

Weekly commentary

Dec. 02, 2019

BlackRock

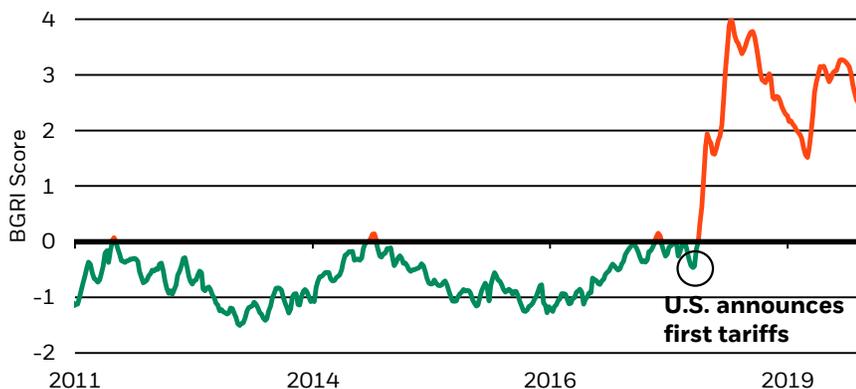
Taking stock of our 2019 views

- We identified the protectionist push as a key market driver this year but we did not foresee the massive move down in global yields.
- We see growth stabilizing and gradually picking up over the next 6 to 12 months thanks in part to loose financial conditions.
- Markets will focus on fresh U.S. manufacturing and jobs data for signs that the worst of the economic slowdown is behind us.

In 2019 the key drivers of global markets have been trade tensions and central bank easing, in our view. We were early to see that a protectionist push would hurt the industrial cycle and business investment – a key reason for our global growth downgrade. And we were correct to say that government bonds would play a crucial role as ballast during equity sell-offs even at low yields. But we did not see such a strong and persistent flight to safety and the unusual synchronized easing pivot from central banks at this advanced stage in the expansion.

Chart of the week

BlackRock Geopolitical Risk Indicator for global trade tensions, 2011-2019



Source: BlackRock Investment Institute, with data from Refinitiv. Data as of November 22, 2019. Notes: We identify specific words related to geopolitical risk in general and to our top-10 risks. We then 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.

We said that geopolitics and trade disputes would be a major driver of asset prices and volatility in 2019. This has played out, as seen in the chart above. Our [BlackRock Geopolitical Risk Indicator](#) for trade tensions shows that market attention to the protectionist push picked up through the year. It remains elevated, even after the U.S. and China talk up phase-1 trade-deal progress. We see a temporary truce in 2020 as likelier than not. Even if a deal isn't signed this year or early next, market participants may be happy if the current détente is preserved and tariffs scheduled for Dec. 15 are postponed. Risks remain: the shifting sands of domestic politics in both countries, including around the situation in Hong Kong, could change the calculus currently favouring a truce.



Scott Thiel
Chief Fixed Income Strategist – BlackRock Investment Institute



Beata Harasim
Senior Investment Strategist – BlackRock Investment Institute



Elga Bartsch
Head of Macro Research – BlackRock Investment Institute



Jean Boivin
Head of BlackRock Investment Institute

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

BlackRock Investment Institute

Central banks have eased policy with the aim of offsetting the trade shock and sustaining the economic expansion. Yet we did not see this coming in our 2019 outlook given the late stage of the business cycle, with interest rates low, inflation subdued and consumers in strong shape. The surprising force of this dovish tilt has made it a big driver of markets, becoming one of our investment themes early in the year. As global bonds have rallied, yields have fallen in some places and tested the lower limits of central bank policy rates. Central bank easing, declining bond yields and strong risk asset markets have led to the recovery of our Financial Conditions Indicator. This now suggests that global growth should pick up over the next 6-12 months. Especially in Europe and Japan, monetary policy may have reached its limit in stoking growth and an unprecedented mix of fiscal and monetary policy will be needed if and when the next downturn arrives.

