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Weekly commentary

BlackRock

November 11, 2024

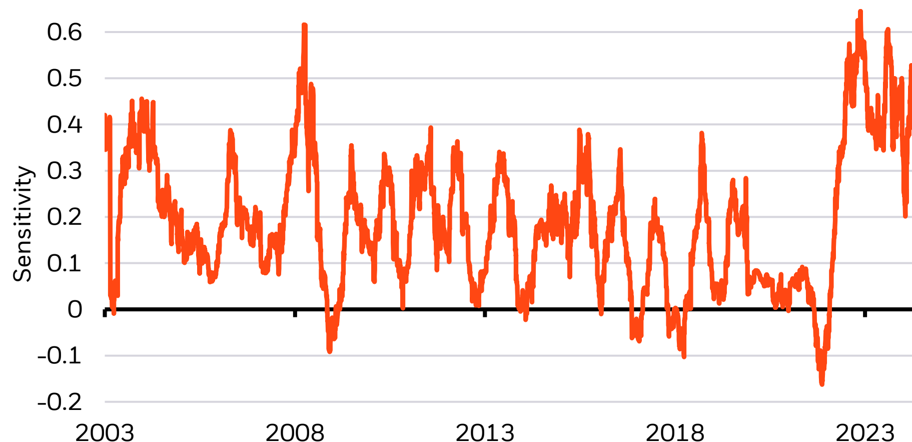
Zeroing in on secular forces, not cycles

- Market-moving events can highlight structural shifts underway. Our investment leaders grapple with the implications of a world shaped by supply.
- U.S. stocks soared last week, marking their largest weekly gain in a year. Small caps and banks led the way following President-elect Donald Trump's victory.
- This week, U.S. CPI will help gauge if inflation is still falling toward the Fed's 2% target. Recent PCE data indicates inflation will settle higher in the medium term.

We are in a world where multiple, starkly different outcomes are possible. The decisive U.S. election outcome has stoked uncertainty about future U.S. policy. At our 2025 Outlook Forum last week, BlackRock investment leaders met to discuss how to invest given large structural shifts happening now – and we updated the range of scenarios we considered feasible six months ago, reflecting our discussions on U.S. exceptionalism, geopolitics and artificial intelligence (AI).

Sensitive to surprises

Sensitivity of U.S. 10-year yield to economic surprises, 2003-2024



Past performance is no guarantee of future results. Source: BlackRock Investment Institute, with data from LSEG Datastream, October 2024. Notes: The line shows how sensitive the U.S. 10-year Treasury yield is to economic surprises, using regression analysis to estimate the relationship between U.S. 10-year Treasury yields and the Citi Economics Surprise Index over a rolling six-month window. This is only an estimate of the relationship between the 10-year Treasury yield and economic surprises.

Our Outlook Forum took place against the backdrop of a momentous U.S. election. Markets welcomed the decisive result that took some near-term uncertainty off the table – even as medium-term policy uncertainty remains. Shifting narratives, from AI booms to recession fears, have driven volatility this year. Markets can overreact to these shifts. We have seen unusually sharp swings in 10-year U.S. Treasury yields with key macro releases. See the chart. We think that reflects investors viewing new data and news through a business cycle lens when broader structural changes are at play. We have been nimble with our tactical view changes this year to lean against narrative-driven volatility. The goal of last week's Forum: tracking the transformation driven by these structural changes. We evolved our macro scenarios to better understand and position for the transformation's opportunities.

Jean Boivin
Head – BlackRock Investment Institute

Wei Li
Global Chief Investment Strategist – BlackRock Investment Institute

Vivek Paul
Global Head of Portfolio Research – BlackRock Investment Institute

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

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BlackRock **Investment** Institute

U.S. exceptionalism – strong economic and corporate earnings growth – was a topic of debate at the Forum. Our portfolio managers are broadly positive on U.S. equity markets. They noted this has more room to run, even if U.S. stock valuations look steep. The contrast with lagging European economic growth, and stock performance, remains stark. Forum participants also spied a disconnect in Fed policy. The Fed cut its policy rate another 25 basis points last week as it sees inflation moving closer to its 2% target. Yet financial conditions are loose after a historically sharp tightening cycle. This unusual backdrop reinforces our view that this is not a typical business cycle – but rather an environment where structural forces are at play.

The geopolitical fragmentation mega force – or structural shift impacting returns now and in the future – ran through most discussions. The incoming U.S. president takes office at a time of greater global fragility given wars in the Middle East and Ukraine, and ongoing tensions with China. A punishing year for incumbents around the globe is pressuring G7 partners. Germany is headed for a new election. This follows France's divided election outcome earlier this year. The reform proposals laid out by Mario Draghi detail the challenges Europe faces. China rolled out some details of its fiscal stimulus highlighting its weak growth near term – and also faces long-term challenges from an aging population. AI will increasingly take center stage in geopolitics, featuring heavily in U.S.-China strategic tech competition. Under the Biden administration, the U.S. has elevated AI to the core of its military and technological priorities.

