March 2023

BlackRock

2023 Global outlook Q2 update

BlackRock Investment Institute

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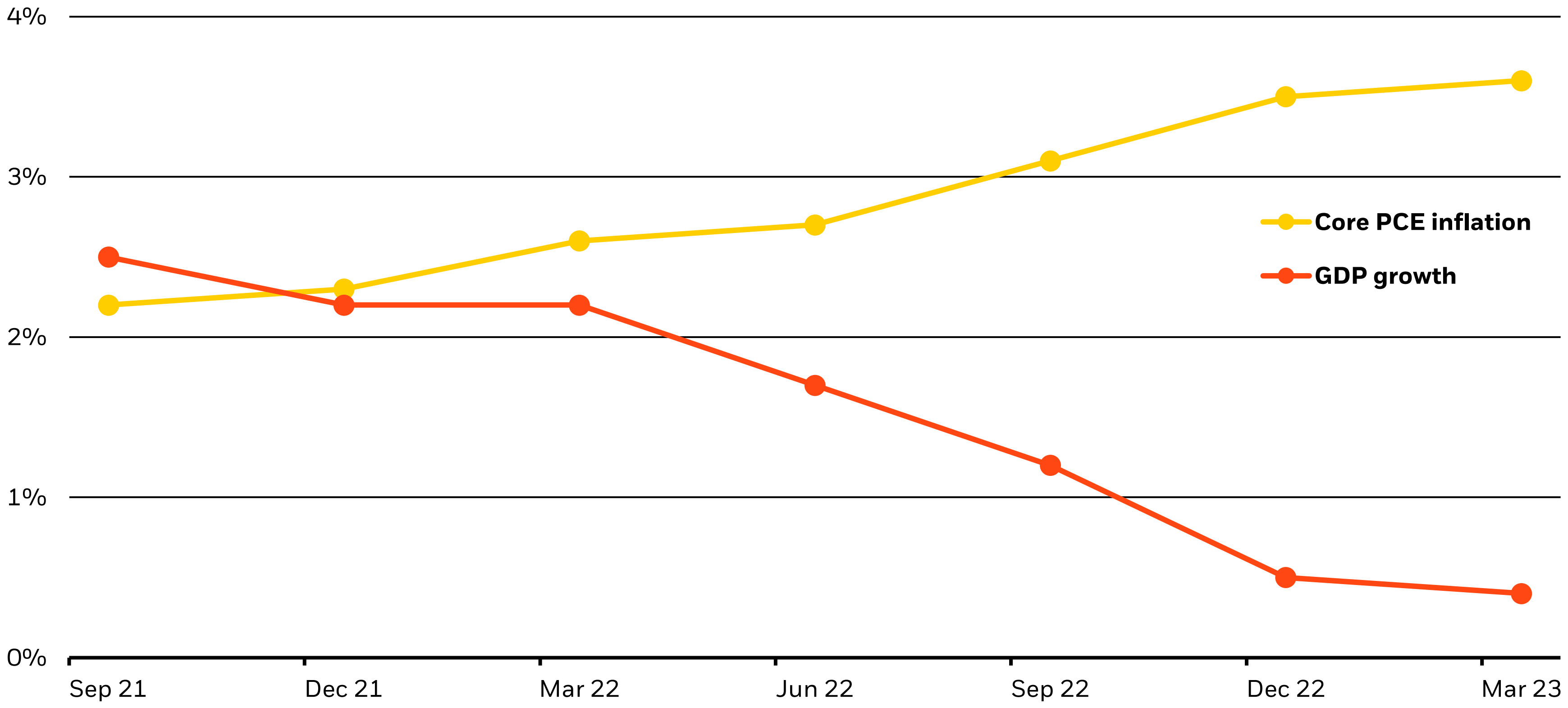
The new regime of sharper trade offs is playing out

The trade off between crushing activity or living with higher inflation in a world shaped by supply is front and center. Central bank projections for higher inflation and slowing growth suggest they are waking up to this trade off now.

U.S. Federal Reserve projections for Q4 2023 GDP growth and inflation



Source: BlackRock Investment Institute, U.S. Federal Reserve, March 2023. Notes: The chart shows the progression of the median Federal Open Market Committee projection for Q4 2023 U.S. real GDP growth and core PCE inflation year-over-year, from September 2021 to March 2023.

Themes and views

1. Pricing the damage

Financial cracks and economic damages from the fastest rate hiking cycle since the 1980s are emerging. What matters: the pricing of these and our assessment of market risk sentiment.

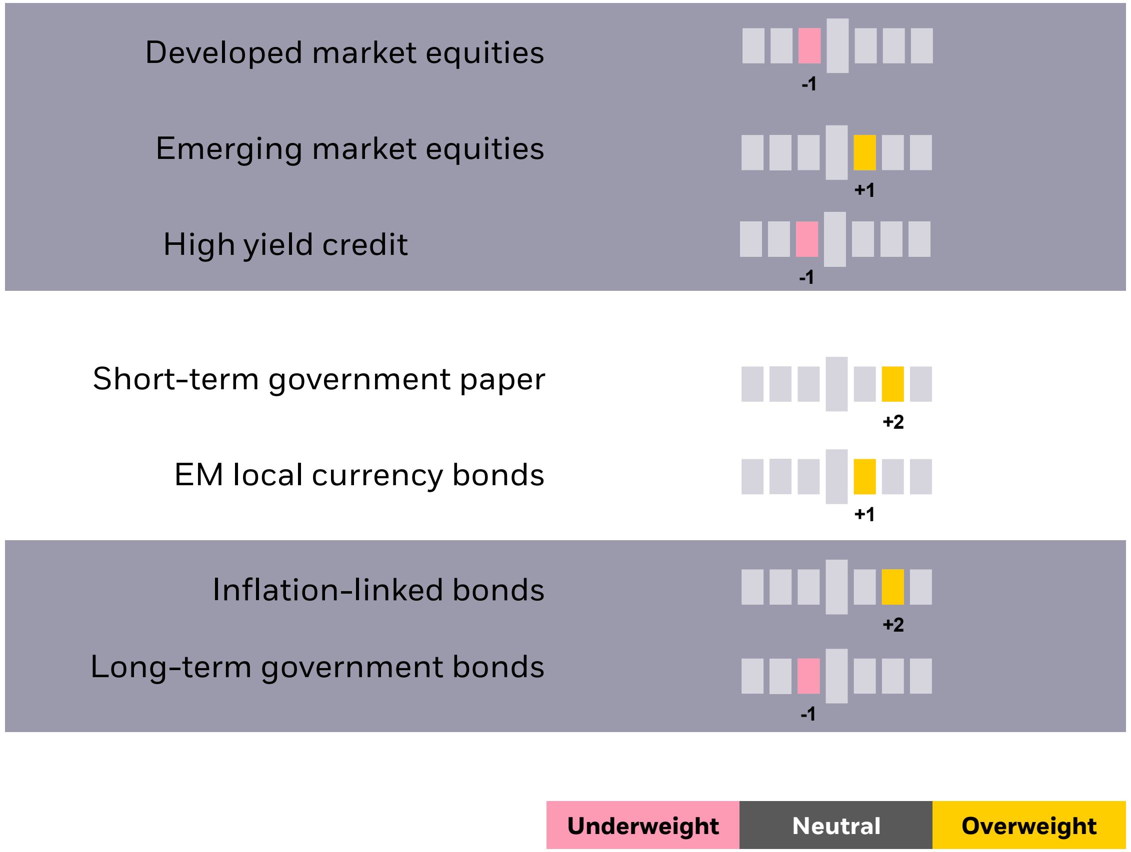
2. Rethinking bonds

We see higher yields, especially in short-term government bonds, as a gift to investors after years of being starved of income.

3. Living with inflation

Central banks are likely to stop their rapid rate hikes when the economic and financial damage becomes clearer, with inflation likely settling above 2% policy targets.

Latest tactical view changes

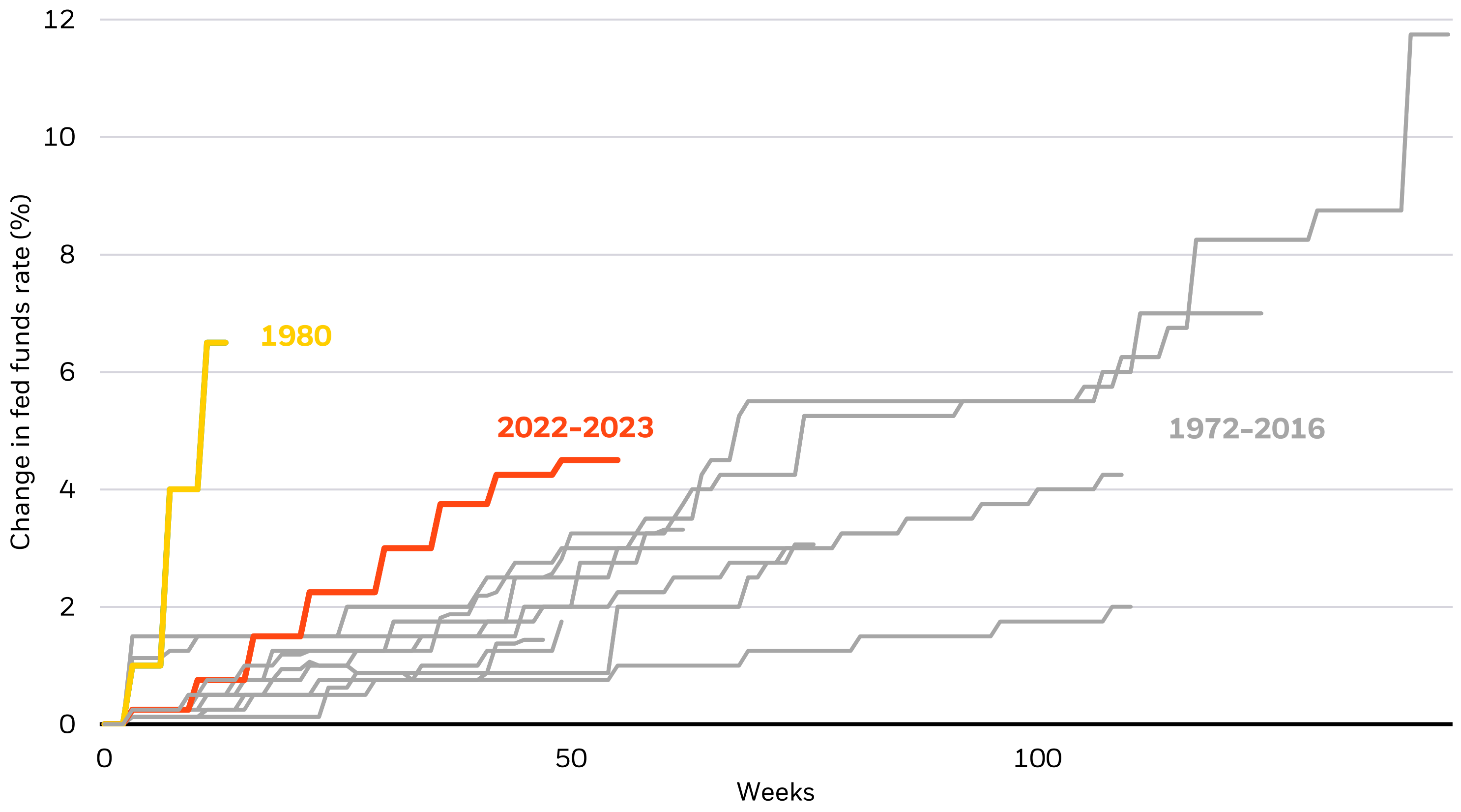


The opinions expressed are as of March 2023 and are subject to change at any time due to changes in market or economic conditions. Strategic implications refer to long-term views of five years and longer, tactical implications refer to asset views on shorter horizons of 12 months or less.

Rapid rate hikes drive economic and financial damage

We've argued that the Fed's fastest rate hiking campaign since the 1980s would cause economic damage and financial cracks. Those financial cracks have burst into view in recent weeks.

Fed rate hiking cycles, 1972–2022

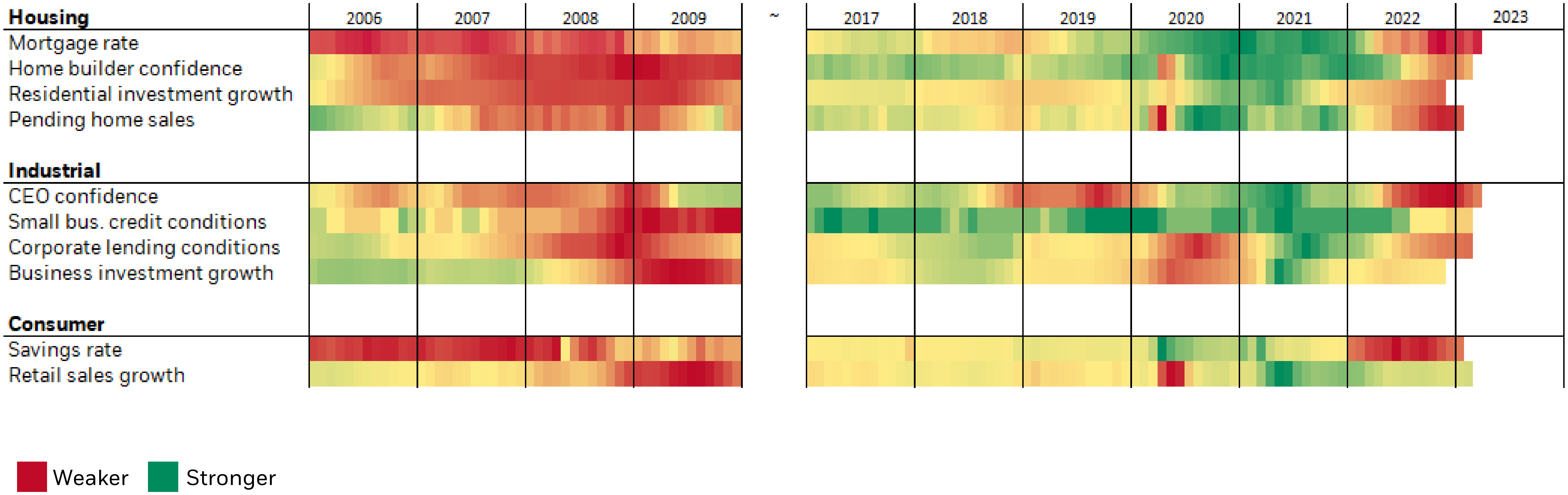


Source: BlackRock Investment Institute, with data from Refinitiv Datastream, March 2023. Notes: The chart shows previous and current Federal Reserve rate hike cycles.

