Official Institutions Digest

Q2 2020

FOR PROFESSIONAL CLIENTS AND QUALIFIED INVESTORS/QUALIFIED CLIENTS ONLY

BlackRock.

Happening In Markets:

Despite a volatile start, Q2 2020 concluded with very **strong performance for most asset classes**, supported by unprecedented policy response boosting markets and positive surprises on the initial rebound upon economic reopening. The **S&P 500 gained 1.5%** to take its **quarter rise to 20.5%**, the largest since 1998, while the **MSCI World's 19.5% rise** was the **biggest** since the **global financial crisis**.

May's data suggested **the worst of the contraction may be behind us**, but we see a **bumpy restart** in coming months. Risk assets have benefitted overall, though economic reopening and easing restrictions throughout Q3 could expose more dispersion between COVID-19 winners and losers, which has potential to impact the positive momentum.

Looking ahead
Q3 has begun with what looks like a steady start for risk assets, but we are not out of the woods yet: contamination **cases are still rising** globally and in parts of the U.S., and the **policy revolution** has left investors grappling with **fundamental questions** about the **post COVID-19** world.

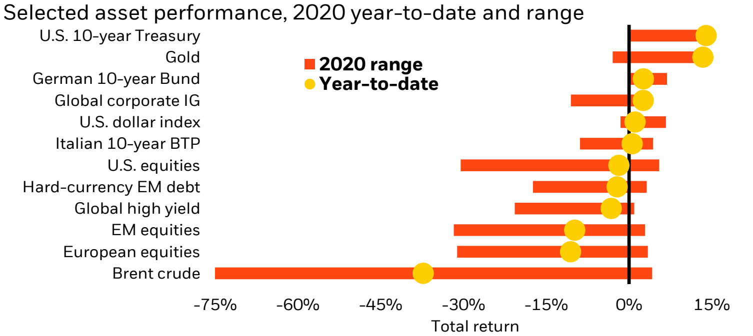
As restrictions ease and caution fades under the impression the pandemic is under control, we are tracking the interplay of **containment measures** and **mobility changes** on activity as economies have started to reopen. The uptick in activity presents potential for a **second wave of infections remains a key risk**.

For now **the market is taking in stride** the **ongoing surge** in coronavirus cases in the US, prompting the closure of bars and other indoor establishments in some sunbelt states and a **pause in reopening** elsewhere.

Virus dynamics will likely continue to hold the key to activity dynamics and hence risk assets. While **activity indicators are bouncing off their lows**, a **full recovery** could take **years**.
See our **H2 outlook** for what to expect next.

Assets In Review

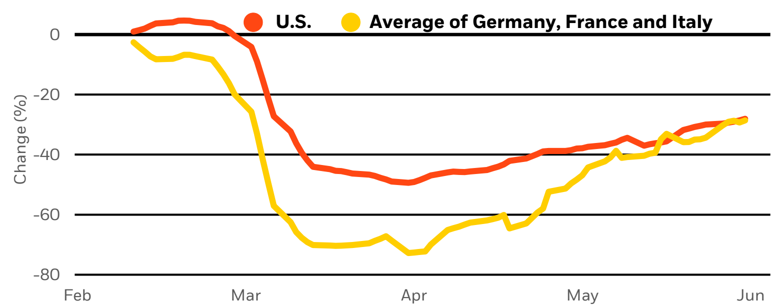
Selected asset performance, 2020 year-to-date and range



The figures shown relate to past performance. 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, June 2020. Notes: The two ends of the bars show the lowest and highest returns versus the end of 2019, and the dots represent 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 Brent crude, MSCI USA Index, the ICE U.S. Dollar Index (DXY), MSCI Europe Index, Bank of America Merrill Lynch Global Broad Corporate Index, Bank of America Merrill Lynch Global High Yield Index, DataStream 10-year benchmark government bond (U.S. , German and Italy), MSCI Emerging Markets Index, spot gold and J.P. Morgan EMBI index.

Warming Up To Europe

Google mobility data for U.S. and key euro area economies, 2020



The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.. Sources: BlackRock Investment Institute, with data from Google, June 2020. Notes: The chart shows the percentage change in mobility (seven-day moving average) relative to the median level between Jan. 3 and Feb. 6, 2020. The yellow line is a simple average of Germany, France and Italy. The lines start on Feb. 24.

