

# Weekly commentary

September 5, 2023

**BlackRock**

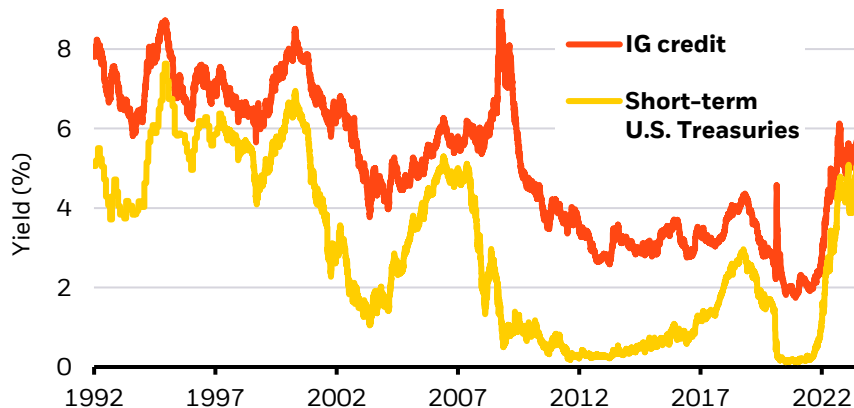
## Favoring short-term bonds long term

- We up short-term sovereign bonds on attractive yields and downgrade credit in the long run. We stay cautious on long-term bonds even with the surge in yields.
- U.S. stocks recovered last week as 10-year yields slid from 16-year highs. Jobs data showed a normalizing labor market. We see demographics starting to bite.
- China data this week will help gauge fading economic momentum. We see weak consumer and export demand leading to growth below the pre-Covid trend.

Sovereign bond yields have surged this year, with U.S. long-term yields hitting 16-year highs last month. We prefer short-term government bonds over credit. We go underweight high quality credit on a strategic view of five years and longer and trim our overall underweight to sovereign bonds. We still see investors demanding more compensation for holding long-term bonds given higher inflation, greater macro volatility and rising debt levels. We also like inflation-linked bonds.

## Closing the gap

Yields on U.S. investment grade (IG) credit and short-term Treasuries, 1992-2023



Source: BlackRock Investment Institute, with data from LSEG Datastream, September 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).

We believe the new regime of greater macro volatility calls for more nimble and dynamic strategic views. Short-term government bond yields have risen alongside long-term yields due to rapid central bank rate hikes. That move has pushed short-term U.S. Treasury yields (yellow line in the chart) near high quality credit yields (orange line), making short-term bond income comparable. We trim our overall underweight to developed market (DM) nominal government bonds to lean into short-term paper and reduce investment grade (IG) credit to underweight from neutral. We think high quality credit offers limited compensation for any potential hit to returns from wider spreads and sensitivity to interest rate swings. We prefer higher yields in private credit and see alternative lenders filling a corporate financing gap as banks curb lending.



**Jean Boivin**  
Head – BlackRock Investment Institute



**Wei Li**  
Global Chief Investment Strategist – BlackRock Investment Institute



**Vivek Paul**  
Head of Portfolio Research – BlackRock Investment Institute



**Devan Nathwani**  
Portfolio Strategist – BlackRock Investment Institute

Visit **BlackRock Investment Institute** for insights on the global economy, markets and geopolitics.

**BlackRock Investment Institute**

Mega forces – structural shifts that can drive returns now and in the future – reinforce why we’re in a new regime of greater macro and market volatility, in our view. Aging DM populations could add to inflation as workforces shrink, keeping labor markets tight and wage growth high. And the rate of growth the economy will be able to sustain without stoking inflation will likely be lower than in the past. Aging also tends to come with elevated levels of government debt. We see the low carbon transition, another mega force we track, driving up energy costs over the next decade. A related capital spending surge and additional government spending will likely boost economic activity and bolster inflationary pressures. These and other mega forces underpin why we see central banks having a tightening bias to try to keep inflation near their policy targets.

