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# 2020 Midyear Outlook The Future is Running at Us

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C20-16607 | 09/2020 | EXP 09/30/2021

**BlackRock®**

# 2020 midyear outlook

 BlackRock  
Investment  
Institute

**The future is running at us**



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**The future is running at us. The coronavirus shock is accelerating structural trends in inequality, globalization, macro policy and sustainability. This is fundamentally reshaping the investment landscape and will be key to investor outcomes. Our three new investment themes – *Activity restart, Policy revolution and Real resilience* – are meant to reflect the rapidly changing world. The most important action investors need to take today, in our view, is to review their strategic asset allocation to ensure portfolios are resilient to the supercharged trends.**

The initial Covid-19 contraction is larger than the great financial crisis, but we believe its cumulative impact on the economy will likely be less as long as the policy response remains strong enough to cushion the blow.

Normal business cycle dynamics do not apply, so we are tracking three signposts: how successful economies are at restarting activity while controlling the virus spread; whether stimulus is still sufficient and reaching households and businesses; and whether any signs of financial vulnerabilities or permanent scarring of productive capacity are emerging. Markets are laser-focused on changes in any of these three “known unknowns,” and a possible second wave of infections and policy fatigue are major risks in the second half.

The shock will have long-term consequences that are starting to play out. Policymakers are funnelling money directly to the (non-financial) private sector, with debt monetization a possibility down the road. The pandemic is reinforcing structural trends such as ecommerce and sustainability; amplifying deglobalization and geopolitical fragmentation; and may deliver a generational shock to the emerging world.

Investors grapple with these issues today. This is why our virtual Midyear Outlook Forum focused on structural trends – and why we emphasize three strategic calls.

First, central banks have committed to keep rates low, enabling an unprecedented fiscal expansion. Combined with the risk of supply shocks, this raises the potential for higher inflation in the medium term and challenges the role of nominal government bonds as ballast over a strategic horizon. Second, the pandemic has accelerated a tectonic shift toward sustainability. Third, deglobalization and fragmentation call for a focus on real resilience: diversifying across companies, sectors and countries that are positioned well for these trends.

On a tactical horizon, we are modestly pro-risk, with an overweight in corporate credit. We prefer up-in-quality assets with strong policy backstops. One of our highest-conviction views is an increased overweight to the quality factor. We upgrade European equities to overweight as the most attractive exposure to a cyclical uptick. We cut U.S. equities to neutral after a stretch of outperformance as we see risks of fading fiscal stimulus and election uncertainty.

# The future is now

The focus of the BlackRock Investment Institute's virtual – but no-less real – Midyear Outlook Forum in early June was decisively on longer-term trends. The Covid-19 shock has pushed the world harder against four key limits we identified at our November forum: inequality, globalization, macro policy and sustainability.

The public health and ensuing economic crisis are exacerbating entrenched forms of inequality across income levels, race and countries. Many emerging markets (EMs) are facing health, policy and deglobalization challenges. From an investment perspective, the group's heterogenous nature creates dispersion and opportunities. See page 9.

The pandemic has exposed vulnerabilities of global supply chains, and added impetus to geopolitical fragmentation. See page 8. It has led to a policy revolution that blurs the boundaries between fiscal and monetary action – and could address some of the rising inequalities. This is positive for markets in the short run but may be less so in the medium term. See page 6. And it has put a premium on sustainability, corporate responsibility and resilience of companies, sectors and countries. See pages 7 and 12.

Market sentiment has been driven by the pandemic's near-term evolution and the policy response, but these structural limits are transforming the investment landscape and will be significant to investment outcomes.

The world has changed, leading us to a completely new macro framework and major view changes. Our revamped 2020 investment themes reflect this, and now include strategic, or long-term, implications. See the boxes on the right.

Our current macro view is captured by the "Activity restart" theme as economies reopen at different speeds. See page 5.

A policy revolution is taking place to cushion the pandemic's impact, making this our second theme. See page 6.

Our third theme is "Real resilience." Financial resilience of portfolios – such as the diversification of equity risk through government bond allocations – will not be enough to offset the real economic changes that we see in motion, in our view. See page 7.

What is needed is a reassessment of the whole portfolio, not just tweaking its edges. This is why we are focused on the big strategic changes investors should consider making now. See pages 10-12.

## Activity restart

Economies are slowly restarting, but at different paces. We are tracking the evolution of the virus and mobility. The longer it takes for activity to restart, the more cracks might appear in the financial system.

**Strategic implication:** We are moderately pro risk, and express it in an overweight to credit.

**Tactical implication:** We have closed our underweights in cyclical assets, with a preference for Europe.

## Policy revolution

The policy revolution was needed to cushion the devastating and deflationary impact of the virus shock. In the medium term, however, the blurring of monetary and fiscal policy could bring about upside inflation risks.

**Strategic implication:** We are underweight nominal government bonds and like inflation-linked bonds.

**Tactical implication:** We like credit, partly on central bank purchases. U.S. stocks are at risk of fading fiscal stimulus.

## Real resilience

Supercharged structural trends will change the nature of portfolio diversification. Countries and sectors will make a comeback as diversifiers in a more fragmented world, in our view, offering resilience to real economy trends.

**Strategic implication:** We favor sustainable assets, private markets and deliberate country diversification.

**Tactical implication:** We have increased our overweight in the quality factor and prefer assets with policy backstops.

# Sizing the shock

The virus shock is entirely different from the normal business cycle. Global economic activity was deliberately frozen to stem the pandemic. The initial shock was sudden and very deep. Yet what matters for asset pricing is the cumulative impact of the growth shortfall over time.

The policy actions to cushion the impact of the virus shock are nothing short of a revolution. Execution remains a risk, but if successful, we see the cumulative economic damage even under the currently most bearish forecasts as below that in the wake of the 2008 global financial crisis. See [How large is the coronavirus shock?](#)

History offers little insight on the path of economic reopening—or on how asset prices should react. Ahead of us is a “restart” of economic activity, with many uncertainties around how quickly people and companies will feel comfortable to resume their pre-pandemic activities.

The longer it takes for activity to restart, the more cracks might appear in the financial system and productive capacity. That leaves us with three key risks: renewed infection waves, policy exhaustion and any permanent damage to the economy.

