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Richard Turnill
Global Chief Investment Strategist

Richard Turnill is BlackRock's Global Chief Investment Strategist. He was previously Chief Investment Strategist for BlackRock's fixed income and active equity businesses, and has also led the Global Equity investment team. Richard started his career at the Bank of England.

Share your feedback at ***BlackRockInvestmentInstitute@blackrock.com***

Isabelle Mateos y Lago
Chief Multi-Asset Strategist
BlackRock Investment Institute

Kate Moore
Chief Equity Strategist
BlackRock Investment Institute

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Key points

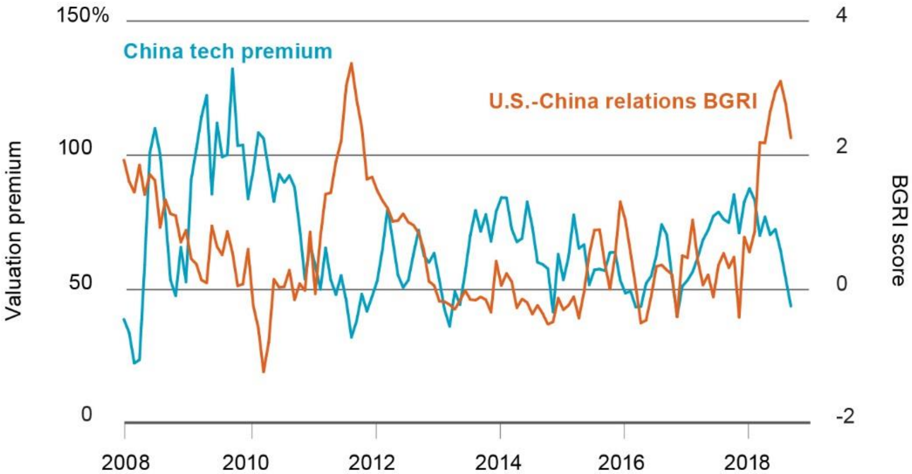
1. We see a compelling opportunity for global investors to consider Chinese tech stocks as a complement to developed market tech exposures.
2. Global stocks and risk assets rallied after the U.S. midterm elections resulted in a divided U.S. government likely to make few policy changes.
3. "Singles Day" retail sales data will be in focus this week for clues about Chinese consumer trends and China's growth outlook.

1 Considering Chinese tech stocks

It's been a tough year for Chinese technology stocks. The fast-growing sector has led emerging market (EM) indexes down amid rising U.S.-China tensions. The upside: The decoupling of Chinese tech from U.S. peers is set to accelerate amid a struggle for tech dominance, giving it diversification benefits. And valuations have fallen.

Chart of the week

China tech vs. DM stocks and market attention to U.S.-China relations



Sources: BlackRock Investment Institute, with data from Thomson Reuters, November 2018. Notes: The blue line represents the relative premium/discount of the MSCI China Technology Index to developed market stocks (DM), as represented by the MSCI World Index, based on 12-month forward PE ratios. The orange line shows the BlackRock Geopolitical Risk Indicator (BGRI) for U.S.-China relations. We identify specific words related to this geopolitical risk and use text analysis to calculate the frequency of their appearance in the Thomson Reuters Broker Report and Dow Jones Global Newswire databases as well as on Twitter. We then adjust for whether the language reflects positive or negative sentiment, and assign a score. A zero score represents the average BGRI level over its history from 2003 up to that point in time. A score of one means the BGRI level is one standard deviation above the average. We weigh recent readings more heavily in calculating the average. The BGRI's risk scenario is for illustrative purposes only and does not reflect all possible outcomes as geopolitical risks are ever-evolving.

Chinese tech stocks typically trade at a premium to developed market stocks or peers given their greater growth potential. But that premium (the blue line above) has come down sharply this year, while market attention to the U.S.-China relations risk, as measured by our BlackRock Geopolitical Risk Indicator (BGRI), has increased (the orange line). Our outlook for global technology stocks broadly is positive, and we believe the door may be open for global investors to diversify their exposure and step into a long-term opportunity in Chinese tech.

Reasons for optimism

Tech stocks are the largest constituent in both the U.S. and Chinese equity markets. Downward earnings revisions, stemming partly from regulatory changes affecting matters such as content dissemination and licensing, have weighed on sentiment for Chinese tech stocks in 2018. Analysts project a rebound in 2019 amid strong consumer demand, fiscal stimulus and waning regulatory hurdles. In addition, the U.S. and China tech sectors are increasingly different, creating distinct opportunities for investors.