We went very underweight nominal government bonds in 2020 – but have trimmed that underweight at times when markets moved in line with our view. We trim it again but are not ready to turn positive on long-term bonds, even with the yield rise. That’s because term premium, or the compensation investors demand for the risk of holding long-term bonds, has risen from its lows but remains negative – especially for U.S. Treasuries, according to LSEG data. That is historically unusual.

We see three reasons long-term bond yields and term premium can climb higher: First, we believe markets will price in inflation settling above DM central bank 2% policy targets longer term. Second, we also see investors demanding more term premium to reflect greater risk in nominal bonds due to higher inflation volatility and rising debt levels. The U.S. credit rating downgrade last month underscored the fiscal challenges ahead. Third, foreign demand for long-term Treasuries may wane: For example, Japanese investors may switch to domestic bonds as yields climb from the Bank of Japan further lifting its cap on long-term yields. To turn positive on long-term bonds, we would need to see term premium rise much more or think market expectations of future policy rates are too high. We are not there yet.

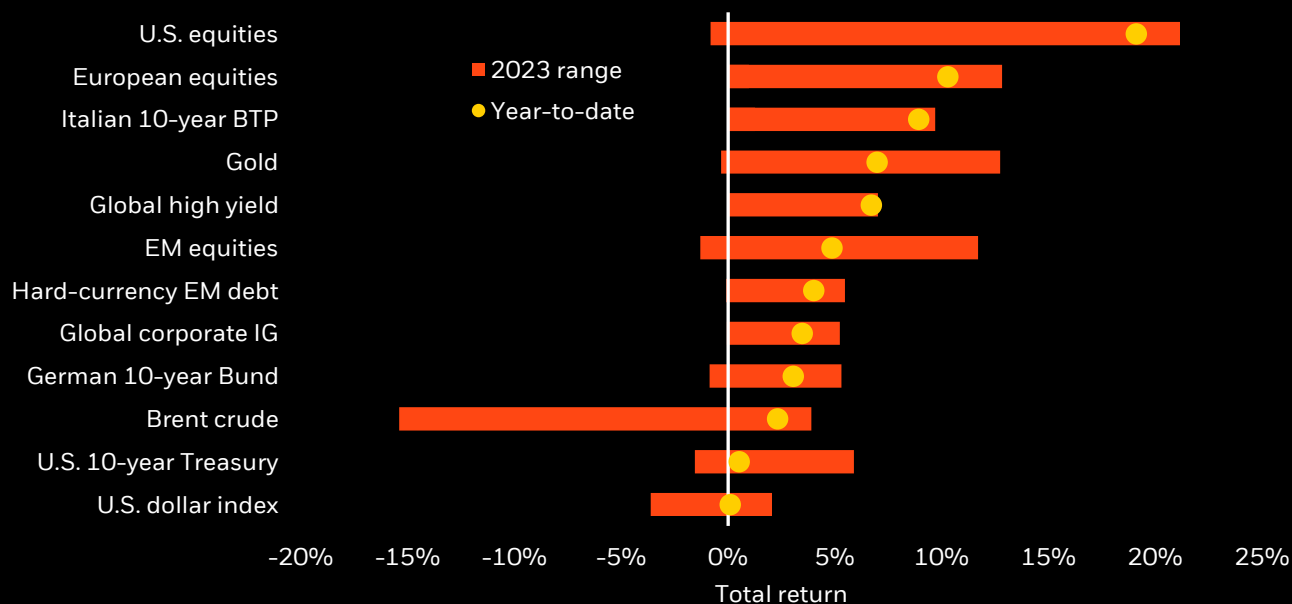
Bottom line: We evolve our views with the August update of capital market assumptions and strategic portfolios. We up our allocation to short-term sovereign bonds, trim our overall underweight to nominal government bonds and cut IG credit to underweight. We stay underweight nominal government bonds overall due to the risks we see in long-term bonds. We favor inflation-linked bonds. And we like equities in the long term. Their returns should surpass fixed income returns when growth rebounds from the near-term stagnation we expect – even if it muddles along due to the demographic hit ahead.

