October 2023

BlackRock

2023 Global outlook Q4 update

BlackRock Investment Institute

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Markets are playing catch-up to the new regime

Bond yields have surged to 16-year highs. We think the market is adjusting to the new regime and its implications – especially higher macro volatility. We center our outlook on structural shifts and look through the market noise.

U.S. 10-year Treasury yields, 1985-2023

Past performance is not a reliable indicator of current or future results Source: BlackRock Investment Institute, with data from LSEG Datastream, October 2023. Notes: The chart shows the yield on the Datastream 10-year Benchmark Treasury..

New regime, new opportunities

1. Holding tight

Markets have come around to the view that central banks will not quickly ease policy in a world shaped by supply constraints. We see them keeping policy tight to lean against inflationary pressures.

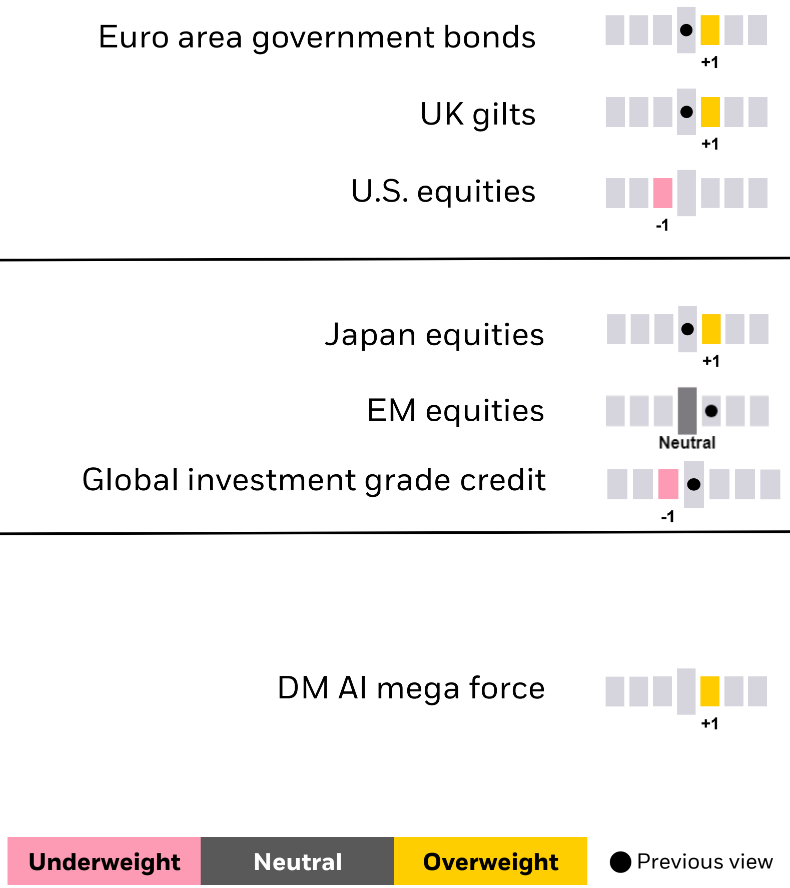
2. Pivoting to new opportunities

Higher macro and market volatility has brought more divergent security performance relative to the broader market. Benefiting from this requires granularity and nimbleness.

3. Harnessing mega forces

The new regime is shaped by five big structural forces we think are poised to create big shifts in profitability across economies and sectors. The key is identifying catalysts that can supercharge them and whether the shifts are priced by markets today.

Key tactical view changes since our Midyear outlook

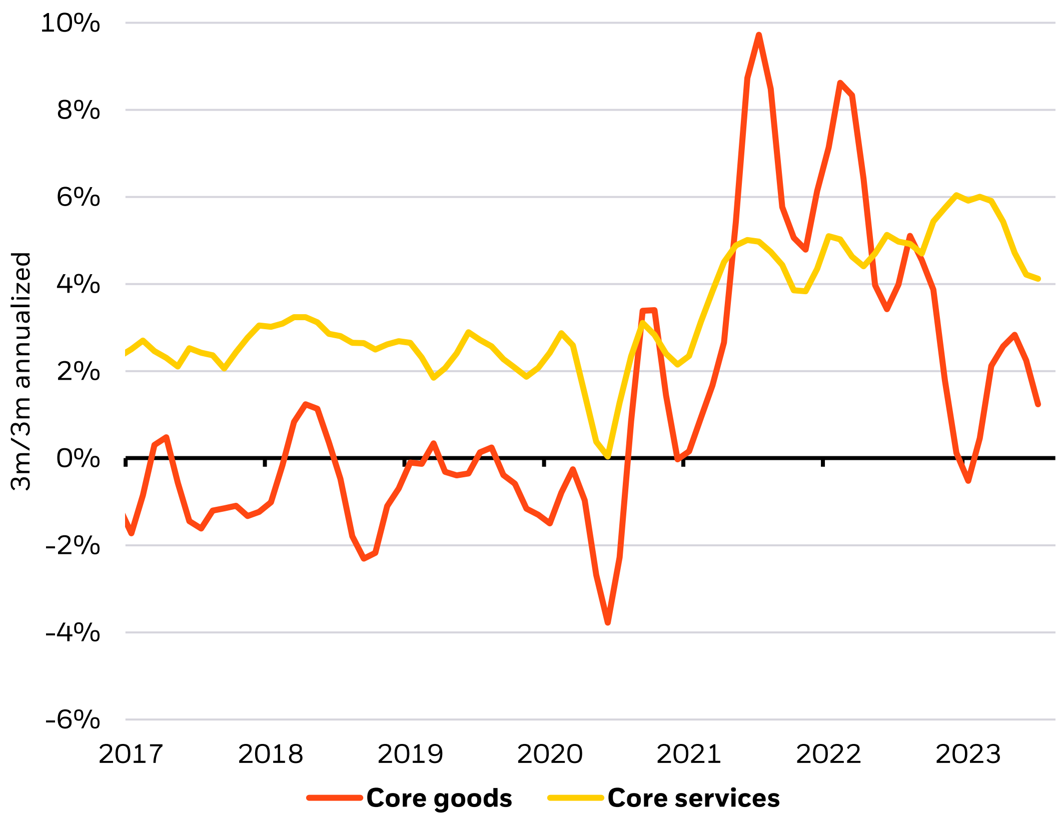


The opinions expressed are as of October 2023 and are subject to change at any time due to changes in market or economic conditions. Strategic implications refer to long-term views of five years and longer, tactical implications refer to asset views on shorter horizons of 12 months or less.

Inflation is falling as pandemic-induced mismatches resolve…

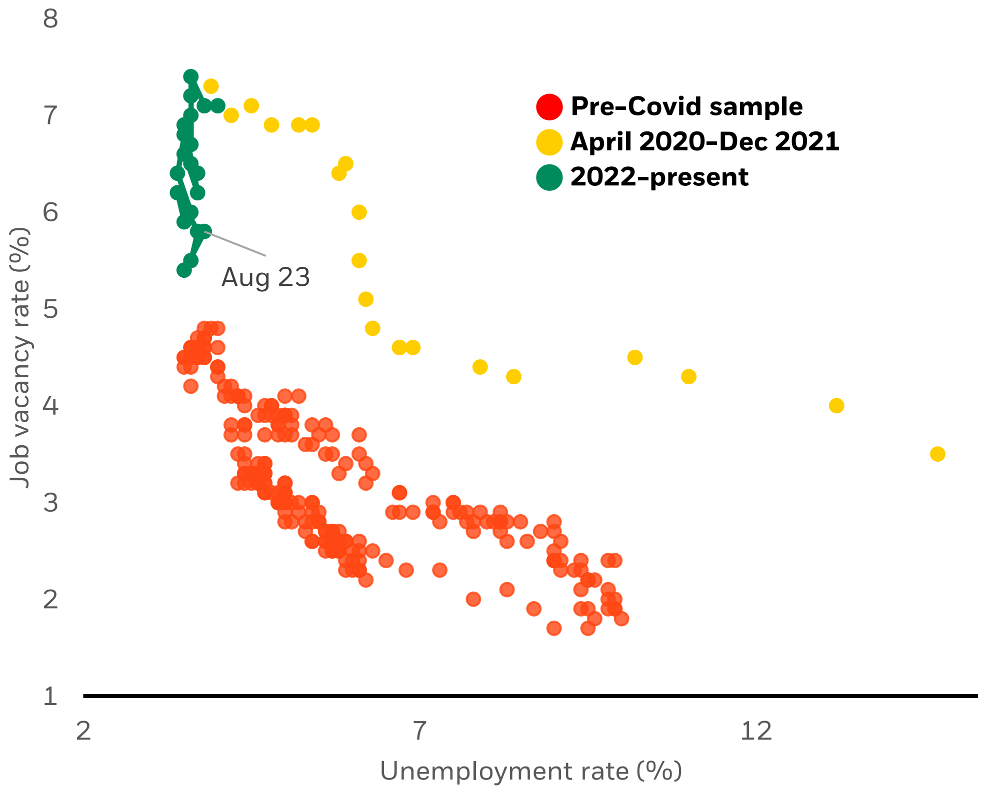
We think about two-thirds of the spending shift to goods from services has unwound. Goods prices are dragging inflation down as demand normalizes. A skills mismatch is also normalizing, helping cool wage growth.

