November 2023

BlackRock

2023 Global outlook Q4 update

BlackRock Investment Institute

FOR INSTITUTIONAL, PROFESSIONAL, WHOLESALE, QUALIFIED INVESTORS AND QUALIFIED CLIENTS ONLY

Our latest investment themes

Holding tight

Markets have come around to the view that central banks will not quickly ease policy in a world shaped by supply constraints. We see them keeping policy tight to lean against inflationary pressures.

Pivoting to new opportunities

Higher macro and market volatility has brought more divergent security performance relative to the broader market. Benefiting from this requires granularity and nimbleness.

Harnessing mega forces

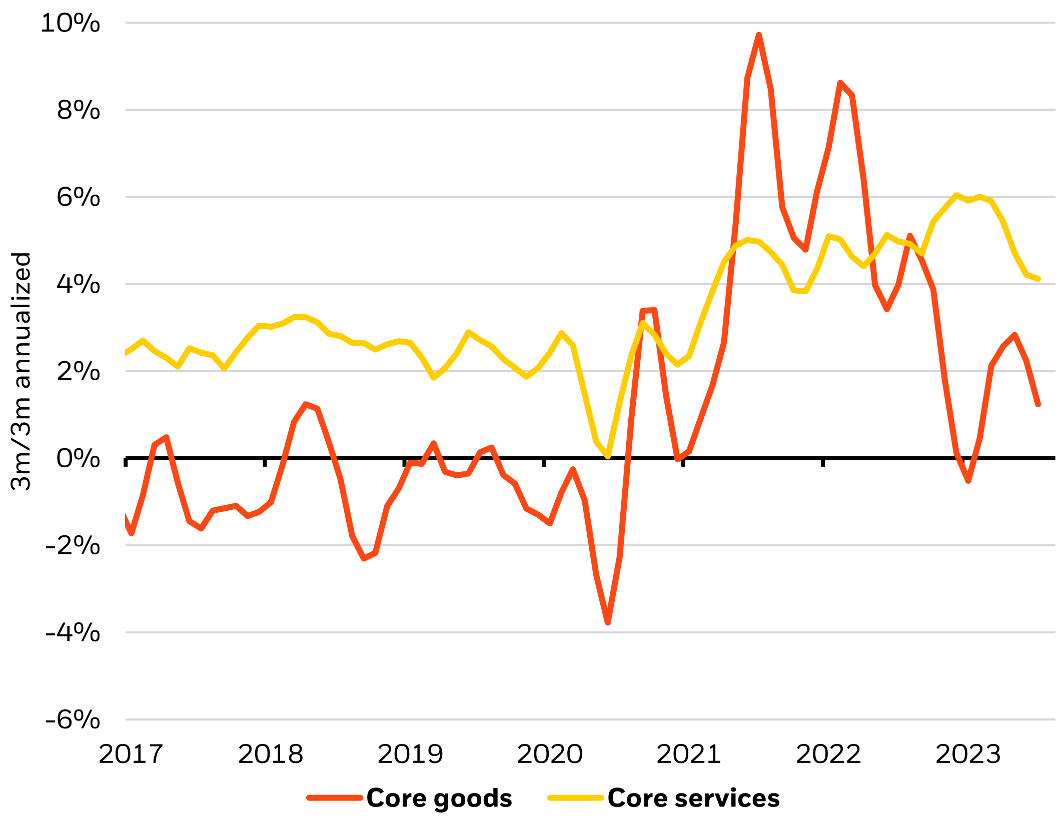
The new regime is shaped by five big structural forces we think are poised to create big shifts in profitability across economies and sectors. The key is identifying catalysts that can supercharge them and whether the shifts are priced by markets today.

The opinions expressed are as of September 2023 and are subject to change at any time due to changes in market or economic conditions.

Inflation is falling as pandemic-induced mismatches resolve…

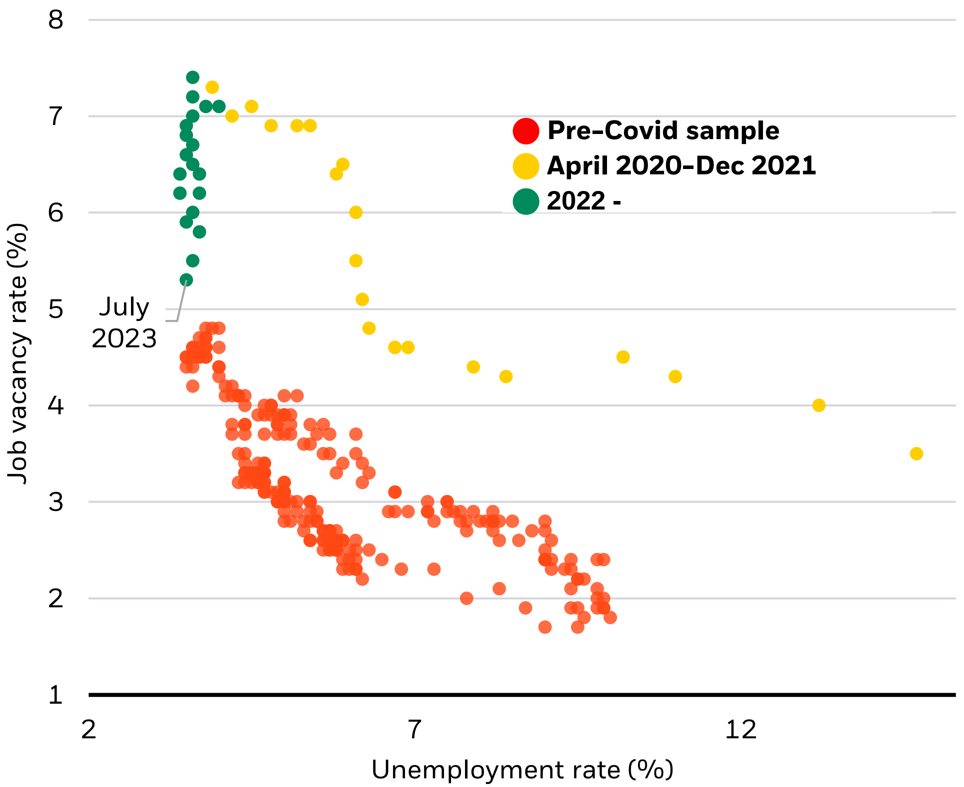
We think about two-thirds of the spending shift to goods from services has unwound. Goods prices are dragging inflation down as demand normalizes. A skills mismatch is also normalizing, helping cool wage growth.

Core goods and services inflation, 2017-2023



Source: BlackRock Investment Institute, U.S. Bureau of Labor Statistics, with data from Haver Analytics, September 2023. Notes: The chart shows core goods and core services PCE inflation. Each line shows the three-month growth over the preceding three months, expressed as an annualized rate.

