March 2020

BlackRock

Global Outlook – Coronavirus update

BlackRock
Investment
Institute

FOR PUBLIC DISTRIBUTION IN THE U.S., CANADA, HONG KONG, SINGAPORE AND AUSTRALIA. FOR INSTITUTIONAL, PROFESSIONAL, QUALIFIED INVESTORS AND QUALIFIED CLIENTS IN OTHER PERMITTED COUNTRIES

2020 investment themes update

Growth downshift – We see the coronavirus outbreaks and containment measures causing near-term disruption to global economic activity. This may push Japan and the euro area to the brink of a technical recession. The U.S. will likely prove more resilient. We expect a recovery in activity once disruptions dissipate, but their depth and duration are highly uncertain. This could weigh on consumption and investment.
Implication: We downgrade our moderate pro-risk stance and turn neutral on equities and credit.

Policy action – The Federal Reserve has delivered an emergency rate cut, and we expect more rate cuts to come. Major central banks are likely to provide stimulus if the market volatility continues, causing sustained tightening of financial conditions or impairment to market liquidity. Yet many – such as in Japan and the euro area – have diminished policy space to lower rates. Fiscal easing will likely be an important part of the loosely coordinated and differentiated policy response.
Implication: Coupon income is crucial as bond yields have plunged to new lows.

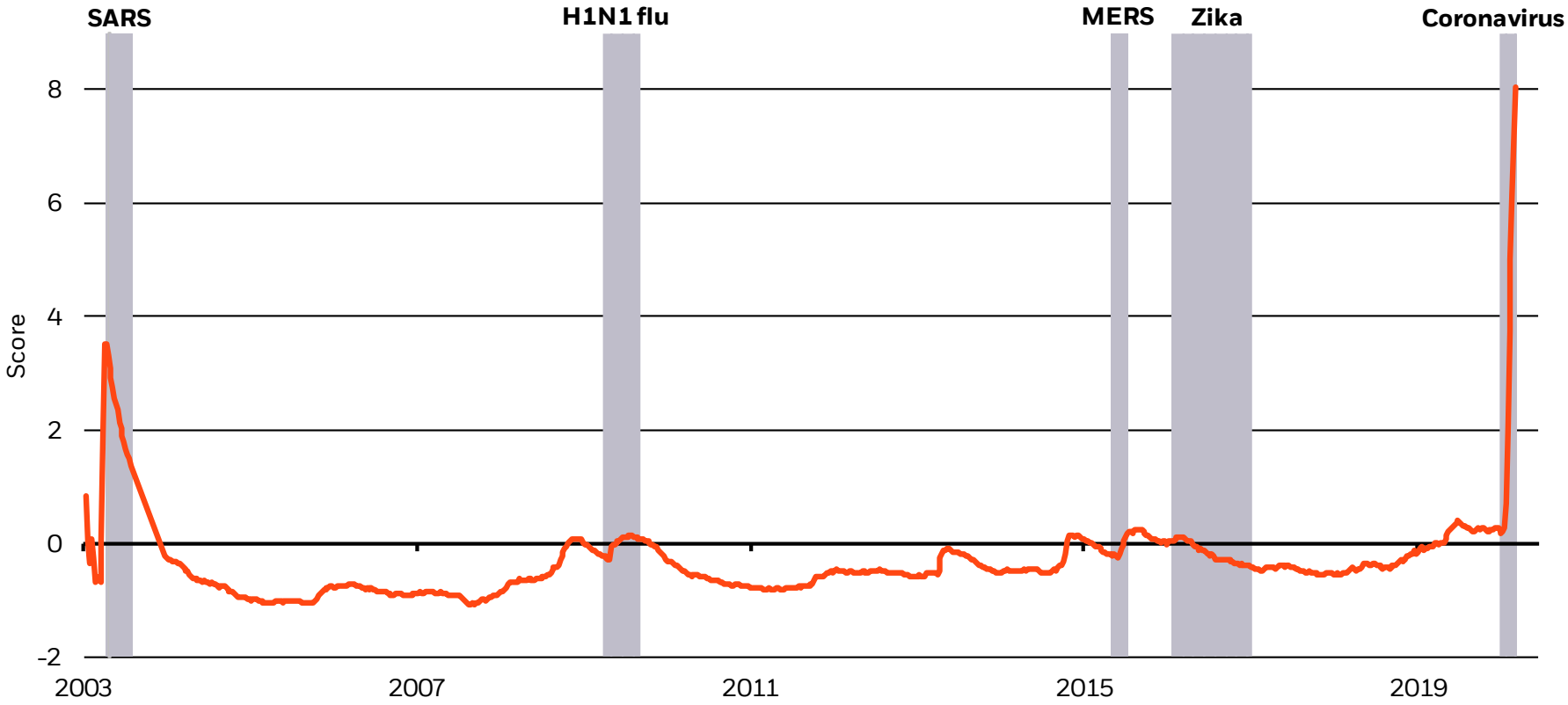
Rethinking resilience – Our preference for U.S. Treasuries and Treasury Inflation-Protected Securities as portfolio ballast worked during the recent virus-related equity volatility. The moves confirmed that some developed market bonds offer less diversification with yields near levels we consider to be their lower bounds. A focus on sustainability can help make portfolios more resilient.
Implication: We still prefer U.S. Treasuries over lower-yielding peers as portfolio ballast and see a strong case for integrating sustainability into investment processes.

The opinions expressed are as of March 2020 and are subject to change at any time due to changes in market or economic conditions.

Record market attention to outbreak

Market attention to the coronavirus, measured by mentions in broker reports and financial media, is far higher than it was for other diseases – and even SARS.

Market attention to global disease outbreaks, 2003–2020

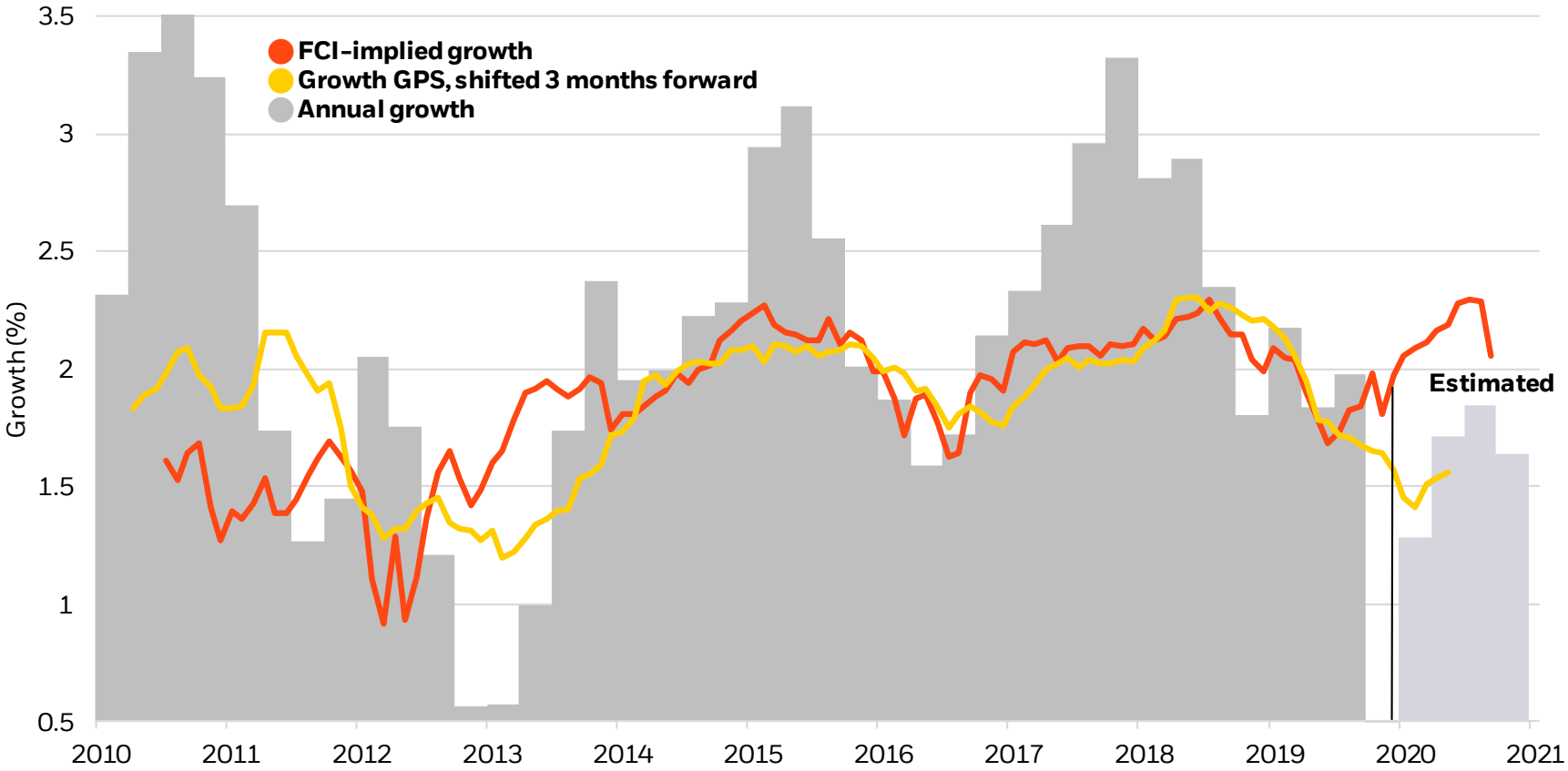


Sources: BlackRock Investment Institute, with data from Refinitiv, March 2020. Notes: We identify specific words related to major disease outbreaks since 2003, then use text analysis to calculate the frequency of their appearance in the Refinitiv Broker Report, as well as the Dow Jones Global Newswire and Reuters News databases. We then adjust for whether the language reflects positive or negative sentiment, and assign a score. A zero score represents the average level over its history from 2003 up to that point in time. A score of one means the attention level is one standard deviation above the average. We weigh recent readings more heavily in calculating the average.

Virus fears start to weigh on financial conditions

We see the economic fallout of the coronavirus outbreak as a temporary shock, albeit one of unknown depth and duration. The global economy is now on a lower track with material downside risks.

