BLACKROCK INVESTMENT INSTITUTE

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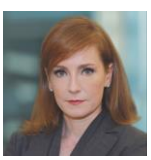

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Key points

1. Oil prices could be close to a trough and we see selected opportunities emerging ahead of a recovery.
2. The U.S. and China put further tariffs on hold for 90 days. We see this boosting risk assets in the short run.
3. Economists expect strong U.S. non-farm payrolls growth in November, and the data will offer a key signal ahead of the Fed's December meeting.

1 Opportunities as oil nears bottom

Oil prices are in a bear market. Both Brent (the international price benchmark) and WTI (the American benchmark) have declined more than 30% from 2018 highs. Where does oil go from here? We see oil prices near their nadir and a potential price recovery opening up opportunity for investors.

Chart of the week

Crude oil price and OPEC production curbs, 2016-2018

Past performance is not a reliable indicator of current or future results. Source: BlackRock Investment Institute, with data from Thomson Reuters, November 2018. Notes: The chart shows cumulative Brent oil price performance starting 60 trading days before three prior OPEC production curb announcements and the bloc's upcoming meeting. The dates reflect an OPEC cut on Nov. 30, 2016, and cut extensions on May 25 and Nov. 30, 2017. The orange line leads into the next OPEC meeting on Dec. 6.

One reason oil prices may be near a bottom: production appears set to decline after oversupply concerns contributed to the recent rout. The Organization of the Petroleum Exporting Countries (OPEC) and its partners are expected to cut production at their meeting this week in an effort to help stabilize prices. OPEC curbs since 2016 have had that effect, as shown above. Brent popped on news of the first cut in November 2016 and stabilized with curb extensions. We estimate a cut of roughly 1.2 million barrels per day this round. This is in the middle of the consensus range, as we see U.S. production growing slightly less than some market participants, but enough to help manage oversupply, in our view. Pressure from the U.S. government to avoid high prices may limit the size of the cut and could inject some downside, however.

Where does oil go from here?

Global oil inventories saw the largest quarterly increase in three years last quarter. Oversupply concerns are poised to fade, however, with the potential OPEC cut, expiring Iranian sanction waivers and production decreases from many U.S. producers amid lower oil prices. Yet the recent selloff wasn't only about supply. Other contributors: Fears of weakening demand amid worries about a global growth slowdown have played a role, while price declines have been exacerbated by market participants unwinding long positions built on earlier speculation of higher oil prices, evident in U.S. Commodity Futures Trading Commission data. Our BlackRock GPS shows solid, albeit slowing, global growth, which should underpin near-term demand and market sentiment. And refiners' recent weak demand is not concerning, in our view, as many refineries were shut down for seasonal maintenance.

Energy equities and debt have suffered along with crude to varying degrees. Energy stocks underperformed spot oil prices at the beginning of the selloff but recently have declined only about half as much. Yet we believe the recent price reset may offer an attractive entry point as capital discipline and balance sheet management remain priorities for many energy companies. We see some opportunities for investors willing to stomach volatility. Within energy equities, we prefer midstream firms focused on oil storage and transportation. Their high-yielding nature may offer a buffer in a risk-off environment. We also favor oil field service companies longer term, as U.S. shale is needed to help meet global demand in the 2020s. In fixed income, we prefer midstream companies in the investment grade space and selected high-quality exploration & production firms.

More broadly, global equities appear less sensitive to oil price fluctuations than in the past. An oil price rebound driven by higher demand amid above-trend global growth may be good for risk assets. A supply adjustment that puts a floor under oil prices may not have as widespread an impact. Stabilization in the oil price should help global markets going forward, but we expect there will be winners and losers, particularly in some emerging markets. Markets in oil-exporting countries could benefit from stabilizing prices, though a big bounce could hurt markets in importing countries with current account issues.

2 Week in review

- Federal Reserve Chair Jerome Powell said he sees U.S. interest rates as "just below the broad range of estimates" of neutral. Risk assets rallied, as markets interpreted the comments as a sign that the pace of future policy tightening in the U.S. may be slower than previously anticipated. Equities rose, led by U.S. and tech stocks and the momentum factor, and U.S. Treasury yields fell.
- U.S. President Donald Trump and Chinese President Xi Jinping agreed to work together to resolve their trade dispute and put further tariffs on hold for 90 days. We see this outcome boosting global risk appetite in the short term.
- The U.S. core Personal Consumption Expenditures index rose 1.8% in October from a year earlier, below the 1.9% growth expected and the lowest level since February.

Global snapshot

Weekly and 12-month performance of selected assets

Equities	Week	YTD	12 Months	Div. Yield
U.S. Large Caps	4.9%	3.2%	4.3%	2.0%
U.S. Small Caps	3.0%	1.0%	0.6%	1.3%
Non-U.S. World	1.4%	-10.1%	-8.1%	3.5%
Non-U.S. Developed	1.0%	-9.4%	-7.9%	3.6%
Japan	1.5%	-6.6%	-6.0%	2.4%
Emerging	2.7%	-12.2%	-9.1%	3.0%
Asia ex-Japan	2.9%	-12.0%	-9.6%	2.9%

Bonds	Week	YTD	12 Months	Yield
U.S. Treasuries	0.1%	-1.3%	-1.0%	3.0%
U.S. TIPS	0.3%	-1.8%	-0.9%	3.1%
U.S. Investment Grade	-0.2%	-3.9%	-3.0%	4.4%
U.S. High Yield	0.4%	0.1%	0.4%	7.2%
U.S. Municipals	0.5%	0.1%	1.1%	2.9%
Non-U.S. Developed	-0.2%	-4.3%	-4.0%	1.0%
EM $ Bonds	0.5%	-5.5%	-4.8%	7.0%

Commodities	Week	YTD	12 Months	Level
Brent Crude Oil	-0.2%	-12.2%	-7.6%	$58.71
Gold	-0.2%	-6.3%	-4.3%	$1,221
Copper	-0.1%	-14.5%	-8.3%	$6,198

Currencies	Week	YTD	12 Months	Level
Euro/USD	-0.2%	-5.7%	-4.9%	1.13
USD/Yen	0.5%	0.8%	0.9%	113.57
Pound/USD	-0.5%	-5.7%	-5.7%	1.27

Source: Bloomberg. As of Nov. 30, 2018. Notes: Weekly data through Wednesday. 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

Dec. 3 China Caixin and U.S. ISM Manufacturing PMIs

Dec. 5 U.S. Fed Beige book, Fed Chair Powell will testify before the U.S. Senate's Joint Economic Committee

Dec. 6 OPEC meeting; U.S. trade data, factory orders

Dec. 7 U.S. employment report; German industrial production, German CDU party convention (Dec. 7-8)

Markets will be looking to Friday's employment report as a key signal ahead of the Fed's Dec. 18-19 meeting, especially in light of the initially dovish interpretation of Fed Chair Powell's comments last week. Consensus expectations are for a solid report showing more than 200,000 jobs added, following a strong print of 250,000 jobs gained in October. Average hourly earnings are expected to increase 3.1%, in line with October's report. Such data would confirm a U.S. economy still operating at a very solid level.

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.BII1218U/E-681505-2103086

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