Not a repeat of 2008, yet our recession view is reinforced

The effects of higher interest rates and tightening financial conditions are hitting the economy with several indicators flashing red. We don't see a repeat of 2008's financial crisis, yet the bank tumult has reinforced our recessions view.

Key U.S. economic indicators, 2006-2023

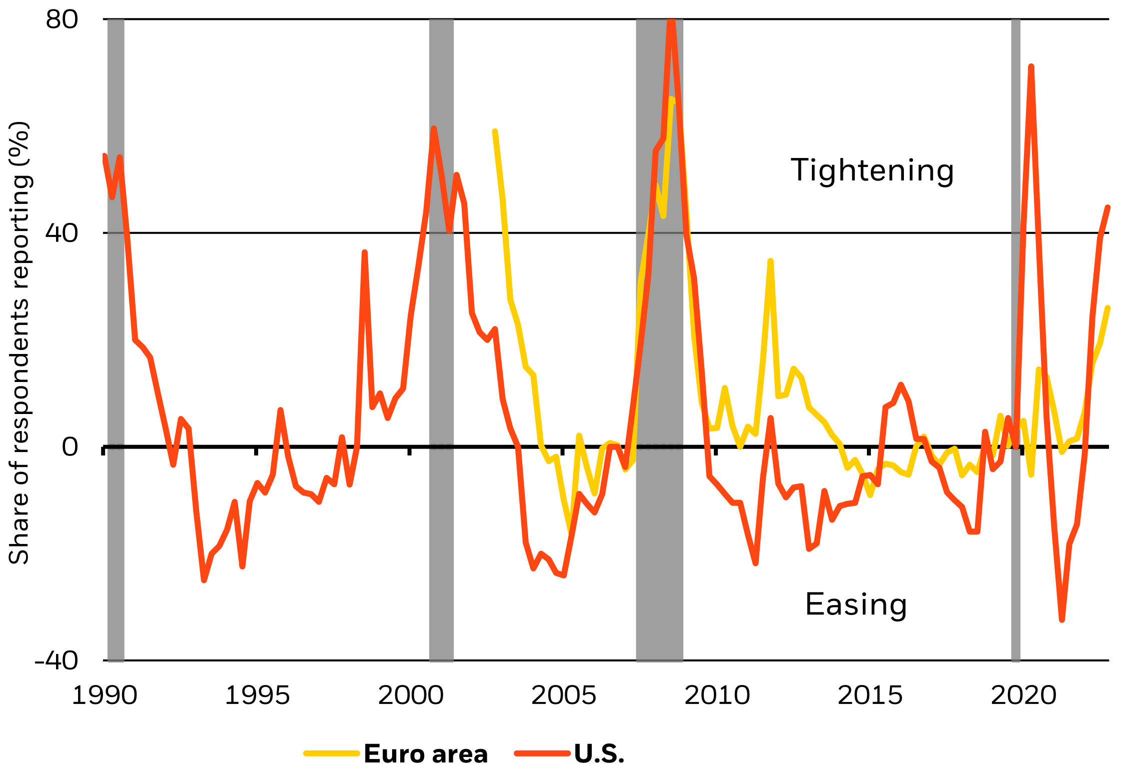


Source: BlackRock Investment Institute, with data from Refinitiv Datastream, March 2023. Notes: The chart shows a heatmap of key economic indicators from 2006-2023. Series are scored based on the number of standard deviations from average over the period. The squares turning more red represents the indicator worsening. The series used are the following. Mortgage rate: the conventional 30-year mortgage rate, Mortgage Bankers Association; Homebuilder confidence: U.S. National Association of Home Builders Housing Market Index; Residential investment growth: the annual change in U.S. residential private domestic investment, U.S. Bureau of Economic Analysis; Pending home sales: U.S. pending home sales, National Association of Realtors; CEO confidence: U.S. Conference Board CEO Confidence Survey. Small business credit conditions: U.S. NFIB Survey percentage of respondents positive on credit conditions less negative. Corporate lending conditions: U.S. C&I loan survey – large and medium firms, tightening credit. Business investment growth: U.S. non-residential private fixed investment. U.S. personal savings rate. U.S. retail sales: The annual change in sales excluding motor vehicle dealers and gas stations, Commerce Department.

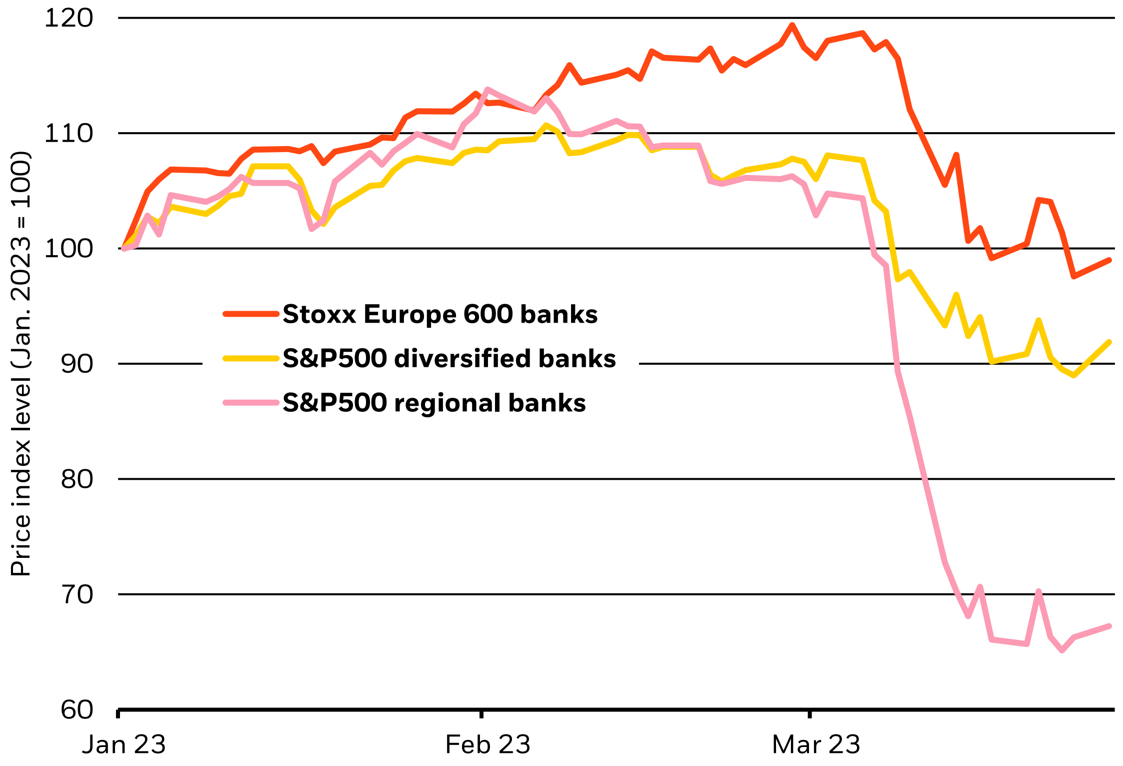
Tightening credit supply to weigh on activity

Bank lending surveys show credit conditions had started to tighten in the U.S. and the euro area since late 2022 as rates climbed. We think the latest episode of banking stress is poised to exacerbate this tightening.

Corporate bank lending conditions, 1980–2023



Regional bank index performance, 2023

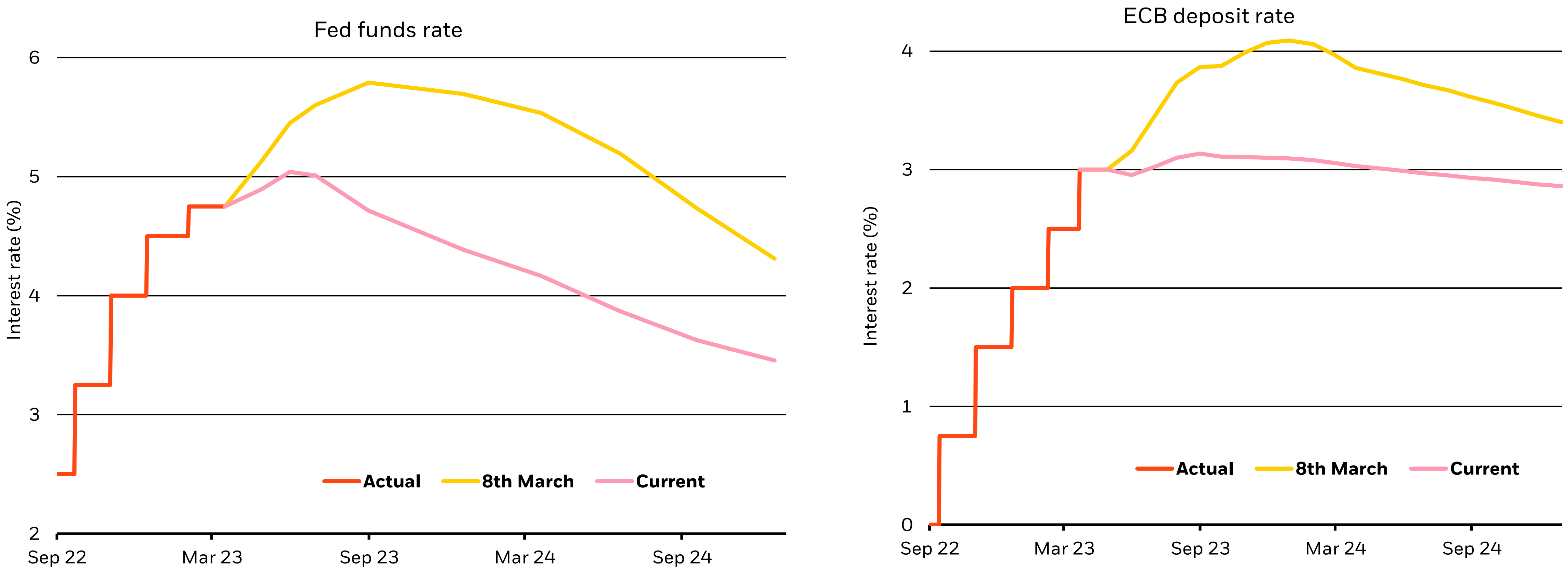


Past performance is not a reliable indicator of current or future results. Source: BlackRock Investment Institute, with data from Refinitiv Datastream, Federal Reserve and the European Central Bank, March 2023. Notes: The chart on the left shows the net percent of respondents that reported credit tightening or credit easing. Above the zero line, respondents reported credit tightening. Below the zero line, respondents reported credit easing. The chart on the right shows the index performance of various large and regional bank indexes. It is not possible to directly invest in an index. Index performances do not account for fees.

We don’t expect central banks to come to the rescue

Bond markets are pricing in rate cuts in 2023, reflecting the old recession playbook where central banks cut rates on signs of economic and financial damages. Yet persistent inflation means we expect rates to stay higher for longer.

Market pricing of the Fed funds rate and European Central Bank policy rate, March 2023

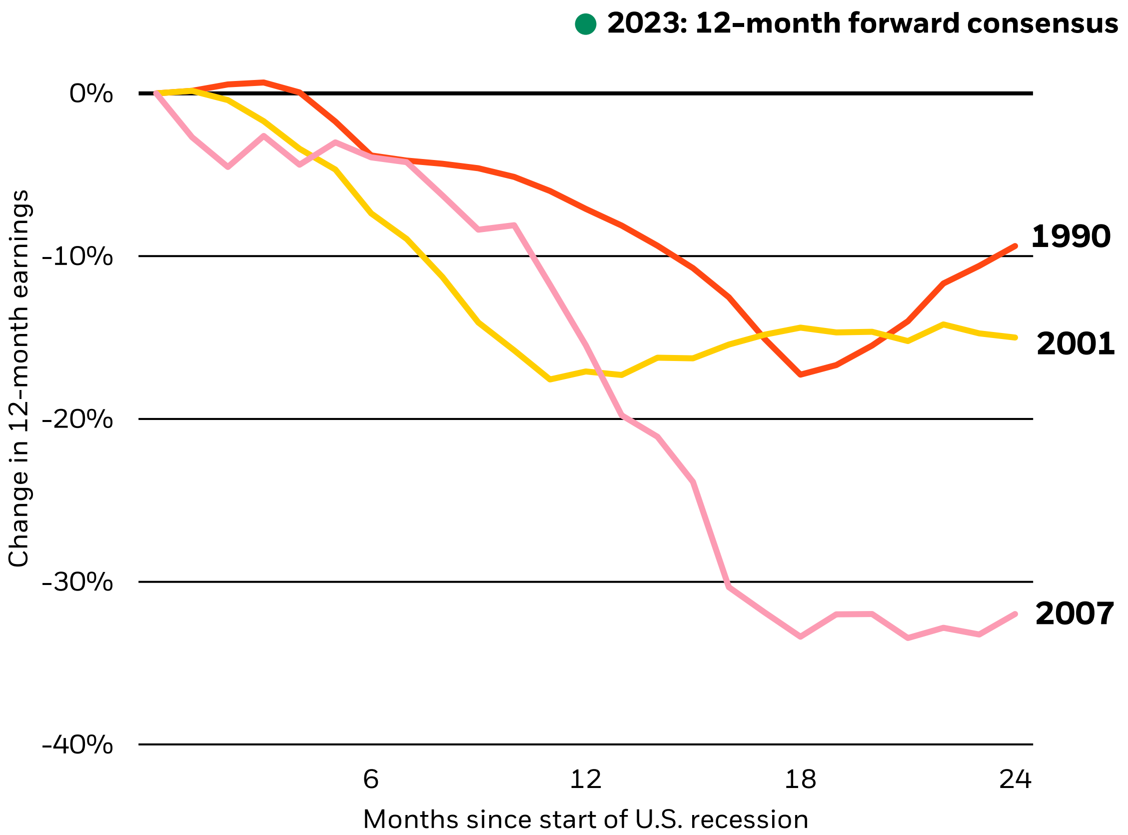


.**Forward looking estimates may not come to pass.** Source: BlackRock Investment Institute, with data from Refinitiv Datastream, March 2023. Notes: The charts show the forward fed funds rate and the European Central Bank deposit rate through December 2024 as implied by futures prices