U.S. job vacancy and unemployment rate, 2001-2023

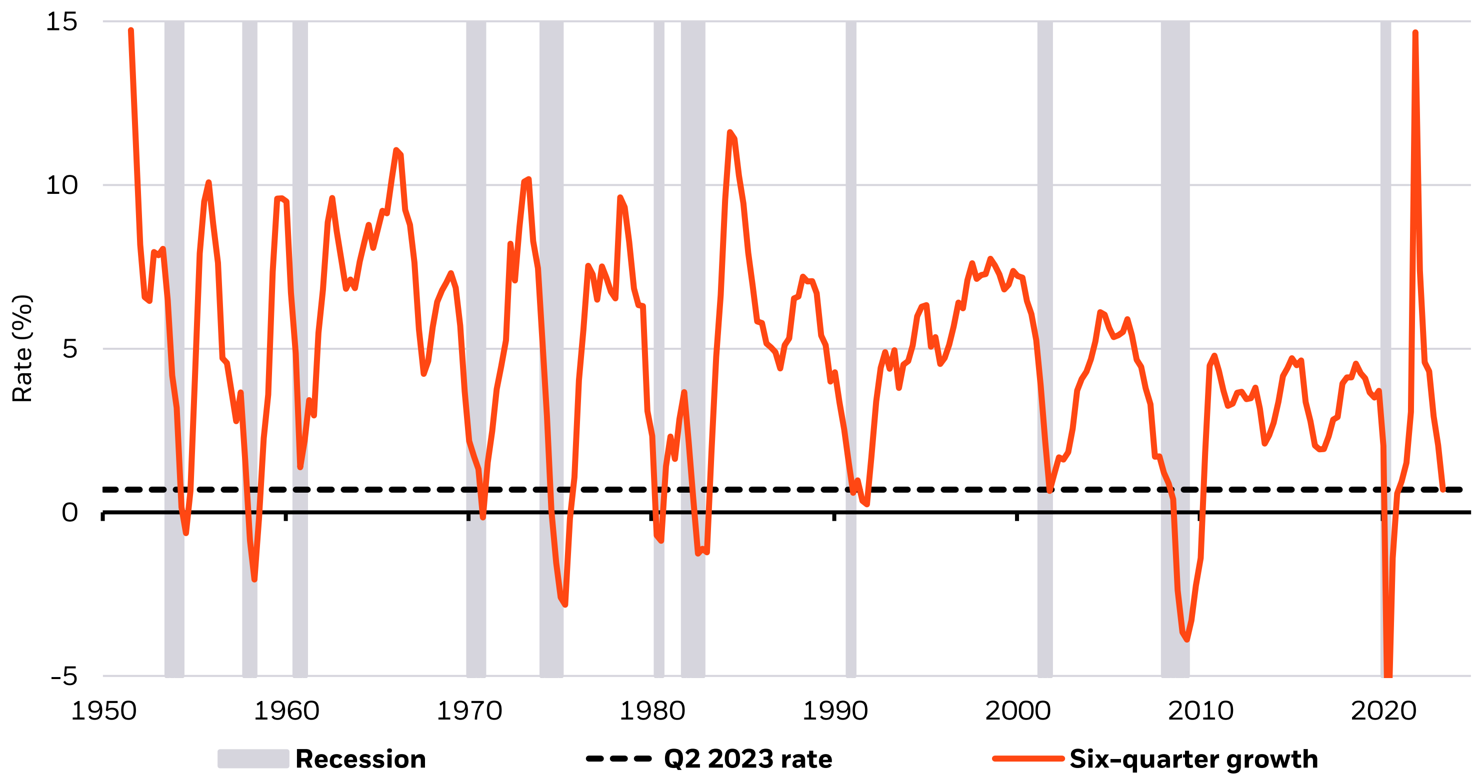


Source: BlackRock Investment Institute, U.S. Bureau of Labor Statistics, with data from Haver Analytics, September 2023. Notes: The chart shows the U.S. job vacancy rate vs the unemployment rate in the same month.

…but with stealth stagnation in the economy

Inflation declining through 2023 has come at the cost of economic growth as tighter policy bites. On some measures, the U.S. economy hasn't actually grown much in the last 18 months – it's never been this weak without a recession.

U.S. output growth over 6 quarters, 1950-2023

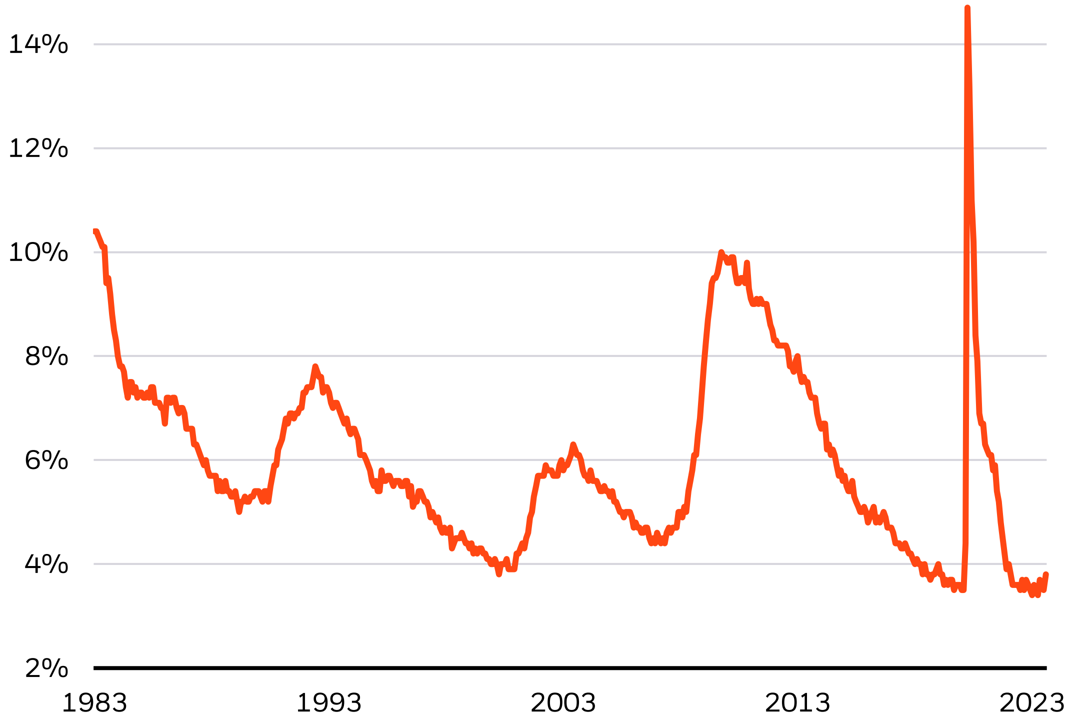


Source: BlackRock Investment Institute, U.S. Bureau of Labor Statistics, with data from Haver Analytics, September 2023. Notes: The chart shows the output growth rate (as measured by the average of GDP and GDI) over a six-quarter period. We use a six-quarter interval to benchmark the growth rate since the beginning of the Fed's current policy tightening cycle.