Top Of Mind and Expected Challenges For Official Institutions (OIs):

- **Second COVID-19 infection wave?**
- **Over-extended market rally?**
- **Post COVID-19 winners & losers?**
- **Sustainability**
- **Inflation on the horizon?**
- **Even lower yields**
- **Elusive diversification**

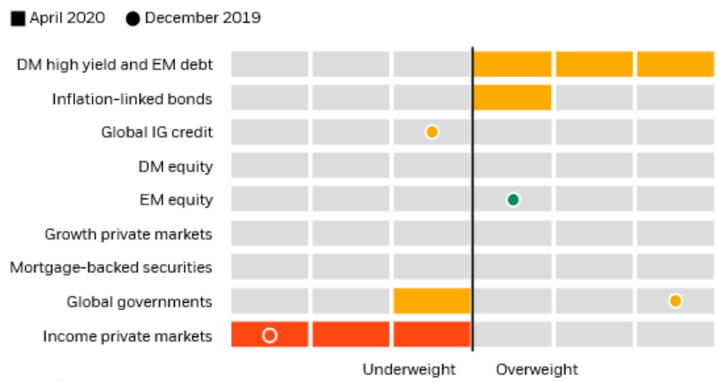
Keep reading for more on:
Strategic asset allocation
OI trends
Top reads from around BlackRock for OIs

The Strategic Asset Allocation Corner

The COVID-19 pandemic has forced the reassessment of pre-crisis asset class views. Based on factors including unprecedented monetary and fiscal policy, realignment of global supply chains, and expectation of government bonds hovering around the lower bound, we have updated our current strategic asset class views based on cyclical views and current market valuations.

Our strategic asset class views based on a hypothetical portfolio developed with our Capital Market Assumptions show our asset class preferences over a 10-year horizon relative to a long-term, cycle-agnostic equilibrium asset allocation. We cut our overweight stance on developed market government bonds to underweight, move to a neutral stance on equities and upgrade credit to overweight.

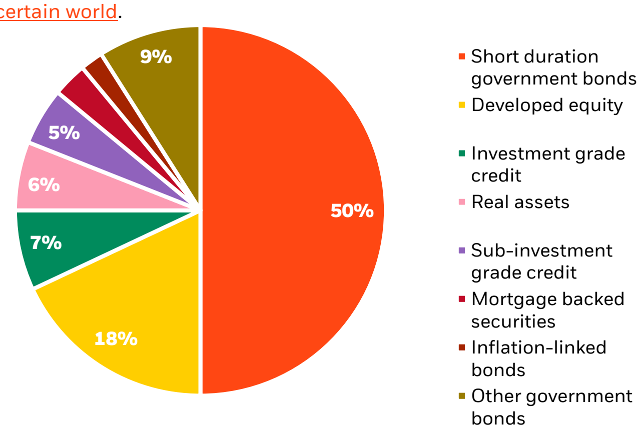
Hypothetical US dollar 10-year strategic allocation vs. our equilibrium view



This information is not intended as a recommendation to invest in any particular asset class or strategy or as a promise - or even estimate - of future performance. Source: BlackRock Investment Institute, May 2020. Data as of 13 April, 2020. Notes: The bar chart shows our asset views on a 10-year view from an unconstrained US dollar perspective, with the number of boxes indicating relative preference. Global government bonds and EM equity allocations include respective China assets. Income private markets include infrastructure debt, direct lending, real estate mezzanine debt and US core real estate. Growth private markets include global private equity buyouts and infrastructure equity. The hypothetical portfolio may differ from those in other jurisdictions, is intended for information purposes only and does not constitute investment advice.

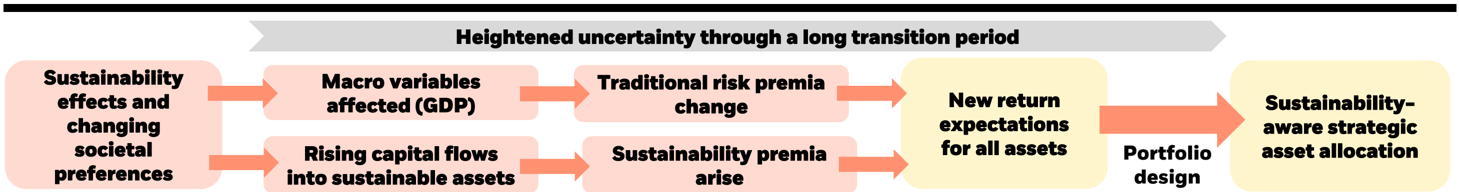
BlackRock's strategic asset allocation for the 2020 OI risk-constrained portfolio

We have modeled an OI portfolio with 50% liquidity floor and a 2.5% target return. This portfolio has been created with an explicit focus on minimizing risk while building resilience – with a one-year maximum drawdown of 1.7%. For a deeper dive, read Reserve management in an uncertain world.



