

Weekly commentary

Sept. 30, 2019

BlackRock

A growth recovery in waiting

- We expect a pickup in global growth in the next six to 12 months, as policy stimulus gradually filters through to the real economy.
- The Fed has cut interest rates, but its noncommittal view on the rate outlook suggests expectations for rate cuts are likely overdone.
- This week’s purchasing managers’ index (PMI) data from China will show if manufacturing weakness has stretched into the fifth month.

Major central banks have eased monetary policy in recent months, delivering on the anticipated policy pivot that informs one of our key investment themes. We expect policy easing to help sustain the economic expansion, and already see easier financial conditions. Yet the road to recovery could be bumpy due to the persistent uncertainty from protectionist policies. We see growth troughing over 6-12 months, supporting our moderately pro-risk stance over this period.

Chart of the week

The BlackRock G3 Financial Conditions Indicator and Growth GPS, 2015-2020



Source: BlackRock Investment Institute with data from Bloomberg and Consensus Economics, September 2019. Notes: The BlackRock Growth GPS shows where the 12-month forward consensus GDP forecast may stand in three months’ time. 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 180 days. 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.

Growth expectations for key developed economies have faltered since 2018, as indicated by our BlackRock Growth GPS for G3 economies (the U.S., Japan and euro area). Financial conditions have eased in recent months in these economies thanks to policy easing, according to our Financial Conditions Indicator (FCI). The historical relationship between our FCI and GPS points to potential for a growth pickup in the coming six months. Some pockets of the economy that are more sensitive to interest rates appear to be slowly responding to easier financial conditions: In the U.S., the housing market appears to have turned a corner and auto sales have held up. In the euro area, machinery investment rebounded. But easier financial conditions have yet to support a broader economic recovery.



Elga Bartsch
Head of Macro Research –
BlackRock Investment
Institute



Mike Pyle
Global Chief Investment
Strategist – BlackRock
Investment Institute



Scott Thiel
Chief Fixed Income
Strategist – BlackRock
Investment Institute

Visit [BlackRock Investment Institute](#) for insights on global economy, markets, geopolitics and portfolio construction.

**BlackRock
Investment
Institute**

Central banks’ policy stimulus is here, as illustrated in our [updated 2019 Investment Outlook](#). The Federal Reserve has delivered its second rate cut since the financial crisis – and looks set to ease policy further. The European Central Bank (ECB) materially exceeded market expectations in early September, launching a broad package with combined impact that should potentially be greater than the sum of its parts. These actions have provided support to risk assets. Yet we do not expect a repeat, and believe markets are likely pricing in too much additional Fed easing in the year ahead. We see little near-term risk of recession, thanks to easier financial conditions and still-robust U.S. consumer spending. And it’s far from certain the Fed will try to respond to the trade war fallout with meaningfully looser monetary policy. Supply chain disruptions could hit productive capacity, fostering mildly higher inflation even as growth slows. This complicates the case for further policy easing.

What does this mean for markets? We see the monetary stimulus delivered to date operating with a lag. We are likely to see the German economy – Europe’s largest – contracting for another quarter. We still view the protectionist push as a key driver of global markets and economy. The U.S. and China appear likely to engage in trade talks again. We see some possibility of a truce, but a comprehensive trade deal as unlikely. Persistent uncertainty from protectionist policies is likely to remain a drag on corporate confidence and business spending. Robust consumer spending in the U.S. is key to our view that this long economic expansion is likely to remain intact.

