ETF Implementation Guide
Spring Update

iShares by BlackRock

KEY TAKEAWAYS

1 **Our base case is that the Fed engineers a soft landing and starts to cut rates in the second half of the year. We expect Canada to avoid a technical recession, but with a higher risk to economic growth than we expect south of the border.** Given this, the risk appears to be skewed for more Bank of Canada (BoC) cuts, relative to both market pricing and the Fed.

2 **Expected rate cuts by the BoC on the back of slowing economic growth and normalizing inflation may reward fixed-income investors for owning bonds with duration around the belly of the curve.**

3 **In the U.S., with rates likely to remain in restrictive territory, we are staying focused on the quality factor.** We believe the resilience of the quality factor is not limited to equities. In other asset classes, such as corporate credit, we believe companies with resilient balance sheets and strong fundamentals are likely to continue outperforming their unprofitable counterparts.

4 **International election uncertainty, monetary policy disparity and the gradual impact of structural trends such as near-shoring all point to a year of elevated global dispersion.** We think this presents investors with opportunities in certain spots in both international equities and fixed income.

> **“Macro matters for investors just as it always has, but the explosive earnings growth of AI-associated companies has broken longstanding macro relationships…the weight of higher rates can still be observed in small-cap equities and non-AI exposed sectors…**

Gargi Pal Chaudhuri

Chief Investment & Portfolio Strategist, Americas at BlackRock

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FIXED INCOME

Views on Fixed Income

	Short Term	Medium Term	Outlook
Cash			Declining returns due to rate cut outlook
Intermediate Duration			Yield curve steepening and healthy price appreciation
Investment grade			Good fundamentals and lower policy rates favourable to short-term
High yield			Attractive all-in yield supported by solid fundamentals
TIPS			Sticky near-term services inflation; long-run disinflation

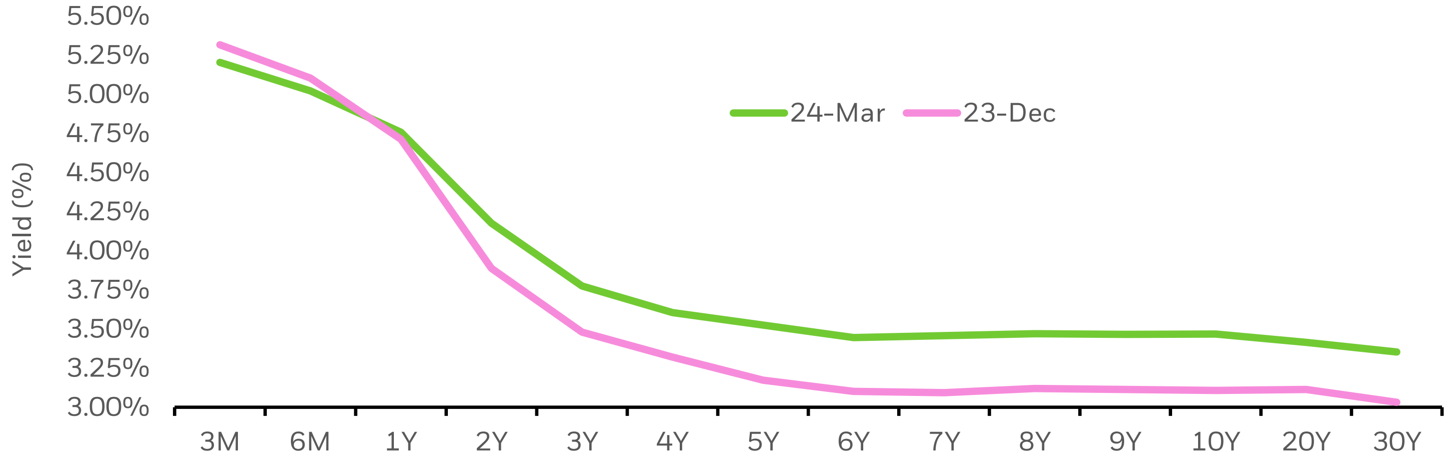
As of March 25, 2024. iShares Investment Strategy views. Views are subject to change.

Expected rate cuts by the BoC on the back of slowing economic growth and normalizing inflation may reward fixed-income investors for owning bonds with duration around the belly of the curve.

We anticipate a normalization of term structure, eventually resulting in an upward sloping yield curve. While short rates should eventually decline with BoC cuts, we think rates on the long end of the yield curve will instead be driven by rising term premium and U.S. treasury supply concerns, which may spillover to the Canadian yield curve. This can result in a steeper yield curve (Figure 1). Given this outlook, investors can consider optimizing the tradeoffs of current yield and price appreciation by positioning in the belly of the yield curve.

