

September 28, 2020

BlackRock[®]

2020 outlook update

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BLI10920E-1345818-1/36

**The future is
running at us**

The future is running at us



New norms of economic activity

This is not about a business cycle recession and recovery – but a long adjustment to new norms of economic activity that mean investment decisions should be linked to the real economy.

Supercharged structural trends

The shift to sustainability, deglobalization and geopolitical fragmentation, and the joint monetary-fiscal policy revolution are being accelerated.

Real resilience for the whole portfolio

This goes beyond using financial resilience to build a better blend of returns – it's about ensuring the portfolio is well positioned at a more granular level to underlying themes, including sustainability.

Strategic allocation decisions should be reassessed now to make portfolios resilient to this new landscape

2020 midyear investment themes

Activity restart – The activity restart has broadened. Yet it is moving at different speeds between countries, driven by differences in virus dynamics – stalling or retrenching in countries that experienced an increase in virus infection rates. An unprecedented joint monetary-fiscal policy response is providing a bridge for disrupted income streams. Fiscal stimulus fatigue is becoming a risk – especially in the U.S. – even as Europe has stepped up its fiscal support. Evidence of permanent damage is limited so far for economies as a whole but the adjustment to a post-Covid world could be painful for some contact-sensitive sectors.

Strategic implication: We are moderately pro-risk, and prefer high yield over equities.

Tactical implication: We have closed our underweights in cyclical assets, with a preference for Europe.

Policy revolution – Closer fiscal-monetary policy coordination, the Federal Reserve's new framework that allows greater tolerance to letting inflation overshoot its target and other structural changes accelerated by Covid-19, such as deglobalization, point to a higher inflation regime in the medium term.

Strategic implication: We are underweight nominal government bonds and like inflation-linked bonds.

Tactical implication: We like high yield and see scope for spreads to tighten further as the economic recovery gathers pace. We believe U.S. stocks are vulnerable to fading fiscal stimulus and unwinds of crowded positions.

Real resilience – Supercharged structural trends will change the nature of portfolio diversification. We believe countries, sectors and companies will make a comeback as diversifiers in a more fragmented world, in our view, offering resilience to real economy trends.

Strategic implication: We favor sustainable assets, private markets and deliberate country diversification.

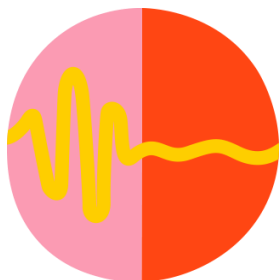
Tactical implication: We have increased our overweight in the quality factor, favor assets with policy backstops and prefer developed markets over the emerging world.

The opinions expressed are as of September 2020 and are subject to change at any time due to changes in market or economic conditions. Strategic implications refer to long-term views, tactical implications refer to asset views on a 6-12 month horizon.

Federal Reserve adopts a new monetary policy framework

The Fed's new monetary policy framework is set to have significant implications for inflation outcomes as it allows for inflation overshoots and doesn't worry about labor markets overheating.

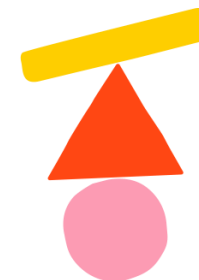
Illustrative schematic of the Federal Reserve's new policy framework, September 2020



Fed moves toward flexible average-inflation targeting to make up for past misses of its target



Fed plans to worry only about “shortfalls” from full employment



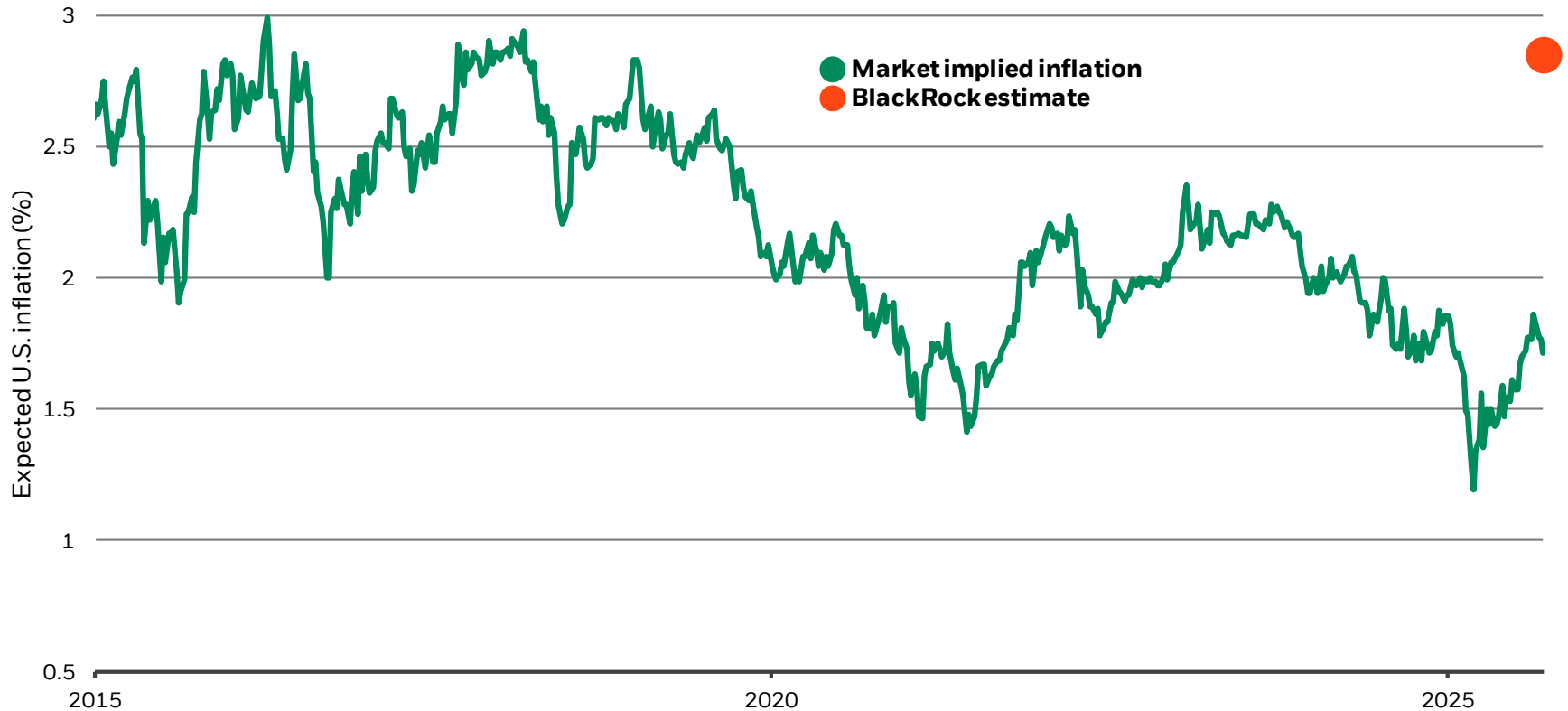
Bottom line: We believe the Fed will tolerate inflation overshoots and find it politically harder to lean against overheating

Sources: BlackRock Investment Institute, September 2020. Notes: For illustrative purposes only. For the Fed's new framework, see: <https://www.federalreserve.gov/monetarypolicy/review-of-monetary-policy-strategy-tools-and-communications-statement-on-longer-run-goals-monetary-policy-strategy.htm>

Preparing for a high inflation regime

Rising production costs due to capacity cuts and deglobalization, new central bank policy frameworks that allow for inflation overshoots and potential political pressures post Covid-19 raise inflation risks.

Market pricing of forward U.S. inflation vs. BlackRock inflation estimate, 2015-2025



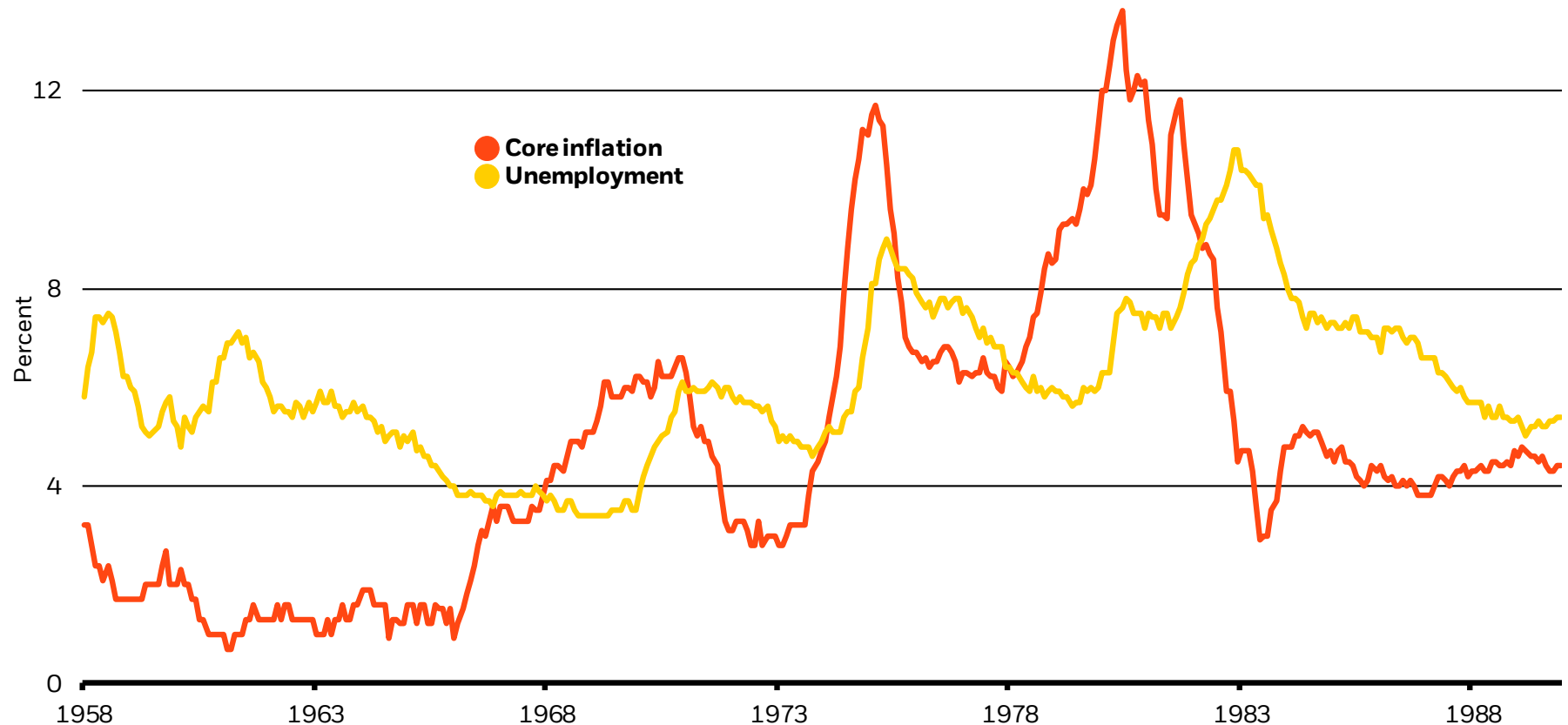
Forward-looking estimates may not come to pass.

