JUNE 2017

Investment directions

Shakespearean revels

Measure for Measure

The era is feeling more and more Shakespearean, with tragic—and comic—figures, and surprising twists and turns. The recent U.K. election was the latest in a string of electoral surprises that continue to define the geopolitical environment these days. But for markets, it seems, these events increasingly are "full of sound and fury, signifying nothing," to quote William Shakespeare from *Macbeth*.

Midsummer Night's Dream

The U.K. vote creates more uncertainty about the path ahead for Brexit negotiations, but doesn't have broader ramifications for global markets. Across the channel, we still like European equities. To be sure, these trades are no longer contrarian. Analysis of flows, price momentum and positioning by BlackRock's Risk and Quantitative Analysis team shows they have become consensus. But global reflation, strong earnings recovery and attractive relative valuations mean they should still have room to run.

As You Like It

In the United States, earnings momentum has been strong, we're seeing decent enough economic data and markets continue to chug along to record highs. But valuations are extended, and prospects for tax reform have been fading—although lowered expectations for the latter lower the bar for positive surprises. We're neutral on U.S. stocks overall, but we favor value, financials, technology, selected health care and dividend growers.

All's Well That Ends Well

We also continue to favor emerging markets. Again, this is no longer a contrarian trade, but we note that the flows from investors into the asset class this year still do not replace those that were withdrawn in the last couple of years. In China, softer manufacturing activity and weaker commodity prices have added to concerns about China's economic path, but we don't see reasons to worry about a near-term hard landing.

The Tempest

In short, despite recent political drama and noise, the economic and earnings backdrop for global markets is positive. For investors, at least for now, these ongoing signs of improved global growth and stronger earnings are "such stuff as dreams are made on."

Risk appetite dial

Risk appetite index

Investor risk appetite increased in May as a positive earnings season in both the United States and Europe helped drive equities to all-time highs. While political uncertainty in the United States abounded in the wake of the firing of FBI Director Comey and initially shook markets, the continued stability of hard and soft economic indicators helped ease sentiment, driving bids for both equities and fixed income. Investors rotated $44 billion into global ETPs in the month, with significant flows into internationally focused funds.

Source: BlackRock.

What's new

- **The big mo – p. 10**

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ICR0617U-183719-525983

Overview

Earnings momentum has been strong against a positive economic backdrop. Still, valuations are expensive and selectivity is important in the U.S. market, where value will vary by sector and individual company.

Consider

Active mutual funds

- Equity Dividend Fund (MADVX)
- Health Sciences Opportunities Fund (SHSSX)
- Science & Technology Opportunities Fund (BGSIX)

ETFs

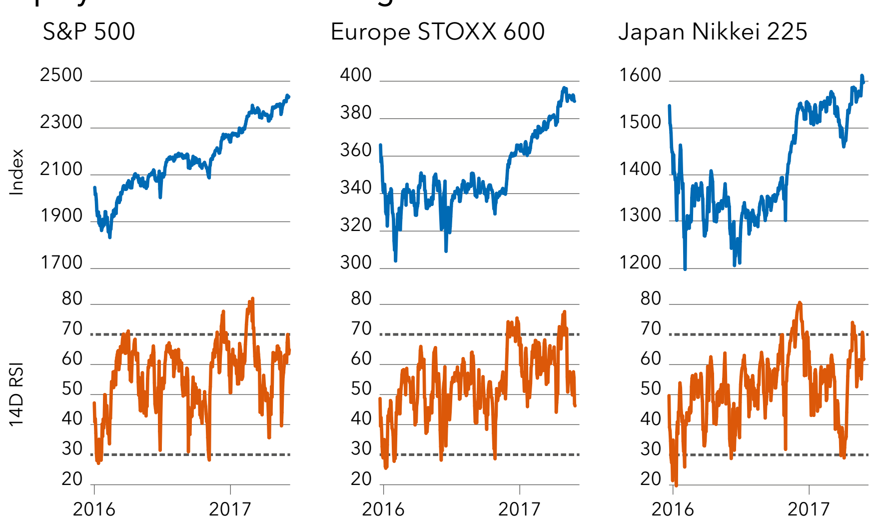
- iShares Core S&P Total U.S. Stock Market ETF (ITOT)
- iShares Core Dividend Growth ETF (DGRO)
- iShares Edge MSCI USA Value Factor ETF (VLUE)
- iShares Edge MSCI Min Vol USA ETF (USMV)