We believe the recent back up in rates is probably the last best opportunity to extend duration. This year, as the market has priced out near-term BoC cuts, short rates have firmed by a further 29 basis points through the 2-year maturity.[1] However, cash alternative returns appear set to decline as central banks are likely to begin cutting in the second half of this year. Waiting until the BoC actually cuts rates means investors may miss out on price appreciation due to the anticipatory nature of market pricing.

Figure 1: Canadian yield curve steepening in Q1



Source: Bloomberg. As of April 8, 2024.

Related funds

XSH — **iShares Core Canadian Short Term Corporate Bond Index ETF**

XSB — **iShares Core Canadian Short Term Bond Index ETF**

XIGS — **iShares 1-5 Year U.S. IG Corporate Bond Index ETF (CAD-Hedged)**

XBB — **iShares Core Canadian Universe Bond Index ETF**

EQUITIES

Views on Equities

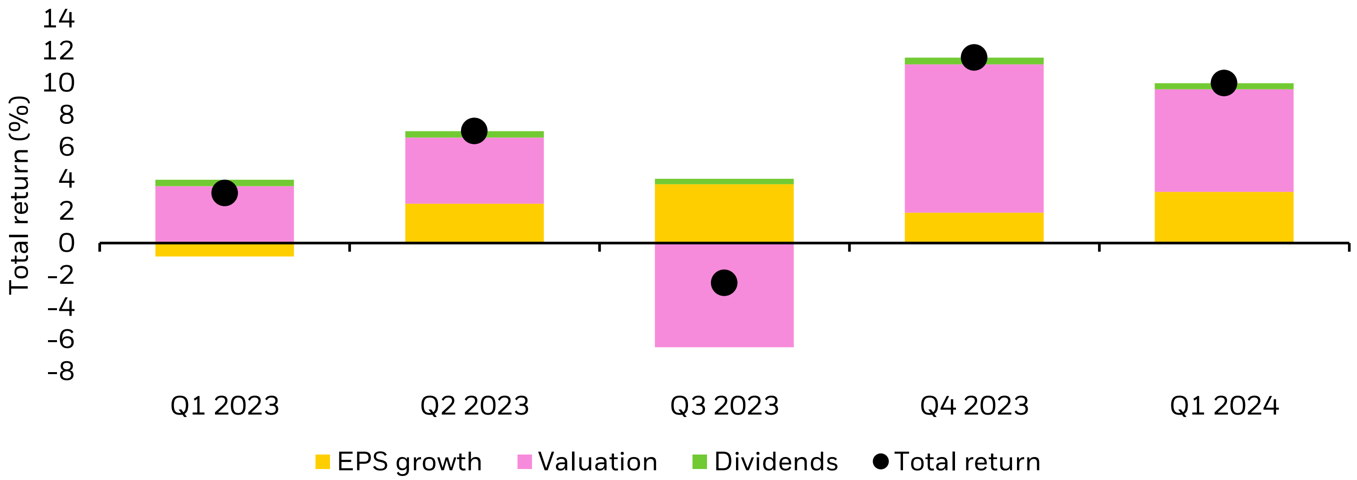
	Short Term	Medium Term	Outlook
U.S. equities	↑	↑	Strong earnings and rate cuts on the horizon
Quality	↑	—	Continued preference for healthy balance sheets and strong fundamentals
Small caps	↓	↑	Need to see further development of a macro shift
Financials	↑	↓	Strong trading revenues bolstered by reacceleration in capital market activity
Healthcare	—	↑	Shifting from constructive to neutral outlook

As of March 25, 2024. iShares Investment Strategy views. Views are subject to change.

Our continued conviction in quality is underpinned by both the macroeconomic and earnings backdrop. As U.S. interest rates remain in restrictive territory, we believe quality factor outperformance will persist on the back of balance sheet resilience and strong earnings fundamentals, while their unprofitable counterparts continue to feel pressure.

The U.S. equity rally has increasingly been driven by earnings, not multiple expansion. Q4 earnings surprised to the upside, led by familiar juggernauts driving both the earnings beat rate and year-over-year growth higher.[2] The top names outperformed despite lofty (and upwardly revised) earnings targets, and this narrow leadership has been sufficient to fuel the continued rally at an index level. While there are worries of a bubble forming, investors should be comforted that the highest quality and most profitable names are driving long-run growth expectations – a far cry from the previous bubbles in which unprofitable and speculative names pushed indexes higher (Figure 2).