BlackRock G3 FCI and Growth GPS, 2010–2020

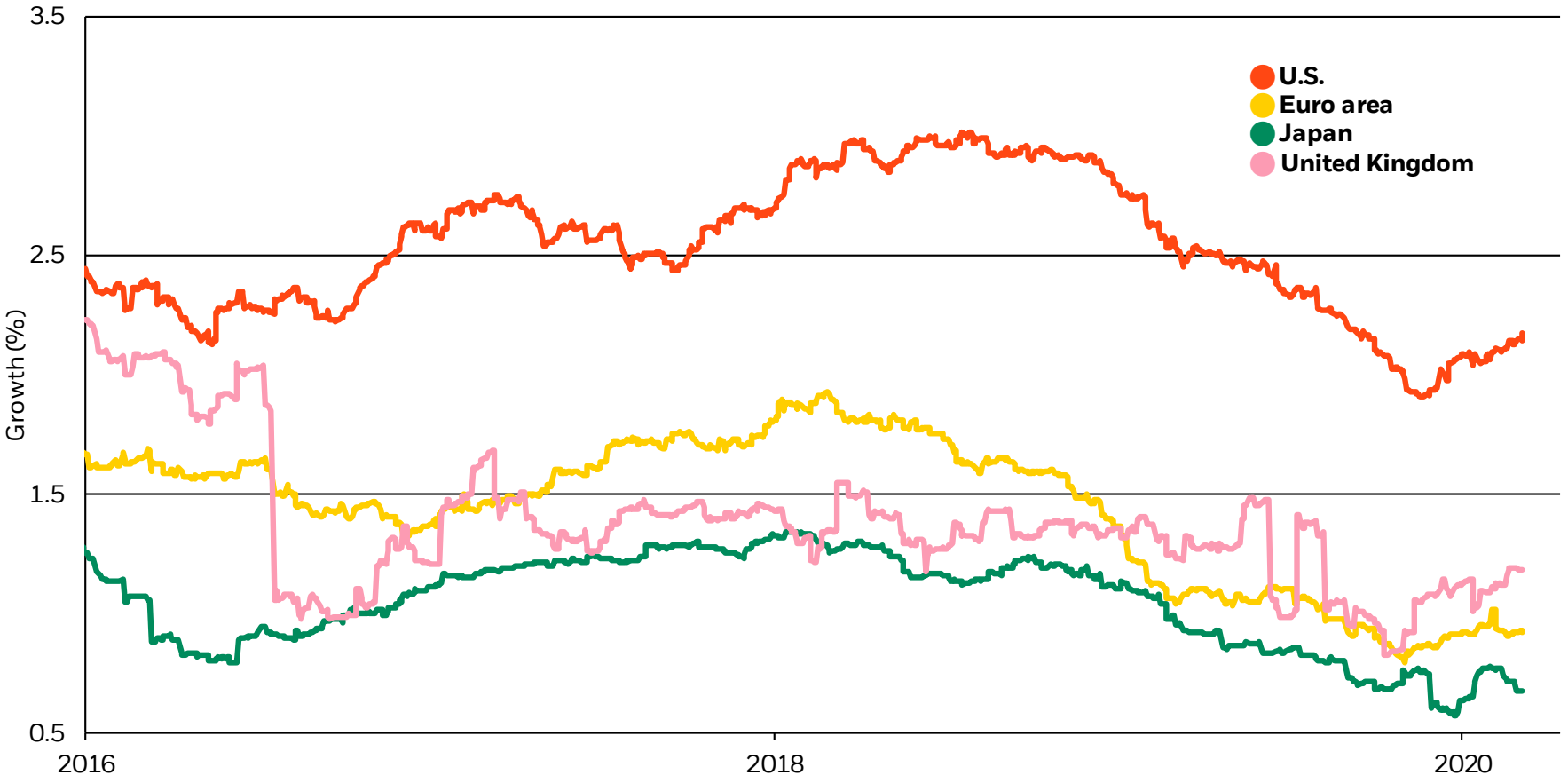


Sources: BlackRock Investment Institute, with data from Consensus Economics and Reuters polls, March 2020. Notes: The Growth GPS shows where consensus GDP forecast may stand in three months' time, shifted forward by three months. The orange line shows the rate of GDP growth implied by our financial conditions indicator (FCI), based on its historical relationship with our Growth GPS, shifted forward by six months. The grey area shows annualized actual growth rates on a quarterly basis; values after Sept 30, 2019 are consensus estimates. The FCI inputs include policy rates, bond yields, corporate bond spreads, equity market valuations and exchange rates. Forward-looking estimates may not come to pass.

Before virus-related disruptions, growth was edging higher

Our Growth GPS had reflected the pickup we expected this year, supported by loose financial conditions. Our indicators have yet to reflect the virus-related disruptions to activity from containment measures.

BlackRock Growth GPS for developed market economies, 2016–2020



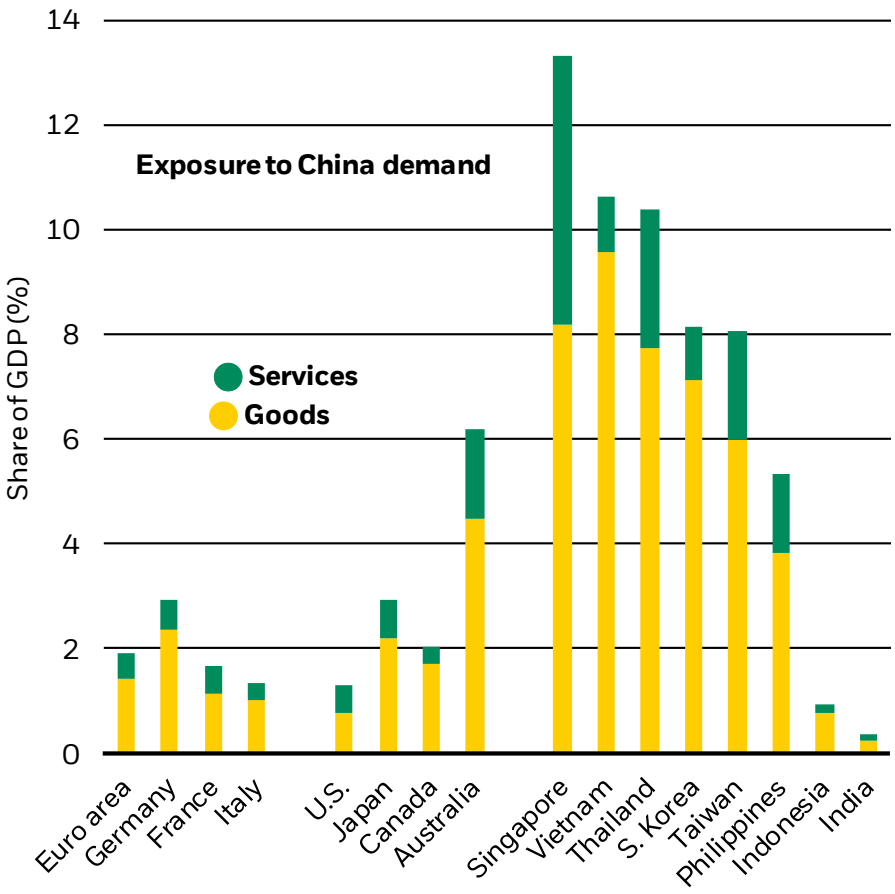
Sources: BlackRock Investment Institute, with data from Consensus Economics, March 2020. Notes: The Growth GPS shows where consensus GDP forecast may stand in three months' time, shifted forward by three months. Forward-looking estimates may not come to pass.

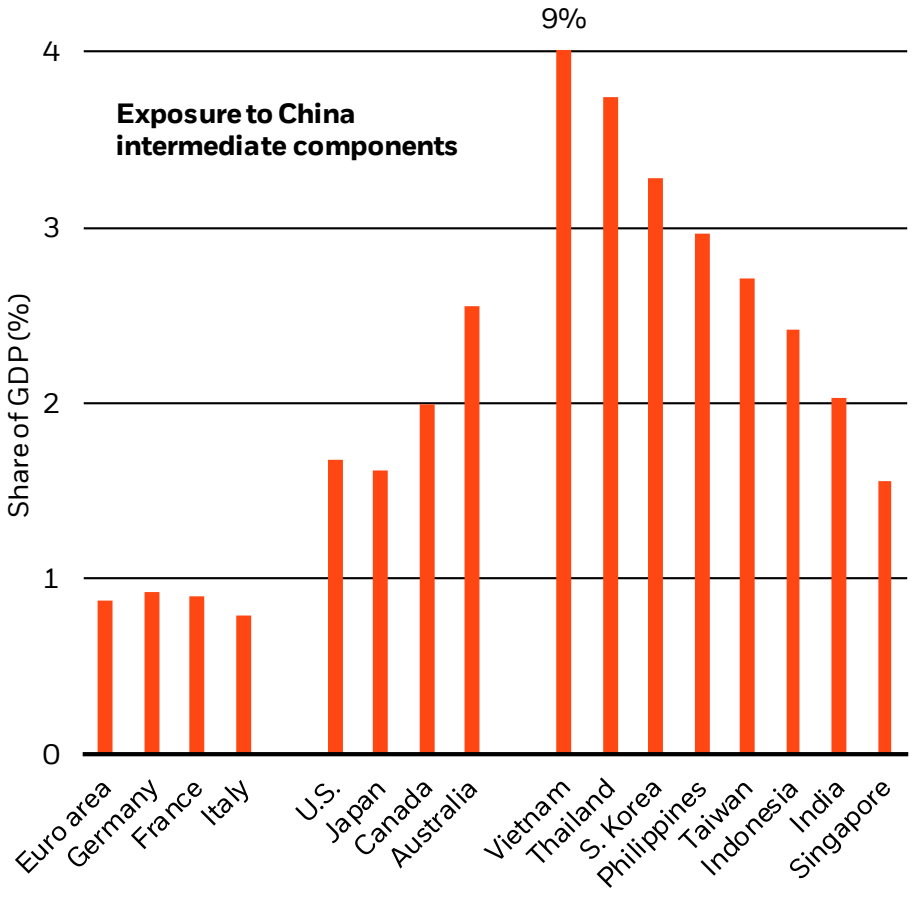
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China's disruption hits both demand and supply side

The coronavirus containment disrupts both demand (exports to China) and supply (intermediate components for final goods). Indirect effects, such as confidence, will also be a key factor.

Exports to and imports from China as a share of local GDP



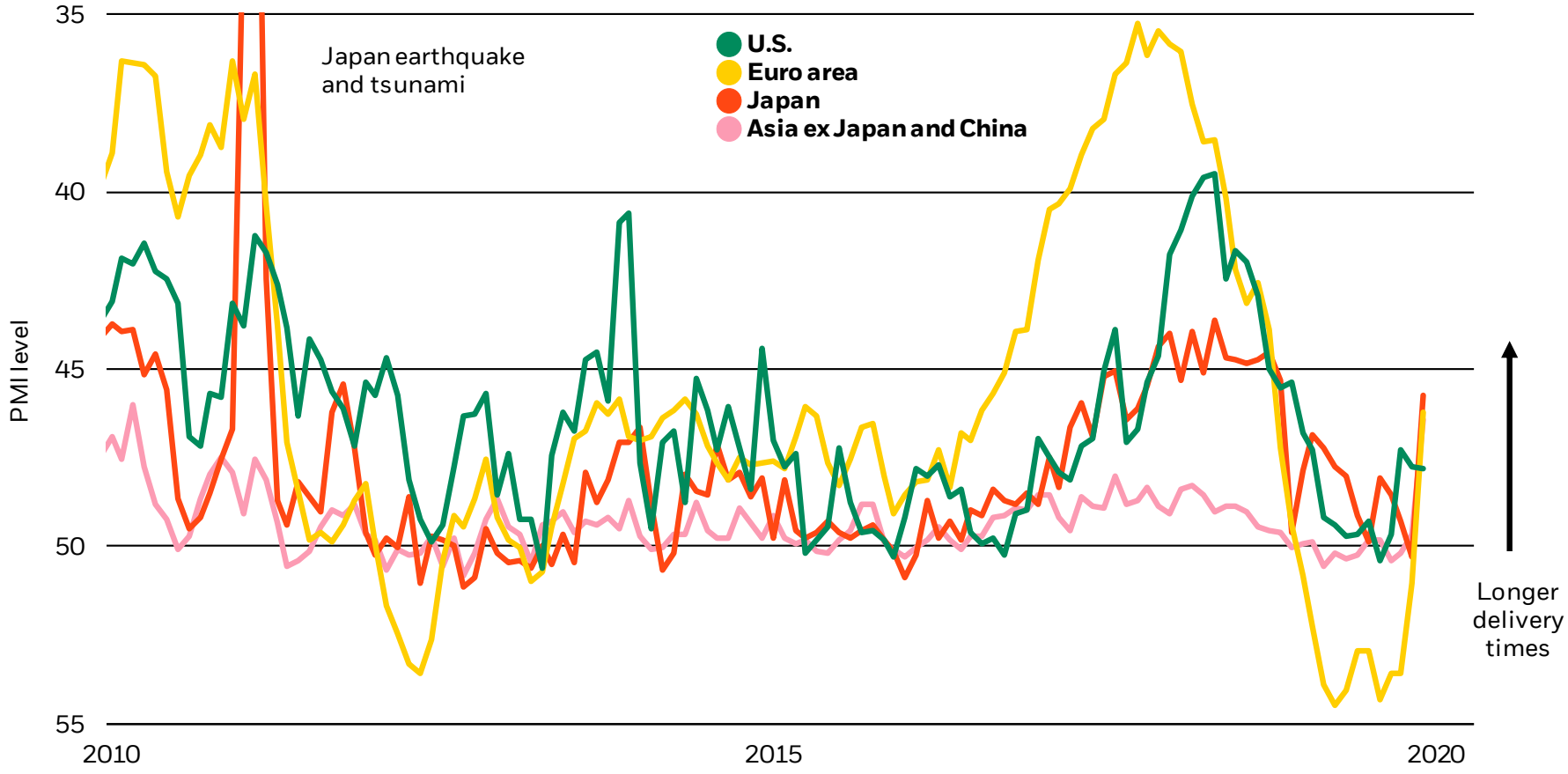


Sources: BlackRock Investment Institute, with data from the Organization for Economic Co-operation and Development, March 2020. Notes: The left chart shows the goods and services that each country or area exports to China as a percentage of local GDP, using trade in added value data from the OECD as of 2015. The right chart shows intermediate goods and services imported from China as a share of local GDP.

