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

Weekly commentary

BlackRock.

February 26, 2024

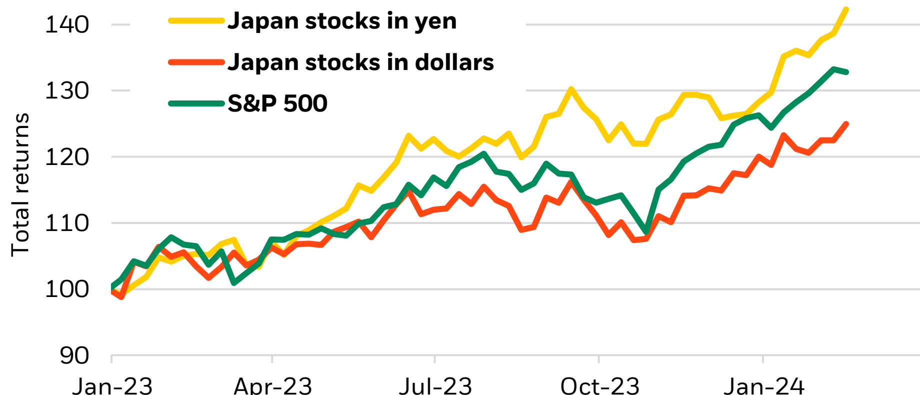
Japan stocks: high can go higher

- We see Japan stocks climbing higher on robust earnings, corporate reforms and a Bank of Japan likely worried about returning to a chronic deflationary mindset.
- U.S. stocks jumped last week on further tech earnings beats. U.S. Treasury yields ticked down due to markets pricing out some rate cuts.
- We're watching U.S. PCE data out this week for further signs inflation is falling toward 2% this year as we expect. Yet we expect it to rebound beyond 2024.

We believe Japan's equity rally has room to run – unlike some past false starts. We think both the macro outlook and company-level developments will drive the next leg. The corporate earnings growth we expected since 2023 is playing out. Yet we don't see markets fully pricing in positive signs like corporate reforms. We think the Bank of Japan will cautiously wind down its ultra-loose monetary policy to avoid disrupting an exit from decades of no inflation. We stay overweight Japan stocks.

Beyond the yen

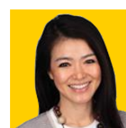
Total returns for Japanese stocks vs. U.S. stocks, 2023-2024



Source: BlackRock Investment Institute, with data from LSEG Refinitiv, February 2024. Notes: The chart shows total returns for TOPIX, the Japanese stock index, valued denominated in yen and U.S. dollars, and total returns for the S&P 500. The data has been rebased so that 100 = Dec. 30, 2022.

Japan's Nikkei index hit a record high last week for the first time since 1989, when stocks soared to the point the real estate-driven bubble later burst. Those events led to decades of low or no inflation and mostly flat growth. The TOPIX (yellow line in chart) is near its own new record, outperforming most major stock markets in U.S. dollars except the S&P 500 (green line). What's driving the stock surge? A weak currency has helped boost the value of corporate earnings made abroad. We expect earnings momentum to stay solid. A stabilizing U.S. dollar is not biting Japanese stock returns in the currency as much. And the excess yield investors receive for the risk of holding Japanese stocks over bonds looks attractive. Our positive outlook is about more than a weak yen. Higher inflation is allowing firms to raise prices and protect margins, while wage growth helps to keep fueling consumer spending.

Jean Boivin
Head – BlackRock Investment Institute



Wei Li
Global Chief Investment Strategist — BlackRock Investment Institute

Ben Powell
Chief Investment Strategist for APAC — BlackRock Investment Institute

Carolina Martinez Arevalo
Portfolio Strategist – BlackRock Investment Institute

Visit BlackRock Investment Institute for insights on the global economy, markets and geopolitics.