Source: BlackRock Investment Institute in collaboration with BlackRock Official Institutions Group, May 2020

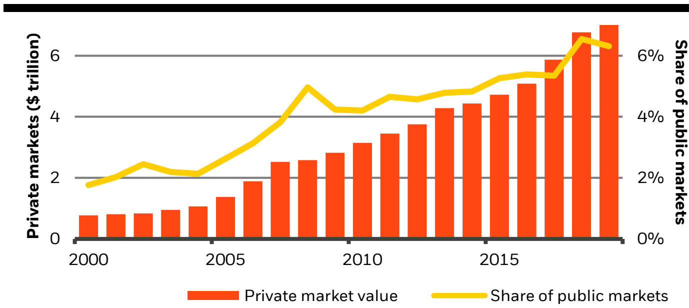
We believe that structural shift in investment patterns may imply sustainability premia



Source: BlackRock Investment Institute, February 2020. For illustrative purposes only and subject to change without notice.

Private Markets: We see opportunities in the slower moving, less liquid private markets, and expect them to offer exposure to structural trends that have been accelerated by the pandemic. Diversification with – and within – private markets will be crucial to building resilient portfolios, in our view. More on the role of private markets in portfolios on the BlackRock Blog.

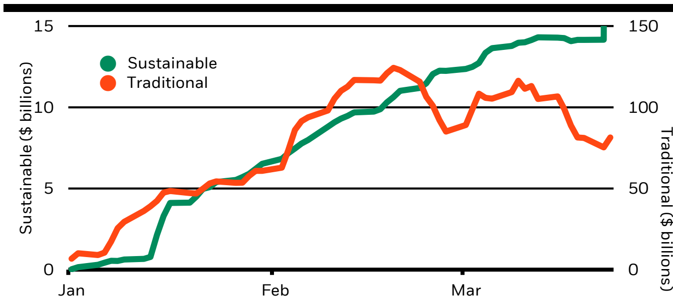
Growth in private markets, 2000-2019



Source: BlackRock Investment Institute, with data from Prequin, June 2020. Notes: The bars represent the sum of net asset value of closed-end funds as well as dry powder of funds in these asset c lasses: private equity and venture capital, real estate, private debt, infrastructure and natural resources. The line shows the size of private markets relative to that of public markets. Currency shown is USD.

Sustainability: A structural shift in investor preferences leading to large and persistent flows into assets perceived as more resilient to sustainability-related risks such as climate change. Investors re-balancing portfolios after the recent risk asset selloff may consider leaning into sustainable assets. More on sustainable investing on the BlackRock Blog.

Net inflows to global sustainable and traditional ETFs, 2020



BlackRock Investment Institute, as of 25 March 2020. Notes: Global sustainable ETFs as any exchange-traded funds that pursue a dedicated sustainable objective, whether using a broad ESG, thematic, impact or exclusionary strategy. Traditional ETFs are other ETFs that are not directly focused on sustainability. Currency shown is USD.

Official Institution Trends

Global round-up of OIs in the news

COVID-19 impact & OI response

- In Q1, Norway's GPFG reported a loss of -14.6%, Swiss National Bank reported record quarterly losses, Korea's NPS was hit by -6% returns due to equities losses, and Australia's Future Fund posted a loss of -3.4%.
- Foreign exchange reserve portfolios began to rebound in Q2 after efforts to defend local currencies and preserve economic stabilization forced significant drawdowns in Q1. In May, Israel's reserves rose by 6.7% to record highs; South Korea saw reserves climb in April to USD$404bn, China reserves rose unexpectedly to USD$3.1tn.
- Across the globe OIs are employing a variety of tactics utilizing state funds to avoid domestic economic meltdown. Those with access to liquid funds are increasing state spending, and in some cases intervening in the private sector to promote stability. At the other end of the spectrum, active participation in promoting stability has meant pausing state sponsored investment activity and waiting for more stable market conditions to resume.
- Norway's Sovereign Wealth Fund liquidated assets for the first time in fund history to meet the country's excess spending, oil-producing Middle East and Africa sovereign wealth funds shed USD$225bn in equities as plummeting oil prices took a toll on state budgets.
- Countries including Ireland and Nigeria turned to their wealth funds for emergency liquidity in response to the crisis, In line with the COVID-19 theme of historic policy intervention, several governments are tapping into FX reserves to maintain economic stability. Hong Kong Monetary Authority has taken stake in airline Cathay Pacific as part of a broader USD$5bn bailout; the Bank of Mauritius plans to use up to USD$2bn of its FX reserves to directly support large firms damaged by the coronavirus pandemic.