Supply chain disruptions from China are picking up sharply

Longer supplier delivery times show a direct impact on supply chains from China's containment measures. The U.S. PMIs do not yet show as much disruption as Europe and Asia.

Supplier delivery time in regional manufacturing PMIs, 2010–2020

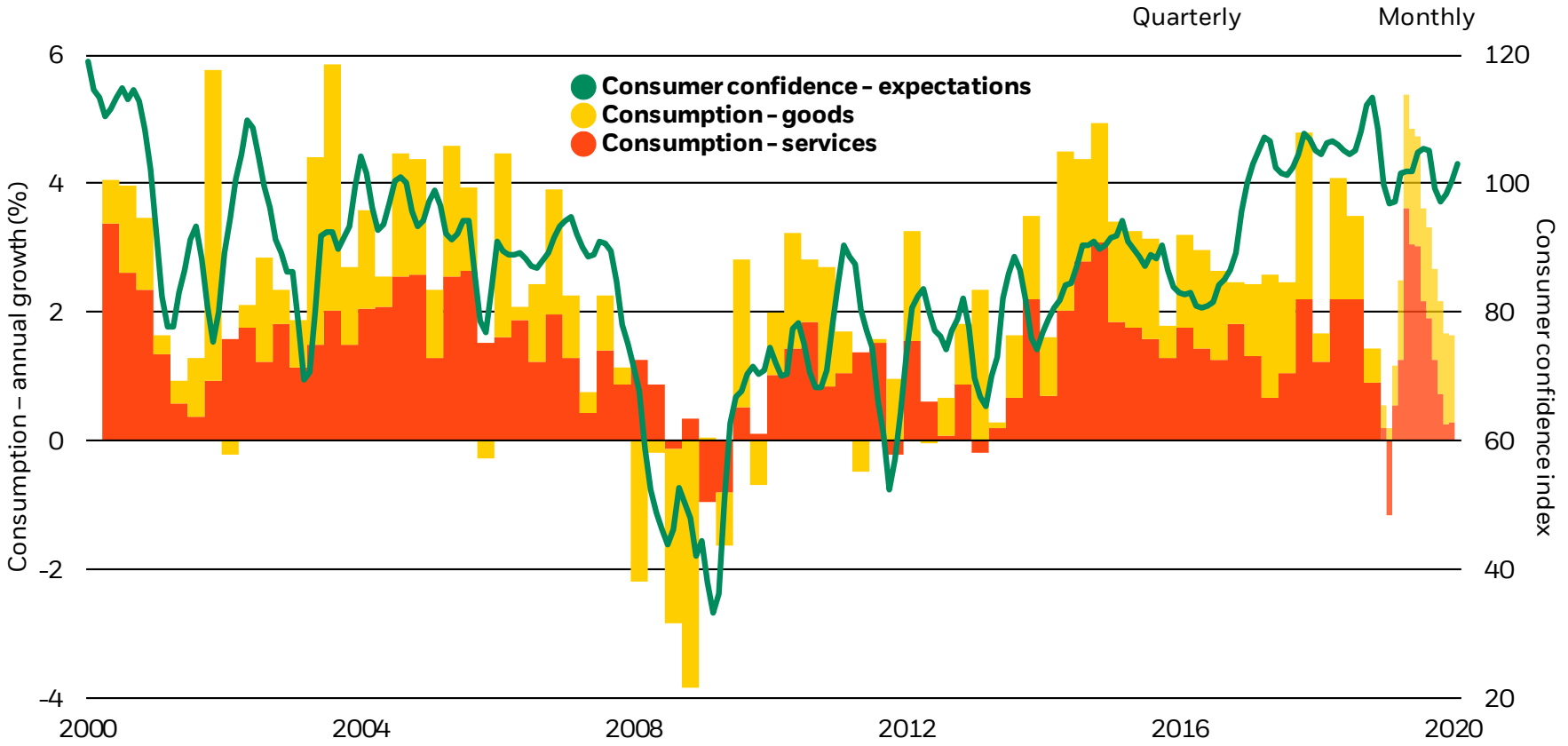


Sources: BlackRock Investment Institute and IHS Markit, with data from Refinitiv Datastream, March 2020. Notes: The lines show the supplier delivery time component of the respective purchasing managers' indexes.

U.S. resilience rests on the consumer

U.S. consumer spending has underpinned the record-long U.S. expansion. U.S. consumers remain upbeat and services spending has been holding steady.

U.S. consumer spending and confidence, 2000–2020

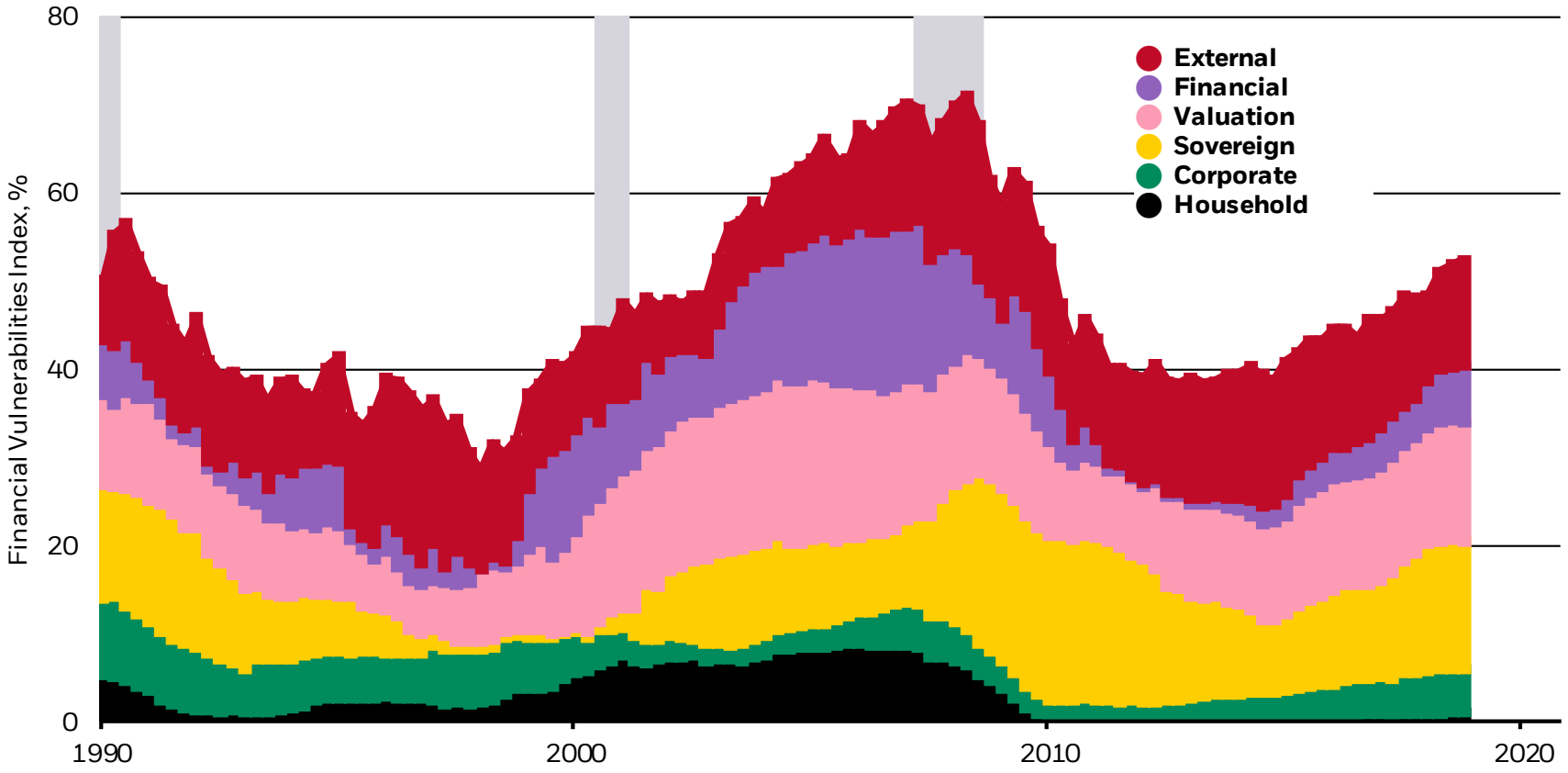


Sources: BlackRock Investment Institute, U.S. Bureau of Economic Analysis and Conference Board, with data from Refinitiv Datastream, March 2020. Notes: The bars show the breakdown of real U.S. personal consumption expenditure in services (orange) and goods (yellow) in seasonally adjusted annual rates of growth on both a quarterly basis – and on a monthly basis for data since 2019. The green line shows the three-month moving average of Conference Board consumer confidence expectations for the next six months.

Moderate financial vulnerabilities limit U.S. recession risks

The lack of overheating in the economy and financial sector – creating vulnerabilities – limit the risk of a U.S. recession. Technical recessions are possible in the euro area and Japan.

