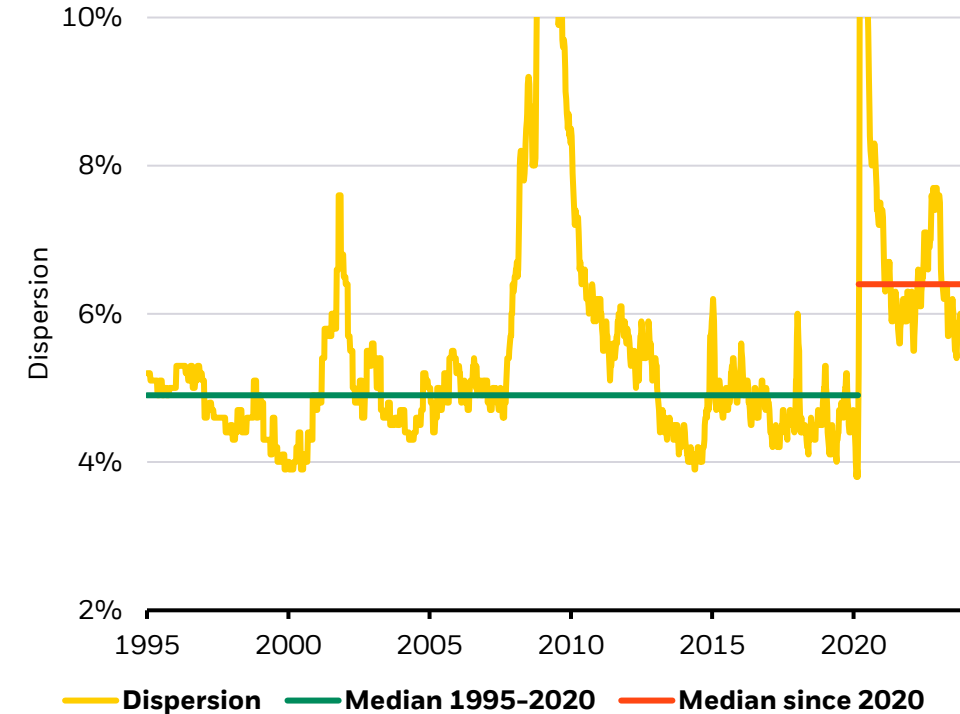
The difference between U.S. three-month Treasury bill and investment grade credit yields is nearly as narrow as it was during the early 1980s. Higher cash returns call for a more active approach to managing portfolios.

Fixed income and money market fund yields



Past performance is not a reliable indicator of current or future results, and index returns do not account for fees. It is not possible to invest directly in an index. Source: BlackRock Investment Institute, iMoneyNet Fund Analyzer with data from LSEG Datastream, November 2023. Notes: The chart shows the U.S. investment grade credit, 3-month Treasury bill and average 7-day U.S. Government institutional money market fund yields. The index proxy used for investment grade credit is the Bloomberg U.S. Corporate Investment Grade USD Index.

Dispersion of equity earnings estimates, 1995-2023

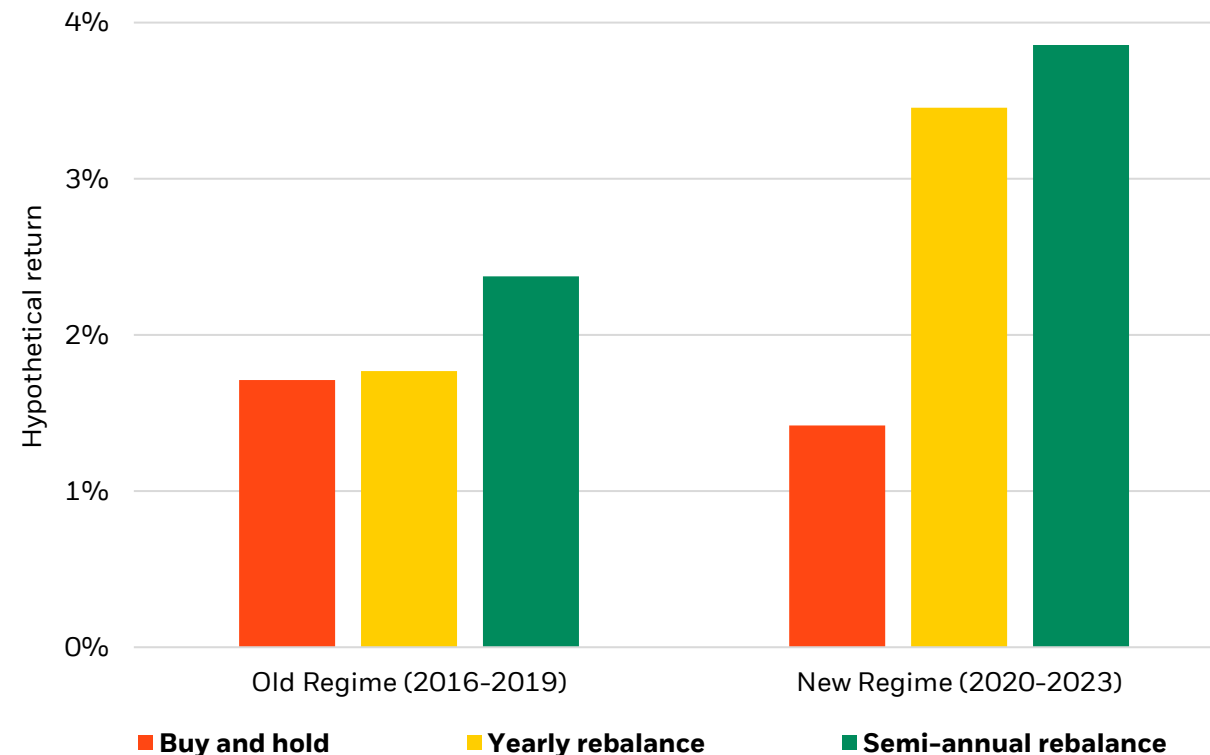


Source: BlackRock Investment Institute, LSEG Datastream, December 2023. Notes: The chart shows the aggregate standard deviation of analyst earnings estimates for S&P companies. The green line shows the median from 1995 to end January 2020, the orange line shows the median since February 2020

We believe the new regime rewards more dynamic portfolios

A new, more volatile regime potentially rewards an active approach to portfolios, in our view. We see one-and-done asset allocations becoming less effective.