We use signposts for tracking these risks in real time:

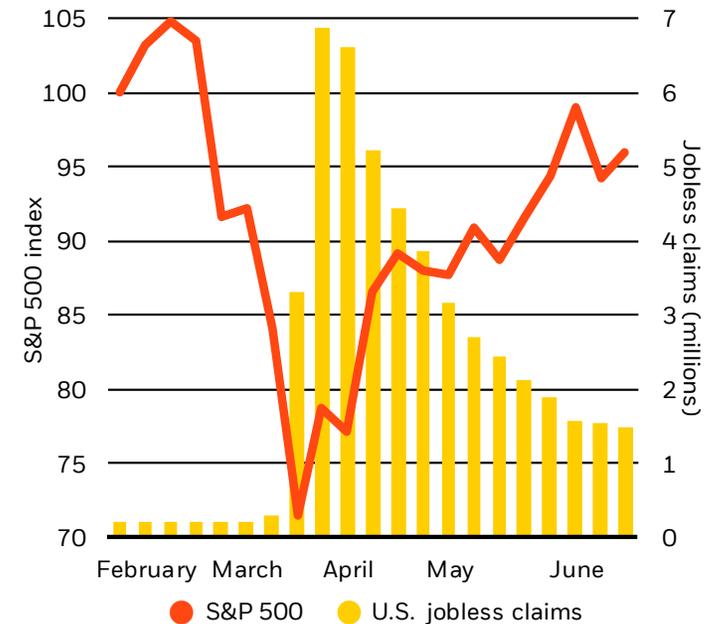
1. Tracking the interplay of mobility, virus spread and containment measures on activity as economies start to reopen (page 5).
2. Monitoring whether policy measures to cushion the shock are reaching households and businesses, and whether fiscal stimulus is fading too fast (page 6).
3. Watching for emerging signs of financial vulnerabilities and any permanent scarring of productive capacity.

The shock was like a natural disaster – and very visible. Markets priced in the impact before the horrendous job losses materialized. The unprecedented policy response initially helped turn risk assets around in late March. Once the extent of the damage became clear in April, markets looked forward to the reopening of economies and eventual recovery. See the *Very visible shock* chart.

As such, there doesn't appear to be a major disconnect between market pricing and the real economy. Yet setbacks on any of our signposts could hit risk assets.

## Very visible shock

S&P 500 Index vs. U.S. initial jobless claims, Feb–June 2020



Source: BlackRock Investment Institute, with data from Refinitiv Datastream, June 2020. Notes: The yellow bars show initial claims for U.S. unemployment insurance. The S&P 500 is indexed to 100 at Jan. 31. **Past performance is no guarantee of future results.** Indexes are unmanaged and are not subject to fees. It is not possible to invest directly in an index.

**Markets are focused on a return of economic activity, delivery of stimulus and signs of financial vulnerabilities.**

## Theme 1

# Activity restart

The pandemic and containment measures brought activity to a virtual standstill, delivering a historic shock to the economy. This is not a business cycle slowdown and recovery. That is why markets could see beyond the unprecedented contraction and started to recover well before any signs of a rebound in activity.

The near-term contraction is the worst since the Great Depression and far deeper than the global financial crisis (GFC), according to OECD forecasts. But the cumulative shortfall in GDP should only be a fraction of that in the wake of the GFC, [our analysis shows](#). The reason is the overwhelming policy response to cushion the pandemic's impact. We don't see the shock morphing into a financial crisis as long as these policies stay in place. See page 6.

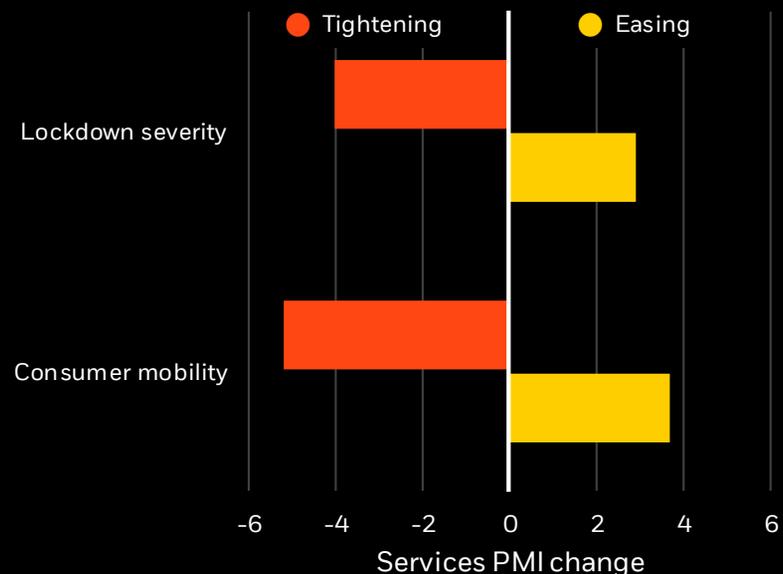
The longer it takes for activity to normalize, the deeper the economic scars will be. We are tracking the interplay between containment measures and mobility changes and activity as economies start to reopen.

Mobility is key to tracking the virus shock. Metrics that gauge the movement of people using mobile phone location data can help capture individual behaviors. They are more closely tied to economic activity than the severity of lockdowns, our analysis shows. See the *Asymmetrical assessment* chart. This means the response of people to the virus has more impact than government policies alone. We also find restricting mobility and imposing lockdowns has a bigger effect on the key services industry than easing those measures.

The pace of the activity restart depends on how successful countries are in suppressing the virus as they reopen. Our mobility research suggests the risk of renewed virus outbreaks may be highest in the U.S. among developed nations. China is on the leading edge of economic reopening. The pandemic's longer-term investment implications are about changing societal preferences, sectoral adjustments, digitalization and the relocation of global supply chains. Alternative data sources are key to getting a handle on this.