Elevated macro uncertainty in the late stage of the cycle reinforced our call for building portfolio resilience. Even at low yields, we said that bonds would play a key role in protecting portfolios against equity sell-offs. This happened in May and August. Yet we did not see how low rates would fall from already depressed levels. U.S. Treasuries rallied more than we anticipated, even though market expectations for aggressive Federal Reserve easing and for a recession were excessive, as we identified. The plunge of bond yields to new lows earlier this year amounts to a paradigm shift that is challenging the role of some government bonds as ballast in portfolios given how close yields are to their effective lower bound.

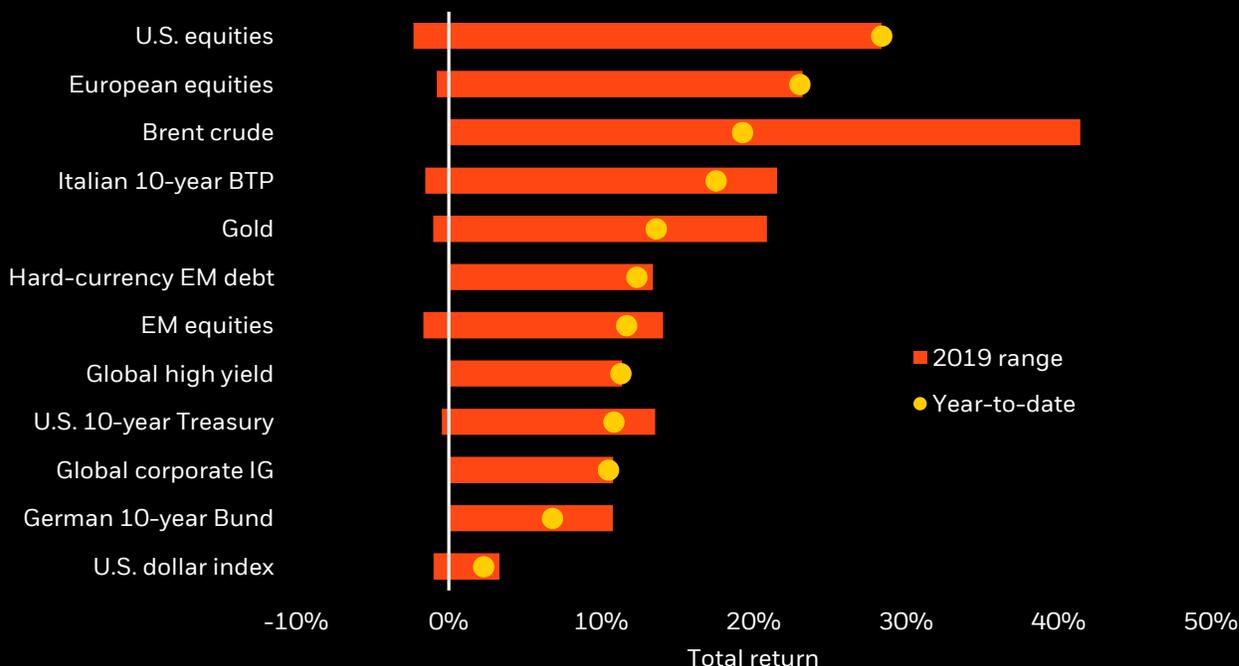
We were correct to take a modestly risk-on stance during the second half of 2019. Yet we were neutral on global duration and should have been overweight given the bond rally. We were right to stay overweight U.S. equities as a way to play our up-in-quality view, and the quality factor also outperformed. We missed the boost that Japanese equities would get starting in September from the lull in the protectionist push, but were right to underweight emerging market (EM) equities given their vulnerability to U.S.-China trade tensions. We were overweight EM debt because of the high yields on offer, and were positive on euro area bonds – especially in the periphery – on the prospect of ECB stimulus. Both outperformed. We will revise some of our asset views in our 2020 outlook as we re-evaluate macro and market drivers on a tactical horizon.

Market backdrop

A perceived lull in geopolitical frictions has boosted risk assets. We are on the watch for more signs that global manufacturing may be bottoming out, as well as signs that the drag on economic activity from the global protectionist push is spreading beyond manufacturing. We see the dovish pivot by major central banks as having run its course for now. Monetary policy is no cure for the weaker growth and firmer inflation pressures that may result from sustained trade tensions. We expect growth to stabilize and gradually pick up over the next 6 to 12 months thanks in part to loose financial conditions. See our macro data dashboard.

