2021 global outlook - update

BlackRock
Investment Institute

March 30, 2021
A new investment order
2021 investment themes

**The new nominal**  –  We see a more muted response of government bond yields to stronger growth and higher inflation than in the past, as central banks lean against any sharp yield rises. We believe this should support risk assets, even as the restart takes shape.

**Strategic implication:** We favor inflation-linked bonds amid inflationary pressures in the medium term.  
**Tactical implication:** We prefer to take risk in equities over credit amid low rates and tight spreads.

**Globalization rewired**  –  Covid-19 has accelerated geopolitical transformations such as a bipolar U.S.-China world order and a rewiring of global supply chains, placing greater weight on resilience.

**Strategic implication:** We favor deliberate country diversification and above-benchmark China exposures.  
**Tactical implication:** We like Asia ex-Japan equities, and see UK equities as an inexpensive, cyclical exposure.

**Turbocharged transformations**  –  The pandemic has added fuel to pre-existing structural trends such as an increased focus on sustainability, rising inequality within and across nations, and the dominance of e-commerce at the expense of traditional retail.

**Strategic implication:** We prefer sustainable assets amid a growing societal preference for sustainability.  
**Tactical implication:** We favor tech and healthcare as well as selected cyclical exposures.

The opinions expressed are as of March 2021 and are subject to change at any time due to changes in market or economic conditions. Strategic implications refer to long-term views, tactical implications refer to asset views on a 6-12 month horizon.
What's new

Directional view changes, March 2021

<table>
<thead>
<tr>
<th>Strategic view</th>
<th>Tactical view</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Credit</strong></td>
<td></td>
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<tr>
<td>-1</td>
<td>Neutral</td>
</tr>
<tr>
<td><strong>Govt bonds</strong></td>
<td></td>
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<tr>
<td>-1</td>
<td>-1</td>
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<tr>
<td><strong>Equities</strong></td>
<td></td>
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<tr>
<td>+1</td>
<td>+1</td>
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</tbody>
</table>

**Credit**
- **Strategic horizon**: Move to underweight given rich valuations, prefer equities to take risk.
- **Tactical horizon**: Downgrade credit to neutral following the tightening in spreads, particularly investment grade. Still like high yield for income.

**Govt bonds**
- **Strategic horizon**: Stay underweight given diminished ability to act as portfolio ballasts. We prefer inflation-linked bonds. Rising debt levels may eventually pose risks to the low-rate regime.
- **Tactical horizon**: Move to underweight duration on expected higher nominal yields driven by the economic restart.

**Equities**
- **Strategic horizon**: We turn overweight equities. A better outlook for earnings, moderate valuations and relative appeal of developed market equities brightened on incorporating climate change in our expected returns.
- **Tactical horizon**: We stay overweight as we see expect the restart to accelerate and interest rates to stay low.

Tactical granular view changes, March 2021

<table>
<thead>
<tr>
<th>Euro area equities</th>
<th>Upgrade to neutral</th>
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</thead>
<tbody>
<tr>
<td><strong>U.S. Treasuries</strong></td>
<td>Increase underweight</td>
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<tr>
<td><strong>Euro area peripheral bonds</strong></td>
<td>Downgrade to neutral</td>
</tr>
<tr>
<td><strong>UK equities</strong></td>
<td>Overweight</td>
</tr>
</tbody>
</table>

- **Euro area equities**: We believe that there is room for the market to close the valuation gap vs. the rest of the world as the economic restart becomes more entrenched.
- **U.S. Treasuries**: We see nominal U.S. yields rising but largely due to a repricing higher of inflation expectations. We prefer inflation-linked bonds.
- **Euro area peripheral bonds**: Yields have pushed to record lows and spreads have narrowed.
- **UK equities**: We believe the end of Brexit uncertainty should reduce the risk premium on UK assets. UK equities are an attractive play on the global cyclical recovery.
Speedy vaccine rollout in the U.S. and UK

The UK vaccination rollout has reached about half the population, with the U.S. not far behind. Reduced pressure on hospitals will be key to relaxing activity restrictions.

Vaccines doses administered per 100 people, March 2021

Source: BlackRock Investment Institute, Our World in Data, and Haver Analytics, with data as of 29 March 2021. Notes: The chart shows the number of Covid-19 vaccination doses administered per 100 people within a given country. The dotted lines represent the path of vaccinations that would result in 25 or 50 doses administered per 100 people by April 1st, 2021, assuming a constant daily pace and a vaccination start date of 15 December 2020. Note that this does not measure the total share of people that have been fully vaccinated. For most vaccines, full vaccination requires two doses.
Reduced estimates of Covid-19 activity impact

Consensus expectations of the size of the shock have been revised down materially, particularly for the euro area. We believe vaccine rollouts are likely to stoke a sharper-than-expected rebound.