Sources: BlackRock Investment Institute and the Federal Reserve with data from Refinitiv Datastream, September 2020. Notes: The chart shows market pricing of expected average inflation over the five-year period starting in 2025. We show it using the five-year/five-year inflation swap which is a measure of market expectation of inflation over five years, starting in five years' time. In the chart, the line is shifted forward five years. The orange dot shows our current estimate of average U.S. CPI for the same five-year period of 2025-2030.

The Fed could lose its grip on inflation expectations

Inflation expectations could become unanchored and keep shifting higher, as they did in the late 1960s when the Fed prioritized full employment over inflation.

U.S. core inflation annual rate vs. unemployment rate, 1958-1988



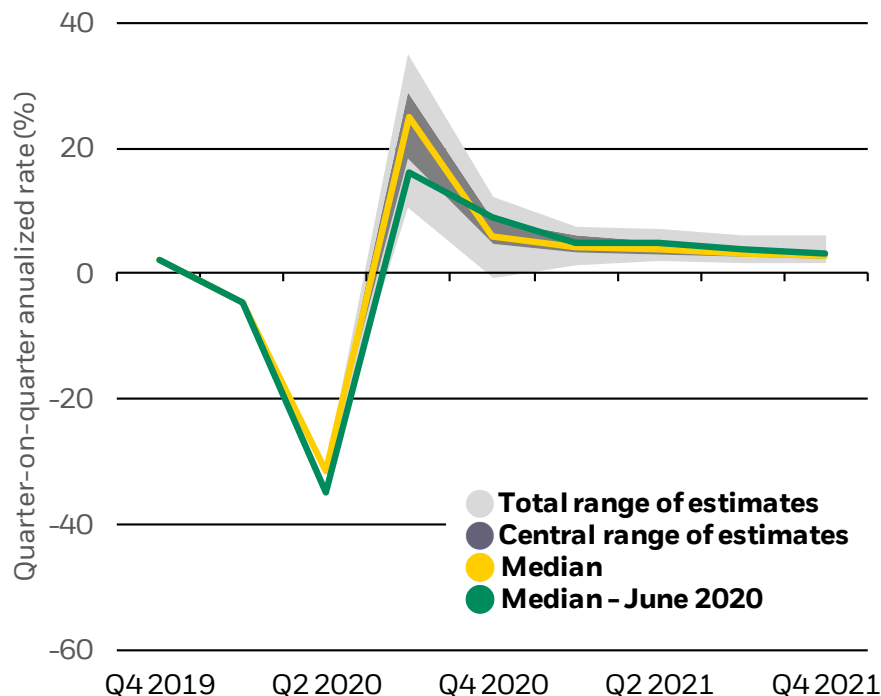
Sources: BlackRock Investment Institute and U.S. Bureau of Labor Statistics, with data from Refinitiv Datastream. Notes: The chart plots the annual change in the core Consumer Price Index against the unemployment rate.

Scaling the Covid-19 shock and closing the activity shortfall

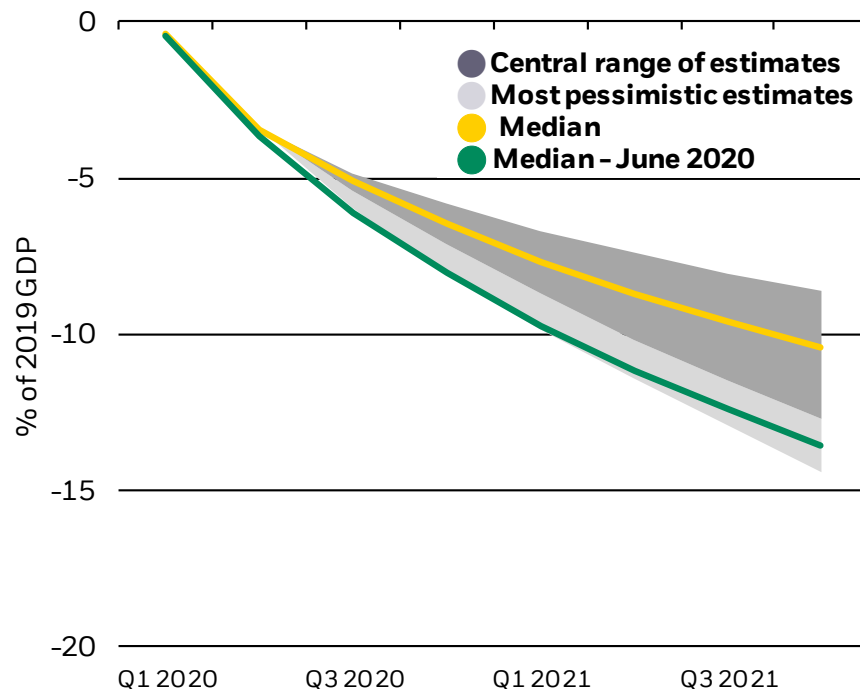
The trough of the shock was in April as economies reopened. We expect the U.S. economy to make up the activity shortfall caused by the shock by early 2022. Europe may close the shortfall earlier.

Hypothetical U.S. GDP decline and overall shortfall from 2019 levels, 2020-2021

U.S. quarterly annualized growth



U.S. shortfall projections

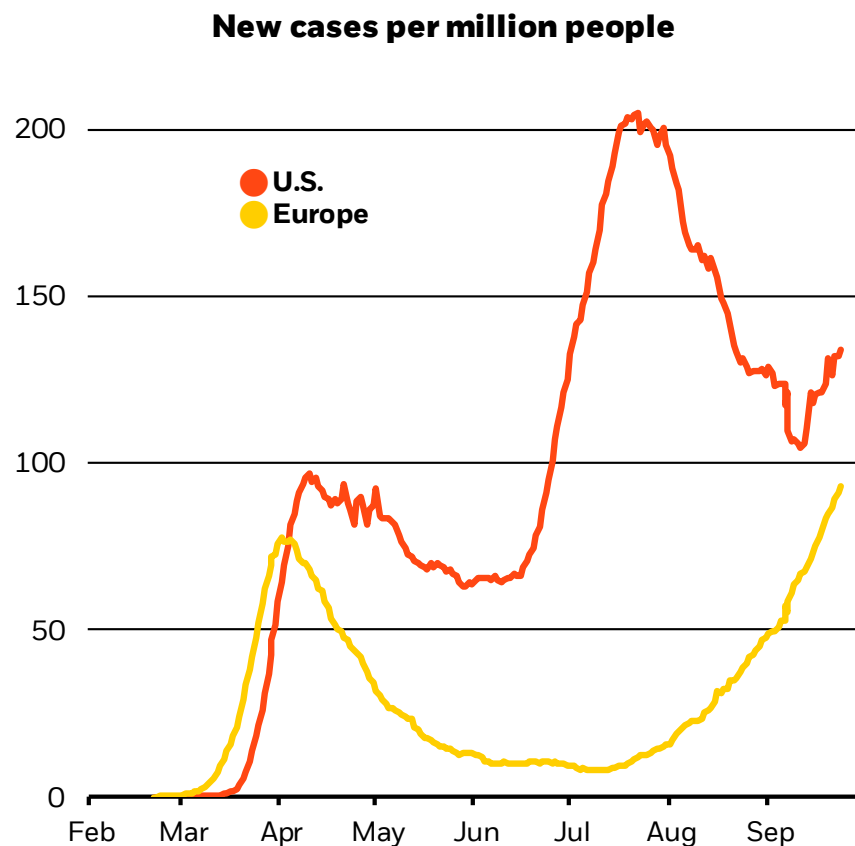
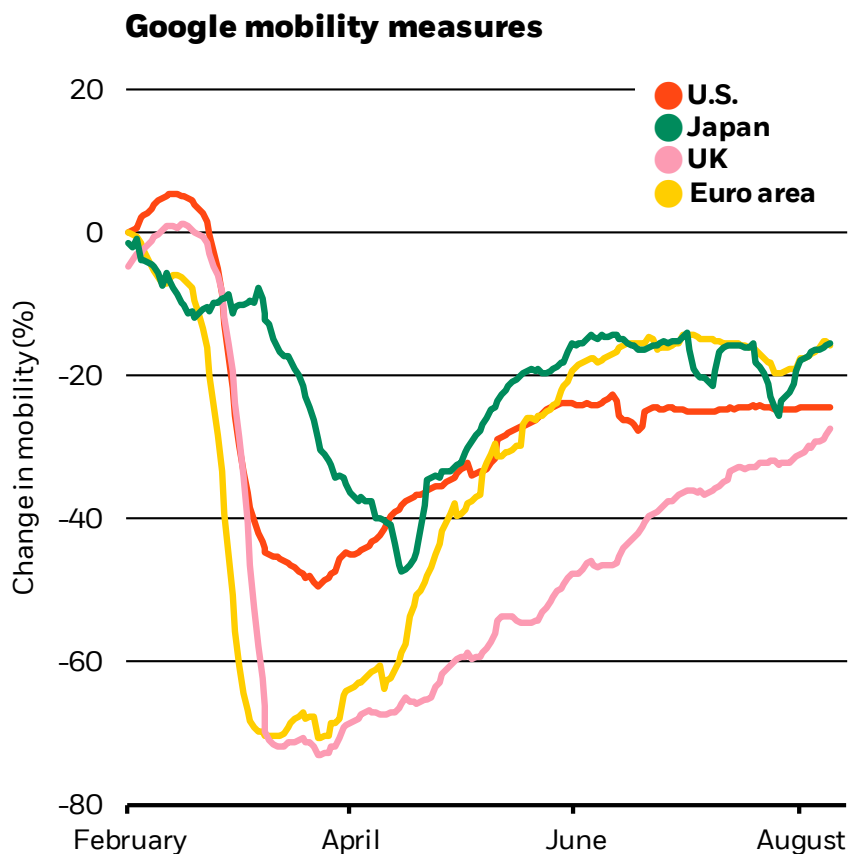