Assets in review

Selected asset performance, 2019 year-to-date and range



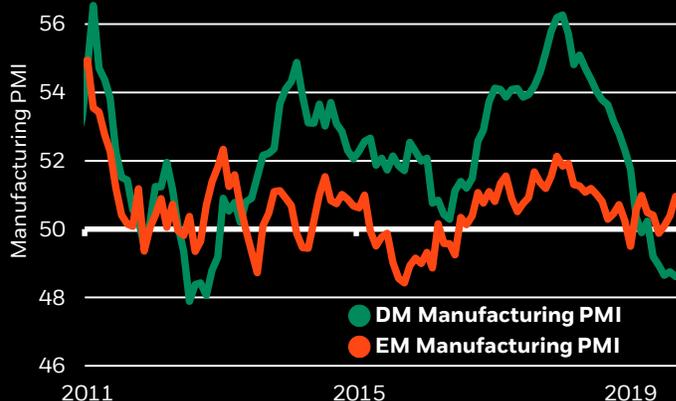
Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index. Sources: BlackRock Investment Institute, with data from Refinitiv Datastream, November 2019. Notes: The two ends of the bars show the lowest and highest returns versus the end of 2018, 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. BIIM119U-1020724-2/5

Macro insights

Economic activity – especially manufacturing – has been slowing over the past two years in developed markets (DM). In 2019 – for the first time since the European debt crisis – the aggregate DM manufacturing PMI has been consistently below the emerging market (EM) equivalent. This is unlikely to change in the short term. Flash PMIs for November in the U.S. and Europe suggested that the worst of the deceleration may have passed. Germany's manufacturing PMI rose and the overall euro area index inched up. Both remained in contractionary territory. Manufacturing activity accelerated in the U.S., helped by the end of auto strikes. Further improvement in the manufacturing cycle is likely. Financial conditions are accommodative and there are signs of a trade détente. Yet the DM manufacturing PMI may not rise back above the EM PMI soon. The IMF expects a faster rebound in the emerging economies in 2020 than in the developed world and the latest round of PMIs support this theme.

Trading Places

EM and DM manufacturing PMIs, 2011–2019



Sources: BlackRock Investment Institute and IHS Markit, with data from Refinitiv Datastream, November 2019. Notes: The chart shows the composite IHS Markit manufacturing purchasing managers' index (PMI) for developed markets and for emerging markets.

Investment themes

1 Protectionist push

- U.S. and China negotiators are working toward a “Phase 1” trade deal. Agreement has so far proven elusive due to additional demands – including tariff rollbacks by China and language on forced technology transfers by the U.S. – as well as a bill relating to Hong Kong that President Trump has now signed into law.
- We see a temporary truce in 2020 as likelier than not. Both sides have incentives that point toward a pause, and China has so far compartmentalized trade talks from broader political differences with the U.S. A key milestone will be Dec. 15, the date scheduled for the next round of U.S. tariff increases.
- The likelihood seems to have risen of a revised North American trade pact being ratified soon.
- Yet persistent uncertainty from protectionist policies is denting corporate confidence and slowing business spending, hurting the global industrial cycle – a key reason for our global growth downgrade.
- The longer-term risk from protectionism: The unravelling of global supply chains delivers a supply shock that saps productivity growth, reinforces a slowdown in potential output and leads to higher inflation.
- Risks of a no-deal Brexit have diminished. Yet a general election on Dec. 12 has created uncertainty on what follows.
- **Market implication:** We favor reducing risk amid rising protectionism, including raising some cash.