United States

We are neutral on U.S. stocks. With many investors focused on June's poor average returns over the course of this millennium (the S&P 500 is down on average 1.16% in the month), and with new all-time highs being struck in U.S. benchmarks, thoughts of a "June swoon" have surfaced. Much of the financial media has focused (rightly or wrongly) on the ultra-low levels of volatility as though markets have lulled themselves into a false sense of security. Geopolitics can always present a threat to market stability, but at the same time it seems that very little in the way of positive surprises is currently being factored in. In such an environment, a healthy picture of market breadth, including the number of stocks making new highs, relative strength indicators, and a high percentage of the market trading above their trailing averages is supportive of stock markets at current levels. The returns of factors like positive price momentum are among the best year-to-date in the last decade, driven by sectors like technology where revenue gains continue to move in sync with the improving economy. Furthermore, we see no obvious cracks in the economy that could cause an immediate threat to that backdrop.

With this in mind, the Federal Reserve (Fed) continued its policy of gradual tightening with another well-telegraphed rate hike this month. Unemployment is at its lowest level in 16 years, and steady, unspectacular wage gains leave the Fed convinced of hitting its dual mandate in the near future. The consumer balance sheet is healthy and business leverage is at a reasonable level, meaning there is scope for spending and investment to increase from current levels, helped in large part by the low cost of funding over longer periods.

Equity market relative strength index



Sources: Thomson Reuters Datastream and BlackRock Investment Institute, June 5, 2017.
Top charts show equity index level. Bottom charts show relative strength indicator (RSI). RSI is a technical momentum indicator that compares the magnitude of recent gains to losses in an attempt to determine overbought and oversold conditions. **Index returns are for illustrative purposes only. Index performance returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results.**

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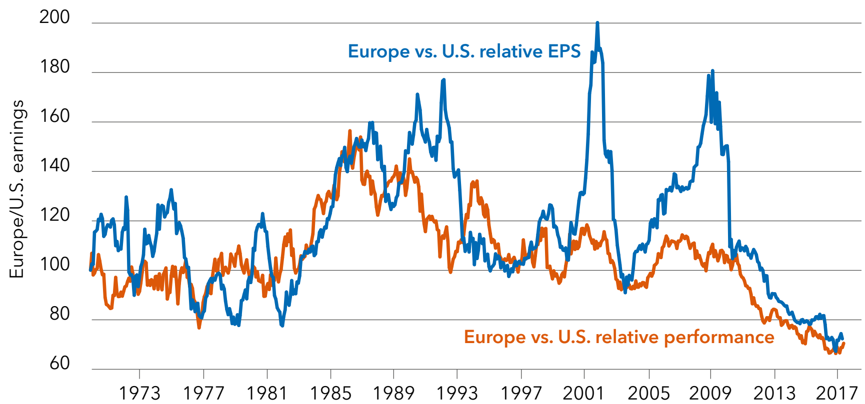
International developed markets

We remain overweight eurozone equities, an exposure that appears to be more consensus but with room to run. This year, just under $20 billion of global exchange traded product (ETP) flows have gone into eurozone equities, which suggests the trade is becoming more popular with investors. Yet the money has not replaced the $40 billion of outflows witnessed from eurozone equities in 2016. Investors seem to have been encouraged by a removal of near-term political risks in the region with a market-friendly outcome from the final round of the French presidential election in May. Going forward, a number of political risks remain, including a potential early Italian general election—recent chatter points to a date as soon as September 2017 alongside the German vote—with anti-euro parties looking to take part. Eurozone equities finished May flat. We think future performance momentum will come mostly from continued earnings outperformance, with the region recently beating other developed markets such as the United States in its earnings growth showing. Historically, eurozone equities have outperformed their U.S. counterparts almost solely during periods of earnings outperformance.