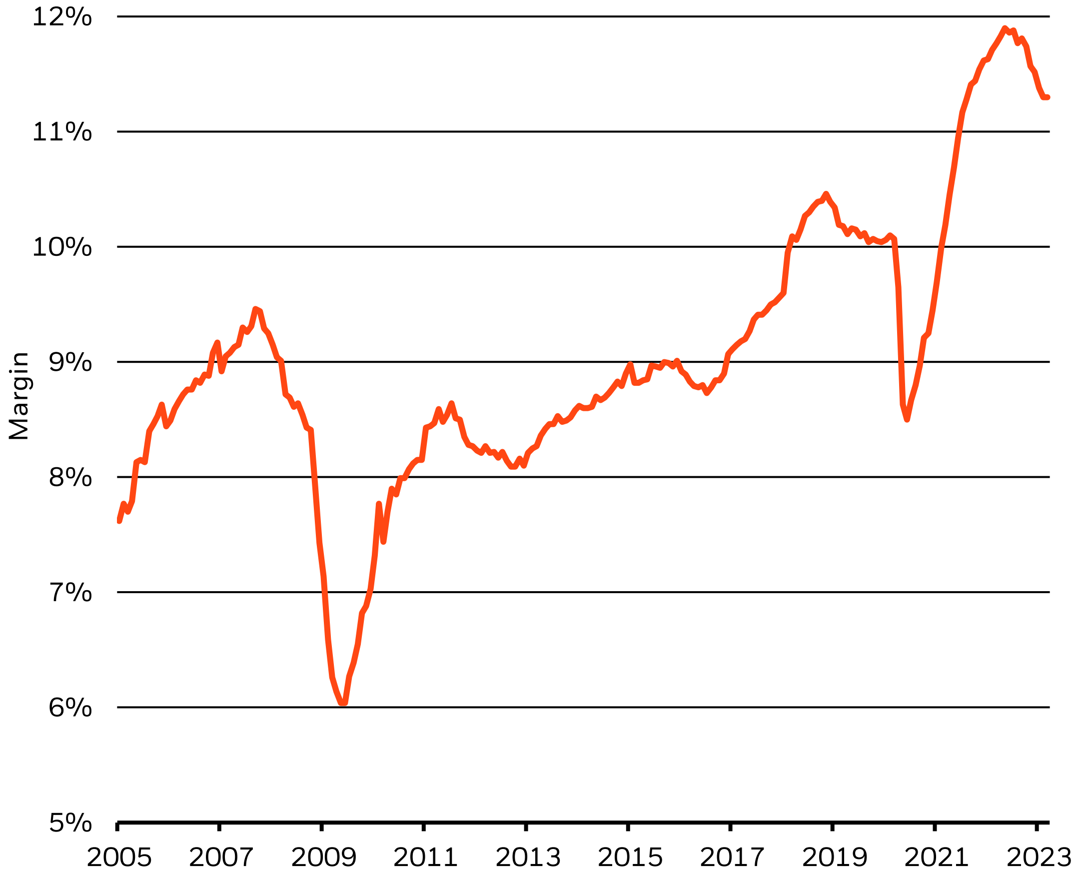
We stay underweight developed market (DM) equities

On top of relying on rate cuts we don't see coming, corporate earnings are running above trends and aren't pricing in the damage from higher rates we think. Cost pressures amid high inflation are likely to crimp profit margins.

S&P 500 earnings after recession



Global equity forward profit margins, 2005-2023

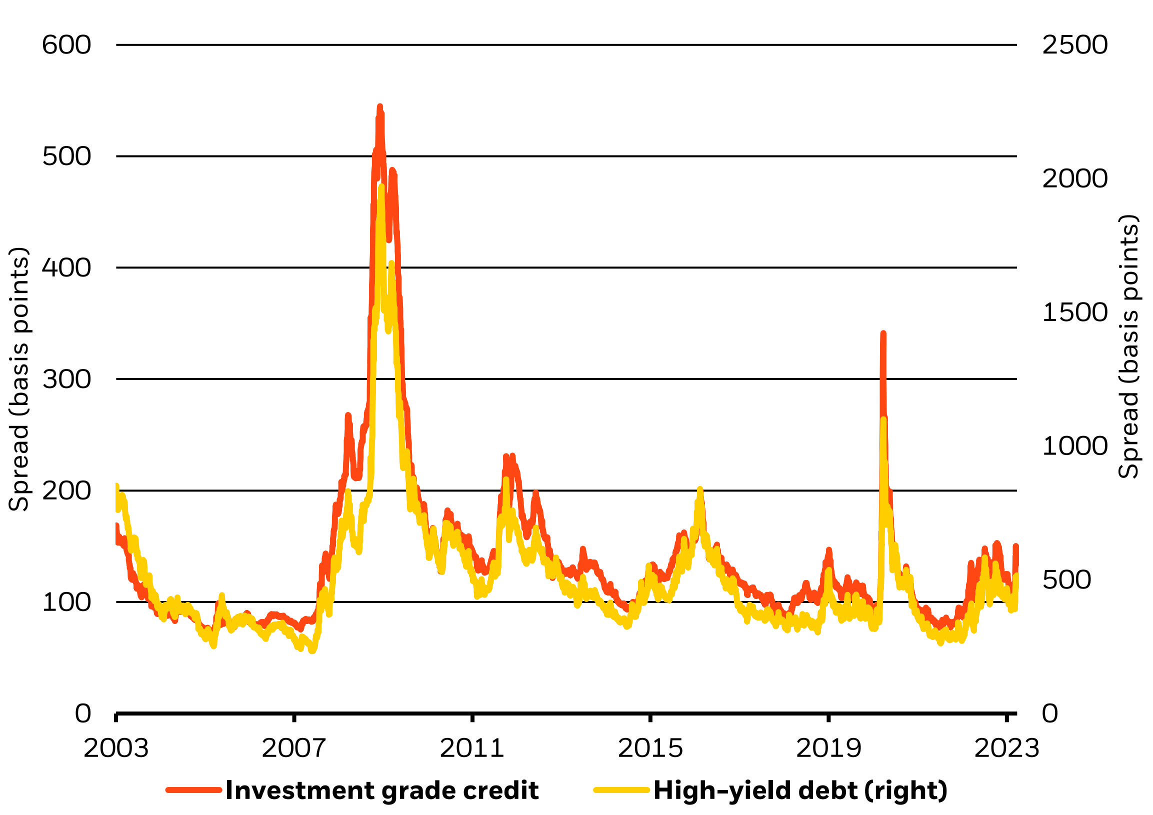


Forward looking estimates may not come to pass. Source: BlackRock Investment Institute, with data from MSCI and Refinitiv Datastream, March 2023. Notes: The lines on the chart on the left shows the path of S&P 500 12-month trailing earnings following the start of a U.S. recession as defined by the National Bureau of Economic Research (NBER), the dot shows the current 12-month forward aggregate analyst earnings growth estimate.. The chart on the right shows MSCI World 12-month forward earnings divided by 12 month forward sales.

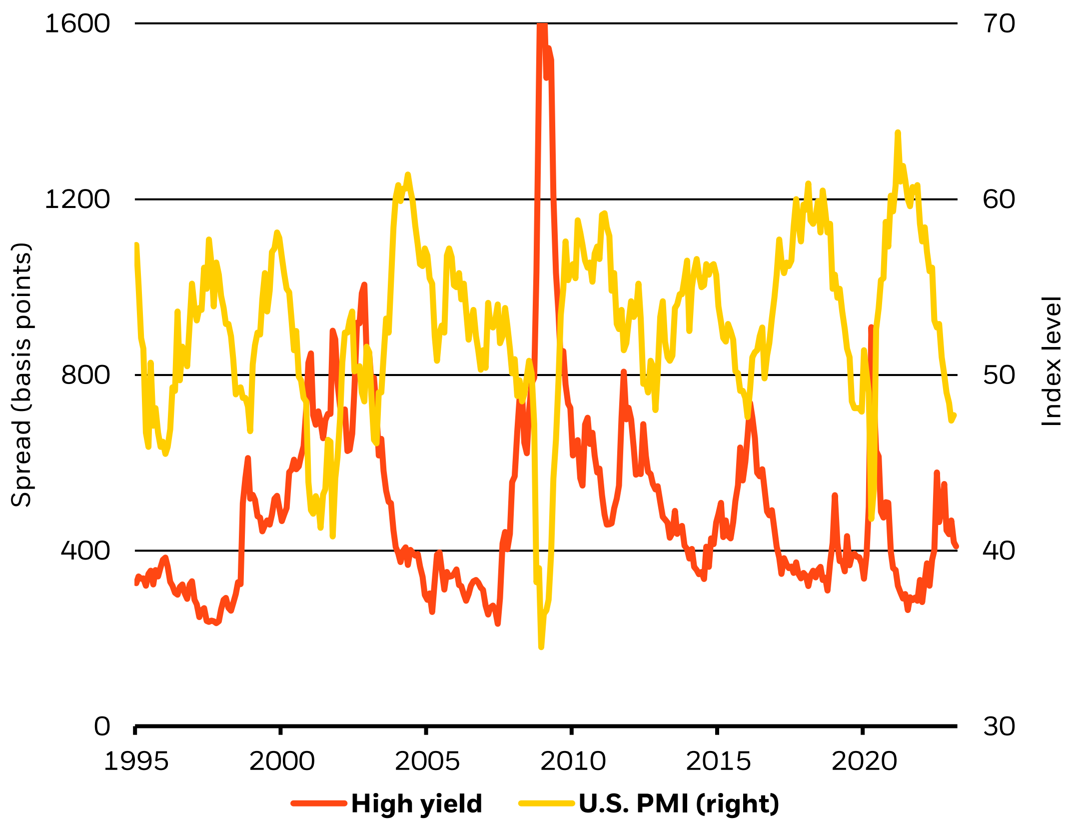
We downgrade credit as we see conditions tightening further

We cut our overall credit view to neutral, trimming investment grade to neutral and high yield to underweight. We see tighter credit and financial conditions in the aftermath of the banking sector troubles.

U.S. investment grade and high yield spreads, 2003–2023



U.S. high yield spread and PMI, 1995–2023

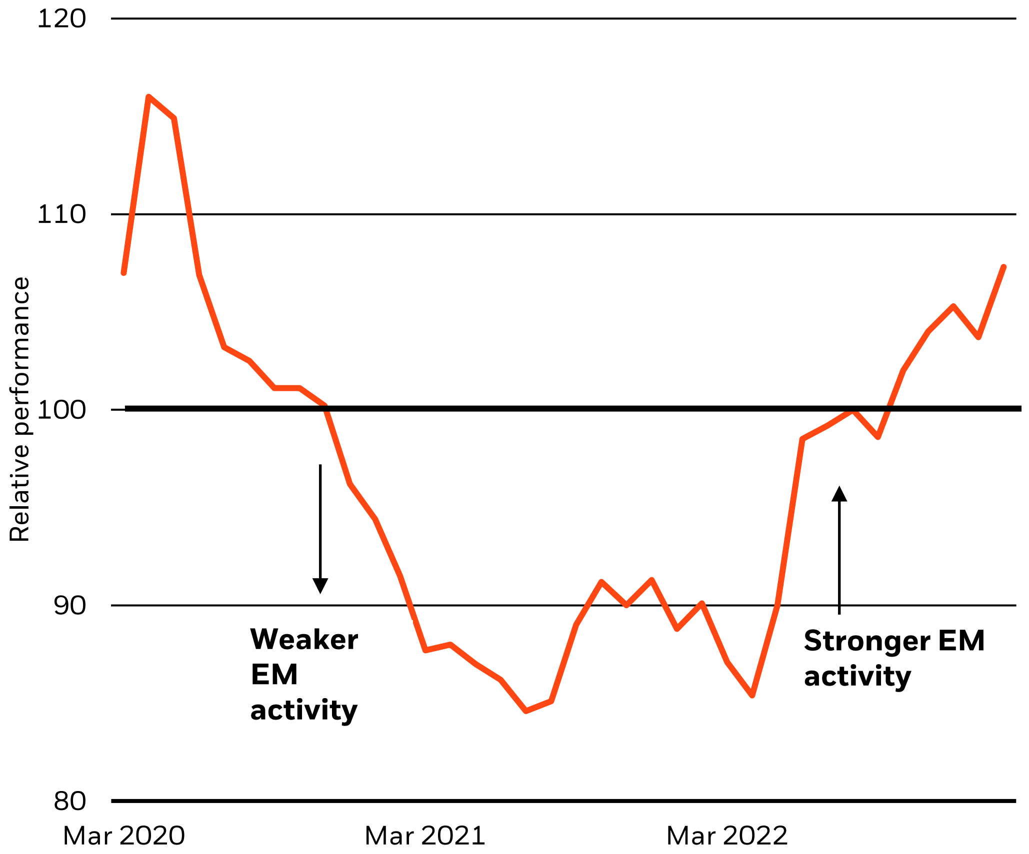


Past performance is not a reliable indicator of current or future results. Source: BlackRock Investment Institute and Bloomberg, with data from Refinitiv Datastream, March 2023. Notes: The chart on the left shows the option-adjusted spreads of U.S. investment grade (IG) credit and high-yield (HY) debt. The index proxies used are the Bloomberg U.S. Credit USD and Bloomberg U.S. Corporate High Yield USD. It is not possible to directly invest in an index. Indexes are unmanaged and performance does not take account of fees. The chart on the right shows the U.S. Institute for Supply Management Manufacturing Purchasing Manager's Index (PMI) and the option-adjusted spread of U.S. high-yield debt. The PMI is used as a gauge for economic activity. The line moving down towards and below 50 represents economic activity contracting. The index used for U.S. high-yield debt is Bloomberg U.S. Corporate High Yield USD.

