



# Global Investment Outlook

Q2 2018



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We update our three 2018 investment themes against a backdrop of synchronised global growth, rising inflation and interest rates, higher equity market volatility and more economic uncertainty. We detail our asset class preferences and highlight two key risks to the global expansion and risk assets: trade wars and a spike in real yields.

- **2018 themes:** the US tax overhaul and public spending plans have supercharged growth and earnings estimates at a time when the US economy is already humming. This adds uncertainty to the economic outlook: potential for greater business spending and productivity growth, but also a risk of overheating and rising risk premia. Inflation has picked up, keeping the Federal Reserve on track to raise rates, but is not high or sticky enough to reverse monetary easing in the eurozone or Japan. We see the overall environment as positive for risk assets, but expect more muted returns and higher volatility than in 2017.
- **Risks:** rising US protectionism is the clearest menace to the near-term global outlook, in our view. We see increasing US actions against China and other countries sparking bouts of volatility but not derailing the benign economic and market backdrop. Yet any escalation into a trade war could deal knock-on blows to sentiment and change our view. A renewed surge in bond yields is another risk, but we believe equities can do well as long as yield rises are steady and driven by improving growth.
- **Market views:** we like equities. US earnings revisions have rocketed higher to factor in the boon from lower corporate taxes - and earnings momentum is rising across the world. We favour US and emerging market (EM) equities but we see choppier markets and less-heady returns than last year ahead. We prefer technology, financials and the momentum style factor. We are negative on government bonds overall but see short-maturity Treasuries now offering a compelling risk/reward proposition. We are neutral on credit amid tight spreads and increasing sensitivity to rate rises.



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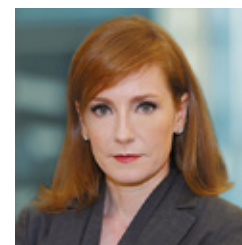
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## Setting the scene

**The synchronised global economic expansion rolls on.** Consensus G7 growth forecasts have snuck past our *BlackRock Growth GPS*. Fiscal stimulus tees up the US economy as the top candidate for an upside growth surprise, whereas growth expectations for the eurozone look to have overshot, with room for disappointments. See the *Charging up* chart.

The US fiscal overhaul adds a dose of economic uncertainty. It could overheat the economy, shortening the cycle. Yet we think overheating can be contained if an ongoing rebound in business investment lifts potential growth and reinforces a global trade upswing. This trade pickup and a softer US dollar have supported EMs. A more protectionist US trade stance could undermine this dynamic and exacerbate any cooling of China's economy. See our March *Global macro outlook* for details.

*The synchronised global economic expansion is rolling on, but we see a wider array of potential outcomes ahead as the cycle matures.*

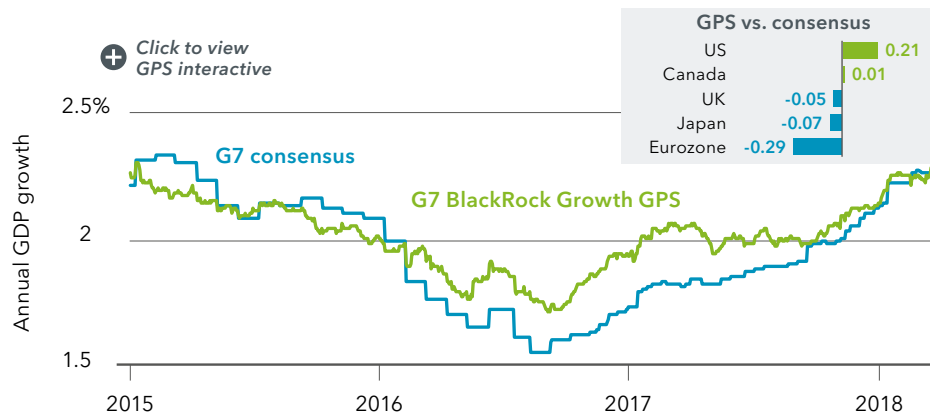
**The economic backdrop is holding firm, yet signs of a market transition are emerging.** We have seen rising yields, sharp equity pull-backs and signs that inflation risks are becoming more two-way. Volatility (vol) is picking up across asset classes. The bouts of equity market vol in 2018 show that the eye-popping risk-adjusted returns of 2017 – robust returns flattered by abnormally low vol – are likely a thing of the past.

This year is proving more 'normal' so far. Equity vol has risen to levels more consistent with previous low-vol regimes. We have seen greater return dispersion across and within asset classes. Performance has been mixed – even as last year's winners, such as EM equities and the momentum style factor, again lead the pack so far. See the *We're not in 2017 anymore* chart. Rising rates challenge both bond prices and equity margins, and valuations remain elevated across most markets. Yet earnings growth is a powerful tonic for equities, and we still see an attractive risk/reward tradeoff.

*We expect mixed and bumpy asset performance after a year of unusually low equity market volatility and steady returns.*

## Charging up

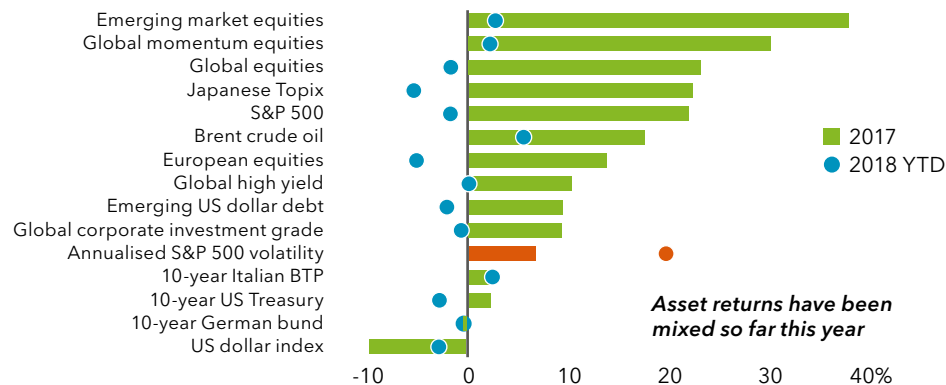
BlackRock Growth GPS vs. G7 consensus, 2015-2018



Sources: BlackRock Investment Institute, with data from Bloomberg and Consensus Economics, March 2018.  
Notes: The BlackRock Growth GPS shows where the 12-month forward consensus GDP forecast may stand in three months' time. The G7 consensus is the current 12-month consensus GDP forecast as measured by Consensus Economics. The inset chart shows the current difference in percentage points between the BlackRock GPS and consensus for the countries/regions shown. The eurozone is a GDP-weighted composite of our German, French, Italian and Spanish series.

