

Weekly commentary

April 24, 2023

BlackRock

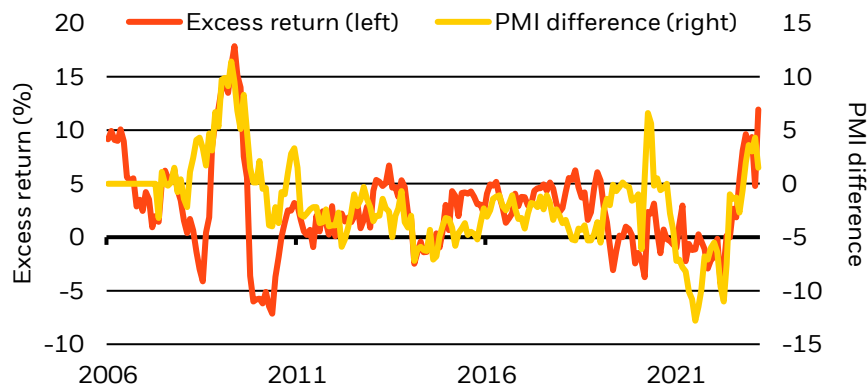
EM assets have the edge – for now

- We are leaning into our preference for emerging market (EM) assets due to China’s restart, ending EM interest rate hiking cycles and a weaker U.S. dollar.
- Global stocks were flat on the week. PMI data showed economic activity holding up in the U.S. and Europe. Sticky UK inflation pointed to more rate hikes.
- This week’s GDP data in the U.S. and euro area will help gauge the economic damage from rate rises. We see hikes hitting growth later this year.

Our new playbook calls for quickly shifting portfolios based on how much damage is priced in. We went overweight EM stocks and our long-held preference for EM debt in March on a six- to 12-month tactical horizon as they price in more rate hike damage than developed markets (DM). We took advantage of near-term events favoring EM assets: China’s economic restart, pausing EM interest rate hikes and a weaker U.S. dollar as the Federal Reserve nears the end of its rate hike campaign.

Relative strength

EM excess total bond returns and activity vs. DM, 2006-2023



Source: BlackRock Investment Institute, Bloomberg, S&P Global and JPMorgan, with data from Refinitiv Datastream, April 2023. Notes: The chart shows 12-month rolling total return of JPMorgan’s GBI-EM index minus the 12-month rolling total return of the Bloomberg U.S. Credit USD. This is referred to as the excess return. It also shows the difference between the S&P emerging market manufacturing PMI and U.S. PMI.

It may seem an unusual time to favor EM after major central banks’ rapid interest rate hikes. Yet we’ve seen a clear resilience in EM economic activity (yellow line in chart) even as rising rates have slowed DM activity. Total returns for EM debt have jumped above returns for DM credit since mid-2022 (dark orange line) as a result. A key difference: EM central banks kicked off rate hikes as much as a year before DM peers. Some already stopped hiking, while DM central banks have more to do and likely won’t cut rates soon given stubborn inflation. Brazil’s central bank has held its policy rate at 13.75% since September. Central banks for India, South Korea and other nations have paused policy rates more recently. Rate cuts would help ramp up EM economic growth sooner than in developed economies. The International Monetary Fund still sees EM GDP growth about three times higher than for advanced economies this year and next, its April forecasts show.



Wei Li

Global Chief Investment Strategist – BlackRock Investment Institute



Alex Brazier

Deputy Head – BlackRock Investment Institute



Ben Powell

Chief Investment Strategist for APAC – BlackRock Investment Institute



Axel Christensen

Chief Investment Strategist for LatAm & Iberia – BlackRock Investment Institute

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

**BlackRock
Investment
Institute**

We don't think EM central banks will need to keep up with DM central banks' rate hikes to avoid currency depreciation. EM currencies have, in fact, gained against the U.S. dollar as the Fed nears the end of its hiking cycle. Plus, EM debt is now more concentrated in local currencies than the dollar, JP Morgan index data show. We think that makes any future weakening in EM currencies easier to handle. This means EM central banks have paused and can begin cutting rates sooner than DM counterparts. We see DM central banks keeping rates higher for longer to fight sticky inflation, making rate cuts this year unlikely. This will all help EM economies keep outpacing developed economies this year, in our view. We turned overweight EM local-currency debt again in March, after having a relative preference for most of last year. While fund flows show investors have favored EM stocks since 2022, flows into EM local debt remain more muted and have the potential to increase.