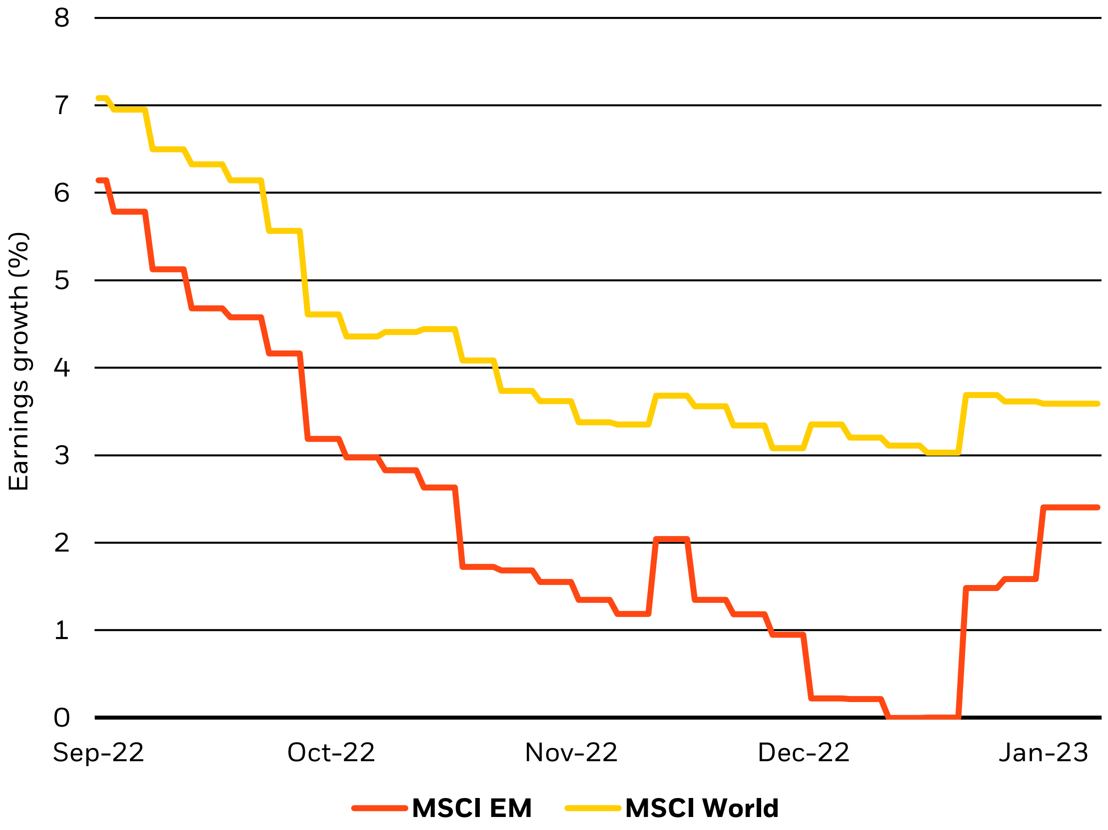
We prefer EM equities as China's restart may boost returns

China's restart is set to provide a boost to emerging market (EM) earnings growth, in our view and we expect this momentum to continue. This contrasts our view that DM earnings expectations are too rosy in light of slowing growth.

Emerging market PMI vs. developed markets, 2020-2023



EM vs. DM earnings estimates, Sept. 2022-March 2023

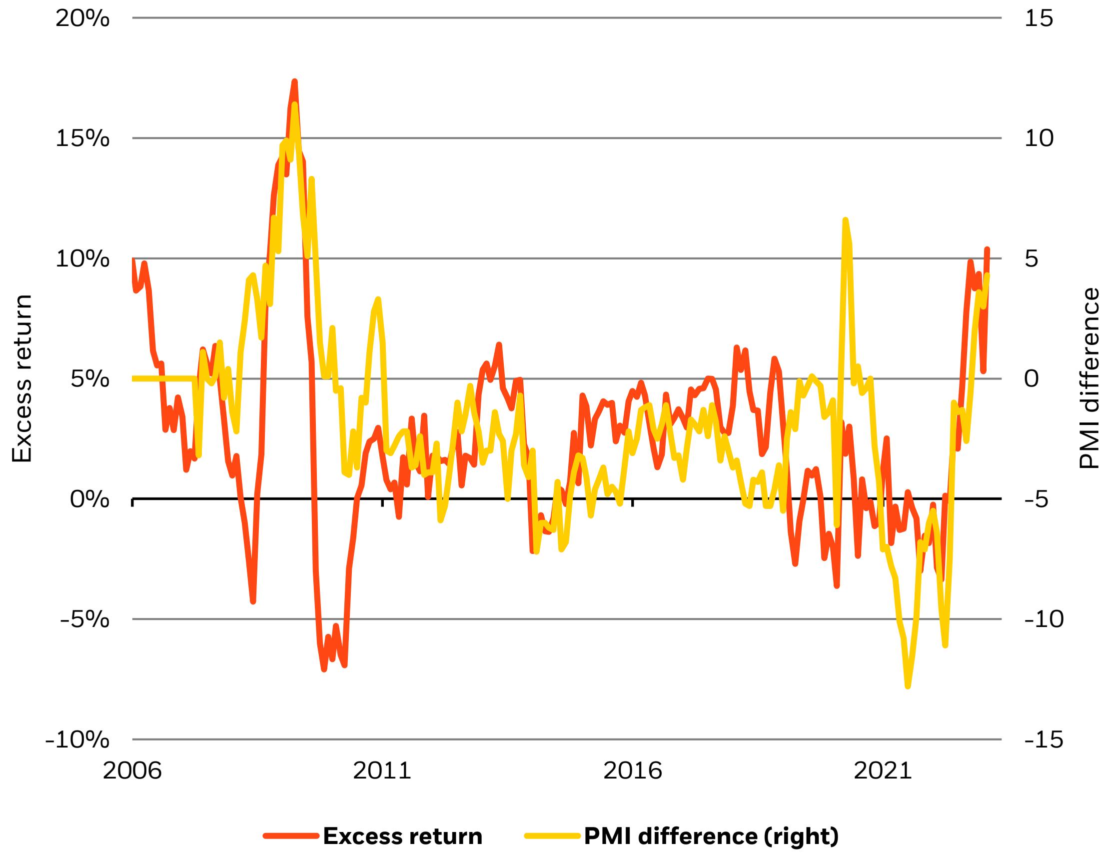


Forward looking estimates may not come to pass. Sources: BlackRock Investment Institute, with data from Refinitiv Datastream, March 2023. Notes: The chart on the left shows the composite S&P Global Purchasing Managers' Index (PMI) for emerging markets relative to developed markets. The line moving towards the 100 mark represents emerging market PMI strengthening relative to developed market PMI. The chart on the right shows 12-month forward earnings per share (EPS) growth estimates for emerging market and developed market equities. The indexes used are MSCI World and MSCI EM USD. You cannot directly invest in an index. Index performance does not account for fees.

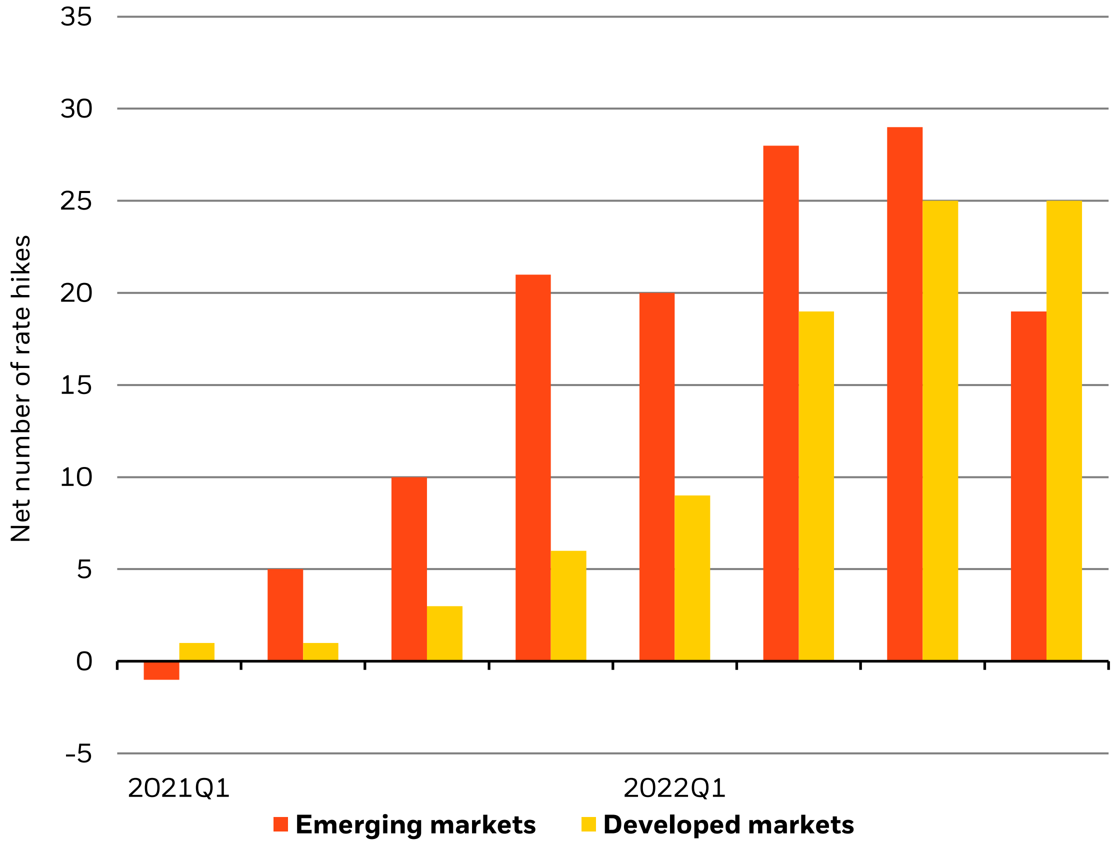
Upgrading EM local debt

We see local currency emerging market (EM) debt as more resilient to tightening financial conditions in developed markets (DMs). On top of that EM central banks are also closer to the peak of rates than their DM peers.

EM excess total bond returns and PMI vs. DM, 2014-2023



Net number of rate hikes, EM and DM central banks, 2016-2022

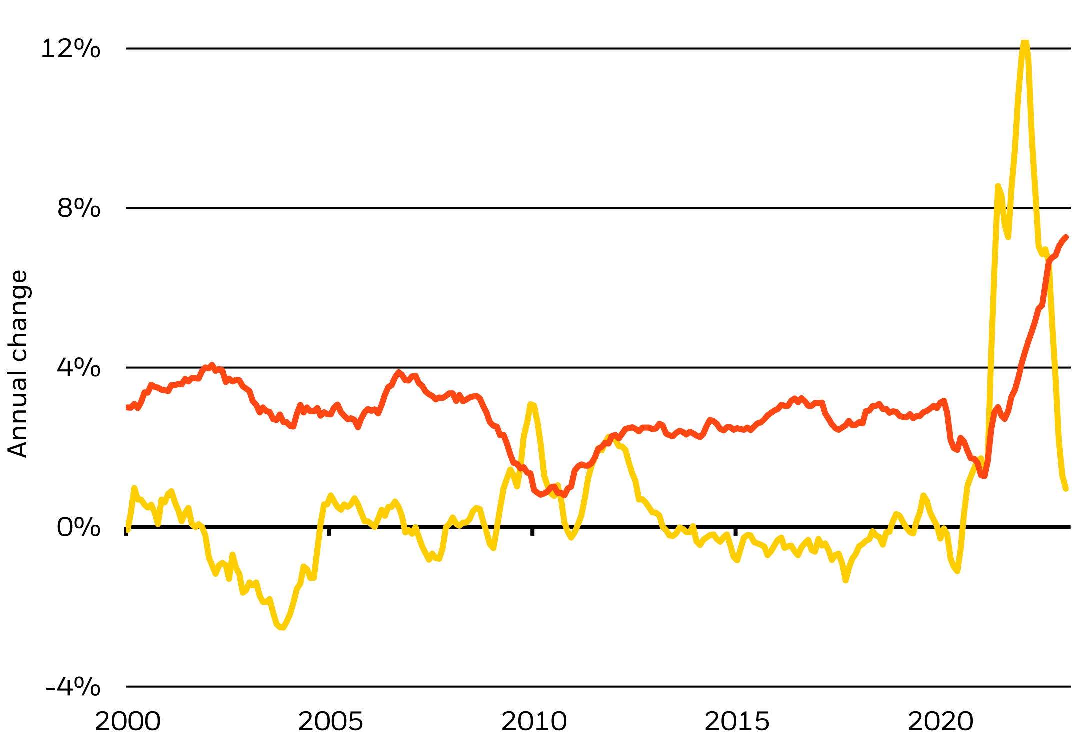


Past performance is not a reliable indicator of current or future results. Source: BlackRock Investment Institute, Bank of International Settlements (BIS), Bloomberg, S&P, JPMorgan with data from Refinitiv Datastream, March 2023. Notes: The chart on the left shows 12-month rolling total return ofJPMorgan's GBI-EM index minus the 12-month rolling total return of the Bloomberg U.S. Credit USD. This is referred to as the excess return. It also shows the difference between the S&P emerging market PMI and U.S. PMI. It is not possible to directly invest in an index. Index performance does not account for fees. The chart on the right shows the net number of rate hikes from emerging market and developed market banks. It counts whether a central bank has either raised rates (+1), cut rates (-1) or kept rates the same (0). We use BIS data to get a list of emerging market countries which in this chart include: Brazil, Chile, China, Colombia, Czech Republic, Hungary, Indonesia, Malaysia, Mexico, Peru, Philippines, Poland, Romania, Serbia, South Africa, Thailand and Turkey.