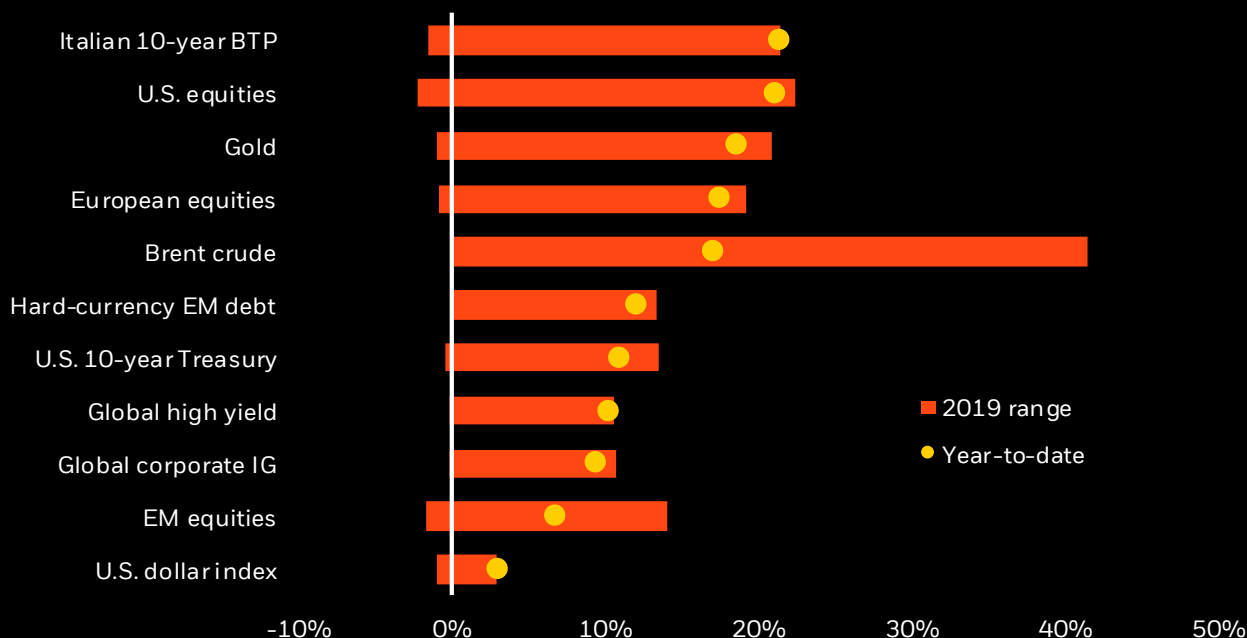
Bottom line: We see moderate risk-taking likely rewarded – even as recent events reinforce our call for a greater focus on portfolio resilience. We prefer U.S. equities for their reasonable valuations and relatively high quality; and the min vol and quality factors for their defensive properties. We like emerging market debt for its coupon income. We are overweight euro area sovereigns: a relatively steeper yield curve brightens their appeal even at low yields. And we see government bonds as important portfolio stabilizers.

Market backdrop

A perceived easing of U.S-China tensions and an attack on Saudi Arabia’s oil infrastructure show how geopolitical frictions are key market drivers. Major central banks have taken a dovish stance – the Fed has cut rates in line with market expectations, following the ECB’s broad stimulus package. Yet the Fed’s noncommittal stance on its future policy path reinforces our view that there are limits to how much monetary easing can be delivered in the near term. Monetary policy is no cure for the weaker growth and firmer inflation pressures associated with sustained trade tensions.

Assets in review

Selected asset performance, 2019 year-to-date and range



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, September 2019. Notes: The dots show total returns of asset classes in local currencies. Exceptions are emerging market (EM), high yield and global corporate investment grade (IG), which are denominated in U.S. dollars. Indexes or prices used: spot Brent crude, MSCI USA Index, DXY, MSCI Europe Index, Bank of America Merrill Lynch Global Broad Corporate Index, Bank of America Merrill Lynch Global High Yield Index, Datastream 10-year benchmark government bond (U.S. and Italy), MSCI Emerging Markets Index, spot gold and J.P. Morgan EMBI index.

Macro insights

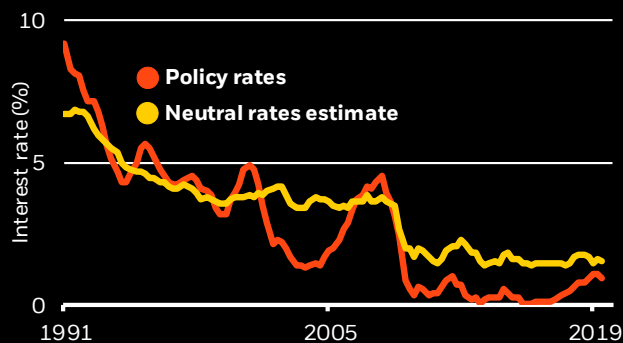
September saw dovish actions from central banks. Easier monetary policy is a key reason why we believe the risk of a global recession in the near-term is limited. The Fed cut rates by 25 basis points, the Bank of Japan and Bank of England kept policy on hold but signaled a willingness to act, and the ECB announced a broad-reaching stimulus package.