## Market backdrop

U.S. stocks bounced back last week from a 2% drop in August as 10-year Treasury yields eased off a 16-year near 4.30%. The stock gains show just how sensitive market sentiment remains to yield moves and expectations for policy rates. The drop in July job openings and the August payrolls report indicated the U.S. labor market is now normalizing from pandemic mismatches. We see inflation on a rollercoaster ride ahead as normalization unfolds and an aging population starts to bite.

### Assets in review

Selected asset performance, 2023 year-to-date return and range



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

Sources: BlackRock Investment Institute, with data from Refinitiv Datastream as of Aug. 31, 2023. Notes: The two ends of the bars show the lowest and highest returns at any point in the last 12-months, and the dots represent current year-to-date returns. Emerging market (EM), high yield and global corporate investment grade (IG) returns are denominated in U.S. dollars, and the rest in local currencies. Indexes or prices used are: spot Brent crude, ICE U.S. Dollar Index (DXY), spot gold, MSCI Emerging Markets Index, MSCI Europe Index, Refinitiv Datastream 10-year benchmark government bond index (U.S., Germany and Italy), Bank of America Merrill Lynch Global High Yield Index, J.P. Morgan EMBI Index, Bank of America Merrill Lynch Global Broad Corporate Index and MSCI USA Index.

## Macro take

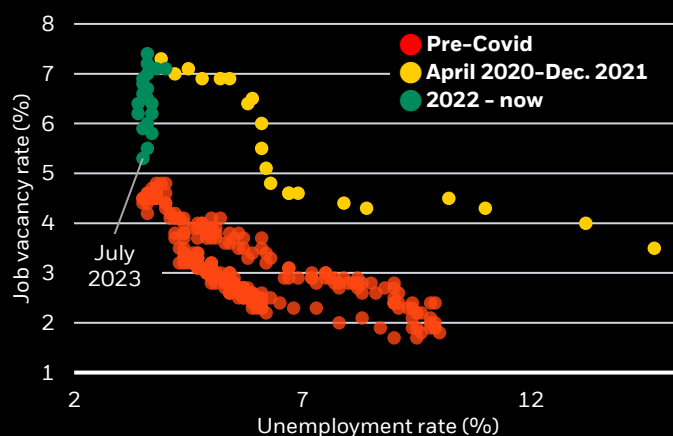
The U.S. has grappled with a huge mismatch after a pandemic-era shift in spending to goods and away from services made it hard for goods-producing companies to fill their vacancies. The latest labor data help confirm this mismatch has kept unwinding.

The level of unfilled job vacancies surged to be far higher since the pandemic for any given level of unemployment. See the yellow and orange dots on the chart. This relationship is slowly returning to pre-Covid levels. Data for July show vacancies falling sharply, even as unemployment was steady that month. That's good news. Consumer spending is normalizing as spending has shifted back to services from goods. That spending swing is reflected in prices: Core goods prices fell 5% at annualized rate in July.

Ultimately, this means inflation is set to decline further as the mismatch resolves. But don't count on this lasting. We think inflation will be on a rollercoaster as a worker shortage constrains how much the economy can grow without stoking higher inflation. See more in our Macro take blog posts [here](#).

## Harder to match workers

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



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

## Investment themes

### 1 Holding tight

- The U.S. is navigating two large and unprecedented shocks. The first: A massive, pandemic-induced shift in consumer spending – most visible from services to goods – created a mismatch in what the economy was set up to produce and what people wanted to buy. The second: a worker shortage as baby boomers age into retirement.
- Our assessment is that we are set for “full-employment stagnation.” Most of the inflation and wage growth we’ve seen to date reflects the mismatch associated with the pandemic. That is now reversing well and inflation is set to fall further. But as the process of resolving the mismatch ends and labor shortages start to bind, we expect inflation to go on a rollercoaster ride, rising again in 2024. A smaller workforce means the rate of growth the economy will be able to sustain without resurgent inflation will be lower than in the past.
- We see central banks being forced to keep policy tight to lean against inflationary pressures. This is not a friendly backdrop for broad asset class returns, marking a break from the four decades of steady growth and inflation known as the Great Moderation.
- **Investment implication:** Income is back. That motivates our overweight to short-dated U.S. Treasuries.