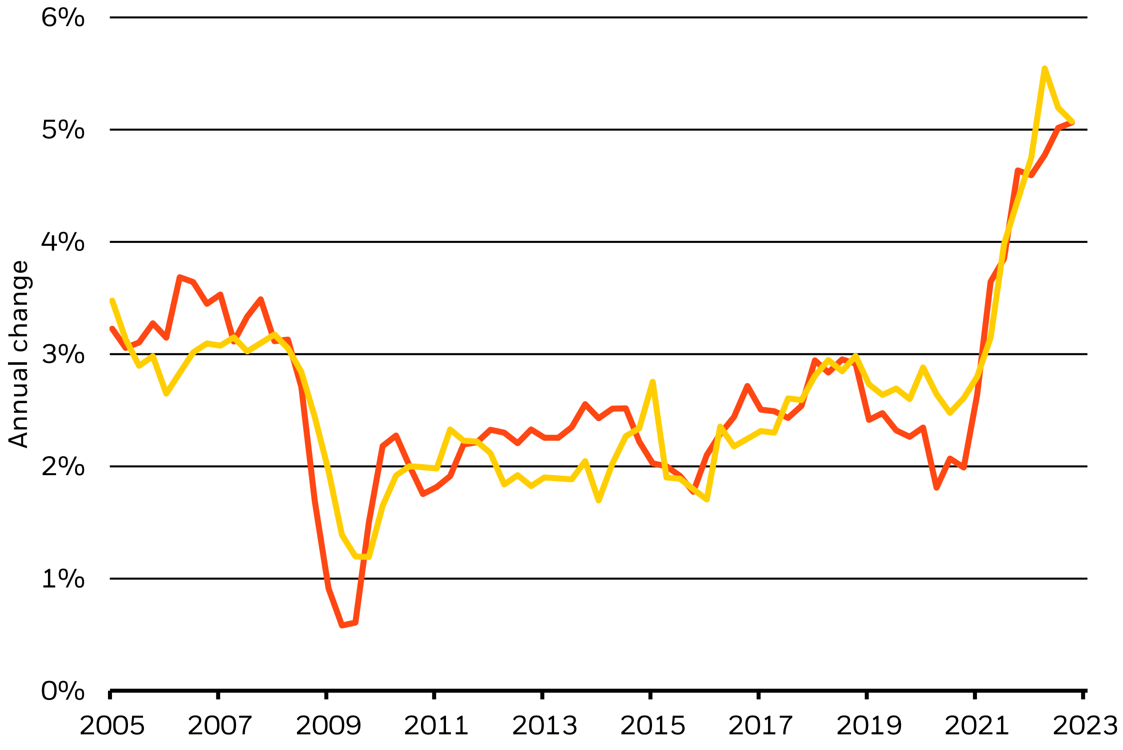
Stubbornly high DM inflation driven by services

Goods prices have fallen, dragging overall inflation down but wage growth has persisted and is fueling stickier core services inflation. That is keeping overall inflation high and driving more upside surprises.

U.S. core goods and services inflation, 2000-2023



Services inflation and private sector wages, 2005-2022

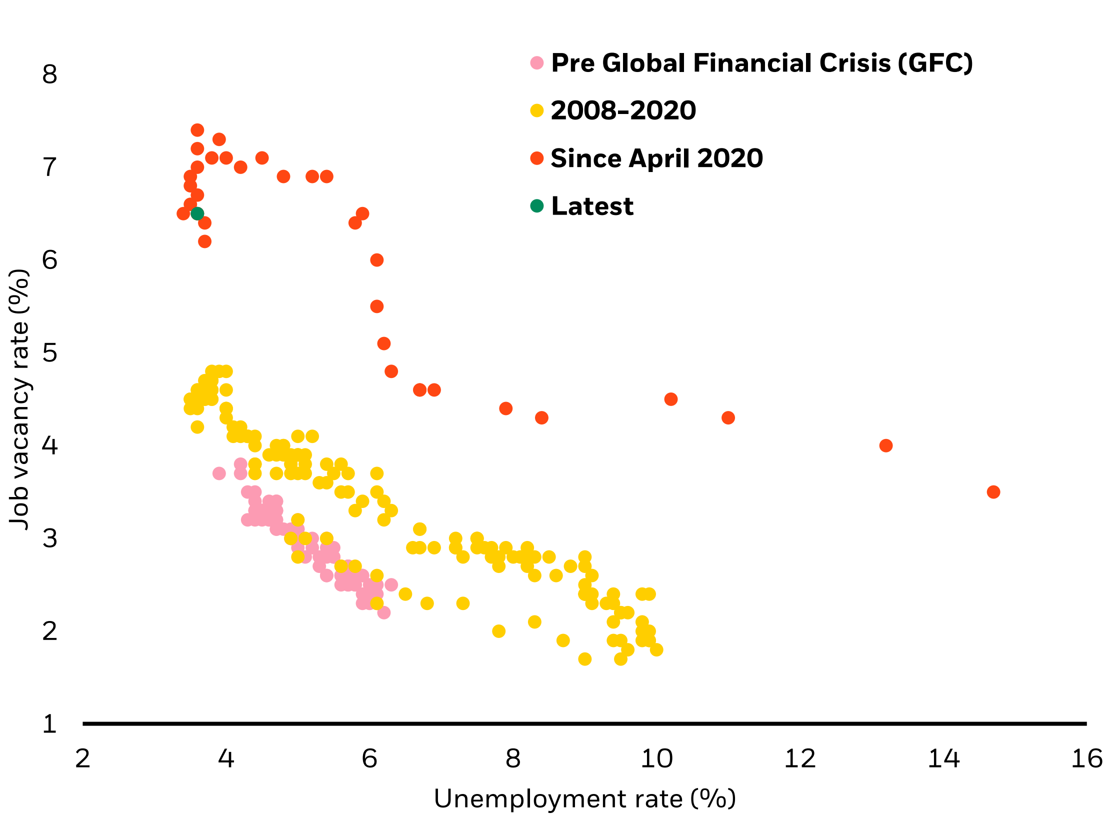


Sources: BlackRock Investment Institute, with data from U.S. Bureau of Labor Statistics and U.S. Bureau of Economic Activity, March 2023. Notes: The chart on the left shows the annual change in U.S. core goods and services consumer price indexes. The chart on the right shows the annual change of the U.S. personal consumer expenditure (PCE) services price index excluding energy services and the U.S. Employment Cost Index measure of annual private sector compensation.

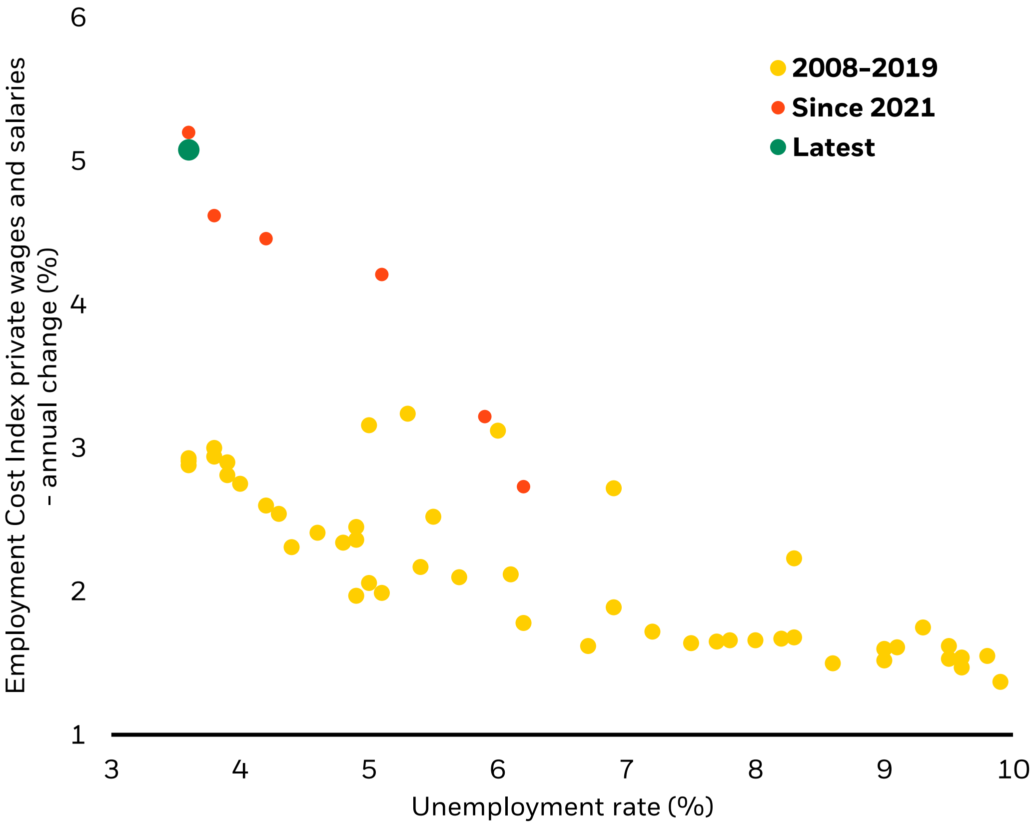
A tight labor market is keeping services inflation elevated

High core services inflation is keeping overall inflation sticky. Core services inflation is particularly sensitive to the higher wages that private sector firms are offering as they face difficulty filling vacancies.

U.S. vacancy rate and unemployment rate



U.S. wage inflation and unemployment rate, 2008 onwards

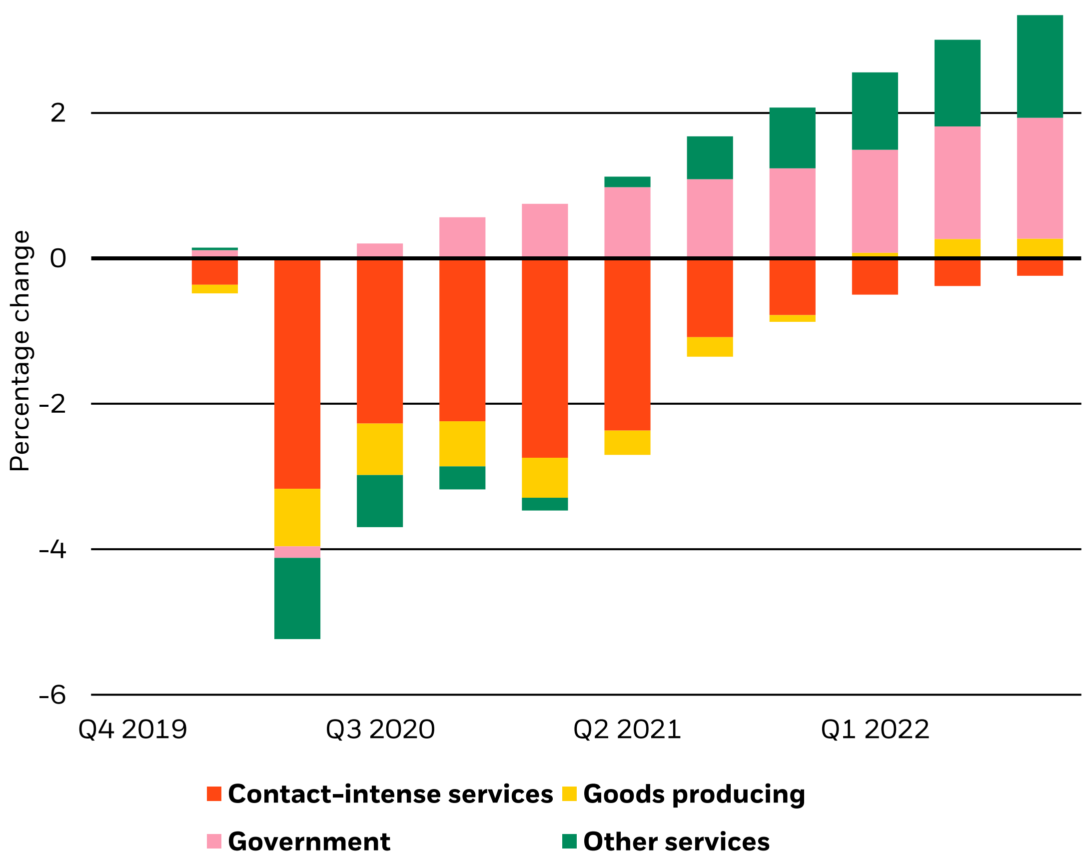


Sources: BlackRock Investment Institute,, with data from Haver Analytics, March 2023. The chart on the left shows the U.S. vacancy rate and unemployment rate – also known as the Beveridge curve. The chart on the right shows U.S. wage inflation and unemployment rate, one version of the Phillips curve.