Core goods and services inflation, 2017–2023



Source: BlackRock Investment Institute, U.S. Bureau of Labor Statistics, with data from Haver Analytics, September 2023. Notes: The chart shows core goods and core services PCE inflation. Each line shows the three-month growth over the preceding three months, expressed as an annualized rate.

U.S. job vacancy and unemployment rate, 2001–2023

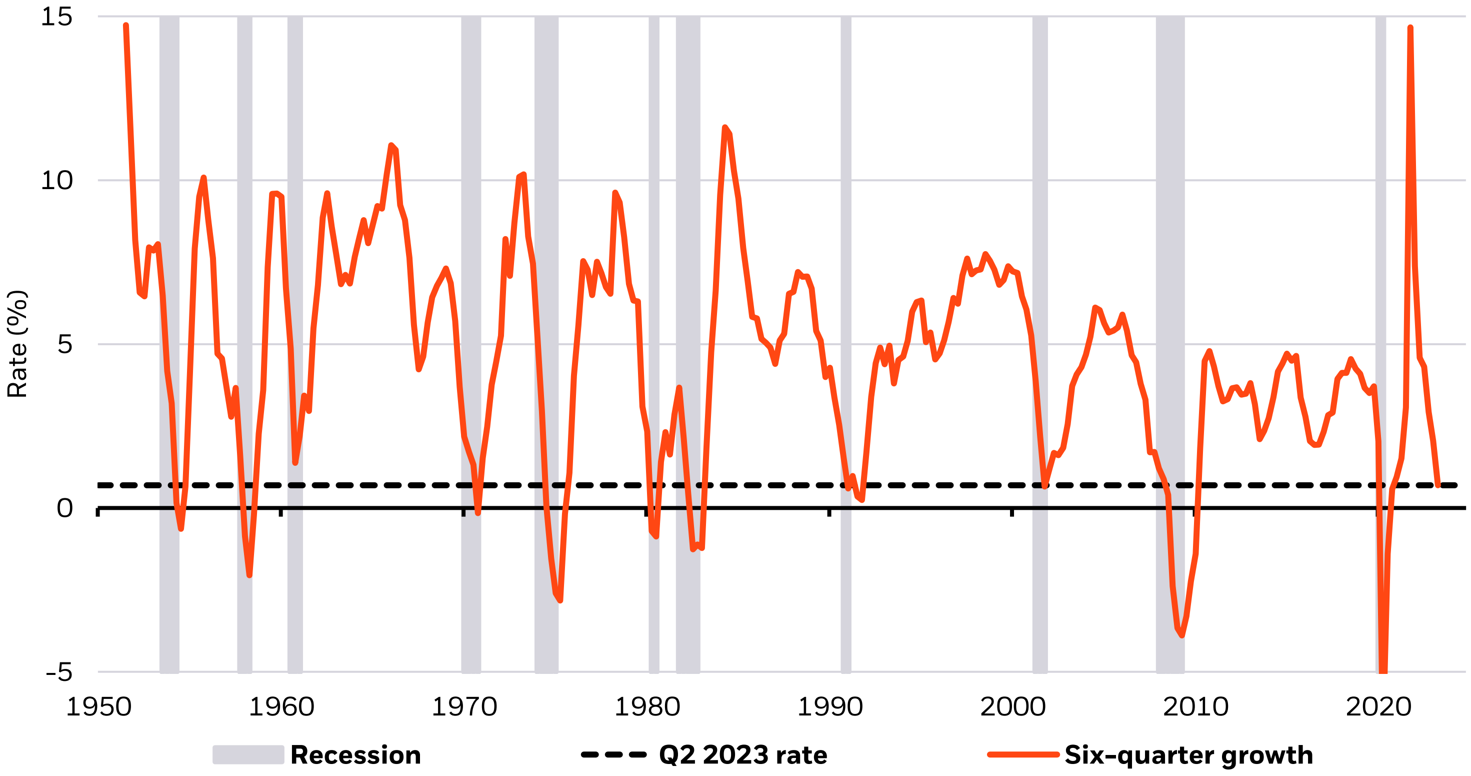


Source: BlackRock Investment Institute, U.S. Bureau of Labor Statistics, with data from Haver Analytics, October 2023. Notes: The chart shows the U.S. job vacancy rate vs the unemployment rate in the same month.

…but with stealth stagnation in the economy

Inflation declining through 2023 has come at the cost of economic growth as tighter policy bites. On some measures, the U.S. economy hasn't actually grown much in the last 18 months – it's never been this weak without a recession.

U.S. output growth over six quarters, 1950–2023

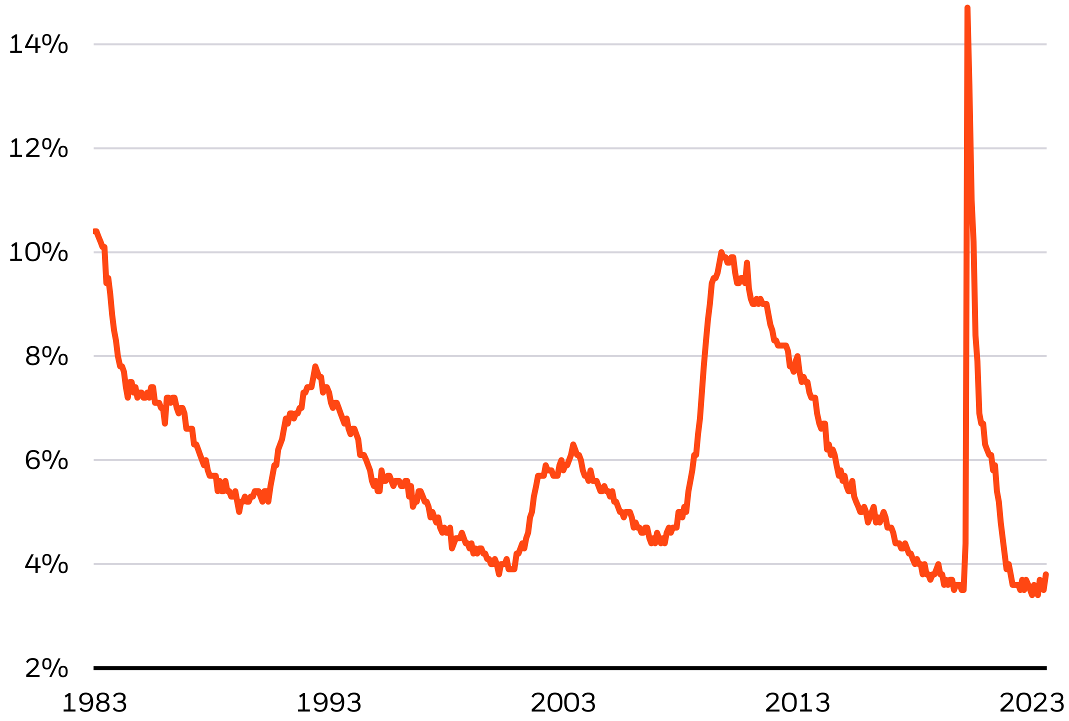


Source: BlackRock Investment Institute, U.S. Bureau of Labor Statistics, with data from Haver Analytics, September 2023. Notes: The chart shows the output growth rate (as measured by the average of GDP and GDI) over a six-quarter period. We use a six-quarter interval to benchmark the growth rate since the beginning of the Fed's current policy tightening cycle.