Europe/U.S. equity outperformance: it is an earnings story



Source: BlackRock Investment Institute, as of May 31, 2017. Earnings values represented have been numerically indexed to 100 with 12/31/69 as a base.

Overview

We favor European and Japanese equities, but selectivity is key.

Consider

Active mutual funds

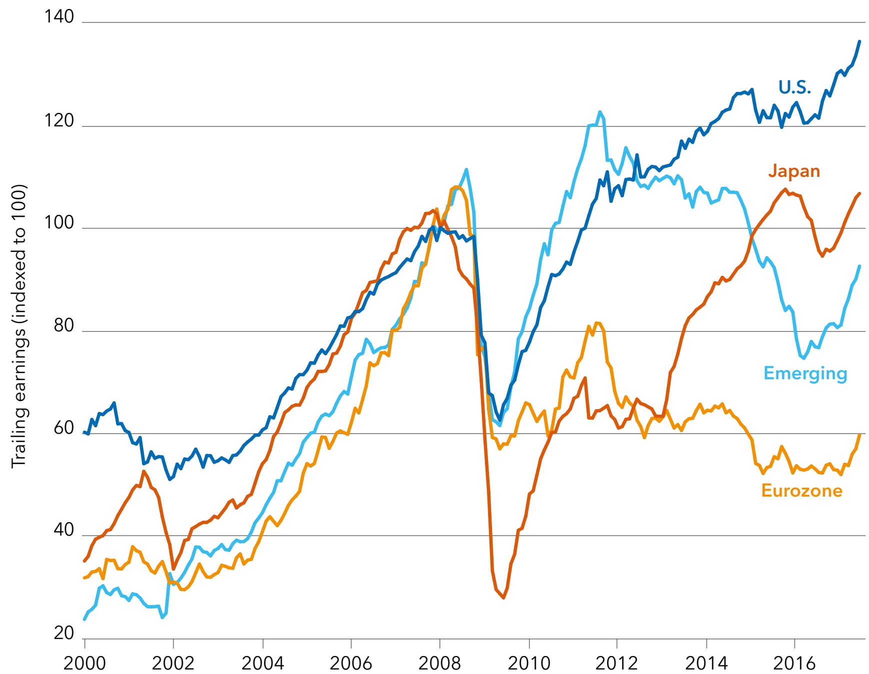
- Global Dividend Fund (BIBDX)
- Global Allocation Fund (MALOX)
- International Fund (MAILX)

ETFs

- iShares Edge MSCI Min Vol Europe ETF (EUMV)
- iShares Currency Hedged MSCI Japan ETF (HEWJ)
- iShares MSCI Canada ETF (EWC)

We are overweight Japanese equities. A raft of positive data over the last month has helped to compress some of the underperformance of Japanese stocks to other global equity peers like Europe, as well as emerging markets. We continue to see Japan as a geared play on global growth. When growth is improving (and surprising), we could expect to see that the historical positive sensitivity to that improvement can once again repeat itself. In that case, the combination of stronger data, a stable yen and positive expectations can continue to follow stronger growth. Furthermore, positioning is not yet at crowded levels, and flows have actually come out of the largest Japan-focused ETFs during a record year for ETF flows. We expect the Bank of Japan to remain supportive for the medium term.

12-month trailing earnings of major regions



Sources: Thomson Reuters Datastream, BlackRock Investment Institute, June 8, 2017. Earnings values represented have been numerically indexed to 100, with 1/1/08 taken as the base.