Rebalancing and asset allocation: building resiliency

- Given the significant toll coronavirus has taken on global markets and economies, pre-crisis asset allocations may not be capable of capturing target returns in a post-crisis world. Changes to allocations observed in Q2 indicate conviction that alternatives and illiquid assets will persist as reliable drivers of return, and geographic diversification will be a key risk mitigation tool.
- CIC is looking for assets that are more resilient in unpredictable markets. Other OIs, including Norway's Sovereign Wealth Fund and Korea's NPS are increasing their geographic exposures outside of their domestic economies. Middle East sovereign funds have expressed interest in increasing allocations to Asian markets.
- OI investors with capacity to include illiquids in their SAA are expanding allocations to alternatives. The UNJSPF is planning to move toward a larger alts target in their SAA over time. After brief pause due to COVID-19, NPS has returned to deploying capital in alternative investments.
- With questions over COVID-19's impact on commercial real estate, Norway is expecting lower returns on their property investments, and the Future Fund CIO is urging investors to reassess infrastructure asset values. Despite these concerns for private market asset valuations, Norway does not plan to withdraw assets from illiquids, such as unlisted real estate.
- Following a decline in central bank gold purchasing, as reserve managers rebuild their portfolios, many are likely to increase their allocation to the metal given its perception as a safe, liquid asset. According to the World Gold Council's May 2020 Central Bank Gold Reserve Survey, 20% of central banks expect to buy gold this year, up from 8% in 2019.

Sustainability

- Sustainable investing conversations amongst OIs center around three key topics: **Reporting Standards, Strategies and Frameworks,** and **Incorporation into Investment Policies.**
- As sustainable investing becomes increasingly mainstream, many – including the IMF, NGFSF and former Bank of England governor Mark Carney – are calling for increasing regulation on climate disclosures, and agreed upon standards for data and materiality. In addition to standards addressing climate change and the "E", given growing interest in socially responsible investing Norges Bank has called for EU human rights and corruption reporting standards.
- Incorporating ESG considerations into stress testing is becoming increasingly important, as the ECB integrates climate risks into supervision, and Japan's GPIF is taking steps to increase ESG expectations for real estate managers. The NGSF has recently published climate scenarios in an attempt to provide a common reference framework.
- While some OIs are still hesitating to commit to sustainable strategies over performance and mandate alignment concerns, negative screening is currently the most popular strategies amongst central banks though a recent whitepaper penned by the Bank for International Settlements argues the case for incorporating green bonds in reserve portfolios. In addition to commitments to sustainability with investment policies, the Bank of England has announced their intention to reduce their carbon footprint by transitioning all electricity and natural gas usage to renewable sources.
- We believe that sustainability and resilience are becoming increasingly intertwined, and that over time sustainability will become the fundamental source of portfolio resiliency. Underscoring this point for how investors can trust ESG funds in future turbulent markets, evidence suggests that ESG-attuned funds were 'sticky' and held their value relative to their benchmarks.

Opportunistic investing

- For global OIs with liquid capital to deploy, the economic repercussions of COVID-19 has presented opportunities of market dislocations to make investments at strategic points of entry. Across the globe, sovereign funds are exploring and investing in tactical deals across public and private markets.
- In Saudi Arabia, drawdowns in reserves resulted from the transfer of USD$40bn from SAMA to the PIF to deploy opportunistically. These investments have thus far included stakes in Live Nation, Equinor, and other tactical bets.
- Across the Middle East, cash-rich funds sought market dislocations from the pandemic, including Qatar seeking investments in health and tech, and Abu Dhabi seeking U.S. deals. Over the course of the market drawdown, Middle East funds have inked USD$25bn of deals.
- In addition to deploying capital, others put transactions on hold to wait out the unfavorable market conditions – ADIA delayed the sale of a USD$2bn private equity book, while the Kuwait Investment Authority paused on pursuing new deals in the event their government would begin capital calls.
- Outside of the GCC, Norway's SWF has taken a similar advantageous approach, while Australia's Future Fund is working to scope out bargains in private markets.

