• Trade disputes and geopolitical frictions have become key drivers of the economy and markets. U.S. trade policy has become increasingly unpredictable. Recent geopolitical volatility – including attacks on Saudi oil infrastructure – underscores this message from our Midyear Outlook.

• A temporary de-escalation in U.S.-China tensions and fading odds of the UK crashing out of the European Union has sparked a relief rally in risk assets. Yet elevated macro uncertainty is holding back economic activity, creating risks to the near term growth outlook. We expect a pickup in global growth in the next six to 12 months, as policy stimulus gradually filters through to the real economy. This suggests moderate risk-taking will likely be rewarded – even as we call for a greater focus on portfolio resilience.

• Central banks face an increasingly challenged policy outlook. Monetary policy ammunition is running low as interest rates are near historic lows. Difficult policy choices are resulting in more deeply divided decision-making bodies on both sides of the Atlantic.

• We do not believe monetary policy alone is a cure for the fallout from global trade tensions. Supply chain disruptions could deliver a hit to productive capacity that fosters mildly higher inflation even as growth slows. This complicates the case for further policy easing.

• Overall, we favor reducing risk amid the ongoing protectionist push. We prefer U.S. equities for their reasonable valuations and relatively high quality; and the min vol and quality factors for their defensive properties. We like EM debt for its coupon income. We are tactically overweight euro area sovereigns: a relatively steeper yield curve brightens their appeal even at low yields. And we see government bonds as important portfolio stabilizers.

Summary
Our 2019 investment themes

**Protectionist push** – The substantial escalation in the U.S.-China conflict – and unpredictability of U.S. policy actions – have injected additional uncertainty into business planning, threatening to weaken economic activity. Market implication: We favor reducing risk, including raising some cash.

**Stretching the cycle** – Central banks have pivoted to easing. The record-long U.S. economic expansion is supported by healthy household spending and looks unlikely to morph into a deeper downturn any time soon. Market implication: We like U.S. equities and EM debt.

**Raising resilience** – Portfolio resilience is crucial at a time of elevated macro uncertainty. Market implication: Government bonds play an important role in building portfolio resilience – even at low yield levels.
Scoring our views

Risk assets have performed strongly this year to date, but geopolitical tensions loom as an ongoing risk. Government bonds have played an important diversification role.

Asset performance, 2019 second-half and year-to-date

- We have been surprised by the extent of the rally in government bonds, which have played a key role in cushioning against equity selloffs.
- Our overweight in U.S. equities has paid off. Yet rising geopolitical risks challenge our overall moderate pro-risk stance.
- EM and Asia-ex-Japan equities have underperformed since midyear, validating our shift to an underweight stance.
- Japanese equities have outperformed, contrary to our expectations, thanks to a lull in trade tensions that we see as temporary.

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

Source: BlackRock Investment Institute, with data from Thomson Reuters. October 2019 Notes: Data are through 22nd October 2019. Indexes or prices used are: MSCI Japan Index, J.P. Morgan GBI-Emerging Markets Index, MSCI USA Index, FTSE EMU Government Bond Index all maturities Index, Bloomberg Barclays Non-Japan Asia Credit Index, MSCI AC World Index, J.P. Morgan EMBI Global Diversified Index, Bloomberg Barclays U.S. Credit Index, Bloomberg Barclays U.S. Treasury Index, MSCI Europe Index, Bloomberg Barclays Global Aggregate Index, U.S. TIPS USD Index, Bloomberg Barclays Pan-European Aggregate: Corporate Index, MSCI EM Index, MSCI AC ASIA ex. Japan Index. Returns in USD. Indexes are unmanaged and not subject to fees.
Multi-decade long spread of globalization reversing

The surge in trade protectionism marks a sharp reversal from decades of increasing openness. Our nowcast points to further deterioration.

Global trade as % of GDP, 1960–2017

BlackRock trade nowcast vs. activity, 2006–2019

Sources: CPB World Trade Monitor, BlackRock Investment Institute, with data from Refinitiv Datastream. October 2019. Notes: The chart on the left shows world trade as a percentage of global GDP. The chart on the right shows the three-month annualised percentage change in real global goods trade volume (in green) and a real-time “nowcast” (in orange) of where that trade volume may stand in three months’ time. The nowcast uses principal component analysis based on 50 indicators, such as exports from South Korea and Taiwan, German manufacturing surveys and the export order components of global PMIs, to track global trade activity. Forward-looking estimates may not come to pass.
Shock to the system
A key question is whether trade tensions will deliver a “demand shock” or a “supply shock” to the economy. Supply shocks would create upside inflation surprises, marking a change from an extended period of low inflation.