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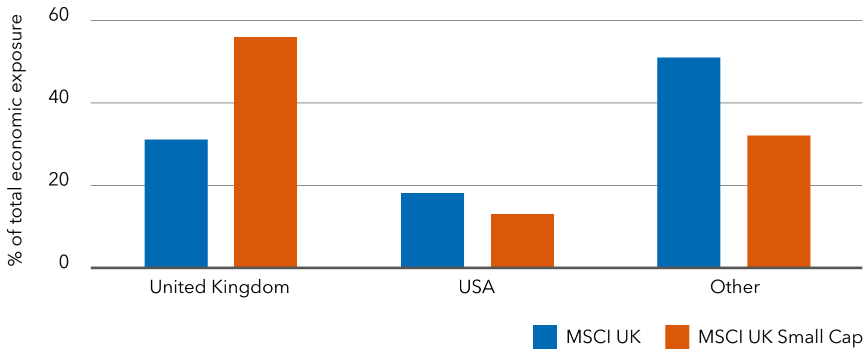
We remain cautious on U.K. equities. The U.K. election resulted in a hung parliament, an outcome that creates uncertainty about the path ahead for Brexit negotiations. Although this is a mild short-term negative for U.K. domestic assets due to the uncertainty, we see a bigger risk of an economically disruptive "no deal" Brexit—one that leaves the United Kingdom without existing trade or security agreements by the hard March 30, 2019 deadline. After the Brexit vote, consensus was that sterling weakness would have less of an influence on U.K. large-cap companies, which typically have more internationally derived revenue, while hurting U.K. small-cap companies, which typically derive more of their revenue domestically. But since Brexit, the MSCI United Kingdom Index has gained 23% and the MSCI United Kingdom Small Cap Index has added 31%, according to Bloomberg as of June 6, 2017. However, recent returns aside, the investment rationale behind the expectation of a U.K. large-cap and small-cap divergence still holds and further sterling weakness could help drive the performance of large cap over small cap.

Trading places

Revenue breakdown by region of the MSCI UK and UK Small Cap Indexes



Source: MSCI, as of June 8, 2017. Economic exposure refers to the source of revenue attributed to the listed regions.

In a reversal of fortunes from 2016, Canadian stocks have lagged most international equity markets this year by a wide margin, particularly those in Asia and Europe. This stands in stark contrast to Canadian economic activity and earnings growth, which so far have eclipsed gains in the rest of the developed world. Annualized first-quarter 2017 GDP growth in Canada expanded 3.2% compared to just 2.0% in the United States and 1.7% in Germany. Estimated 12-month forward earnings per share for Canadian stocks has increased a touch over 20% in the past year, reflecting higher oil prices, better economic growth and fewer energy sector-related writedowns among Canadian banks. Much of the underperformance in Canada this year owes to having too little technology and health care (global leaders) and too much energy and financials (global laggards), but valuations also started the year on the expensive side. Although Canadian stocks have cheapened modestly, expected earnings growth could prove tough to achieve without higher oil prices and more robust economic activity.

Overview

The broad outlook remains positive for emerging markets, but investors should be aware of the risks and remain very selective.

Consider

Active mutual funds

- Total Emerging Markets Fund (BEEIX)

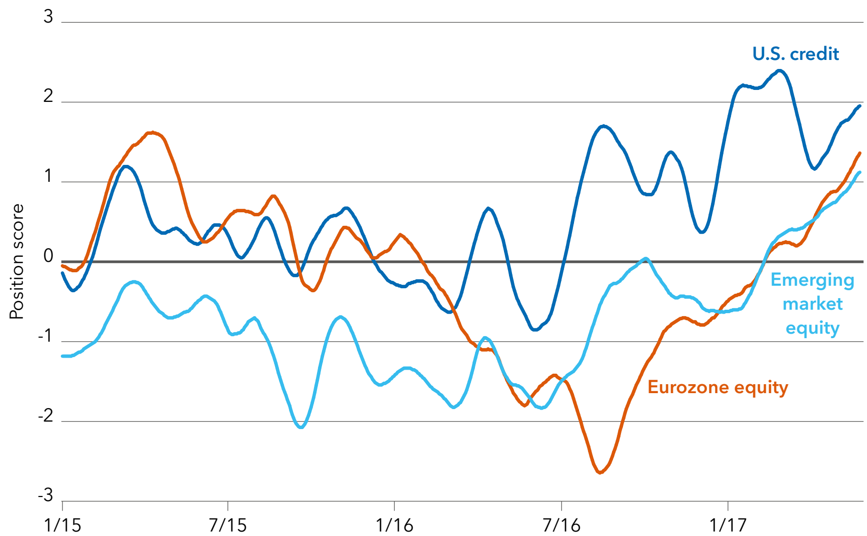
ETFs

- iShares Core MSCI Emerging Markets ETF (IEMG)
- iShares Edge MSCI Min Vol Emerging Markets ETF (EEMV)
- iShares MSCI China ETF (MCHI)
- iShares MSCI India ETF (INDA)