This is a tight labor market, not a strong one

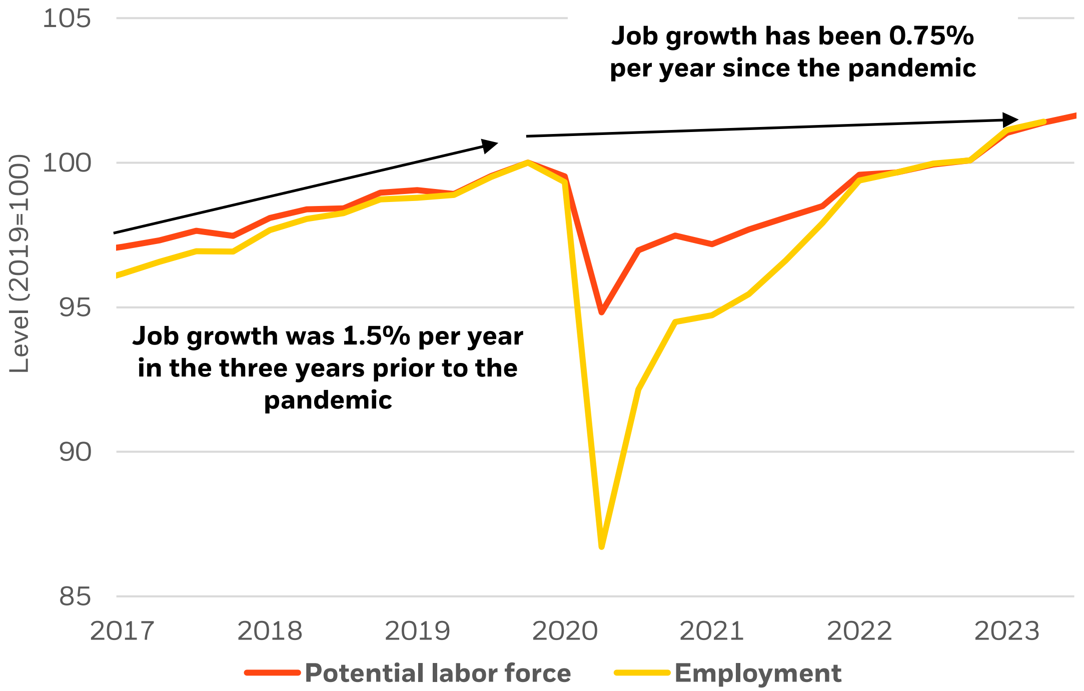
An aging population is set to constrain labor supply from here, we think. We find it'll mean the U.S. economy can only add around 70K new jobs a month without stoking higher inflation, compared to 200K previously.

U.S. unemployment rate, 1983-2023



Source: BlackRock Investment Institute, U.S. Bureau of Labor Statistics, with data from Haver Analytics, September 2023. Notes: The chart shows the U.S. unemployment rate.

U.S. employment and potential labor force

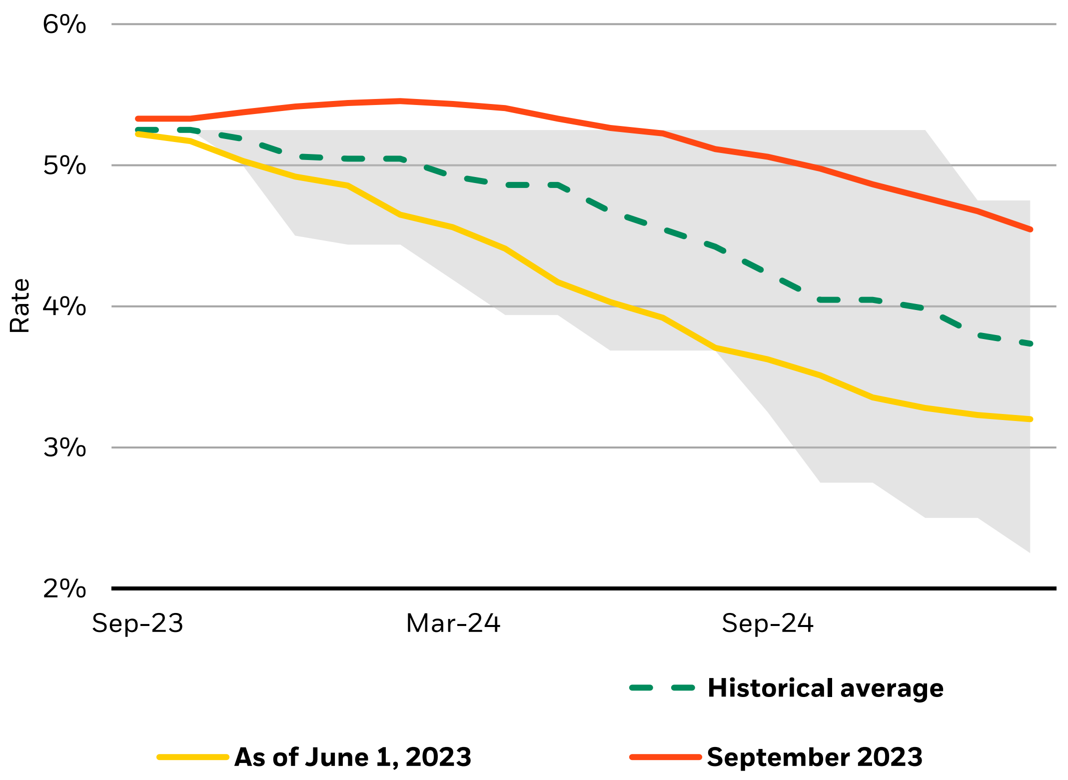


Source: BlackRock Investment Institute, U.S. Bureau of Labor Statistics, with data from Haver Analytics, September 2023. Note: The yellow line shows U.S. employment level measured by the survey of households. The red line shows the level of employment that would have been obtained had the unemployment rate held steady at 3.6%, the level in Q4 2019, given the actual labor force.

Central banks’ response to stagnation will likely be muted…

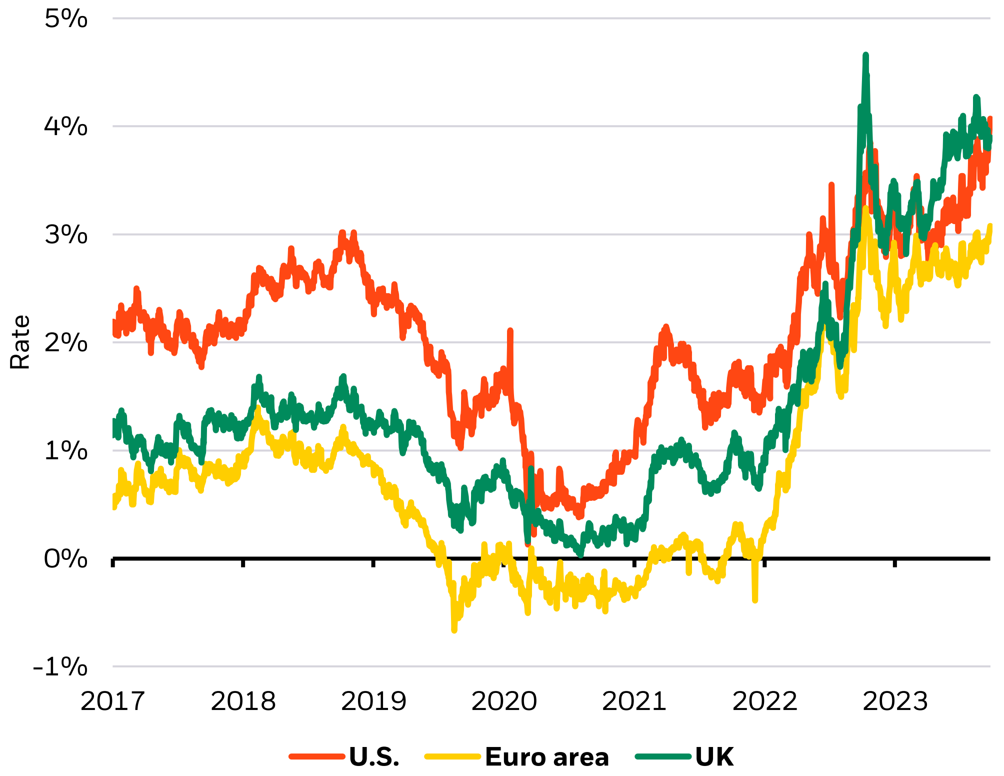
Some markets have come around to our view that central banks won’t be riding to the rescue with sizeable rate cuts. Persistent inflationary pressures driven by supply constraints means central banks will have to hold policy tight.