This is a tight labor market, not a strong one

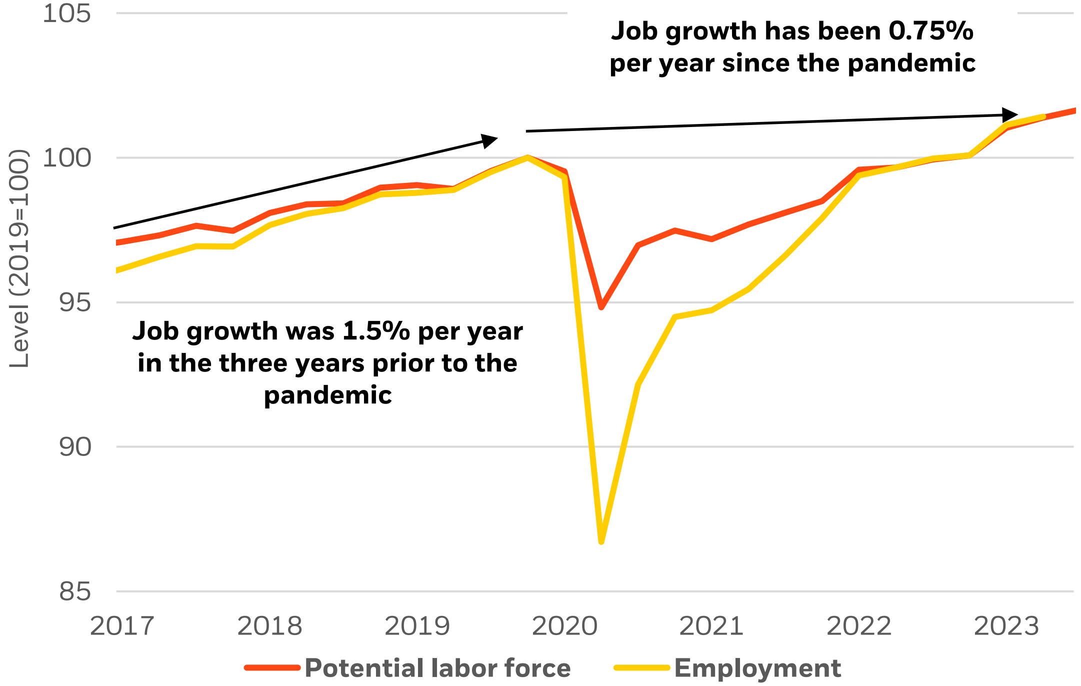
An aging population is set to constrain labor supply from here, we think. We find it'll mean the U.S. economy can only add around 70K new jobs a month without stoking higher inflation, compared to 200K previously.

U.S. unemployment rate, 1983–2023



Source: BlackRock Investment Institute, U.S. Bureau of Labor Statistics, with data from Haver Analytics, September 2023. Notes: The chart shows the U.S. unemployment rate.

U.S. employment and potential labor force

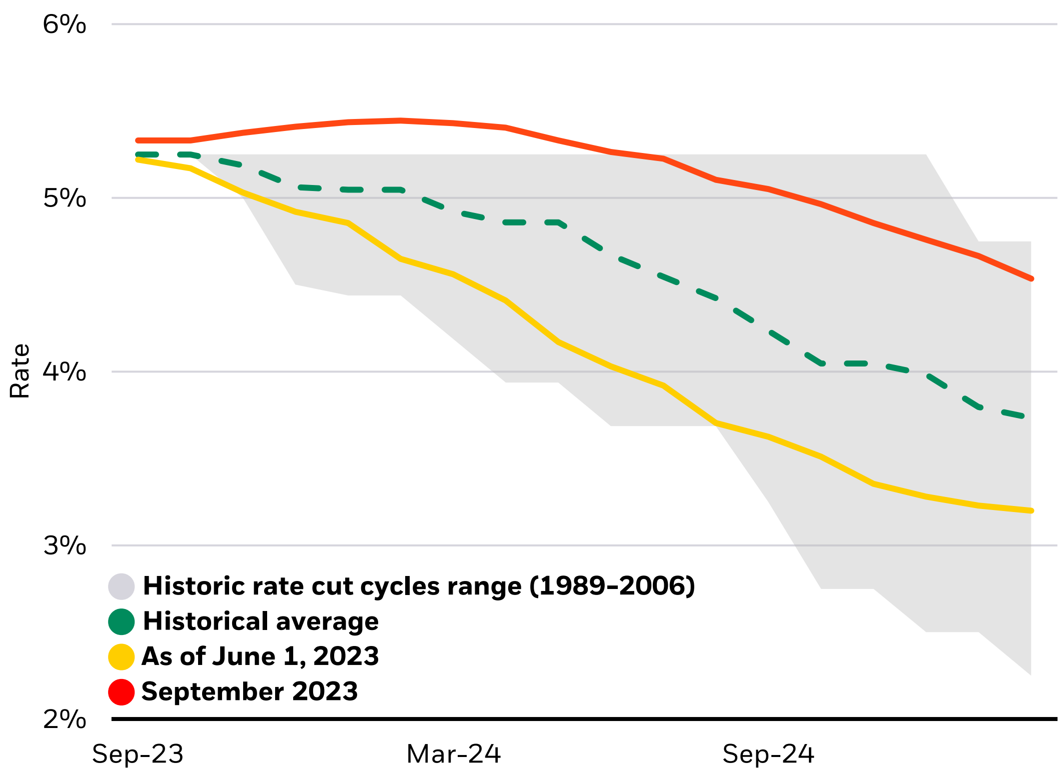


Source: BlackRock Investment Institute, U.S. Bureau of Labor Statistics, with data from Haver Analytics, September 2023. Note: The yellow line shows U.S. employment level measured by the survey of households. The red line shows the level of employment that would have been obtained had the unemployment rate held steady at 3.6%, the level in Q4 2019, given the actual labor force.

The central bank response to stagnation will likely be muted…

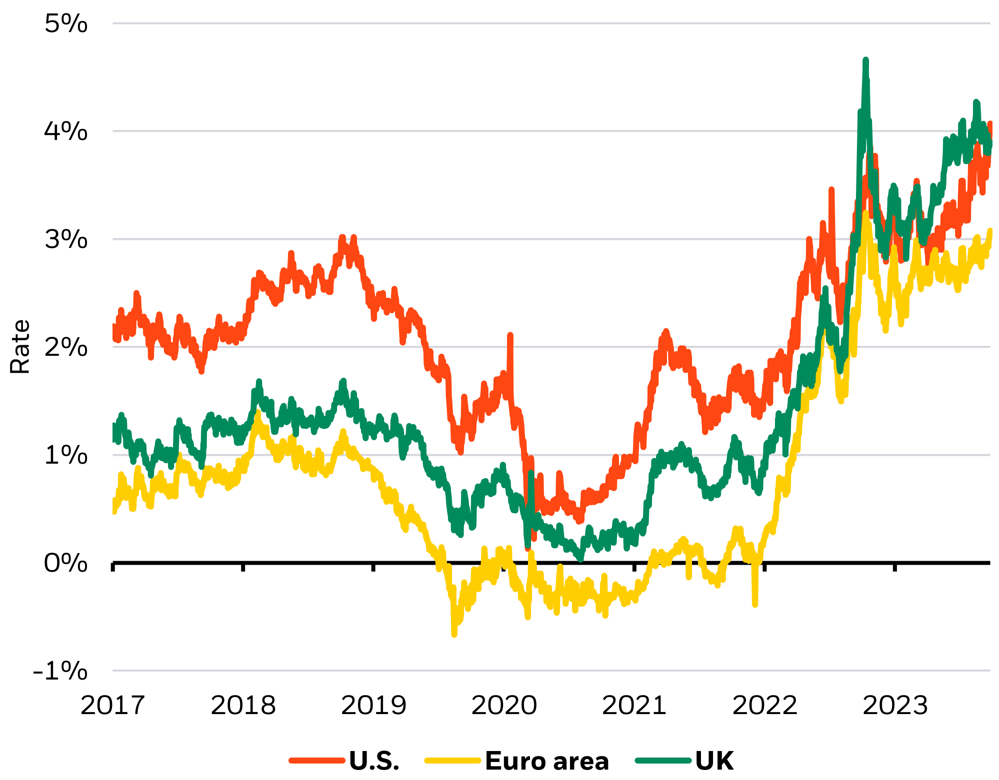
Some markets have come around to our view that central banks won't be riding to the rescue with sizeable rate cuts. Persistent inflationary pressures driven by supply constraints means central banks will have to hold policy tight.

Fed funds rate expectations, Sep. 2023- Sep. 2024



Forward looking estimates may not come to pass. Source: BlackRock Investment Institute, with data from LSEG Datastream, September 2023. Notes: The lines show market pricing of the path of future U.S. policy rates based on Fed Funds Futures. The orange line shows the current pricing the yellow line shows the pricing as at the start of June 2023. The grey area and green line shows historic rate cut cycles since 1989 and the average rate cuts during that period.

