

Weekly commentary

September 16, 2024

BlackRock

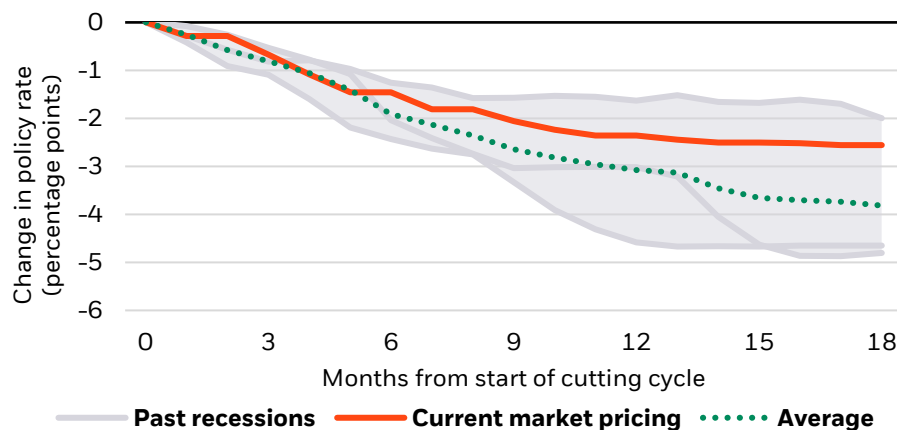
Starting the tight policy unwind

- The Fed is set to cut interest rates for the first time since the pandemic. Yet central banks are not heading for an easy policy stance given sticky inflation.
- U.S. stocks rose about 4% last week, led by tech. U.S. 10-year Treasury yields touched 15-month lows, with markets pricing steep Fed cuts that look overdone.
- The Fed policy meeting takes center stage this week. The recent drop in U.S. core CPI stalled in August, likely taking a 50-basis-point cut off the table, in our view.

The Federal Reserve is set to start rate cuts this week after its rapid hikes to rein in inflation. Markets expect the Fed to cut rates sharply – and we think this pricing is overdone. U.S. inflation has slowed as pandemic disruptions have faded and due to a temporary immigration boost to the workforce. We see inflation staying sticky due to loose fiscal policy and the impact of mega forces, limiting how far the Fed can cut. Yet we think recession fears are overdone and stay overweight U.S. stocks.

No recession response required

Fed rate cuts in response to previous recessions and current pricing



Forward looking estimates may not come to pass. Source: BlackRock Investment Institute, U.S. Federal Reserve Board with data from Bloomberg and Haver Analytics, September 2024. Notes: The chart shows how much the Federal Reserve cut rates in response to recessions in 1989, 2000 and 2007 compared with current market pricing of Fed rate cuts using SOFR futures.

Markets have been quick to price in rate cuts after the Fed finished its fastest hikes since the 1980s – and price them out when inflation spooked to the upside. As the Fed readies to start cutting, markets are pricing in cuts as deep as those in past recessions. See the chart. We think such expectations are overdone. An uptick in the unemployment rate has stoked recession fears, yet employment is still growing. The unemployment rate is not rising due to layoffs, but because elevated immigration has expanded the workforce. Consumer spending shifting back to services from goods after the pandemic has helped inflation fall from its recent highs, allowing the Fed to cut rates. A larger workforce is helping cool services inflation. Yet in this new regime, central banks face a sharper trade-off between curbing inflation and protecting growth than in the decades-long period of steady growth and inflation.



Jean Boivin
Head – BlackRock Investment Institute



Wei Li
Global Chief Investment Strategist – BlackRock Investment Institute



Ben Powell
Chief Investment Strategist for the Middle East and APAC – BlackRock Investment Institute



Nicholas Fawcett
Macro Research – BlackRock Investment Institute

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

BlackRock Investment Institute

Cooling inflation is likely temporary. The post-pandemic normalization of spending and supply mismatches is largely over, while immigration is likely to fall back to historic trends. Once it does, the economy won't be able to add jobs as fast as it has been without stoking inflation. Wage growth has slowed but not enough to suggest that core inflation could fall to the 2% target. Supply constraints from mega forces, or structural shifts, are set to add to global inflation pressures. That's why the Fed and other central banks will keep rates higher for longer. Yet short-term U.S. Treasury yields have slid on expectations for deep rate cuts, so we went underweight. We stay overweight U.S. stocks but broaden our artificial intelligence view beyond tech. Our Midyear Outlook scenarios acknowledge the low odds of the Fed cutting rates as much as markets expect. That could occur if the Fed sees cooling job growth as a sign it's been too slow to react to worsening growth, echoing its rapid rate hikes. Risk sentiment may sour once it's clear the Fed won't cut rates as low as markets expect.