## We're not in 2017 anymore

Asset performance: full-year 2017 vs. 2018 year-to-date



**Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index.**  
Sources: BlackRock Investment Institute, with data from Thomson Reuters, March 2018.  
Notes: 2018 data are through March 27. The bars show total returns, except volatility (annualised daily realised level). Indexes or prices used are, from top to bottom: MSCI Emerging Markets (in USD), MSCI World Momentum (USD), MSCI World (USD), TOPIX (local currency), S&P 500 (USD), Brent crude spot (USD), MSCI Europe (local), Bank of America Merrill Lynch Global High Yield (multi-currency), JP Morgan EMBI Global Composite (USD), Bank of America Merrill Lynch Global Broad Corporate (multi), Datastream 10-Year Benchmark Government Bond (Italy, US and Germany; local) and DXY (USD).

## Theme 1: Room to run

### The US economy is getting a fiscal shot in the arm just as it reaches full capacity.

This is the first time in decades that hefty US stimulus is coming outside of a recession. We see tax cuts and public spending adding about one percentage point to growth this year. See the *Hello, big stimulus* chart.

Faster growth could hasten the expansion's expiration date if it does not come with increased productivity. The tax overhaul gives businesses an incentive to further boost investment after years of caution. See [page 9](#). Greater capex and pent-up productivity gains from technology investment could lift potential growth over time, helping to contain any overheating. See our February [Global macro outlook](#) for details. A capex upswing may also help drive EM export growth, reinforcing the global cycle, we find. EM growth is set to quicken in 2018, even if China modestly slows. We see still robust growth in Europe, albeit at a slower pace than consensus, with ample spare capacity left.

*US fiscal stimulus could shorten the cycle, but an ongoing investment rebound may lift potential growth and help contain overheating.*

### We see synchronised global growth providing a solid foundation for equities.

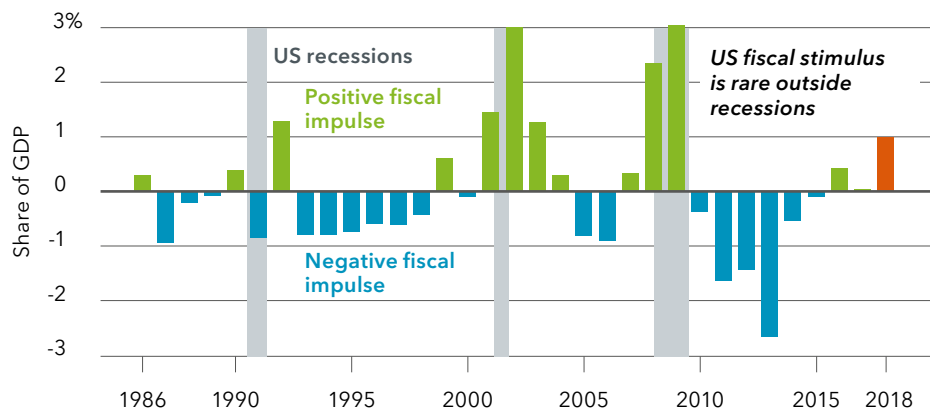
US tax and spending plans have lit a fire under earnings growth, which was already gaining momentum on the back of economic strength. The *Earnings power* chart shows US earnings upgrades relative to downgrades have shot up as analysts factor in the stimulus. The earnings revision trend goes beyond the US and makes for the healthiest global earnings outlook since the post-crisis bounce. We like equities elsewhere too, with EM stocks at the top of our list.

Dividend payouts and share buybacks are another support, particularly in the US as companies look to deploy their tax windfalls. Combined with earnings growth, we see these returns of capital to shareholders offsetting some valuation challenges: investors are typically unwilling to bid up equity valuation multiples when rising interest rates and inflation threaten to erode corporate profit margins.

*Equities look appealing amid a solid economic backdrop and earnings momentum supercharged by US fiscal stimulus.*

## Hello, big stimulus

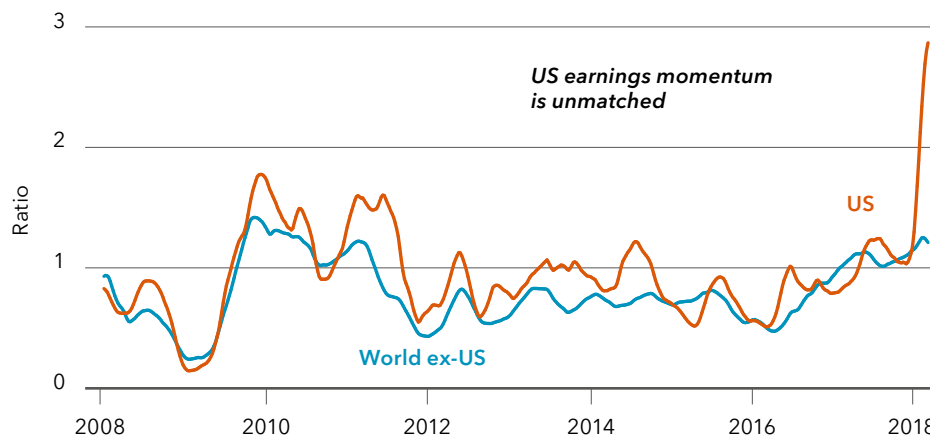
US fiscal impulse, 1986-2018



Sources: BlackRock Investment Institute, with data from the Organisation for Economic Cooperation and Development (OECD), March 2018. Notes: The fiscal impulse gauges the annual impact of fiscal policy on GDP growth, measured by the change in the primary US fiscal deficit (excluding net interest costs) as a share of GDP. OECD figures are cyclically adjusted. The orange bar is a full-year 2018 BlackRock estimate of tax cuts (+0.4 percentage point) and spending increases (+0.6 percentage point), both based on a multiplier below one because late-cycle stimulus typically has reduced knock-on effects.

