BlackRock

Global Product Solutions
Investment Strategy
Product Distribution

Investment Directions

Implementing ideas for today's market

Investment Directions *is designed to help navigate opportunities in equities, fixed income and portfolio diversifiers for H2 2024, with actionable implementation ideas across index, alpha-seeking, liquid alternative and private market strategies.*

Positioning for fundamental transformation

A seismic structural transformation is underway, potentially reshaping the investment landscape. It is being driven by three key mega forces playing out in parallel: artificial intelligence, the rewiring of global supply chains, and the low-carbon transition.

- **Within equities:** uncertainty and dispersion are driving opportunities. Selectivity, quality and high conviction will be key.
- **Within fixed income**: higher-for-longer rates mean income & carry are in focus. Stay nimble with duration.
- **Portfolio diversifiers:** Japan, active income and liquid alternatives are coming to the fore.

Overall, the environment of structurally higher uncertainty calls for a more nimble, granular approach.

How we're investing this quarter

EQUITY

Uncertainty and dispersion drive opportunity in equities

We think the current environment favours an active approach in equities, to capture deeper pockets of quality with conviction. We look to AI beneficiaries as well as early-cycle plays and see better opportunities in DM vs. EM – though select opportunities persist across regions.

Quality at the core: In an environment of uncertainty, we seek to build quality exposure in equities- broadly defined by high margins and stable earnings. Historically, the duration of high-quality companies has been underestimated[1]. Maintaining conviction over the long-term can help build exposure to businesses with dominant market positions, supported by strategic tailwinds that may compound long term cashflows.

Selectivity in EM Equities: We see political uncertainty in the region starting to recede in Q3 but prefer emerging markets with stable macro backdrops and more certain policy outlooks, such as India. We like long term tailwinds including demographics and the rewiring of global supply chains. As the cautious stance from foreign investors on China continues, EM- ex China continues to gain traction as a benchmark[2].

Looking to the next leg in AI: Our conviction in AI continues to grow: the past year has seen rising adoption of AI tools, with the promise of much more to come. We think the AI wave is underpinned by solid fundamentals: in Q1, the 493 companies excluding the 'Magnificent 7' in the SPX 500 registered earnings growth of -3.8% YoY vs. 0.7% YoY for the broader index that included those seven companies[3].

The low-carbon transition: The electricity required to train AI software ChatGPT-3 could power 90,000 U.S. homes for a year; training its successor, GPT-4, needed the electricity to power 2.5 million homes. Models are only getting larger- data centres accounted for 2.5% of power demand in the US in 2022 and could triple by 2030[4]. This highlights an opportunity for electricity providers as the world's energy demands begin to shift.

Key

- Exchange-traded product
- Alpha- seeking strategies

Our highest-conviction ideas:

- **MSCI USA Quality Factor Index** (Exchange-traded product)
- **Global Unconstrained Equities** (Alpha-seeking strategy)
- **MSCI India Index Net USD** (Exchange-traded product)
- **MSCI Emerging Markets-ex China Index** (Exchange-traded product)
- **ICE Semiconductor Index** (Exchange-traded product)
- **World Technology** (Alpha-seeking strategy)
- **STOXX Global Copper Miners Index** (Exchange-traded product)

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FIXED INCOME

Higher-for-longer rates mean income & carry are key

Rates across DM could start to fall from cycle-highs over Q3, but it is likely to be a halting descent. We see limited value in extending US duration beyond the front and belly of the curve. In contrast, the expected onset of 2H24 rate cuts in Asia supports our willingness to extend duration into Asian High Yield.

Staying Nimble with duration in rates: Whilst the front end of the curve still looks attractive, we think the intermediate portion of the yield curve represents the 'sweet spot', optimizing potential price appreciation, liquidity, and current yield. We are still weary about taking exposure at the very long end of the US yield curve, as we expect additional issuance and the normalization of term premium will keep longer rates elevated.