Estimated cumulative loss from the Covid-19 shock and GDP estimate, March 2021

Forward looking estimates may not come to pass. Sources: BlackRock Investment Institute, with data from Refinitiv Datastream and Reuters News, March 2021. The left chart tracks the evolution of consensus estimates for the cumulative loss in GDP due to the Covid shock. The standalone dots on the left show the total cumulative loss as a result of the global financial crisis. Lines show the evolution of the most pessimistic estimates of the cumulative loss in GDP arising from the Covid shock, based on data and consensus forecasts available at each point in time. The numbers change over time due to the publication of GDP data and updated consensus forecasts of future GDP growth. Early aftermath forecasts were dated from April for China, and June for the U.S. and Euro area, reflecting the fact that the Covid shock hit China GDP most in 2020Q1, but in other countries in 2020Q2. The middle estimates ‘Just before vaccine news’ are dated from early November 2020, prior to the first announcement of an effective globally available vaccine in mid-November. The ‘Latest’ forecasts are based on GDP data up to 2020Q4 in all economies, and consensus forecasts of GDP growth as of late January 2021.
Pent-up demand to fuel the powerful restart

We see pent-up demand in contact-intense services rebounding sharply as restrictions are lifted in the U.S. and euro area – and as seen in China – supported by the accumulation in personal savings.

U.S. and euro area disposable income vs consumer spending, March 2021

Source: BlackRock Investment Institute, Bureau of Economic Analysis, U.S. Treasury Department, Opportunity Insights, Bureau of Labor Statistics, Eurostat, with data from Haver Analytics, March 2021. Notes: The left-hand chart shows U.S. nominal household disposable income (orange line) and nominal personal consumer spending (yellow line). Data for March 2021 are forecasts based on data from the Daily Treasury Statement, U.S. Employment Situation Report and weekly card spending data. The chart on the right shows euro area household disposable income (orange line) and household consumer spending (yellow line). Data for 2020Q4 are projected based on preliminary data for Germany and France. Excess saving is defined as total household saving since February 2020 in excess of average annual household savings in 2019.
The new nominal

We see a more muted response of government bond yields to stronger growth and higher inflation than in the past, as central banks lean against any sharp yield rises. We believe this should support risk assets.

Strategic implication: We favor inflation-linked bonds amid inflationary pressures in the medium term.

Tactical implication: We prefer to take risk in equities over credit amid low rates and tight spreads.
Huge fiscal support: ¼ the shock, 4x times the fiscal impulse
This is a huge fiscal impulse relative to the size and the nature of the Covid-19 shock. And it is not about stimulating activity – a large share of activity will restart on its own as vaccines are rolled out.

Estimate of Covid-19 shock and discretionary fiscal support compared vs the GFC, March 2021

Sources: BlackRock Investment Institute, with data from Haver Analytics, March 2021. Notes: The charts show our estimate of the cumulative GDP loss from the GFC (2008-2009) and our expectation for the Covid-19 (2020-2021) and the discretionary fiscal support for the US and euro area during each period.
U.S. debt: double the level, half the cost
Debt levels have risen to record highs as fiscal stimulus has driven the recovery. Markets do not appear overly concerned so far but perceptions and sentiment could shift – the equilibrium is fragile.

U.S. debt and interest cost, 1990–2025

Forward-looking estimates may not come to pass. Source: BlackRock Investment Institute, IMF and OECD using data from Haver Analytics, March 2021. Note: the left chart shows U.S. government debt and net interest costs. Net interest cost is calculated as the difference between U.S. general government net borrowing and U.S. general government primary deficit and expressed as a share of nominal GDP. For the period 1990–2000 data are from the OECD, and for 2001 data are from the IMF. For the period 2021–2025 projections are provided by the IMF October 2020 World Economic Outlook. The right chart shows interest costs and a few scenarios. The first scenario in red shows hypothetical interest costs assuming that the effective interest rate on the existing debt stock rises quickly to 2.5% and holds there over the next four years. The second scenario shows the hypothetical impact of a more gradual rise to 2.5% by 2025. The green line shows the IMF’s October 2020 projections.
The new nominal accelerates
U.S. real yields remain low – a positive for risk assets – even as nominal yields have risen to reflect the sharp repricing higher of inflation expectations as reflected in breakeven inflation rates.

