

# Weekly commentary

Nov. 2, 2020

**BlackRock**<sup>®</sup>

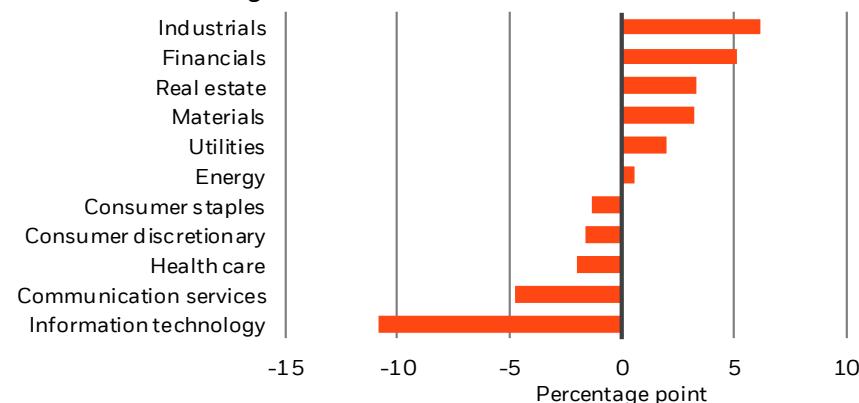
## Our latest equity views

- We update our equity views ahead of the U.S. election, including upgrading emerging market equities and introducing an overweight in the size style factor.
- A resurgence of Covid-19 cases may weigh on mobility and activity in the near term. We still see this wave of infections as shallower than the spring one.
- Democratic nominee and former Vice President Joe Biden retains his lead in national polls as the U.S. nears Election Day.

Polls are suggesting a greater likelihood of a Democratic sweep in this week's U.S. election. We are starting to incorporate themes we believe would outperform in that event, moving toward a more pro-risk stance overall despite last week's market pullback. We debut an overweight in the U.S. size style factor, and upgrade broad emerging market (EM) and Asia ex-Japan equities to overweight.

## Chart of the week

Relative sector weight of MSCI USA Low Size Index, 2020



Sources: BlackRock Investment Institute and MSCI, data as of Sept. 30, 2020. Notes: The bars show the weights of sectors on the MSCI USA Low Size Index minus those on the parent MSCI USA Index.

Large-cap technology stocks have driven U.S. equity market performance this year. We believe a repeat is unlikely in 2021, and see potential for smaller companies to outperform, especially in the case of a Democratic sweep that would result in significant fiscal stimulus. This electoral outcome also would likely lead to a new global minimum tax and more strenuous anti-trust review – which could weigh on large-cap tech and pharmaceutical companies. A boost in infrastructure spending could lend support to companies in industrials and materials – many of them small in size. We introduce an overweight in the size style factor in the U.S. market to capture our preference for smaller, high-growth companies. The chart above illustrates what underpins our view: The MSCI USA Low Size Index has a much higher share of industrials – and much lower exposure to information technology and communication services – than the parent MSCI USA Index. Meanwhile we downgrade minimum volatility to underweight, as we expect a cyclical upswing over the next six to 12 months – an environment where min vol typically lags in performance. This comes as U.S. earnings reports for the third quarter have beaten expectations.



**Mike Pyle**

Global Chief Investment Strategist – BlackRock Investment Institute



**Elga Bartsch**

Head of Macro Research – BlackRock Investment Institute



**Kurt Reiman**

Senior Strategist for North America – BlackRock Investment Institute



**Tara Sharma**

Member of the Macro Research team – BlackRock Investment Institute

Visit [BlackRock Investment Institute](#) for insights on global economy, markets and geopolitics.

