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WEEKLY COMMENTARY • MAY 28, 2019

Key points

1 Heightened geopolitical tensions increase the risk of cyberattacks, with growing market implications, in our view.

2 Risk assets including stocks sold off on mounting worries about growth and U.S.-China tensions. UK Prime Minister Theresa May resigned.

3 This week's Chinese economic data will be in focus. We expect steady economic activity in the second quarter after a bounce earlier in the year.

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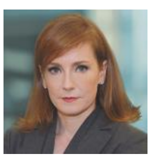


Kate Moore
Chief Equity Strategist
BlackRock Investment Institute

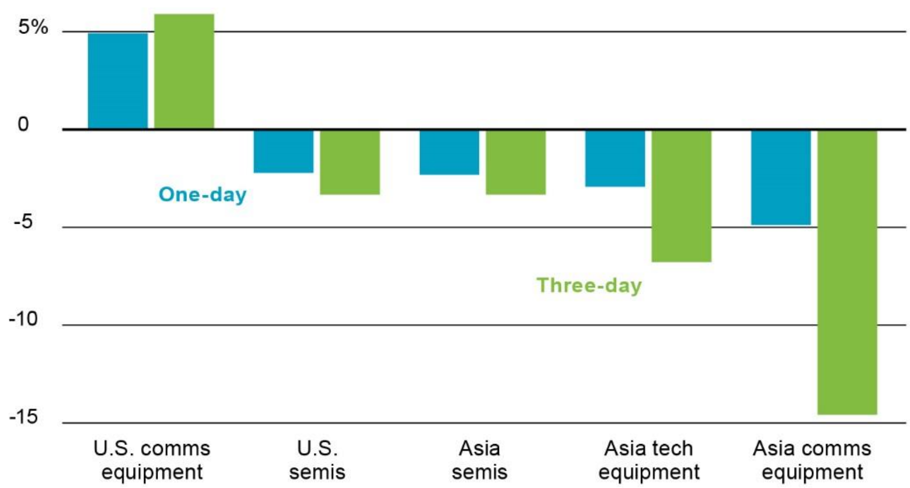
Scott Thiel
Chief Fixed Income Strategist
BlackRock Investment Institute

1 When cyber risks meet geopolitics

Cybersecurity is becoming a pressing issue – and a flash point where countries' economic and national security interests can intersect. The combination of these issues is complicating U.S.-China trade negotiations, with market implications across the technology supply chain in particular.

Chart of the week

Relative performance of selected tech industries after U.S. action on Huawei



Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index. Sources: BlackRock Investment Institute, with data from Thomson Reuters, May 2019. Notes: Notes: The bars show the performance of selected industries in the tech supply chain relative to that of the MSCI ACWI Index one day and three days after the U.S. government added Huawei to its "Entity List" on May 15. U.S. and Asia comms equipment refer to communications equipment stocks on the MSCI USA Index and MSCI AC Asia Index respectively. U.S. and Asia semis refer to semiconductors and related equipment stocks on those two indexes. Asia tech equipment refers to electronic equipment, instruments and components stocks on the MSCI AC Asia Index.

U.S.-China tech competition is heating up, amid rising trade tensions between the two nations. These two previously distinct risks are spilling into each other. The U.S. has added China's Huawei Technologies, the world's largest telecoms equipment maker, to its "Entity List", a list of companies deemed a national security risk by the U.S. This designation prevents Huawei and its affiliates from buying or using U.S. technology and components without a license. The news hit the stocks of a slew of industries in the global telecom equipment supply chain. One exception: U.S. telecom equipment makers, which initially gained. See the chart above. Yet the ban could damage the global telecom supply chain in the medium term, as there are no simple substitutes for a lot of Chinese tech equipment.

Cyber risks and investment implications

Cyberattacks are increasing in scope and intensity. Cyber actors across the world vary in sophistication and capability, ranging from well-funded government agencies and terrorist networks to poorly resourced criminal groups. Their objectives span beyond stealing personal and business information to include broader geopolitical and economic aims. We view cyberattacks as a growing risk to critical infrastructure and increasingly part of the arsenal of nation states.

Geopolitical tensions are driving an increase in the scale and sophistication of cyber-attacks—specifically those from nation states or with nation-state backing. This is the backdrop against which the U.S. has moved to restrict the use of Chinese-made equipment that it believes could potentially be used to intercept sensitive materials or disrupt American infrastructure. The seemingly abrupt U.S. action on Huawei was a long time coming, given the intensifying rivalry between the two countries: The U.S. has long complained of Chinese practices such as forced technology transfer and a lack of protections for intellectual property. China has shown its ambition to lead the development of advanced technologies including the fifth-generation cellular network (5G), yet it remains heavily dependent on the U.S. tech sector. The chips used in 5G development are dominated by U.S. semiconductor suppliers, for example. U.S semiconductor suppliers had enjoyed higher demand for their products in recent quarters as some Chinese companies built up their inventories in anticipation of a U.S. government ban; that demand now looks likely to plummet.