Hypothetical impact of rebalancing on U.S. equity returns

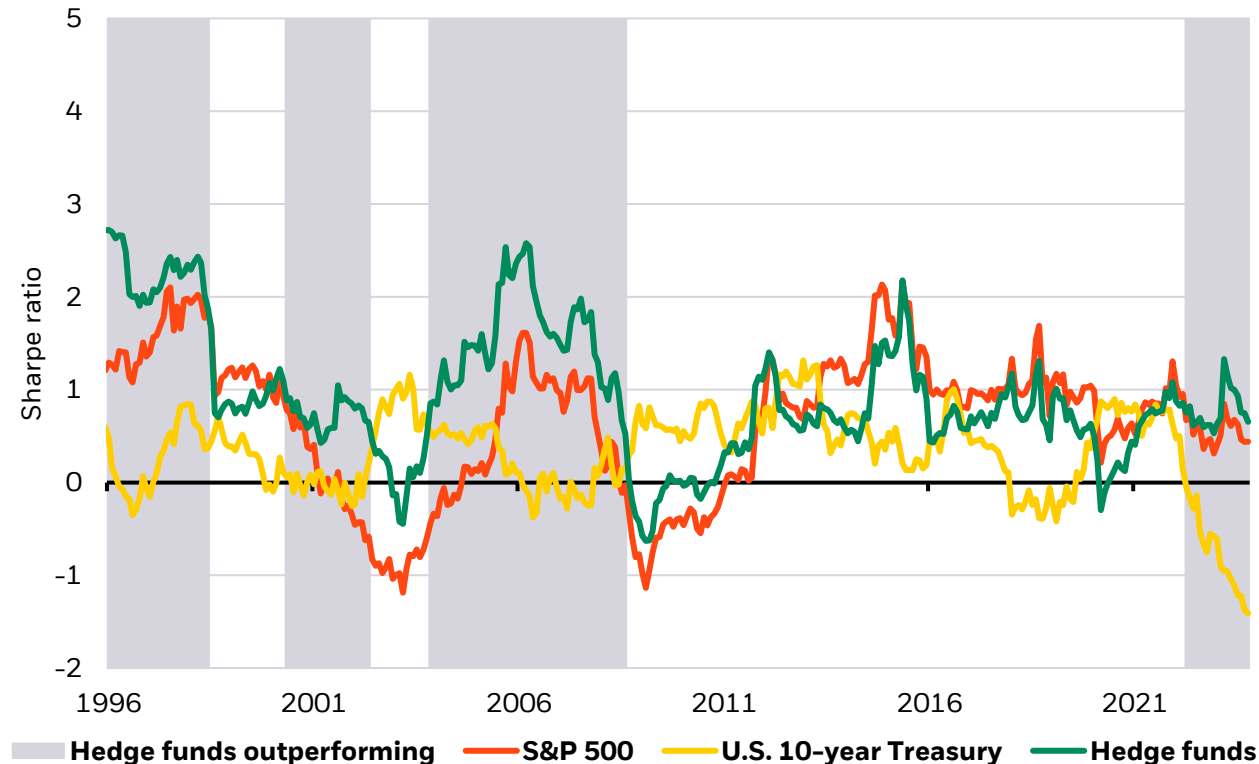


Past performance is not a reliable indicator of future performance. Index returns do not account for fees. It is not possible to invest directly in an index. Source: BlackRock Investment Institute, MSCI with data from Bloomberg, December 2023. Notes: The chart shows monthly U.S. equity returns - based on the MSCI USA - in the old and new regime under three scenarios: keeping the holdings unchanged (buy-and-hold), yearly rebalances and semi-annual rebalances. The rebalances optimize the portfolio for returns, diversification and risk with perfect foresight of equity sector returns in the MSCI USA index. This analysis uses historical returns and has been conducted with the benefit of hindsight. Future returns may vary and these results may not be the same other asset classes. It does not consider potential transaction costs that may detract from returns. It also does not represent an actual portfolio and is shown for illustrative purposes only.

Active strategies may benefit from greater dispersion

More macro volatility has spurred greater dispersion between and within asset classes. We see this environment as more conducive for strategies looking to beat market benchmark returns such as those employed by hedge funds.

Sharpe ratios for the S&P 500, U.S. 10-year Treasury and hedge funds, 1995-2023

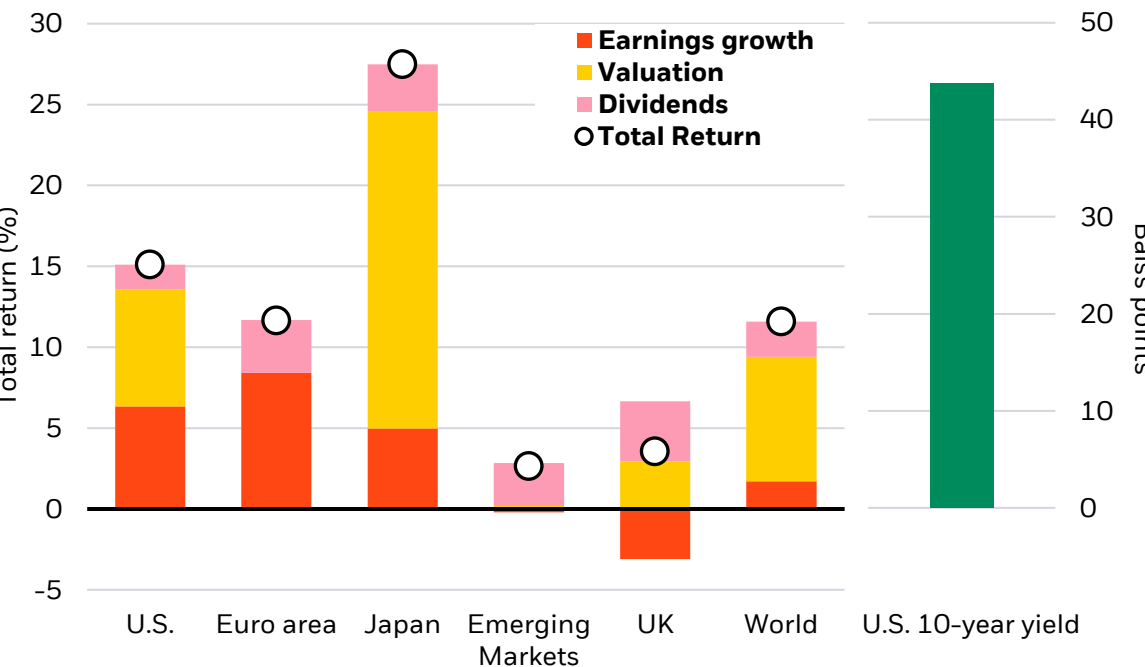


Past performance is not a reliable indicator of future performance. Index returns do not account for fees. It is not possible to invest directly in an index. This information should not be relied upon by the reader as research or investment advice regarding any funds, strategy or security in particular. Source: BlackRock Investment Institute, HFRI with data from LSEG Datastream, December 2023. Notes: The chart shows the Sharpe ratios for the S&P 500, U.S. 10-year Treasury and Hedge funds. The index proxy used for hedge funds is the HFRI Weighted index. The Sharpe ratio measures an asset's risk-adjusted returns. It is calculated by dividing the asset's excess returns (typically over cash) by its standard deviation, which represents its risk.