Breakdown of BII's financial vulnerabilities index by sector and U.S. recession bands, 1990–2020

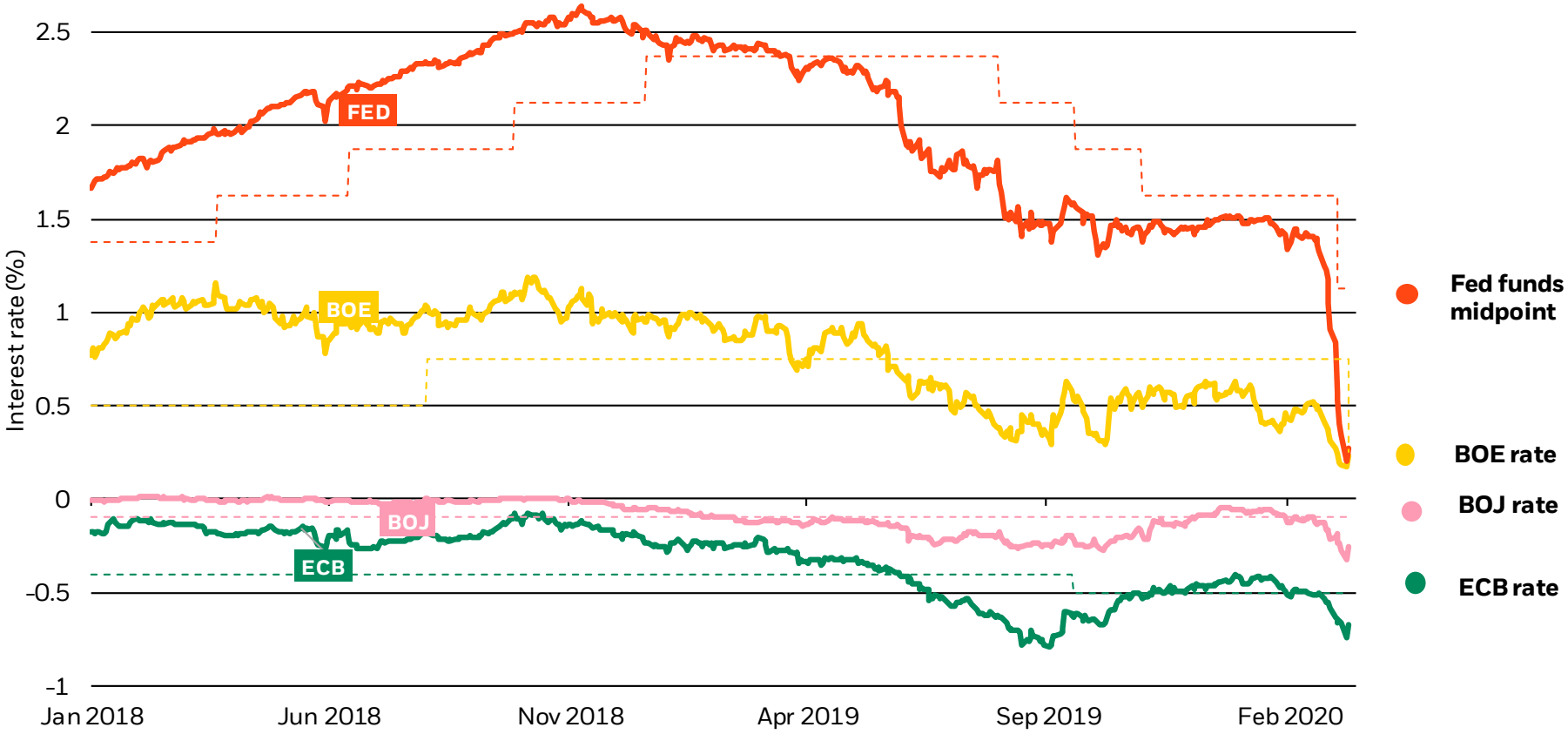


Sources: BlackRock Investment Institute, with data from Refinitiv Datastream, March 2020. Note: The chart shows a breakdown of our financial vulnerabilities index (FVI). The FVI is based on six sources of vulnerabilities: the financial sector, corporate sector, households, sovereign debt, external vulnerabilities and asset valuations. It aggregates these sources of vulnerabilities whose extremes have historically been associated with periods of financial stress. The grey bars indicate recessions, as defined by National Bureau of Economic Research.

Major central banks shift to a new monetary easing cycle

Markets are pricing in aggressive rate cuts, especially by the Federal Reserve. We expect the policy response to be differentiated and across multiple dimensions given the nature of the shock.

Central bank policy rates and 1-year/1-year forwards, 2018–2020

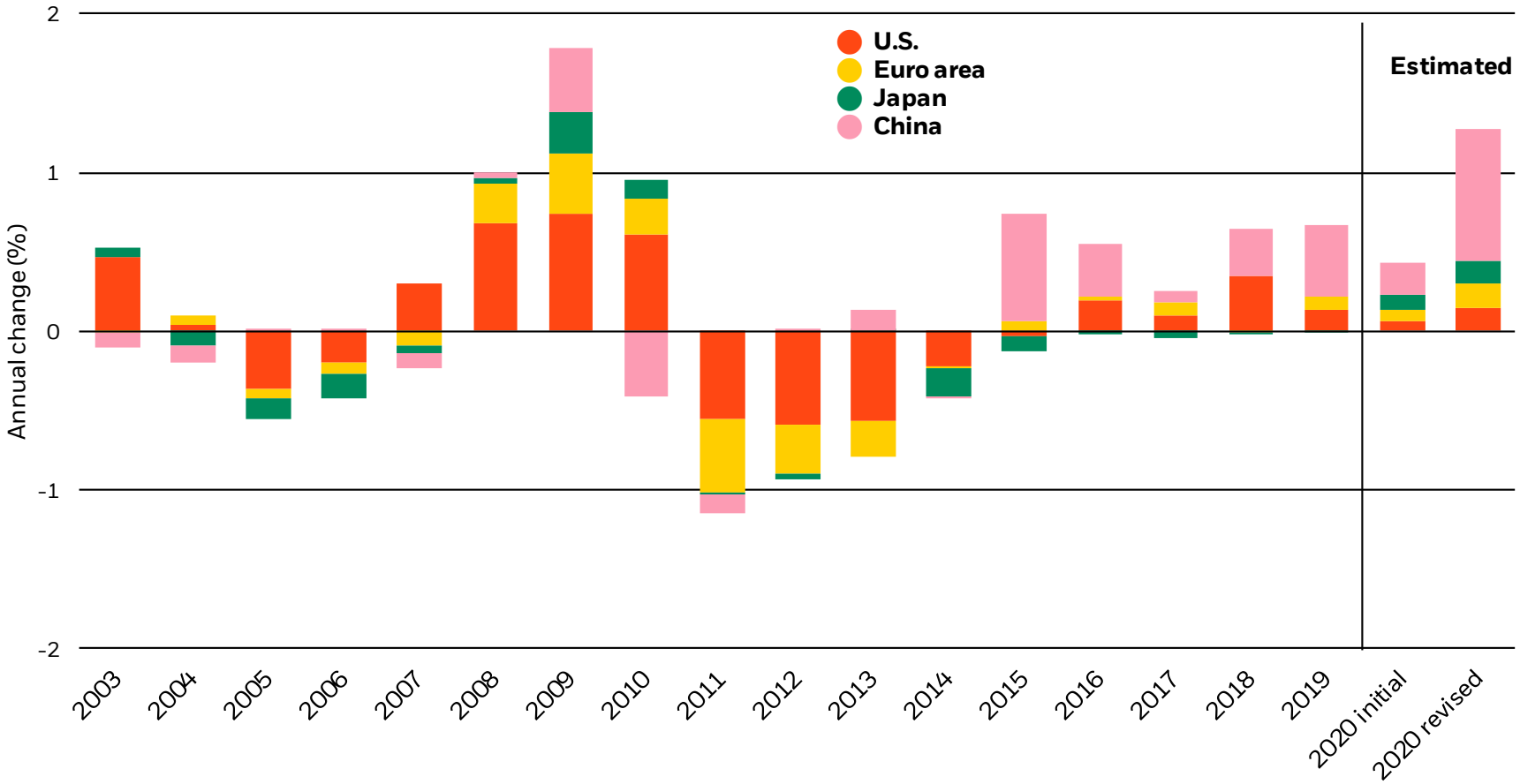


Sources: BlackRock Investment Institute, with data from Refinitiv Datastream, March 2020. Data as of 11 March, 2020. Notes: The solid lines show the market pricing of policy rates in overnight index swaps on a one-year horizon starting in one year's time. Dotted lines show policy rates for each region; we use the midpoint of the fed funds target range for the U.S.

Fiscal stimulus on the way

We expect governments to ramp up fiscal stimulus– beyond what was already estimated in 2020 – on health systems and to provide support to disrupted industries, especially smaller businesses.

Global fiscal impulse from G3 and China and estimates for this year, 2002–2020



There is no guarantee that any forecasts made will come to pass. Past performance is no guarantee of future results.

Source: BlackRock Investment Institute, IMF, OECD and the European Commission, with data from Bloomberg, March 2020. The chart shows the annual change in the cyclically adjusted government primary balance weighted by GDP in purchasing power parity terms. The bars show the fiscal impulse from each region relative to the size of the global economy.

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Grimmer potential shifts in the macro regime

We still see a slowdown macro regime for 2020. Compared with our previous assessment, the alternative regime is between recession and stagflation – and goldilocks is less likely.

Current regime

Slowdown: Decelerating growth and inflation; rising uncertainty accompanied by monetary easing.

Our base case: The virus is a negative shock of unknown depth and duration but does not end the expansion.

Potential regime shifts

Recession: Economic contraction with falling inflation, rising uncertainty and monetary easing.

Stagflation: Slowing growth and rising inflation; contracting credit.

Other regimes

Goldilocks: Growth-supportive policy with little inflationary pressure and credit expansion.

Reflation: Supportive policy and low uncertainty; accelerating growth and inflation.

Running hot: Monetary policy tightening to limit vulnerabilities, including inflation and financial.

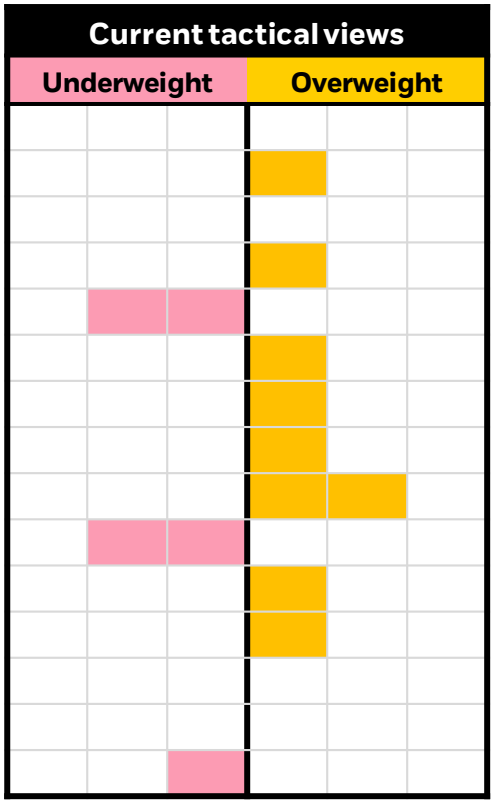
Hawkish squeeze: Decelerating growth and inflation while monetary policy is tightening.

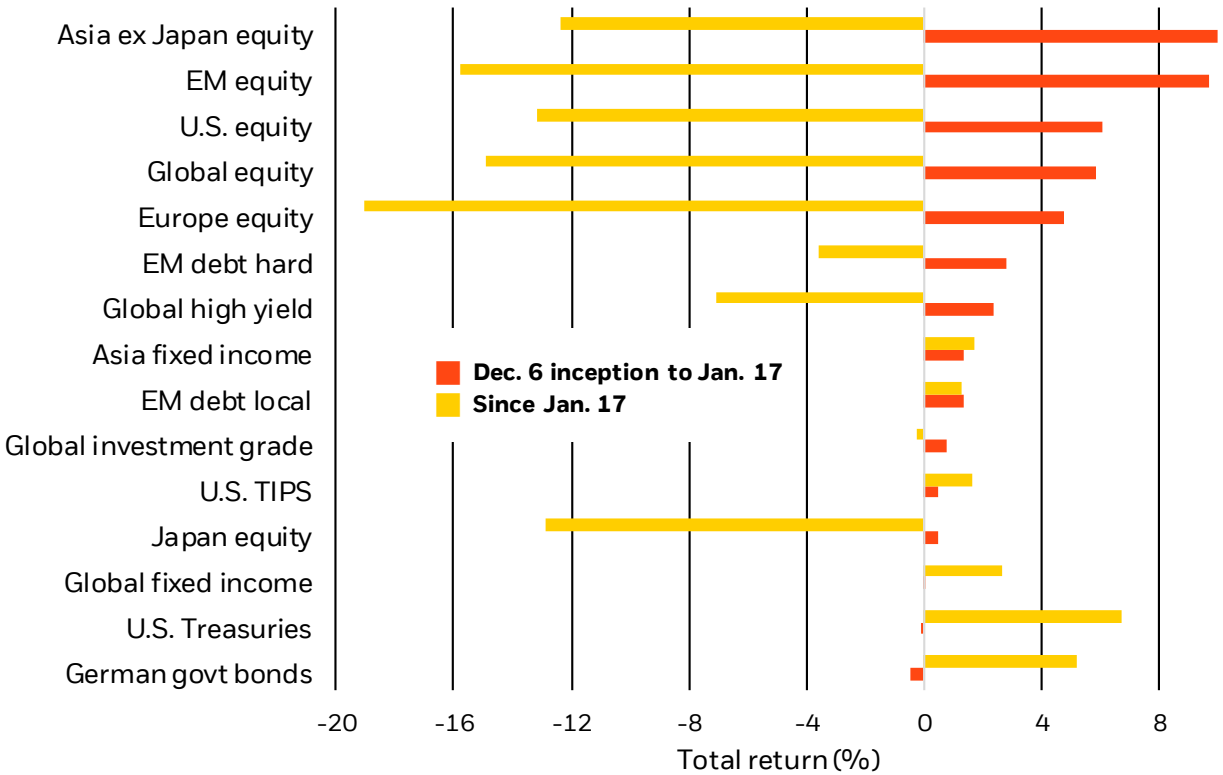
Source: BlackRock Investment Institute, March 2020. Note: For illustrative purposes only. The opinions expressed are subject to change at any time due to changes in market or economic conditions.

