

Weekly commentary

June 29, 2020



Our midyear outlook

- The virus shock is accelerating key structural trends. We update our three investment themes and investment views against this backdrop.
- We are tracking the interplay of containment measures and mobility changes on activity as economies have started to reopen.
- Markets this week will focus on the latest U.S. employment data as well as on the virus case count and its implication on the economic restart.

The COVID-19 shock is accelerating structural trends in inequality, globalization, macro policy and sustainability. This is fundamentally reshaping the investment landscape and will be key to investor outcomes. Our [Midyear outlook](#) explains why the most important action investors need to take today is to review their strategic asset allocation to ensure portfolios are resilient to these trends.



Jean Boivin
Head – BlackRock Investment Institute



Elga Bartsch
Head of Macro Research – BlackRock Investment Institute



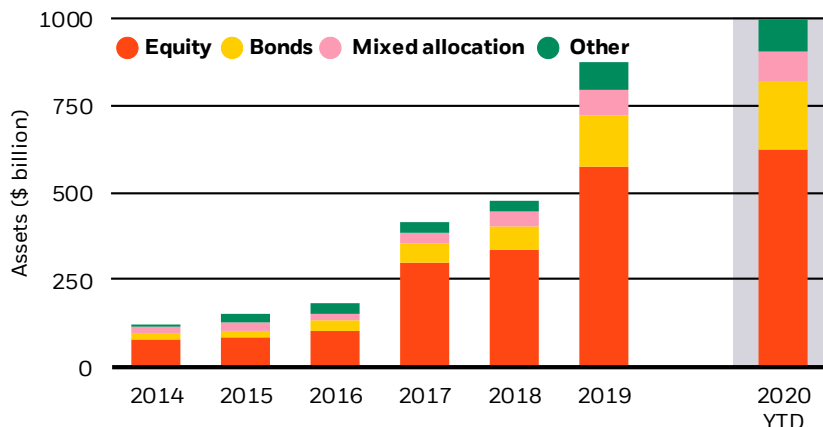
Mike Pyle
Global Chief Investment Strategist – BlackRock Investment Institute



Scott Thiel
Chief Fixed Income Strategist – BlackRock Investment Institute

Chart of the week

Assets under management at ESG-mandated funds, 2014-2020 YTD



Sources: BlackRock Investment Institute with data from EPFR, as of June 2020. Notes: The chart shows the global total assets under management at ESG-mandated funds. The “other” category includes money-market and alternatives funds. Data for 2020 through May 31, 2020.

The pandemic has supercharged a shift toward sustainability. Assets under management at environmental, social and governance (ESG)-mandated funds in the U.S. exceeded last year’s record levels at the end of May, even as markets had sold off. See the chart above. Sustainable flows are in their early stages, in our view, and the [sustainability wave](#) will likely unfold over years and decades. We also believe markets still underappreciate the [potential economic damage caused by climate change](#), as well as related opportunities such as the long-term rise in renewable energy. The pandemic has brought some setbacks in sustainability-related trends. For example, some governments have paused efforts to curb plastic use. Yet we believe these setbacks are temporary, and the pandemic has thrown spotlight on the “S” in ESG, as issues such as employee safety and social purpose of companies come to the fore. We see sustainability rising above the mere labels of environment, social and governance. A focus on sustainability can help portfolios achieve greater resilience to shocks, in our view.

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

BlackRock Investment Institute

The focus of the BlackRock Investment Institute’s virtual – but no-less real – Midyear Outlook Forum in early June was decisively on longer-term trends. The COVID-19 shock has pushed the world harder against four key limits we identified at our November forum: inequality, globalization, macro policy and sustainability. We have revamped our three investment themes to reflect the changes. Our new macro view is captured by the “Activity restart” theme as economies reopen at different speeds. A “Policy revolution” is taking place to cushion the pandemic’s shock, making this our second theme. Our third theme is “Real resilience,” as countries and sectors look set to make a comeback as diversifiers in a more fragmented world, offering resilience to real economy trends.

We highlight the importance of the “Real resilience” theme in particular. The structural shifts accelerated by the pandemic shock are already challenging the resilience of portfolios here and now. The chart on the previous page illustrated one such trend – a shift toward sustainable investing. Others include the intensifying U.S.-China strategic rivalry across multiple dimensions. In this increasingly bipolar world, investors need to balance the investment case for gaining exposure to both these engines of global growth, with possible investment restrictions on each side. We see structural portfolio resilience as much more than just relying on broad asset class correlations in public markets. It’s making sure portfolios are well positioned at regional, country and company level to underlying themes.

