Weekly commentary

BlackRock

September 23, 2024

Policy focus sharpens in U.S. election

- The U.S. election outlook is coming into focus with election day just weeks out. We assess the impact of likely policy differences on the economy and sectors.
- U.S. stocks hit new highs last week after the Federal Reserve's hefty rate cut. We think the Fed's mixed messages after the decision could stoke future volatility.
- We watch U.S. core PCE data for August out this week. We think inflation will prove sticky and could surprise the Fed again as it did earlier in the year.

The U.S. presidential election has undergone a reset in recent months, with Vice President Kamala Harris replacing President Joe Biden atop the Democratic ticket. Most national and battleground state polls are showing a close race between Harris and former President Donald Trump. Policy differences are becoming sharper – yet control of Congress will be key for implementation. We stay focused on areas such as tax, energy, trade and regulation for the investment implications.

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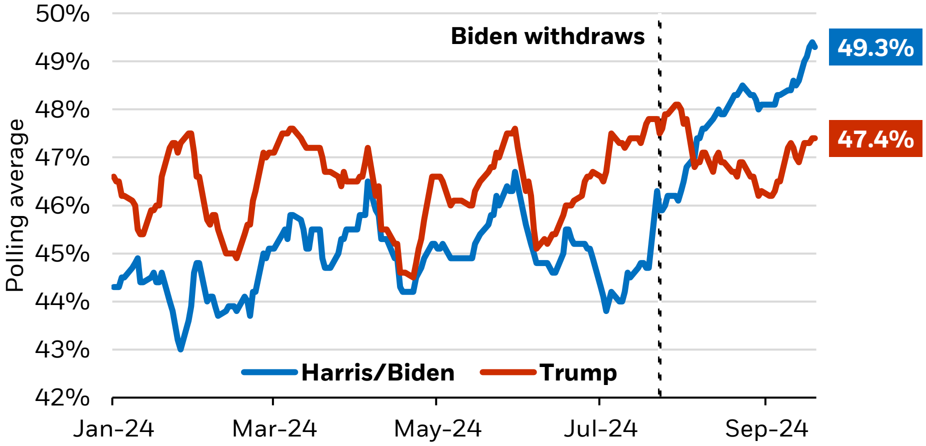
A tight race

U.S. presidential candidate polling averages, Jan.-Sept. 2024



Source: BlackRock Investment Institute, with data from RealClearPolitics and LSEG Datastream, September 19, 2024. Notes: The chart shows the average of the U.S. presidential election race results for Harris/Biden vs. Trump from election polls conducted by various U.S. polling agencies.

The U.S. presidential election outlook underwent a reset after Biden's decision to drop out and endorse Harris as the Democratic nominee for president. Since then and following the debate this month, Harris has taken a slight lead in most national polls, according to RealClearPolitics data. See the chart. The race appears to be close in key battleground states where Harris has closed Trump's lead and made the race more competitive. Harris' policy views have mostly been consistent with Biden's – though she has outlined a number of new proposals including expanding the child tax credit and offering financial support for homebuyers. Yet both candidates could face constraints on enacting their agenda – especially on fiscal policy – if their party doesn't hold unified control of Congress. This comes as federal regulation may face new limits after recent Supreme Court decisions.

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Neither party has prioritized tackling the budget deficit. Harris has largely adopted Biden's tax plan, such as higher corporate taxes, with some key differences like the capital gains tax on wealthy households. Trump plans to fully extend the provisions of the Tax Cuts and Jobs Act (TCJA) expiring in 2025 and propose new cuts, including to corporate taxes. Trump says he will boost revenues by levying tariffs on a broad range of U.S. imports. Control of Congress will dictate the size and scope of TCJA extensions and any government spending cuts. Deficits are one reason we see inflation staying above pre-pandemic levels.

Energy would be a key policy priority of either administration, including bipartisan agreement on the need for permitting reform to build energy infrastructure. U.S. oil and gas output hit new highs under Biden, supporting the energy sector. A Harris administration would mean a continuation of current energy policies, including support for clean energy. Under a Trump administration, Republicans would look to boost energy production and scale back implementation of the Inflation Reduction Act, like credits for electric vehicles. Yet we think the act is unlikely to be repealed entirely.

We see trade as another area with macro implications. Both candidates are likely to pursue additional export controls on national security grounds, especially in advanced technology. On tariffs, Harris is likely to maintain the status quo, with the potential for more targeted tariffs against China. Trump's proposed 60% tariffs on China and 10-20% broad tariffs would be a major escalation. Increased protectionism under either administration reinforces geopolitical and economic fragmentation, one of the structural factors we see keeping inflation higher medium term. Reduced legal immigration under either administration – though it is a centerpiece of Trump's campaign – could also have implications on the labor market.