The European Central Bank (ECB) cut rates again last week even as inflation is above its target for now. We see euro area inflation falling to 2% and staying near there, unlike in the U.S. That's still far from the low inflation of the past decade. But the ECB tightened policy more than the Fed – even as it faced weaker economic activity – so it has more room to cut rates, in our view. We're neutral euro area government bonds and UK gilts as market pricing of rate cuts could go further, in our view.

The People's Bank of China has been cutting rates but it's not in the same boat as the Fed. It's facing weak consumer demand, excess production capacity and deflation – based on broad measures of inflation – that could become entrenched. The lack of fiscal and other policy support casts doubt on if the economy will hit this year's growth target. Export activity has been supporting growth, so it will be key to watch for any signs of weakness. Chinese equity valuations are low relative to other regions but given the tough macro outlook, we prefer developed market equities over emerging markets and China.

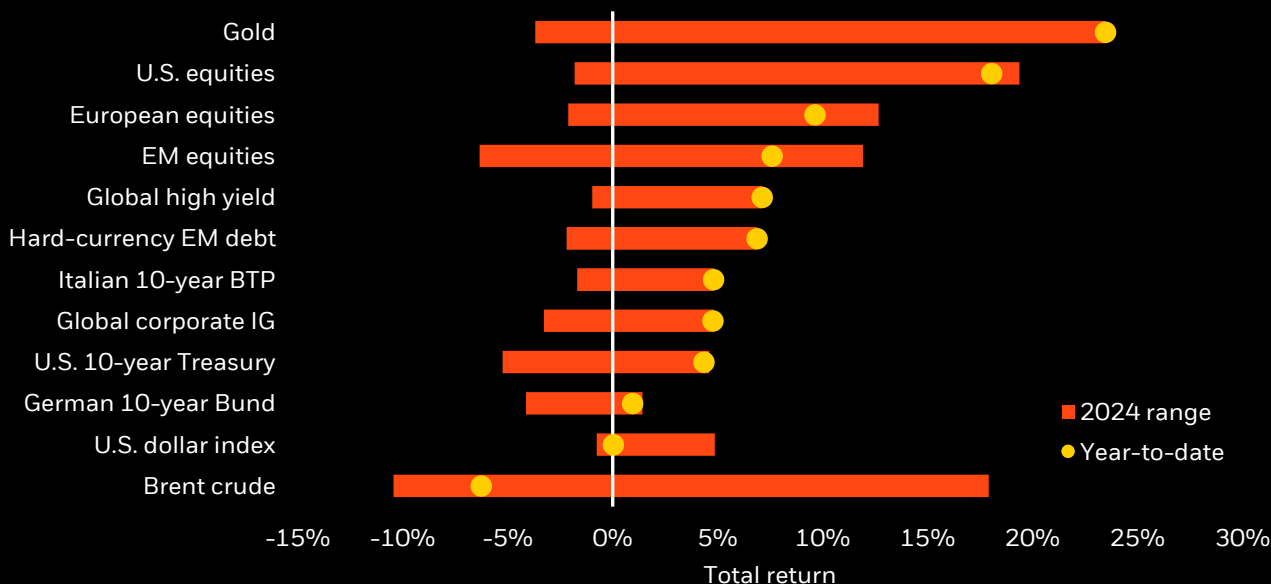
Bottom line: The Fed is following in the footsteps of other central banks to cut rates this week. We see sticky inflation limiting how far central banks can cut. We stay overweight U.S. equities and prefer European over U.S. bonds.

Market backdrop

U.S. stocks rose about 4% last week, rebounding from their largest weekly drop in 18 months, with tech helping lead the way as recession fears faded and on coming Fed rate cuts. U.S. 10-year Treasury yields touched 15-month lows, settling near 3.66% with markets pricing in 200 basis points of Fed cuts by next June. We think this is overdone and could set up more sharp pricing shifts as markets see-saw between starkly different potential outcomes.

Assets in review

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



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.

Sources: BlackRock Investment Institute, with data from LSEG Datastream as of Sept. 12, 2024. Notes: The two ends of the bars show the lowest and highest returns at any point year to date, and the dots represent current 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, ICE U.S. Dollar Index (DXY), spot gold, MSCI Emerging Markets Index, MSCI Europe Index, LSEG Datastream 10-year benchmark government bond index (U.S., Germany and Italy), Bank of America Merrill Lynch Global High Yield Index, J.P. Morgan EMBI Index, Bank of America Merrill Lynch Global Broad Corporate Index and MSCI USA Index.