The U.S. tech sector has a global bent versus China's domestic one. Concentration is greater in China, where just three stocks represent most of the tech market cap. Other distinctions: The Chinese market for tech services is larger, the Chinese consumer base has a different income profile and the regulatory framework in China is developing faster. We see changes in trade and the competition for tech dominance amplifying these differences and limiting co-development. Reduced IPOs and cross-border investment could be by-products of ongoing tensions, yet we see China's focus on domestic demand and self-reliance as positives amid trade disputes. Cross-country investment restrictions could limit redundancy and direct competition, while rivalry-fueled innovation may benefit both tech sectors. A near-term uncertainty posing an upside or downside risk: a potential meeting between U.S.-China leaders later this month. Yet we see Chinese and U.S. tech decoupling even without worsening tensions, as China devotes capital to its innovation priorities.

Bottom line: The long-term potential in Chinese tech firms may be underappreciated amid strained U.S.-China relations. We advocate digging deeper than the index-dominating mega-cap names in China to uncover opportunities in smaller software and services firms. In the U.S., we favor software as a service (SaaS) firms, as companies large and small move their systems to the cloud. Valuation multiples in the U.S. tech sector have risen in the post-crisis period but are now in line with their five-year historical average, and they do not look particularly extended over a longer horizon. We maintain our favorable view of global tech stocks and advocate broadening exposure to capture the diverse opportunities in China and the U.S.

2 Week in review

- Developed market risk assets rallied following the U.S. midterm elections. Stocks gained, led by the U.S., with the software and health care sectors outperforming and the VIX volatility gauge fading down to around 16. The divided-government outcome heralds political gridlock for at least the next two years, in our view. We expect little progress even in potential areas of bipartisan cooperation such as infrastructure or drug price controls, and see recent deep corporate tax cuts as likely here to stay.
- The Fed held rates steady as expected and acknowledged some moderation in rate-sensitive areas of the economy. Short-term rates rose on expectations of a Fed rate hike in December, U.S. 10-year Treasury yields stayed near seven-year highs, and the curve between 2-year and 30-year Treasuries flattened. Longer-term rates fell on reduced expectations of additional U.S. stimulus. The yield spread between 10-year U.S. Treasuries and German Bunds touched its widest level since the late 1980s. Oil fell into a bear market.

Global snapshot

Weekly and 12-month performance of selected assets

Equities	Week	YTD	12 Months	Div. Yield
U.S. Large Caps	2.2%	4.0%	7.6%	2.0%
U.S. Small Caps	0.1%	1.9%	6.4%	1.3%
Non-U.S. World	-0.3%	-9.5%	-7.2%	3.5%
Non-U.S. Developed	0.2%	-8.0%	-5.6%	3.6%
Japan	0.1%	-6.4%	-5.7%	2.4%
Emerging	-2.0%	-13.9%	-11.8%	3.1%
Asia ex-Japan	-2.3%	-14.4%	-13.1%	3.0%

Bonds	Week	YTD	12 Months	Yield
U.S. Treasuries	0.2%	-2.2%	-2.3%	3.2%
U.S. TIPS	0.3%	-2.4%	-1.9%	3.3%
U.S. Investment Grade	0.5%	-3.5%	-2.7%	4.3%
U.S. High Yield	0.1%	1.2%	2.1%	6.8%
U.S. Municipals	0.2%	-1.1%	-1.2%	3.1%
Non-U.S. Developed	-0.3%	-4.4%	-2.1%	1.1%
EM $ Bonds	0.0%	-4.8%	-3.3%	6.8%

Commodities	Week	YTD	12 Months	Level
Brent Crude Oil	-3.6%	4.9%	9.8%	$70.18
Gold	-1.9%	-7.2%	-5.9%	$1,210
Copper	-3.6%	-16.4%	-11.0%	$6,056

Currencies	Week	YTD	12 Months	Level
Euro/USD	-0.5%	-5.6%	-2.6%	1.13
USD/Yen	0.6%	1.0%	0.3%	113.83
Pound/USD	0.0%	-4.0%	-1.3%	1.30

Source: Bloomberg. As of Nov. 9, 2018. Notes: Weekly data through Friday. Equity and bond performance are measured in total index returns in U.S. dollars. U.S. large caps are represented by the S&P 500 Index; U.S. small caps are represented by the Russell 2000 Index; non-U.S. world equity by the MSCI ACWI ex U.S.; non-U.S. developed equity by the MSCI EAFE Index; Japan, Emerging and Asia ex-Japan by their respective MSCI indexes; U.S. Treasuries by the Bloomberg Barclays U.S. Treasury Index; U.S. TIPS by the U.S. Treasury Inflation Notes Total Return Index; U.S. investment grade by the Bloomberg Barclays U.S. Corporate Index; U.S. high yield by the Bloomberg Barclays U.S. Corporate High Yield 2% Issuer Capped Index; U.S. municipals by the Bloomberg Barclays Municipal Bond Index; non-U.S. developed bonds by the Bloomberg Barclays Global Aggregate ex USD; and emerging market $ bonds by the JP Morgan EMBI Global Diversified Index. Brent crude oil prices are in U.S. dollars per barrel, gold prices are in U.S. dollar per troy ounce and copper prices are in U.S. dollar per metric ton. The Euro/USD level is represented by U.S. dollar per euro, USD/JPY by yen per U.S. dollar and Pound/USD by U.S. dollar per pound. Index performance is shown for illustrative purposes only. It is not possible to invest directly in an index. Past performance is not indicative of future results.