Equity valuations yet to fully reflect higher interest rates

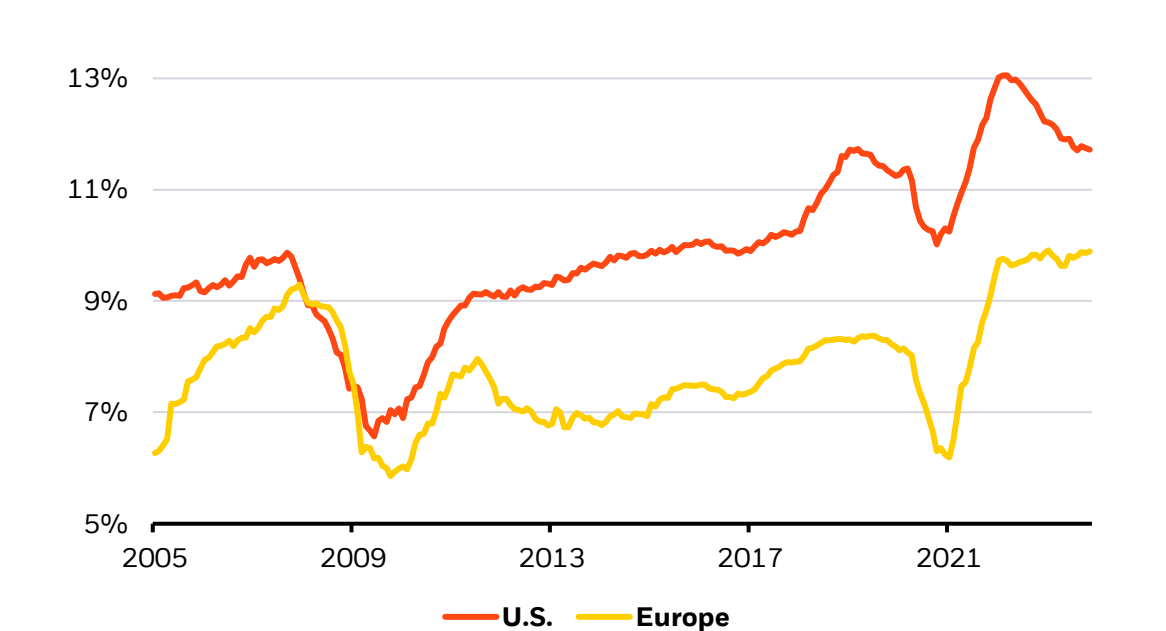
We don't think equity valuations fully reflect the higher-for-longer interest rates of the new regime. We see higher interest rates dragging on equity valuations from here and putting profit margins under pressure.

Change in equity total returns & U.S. 10-year yield



Past performance is not a reliable indicator of future results. Indexes are unmanaged and index returns do not account for fees. It is not possible to invest directly in an index. Source: BlackRock Investment Institute, MSCI with data from LSEG Datastream, December 2023. Notes: The bars show the breakdown of each market's 12-month return into dividends, earnings growth and valuation. The dots show each market's total 12-month local-currency returns. Earnings growth is based on the 12-month change in 12-month forward I/B/E/S earnings estimates. World is defined as the MSCI All Country World Index (\$). Returns are based on MSCI indexes. The index proxies used are: MSCI USA, MSCI EMU, MSCI Japan, MSCI EM U\$, MSCI UK. The bar on the right shows the change in the U.S. 10-year Treasury yield, year-to-date

Regional profit margins, 2005-2023

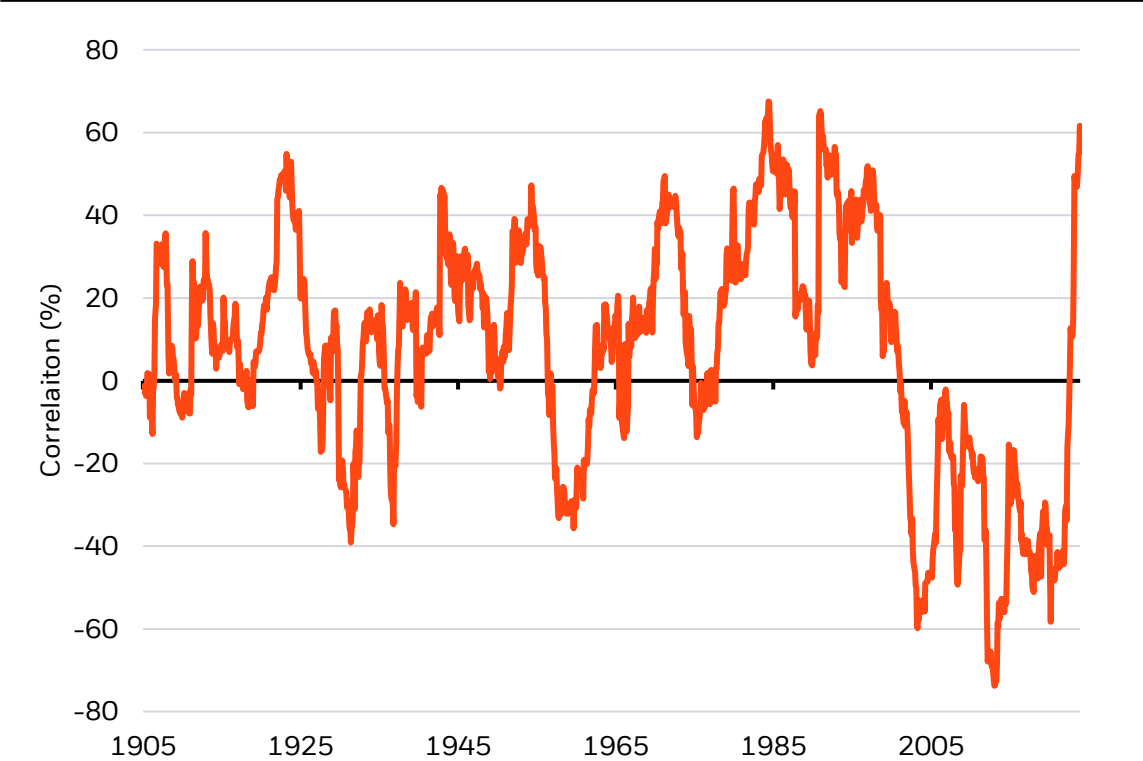


Past performance is not a reliable indicator of future results. Indexes are unmanaged and index returns do not account for fees. It is not possible to invest directly in an index. Source: BlackRock Investment Institute, October 2023 with data from LSEG Datastream. Notes: The chart shows Trailing Net Operating Profit Margins as the results of 12 months rolling sum of total earnings divided by the 12 months rolling sum of total sales. Index proxies used are MSCI US and MSCI Europe ex UK.