**BlackRock  
Investment  
Institute**

We are also updating some of our regional equity market views. This includes upgrading broad EM equities to overweight. Positive spillovers to global growth from increased fiscal stimulus, more predictable U.S. trade and foreign policy and the prospect of a weaker dollar amid negative U.S. real rates in the event of a Democratic sweep would all bode well for EM assets, we believe. We also downgrade Japanese equities to underweight. That said, we are not outright negative on this market. We just expect Japanese stocks to benefit less than other Asian markets and EM in general from a recovery in global trade: A weaker dollar could send the Japanese yen up, putting pressure on the country's export sector.

The evolving virus dynamics are another key factor. We are upgrading Asia ex-Japan equities and Asia fixed income to overweight, as China and other Asian economies have done a better job of containing Covid – and are further ahead in the economic restart. We expect this dynamic to continue over the months ahead. We are downgrading European equities to neutral. A resurgence in Covid cases has triggered lockdowns on local and national levels – albeit with more flexibility than earlier in the year – just as the economic restart shows signs of weakness. The renewed restrictions are already putting pressure on activity in the region. We still like euro area peripheral bonds due to the European Central Bank's easing stance.

The bottom line: We are taking another step toward a pro-risk stance despite last week's market pullback and the uncertainties just ahead. This follows our tactical move last week to downgrade U.S. Treasuries and upgrade their inflation-linked peers on a growing likelihood of significant fiscal expansion. A Democratic sweep outcome in the election would tip us to a more pro-risk stance overall, strengthening our conviction that a cyclical upswing will benefit risk assets over a 6-12 month horizon.

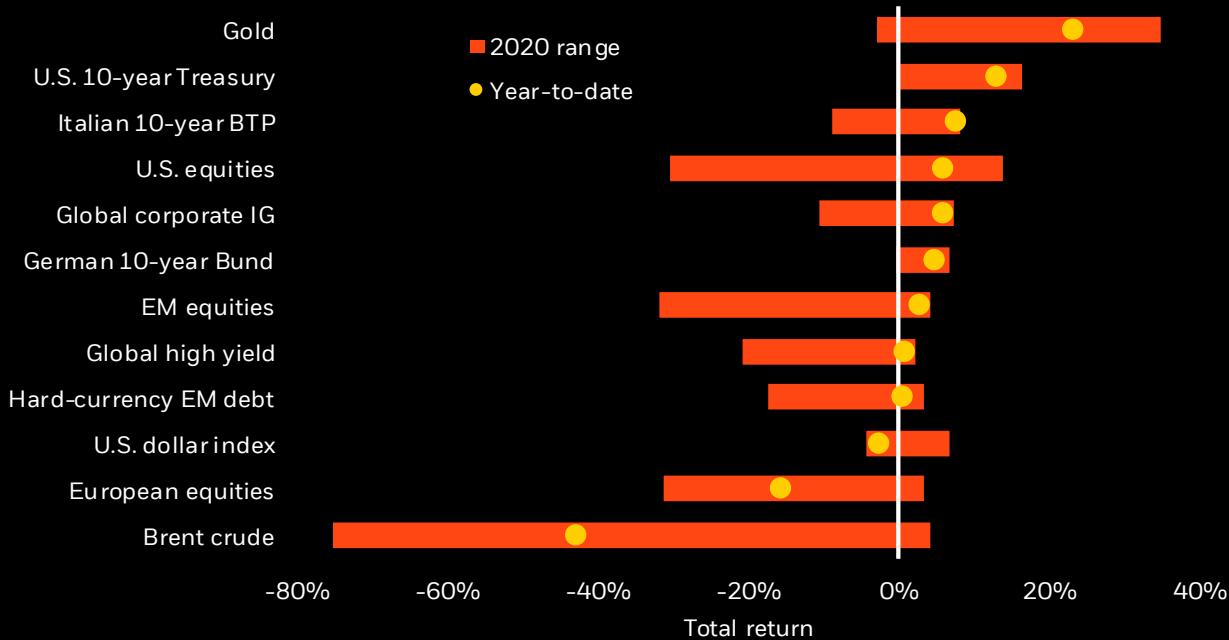
The key risk to our view: There is a material probability of an election outcome that would deliver much less fiscal stimulus. That's why our moves to a pro-risk stance have been partial to date and granular in nature. There is also a chance of a contested election, but we believe there are mechanisms for resolving this. We prefer to look through any market volatility that a delayed result would likely bring and favor taking advantage of any selloffs in risk assets during this period of uncertainty to add to high-conviction positions. See our [U.S. elections primer](#) for key election scenarios and investment implications.

