BlackRock Investment Institute

2020 Outlook Update

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October 27, 2020

BlackRock.

2020 outlook update

BlackRock Investment Institute

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The future is running at us

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A new investment landscape

The impact from Covid-19 will change the course of society, the economy and financial markets for years to come

1

New norms of economic activity

This is not about a business cycle recession and recovery – but a long adjustment to new norms of economic activity that mean investment decisions should be linked to the real economy.

2

Supercharged structural trends

The shift to sustainability, deglobalization and geopolitical fragmentation, and the joint monetary-fiscal policy revolution are being accelerated.

3

Real resilience for the whole portfolio

This goes beyond using financial resilience to build a better blend of returns – it's about ensuring the portfolio is well positioned at a more granular level to underlying themes, including sustainability.

Strategic allocation decisions should be reassessed *now* to make portfolios resilient to this new landscape

2020 investment themes

Activity restart – The activity restart has been faster than expected but is moving into a more difficult phase just as a flare-up of coronavirus infections prompts tighter restrictions. The evidence of permanent damage to overall economies is limited so far, but the adjustment to a post-Covid world could be painful for some contact-sensitive sectors if mobility is curtailed for an extended period of time.

Strategic implication: We are moderately pro-risk and prefer high yield over equities.
Tactical implication: We have closed our underweights in cyclical assets, with a preference for Europe.

Policy revolution – An unprecedented joint monetary-fiscal policy response is providing a bridge for disrupted income streams. Fiscal support fatigue is a risk – especially in the U.S. – even as Europe has maintained its fiscal help. The Federal Reserve is leading major central banks in evolving policy frameworks to explicitly aim to let inflation overshoot targets – a desirable move in the current environment but the lack of proper guardrails amid a blurring of boundaries between fiscal and monetary policy raises concerns.

Strategic implication: We are underweight nominal government bonds and like inflation-linked bonds.
Tactical implication: We like high yield and see scope for spreads to tighten further as the economic recovery gathers pace. We believe U.S. stocks are vulnerable to fading fiscal stimulus and unwinds of crowded positions.

Real resilience – Supercharged structural trends will change the nature of portfolio diversification. We believe countries, sectors and companies 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, favor assets with policy backstops and prefer developed markets over the emerging world.

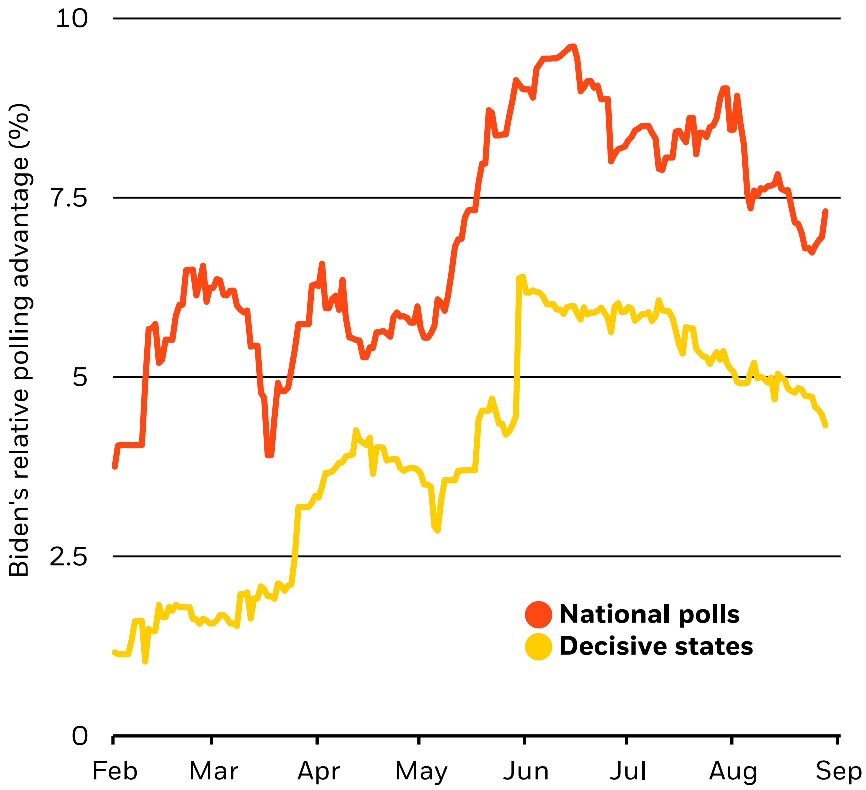
The opinions expressed are as of October 2020 and are subject to change at any time due to changes in market or economic conditions. Strategic implications refer to long-term views, tactical implications refer to asset views on a 6-12 month horizon.

The U.S. election race is becoming less uncertain

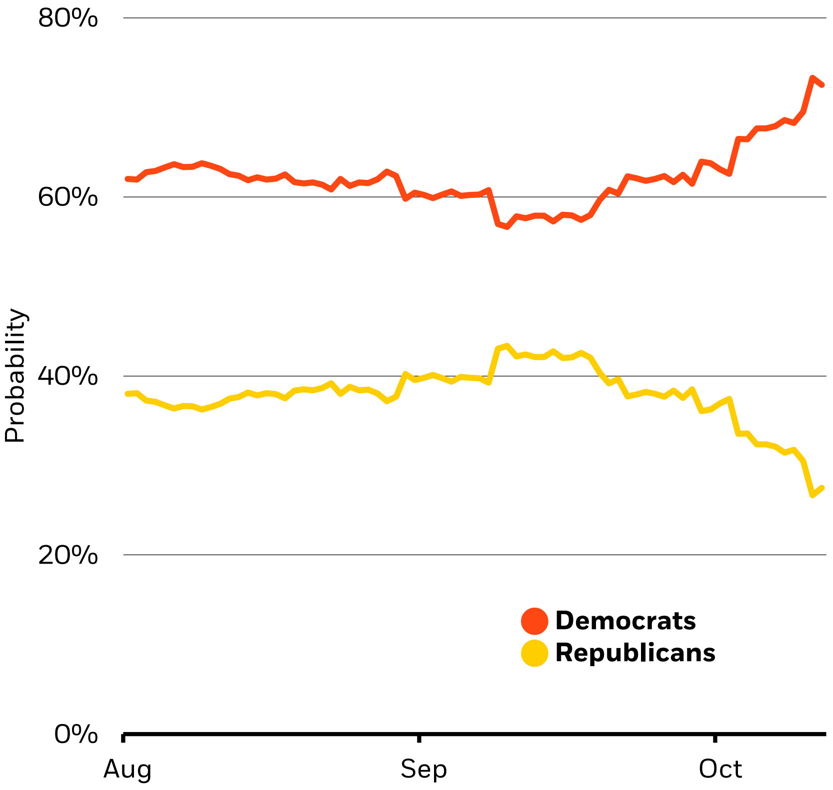
Democratic nominee Joe Biden looks to have an edge in national polls, yet his lead is narrower in decisive electoral states. The Democrats' chance of controlling the Senate look to be rising.

Joe Biden's advantage and race for the U.S. Senate, October 2020

Joe Biden's polling advantage



Chances of controlling the Senate



Sources: BlackRock Investment Institute, with data from FiveThirtyEight, September 2020. Notes: The left chart shows the advantage of former Vice President Joe Biden over President Donald Trump in national polls (orange line). The yellow line shows Biden's average advantage in six decisive states: Arizona, Florida, Michigan, North Carolina, Pennsylvania and Wisconsin The chart on the right shows the likelihood over time of each party controlling the Senate. See here for more.

A Democratic sweep likely to spur biggest policy changes

The U.S. election result is set to have big implications for markets as U.S. fiscal stimulus, public investment, taxation, regulation and foreign affairs could shift, especially in a Democratic sweep.

U.S. election scenarios and potential market implications, October 2020

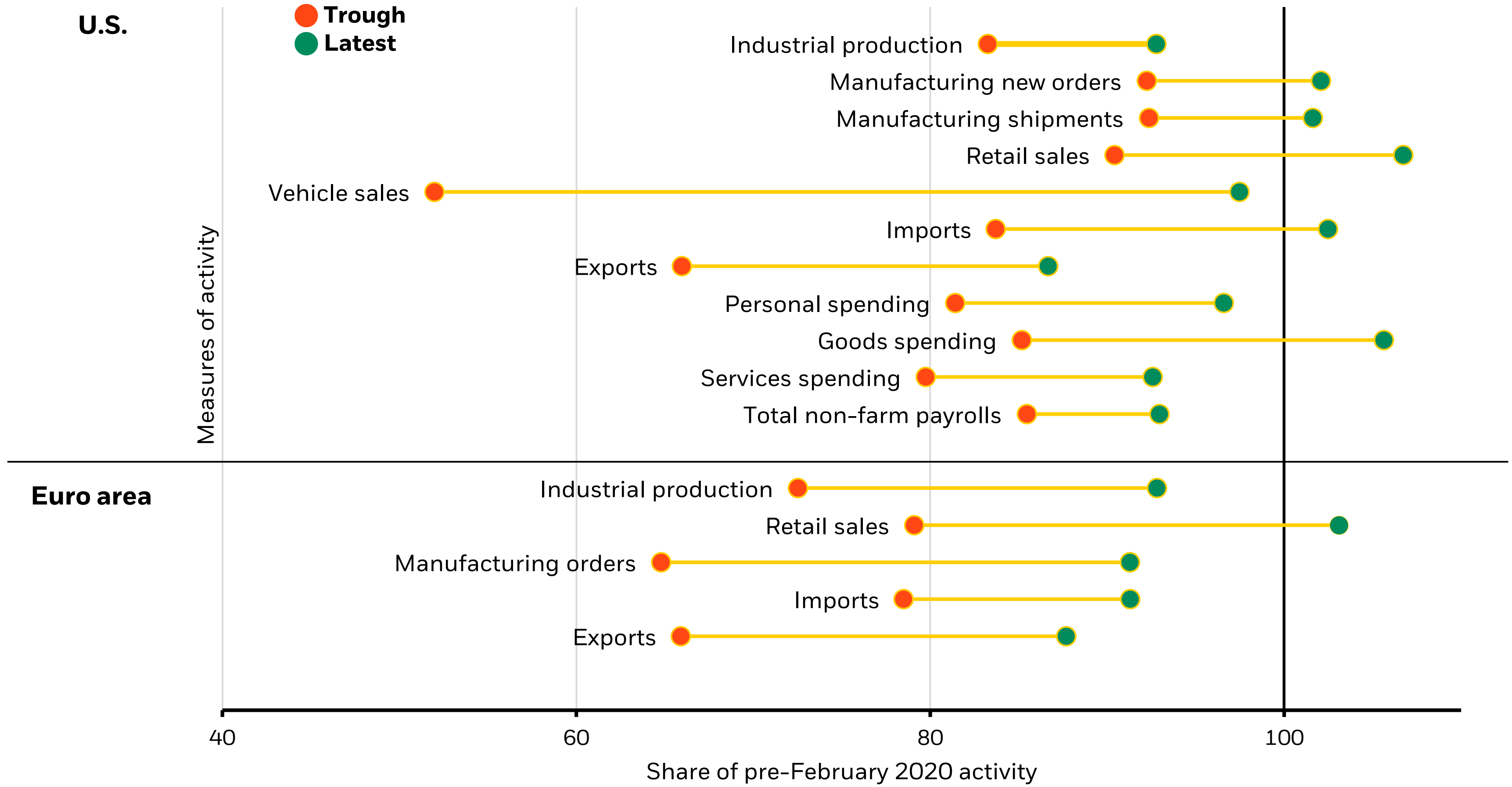
	Fiscal stimulus	Public investment	Taxation	Regulation	Foreign & trade policy	Market implications
Trump (divided government)	+	No change	No change	No change	–	Tech and quality may keep outperforming; EM and Europe likely to underperform. Lack of a reflationary impulse may cap breakevens and any steepening of the yield curve.
Biden (divided government)	–	–	No change	–	+	Quality may outperform but tech challenged due to potential regulation and anti-trust measures. EM assets could be boosted by a softer stance on China. Lack of a reflationary impulse may cap breakevens and any yield curve steepening.
Biden (unified Democratic control)	++	++	– –	–	+	Global cyclicals and domestic small-caps could benefit from U.S. stimulus plans. Sustainable assets may get a boost. The yield curve could steepen and breakeven rates rise as inflation expectations ratchet higher.

Sources: BlackRock Investment Institute, October 2020. Notes: The table shows the potential market implications of likely policy changes under three possible U.S. election outcomes. The "+" and "-" sign indicate whether the policy impact is a potential boost or drag, respectively, to risk assets. This material represents an assessment of the market environment at a specific time and is subject to change. This 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 the funds, strategy or any security in particular.

Activity restart: faster than expected, now the difficult part

The restart continues, led by manufacturing. But the restart is reaching a more difficult phase and is complicated by the virus flare-up. The risk is a stalling of activity and scarring of productive capacity.

U.S. and euro area economic activity versus February 2020

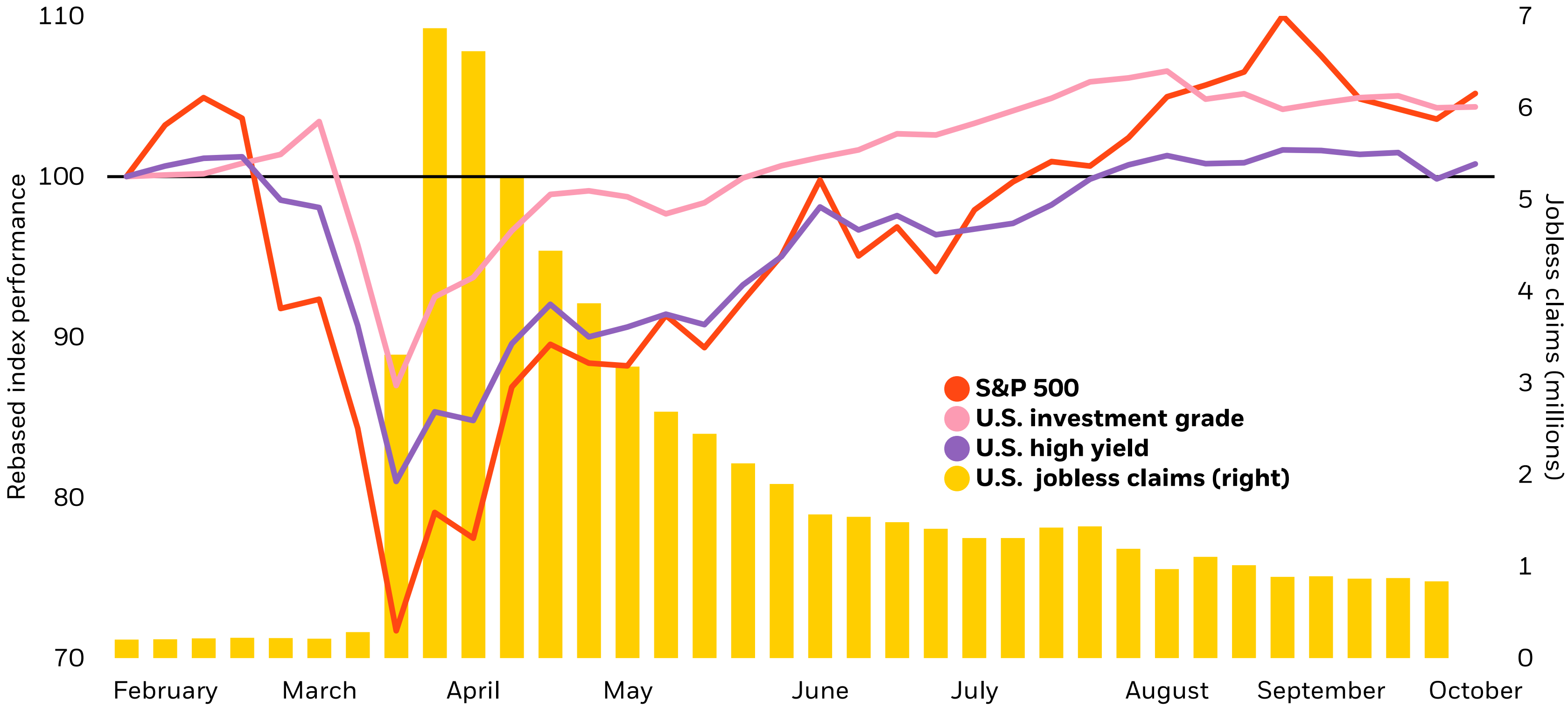


Sources: BlackRock Investment Institute, with data from U.S. Census Bureau, Federal Reserve, Bureau of Economic Analysis, Bureau of Labor Statistics, Eurostat and European Central Bank., October 2020. Notes: The chart shows the trough in activity since February 2020 (orange dot) and the latest value (green dot), with all values rebased to 100 at February 2020.