Figure 2: Returns increasingly fueled by EPS growth, not valuations



Source: LSEG Datastream, MSCI and BlackRock Investment Institute. Equities represent by MSCI USA Index. As of March 25, 2024. **Past performance does not guarantee future results.**

Related funds

XUS — **iShares Core S&P 500 Index ETF**

XQLT — **iShares MSCI USA Quality Factor Index ETF**

XQQU — **iShares NASDAQ 100 Index ETF**

XDIV — **iShares Core MSCI Canadian Quality Dividend Index ETF**

Views on International

	Short Term	Medium Term	Outlook
EM ex-China	↑	—	Reallocations away from China's structural headwinds
Japan	↑	↑	Strong international investment opportunities
India	—	↑	Fairly valued with strong earnings growth
EM debt	↑	↑	Central banks have already begun cutting rates
China	—	↓	Lack of monetary policy support, longer-term geopolitical tensions

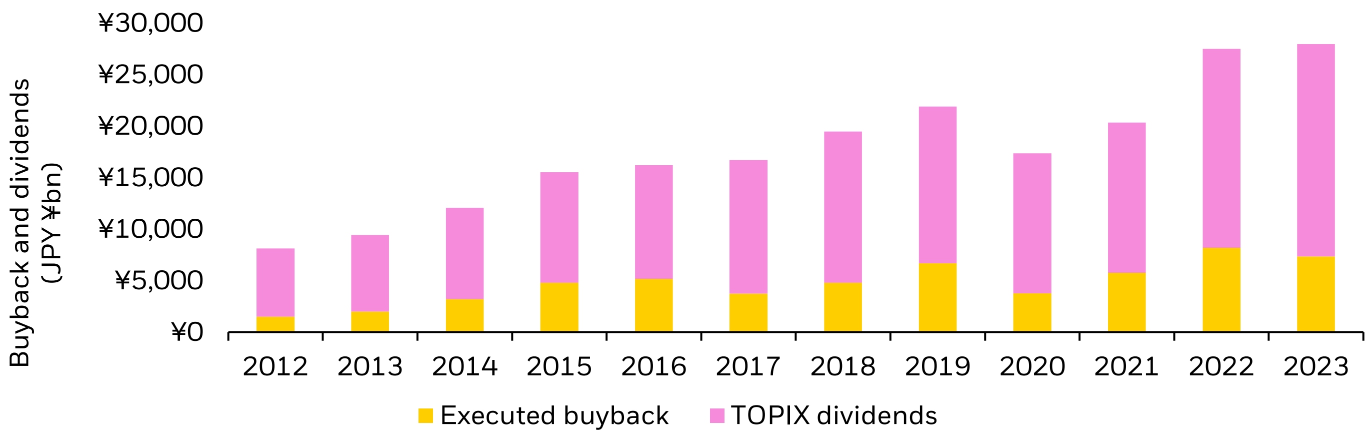
As of March 25, 2024. iShares Investment Strategy views. Views are subject to change.

International election uncertainty, monetary policy disparity and the gradual impact of structural trends such as near-shoring all point to a year of elevated global dispersion. We think this presents investors with opportunities in certain spots in both international equities and fixed income.

In emerging markets equities, investors could continue to separate China from broad exposures. While increased policy urgency and extreme bearish sentiment could set up Chinese equities for near-term tactical rebounds, we think a sustained rally is unlikely without the presence of large-scale monetary support. Poor investor sentiment towards China creates opportunities for other Asian countries to fill the gap.

We maintain our preference for Japan and India over China. While Japan is slightly more expensive than last year, it is still trading at a valuation roughly in line with its 10-year average.[3] We believe this fair valuation, alongside supportive policies for international investors and increased dividends and buybacks, make Japan a strong international opportunity, especially as the Bank of Japan exits negative interest rate territory on the heels of positive inflation (Figure 3).