2 Stretching the cycle

- Central banks have eased policy significantly with the aim of offsetting the trade shock and sustaining the economic expansion in the face of a manufacturing recession.
- We expect growth to stabilize over 6-12 months and see a mild pick up thanks in part to loose financial conditions and a manufacturing recovery. This should take the reins from monetary policy in supporting risky assets.
- We believe the Federal Reserve and other central banks are done with policy easing barring other shocks. We don't expect China to provide major stimulus as its economy slows further, reflected in last month's small rate cut.
- The trade war is bad for growth, but we still see potential for U.S. inflation to rise in the near term due to the direct impact of tariffs and in the long term due to the hit to production capacity, complicating the case for policy easing.
- We believe policymakers should lay the groundwork for a credible plan to navigate the next economic shock that includes unprecedented coordination between monetary and fiscal measures. We lay out the contours of such a framework in [Dealing with the next downturn](#).
- **Market implication:** We like U.S. equities and EM debt. We are tactically overweight euro area government bonds: a relatively steeper yield curve brightens their appeal even at low yields. We are neutral European equities and credit.

3 Raising resilience

- This year's sharp shift on monetary policy and interest rate expectations has pushed some bond yields near levels we consider as their lower bound, implying less room to fall during risk asset sell-offs.
- A weakening or breakdown of the negative correlation between stocks and bonds could also undermine the portfolio ballast role of government bonds.
- **Market implication:** We prefer U.S. Treasuries over German and Japanese government bonds on a strategic basis.

Week ahead

Dec. 02 – Dec. 06 – Data releases this week in the U.S. should provide further insights on whether the worst of the economic slowdown is behind us. We will watch ISM PMIs to see if the manufacturing slowdown is bottoming out and U.S. non-farm payrolls for a sign that consumer momentum is maintained after a positive surprise last month. U.S. growth has been slowing this year but we expect it to pick-up in 2020.

Asset views

Views from a U.S. dollar perspective over a 6-12 month horizon

| Asset class | View | Comments |
|--------------|-----------------------|---|
| Equities | U.S. | ▲ 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. |
| | Europe | — 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. |
| | Japan | ▼ 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. |
| | EM | — 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. |
| | Asia ex-Japan | ▼ 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. |
| Fixed income | U.S. government bonds | ▼ 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. |
| | U.S. municipals | — Favorable supply-demand dynamics and improved fundamentals are supportive. The tax overhaul has made munis' tax-exempt status more attractive. Yet muni valuations are on the high side, and the asset class may be due for a breather after a 10-month stretch of positive performance. |
| | U.S. credit | — 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. |
| | European sovereigns | ▲ 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. |
| | European credit | — 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. |
| | EM debt | ▲ 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. |
| | Asia fixed income | — 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. |

▲ Overweight — Neutral ▼ Underweight

BlackRock Investment Institute

The BlackRock Investment Institute (BII) leverages the firm's expertise and generates proprietary research to provide insights on the global economy, markets, geopolitics and long-term asset allocation – all to help our clients and portfolio managers navigate financial markets. BII offers strategic and tactical market views, publications and digital tools that are underpinned by proprietary research.

General Disclosure: This material is not intended to be relied upon as a forecast, research or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy. The opinions expressed are as of Dec. 02, 2019, and may change. The information and opinions are derived from proprietary and non-proprietary sources deemed by BlackRock to be reliable, are not necessarily all-inclusive and are not guaranteed as to accuracy. As such, no warranty of accuracy or reliability is given and no responsibility arising in any other way for errors and omissions (including responsibility to any person by reason of negligence) is accepted by BlackRock, its officers, employees or agents. This material may contain 'forward looking' information that is not purely historical in nature. Such information may include, among other things, projections and forecasts. There is no guarantee that any forecasts made will come to pass. Reliance upon information in this material is at the sole discretion of the reader.