## Market backdrop

The current wave of Covid infections is still smaller than that of March and April, after adjusting for the increased testing capacity today. Yet an acceleration in hospitalization rates has triggered restrictions on local and national levels in Europe, though they are less stringent than during the initial wave. The economic restart has been quicker than expected, but the economic restart looks to face significant challenges in the near term. All eyes are on the U.S. election given the significant policy and market implications.

## Assets in review

Selected asset performance, 2020 year-to-date and range



**Past performance is not a reliable indicator of current or future results. Indexes are unmanaged. It is not possible to invest directly in an index.** Sources: BlackRock Investment Institute, with data from Refinitiv Datastream, October 2020. Notes: The two ends of the bars show the lowest and highest returns at any point this 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 gold, Datastream 10-year benchmark government bond (U.S., German and Italy), MSCI USA Index, Bank of America Merrill Lynch Global Broad Corporate Index, MSCI Emerging Markets Index, J.P. Morgan EMBI index, Bank of America Merrill Lynch Global High Yield Index, the ICE U.S. Dollar Index (DXY), MSCI Europe Index and spot Brent crude.

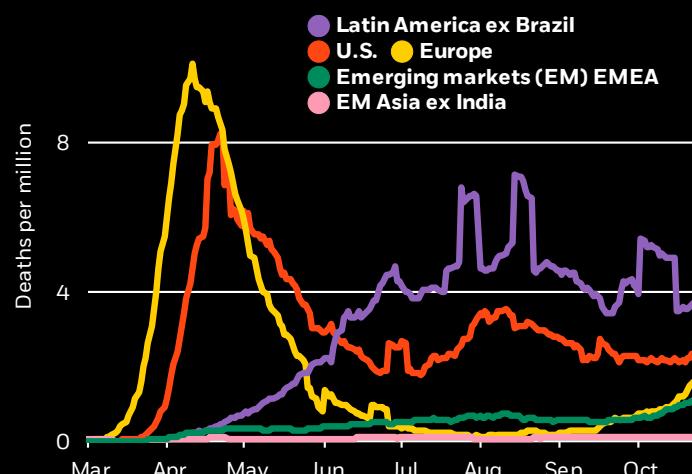
## Macro insights

The hit from Covid-19 – and the outlook for economic recovery – varies widely across EMs. The disparity in the number of deaths is especially stark. Latin America has suffered more greatly than Asia. See the chart.

China is the only country expected to have positive GDP growth in 2020, according to the International Monetary Fund. Production and exports have rebounded in South Korea and Taiwan. Yet the outlook is less optimistic in other countries. For example, activity in India well below its pre-Covid levels. EM economies also vary in their ability to mobilize policy to bridge income gaps. Concerns around long-term monetary and financial stability have limited policy space. Inflation pressures could hinder the scope for further easing, alongside weaker currencies. This is most acute in Latin America and Turkey. EM debt to GDP ratios could reach the highest levels in the past 30 years, the IMF says, exceeding 100% in Brazil. Yet as long as U.S. monetary policy remains accommodative, the risk of an abrupt tightening in financial conditions remains low.

## Stark divergence within EM

Regional daily new Covid-19 deaths per capita



Sources: BlackRock Investment Institute and the European Centre for Disease Prevention and Control, Oct. 2020. Notes: The chart shows daily new Covid-19 deaths for each county or region.