## Earnings power

Corporate earnings revision ratios, 2008-2018



Sources: BlackRock Investment Institute, with data from Thomson Reuters, February 2018. Notes: The lines show the three-month moving average of the number of companies in the MSCI USA and All-Country World ex-US indexes with 12-month forward earnings-per-share (EPS) estimates revised up in the previous month divided by the number of companies with downward revisions. A ratio above one means there are more upgrades than downgrades.

## Theme 2: Inflation comeback

**Inflation is perking up, led by the US.** Our Inflation GPS points to further upside around the world, a big shift from 2017. The **US Inflation GPS** has consumer price inflation near 2.4%, enough to pull Personal Consumption Expenditures inflation, the Fed's preferred gauge, near its 2% target. This gives us confidence the central bank will likely forge ahead with raising rates. We do not see inflation sailing far above 2%, but the risks are now two-way after years of deflation fears dominating. See the *On the rise* chart.

Our GPS sees some upside for eurozone inflation but expects it to remain well below the European Central Bank's (ECB) target. As a result, we expect the ECB to stop adding to net asset purchases by the year's end but to hold off on raising rates until mid-2019. Japanese inflation has edged up from very low levels. We believe the Bank of Japan (BoJ) wants to see a sustained rise to above 1% before adjusting its yield curve target and asset purchases.

**US inflation is moving back toward target. Inflation remains muted in Europe and Japan, supporting ongoing monetary accommodation there.**

**Markets have long doubted the Fed's resolve to normalise monetary policy.**

The market-implied path of interest rates for the coming 12 months has lagged that indicated by Federal Open Market Committee (FOMC) policymakers. Markets have now caught up. Two additional rate rises are priced in for 2018, and we could see three due to robust growth and moderately rising inflation. For 2019 and 2020, however, the Fed remains ahead of the market. See the *Bowing to the Fed* chart.

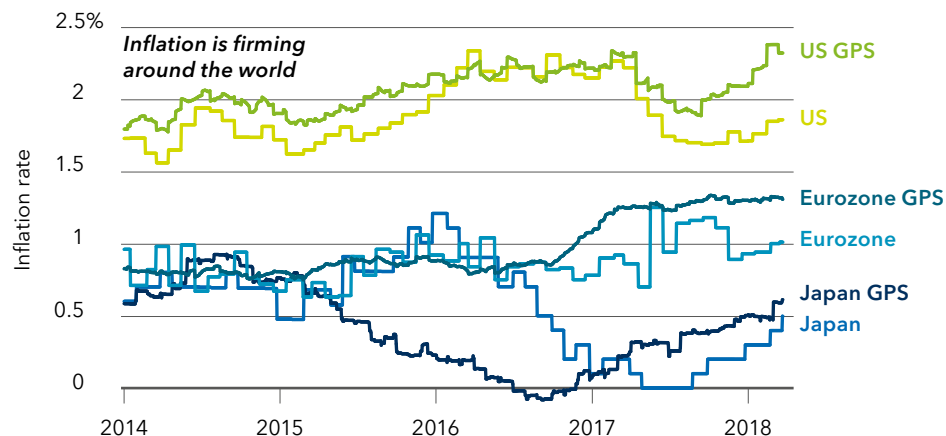
An even faster pace of tightening appears unlikely for now. We could see temporary inflation overshoots, but it will likely take some time for any economic overheating to challenge the central bank's gradual pace of normalisation. This, twinned with ongoing monetary accommodation by the ECB and BoJ, is why we expect yields to rise only gradually from here. It is also why we like shorter-maturity US debt, as detailed on [page 8](#).

**Markets have caught up with the Fed's pace of rate increases in 2018.**

**We believe this points to a stable backdrop for risk assets.**

### On the rise

Core inflation: actual vs. BlackRock GPS-implied, 2014–2018

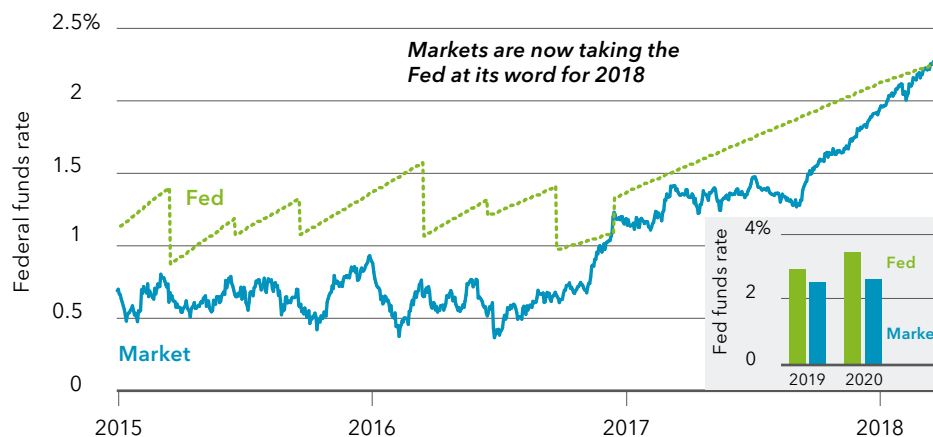


Sources: BlackRock Investment Institute, with data from Thomson Reuters, March 2018.

Notes: The inflation GPS shows where core (excluding food and energy) consumer price inflation may stand in six months' time. The lighter shaded lines show actual core CPI for the US and Japan and the harmonised index of consumer prices (HICP) for the eurozone. Japanese CPI excludes the impact of tax changes.

### Bowing to the Fed

Market vs. Fed expectations for fed funds rate, 2015–2020



Sources: BlackRock Investment Institute, with data from Bloomberg and Credit Suisse, March 2018.