### 2 Pivoting to new opportunities

- Greater volatility has brought more divergent security performance relative to the broader market. Benefiting from this requires getting more granular and eyeing opportunities on horizons shorter than our tactical one. We go granular by tilting portfolios to areas where we think our macro view is priced in.
- We think dispersion within and across asset classes – or the extent to which prices deviate from an index – will be higher in the new regime amid the various crosscurrents at play, allowing for granularity. That offers more ways to build portfolio “breadth” via uncorrelated exposures, in our view.
- We think it also means security selection, expertise and skill are even more important to achieving above benchmark returns. Relative value opportunities from potential market mispricings are also likely to be more abundant.
- **Investment implication:** We like quality in both equities and fixed income.

### 3 Harnessing mega forces

- Mega forces are structural changes we think are poised to create big shifts in profitability across economies and sectors. These mega forces are digital disruption like artificial intelligence (AI), the rewiring of globalization driven by geopolitics, the transition to a low-carbon economy, aging populations and a fast-evolving financial system.
- The mega forces are not in the far future – but are playing out today. The key is to identify the catalysts that can supercharge them and the likely beneficiaries – and whether all of this is priced in today. We think granularity is key to find the sectors and companies set to benefit from mega forces.
- We think markets are still assessing the potential effects as AI applications could disrupt entire industries.
- Geopolitical fragmentation, like the strategic competition between the U.S. and China, is set to rewire global supply chains, we think.
- The low-carbon transition causing economies to decarbonize at varying speeds due to policy, tech innovation and shifting consumer and investor preferences. Markets have historically been slow to fully price in such shifts.
- We see profound changes in the financial system. Higher rates are accelerating changes in the role of banks and credit providers, shaping the future of finance.
- **Investment implication:** We are overweight AI as a multi-country, multi-sector investment cycle unfolds.

# Week ahead

**Sept. 5**

China Caixin services PMI

**Sept. 7**

China trade data

**Sept. 6**

U.S. ISM services PMI

**Sept. 8-15**

China total social financing;  
China CPI and PPI (Sept. 9)

A slew of China data this week will help gauge fading economic momentum after a rapid post-Covid restart. China is facing two key challenges: weak consumer and export demand. We cut our growth expectation for this year to around 5% as a result. Two-year average growth over 2022-23 is set to be about 4%, much lower than the pre-Covid rate of roughly 5%.

## Directional views

Strategic (long-term) and tactical (6-12 month) views on broad asset classes, September 2023

**Underweight**

**Neutral**

**Overweight**

● Previous view

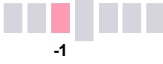







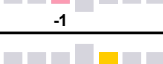

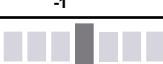


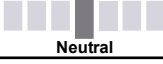


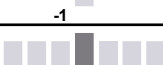



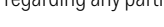
	Asset	Strategic	Tactical	Commentary
<b>Equities</b>	Developed	+1	-1	We are overweight equities in our strategic views as we estimate the overall return of stocks will be greater than fixed-income assets over the coming decade. Valuations on a long horizon do not appear stretched. Tactically, we're underweight DM stocks as central banks' rate hikes cause financial cracks and economic damage. Corporate earnings expectations have yet to fully reflect even a modest recession.
	Emerging	Neutral	+1	Strategically, we are neutral as we don't see significant earnings growth or higher compensation for risk. We are overweight tactically on brighter growth trends in EM over DM, still appealing valuations and EM rate cycles nearing their peaks.
<b>Developed market government bonds</b>	Nominal	-1	-1	Higher-for-longer policy rates have bolstered the case for short-dated government debt in portfolios on both tactical and strategic horizons. We stay underweight nominal long-dated government bonds on both horizons as we expect investors to demand more compensation for the risk of holding them. Tactically, we are neutral on euro area and UK long-term bonds because higher yields better reflect our view.
	Inflation-linked	+3	Neutral	Our strategic views are maximum overweight DM inflation-linked bonds where we see higher inflation persisting – but we have trimmed our tactical view to neutral on current market pricing in the euro area.
<b>Public credit and emerging market debt</b>	Investment grade	-1	Neutral	Strategically, we're underweight investment grade due to limited compensation above short-dated government bonds. Tactically, we're neutral on tightening credit and financial conditions.
	High yield	Neutral	-1	Strategically, we are neutral high yield as we see the asset class as more vulnerable to recession risks. We're tactically underweight. Spreads don't fully compensate for slower growth and tighter credit conditions we expect.
	EM debt	Neutral	+1	Strategically, we're neutral and see more attractive income opportunities elsewhere. Tactically, we're overweight local-currency EM debt. We see it as more resilient with EM central banks closer to cutting rates than DM counterparts.
<b>Private markets</b>	Income	+1	—	We are strategically overweight private markets income. For investors with a long-term view, we see opportunities in private credit as private lenders help fill a void left by a bank pullback.
	Growth	-1	—	Even in our underweight to growth private markets, we see areas like infrastructure equity as a relative bright spot.