U.S. 10-year Treasury yield, breakeven inflation and real yield vs. our estimate, March 2021

Source: BlackRock Investment Institute and Refinitiv Datastream, data as of 29 March 2021. Notes: The chart shows the U.S. 10-year Treasury yield and the pricing of Treasury inflation protected securities – the 10-year TIPS yield, or real yield, and the breakeven inflation rate, or the future rate of inflation being priced by markets in TIPS. The chart also shows our 5-year ahead expected values for U.S. 10-year nominal yields using the Bloomberg Barclays U.S. Government bond index as a proxy and our estimates for 10-year average inflation from Dec 2026-2036. Forward looking estimates may not come to pass. Past performance is not a reliable indicator of current or future results. Indexes are unmanaged and do not account for fees. It is not possible to invest directly in an index.
We prefer equity to credit in strategic allocations
We find more appeal in equities where valuations are more in line with history even after the rally. Credit spreads have tightened to historical lows following the sharp rebound from last March.

Equity risk premiums and credit spreads, current vs historical, March 2021

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Source: BlackRock Investment Institute and Refinitiv Datastream, data as of February 2021. The chart shows the equity risk premium and historical ranges since 1995 for major equity regions based on MSCI indices and the credit spreads for the U.S. Investment Grade and High Yield markets based on Bloomberg Barclays indices. We calculate the equity risk premium based on our expectations for nominal interest rates and the implied cost of capital for respective equity markets. Credit spreads are calculated by taking the difference between the credit market yields and the corresponding government bond yields.
We close our directional long credit view

We are reducing our tactical credit view to neutral given the sizeable tightening in spreads. We prefer equities given relatively more attractive valuations.

Credit yields, January 2020–March 2021

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Source: BlackRock Investment Institute and Refinitiv Datastream, data as of March 2021. Notes: The chart shows the credit yields for the Bloomberg Barclays U.S. Investment Grade and High Yield indexes.
We are turning underweight U.S. Treasuries

We anticipate gradual increases in nominal yields as markets start to price in an accelerated economic restart support by fiscal stimulus.

Breakeven inflation expectations, 2011–2021

Market bond yield expectations, 2011–2021

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Sources: BlackRock Investment Institute, with data from Refinitiv Datastream, March 2021. Notes: The chart on the left shows the breakeven inflation rate, or the difference between the 10-year government bond yield and the pricing of corresponding inflation protected securities – or real yield, for the U.S. and euro area. The chart on the right shows the one-year forward rates implied by the pricing of futures on 10-year government bonds for the respective markets. Forward looking estimates may not come to pass.
Closing overweight to peripheral euro area bonds

We are closing our long-held overweight position after the significant rally in peripheral spreads. We see less scope for further spread compression and prefer to express a pro-cyclical view in other assets.

10-year Italian BTP-German bund spread, 2016-2021

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Sources: BlackRock Investment Institute, with data from Refinitiv Datastream, March 2021. Notes: The chart shows the yields of 10-year Italian BTPs and German government bunds. The spread is the difference between the two yields.
Globalization rewired

Covid-19 has accelerated geopolitical transformations such as a bipolar U.S.-China world order and a remaking of global supply chains, placing greater weight on resilience – even at the expense of efficiency.

**Strategic implication:** We favor deliberate country diversification and above-benchmark China exposures.

**Tactical implication:** We like Asia ex-Japan equities, and see UK equities as an inexpensive, cyclical exposure.
Global trade activity has rebounded strongly
Resurgent China demand has led the restart, helping stoke a strong recovery in manufacturing and trade activity less hampered by mobility restrictions. Yet globalization appears to have peaked.

Global trade as a share of GDP, 1970–2020

Trade nowcast vs activity, 2017–2021

Sources: CPB World Trade Monitor, BlackRock Investment Institute, with data from Refinitiv Datastream, March 2021. Notes: The chart on the left shows global trade as a percentage of global GDP. The dotted line shows the linear trend on global trade as a share of global GDP from 1986–2008, just before the global financial crisis. The chart on the right shows the three-month annualised percentage change in real global goods trade volume (in yellow) and our 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.
Supply chain pressures underscore globalization rewiring

Purchasing manager surveys indicate longer delivery times, partly on shipping capacity shortages. Longer-term, trade relations are likely to become concentrated around two poles – U.S. and China.