Notes: The chart shows the 12-month forward market-implied fed funds rate (using overnight index swaps) versus the 12-month forward path implied by the Fed's 'dots' in its Statement of Economic Projections. The inset chart shows the Fed's dots for 2019 and 2020 versus market expectations as measured by Credit Suisse.

## Theme 3: Reduced reward for risk

**The low-vol environment has felt its first tremors of change.** February's spike in equity market vol served as the first warning sign. Volatility has historically moved in regimes – high or low – our research suggests. The low volatility of 2017 was abnormal, even in the context of low-vol regimes we have seen since 1980. See the *When low is really low* chart.

We see the low-vol regime sticking for longer, even as vol returns to more 'normal' levels. Steady, above-trend global growth is supportive of low-vol regimes, which in the past have tended to play out over many quarters. Yet we do see the potential for greater macroeconomic uncertainty – and volatility. A shot of fiscal stimulus when the US expansion is already at full capacity could lead to overheating. See [page 4](#). And the risk of tit-for-tat trade spats makes for bumpier global markets. See [page 7](#).

*Volatility is back ... sort of. We expect the current low-vol regime to persist, but see potential for episodic spikes amid rising risks.*

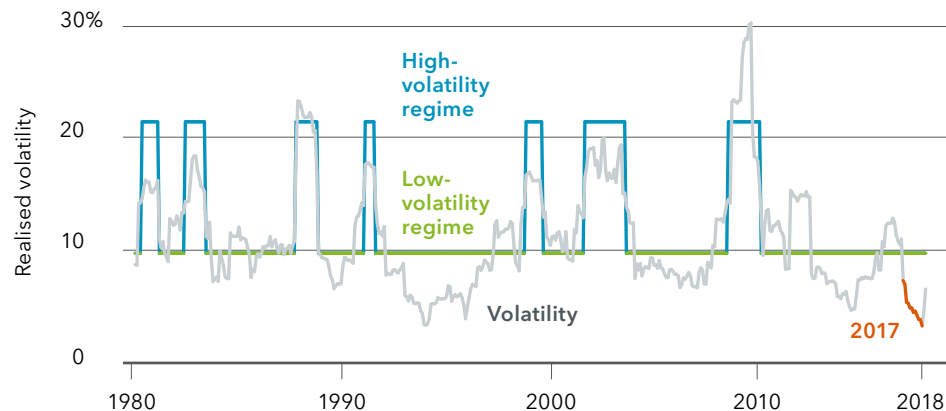
**Last year was nearly nirvana for diversified portfolios.** Returns were strong – and volatility was exceptionally low. A hypothetical global portfolio of 60% equities and 40% bonds would have seen its Sharpe ratio, a measure of returns over cash relative to realised volatility, soar in 2017. See the *Back to earth* chart. Yet more muted returns, rising cash rates and 'normal' volatility challenge this dynamic. The 60/40 portfolio's Sharpe ratio would have plunged this year.

Another challenge: as rates rise, bonds may be less effective portfolio shock absorbers. The rolling 90-day correlation of S&P 500 and 10-year US Treasury daily returns has been negative for most of the new millennium, but periodic post-crisis 'tantrums' have occasionally flipped the relationship. This means bond and stock prices can both go down at the same time. Also, the yield spread between US Treasuries and corporate bonds has tightened, meaning credit offers thinner insulation against rate rises. See [page 8](#). What to own when bonds offer less shelter? Duration will likely still work when it matters most (global risk-off events), but we prefer higher-quality and shorter-maturity bonds.

*Diversification needs a rethink as bonds work less reliably as shock absorbers.*

### When low is really low

Realised monthly US equity volatility, 1980–2018

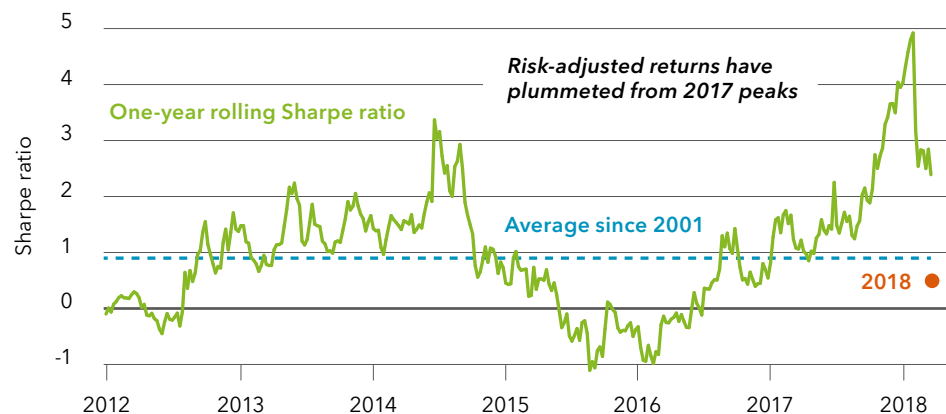


Sources: BlackRock Investment Institute and Robert Shiller, February 2018.

Notes: The grey line (volatility) shows the annualised standard deviation of monthly changes in the S&P 500 Index over a rolling 12-month period. We calculate two historic states, or regimes, for volatility: a high-volatility regime and a low-volatility regime. The green/blue lines plot the average level of volatility during each regime based on data from 1871 to 2017. The estimate of historic regime is based on an expectation-maximisation algorithm using a Markov-switching regression model.

### Back to earth

Rolling one-year Sharpe ratio of a hypothetical global 60/40 portfolio, 2012–2018



**Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index.**

Sources: BlackRock Investment Institute, with data from Bloomberg Barclays, MSCI and Thomson Reuters, March 2018.

Notes: The Sharpe ratio is calculated using the rolling one-year return of a hypothetical portfolio comprising 60% MSCI All-Country World Index and 40% Bloomberg Barclays Global Aggregate Index. We subtract the rolling one-year return of the JP Morgan three-month US Cash Index and then divide by the rolling one-year annualised daily volatility of the portfolio.

## Risks

### Rising US protectionism is a key risk to the benign economic backdrop.

Planned US tariffs on a wide range of Chinese imports have already prompted threats of retaliation. The actions test the post-WWII trade architecture long championed by the world's largest economy. Import duties have dwindled over the period. See the *Shifting trade winds* chart.