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 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.

# Granular views

Six- to 12-month tactical views on selected assets vs. broad global asset classes by level of conviction, September 2023

Underweight
Neutral
Overweight
● Previous view

Asset	View	Commentary	
<b>Developed markets</b>			
<b>Equities</b>	United States	 <p>-1</p>	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	 <p>-1</p>	We are underweight. We see the European Central Bank holding policy tight in a slowdown, and the support to growth from lower energy prices is fading.
	UK	 <p>Neutral</p>	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	 <p>Neutral</p>	We are neutral. Bank of Japan policy is still easy, shareholder-friendly reforms are taking root and negative real rates support equities.
	Pacific ex-Japan	 <p>Neutral</p>	We are neutral. China's restart is losing steam and we don't see valuations compelling enough to turn overweight.
	DM AI mega force	 <p>+1</p>	We are overweight. We see a multi-country and multi-sector AI-centered investment cycle unfolding set to support revenues and margins.
<b>Emerging markets</b>			
<b>Fixed Income</b>	China	 <p>+1</p>	We are overweight. We see brighter relative growth trends in EM over DM, valuations remain appealing and EM rates cycles are nearing peaks.
	Short U.S. Treasuries	 <p>+1</p>	We are overweight. We prefer short-term government bonds for income as interest rates stay higher for longer.
	Long U.S. Treasuries	 <p>-1</p>	We are underweight. We see long-term yields moving up further as investors demand greater term premium.
	U.S. inflation-linked bonds	 <p>+1</p>	We are overweight and prefer the U.S. over the euro area. We see market pricing underestimating sticky inflation.
	Euro area inflation-linked bonds	 <p>-1</p>	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 is set to hold policy tight, in our view.
	Euro area govt bonds	 <p>Neutral</p>	We are neutral. Market pricing better reflects rates staying higher for longer. We see risk of wider peripheral bond spreads due to tighter financial conditions.
	UK gilts	 <p>Neutral</p>	We are neutral. We find gilt yields better reflect our expectations for the macro outlook and Bank of England policy.
	Japanese govt bonds	 <p>-1</p>	We are underweight. We see upside risks to yields from the Bank of Japan winding down its ultra-loose policy.
	China govt bonds	 <p>Neutral</p>	We are neutral. Bonds are supported by looser policy. Yet we find yields more attractive in short-term DM paper.
	Global IG credit	 <p>Neutral</p>	We are neutral on tighter credit and financial conditions. We prefer Europe's more attractive valuations over the U.S.
	U.S. agency MBS	 <p>+1</p>	We're overweight. We see agency MBS as a high-quality exposure within diversified bond allocations.
	Global high yield	 <p>-1</p>	We are underweight. Spreads do not fully compensate for slower growth and tighter credit conditions we anticipate.
	Asia credit	 <p>Neutral</p>	We are neutral. We don't find valuations compelling enough to turn more positive.
	Emerging hard currency	 <p>+1</p>	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.
Emerging local currency	 <p>Neutral</p>	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.	

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.