Visibility on the virus explains strong market performance

The visibility of the shock – and the "known unknowns" ahead – has helped drive the market rebound, with risk assets anticipating the quicker-than-expected restart. Now visibility on a vaccine is helping.

Select asset class performance vs. U.S. initial jobless claims, February–September 2020



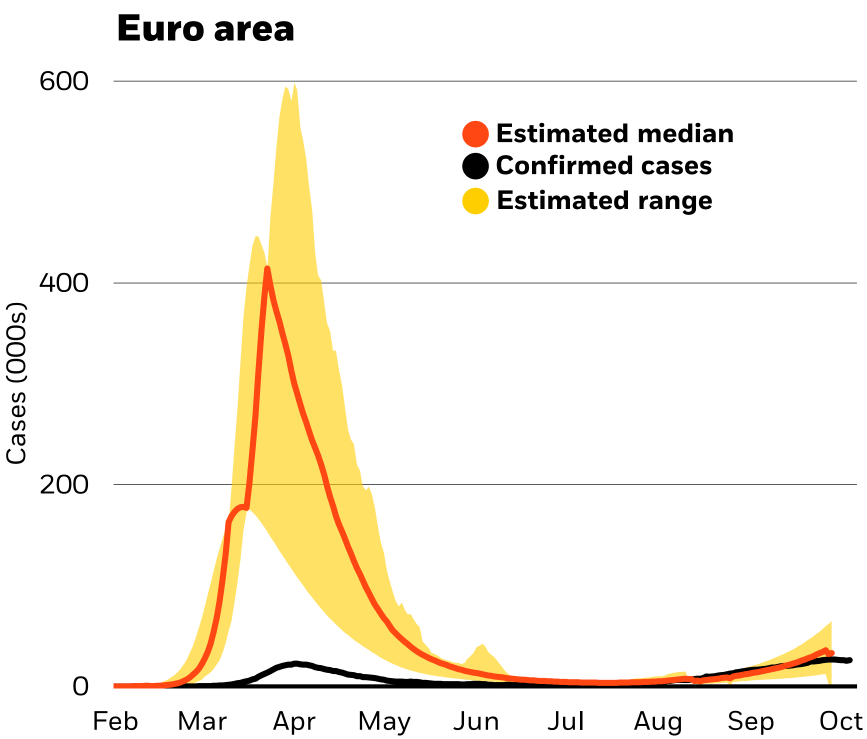
Past performance is no guarantee of future results.

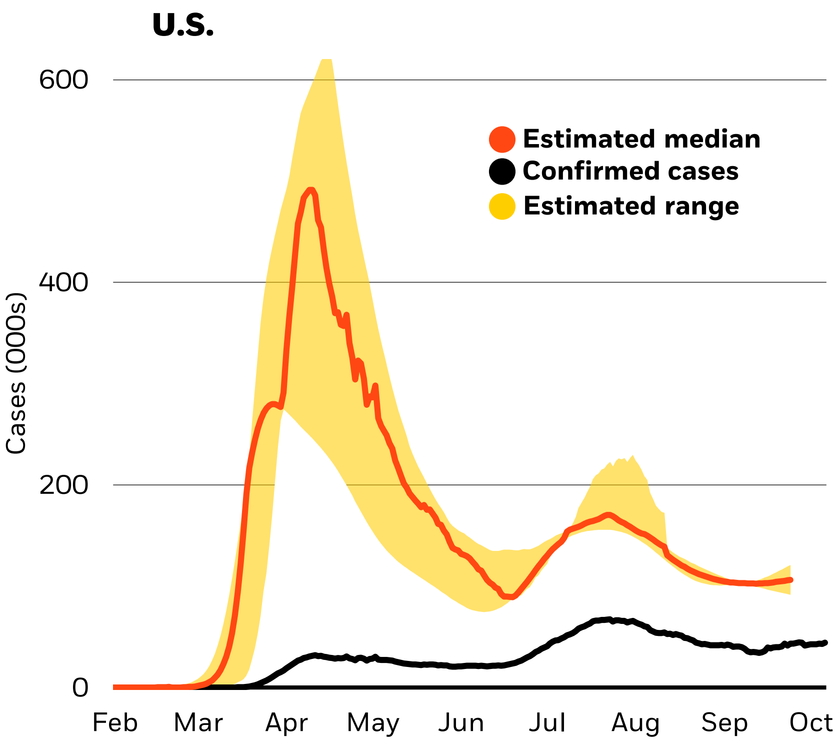
Source: BlackRock Investment Institute, with data from Refinitiv Datastream, October 2020. Notes: The yellow bars show initial claims for U.S. unemployment insurance. The S&P 500, Bloomberg Barclays U.S. investment grade, Bloomberg Barclays U.S. Corporate High Yield indexes are rebased to 100 at Jan. 31. Indexes are unmanaged and are not subject to fees. It is not possible to invest directly in an index.

Ongoing surge in infections is different from the first wave

Epidemiological estimates of the true number of cases suggest that the first wave was multiple times bigger than what confirmed cases showed at the time.

Estimated and confirmed new coronavirus cases, Feb.–Oct. 2020



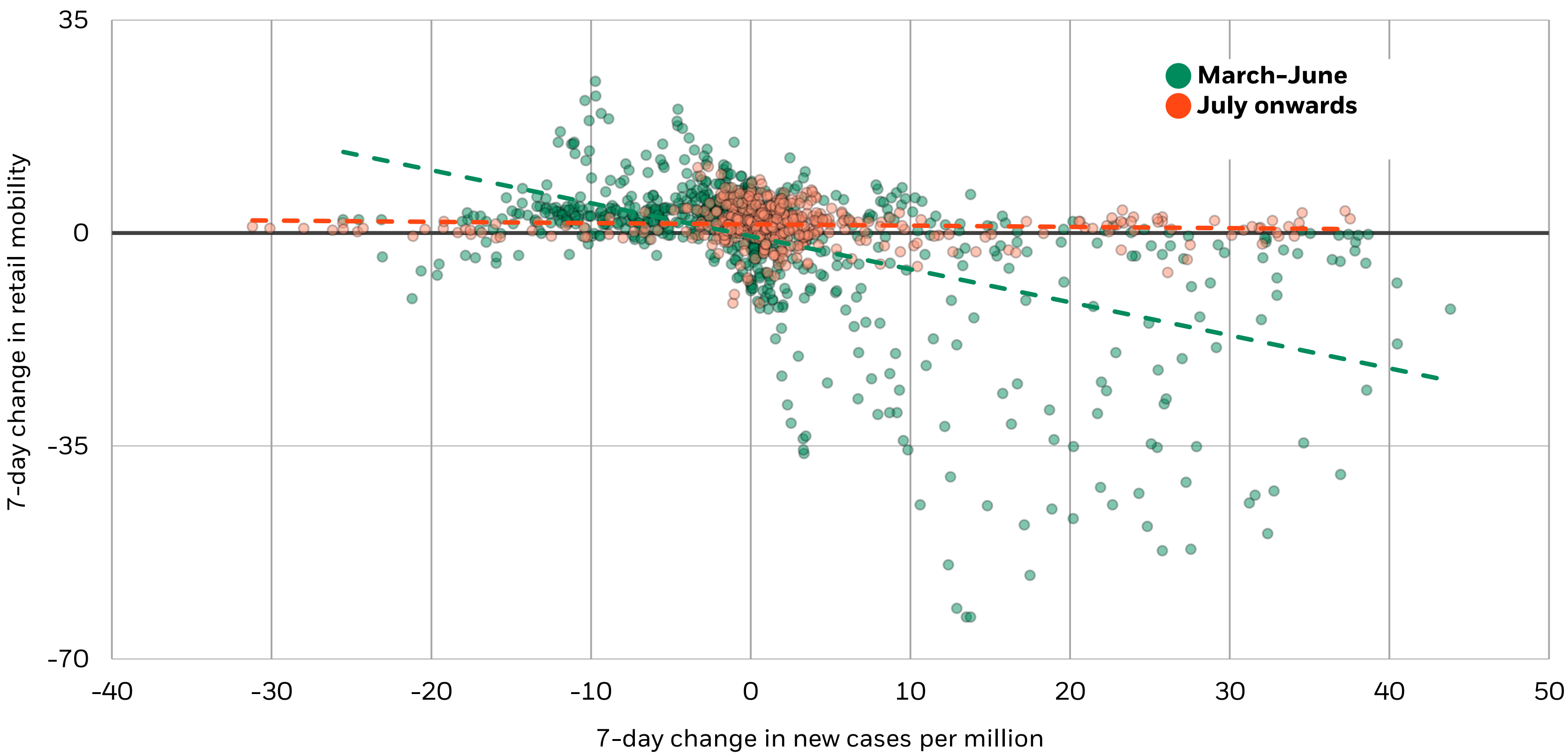


Sources: BlackRock Investment Institute, with data from the Imperial College London, IHME, and London School of Hygiene & Tropical Medicine (LSHTM), October 2020. Notes: The charts show estimates of the true number of daily new cases over time from three epidemiological models: Imperial College London, IHME, and London School of Hygiene & Tropical Medicine (LSHTM). The red line plots the median of the three estimates, while the shaded area covers the range of highest to lowest of the three estimates. To construct the median and range, we use the central estimate from each model – the mean model estimate for Imperial and IHME, and the median for LSHTM. The euro area data is constructed by summing estimates of each model for France, Germany, Italy and Spain.

Trade-off between activity and public health has improved

Rising Covid-19 cases have not dented mobility since July. The absence of stringent lockdown has helped, but precautionary measures have allowed activity to continue even as cases rise.

Change in retail mobility vs. change in new cases for G7 economies, March-October 2020



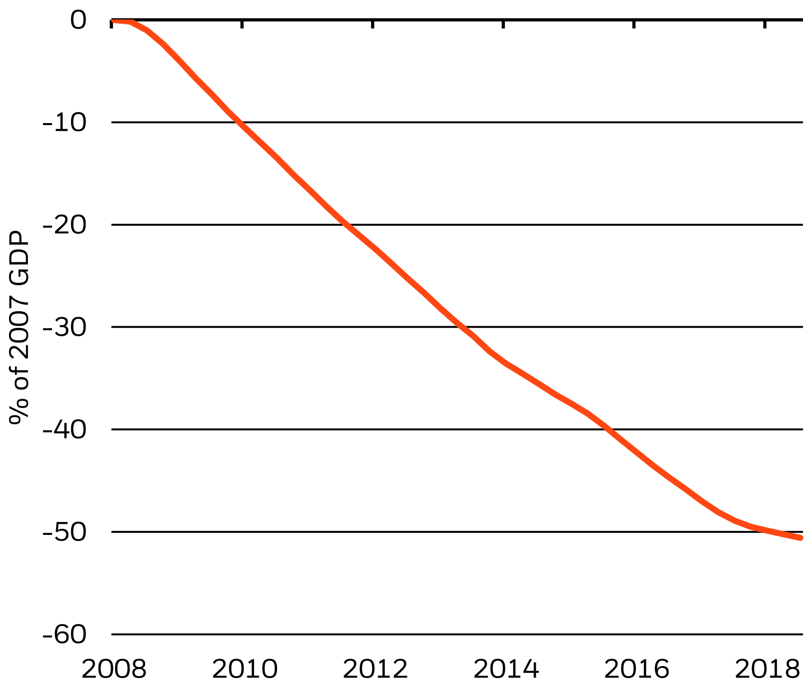
Sources: BlackRock Investment Institute, with data from the European Centre for Disease Prevention and Control and Google. Data as of 5 October 2020. Notes: The chart shows the correlation between the seven-day change in Google's retail mobility and the rolling 7-day average change in new cases per million across G7 countries. The green dotted line plots the linear regression showing the relationship between the two between March and June – increases in case dragged retail mobility lower. The orange dotted line shows the relation between the two from July to October 2020.

Scaling the Covid-19 shock and closing the activity shortfall

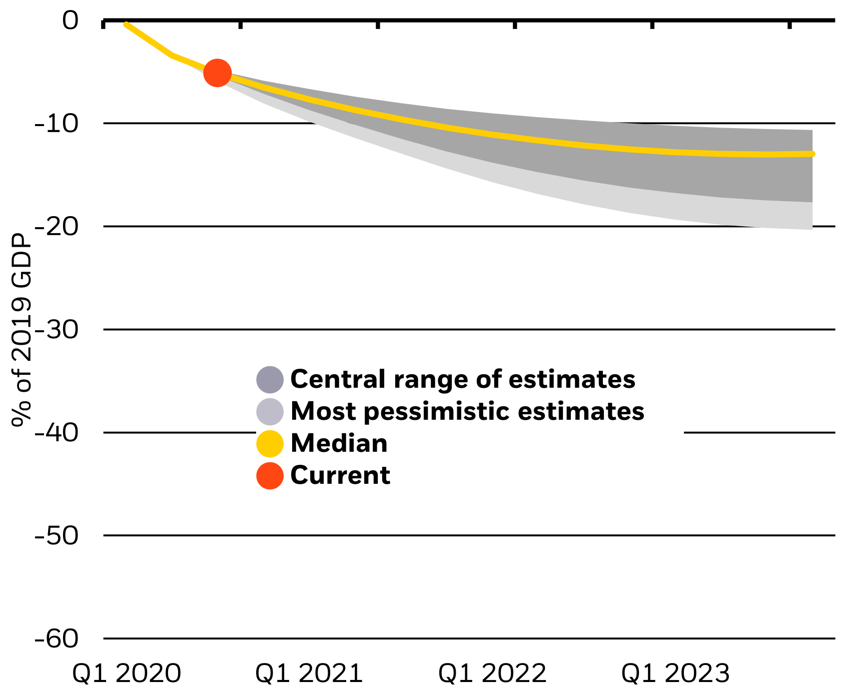
We believe the cumulative shortfall – the key for asset prices - from the Covid-19 shock is likely to be significantly smaller than in the aftermath of the global financial crisis (GFC).