Source: BlackRock Investment Institute, with data from Reuters News, September 2020. Notes: These charts show hypothetical U.S. GDP quarterly annualized changes through Q4 2021 and the total shortfall of U.S. GDP relative to 2019 levels over the next two years based on a Reuters poll of economists. We use the Reuters poll of economists published on 10 September 2020 but trim the overall sample by taking the estimates within the 20th and 80th percentiles to reduce extreme outliers or stale forecasts (dark grey shaded band). We derive our range of estimates and median from an adjusted sample of 46 forecasts for which we have complete forecasts. The light-grey shaded area on the left-hand growth chart illustrates the full range of estimates from the 55 forecasts, while the most pessimistic estimate in the right-hand charts shows the lower quintile of forecasts to help us gauge the size of the policy response needed to the shock. For illustrative purposes only. There is no guarantee that any forecasts made will come to pass. The hypothetical scenario is subject to signification limitations, in particular that this is an evolving situation and we are still trying to understand the potential for more extensive activity shutdowns due to the virus.

Virus dynamics continue to drive activity restart

Major economies have started reopening, as reflected in mobility data. The lower incidence of new deaths partly explains the relatively muted market response to a renewed rise in infections.

Mobility metrics and new cases per capita in U.S. and Europe, September 2020

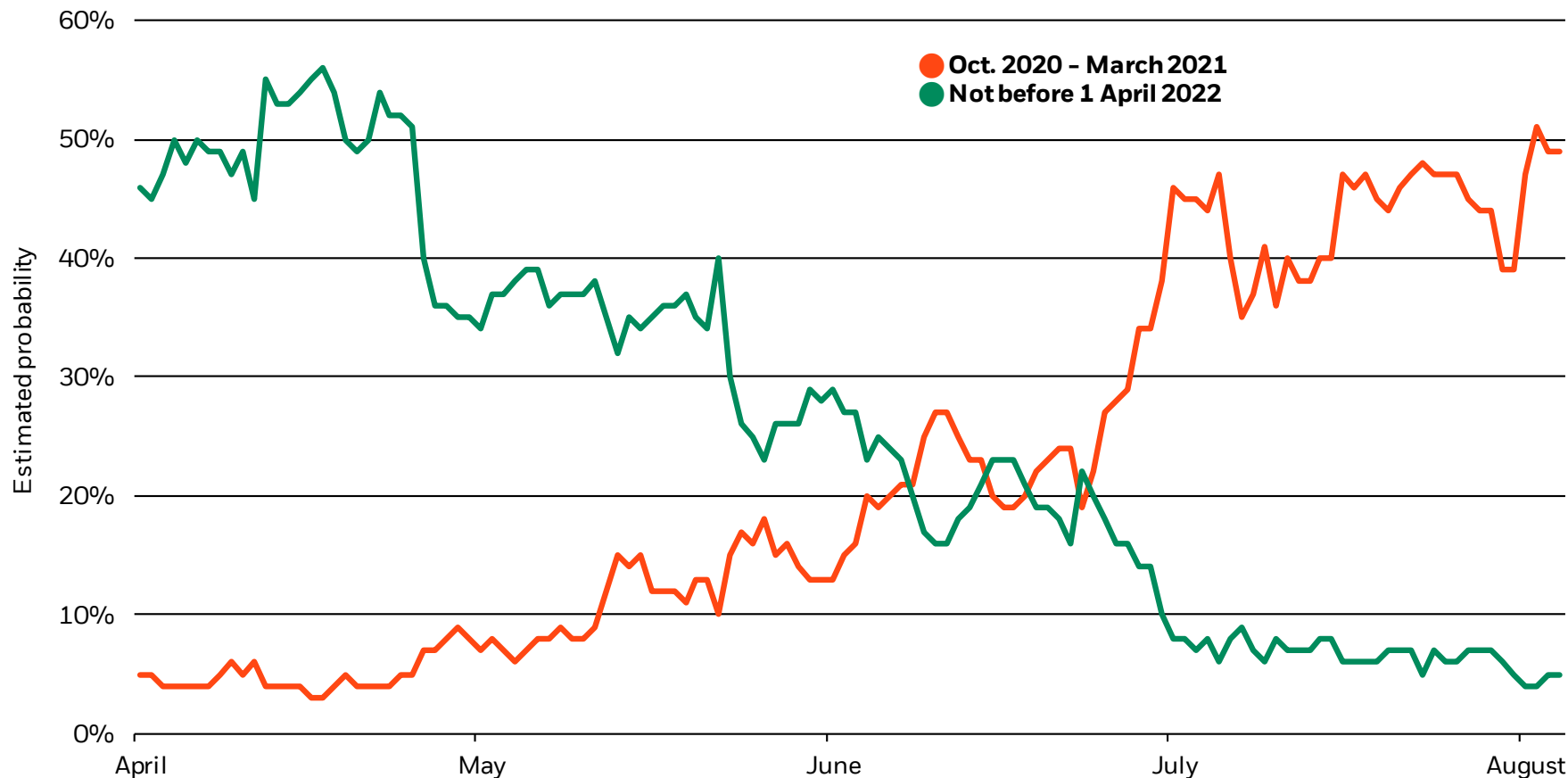


Sources: BlackRock Investment Institute, with data from the European Centre for Disease Prevention and Control and Google. Data as of 28 September 2020. Notes: The chart on the left maps Google mobility data based on the average of the retail and recreation, workplace and transit categories. The lines show the 7-day rolling average. Euro area based on average of Germany, France and Italy. The chart on the right tracks new confirmed Covid-19 deaths per million people as a 7-day rolling average.

Expectations for a Covid-19 vaccine have ramped up

The timeline for a vaccine has surprised to the upside following accelerated efforts worldwide. Yet immunization is not a panacea for the economy and a recovery to pre-Covid levels will take time.

Probability of approved vaccine available for 25 million people in the U.S., April-Aug. 2020



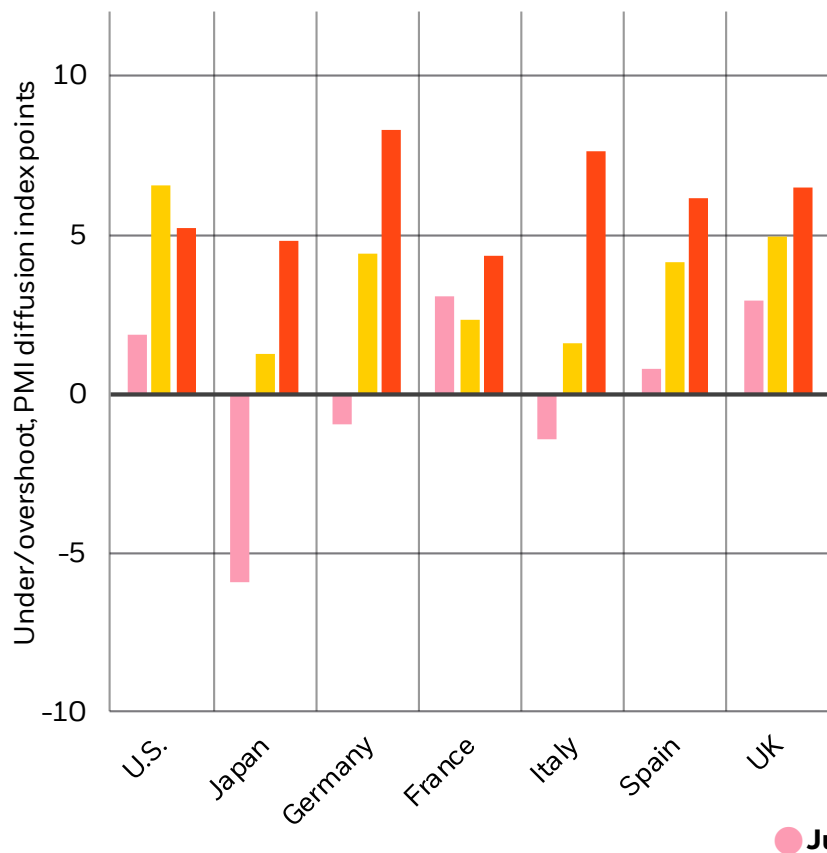
Source: BlackRock Investment Institute, with data from the Good Judgment Superforecasters project, September 2020. Notes: The chart shows the probabilities assigned by the Good Judgment project – a forecasting services firm – to various time frames over which an FDA-approved vaccine might be available to inoculate 25 million people in the U.S. Full details available [here](#).