Medium-term policy rate expectations, 2018-2023

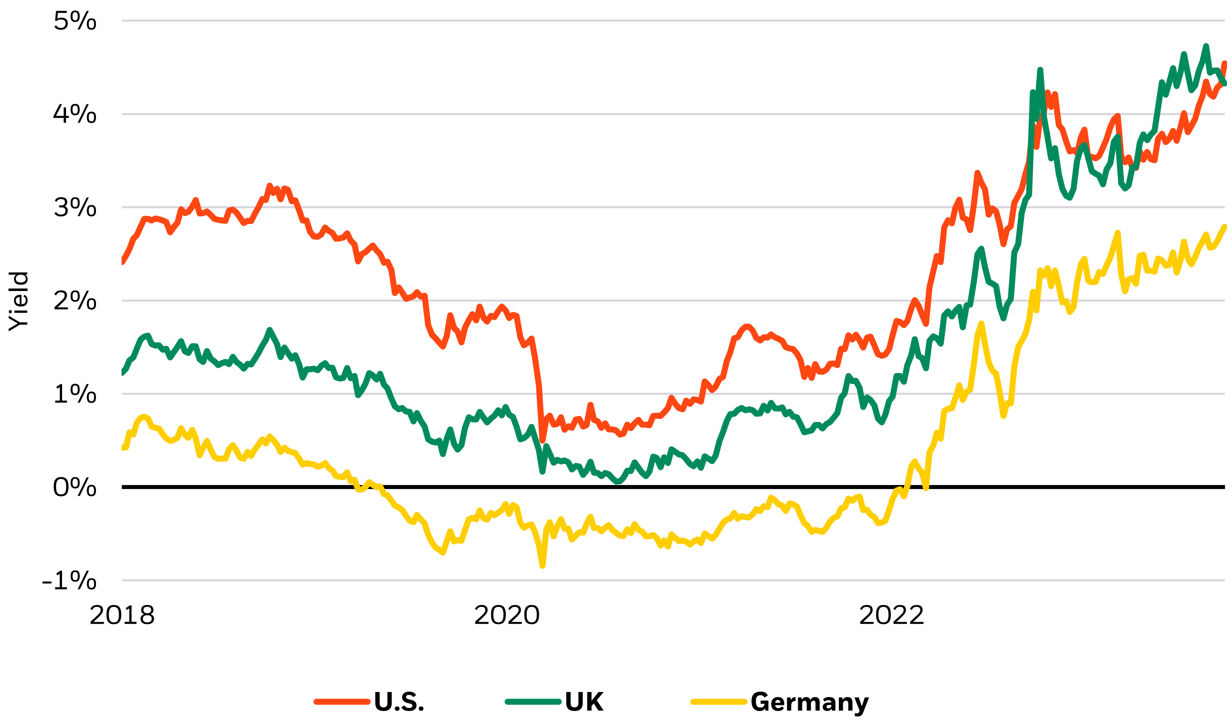


Forward looking estimates may not come to pass. Source: BlackRock Investment Institute, with data from LSEG Datastream, October 2023. Notes: The chart shows market expectations for 1-year rates in 5 years' time based on interest rate swaps.

...and that's creating exciting opportunities for income

As markets realize that central banks will have to keep a lid on activity to stem inflation it creates exciting opportunities for income. We like UK and euro area bonds, where yields spiked far above their pre-pandemic level.

10-year government bond yields, 2018-2023

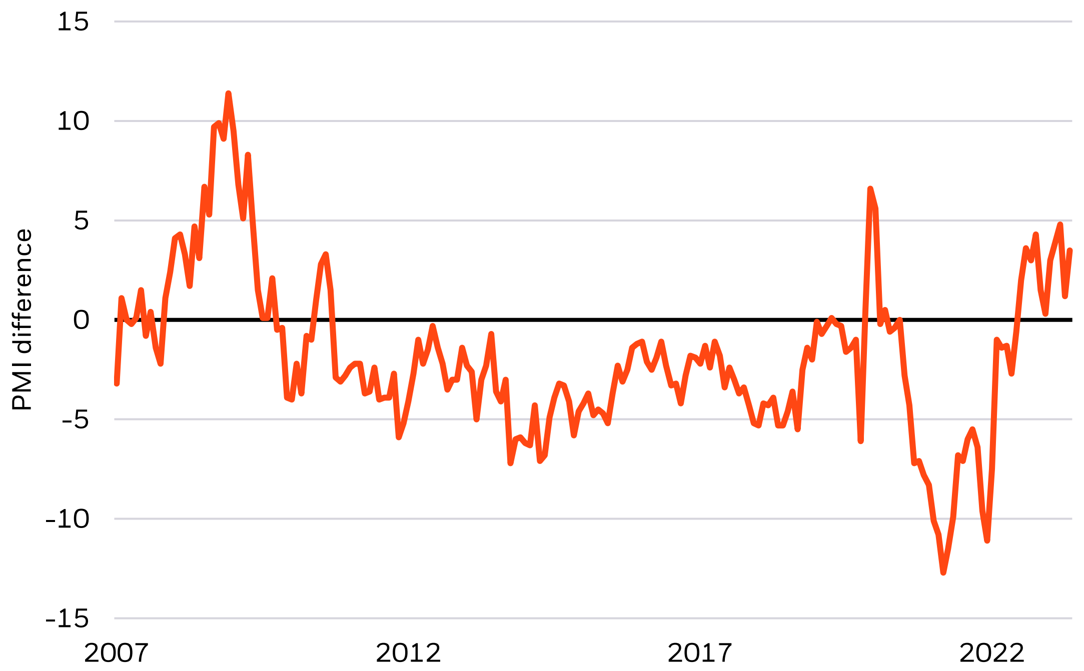


Past performance is not a reliable indicator of current or future results. Source: BlackRock Investment Institute with data from LSEG Datastream, October 2023. Notes: The chart shows the 10-year government bond yield for the U.S.., Germany and the UK

We are overweight hard currency EM debt

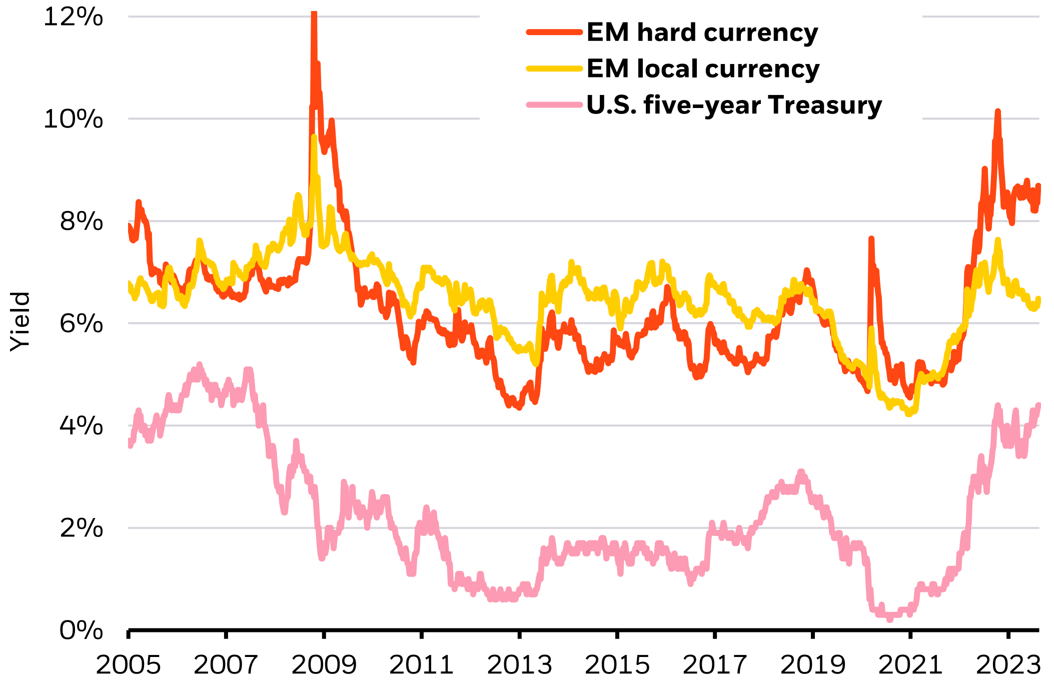
We prefer emerging hard currency debt due to higher yields. It is also cushioned from weakening local currencies as EM central banks start to cut policy rates.