Our estimate of the combined G3 nominal neutral rate of interest is above the GDP-weighted nominal policy rates of the U.S., euro area and Japan. This gap has widened following recent policy actions, suggesting the level of monetary policy accommodation has increased.

Accommodative financing conditions reduce the likelihood that weakness in the global industrial sector would lead to a broader economic downturn, in our view.

Stimulus is here

G3 policy rates and estimated neutral rates, 1991-2019



Source: BlackRock Investment Institute, Federal Reserve, NBER and European Central Bank, with data from Datastream Refinitiv, September 2019. Notes: The chart shows our estimate of neutral rates in nominal terms, adjusting for actual inflation, and the GDP-weighted nominal policy rates of the U.S., euro area and Japan. The neutral rate is an estimate of the short-term rate that neither fosters nor hinders GDP growth. The neutral rates are estimates based on an econometric model from a [July 2018 ECB working paper](#). We detailed our estimates of neutral rates in the November 2018 [Macro and market perspectives](#).

Investment themes

1 Protectionist push

- U.S.-China tensions ostensibly eased ahead of a new round of trade talks in October. We don't see any short-term deal solving long-term strategic issues such as technological dominance and implications for national security.
- Persistent uncertainty from protectionist policies is denting corporate confidence and slowing business spending, hurting the global industrial cycle – a key reason for our global growth downgrade.
- The longer-term risk from protectionism: The unravelling of global supply chains delivers a supply shock that saps productivity growth, reinforces a slowdown in potential output and leads to higher inflation.
- The attack on Saudi Arabia's oil facilities shows how geopolitical risks can materialize in multiple ways. A prolonged oil price shock, along with tariffs, could deepen concerns around the risk of lower growth and firmer inflation pressures.
- **Market implication:** We favor reducing risk amid rising protectionism, including raising some cash.

2 Stretching the cycle

- The record-long U.S. economic expansion is supported by healthy household spending and looks unlikely to morph into a deeper downturn any time soon.
- The Fed cut rates by a quarter-point for a second time since the financial crisis, yet stopped short of bolder actions. This supports our view that the market's easing expectations are excessive. The trade war is bad for growth, but we still see potential for U.S. inflation to rise in the near term due to the direct one-off impact of tariffs. In the longer term the resulting hit to production capacity could also be inflationary, complicating the case for policy easing.
- We believe policymakers should lay the groundwork for a credible plan to navigate the next economic shock that includes unprecedented coordination between monetary and fiscal measures. We lay out the contours of such a framework in [our latest Macro and market perspectives](#). Absence of a credible plan is contributing to market anxiety, and adding to the rush into the perceived safety of government bonds.
- Chinese authorities have cut bank reserve requirements, lowered private sector borrowing costs and boosted infrastructure spending. Yet the stimulus remains limited, with a focus still on shoring up the financial system.
- **Market implication:** We like U.S. equities and EM debt. We are overweight euro area government bonds: a relatively steeper yield curve brightens their appeal even at low yields. We are neutral European equities and credit.

3 Raising resilience

- A sharp spike higher in U.S. money market rates – a cornerstone of the financial system – jolted market participants and highlighted the importance of portfolio resilience.
- The underperformance of momentum and outperformance of value show the importance of minimizing portfolio exposure to pockets of the market where pricing appears stretched.
- **Market implication:** Government bonds play an important role in building portfolio resilience – even at low yield levels – both on a tactical basis and in long-term portfolios.

Week ahead

Sept. 30 – China PMI data offers an opportunity to assess the health of the country’s vast manufacturing sector. Factory activities have contracted since May, pressured by U.S.-China trade tensions and sluggish domestic demand.

Oct. 1 – Euro area’s flash inflation reading is likely to show core inflation rising from current exceptionally low levels, but still far below ECB’s target. Our outlook on the area’s inflation has become more subdued.