PMI supplier delivery index, 2018–2021

Global export share by country, 1990–2020

Sources: BlackRock Investment Institute, Markit, with data from Refinitiv Datastream and Haver Analytics, March 2021. Notes: Chart on the left shows an index of delivery times for items used in the production process, for manufacturing firms. As delivery times lengthen (for example due to capacity constraints) the level of the index falls (note the Y-axis is inverted). The right-hand chart shows the export market share of selected large economies, expressed as a share of total world exports.
China has weathered trade tensions relatively well
Foreign direct investments into China and its exports have rebounded sharply. That strength has translated into currency strength.

China FDI and exports, 2011-2021

China U.S. dollar exchange rate, 2011-2021

Sources: BlackRock Investment Institute, with data from CEIC and Haver Analytics, March 2021. Notes: Chart on the left shows China's FDI and export index. The chart on the right shows the yuan's exchange rate against the U.S. dollar.
Getting more positive on the global activity rebound

We upgrade European equities to neutral. We find UK stocks offering relatively better risk-reward as we see the Brexit discount that has impeded performance begin to fade.

**UK vs euro area equity risk premium and performance, February 2021**

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Sources: BlackRock Investment Institute, with data from Refinitiv Datastream, March 2021. Notes: The LHS chart shows the equity risk premium and historical ranges since 1995 for the UK and euro area. We calculate the equity risk premium based on our expectations for nominal interest rates and the implied cost of capital for respective equity markets. The chart on the RHS shows the performance of the UK and euro area equity markets, rebased at 100 in February 2020.
Turbocharged transformations

The pandemic has added fuel to pre-existing structural trends such as an increased focus on sustainability, rising inequality within and across nations, and the dominance of e-commerce at the expense of traditional retail.

Strategic implication: We prefer sustainable assets amid a growing societal preference for sustainability.

Tactical implication: We favor tech and healthcare as well as selected cyclical exposures.
U.S. bankruptcy filings muted, business formations surge

Scarring of productive capacity still very limited with muted levels of bankruptcy filings. At the same time, there have been an unusually high number of new business formations.

Source: BlackRock Investment Institute, National Association of Credit Managers, Census Bureau, with data from Haver Analytics, March 2021. Notes: left-hand chart shows indices of bankruptcy for U.S. manufacturing and services firms (orange and yellow lines respectively). A decline in the index denotes an increase in reported bankruptcies (note the vertical scale is inverted). The right-hand chart shows the 3-month rolling average number of monthly new business formations.
China is focusing on quality – not quantity – of growth

Policymakers are focused on improving the composition of growth – with sustainability a key pillar.

**China: car sales, 2017-2020**

**China: air quality index, 2015-2020**

Sources: BlackRock Investment Institute with data from CEIC, March 2021. Notes: The chart on the left shows year/year annual China car sales. The right chart shows CEIC’s China air quality index for Beijing and nationwide. See here.
Tech sector likely to maintain its strengths

Accelerated trends and scarce growth amid rock-bottom yields underpin tech. We see potential for leadership within the sector to broaden to a wider set of beneficiaries across themes, including 5G connectivity.

MSCI All-Country World equity sectors return on equity, March 2021

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## Directional views

### Strategic (long-term) and tactical (6-12 month) views on broad asset classes, March 2021

<table>
<thead>
<tr>
<th>Asset</th>
<th>Strategic view</th>
<th>Tactical view</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Equities</strong></td>
<td>![+1]</td>
<td>![+1]</td>
</tr>
<tr>
<td><strong>Credit</strong></td>
<td>![−1]</td>
<td>![Neutral]</td>
</tr>
<tr>
<td><strong>Govt bonds</strong></td>
<td>![−1]</td>
<td>![−1]</td>
</tr>
<tr>
<td><strong>Cash</strong></td>
<td></td>
<td>![Neutral]</td>
</tr>
<tr>
<td><strong>Private markets</strong></td>
<td>![Neutral]</td>
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</tbody>
</table>

Note: Views are from a U.S. dollar perspective as of March 2021. 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.
## Tactical granular views: equities

Six to 12-month tactical views on selected assets vs. broad global asset classes by level of conviction, March 2021