Week ahead

Sept. 18

Fed policy decision; UK CPI; Japan trade data

Sept. 20

Bank of Japan policy decision; Japan CPI; euro area consumer confidence

Sept. 19

Bank of England policy decision; Philly Fed business index

Central bank policy meetings take center stage this week, headlined by the Fed. We expect the Fed to cut rates for the first time since its rapid hikes launched in 2022. Yet the recent drop in U.S. core CPI stalled in August, likely taking a 50-basis-point cut off the table, in our view. The BOJ will also be in focus after being a source of market volatility after its last meeting in late July.

Big calls

Our highest conviction views on tactical (6-12 month) and strategic (long-term) horizons, September 2024

Tactical	Reasons
AI and U.S. equities	<ul style="list-style-type: none"> We see the AI buildout and adoption creating opportunities across sectors. We get selective, moving toward beneficiaries outside the tech sector. Broad-based earnings growth and a quality tilt make us overweight U.S. stocks overall.
Japanese equities	<ul style="list-style-type: none"> A brighter outlook for Japan's economy and corporate reforms are driving improved earnings and shareholder returns. Yet the drag on earnings from a stronger yen and some mixed policy signals from the Bank of Japan are risks.
Income in fixed income	<ul style="list-style-type: none"> The income cushion bonds provide has increased across the board in a higher rate environment. We like quality income in short-term credit. We're neutral long-term U.S. Treasuries.
Strategic	Reasons
Private credit	<ul style="list-style-type: none"> We think private credit is going to earn lending share as banks retreat – and at attractive returns relative to public credit risk.
Fixed income granularity	<ul style="list-style-type: none"> We prefer intermediate credit, which offers similar yields with less interest rate risk than long-dated credit. We also like short-term government bonds, and UK long-term bonds.
Equity granularity	<ul style="list-style-type: none"> We favor emerging over developed markets yet get selective in both. EMs at the cross current of mega forces – like India and Saudi Arabia – offer opportunities. In DM, we like Japan as the return of inflation and corporate reforms brighten our outlook.

Note: Views are from a U.S. dollar perspective, September 2024. 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.

Tracking five mega forces

Mega forces are big, structural changes that affect investing now – and far in the future. As key drivers of the new regime of greater macroeconomic and market volatility, they change the long-term growth and inflation outlook and are poised to create big shifts in profitability across economies and sectors. This creates major opportunities – and risks – for investors. See our [web hub](#) for our research and related content on each mega force.

- Demographic divergence:** The world is split between aging advanced economies and younger emerging markets – with different implications.
- Digital disruption and artificial intelligence (AI):** Technologies are transforming how we live and work.
- Geopolitical fragmentation and economic competition:** Globalization is being rewired as the world splits into competing blocs.
- Future of finance:** A fast-evolving financial architecture is changing how households and companies use cash, borrow, transact and seek returns.
- Transition to a low-carbon economy:** The transition is set to spur a massive capital reallocation as energy systems are rewired.

Granular views

Six- to 12-month tactical views on selected assets vs. broad global asset classes by level of conviction, September 2024

Our approach is to first determine asset allocations based on our macro outlook – and what’s in the price. **The table below reflects this and, importantly, leaves aside the opportunity for alpha, or the potential to generate above-benchmark returns.** The new regime is not conducive to static exposures to broad asset classes, in our view, but is creating more space for alpha.