Asset views

Views from a U.S. dollar perspective over a 6-12 month horizon

Asset class	View	Comments
Equities	U.S.	▲ A supportive policy mix and the prospect of an extended cycle underpin our positive view. Valuations still appear reasonable against this backdrop. From a factor perspective we like min-vol, which has historically tended to perform well during economic slowdowns.
	Europe	— We have upgraded European equities to neutral. We find European risk assets modestly overpriced versus the macro backdrop, yet the dovish shift by the European Central Bank (ECB) should provide an offset. Trade disputes, a slowing China and political risks are key challenges.
	Japan	▼ We have downgraded Japanese equities to underweight. We believe they are particularly vulnerable to a Chinese slowdown with a Bank of Japan that is still accommodative but policy-constrained. Other challenges include slowing global growth and an upcoming consumption tax increase.
	EM	— We have downgraded EM equities to neutral amid what we see as overly optimistic market expectations for Chinese stimulus. We see the greatest opportunities in Latin America, such as in Mexico and Brazil, where valuations are attractive and the macro backdrop is stable. An accommodative Fed offers support across the board, particularly for EM countries with large external debt loads.
	Asia ex-Japan	▼ We have downgraded Asia ex-Japan equities to underweight due to the region’s China exposure. A worse-than-expected Chinese slowdown or disruptions in global trade would pose downside risks. We prefer to take risk in the region’s debt instruments instead.
Fixed income	U.S. government bonds	▼ We remain underweight U.S. Treasuries. We do expect the Fed to cut rates by a further quarter percentage point this year. Yet market expectations of Fed easing look excessive to us. This, coupled with the flatness of the yield curve, leaves us cautious on Treasury valuations. We still see long-term government bonds as an effective ballast against risk asset selloffs.
	U.S. municipals	— Favorable supply-demand dynamics and improved fundamentals are supportive. The tax overhaul has made munis’ tax-exempt status more attractive. Yet muni valuations are on the high side, and the asset class may be due for a breather after a 10-month stretch of positive performance.
	U.S. credit	— We are neutral on U.S. credit after strong performance in the first half of 2019 sent yields to two-year lows. Easier monetary policy that may prolong this cycle, constrained new issuance and conservative corporate behavior support credit markets. High-yield and investment-grade credit remain key part of our income thesis.
	European sovereigns	▲ The resumption of asset purchases by the ECB supports our overweight, particularly in non-core markets. A relatively steep yield curve – particularly in these countries – is a plus for euro area investors. Yields look attractive for hedged U.S. dollar-based investors thanks to the hefty U.S.-euro interest rate differential.
	European credit	— Renewed ECB purchases of corporate debt and a “lower for even longer” rate shift are supportive. European banks are much better capitalized after years of balance sheet repair. Even with tighter spreads, credit should offer attractive income to both European investors and global investors on a currency-hedged basis.
	EM debt	▲ We like EM bonds for their income potential. The Fed’s dovish shift has spurred local rates to rally and helped local currencies recover versus the U.S. dollar. We see local-currency markets having room to run and prefer them over hard-currency markets. We see opportunities in Latin America (with little contagion from Argentina’s woes) and in countries not directly exposed to U.S.-China tensions.
	Asia fixed income	— The dovish pivot by the Fed and ECB gives Asian central banks room to ease. Currency stability is another positive. Valuations have become richer after a strong rally, however, and we see geopolitical risks increasing. We have reduced overall risk and moved up in quality across credit as a result.

▲ Overweight — Neutral ▼ Underweight

BlackRock Investment Institute

The BlackRock Investment Institute (BII) leverages the firm's expertise and generates proprietary research to provide insights on the global economy, markets, geopolitics and long-term asset allocation – all to help our clients and portfolio managers navigate financial markets. BII offers strategic and tactical market views, publications and digital tools that are underpinned by proprietary research.

General Disclosure: This material is not intended to be relied upon as a forecast, research or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy. The opinions expressed are as of Sept. 30, 2019, and may change. The information and opinions are derived from proprietary and non-proprietary sources deemed by BlackRock to be reliable, are not necessarily all-inclusive and are not guaranteed as to accuracy. As such, no warranty of accuracy or reliability is given and no responsibility arising in any other way for errors and omissions (including responsibility to any person by reason of negligence) is accepted by BlackRock, its officers, employees or agents. This material may contain 'forward looking' information that is not purely historical in nature. Such information may include, among other things, projections and forecasts. There is no guarantee that any forecasts made will come to pass. Reliance upon information in this material is at the sole discretion of the reader.

