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Weekly commentary

September 30, 2024

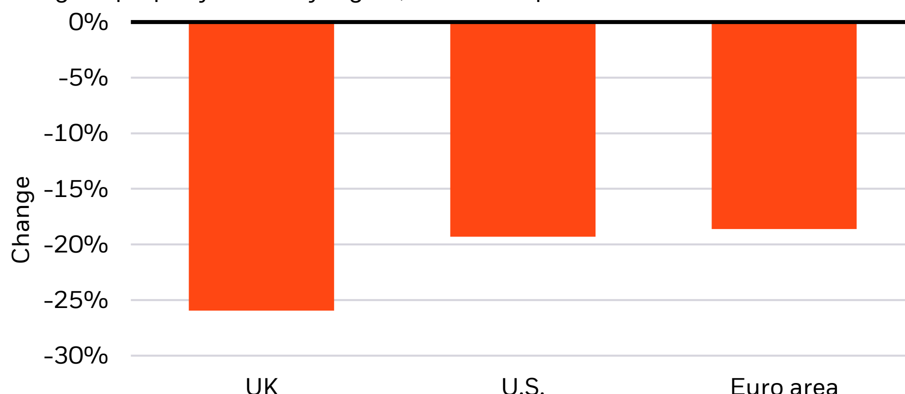
Real estate looks brighter after rate hit

- The outlook for real estate is brightening as values start to stabilize and mega forces stoke demand. We key on important nuances by region and sector.
- Chinese onshore shares shot to their largest weekly gains since 2008 last week on stimulus expectations. U.S. stocks hit new record highs.
- U.S. nonfarm payrolls for September are out this week. We think the Fed faces a trade-off between inflation and growth once immigration's boost to labor fades.

The outlook for the $13.2 trillion real estate market is brightening as values broadly start to stabilize after a difficult two years – a decline we had expected. This creates opportunities that go beyond lower interest rates, we think. Sticky inflation makes real estate more attractive medium term. We also see structural changes from mega forces driving demand. We get granular across regions and sectors. Separately, Beijing's fiscal stimulus signal spurs us to upgrade Chinese stocks.

Hit from higher rates

Change in property values by region, from 2022 peak to 2024 low



Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index. Index performance does not account for fees. Private markets can be a complex, illiquid and highly volatile asset class. It may not suit all investors. Source: BlackRock Investment Institute, MSCI, NCREIF, Sept. 2024. Notes: The chart shows the maximum decline in real estate index valuations from its highest to its lowest in the UK (July 2022 – March 2024), U.S. (Sept. 2022 – March 2024), and the euro area (Sept. 2022 – March 2024). Index proxies: MSCI UK Property Monthly Index, NCREIF Property Index, MSCI EU Property Index.

The global real estate market – a part of many portfolios that totals $13.2 trillion, according to MSCI data – is perking up. We had long expected a tough backdrop for core real estate due to the fastest central bank rate hikes in decades. That's why we went underweight U.S. open-end funds, those that allow periodic investment and redemption, in strategic portfolios in Q2 2022. Property values have declined in line with our view across developed markets (DMs). See the chart. While values are still falling in the U.S., they are bottoming in Europe and rising in the UK. Tremors in this market can have an economy-wide impact, seen last year in the selloff of regional banks on worries about their exposure to commercial real estate mortgages and mortgage-backed securities. Yet broad real estate concerns have started to ease on policy rate cuts: Transaction volumes are rising from recent lows in most sectors.

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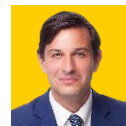

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As rates come down, lower financing costs and reduced yields in other markets like credit and money markets should boost real estate's relative appeal. Capitalization rates for public real estate investment trusts had surged as real estate values retreated in recent years, but now they are starting to fall, reflecting rising valuations on expected cash flows, Green Street data show. Yet some open-ended core real estate vehicles don't yet fully reflect the past drop in public real estate values, according to MSCI and NCREIF data. As a result, we think real estate funds deploying capital in coming years can benefit from better starting values. Outcomes can vary widely, making implementation key. We see mega forces – structural shifts impacting returns now and in the future – driving demand long term in areas such as logistics. Geopolitical fragmentation pushes companies to bring production closer to home. New green building regulations are spurring energy-efficient refurbishments or new builds. The supply disruption from mega forces underpins our view of sticky inflation – and also makes real estate attractive as the asset class benefits from inflation-linked cash flows. We find opportunities by getting granular by region and sector. The real estate recovery looks further along in Europe and UK than the U.S. Private markets are complex, with high risk and volatility, and aren't suitable for all investors.