U.S. GDP shortfall during the GFC and estimated shortfall due to Covid-19, October 2020

U.S. GDP shortfall resulting from the GFC



Estimated U.S. GDP shortfall from the Covid-19 shock

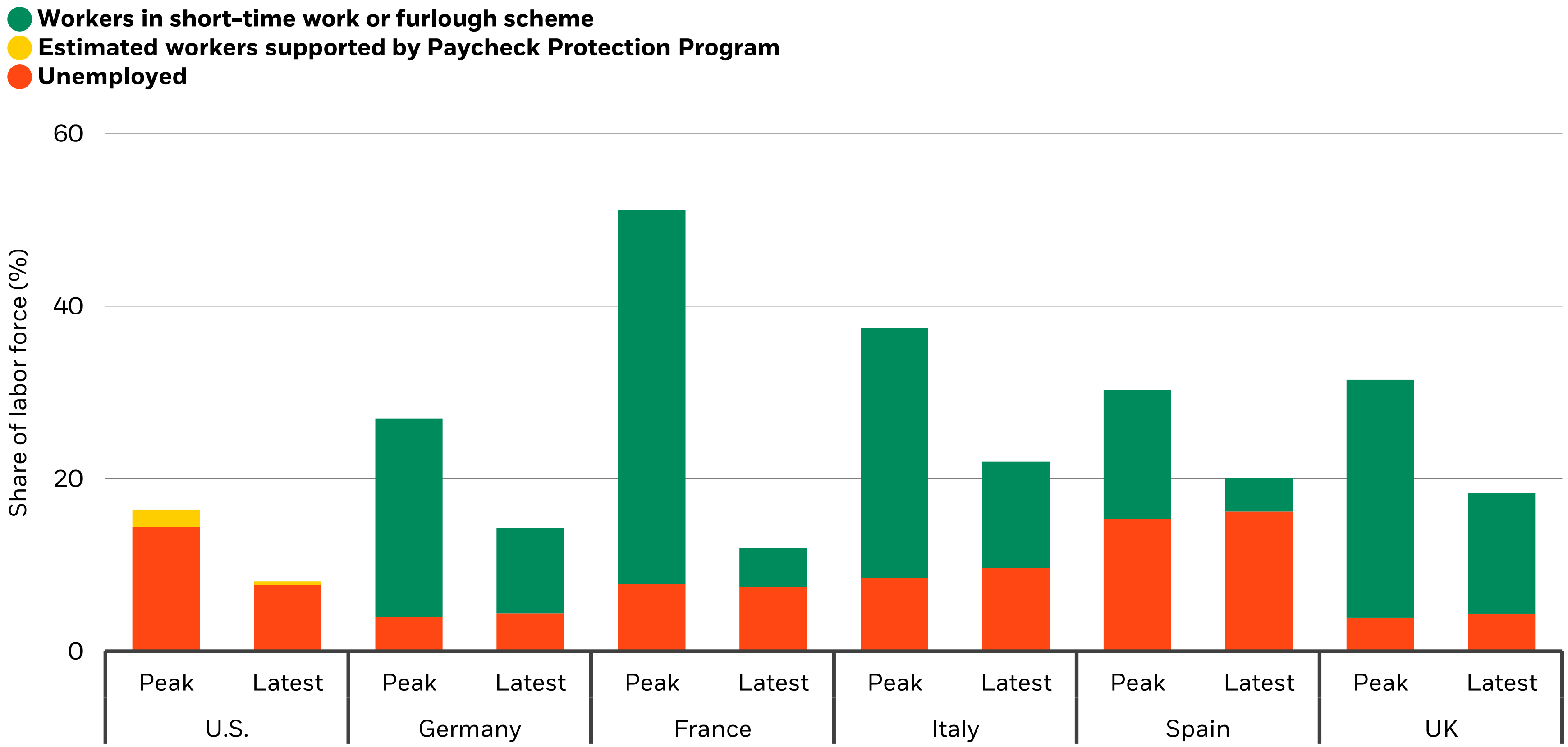


Source: BlackRock Investment Institute, with data from Reuters News, October 2020. Notes: The left chart shows the cumulative sum of the difference between actual U.S. GDP and where it would have been had it grown at its pre-financial crisis trend level of U.S. nominal growth of 3.4% a year from the 2007 onwards. The right chart shows hypothetical U.S. GDP quarterly annualized changes through to the end of 2023 and the total shortfall of U.S. GDP relative to 2019 levels over the next two years based on a Reuters poll of economists. We use the Reuters poll of economists published on 25 September 2020 but trim the overall sample by taking the estimates within the 20th and 80th percentiles to reduce extreme outliers (dark grey shaded band). We derive our range of estimates and median from an adjusted sample of 39 forecasts for which we have complete forecasts. The grey shaded area illustrates the full range of estimates from all forecasts, while the most pessimistic estimate in the right-hand charts shows the lower quintile of forecasts to help us gauge the size of the policy response needed to the shock. For illustrative purposes only. There is no guarantee that any forecasts made will come to pass. The hypothetical scenario is subject to signification limitations, in particular that this is an evolving situation and we are still trying to understand the potential for more extensive activity shutdowns due to the virus.

Fiscal support has been key for the labor market

Furlough schemes have prevented a sharp rise in unemployment in the euro area and the UK. Supplementary U.S. unemployment insurance limited the income shock but has since expired.

Labor market support, June–September 2020

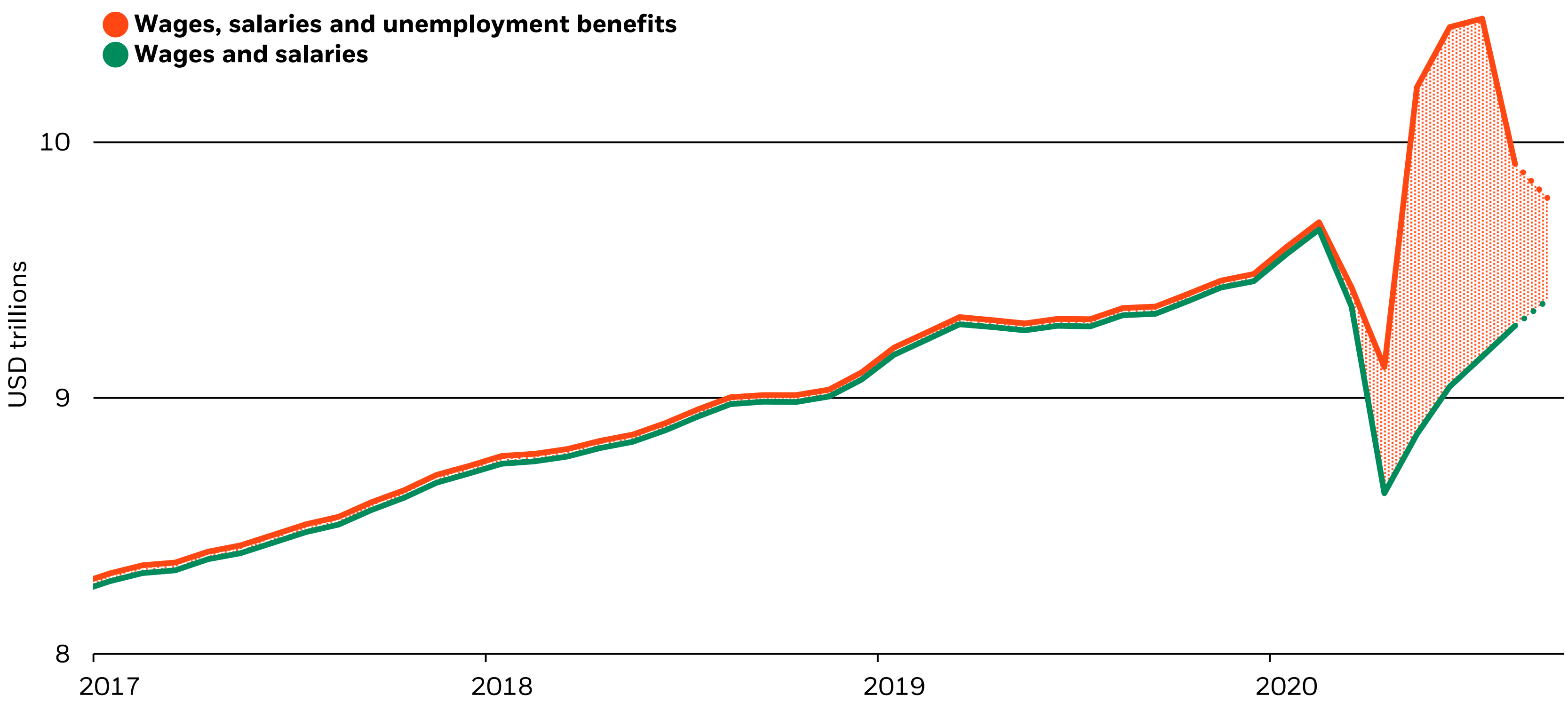


Sources: BlackRock Investment Institute, using data from Haver Analytics, BLS, Eurostat, ONS, DARES, Spanish Labour Ministry, INPS, Autor et al (2020), October 2020. Notes: Data as of 7 September 2020. Latest estimates relate to September in the U.S., August in Germany, France, Italy and Spain and July in the UK. Official estimates of workers still covered by the U.S. PPP scheme are not publicly available, so the yellow bar uses an estimate published by Autor et al for June. Peak bars show the levels at the point where the take-up of furlough schemes was at its highest over the period March 2020-present.

Fiscal support has been key for the labor market

Supplementary U.S. unemployment insurance limited the income shock but has since expired. The election outcome will be key for determining the future shape of any further fiscal support.

U.S. household compensation, 2016–2020

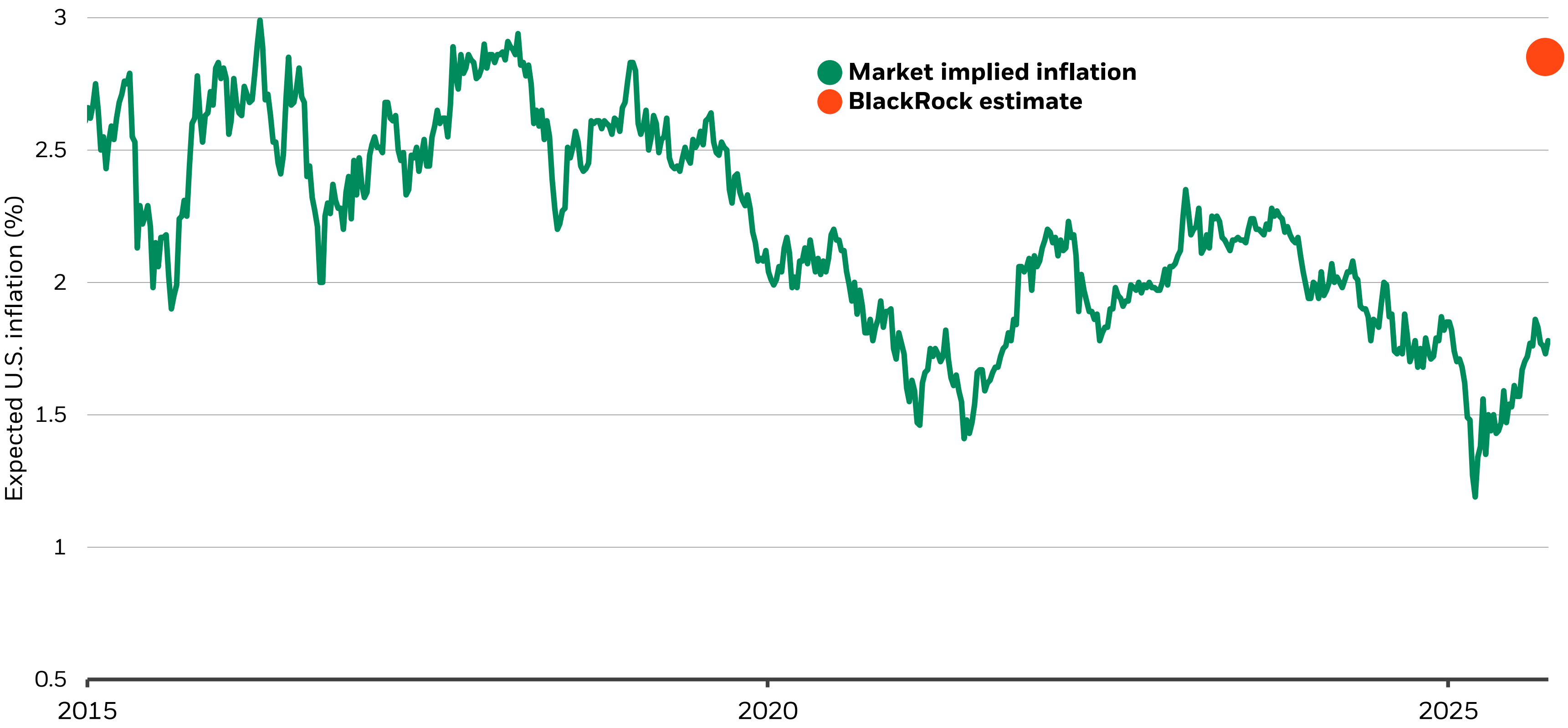


Sources: BlackRock Investment Institute, using data from BEA, US Treasury, Haver Analytics, October 2020. Note: Green line shows annualized wages and salaries for US workers. Data up to August are from the most recent BEA personal income report, and the figure for September is projected using the monthly change in labor income calculated from the August employment report (dotted lines). The orange line adds together wages and salaries and unemployment insurance (UI) benefits. The UI data are published up to August from the most recent BEA personal income report, and projected for September based on high frequency data from the Daily Treasury Statement (green dotted line).

Dimming appeal of U.S. Treasuries in favor of TIPS

Increasing production costs, changes in the monetary policy framework and greater political pressure on central banks to keep rates low in a high-debt environment risk spurring higher inflation.

Market pricing of forward U.S. inflation vs. BlackRock inflation estimate, 2015-2025



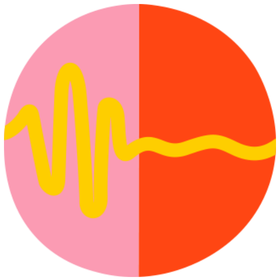
Forward-looking estimates may not come to pass.

Sources: BlackRock Investment Institute and the Federal Reserve with data from Refinitiv Datastream, October 2020. Notes: The chart shows market pricing of expected average inflation over the five-year period starting in 2025. We show it using the five-year/five-year inflation swap which is a measure of market expectation of inflation over five years, starting in five years' time. In the chart, the line is shifted forward five years. The orange dot shows our current estimate of average U.S. CPI for the same five-year period of 2025-2030.

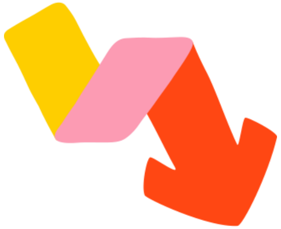
Federal Reserve adopts a new monetary policy framework

The Fed's new monetary policy framework is set to have significant implications for inflation outcomes as it allows for inflation overshoots and doesn't worry about labor markets overheating.