Even with investors leaning into EM shares, they've underperformed DM stocks for over a decade. We don't think EM shares are reflecting the likely growth outperformance of emerging economies this year. We went overweight EM stocks in February to get short-term exposure to China's restart. The restart helped China's Q1 GDP beat market expectations last week, in line with our view of growth around 6% for the year. It's also helped EM economic activity outpace DM economies since the year started. We expect policy in China to stay supportive given very low inflation, and that benefits EM stocks: Chinese companies make up a large share of major EM equity indexes. The pickup in Chinese demand and tourism should especially boost Asian firms' earnings and shares. Renewed demand for commodities is another positive helping emerging economies such as in Latin America. Longer term, China's powerful restart doesn't change structural trends like aging populations and tensions with the U.S that will drag on long-term growth. We think the geopolitical risk of holding Chinese assets has risen. We see investors demanding more compensation to reflect that and risks from regulatory and government intervention.

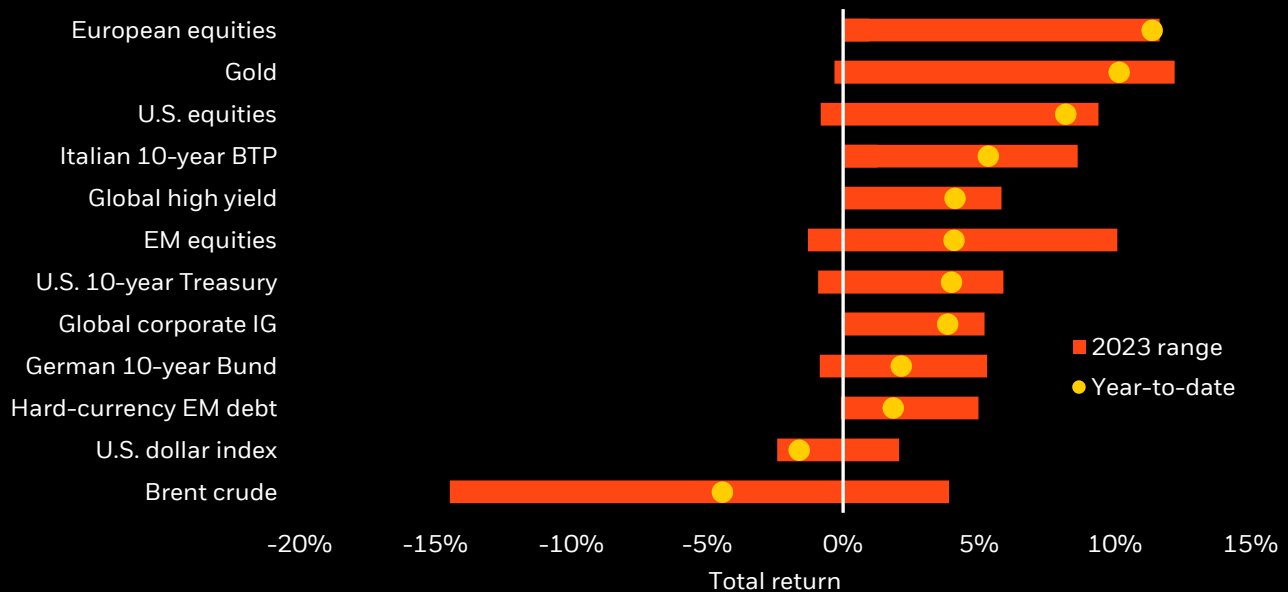
Bottom line: We like EM stocks and bonds over DM in the short run. We also prefer higher-rated countries within EM debt such as Mexico, similar to our overall quality preference – especially within DM equities and credit. Higher-rated countries have falling inflation, more balanced external accounts, adequate currency reserves and lower debt-to-GDP levels. Yet EM assets wouldn't be immune to a risk asset selloff and U.S. dollar surge from more Fed hikes. Our relative views flip on a horizon of five years and over. We see geopolitical risks weighing on EM risk-adjusted returns, so we prefer DM equities in the long run. We also think DM economies will benefit more from the transition to a lower-carbon world than EM on that horizon.