Scoring our views

Our modestly risk-on stance tilting into equities and EM, and away from Europe, worked – until the coronavirus outbreak. We turned to a neutral stance since and are reconsidering our granular views.

Asset performance in USD terms since publication of our 2020 tactical views





Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index.

Source: BlackRock Investment Institute, with data from Refinitiv Datastream, March 2020. Data as of 10 March 2020. Notes: The bars show asset performance from the last close before we published our latest views and from just before Jan. 20 when China confirmed that the coronavirus could spread from person to person. TIPS refers to Treasury inflation-protected securities. Indexes or prices used: MSCI AC ASIA ex Japan Index, MSCI EM Index, MSCI USA Index , MSCI World Index, MSCI Europe Index , JPM EMBI Global Diversified Index, Bloomberg Barclays Global High Yield Index, Bloomberg Barclays Non-Japan Asia Credit Index, JPM GBI-EM Global Diversified Composite Index, Bloomberg Barclays Global Credit Index, U.S. TIPS USD Index, MSCI Japan Index, Bloomberg Barclays Global Aggregate Index, Bloomberg Barclays U.S. Treasury Index, FTSE German Government Bond all maturities Index. Indexes are unmanaged and not subject to fees.

Directional views

Six to 12-month tactical views on major global asset classes, March 2020

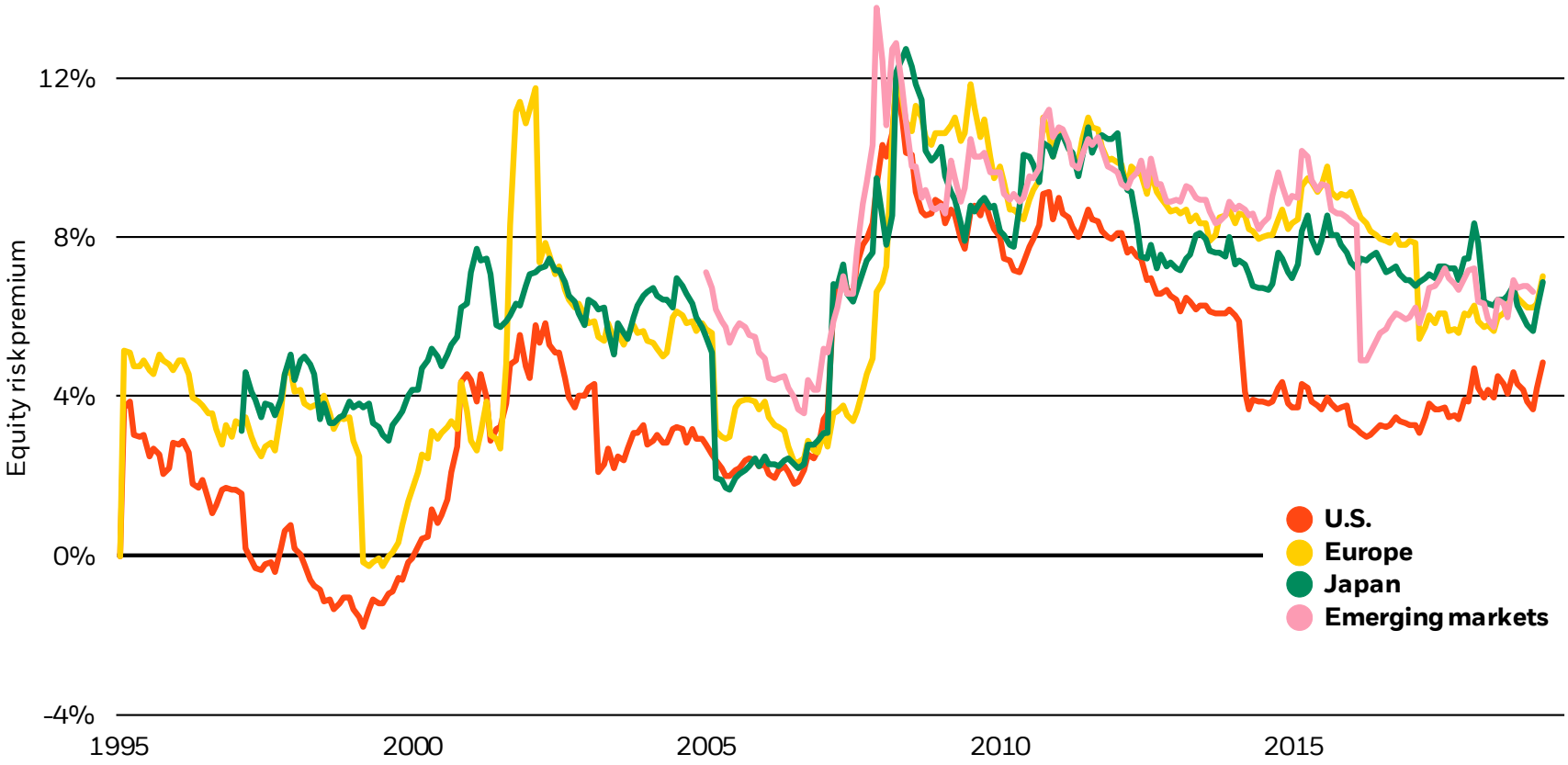
Asset	Underweight	Neutral	Overweight
Equities			
	We downgrade global equities to neutral. The coronavirus outbreak is disrupting economic activity and supply chains. The outbreak also poses risks to corporate earnings, in our view. Accommodative monetary policy is a support.		
Credit			
	We cut our overall view on credit to neutral. Downside risks and increased uncertainty around the economic outlook reduce our preference for risk assets. We could also see a risk of temporary liquidity crunches. We remain neutral as coupon income is king in a world starved for yield, especially at a time government bond yields are hovering near record lows.		
Govt bonds			
	We stay neutral overall on global government bonds. They act as ballast against risk-off episodes. Additional easing by major central banks has become more likely, in our view. We favor U.S. Treasuries over government bonds in other regions, but see risks of a diminishing buffer against equity market selloffs and a snap-back in yields from historically low levels.		
Cash			
	We maintain our neutral position on cash for risk mitigation. We also see cash as a robust buffer against risks around regime shifts, especially those triggered by a negative supply shock that could drive both stocks and bonds lower together.		

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Increased risk priced into global equities

Equity risk premia have spiked with the market slide, offering more compensation for risk. We expect the virus to hurt corporate earnings.

Equity risk premia, 1995–2020



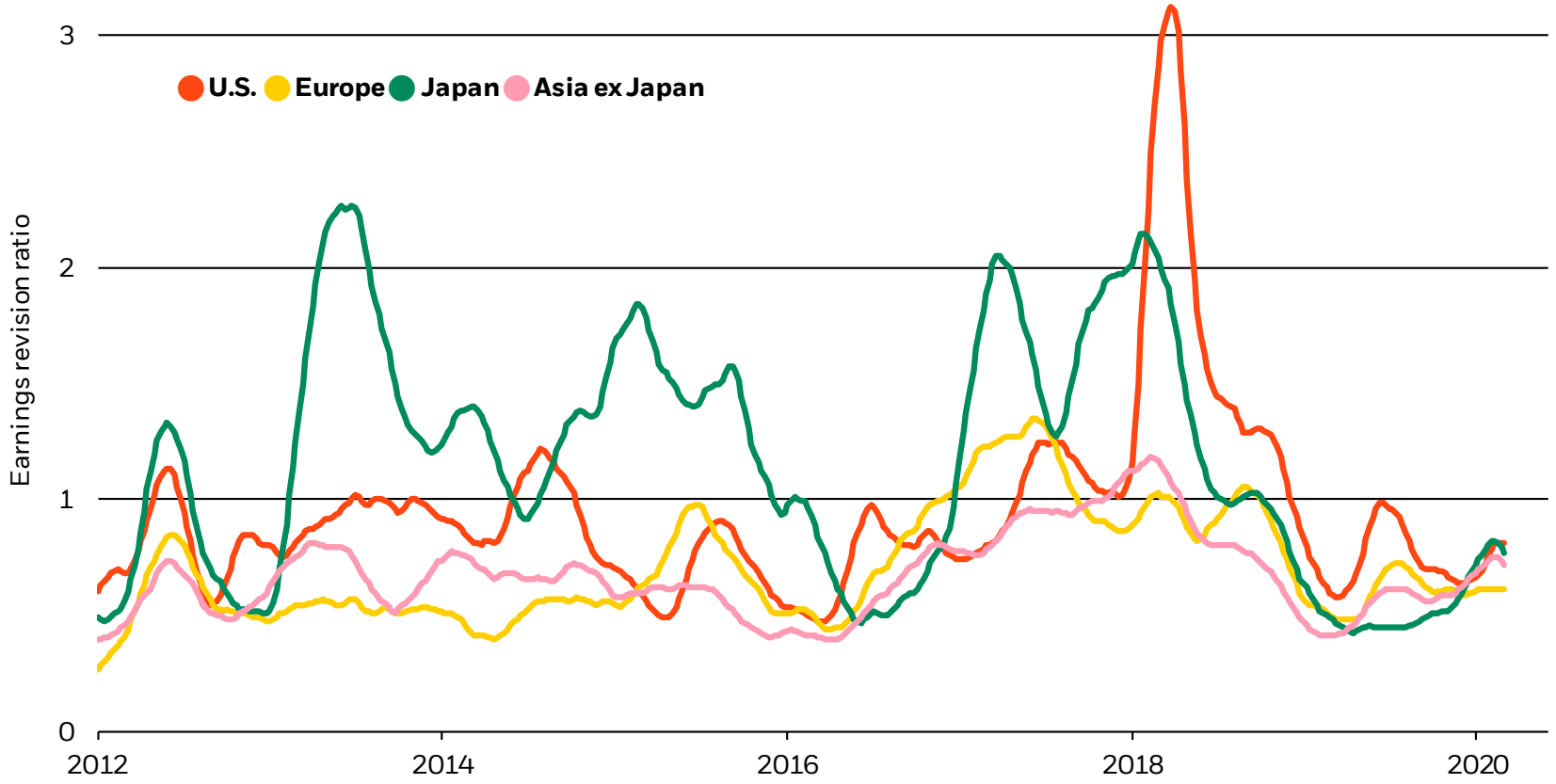
Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index.

Sources: BlackRock Investment Institute, March 2020. Notes: Data as of 28 Feb. 2020. We calculate the equity risk premium based on our expectations for nominal interest rates and the earnings yields for respective equity markets. We use MSCI indices as the proxy for the markets shown. We use our BlackRock expectations for interest rates so the estimate is not influenced by the term premium in long-term bond yields.

