

BLACKROCK SYSTEMATIC

Victory not yet secured

Equity market views from BlackRock Systematic

As we look ahead, our systematic analysis continues to support the case for an eventual “soft landing” economic scenario, where inflation falls to central bank targets without causing a recession.

But the macroeconomic and market backdrop isn’t without uncertainty and there are several unknowns facing equity investors in the months ahead. What are the implications of policymakers approaching the cutting cycle with caution? Is all the positive macro news priced in after the recent rally, or is there more room for equities to run? And are there any opportunities or risks that markets may not be fully pricing? In this outlook, we take a data-driven approach to answering these questions and discuss how they’re influencing our portfolio positioning in the months ahead.



Raffaele Savi
Head of Systematic
& Co-Head of
Systematic Active
Equity



Jeff Shen, PhD
Co-Head of
Systematic Active
Equity

Key highlights

Could policymakers fall behind the curve?

Rapid disinflation has fueled consensus expectations for significant rate cuts this year. But pushback from the US Federal Reserve (“Fed”) on the timing of the first rate cut raises the possibility that policymakers could be more cautious with easing this year than markets are expecting.

More room for equities to price disinflation

Our analysis suggests that the cross-sectional price action that took place during the abnormally high inflation period hasn’t reversed as inflation has normalized. This creates opportunities to generate alpha as disinflation becomes more fully priced.

Navigating global opportunities and risks

Beyond the broadly constructive macroeconomic environment, we discuss how we’re navigating the Red Sea shipping crisis and assessing the evolving outlook for Chinese equities.

BlackRock.com/SAEOutlook

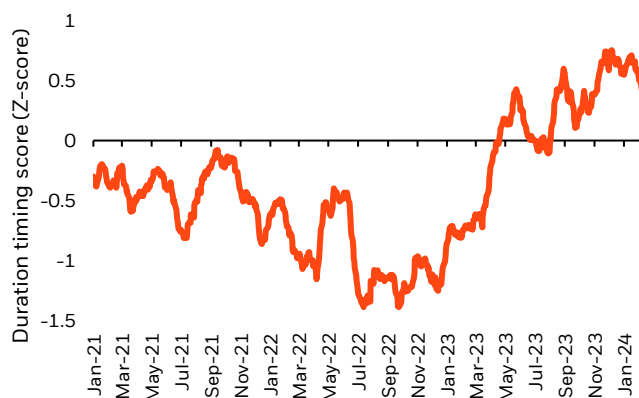
Soft landing still on track... but will the Fed fall behind the curve?

In recent months, declines in official inflationary data largely driven by goods prices have increasingly aligned with our view that a soft landing is playing out. Now, the question is whether policy will keep up with how the macro backdrop has been evolving.

Figure 1 shows our systematic duration timing model which uses a combination of real-time economic, policy, and market indicators to forecast the direction of interest rates. The model turned constructive on bonds (rates falling) as inflation rapidly declined and policy sentiment became increasingly dovish over the last six months. While the model remains long duration largely driven by inflation dynamics, recent pushback from Chair Powell on the timing of the first rate cut has reduced the level of conviction in that view. And because markets continue to price in significant expectations for rate cuts later this year, the Fed's cautiousness against a backdrop of continued economic resilience raises the possibility that monetary policy will lag both the pace of disinflation and market expectations for rate cuts. As a result, the potential for a growing disconnect between inflation and policy dynamics is becoming increasingly important in our model.

Figure 1: Duration timing model points to downward pressure on yields, but with less conviction following cautious Fed comments

Duration timing model (positive: yields down, negative: yields up)



Source: BlackRock Systematic, as of February 2024. Chart shows impulse expressed as Z-Score from the duration timing model. This is constructed by combining a broad suite of market and macro inputs to forecast future fixed income returns.

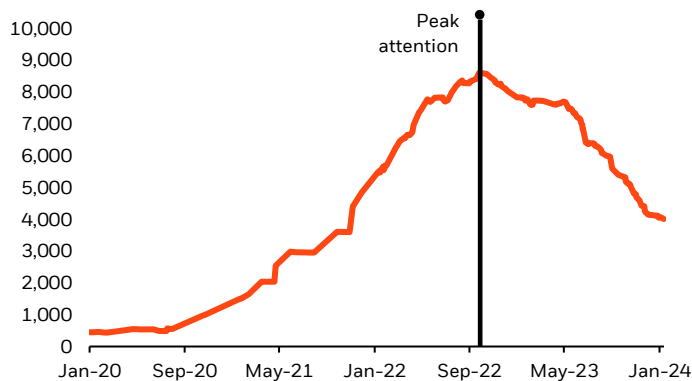
More room for equities to price in disinflation

For equity investors, the recent pace of disinflation and strength of the recent equity market rally raises the question of whether all the potential “good news” on the economy is already reflected in market pricing.