# BlackRock Investment Institute

The BlackRock Investment Institute (BII) leverages the firm's expertise and generates proprietary research to provide insights on macroeconomics, sustainable investing, geopolitics and portfolio construction to help BlackRock's portfolio managers and clients navigate financial markets. BII offers strategic and tactical market views, publications and digital tools that are underpinned by proprietary research.

**General disclosure:** This material is intended for information purposes only, and does not constitute investment advice, a recommendation or an offer or solicitation to purchase or sell any securities to any person in any jurisdiction in which an offer, solicitation, purchase or sale would be unlawful under the securities laws of such jurisdiction. This material may contain estimates and forward-looking statements, which may include forecasts and do not represent a guarantee of future performance. This information is not intended to be complete or exhaustive and no representations or warranties, either express or implied, are made regarding the accuracy or completeness of the information contained herein. The opinions expressed are as of Sept. 5, 2023, and are subject to change without notice. Reliance upon information in this material is at the sole discretion of the reader. Investing involves risks.

In the **U.S. and Canada**, this material is intended for public distribution. **In the European Economic Area (EEA):** this is Issued by BlackRock (Netherlands) B.V. is authorised and regulated by the Netherlands Authority for the Financial Markets. Registered office Amstelplein 1, 1096 HA, Amsterdam, Tel: 020 – 549 5200, Tel: 31-20-549-5200. Trade Register No. 17068311 For your protection telephone calls are usually recorded. **In the UK and Non-European Economic Area (EEA) countries:** this is Issued by BlackRock Advisors (UK) Limited, which is authorised and regulated by the Financial Conduct Authority. Registered office: 12 Throgmorton Avenue, London, EC2N 2DL, Tel: +44 (0)20 7743 3000. Registered in England and Wales No. 00796793. For your protection, calls are usually recorded. Please refer to the Financial Conduct Authority website for a list of authorised activities conducted by BlackRock. **In Italy**, for information on investor rights and how to raise complaints please go to <https://www.blackrock.com/corporate/compliance/investor-right> available in Italian. **For qualified investors in Switzerland:** This document is marketing material. This document shall be exclusively made available to, and directed at, qualified investors as defined in Article 10 (3) of the CISA of 23 June 2006, as amended, at the exclusion of qualified investors with an opting-out pursuant to Art. 5 (1) of the Swiss Federal Act on Financial Services ("FinSA"). For information on art. 8 / 9 Financial Services Act (FinSA) and on your client segmentation under art. 4 FinSA, please see the following website: [www.blackrock.com/finsa](http://www.blackrock.com/finsa). **For investors in Israel:** BlackRock Investment Management (UK) Limited is not licensed under Israel's Regulation of Investment Advice, Investment Marketing and Portfolio Management Law, 5755-1995 (the "Advice Law"), nor does it carry insurance thereunder. **In South Africa**, please be advised that BlackRock Investment Management (UK) Limited is an authorized financial services provider with the South African Financial Services Board, FSP No. 43288. **In the DIFC** this material can be distributed in and from the Dubai International Financial Centre (DIFC) by BlackRock Advisors (UK) Limited – Dubai Branch which is regulated by the Dubai Financial Services Authority (DFSA). This material is only directed at 'Professional Clients' and no other person should rely upon the information contained within it. BlackRock Advisors (UK) Limited - Dubai Branch is a DIFC Foreign Recognised Company registered with the DIFC Registrar of Companies (DIFC Registered Number 546), with its office at Unit 06/07, Level 1, Al Fattan Currency House, DIFC, PO Box 506661, Dubai, UAE, and is regulated by the DFSA to engage in the regulated activities of 'Advising on Financial Products' and 'Arranging Deals in Investments' in or from the DIFC, both of which are limited to units in a collective investment fund (DFSA Reference Number F000738) **In the Kingdom of Saudi Arabia**, issued in the Kingdom of Saudi Arabia (KSA) by BlackRock Saudi Arabia (BSA), authorised and regulated by the Capital Market Authority (CMA), License No. 18-192-30. Registered under the laws of KSA. Registered office: 29th floor, Olaya Towers – Tower B, 3074 Prince Mohammed bin Abdulaziz St., Olaya District, Riyadh 12213 – 8022, KSA, Tel: +966 11 838 3600. The