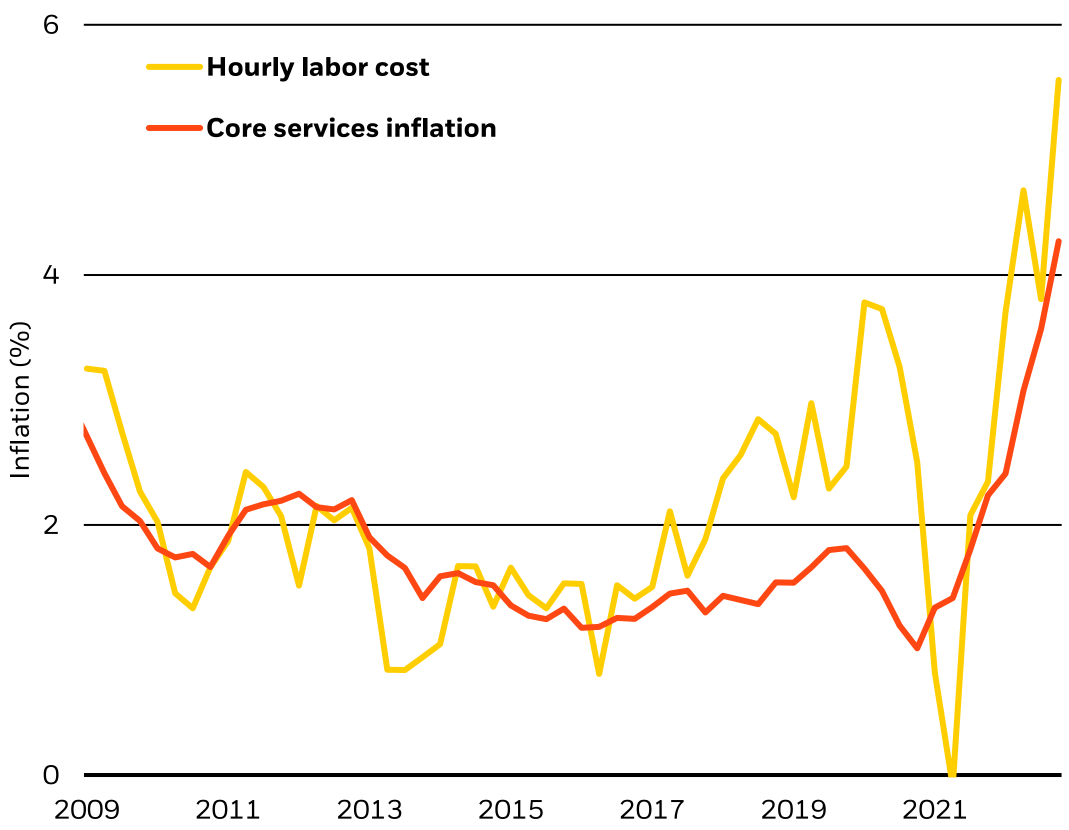
Europe also has a tight labor market fueling inflation

Europe is dealing with a different kind of labor shortage – the public sector has absorbed a large proportion of workers. Private firms are raising wages to attract and retain workers and it's pushing inflation higher.

Euro area change in share of employment, 2019-2022



Euro area wages and services inflation, 2005-2022

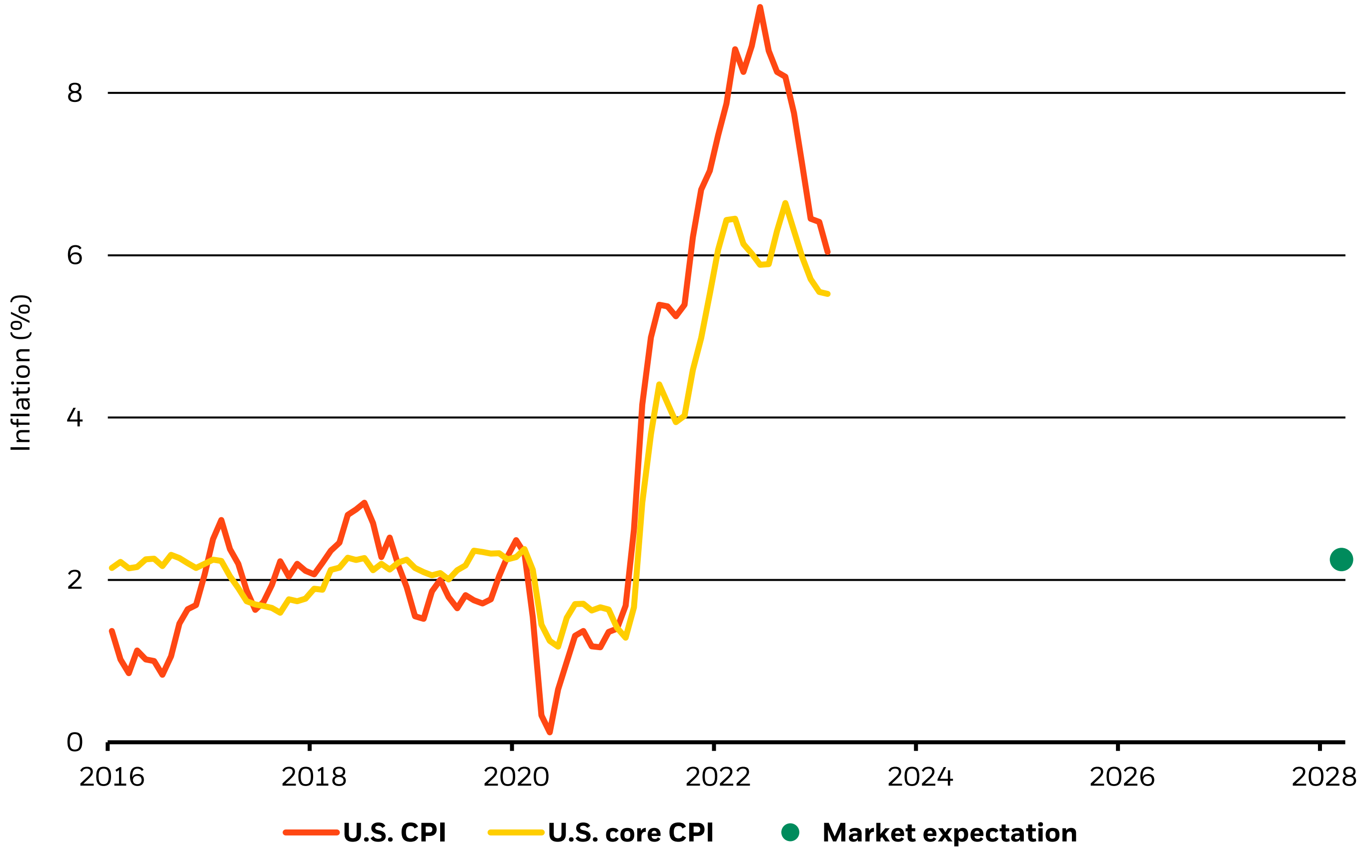


Sources: BlackRock Investment Institute, Eurostat, with data from Haver Analytics, January 2023. Notes: The chart on the left shows the change in euro area employment since the fourth quarter of 2019 in millions of workers, broken down into changes by different sectors. Other services refers to all services excluding contact-intense services.The chart on the right shows the contributions of different components to euro area core inflation, measured by the Harmonised Index of Consumer Prices. Core inflation contributions are broken into energy-intensive and non-energy intensive core using a method similar to the ECB, distinguishing between core components with above-average or below-average shares of labor costs in total costs.

We favor inflation-linked bonds as higher inflation persists

Markets are expecting inflation to fall back near 2%. We think the market is underappreciating the persistence of inflation in a world shaped by supply. We stay overweight inflation-linked bonds as a result.

U.S. CPI inflation and market expectation, 2016-2028

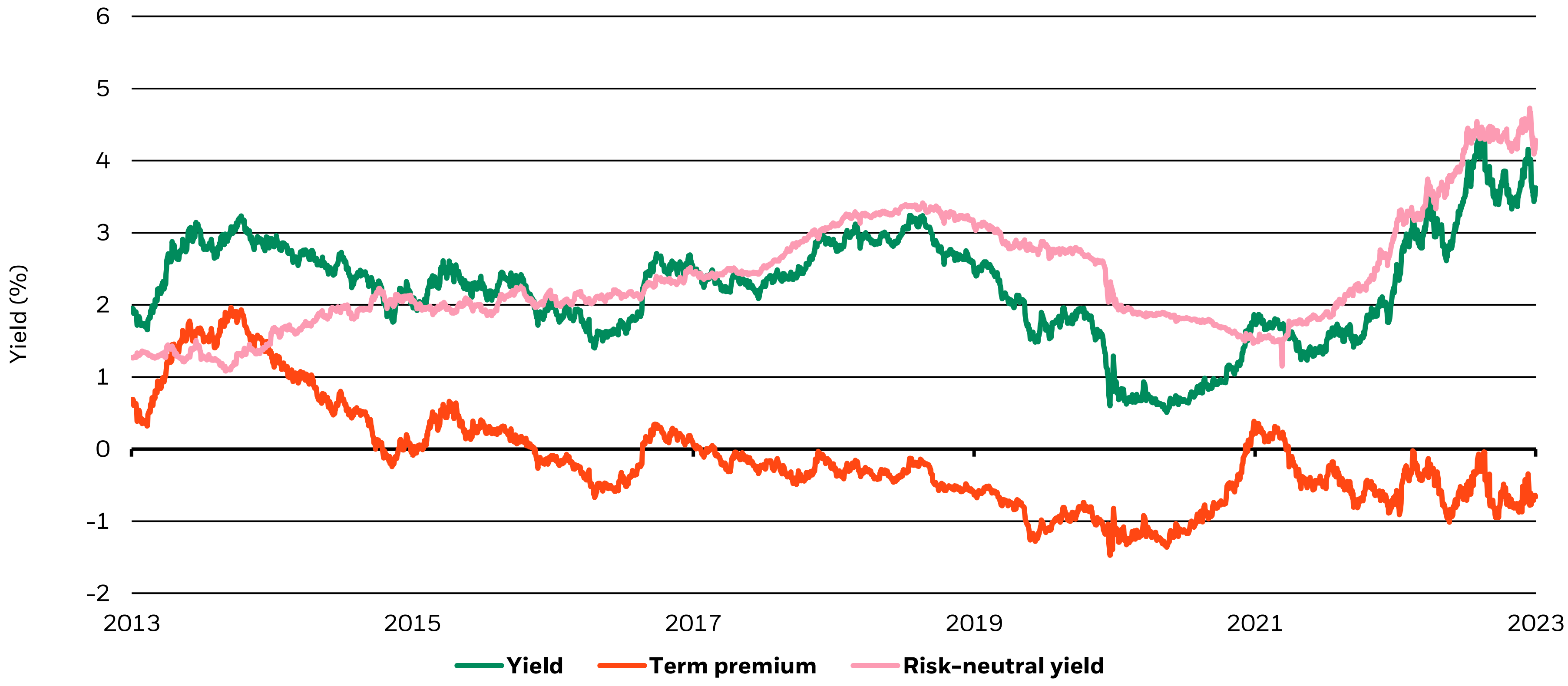


Forward looking estimates may not come to pass. Source: BlackRock Investment Institute, with data from Refinitiv Datastream, March 2023. Notes: The chart shows U.S. CPI and core CPI inflation and market pricing of what inflation will average over the five-year period that begins five years from today – also known as the 5-year/5-year inflation swap.

We see longer-term yields rising as term premia returns

Persistent inflation, high debt burdens post-pandemic and tightening liquidity in bond markets as central banks unwind their balance sheet expansions will spur a return of term premia pushing up longer-term yields, in our view.

U.S. 10-year term premium breakdown, 2013-2023

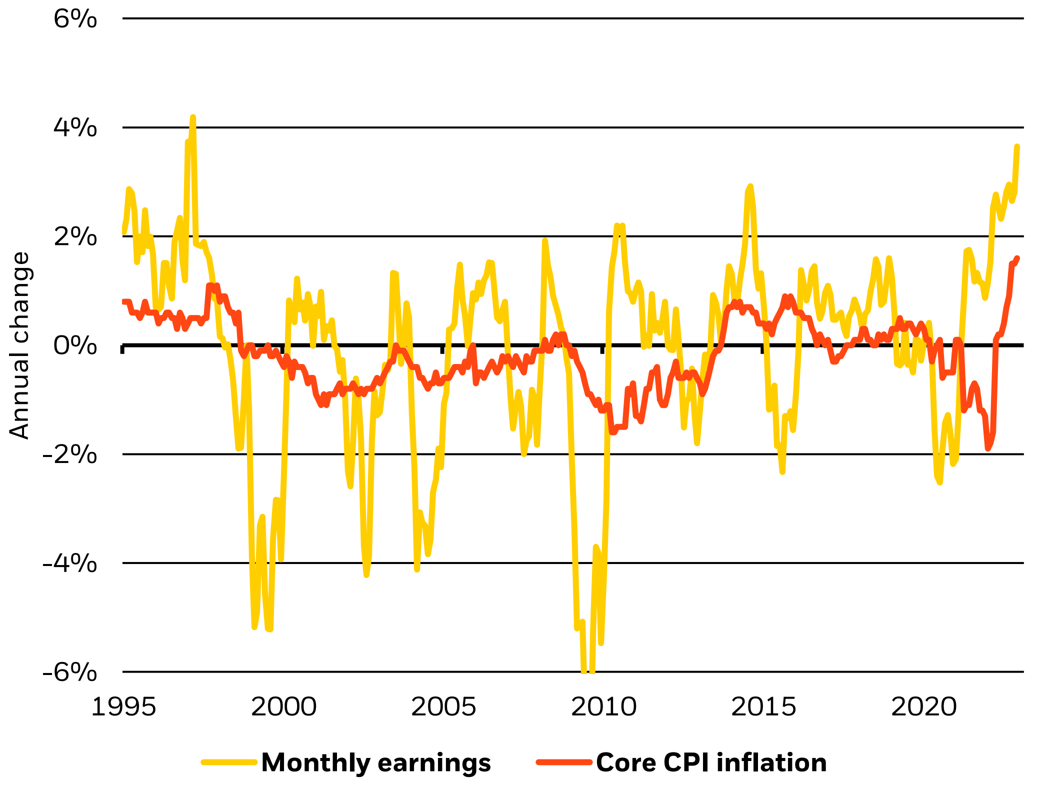


Past performance is not a reliable indicator of current or future returns. Source: BlackRock Investment Institute, NY Fed with data from Refinitiv Datastream, March 2023. Notes: The chart shows the breakdown of the U.S. 10-year yield (green line) into the risk-neutral yield (pink) and the term premium (red). Term premium is the additional compensation investors demanded for bearing the risk of holding a long-term government bond to maturity. For more detail on the calculation of the term premium see the NY Fed website.