EM PMI vs. DM, 2007–2023



Past performance is not a reliable indicator of current or future results. Source: BlackRock Investment Institute, Bank of International Settlements (BIS), Bloomberg, S&P, JPMorgan with data from Refinitiv Datastream, September 2023. Notes: The chart shows the difference between the S&P emerging market manufacturing PMI and U.S. PMI.

EM bonds vs. U.S. Treasury yields, 2005–2023



Past performance is not a reliable indicator of current or future results, and index returns do not account for fees. It is not possible to invest directly in an index. Source: BlackRock Investment Institute, with data from Refinitiv Datastream, October 2023. Notes: The chart shows yield levels for the JP Morgan Emerging Market Bond Index Global Diversified (EM hard currency), JP Morgan GBI-Emerging Market Bond Index Global Diversified and the benchmark U.S. five-year Treasury.

We prefer short-term government bonds for income over credit

The back-up in yields boosts the appeal of short-dated government bonds for income. We prefer the asset class to investment grade (IG) credit where tight spreads offer poorer reward for higher risk, in our view.

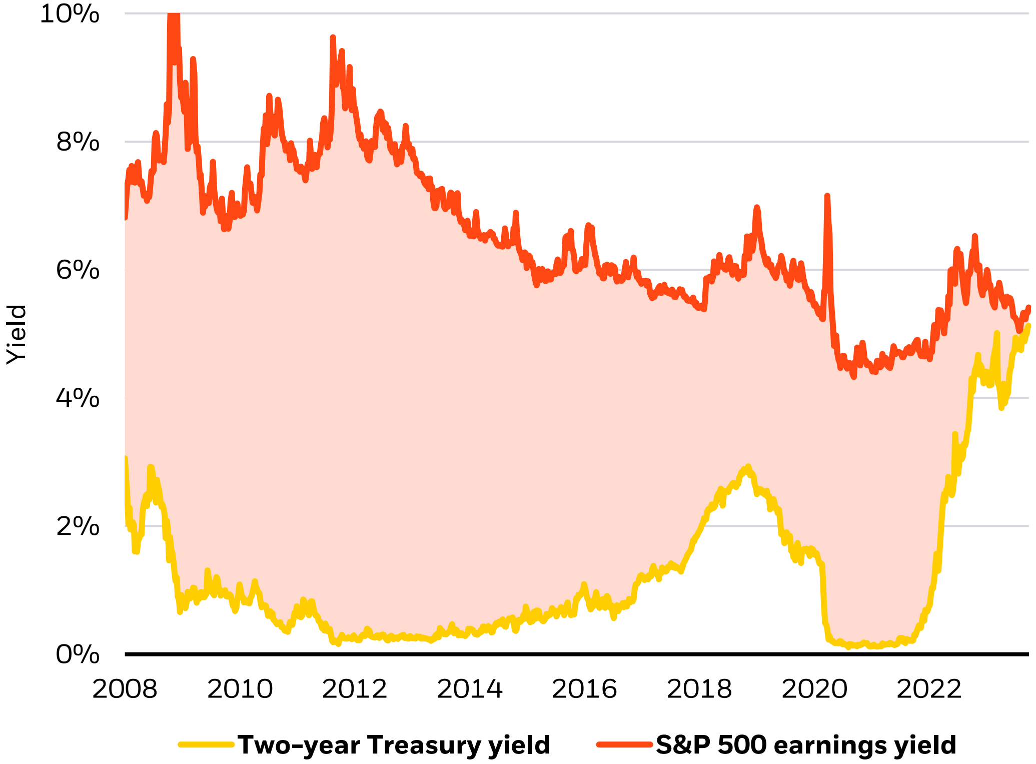
U.S. IG credit and short-term Treasuries, 1992-2023

Past performance is not a reliable indicator of current or future results, and it is not possible to invest directly in an index. Index returns do not account for fees Source: BlackRock Investment Institute, with data from LSEG Datastream, October 2023. Notes: The chart shows the yields for U.S. investment grade credit (using the Bloomberg U.S. Credit USD index) and short-term U.S. Treasuries (Bloomberg U.S. Treasury 1-3 Year USD index).

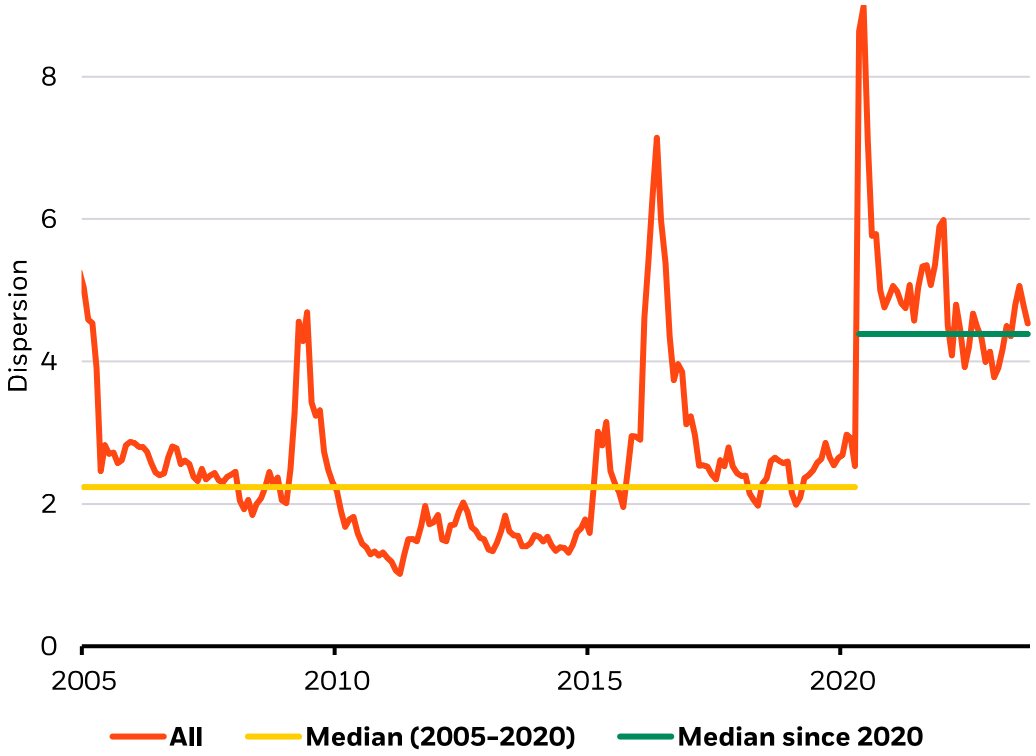
Greater dispersion = greater opportunities

Surging yields and stealth stagnation aren't friendly conditions for broad equity exposures. Valuation dispersion within sectors has moved meaningfully higher relative to the past – creating new opportunities, we think.

U.S. equity earnings and two-year Treasury yields



Dispersion of global sector price-earnings ratios

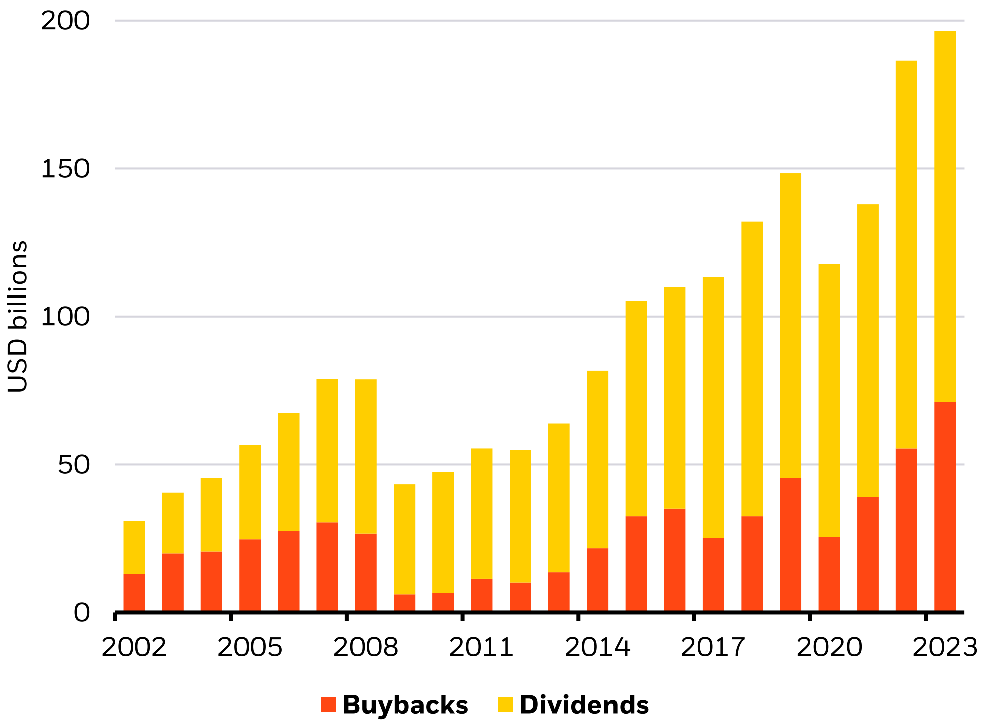


Past performance is not a reliable indicator of current or future results, and index returns do not account for fees. It is not possible to invest directly in an index. Source: BlackRock Investment Institute with data from LSEG Datastream, October 2023. Notes: The left chart shows the S&P 500 12-month forward earnings yield and the two-year U.S. Treasury yields.. The right chart shows the cross-sectional standard deviation of 12-month forward price-earnings (P/E) ratios for the 11 standard GICs sectors.

