

Weekly commentary

January 22, 2024

BlackRock

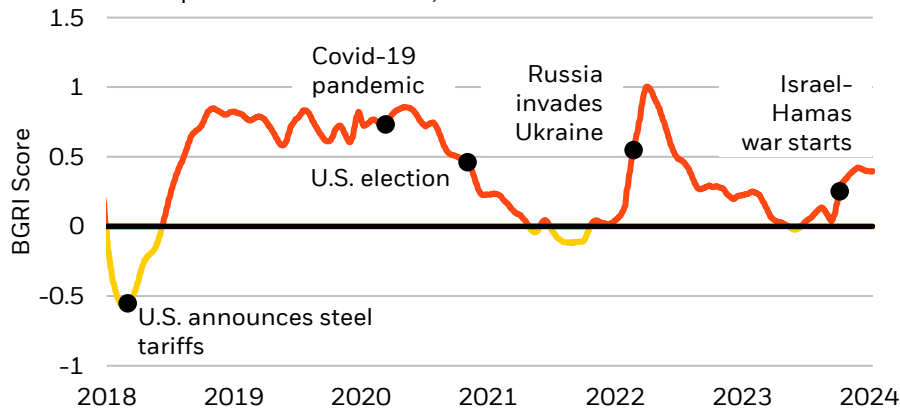
Geopolitical fragmentation plays out

- Geopolitical fragmentation is accelerating, as seen with recent events in Asia and the Middle East. We see it keeping inflation pressures elevated longer term.
- U.S. stocks climbed to record highs last week. The 10-year U.S. Treasury yield rose as markets priced in fewer rate cuts – but still more than we expect.
- We think the European Central Bank will hold rates steady at its policy meeting this week, and the Bank of Japan faces pressure to tighten its ultra-loose policy.

Geopolitical fragmentation, one of five mega forces or structural shifts we track, is playing out in recent events in Asia and the Middle East. Yemen’s Houthi militants attacking Red Sea shipping highlights how hot spots can hit supply chains and up production costs. Fragmentation is a key reason we see persistent inflation pressures – keeping policy rates above pre-Covid levels. Countries like Mexico and Vietnam, and strategic sectors like tech could benefit from globalization rewiring.

Paying greater attention

BlackRock Geopolitical Risk Indicator, 2018-2024



Forward-looking estimates may not come to pass. Source: BlackRock Investment Institute, with data from LSEG and Dow Jones, January 2024. Notes: The BlackRock Geopolitical Risk Indicator tracks the relative frequency of brokerage reports and financial news stories related to specific geopolitical risks. We adjust for whether sentiment in the text is positive or negative, and then assign a score that reflects the level of market attention to each risk versus a five-year history. More on our [methodology](#).

Geopolitics has become a persistent and structural market risk over the last half-decade, in our view. The world has faced cascading crises – from the U.S. trade wars to the Covid-19 pandemic, Russia’s invasion of Ukraine and now war in the Middle East. These developments have accelerated global fragmentation and the emergence of competing geopolitical and economic blocs. And the openness of countries to trade with each other has stalled, based on world trade as a share of global GDP. This is a marked departure from the globalization and geopolitical moderation of the post-Cold War period. We see the rewiring of globalization along geopolitical lines ramping up as countries and companies favor national security and resilience over pure cost efficiency. So it’s no surprise markets are paying more attention to geopolitics, as measured by our Geopolitical Risk Indicator (see chart).



Wei Li
Global Chief Investment Strategist – BlackRock Investment Institute



Catherine Kress
Head of Geopolitical Research – BlackRock Investment Institute



Alex Brazier
Deputy Head – BlackRock Investment Institute



Axel Christensen
Chief Investment Strategist for Latin America – BlackRock Investment Institute

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

BlackRock Investment Institute

Geopolitical fragmentation is one of the reasons we see persistent inflation pressures – and policy rates staying above pre-pandemic levels. Supply chains are becoming longer and more complex as “connector” countries like Mexico and Vietnam increasingly act as intermediate trading partners between different geopolitical blocs. Such countries may stand to benefit from competition between blocs, yet significant investment will be needed in areas like critical infrastructure for benefits to fully materialize. Companies that prove resilient to shifting supply chains may have a competitive edge – and some will also benefit from robust industrial policies like the U.S. Inflation Reduction Act and CHIPS and Science Act.