Market backdrop

U.S. stocks paused as European stocks hit a 14-month high last week. U.S Treasury yields largely steadied after a recent rise on expectations for the Fed to hike rates in May. The March UK inflation data showed how sticky inflation is proving across major economies. Sticky inflation and the April PMI data showing economic activity holding up in the U.S and Europe suggest major central banks have more work to do to fight inflation. We don't see them coming to the rescue with rate cuts this year.

Assets in review

Selected asset performance, 2023 year-to-date return and range



Past performance is not a reliable indicator of current or future results. Indexes are unmanaged and do not account for fees. It is not possible to invest directly in an index.

Sources: BlackRock Investment Institute, with data from Refinitiv Datastream as of April 20, 2023. Notes: The two ends of the bars show the lowest and highest returns at any point in the last 12-months, and the dots represent current 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, ICE U.S. Dollar Index (DXY), spot gold, MSCI Emerging Markets Index, MSCI Europe Index, Refinitiv Datastream 10-year benchmark government bond index (U.S., Germany and Italy), Bank of America Merrill Lynch Global High Yield Index, J.P. Morgan EMBI Index, Bank of America Merrill Lynch Global Broad Corporate Index and MSCI USA Index.

Macro take

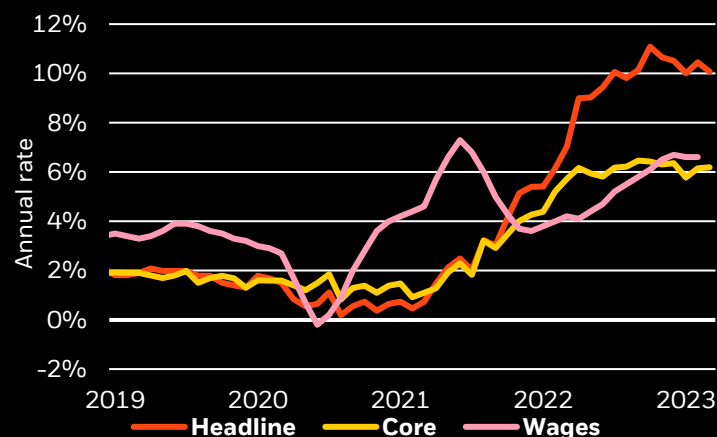
UK inflation remains in double-digit territory: The March data showed the overall CPI still rising at a 10.1% annual rate, above consensus forecasts.

That's largely driven by energy and food prices. Energy prices have started to fall, but food prices are still rising. And crucially for the Bank of England, core inflation – which excludes energy and food prices – is stubbornly high at 6.2%. See the yellow line. Services inflation is the main driver here: Wages are still rising quickly (pink line), even with some improvement in labor supply as more people return to the workforce. We think worker shortages – due to long-term sickness, Brexit and early retirement in the pandemic – will remain a key constraint for the UK economy.

The Bank of England expected those pressures to cool slightly, allowing it to stop rate hikes. But such stubborn inflation highlights the sharp growth-inflation trade-off it faces. The UK economy hasn't recovered to its pre-pandemic level and more rate hikes could mean even more economic damage. Explore our recent Macro take blog posts [here](#).

Running hot

UK inflation and wages, 2019-2023



Source: BlackRock Investment Institute, UK Office for National Statistics, with data from Haver Analytics, April 2023. Notes: The orange line shows annual headline inflation, and the yellow line shows the inflation rate for all items, excluding food and energy. The pink line shows the three-month moving average for annual wage growth.

Investment themes

1 Pricing in the damage

- Recession is foretold as central banks try to bring inflation back down to policy targets. It's the opposite of past recessions: Rate cuts are not on the way to help support risk assets, in our view.
- That's why the old playbook of simply "buying the dip" doesn't apply in this regime of sharper trade-offs and greater macro volatility. The new playbook calls for a continuous reassessment of how much of the economic damage being generated by central banks is in the price.
- In the U.S., it's now evident in the financial cracks emerging from higher interest rates on top of rate-sensitive sectors. Higher mortgage rates have hurt sales of new homes. We also see other warning signs, such as deteriorating CEO confidence, delayed capital spending plans and consumers depleting savings.
- The ultimate economic damage depends on how far central banks go to get inflation down. We think the Federal Reserve will halt rate hikes once the economic damage becomes clear. We see the European Central Bank going full steam ahead with rate hikes to get inflation to target – regardless of the damage that entails.
- **Investment implication:** We're tactically underweight DM equities. They're not pricing the recession we see ahead.