Fed funds rate expectations, Sep. 2023- Sep. 2024



Forward looking estimates may not come to pass. Source: BlackRock Investment Institute, with data from LSEG Datastream, October 2023. Notes: The lines show market pricing of the path of future U.S. policy rates based on Fed Funds Futures. The orange line shows the current pricing the yellow line shows the pricing as at the start of June 2023. The grey area and green line shows historic rate cut cycles since 1989 and the average rate cuts during that period.

Medium-term policy rate expectations, 2018-2023

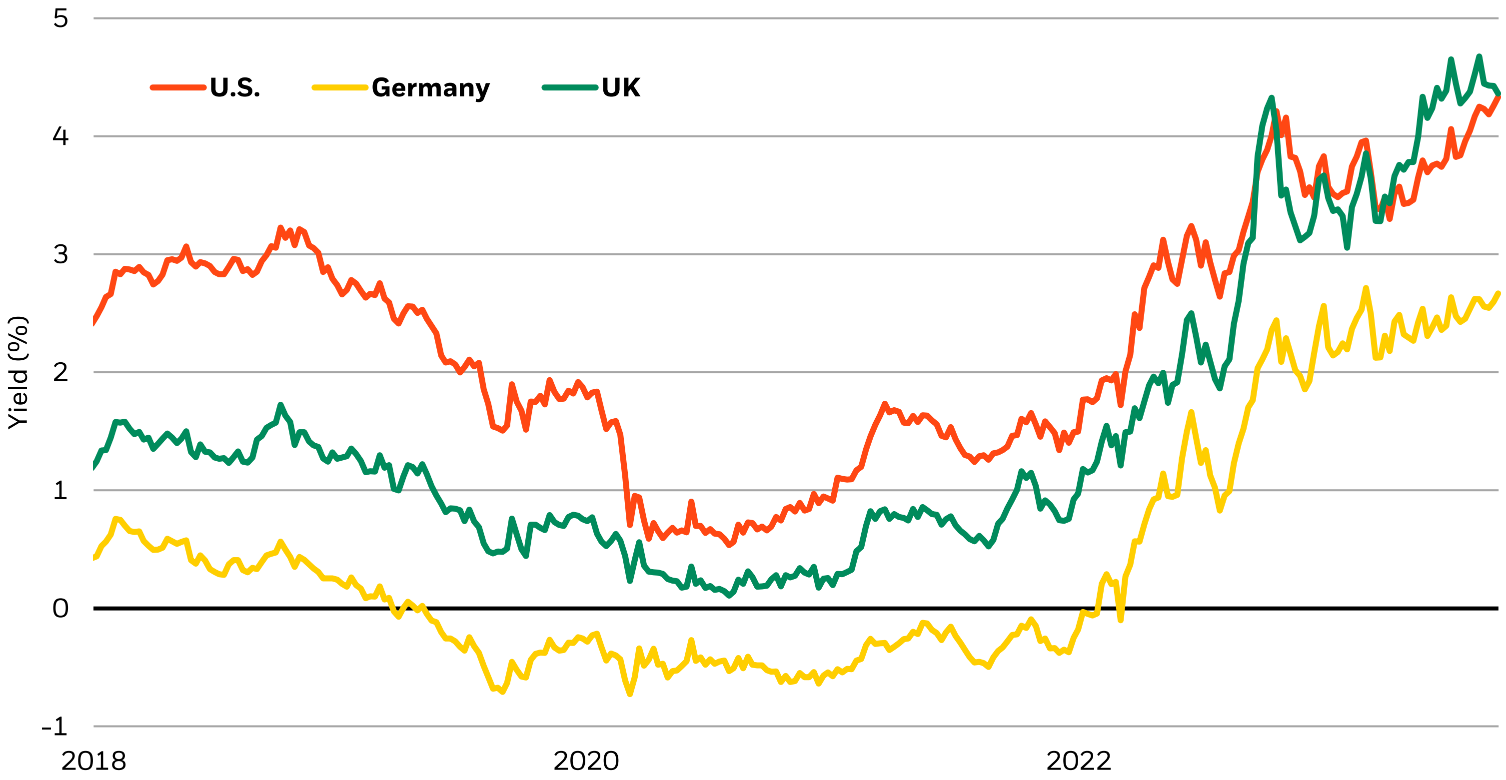


Forward looking estimates may not come to pass. Source: BlackRock Investment Institute, with data from LSEG Datastream, October 2023. Notes: The chart shows market expectations for 1-year rates in 5 years’ time based on interest rate swaps.

...and that's creating exciting opportunities for income

As markets realize that central banks will have to keep a lid on activity to stem inflation it creates exciting opportunities for income. We like UK and euro area bonds, where yields spiked far above their pre-pandemic level.

