Weekly commentary

BlackRock

July 6, 2021

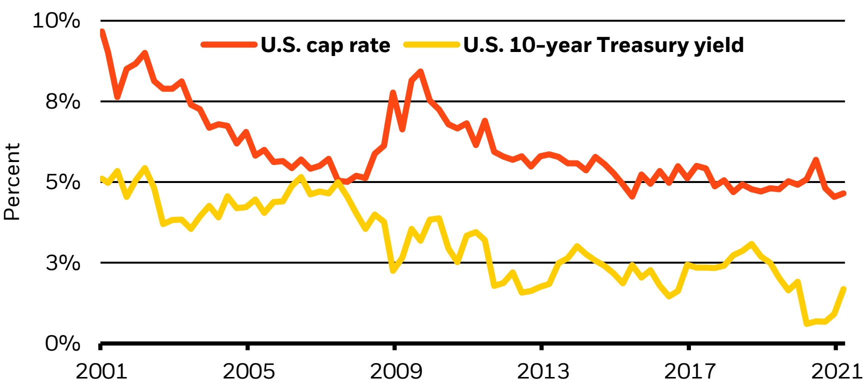
Death of the office? Far from it.

- We still see opportunities in the office sector of the global real estate market, but with changing work patterns driving dispersion across assets and locations.
- U.S. job growth accelerated in June, signaling labor market bottlenecks could be starting to ease. Stocks hit record highs.
- Investors will focus on global services purchasing managers' index (PMI) data to gauge if the restart has broadened out to the contact-intense sector.

The pandemic has led to widespread remote working, raising doubts about the future of offices. We believe the office is far from dead, but expect the impact of flexible working to vary across assets and locations. We see the restart and higher inflation driving up rental income and a more muted response of interest rates to rising inflation than in the past supporting real estate valuations.

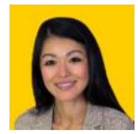
Chart of the week

U.S. real estate valuations vs. 10-year Treasury yields, 2001-2021



Sources: BlackRock Investment Institute, National Council of Real Estate Investment Fiduciaries, with data from Refinitiv Datastream, as of March 31, 2021. Notes: The orange line shows U.S. core real estate cap rates as represented by the NCREIF Property Index. The yellow line shows the yield of the Refinitiv Datastream U.S. 10-year benchmark government bond index. Cap rates – calculated as net operating income/property value – are a commonly quoted valuation metric for real estate. It is similar to an earnings yield – a lower cap rate means higher valuations. Past performance is no guarantee of future results.

Private market valuations have historically been closely linked to the interest rate and credit spread environment. The U.S. real estate cap rate – a measure of valuations – has trended lower since the global financial crisis, in line with the decline in Treasury yields. The cap rate stood around three percentage points above the Treasury yield at the end of March, in line with the 20-year average. A lower cap rate indicates higher valuations. See the chart above. We see a more muted monetary policy response to rising inflation than in the past – what we call the *new nominal* – and expect it to support real estate valuations overall. Yet cap rates are just one of the drivers of real estate returns. Cash flow growth is also key – and the pandemic has highlighted the uneven impact on cash flows across assets. Properties that have benefitted from the structural trends accelerated by the pandemic, such as warehouses, have performed well and are still attracting high investor interest. Office and retail lagged, though office occupancy rates and income have been rebounding amid the restart. We see a growing dispersion of fortunes even within the office sector, which accounted for nearly 40% of the global real estate market value at the end of 2020 as estimated by MSCI.



Wei Li
Global Chief Investment Strategist – BlackRock Investment Institute

Mark Everitt
Head of Research and Strategy, BlackRock Alternative Investors

Elga Bartsch
Head of Macro Research — BlackRock Investment Institute

Christian Olinger
Portfolio Strategist – BlackRock Investment Institute

Flexible working will likely reduce aggregate demand for offices in some markets, but the effect may not be as large as one may expect – due to tenants' desire for less density and the need to accommodate peak demand days, in our view. In a survey by real estate service firm CBRE just 9% of large companies expected significantly smaller office prints in the long term, compared with 39% last September. A wait-and-see attitude as the new normal of flexible working shapes up may also have helped moderate the desire to shrink the office size, with existing lease commitments limiting the short-term impact, in our view. We believe the effect will also vary by region, country and even city. For example, we expect much higher occupancy rates in parts of Asia Pacific where homes tend to be smaller and less conducive to remote working.