2 Rethinking bonds

- Fixed income finally offers "income" after yields surged globally. This has boosted the allure of bonds after investors were starved for yield for years. We take a granular investment approach to capitalize on this, rather than taking broad, aggregate exposures.
- Very short-term government paper looks more attractive for income at current yields, and we like their ability to preserve capital. Tighter credit and financial conditions reduce the appeal of credit.
- In the old playbook, long-term government bonds would be part of the package as they historically have shielded portfolios from recession. Not this time, we think. The negative correlation between stock and bond returns has already flipped, meaning they can both go down at the same time. Why? Central banks are unlikely to come to the rescue with rapid rate cuts in recessions they engineered to bring down inflation to policy targets. If anything, policy rates may stay higher for longer than the market is expecting. Investors also will increasingly ask for more compensation to hold long-term government bonds – or term premium – amid high debt levels, rising supply and higher inflation.
- **Investment implication:** We prefer very short-term government paper over long-term government bonds.

3 Living with inflation

- High inflation has sparked cost-of-living crises, putting pressure on central banks to tame inflation with whatever it takes. Yet there has been little debate about the damage to growth and jobs. We think the "politics of inflation" narrative is on the cusp of changing. The Fed's rapid rate hikes will stop without inflation being back on track to return fully to 2% targets, in our view. We think we are going to be living with inflation. We do see inflation cooling as spending patterns normalize and energy prices relent – but we see it persisting above policy targets in coming years.
- Beyond Covid-related supply disruptions, we see three long-term constraints keeping the new regime in place and inflation above pre-pandemic levels: aging populations, geopolitical fragmentation and the transition to a lower-carbon world.
- **Investment implication:** We're overweight inflation-linked bonds on a tactical and strategic horizon.

Week ahead

April 25

U.S. consumer confidence

April 28

U.S. PCE and Employee Cost Index; euro area GDP; Bank of Japan policy decision

April 27

U.S. Q1 GDP

GDP data in the U.S. and euro area this week will help gauge the economic damage from rate rises. We see hikes hitting growth later this year and no rate cuts in 2023 from major central banks. We expect the Fed to stop hikes when the damage is clear but think the European Central Bank will keep going to get inflation to target regardless of the damage that entails.

Directional views

Strategic (long-term) and tactical (6-12 month) views on broad asset classes, April 2023

	Underweight	Neutral	Overweight	● Previous view		
Asset	Strategic view		Tactical view			
Equities	<p>+1</p>			<p>-1</p>		<p>We are overweight equities in our strategic views as we estimate the overall return of stocks will be greater than fixed-income assets over the coming decade. Valuations on a long horizon do not appear stretched to us. Tactically, we're underweight DM stocks as central banks' rate hikes cause financial cracks and economic damage. Corporate earnings expectations have yet to fully reflect even a modest recession. We are overweight EM stocks and have a relative preference due to China's restart, peaking EM rate cycles and a broadly weaker U.S. dollar.</p>
Credit	<p>+1</p>			<p>Neutral</p>		<p>Strategically, we are overweight global investment grade but have reduced it given the tightening of spreads in recent months. We are neutral high yield as we see the asset class as more vulnerable to recession risks. Tactically, we're neutral investment grade due to tightening credit and financial conditions. We're underweight high yield as we see a recession coming and prefer to be up in quality. We're overweight local-currency EM debt – we see it as more resilient with monetary policy tightening further along than in DMs.</p>
Govt bonds	<p>Neutral</p>			<p>-1</p>		<p>We are neutral in our strategic view on government bonds. This reflects an overweight to short-term government bonds and max overweight to inflation-linked bonds. We remain underweight nominal long-term bonds: We think markets are underappreciating the persistence of high inflation and investors likely demanding a higher term premium. Tactically, we are underweight long-dated DM government bonds for the same reason. We favor short-dated government bonds – higher yields now offer attractive income with limited risk from interest rate swings.</p>
Private markets	<p>-1</p>					<p>We're underweight private growth assets and neutral on private credit from a starting allocation that is much larger than what most qualified investors hold. Private assets are not immune to higher macro and market volatility or higher rates, and public market selloffs have reduced their relative appeal. Private allocations are long-term commitments, however, and we see opportunities as assets reprice over time. Private markets are a complex asset class not suitable for all investors.</p>