- **ICE US Treasury 3-7yr Bond Index**
- **ICE US Treasury 1-3yr Bond Index**

Getting selective with Indian Government Bonds: We see room for investors to start building allocations to India in fixed income, given that international ownership is still just 1.9%[5]. Low foreign ownership means IGBs can act as a diversifier; they are not only lowly-correlated to euro credit and global HY (at 0.17 and 0.46, respectively), but also vs. broader EM debt, with a sub 0.5 correlation to both local and hard currency debt indices[6].

- **BBG Indian Government FAR Bond Index**

Seeking relative value in Asian High Yield: We prefer Asian high yield (HY) to US HY on a relative basis for income generation in portfolios, due to a current yield of 8.6% vs 7.8% for USD HY Corporate bonds, and exposure to USD denominated bonds issued by Asian entities across 14 countries and 10 sectors[7]. We think the portfolio benefits of diversification and high income compensate for some potential spread widening.

- **USD Asia High Yield Bond Index**
- **Asian High Yield Bonds**

PORTFOLIO DIVERSIFIERS

Building a portfolio for the new regime

In the new regime of higher equity-bond correlation, lack of term premium and inverted yield curves, long-dated fixed income may not provide the same ballast it once did in portfolios. We think investors need to look at a broad range of portfolio diversifiers, across regions, sectors, strategies and asset classes.

Japan Underexposure: We think Japan is still interesting due to shareholder-friendly corporate reforms, an inflation renaissance and increased domestic investor participation. Closing foreign investor underweights can help to diversify investor equity sleeves on two levels- 1) from areas of concentration, such as the Magnificent 7 and 2) at an FX level for non-JPY investors as BOJ and Fed rate paths diverge[8]

- **MSCI Japan Index**
- **Japan Flexible Equities**

Active Income as equity ballast: Elevated macro uncertainty and the decoupling of traditional asset correlations have led investors to seek sources of return with less correlation to broad equity market risks. Dividend stocks, particularly when combined with options overlays, offer a defensive tilt within equities, with consistent cash flows helping to boost diversification[9]

- **World Equity High Income Strategy***
- **Systematic Global High Income Equities**

Diversifying with liquid alts: Recent heightened correlation of fixed income to equities means fixed income may not provide the same ballast in portfolios versus previous regimes[10]. We maintain that liquid alternatives, especially those targeting higher absolute returns, can enhance portfolios by delivering returns without as much broad equity market risk.

- **Systematic Asia Pacific Absolute Return Equities**
- **Tactical Opportunities**

Hedging for geopolitical risk via gold: We remain constructive on gold as we expect demand from central banks to support prices into year-end, following a recent pause in gold buying by the People's Bank of China[11]. We see a strong role for gold as a diversifier and portfolio hedge, with inflation expected to remain above central bank targets in many DMs, and elections and ongoing conflicts driving geopolitical risk higher.

- **Physical Gold Index**

** Actively Managed ETFs*

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Sourcing

1 Source: Bloomberg, as of 18 June 2024. Note: equity market as represented by SPX Index.
2 Source: BlackRock and Markit, as of 28 June 2024
3 Source: Bloomberg, June 2024.
4 Source: BlackRock Systematic, Nvidia, OpenAI. As of June 20, 2024.
5 Source: Reuters, as of 1 December 2023.
6 This information is not intended as a recommendation to invest in any particular asset class or strategy or as a promise – or even estimate – of future performance. Source: BlackRock Investment Strategy EMEA, BlackRock Aladdin, Morningstar. Portfolio average allocation based on 294 moderate multi-asset portfolios collected by between 02/01/2024 – 28/03/2024. Currency: EUR. Correlations data as of 21 May 2024. For Illustrative purposes only, and subject to change.
7 Source: Bloomberg, June 2024.
8 Source: Bloomberg, June 2024.
9, 10, 11 Source: Bloomberg, as of 28 June 2024.

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