We view US trade actions targeting China more as an opening gambit for negotiations than the start of a trade war. We expect China to try to address its trade deficit with the US by opening up its markets in the medium term. We take some comfort that talks are led by seasoned trade pros on both sides. We also see a decreased chance of the US withdrawing from the North American Free Trade Agreement as negotiations appear to have become more productive. What would change our mind? Escalation triggers include the US announcing and implementing harder-hitting trade measures, the trade pros losing control of negotiations and China retaliating with meaningful trade actions or a sharp currency devaluation.

### Rising protectionism is a big risk but we do not see trade wars for now.

### The speedy rise in government bond yields this year has unnerved investors.

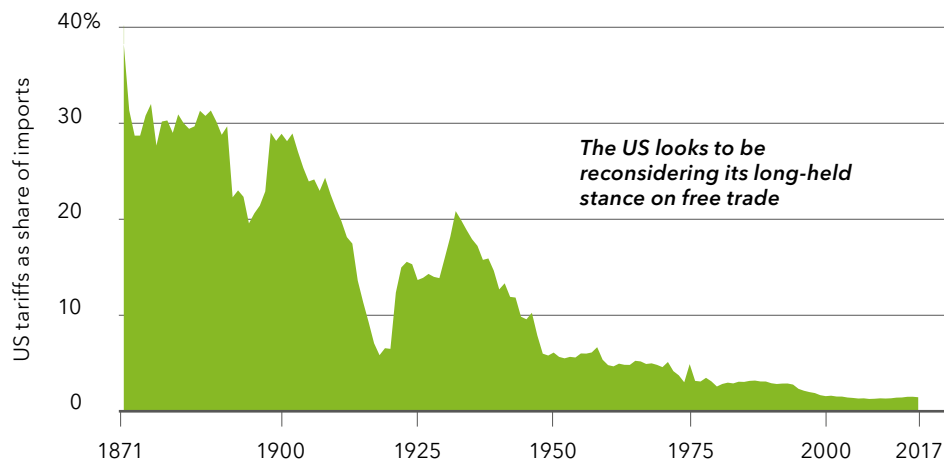
It was driven by a mix of higher inflation expectations and rising real yields on market fears of a supply glut in the short run and a re-assessment of long-term growth. We see yields climbing further, if not at the brisk pace of recent months. And we believe risk assets can do well in this scenario: improved growth implies stronger corporate earnings.

We would be more concerned about a surge in rates unrelated to the growth outlook, such as one driven by fears of central banks getting behind the curve on inflation. That would likely be reflected in a spike in the term premium, or the extra yield investors demand for holding long-term bonds. See the *Getting real* chart. Yet we see an ongoing investor thirst for income, as well as structural factors – lower potential growth, ageing populations and abundant global savings – keeping rates low relative to the past.

### We see risk assets doing well if yields rise on a strong growth outlook.

## Shifting trade winds

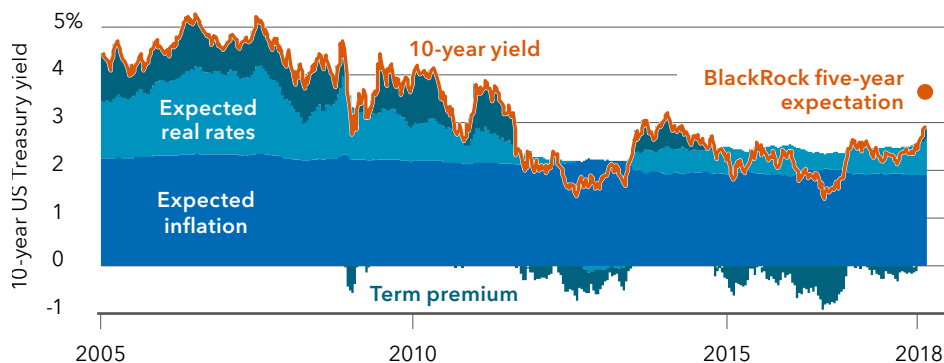
US customs duties as a share of imports, 1871-2017



Sources: BlackRock Investment Institute, with data from the US Bureau of Economic Analysis and the National Bureau of Economic Research, March 2018. Note: The chart shows the average level of US federal customs duties as a share of total imports, using annual data.

## Getting real

US yield drivers and five-year expectations, 2005-2018



This information is not intended as a recommendation to invest in any particular asset class or strategy or as a promise – or even an estimate – of future performance.

Sources: BlackRock Investment Institute, with data from Thomson Reuters, February 2018. Notes: The chart shows a decomposition of the 10-year US Treasury yield based on historical market pricing of expected inflation, expected real rates and the term premium. The term premium is based on a model similar to Andreasen et al. (<https://www.frbf.org/economic-research/files/wp2017-11.pdf>) (2017). The orange dot on the right marks our five-year expectation for the 10-year Treasury yield. There is no guarantee any forecasts made will come to pass.

## Government bonds and credit

**Short-maturity bonds offer enough income to offset inflation for the first time in years.** Why? Rising US rates. To boot, short-term yields now provide a thicker cushion against further rate rises than longer maturities. See the *Get shorty* chart. Rates would need to jump more than one percentage point to wipe out a year of income in the two-year US Treasury note, we estimate. This is nearly double the cushion on offer two years ago – and far larger than the thin insulation provided by longer-term bonds today. For details, see *A mighty (tail)wind* of March 2018. Higher US rates are largely an illusion for hedged eurozone and Japanese investors. These non-US dollar investors pay higher costs for hedging US dollar exposure. The flipside: US investors are now paid to hedge purchases of foreign debt. This makes European and Japanese bond markets more attractive to dollar-based investors, despite lower absolute yields.