Falling property prices have been a key factor in China's sluggish growth and deflation. We favored U.S. and DM stocks over China – even as China's valuations turned attractive – as policy support to the economy proved piecemeal. The policy signal from the September politburo meeting suggests major fiscal stimulus may be on the way. That doesn't change the long-term, structural challenges we are concerned about. But we see room to turn modestly overweight Chinese stocks in the near term given their near-record discount to DM shares – even with last week's surge – and a catalyst that could spur investors to step back in. We stay nimble and could change our view if the stimulus details disappoint or a ratcheting up of trade restrictions appears likely. The structural challenges include risks from geopolitical and economic competition, the need to reform its indebted economy and an aging population. We do not think the latest policy announcements will address those challenges.

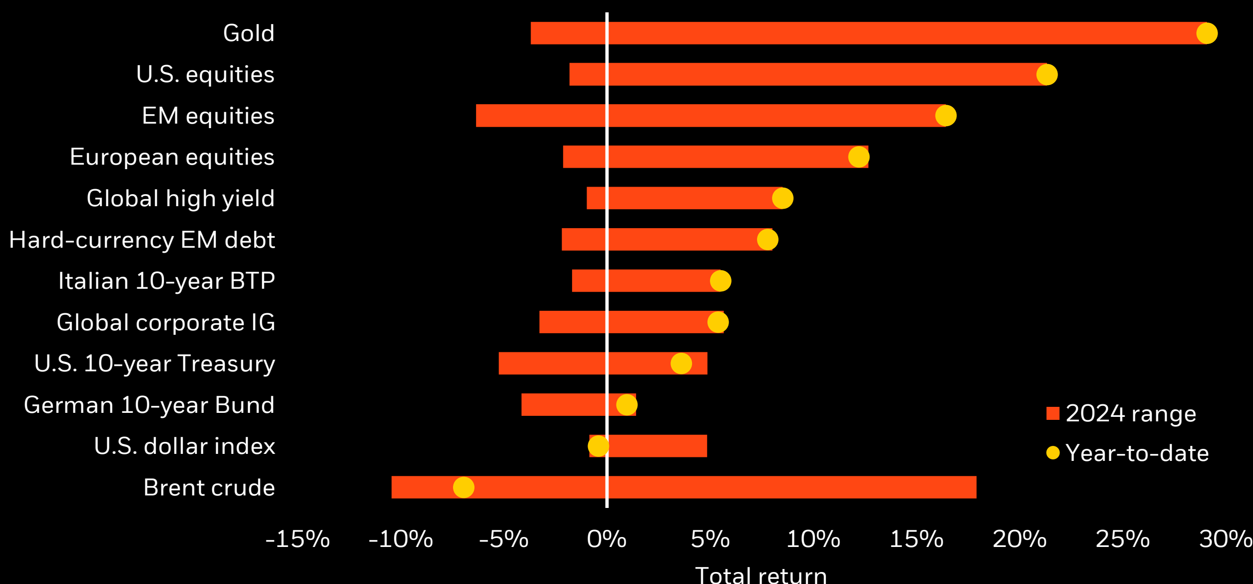
Bottom line: We see a brightening outlook for real estate. We look for opportunities in areas that took a bigger hit from higher rates – and from nuances at the regional and sector level. We upgrade Chinese stocks on expected fiscal stimulus.

Market backdrop

Official pledges for fiscal stimulus in China sparked a nearly 16% surge in the benchmark CSI 300 index – its biggest one-week gain since late 2008. Hong Kong-listed H shares jumped 14% for the biggest weekly gain in 13 years. U.S. stocks hit new record highs as still-low jobless claims pointed to a solid labor market. We think recession fears tied to softening job gains are overdone – and see next week's payrolls data confirming that.

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. 26, 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.

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Week ahead

Oct. 1	Euro area HICP; Japan unemployment data	**Oct. 4**	U.S. payrolls
Oct. 2	Euro area unemployment		

U.S. payrolls for September are on tap this week. The U.S. economy is still adding jobs at a healthy pace thanks to a boost from immigration – even if that pace has slowed in recent months. We don't think some of the recession fears sparked by the slowing in job gains are justified. Once immigration normalizes, the economy will not be able to add jobs as quickly without stoking inflation due to an aging workforce. That means the Federal Reserve will likely keep policy rates higher for longer.

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.

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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	+1 (previous view: Neutral)	We are modestly overweight. Major fiscal stimulus may be coming and prompt investors to step in given Chinese stocks are at a deep discount to DM shares. Yet we stay ready to pivot. We are cautious long term given China's 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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