## Asymmetrical assessment

Impact of mobility and lockdown severity on services sector, June 2020



Sources: BlackRock Investment Institute, Oxford University and Google with data from Haver Analytics, June 2020. Note: This chart shows the impact that a 10-point move up or down in consumer mobility data and stringency measures have on the service sectors of the U.S., Japan, France, UK, Canada, Spain, Italy, Germany and Sweden. We use [Google](#) data on retail and recreation activity for the mobility score and [Oxford data](#) on lockdown stringency. "Tightening" means increased lockdown severity and reduced mobility. We use a panel regression to measure the effect of mobility on services activity and how this differs between tightening and easing.

**We find that measures of mobility are more closely tied to activity than the severity of lockdown measures. This suggests investors should focus on mobility rather than government rules.**

## Theme 2

# Policy revolution

There has been a much-needed policy revolution to cushion the coronavirus shock. Policymakers are relying less on financial sector transmission to stimulate activity – and more on direct support to the real economy. There is a blurring of fiscal and monetary policies as well as government intervention in the economy and financial markets.

The global policy response to the pandemic has been unprecedented in speed and size. The combined sum of fiscal and monetary actions is covering the virus hit to the economy in both the U.S. and euro area. See the *Filling the gap* chart. We now see a risk of policy fatigue in the U.S. as policymakers face a series of “fiscal cliffs” and may cut fiscal relief prematurely—one reason for our U.S. equities downgrade. By contrast, Europe has ramped up stimulus efforts. This partly underpins our upgrade of European stocks to overweight.

We wrote last August about the necessity for effective monetary and fiscal coordination in a major shock because it would help reduce lost output and could lessen risks such as rising inequality.

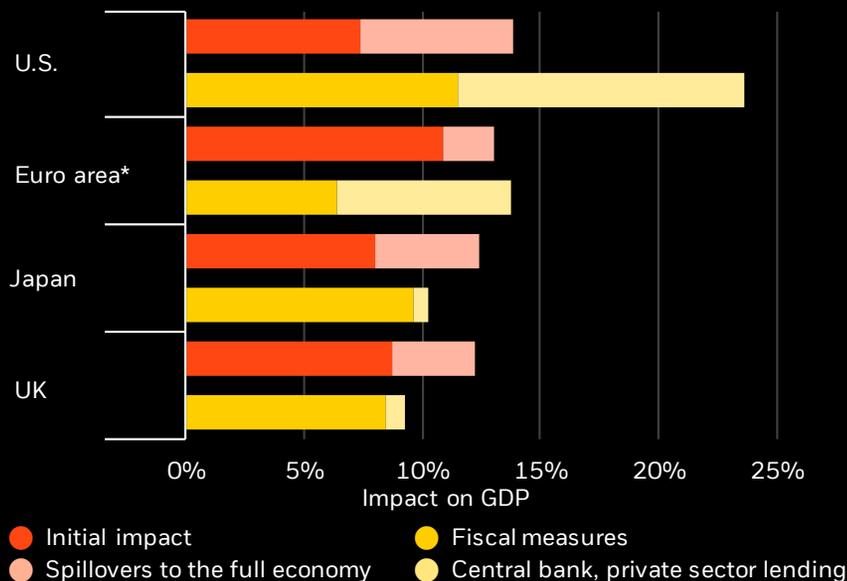
Without proper guardrails and a clear exit strategy, however, we warned of a medium-term risk of uncontrolled deficits with commensurate monetary expansion and, ultimately, rising inflation.

Where are we now? Debt has ballooned – so far without a rise in rates. If coordination made that possible, it could be tempting to continue even in normal times. But there is no free lunch. Debt rollover will become harder when rates rise. It may eventually have to be dealt with through austerity, default or inflation. Inflation could be seen as the most politically palatable solution. And even a well-designed monetary policy strategy may not prevent inflation over time due to deglobalization and re-regulation.

Our bottom line: The policy revolution was essential. It is a near-term positive for risk assets—but is unlikely to be the prelude to the type of policy-driven, decade-long bull market that followed the GFC. A key implication is reduced ballast of nominal government bonds over a strategic horizon. Rates are near their effective lower bounds, and we see inflation risks in coming years.

## Filling in the gap

Estimated virus hit to GDP vs. offsetting policy measures, 2020



\*The euro area is represented by averages of Germany, France, Italy and Spain.

Sources: BlackRock Investment Institute, with data from the Federal Reserve, ECB, BOJ, BOE and Haver Analytics, June 2020. Notes: The chart shows the magnitude of the negative shock (orange) and the associated positive policy response (yellow) as percentages of GDP. We use estimated 2020 targets for the U.S. and euro area central bank purchases and lending programs. The euro area includes the ECB's Targeted Longer-Term Refinancing Operations. The UK includes central bank support for the Term Funding Scheme.

**The policy revolution is essential to deal with the shock and is good news for markets in the short run. But that may not be the case in the medium term.**

## Theme 3

# Real resilience

Structural shifts are challenging the resilience of portfolios. With the policy revolution pushing yield curves close to their lower bounds, we see government bonds providing less diversification benefits in strategic allocations. See page 10.

Many assets are vulnerable to the physical and regulatory implications of climate change and other sustainability-related risks. The pandemic has sparked concerns about fragile supply chains and companies' social license to operate, accelerating a trend toward sustainable investing. See page 11.

China and the U.S. are intensifying their strategic rivalry across multiple dimensions, resulting in an increasingly bipolar world. See page 8. Investors need to balance the investment case for gaining exposure to both poles with possible investment restrictions on each side. Greater geopolitical fragmentation means that portfolio resilience will have to be driven by deliberate diversification across countries and regions.