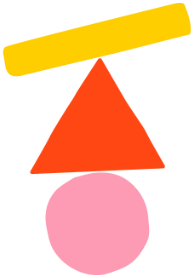
Illustrative schematic of the Federal Reserve's new policy framework, October 2020



Fed moves toward flexible average-inflation targeting to make up for past misses of its target



Fed plans to worry only about "shortfalls" from full employment



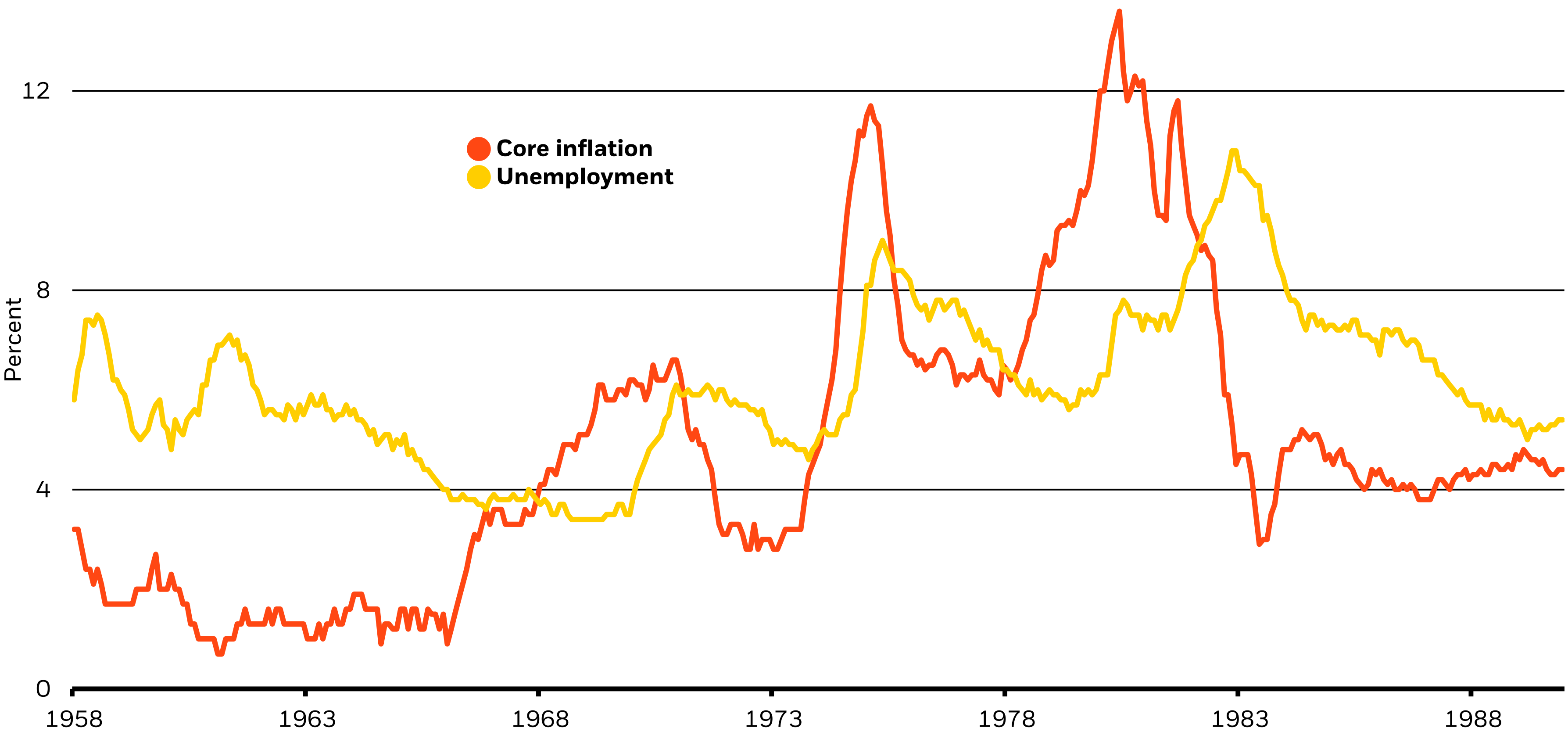
Bottom line: We believe the Fed will tolerate inflation overshoots and find it politically harder to lean against overheating

Sources: BlackRock Investment Institute, October 2020. Notes: For illustrative purposes only. For the Fed's new framework, see: https://www.federalreserve.gov/monetarypolicy/review-of-monetary-policy-strategy-tools-and-communications-statement-on-longer-run-goals-monetary-policy-strategy.htm

The Fed could lose its grip on inflation expectations

Inflation expectations could become unanchored and keep shifting higher, as they did in the late 1960s when the Fed prioritized full employment over fighting inflation.

U.S. core inflation annual rate vs. unemployment rate, 1958–1988

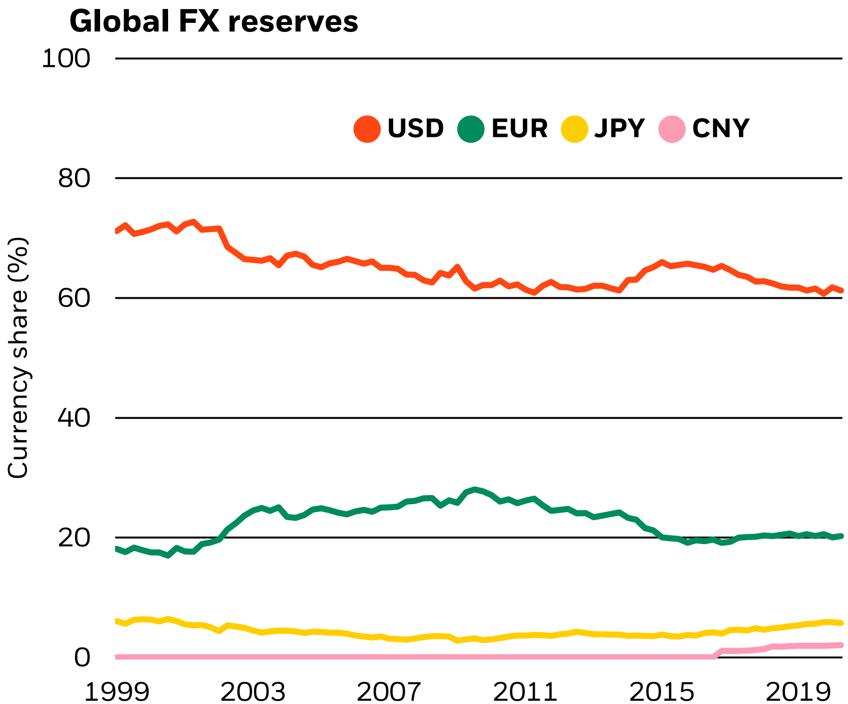


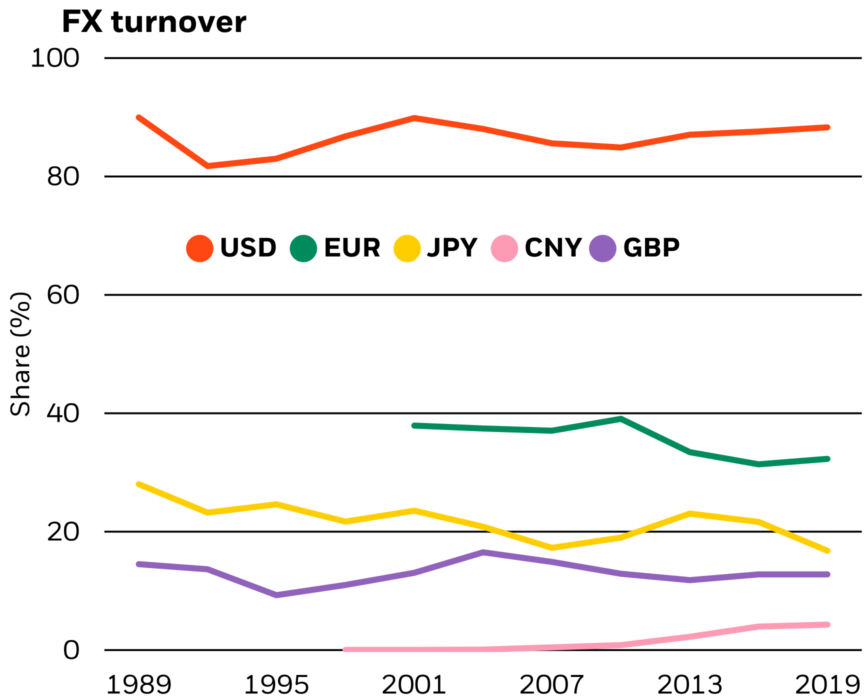
Sources: BlackRock Investment Institute and U.S. Bureau of Labor Statistics, with data from Refinitiv Datastream, October 2020. Notes: The chart plots the annual change in the core Consumer Price Index against the unemployment rate.

U.S. dollar dominance

The U.S. dollar has consolidated its dominance in FX market transactions, and continues to account for a large majority of official FX reserves.

Share of global reserves and foreign exchange turnover by currency, 1999–2019



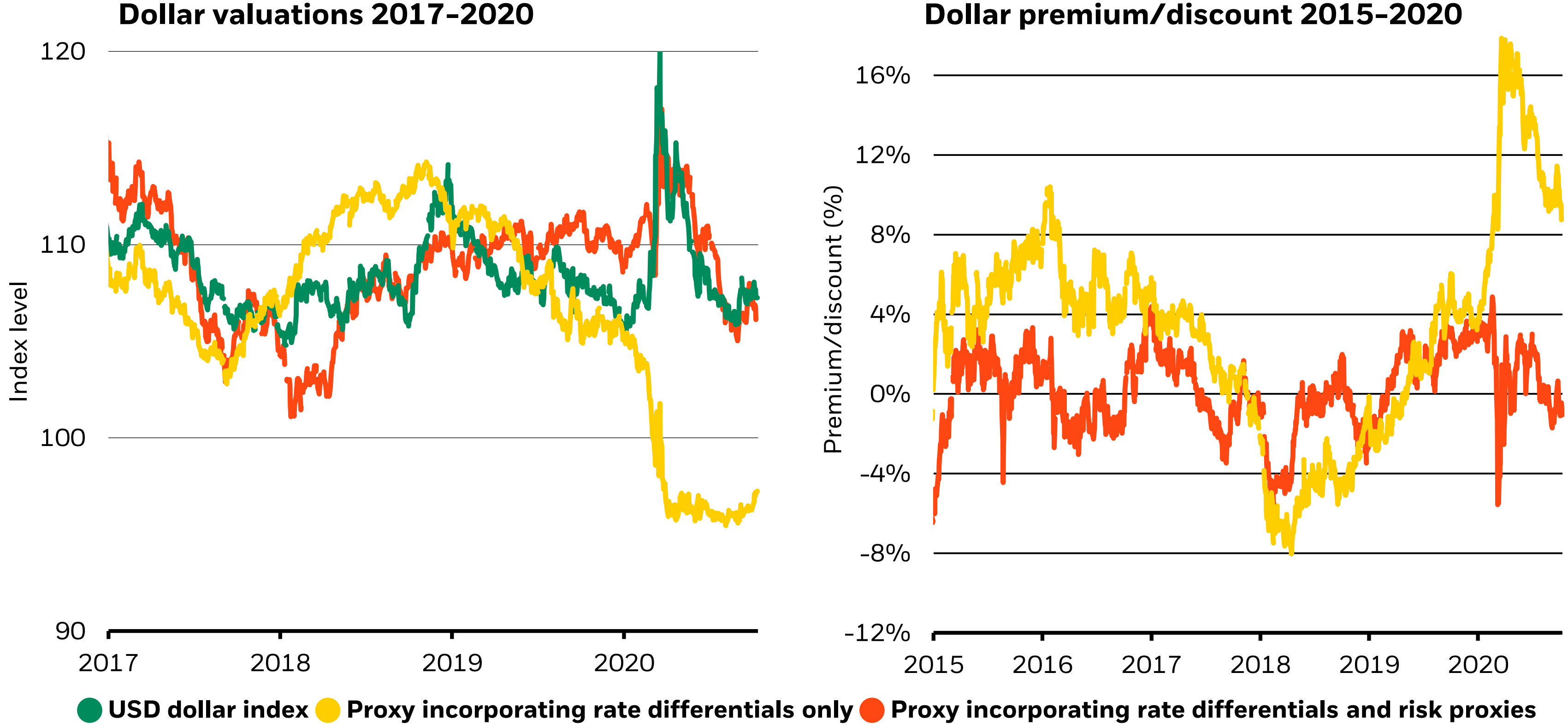


Sources: BlackRock Investment Institute, BIS Triennial Central Bank Survey, IMF COFER, using data from Haver Analytics and Refinitiv Datastream, October 2020. The chart on the left shows the proportion on global central bank reserves held in the respective currency. The chart on the right shows the share of FX market turnover by currency on a net basis, to avoid double counting of local and cross border inter dealer transactions. As two currencies are involved in each transaction, the sum of individual shares across all currencies will total 200%.

U.S. dollar's recent moves do not herald a new regime

The dollar does not appear to be trading at a significant premium or discount to our USD trade-weighted proxy that incorporates interest differentials plus key market risk drivers.

Trade-weighted US dollar index and our proxies based on different drivers



Sources: BlackRock Investment Institute, with data from the Federal Reserve, October 2020. The charts compare the trade-weighted valuation of the U.S. dollar through time against estimates that i) incorporate interest differentials between the U.S. and its trading partners and ii) incorporate interest rate differentials and consider proxies for risk sentiment. The green line in the left chart shows the trade-weighted U.S. dollar index - the real effective exchange rate (REER) calculated by the Federal Reserve against the currencies of a group of developed economies comprising Australia, Canada, the euro area, Japan, Sweden, Switzerland and the United Kingdom. Interest rate differentials are measured as the difference between the 10-year and 2-year sovereign bond issued by each country. Proxies for risk sentiment include the term premium, equity volatility and euro area peripheral bond spreads – factors that have been material drivers of the exchange rate according to our analysis. The right chart shows the premium or discount in percentage terms of the value of the REER index to estimates based on the two approaches.

Directional views

Major asset class views on strategic and tactical horizons, October 2020

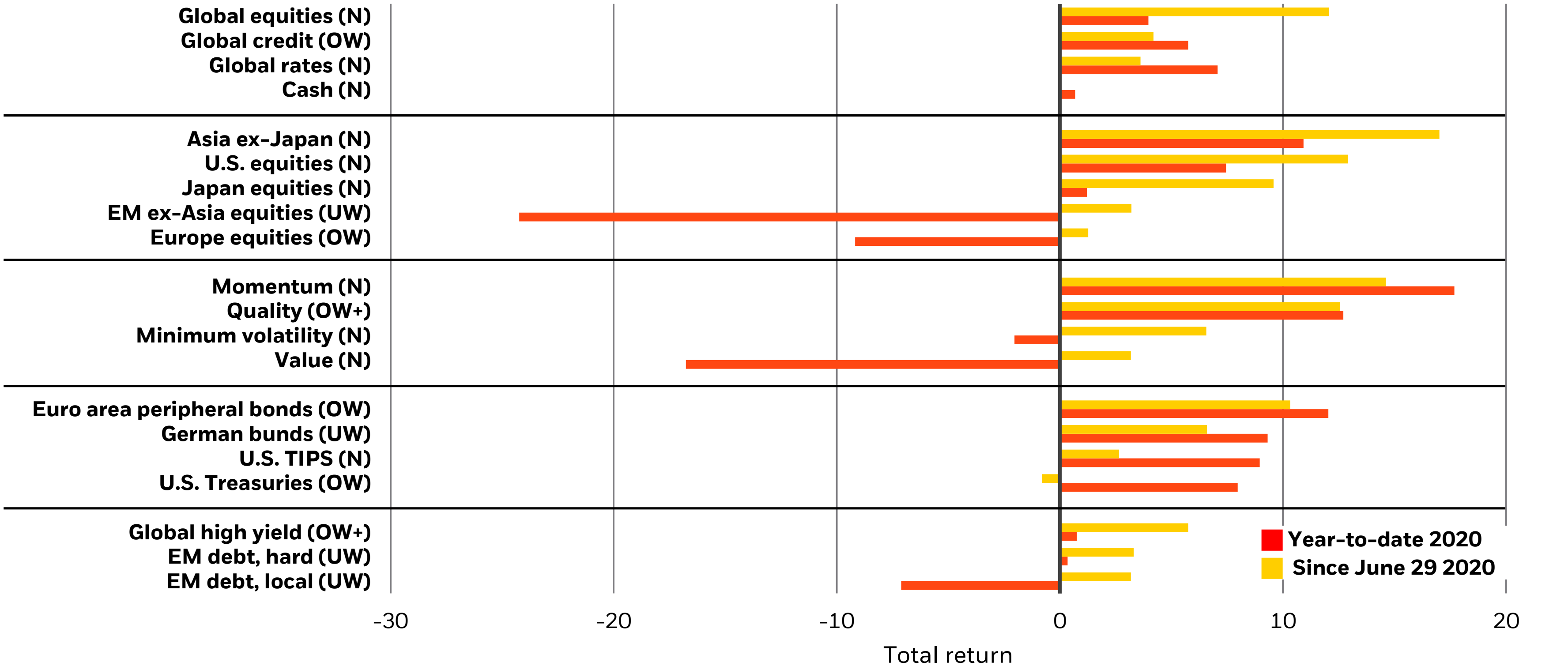
Asset	Strategic view	Tactical view	
Equities	Neutral	Neutral	We have turned neutral on equities on a strategic horizon given increased valuations and a challenging backdrop for earnings and dividend payouts. We move to a modest underweight in DM equities and tilt toward EM equities. Tactically, we are also neutral on equities overall . We like the quality factor for its resilience and favor Europe among cyclical exposures.
Credit	Neutral	+1	We are neutral on credit on a strategic basis because we see investment grade (IG) spreads offering less compensation for any increase in default risks. We still like high yield for income. On a tactical horizon, we strongly prefer high yield for its income and more room for spread tightening. We are neutral on IG and underweight emerging market debt.
Govt bonds	-1	Neutral	The strategic case for holding nominal government bonds has materially diminished with yields closer to perceived lower bounds. Such low rates reduce the asset class's ability to act as ballast against equity market selloffs. We prefer inflation-linked bonds as we see risks of higher inflation in the medium term. On a tactical basis, we keep duration at neutral as unprecedented policy accommodation suppresses yields.
Cash		Neutral	We are neutral on cash and believe holding some cash makes sense as a buffer against supply shocks that could drive both stocks and bonds lower, in our view.
Private markets	Neutral		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 may overestimate liquidity risks, in our view. Private assets reflect a diverse array of exposures but valuations and inherent uncertainties of some private assets keep us neutral overall. Private markets are a complex asset class not suitable for all investors.