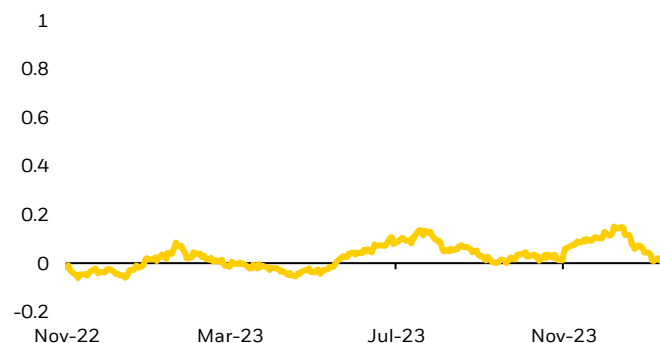
To answer this, we examine the strength of the cross-sectional market rotation observed since attention to higher inflation versus lower inflation peaked in Q4 2022 and compare these moves with what would be required to return pricing fully to the last point at which inflation dynamics appeared normal. We used this same conceptual framework during the COVID-19 reopening phase to determine whether the market had rotated enough following the price movements observed during the earlier lockdown period. Figure 2 shows the strength of the rotation in the period since attention to higher inflation peaked, as measured by the coefficient (a coefficient of 1 would imply that a rotation has fully taken place). We find that close to none of the cross-sectional price action that took place during the abnormally high inflation period has since reversed—even with peak price pressures far behind us and substantial progress on inflation normalization. This suggests that markets may be behind in pricing the magnitude of recent declines in inflation and presents an opportunity to generate alpha in the cross-section of markets as pricing dynamics reverse.

Figure 2: The decline from peak inflation attention hasn't coincided with a reversal in cross-sectional price action

Number of news articles discussing “high” vs. “low” inflation



Inflation rotation coefficient (1 = full rotation)



Source: BlackRock Systematic, Dow Jones News, as of January 2024.

NM0324U-3470188-2/4

Assessing global equity opportunities and risks

Beyond the constructive macroeconomic backdrop that has remained a key focus of markets, there are a range of other opportunities and risks influencing our global equity views and positioning. In this section we'll cover two of these topics—our approach to navigating the Red Sea crisis and the evolving outlook for China.

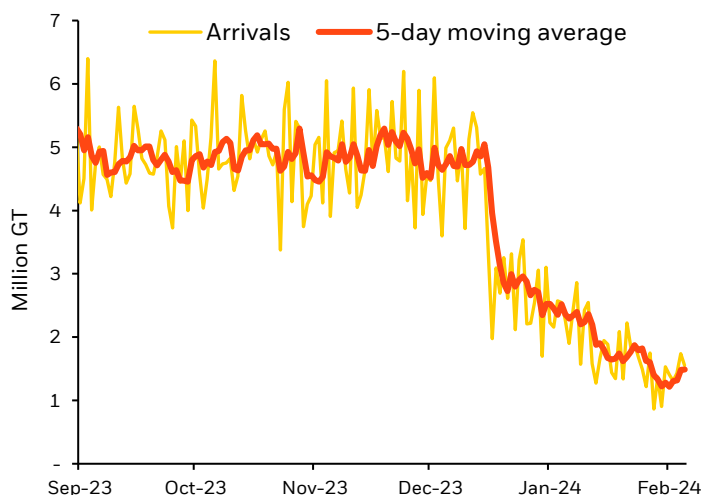
1. Mapping the impact of Red Sea risks

Supply chain disruptions and shipping curtailment driven by the Red Sea crisis have the potential to influence cross-sectional pricing dynamics and could pose an upside risk to inflation should they continue to escalate.

Figure 3 shows how higher frequency shipping data helps us closely monitor the evolving crisis and what it may mean for the global economy and markets in real-time. At a high level, the five-day moving average of vessel arrivals to the Gulf of Aden is now 68% below 2023 average levels in terms of gross tonnage. Looking at the details, we see disruptions which were first concentrated in container ships (largely transporting goods) and car carriers, now increasingly affecting ships carrying oil, food, and gas. This has coincided with a significant escalation of attacks in recent weeks.

Figure 3: Shipping data provides real-time insight into evolving Red Sea risks

Vessel arrivals to Gulf of Aden in gross tonnage



Source: BlackRock, with data from Clarksons, as of February 2024.