## Investment themes

### 1 Activity restart

- The activity restart is moving into a more difficult phase just as a flare-up of coronavirus infections prompts tighter restrictions. The initial phase of the economic restart has been quicker than expected, as reflected by the IMF's recent upgrade to its global growth outlook. We see the hardest part lying ahead.
- The sharp rise in Covid hospitalization rates in Europe has led to restrictions on local and national levels – albeit not as stringent as in the spring. The current wave is still smaller than the initial one, correcting for more testing. The next few weeks will be key in containing the virus – and in determining if more restrictions will be needed.
- Evidence of permanent damages is limited so far for economies as a whole but the adjustment to a post-Covid world could be painful, especially for contact-intensive sectors if mobility is curtailed for an extended period of time.
- Market implication:** We are moderately pro-risk, and express it in an overweight in high yield on both a strategic and tactical horizon. We are tactically overweight broad EM, Asia ex-Japan equities and the size style factor in the U.S., and have closed our overweight in European equities.

### 2 Policy revolution

- The joint fiscal-monetary coordination in response to the Covid-19 shock is nothing short of a policy revolution. The Federal Reserve is leading major central banks in evolving policy frameworks to explicitly aim to let inflation overshoot targets – a desirable move in the current environment but the lack of proper guardrails raise concerns.
- The combined sum of fiscal and monetary actions is covering the virus hit to the economy in both the U.S. and euro area, our [analysis](#) shows. Yet the recent surge in Covid cases is driving up the need for further policy support.
- Risks of policy fatigue are rising. There are growing concerns that the U.S. recovery may lose steam without further fiscal stimulus. The likelihood of additional fiscal stimulus before a new Congress is seated in early 2021 looks to be dwindling. The European Central Bank has committed to take new action in its December policy meeting.
- Europe's historic recovery fund will introduce mutualized debt and create jointly issued European bonds that can compete with other perceived safe-haven assets. It still needs approvals by the European and national parliaments.
- The blurring of monetary and fiscal policy means that it is crucial to have proper guardrails around policy coordination. In their absence we see a risk that major central banks could lose grip of inflation expectations relative to their target levels. Combined with other structural changes accelerated by Covid such as deglobalization, it could lead to a higher inflation regime in the next five years.
- Market implication:** We are underweight nominal government bonds and like inflation-linked bonds on both strategic and tactical horizons. Tactically we prefer high yield and see U.S. equities vulnerable to fading fiscal stimulus and the unwinding of crowded positions in technology stocks.

### 3 Real resilience

- Supercharged structural trends are changing the nature of portfolio diversification. We see countries, sectors and companies making a comeback as potential diversifiers in a fragmented world, offering resilience to these trends.
- Portfolio resilience has to go beyond broad asset class diversification alone. We believe investors should consider alternative return sources that can provide potential diversification.
- A focus on sustainability makes portfolios more resilient, in our view. We believe the adoption of sustainable investing is a [tectonic shift](#) carrying a return advantage for years to come – and the coronavirus shock seems to be accelerating this shift.
- Market implication:** We prefer sustainable assets, private markets and deliberate country diversification on a strategic basis. We are overweight the quality factor on a tactical horizon, favor assets with policy backstops.

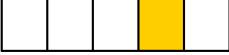
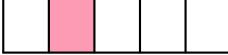
## Week ahead

<b>Nov. 2</b>	IHS Markit manufacturing purchasing managers' index (PMI) for China (Caixin), Japan euro area, the U.S.	<b>Nov. 5</b>	Federal Open Market Committee meeting; Bank of England policy meeting
<b>Nov. 3</b>	U.S. election	<b>Nov. 6</b>	U.S. nonfarm payrolls

All eyes are on the U.S. election this week. Democratic nominee and former Vice President Joe Biden has held a steady lead in national polls over President Donald Trump, though in battleground states his lead is narrower. The outcome of the election will have significant implications for policies and markets. Read our election primer here ([LINK](#)).