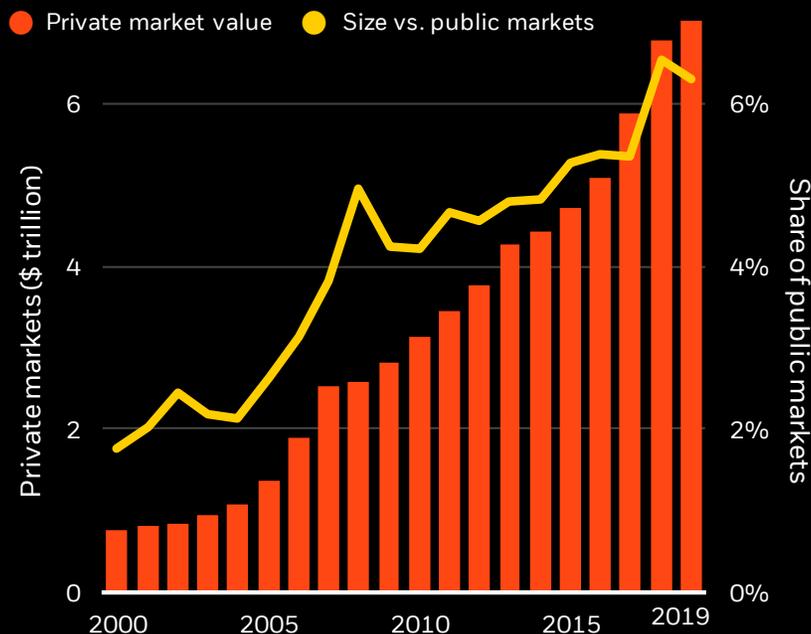
Investors need to embrace uncertainty in this environment. Our methodology for constructing portfolios explicitly takes into account fundamental uncertainty around long-term mean returns. The coronavirus shock only underscores the importance of uncertainty for building portfolio resilience. Structural portfolio resilience is much more than just relying on broad asset class correlations in public markets. It's making sure the portfolio is well positioned at the regional, country and company level to underlying themes.

Private markets, which are not suitable for all investors, offer this potential. Managers have a say in structuring the investments and are able to add custom-made resilience. Private markets can give exposures to emerging technologies and other real-economy trends not available in public markets, in our view. And they are bigger and deeper than ever. See the *Going private* chart.

Bottom line: The virus shock is creating new norms and accelerating structural trends. What is needed now is real resilience.

## Going private

Growth in private markets, 2000 -2019



Sources: BlackRock Investment Institute, with data from Preqin, June 2020. Notes: The bars represent the sum of net asset value of closed-end funds as well as dry powder of funds in these asset classes: private equity and venture capital, real estate, private debt, infrastructure and natural resources. The line shows the size of private markets relative to that of public markets.

**Structural portfolio resilience is much more than just relying on broad asset class correlations in public markets. It's making sure the portfolio is well positioned for underlying themes.**

Forum focus

# Geopolitics

The pandemic has added fuel to geopolitical dynamics already underway. The post-coronavirus world is likely to be characterized by four key themes: First, the world is increasingly becoming bifurcated, with the U.S. and China at opposite poles. Intense rivalry looks set to affect nearly every dimension of the U.S.-China relationship – regardless of the U.S. election outcome. Other countries will increasingly be pushed to choose sides. Decoupling is focused on – but not limited to – the technology sector. This means investors need exposure to both markets, especially as the center of gravity of global growth is moving to Asia, as the *Shifting center of gravity* chart shows.

Second, the pandemic is poised to accelerate deglobalization as it magnifies nationalist and protectionist trends. The crisis adds to existing pressures such as global trade tensions and populism. This threatens to disrupt the web of global supply chains at the expense of efficiency. It may lead to onshoring the production of strategic goods.

Third, government intervention in economies is likely to become more entrenched. Unprecedented policy support comes with strings attached – including curbs on share buybacks and dividend payouts – and companies increasingly will need a social license to operate. Lastly, the pandemic exacerbates inequalities within and across countries. It has hit hard emerging economies with more limited institutional capacity.

Domestic polarization is on the rise too, with the U.S. presidential election set to take place against the most tumultuous domestic backdrop since 1968. The two parties are as far apart on policy as they have ever been, making the result consequential for markets.

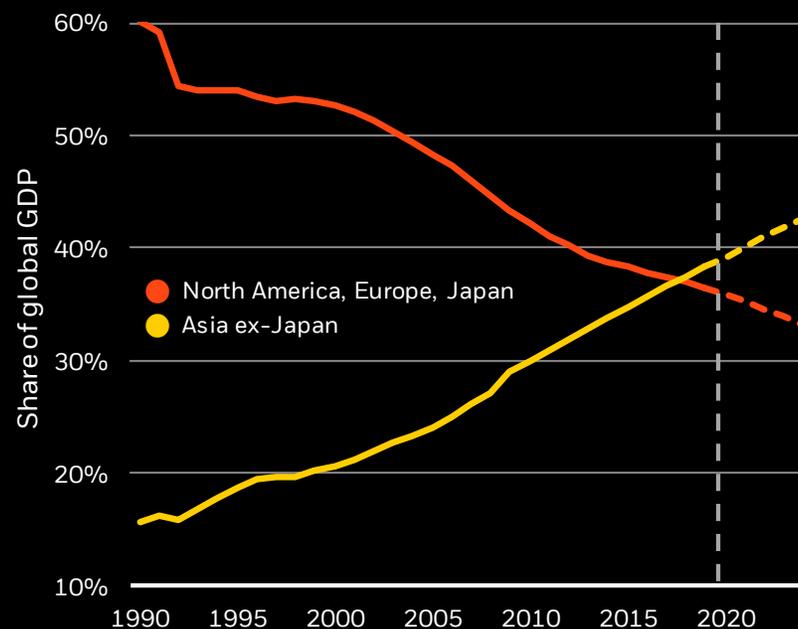
**“**  
**We face a far less globalized international system, with states playing a greater role in the private economy.**



**Tom Donilon**  
Chairman, BlackRock Investment Institute

## Shifting center of gravity

Regional share of global GDP, 1990-2024



Sources: BlackRock Investment Institute, with data from IMF, Refinitiv, June 2020. Notes: The lines show how each region’s combined share of global GDP on a purchasing power parity basis. The dotted lines show the forecast period based on IMF projections to 2024.

**The world looks increasingly bifurcated, with the U.S. and China at opposite poles as their rivalry intensifies. Investors should consider gaining exposure to both spheres.**

## Forum focus

# Emerging markets

Many emerging markets entered the crisis in stronger financial shape than in the past and – unlike in previous crises – let currencies depreciate as a release valve.

Many have weak public health systems, however, and the pandemic has not yet peaked. See the *Stark divergence* chart. Activity remains frozen in many EMs, debt levels are on the rise, and some have limited ability to cushion the virus shock. This challenges long-standing pillars of EM investing: strong growth, strong balance sheets and fiscal conservatism.