Emerging markets

We remain overweight emerging market equities. As optimism around the outlook for global growth has been building and tail risks such as trade wars appear to be receding—even if only momentarily—investors have been pouring into the asset class. Yet the strong inflows this year have only replaced one-quarter of the outflows experienced over the past four years. Continued global reflation, a pickup in earnings momentum and still-reasonable valuations continue to bode well for emerging market equities. The path of the dollar remains a key factor to monitor. Within the asset class, we favor countries showing strong commitment to reforms and solid economic fundamentals, including India and select Southeast Asian markets.

Positioning across asset classes, 2015-2017



Source: Bloomberg, as of May 1, 2017. **Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results.**

We maintain our overweight to Chinese equities. We anticipate continued stability throughout 2017 but recognize Chinese authorities must strike the right balance between carrying out structural reforms and sustaining economic growth. Recent data have been mixed, with PMIs showing a trend of divergence between weakening manufacturing activity and a still-solid service sector. Furthermore, demand for exports fueled by the broader uptick in global growth remains steady, and industrial profits continue to show momentum, albeit rising at a more moderate pace than prior months. That said, we continue to monitor closely the pace and magnitude of targeted tightening by the People's Bank of China as they could have significant impact on credit growth and economic activity. From an equity perspective, we continue to see potential opportunities in what we see as an underowned asset class and news flow around the opening of China's capital markets as potential catalysts.

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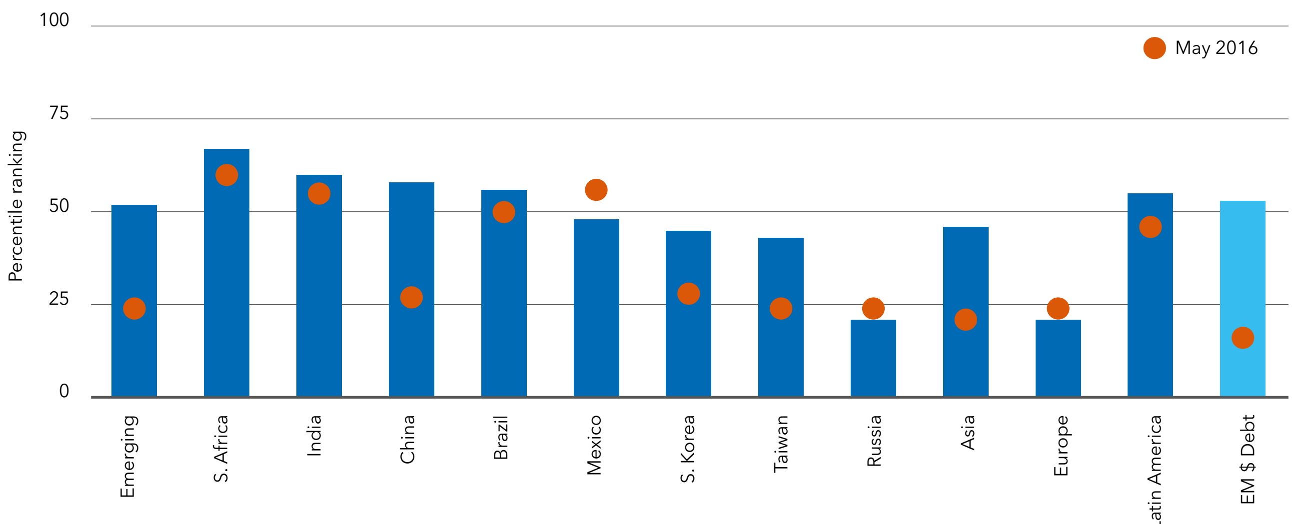
We hold a strategic overweight in Indian equities. Investor confidence in the pro-reform government has continued to fuel returns for risk assets in the Asian country. Economic data including fiscal and trade balances, as well as domestic earnings, are showing slow improvements. As we enter the 2017 monsoon season, rainfall expectations are for a normal year, which is supportive of a continued benign inflation outlook. We watch out for the implementation of the Goods and Services Tax in the near term. Nevertheless, we believe India is on a promising path for the long term and investors should consider building a strategic exposure to its stock market, taking advantage of potential attractive entry points.