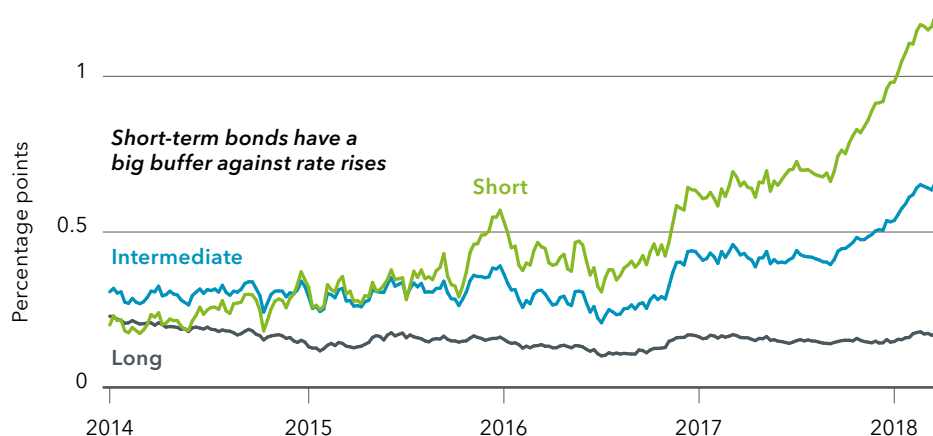
*Short-term US debt now offers compelling income, along with a healthy buffer against the risk of further interest rate rises.*

**Rising interest rates dim the appeal of credit.** Tight credit spreads reflect low default risks against a backdrop of solid global growth and modestly rising inflation. Credit spreads in many markets are trading at the lowest levels as a percentage of their overall yield in a decade. See the *Fading attractions* chart. This is leading to a rising correlation with rate swings. Spreads are tightening by less than usual as rates rise – and in some cases are widening. That makes credit less effective in cushioning against rising rates. We are neutral on US credit and prefer up-in-quality exposures. We are cautious on euro credit. Spreads are tight after ongoing ECB purchases of corporate debt, and the risk of shifting policy adds uncertainty. The hedging dynamic described above does create opportunities for US dollar investors. We like EM debt for its relatively high income, and see local-currency debt and short-duration strategies as more resilient in a more uncertain environment.

*Credit is looking less attractive, with a diminishing cushion against interest rate spikes and a rising correlation with rate swings.*

### Get shorty

US Treasury yield cushion by maturity, 2014–2018

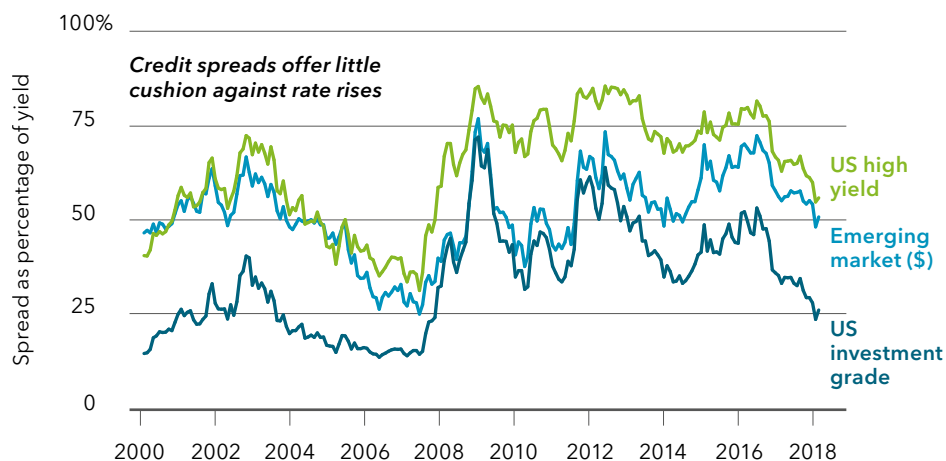


Sources: BlackRock Investment Institute, with data from Bloomberg, March 2018.

Notes: The yield cushion is defined as the percentage point rise in yield that would cause a price decline large enough to wipe out one year's worth of income. Short-, intermediate- and long-maturity Treasuries are represented by the Bloomberg Barclays 1–3 year, Intermediate and Long US Treasury indexes.

### Fading attractions

Credit spreads as a percentage of total yield, 2000–2018



Sources: BlackRock Investment Institute, with data from Bloomberg Barclays and JP Morgan, March 2018.

Notes: The lines show the spreads on the Bloomberg Barclays US High Yield, the Bloomberg Barclays US Credit and the JP Morgan EMBI Global Diversified indexes as a percentage of their total yields.



## Equities

**The global expansion and US tax overhaul have laid the groundwork for an upswing in business spending.** Our text mining of corporate conference calls suggests the lion's share is going toward technology. We have favoured the sector as earnings have outpaced the S&P 500's in recent years. See the *Inside the tech powerhouse* chart. We now see upside to 2018 tech earnings as companies upgrade their platforms. Hardware providers may have a leg up as their products now qualify for immediate expensing.

Increased capex in developed markets also has an outsized impact on EM growth, we find, strengthening our conviction on EM equities. Tech and EM aside, we observe a reluctance among some US large caps to spend big. We expect many to emphasise share buybacks. These can be turned on – and off – quickly, unlike business investment and dividends. Yet we see earnings growth as the biggest return driver globally and, therefore, favour US equities over developed market peers.

*An upswing in US company spending could be a boon for tech providers.*

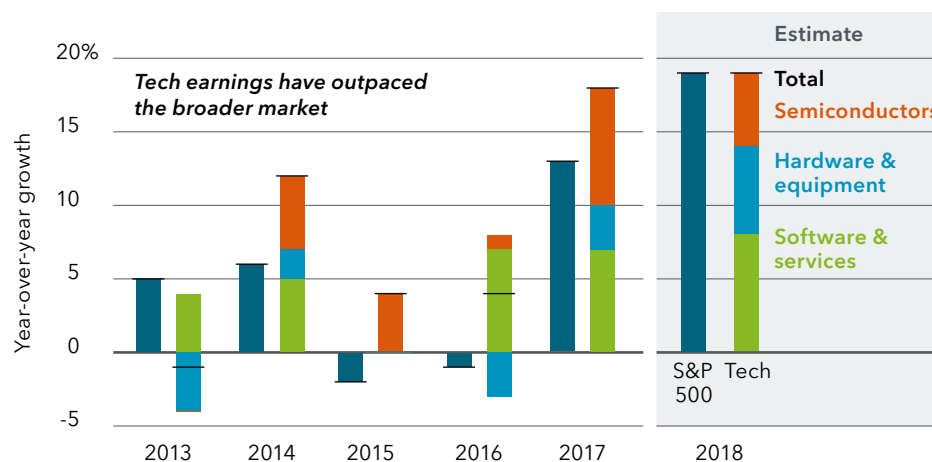
**High-yielding stocks, or 'bond proxies,' have tended to outperform in most economic downturns.** We are not in that place today. Their recent slog illuminates two key points: 1) bond proxies, other 'stable' dividend stocks and min-vol strategies tend to play poor defense when rates are rising, and 2) higher rates mean they face competition from bonds for the first time since the financial crisis. Nominal yields have caught up with dividend yields, and real yields are closing in. See the *Closing the gap* chart.

