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WEEKLY COMMENTARY • JAN. 7, 2019

Key points

1 We highlight three key events: the January Federal Reserve meeting, a potential end to the U.S.-China trade war truce, and looming Brexit.

2 Risk assets rallied on strong U.S. job market data, Fed Chairman Jerome Powell's perceived dovish comments and China's bank reserve ratio cuts.

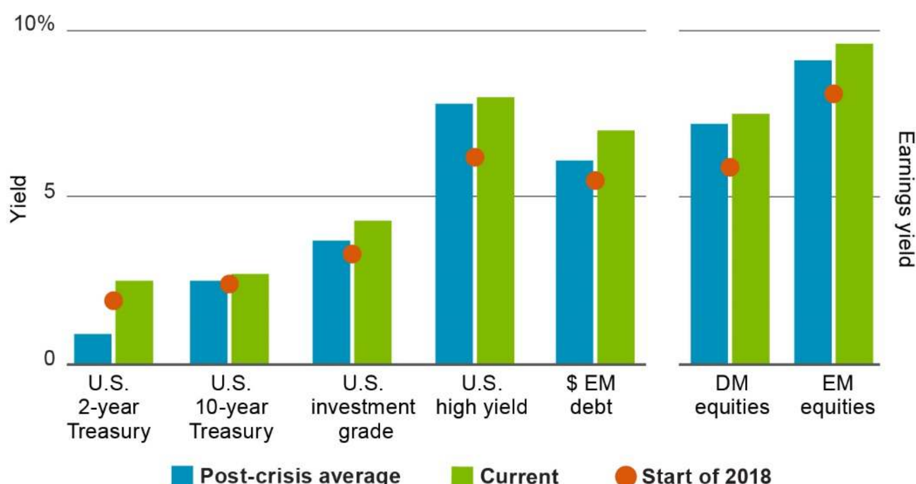
3 Any downside surprise in this week's U.S. consumer price index (CPI) inflation data could further weigh on U.S. government bond yields.

1 Three key dates for markets this quarter

Will the Fed take a breather from its quarterly pace of rate hikes? The policymakers' Jan. 29-30 meeting will be a key event in the first quarter, as the U.S. economy nears late cycle and financial conditions tighten. Both Fed policymakers and the markets will be laser-focused on economic data for clues about the health of the global economy.

Chart of the week

Asset yields, January 2019 vs. post-crisis average and start of 2018



Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index. Source: BlackRock Investment Institute, with data from Thomson Reuters, January 2019. Notes: The post-crisis average is measured from the start of 2009 through Jan. 2, 2019. Equity market yields are represented by 12-month forward earnings yields. Indexes used from left to right are: Thomson Reuters Datastream 2-year and 10-year U.S. Government Benchmark Indexes, Bloomberg Barclays U.S. Credit Index, Bloomberg Barclays U.S. High Yield Index, JP Morgan EMBI Global Diversified Index, MSCI World Index and MSCI Emerging Markets Index.

Asset valuations cheapened significantly in 2018 – as uncertainty increased and the Fed raised rates. Equity valuations are back in line with post-crisis averages, as gauged by earnings yields. See the chart above. We enter 2019 with less-demanding valuations and risks better reflected in many asset prices. Yet fears over an economic slowdown and trade conflicts loom large. U.S. stocks in December posted their worst month since February 2009, while perceived "safe havens" such as gold, the Japanese yen and U.S. government bonds garnered more interest. Ten-year U.S. Treasury yields fell to the lowest levels since early 2018 (as prices rallied), underscoring government bonds' diversification benefits during risk-off events. Our 2019 Global investment outlook offers further details on how to balance risk and reward in today's environment.

The Fed, trade and Brexit

We see the Fed becoming more cautious as U.S. interest rates near neutral – the level at which monetary policy neither stimulates nor restricts growth. The Fed reiterated its tightening bias in December, citing a still robust growth backdrop. But the policymakers' median rate expectations for 2019 dropped to two hikes from three, the latest "dot plot" projection shows – in line with our base case. The impetus: a softer growth and inflation outlook. The January meeting could provide clues to the Fed's future path. We see a pause in March looking increasingly likely, as the Fed weighs the impact of tightening financial conditions and economic fundamentals.

A second key date: the potential end of the 90-day trade war truce between the U.S. and China on March 1. A lack of clarity as to what was agreed between U.S. President Donald Trump and China's President Xi Jinping on Dec. 1 highlights the fragility of the truce. Recent steps taken by China to increase its purchases of U.S. goods, protect intellectual property and further open its economy could lead to an extension of the truce, but we expect structural tensions related to China's industrial policy and competition for global technology leadership to persist. Negotiations between the two sides are set to resume this week.

The third key date: March 29, when the UK is scheduled to leave the European Union (EU). The UK needs to agree on a withdrawal deal with the EU to avoid a messy exit. Yet the odds of the parliament passing Prime Minister Theresa May's current deal with the EU look very low given deep domestic political division. A change of path is likely necessary, but we don't see a clear direction. We still put a low probability on a "no-deal" Brexit, though the valuation of the British pound appears to reflect significant fears of a disruptive exit.

Bottom line: Uncertainty around key events is likely to stoke volatility, arguing for greater portfolio resilience in 2019. We prefer a barbell approach: exposures to government debt as a portfolio buffer on one side and allocations to assets offering attractive risk/return prospects such as quality and EM stocks on the other. This includes steering away from assets with more downside than upside potential, such as European equities and European sovereign bonds.