The debate on the impact of the AI mega force keeps evolving. Much of the discussion at our last Forum in June centered on AI and its energy and investment needs. That was still a focus – and we generally agreed that the AI buildout can broaden to include other beneficiaries. Quantifying AI's longer-term economic impact remains challenging, but we think AI has the potential to eventually reshape economies and boost economic growth.

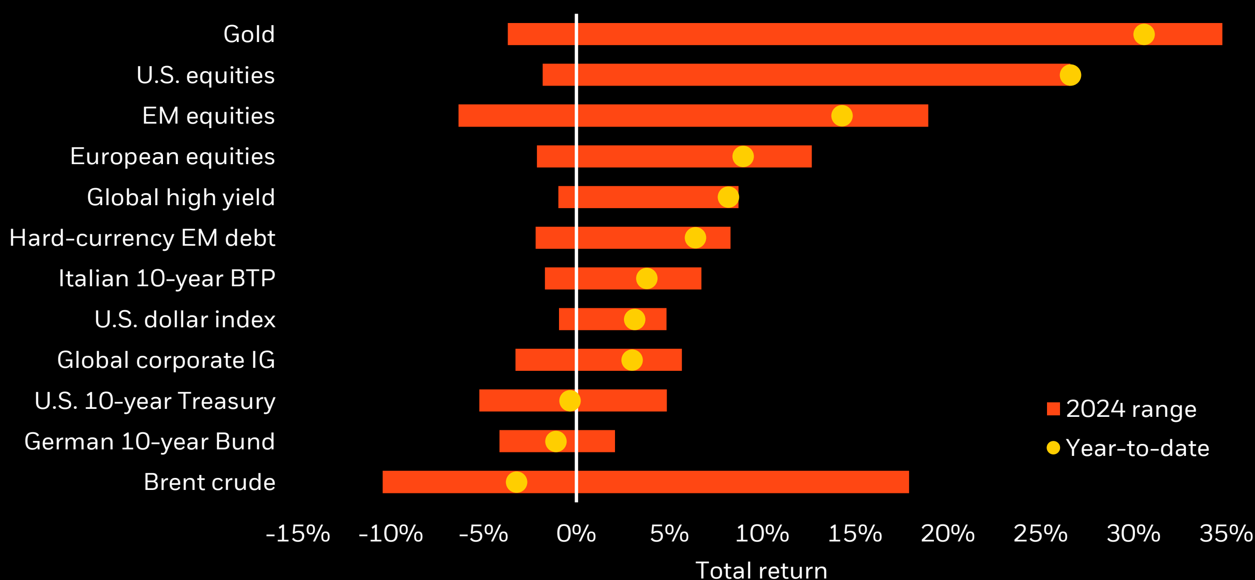
Bottom line: Our Forum discussion sought to clarify how structural shifts are driving the investment opportunities we see while assessing what's in the price. We think having a solid framework is key for anchoring views in this unusual environment.

Market backdrop

U.S. stocks soared to new all-time highs last week, notching their largest weekly gain of the year. Small caps and banks led the way as possible beneficiaries of a second Trump term. U.S. 10-year Treasury yields finished around 4.30%, down slightly on the week after jumping to four-month highs. A telegraphed 25-basis point Fed rate cut failed to move markets. Pricing of future cuts has come closer to our view, yet we still see rates settling higher than markets do.

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 Nov. 7, 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

Nov. 12	UK employment data	**Nov. 15**	UK GDP; Japan GDP
Nov. 13	U.S. core CPI		

This week, we focus on U.S. CPI to see if inflation will keep falling toward the Fed's 2% target. Short-term inflation has been decreasing, with immigration boosting the labor supply and cooling wage growth. However, recent services PCE data remains sticky, indicating that inflation may settle above 2% in the medium term. Long-term, structural supply constraints – like a shrinking workforce due to population aging – are expected to keep inflation pressures persistent.

Big calls

Our highest conviction views on tactical (6-12 month) and strategic (long-term) horizons, November 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, November 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, November 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	We are modestly overweight. China's fiscal stimulus is not yet enough to address the drags on economic growth, but we think stocks are at attractive valuations to DM shares. We stand 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 are pricing in sharp Fed rate cuts and term premium is close to zero. We think yields will keep swinging in both directions on incoming data. We prefer intermediate maturities less vulnerable to investors demanding greater term premium.
	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	+1	We are overweight. Gilt yields offer attractive income, and we think the Bank of England will cut rates more than the market is pricing given a soft economy.
	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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