Earnings revisions likely to take a hit

Analysts have yet to factor in the virus impact on corporate earnings. Earnings revisions are likely to be knocked even lower from already soft levels.

Earnings revisions, 2012–2020



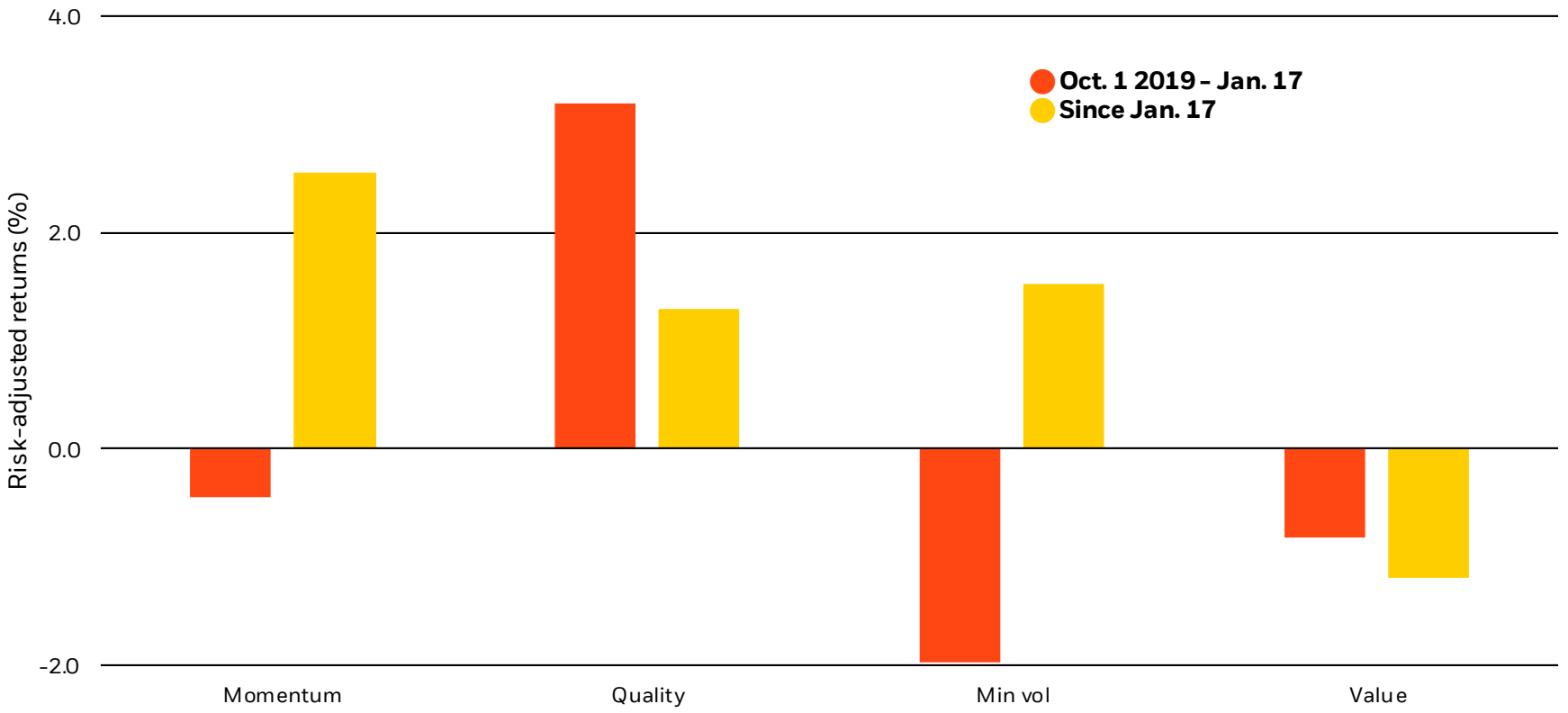
Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index.

Sources: BlackRock Investment Institute, with data from Refinitiv Datastream, March 2020. Notes: The chart shows the rolling three-month average of the net earnings revisions of the S&P 500, the MSCI Europe Index, the MSCI Japan Index and the MSCI Asia ex Japan Index. A reading under one means net downgrades to earnings forecasts.

We still like quality

We still favor the quality equity style for its resiliency despite its muted performance this year. We have downgraded the value factor and upgraded min vol as we moved to a risk neutral stance.

Equity style factor performance, October 2019 – March 2020



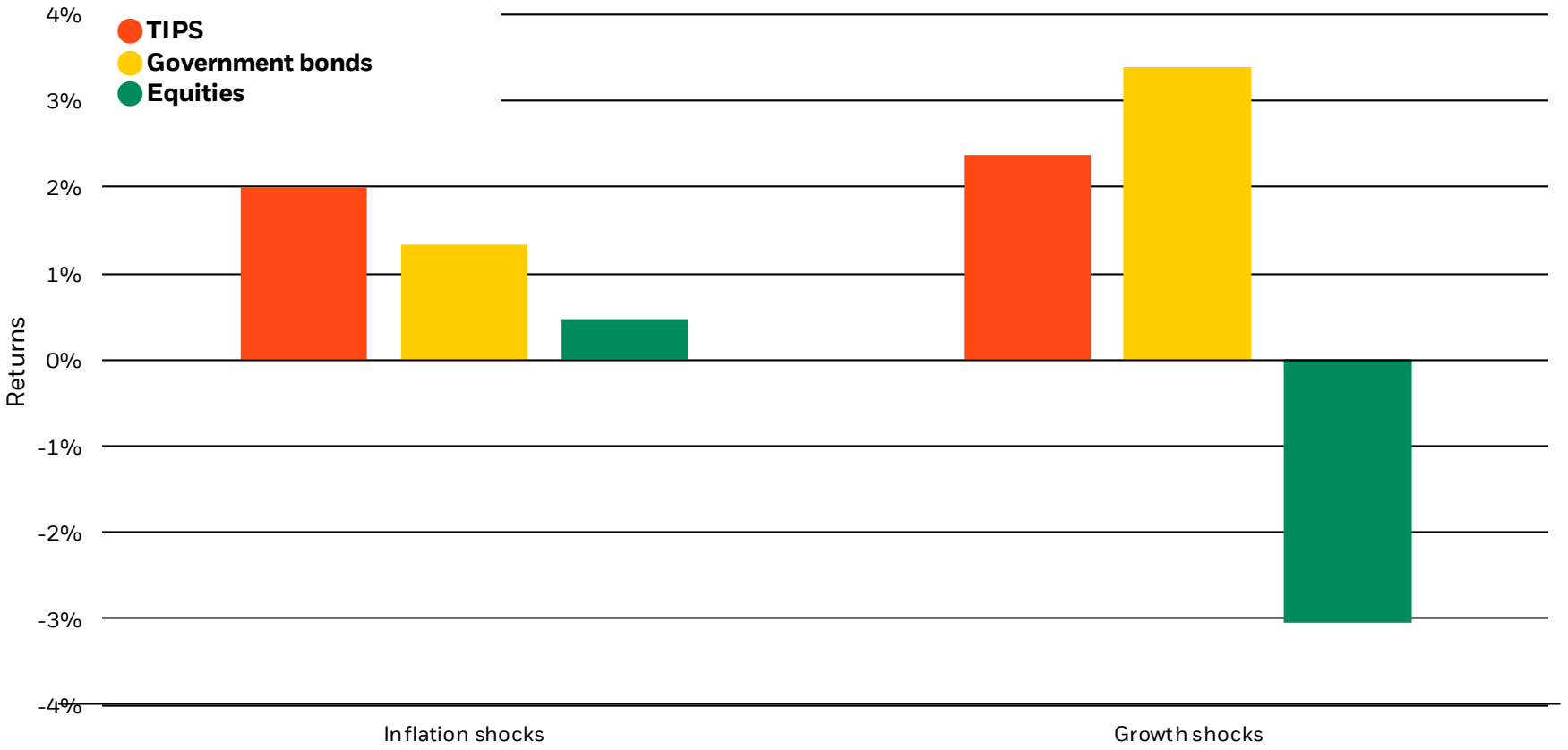
Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index.

Sources: BlackRock Investment Institute, with data from Refinitiv Datastream, March 2020. Notes: The bars show risk-adjusted returns of MSCI World Momentum, Quality, Minimum volatility and Value indexes from Oct.1, 2019 to just before Jan. 20 when China confirmed that the coronavirus could spread from person to person, and from Jan. 20 to March 10. We used the MSCI World Index as the benchmark in this analysis. The risk-adjusted returns are calculated by subtracting a factor index's return for a given period from the total return of the benchmark, then dividing that result by the tracking error, or the standard deviation of the difference between individual index and benchmark returns.

Reasons to like inflation-linked bonds

U.S. Treasury inflation-protected securities (TIPS) offer some diversification during both growth and inflation shocks – and have an important role in strategic portfolios.

Average asset returns under inflation and growth shocks, 1997-2019



Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index.

Sources: BlackRock Investment Institute, MSCI, Citigroup, with data from Refinitiv Datastream, December 2019. Notes: The chart shows quarterly returns for US government bonds (Bloomberg Barclays US Treasury Total Return), TIPS (Bloomberg Barclays US Treasury inflation notes total return index) and equities (MSCI USA Total Return index) in US dollar terms during upside inflation shocks and downside growth shocks. The periods for inflation and growth shocks are measured as those quarters during which Citi's inflation and growth surprise indexes recorded a greater than 1 standard deviation relative to their history. Indexes are unmanaged and not subject to fees.

Granular tactical views

Six to 12-month tactical views on selected assets vs. broad global asset classes by level of conviction, March 2020