In the U.S. and Canada, this material is intended for public distribution. **In the UK and outside the EEA:** This material is for distribution to professional clients (as defined by the Financial Conduct Authority or MiFID Rules) and qualified investors only and should not be relied upon by any other persons. Issued by BlackRock Investment Management (UK) Limited, authorised and regulated by the Financial Conduct Authority. Registered office: 12 Throgmorton Avenue, London, EC2N 2DL. Tel: 020 7743 3000. Registered in England No. 2020394. BlackRock is a trading name of BlackRock Investment Management (UK) Limited. In the EEA, it is issued by BlackRock (Netherlands) BV, Amstelplein 1, 1096 HA, Amsterdam, Tel: 020-549 5200, Trade Register No. 17068311. BlackRock is a trading name of BlackRock (Netherlands) B.V. **For qualified investors in Switzerland**, this material shall be exclusively made available to, and directed at, qualified investors as defined in the Swiss Collective Investment Schemes Act of 23 June 2006, as amended. **In South Africa**, please be advised that BlackRock Investment Management (UK) Limited is an authorised financial services provider with the South African Financial Services Board, FSP No. 43288. **In DIFC:** This information can be distributed in and from the Dubai International Financial Centre (DIFC) by BlackRock Advisors (UK) Limited – Dubai Branch which is regulated by the Dubai Financial Services Authority (DFSA) and is only directed at 'Professional Clients' and no other person should rely upon the information contained within it. Neither the DFSA or any other authority or regulator located in the GCC or MENA region has approved this information. This information and associated materials have been provided for your exclusive use. This document is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution would be unlawful under the securities laws of such. Any distribution, by whatever means, of this document and related material to persons other than those referred to above is strictly prohibited. **In Singapore**, this is issued by BlackRock (Singapore) Limited (Co. registration no. 200010143N). **In Hong Kong**, this material is issued by BlackRock Asset Management North Asia Limited and has not been reviewed by the Securities and Futures Commission of Hong Kong. **In South Korea**, this material is for distribution to the Qualified Professional Investors (as defined in the Financial Investment Services and Capital Market Act and its sub-regulations). **In Taiwan**, independently operated by BlackRock Investment Management (Taiwan) Limited. Address: 28F., No. 100, Songren Rd., Xinyi Dist, Taipei City 110, Taiwan. Tel: (02)23261600. **In Japan**, this is issued by BlackRock Japan, Co., Ltd. (Financial Instruments Business Operator: The Kanto Regional Financial Bureau. License No375, Association Memberships: Japan Investment Advisers Association, the Investment Trusts Association, Japan, Japan Securities Dealers Association, Type II Financial Instruments Firms Association.) For Professional Investors only (Professional Investor is defined in Financial Instruments and Exchange Act). **In Australia**, issued by BlackRock Investment Management (Australia) Limited ABN 13 006 165 975 AFSL 230 523 (BIMAL). The material provides general information only and does not take into account your individual objectives, financial situation, needs or circumstances. **In China**, this material may not be distributed to individuals resident in the People's Republic of China ("PRC", for such purposes, excluding Hong Kong, Macau and Taiwan) or entities registered in the PRC unless such parties have received all the required PRC government approvals to participate in any investment or receive any investment advisory or investment management services. **For Other APAC Countries**, this material is issued for Institutional Investors only (or professional/sophisticated/qualified investors, as such term may apply in local jurisdictions) and does not constitute investment advice or an offer or solicitation to purchase or sell in any securities, BlackRock funds or any investment strategy nor shall any securities be offered or sold to any person in any jurisdiction in which an offer, solicitation, purchase or sale would be unlawful under the securities laws of such jurisdiction. **In Latin America**, for institutional investors and financial intermediaries only (not for public distribution). This material is for educational purposes only and does not constitute investment advice or an offer or solicitation to sell or a solicitation of an offer to buy any shares of any fund or security. If any funds are mentioned or inferred in this material, such funds may not be registered with the securities regulators of any Latin American country and thus, may not be publicly offered in any such countries. The provision of investment management and investment advisory services is a regulated activity in Mexico thus is subject to strict rules. No securities regulator within Latin America has confirmed the accuracy of any information contained herein.

The information provided here is neither tax nor legal advice. Investors should speak to their tax professional for specific information regarding their tax situation. Investment involves risk including possible loss of principal. International investing involves risks, including risks related to foreign currency, limited liquidity, less government regulation, and the possibility of substantial volatility due to adverse political, economic or other developments. These risks are often heightened for investments in emerging/developing markets or smaller capital markets.

© 2019 BlackRock, Inc. All Rights Reserved. **BlackRock** is a registered trademark of BlackRock, Inc. or its subsidiaries in the United States and elsewhere. All other trademarks are those of their respective owners.