In the U.S. and Canada, this material is intended for public distribution. **In the UK and outside the EEA:** This material is for distribution to professional clients (as defined by the Financial Conduct Authority or MiFID Rules) and qualified investors only and should not be relied upon by any other persons. Issued by BlackRock Investment Management (UK) Limited, authorised and regulated by the Financial Conduct Authority. Registered office: 12 Throgmorton Avenue, London, EC2N 2DL. Tel: 020 7743 3000. Registered in England No. 2020394. BlackRock is a trading name of BlackRock Investment Management (UK) Limited. In the EEA, it is issued by BlackRock (Netherlands) BV: Amstelplein 1, 1096 HA, Amsterdam, Tel: 020 – 549 5200, Trade Register No. 17068311. BlackRock is a trading name of BlackRock (Netherlands) B.V. **For qualified investors in Switzerland,** this material shall be exclusively made available to, and directed at, qualified investors as defined in the Swiss Collective Investment Schemes Act of 23 June 2006, as amended. **In South Africa,** please be advised that BlackRock Investment Management (UK) Limited is an authorised financial services provider with the South African Financial Services Board, FSP No. 43288. **In DIFC:** This information can be distributed in and from the Dubai International Financial Centre (DIFC) by BlackRock Advisors (UK) Limited – Dubai Branch which is regulated by the Dubai Financial Services Authority (DFSA) and is only directed at 'Professional Clients' and no other person should rely upon the information contained within it. Neither the DFSA or any other authority or regulator located in the GCC or MENA region has approved this information. This information and associated materials have been provided for your exclusive use. This document is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution would be unlawful under the securities laws of such. Any distribution, by whatever means, of this document and related material to persons other than those referred to above is strictly prohibited. **In Singapore,** this is issued by BlackRock (Singapore) Limited (Co. registration no. 200010143N). **In Hong Kong,** this material is issued by BlackRock Asset Management North Asia Limited and has not been reviewed by the Securities and Futures Commission of Hong Kong. **In South Korea,** this material is for distribution to the Qualified Professional Investors (as defined in the Financial Investment Services and Capital Market Act and its sub-regulations). **In Taiwan,** Independently operated by BlackRock Investment Management (Taiwan) Limited. Address: 28F., No. 100, Songren Rd., Xinyi Dist., Taipei City 110, Taiwan. Tel: (02)23261600. **In Japan,** this is issued by BlackRock Japan, Co., Ltd. (Financial Instruments Business Operator: The Kanto Regional Financial Bureau. License No375, Association Memberships: Japan Investment Advisers Association, the Investment Trusts Association, Japan, Japan Securities Dealers Association, Type II Financial Instruments Firms Association.) For Professional Investors only (Professional Investor is defined in Financial Instruments and Exchange Act). **In Australia,** issued by BlackRock Investment Management (Australia) Limited ABN 13 006 165 975 AFSL 230 523 (BIMAL). The material provides general information only and does not take into account your individual objectives, financial situation, needs or circumstances. **In China,** this material may not be distributed to individuals resident in the People's Republic of China ("PRC", for such purposes, excluding Hong Kong, Macau and Taiwan) or entities registered in the PRC unless such parties have received all the required PRC government approvals to participate in any investment or receive any investment advisory or investment management services. **For Other APAC Countries,** this material is issued for Institutional Investors only (or professional/sophisticated/qualified investors, as such term may apply in local jurisdictions) and does not constitute investment advice or an offer or solicitation to purchase or sell in any securities, BlackRock funds or any investment strategy nor shall any securities be offered or sold to any person in any jurisdiction in which an offer, solicitation, purchase or sale would be unlawful under the securities laws of such jurisdiction. **In Latin America,** for institutional investors and financial intermediaries only (not for public distribution). This material is for educational purposes only and does not constitute investment advice or an offer or solicitation to sell or a solicitation of an offer to buy any shares of any fund or security. If any funds are mentioned or inferred in this material, such funds may not be registered with the securities regulators of any Latin American country and thus, may not be publicly offered in any such countries. The provision of investment management and investment advisory services is a regulated activity in Mexico thus is subject to strict rules. No securities regulator within Latin America has confirmed the accuracy of any information contained herein.

The information provided here is neither tax nor legal advice. Investors should speak to their tax professional for specific information regarding their tax situation. Investment involves risk including possible loss of principal. International investing involves risks, including risks related to foreign currency, limited liquidity, less government regulation, and the possibility of substantial volatility due to adverse political, economic or other developments. These risks are often heightened for investments in emerging/developing markets or smaller capital markets.

© 2019 BlackRock, Inc. All Rights Reserved. **BlackRock** is a registered trademark of BlackRock, Inc. or its subsidiaries in the United States and elsewhere. All other trademarks are those of their respective owners.