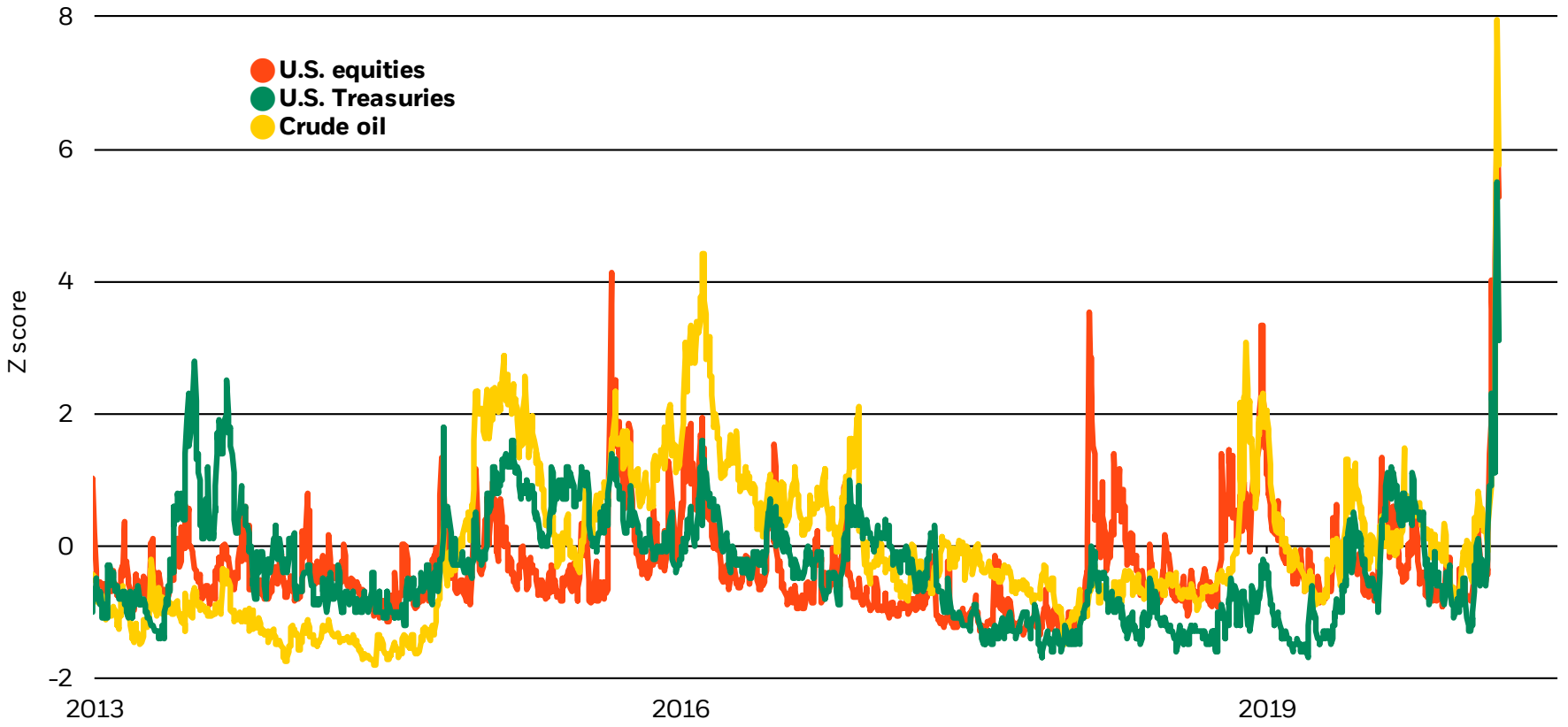
	Asset	Underweight / Overweight	
Equities	United States		The U.S. market's relative quality bias is a support. Uncertainty around the 2020 election has lessened with reduced risk of maximally divergent policy agendas between the two parties.
	Europe		We maintain European equities at underweight. We see greater upside elsewhere in an eventual cyclical recovery – and markets look to have priced in easing by the European Central Bank.
	Japan		We see Japanese equities benefiting most from an eventual global manufacturing recovery and a lull in trade tensions. We see near-term risks to growth due to the virus outbreak and a sales tax increase.
	Emerging markets		We see EM equities as beneficiaries from the global recovery once the current shock dissipates. EM central banks are likely to stay on their easing paths, supporting growth and equity markets.
	Asia ex Japan		We hold Asia ex-Japan equities at neutral amid prospects of a growth uptick, even if delayed. We see China's economy eventually recovering from disruptions tied to the coronavirus outbreak.
	Momentum		We upgrade momentum to neutral. The factor has outperformed amid the growth slowdown, partly due to its exposure to "secular growers" in the tech industry as well as dividend paying bond proxies.
	Value		We downgrade value to underweight. Value tends to perform best in periods of accelerating growth, and we now see the coronavirus outbreak posing downside risks to the economy.
	Minimum volatility		We upgrade min-vol to overweight. We prefer its defensive properties in a growth slowdown. The factor has historically performed well late in the cycle.
	Quality		We hold quality as an overweight. We like that it tends to be resilient in late-cycle periods, despite relatively high valuations.
Fixed Income	U.S. Treasuries		We maintain U.S. Treasuries at neutral, preferring the front end of the curve. Yet we acknowledge the risk of a sharp snapback in yields from record lows.
	Treasury Inflation-Protected Securities		The asset class has rallied amid the coronavirus outbreak, making an entry point less attractive now. We still see potential for higher inflation amid U.S. wage pressures and like TIPS in strategic portfolios.
	German bunds		We remain underweight bunds as they provide little cushion against major risk events, but would not add to our underweight after recent underperformance versus U.S. Treasuries.
	Euro area peripherals		We hold an underweight in euro area peripheral government bonds. We see yields and spreads as insufficient to compensate investors for underappreciated political risks in the region.
	Global investment grade		We keep global investment grade credit as an underweight. Low coupon rates make the sector's income relatively unattractive on a risk-adjusted basis.
	Global high yield		We like global high yield for its income potential. Near-term risks include the coronavirus shock hitting growth and the oil price fall hurting energy issuers.
	Emerging market – hard currency		We still like hard-currency EM debt against a backdrop of dovish EM central banks and a stable to weaker U.S. dollar. We prefer the high-yielders. The coronavirus outbreak is a risk to growth.
	Emerging market – local currency		We are overweight local-currency EM debt. Coupons look attractive, but currency depreciation is a risk – and may constrain the ability of central banks to cut interest rates.
	Asia fixed income		We maintain Asia fixed income as an overweight, with a preference for up-in-quality exposures. Asian central banks have some room to ease policy,

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Implied volatility has spiked on risk asset selloff

Coronavirus-driven uncertainty has spurred higher implied volatility across asset classes, exacerbated by the oil supply war. The virus-related disruptions are likely to lead to higher macro volatility as well.

Cross-market implied volatility, 2013–2020



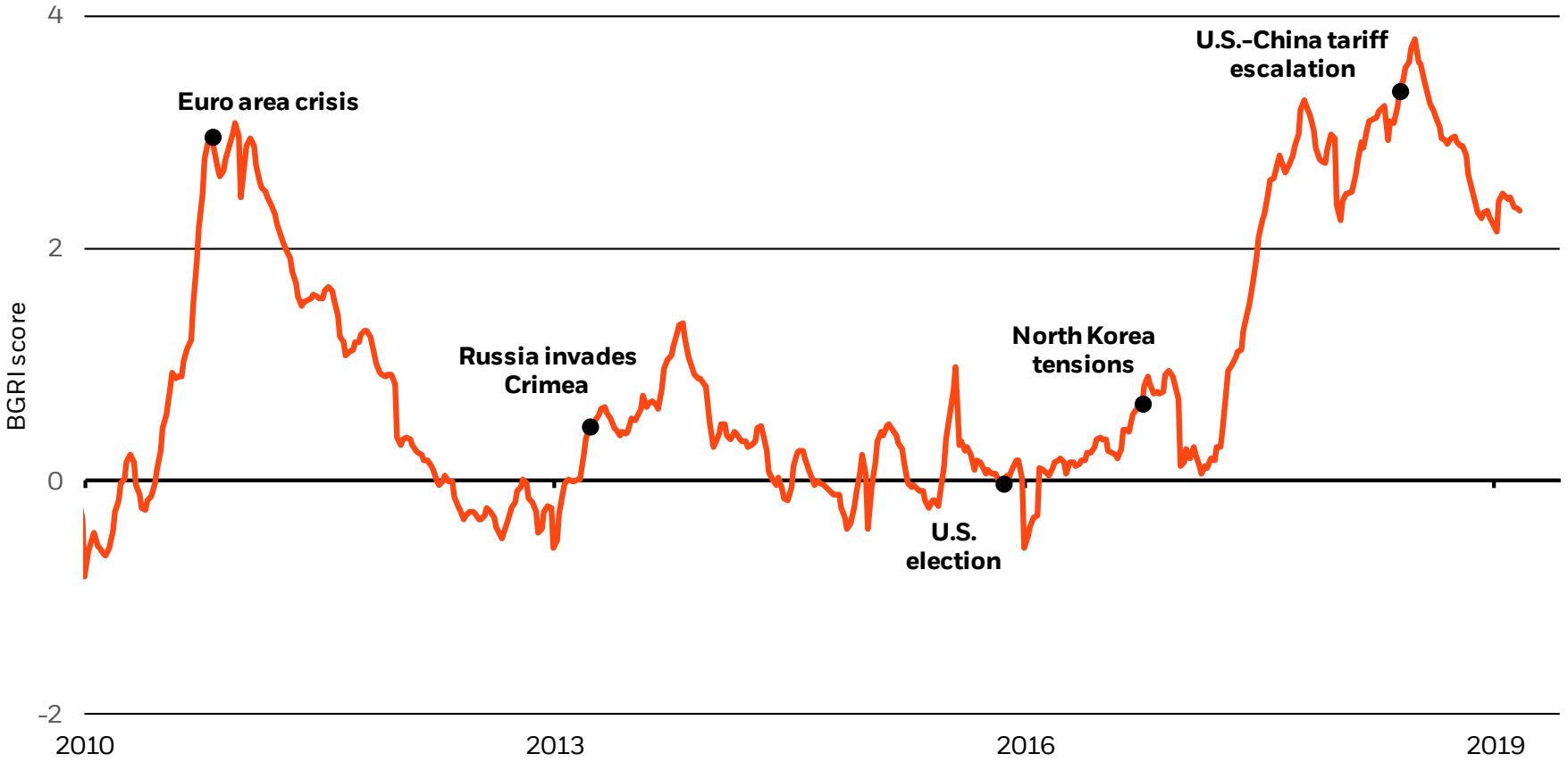
Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index.

Sources: BlackRock Investment Institute, CBOE and Bank of America-Merrill Lynch, with data from Refinitiv Datastream, March 2020. Notes: The chart shows the Z-score, or standard deviation relative to a long-term mean, of the CBOE VIX Volatility Index of S&P 500 implied volatility, the Bank of America Merrill Lynch MOVE Index of U.S. Treasury implied volatility and the CBOE Oil Volatility Index of implied volatility on U.S. crude oil.

Market attention to geopolitical risks slips from highs

The U.S. and China appear to have hit pause on their trade conflict after agreeing to a limited "phase one" trade deal. The U.S. presidential election and coronavirus impact are a bigger market focus.