The shock's size—and ability to withstand it—varies greatly across EM countries, and the resulting dispersion offers opportunity.

We divide EM economies into three columns. First: those with relatively strong balance sheets and the policy space to weather the downturn. Many northern Asian economies, including China and South Korea, fit this bill. Second is a group of troubled economies with high external imbalances and rising indebtedness that face financial distress. The third group includes large EM economies such as Mexico, India and Russia, which face large economic shocks but likely have the tools to weather them. Our [Emerging markets marker](#) shows the diversity.

Bottom line: We downgrade broad EM equities and debt to tactical underweights, and see country and security selection as key.

**“EM investing has never been more compelling given the dispersion and resiliency to shocks of many economies.”**



**Sergio Trigo Paz**

Head of BlackRock Emerging Markets Fixed Income

**“A large number of emerging markets are not capable of handling the shock.”**

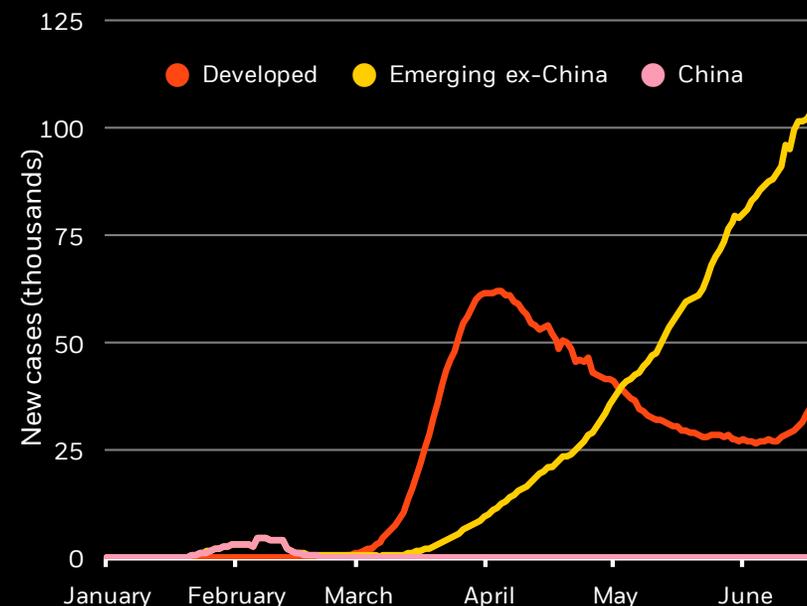


**Amer Bisat**

Head of Sovereign and Emerging Markets Alpha, BlackRock Global Fixed Income

## Stark divergence

New Covid-19 cases in developed and emerging markets, 2020



Source: BlackRock Investment Institute, with data from Oxford Covid-19 Government Response Tracker, June 2020. Notes: The chart shows the rolling 7-day average of new confirmed cases. DM countries are based on those in the MSCI World index; EM is based on countries in the MSCI Emerging Market index and MSCI Frontier Market index.

**The pandemic has dealt a generational shock to the emerging world. Yet the impact varies greatly across economies. This increases dispersion, and makes country and security selection crucial.**

## Strategic view 1

# The role of bonds

The traditional approach to building financial resilience in multi-asset portfolios has been to rely on nominal government bonds as a cushion against risk asset sell-offs. One consequence of the policy revolution – bond yields tethered by central bank intervention – challenges this and forces investors to seek out alternatives.

We expect negative returns across developed market government bonds on a five-year horizon given low and negative yields today. Also, the inverse correlation between bonds and stocks decreases as yields near perceived lower bounds, compromising bonds' ballast role. The underperformance of German and Japanese bonds in recent equity selloffs illustrates this.

Both these effects lead us to prefer reduced allocations to government bonds. We show this for an illustrative multi-asset portfolio in the *Fading case for nominal bonds* chart. If yield curve control were to cap yields as well as provide a floor for them, returns may be less punitive. This would result in a higher allocation (the third bar) than with a floor alone (the fourth).

No one asset can directly replace the ballast role of nominal government bonds, but we believe inflation-linked bonds offer an increasingly attractive alternative. Inflationary pressures could build up once the initial deflationary shock from the sizeable demand shortfall dissipates. Deglobalization, re-regulation and deficits are possible catalysts. And central banks will likely tolerate temporary overshoots above inflation targets.

Bottom line: Investors need to re-evaluate nominal government bond exposures in an environment of increased deglobalization, lower-for-longer yields and unprecedented policy action. We favor alternatives such as inflation-linked securities.

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**We can't expect nominal government bonds to provide as much ballast as they have in the past with yields so low.**

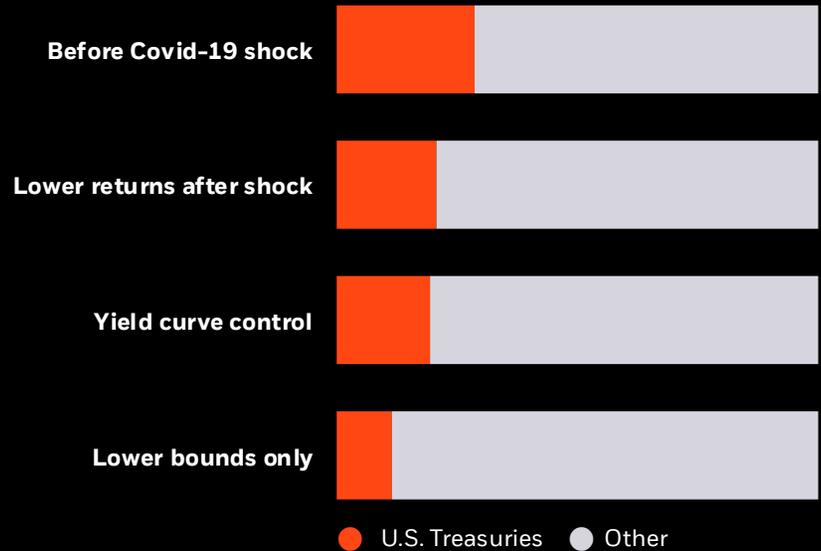


**Vivek Paul**

Senior Portfolio Strategist,  
BlackRock Investment  
Institute

## Fading case for nominal bonds

Illustrative U.S. Treasuries allocations in various scenarios, June 2020



Source: BlackRock Investment Institute, June 2020. Notes: The chart shows the allocation to nominal U.S. Treasuries in an illustrative multi-asset U.S. dollar portfolio with a conservative risk target of 6%, investing on a 10-year horizon. For the “lower returns after shock” scenario we use our latest capital market assumptions as of April 13, 2020. For allocations under the “yield curve control” scenario, we assume the Federal Reserve is explicitly capping yields at 1.5% and providing a floor of 0% for them. For the “lower bound” allocation we assume an effective lower bound of 0% for the Bloomberg Barclays U.S. government bond index.