U.S. inflation shocks, 1966-2019

Tariff impact on U.S. CPI, 2015-2019

Sources: BlackRock Investment Institute and the U.S. Bureau of Labor Statistics, with data from Refinitiv Datastream, October 2019. Notes: The chart on the left shows the difference between the actual and expected inflation outcomes. We use a statistical model to estimate inflation expectations back to 1966, drawing on the relationship between the actual U.S. Consumer Price Index (CPI), GDP and policy interest rates over trailing three-year periods. We use these regressions to estimate the expected annual inflation rate in three months’ time. The chart on the right shows the change in the core goods US Consumer Price Index (CPI) from 2015 to 2019. The core goods CPI index is broken down into the goods components affected by tariffs and all other core goods. We show the change since the first quarter of 2018 when additional tariffs on Chinese goods were first announced.
Persistent geopolitical uncertainty
Ongoing trade frictions and simmering Gulf tensions underscore the risk of supply shocks. We view the latest détente in U.S.-China trade tensions as temporary as it does not address strategic issues.

BlackRock Geopolitical Risk Indicators (BGRIs) for global trade and Gulf tensions, 2005–2019

Source: BlackRock Investment Institute, with data from Refinitiv Datastream, October 2019. Notes: See BlackRock’s Geopolitical risk dashboard for full details. We identify specific words related to geopolitical risk in general and to our top-10 risks. We use text analysis to calculate the frequency of their appearance in the Refinitiv Broker Report and Dow Jones Global Newswire databases as well as on Twitter. We then adjust for whether the language reflects positive or negative sentiment, and assign a score. A zero score represents the average BGRI level over its history from 2003 up to that point in time. A score of one means the BGRI level is one standard deviation above the average. We weigh recent readings more heavily in calculating the average. The BGRI’s risk scenario is for illustrative purposes only and does not reflect all possible outcomes as geopolitical risks are ever-evolving.
**Stretching the cycle**

The U.S. economy entered the late stage of its expansion earlier this year. Below-trend growth and monetary policy easing suggests a reversal to mid-cycle conditions in coming months.


Source: BlackRock Investment Institute, with data from Refinitiv Datastream, as of July 2019. Notes: This chart shows an estimate of the U.S. output gap (that is, GDP as a percentage of potential GDP). We have classified different time periods as belonging to certain stages of the business cycle. The classification of the stage is done via a ‘cluster analysis’ that groups together time periods where economic series have behaved in similar ways.
Even lower for even longer

We see the Fed cutting rates further, but not by as much as what markets are pricing in. The ECB has launched open-ended asset purchases, cut rates and strengthened forward guidance.

One-year forward central bank policy rate pricing

There is no guarantee that any forecasts made will come to pass. Past performance is no guarantee of future results.

Source: BlackRock Investment Institute with data from Bloomberg, as of 22nd October 2019. Notes: The chart shows the market pricing of policy rates in overnight index swaps on a one-year horizon starting in one year’s time.
A confident consumer
The record-long U.S. economic expansion is underpinned by healthy household spending and looks unlikely to morph into a deeper downturn in the near term.


Sources: BlackRock Investment Institute, with data from Refinitiv Datastream, University of Michigan, Institute of Supply Management, National Bureau of Economic Research, October 2019.
Notes: The University of Michigan’s survey of consumers captures consumer attitudes and expectations. It focuses on three areas: how consumers view prospects for their own financial situation, how they view prospects for the general economy over the near term, and their view of prospects for the economy over the long term. The University of Michigan assigns a value of 100 to the index as of the first quarter of 1966. The ISM manufacturing survey is based on data compiled from purchasing and supply executives across the U.S. manufacturing sector. Z-scores measure how much current readings compare to historical averages over the 1985–2019 period, and are measured in standard deviations.
Easy does it
Accommodative financing conditions underpin our belief that weakness in the global industrial sector is unlikely to lead to a broader economic downturn in the near term.

BlackRock G3 Growth GPS and FCI, 2015-2019

- Easier monetary policy has spurred a swift rebound in our financial conditions indicator (FCI).
- Growth expectations, highlighted by our G3 Growth GPS, are yet to reflect the significant easing of financial conditions. See more on our Macro dashboard.
- Persistent and intensifying trade uncertainty is holding back business spending, in our view.

Sources: BlackRock Investment Institute with data from Bloomberg and Consensus Economics, October 2019. Notes: The BlackRock Growth GPS shows where the 12-month forward consensus GDP forecast may stand in three months’ time. The orange line shows the rate of GDP growth implied by our financial conditions indicator (FCI), based on its historical relationship with our Growth GPS, shifted forward six months. The FCI inputs include policy rates, bond yields, corporate bond spreads, equity market valuations and exchange rates. Forward-looking estimates may not come to pass.
Hitting the limit
Monetary policy is almost exhausted as global interest rates plunge towards zero or below. We believe policymakers should lay the groundwork for a credible plan to navigate the next economic shock.