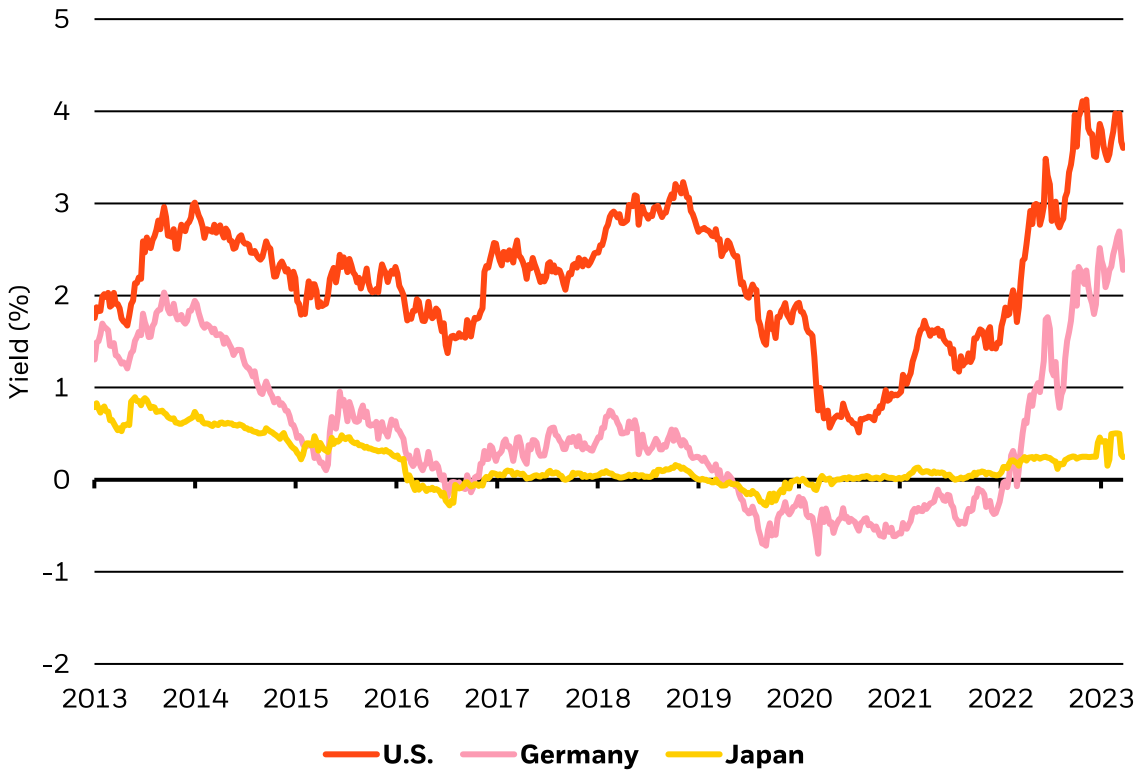
Japan policy shift could push up global bond yields

Inflation near four-decade highs amid higher wages paves the way for the Bank of Japan to move away from its ultra-loose monetary policy. That could spur Japanese bond yields higher, potentially lifting other DM long-term yields too.

Japanese wages and core CPI inflation, 1995–2023



10-year bond yields, 2013–2023

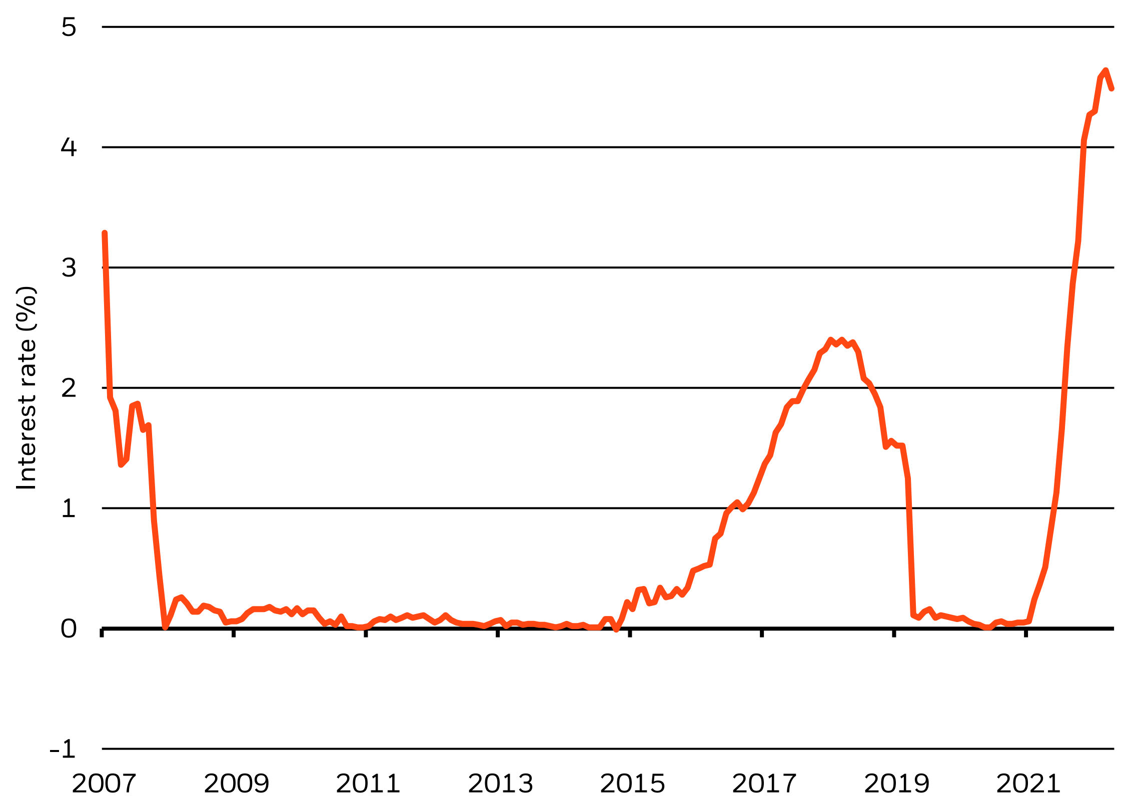


Past performance is not a reliable indicator of current or future results. Source: BlackRock Investment Institute, with data from Haver Analytics and Refinitiv Datastream, March 2023. Notes: The chart on the left shows core CPI inflation, excluding food, non-alcoholic beverages and energy (Western core). The earnings line is based on the three-month moving average. The chart on the right shows 10-year government bond yields for the U.S., Germany and Japan.

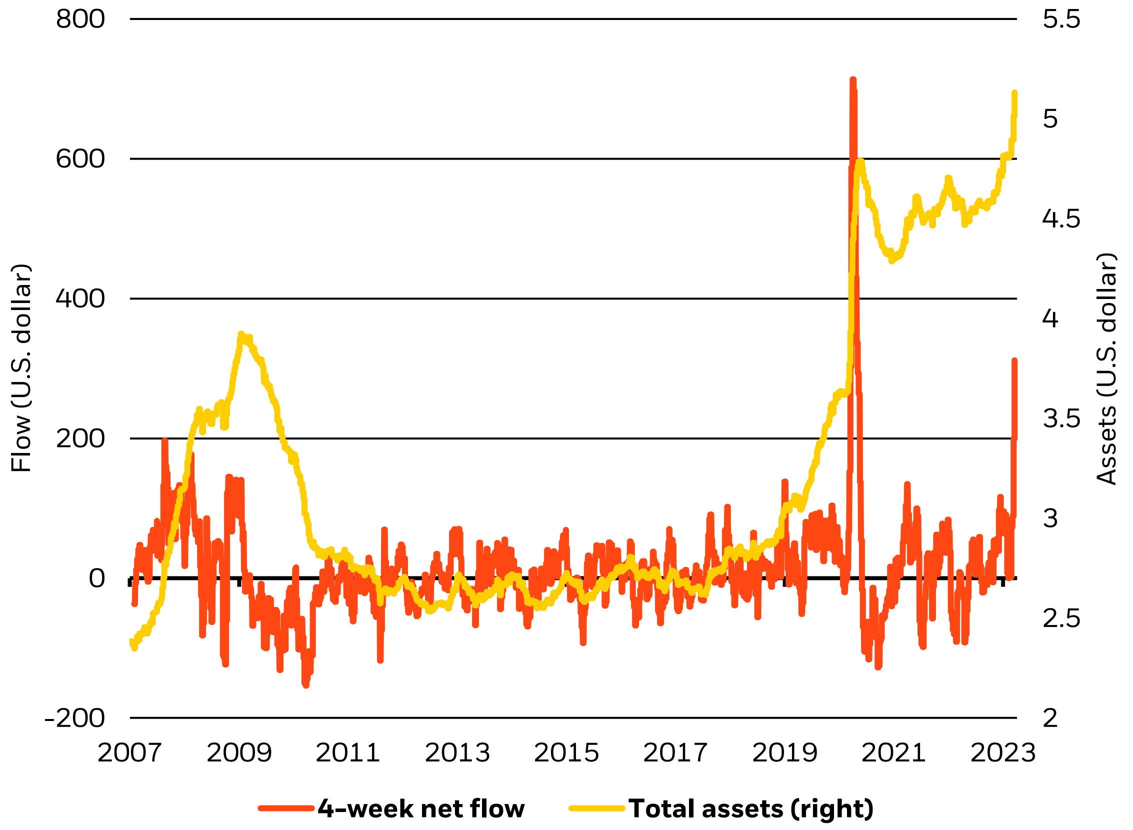
We're overweight very short-term bonds for income

Higher short-term rates and the inverted U.S. yield curve make Treasury bills – with maturities of a year or under – more attractive for their income and lower duration risk. Money market funds have seen record inflows as a result.

U.S. Treasury 3-month bill rate, 2013-2023



U.S. money market fund flows and total assets, 2008-2023

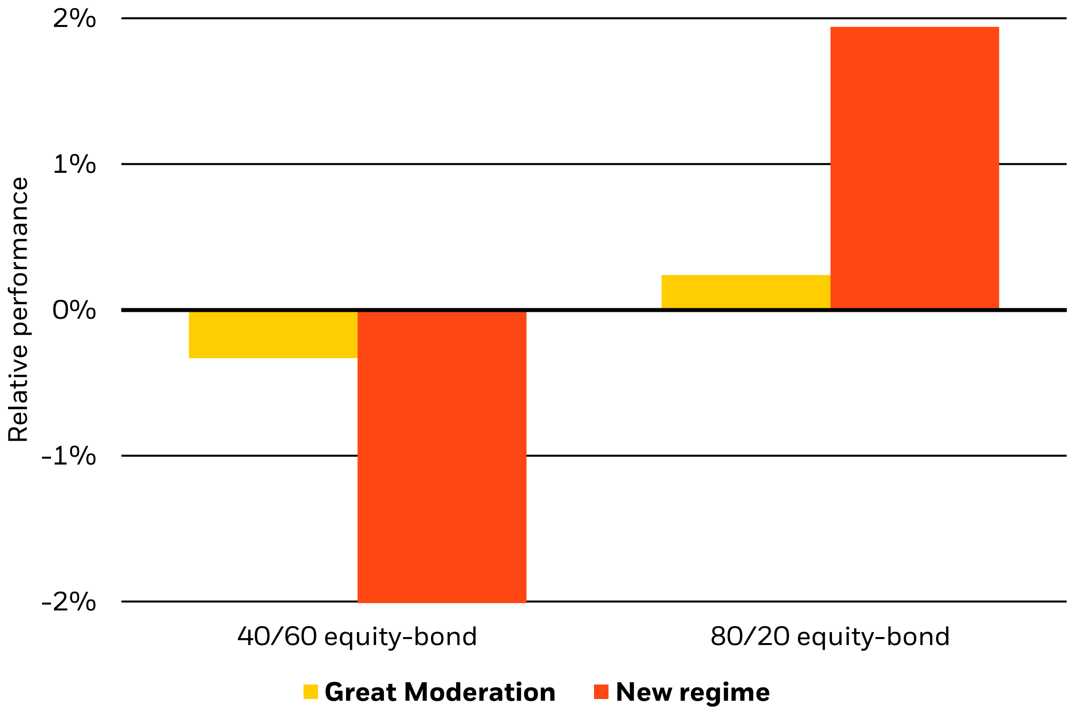


Source: BlackRock Investment Institute, with data from Refinitiv Datastream, March 2023. Notes: The chart on the left shows the interest rate on the 3-month U.S. Treasury bill. The chart on the right shows the weekly net flow and total assets of U.S. money market funds.

Asset allocation matters more in the new regime

We think the cost of getting the asset mix wrong is likely to be much higher in the new regime compared with the Great Moderation – the four-decade period of stable activity and inflation.