We complement our suite of in-house data sources with insight from an elite panel of subject matter experts known as “superforecasters” who have a proven track record of forecasting geopolitical events with a high degree of accuracy. These expert views have validated our assessment that Red Sea risks are accelerating and not fully reflected in market pricing.

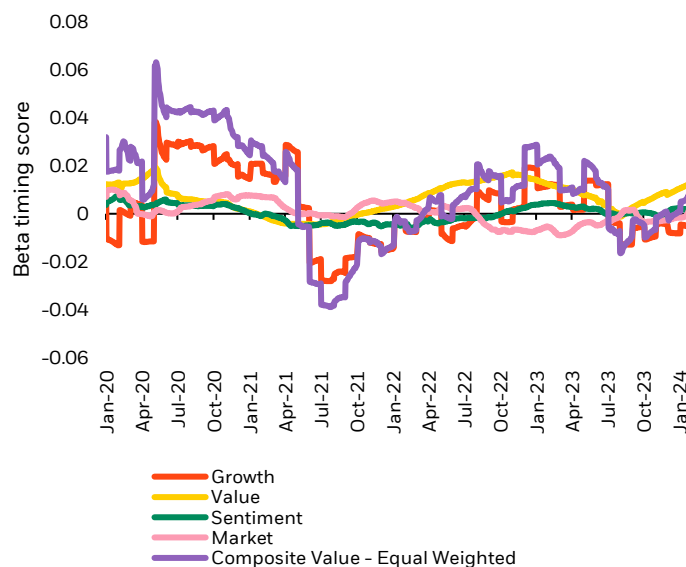
In mapping these risks to company exposures, large language models allow us to leverage the massive volume of text that tends to surround market-relevant themes—including news articles, conference call transcripts, and broker reports—to create bespoke equity baskets. Used alongside the above insights, this text analysis helps to uncover even the most subtle company connections that inform our long and short security positioning. Our analysis suggests that certain retail, automotive, manufacturing, and airline companies are most vulnerable to ongoing challenges, whereas certain freight and logistics and energy companies may experience tailwinds.

2. Reassessing the China opportunity

Along the country dimension, Chinese equities struggled in 2023 as sentiment continued to deteriorate. However, signs of Chinese policymakers aiming to shift that narrative have been surfacing in recent weeks with more pro-growth/pro-market actions and a change in the tone of policy announcements. Our systematic timing model for China has recently turned positive, driven largely by valuation and sentiment insights (Figure 4). Given how negative sentiment and positioning have been, a continuation of these trends could potentially present opportunities for investors who are considering adding China exposure.

Figure 4: Systematic models have turned positive on China relative to recent history

China beta timing score



Source: BlackRock Systematic, as of February 2024.

Putting it all together

Our conviction in the soft landing outcome and the opportunity to exploit related equity pricing dynamics remains intact. In terms of broad portfolio positioning, our largely pro-risk stance is reflected in a favorable outlook for cyclical value across consumer discretionary and industrial sectors. At the same time, duration timing insights referenced above remain supportive of rate-sensitive growth exposures within the information technology sector—albeit to a lesser degree than at the end of 2023.

While the pace of disinflation should allow expectations for rate cuts in 2024 to play out, the timing and magnitude of cuts remains less certain. Additionally, we're closely monitoring market-relevant risks including macroeconomic and geopolitical uncertainty. Our systematic approach to navigating these dynamics helps us remain nimble in harnessing emerging alpha opportunities and managing risks.



Want to explore more?

View the latest insights at [BlackRock.com/Systematic-Investing](https://www.blackrock.com/Systematic-Investing)

© 2024 BlackRock, Inc. or its affiliates. All rights reserved.

This material is prepared by BlackRock and 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 February 2024 and may change as subsequent conditions vary. The information and opinions contained in this material are derived from proprietary and nonproprietary 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 of these views will come to pass. Reliance upon information in this material is at the sole discretion of the reader. This material is intended for information purposes only 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.

Stock and bond values fluctuate in price so the value of your investment can go down depending upon market conditions. The two main risks related to fixed income investing are interest rate risk and credit risk. Typically, when interest rates rise, there is a corresponding decline in the market value of bonds. Credit risk refers to the possibility that the issuer of the bond will not be able to make principal and interest payments.

Index performance is shown for illustrative purposes only. Indexes are unmanaged and one cannot invest directly in an index.

Investing involves risk, including possible loss of principal.

©2024 BlackRock, Inc. or its affiliates. All rights reserved. **BLACKROCK** is a trademark of BlackRock, Inc. or its affiliates. All other trademarks are the property of their respective owners.

Prepared by BlackRock Investments, LLC, member FINRA.

BlackRock