10-year government bond yields, 2018-2023

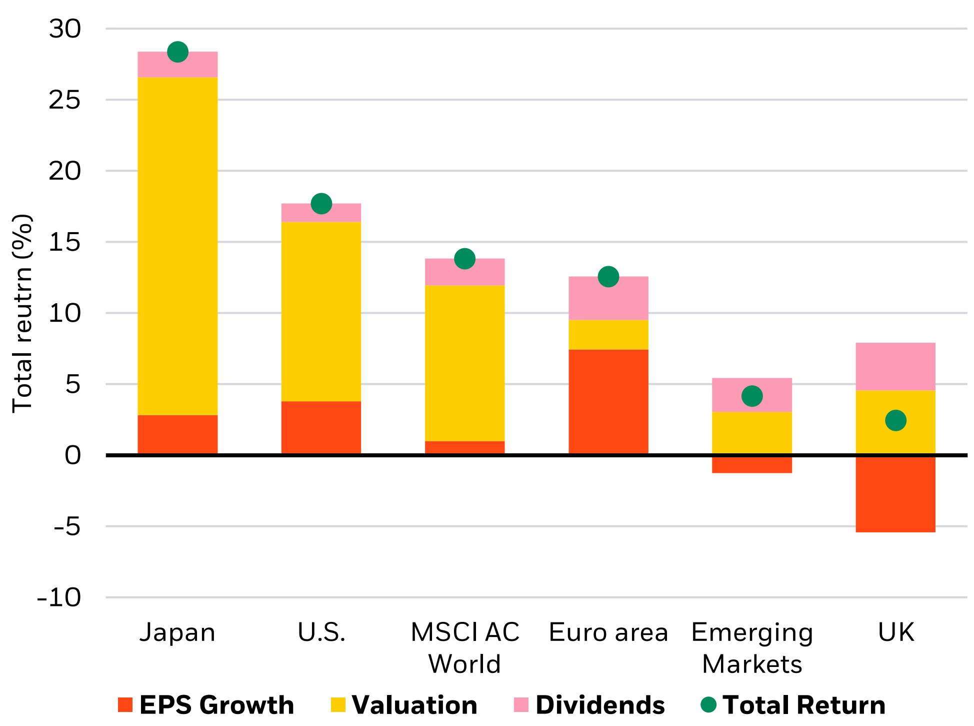


Past performance is not a reliable indicator of current or future results.. Source: BlackRock Investment Institute with data from LSEG Datastream, October 2023. Notes: The chart shows the 10-year government bond yield for the U.S.., Germany and the UK

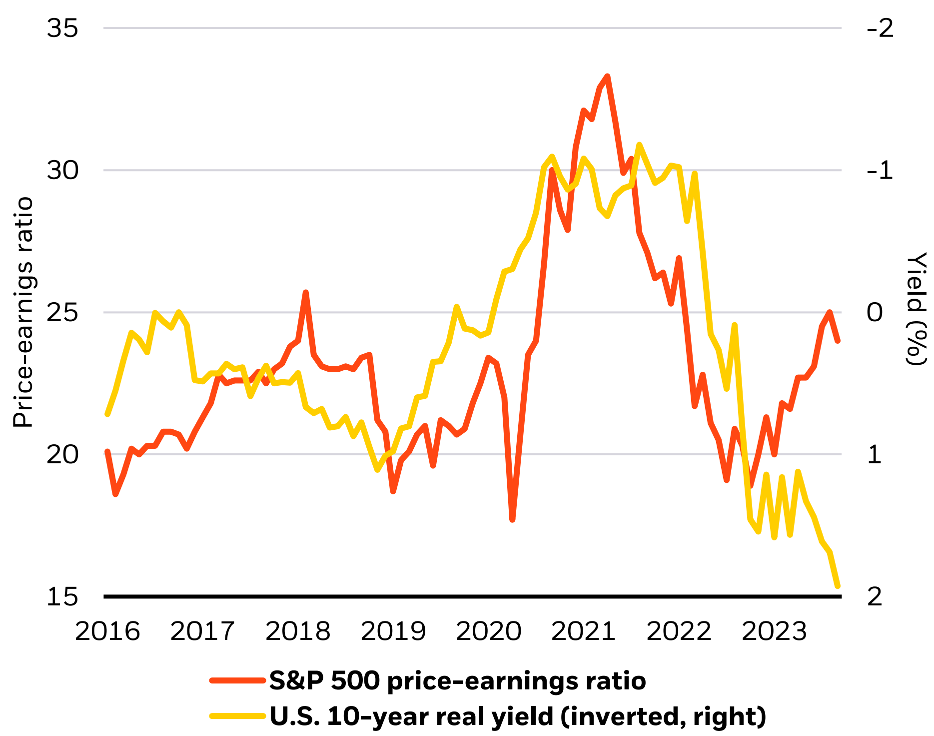
Equity gains could lose steam without strong earnings growth

We find rising valuations account for most equity returns year-to-date with little contribution from earnings. We think strong earnings growth is needed to justify any further price rises as real yields could potentially drag valuations lower.

Equity sources of return, 2023



S&P 500 valuations and U.S. real yields, 2016–2023

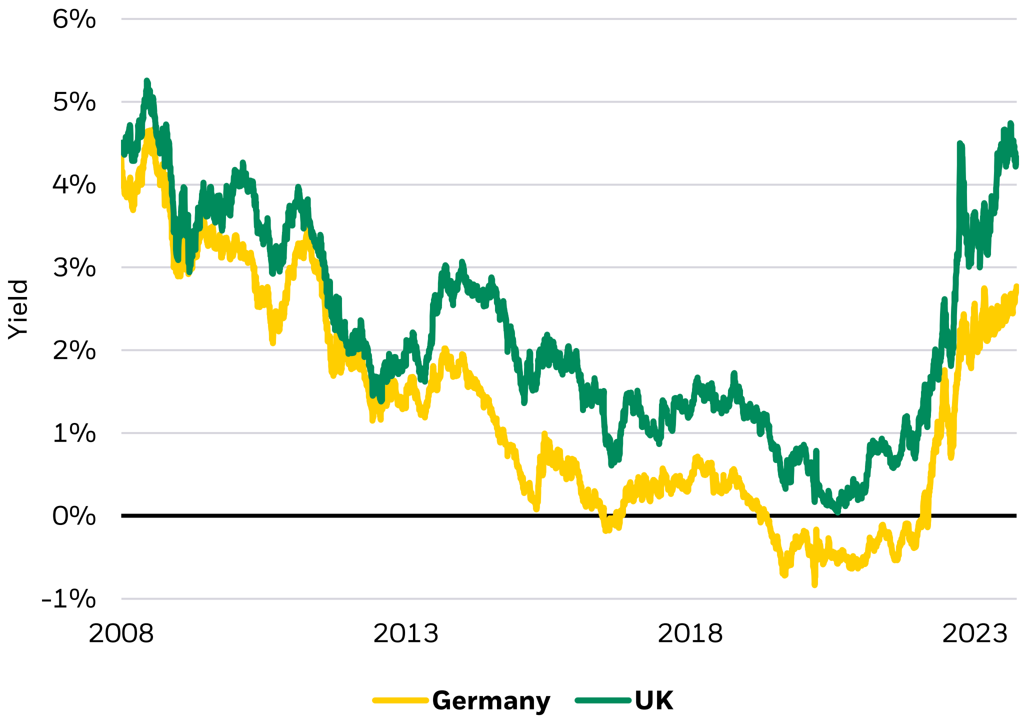


Past performance is not a reliable indicator of current or future results, and index returns do not account for fees. It is not possible to invest directly in an index. Source: BlackRock Investment Institute, with data from LSEG Datastream October 2023. Notes: The chart on the left shows sources of returns for various equity indexes. The index proxies used are MSCI Japan for Japan, MSCI USA for U.S., MSCI AC World U$ for MSCI AC World, MSCI EMU for Euro area, MSCI EM U$ for Emerging markets and MSCI UK for UK. The chart on the right shows the S&P 500 price-earnings ratio – a common valuation measure for equities – and the U.S. 10-year real yield. The real yield is calculated by taking the yield on 10-year U.S. Treasuries and subtracting the annual rate of CPI inflation from it.