Digging under the hood of broad building blocks

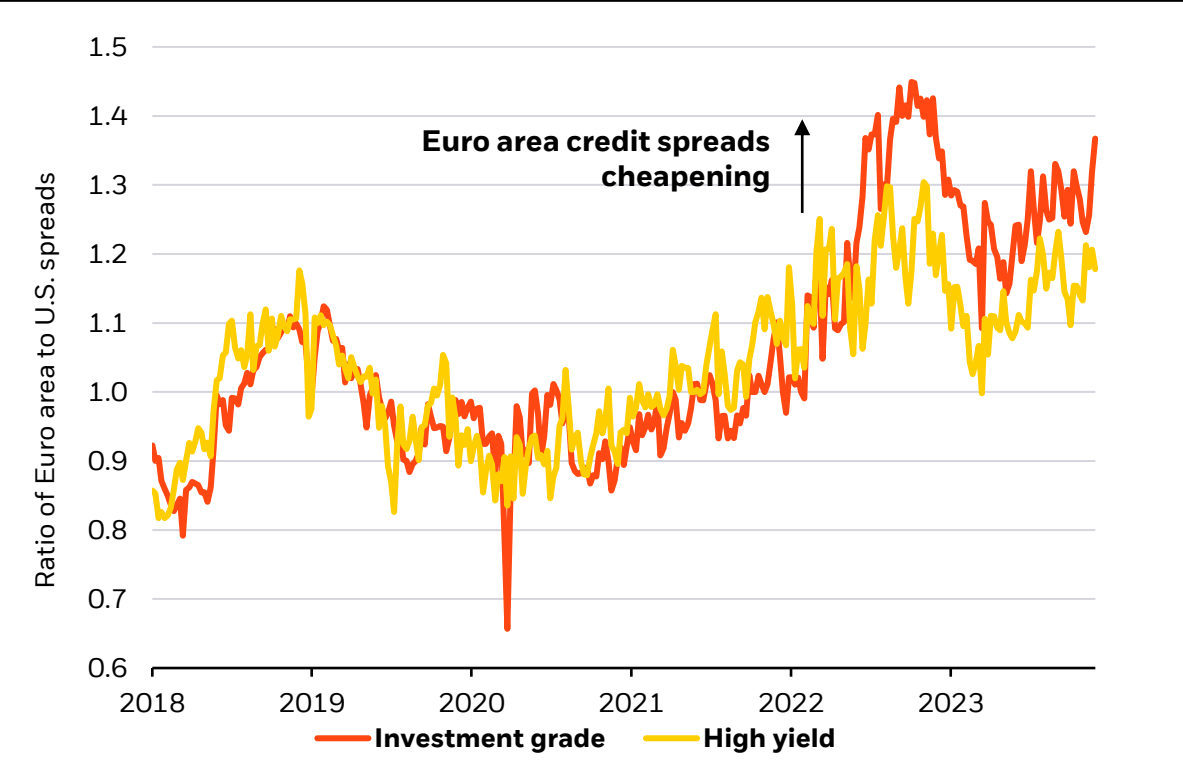
A positive correlation between equity and bond returns demands a more selective approach to investing, in our view. We prefer the Euro area over the U.S. in both investment grade and high yield credit, given cheaper valuations.

Equity-bond return correlations, 1903-2023



Source: BlackRock Investment Institute, with data from LSEG Datastream, December 2023. Notes: The chart shows the correlation of daily U.S. 10-year Treasury and equity returns over a rolling three-year period. The equity indexes used are the Dow Jones industrial average until 1981 and the S&P 500 after 1981.

Euro area credit spreads relative to the U.S.

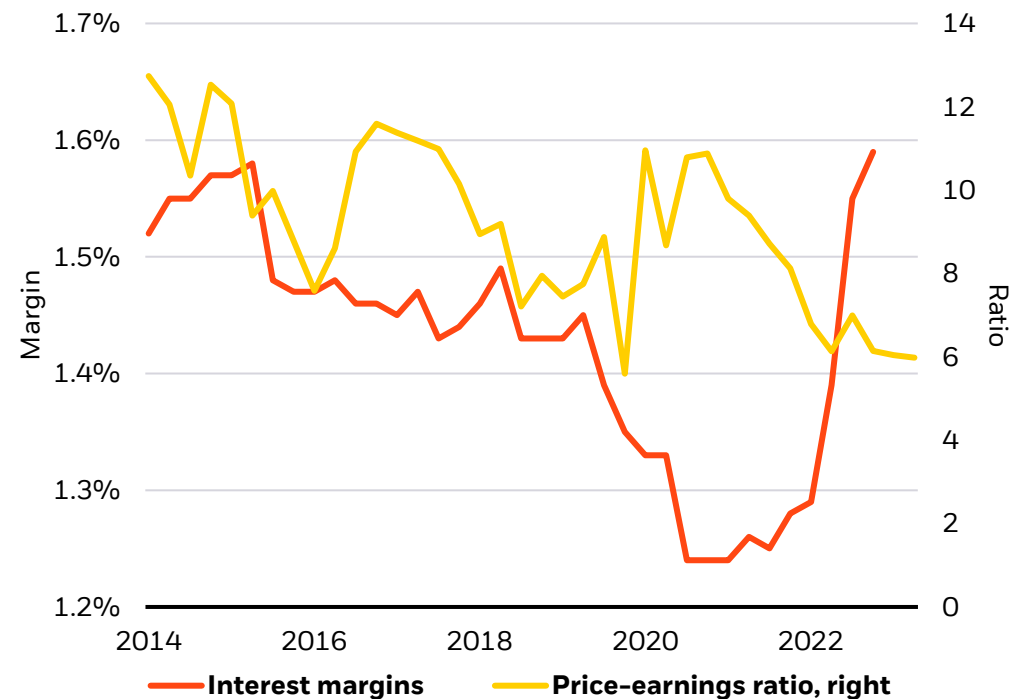


Source: BlackRock Investment Institute, with data from LSEG Datastream, December 2023. Notes: The chart shows the ratio of Euro area credit spreads to U.S. credit spreads for investment grade and high yield corporate credit. A higher ratio indicates cheaper Euro area spreads relative to U.S. spreads. Index proxies used are: Bloomberg U.S. Corporate Investment Grade and Bloomberg Euro-Aggregate: Corporates for investment grade and Bloomberg U.S. Corporate High Yield and Bloomberg Pan-European High Yield for High yield