Activity restart: faster than expected

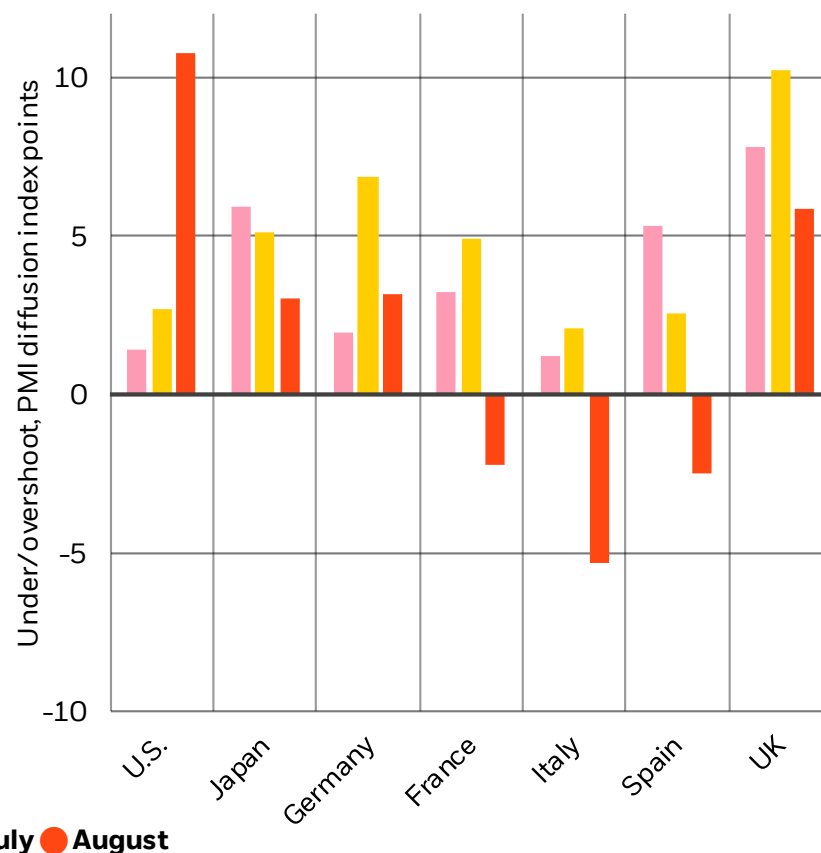
Survey data point to a more rapid recovery in manufacturing than services.

Services data in August has been more mixed, with parts of the euro area starting to undershoot.

Manufacturing PMI surprise, June–Aug. 2020



Services PMI surprise, June–Aug. 2020



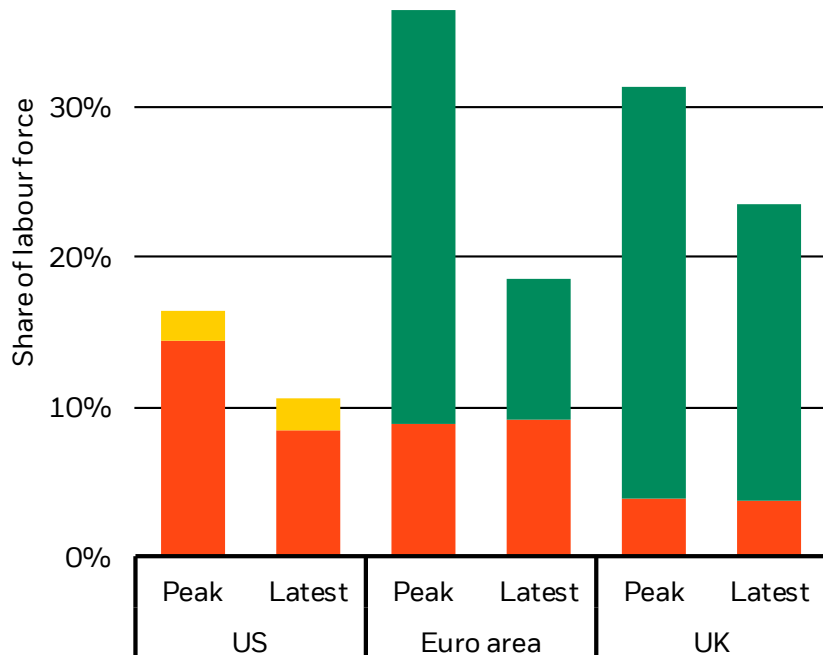
Source: BlackRock Investment Institute, with data from Haver Analytics, September 2020. Notes: Charts show the gap between actual and predicted PMIs for the past three months of data, with predictions derived from a model mapping PMI activity onto measures of mobility. A positive (negative) number implies that the data are stronger (weaker) than would be expected, based on the estimated relationship between activity and mobility. For the services model we use Google consumer mobility data and for manufacturing we use Google workplace mobility data. Both models include country fixed effects.

Fiscal support has been key for the labor market

Furlough schemes have prevented a sharp rise in unemployment in the euro area and the UK. Supplementary unemployment insurance in the U.S. has been key in limiting the income shock.

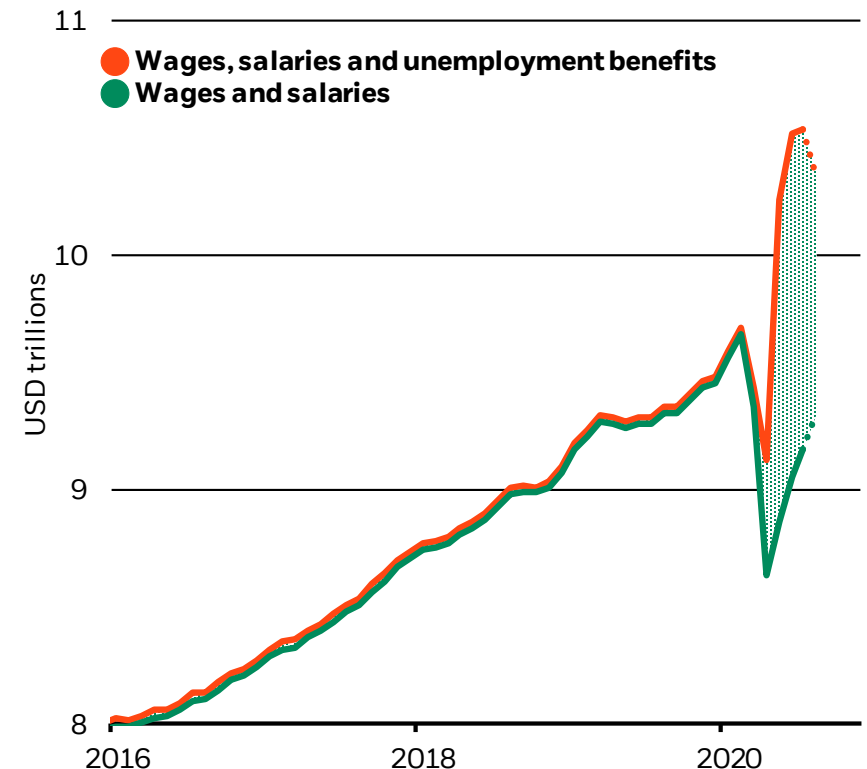
Labor market support, June–August 2020

- Workers in short-time work or furlough scheme
- Estimated workers supported by Paycheck Protection Program
- Unemployed



Sources: BlackRock Investment Institute, using data from Haver Analytics, BLS, Eurostat, ONS, DARES, Spanish Labour Ministry, INPS, Autor et al (2020), September 2020. Notes: Data as of 7 September 2020. Latest estimates relate to August in the U.S., July in the Euro area and June in the UK. Official estimates of workers still covered by the U.S. PPP scheme are not publicly available, so the yellow bar uses an estimate published by Autor et al for June. Peak bars show the levels at the point where the take-up of furlough schemes was at its highest over the period March 2020–present. Euro area is based on an average of Germany, France, Italy and Spain.