## Directional views

Strategic (long-term) and tactical (6-12 month) views on broad asset classes, November 2020

Asset	Strategic view	Tactical view	
<b>Equities</b>	 Neutral	 Neutral	We are neutral on equities on a strategic horizon given increased valuations and a challenging backdrop for earnings and dividend payouts. We move to a modest underweight in DM equities and tilt toward EM equities. Tactically, we are also neutral on equities overall. We like the quality factor for its resilience and favor Europe among cyclical exposures.
<b>Credit</b>	 Neutral	 +1	We are neutral on credit on a strategic basis because we see investment grade (IG) spreads offering less compensation for any increase in default risks. We still like high yield for income. On a tactical horizon, we strongly prefer high yield for its income and more room for spread tightening. We are neutral on IG and underweight emerging market debt.
<b>Govt bonds</b>	 -1	 Neutral	The strategic case for holding nominal government bonds has materially diminished with yields closer to perceived lower bounds. Such low rates reduce the asset class's ability to act as ballast against equity market selloffs. We prefer inflation-linked bonds as we see risks of higher inflation in the medium term. On a tactical basis, we keep duration at neutral as unprecedented policy accommodation suppresses yields.
<b>Cash</b>		 Neutral	We are neutral on cash. Holding some cash makes sense, in our view, as a buffer against supply shocks that could drive both stocks and bonds lower.
<b>Private markets</b>	 Neutral		Non-traditional return streams, including private credit, have the potential to add value and diversification. Many institutional investors remain underinvested in private markets as they overestimate liquidity risks, in our view. Private assets reflect a diverse array of exposures but valuations and inherent uncertainties of some private assets keep us neutral overall.

Note: Views are from a U.S. dollar perspective, November 2020. 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.

# Granular views

Change in view

Previous

New

Six to 12-month tactical views on selected assets vs. broad global asset classes by level of conviction, November 2020

Asset	Underweight	Overweight	
Equities	United States		We are neutral on U.S. equities. Risk of fading fiscal stimulus and an extended epidemic weigh on markets. Renewed U.S.-China tensions and a divisive election also weigh.
	Euro area	←	We downgrade European equities to neutral. Covid cases have surged just as the economic restart appears to be losing steam. Renewed restrictions are weighing on activity.
	Japan	↔	We downgrade Japanese equities to overweight. A weaker dollar may be reflected in a stronger yen, weighing on Japanese exporters. Other Asian economies may be greater beneficiaries of more predictable U.S. trade policy.
	Emerging markets	↔	We upgrade broad EM equities to overweight on rising probability of a Democratic sweep outcome, as a large fiscal spending, more stable foreign policy, a weaker dollar and negative real rates would benefit EM assets.
	Asia ex-Japan	→	We upgrade Asia ex-Japan equities to overweight. China and a number of other Asian countries have done a better job of containing the virus – and are further ahead on the road to economic recovery.
	Momentum		We keep momentum at neutral. The sectoral composition of the factor provides exposure to both growth (tech) and defensive stocks (pharma). Yet momentum's high concentration poses risks as recovery takes hold.
	Value		We are neutral on value. We see the ongoing restart of economies likely benefiting cyclical assets and potentially helping value stage a rebound after a long stretch of underperformance.
	Minimum volatility	↔	We downgrade min vol to overweight. We expect a cyclical upswing over the next six to 12 months, and min vol tends to lag in such an environment.
	Quality	→ ←	We reduce our overweight on quality by a notch as the election could lead to a cyclical expansion where quality appears less attractive. We see it as resilient against a range of outcomes in the pandemic and economy.
	Size	→	We debut size, a new addition to our style factor lineup, at overweight. Small- and mid-cap companies in the U.S. are set to benefit from fiscal expansion under a potential Democratic sweep.
Fixed Income	U.S. Treasuries	↔	We downgrade U.S. Treasuries to overweight. The potential for fiscal spending – particularly in a Democratic sweep election outcome – could spur higher yields and a steeper yield curve.
	Treasury Inflation-Protected Securities	→	We upgrade TIPS to overweight. We see potential for higher inflation expectations to get increasingly priced in on the back of loose monetary policy, greater fiscal stimulus and increasing production costs.
	German bunds		We upgrade bunds to neutral. We see the balance of risks shifting back in favor of more monetary policy easing from the European Central Bank as the regional economic rebound shows signs of flagging.
	Euro area peripherals	→	We are overweight euro area peripheral government bonds despite recent outperformance. We see further rate compression due to stepped-up quantitative easing by the European Central Bank and other policy actions.
	Global investment grade		We hold investment grade credit at neutral. We see little room for further yield spread compression. Central bank asset purchases and a broadly stable rates backdrop still are supportive.
	Global high yield	→ →	We keep our strong overweight on high yield. We see the very high implied default rates as overly pessimistic, and high yield remains an attractive source of income in a yield-starved world.
	Emerging market – hard currency	↔	We are overweight hard-currency EM debt due to the pandemic's spread, heavy exposure to energy exporters and limited policy space in some emerging economies. Default risks may be underpriced.
	Emerging market – local currency	↔	We are still overweight local-currency EM debt. We see many EM countries as having insufficient capacity to rein in the virus spread and limited policy space to cushion the shock from the pandemic.
	Asia fixed income	→	We upgrade Asia fixed income to overweight. China and other Asian countries have done better in containing the virus and are further ahead on economic recovery.