BlackRock **Investment** Institute

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

March will be a pivotal month for Japanese markets, with the annual union wage negotiations – likely to shape the inflation outlook – taking place at the same time as the BOJ's next policy meeting. The negotiations should help signal if inflation has become entrenched. We think the BOJ will end negative interest rates in coming months but will need more evidence of sustained inflation before raising rates further. We don't see wages growing enough to keep inflation sustainably at the BOJ's 2% target – and that's why we don't think the BOJ will tighten policy as much as markets expect. While not our expectation, we see a risk the BOJ tightens too quickly and too much. That scenario could be more damaging than a slight delay in policy adjustment, in our view, as it could undercut the BOJ's attempt to end the long stretch of deflation, or no inflation.

Corporate governance reforms are a key driver of the stock gains. The Tokyo Stock Exchange (TSE) has kept pushing for firms to improve their profitability and return money to shareholders. The TSE has begun disclosing companies that are planning to improve their capital management – a nudge to those that are trading below book value with no improvement plans. Since former Prime Minister Shinzo Abe introduced reforms more than a decade ago, Japanese firms have made some progress on boosting lackluster return on equity – or profitability. That has risen from negative levels in 2010 to 9%, LSEG Datastream data show. It is still half of the U.S. metric, but we think reforms can help narrow the gap. The ongoing earnings season is validating our expectations of robust growth, with TOPIX operating profits up 17% year over year, Bank of America data show.

Alongside these developments, a revamped government tax-free stock investment scheme kicked off this year aiming to stoke domestic investor flows into Japanese stocks. This scheme could facilitate Japanese savers reallocating some savings out of cash and into real assets, including equities, to try to preserve the value of their money in the new inflationary regime.

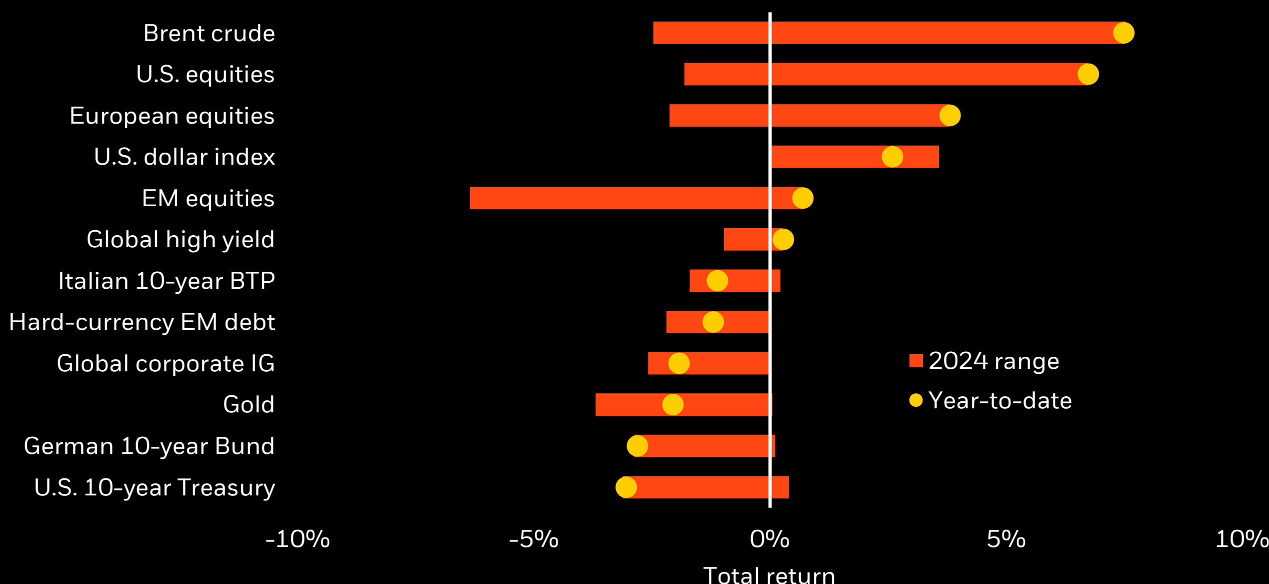
Bottom line: We stay overweight Japanese stocks and think they can best their all-time highs. On top of support from the return of mild inflation, we see company-level developments driving the next leg of the rally. We don't see the BOJ disrupting the optimistic outlook as it likely stays cautious on policy. We see Japanese stocks as attractive given their growth potential.