Bottom line: We see cyber security as an increasingly important risk for all investors to monitor, with implications that cut across sectors, from financials to utilities. This risk has become entangled with concerns about national security, economic competitiveness, and leadership in advanced technologies. We are still positive on makers of semiconductor products related to 5G development over the long term, but believe investors need to pay more attention to potential impacts of geopolitical tensions on the supply chain. And more broadly, we see potential for such tensions to drive a gradual decoupling of the U.S. and Chinese technology sectors – a reason why we believe there is a case for owning tech companies in both.

2 Week in review

- Global stocks fell on growing concerns about global growth and rising U.S.-China trade tensions. Energy and technology sectors led the retreat. Crude oil prices dipped to two-month lows. Government bond yields fell in the U.S., and hovered near the lowest levels in more than two years in the eurozone, as investors sought shelter in perceived safe-haven assets.
- The resignation of Britain's Prime Minister Theresa May deepened uncertainties around Brexit. Central bank policy meeting minutes showed European Central Bank policymakers were concerned about weaker-than-expected growth in the eurozone, while their peers at the Federal Reserve were adhering to their view that the below-target inflation was "transitory".
- Manufacturing and business sentiment data from the U.S. and eurozone disappointed. U.S. manufacturing sector in May recorded its slowest activity level in nearly a decade and new orders fell for the first time since August 2009 amid rising U.S.-China trade tensions. The growth in the eurozone's manufacturing sector was slower than expected. German business morale faltered.

Global snapshot

Weekly and 12-month performance of selected assets

Equities	Week	YTD	12 Months	Div. Yield
U.S. Large Caps	-0.5%	13.7%	6.0%	2.0%
U.S. Small Caps	-0.7%	12.9%	-5.6%	1.6%
Non-U.S. World	-0.1%	8.8%	-5.8%	3.3%
Non-U.S. Developed	0.0%	10.2%	-4.6%	3.5%
Japan	-0.2%	5.5%	-9.0%	2.5%
Emerging	-0.3%	3.2%	-10.4%	2.9%
Asia ex-Japan	-0.7%	4.0%	-11.5%	2.7%

Bonds	Week	YTD	12 Months	Yield
U.S. Treasuries	0.5%	3.0%	5.7%	2.3%
U.S. TIPS	0.3%	3.9%	3.8%	2.5%
U.S. Investment Grade	0.3%	6.2%	6.9%	3.6%
U.S. High Yield	-0.1%	8.1%	6.0%	6.4%
U.S. Municipals	0.0%	4.3%	6.5%	2.1%
Non-U.S. Developed	0.6%	1.6%	0.4%	0.8%
EM $ Bonds	0.2%	7.5%	6.7%	6.0%

Commodities	Week	YTD	12 Months	Level
Brent Crude Oil	-2.6%	30.3%	-8.3%	$ 70.11
Gold	0.6%	0.2%	-1.3%	$ 1,285
Copper	-1.2%	-0.2%	-13.5%	$ 5,955

Currencies	Week	YTD	12 Months	Level
Euro/USD	0.3%	-2.4%	-3.9%	1.12
USD/Yen	-0.5%	-0.1%	0.1%	109.52
Pound/USD	-0.4%	-0.6%	-4.7%	1.27

Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index. Source: Thomson Reuters. As of May 27, 2019. Notes: Weekly data through Monday. Equity and bond performance are measured in total index returns in U.S. dollars. U.S. large caps are represented by the S&P 500 Index; U.S. small caps are represented by the Russell 2000 Index; Non-U.S. world equity by the MSCI ACWI ex U.S.; non-U.S. developed equity by the MSCI EAFE Index; Japan, Emerging and Asia ex-Japan by their respective MSCI Indexes; U.S. Treasuries by the Bloomberg Barclays U.S. Treasury Index; U.S. TIPS by the U.S. Treasury Inflation Notes Total Return Index; U.S. investment grade by the Bloomberg Barclays U.S. Corporate Index; U.S. high yield by the Bloomberg Barclays U.S. Corporate High Yield 2% Issuer Capped Index; U.S. municipals by the Bloomberg Barclays Municipal Bond Index; non-U.S. developed bonds by the Bloomberg Barclays Global Aggregate ex USD; and emerging market $ bonds by the JP Morgan EMBI Global Diversified Index. Brent crude oil prices are in U.S. dollars per barrel, gold prices are in U.S. dollar per troy ounce and copper prices are in U.S. dollar per metric ton. The Euro/USD level is represented by U.S. dollar per euro, USD/JPY by yen per U.S. dollar and Pound/USD by U.S. dollar per pound.