We are overweight Japanese equities

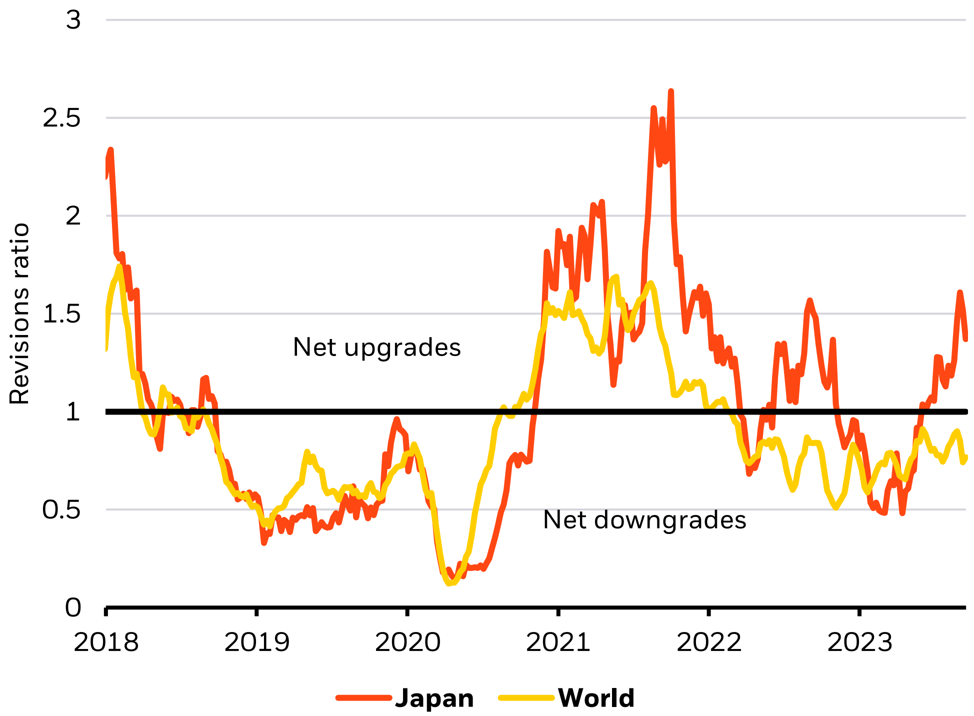
Japan stands apart from the DM pack. Accelerating share buy backs and other shareholder friendly corporate reforms, strong earnings and still-accommodative monetary policy boost their appeal.

Japan share buybacks and dividends, 2002–2023



.Source: BlackRock Investment Institute, with data from Morgan Stanley Research, Nikkei NEEDS-BULK/FDS, TSE, Alphasense, Bloomberg and FactSet, August 2023. Notes: The chart shows the annual cumulative capital returned to shareholders via buybacks and dividends for the top-tier companies listed on the TSE and Prime Market firms. 2023 data is annualized.

Equity earnings revision ratio, 2000–2023

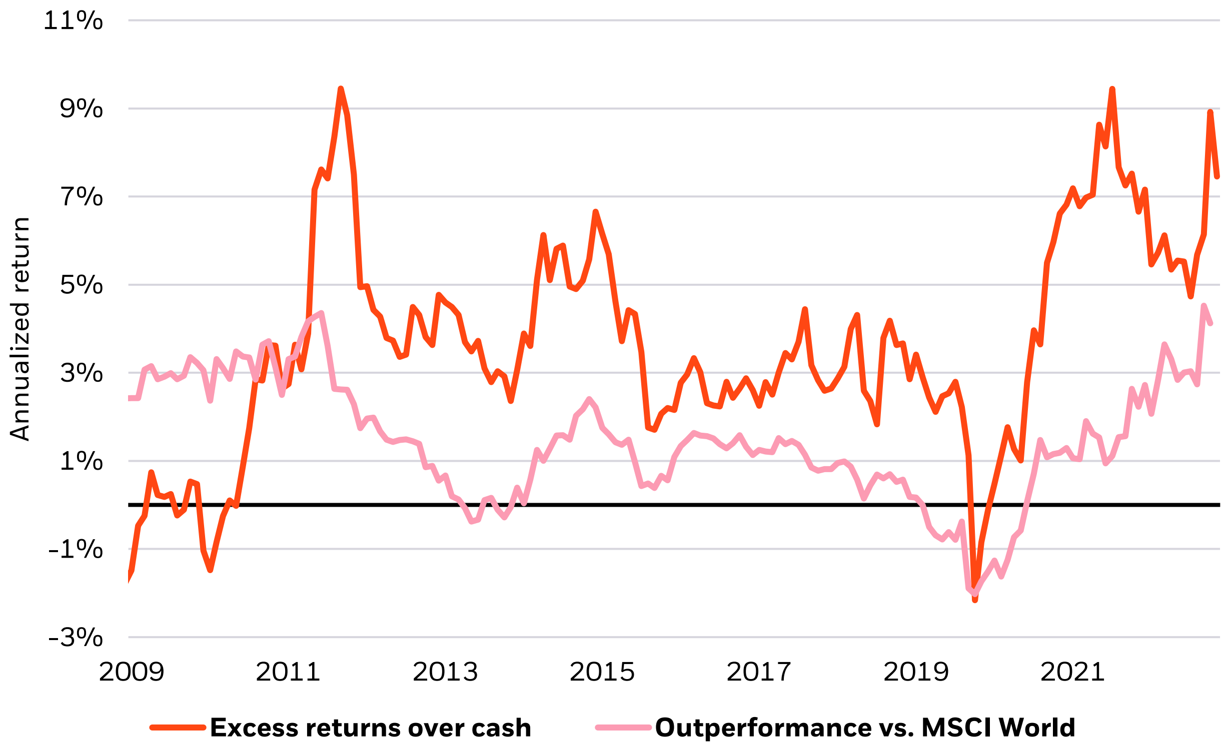


Past performance is not a reliable indicator of current or future returns. Index performance does not account for fees, it is not possible to invest directly in an index. Source: BlackRock Investment Institute, with data from LSEG Datastream, October 2023. Notes: The chart shows the equity earnings revisions for Japan and World equities. The lines show the number of companies with upward revisions to 12-month forward earnings divided by the number with downward revisions. Index proxies used: MSCI Japan and MSCI ACWI.

Active strategies may benefit from greater dispersion

More macro volatility has seen greater dispersion between and within asset classes. We see this environment as more conducive for active strategies looking to beat market benchmark returns such as those employed by hedge funds.

Hedge fund excess returns over cash and outperformance vs. MSCI World, 2009–2023



Past performance is not a reliable indicator of current or future results, and it is not possible to invest directly in an index. Index returns do not account for fees. 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, Hedge Fund Research with data from LSEG Datastream, October 2023. Notes: The chart shows the three-year rolling average of the excess returns of the HFRI Fund Weighted Composite Index over the returns from cash. The chart also shows the outperformance of the HFRI Fund Weighted Composite Index over the MSCI World Index. This outperformance is calculated using HFR data and three-year rolling regression analysis to remove the effects of broad market risk. The outperformance is measured as the difference between the returns of both indexes once the effects of broad market risk have been removed. Regression analysis is only an estimate of a relationship and may not fully reflect the true relationship between variables.

Mega forces are creating new opportunities

We see mega forces, or structural shifts shaping the long-term growth and inflation outlook, creating big shifts in profitability across economies and sectors – and new investment opportunities.

Low-carbon transition

The transition to is set to spur a massive reallocation of capital. We see the transition's speed and shape driven by an interplay of policy, technology, and consumer and investor preferences.