The pandemic has also accelerated structural trends such as an increased focus on sustainability – now a key consideration among real estate investors and building occupiers. Sustainable assets such as "green buildings" are likely to trade at a premium to non-sustainable assets, in our view. Large real estate investors such as pension funds and insurance companies are setting more stringent environmental, social and governance (ESG) metrics for their investment managers as the issue has risen to the top of investment mandate requirements.

A transformation to a "hub-and-home" flexible working model in some markets could take a couple of years, and will drive a shift in the capabilities and functions of offices, in our view. We expect higher-quality office properties - typically large, newly built spaces with greater flexibility and better sustainability credentials – to benefit at the expense of offices that are smaller, less energy-efficient, and outside core locations. Other factors that are also likely to contribute to the dispersion of performance include the proximity to major transport hubs, ease of access for employees commuting by car, and the quality of building management.

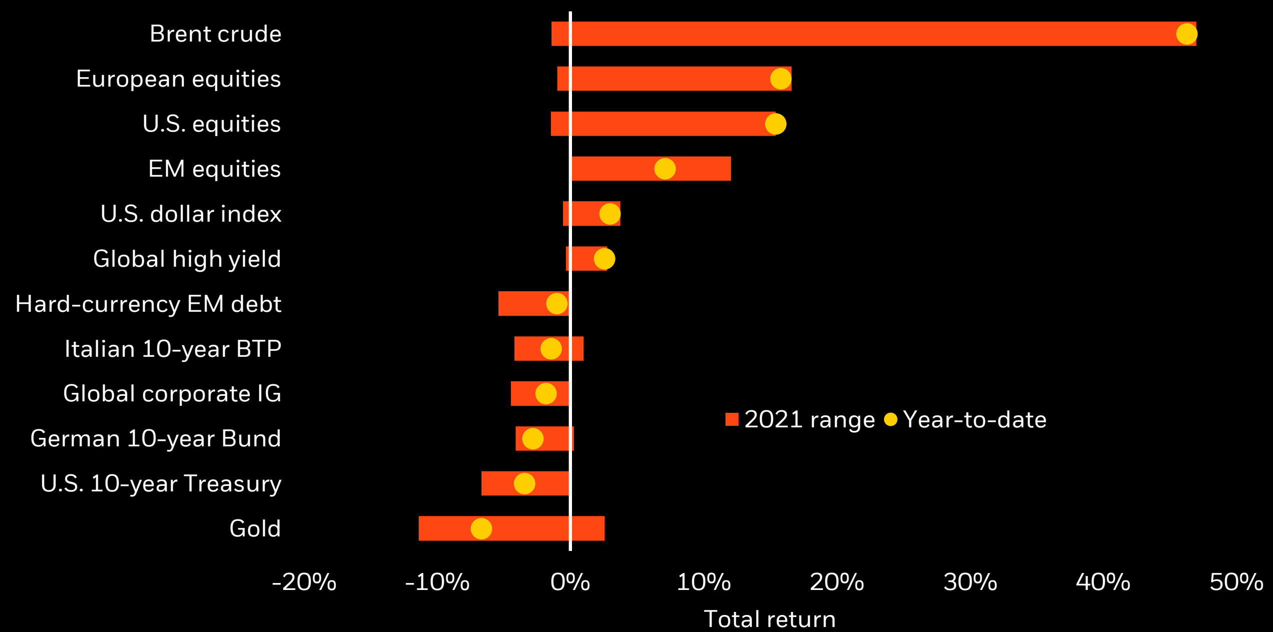
The bottom line: We still see opportunities in the office sector despite changing work patterns, but expect a dispersion across locations and property types and an increased focus on sustainability to be another key driver. Elsewhere in real estate, we still like logistics properties due to their exposure to the accelerated expansion of e-commerce, but see some parts of that market nearing peak valuation. We stress the importance of expert asset management as tenants, owners, operators and investors alike navigate an uncharted territory, both in the future of work and the macro environment.

Market backdrop

U.S. job growth accelerated in June, with nonfarm payrolls increasing by 850,000 after a rise of 583,000 in May. Stocks rallied to record highs after the better-than-expected employment data. We see labor market bottlenecks as real but expect them to resolve over time. Some 130 countries have backed plans for a global minimum tax as part of an OECD initiative to tax cross-border digital services and limit multinationals from shifting profit to lower-tax jurisdictions.