**The cost-benefit calculus of holding nominal government bonds in strategic allocations has changed. Their ballast properties have weakened because of lower-for-longer rates, and the risks are greater due to rising inflation risks.**

## Strategic view 2

# Diversification

Globalization led to growing cross-border flows and integrated consumer markets, with differences between companies, countries and regions dissipating. Now, the world is becoming more fragmented, with the U.S. and China at opposite poles.

We see return dispersion growing across regions as a result. This creates more diversification potential – as in the rapidly decoupling U.S. and Chinese tech industries. Investors will likely need strategic exposure to both markets, as we see two main but separate engines of global growth ahead.

State intervention in economies and policy will vary greatly by country. The pandemic is exacerbating inequalities within and across countries, and magnifying protectionist trends. All this questions the usefulness of broad asset classes such as EM, and makes “real resilience” critical, through considered diversification across countries and sectors. Most portfolios have yet to embrace this new normal, as investors are traditionally focused on using broad asset classes to diversify.

Mainstays of portfolio diversification – such as U.S. Treasuries – may be less effective in this role going forward. By contrast, geopolitical bifurcation and higher inflation could raise the diversification potential of assets such as Chinese government bonds and inflation protected securities over time. See the *Outdated diversification* chart. We also see a bigger role for private markets, both for diversification and exposure to real-economy trends.

Bottom line: We believe asset class diversification alone is not going to work anymore. Granular analysis at the country and sector level is crucial to understanding exposure to the structural limits that will be tested in the post-Covid-19 world.

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**The old data sources and existing playbooks are simply not enough to navigate this changing landscape.**

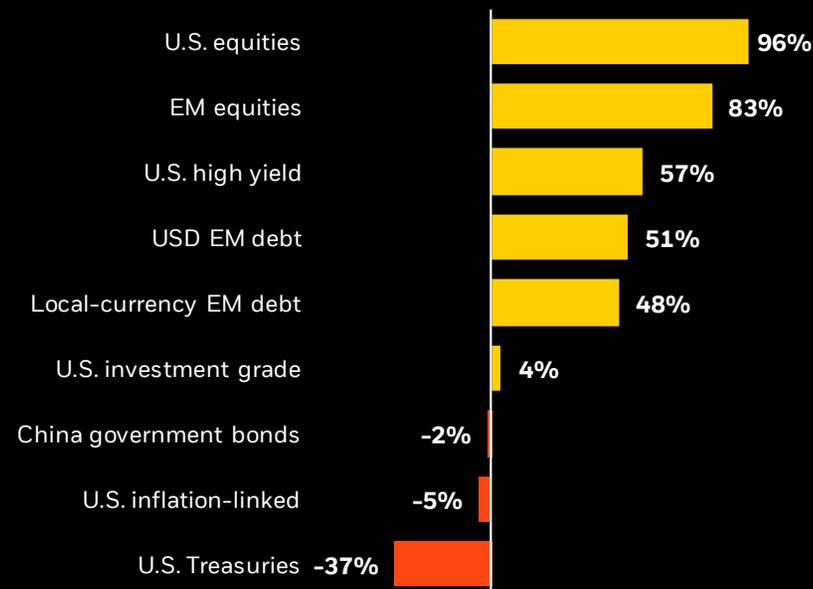


**Maura Farley, CFA**

Investment grade credit analyst – BlackRock Global Fixed Income

## Outdated diversification

Historical 20-year asset correlations with global equities



This information is not intended as a recommendation to invest in any particular asset class or strategy or as a promise or even estimate of future performance. Source: BlackRock Investment Institute, June 2020. Notes: The chart shows the historical 20-year correlation of weekly returns with global equities. Indexes used: MSCI USA, MSCI Emerging Markets, Bloomberg Barclays U.S. High Yield, JP Morgan EMBI Diversified, JP Morgan GBI-EM, Bloomberg Barclays U.S. Credit, Bloomberg Barclays Aggregate China, U.S. Inflation-Linked and U.S. Treasuries.

**Achieving real resilience goes beyond broad asset class diversification. It requires considered diversification across country and sector exposures that can thrive in the new normal.**

## Strategic view 3

# Sustainability

The pandemic has supercharged a shift toward sustainability. Assets at environmental, social and governance (ESG)-mandated funds in the U.S. exceeded last year's record levels at the end of May, even as markets had sold off. See the *Sustainable assets* chart.

Sustainable flows are in their early stages, in our view, and the sustainability wave will unfold over years and decades. Importantly, a return advantage may be gained during the transition to a more sustainable world, as we argued in [Sustainability: the tectonic shift transforming investing](#). We also believe markets still under-appreciate the potential economic damage caused by climate change as well as related opportunities, such as the rise in renewable energy. Extreme weather and other climate events are not yet reflected in valuations, as shown in [Getting physical](#) of April 2019.

There have been setbacks in some sustainability-related trends – the crisis has led some governments to pause efforts to curb plastics use, for example.

We believe these setbacks are temporary. We see the “S” (social) in ESG capturing greater attention as the pandemic spotlights issues such as employee safety and satisfaction and forces companies to reconsider their social purpose. In fact, we see sustainability rising beyond the mere labels of environmental, social and governance. What matters is the resilience of companies to shocks, and we see sustainability becoming a core part of the investment process as a result.

Our bottom line: The shift toward sustainability is not just poised to give sustainable assets a potential return advantage for years to come, but we also see it altering other return drivers and creating entirely new sources of returns.