BlackRock Geopolitical Risk Indicator, 2006–2020

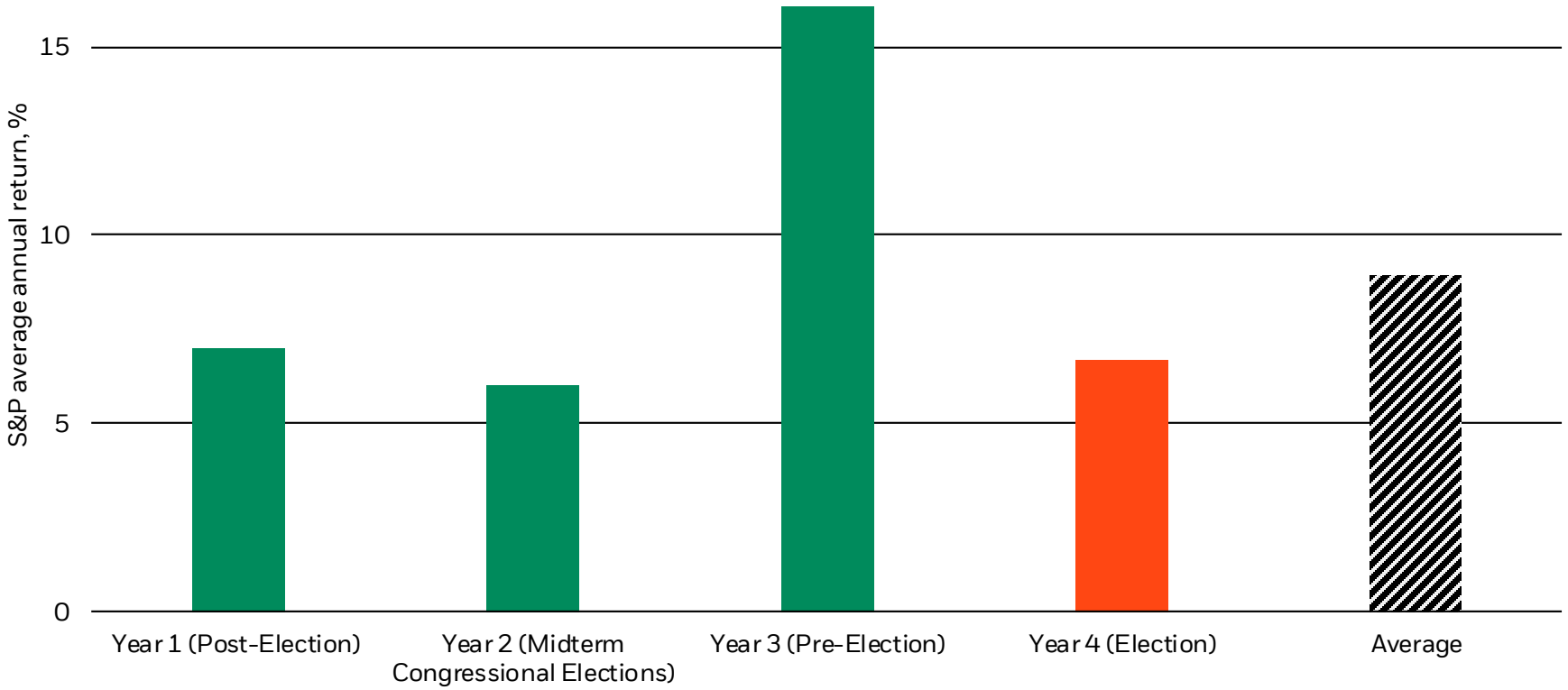


Source: BlackRock Investment Institute, with data from Refinitiv Datastream, March 2020. Notes: See BlackRock's Geopolitical risk dashboard (https://www.blackrock.com/corporate/insights/blackrock-investment-institute/interactive-charts/geopolitical-risk-dashboard) for full details. We identify specific words related to geopolitical risk in general and to our top-10 risks. We then use text analysis to calculate the frequency of their appearance in the Refinitiv Broker Report and Dow Jones Global Newswire databases as well as on Twitter. We then adjust for whether the language reflects positive or negative sentiment, and assign a score. A zero score represents the average BGRI level over its history from 2003 up to that point in time. A score of one means the BGRI level is one standard deviation above the average. We weigh recent readings more heavily in calculating the average.

Cautious on U.S. equities in election year

We remain neutral on U.S. equities. Rising uncertainty around the 2020 election and a wide range of policy outcomes may weigh on sentiment and prevent a repeat of outperformance.

Average annual returns for the S&P 500 in U.S. presidential election cycles, 1949–2019



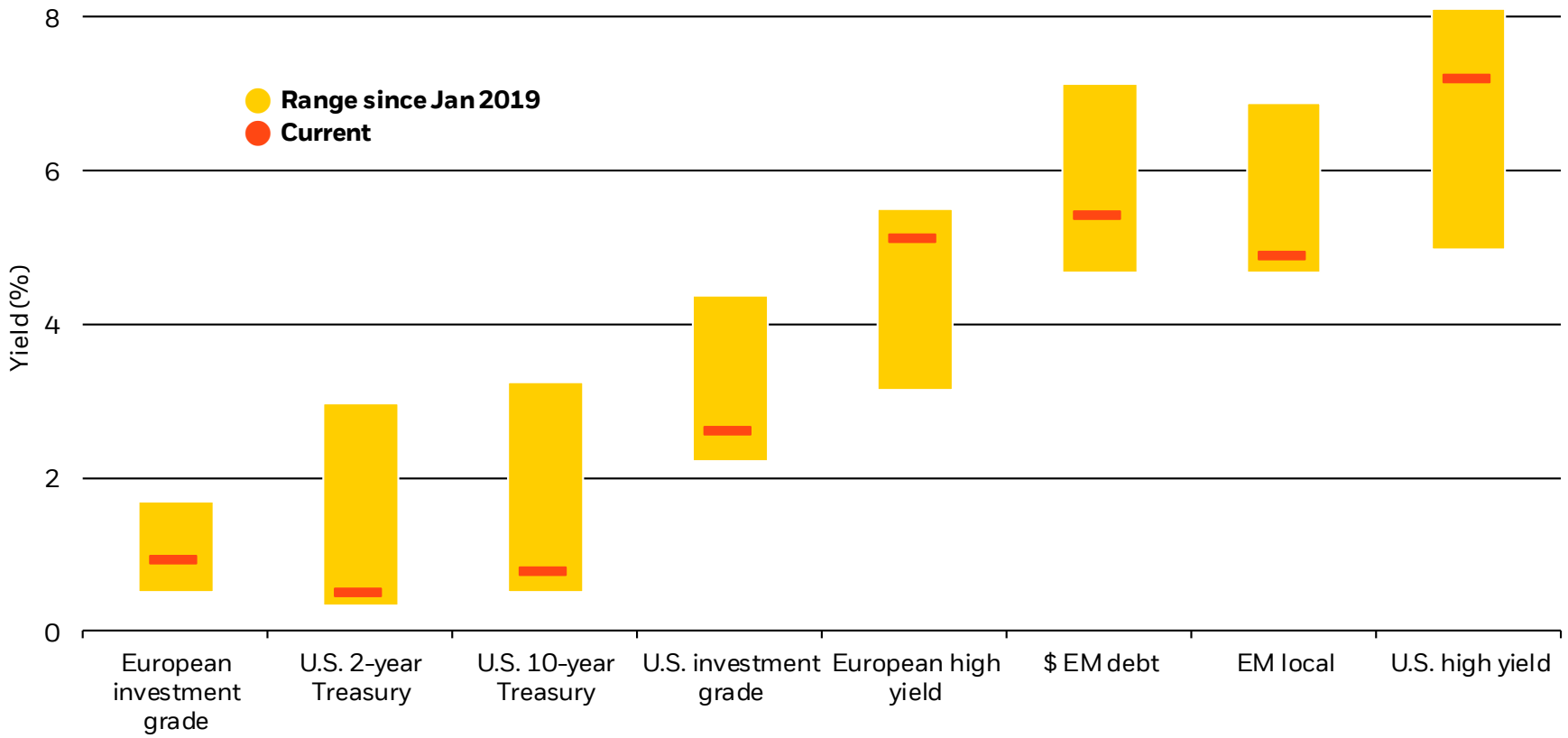
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Sources: BlackRock Investment Institute, with data from Jeffrey A. Hirsch, StockTradersAlmanac.com and Hirsch Holdings Inc, March 2020.

Preferring EM debt and high yield

We like sources of coupon income from higher-yielding asset classes. We have reduced positions but maintain an overweight in EM, partly due to expected central bank easing, and high yield.

Selected fixed income yields, 2019–2020



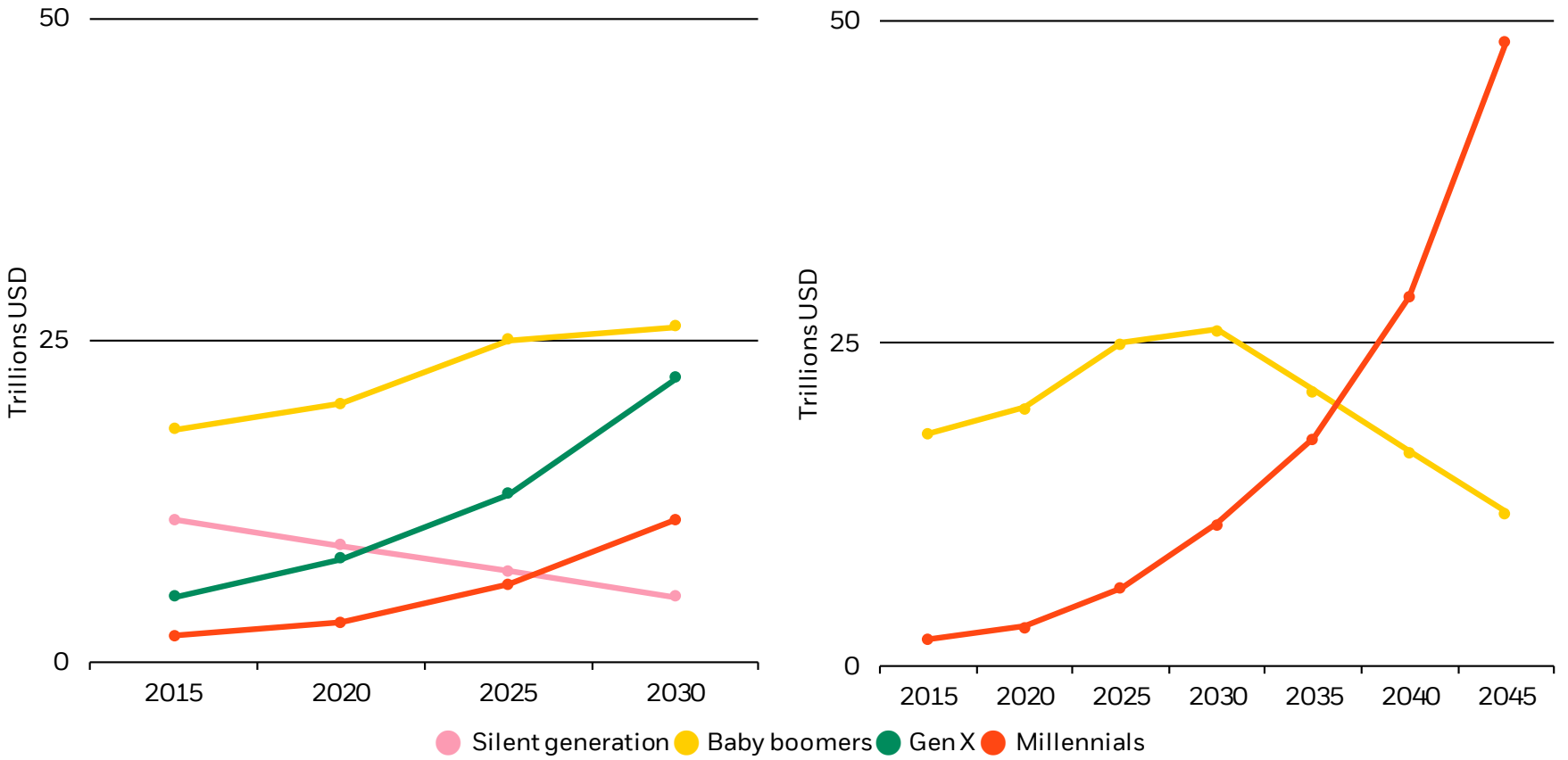
Sources: BlackRock Investment Institute, with data from Refinitiv Datastream, Bloomberg Barclays and J.P. Morgan, March 2020. Data as of 10 March 2020. Notes: The bars show the range in yields for each index from the start of January 2019. Indices used: Bloomberg Barclays Pan-European Corporate, Refinitiv 2-year and 10-year benchmark U.S. Treasury, Bloomberg Barclays U.S. Corporate Investment Grade, Bloomberg Barclays Pan-European Corporate High Yield, J.P. Morgan GBI-Emerging Market Index, J.P. Morgan EMBI-Global Diversified Index and Bloomberg Barclays U.S. Corporate High Yield Index. Indexes are unmanaged and not subject to fees. It is not possible to invest directly in an index.

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Wealth transfer – just one factor driving ESG adoption

An ongoing transfer of wealth to a younger generation with greater awareness of sustainability is just one of the structural factors that will drive a sustainability wave in coming years and decades.

Estimates of financial asset holdings by U.S. generations and extrapolating trends, 2015–2045



Sources: BlackRock Investment Institute, with data from Deloitte Center for Financial Services, March 2020. Notes: The chart on the left shows the distribution of investable financial assets across different generational cohorts as defined by Deloitte in this paper https://www2.deloitte.com/us/en/insights/industry/investment-management/us-generational-wealth-trends.html. The chart on the right shows a hypothetical rate of change in wealth applying the rate of increase between 2015-2030 of Gen X (born 1965-1980) to millennials (born 1981-1997) in 2030-2045 and applying the rate of change of the silent generation (born 1928-1945) to baby boomers (born 1946-1964) over the same period. Forward-looking estimates may not come to pass.



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