U.S. household compensation, 2016–2020

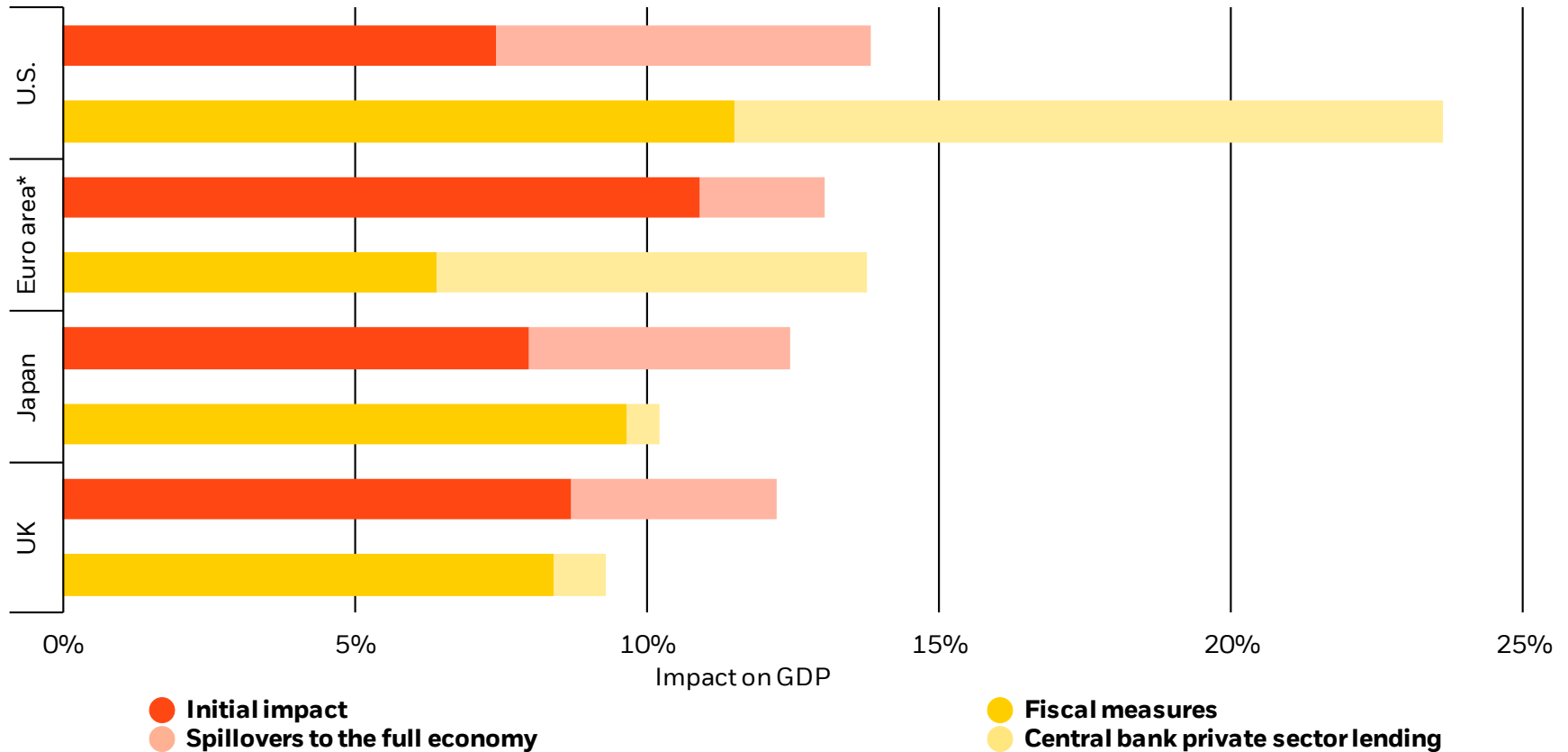


Sources: BlackRock Investment Institute, using data from BEA, US Treasury, Haver Analytics, September 2020. Note: Green line shows annualized wages and salaries for US workers. Data up to July are from the most recent BEA personal income report, and the figure for August is projected using the monthly change in labor income calculated from the August employment report (dotted lines). The orange line adds together wages and salaries and unemployment insurance benefits. The UI data are published up to July from the most recent BEA personal income report, and projected for August based on high frequency data from the Daily Treasury Statement (dotted line).

A policy revolution is cushioning the coronavirus shock

The combined monetary-fiscal policy response is helping fill the activity shock. Policy fatigue is a risk in the U.S. as policymakers face a series of “fiscal cliffs” and may cut fiscal relief prematurely.

Estimated virus hit to GDP vs. offsetting policy measures, 2020

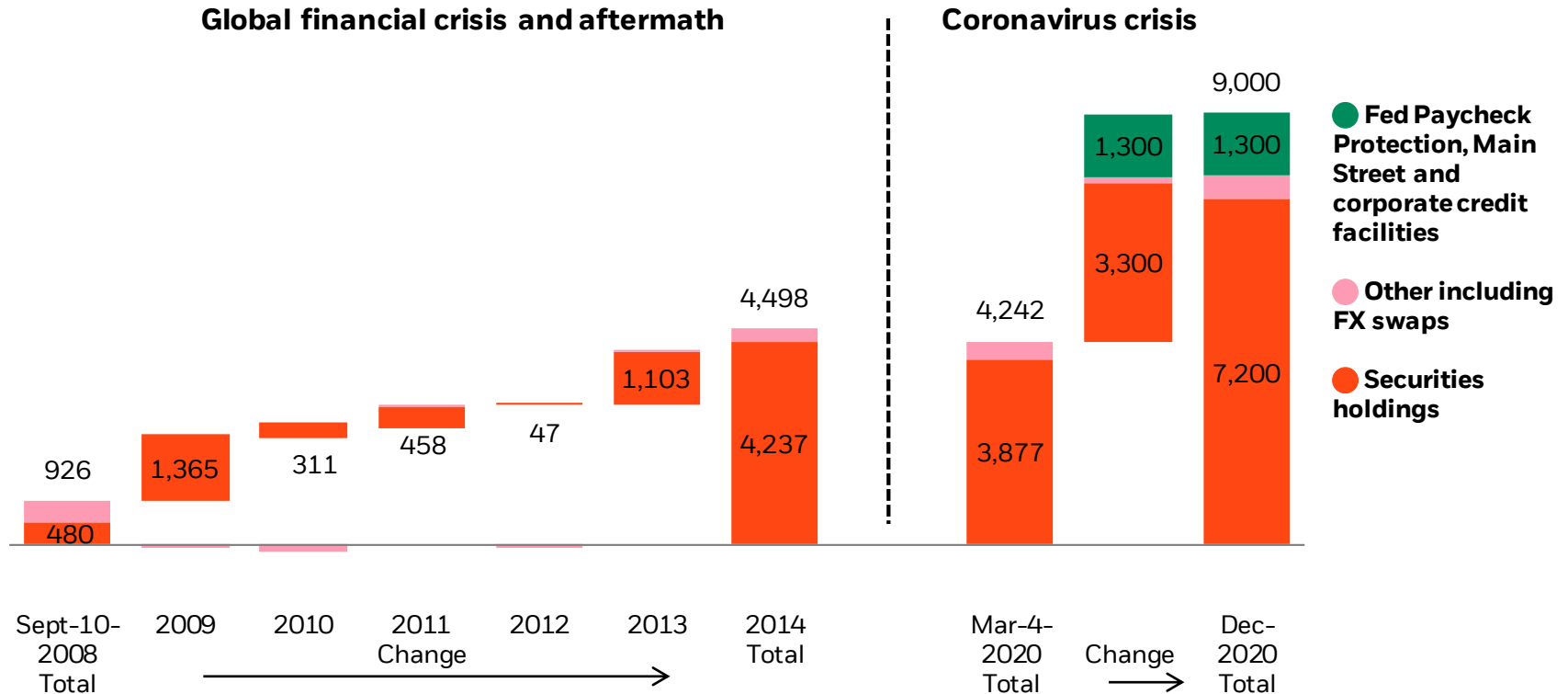


Sources: BlackRock Investment Institute, with data from the Federal Reserve, ECB, BOJ, BOE and Haver Analytics, September 2020. Notes: The chart shows the magnitude of the negative shock (red) and the associated positive policy response (yellow) as percentages of GDP. We use estimated 2020 targets for the U.S. and euro area central bank purchases and lending programs. The euro area includes the ECB’s Targeted Longer-Term Refinancing Operations, and the UK includes central bank support for the Term Funding Scheme. The euro area is represented by averages of Germany, France, Italy and Spain.

Fed has used its full range of tools – and created new ones

Central banks – especially the Fed – have deployed their full range of tools and invented new ones in a far shorter timeframe than in 2008. The Fed’s actions will dwarf those taken during and after the GFC.

Contributors to Federal Reserve balance sheet changes in billions USD, 2008–2014 and 2020

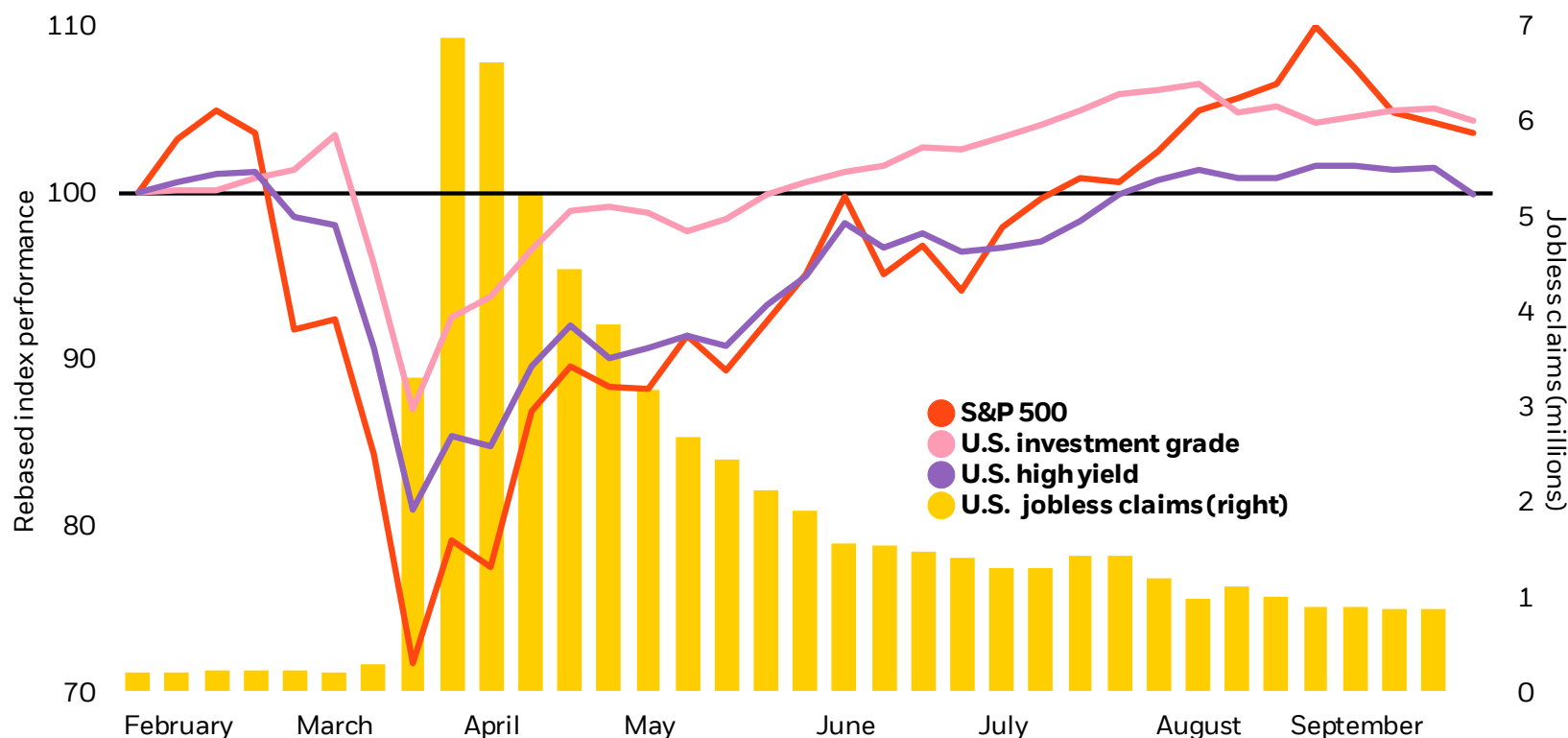


Source: BlackRock Investment Institute and Federal Reserve, with data from Haver Analytics, September 2020. Notes: The chart shows what the Fed's balance sheet could look like by the end of 2020 with the new facilities launched in the past two months compared with March 4 – just before it began its interventions. The balance sheet at the end of 2020 is based on estimates made by BlackRock's Global Fixed Income economics team. We assume that the Fed may have to increase its planned support for its Payroll Protection Program loan facility, and potentially expand its support for states and municipalities, together by several hundred billion dollars compared with the initial announcements. By comparison, the Federal Reserve pledged as much as \$2.3 trillion in loans to support the economy in its April 9 announcement. (See here: <https://www.federalreserve.gov/newsevents/pressreleases/monetary20200409a.htm>). Estimates of the expected increase and December 2020 totals are rounded. The funding facilities in the green area are funded with credit loss protection provided by the U.S. Treasury and lending by the Federal Reserve. These programs also include the Term Asset-Backed Securities Loan Program and Municipal Liquidity Facility. Forward looking estimates may not come to pass.