Getting granular across sectors and away from home

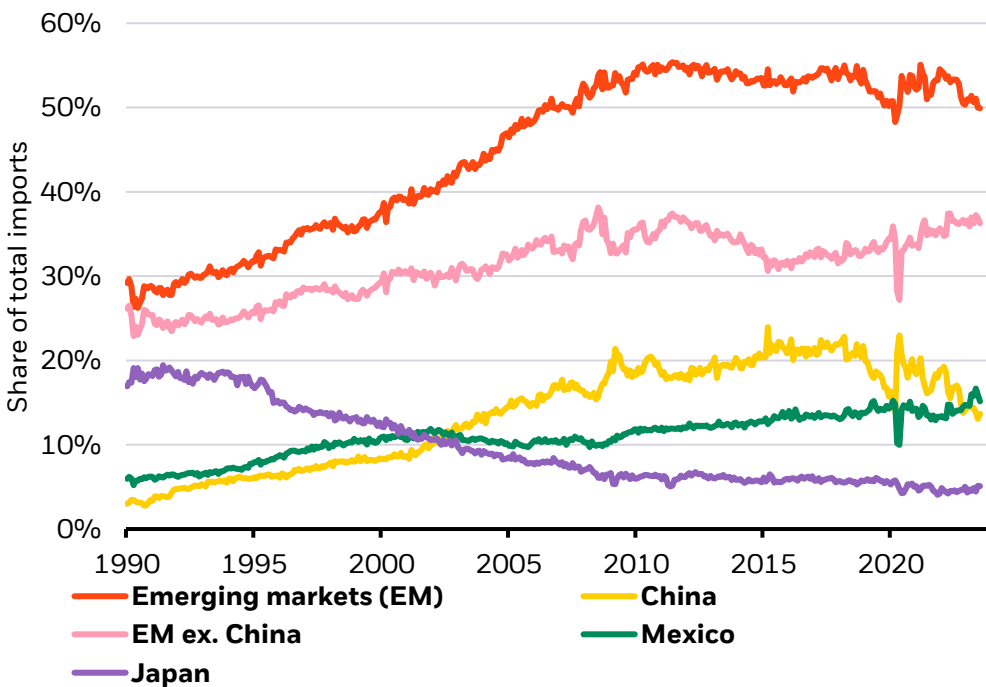
Greater dispersion creates opportunities beyond broad equity exposures. We spot opportunities in European banks where valuations look attractive, in our view, and emerging markets that could benefit from rewiring supply chains.

European bank margins and price-earnings ratio



Past performance is not a reliable indicator of future results. Indexes are unmanaged and index returns do not account for fees. It is not possible to invest directly in an index. Source: BlackRock Investment Institute, European Banking Authority, with data from LSEG Datastream, December 2023. Notes: The chart shows weighted net interest margin of a sample of European banks, taken from the European Banking Authority and the forward earnings to price ratio of banks in the Euro Stoxx 600 index.

U.S. imports from emerging markets 1990-2023

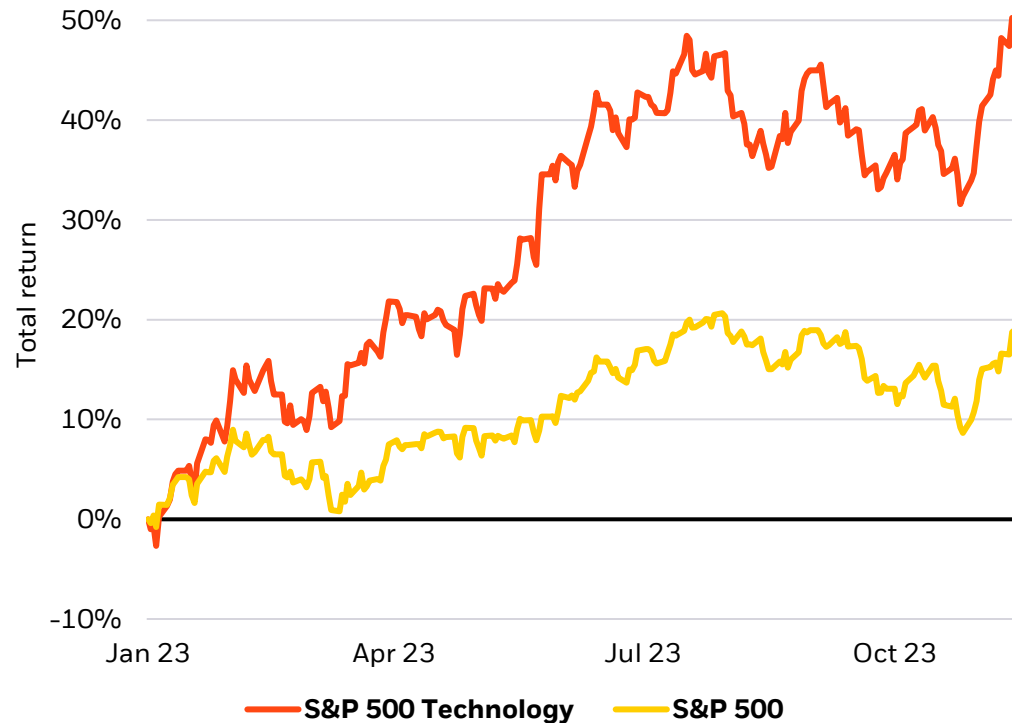


Source: BlackRock Investment Institute, IMF with data from LSEG Datastream, October 2023. Notes: The chart shows the share of total U.S. imports from five regions/countries – Emerging markets, China, Mexico, Japan and emerging markets excluding China.

The AI mega force persists through a challenging backdrop

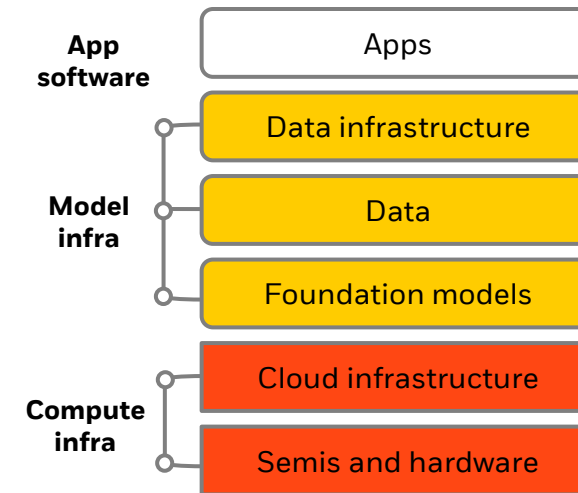
Investor enthusiasm for AI and digital tech has offset the drag of rising yields. That has pushed U.S. tech stocks to easily outshine the broader market in 2023. We see the potential impact of AI spreading to other sectors too.