Fragmentation’s economic and market impact will depend, in part, on if changes to the global order are managed or disorderly. Greater geopolitical volatility – and the rising number of violent conflicts worldwide – increase the risk of a more disorderly and less predictable path. Yet as broad stocks and other assets move on quickly from geopolitical events, we worry they may not be appreciating that we have entered a new geopolitical regime. The old playbook no longer applies, in our view.

On the risks we’re monitoring, we reaffirmed our highest-level *Gulf tensions* rating in December given the ongoing Israel-Hamas war. The risk of escalation is high, we believe, with attacks by Iranian-backed groups on the rise. The disruption of Red Sea shipping aiming to pass through the Suez Canal shows how the conflict can expand to hamper supply chains and drive up production costs, in this case via rising shipping costs. We keep our *U.S.-China strategic competition* risk rating at a high level. The November meeting between the U.S. and Chinese presidents has helped set a more positive tone for relations and expanded communications in the near term. But Taiwan remains a significant flashpoint, as the recent election shows. We think intense, structural competition between the U.S. and China is the new normal, especially in defense and technology.

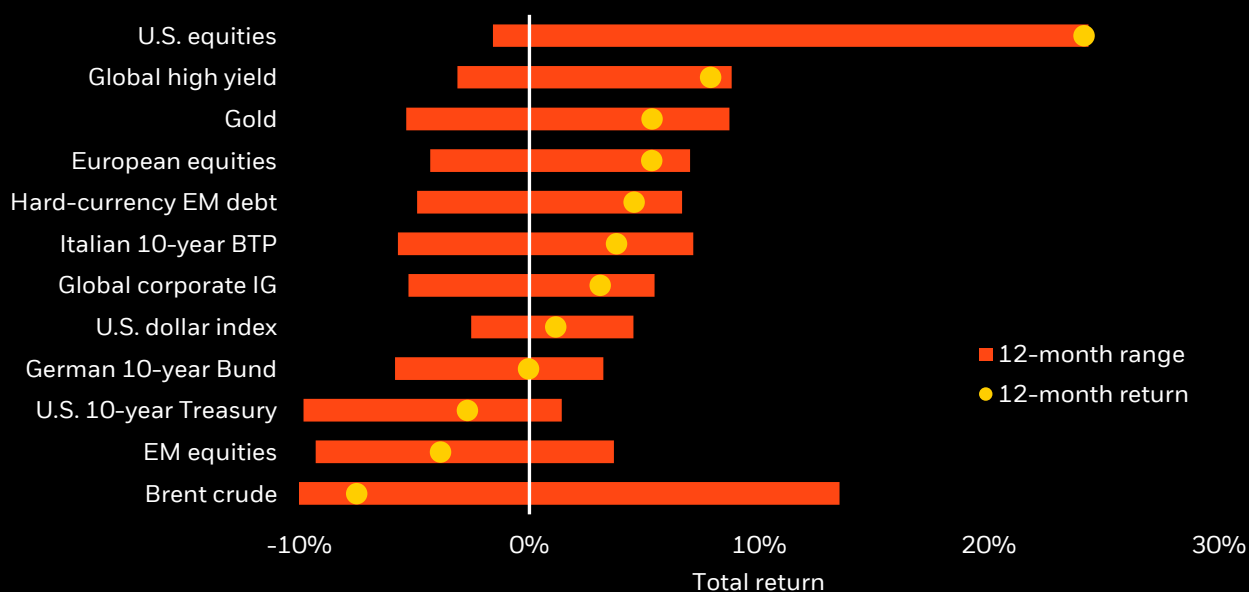
Bottom line: We expect deeper fragmentation, heightened competition and less cooperation between major nations in 2024. We see the rewiring of globalization benefiting countries like Mexico and Vietnam. It will also likely spur a surge of investment in advanced tech, clean energy, defense and other sectors seen as critical to a country’s economic and geopolitical goals.