Implications: We see opportunities across the energy system – high-carbon and low. The impact on portfolios depends on the timing and size of these shifts – and when markets price them in.

Shifting demographics

Shrinking workforces in DMs mean tight labor markets will likely keep inflation elevated. By contrast, selected emerging market economies are poised to benefit from younger populations.

Implications: We see opportunities in healthcare, real estate, leisure and companies with products and services for seniors.

Geopolitics and economic competition

We have entered a new era of competing geopolitical and economic blocs. We see countries favoring national security and resilience over economic efficiency, accelerating the rewiring of supply chains.

Implications: A surge in investment in areas like technology, clean energy, infrastructure and defense could create opportunities

Digital disruption and AI

Artificial intelligence advances have sparked market euphoria over its potential. AI tools can automate laborious tasks, analyze huge sets of data and help generate fresh ideas.

Implications: We think the market focus will move beyond the technology producers to large-scale data owners and AI users within and across industries.

Future of finance

Regulatory shifts, changes in the financial architecture, the end of zero rates and technological innovation are changing the markets for deposits and credit, disrupting traditional business models.

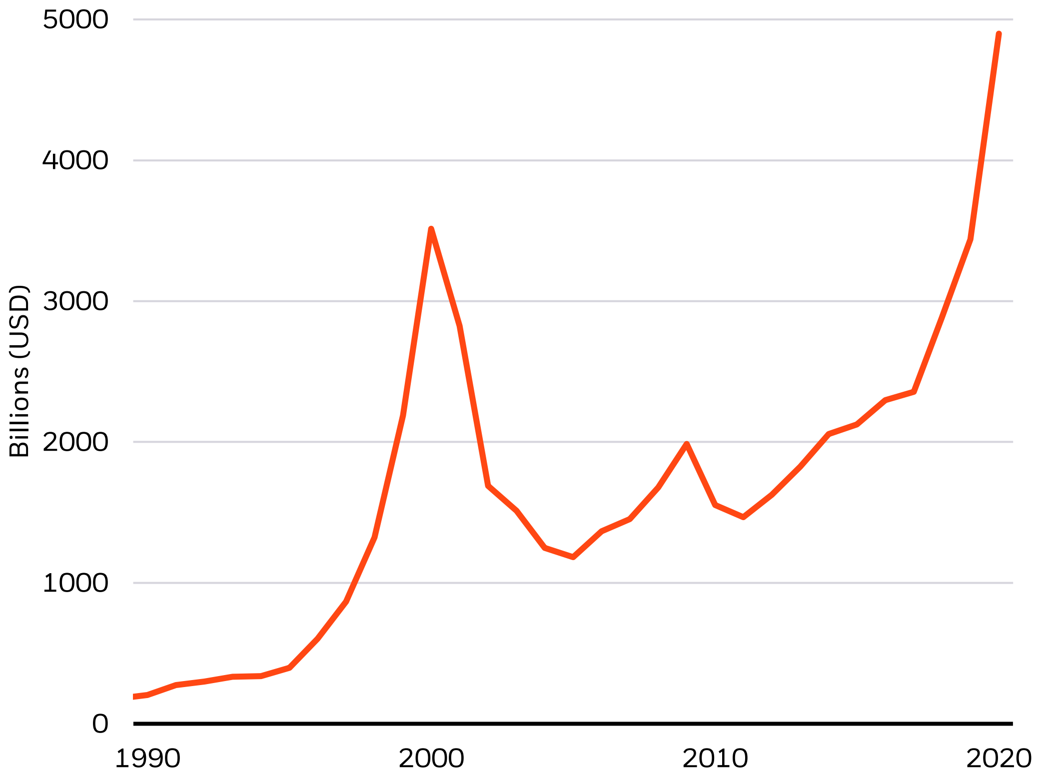
Implications: We expect more borrowers to turn to private credit as it becomes relatively better priced. We see the recent repricing as a chance to be nimble.

For illustrative purposes only. Forward looking estimates may not come to pass. Source: BlackRock Investment Institute, October 2023. 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 funds, strategy or security in particular.

AI may prove to be a value driver for public companies

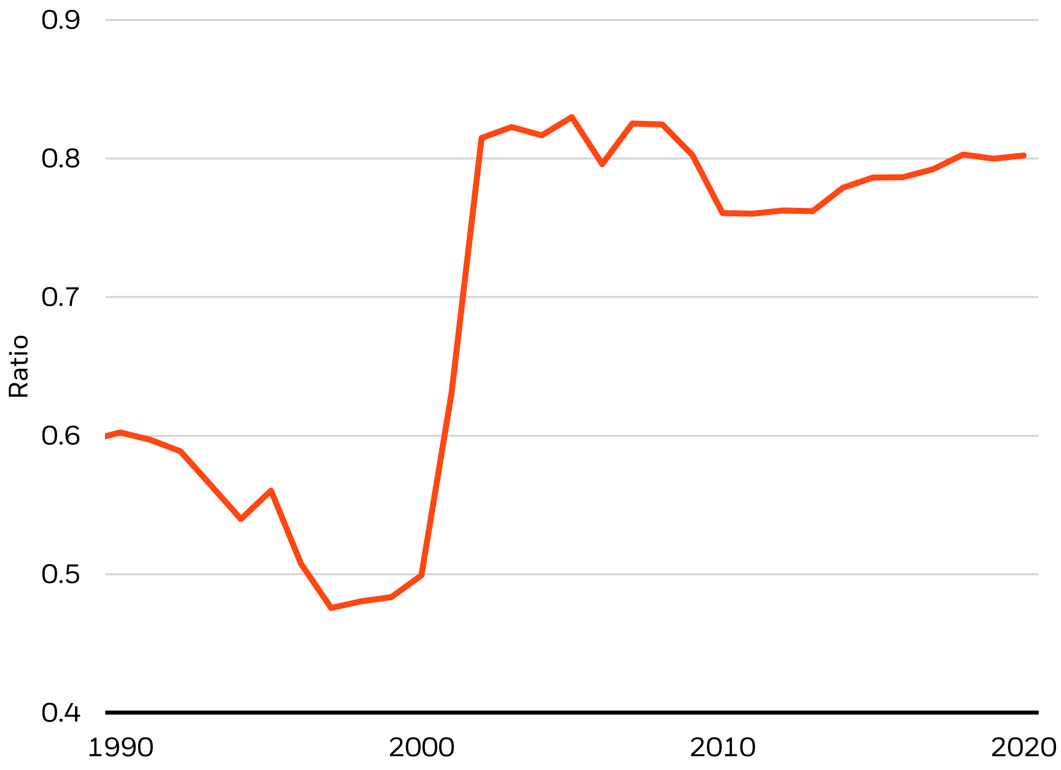
The value of AI patents from public companies has surged and it could suggest they're submitting higher quality patents. Excitement for AI could spread to private markets too.

Value of public company AI patents. 1990–2020



Sources: BlackRock Investment Institute, with data from United States Patent and Trademark Office (USPTO) and Dimitris Papanikolaou, Professor of Finance at Kellogg School of Management, September2023. Notes: This chart shows the aggregate USD$ value of AI patents granted to public firms and is measured as stock market reaction around the day each patent is granted.

Share of non-public company AI patents, 1990–2020

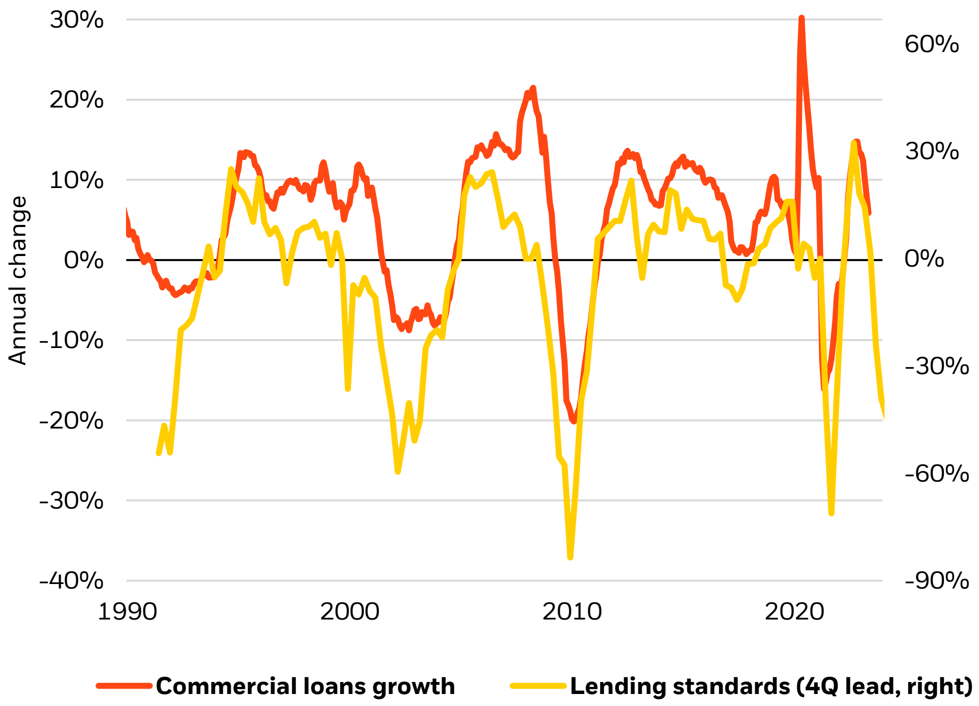


Sources: BlackRock Investment Institute, with data from United States Patent and Trademark Office (USPTO) and Dimitris Papanikolaou, Professor of Finance at Kellogg School of Management, September2023. Notes: This chart shows the number of AI patents granted to non-public companies divided by the total number of AI patents granted by the USPTO.