# BlackRock Investment Institute

The BlackRock Investment Institute (BII) leverages the firm's expertise and generates proprietary research 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. BII offers strategic and tactical market views, publications and digital tools that are underpinned by proprietary research.

**General disclosure:** This material is intended for information purposes only, and does not constitute investment advice, a recommendation or an offer or solicitation to purchase or sell any securities to any person in any jurisdiction in which an offer, solicitation, purchase or sale would be unlawful under the securities laws of such jurisdiction. The opinions expressed are as of Nov. 2, 2020, and are subject to change without notice. Reliance upon information in this material is at the sole discretion of the reader. Investing involves risks. Asset allocation and diversification does not guarantee investment returns and does not eliminate the risk of loss.

In the **U.S. and Canada**, this material is intended for public distribution. **In EMEA** Until 31 December 2020, issued by BlackRock Investment Management (UK) Limited, authorised and regulated by the Financial Conduct Authority. Registered office: 12 Throgmorton Avenue, London, EC2N 2DL. Tel: +44 (0)20 7743 3000. Registered in England and Wales No. 2020394, has issued this document for access by Professional Clients only and no other person should rely upon the information contained within it. For your protection telephone calls are usually recorded. Please refer to the Financial Conduct Authority website for a list of authorised activities conducted by BlackRock. From 31 December 2020, in the event the United Kingdom and the European Union do not enter into an arrangement which permits United Kingdom firms to offer and provide financial services into the European Union, the issuer of this material is: (i) BlackRock Investment Management (UK) Limited for all outside of the European Union; and (ii) BlackRock (Netherlands) B.V. for in the European Union, BlackRock (Netherlands) B.V. is authorised and regulated by the Netherlands Authority for the Financial Markets. Registered office Amstelplein 1, 1096 HA, Amsterdam, Tel: 020 – 549 5200, Tel: 31-20-549-5200. Trade Register No. 17068311. For your protection telephone calls are usually recorded. **In Switzerland**, this document is marketing material. This document shall be exclusively made available to, and directed at, qualified investors as defined in the Swiss Collective Investment Schemes Act of 23 June 2006, as amended. **For investors in Israel:** BlackRock Investment Management (UK) Limited is not licensed under Israel's Regulation of Investment Advice, Investment Marketing and Portfolio Management Law, 5755-1995 (the "Advice Law"), nor does it carry insurance thereunder. **In South Africa**, please be advised that BlackRock Investment Management (UK) Limited is an authorized financial services provider with the South African Financial Services Board, FSP No. 43288. **In the DIFC** this material can be distributed in and from the Dubai International Financial Centre (DIFC) by BlackRock Advisors (UK) Limited – Dubai Branch which is regulated by the Dubai Financial Services Authority (DFSA). This material is only directed at 'Professional Clients' and no other person should rely upon the information contained within it. **In the Kingdom of Saudi Arabia** this information is only directed to Exempt Persons, Authorized Persons or Investment Institutions, as defined in the relevant implementing regulations issued by the Capital Markets Authority (CMA). **In the United Arab Emirates** this material is only intended for -natural Qualified Investor as defined by the Securities and Commodities Authority (SCA) Chairman Decision No. 3/R.M. of 2017 concerning Promoting and Introducing Regulations. Neither the DFSA or any other authority or regulator located