Assets in review

Selected asset performance, 2021 year-to-date 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 July 1, 2021. Notes: The two ends of the bars show the lowest and highest returns at any point this year to date, 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, in descending order: spot Brent crude, MSCI Europe Index, MSCI USA Index, MSCI Emerging Markets Index, ICE U.S. Dollar Index (DXY), Bank of America Merrill Lynch Global High Yield Index, J.P. Morgan EMBI index, Refinitiv Datastream Italy 10-year benchmark government bond index, Bank of America Merrill Lynch Global Broad Corporate Index, Refinitiv Datastream Germany 10-year benchmark government bond index, Refinitiv Datastream U.S. 10-year benchmark government bond index and spot gold.

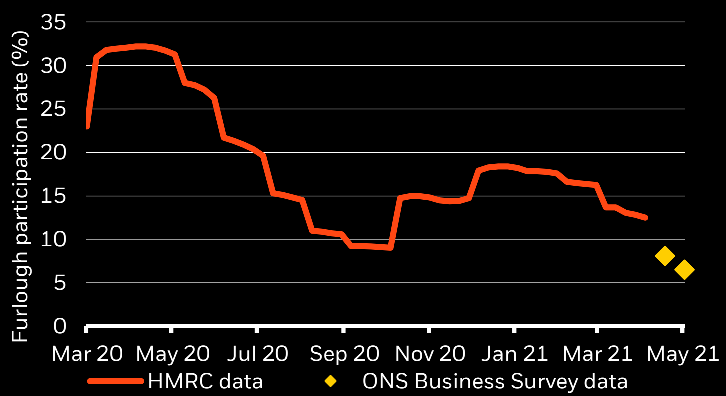
Macro insights

The UK economic restart has accelerated, and growth momentum is yet to peak, in our view. The rapid spread of the Delta variant looks unlikely to derail the reopening, but the UK may still have some room to run before getting back up to its pre-Covid growth level – now expected to happen in the first quarter of 2022.

The biggest challenge ahead will likely be the end of key policy support measures. The most important of these is the furlough scheme, set to expire at the end of September. The scheme has been instrumental in cushioning the Covid blow to the labor market. As much as about a third of private-sector employees were furloughed in early 2020, compared with an estimate of just 6.5% today. See the chart. A sharp – albeit temporary – rise in unemployment may follow the program expiry, while the labor market adjusts and workers find new jobs elsewhere. The labor market recovery will likely be a focus of the Bank of England, in our view. See our macro insights hub.

Back in business

Take-up of UK furlough scheme, March 2020 - May 2021



Sources: BlackRock Investment Institute, Her Majesty's Revenue and Customs (HMRC), UK Office for National Statistics (ONS), with data from Haver Analytics, June 2021. Notes: The chart shows the share of private-sector employees participating in the government furlough program. The orange line shows data from the HMRC, which runs to April 2021. More recent estimates are obtained from the ONS Covid indicators for the UK economy.

Investment themes

1 The new nominal

- We see the U.S. and UK leading the developed world's economic restart – with the euro area catching up - powered by pent-up demand and sky-high excess savings. The huge growth spurt will be transitory, in our view. This is because a restart is not a recovery: the more activity restarts now, the less there will be to restart later.
- Fed officials in June projected higher inflation and moved up the lift-off in policy rates to 2023. We believe this confirmed our new nominal theme – that interest rates will rise more slowly than in the past in response to higher inflation – as the Fed's acknowledgement of rising price pressures has not translated into projections for significantly higher interest rates any time soon.
- We believe the rise in nominal government bond yields this year is justified and reflects markets awakening to a strong, vaccine-driven activity restart combined with historically large fiscal stimulus.
- We expect short-term rates will stay anchored near zero, supporting equity valuations. The Fed could be more willing to lean against rising long-term yields than the past, yet the direction of travel over the next few years is clearly towards higher long-term yields. We see important limits on the level of yields the global economy can withstand.
- **Market implication**: We favor inflation-linked bonds amid inflationary pressures in the medium term. Tactically we prefer to take risk in equities over credit amid low rates and tight spreads.