Structurally higher demand for private credit ahead

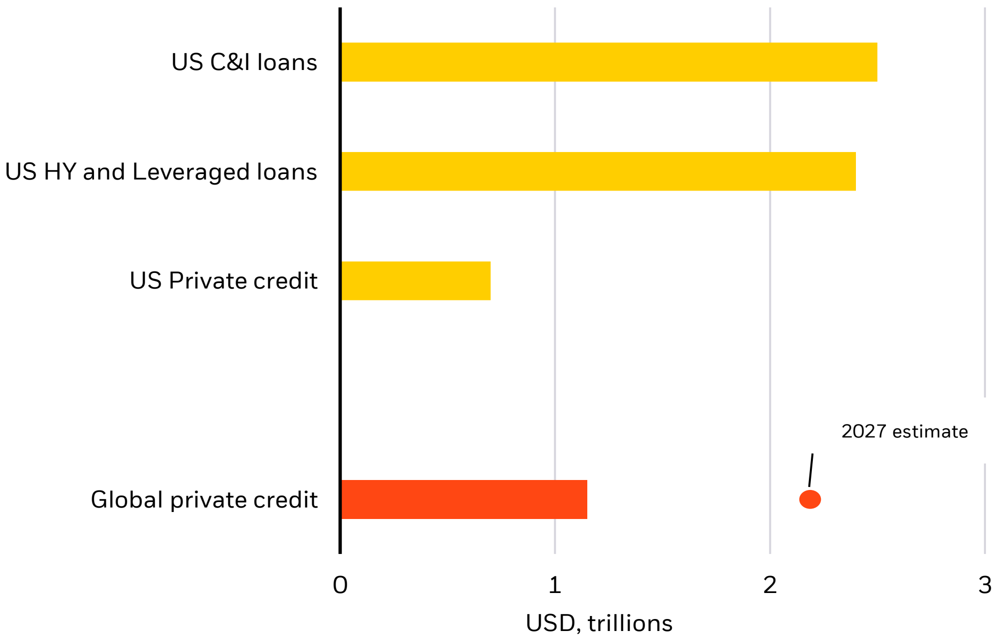
We see companies turning to alternative sources of credit as bank credit becomes less readily available. We expect demand for private credit to increase sharply.

Commercial loan growth and lending standards



Source: BlackRock Investment Institute, FED, with data from Haver, September 2023. Notes: The chart shows growth in commercial and industrial loans and results from FRB Senior Loan Officers Survey – net percentage balance tightening in standards for commercial and industrial loans large and middle-market firms (RHS).

Comparison of global debt markets, 2023



Source: BlackRock Investment Institute with data from Bloomberg, St. Louis Federal Reserve, ICE Bank of America, Pitchbook LCD and Preqin. September 2023. Notes: The measures used to size the markets are:outstanding stock of commercial and industrial (C&I) loans from the St. Louis Fed; total market value for index proxies Bloomberg US high yield corporate index, Morningstar LSTA USD Leveraged loans index, and the value of assets under management of private credit funds (historical private credit numbers exclude uninvested cash, so called "dry powder")

Tactical granular views: equities

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

Equities	View	Commentary
Developed markets		
U.S.	-1	We are underweight the broad market – still our largest portfolio allocation. We don't think earnings expectations reflect the macro damage we expect. We recognize momentum is strong near-term.
Europe	-1	We are underweight. The ECB keeps tightening in a slowdown and the support to growth from lower energy prices is fading.
UK	Neutral	We are neutral. We find that attractive valuations better reflect the weak growth outlook and the Bank of England's sharp rate hikes to deal with sticky inflation.
Japan	+1	We are overweight. We think stronger growth can help earnings top expectations. Stock buybacks and other shareholder-friendly actions may keep attracting foreign investors.
Pacific ex-Japan	Neutral	We are neutral. China's restart is losing steam and we don't see valuations compelling enough to turn overweight.
DM AI mega force	+1	We are overweight. We see a multi-country and multi-sector AI-centered investment cycle unfolding set to support revenues and margins.
Emerging markets	Neutral	We are neutral given a weaker growth trajectory. We prefer EM debt over equity.
China	Neutral	We are neutral. Growth has slowed. Policy stimulus is not as large as in the past. Yet we believe it should stabilize activity, and valuations have come down. Structural challenges imply deteriorating long-term growth. Geopolitical risks persist.

Underweight **Neutral** **Overweight** ● Previous view

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Tactical granular views: fixed income

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

Fixed income	View	Commentary
Short U.S. Treasuries	+1	We are overweight. We prefer short-term government bonds for income as interest rates stay higher for longer.
Long U.S. Treasuries	-1	We are underweight. We see long-term yields moving up further as investors demand greater term premium.
U.S. inflation-linked bonds	+1	We are overweight and prefer the U.S. over the euro area. We see market pricing underestimating sticky inflation.
Euro area inflation-linked bonds	-1	We prefer the U.S. over the euro area. Markets are pricing higher inflation than in the U.S., even as the European Central Bank has signaled more interest rate hikes ahead.
Euro area govt bonds	+1	We are overweight. Market pricing reflects policy rates staying higher for longer even as growth deteriorates. Widening peripheral bond spreads remain a risk.
UK gilts	+1	We are overweight. Gilt yields are holding near their highest in 15 years. Markets are pricing in restrictive Bank of England policy rates for longer than we expect.
Japanese govt bonds	-1	We are underweight. We see upside risks to yields from the Bank of Japan winding down its ultra-loose policy.
China govt bonds	Neutral	We are neutral. Bonds are supported by looser policy. Yet we find yields more attractive in short-term DM paper.
Global IG credit	-1	We are underweight. We prefer to take risk elsewhere as spreads remain tight.
U.S. agency MBS	+1	We're overweight. We see agency MBS as a high-quality exposure within diversified bond allocations.
Global high yield	-1	We are underweight. Spreads do not fully compensate for slower growth and tighter credit conditions we anticipate.
Asia credit	Neutral	We are neutral. We don't find valuations compelling enough to turn more positive.
EM hard currency	+1	We are overweight. We prefer emerging hard currency debt due to higher yields. It is also cushioned from weakening local currencies as EM central banks start to cut policy rates.
EM local currency	Neutral	We are neutral. Yields have fallen closer to U.S. Treasury yields. Plus, central bank rate cuts could put downward pressure on EM currencies, dragging on potential returns.

Underweight **Neutral** **Overweight** ● Previous view

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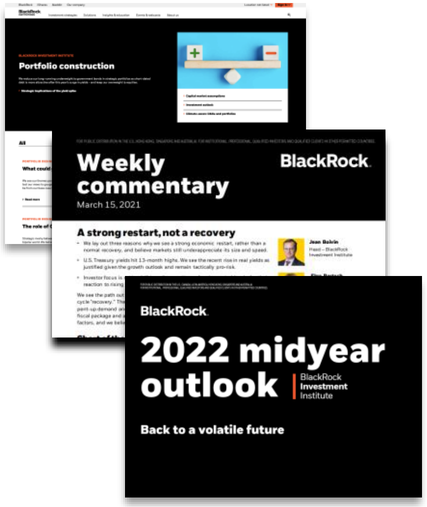
BlackRock **Investment** Institute

> “To build robust portfolios, you need to connect the dots between economics, markets, return drivers, policy and geopolitics.”

Jean Boivin
Head – BlackRock Investment Institute



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- Portfolio design and return expectations for institutional and professional investors
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