information contained within is intended strictly for Sophisticated Investors as defined in the CMA Implementing Regulations. Neither the CMA or any other authority or regulator located in KSA has approved this information. The information contained within, does not constitute and should not be construed as an offer of, invitation or proposal to make an offer for, recommendation to apply for or an opinion or guidance on a financial product, service and/or strategy. Any distribution, by whatever means, of the information within and related material to persons other than those referred to above is strictly prohibited. **In the United Arab Emirates** is only intended for - natural Qualified Investor as defined by the Securities and Commodities Authority (SCA) Chairman Decision No. 3/R.M. of 2017 concerning Promoting and Introducing Regulations. Neither the DFSA or any other authority or regulator located in the GCC or MENA region has approved this information. **In the State of Kuwait**, those who meet the description of a Professional Client as defined under the Kuwait Capital Markets Law and its Executive Bylaws. **In the Sultanate of Oman**, to sophisticated institutions who have experience in investing in local and international securities, are financially solvent and have knowledge of the risks associated with investing in securities. **In Qatar**, for distribution with pre-selected institutional investors or high net worth investors. **In the Kingdom of Bahrain**, to Central Bank of Bahrain (CBB) Category 1 or Category 2 licensed investment firms, CBB licensed banks or those who would meet the description of an Expert Investor or Accredited Investors as defined in the CBB Rulebook. The information contained in this document, does not constitute and should not be construed as an offer of, invitation, inducement or proposal to make an offer for, recommendation to apply for or an opinion or guidance on a financial product, service and/or strategy. **In Singapore**, this is issued by BlackRock (Singapore) Limited (Co. registration no. 200010143N). This advertisement or publication has not been reviewed by the Monetary Authority of Singapore. **In Hong Kong**, this material is issued by BlackRock Asset Management North Asia Limited and has not been reviewed by the Securities and Futures Commission of Hong Kong. **In South Korea**, this material is for distribution to the Qualified Professional Investors (as defined in the Financial Investment Services and Capital Market Act and its sub-regulations). **In Taiwan**, independently operated by BlackRock Investment Management (Taiwan) Limited. Address: 28F., No. 100, Songren Rd., Xinyi Dist., Taipei City 110, Taiwan. Tel: (02)23261600. **In Japan**, this is issued by BlackRock Japan, Co., Ltd. (Financial Instruments Business Operator: The Kanto Regional Financial Bureau. License No375, Association Memberships: Japan Investment Advisers Association, the Investment Trusts Association, Japan, Japan Securities Dealers Association, Type II Financial Instruments Firms Association.) For Professional Investors only (Professional Investor is defined in Financial Instruments and Exchange Act). **In Australia**, issued by BlackRock Investment Management (Australia) Limited ABN 13 006 165 975 AFSL 230 523 (BIMAL). The material provides general information only and does not take into account your individual objectives, financial situation, needs or circumstances. **In China**, this material may not be distributed to individuals resident in the People's Republic of China ("PRC", for such purposes, excluding Hong Kong, Macau and Taiwan) or entities registered in the PRC unless such parties have received all the required PRC government approvals to participate in any investment or receive any investment advisory or investment management services. **For Other APAC Countries**, this material is issued for Institutional Investors only (or professional/sophisticated /qualified investors, as such term may apply in local jurisdictions). **In Latin America**, no securities regulator within Latin America has confirmed the accuracy of any information contained herein. The provision of investment management and investment advisory services is a regulated activity in Mexico thus is subject to strict rules. For more information on the Investment Advisory Services offered by BlackRock Mexico please refer to the Investment Services Guide available at [www.blackrock.com/mx](http://www.blackrock.com/mx)

©2023 BlackRock, Inc. All Rights Reserved. **BLACKROCK** is a trademark of BlackRock, Inc., or its subsidiaries in the United States and elsewhere. All other trademarks are those of their respective owners.

**BlackRock**

Not FDIC Insured • May Lose Value • No Bank Guarantee