S&P index performance, year-to-date



Past performance is not a reliable indicator of future results. Index returns do not account for fees. It is not possible to invest directly in an index. Source: BlackRock Investment Institute, with data from LSEG Datastream, December 2023. Notes: The chart shows the total year-to-date returns in U.S. dollar terms for the S&P 500 Technology sector (orange line) and the S&P 500 index (yellow line).

BlackRock view of tech needed for AI applications

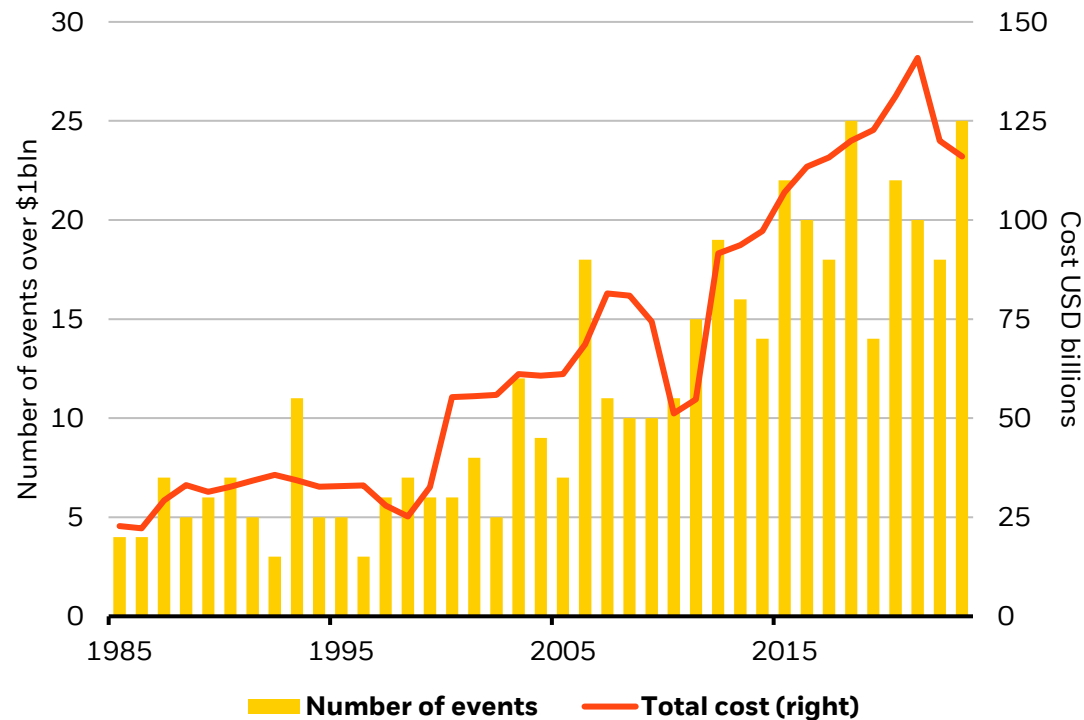


Source: BlackRock Investment Institute, December 2023. Notes: The schematic shows the technologies we think will be needed – across hardware and software – to develop AI applications. Each layer builds on the one preceding as technologies get “stacked” on top of one another enabling further innovation. The schematic is for illustrative purposes only and intended as a guide based on what we know today. As the AI ecosystem evolves some categories may be replaced by newer ones.

Physical damage from climate mounts

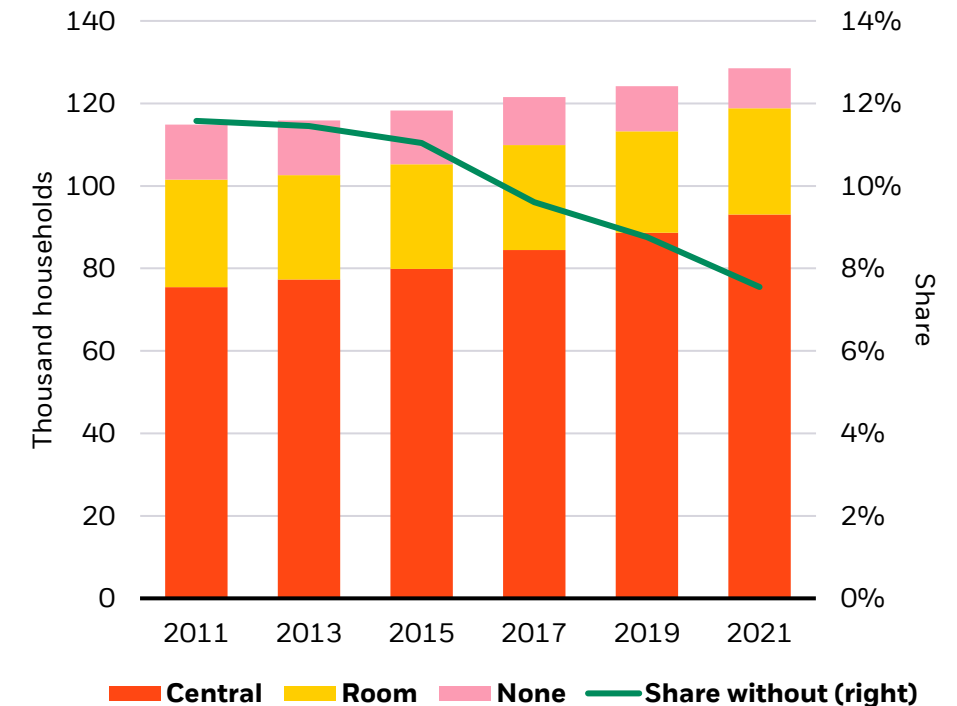
The number of climate-related events with damages totaling more than \$1 billion has increased over the past three decades. And as climate damages accelerate, we are already seeing early signs of demand for resilience solutions.

U.S. events with losses over \$1 billion, 1980-2023



Sources: BlackRock Investment Institute, NOAA National Centers for Environmental Information (NCEI) U.S. Billion-Dollar Weather and Climate Disasters (2023), November 2023. Notes: The bars (yellow) show the number of climate events with losses greater than USD\$1 billion. The data include droughts, flooding, severe storms, tropical cyclones, wildfires, winter storms and freezes. The line (red) shows the total cost as a ten-year average. The data are adjusted for inflation using 2022 dollars. All currency figures are in USD.