Market backdrop

The S&P 500 closed at its highest ever last week, and gains in tech shares pushed the Nasdaq 100 to an all-time high. The U.S. 10-year yield climbed above 4.10% as markets trimmed expectations for Federal Reserve interest rate cuts this year but still eye about six quarter-point cuts. Better-than-expected retail sales and Fed comments warning against rapid rate cuts spurred the repricing. We still see market pricing of rate cuts as overdone given the inflation rollercoaster we expect, but the quick shift in expectations underscores the importance of managing macro risk as market narratives can suddenly flip flop.

Assets in review

Selected asset performance, 12-month 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 LSEG Datastream as of Jan. 18, 2024. 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 12-month 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, LSEG 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.

Week ahead

Jan. 23	Bank of Japan (BOJ) policy decision	Jan. 25	U.S. GDP; European Central Bank (ECB) policy decision
Jan. 24	Global flash PMIs	Jan. 26	U.S. PCE

Policy rate decisions by central banks are in focus this week as both the ECB and BOJ meet. We expect the ECB to hold rates steady ahead while communicating future cuts. We're also following the BOJ as it faces pressure to tighten its ultra-loose policy. In the U.S, a slew of activity data is due for release, including PCE inflation data. We expect inflation to fall to 2% by year end as goods prices slide, but we see the risk of resurgent inflation coming into view later this year.

Big calls

Our highest conviction views on tactical (6-12 month) and strategic (long-term) horizons, January 2024

Tactical	Reasons
DM equities	<ul style="list-style-type: none"> Our macro view keeps us underweight, but we think the AI theme and alpha potential has taken us closer to a neutral view. See below.
Income in fixed income	<ul style="list-style-type: none"> The income cushion bonds provide has increased across the board in a higher rate environment. We like short-term bonds and are now neutral long-term U.S. Treasuries as we see two-way risks ahead.
Geographic granularity	<ul style="list-style-type: none"> We favor getting granular by geography and like Japan equities in DM. Within EM, we like India and Mexico as beneficiaries of mega forces even as relative valuations appear rich.
Strategic	Reasons
Private credit	<ul style="list-style-type: none"> We think private credit is going to earn lending share as banks retreat – and at attractive returns relative to credit risk.
Inflation-linked bonds	<ul style="list-style-type: none"> We see inflation staying closer to 3% in the new regime than policy targets, making this one of our strongest views on a strategic horizon.
Short- and medium-term bonds	<ul style="list-style-type: none"> We overall prefer short-term bonds over long term. That's due to more uncertain and volatile inflation, heightened bond market volatility and weaker investor demand.

Note: Views are from a U.S. dollar perspective, January 2024. 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.

Tracking five mega forces

Mega forces are big, structural changes that affect investing now – and far in the future. As key drivers of the new regime of greater macroeconomic and market volatility, they change the long-term growth and inflation outlook and are poised to create big shifts in profitability across economies and sectors. This creates major opportunities – and risks – for investors. See our [web hub](#) for our research and related content on each mega force.

- Demographic divergence:** The world is split between aging advanced economies and younger emerging markets – with different implications.
- Digital disruption and artificial intelligence (AI):** Technologies that are transforming how we live and work.
- Geopolitical fragmentation and economic competition:** Globalization is being rewired as the world splits into competing blocs.
- Future of finance:** A fast-evolving financial architecture is changing how households and companies use cash, borrow, transact and seek returns.
- Transition to a low-carbon economy:** The transition is set to spur a massive capital reallocation as energy systems are rewired.

Granular views

Six- to 12-month tactical views on selected assets vs. broad global asset classes by level of conviction, January 2024

Our approach is to first determine asset allocations based on our macro outlook – and what’s in the price. **The table below reflects this and, importantly, leaves aside the opportunity for alpha, or the potential to generate above-benchmark returns.** The new regime is not conducive to static exposures to broad asset classes, in our view, but is creating more space for alpha.