Visibility on the virus explains strong market performance

The visibility of the shock – and the “known unknowns” ahead – has helped drive the market rebound, with risk assets anticipating the quicker-than-expected restart.

Select asset class performance vs. U.S. initial jobless claims, February–September 2020



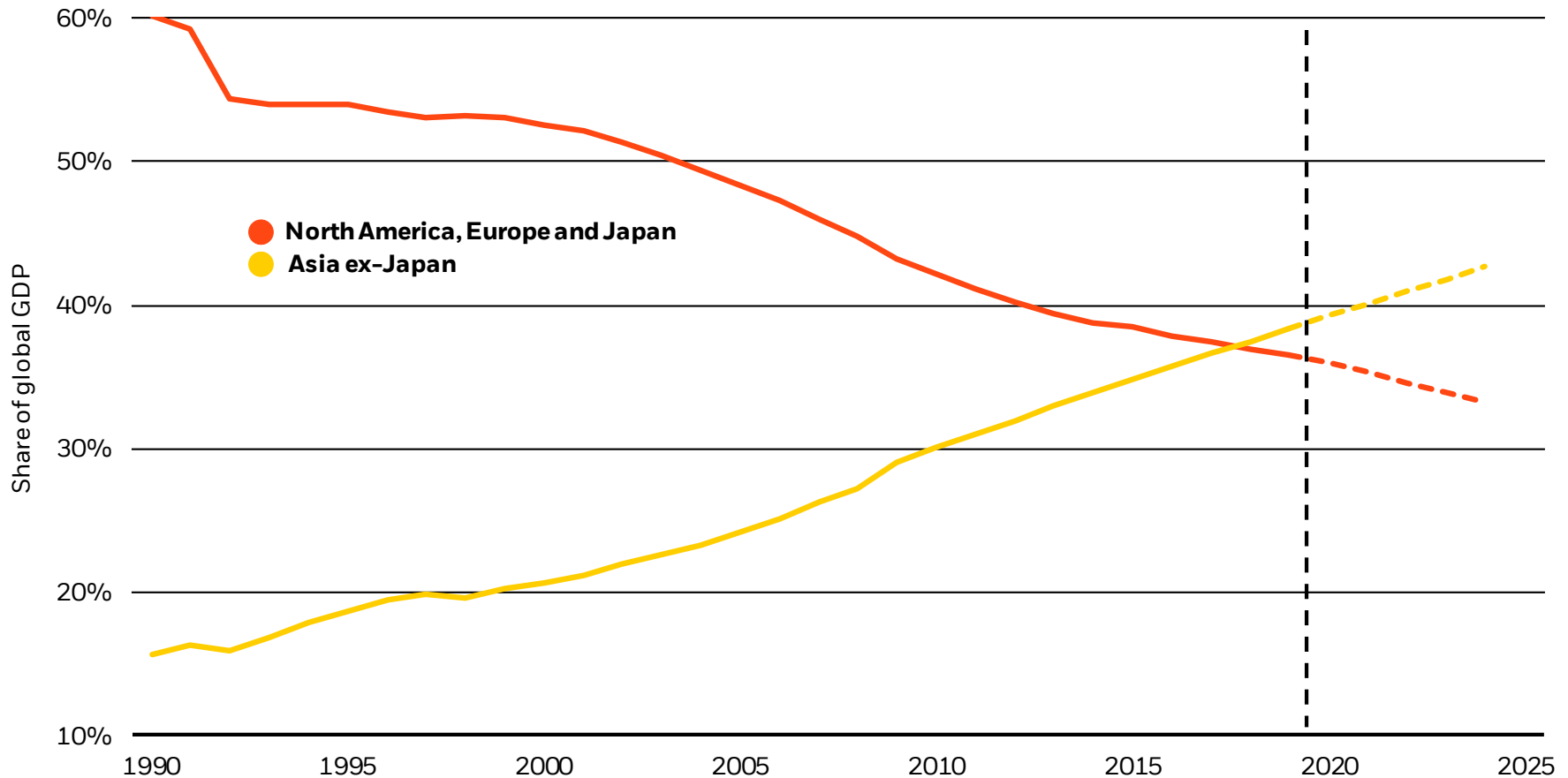
Past performance is no guarantee of future results.

Source: BlackRock Investment Institute, with data from Refinitiv Datastream, September 2020. Notes: The yellow bars show initial claims for U.S. unemployment insurance. The S&P 500, Bloomberg Barclays U.S. investment grade, Bloomberg Barclays U.S. Corporate High Yield indexes are rebased to 100 at Jan. 31. Indexes are unmanaged and are not subject to fees. It is not possible to invest directly in an index.

Pandemic likely to heighten geopolitical fragmentation

The world looks increasingly fragmented, with the U.S. and China at opposite poles. Investors should consider gaining exposure to both spheres, as global growth gravitates toward Asia.

Regional share of global GDP, 1990-2024

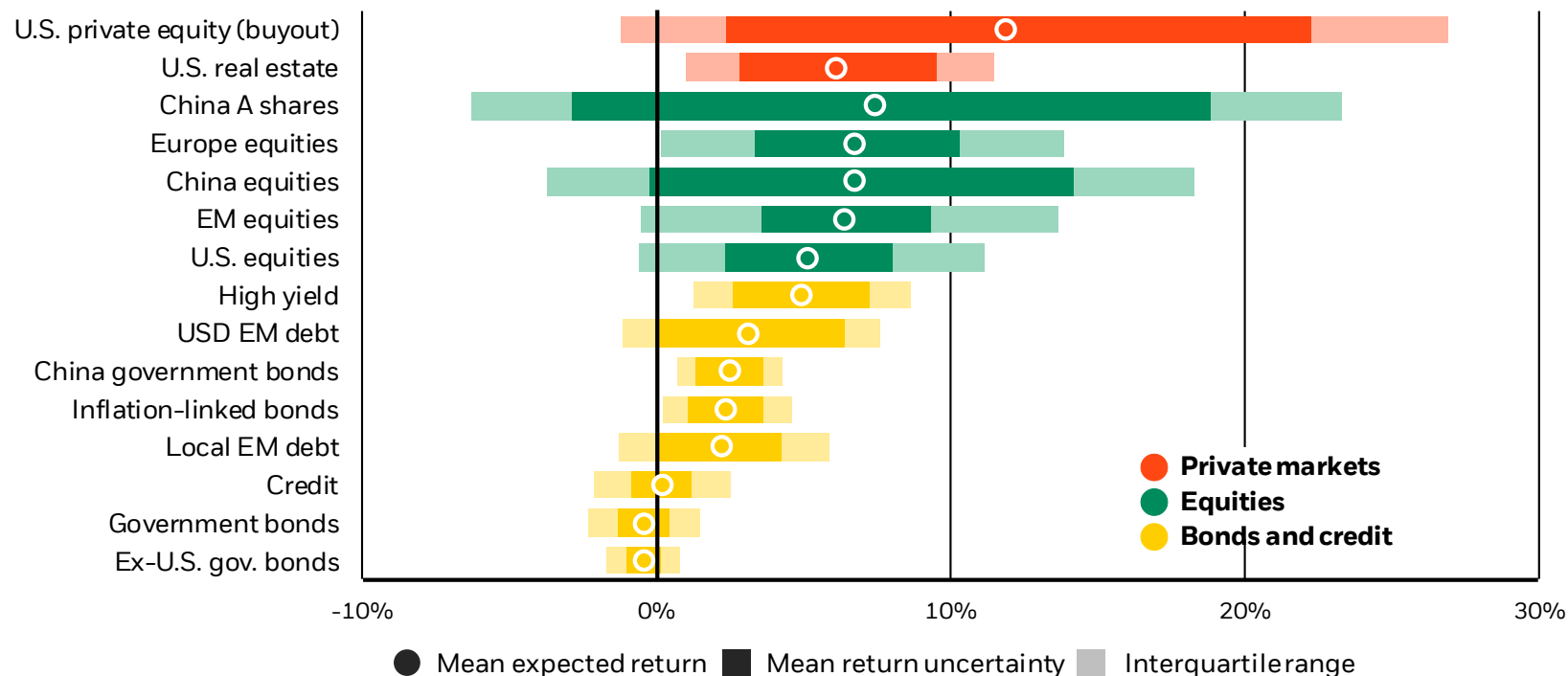


Sources: BlackRock Investment Institute, with data from IMF, Refinitiv, September 2020. Notes: The lines show each region's combined share of global GDP on a purchasing power parity (PPP) basis. The dotted lines show the forecast period based on IMF projections to 2024.

Our CMAs reflect a very different future

Expected government bond returns are negative across developed markets, keeping us underweight on a strategic horizon. We see better opportunities in private markets and inflation-linked bonds.