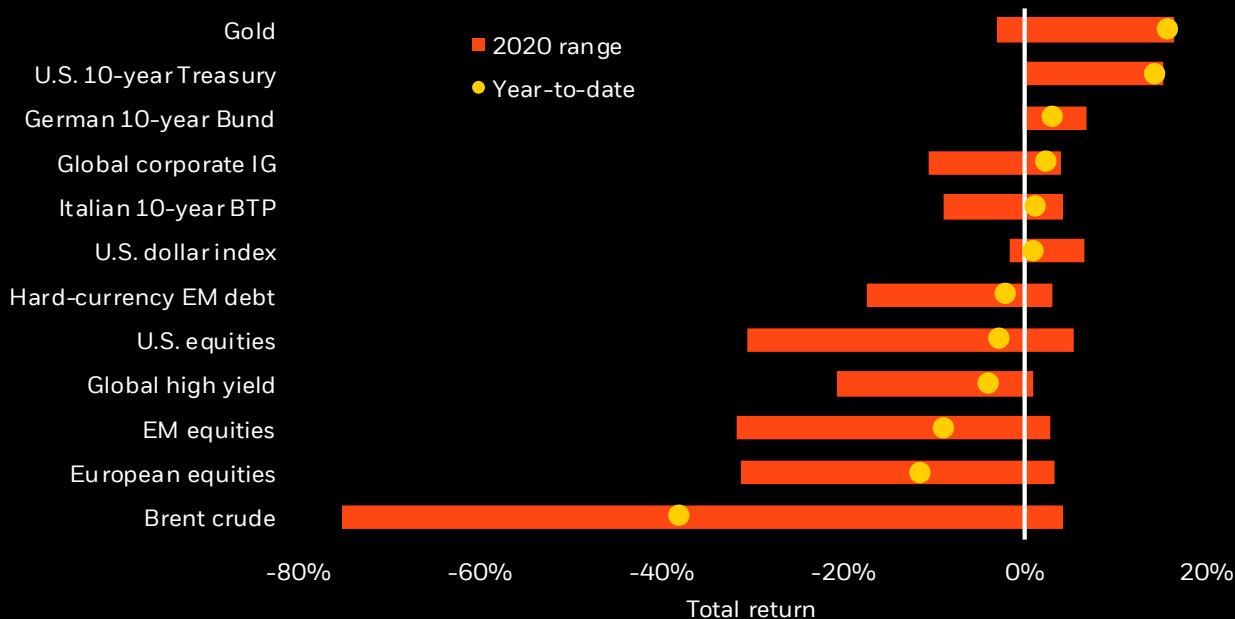
We believe what is needed today is a reassessment of the whole portfolio, not just a tweaking at the edges. On a strategic horizon, we highlight the fading role of nominal government bonds as their expected long-term returns fall into negative territory in developed markets. We instead prefer inflation-protected bonds as inflation risk builds up in coming years. We also view portfolio diversification as key, as return dispersion grows across regions, and within asset classes. On a tactical basis we maintain a modest pro-risk stance overall, and prefer credit to equities, favoring up-in-quality assets that have policy backstops and are higher up the corporate capital structure. We upgrade European equities to overweight, as we see the region as offering the most attractive exposure to any cyclical uptick due to its public health measures and ramped-up policy response. See our full [Midyear outlook](#) for the granular changes to our asset views.

Market backdrop

Measures to contain the virus are gradually being eased in many developed economies. May’s data suggested the worst of the contraction may be behind us, but we see a bumpy restart in coming months. We are tracking the interplay of containment measures and mobility changes on activity as economies have started to reopen. The unprecedented policy response has boosted markets, leaving a potential resurgence of infections and policy implementation as key risks. U.S. Congress is headed for a fiscal cliff as jobless benefits, state support and payroll protection measures are expiring soon.

Assets in review

Selected asset performance, 2020 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, June 2020. Notes: The two ends of the bars show the lowest and highest returns versus the end of 2019, and the dots represent 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, MSCI USA Index, the ICE U.S. Dollar 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., German and Italy), MSCI Emerging Markets Index, spot gold and J.P. Morgan EMBI index.