US and German yield curves, actual vs recession, 2019

We expect current central bank easing to be sufficient to sustain the expansion. Yet the plunge in bond yields shows there is not enough policy space to deal with the next downturn.

The German yield curve is already near levels that would have prevailed based on past recessions. Further support cannot rely on interest rates falling.

Fiscal policy should play a greater role – but it is unlikely to be effective on its own. An unprecedented response is needed when monetary policy is exhausted and fiscal policy alone is not enough.

We believe there is a practical way for central banks to “go direct” in providing monetary financing for fiscal policy. Read more in our August 2019 Macro and market perspectives.

Source: BlackRock Investment Institute, with data from Refinitiv Datastream, September 2019. Notes: The chart shows the current US Treasury and German bund yield curves and a hypothetical representation of the yield curve during recessions, based on the median yield moves during the past five recessions. The light grey bars show the range of the yield moves during those recessions. To account for the changing interest rate environment of the past few decades, the curve moves are adjusted based on the structural decline in neutral rates discussed on this page. Forward looking estimates may not come to pass.
Raising resilience

Government bonds have played an important role in building portfolio resilience – even at ultra-low yields. In Europe, German bunds are less effective shock absorbers as yields approach their perceived floor.

Stock-bond correlations in the U.S. and Europe, 2000–2019

Past performance is not a reliable indicator of current or future results.

Source: BlackRock Investment Institute, with data from Refinitiv Datastream, October 2019. Notes: The charts show the correlations between daily percentage moves for stocks and bonds over a rolling one-year period. The dot shows the correlation over the most recent 90 day period. For the United States, we use the MSCI USA index for stocks and the 10-year Treasury for bonds. For the euro area, we use MSCI Europe ex-UK index and the German 10-year bund. Indexes are unmanaged and not subject to fees. It is not possible to invest directly in an index.
Eyes on volatility
Relatively muted cross-asset volatility suggests markets are not fully pricing in heightened geopolitical risks. We believe central banks’ dovish pivot is buying investors time to add resilience to portfolios.

Cross asset volatility, 2008–2019

Sources: BlackRock Investment Institute with data from Refinitive Datastream, CBOE and Bank of America–Merrill Lynch, October 2019. Notes: The chart shows cross-asset volatility measured as z-scores, or how current readings compare to historical risk-adjusted averages over the 2008–2019 period. Equities are represented by the VIX, Oil by CBOE’s Oil VIX, and US Treasuries by the BofA-ML’s MOVE index.
Equities through the lens of factors

The sector-neutral measure of the value factor has lagged significantly, but is recently showing signs of life. The reversal hints at risks of overcrowding, as well as the sensitivity of factor leadership to rates moves.

Relative performance of global value vs. momentum equities, 2017–2019

Past performance is not a reliable indicator of current or future results.

Source: BlackRock Investment Institute, with data from Refinitiv Datastream, October 2019. Notes: The indexes used are MSCI World Momentum Index and the MSCI World Enhanced Value Index. The performance is on total returns basis, in U.S. dollar terms and rebased to the start of 2017. Indexes are unmanaged and not subject to fees. It is not possible to invest directly in an index.
**Market views: equities**

We remain positive on U.S. equities on reasonable valuations and the concentration of high-quality companies, but rising geopolitical risks challenge our overall preference for equities over bonds.

**Sources of equity total return in 2019**

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 Refinitiv Datastream and MSCI, October 2019. Notes: The bars show the breakdown of each market’s return year to date into dividends, earnings and multiples. The dots show each market’s total return over the same period. Earnings refers to changes in 12-month forward earnings estimates from Refinitiv. Multiples refers to multiple expansion (or contraction) – the change in the 12 month forward price-to-earnings ratio. The indexes used are MSCI indexes representing each market. Returns are in local currency except World, Asia ex-Japan and EM returns, which are in U.S. dollars. Indexes are unmanaged and not subject to fees.
Market views: fixed income

We like sources of coupon income such as EM local debt, despite outsized returns this year. Valuations appear full in many sectors, with yields still near the bottom of historical ranges.

Selected fixed income yields, 2018–2019

Past performance is not a reliable indicator of current or future results.