2 Globalization rewired

- Covid-19 has accelerated geopolitical transformations such as a bipolar U.S.-China world order and a rewiring of global supply chains, placing greater weight on resilience.
- The Biden administration is engaging in strategic competition with China, particularly on technology, and has criticized Beijing on human rights. Pending legislation in the U.S. would direct large-scale investment to meet the China challenge. We see a case for greater exposure to China-related assets for potential returns and diversification – and view them as core strategic holdings that are distinct from EM exposures.
- We expect persistent inflows to Asian assets as we believe many global investors remain underinvested and China's weight in global indexes grows. Risks to China-exposed assets include China's high debt levels and U.S.-China conflicts, but we believe investors are compensated for these risks.
- Momentum is growing at the G20 for a global minimum tax that would reduce the ability of multinationals to shift profits to low-tax jurisdictions.
- **Market implication**: Strategically we favor deliberate country diversification and above-benchmark China exposures. Tactically we like Asia ex-Japan equities, and see UK equities as an inexpensive, cyclical exposure.

3 Turbocharged transformations

- The pandemic has added fuel to pre-existing structural trends such as an increased focus on sustainability, rising inequality within and across nations, and the dominance of e-commerce at the expense of traditional retail.
- The pandemic has focused attention on underappreciated sustainability-related factors and supply chain resilience.
- It has also accelerated "winner takes all" dynamics that have led to the strong performance of a handful of tech giants in recent years. We see tech as having long-term structural tailwinds despite its increased valuations, yet it could face challenges from higher corporate taxes and tighter regulation under a united Democratic government.
- The pandemic has heightened the focus on inequalities within and across countries due to the varying quality of public health infrastructure – particularly across EMs – and access to healthcare. We see a risk of social unrest.
- **Market implication**: Strategically we see returns being driven by climate change impacts, and view developed market equities as an asset class positioned to capture the opportunities from the climate transition. Tactically we favor tech and healthcare as well as selected cyclical exposures.

Week ahead

July 5	Euro area composite purchasing managers' index (PMI); China services PMI
July 6	Germany ZEW indicator of economic sentiment; U.S. services PMI
July 7	German industrial output; Fed June meeting minutes release
July 9	China consumer price index and producers price index

Investors will focus on global services PMI data this week. U.S. data will be particularly noteworthy, as it may show signs that the economic restart is broadening out to the contact-intense sectors that have been hit particularly bad by the pandemic. The minutes of the Federal Reserve's June meeting will also be in focus as investors seek clarity on the central bank's new policy framework.

Directional views

Strategic (long-term) and tactical (6-12 month) views on broad asset classes, May 2021

Change in view: Previous → New

Asset	Strategic view	Tactical view	
Equities	+1	+1	We are overweight equities on a strategic horizon. We see a better outlook for earnings amid moderate valuations. Incorporating climate change in our expected returns brightens the appeal of developed market equities given the large weights of sectors such as tech and healthcare in benchmark indexes. Tactically, we stay overweight equities as we expect the restart to re-accelerate and interest rates to stay low. We tilt toward cyclicality and maintain a bias for quality.
Credit	-1	Neutral	We are underweight credit on a strategic basis as valuations are rich and we prefer to take risk in equities. On a tactical horizon, credit, especially investment grade, has come under pressure from tightening spreads, but we still like high yield for income.
Govt bonds	-1	-1	We are strategically underweight nominal government bonds as their ability to act as portfolio ballasts are diminished with yields near lower bounds and rising debt levels may eventually pose risks to the low-rate regime. This is part of why we underweight government debt strategically. We prefer inflation-linked bonds as we see risks of higher inflation in the medium term. We are underweight duration on a tactical basis as we anticipate gradual increases in nominal yields supported by the economic restart.
Cash		Neutral	We use cash to fund overweight in equities. Holding some cash makes sense, in our view, as a buffer against supply shocks driving both stocks and bonds lower.
Private markets	Neutral		We believe non-traditional return streams, including private credit, have the potential to add value and diversification. Our neutral view is based on a starting allocation that is much larger than what most qualified investors hold. Many institutional investors remain underinvested in private markets as they overestimate liquidity risks, in our view. Private markets are a complex asset class not suitable for all investors.

Notes: Views are from a U.S. dollar perspective, May 2021. 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

Change in view

Previous → New

Six to 12-month tactical views on selected assets vs. broad global asset classes by level of conviction, May 2021