<table>
<thead>
<tr>
<th>Asset</th>
<th>Underweight</th>
<th>Overweight</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td></td>
<td>We are overweight U.S. equities. We see the tech and healthcare sectors offering exposure to structural growth trends, and U.S. small caps geared to an expected cyclical upswing in 2021.</td>
</tr>
<tr>
<td>Euro area</td>
<td></td>
<td>We turn neutral European equities. We believe that there is room for the market to close the valuation gap vs. the rest of the world as the economic restart becomes more entrenched.</td>
</tr>
<tr>
<td>Japan</td>
<td></td>
<td>We are underweight Japanese equities. Other Asian economies may be greater beneficiaries of more predictable U.S. trade policy under a Biden administration. A stronger yen amid potential U.S. dollar weakness may weigh on Japanese exporters.</td>
</tr>
<tr>
<td>Emerging markets</td>
<td></td>
<td>We are overweight EM equities. We see them as principal beneficiaries of a vaccine-led global economic upswing in 2021. Other positives: our expectation of a flat to weaker U.S. dollar and more stable trade policy under a Biden administration.</td>
</tr>
<tr>
<td>Asia ex-Japan</td>
<td></td>
<td>We are overweight Asia ex-Japan equities. Many Asian countries have effectively contained the virus – and are further ahead in the economic restart. We see the region’s tech orientation allowing it to benefit from structural growth trends.</td>
</tr>
<tr>
<td>UK</td>
<td></td>
<td>We are overweight UK equities. The removal of uncertainty over a Brexit deal should see the risk premium on UK assets attached to that outcome erode. We also see UK large-caps as a relatively attractive play on the global cyclical recovery as it has lagged peers.</td>
</tr>
<tr>
<td>Momentum</td>
<td></td>
<td>We keep momentum at neutral. The factor has become more exposed to cyclicality, could face challenges in the near term as a resurgence in Covid-19 cases and a slow start to the vaccination efforts create potential for choppy markets.</td>
</tr>
<tr>
<td>Value</td>
<td></td>
<td>We are neutral on value despite recent underperformance. The factor could benefit from an accelerated restart, but we believe that many of the cheapest companies – across a range of sectors – face structural challenges.</td>
</tr>
<tr>
<td>Minimum volatility</td>
<td></td>
<td>We are underweight min vol. We expect a cyclical upswing over the next six to 12 months, and min vol has historically lagged in such an environment.</td>
</tr>
<tr>
<td>Quality</td>
<td></td>
<td>We are overweight quality. We like tech companies with structural tailwinds and see companies with strong balance sheets and cash flows as resilient against a range of outcomes in the pandemic and economy.</td>
</tr>
<tr>
<td>Size</td>
<td></td>
<td>We are overweight the U.S. size factor. We see small- and mid-cap U.S. companies as a key place where exposure to cyclicality may be rewarded amid a vaccine-led recovery.</td>
</tr>
</tbody>
</table>

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## Tactical granular views: fixed income

### Six to 12-month tactical views on selected assets vs. broad global asset classes by level of conviction, March 2021

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<tr>
<td>Treasury Inflation-Protected Securities</td>
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<tr>
<td>German bunds</td>
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<tr>
<td>Euro area peripherals</td>
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<tr>
<td>Global investment grade</td>
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<tr>
<td>Global high yield</td>
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<tr>
<td>Emerging market – hard currency</td>
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<tr>
<td>Emerging market – local currency</td>
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<tr>
<td>Asia fixed income</td>
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</tbody>
</table>

**U.S. Treasuries**: We are underweight U.S. Treasuries. We see nominal U.S. yields rising but largely due to a repricing higher of inflation expectations. This leads us to prefer inflation-linked over nominal government bonds.

**Treasury Inflation-Protected Securities**: We are overweight TIPS. We see potential for higher inflation expectations to get increasingly priced in on the back of structurally accommodative monetary policy and increasing production costs.

**German bunds**: We are neutral on bunds. We see the balance of risks shifting back in favor of more monetary policy easing from the European Central Bank as the regional economic rebound shows signs of flagging.

**Euro area peripherals**: We are closing our overweight to euro peripheral bond markets that we have held since April 2020. Yields have rallied to near record lows and spreads have narrowed. The ECB supports the market but it is not price-agnostic – its purchases have eased as spreads have narrowed.

**Global investment grade**: We are underweight investment grade credit. We see little room for further yield spread compression and favor more cyclical exposures such as high yield and Asia fixed income.

**Global high yield**: We are moderately overweight global high yield. Spreads have narrowed significantly, but we believe the asset class remains an attractive source of income in a yield-starved world.

**Emerging market – hard currency**: We are neutral hard-currency EM debt. We expect it to gain support from the vaccine-led global restart and more predictable U.S. trade policies.

**Emerging market – local currency**: We are neutral local-currency EM debt. We see catch-up potential as the asset class has lagged the risk asset recovery. Easy global monetary policy and a stable-to-weaker U.S. dollar should also underpin EM.

**Asia fixed income**: We are overweight Asia fixed income. We see the asset class as attractively valued. Asian countries have done better in containing the virus and are further ahead in the economic restart.

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