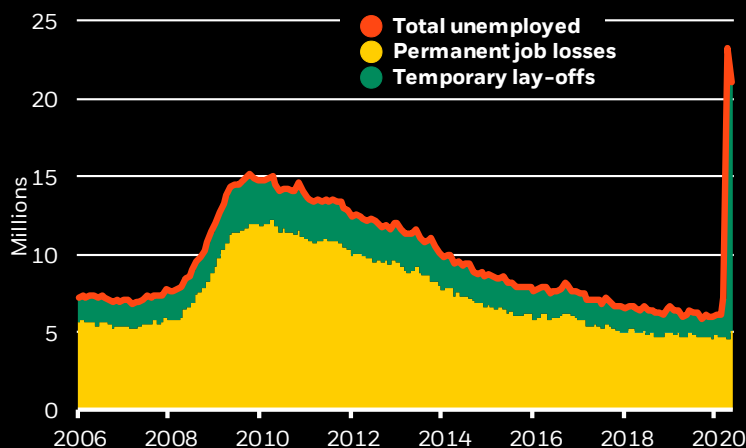
Macro insights

The coronavirus shock could lead to long-term scarring—a permanent reduction of productive economic capacity—via three channels: the labor market, business investment and innovation. Many job losses should be temporary, and capex should recover. But under the hood a major reshuffle of the workforce between sectors is likely necessary. Employment in sectors such as leisure and hospitality may struggle to reach pre-shock levels. Investment has taken a short-term hit, and intangible assets could be lost on the back of insolvencies.

There has been a huge jump in unemployment in the U.S. and use of short-time work programs in Europe. The U.S. picture is reassuring for now, with most unemployment categorized as temporary. See the *Jobless jump* chart. If these job seekers return quickly to work, a rise in long-term unemployment can be avoided. Yet there is already some pickup in permanent layoffs, especially among older workers who are unlikely to re-enter the workforce. Labor market policies may be needed to help retrain workers.

Jobless jump

U.S. unemployment breakdown, 2006–2020



Sources: BlackRock Investment Institute and the U.S. Bureau of Labor Statistics, with data from Haver Analytics, June 2020. Note: The chart shows the total number of unemployed people in the U.S., and the proportion of this number made up of permanent job losers, leavers and new entrants (yellow bars) and temporary layoffs and temporary job completions (green).

Investment themes

1 Activity restart

- Economies are slowly restarting, but at different paces. We are tracking the evolution of the virus and mobility. The longer it takes for activity to restart, the more cracks might appear in the financial system and productive capacity.
- Stringent shutdown measures are gradually being lifted even though the rate of growth in virus cases has picked up in some regions.
- The nature of the activity rebound will depend on the path of the outbreak, delivery of policy response and potential changes to consumer and corporate behaviors. Success will not just be about restarting the economy and containing the virus – but balancing both objectives.
- **Market implication:** We are moderately pro-risk, and express it in an overweight to credit in strategic, long-term portfolios. We prefer Europe among cyclical exposures on a tactical horizon.

2 Policy revolution

- The policy revolution was needed to cushion the devastating and deflationary impact of the virus shock. In the medium term, however, the blurring of monetary and fiscal policy could bring about upside inflation risks.
- The Federal Reserve built on its “whatever it takes” approach to helping the economy through the shock and ensuring markets function properly, but has so far steered clear of committing to explicit yield curve control. We could see its balance sheet more than double to just over \$10 trillion by year end to support the fiscal response. The U.S. Treasury set out a \$3 trillion borrowing plan in its quarterly refunding to fund the response.
- We now see a risks of policy exhaustion in the U.S. Next rounds of fiscal stimulus look harder to achieve because of a return of political polarization after a short window of bipartisanship.
- By contrast, we have gained confidence in Europe’s policy response. Combined with additional monetary support, the size of stimulus is broadly sufficient to match the income shortfall on a euro area level, our analysis shows.
- Policy implementation risks remain. It’s crucial to have proper guard rails around policy coordination, as we discuss in [Policy Revolution](#).
- **Market implication:** We are underweight nominal government bonds and like inflation-linked bonds on a strategic horizon. Tactically, we like credit as it’s supported by central bank purchases, and see U.S. stocks as at risk of fading fiscal stimulus.

3 Real resilience

- Supercharged structural trends are changing the nature of portfolio diversification. Countries and sectors will make a comeback as diversifiers in a more fragmented world, in our view, offering resilience to real economy trends.
- Portfolio resilience has to go beyond broad asset class diversification alone. Investors should consider alternative return sources that can provide diversification, such as private markets.
- A focus on sustainability can help make portfolios more resilient. We believe the adoption of sustainable investing is a [tectonic shift](#) that will carry a return advantage for years to come – and the coronavirus shock seems to be accelerating this shift.
- **Market implication:** We prefer sustainable assets, private markets and deliberate country diversification for strategic portfolios. We have raised our overweight in the quality factor on a tactical horizon, and favor assets with policy backstops.