3 Week ahead

May 28 U.S. Consumer Confidence Index; eurozone Business Climate Indicator

May 31 China official purchasing managers index (PMI); Japan industrial output

June 1 China raises tariffs on $60 billion of U.S. imports

Chinese economic data is likely to be the market's main focus this week, against a backdrop of rising U.S.-China trade tensions. The official China PMI number is likely to indicate economic activity was still expanding in May. Any signs that increased U.S. tariffs have dented sentiment will be worth watching for. We expect Chinese activity to remain steady through the second quarter, after having rebounded in the previous quarter with significant policy stimulus providing ongoing support.

Asset class views

Views from a U.S. dollar perspective over a three-month horizon

Asset class		View	Comments
Equities	U.S.	▲	A slowing but still growing economy underlies our positive view. We prefer quality companies with strong balance sheets in a late-cycle environment. Health care and technology are among our favored sectors.
	Europe	▼	Weak economic momentum and political risks are still challenges to earnings growth. A value bias makes Europe less attractive without a clear catalyst for value outperformance, such as a global growth rebound. We prefer higher-quality, globally oriented firms.
	Japan	—	Cheap valuations are supportive, along with shareholder-friendly corporate behavior, central bank stock buying and political stability. Earnings uncertainty is a key risk.
	EM	▲	Economic reforms and policy stimulus support EM stocks. Improved consumption and economic activity from Chinese stimulus could help offset any trade-related weakness. We see the greatest opportunities in EM Asia.
	Asia ex-Japan	▲	The economic backdrop is encouraging, with near-term resilience in China and solid corporate earnings. We like selected Southeast Asian markets but recognize a worse-than-expected Chinese slowdown or disruptions in global trade would pose risks to the entire region.
Fixed income	U.S. government bonds	—	We are cautious on U.S. Treasury valuations, but still see the bonds as important portfolio diversifiers. We see recent moves lower in yields as excessive and advocate patience before increasing exposure. We prefer shorter-dated and inflation-linked bonds and expect a gradual yield curve steepening, driven by still-solid U.S. growth and the Fed's stated willingness to tolerate temporary inflation overshoots.
	U.S. municipals	▲	We see coupon-like returns amid a benign interest rate backdrop and favorable supply-demand dynamics. New issuance is lagging the total amount of debt that is called, refunded or matures. The tax overhaul has made munis' tax-exempt status more attractive in many U.S. states, driving inflows.
	U.S. credit	—	Increased demand for income amid stable monetary policy, signs of more conservative corporate behavior and constrained supply remain supportive. We prefer an up-in-quality stance overall, but recent spread widening may also offer an attractive opportunity in BBB-rated credits. We favor bonds over loans in high yield.
	European sovereigns	▼	Low yields, European political risks, and the potential for a market reassessment of pessimistic euro area growth expectations all make us wary on European sovereigns, particularly peripherals. European sovereign bonds offer an attractive income opportunity for U.S.-dollar based investors on a currency-hedged basis.
	European credit	▼	"Low for longer" ECB policy should reduce market volatility and support credit as a source of income, yet valuations are relatively rich after a rally this year. We prefer high yield credits, supported by muted issuance and strong inflows. Euro high yield also offers a significant spread premium to its U.S. counterparts.
	EM debt	—	Prospects for a Chinese growth turnaround and a pause in U.S. dollar strength support both local- and hard-currency markets. Valuations are attractive despite the recent rally, with limited issuance adding to positives. Risks include worsening U.S.-China relations and slower global growth.
	Asia fixed income	—	We favor investment grade in India, China and parts of the Middle East, and high yield in Indonesia. Portfolio rebalancing could cause material capital inflows into China, as the country opens its markets to foreign capital.
Other	Commodities and currencies	*	A reversal of recent oversupply is likely to underpin oil prices. Any relaxation in trade tensions could boost industrial metal prices. We are neutral on the U.S. dollar. It has perceived "safe-haven" appeal but gains could be limited by a high valuation and a narrowing growth gap with the rest of the world.

▲ Overweight — Neutral ▼ Underweight *Given the breadth of this category, we do not offer a consolidated view.

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