Underweight **Neutral** **Overweight** ● Previous view

Asset	View	Commentary
Developed markets		
United States	+1	We are overweight given our positive view on the AI theme. Valuations for AI beneficiaries are supported as tech companies keep beating high earnings expectations. We think upbeat sentiment can broaden out. Falling inflation is easing pressure on corporate profit margins.
Europe	-1	We are underweight relative to the U.S., Japan and the UK – our preferred markets. Valuations are fair. A growth pickup and European Central Bank rate cuts support a modest earnings recovery. Yet political uncertainty could keep investors cautious.
UK	+1	We are overweight. Political stability and a growth pickup could improve investor sentiment, lifting the UK’s low valuation relative to other DM stock markets.
Japan	+1	We are overweight. A brighter outlook for Japan’s economy and corporate reforms are driving improved earnings and shareholder returns. Yet the drag on earnings from a stronger yen and some mixed policy signals from the Bank of Japan are risks.
Emerging markets		
China	Neutral	We are neutral. We see risks from weak consumer spending, even with measured policy support. An aging population and geopolitical risks are structural challenges.
Short U.S. Treasuries	-1	We are underweight. We don’t think the Fed will cut rates as sharply as markets expect. An aging workforce, persistent budget deficits and the impact of structural shifts like geopolitical fragmentation should keep inflation and policy rates higher over the medium term.
Long U.S. Treasuries	Neutral	We are neutral. Markets have priced back in sharp Fed rate cuts and term premium is close to zero. We think yields will keep swinging in both directions on new economic data.
Global inflation-linked bonds	Neutral	We are neutral. We see higher medium-term inflation, but cooling inflation and growth may matter more near term.
Euro area govt bonds	Neutral	We are neutral. Market pricing reflects policy rates in line with our expectations and 10-year yields are off their highs. Political uncertainty remains a risk to fiscal sustainability.
UK gilts	Neutral	We are neutral. Gilt yields have tightened to U.S. Treasuries and market pricing of future yields is in line with our view.
Japanese govt bonds	-2	We are underweight. Stock returns look more attractive to us. We see some of the least attractive returns in JGBs.
China govt bonds	Neutral	We are neutral. Bonds are supported by looser policy. Yet we find yields more attractive in short-term DM paper.
U.S. agency MBS	Neutral	We are neutral. We see agency MBS as a high-quality exposure in a diversified bond allocation and prefer it to IG.
Short-term IG credit	+1	We are overweight. Short-term bonds better compensate for interest rate risk. We prefer Europe over the U.S.
Long-term IG credit	-1	We are underweight. Spreads are tight, so we prefer taking risk in equities from a whole portfolio perspective. We prefer Europe over the U.S.
Global high yield	Neutral	We are neutral. Spreads are tight, but the total income makes it more attractive than IG. We prefer Europe.
Asia credit	Neutral	We are neutral. We don’t find valuations compelling enough to turn more positive.
Emerging hard currency	Neutral	We are neutral. The asset class has performed well due to its quality, attractive yields and EM central bank rate cuts. We think those rate cuts may soon be paused.
Emerging local currency	Neutral	We are neutral. Yields have fallen closer to U.S. Treasury yields, and EM central banks look to be turning more cautious after cutting policy rates sharply.

Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index. Note: Views are from a U.S. dollar perspective. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast or guarantee of future results. This information should not be relied upon as investment advice regarding any particular fund, strategy or security.

BlackRock Investment Institute

The BlackRock Investment Institute (BII) leverages the firm's expertise and generates proprietary research to provide insights on macroeconomics, sustainable investing, geopolitics and portfolio construction to help BlackRock's portfolio managers and clients 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 intended for information purposes only, and does not constitute investment advice, a recommendation or an offer or solicitation to purchase or sell any securities to any person in any jurisdiction in which an offer, solicitation, purchase or sale would be unlawful under the securities laws of such jurisdiction. The opinions expressed are as of Sept. 16, 2024, and are subject to change without notice. Reliance upon information in this material is at the sole discretion of the reader. Investing involves risks. This information is not intended to be complete or exhaustive and no representations or warranties, either express or implied, are made regarding the accuracy or completeness of the information contained herein. This material may contain estimates and forward-looking statements, which may include forecasts and do not represent a guarantee of future performance.