Week ahead

June 30 U.S. consumer confidence; China official manufacturing purchasing managers' index

July 2

U.S. nonfarm payrolls

July 1 Manufacturing PMI for Japan, China (Caixin), the euro zone and U.S.





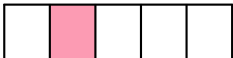



July 3

Caixin China services PMI

The U.S. job market data will be in focus. Consensus estimates point toward modest pickup in U.S. employment, yet there is a risk of a sizable decline. Markets will closely watch the U.S. COVID-19 case count trend this week and next, to gauge the development of the outbreak and its implication on the restart process of the economy.

Directional views


















Strategic (long-term) and tactical (6-12 month) views on broad asset classes, June 2020

Asset	Strategic view	Tactical view
Equities	 <p>Neutral</p>	 <p>Neutral</p> <p>We have turned neutral on equities on a strategic horizon given the challenging backdrop for earnings and dividend payouts. We trim our modest overweight in EM and maintain our DM exposure at neutral. Tactically, we are also neutral on equities. We like the quality factor for its resilience and favor Europe among cyclical exposures.</p>
Credit	 <p>+1</p>	 <p>+1</p> <p>We have moved to a strategic overweight on credit after being underweight for the past year. Sizeable spread widening compensates for the risks of defaults and downgrades, in our view. On a tactical horizon, extraordinary measures by central banks – including purchases of corporate debt – are supportive. Risks of a temporary liquidity crunch remain, but coupon income is crucial in a world starved for yield.</p>
Govt bonds	 <p>-1</p>	 <p>Neutral</p> <p>The strategic case for holding nominal government bonds has materially diminished with yields closer to perceived lower bounds. The “even-lower-for-even-longer” outlook for rates is compromising the asset class’ ability to act as ballast against equity market selloffs in the long run. On a tactical basis, we keep duration at neutral as unprecedented policy accommodation skews yields to the downside.</p>
Cash		 <p>Neutral</p> <p>We are neutral on cash and are using it to support our view on credit. Some cash makes sense as a buffer against supply shocks that drive both stocks and bonds lower.</p>
Private markets	 <p>Neutral</p>	<p>Non-traditional return streams, including private credit, have the potential to add value and diversification. Many institutional investors remain underinvested in private markets as they overestimate liquidity risks, in our view. Private assets reflect a diverse array of exposures—but valuations and greater inherent uncertainties of some private assets keep us neutral overall.</p>

Note: Views are from a U.S. dollar perspective, June 2020. 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.

Granular views

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

Asset	Underweight	Overweight		
Equities			United States	 <p>We downgrade U.S. equities to neutral. Risks of fading fiscal stimulus and an extended epidemic are threatening to derail the market's strong run. Renewed U.S.-China tensions and a divisive election also weigh.</p>
			Euro area	 <p>We upgrade European equities to overweight. The region is exposed to a cyclical upside as the economy restarts, against a backdrop of solid public health measures and a galvanizing policy response.</p>
			Japan	 <p>We upgrade Japanese equities to neutral. We see strong fiscal policy and public health measures allowing for rapid normalization.</p>
			Emerging markets	 <p>We downgrade emerging market equities to underweight. We are concerned about the pandemic's spread and see less room or willingness for policy measures to cushion the impact in many – but not all – countries.</p>
			Asia ex-Japan	 <p>We downgrade Asia ex-Japan equities to neutral. Renewed U.S.-China tension is a risk. China's goal to balance growth with financial stability has led to relatively muted policy measures to cushion the virus fallout.</p>
			Momentum	 <p>We keep momentum at neutral. The factor is now dominated by tech stocks on the one hand and defensives on the other, giving investors exposure to growth companies and some potential ballast.</p>
			Value	 <p>We upgrade value to neutral. We see the ongoing restart of economies likely benefiting cyclical assets and potentially helping value stage a rebound after a long stretch of underperformance.</p>
			Minimum volatility	 <p>We downgrade min vol to neutral. The restart of economies is likely to benefit cyclical assets and reduce the need for defensive exposures.</p>
			Quality	 <p>We increase our overweight in quality. We see it as the most resilient exposure against a range of outcomes in terms of developments in the pandemic and economy.</p>
	Fixed Income			U.S. Treasuries
			Treasury Inflation-Protected Securities	 <p>We are neutral on TIPS. A huge decline in rates makes the entry point less attractive. We still see potential for higher inflation over time and like TIPS in strategic allocations.</p>
			German bunds	 <p>We remain underweight bunds as current yield levels provide little cushion against major risk events. Also, potential issuance related to the proposed EU recovery fund could compete with bunds for investment.</p>
			Euro area peripherals	 <p>We overweight euro area peripheral government bonds despite recent outperformance. We see further rate compression due to stepped-up quantitative easing by the European Central Bank and other policy actions.</p>
			Global investment grade	 <p>We overweight global investment grade credit even as valuations have risen. Asset purchases by central banks and a broadly stable rates backdrop support the sector.</p>
			Global high yield	 <p>We stay overweight high yield as a source of income despite recent underperformance. We avoid energy as lower oil prices challenge the ability of issuers to refinance near-term maturities.</p>
			Emerging market – hard currency	 <p>We have downgraded hard-currency EM debt due to the pandemic's spread, heavy exposure to energy exporters and limited policy space in some emerging economies. Default risks may be underpriced.</p>
			Emerging market – local currency	 <p>We remain neutral on local-currency EM debt for its attractive coupon income. Currencies have adjusted and valuations have cheapened. A risk of further currency declines remains amid monetary and fiscal easing.</p>
			Asia fixed income	 <p>We have turned neutral on Asia fixed income. The pandemic's containment in many countries and low energy exposure are positives. Renewed U.S.-China tensions and China's relatively muted policy fallout are risks.</p>