Note: Views are from a U.S. dollar perspective as of October 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.

A strong risk rebound

Our tactical overweight on euro area peripheral bonds and underweight on EM ex-Asia equities have worked well. European equities have not yet seen the expected boost from the growth rebound.

Asset performance year-to-date and since our midyear outlook, October 2020



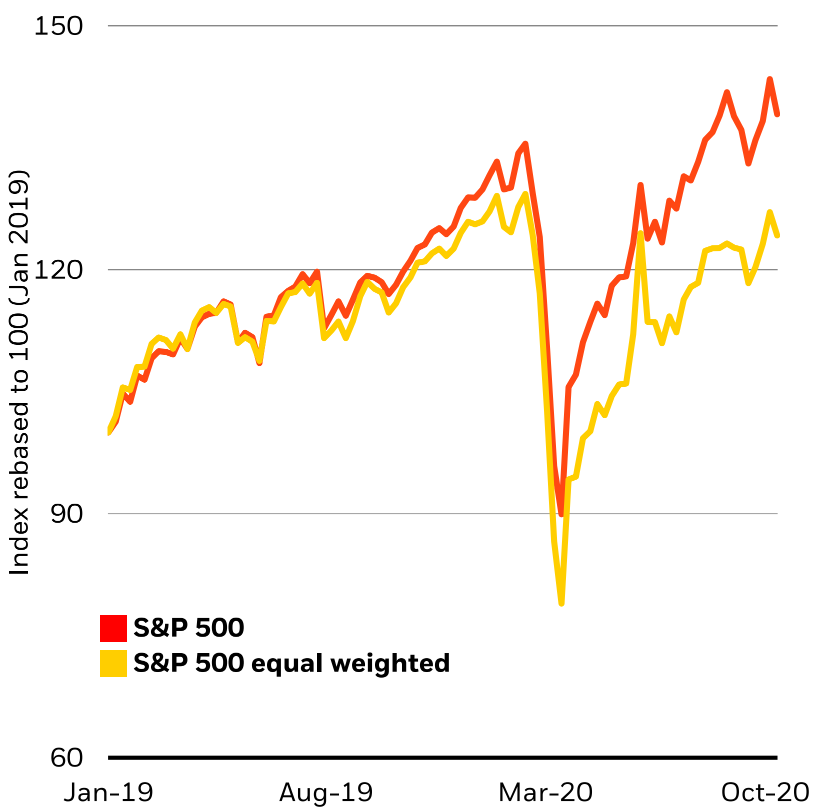
Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index.

Source: BlackRock Investment Institute, with data from Datastream Refinitiv, October 2020. Notes: Data are through 21 October. The chart shows total returns year-to-date and from 29 June 2020 – the date we published our midyear investment outlook. The letters in brackets indicate our current investment view on the asset class. Indexes or prices used are MSCI World Momentum USD, MSCI AC Asia Ex JP USD, Bloomberg Barclays Euro Aggregate Treasury Italy USD, MSCI EM USD, S&P 500 Composite, MSCI World Quality USD, MSCI AC World USD , Bloomberg Barclays Euro Aggregate Treasury Germany USD, MSCI Japan USD, MSCI World Minimum Volatility USD, Bloomberg Barclays Global Credit USD, Bloomberg Barclays Global High Yield USD, Bloomberg Barclays Global Aggregate - Corporate USD, Bloomberg Barclays Global Aggregate - Treasuries USD, Bloomberg Barclays U.S. Treasury: U.S. Tips USD, JPM EMBI Global Diversified - Index Level, STOXX Europe 50 (USD), MSCI World Enhanced Value USD, MSCI EM Ex Asia USD, JPM JACI Index - Index Level, JPM GBI-EM Composite - Index Level , S&P Us Treasury Bill Current 3m Index - Price Index and Bloomberg Barclays U.S. Treasury USD. Returns are shown in USD. Indexes are unmanaged and not subject to fees.

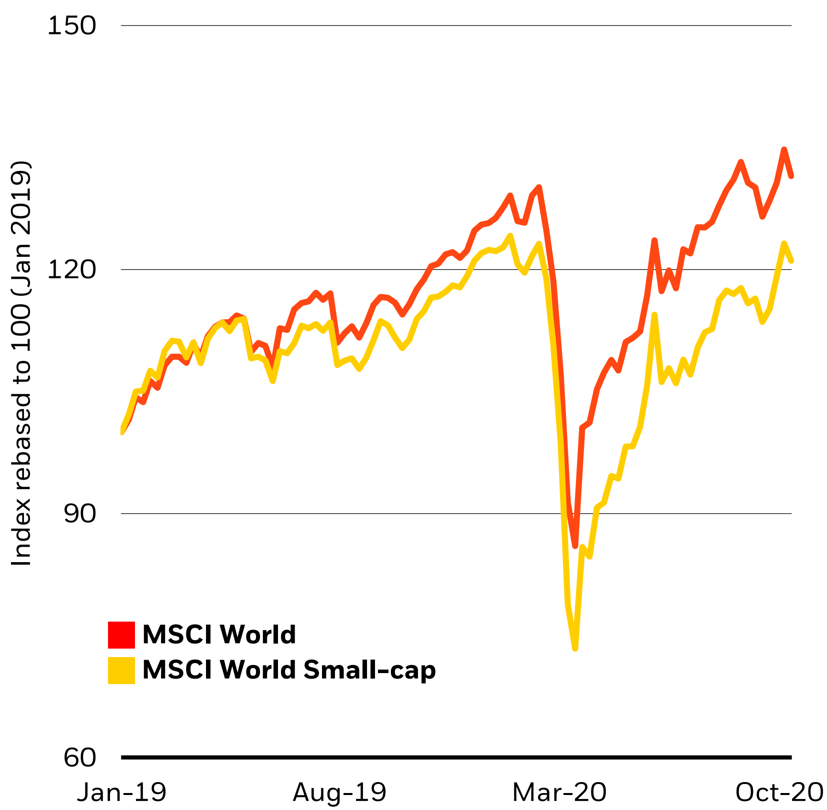
Democratic sweep could spur factor rotation

Increased fiscal spending could boost prospects for cyclicals and small-caps whose persistent underperformance has seen their weight in benchmark indices fall.

S&P 500 index performance, Oct. 2020



MSCI World large-cap vs small-caps, Oct. 2020

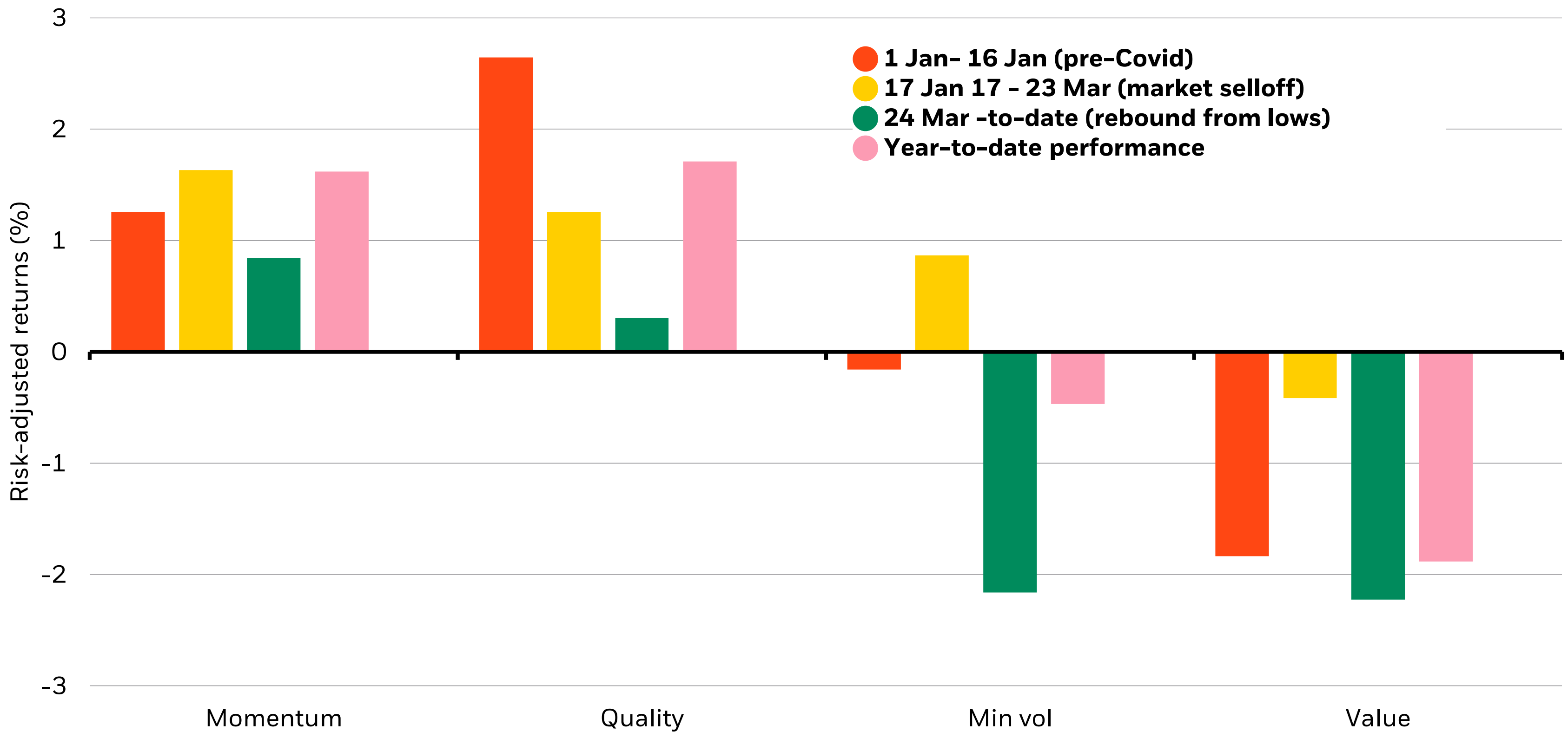


Sources: BlackRock Investment Institute, with data from MSCI and Refinitiv Datastream. Notes: The left chart shows index rebased performance of the S&P 500 composite – that is weighted according to market capitalization – relative to the equal weighted S&P 500. The right chart contrasts performance of the MSCI World against MSCI World small-caps. All returns are total returns in USD terms.

We maintain our overweight on the quality factor

We still favor the quality factor for its resilience against a range of economic outcomes. Stretched positioning and dominance of richly valued tech and defensive stocks leave the momentum factor vulnerable to reversals.

Risk-adjusted returns for style factors, 2019-2020

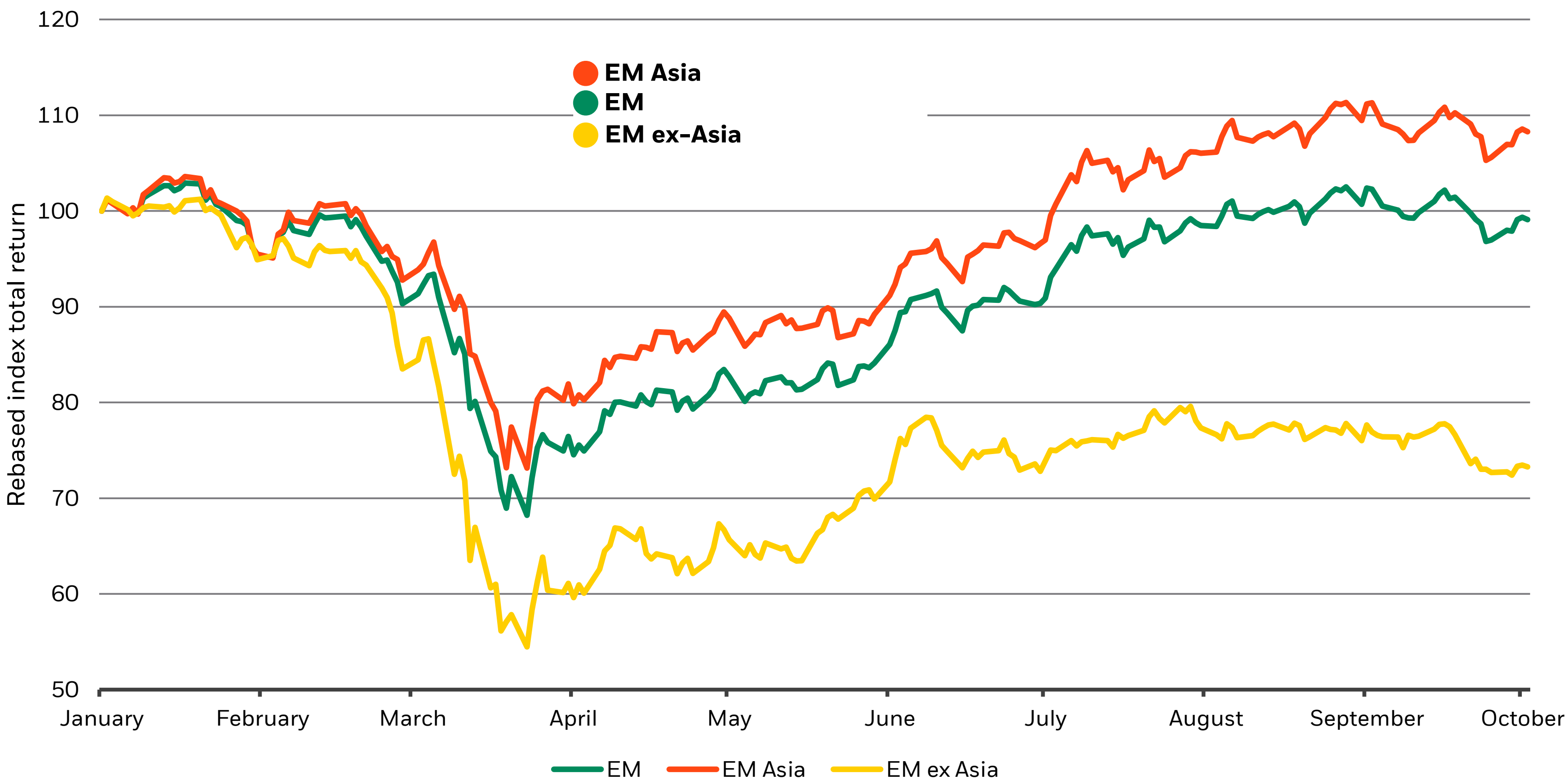


Past performance is not a reliable indicator of current or future results. Indexes are unmanaged and not subject to fees. You cannot invest directly in an index.
Sources: BlackRock Investment Institute, with data from Refinitiv Datastream, October 2020. Notes: The bars show risk-adjusted returns of MSCI World Momentum, Quality, Minimum volatility and Value indexes from 1 Jan 2020 to 19 June 2020. This is split as: 1 Jan to 16 January (Pre-Covid), 17 Jan to 23 March (Covid-19 Market selloff), 24 Mar (rebound from the lows) and year-to-date as of 25 October 2020. We use the MSCI World Index as the benchmark in this analysis. The risk-adjusted returns are calculated by subtracting a factor index's return for a given period from the total return of the benchmark, then dividing that result by the tracking error, or the standard deviation of the difference between individual index and benchmark returns.