Illustrative impact of asset mix on estimated returns in Great Moderation vs new regime of heightened volatility

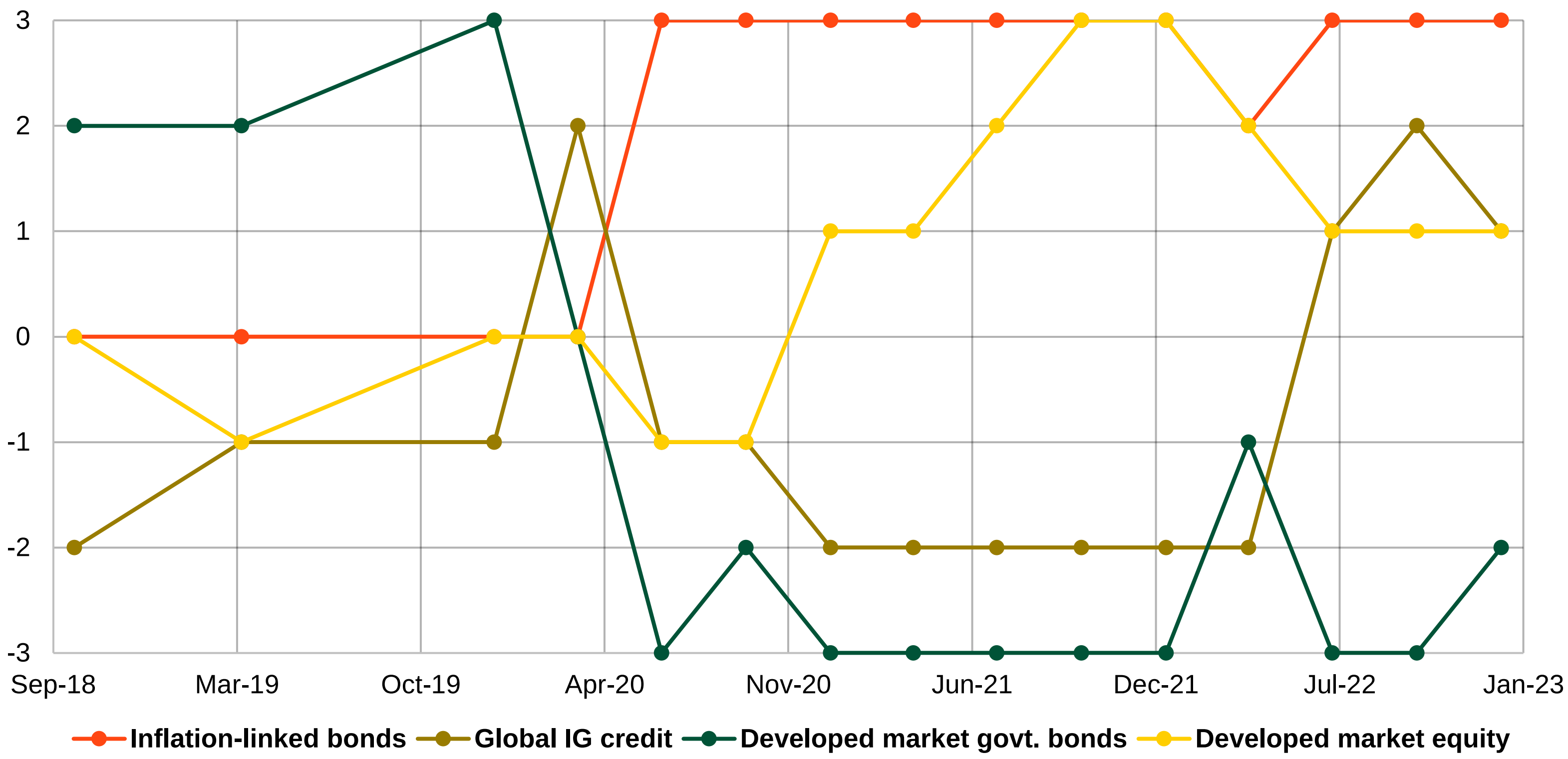


For illustrative purposes only. These do not represent actual portfolios and do not constitute investment advice.. Source: BlackRock Investment Institute with data from Refinitiv Datastream and Morningstar. Returns data as of March 2023. Notes: The chart illustrates the contrast between the average annual relative performance of two hypothetical portfolios against a 60-40 global equity-global bond portfolio over the Great Moderation era (Jan 1990- Dec 2019) of stable growth and inflation and the period of heightened macro and market volatility between Jan 2020-March 2023, that marks the start of the new regime. We use actual equity and bond returns for the study. We show hypothetical performance of portfolios comprising a 40%-global equity-60% global bond split and an 80% global equity-20% global bond mix. Index proxies: MSCI AC World for equities and the Bloomberg Global Aggregate Index for bonds. We use the actual returns for both indexes using Refinitiv data to estimate portfolio returns. We do not expect the returns to be as elevated as they have been since Jan 2020 but the analysis illustrates that the impact of the asset mix in a strategic asset allocation is greater in period of heightened volatility. An inherent limitation of hypothetical results is that allocation decisions reflected in the performance record were not made under actual market conditions. They cannot completely account for the impact of financial risk in actual portfolio management. We also assume no transaction costs in our estimates. Indexes are unmanaged and do not account for fees. It is not possible to invest directly in an index.

Staying nimble in the new regime

Investors could “set-and-forget” strategic allocations during a less volatile regime. This period is over, so we think being static risks missing out on potential opportunities forged by a more volatile regime.

Our strategic tilts to select asset classes, September 2018 – January 2023

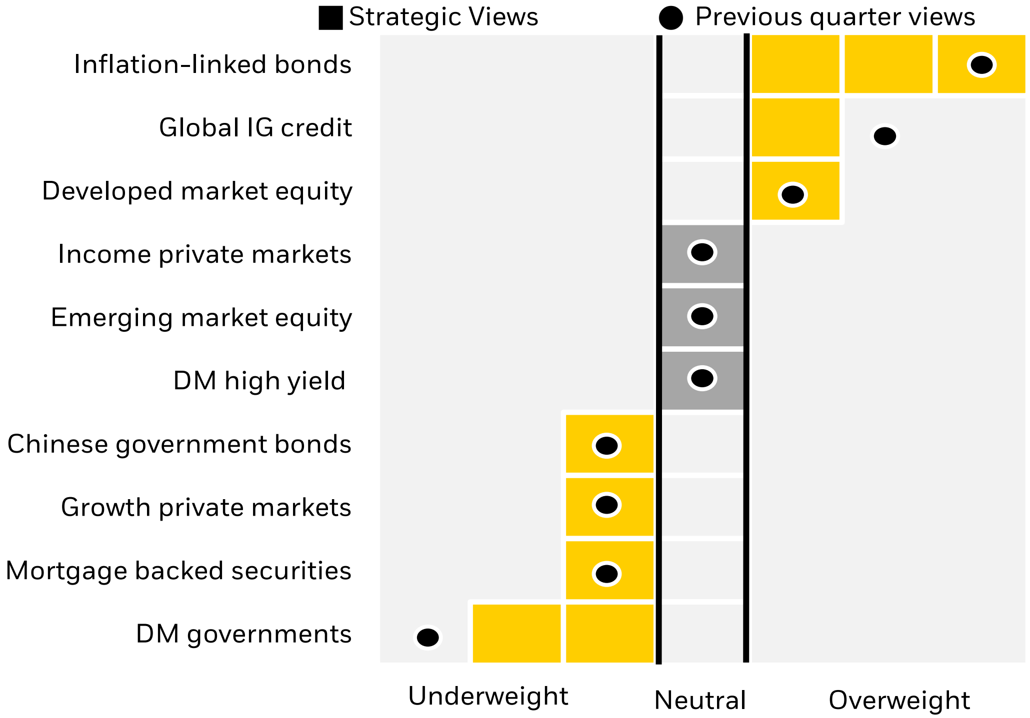


This information is not intended as a recommendation to invest in any particular asset class or strategy or as a promise - or even estimate - of future performance. Source: BlackRock Investment Institute. Data as of 23 January 2023. Notes: The chart shows how our strategic views for selected asset classes have changed through time.. Global government bonds and EM equity allocations comprise respective China assets. Income private markets comprise infrastructure debt, direct lending, real estate mezzanine debt and U.S. core real estate. Growth private markets comprise global private equity buyouts and infrastructure equity. The allocation shown is hypothetical and does not represent a real portfolio. It is intended for information purposes only and does not constitute investment advice. Index proxies: Bloomberg Barclays US Government Inflation-Linked Bond Index, MSCI World US$, Bloomberg Barclays Global Credit Index, Bloomberg Barclays U.S. Credit index,, Bloomberg Barclays Global Aggregate Treasury index,. We use BlackRock proxies for private market assets. The hypothetical portfolio may differ from those in other jurisdictions, is intended for information purposes only and does not constitute investment advice..

Our latest strategic views

Narrower spreads and higher bond yields drive the latest changes to our strategic views. We trim our overweight in investment grade (IG) credit and reduce our underweight to DM government bonds.

Hypothetical U.S. dollar 10-year strategic views vs. equilibrium, February 2023



This information is not intended as a recommendation to invest in any particular asset class or strategy or as a promise - or even estimate - of future performance. Source: BlackRock Investment Institute. Data as of 31 December 2022. Notes: The chart shows our asset views on a 10-year view from an unconstrained U.S. dollar perspective against a long-term equilibrium allocation. Global government bonds and EM equity allocations comprise respective China assets. Income private markets comprise infrastructure debt, direct lending, real estate mezzanine debt and U.S. core real estate. Growth private markets comprise global private equity buyouts and infrastructure equity. The allocation shown is hypothetical and does not represent a real portfolio. It is intended for information purposes only and does not constitute investment advice. Index proxies: Bloomberg Barclays US Government Inflation-Linked Bond Index, MSCI World US$, Bloomberg Barclays U.S. High Yield Index. Bloomberg Barclays Global Credit Index, Bloomberg Barclays U.S. Credit index, JP Morgan EMBI Global Diversified Index, MSCI EM, Bloomberg Barclays China Treasury + Policy Bank Total Return Index, Bloomberg Barclays U.S. MBS Index, Bloomberg Barclays Global Aggregate Treasury index,. We use BlackRock proxies for selected private markets because of lack of sufficient data. These proxies represent the mix of risk factor exposures that we believe represents the economic sensitivity of the given asset class. The hypothetical portfolio may differ from those in other jurisdictions, is intended for information purposes only and does not constitute investment advice.

Tactical granular views: equities

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

Region	View	Commentary
Developed markets	-1	We are underweight. We believe earnings expectations and valuations don't fully reflect recession risk. We prefer a sectoral approach: energy, financials and healthcare.
United States	-1	We are underweight. Financial cracks are emerging from Fed rate hikes. We don't think earnings expectations reflect the recession we see ahead.
Europe	-1	We are underweight. The impact of higher interest rates and elevated inflation pose a challenge for earnings, even as the energy shock fades.
UK	-1	We are underweight. Earnings expectations don't fully reflect the economic damage we see ahead.
Japan	-1	We are underweight. The Bank of Japan looks set to wind down its ultra-loose policy. Japan is exposed to the weaker activity we see in other DM economies.
Emerging markets	+1	We are overweight and have a relative preference over DM stocks due to China's powerful restart, peaking EM rate cycles and a broadly weaker U.S. dollar.
China	+1	We see short-term opportunities from China's restart. But geopolitical risks have risen, and we still see long-term, structural challenges and risks.
Asia ex-Japan	Neutral	We are neutral. China's restart is a positive yet we don't see valuations compelling enough to turn overweight.

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

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, March 2023. 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.

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
Long U.S. Treasuries	-1	We are underweight. We see long-term yields moving up further as investors demand a greater term premium.
Short U.S. Treasuries	+2	We are overweight. We prefer short-term government bonds for income in this environment given the rise in yields and limited exposure to interest rate swings.
Global inflation-linked bonds	+2	We are overweight. We see market pricing underestimating the risk of persistently higher inflation.
European government bonds	-1	We are underweight. We see investors demanding greater term premium, with peripheral bonds at risk from tighter financial conditions.
UK gilts	-1	We are underweight. Gilts won't be immune to the factors we see driving DM bond yields higher. We prefer short-dated gilts for income.
China govt bonds	Neutral	We are neutral. Yields are less attractive relative to those on short-term DM government bonds.
Global IG credit	Neutral	We are neutral. We see tighter credit and financial conditions. We prefer European investment grade over the U.S. given more attractive valuations.
U.S. agency MBS	Neutral	We are neutral. We see the asset class as a high-quality exposure within a diversified bond allocation. But tighter spreads make valuations less compelling.
Global high yield	-1	We are underweight. We think spreads are still too tight given our expectation for tighter credit and financial conditions – and an eventual recession.
EM hard currency	Neutral	We are neutral. We see support from higher commodities prices yet it is vulnerable to rising U.S. yields.
EM local currency	+1	We are overweight due to China's restart, and we see EM debt as more resilient to tightening financial conditions than DM as EM hiking cycles near peaks.
Asia fixed income	Neutral	We are neutral. We don't find valuations compelling enough yet to turn more positive.

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

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, March 2023. 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.

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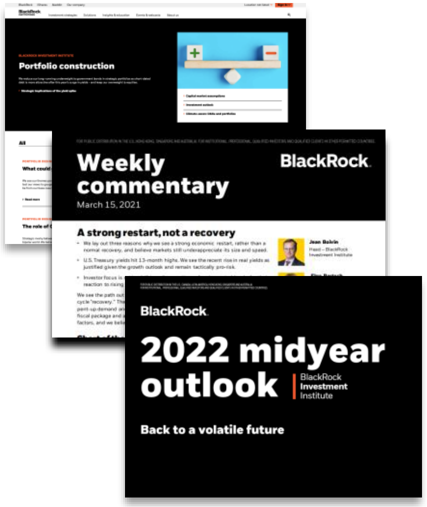
To build robust portfolios, you need to connect the dots between economics, markets, return drivers, policy and geopolitics.

”

Jean Boivin
Head – BlackRock Investment Institute



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