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**We have seen a striking degree of resilience in companies and portfolios that show greater sustainability characteristics.**

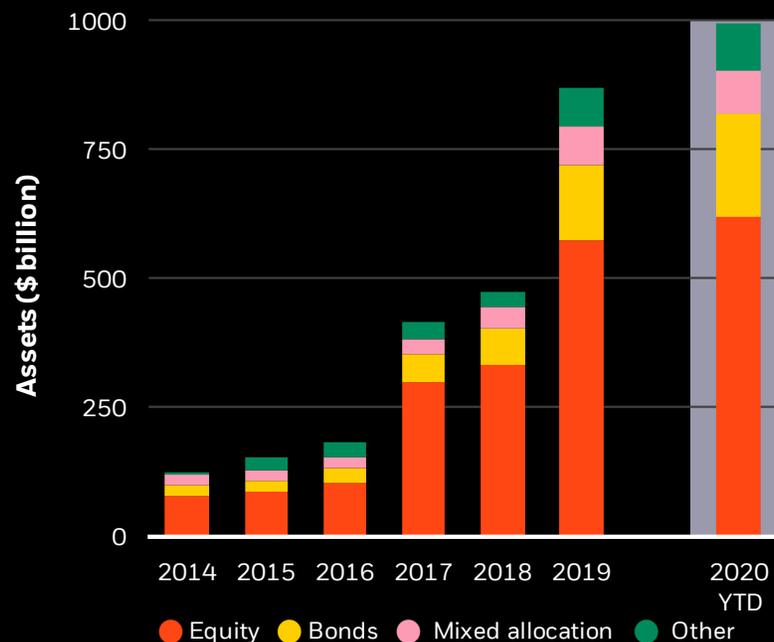


**Brian Deese**

Global Head of Sustainable Investing

## Sustainable assets

Assets under management at ESG-mandated funds, 2014-2020 YTD



Sources: BlackRock Investment Institute with data from EPFR, as of June 2020. Notes: The chart shows the global assets under management for ESG-mandated funds. The “other” category includes money-market and alternatives funds. Data for 2020 through May 31, 2020.

**A tectonic shift toward sustainability is poised to give a return advantage to sustainable assets for years to come – and affect all drivers of returns.**

Asset class views

# The broad view

We quickly concluded Covid-19 would cause an unprecedented near-term economic contraction – but that an overwhelming policy response would help mitigate the damage and make the cumulative GDP shortfall much smaller than that of the GFC.

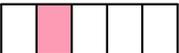
As a result, we advocated taking advantage of historic opportunities in sustainability in late February and risk assets in strategic portfolios in late March. We have since turned neutral on equities in our strategic framework after the significant rally but keep our overweight in credit. Higher spread levels make up for increased default risk, in our view.

On a tactical basis, reflecting a shorter investment horizon, we turned cautious on Feb. 28, taking both equities and credit to neutral. We returned to a mild pro-risk stance on April 6, overweighting credit and favoring up-in-quality assets with strong policy backstops. This was reflected in a preference for U.S. stocks, investment grade credit and the quality factor.

We have now downgraded U.S. equities to neutral amid risks of fading fiscal stimulus and election uncertainty, and have turned cautious on emerging markets. We have upgraded European equities as we see them offering the most attractive exposure to a cyclical upswing. We are keeping our credit overweight because of a global hunt for yield and central bank purchases. See pages 14 and 15.

## Directional views

Strategic (long-term) and tactical (6-12 month) views on broad asset classes, June 2020

Asset	Strategic view	Tactical view
Equities	 <p>Neutral</p>	 <p>Neutral</p> <p>We have turned neutral on equities on a strategic horizon given the challenging backdrop for earnings and dividend payouts. We trim our modest overweight in EM and maintain our DM exposure at neutral. Tactically, we are also neutral on equities. We like the quality factor for its resilience and favor Europe among cyclical exposures.</p>
Credit	 <p>+1</p>	 <p>+1</p> <p>We have moved to a strategic overweight on credit after being underweight for the past year. Sizeable spread widening compensates for the risks of defaults and downgrades, in our view. On a tactical horizon, extraordinary measures by central banks – including purchases of corporate debt – are supportive. Risks of a temporary liquidity crunch remain, but coupon income is crucial in a world starved for yield.</p>
Govt bonds	 <p>-1</p>	 <p>Neutral</p> <p>The strategic case for holding nominal government bonds has materially diminished with yields closer to perceived lower bounds. The “even-lower-for-even-longer” outlook for rates is compromising the asset class’ ability to act as ballast against equity market selloffs in the long run. On a tactical basis, we keep duration at neutral as unprecedented policy accommodation skews yields to the downside.</p>
Cash		 <p>Neutral</p> <p>We are neutral on cash and are using it to support our view on credit. Some cash makes sense as a buffer against supply shocks that drive both stocks and bonds lower.</p>
Private markets	 <p>Neutral</p>	 <p>Neutral</p> <p>Non-traditional return streams, including private credit, have the potential to add value and diversification. Many institutional investors remain underinvested in private markets as they overestimate liquidity risks, in our view. Private assets reflect a diverse array of exposures—but valuations and greater inherent uncertainties of some private assets keep us neutral overall.</p>

Note: Views are from a U.S. dollar perspective, June 2020. 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.

Asset class views

# Tactical calls

We maintain a modest pro-risk stance overall, given our macro assessment of the virus shock and the strong policy response. This is balanced by a preference for up-in-quality assets that have policy backstops and are high up the corporate capital structure.

We prefer credit over equities as a result. This includes overweights in investment grade credit (our quality bias), high yield and euro area peripheral debt. The common thread: renewed asset purchases by central banks, a stable interest rate backdrop and attractive income in a world where decently yielding assets are hard to find.

We have downgraded EM equities and USD-denominated debt. Many EM economies are still battling to contain the virus outbreak and lack policy space to cushion the blow.

We have upgraded European equities to overweight. The region offers more attractive cyclical exposure than EMs due to its public health measures and ramped-up policy response. We are raising Japanese equities to neutral for similar reasons.