One area highly dependent on the election outcome is regulation. A Trump win could mean some deregulation, including the rolling back of regulation for banking in particular. Big tech may still be a target for bipartisan antitrust measures. By contrast, a Harris win could reshape the healthcare landscape through expanded Medicare or drug price caps.

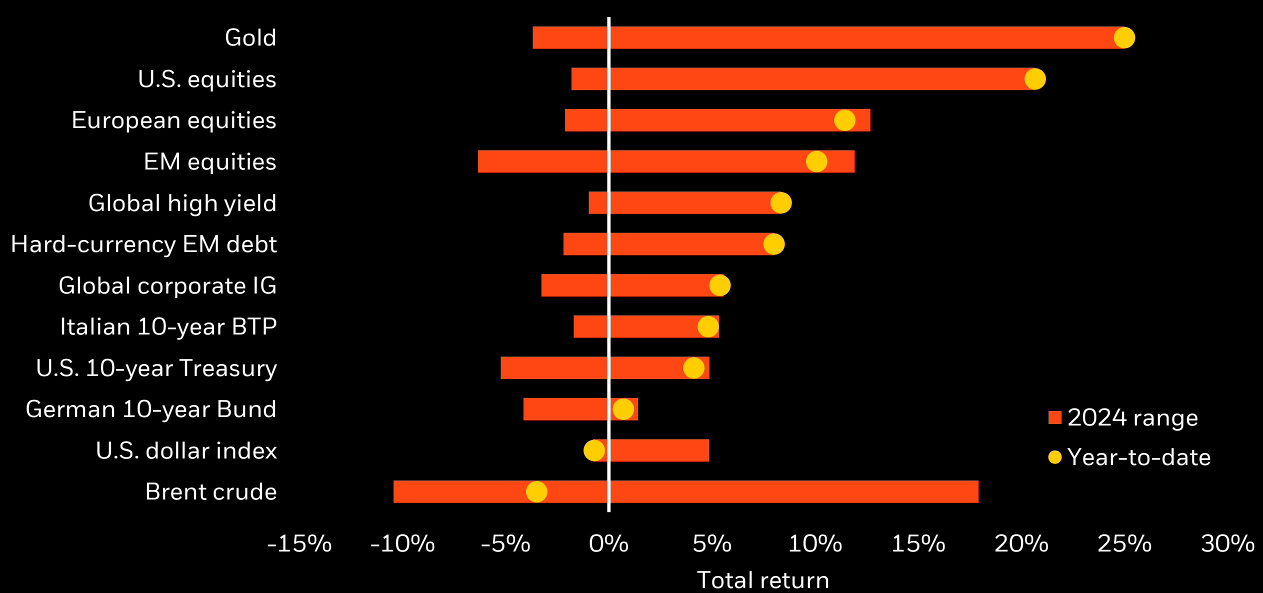
Bottom line: Policy differences between Harris and Trump are sharpening. Control of Congress will be key for assessing how their policy agendas could be implemented. We see potential impacts in sectors like energy, tech, healthcare and financials.

Market backdrop

U.S. stocks struck new all-time highs last week, with small cap stocks leading the way. Stocks regained their footing after the Fed delivered a larger 50-basis point rate cut. We think the Fed's mixed messages – speaking of solid growth and many more rate cuts to come – could mean abrupt policy changes and volatility. U.S. 10-year Treasury yields inched up to around 3.75% after reaching 15-month lows. The curve between two- and 10-year yields hit its steepest levels since mid-2022.

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. 19, 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. 23	Global flash PMIs	**Sept. 26**	U.S. durable goods
Sept. 24	U.S. consumer confidence	**Sept. 27**	U.S. PCE

We watch U.S. core PCE data, the Federal Reserve's preferred measure of inflation, for August out this week. The Fed's mixed messages after its 50-basis point policy rate cut last week show that it risks being surprised again if inflation proves sticky, as it was at the start of the year. The hotter-than-expected CPI for August was a reminder that inflation pressures remain, and wage gains have not eased enough for inflation to stay near the Fed's 2% target.

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	• 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	• 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	• 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	• 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	• 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	• 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.

1. **Demographic divergence:** The world is split between aging advanced economies and younger emerging markets – with different implications.
2. **Digital disruption and artificial intelligence (AI):** Technologies are transforming how we live and work.
3. **Geopolitical fragmentation and economic competition:** Globalization is being rewired as the world splits into competing blocs.
4. **Future of finance:** A fast-evolving financial architecture is changing how households and companies use cash, borrow, transact and seek returns.
5. **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
Equities	**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	Neutral	We are neutral. The growth and earnings outlook is mixed. We see valuations for India and Taiwan looking high.
	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.
Fixed Income	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.

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