	Asset	Underweight	Overweight	
Equities	United States		■	We are overweight U.S. equities. We see the tech and healthcare sectors offering exposure to structural growth trends, and U.S. small caps geared to an expected cyclical upswing in 2021.
Equities	Euro area			We are neutral European equities. We believe the broad economic restart later in the year will help narrow the performance gap between this market and the rest of the world.
Equities	Japan	■		We are underweight Japanese equities. Other Asian economies may be greater beneficiaries of a more predictable U.S. trade policy under a Biden administration. A stronger yen amid potential U.S. dollar weakness may weigh on Japanese exporters.
Equities	Emerging markets		■	We are overweight EM equities. We see them as principal beneficiaries of a vaccine-led global economic upswing in 2021. Other positives: our expectation of a flat to weaker U.S. dollar and more stable trade policy under a Biden administration.
Equities	Asia ex-Japan		■	We are overweight Asia ex-Japan equities. Many Asian countries have effectively contained the virus – and are further ahead in the economic restart. We see the region's tech orientation allowing it to benefit from structural growth trends.
Equities	UK		■	We are overweight UK equities. The removal of uncertainty over a Brexit deal should see the risk premium on UK assets attached to that outcome erode. We also see UK large-caps as a relatively attractive play on the global cyclical recovery as it has lagged peers.
Equities	Momentum			We keep momentum at neutral. The factor has become more exposed to cyclicality, could face challenges in the near term as a resurgence in Covid-19 cases and a slow start to the vaccination efforts create potential for choppy markets.
Equities	Value			We are neutral on value despite recent outperformance. The factor could benefit from an accelerated restart, but we believe that many of the cheapest companies – across a range of sectors – face structural challenges.
Equities	Minimum volatility			We turn neutral min vol. Our regional and sectoral preferences warrant a higher exposure to the factor. Min vol's underperformance has brought valuations to more reasonable levels in our view.
Equities	Quality		■	We are overweight quality. We like tech companies with structural tailwinds and see companies with strong balance sheets and cash flows as resilient against a range of outcomes in the pandemic and economy.
Equities	Size		■	We are overweight the U.S. size factor. We see small- and mid-cap U.S. companies as a key place where exposure to cyclicality may be rewarded amid a vaccine-led recovery.
Fixed Income	U.S. Treasuries	■		We are underweight U.S. Treasuries. The accelerated economic restart has sent yields surging, but we prefer to stay underweight as we expect short-term rates will stay anchored near zero.
Fixed Income	Treasury Inflation-Protected Securities			We are neutral TIPS after the sharp rise in inflation expectations since late year. Further increases seem unlikely in the near-term. We still see inflation pressures building over the medium term due to structural reasons.
Fixed Income	German bunds			We are neutral on bunds. 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.
Fixed Income	Euro area peripherals			We are neutral euro peripheral bond markets. Yields have rallied to near record lows and spreads have narrowed. The ECB supports the market but it is not price-agnostic - its purchases have eased as spreads have narrowed.
Fixed Income	Global investment grade	■		We are underweight investment grade credit. We see little room for further yield spread compression and favor more cyclical exposures such as high yield and Asia fixed income.
Fixed Income	Global high yield		■	We are moderately overweight global high yield. Spreads have narrowed significantly, but we believe the asset class remains an attractive source of income in a yield-starved world.
Fixed Income	Emerging market – hard currency			We are neutral hard-currency EM debt. We expect it to gain support from the vaccine-led global restart and more predictable U.S. trade policies.
Fixed Income	Emerging market – local currency		■	We are overweight EM local debt as its year-to-date underperformance has left valuations more appealing, particularly if U.S. Treasury yields and the U.S. dollar stabilize. We see limited contagion to broader EM from selected country-specific volatility.
Fixed Income	Asia fixed income		■	We are overweight Asia fixed income. We see the asset class as attractively valued. Asian countries have done better in containing the virus and are further ahead in the economic restart.

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 the global economy, markets, geopolitics and long-term asset allocation – all to help our clients and portfolio managers 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 July 6, 2021 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 EMEA** Until 31 December 2020, issued by BlackRock Investment Management (UK) Limited, authorized 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. 2020394, has issued this document for access by Professional Clients only and no other person should rely upon the information contained within it. For your protection telephone calls are usually recorded. Please refer to the Financial Conduct Authority website for a list of authorized activities conducted by BlackRock. From 1 January 2021, in the event the United Kingdom and the European Union do not enter into an arrangement which permits United Kingdom firms to offer and provide financial services into the European Union, the issuer of this material is:(i) BlackRock Investment Management (UK) Limited for all outside of the European Union; and(ii) BlackRock (Netherlands) B.V. for in the European Union, BlackRock (Netherlands) B.V. is authorized 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 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/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), authorized 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** 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 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**, for institutional investors and financial intermediaries only (not for public distribution). 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

BlackRock.

Not FDIC Insured • May Lose Value • No Bank Guarantee