A tale of two EM regions

The divergence in performance within emerging markets underscores the importance of taking deliberate regional exposures.

EM Asia vs. EM ex-Asia performance, year-to-date 2020

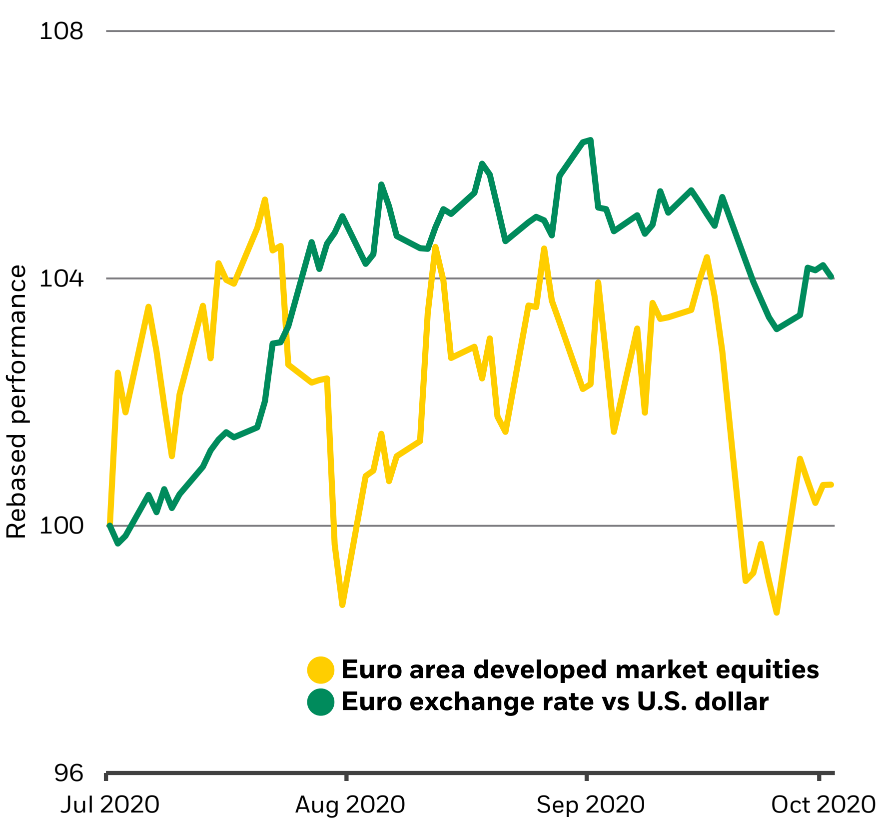


Past performance is not a reliable indicator of current or future results. Indexes are unmanaged and not subject to fees. It is not possible to invest directly in an index.
Sources: BlackRock Investment Institute, data as of 5 October 2020. Notes: The chart shows the performance of EM regions rebased to 100 as of 31/12/2019. Indexes used are: MSCI Emerging Market index, MSCI EM Asia index and MSCI EM ex-Asia index.

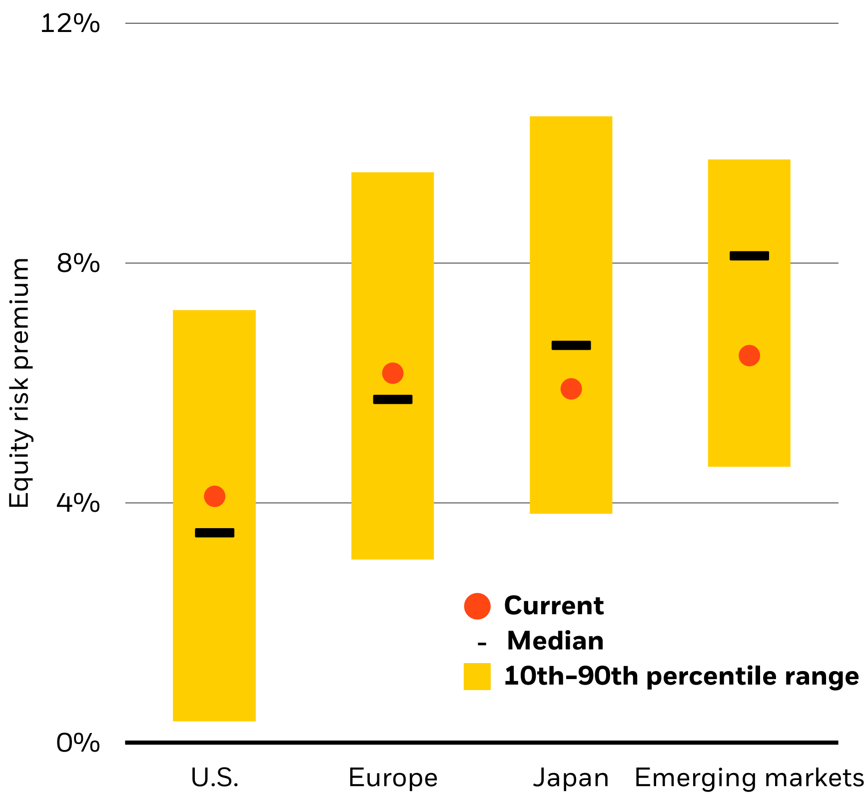
Euro optimism has not translated to European equities

European equity performance has lagged on risks of renewed activity setbacks as virus cases rise, relatively poor economic performance and investors' aversion to value-oriented exposures.

Euro area equities vs euro, June-Oct. 2020



Equity risk premium ranges, Sept. 2020

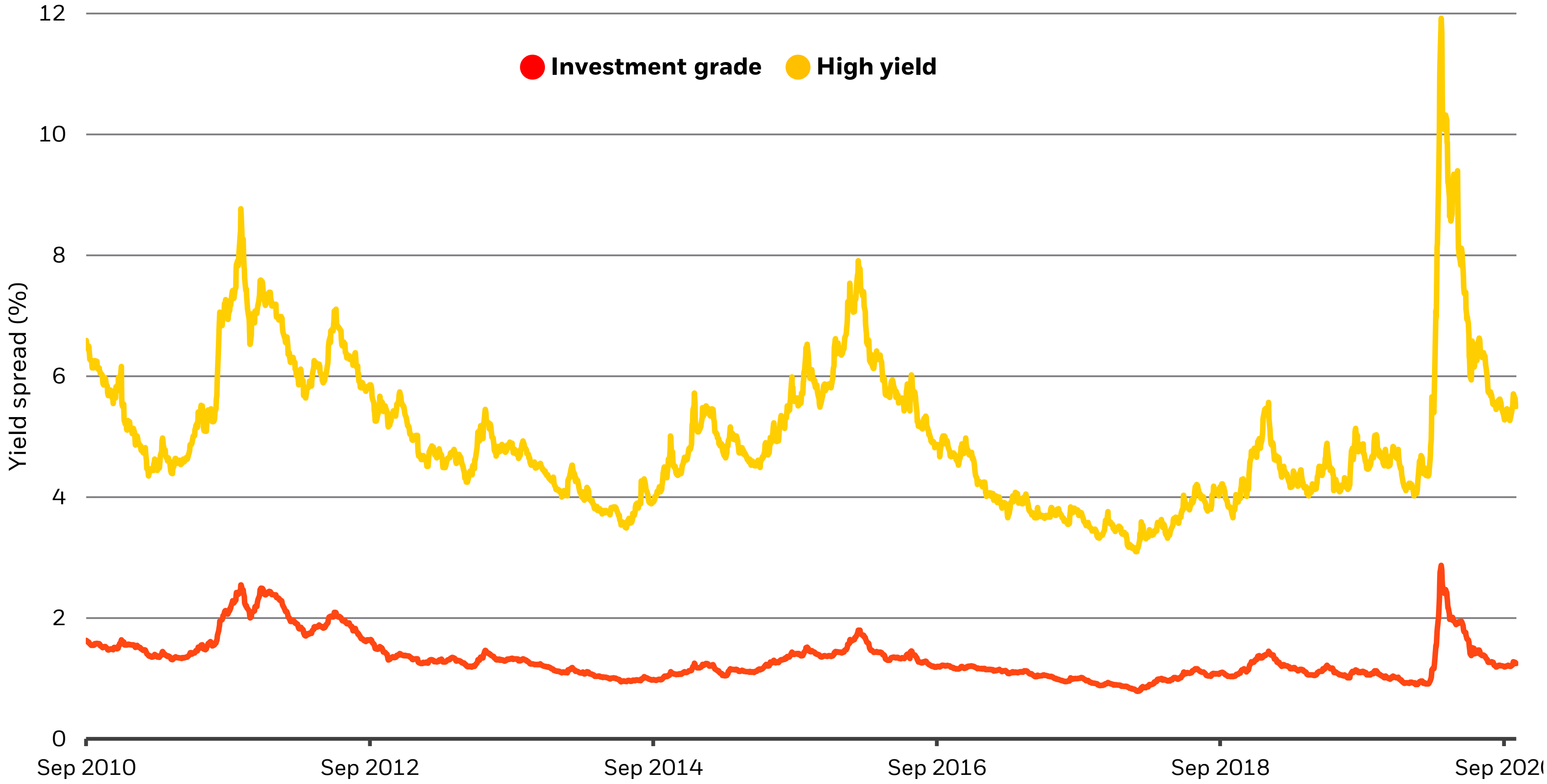


Past performance is not a reliable indicator of current or future results. Indexes are unmanaged and not subject to fees. It is not possible to invest directly in an index. Sources: BlackRock Investment Institute, with data from Refinitiv Datastream, October 2020. Notes: The left chart shows rebased performance since 29 June 2020 for the euro exchange rate against the U.S. dollar and euro area developed market stocks. We use the MSCI EMU index as the proxy for euro area developed market equities. The chart on the right shows the equity risk premium and historical ranges since 1995 for major equity regions. We calculate the equity risk premium based on our expectations for nominal interest rates and the implied cost of capital for respective equity markets.

We still like high yield for income potential

We see scope for high yield spreads to tighten further as the economic recovery gathers steam. Risk-reward on IG spreads looks less appealing spurring a tactical downgrade of the asset class.

Investment grade and high yield credit spreads, 2010-2020



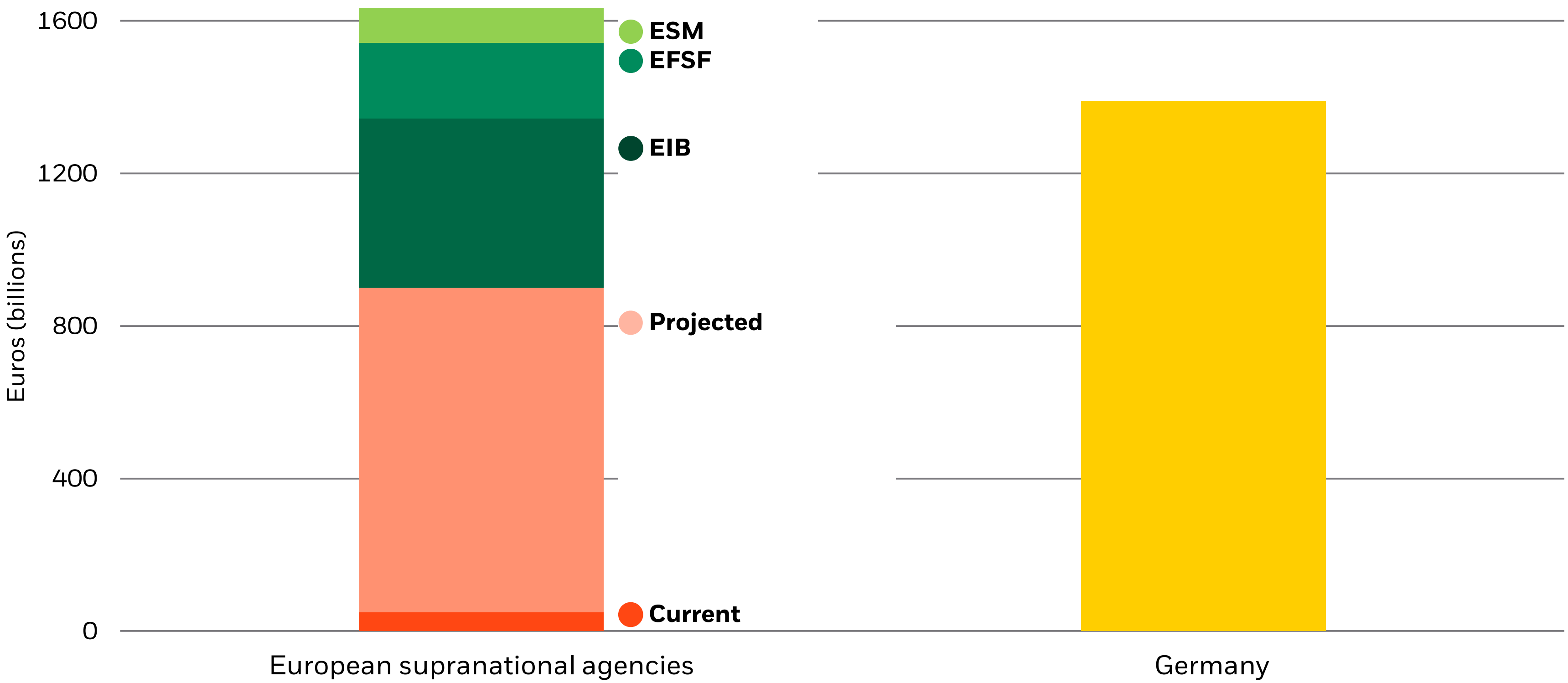
Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index. Indexes are unmanaged and do not account for fees.

Sources: BlackRock Investment Institute, with data from Refinitiv, October 2020. Notes: The lines show yield spread of investment grade and high yield credit over the past 10 years, represented by the option-adjusted spread of Bloomberg Barclays Global Aggregate Total Return Index and Bloomberg Barclays Global High Yield Total Return Index.