Top reads from around BlackRock

Tactical Investment Views

Mid-year global outlook

The future is running at us. The coronavirus shock is accelerating structural trends in inequality, globalization, macro policy and sustainability. This is fundamentally reshaping the investment landscape and will be key to investor outcomes. The most important action investors need to take today, in our view, is to review their strategic asset allocation to ensure portfolio resiliency. See our investment views.

Opportunities amid volatility

In Q2 2020 BlackRock hosted a weekly client webinar ***BlackRock: Your Week in Context*** on a variety of topics including Sustainability, Real Estate, Portfolio Construction, Fixed Income, Equities and Multi-Asset. Click here for key insights and takeaways from the webinars and polling question responses from institutional clients.

Navigating credit Markets after COVID-19

The coronavirus crisis has brought on a swift turn in the credit downgrade cycle. Through Q1, IG debt downgrades topped USD$400bn in the US, and volumes of fallen angel bonds have hit USD$130bn. As we are only beginning to understand the economic repercussions, we believe this leads to both opportunities and risks for credit investors.

Invest with Impact

Impact investing is gaining interest as a growing share of investors seek tangible progress on environmental and social goals alongside financial returns. In our case for impact investing in public equities, we explore our belief that public equity markets have historically been overlooked in the impact investing space.

Portfolio Construction

Capital Market Assumptions

The coronavirus shock has turned on its head the economic trajectory that markets had priced in at the end of last year. This update to our CMAs considers three important factors: near-term shock, significant market moves and potential impact on medium-term fundamentals of the monetary and fiscal policy revolution.

Investing without a parachute

In the wake of the coronavirus crisis, low and negative government bond interest rates call into question the ability of bonds to provide ballast in future equity selloffs. In such an environment, investors should be rethinking the role of fixed income in portfolio construction and ask if they are at risk of investing without a parachute.

Sustainable Investing: Resilience amid uncertainty

The tremendous toll of the COVID-19 crisis has precipitated a widespread reassessment of the way we live our lives. For governments, businesses, and investors, an essential question has been to understand the sources of resilience and how to build on them to prepare for future crises. Read more on how we're taking this into account.

Private Markets in Downturns: 3 Observations

Defining the optimal set of actions in coping with COVID-19 induced shocks requires all private equity stakeholders to address some major questions. To understand some of the processes, we can build on lessons drawn from previous shocks, from the early 2000 recession and the aftermath of the Global Financial Recession in 2008-09. Read more here.

Additional Resources

Policy Revolution

Macroeconomic policy has undergone a revolution in just three months. But without proper guardrails and a clear exit strategy, read why we believe it is a slippery slope.

Geopolitical risk dashboard

The coronavirus pandemic is the third great crisis of the 21st century. We see the pandemic as accelerating and exacerbating trends that preceded it, including geopolitical fragmentation across trade and technology, rising U.S.-China competition and de-globalization. Read more here.

Investment Stewardship

BlackRock Investment Stewardship publishes a quarterly report offering a global prospective of the range of issues our engagements and voting analyses cover, providing examples that highlight particular ESG considerations, emerging practices and issues. Read our Q1 report .

The BID Podcast

The Bid breaks down what's happening in the markets and explores the forces that are changing investing. Recent highlights include discussions on the climate data revolution, and the role of coronavirus in amplifying geopolitical tensions.

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Proxy Indexes
Global govt bonds = Bloomberg Barclays Global Treasury index
Japan govt bonds = Bloomberg Barclays Global Treasury Japan Index
Euro area credit = ICE BofA Merrill Lynch 10+ Year Euro Corporate Index
Global high yield = ICE BofA Merrill Lynch Global High Yield Index
Euro area govt bonds = Bloomberg Barclays Euro Aggregate Treasury Index
U.S. credit = Bloomberg Barclays U.S. Credit Index
Global IG credit = Bloomberg Barclays Global Aggregate - Corporate
Inflation-linked bonds = ICE BofA Merrill Lynch Global Inflation-Linked Government Index
Euro area inflation-linked bonds = ICE BofA ML EMU Direct Government Inflation Linked Index
US TIPS = Bloomberg Barclays US Government Inflation-Linked Bond Index
EM debt, local = JP Morgan GBI-EM Index
EM debt, hard = JP Morgan EMBI Global Diversified Index
Japan equities = MSCI Japan index
European equities = MSCI Europe index
EM ex-China equities = MSCI Emerging Markets ex-China index
DM equities = MSCI World index
EM equity = MSCI Emerging Markets Index
Onshore Chinese equities = MSCI China A Inclusion NET Index

EMEA
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ADGM

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