U.S. household air-conditioning, 2011-2021

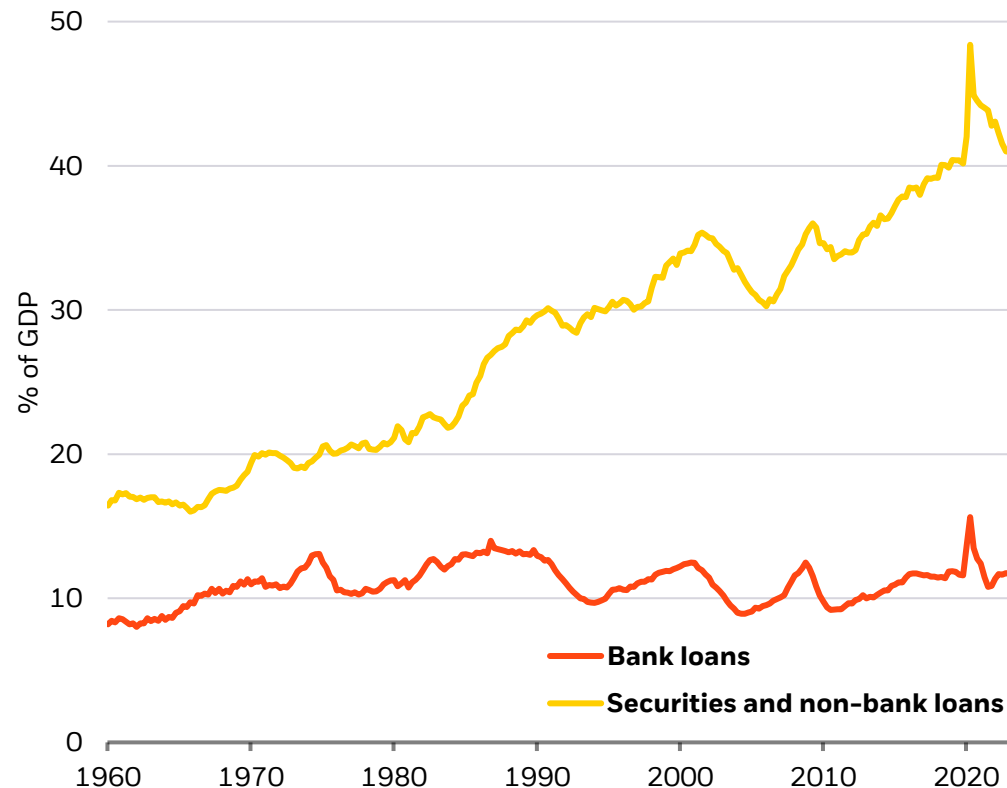


Sources: BlackRock Investment Institute, and U.S. Census, with data from the American Housing Survey, November 2023. Notes: The chart shows the number of U.S. households that have air conditioning installed either centrally and covering the whole home (red bars) or in an individual room (yellow bars), as well as the number (pink bars) and share (green line) of households that do not have any type of air conditioning.

We believe demand for private credit could grow further

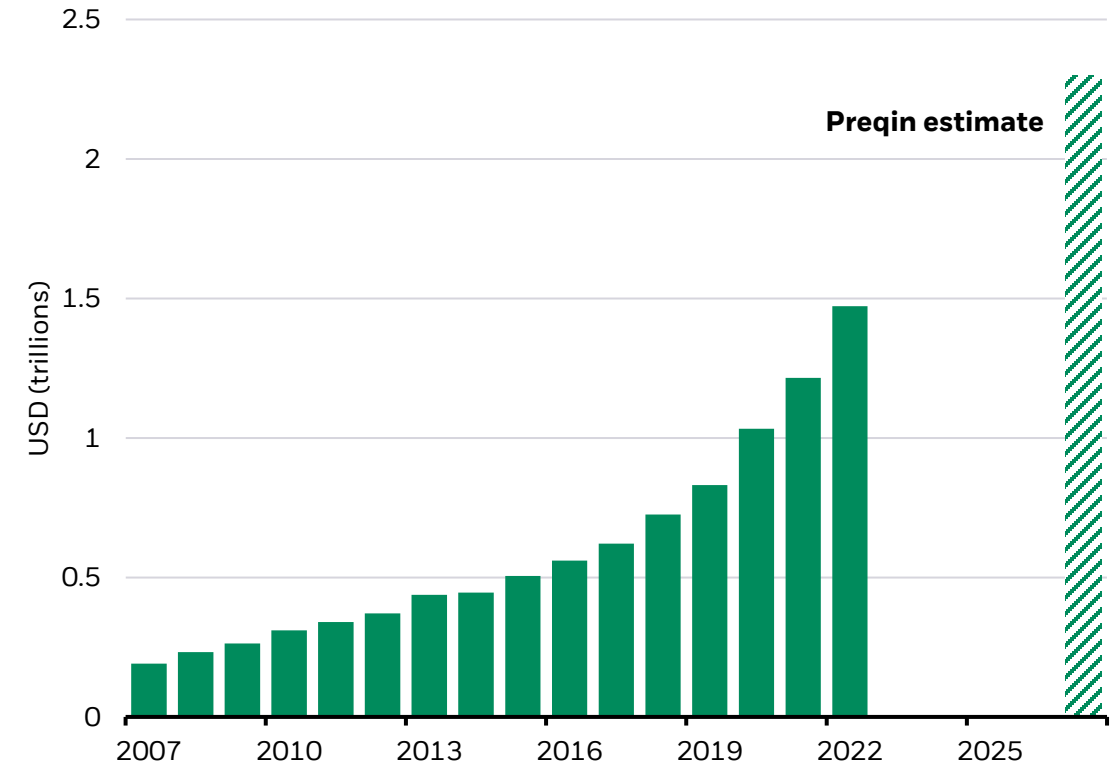
We see companies turning to alternative sources of credit as bank credit becomes less readily available. We expect demand for private credit to increase sharply.

U.S. non-financial business debt by source of finance



Sources: BlackRock Investment Institute, Federal Reserve, with data from Haver Analytics, September 2023. Notes: The chart shows the level of outstanding bank loans (in yellow) and debt securities and other non-bank loans (in orange) for U.S. nonfinancial business. The data are reported in the Federal Reserve U.S. financial accounts. Bank loans exclude mortgages. Both series are expressed as a share of nominal GDP. The latest data point is for 2023 Q1.