Euro area and UK market pricing better reflects tighter policy

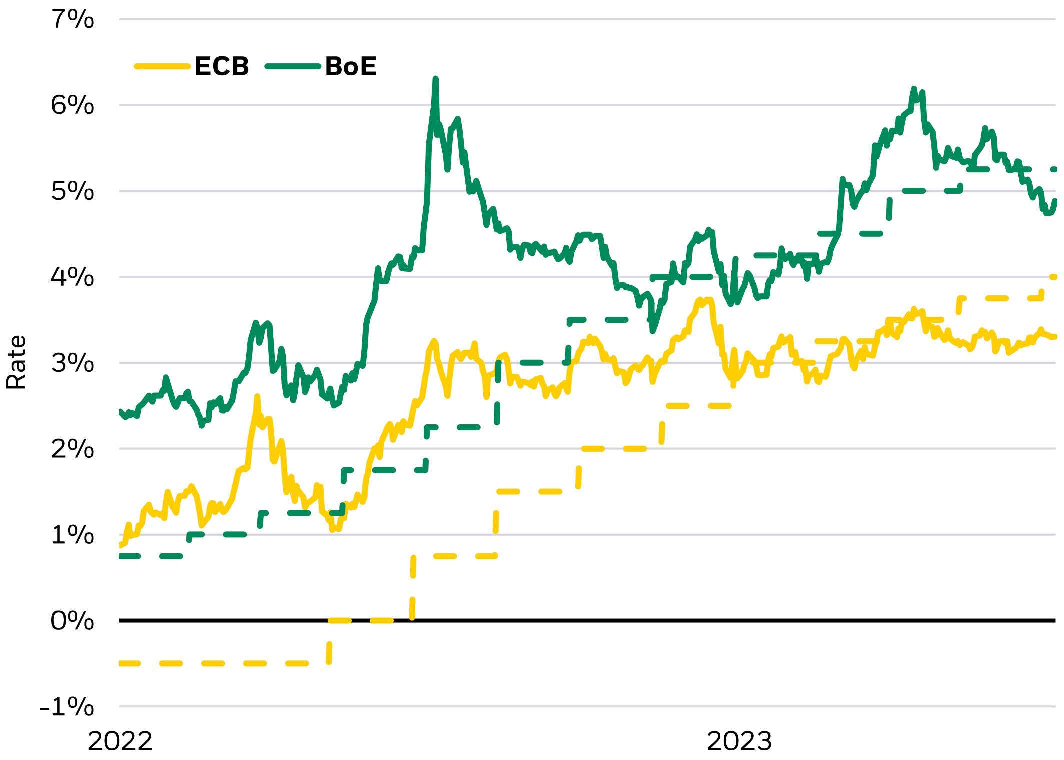
Market pricing in the euro area better reflects rates staying higher for longer even as growth deteriorates. UK gilt yields are holding near 15-year highs and markets are pricing in restrictive policy for longer than we expect.

10-year government bond yields, 2008-2023



Past performance is not a reliable indicator of current or future results.. Source: BlackRock Investment Institute with data from LSEG Datastream, October 2023. Notes: The chart shows the 10-year government bond yield for Germany and the UK

Market policy rate expectations, 2022-2023



Past performance is not a reliable indicator of current or future results.. Source: BlackRock Investment Institute with data from LSEG Datastream, October 2023. Notes: The lines show 1-year rate expectations in 1 years' time based on interest rate swaps. The dashed lines show central bank policy rates.

We prefer short-term government bonds for income over credit

The back-up in yields boosts the appeal of short-dated government bonds for income. We prefer the asset class to investment grade (IG) credit where tight spreads offer poorer reward for higher risk, in our view.

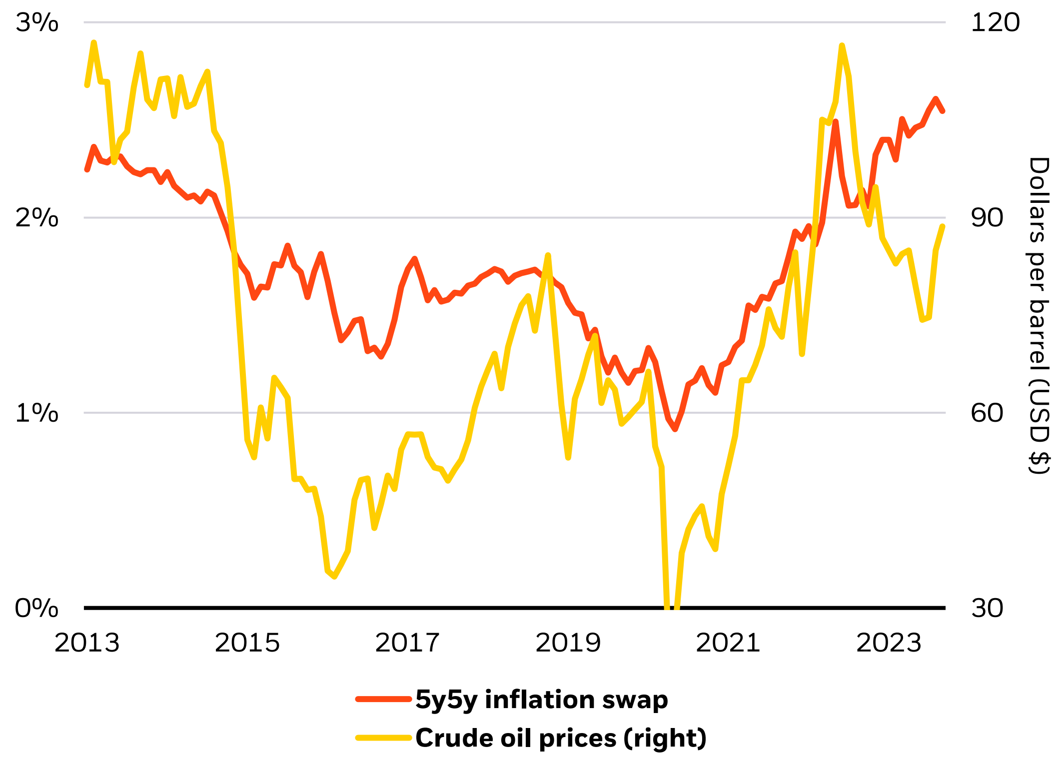
U.S. IG credit and short-term Treasuries, 1992-2023

Past performance is not a reliable indicator of current or future results, and it is not possible to invest directly in an index. Index returns do not account for fees Source: BlackRock Investment Institute, with data from LSEG Datastream, October 2023. Notes: The chart shows the yields for U.S. investment grade credit (using the Bloomberg U.S. Credit USD index) and short-term U.S. Treasuries (Bloomberg U.S. Treasury 1-3 Year USD index).