Note: Views are from a U.S. dollar perspective. 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, April 2023

Underweight
Neutral
Overweight
● Previous view

Asset	View	Commentary	
Equities	Developed markets	<p style="text-align: center;">-1</p>	We are underweight. Earnings expectations and valuations don't fully reflect recession risk. We prefer a sectoral approach: energy and healthcare.
	United States	<p style="text-align: center;">-1</p>	We are underweight. Financial cracks are emerging from Fed rate hikes. We don't think earnings expectations reflect the recession we see ahead.
	Europe	<p style="text-align: center;">-1</p>	We are underweight. The impact of higher interest rates and elevated inflation pose a challenge for earnings, even as the energy shock fades.
	UK	<p style="text-align: center;">-1</p>	We are underweight. Earnings expectations don't fully reflect the economic damage we see ahead.
	Japan	<p style="text-align: center;">-1</p>	We are underweight. The Bank of Japan looks set to wind down its ultra-loose policy. Japan is exposed to the weaker activity we see in other DM economies.
	Emerging markets	<p style="text-align: center;">+1</p>	We are overweight and have a relative preference over DM stocks due to China's powerful restart, peaking EM rate cycles and a broadly weaker U.S. dollar.
	China	<p style="text-align: center;">+1</p>	We see short-term opportunities from China's restart. But geopolitical risks have risen, and we still see long-term, structural challenges and risks.
	Asia ex-Japan	<p style="text-align: center;">Neutral</p>	We are neutral. China's restart is a positive yet we don't see valuations compelling enough to turn overweight.
	Long U.S. Treasuries	<p style="text-align: center;">-1</p>	We are underweight. We see long-term yields moving up further as investors demand a greater term premium.
	Short U.S. Treasuries	<p style="text-align: center;">+2</p>	We are overweight. We prefer very short-term government paper for income given the potential for a sharp jump in Fed rate expectations.
Fixed Income	Global inflation-linked bonds	<p style="text-align: center;">+2</p>	We are overweight. We see market pricing underestimating the risk of persistently higher inflation.
	Euro area govt bonds	<p style="text-align: center;">-1</p>	We are underweight. We see investors demanding greater term premium, with peripheral bonds at risk from tighter financial conditions.
	UK gilts	<p style="text-align: center;">-1</p>	We are underweight. Gilts won't be immune to the factors we see driving DM bond yields higher. We prefer short-dated gilts for income.
	China govt bonds	<p style="text-align: center;">Neutral</p>	We are neutral. Yields are less attractive relative to those on short-term DM government bonds.
	Global IG credit	<p style="text-align: center;">Neutral</p>	We are neutral. We see tighter credit and financial conditions. We prefer European investment grade over the U.S. given more attractive valuations.
	U.S. agency MBS	<p style="text-align: center;">Neutral</p>	We're neutral. We see agency MBS as a high-quality exposure within diversified bond allocations. But spreads near long-term averages look less compelling.
	Global high yield	<p style="text-align: center;">-1</p>	We are underweight. We think spreads are still too tight, given our expectation for tighter credit and financial conditions – and an eventual recession.
	Emerging hard currency	<p style="text-align: center;">Neutral</p>	We are neutral. We see support from higher commodities prices, yet it is vulnerable to rising U.S. yields.
	Emerging local currency	<p style="text-align: center;">+1</p>	We are overweight due to China's restart, and we see EM debt as more resilient to tightening financial conditions than DM as EM hiking cycles near peaks.
	Asia fixed income	<p style="text-align: center;">Neutral</p>	We are neutral. We don't find valuations compelling enough yet to turn more positive.

Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index. Note: Views are from a U.S. dollar perspective. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast or guarantee of future results. This information should not be relied upon as investment advice regarding any particular fund, strategy or security.