We hold a neutral view in Brazil. Recent news surrounding the current president's potential involvement in a bribery scheme have brought political uncertainty in Brazil back to the forefront. This comes at a time when investors had been bidding up the country's assets on the back of optimism about the recovery and what the current administration could deliver from a reform perspective. Renewed uncertainty and the consequent potential delays in passing much-needed structural reforms will likely weigh on the near-term prospects for the Latin American economy, especially on the fiscal front. From an economic perspective, activity is displaying signs of an early recovery with the latest first-quarter GDP reading showing a positive number, the first after eight consecutive quarters of contraction. Meanwhile, the central bank continues its easing program with a recent cut of 100 basis points, adding up to 400 basis points so far in this cycle. The equity market itself has regained some value after the recent correction, but we remain cautious in the face of rising uncertainty.

Valuations of assets vs. historical norm

Current valuation (bars) vs. one year ago (dots)



Sources: BlackRock Investment Institute and Thomson Reuters, as of May 31, 2017.

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Overview

With interest rates still at historic lows in the United States, fixed income investors continue to face challenges in their bond portfolios in managing interest rate duration and interest rate risk, as well as in seeking income or building a diversified core.

Consider

Active mutual funds

- Strategic Income Opportunities Fund (BSIIX)
- Total Return Fund (MAHQX)
- Multi-Asset Income Fund (BIICX)
- Strategic Municipal Opportunities Fund (MAMTX)
- High Yield Bond Fund (BHYIX)

ETFs

- iShares Core U.S. Aggregate Bond ETF (AGG)
- iShares Core Total USD Bond Market ETF (IUSB)
- iShares iBoxx $ Investment Grade Corporate Bond ETF (LQD)
- iShares Edge U.S. Fixed Income Balanced Risk ETF (FIBR)
- iShares iBoxx $ High Yield Corporate Bond ETF (HYG)
- iShares 0-5 Year High Yield Corporate Bond ETF (SHYG)
- iShares National Muni Bond ETF (MUB)
- iShares J.P. Morgan USD Emerging Markets Bond ETF (EMB)

Fixed income

We remain underweight U.S. Treasuries. Treasury yields are trading back near post-election levels, with 10-year yields breaking the recent lower bound of 2.20%. Political turmoil is placing legislative initiatives in doubt and recent CPI data calls into question a trend in firming core inflation. With oil prices once again falling and a number of inflation metrics rolling over, we could be seeing a transitory pause in the reflationary trend, as well as potential yield curve steepening. While many market participants believe that the Fed could pause after the June hike, we believe that at least one more hike is likely to follow later in 2017 as the Fed seems to be determined to embark on an overall policy of "normalization" with respect to the Fed Funds rate and balance sheet. Despite the pause in the reflation trend, investors should consider TIPS longer term for Treasury exposure in portfolios, as tightening labor conditions and wage pressure should eventually impact price levels more broadly.

We are underweight non-U.S. developed market bonds. While some potential event risk exists (e.g., the aftermath of the U.K. election and its implications for Brexit, as well as ongoing questions over funding for Greece), European growth prospects remain largely intact and the European Central Bank seems to be retaining a relatively neutral posture.

We maintain a benchmark weight in high yield. On the back of volatile oil prices and questions surrounding U.S. growth prospects, high yield spreads have ceased tightening and have recently started to come under pressure. While recognizing the income contribution of the sector, we are increasingly cautious as downside risk continues to increase.

We remain overweight investment grade corporates. While remaining at fairly tight levels in spread terms, we continue to favor investment grade as an asset class due to its income profile relative to U.S. Treasuries and more balanced risk profile relative to high yield.