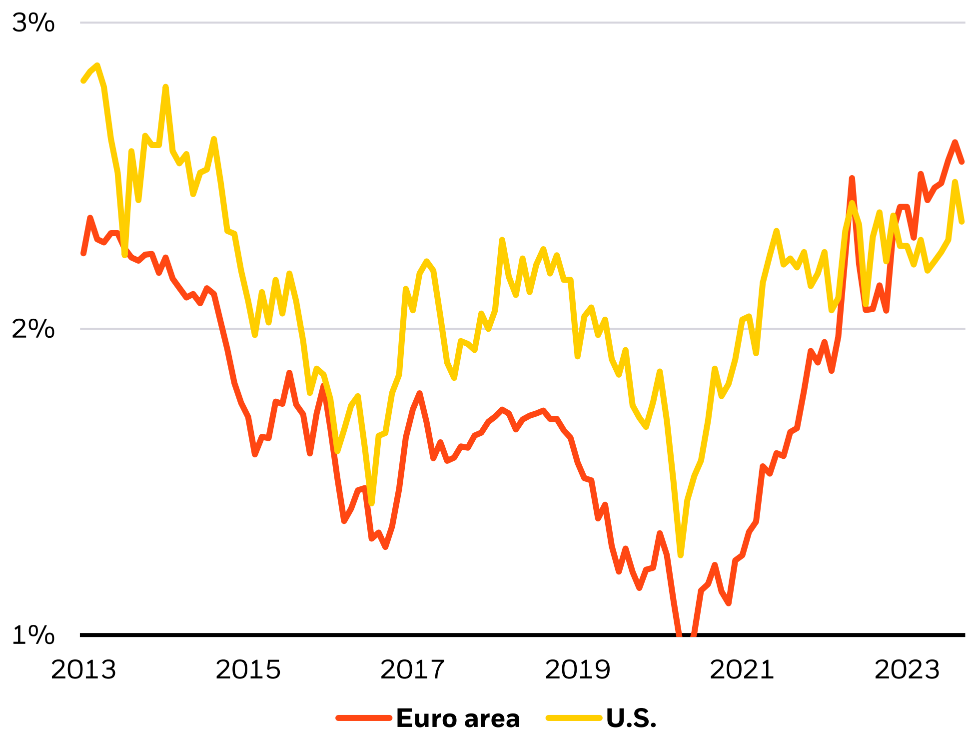
Markets are pricing more persistent inflation in Europe

Inflation expectations have risen to decade-highs even as oil prices – historically a key driver of market pricing – declined. We prefer U.S. inflation-linked bonds where we think markets still underappreciate inflation's persistence.

Euro area inflation expectations and oil prices



Market-based inflation expectations, 2013-2023

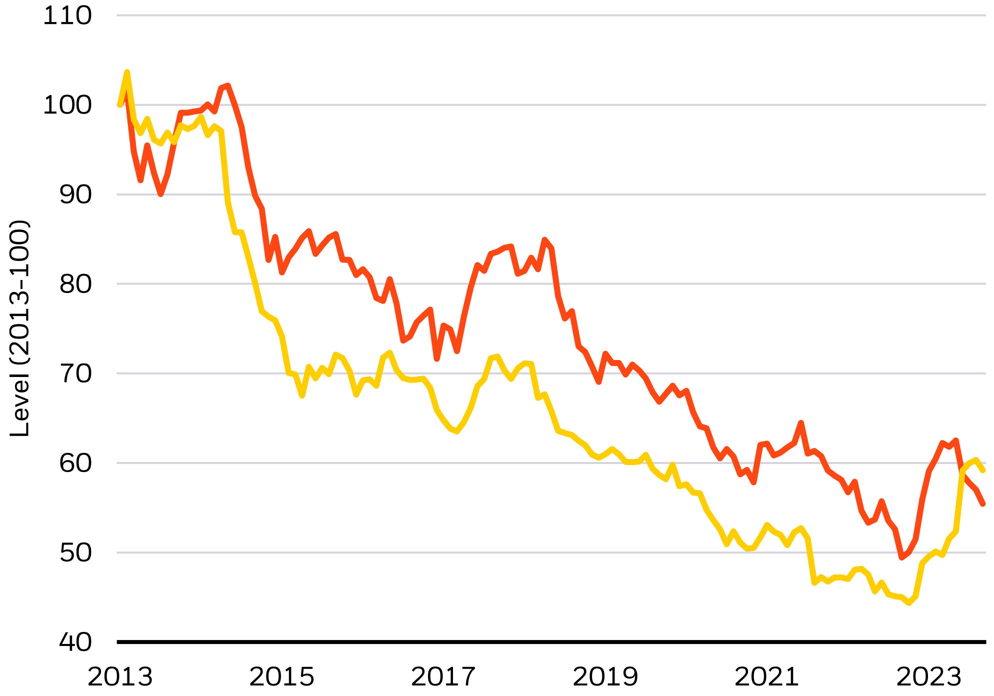


Source: BlackRock Investment Institute, with data from LSEG Datastream, October 2023. Notes: The chart on the left shows long-term inflation expectations in the euro area and crude oil prices . The long-term inflation expectations used is market pricing of the five-year average of inflation in five-years' time, referred to as the 5y5y inflation swap. The chart on the right shows the same for both the Euro area and the U.S.

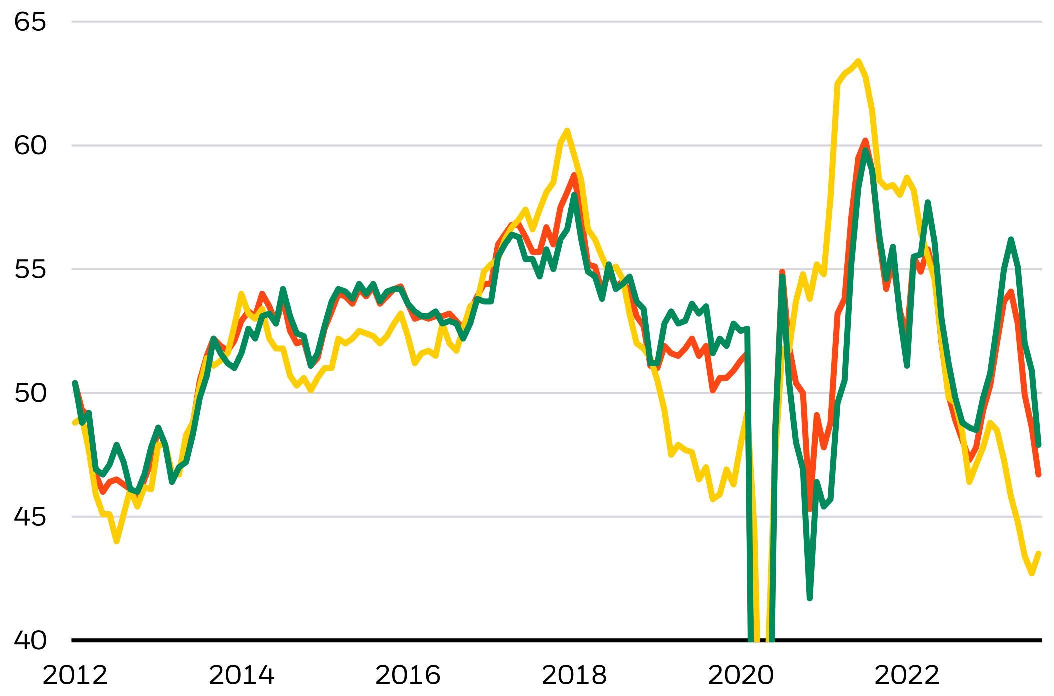
We remain cautious on European equities given dour outlook

A gloomy near-term outlook combined with weaker demand for Europe keeps us cautious on European equities for now. Weak activity is fuelling earnings downgrades and could also result in a higher risk premium.