Market backdrop

The S&P 500 jumped nearly 2% last week, with more tech earnings beats boosting the upward momentum. U.S. tech gains lifted tech stocks globally, and a rally in chipmakers helped Japan's Nikkei set a record for the first time since 1989. Meanwhile, short- and long-term U.S. Treasury yields fell lower from markets pricing out some Federal Reserve rate cuts this year. We think the positive market sentiment can persist for now as inflation cools and the Fed prepares to cut rates.

Assets in review

Selected asset performance, 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 LSEG Datastream as of Feb. 22, 2024. Notes: The two ends of the bars show the lowest and highest returns at any point year to date, 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, LSEG 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.

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

Week ahead

Feb. 27	U.S. consumer confidence, durable goods; Japan CPI	**March 1**	Euro area inflation
Feb. 29	U.S. PCE		

This week, we're closely watching the release of U.S. PCE data – the Federal Reserve's preferred inflation metric – for signs that inflation is still heading down toward 2% this year as we expect. Falling goods prices have been pushing inflation down, but we see that drag fading in due course. We think inflation will resurge due to stubbornly high services inflation, but we expect that to only become visible later this year.

Big calls

Our highest conviction views on tactical (6-12 month) and strategic (long-term) horizons, February 2024

Tactical	Reasons
U.S. equities	• Our macro view has us neutral at the benchmark level. But the AI theme and its potential to generate alpha – or above-benchmark returns – push us to be overweight overall.
Income in fixed income	• The income cushion bonds provide has increased across the board in a higher rate environment. We like short-term bonds and are now neutral long-term U.S. Treasuries as we see two-way risks ahead.
Geographic granularity	• We favor getting granular by geography and like Japan equities in DM. Within EM, we like India and Mexico as beneficiaries of mega forces even as relative valuations appear rich.
Strategic	**Reasons**
Private credit	• We think private credit is going to earn lending share as banks retreat – and at attractive returns relative to credit risk.
Inflation-linked bonds	• We see inflation staying closer to 3% in the new regime on a strategic horizon.
Short- and medium-term bonds	• We overall prefer short-term bonds over long term. That's due to more uncertain and volatile inflation, heightened bond market volatility and weaker investor demand.

Note: Views are from a U.S. dollar perspective, February 2024. 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.

Tracking five mega forces

Mega forces are big, structural changes that affect investing now – and far in the future. As key drivers of the new regime of greater macroeconomic and market volatility, they change the long-term growth and inflation outlook and are poised to create big shifts in profitability across economies and sectors. This creates major opportunities – and risks – for investors. See our web hub for our research and related content on each mega force.

1. **Demographic divergence:** The world is split between aging advanced economies and younger emerging markets – with different implications.
2. **Digital disruption and artificial intelligence (AI):** Technologies that are transforming how we live and work.
3. **Geopolitical fragmentation and economic competition:** Globalization is being rewired as the world splits into competing blocs.
4. **Future of finance:** A fast-evolving financial architecture is changing how households and companies use cash, borrow, transact and seek returns.
5. **Transition to a low-carbon economy:** The transition is set to spur a massive capital reallocation as energy systems are rewired.

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

Granular views

Six- to 12-month tactical views on selected assets vs. broad global asset classes by level of conviction, February 2024

Our approach is to first determine asset allocations based on our macro outlook – and what's in the price. **The table below reflects this and, importantly, leaves aside the opportunity for alpha, or the potential to generate above-benchmark returns.** The new regime is not conducive to static exposures to broad asset classes, in our view, but is creating more space for alpha**.**