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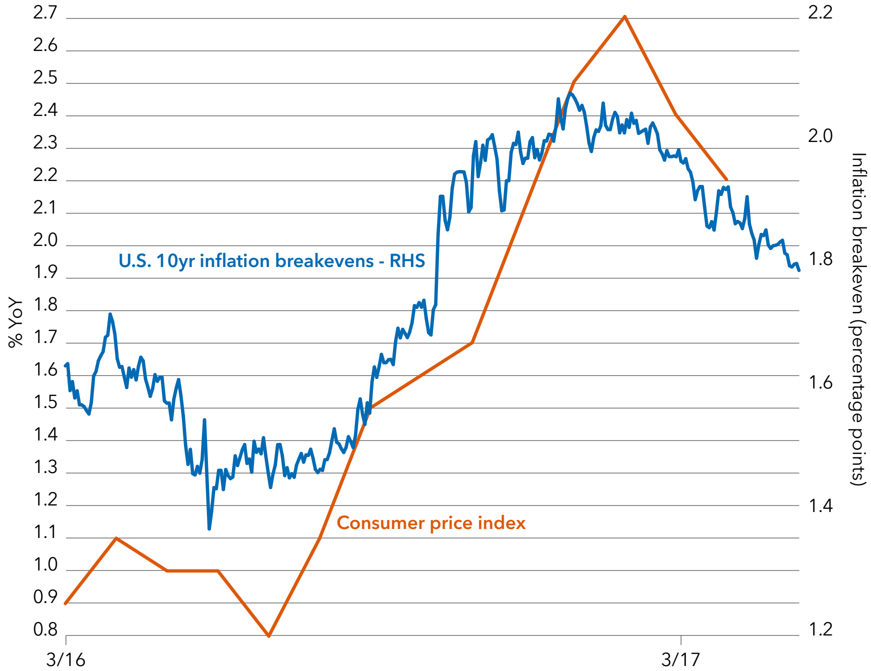
Inflation pause?



Source: Bloomberg, as of June 12, 2017.

We remain neutral on municipal bonds. Municipal bonds turned in a strong performance in May, with the S&P National AMT-Free Municipal Bond Index up nearly 1.5%. With dramatic changes to the tax code seemingly put off for now, there is less uncertainty surrounding the asset class. Supply technicals actually appear favorable, with net maturities and coupon payments projected to exceed seasonal issuance. However, we remain neutral as the asset class now appears somewhat richly valued, especially compared to Treasuries.

We maintain a benchmark weight in U.S. agency mortgages. With interest rate levels and volatility remaining relatively constrained, agency mortgages are currently providing better risk-adjusted yield relative to similar duration U.S. Treasuries. Longer term, however, change to the Fed's reinvestment policy regarding holdings of mortgage-backed securities (balance sheet normalization) does create some risk for the asset class and current valuations underscore our neutral rating.

We maintain a neutral position on emerging market bonds. EM debt, particularly hard currency, has been the beneficiary of significant flows as of late and the asset class posted strong returns in May. While local currency, which we favored on a relative basis, did indeed outperform hard currency debt in May, EM debt broadly appears to be richly valued, causing us to maintain our neutral position.

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The big mo

The recent return of the “FANG” stocks (Facebook, Amazon/Apple, Netflix, Google) to the popular lexicon is no surprise given the performance of technology this year. However, the performance of stocks overall comes against a backdrop of solid economic data, with markets generally aligned with and accepting of Federal Reserve policy.