2 Week in review

- A strong U.S. job market report eased worries about weakening growth that had driven risk assets to deep losses since early December. China's central bank cut bank reserve requirements to shore up lending and growth. Fed Chairman Powell pledged that the central bank is sensitive to risks and will be patient with its monetary policy in 2019, and expressed confidence in solid U.S. economic momentum.
- Global stocks rallied with other risk assets late in the week, reversing earlier declines. U.S. Treasury yields rose. Equity and credit market liquidity started to normalize after some tightness in late December. Saudi Arabia's lower crude exports helped drive oil up.
- Global manufacturing data were lackluster. U.S. manufacturing activity fell to a two-year low, according to Institute for Supply Management (ISM) data. China's factory activity shrank for the first time in over two years, Purchasing Managers' Index (PMI) data show. Eurozone's activity slowed to the lowest since early 2016 – though still in the expansionary territory.

Global snapshot

Weekly and 12-month performance of selected assets

Equities	Week	YTD	12 Months	Div. Yield
U.S. Large Caps	1.9%	1.0%	-5.2%	2.3%
U.S. Small Caps	3.2%	2.4%	-10.1%	1.8%
Non-U.S. World	1.2%	0.8%	-15.3%	3.8%
Non-U.S. Developed	1.4%	1.0%	-14.5%	4.0%
Japan	0.5%	-0.1%	-15.2%	2.7%
Emerging	0.2%	-0.1%	-17.1%	3.4%
Asia ex-Japan	-1.0%	-1.4%	-17.8%	3.2%

Bonds	Week	YTD	12 Months	Yield
U.S. Treasuries	0.5%	0.2%	1.4%	2.7%
U.S. TIPS	0.7%	0.5%	-0.6%	2.8%
U.S. Investment Grade	0.4%	0.2%	-2.0%	4.2%
U.S. High Yield	1.4%	1.2%	-1.5%	7.7%
U.S. Municipals	0.4%	0.3%	1.6%	2.6%
Non-U.S. Developed	0.8%	0.6%	-1.8%	0.9%
EM $ Bonds	0.9%	1.0%	-3.7%	6.7%

Commodities	Week	YTD	12 Months	Level
Brent Crude Oil	9.3%	6.1%	-16.2%	$57.06
Gold	0.4%	0.3%	-2.8%	$1,286
Copper	-1.3%	-0.8%	-17.7%	$5,918

Currencies	Week	YTD	12 Months	Level
Euro/USD	-0.4%	-0.6%	-5.6%	1.14
USD/Yen	-1.6%	-1.1%	-3.8%	108.51
Pound/USD	0.2%	-0.2%	-6.1%	1.27

Source: Bloomberg. As of Jan. 4, 2019. 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

Jan. 7-8 The U.S. and China hold trade talks in Beijing

Jan. 9 Federal Open Market Committee Dec. 2018 meeting minutes; eurozone unemployment rate

Jan. 10 China CPI and producer price index (PPI)

Jan. 11 U.S. CPI

U.S. CPI data are in focus this week – especially as falling inflation expectations have been a primary driver behind the recent sharp decline in U.S. government bond yields. Consensus estimates point to a December core CPI reading of 2.2% year-on-year, the same as the previous month. A lower-than-expected number could put further downward pressure on Treasury yields. Our BlackRock Inflation GPS suggests the U.S. core CPI reading should remain slightly above the Fed's 2% target over the next six months.

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 ongoing economic expansion underpin our positive view. We have a growing preference for quality companies with strong balance sheets as the 2019 macro and earnings outlooks become more uncertain. Health care is among our favored sectors.
	Europe	▼	Weak economic momentum and political risks are challenges to earnings growth. A value bias makes Europe less attractive without a clear catalyst for value outperformance. We prefer higher-quality, globally-oriented names.
	Japan	—	We see solid corporate fundamentals and cheap valuations as supportive, but the market lacks a clear catalyst for sustained outperformance. Other positives include shareholder-friendly corporate behavior, central bank stock buying and political stability.
	EM	▲	Attractive valuations, coupled with a backdrop of economic reforms and policy stimulus, support the case for EM stocks. We view financial contagion risks as low. Uncertainty around trade is likely to persist, though much has been priced in. We see the greatest opportunities in EM Asia.
	Asia ex-Japan	▲	The economic backdrop is encouraging, with near-term resilience in China and solid corporate earnings. 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	—	U.S. Treasuries are an attractive offset to equity risk, particularly as U.S. interest rates near neutral and upward rate pressure eases. Weakening economic fundamentals and a slowdown in Fed normalization would support Treasuries. We see reasonable value in mortgages. Inflation-linked debt has cheapened, but we see no obvious catalyst for outperformance.
	U.S. municipals	—	Solid demand for munis as a tax shelter and expectations for muted issuance should support the asset class. We prefer a long duration stance, expressed via a barbell strategy focused on two- and 20-year maturities.
	U.S. credit	—	Solid fundamentals support credit markets, but late-cycle economic concerns pose a risk to valuations. We favor an up-in-quality stance with a preference for investment grade credit. We hold a balanced view between high yield bonds and loans.
	European sovereigns	▼	Yields are relatively unattractive and vulnerable to any growth uptick. Rising rate differentials have made European sovereigns more appealing for global investors with currency hedges. Italian spreads reflect quite a bit of risk.
	European credit	—	Valuations are attractive, particularly on a hedged basis for U.S. dollar investors. We see opportunities in industrials but are cautious on other cyclical sectors. We favor senior financial debt that would stand to benefit from any new ECB support, over subordinated financials. We prefer European over UK credit on Brexit risks. 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. Any relaxation in trade tensions could signal upside to industrial metal prices. We are neutral on the U.S. dollar. It maintains "safe-haven" appeal but gains could be limited by a high valuation and a narrowing growth gap with the rest of the world.

▲ Overweight — Neutral ▼ Underweight *Given the breadth of this category, we do not offer a consolidated view.BIIM0119U/E-705506-3/4

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