We believe defense today requires stocks that can keep up with inflation – and prefer dividend growers to the highest yielders. Our picks fall outside the RUST (REITS, utilities, staples and telecoms) belt and include selected tech companies and US banks. We see the latter resilient in any market selloff driven by higher rates rather than recession fears. And we like the momentum style factor. See our April *Global equity outlook* for more.

*Bond proxies are losing their lustre as defensive plays. We prefer stocks offering both income and growth potential.*

### Inside the tech powerhouse

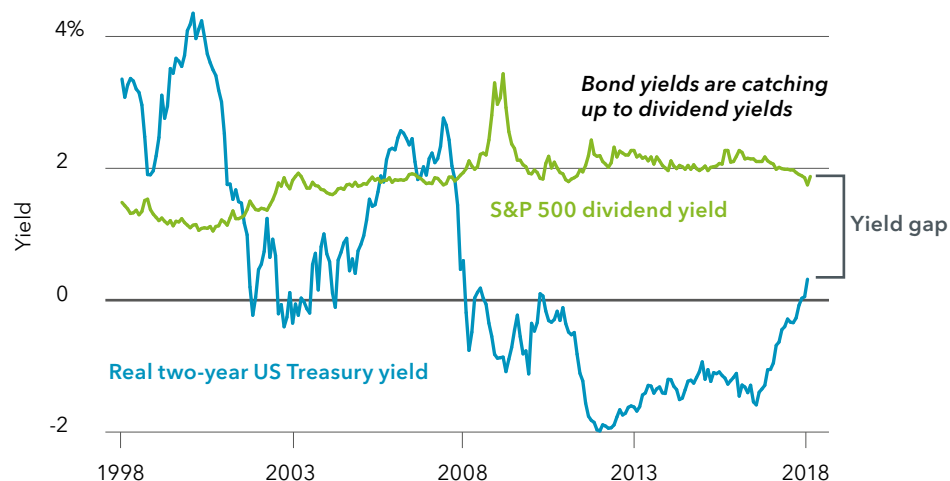
Earnings growth: S&P 500 vs. S&P Information Technology, 2013–2018



Sources: BlackRock Investment Institute, with data from Thomson Reuters, March 2018. Notes: The bars show the annual earnings growth for the S&P 500 versus the S&P 500 Information Technology Index broken down into contribution by tech industry group. The 2018 figures are I/B/E/S analyst estimates from Thomson Reuters.

### Closing the gap

US two-year real yields vs. S&P 500 dividend yield, 1998–2018



Sources: BlackRock Investment Institute, with data from Thomson Reuters, March 2018. Notes: The real yield is calculated as the two-year US Treasury benchmark yield minus US consumer price inflation excluding food and energy.

## Commodities and currencies

**The US dollar has tumbled in the past year, even as its yield advantage over other currencies marched higher.** This is a puzzling disconnect: The factors driving currencies are ever-changing, but one constant is that global capital tends to seek returns in higher-yielding currencies, pushing them higher. The recent dollar decline has flipped the usual correlation between major currencies and interest rate differentials. See the *Correlation collapse* chart.

What explains this anomaly? One theory: The US dollar's recent performance is a mirror image of global risk appetite. Non-US investors look to have embraced domestic risk assets, instead of plowing more funds into US assets. This has left the greenback in the dust and boosted currencies such as the yen, weighing on Japanese stocks. We expect the US dollar to gain some support as this portfolio rebalancing runs its course and economic uncertainty rises. Yet we see upside being capped as major non-US central banks start to raise rates or prepare to wind back policy support. This keeps us neutral on the US dollar.

*We see upside potential for the US dollar, but gains are likely to be capped as non-US central banks move toward normalising policy.*

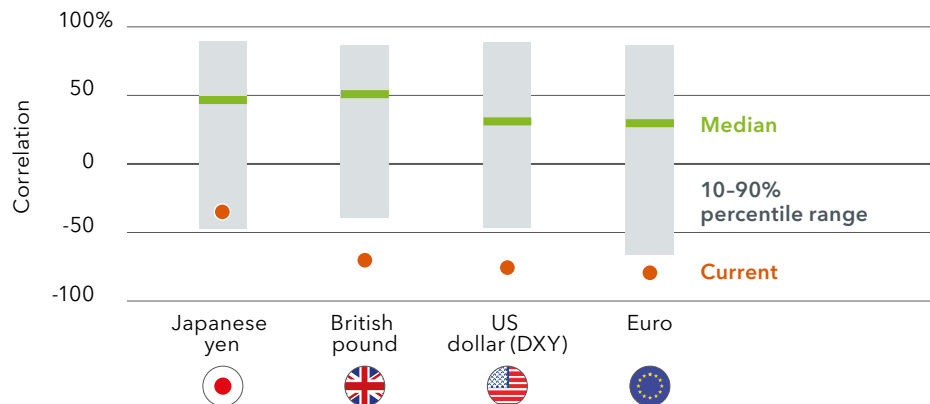
**Commodity prices are riding the wave of global economic momentum.** Healthier demand, tighter inventories and OPEC production cuts have corrected the supply glut that was depressing oil prices. See the *Oil's well* chart. Prices have bounced back from 2016 lows and are now hovering near their highest level in three years. Increased US shale oil production is likely to put a lid on further appreciation, we believe.