Asset return expectations and uncertainty in U.S. dollars on a five-year horizon



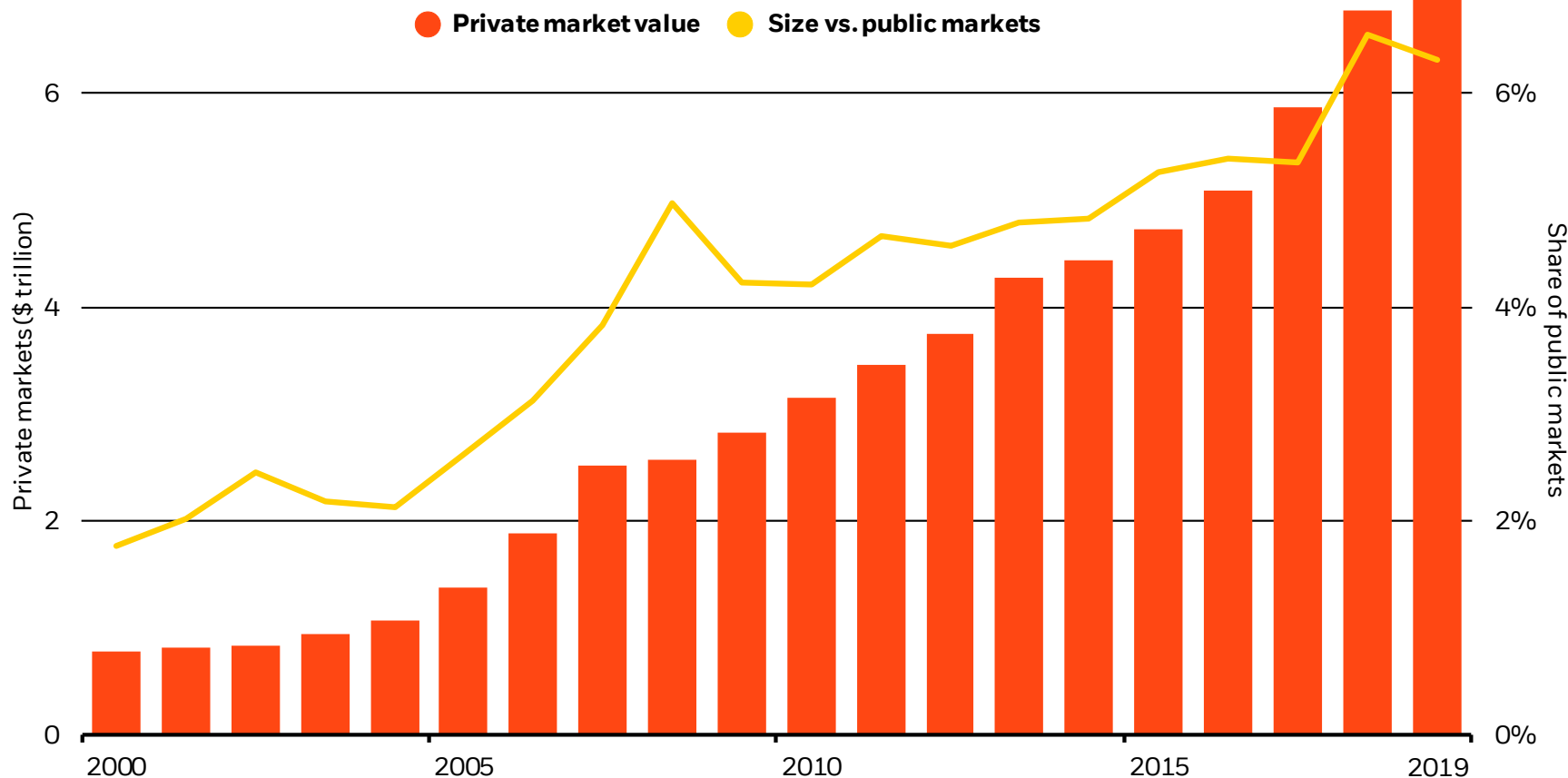
This information is not intended as a recommendation to invest in any particular asset class or strategy or as a promise - or even estimate - of future performance.

Source: BlackRock Investment Institute, data as of 30 June 2020. Notes: Return assumptions are total nominal returns. U.S. dollar return expectations for all asset classes are shown in hedged terms, with the exception of regional equity markets, Chinese government bonds, local-currency EM debt and private markets other than hedge funds. Our CMAs generate market, or beta, geometric return expectations. Asset return expectations are gross of fees. For a list of indices used see appendix. Professional investors can visit our Capital market assumptions website at blackrock.com/institutions/en-zz/insights/charts/capital-market-assumptions and click on the information icon in the *Asset class return and volatility expectation* stable for further details. 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. There are two sets of bands around our mean return expectation. The darker bands show our estimates of uncertainty in our mean return estimates. The lighter bands are based on the 25th and 75th percentile of expected return outcomes - the interquartile range. For more detail read our *Portfolio perspectives*. Indices are unmanaged and used for illustrative purposes only. They are not intended to be indicative of any fund or strategy's performance. It is not possible to invest directly in an index.

Real resilience requires looking beyond past correlations

Non-traditional return streams have the potential to add value and diversification. Many institutional investors remain underinvested in private markets as they may overestimate liquidity risks, in our view.

Growth in private market assets and share of public markets, 2000–2019

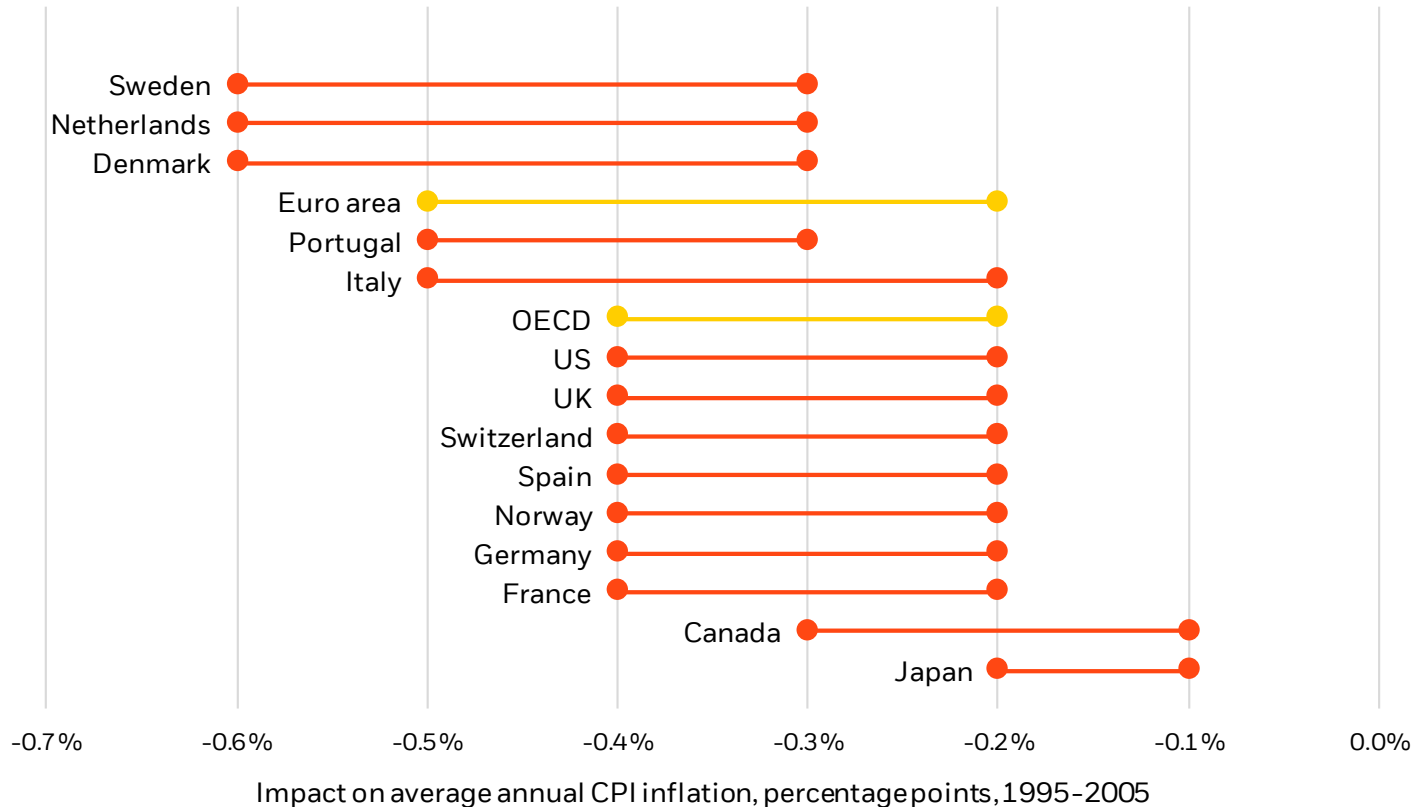


Sources: BlackRock Investment Institute, with data from Preqin, September 2020. Notes: The bars represent the sum of net asset value of closed-end funds as well as dry powder of funds in these asset classes: private equity and venture capital, real estate, private debt, infrastructure and natural resources. The line shows the size of private markets relative to that of public markets.

Preparing for a higher inflation regime

The policy revolution, evolving monetary policy frameworks and a persistent rise in production costs are likely to present a material inflation risk over the next five years.











Impact of globalization on consumer price inflation, 1995-2005



Sources: BlackRock Investment Institute and OECD, September 2020. Notes: The chart shows an estimated range of the impact of lower import prices on domestic consumer price inflation – expressed in percentage points of annual inflation – over the period of Q1 1995 and Q1 2005 from [Globalisation and OECD Consumer Price Inflation](#) OECD Economic study 44. OECD and euro area bars show country averages of the member countries in each bloc/group.