	Underweight	Neutral	Overweight	● Previous view	
Asset	View				Commentary
Equities					
Developed markets					
United States				-1	We are underweight the broad market – still our largest portfolio allocation. Hopes for rate cuts and a soft landing have driven a rally. We see the risk of these hopes being disappointed.
Europe				-1	We are underweight. The ECB is holding policy tight in a slowdown. Valuations are attractive, but we don't see a catalyst for improving sentiment.
UK				Neutral	We are neutral. We find attractive valuations better reflect the weak growth outlook and the Bank of England's sharp rate hikes to fight sticky inflation.
Japan				+1	We are overweight. We see stronger growth helping earnings top expectations. Stock buybacks and other shareholder-friendly actions are positives. Potential policy tightening is a near-term risk.
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					
China				Neutral	We are neutral. We see growth on a weaker trajectory and see only limited policy stimulus from China. We prefer EM debt over equity.
Fixed Income					
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				Neutral	We are neutral. The yield surge driven by expected policy rates has likely peaked. We now see about equal odds that long-term yields swing in either direction.
U.S. inflation-linked bonds				Neutral	We are neutral. We see higher medium-term inflation, but cooling inflation and growth may matter more near term.
Euro area inflation-linked bonds				-1	We are underweight. We prefer the U.S. over the euro area. We see markets overestimating how persistent inflation in the euro area will be relative to the U.S.
Euro area govt bonds				Neutral	We are neutral. Market pricing reflects policy rates in line with our expectations and 10-year yields are off their highs. Widening peripheral bond spreads remain a risk.
UK gilts				Neutral	We are neutral. Gilt yields have compressed relative to U.S. Treasuries. Markets are pricing in Bank of England policy rates closer to our expectations.
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. Tight spreads don't compensate for the expected hit to corporate balance sheets from rate hikes, in our view. We prefer Europe over the U.S.
U.S. agency MBS				+1	We are overweight. We see agency MBS as a high-quality exposure in a diversified bond allocation and prefer it to IG
Global high yield				Neutral	We are neutral. Spreads are tight, but we like its high total yield and potential near-term rallies. We prefer Europe.
Asia credit				Neutral	We are neutral. We don't find valuations compelling enough to turn more positive.
Emerging hard currency				+1	We are overweight. We prefer EM hard currency debt due to higher yields. It is also cushioned from weakening local currencies as EM central banks cut policy rates.
Emerging local currency				Neutral	We are neutral. Yields have fallen closer to U.S. Treasury yields. Central bank rate cuts could hurt EM currencies, dragging on potential returns.

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. The opinions expressed are as of Jan. 22, 2024, and are subject to change without notice. Reliance upon information in this material is at the sole discretion of the reader. Investing involves risks. 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. This material may contain estimates and forward-looking statements, which may include forecasts and do not represent a guarantee of future performance.

In the **U.S. and Canada**, this material is intended for public distribution. In **EMEA**, in the UK and Non-European Economic Area (EEA) countries: this is Issued by BlackRock Investment Management (UK) Limited, 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. 02020394. For your protection telephone calls are usually recorded. Please refer to the Financial Conduct Authority website for a list of authorised activities conducted by BlackRock. 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 **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. In **Switzerland**, for qualified investors in Switzerland: This document is marketing material. Until 31 December 2021, this document shall be exclusively made available to, and directed at, qualified investors as defined in the Swiss Collective Investment Schemes Act of 23 June 2006 ("CISA"), as amended. From 1 January 2022, 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/finisa 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. In the **United Arab Emirates** this material 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 **New Zealand**, issued by BlackRock Investment Management (Australia) Limited ABN 13 006 165 975, AFSL 230 523 (BIMAL) for the exclusive use of the recipient, who warrants by receipt of this material that they are a wholesale client as defined under the New Zealand Financial Advisers Act 2008. 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

©2024 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