US dollar weakness has added to commodity price gains, but we see other factors driving prices from here. Commodities have historically performed better in later parts of the economic cycle as demand for resources outpaces supply. We prefer commodities exposure via related equities and debt. Both have lagged the recovery in underlying spot prices. Major producers' capex discipline and sharper focus on profitability are encouraging.

*We see commodities underpinned by the global expansion and prefer commodity-linked equities and debt over the actual commodities.*

### Correlation collapse

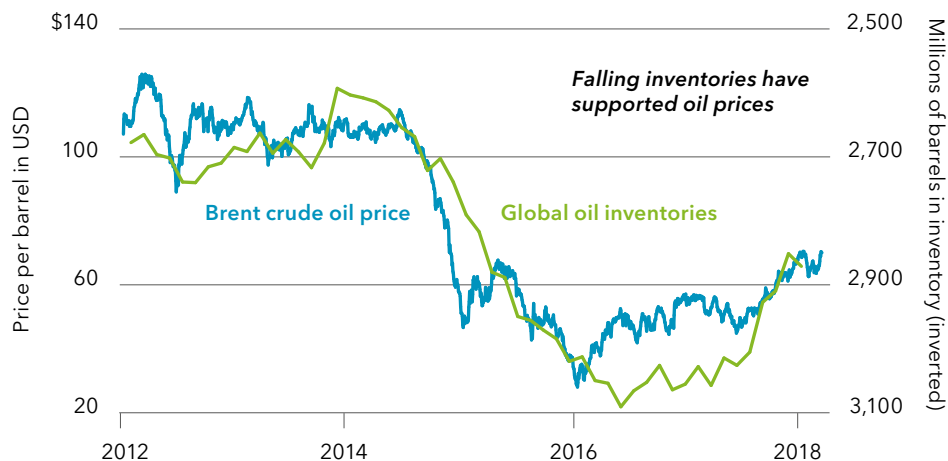
Currency correlations with yield differentials, 2000-2018



Sources: BlackRock Investment Institute, with data from Thomson Reuters, March 2018. Notes: Calculations are based on one-year correlations of currency movements and the difference between local and US dollar two-year government bond yields. The euro uses an average of German, French and Italian two-year yields. For the US dollar, the correlation is between the DXY dollar index and the two-year government bond yield differential between US and a GDP-weighted yield based on the eurozone, Japan and UK. The percentile ranges and median levels are based on correlation data since the start of 2000.

### Oil's well

Brent crude oil price and OECD oil inventories, 2012-2018



Sources: BlackRock Investment Institute, with data from Thomson Reuters and the International Energy Agency, March 2018. Notes: The green line shows the level of commercial oil inventories in Organisation for Economic Cooperation and Development (OECD) countries.

## Assets in brief

Tactical views on assets, April 2018

	Asset class	View	Comments
Equities	US	▲	Extraordinarily strong earnings momentum, corporate tax cuts and fiscal stimulus underpin our positive view. We like the momentum and value style factors, as well as financials and technology.
	Europe	—	We see economic expansion and a steady earnings outlook supporting cyclicals. Our neutral stance acknowledges that earnings momentum lags other regions. Euro strength also is a source of pain.
	Japan	▲	Positives are improving global growth, more shareholder-friendly corporate behavior and solid earnings. We see Bank of Japan policy and domestic investor buying as supportive. Further yen strengthening would be a risk.
	EM	▲	Economic reforms, improving corporate fundamentals and reasonable valuations support EM stocks. Above-trend expansion in the developed world is another positive. Risks include a sharp rise in the US dollar, trade tensions and elections. We see the greatest opportunities in EM Asia. We like Brazil and India, and are cautious on Mexico.
	Asia ex-Japan	▲	The economic backdrop is encouraging. China's growth and corporate earnings appear likely to remain solid in the near term. We like selected Southeast Asian markets but recognise a faster-than-expected Chinese slowdown would pose risks to the entire region.
Fixed income	US government bonds	▼	We see rates rising moderately amid economic expansion and Fed normalisation. Shorter maturities offer a more compelling risk/reward tradeoff. They and inflation-linked securities can be buffers against rising rates and inflation. We like 15-year mortgages relative to their 30-year counterparts and to short-term corporates.
	US municipal bonds	—	Solid retail investor demand and muted supply are supportive of munis, but rising rates weigh on absolute performance. A more defensive stance is warranted near term, we believe, though any material weakness due to supply may represent a buying opportunity. We favour a barbell approach focused on two- and 20-year maturities.
	US credit	—	Sustained growth supports credit, but high valuations limit upside. We prefer up-in-quality exposures as ballast to equity risk. Higher-quality floating rate instruments and shorter maturities are well positioned for rising rates, in our view.
	European sovereigns	▼	The ECB's negative interest rate policy has made yields unattractive and vulnerable to the improving growth outlook. We expect core eurozone yields to rise. We are cautious on peripherals given tight valuations and the prospect of the ECB reducing its asset purchases.
	European credit	▼	Ongoing ECB purchases have compressed spreads across sectors and credit-quality buckets. Negative rates have crimped absolute yields – but rising rate differentials make currency-hedged positions increasingly attractive for US-dollar investors. Subordinated financial debt looks less compelling versus equities after a strong 2017.
	EM debt	—	Gradual Fed rate rises favour local-currency exposures – particularly given their higher yields relative to major bond markets. A shift by EM central banks toward tighter policy reduces our return expectations. We see solid fundamentals and investor inflows limiting EM currency volatility.
	Asia fixed income	—	Regional growth and inflation dynamics are supportive of credit. China's rising representation in the region's bond universe reflects its growing credit market. Higher-quality growth and a focus on financial sector reform are long-term positives, but any China growth slowdown would be a near-term challenge.
Other	Commodities and currencies	*	A reduction in global oil inventories is supporting oil prices. We are neutral on the US dollar. The factors driving its recent slide are likely temporary, but it's unclear when the US yield differential with other economies will reassert itself as the main driver.

Note: Views are from a US dollar perspective as of April 2018. \*Given the breadth of this category, we do not offer a consolidated view.

▲ Overweight    — Neutral    ▼ Underweight

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