Underweight | Neutral | Overweight | ● Previous view

	Asset		View	Commentary
Equities	**Developed markets**			
	United States	Benchmark	Neutral	We are neutral in our largest portfolio allocation. Falling inflation and coming Fed rate cuts can underpin the rally's momentum. We are ready to pivot once the market narrative shifts.
		Overall	+1	We are overweight overall when incorporating our U.S.-centric positive view on artificial intelligence (AI). We think AI beneficiaries can still gain while earnings growth looks robust.
	Europe		-1	We are underweight. The ECB is holding policy tight in a slowdown. Valuations are attractive, but we don't see a catalyst for improving sentiment.
	UK		Neutral	We are neutral. We find attractive valuations better reflect the weak growth outlook and the Bank of England's sharp rate hikes to fight sticky inflation.
	Japan		+1	We are overweight. We see stronger growth helping earnings top expectations. Stock buybacks and other shareholder-friendly actions are positives. Policy tightening is a near-term risk.
	Emerging markets		Neutral	We are neutral. We see growth on a weaker trajectory and see only limited policy stimulus from China. We prefer EM debt over equity.
	China		Neutral	We are neutral. Modest policy stimulus may help stabilize activity, and valuations have come down. Structural challenges such as an aging population and geopolitical risks persist.
Fixed Income	Short U.S. Treasuries		+1	We are overweight. We prefer short-term government bonds for income as interest rates stay higher for longer
	Long U.S. Treasuries		Neutral	We are neutral. The yield surge driven by expected policy rates has likely peaked. We now see about equal odds that long-term yields swing in either direction.
	U.S. inflation-linked bonds		Neutral	We are neutral. We see higher medium-term inflation, but cooling inflation and growth may matter more near term.
	Euro area inflation-linked bonds		-1	We are underweight. We prefer the U.S. over the euro area. We see markets overestimating how persistent inflation in the euro area will be relative to the U.S.
	Euro area govt bonds		Neutral	We are neutral. Market pricing reflects policy rates in line with our expectations and 10-year yields are off their highs. Widening peripheral bond spreads remain a risk.
	UK gilts		Neutral	We are neutral. Gilt yields have compressed relative to U.S. Treasuries. Markets are pricing in Bank of England policy rates closer to our expectations.
	Japanese govt bonds		-1	We are underweight. We see upside risks to yields from the Bank of Japan winding down its ultra-loose policy.
	China govt bonds		Neutral	We are neutral. Bonds are supported by looser policy. Yet we find yields more attractive in short-term DM paper.
	Global IG credit		-1	We are underweight. Tight spreads don't compensate for the expected hit to corporate balance sheets from rate hikes, in our view. We prefer Europe over the U.S.
	U.S. agency MBS		Neutral	We are neutral. We see agency MBS as a high-quality exposure in a diversified bond allocation and prefer it to IG.
	Global high yield		Neutral	We are neutral. Spreads are tight, but we like its high total yield and potential near-term rallies. We prefer Europe.
	Asia credit		Neutral	We are neutral. We don't find valuations compelling enough to turn more positive.
	Emerging hard currency		+1	We are overweight. We prefer EM hard currency debt due to its relative value and quality. It is also cushioned from weakening local currencies as EM central banks cut policy rates.
	Emerging local currency		Neutral	We are neutral. Yields have fallen closer to U.S. Treasury yields. Central bank rate cuts could hurt EM currencies, dragging on potential returns.

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. The opinions expressed are as of Feb. 26, 2024, and are subject to change without notice. Reliance upon information in this material is at the sole discretion of the reader. Investing involves risks. 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. This material may contain estimates and forward-looking statements, which may include forecasts and do not represent a guarantee of future performance.

In the **U.S. and Canada**, this material is intended for public distribution. **In EMEA**, in the UK and Non-European Economic Area (EEA) countries: this is Issued by BlackRock Investment Management (UK) Limited, 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. 02020394. For your protection telephone calls are usually recorded. Please refer to the Financial Conduct Authority website for a list of authorised activities conducted by BlackRock. 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 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. **In Switzerland**, for qualified investors in Switzerland: This document is marketing material. Until 31 December 2021, 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 ("CISA"), as amended. From 1 January 2022, 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. **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 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 New Zealand,** issued by BlackRock Investment Management (Australia) Limited ABN 13 006 165 975, AFSL 230 523 (BIMAL) for the exclusive use of the recipient, who warrants by receipt of this material that they are a wholesale client as defined under the New Zealand Financial Advisers Act 2008. **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

©2024 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