3 Week ahead

Nov. 13 OPEC Monthly Oil Market Report; Germany ZEW Economic Sentiment Index

Nov. 14 IEA Oil Market Report; U.S. Consumer Price Index; Japan Q3 GDP; eurozone Q3 GDP, industrial production; China retail sales, industrial production, fixed asset investment

Nov. 15 U.S. retail sales, import price index, business inventories

Nov. 16 U.S. industrial production

Investors this week will be digesting and parsing over data from a timely gauge of Chinese retail sales: "Singles Day" shopping. China's unofficial Nov. 11 holiday celebrating singles has become the world's largest shopping event, eclipsing Black Friday and Cyber Monday in the U.S. Revenue growth and details on categories faring well will provide insight on Chinese consumer trends, an increasingly important part of China's growth outlook as the country rebalances its economy away from heavy industry. In addition, both the U.S. and China will release retail sales for October.

Asset class views

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

Asset class		View	Comments
Equities	U.S.	▲	Solid corporate earnings and strong economic growth underpin our positive view. We still like the momentum factor, but have a growing preference for quality as the 2019 macro and earnings outlooks become more uncertain. Technology tops our list of favored sectors.
	Europe	▼	Relatively muted earnings growth, weak economic momentum and political risks are challenges. A value bias makes Europe less attractive without a clear catalyst for value outperformance. We prefer higher-quality, globally-oriented names.
	Japan	—	We see a weaker yen, solid corporate fundamentals and cheap valuations as supportive, but await a clear catalyst to propel sustained outperformance. Other positives include shareholder-friendly corporate behavior, central bank stock buying and political stability.
	EM	▲	Attractive valuations, along with a backdrop of economic reforms and robust earnings growth, support the case for EM stocks. We view financial contagion risks as low. Uncertainty around trade is likely to persist, though a lot of it has been priced in. We see the greatest opportunities in EM Asia on the back of strong fundamentals.
	Asia ex-Japan	▲	The economic and earnings backdrop is encouraging, with near-term resilience in China despite slower credit growth. We like selected Southeast Asian markets but recognize a worse-than-expected Chinese slowdown or disruptions in global trade would pose risks to the entire region.
Fixed income	U.S. government bonds	▼	Sustained growth, rising inflation and fiscal stimulus point to ongoing Fed normalization. We still prefer the short end, but longer maturities are starting to look more attractive as we see limited further upside for rates. We see improved valuations on inflation-linked debt adding to its appeal. We find reasonable longer-term value in mortgages, but see short-term challenges as the Fed winds down its mortgage holdings.
	U.S. municipals	—	Solid retail investor demand and muted supply are supportive, but rising rates could weigh on absolute performance. We prefer a neutral duration stance and up-in-quality bias in the near term. We favor a barbell approach focused on two- and 20-year maturities.
	U.S. credit	—	Sustained growth supports credit, but high valuations limit upside. We favor investment grade (IG) credit as ballast to equity risk. We believe higher-quality floating rate debt and shorter maturities look well positioned for rising rates.
	European sovereigns	▼	Yields are unattractive relative to global peers and vulnerable to the potential of an improving growth outlook. We see core eurozone sovereigns as ballast against ongoing political risks. Peripheral spreads reflect quite a bit of risk. Rising rate differentials have made high-quality European sovereigns more appealing for global investors with currency hedges.
	European credit	—	Valuations are attractive, particularly on a hedged basis for U.S. dollar investors. We favor subordinated financial debt, where yields are more attractive. We also prefer European over UK credit as the market is not pricing in a significant Brexit premium. Industrials and financials are favored sectors. Political uncertainty is a concern.
	EM debt	—	We prefer hard-currency over local-currency debt and developed market corporate bonds. Slowing supply and broadly strong EM fundamentals add to the relative appeal of hard-currency EM debt. Trade conflicts and a tightening of global financial conditions call for a selective approach.
	Asia fixed income	—	Stable fundamentals, cheapening valuations and slowing issuance are supportive. China's representation in the region's bond universe is rising. Higher-quality growth and a focus on financial sector reform are long-term positives, but a sharp China growth slowdown would be a challenge.
Other	Commodities and currencies	*	A reversal of recent oversupply is likely to underpin oil prices. Trade tensions add downside risk to industrial metal prices. We are neutral on the U.S. dollar. Rising global uncertainty and a widening U.S. yield differential with other economies provide support, but an elevated valuation may constrain further gains.

▲ Overweight — Neutral ▼ Underweight *Given the breadth of this category, we do not offer a consolidated view.BII1118U/E-655357-2034999

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