In the **U.S. and Canada**, this material is intended for public distribution. **In EMEA**, in the UK and Non-European Economic Area (EEA) countries: this is Issued by BlackRock Investment Management (UK) Limited, authorised and regulated by the Financial Conduct Authority. Registered office: 12 Throgmorton Avenue, London, EC2N 2DL. Tel: + 44 (0)20 7743 3000. Registered in England and Wales No. 02020394. For your protection telephone calls are usually recorded. Please refer to the Financial Conduct Authority website for a list of authorised activities conducted by BlackRock. **In the European Economic Area (EEA)**: this is Issued by BlackRock (Netherlands) B.V. is authorised and regulated by the Netherlands Authority for the Financial Markets. Registered office Amstelplein 1, 1096 HA, Amsterdam, Tel: 020 – 549 5200, Tel: 31-20-549-5200. Trade Register No. 17068311 For your protection telephone calls are usually recorded. **In Italy**, for information on investor rights and how to raise complaints please go to <https://www.blackrock.com/corporate/compliance/investor-right> available in Italian. **In Switzerland**, for qualified investors in Switzerland: This document is marketing material. Until 31 December 2021, this document shall be exclusively made available to, and directed at, qualified investors as defined in the Swiss Collective Investment Schemes Act of 23 June 2006 ("CISA"), as amended. From 1 January 2022, this document shall be exclusively made available to, and directed at, qualified investors as defined in Article 10 (3) of the CISA of 23 June 2006, as amended, at the exclusion of qualified investors with an opting-out pursuant to Art. 5 (1) of the Swiss Federal Act on Financial Services ("FinSA"). For information on art. 8 / 9 Financial Services Act (FinSA) and on your client segmentation under art. 4 FinSA, please see the following website: www.blackrock.com/finisa. **For investors in Israel:** BlackRock Investment Management (UK) Limited is not licensed under Israel's Regulation of Investment Advice, Investment Marketing and Portfolio Management Law, 5755-1995 (the "Advice Law"), nor does it carry insurance thereunder. **In South Africa**, please be advised that BlackRock Investment Management (UK) Limited is an authorized financial services provider with the South African Financial Services Board, FSP No. 43288. **In the DIFC** this material 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). This material is only directed at 'Professional Clients' and no other person should rely upon the information contained within it. BlackRock Advisors (UK) Limited - Dubai Branch is a DIFC Foreign Recognised Company registered with the DIFC Registrar of Companies (DIFC Registered Number 546), with its office at Unit 06/07, Level 1, Al Fattan Currency House, DIFC, PO Box 506661, Dubai, UAE, and is regulated by the DFSA to engage in the regulated activities of 'Advising on Financial Products' and 'Arranging Deals in Investments' in or from the DIFC, both of which are limited to units in a collective investment fund (DFSA Reference Number F000738). **In the Kingdom of Saudi Arabia**, issued in the Kingdom of Saudi Arabia (KSA) by BlackRock Saudi Arabia (BSA), authorised and regulated by the Capital Market Authority (CMA), License No. 18-192-30. Registered under the laws of KSA. Registered office: 7976 Salim Ibn Abi Bakr Shaikan St, 2223 West Umm Al Hamam District Riyadh, 12329 Riyadh, Kingdom of Saudi Arabia, Tel: +966 11 838 3600. CR No, 1010479419. The information contained within is intended strictly for Sophisticated Investors as defined in the CMA Implementing Regulations. Neither the CMA or any other authority or regulator located in KSA has approved this information. **In the United Arab Emirates** this material is only intended for -natural Qualified Investor as defined by the Securities and Commodities Authority (SCA) Chairman Decision No. 3/R.M. of 2017 concerning Promoting and Introducing Regulations. Neither the DFSA or any other authority or regulator located in the GCC or MENA region has approved this information. **In the State of Kuwait**, those who meet the description of a Professional Client as defined under the Kuwait Capital Markets Law and its Executive Bylaws. **In the Sultanate of Oman**, to sophisticated institutions who have experience in investing in local and international securities, are financially solvent and have knowledge of the risks associated with investing in securities. **In Qatar**, for distribution with pre-selected institutional investors or high net worth investors. **In the Kingdom of Bahrain**, to Central Bank of Bahrain (CBB) Category 1 or Category 2 licensed investment firms, CBB licensed banks or those who would meet the description of an Expert Investor or Accredited Investors as defined in the CBB Rulebook. The information contained in this document, does not constitute and should not be construed as an offer of, invitation, inducement or proposal to make an offer for, recommendation to apply for or an opinion or guidance on a financial product, service and/or strategy. **In Singapore**, this is issued by BlackRock (Singapore) Limited (Co. registration no. 200010143N). This advertisement or publication has not been reviewed by the Monetary Authority of Singapore. **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 New Zealand**, issued by BlackRock Investment Management (Australia) Limited ABN 13 006 165 975, AFSL 230 523 (BIMAL) for the exclusive use of the recipient, who warrants by receipt of this material that they are a wholesale client as defined under the New Zealand Financial Advisers Act 2008. **In China**, this material may not be distributed to individuals resident in the People's Republic of China ("PRC", for such purposes, not applicable to 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). **In Latin America**, no securities regulator within Latin America has confirmed the accuracy of any information contained herein. The provision of investment management and investment advisory services is a regulated activity in Mexico thus is subject to strict rules. For more information on the Investment Advisory Services offered by BlackRock Mexico please refer to the Investment Services Guide available at www.blackrock.com/mx.

©2024 BlackRock, Inc. All Rights Reserved. BLACKROCK is a trademark of BlackRock, Inc., or its subsidiaries in the United States and elsewhere. All other trademarks are those of their respective owners.

BlackRock

Not FDIC Insured • May Lose Value • No Bank Guarantee