EU bonds may become a viable complementary asset to bunds

Planned issuance to support the recovery fund and other plans in coming years will likely see the EU become one of the largest single issuers of highly rated, euro-denominated bonds.

Actual and expected volume of outstanding debt from select euro area entities, September 2020



Sources: BlackRock Investment Institute, with data from the European Central Bank, Bloomberg, Haver Analytics, October 2020. Notes: The chart compares the total outstanding debt stock for Germany to that of the cumulative outstanding debt issued by the largest euro area supranational issuers such as the European Investment Bank (EIB), the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM), and to the total current and projected volume of bonds to be issued by the European Union as a single entity. The projected issuance (light orange) comprises the nearly 850 billion euros of funding agreed upon related to the EU's Support to mitigate Unemployment Risks in an Emergency (SURE) loan programme and the Next Generation EU (NGEU) recovery fund.

Tactical granular views

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

Change in view

Previous New

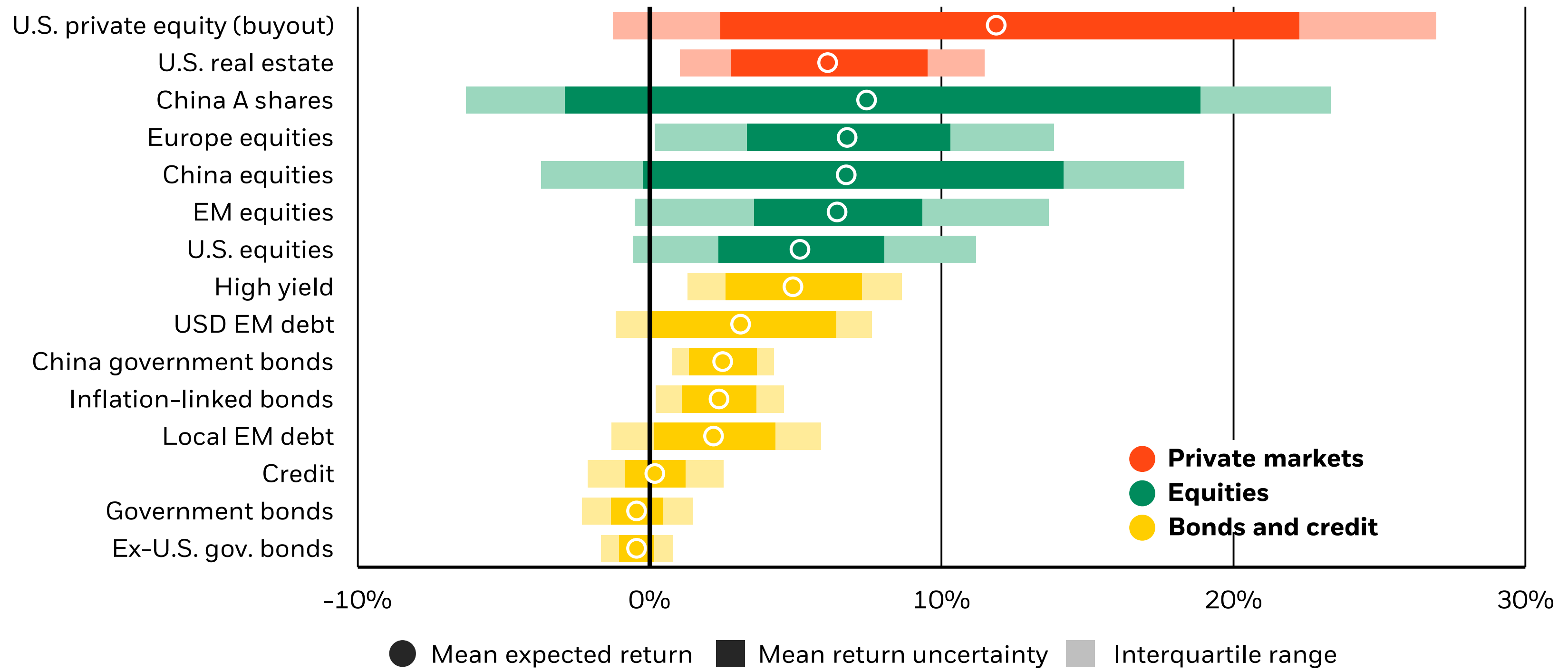
	Asset	Underweight	Overweight	
Equities	United States			We are neutral U.S. equities. Risks of fading fiscal stimulus and an extended epidemic are threatening to derail the market's strong run. Renewed U.S.-China tensions and a divisive election are also likely to weigh on the asset class.
	Euro area			We are overweight European equities. 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 keep Japanese equities at neutral. We see strong fiscal policy and public health measures allowing for rapid normalization.
	Emerging markets			We are underweight emerging market equities. 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 hold Asia ex-Japan equities at 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 sectoral composition of the factor provides exposure to both growth (tech) and defensive stocks (pharma). Yet momentum's high concentration poses risks as recovery takes hold.
	Value			We are neutral on value. 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 hold min vol at neutral. The restart of economies is likely to benefit cyclical assets and reduce the need for defensive exposures.
	Quality			We keep our strong overweight on quality. We see it as the most resilient exposure against a range of outcomes in terms of developments in the pandemic and economy.
Fixed income	U.S. Treasuries			We have downgraded U.S. Treasuries to underweight. The potential for fiscal spending – particularly in a Democratic sweep election outcome – could spur higher yields and a steeper yield curve.
	Treasury Inflation-Protected Securities			We have upgraded TIPS to overweight. We see potential for higher inflation expectations to get increasingly priced in on the back of loose monetary policy, greater fiscal stimulus and increasing production costs.
	German bunds			We have upgraded bunds to neutral as we see the balance of risks shifting back in favor of more monetary policy easing from the European Central Bank as the regional economic rebound shows signs of flagging.
	Euro area peripherals			We are 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 hold investment grade credit at neutral. We see little room for more yield spread compression, as deeper rate cuts and more asset purchases are unlikely as a policy response. Central bank asset purchases and a broadly stable rates backdrop still are supportive.
	Global high yield			We have a strong overweight in high yield. We see the very high implied default rates as overly pessimistic and believe high yield remains an attractive source of income in a yield-starved world.
	Emerging market – hard currency			We are underweight 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 under priced.
	Emerging market – local currency			We are underweight local currency EM debt to underweight. We see many EM countries as having insufficient capacity to rein in the virus spread and limited policy space to cushion the shock from the pandemic.
	Asia fixed income			We are 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.

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.

Our CMAs reflect a very different future

Expected government bond returns are negative across developed markets, keeping us underweight on a strategic horizon. We see better opportunities in private markets and inflation-linked bonds.

Asset return expectations and uncertainty in U.S. dollars on a five-year horizon

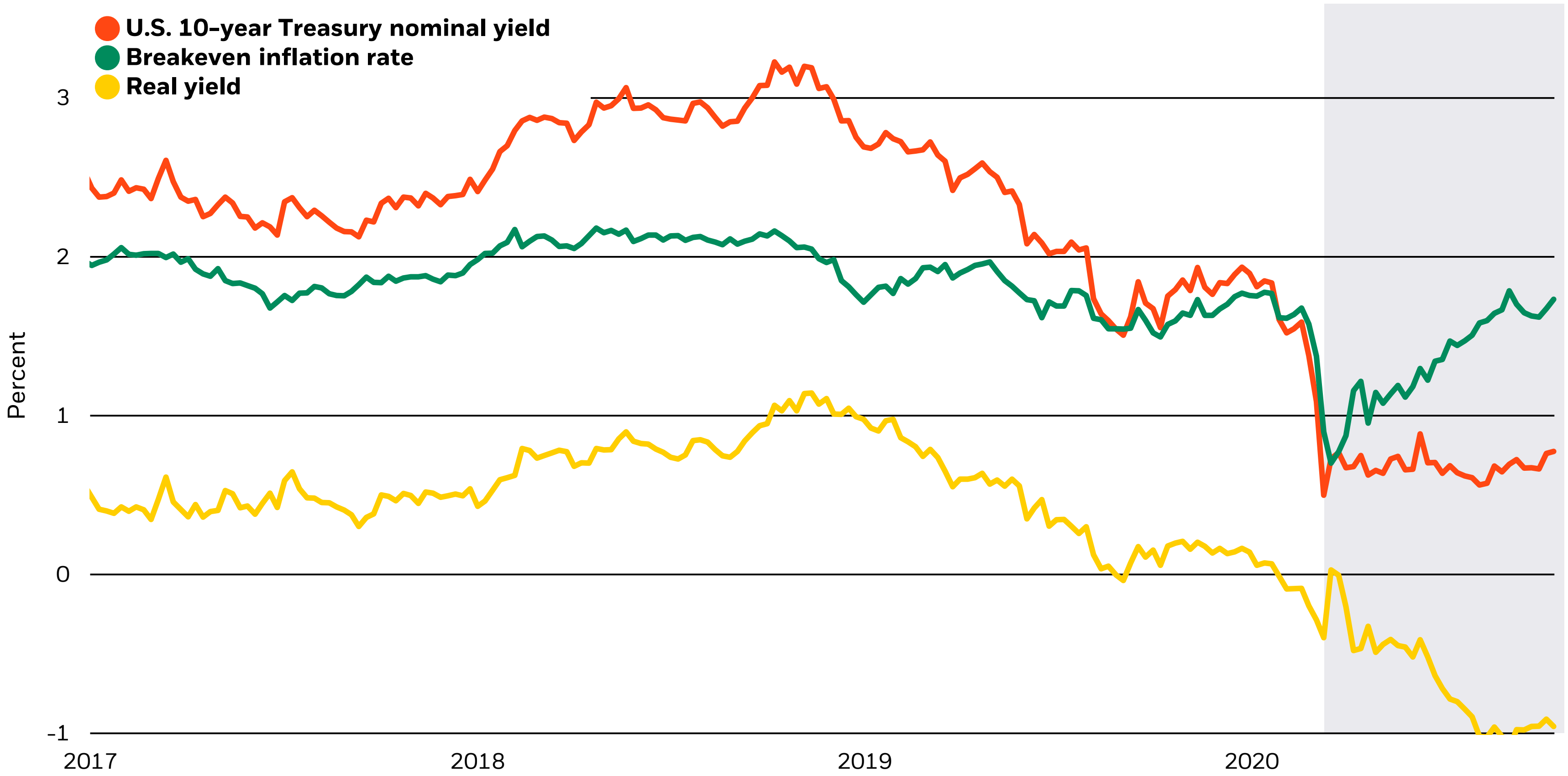


This information is not intended as a recommendation to invest in any particular asset class or strategy or as a promise - or even estimate - of future performance.
Source: BlackRock Investment Institute, data as of 30 June 2020. Notes: Return assumptions are total nominal returns. U.S. dollar return expectations for all asset classes are shown in hedged terms, with the exception of regional equity markets, Chinese government bonds, local-currency EM debt and private markets other than hedge funds. Our CMAs generate market, or beta, geometric return expectations. Asset return expectations are gross of fees. For a list of indices used see appendix. Professional investors can visit our Capital market assumptions website at blackrock.com/institutions/en-zz/insights/charts/capital-market-assumptions and click on the information icon in the *Asset class return and volatility expectations* table for further details. We use BlackRock proxies for selected private markets because of lack of sufficient data. These proxies represent the mix of risk factor exposures that we believe represents the economic sensitivity of the given asset class. There are two sets of bands around our mean return expectation. The darker bands show our estimates of uncertainty in our mean return estimates. The lighter bands are based on the 25th and 75th percentile of expected return outcomes – the interquartile range. Professional investors can find more detail in our *Portfolio perspectives*. Indices are unmanaged and used for illustrative purposes only. They are not intended to be indicative of any fund or strategy's performance. It is not possible to invest directly in an index.

Higher expected inflation does not mean higher bond yields

In the past higher inflation has often lead to higher nominal rates. This year the bond market has priced higher expected inflation but central banks have limited the rise in government bond yields.

U.S. 10-year Treasury yield, breakeven inflation rate and real yield, 2017-2020



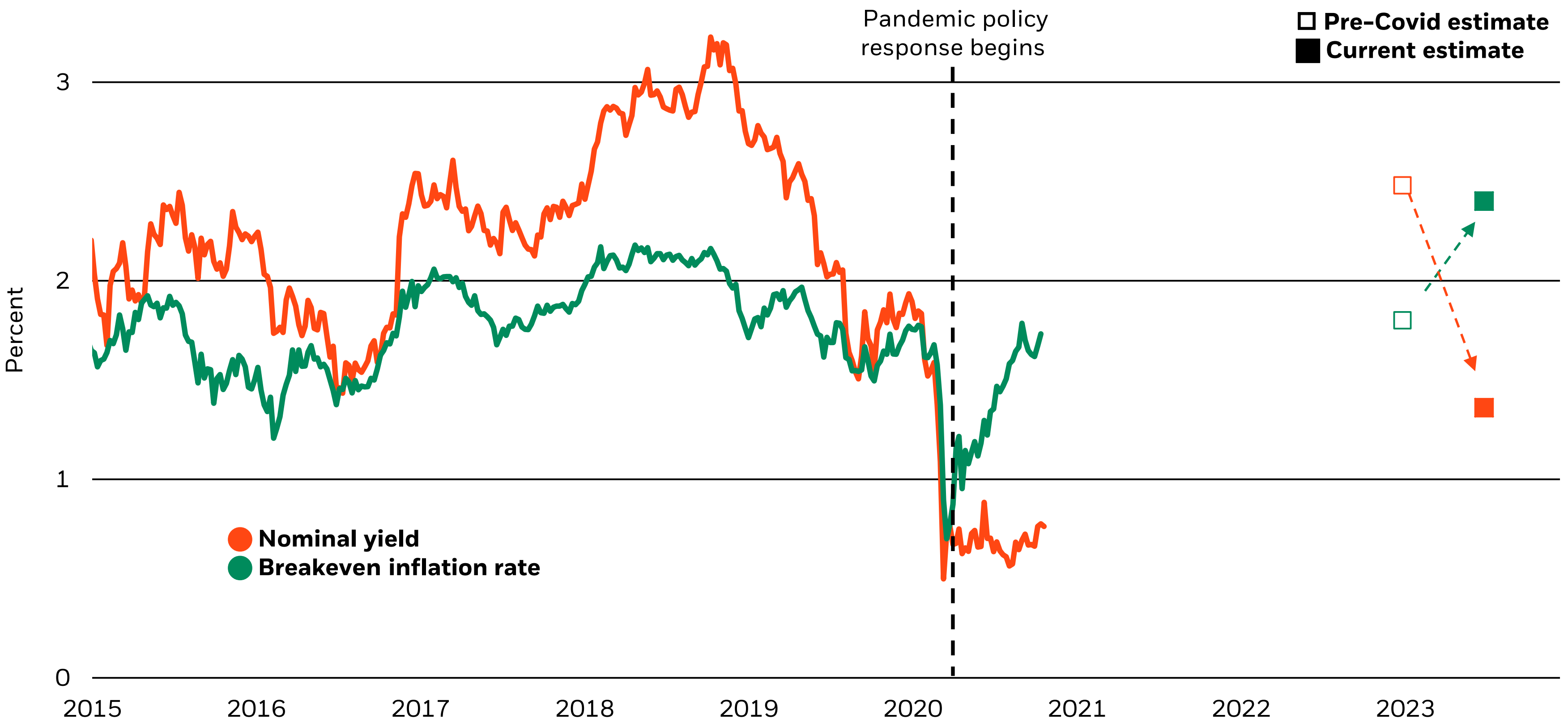
Past performance is no guarantee of current or future results.