in the GCC or MENA region has approved this information. **In the State of Kuwait**, those who meet the description of a Professional Client as defined under the Kuwait Capital Markets Law and its Executive Bylaws. **In the Sultanate of Oman**, to sophisticated institutions who have experience in investing in local and international securities, are financially solvent and have knowledge of the risks associated with investing in securities. **In Qatar**, for distribution with pre-selected institutional investors or high net worth investors. **In the Kingdom of Bahrain**, to Central Bank of Bahrain (CBB) Category 1 or Category 2 licensed investment firms, CBB licensed banks or those who would meet the description of an Expert Investor or Accredited Investors as defined in the CBB Rulebook. The information contained in this document, does not constitute and should not be construed as an offer of, invitation, inducement or proposal to make an offer for, recommendation to apply for or an opinion or guidance on a financial product, service and/or strategy. **In Singapore**, this is issued by BlackRock (Singapore) Limited (Co. registration no. 200010143N). This advertisement or publication has not been reviewed by the Monetary Authority of Singapore. **In Hong Kong**, this material is issued by BlackRock Asset Management North Asia Limited and has not been reviewed by the Securities and Futures Commission of Hong Kong. **In South Korea**, this material is for distribution to the Qualified Professional Investors (as defined in the Financial Investment Services and Capital Market Act and its sub-regulations). **In Taiwan**, independently operated by BlackRock Investment Management (Taiwan) Limited. Address: 28F., No. 100, Songren Rd., Xinyi Dist., Taipei City 110, Taiwan. Tel: (02)23261600. **In Japan**, this is issued by BlackRock Japan, Co., Ltd. (Financial Instruments Business Operator: The Kanto Regional Financial Bureau. License No.375, Association Memberships: Japan Investment Advisers Association, the Investment Trusts Association, Japan, Japan Securities Dealers Association, Type II Financial Instruments Firms Association.) For Professional Investors only (Professional Investor is defined in Financial Instruments and Exchange Act). **In Australia**, issued by BlackRock Investment Management (Australia) Limited ABN 13 006 165 975 AFSL 230 523 (BIMAL). The material provides general information only and does not take into account your individual objectives, financial situation, needs or circumstances. **In China**, this material may not be distributed to individuals resident in the People's Republic of China ("PRC", for such purposes, excluding Hong Kong, Macau and Taiwan) or entities registered in the PRC unless such parties have received all the required PRC government approvals to participate in any investment or receive any investment advisory or investment management services. **For Other APAC Countries**, this material is issued for Institutional Investors only (or professional/sophisticated/qualified investors, as such term may apply in local jurisdictions). **In Latin America**, for institutional investors and financial intermediaries only (not for public distribution). No securities regulator within Latin America has confirmed the accuracy of any information contained herein. The provision of investment management and investment advisory services is a regulated activity in Mexico thus is subject to strict rules. For more information on the Investment Advisory Services offered by BlackRock Mexico please refer to the Investment Services Guide available at [www.blackrock.com.mx](http://www.blackrock.com.mx).

©2020 BlackRock, Inc. All Rights Reserved. **BLACKROCK** is a trademark of BlackRock, Inc., or its subsidiaries in the United States and elsewhere. All other trademarks are those of their respective owners.



Not FDIC Insured • May Lose Value • No Bank Guarantee