BlackRock Investment Institute

The BlackRock Investment Institute (BII) leverages the firm's expertise and generates proprietary research to provide insights on macroeconomics, sustainable investing, geopolitics and portfolio construction to help BlackRock's portfolio managers and clients 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. This material may contain estimates and forward-looking statements, which may include forecasts and do not represent a guarantee of future performance. This information is not intended to be complete or exhaustive and no representations or warranties, either express or implied, are made regarding the accuracy or completeness of the information contained herein. The opinions expressed are as of April 24, 2023 and are subject to change without notice. Reliance upon information in this material is at the sole discretion of the reader. Investing involves risks.

In the **U.S. and Canada**, this material is intended for public distribution. **In the European Economic Area (EEA):** this is Issued by BlackRock (Netherlands) B.V. is authorised 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 For your protection telephone calls are usually recorded. **In the UK and Non-European Economic Area (EEA) countries:** this is Issued by BlackRock Advisors (UK) Limited, which is authorised 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. 00796793. For your protection, calls are usually recorded. Please refer to the Financial Conduct Authority website for a list of authorised activities conducted by BlackRock. **In Italy,** for information on investor rights and how to raise complaints please go to <https://www.blackrock.com/corporate/compliance/investor-right> available in Italian. **For qualified investors in Switzerland:** This document is marketing material. This document shall be exclusively made available to, and directed at, qualified investors as defined in Article 10 (3) of the CISA of 23 June 2006, as amended, at the exclusion of qualified investors with an opting-out pursuant to Art. 5 (1) of the Swiss Federal Act on Financial Services ("FinSA"). For information on art. 8 / 9 Financial Services Act (FinSA) and on your client segmentation under art. 4 FinSA, please see the following website: www.blackrock.com/finsa. **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. BlackRock Advisors (UK) Limited - Dubai Branch is a DIFC Foreign Recognised Company registered with the DIFC Registrar of Companies (DIFC Registered Number 546), with its office at Unit 06/07, Level 1, Al Fattan Currency House, DIFC, PO Box 506661, Dubai, UAE, and is regulated by the DFSA to engage in the regulated activities of 'Advising on Financial Products' and 'Arranging Deals in Investments' in or from the DIFC, both of which are limited to units in a collective investment fund (DFSA Reference Number F000738) **In the Kingdom of Saudi Arabia,** issued in the Kingdom of Saudi Arabia (KSA) by BlackRock Saudi Arabia (BSA), authorised and regulated by the Capital Market Authority (CMA), License No. 18-192-30. Registered under the laws of KSA. Registered office: 29th floor, Olaya Towers – Tower B, 3074 Prince Mohammed bin Abdulaziz St., Olaya District, Riyadh 12213 – 8022, KSA, Tel: +966 11 838 3600. The information contained within is intended strictly for Sophisticated Investors as defined in the CMA Implementing Regulations. Neither the CMA or any other authority or regulator located in KSA has approved this information. The information contained within, does not constitute and should not be construed as an offer of, invitation or proposal to make an offer for, recommendation to apply for or an opinion or guidance on a financial product, service and/or strategy. Any distribution, by whatever means, of the information within and related material to persons other than those referred to above is strictly prohibited. **In the United Arab Emirates** 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 the State of Kuwait,** those who meet the description of a Professional Client as defined under the Kuwait Capital Markets Law and its Executive Bylaws. **In the Sultanate of Oman,** to sophisticated institutions who have experience in investing in local and international securities, are financially solvent and have knowledge of the risks associated with investing in securities. **In Qatar,** for distribution with pre-selected institutional investors or high net worth investors. **In the Kingdom of Bahrain,** to Central Bank of Bahrain (CBB) Category 1 or Category 2 licensed investment firms, CBB licensed banks or those who would meet the description of an Expert Investor or Accredited Investors as defined in the CBB Rulebook. The information contained in this document, does not constitute and should not be construed as an offer of, invitation, inducement or proposal to make an offer for, recommendation to apply for or an opinion or guidance on a financial product, service and/or strategy. **In Singapore,** this is issued by BlackRock (Singapore) Limited (Co. registration no. 200010143N). This advertisement or 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). **In Latin America,** 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 www.blackrock.com/mx

©2023 BlackRock, Inc. All Rights Reserved. **BLACKROCK** is a 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