Source: BlackRock Investment Institute and Refinitiv Datastream, data as of 5 October 2020. Notes: The chart shows the U.S. 10-year Treasury nominal yield and the pricing of Treasury inflation-protected securities – the 10-year TIPS yield, or real yield, and the breakeven inflation rate, or the future rate of inflation being priced by markets in TIPS. Forward-looking estimates may not come to pass. The grey band represents the period post March 2020 highlighting how monetary policy has kept nominal yields in check even as inflation expectations rose.

Raising inflation expectations but low yields ahead

We have raised our inflation expectation over the medium-term but not our nominal yield expectations – we see a higher likelihood of lower real yields.

U.S. 10-year Treasury yield and breakeven inflation, 2015-2023



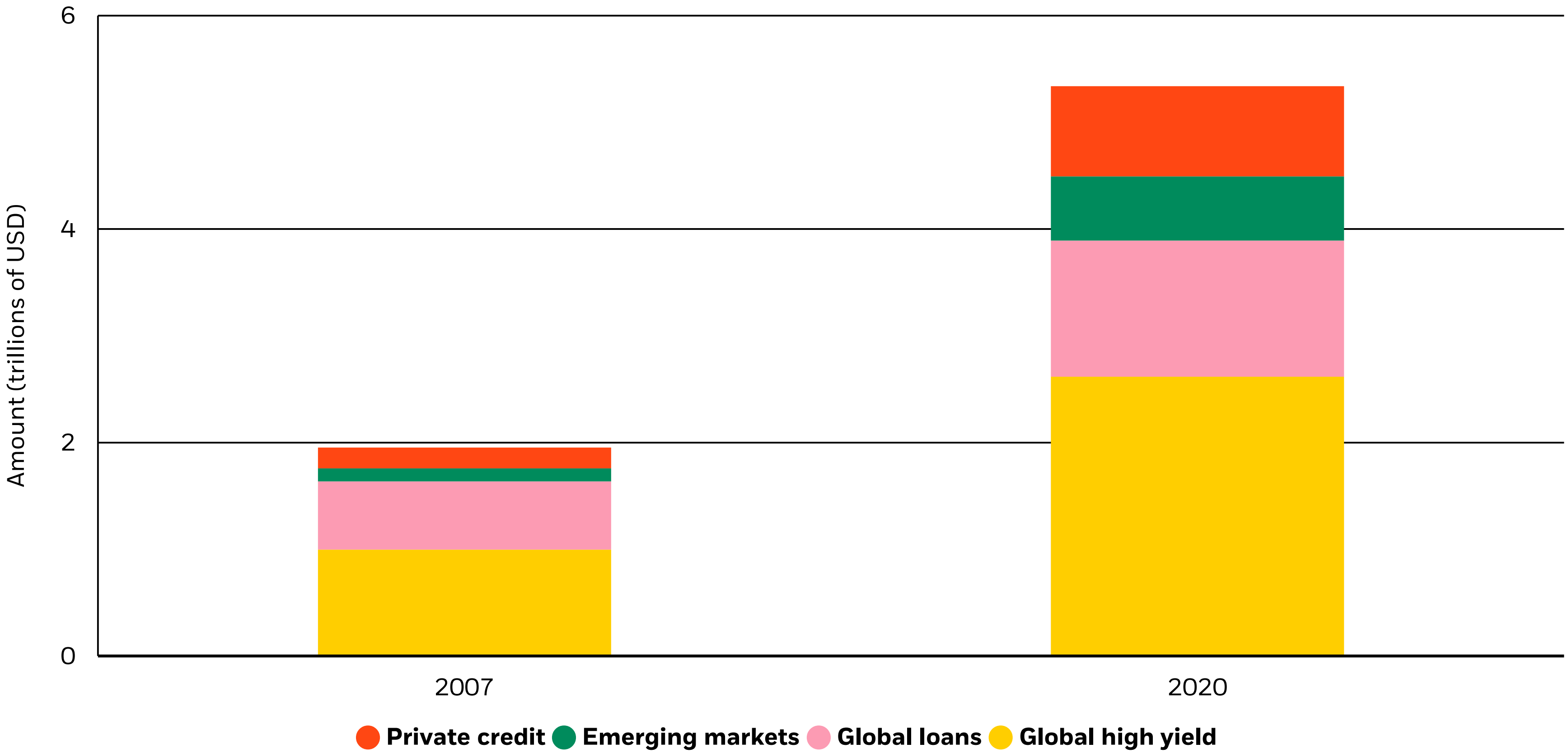
This information is not intended as a recommendation to invest in any particular asset class or strategy or as a promise - or even estimate - of future performance. Past performance is no guarantee of current or future results.

Source: BlackRock Investment Institute and Refinitiv Datastream, data as of 15 October 2020. Notes: The chart shows the U.S. 10-year Treasury yield and the 10-year breakeven inflation rate, or the future rate of inflation being priced by markets in TIPS. Between January 2015 and October 2020.. The chart also shows our expected estimated values three-years forward for nominal yields and market implied inflation rate as at Q4 2019 ('pre-Covid forecasts') and as at Q2 2020 based on our capital market assumptions.

Private market opportunities from post-Covid restructuring

A wave of corporate restructuring offers opportunities in private credit, but manager selection is crucial. Private market assets are not suitable for all investors.

Sub-investment grade debt outstanding, 2007 and 2020

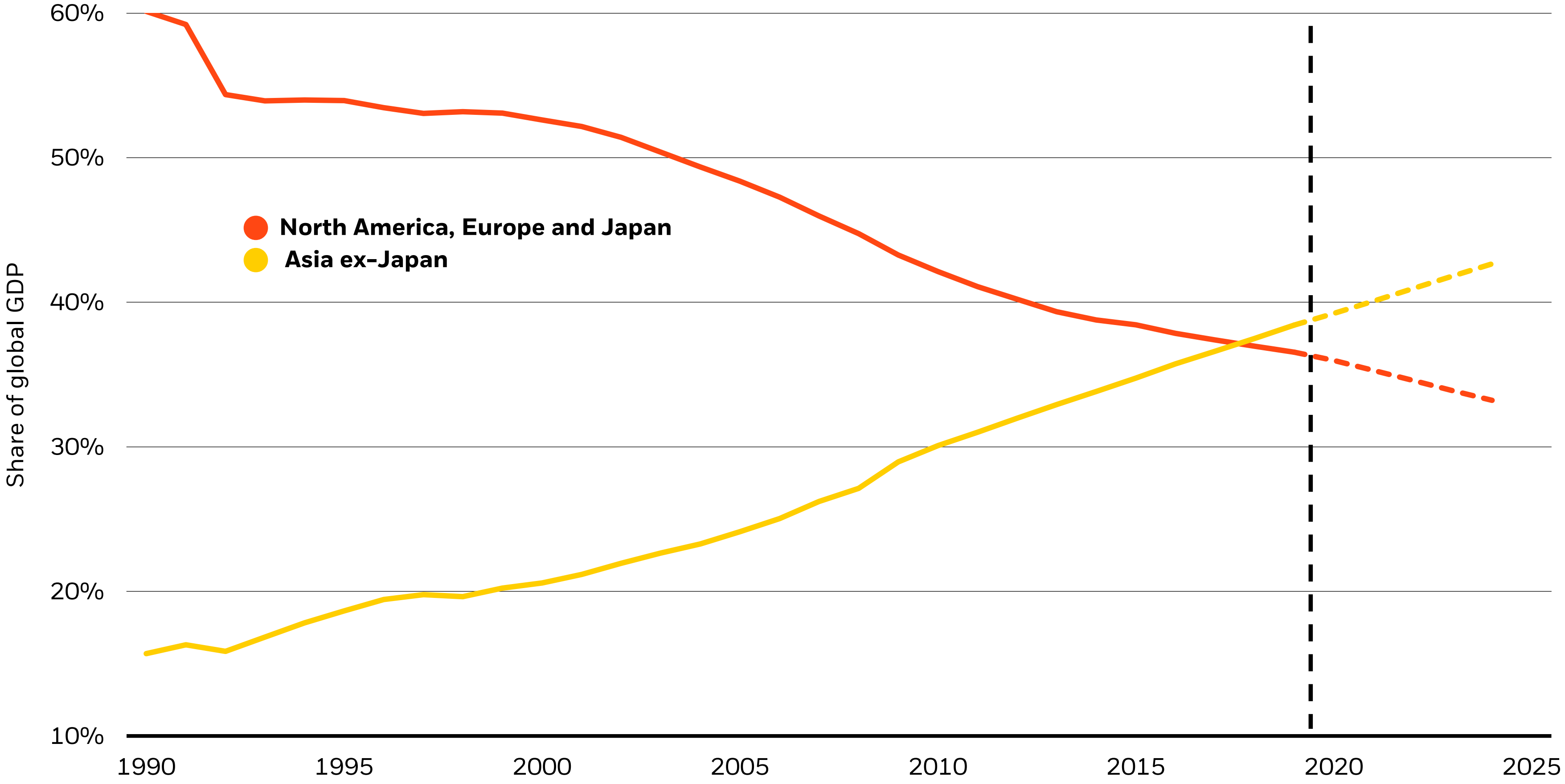


This information is not intended as a recommendation to invest in any particular asset class or strategy or as a promise - or even estimate - of future performance.
Sources: BlackRock Investment Institute, October 2020. Notes: Private credit data are from Preqin. Indexes used for public markets shown are the JP Morgan CEMBI Index, S&P/LSTA Leveraged Loan Index + S&P European All Loans Index and the Bloomberg Barclays Global High Yield Index. Index data are as of June 30, 2020, and the private credit data as of Dec. 31, 2019. Indexes are unmanaged and do not account for fees. It is not possible to invest directly in an index.

Pandemic likely to heighten geopolitical fragmentation

The world looks increasingly fragmented, with the U.S. and China at opposite poles. We believe investors should consider gaining exposure to both spheres, as global growth gravitates toward Asia.

Regional share of global GDP, 1990–2024

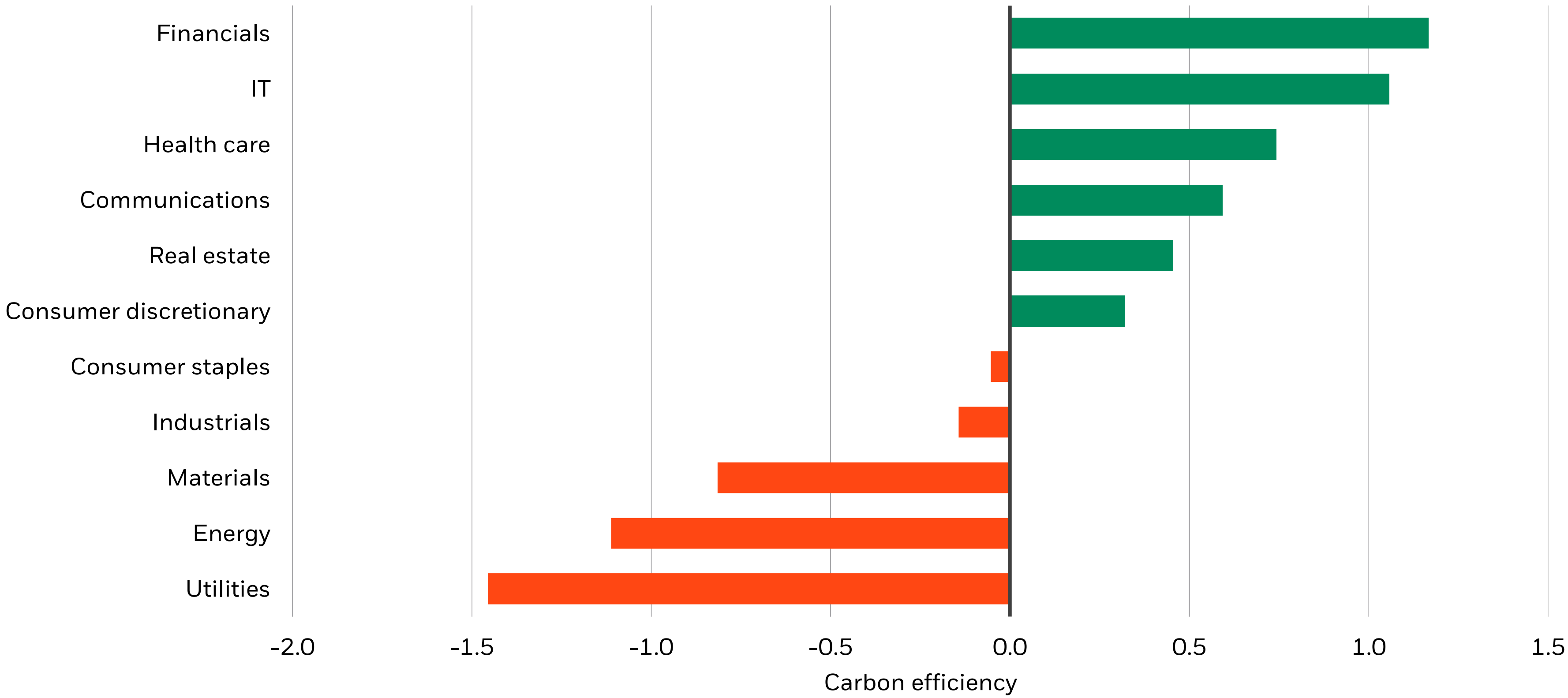


Sources: BlackRock Investment Institute, with data from IMF, Refinitiv, October 2020. Notes: The lines how each region's combined share of global GDP on a purchasing power parity (PPP) basis. The dotted lines show the forecast period based on IMF projections to 2024.

Granular views are key to taking sustainable exposures

Sustainability is likely to be an increasing driver of returns as investors allocate toward perceived ESG-friendly assets. Yet differentiation will be greater at the stock and sector level, in our view.

Estimated carbon efficiency for MSCI sectors, October 2020



Sources: BlackRock Investment Institute with data from Refinitiv Datastream and MSCI, October 2020. Notes: The chart shows the carbon efficiency – measured as total carbon emissions relative to the aggregate firm value – for underlying companies within the main sub-sectors of the MSCI USA index. The carbon efficiency measure is shown in Z-score terms. Both direct and indirect carbon emissions are considered. Direct and indirect carbon emissions indicate the exposure of companies to carbon taxes introduced as part of climate change mitigation policies. It is a metric commonly used by investors to measure the climate change impact of their portfolios.

Appendix

Indexes

Global government bonds = Bloomberg Barclays Global Treasury index

Japan government bonds = Bloomberg Barclays Global Treasury Japan Index

Euro area credit = ICE BofA Merrill Lynch 10+ Year Euro Corporate Index

Global high yield = ICE BofA Merrill Lynch Global High Yield Index

Euro area government bonds = Bloomberg Barclays Euro Aggregate Treasury Index

U.S. credit = Bloomberg Barclays U.S. Credit Index

Global IG credit = Bloomberg Barclays Global Aggregate - Corporate

Inflation-linked bonds = ICE BofA Merrill Lynch Global Inflation-Linked Government Index

Euro area inflation-linked bonds = ICE BofA ML EMU Direct Government Inflation Linked Index

U.S. TIPS = Bloomberg Barclays US Government Inflation-Linked Bond Index

EM debt, local = JP Morgan GBI-EM Index

EM debt, hard = JP Morgan EMBI Global Diversified Index

Japan equities = MSCI Japan index

European equities = MSCI Europe index

DM equities = MSCI World index

EM equity = MSCI Emerging Markets Index

Onshore Chinese equities = MSCI China A Inclusion NET Index

Private equity = BlackRock proxy

U.S. Real estate = BlackRock proxy

We use BlackRock proxies for selected private markets because of lack of sufficient data. These proxies represent the mix of risk factor exposures that we believe represents the economic sensitivity of the given asset class.

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