Relative performance of European equities vs. U.S.



Europe PMIs, 2012–2023



Past performance is not a reliable indicator of current or future results. Source: BlackRock Investment Institute with data from LSEG Datastream, October 2023. Notes: The chart on the left shows the relative performance of European equities vs. U.S. equities. The line for Total returns takes the Total returns of European equities and divides it by the total returns for U.S. equities. The line for forward earnings takes the level of 12-month forward earnings per share (EPS) estimates for Europe equities and divides it by the 12-month forward EPS estimates for U.S. equities. Both lines are rebased to January 2013. The chart on the left shows various HCOG Euro area Purchasing Manager Indexes (PMIs). The lines moving below 50 denote activity contracting and the lines moving above 50 show activity growing. The chart on the right shows the overall PMIs, as well as the PMIs for manufacturing and services sectors.

Mega forces are shaping the macro regime

We see structural mega forces affecting the strategic macro outlook in different ways.

Low-carbon transition

Driving up energy costs over the next decade and creating large capital reallocations.

Aging populations

Shrinking workforces in DMs mean tight labor markets will likely keep wage growth and inflation elevated.

Geopolitical fragmentation

Rewiring of global supply chains is set to drive up production costs.

Digital disruption

AI may help offset supply constraints thanks to productivity gains over the next decades.

Future of finance

Higher interest rates are accelerating changes in the role of banks and credit providers.

Mega force

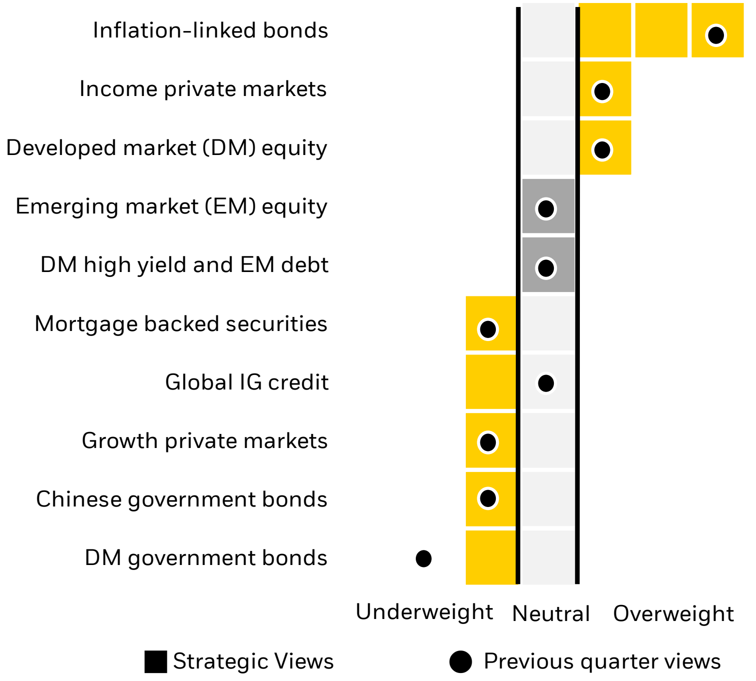
Macro parameter	Low-carbon transition	Aging populations	Geopolitics	Digital disruption
Growth	↓	↓	↓	↑
Inflation	↑	↑	↑	↓
Real rates	↑	–	↑	–
Nominal rates	↑	–	↑	↓

For illustrative purposes only. Forward looking estimates may not come to pass. Source: BlackRock Investment Institute, August 2023. Notes: The table shows our qualitative, directional estimate of the mega force's impact on the respective macro parameter over the duration of our strategic horizon of 10 years and beyond . 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 funds, strategy or security in particular.

Our latest strategic views

We keep our strong overweight to inflation-linked bonds and maintain a modest overweight to developed market (DM) equities. We turn underweight IG credit and see better opportunities for income in short-term government bonds.

Hypothetical U.S. dollar 10-year strategic views vs equilibrium, October 2023



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 Institute. Data as of 30 June 2023. Notes: The chart shows our asset views on a 10-year view from an unconstrained U.S. dollar perspective against a long-term equilibrium allocation. Global government bonds and EM equity allocations comprise respective China assets. Income private markets comprise infrastructure debt, direct lending, real estate mezzanine debt and U.S. core real estate. Growth private markets comprise global private equity buyouts and infrastructure equity. The allocation shown is hypothetical and does not represent a real portfolio. It is intended for information purposes only and does not constitute investment advice. Index proxies for public securities: Bloomberg US Government Inflation-Linked Bond Index, MSCI World US$, MSCI EM, a combination of the Bloomberg US High Yield, Bloomberg Euro High Yield and JP Morgan EMBI Global Diversified indexes for DM high yield and EM debt. Bloomberg US MBS Index, a combination of Bloomberg US Credit, Bloomberg Euro Corporate Credit, Bloomberg UK Corporate Credit indexes for Global IG credit, Bloomberg China Treasury + Policy Bank Total Return Index, and a combination of Bloomberg Treasury 1-10 Yr Index, Bloomberg US Long Treasury Index, Bloomberg Euro Treasury 1-15 Year index, Bloomberg Euro Aggregate Treasury 15 Year+ Index, Bloomberg Sterling Aggregate: Gilts 1-10 Year Index, Bloomberg Sterling Aggregate: Gilts 10+ Year Index and Bloomberg Asia Pacific Japan Treasury Index for DM government bonds. We use a combination of indexes to better reflect our investment universe. We use BlackRock proxies for private market assets. The hypothetical portfolio may differ from those in other jurisdictions, is intended for information purposes only and does not constitute investment advice.

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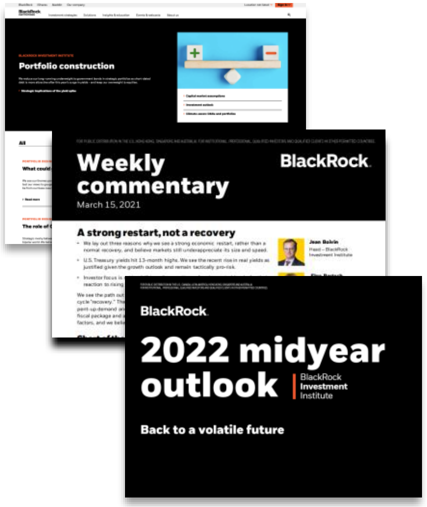
To build robust portfolios, you need to connect the dots between economics, markets, return drivers, policy and geopolitics.

”

Jean Boivin

Head – BlackRock Investment Institute



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