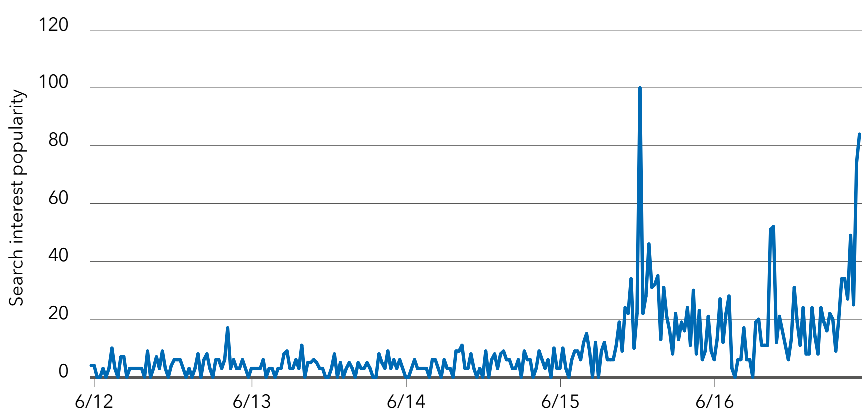
Stocks have been demonstrating elements of classic “momentum,” the investment approach that isolates stocks with improving prices or for which there is strong market sentiment, with the idea that they will continue to trend higher in the short term. Our research indicates that the prevailing economic environment and the breadth of returns in equity markets are supportive of momentum continuing to contribute to returns.

Moreover, when nearly 80% of the names in each of the major U.S., European and Japanese markets are trading above their one-year moving average by mid-May, U.S. equity markets have posted solid gains in the next 6 to 12 months.[1] Of course, high momentum markets do not exclude the chances of bumps in the road.

For example, in each of the last five years with gaudy year-end returns, there were temporary second-half pullbacks in the S&P 500, ranging from monthly returns of -1.2% to -14.6%, with the average being -5.8%.

To be sure, past performance does not indicate the future, and we still believe that future market returns are likely to be muted in the United States. But with the economic cycle on solid footing and the current expansion continuing with room to progress further, investors will want to pay attention to the market’s breadth.

“FANG” internet search interest (Category: Finance, United States)



Source: Google Trends, as of June 8, 2017. Numbers represent search interest relative to the highest point on the chart for the given region and time. A value of 100 is the peak popularity for the term. A value of 50 means that the term is half as popular. Likewise a score of 0 means the term was less than 1% as popular as the peak.

1 Source: BlackRock analysis of S&P 500 data since 1990.

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Drilling down: Equity and fixed income outlooks

Our View and Outlook

Global Region	underweight ◀		neutral		▶ overweight
Developed markets	○	○	●	○	○
North America					
United States	○	○	●	○	○
Canada	○	○	●	○	○
Europe					
Eurozone	○	○	○	●	○
United Kingdom	○	●	○	○	○
Asia Pacific					
Japan	○	○	○	●	○
Emerging Markets	○	○	○	●	○
Asia Pacific					
China	○	○	○	●	○
India	○	○	○	●	○
South Korea	○	●	○	○	○
Latin America					
Brazil	○	○	●	○	○
Mexico	○	○	●	○	○
Fixed Income Sector	**underweight ◀**		**neutral**		**▶ overweight**
U.S. Treasuries	○	●	○	○	○
U.S. TIPS	○	○	○	●	○
U.S. Investment Grade Credit	○	○	○	●	○
U.S. High Yield Credit	○	○	●	○	○
U.S. Municipals	○	○	●	○	○
U.S. Mortgage-Backed Securities	○	○	●	○	○
Non-U.S. Developed Markets	○	●	○	○	○
Emerging Markets	○	○	●	○	○
	underweight ◀		**neutral**		**▶ overweight**
Gold	○	○	●	○	○

● underweight outlook ● slightly underweight outlook
● current neutral outlook ● slightly overweight outlook
● overweight outlook

Underweight: Potentially decrease allocation
Neutral: Consider benchmark allocation
Overweight: Potentially increase allocation

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Let us know…

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Fixed income risks include interest-rate and credit risk. Typically, when interest rates rise, there is a corresponding decline in bond values. Credit risk refers to the possibility that the bond issuer will not be able to make principal and interest payments. There may be less information on the financial condition of municipal issuers than for public corporations. The market for municipal bonds may be less liquid than for taxable bonds. Some investors may be subject to federal or state income taxes or the Alternative Minimum Tax (AMT). Capital gains distributions, if any, are taxable. Noninvestment-grade debt securities (high-yield/junk bonds) may be subject to greater market fluctuations, risk of default or loss of income and principal than higher-rated securities.

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