Figure 3: Capital returns from buybacks and dividends on the rise in Japan



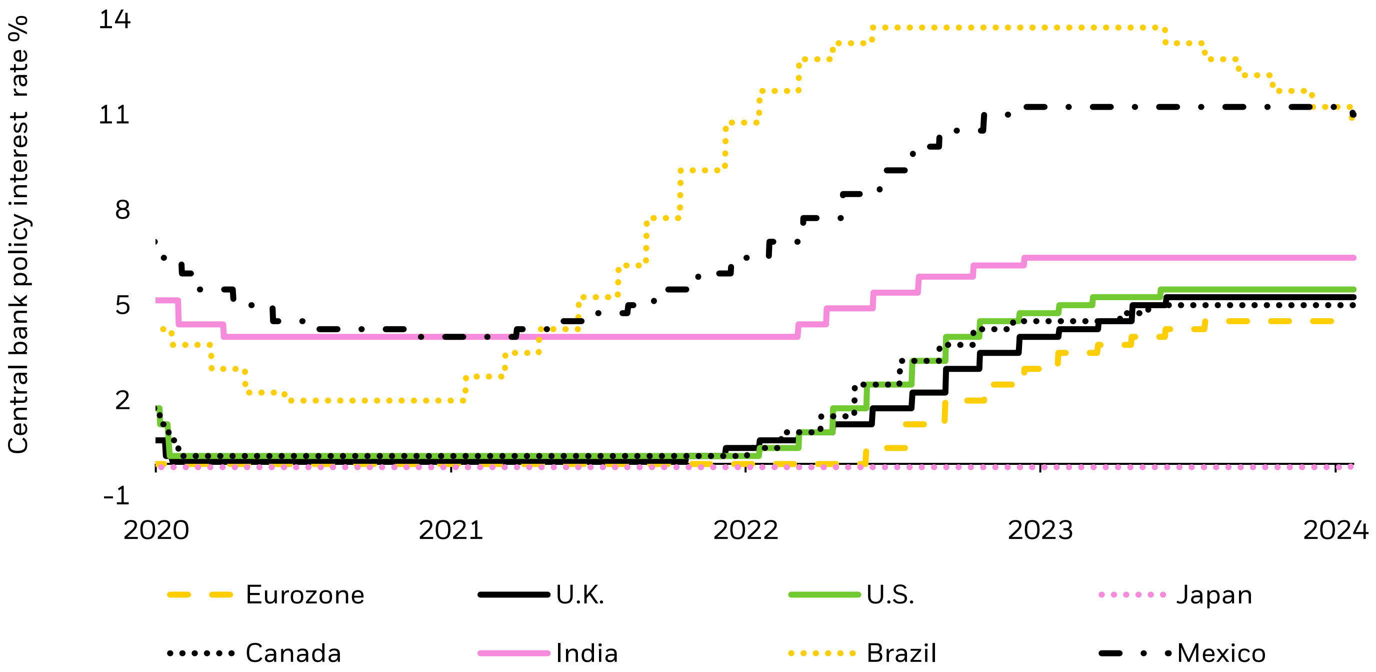
Source: BlackRock Investment Institute with data from Nikkei NEEDS, Bloomberg, AlphaSense, Morgan Stanley Research. As of February 29, 2024.

Our optimism for emerging markets fixed income is strong. Facing continued deceleration in inflation and strong growth, EM central banks across Latin America have begun easing - rates in LatAm have stabilized given the regional cuts, while remaining slightly higher in Asia where central bank cuts have yet to play out.

INTERNATIONAL

We believe the USD will remain rangebound this year, with room for short-term strength as expectations for first-half rate cuts are priced out. This presents a supportive backdrop for EMs across the board, in our view, alleviating pressure from EM economies with large external debt loads. This currency and rate backdrop underpin our preference for USD-denominated EM debt, which historically performs well in a rangebound dollar environment.

Figure 4: Global central bank policy divergence



Source: Bloomberg, as of March 22, 2024. Chart by IPS Investment Strategy at BlackRock.

Related funds

XEMC	**iShares MSCI Emerging Markets ex China Index ETF**
CJP	**iShares Japan Fundamental Index ETF (CAD-Hedged)**
XEB	**iShares J.P. Morgan USD Emerging Markets Bond Index ETF (CAD-Hedged)**
XID	**iShares India Index ETF**
XEF	**iShares Core MSCI EAFE IMI Index ETF**

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[1] Source : Bloomberg, 2-year rates as represented by Canada Generic Govt 2 Yr Index. Data between Dec 31, 2023 and March 31, 2024. A basis point (bps) is one hundredth of one percent (e.g. one basis point = 0.01%).
[2] Source: Bloomberg, Refinitiv. As of March 22, 2024.
[3] Source: Bloomberg, as represented by NKY Index. Valuation as determined by price/earnings. As of March 18, 2024.

Publication date: April 15, 2024

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EIIiM0424C/S-3518115-6/6