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 intended for information purposes only, and does not constitute investment advice, a recommendation or an offer or solicitation to purchase or sell any securities to any person in any jurisdiction in which an offer, solicitation, purchase or sale would be unlawful under the securities laws of such jurisdiction. The opinions expressed are as of June 29, 2020 and are subject to change without notice. Reliance upon information in this material is at the sole discretion of the reader. Investment involves risks.

In the U.S. and Canada, this material is intended for public distribution. In the U.S. and Canada, this material is intended for public distribution. **In the UK and outside the EEA:** Until 31 December 2020, issued by BlackRock Investment Management (UK) Limited, authorized and regulated by the Financial Conduct Authority. Registered office: 12 Throgmorton Avenue, London, EC2N 2DL. Tel: + 44 (0)20 7743 3000. Registered in England and Wales No. 2020394. For your protection telephone calls are usually recorded. Please refer to the Financial Conduct Authority website for a list of authorized activities conducted by BlackRock. From 31 December 2020 in the event the United Kingdom and the European Union do not enter into an arrangement which permits United Kingdom firms to offer and provide financial services into the European Union, the issuer of this material is: BlackRock Investment Management (UK) Limited for all outside of the European Union; and BlackRock (Netherlands) B.V. for in the European Union. BlackRock (Netherlands) B.V. is authorized and regulated by the Netherlands Authority for the Financial Markets. Registered office Amstelplein 1, 1096 HA, Amsterdam, Tel: 020 – 549 5200, Tel: 31-20-549-5200. Trade Register No. 17068311. **In Switzerland,** this document is marketing material. This document 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. **For investors in Israel:** BlackRock Investment Management (UK) Limited is not licensed under Israel's Regulation of Investment Advice, Investment Marketing and Portfolio Management Law, 5755-1995 (the "Advice Law"), nor does it carry insurance thereunder. **In South Africa,** please be advised that BlackRock Investment Management (UK) Limited is an authorized financial services provider with the South African Financial Services Board, FSP No. 43288. **In the DIFC** this material 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). This material is only directed at 'Professional Clients' and no other person should rely upon the information contained within it. **In the Kingdom of Saudi Arabia** this information is only directed to Exempt Persons, Authorized Persons or Investment Institutions, as defined in the relevant implementing regulations issued by the Capital Markets Authority (CMA). **In the United Arab Emirates** this material is only intended for -natural Qualified Investor as defined by the Securities and Commodities Authority (SCA) Chairman Decision No. 3/R.M. of 2017 concerning Promoting and Introducing Regulations. Neither the DFSA or any other authority or regulator located in the GCC or MENA region has approved this information. **In Singapore,** this is issued by BlackRock (Singapore) Limited (Co. registration no. 200010143N). This publication has not been reviewed by the Monetary Authority of Singapore. **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). No securities regulator within Latin America has confirmed the accuracy of any information contained herein. The provision of investment management and investment advisory services is a regulated activity in Mexico thus is subject to strict rules. For more information on the Investment Advisory Services offered by BlackRock Mexico please refer to the Investment Services Guide available at <http://www.blackrock.com/mx>.

© 2020 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.

BlackRock

Not FDIC Insured • May Lose Value • No Bank Guarantee