We have downgraded U.S. stocks to neutral after a strong run of outperformance. Risks include policy fatigue, a re-emergence of the virus, intensifying U.S.-China tensions, and a turbulent election season. We also cut Asia-ex Japan equities to neutral as renewed U.S.-China tensions may hurt investor sentiment as China balances its growth and stability objectives.

From a factor perspective, we increase our overweight in quality, for what we see as its likely resilience against a range of future outcomes. The possibility of a cyclical uptick has caused us to upgrade the value factor to neutral and downgrade minimum volatility to neutral. We also remain neutral on momentum.



**The case for owning credit over equities is clear: Credit has direct policy support and lagged in the recovery.**

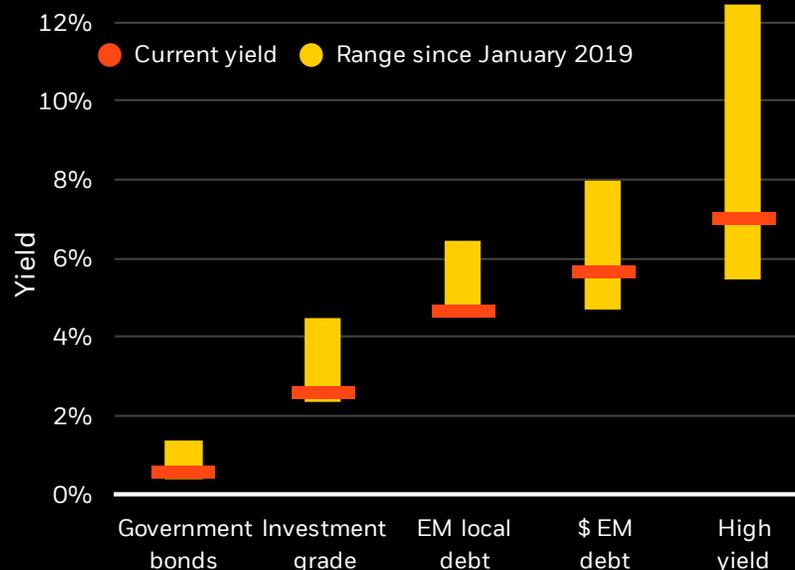


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Senior Investment Strategist, BlackRock Investment Institute

## In search of income

Selected fixed income yields, 2019-2020



Past performance is not a reliable indicator of current or future results. Indexes are unmanaged and not subject to fees. It is not possible to invest directly in an index. Sources: BlackRock Investment Institute, with data from Refinitiv, June 2020. Notes: The bars show the range in yields for each index from the start of January 2019. Indexes used: Bloomberg Barclays Global Treasuries and Global Credit; J.P. Morgan GBI-Emerging Market Index and EMBI-Global Diversified Index; and Bloomberg Barclays Global High Yield.

**We keep our preference for credit, based on renewed asset purchases by central banks, a stable interest rate backdrop and attractive income in a world where decently yielding assets are hard to find.**

## Tactical granular views

Six to 12-month tactical views on selected assets vs. broad global asset classes by level of conviction, June 2020



Asset	Underweight	Overweight	
<b>Equities</b>	United States		←● We downgrade U.S. equities to neutral. Risks of fading fiscal stimulus and an extended epidemic are threatening to derail the market's strong run. Renewed U.S.-China tensions and a divisive election also weigh.
	Europe	●→	We upgrade European equities to overweight. The region is exposed to a cyclical upside as the economy restarts, against a backdrop of solid public health measures and a galvanizing policy response.
	Japan	●→	We upgrade Japanese equities to neutral. We see strong fiscal policy and public health measures allowing for rapid normalization.
	Emerging markets	←●	We downgrade emerging market equities to underweight. We are concerned about the pandemic's spread and see less room or willingness for policy measures to cushion the impact in many – but not all – countries.
	Asia ex-Japan		←● We downgrade Asia ex-Japan equities to neutral. Renewed U.S.-China tension is a risk. China's goal to balance growth with financial stability has led to relatively muted policy measures to cushion the virus fallout.
	Momentum		We keep momentum at neutral. The factor is now dominated by tech stocks on the one hand and defensives on the other, giving investors exposure to growth companies and some potential ballast.
	Value	●→	We upgrade value to neutral. We see the ongoing restart of economies likely benefiting cyclical assets and potentially helping value stage a rebound after a long stretch of underperformance.
	Minimum volatility		←● We downgrade min vol to neutral. The restart of economies is likely to benefit cyclical assets and reduce the need for defensive exposures.
	Quality		●→ We increase our overweight in quality. We see it as the most resilient exposure against a range of outcomes in terms of developments in the pandemic and economy.
<b>Fixed income</b>	U.S. Treasuries		● We like U.S. Treasuries. Long-term yields are likely to fall further than other developed market peers, even as low rates reduce their ability to cushion against risk asset selloffs.
	Treasury Inflation-Protected Securities		We are neutral on TIPS. A huge decline in rates makes the entry point less attractive. We still see potential for higher inflation over time and like TIPS in strategic allocations.
	German bunds	●	We remain underweight bunds as current yield levels provide little cushion against major risk events. Also, potential issuance related to the proposed EU recovery fund could compete with bunds for investment.
	Euro area peripherals		● We overweight euro area peripheral government bonds despite recent outperformance. We see further rate compression due to stepped-up quantitative easing by the European Central Bank and other policy actions.
	Global investment grade		● We overweight global investment grade credit even as valuations have risen. Asset purchases by central banks and a broadly stable rates backdrop support the sector.
	Global high yield		● We stay overweight high yield as a source of income despite recent underperformance. We avoid energy as lower oil prices challenge the ability of issuers to refinance near-term maturities.
	Emerging market – hard currency	←●	We have downgraded hard-currency EM debt due to the pandemic's spread, heavy exposure to energy exporters and limited policy space in some emerging economies. Default risks may be underpriced.
	Emerging market – local currency		We remain neutral on local-currency EM debt for its attractive coupon income. Currencies have adjusted and valuations have cheapened. A risk of further currency declines remains amid monetary and fiscal easing.
	Asia fixed income		←● We have turned neutral on Asia fixed income. The pandemic's containment in many countries and low energy exposure are positives. Renewed U.S.-China tensions and China's relatively muted policy fallout are risks.

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