Global private debt assets under management










Forward looking estimates may not come to pass. Source: BlackRock Investment Institute, October 2023, with data from Preqin. Notes: The chart shows the assets under management (AUM) in USD trillions of the global private debt market. The 2027 estimate is a forecast from Preqin.

Tactical granular views: equities

Six- to 12-month tactical views on selected assets vs. broad global asset classes by level of conviction, December 2023

Our approach is to first determine asset allocations based on our macro outlook – and what’s in the price. The table below reflects this. It 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 it is creating more space for alpha. For example, the alpha opportunity in highly efficient DM equities markets historically has been low. That’s no longer the case, we think, thanks to greater volatility, macro uncertainty and dispersion of returns. The new regime puts a premium on insights and skill, in our view.

| Equities | View | Commentary |
|--|---|--|
| Developed markets | | |
| U.S. |  | We are underweight the broad market – still our largest portfolio allocation. Hopes for rate cuts and a soft landing have driven a rally. We see the risk of these hopes being disappointed. |
| Europe |  | We are underweight. The ECB is holding policy tight in a slowdown. Valuations are attractive, but we don’t see a catalyst for improving sentiment. |
| UK |  | 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 |  | We are overweight. We see stronger growth helping earnings top expectations. Stock buybacks and other shareholder-friendly actions are positives. Potential policy tightening is a near-term risk. |
| DM AI mega force |  | We are overweight. We see a multi-country, multi-sector AI-centered investment cycle unfolding, likely supporting revenues and margins. |
| Emerging markets | | |
| |  | |
| China |  | 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. |
| <div><div>Underweight</div><div>Neutral</div><div>Overweight</div><div>● Previous view</div></div> | | |

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Tactical granular views: fixed income

Six- to 12-month tactical views on selected assets vs. broad global asset classes by level of conviction, December 2023

| Fixed income | View | Commentary |
|---|---------|--|
| 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 | -1 | We are underweight. We prefer the U.S. over the euro area. We see markets overestimating how persistent inflation in the euro area will be relative to the U.S. |
| 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 | -1 | We are underweight. We see upside risks to yields from the Bank of Japan winding down its ultra-loose policy. |
| China govt bonds | Neutral | We are neutral. Bonds are supported by looser policy. Yet we find yields more attractive in short-term DM paper. |
| 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. |
| U.S. agency MBS | +1 | We are overweight. We see agency MBS as a high-quality exposure in a diversified bond allocation and prefer it to IG. |
| 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. |
| EM hard currency | +1 | We are overweight. We prefer emerging hard currency debt due to higher yields. It is also cushioned from weakening local currencies as EM central banks cut policy rates. |
| EM 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. |
| <div>Underweight</div> <div>Neutral</div> <div>Overweight</div> | | ● Previous view |

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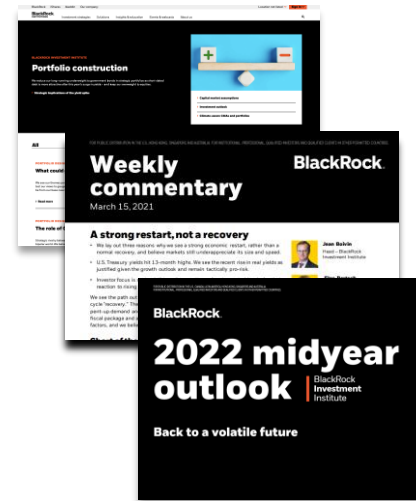


Jean Boivin
Head – BlackRock
Investment Institute

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To build robust portfolios, you need to connect the dots between economics, markets, return drivers, policy and geopolitics.

”



We generate macro, market and portfolio research to help our portfolio managers and clients navigate markets and build robust portfolios. We share our insights through publications on:

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- Portfolio design and return expectations for institutional and professional investors
- Policy and politics

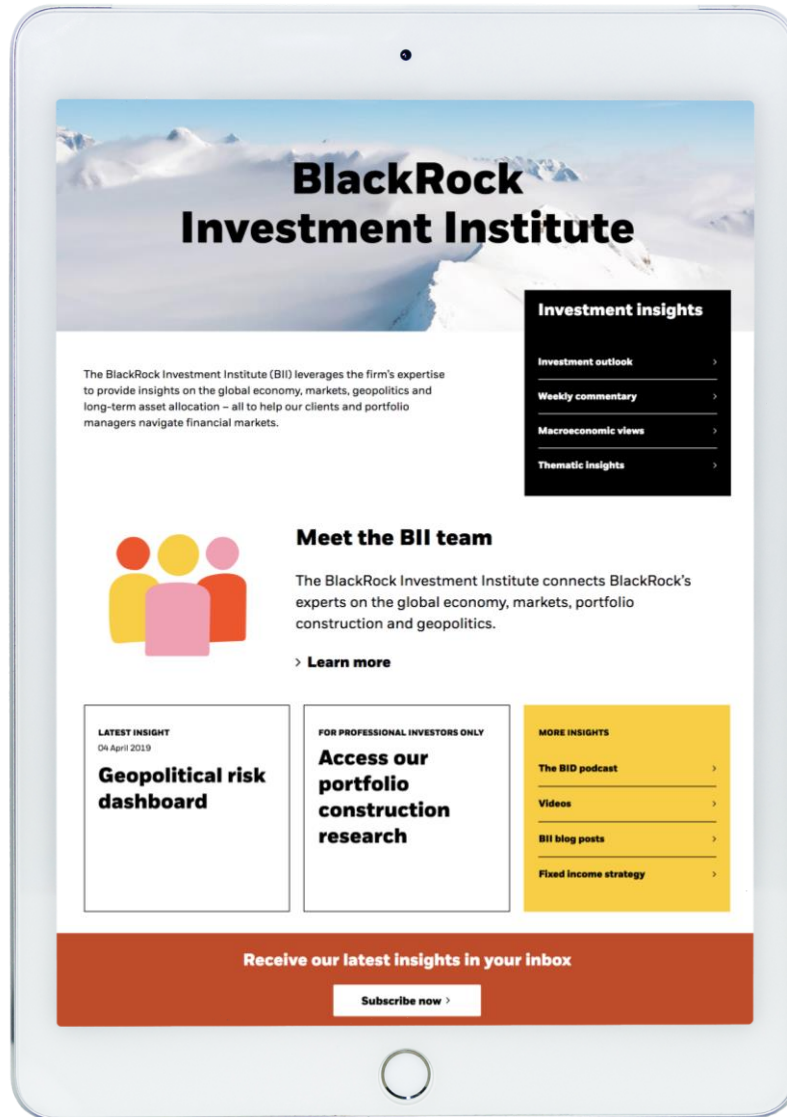


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