Sources: BlackRock Investment Institute, with data from Refinitiv Datastream, Bloomberg Barclays and J.P. Morgan, October 2019. The bars show the range in yields for each index from the start of January 2018. Indices used: Bloomberg Barclays Pan-European Corporate, Refinitiv 2-year and 10-year benchmark U.S. Treasury, Bloomberg Barclays U.S. Corporate Investment Grade, Bloomberg Barclays Pan-European Corporate High Yield, J.P. Morgan GBI-Emerging Market Index, J.P. Morgan EMBI-Global Diversified Index and Bloomberg Barclays U.S. Corporate High Yield Index. Indexes are unmanaged and not subject to fees. It is not possible to invest directly in an index.
### Assets allocation views in brief
Six-to-12 month tactical views on selected assets, November 2019

<table>
<thead>
<tr>
<th>Asset class</th>
<th>View</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S.</td>
<td>▲</td>
<td>A supportive policy mix and the prospect of an extended cycle underpin our positive view. Valuations still appear reasonable against this backdrop. From a factor perspective we like min-vol and quality, which have historically tended to perform well during economic slowdowns.</td>
</tr>
<tr>
<td>Europe</td>
<td>–</td>
<td>We have upgraded European equities to neutral. We find European risk assets modestly overpriced versus the macro backdrop, yet the dovish shift by the European Central Bank (ECB) should provide an offset. Trade disputes, a slowing China and political risks are key challenges.</td>
</tr>
<tr>
<td>Japan</td>
<td>▼</td>
<td>We have downgraded Japanese equities to underweight. We believe they are particularly vulnerable to a Chinese slowdown with a Bank of Japan that is still accommodative but policy-constrained. Other challenges include slowing global growth and an upcoming consumption tax increase.</td>
</tr>
<tr>
<td>EM</td>
<td>–</td>
<td>We have downgraded EM equities to neutral amid what we see as overly optimistic market expectations for Chinese stimulus. We see the greatest opportunities in Latin America, such as in Mexico and Brazil, where valuations are attractive and the macro backdrop is stable. An accommodative Fed offers support across the board, particularly for EM countries with large external debt loads.</td>
</tr>
<tr>
<td>Asia ex-Japan</td>
<td>▼</td>
<td>We have downgraded Asia ex-Japan equities to underweight due to the region’s China exposure. A worse-than-expected Chinese slowdown or disruptions in global trade would pose downside risks. We prefer to take risk in the region’s debt instruments instead.</td>
</tr>
<tr>
<td>U.S. government bonds</td>
<td>▼</td>
<td>We remain underweight U.S. Treasuries. We do expect the Fed to cut rates by a further quarter percentage point this year. Yet market expectations of Fed easing look excessive to us. This, coupled with the flatness of the yield curve, leaves us cautious on Treasury valuations. We still see long-term government bonds as an effective ballast against risk asset selloffs.</td>
</tr>
<tr>
<td>U.S. municipal bonds</td>
<td>–</td>
<td>Favorable supply-demand dynamics and improved fundamentals are supportive. The tax overhaul has made munis’ tax-exempt status more attractive. Yet munis’ yield dynamics are on the high side, and the asset class may be due for a breather after a 10-month stretch of positive performance.</td>
</tr>
<tr>
<td>U.S. credit</td>
<td>–</td>
<td>We are neutral on U.S. credit after strong performance in the first half of 2019 sent yields to two-year lows. Easier monetary policy that may prolong this cycle, constrained new issuance and conservative corporate behavior support credit markets. High-yield and investment-grade credit remain key parts of our income thesis.</td>
</tr>
<tr>
<td>European sovereigns</td>
<td>▲</td>
<td>The resumption of asset purchases by the ECB supports our overweight, particularly in non-core markets. A relatively steep yield curve – particularly in these countries – is a plus for euro area investors. Yields look attractive for hedged U.S. dollar-based investors thanks to the hefty U.S.-euro interest rate differential.</td>
</tr>
<tr>
<td>European credit</td>
<td>–</td>
<td>Renewed ECB purchases of corporate debt and a “lower for even longer” rate shift are supportive. European banks are much better capitalized after years of balance sheet repair. Even with tighter spreads, credit should offer attractive income to both European investors and global investors on a currency-hedged basis.</td>
</tr>
<tr>
<td>EM debt</td>
<td>–</td>
<td>We like EM bonds for their income potential. The Fed’s dovish shift has spurred local rates to rally and helped local currencies recover versus the U.S. dollar. We see local-currency markets having room to run and prefer them over hard-currency markets. We see opportunities in Latin America (with little contagion from Argentina’s woes) and in countries not directly exposed to U.S.-China tensions.</td>
</tr>
<tr>
<td>Asia fixed income</td>
<td>▲</td>
<td>The dovish pivot by the Fed and ECB gives Asian central banks room to ease. Currency stability is another positive. Valuations have become richer after a strong rally, however, and we see geopolitical risks increasing. We have reduced overall risk and moved up in quality across credit as a result.</td>
</tr>
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Note: Views are from a U.S. dollar perspective as of November 2019. 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.
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