Directional views

Major asset class views on strategic and tactical horizons, September 2020

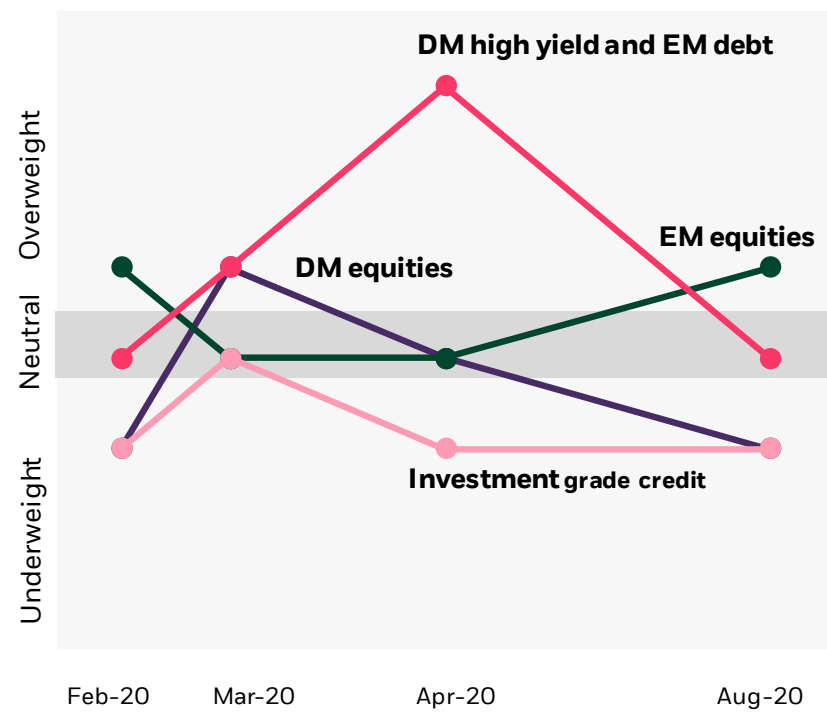
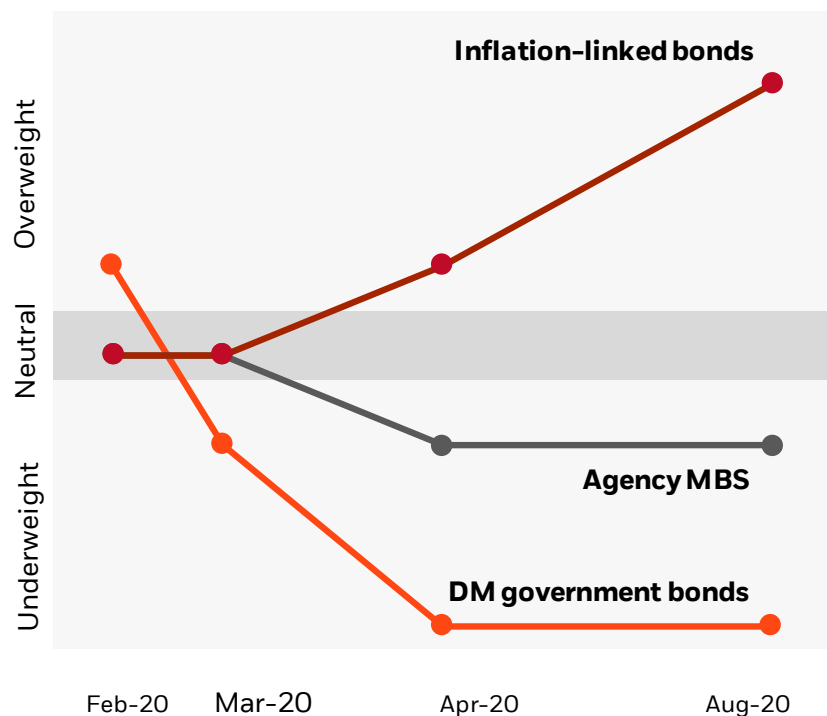
Asset	Strategic view	Tactical view	
Equities	 Neutral	 Neutral	<p>We have turned neutral on equities on a strategic horizon given increased valuations and a challenging backdrop for earnings and dividend payouts. We move to a modest underweight in DM equities and tilt toward EM equities. Tactically, we are also neutral on equities overall. We like the quality factor for its resilience and favor Europe among cyclical exposures.</p>
Credit	 Neutral	 +1	<p>We have turned neutral on credit on a strategic basis because we see investment grade (IG) spreads offering less compensation for any increase in default risks. We still like high yield for income. On a tactical horizon, we strongly prefer high yield for its income and more room for spread tightening. We are neutral on IG and underweight emerging market debt.</p>
Govt bonds	 -1	 Neutral	<p>The strategic case for holding nominal government bonds has materially diminished with yields closer to perceived lower bounds. Such low rates reduce the asset class's ability to act as ballast against equity market selloffs. We prefer inflation-linked bonds as we see risks of higher inflation in the medium term. On a tactical basis, we keep duration at neutral as unprecedented policy accommodation suppresses yields.</p>
Cash		 Neutral	<p>We are neutral on cash and believe holding some cash makes sense as a buffer against supply shocks that could drive both stocks and bonds lower, in our view.</p>
Private markets	 Neutral		<p>Non-traditional return streams, including private credit, have the potential to add value and diversification. Many institutional investors remain underinvested in private markets as they may overestimate liquidity risks, in our view. Private assets reflect a diverse array of exposures but valuations and inherent uncertainties of some private assets keep us neutral overall. Private markets are a complex asset class not suitable for all investors.</p>

Note: Views are from a U.S. dollar perspective as of September 2020. 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.

Slow-moving strategic decisions need to be taken quicker

Developed market government bonds – our biggest overweight at the start of the year – are now our biggest underweight. Inflation-linked bonds are our biggest overweight.

Our fixed income, equity and credit strategic views since the start of the year, September 2020



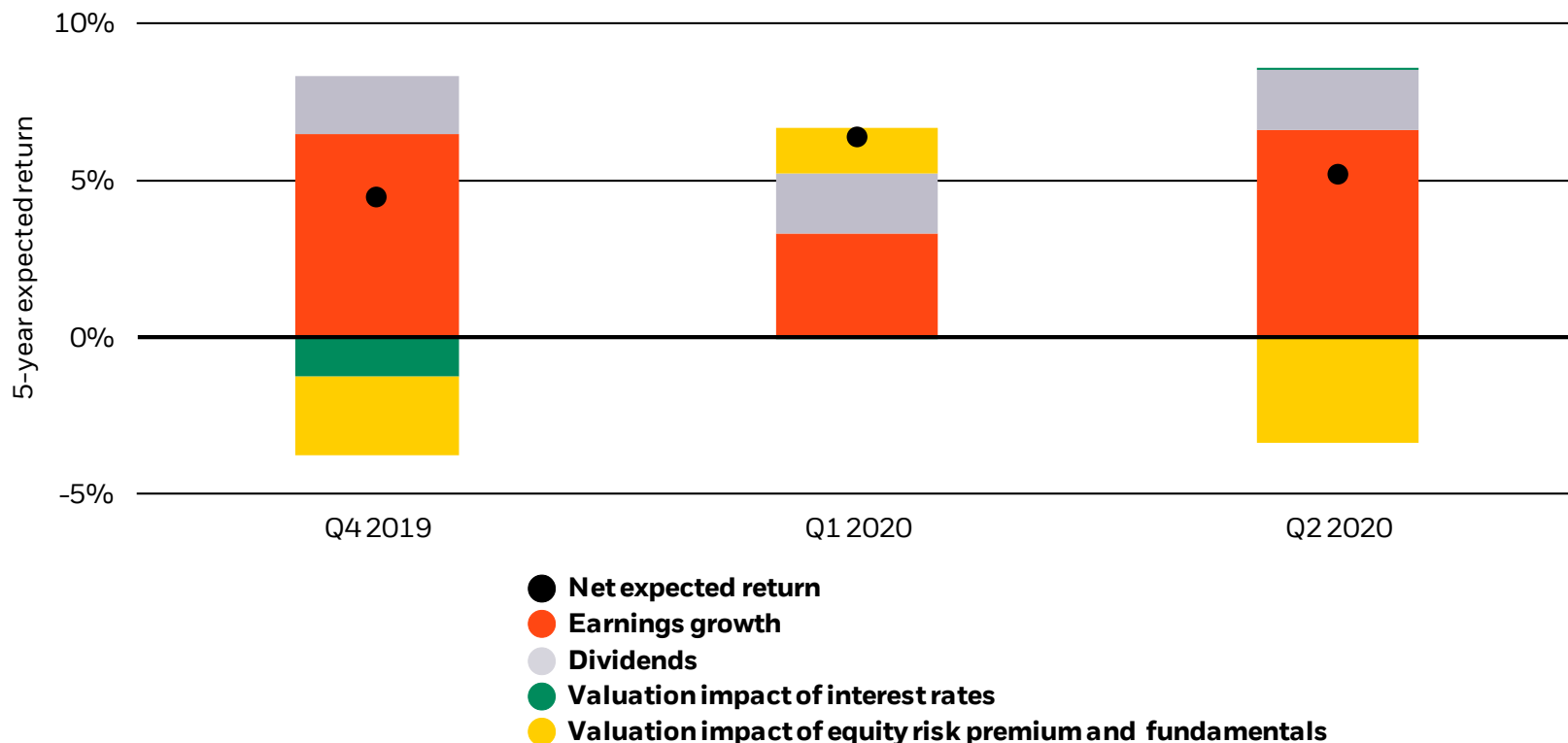
This information is not intended as a recommendation to invest in any particular asset class or strategy or as a promise- or even estimate- of future performance.

Sources: BlackRock Investment Institute. August 2020. Data as of June 2020. Notes: The charts show how our asset preferences on a 10-year horizon from an unconstrained U.S. dollar perspective have changed through the course of the year. Our February 2020 views represent our asset preferences based on our capital market assumptions as of 31 Dec. 2019. The March 2020 views show asset preferences based on CMA as of 26 March 2020 and the May 2020 views represent preferences based on CMA as of 13 April 2020. Developed market government bonds and EM equity allocations include respective China assets. The “overweight”, “neutral” and “underweight” refer to relative asset class tilts against a long-term equilibrium allocation as shown on our capital market assumptions website. Index proxies are in the appendix.

The longer-term impact on earnings matters for equities

Expected equity returns have fallen as the sharp rally since March lows has lifted valuations. The worst of the expected short-term earnings shock due to Covid-19 is likely behind us.

Breakdown of expected equity returns, Q4 2019-Q2 2020

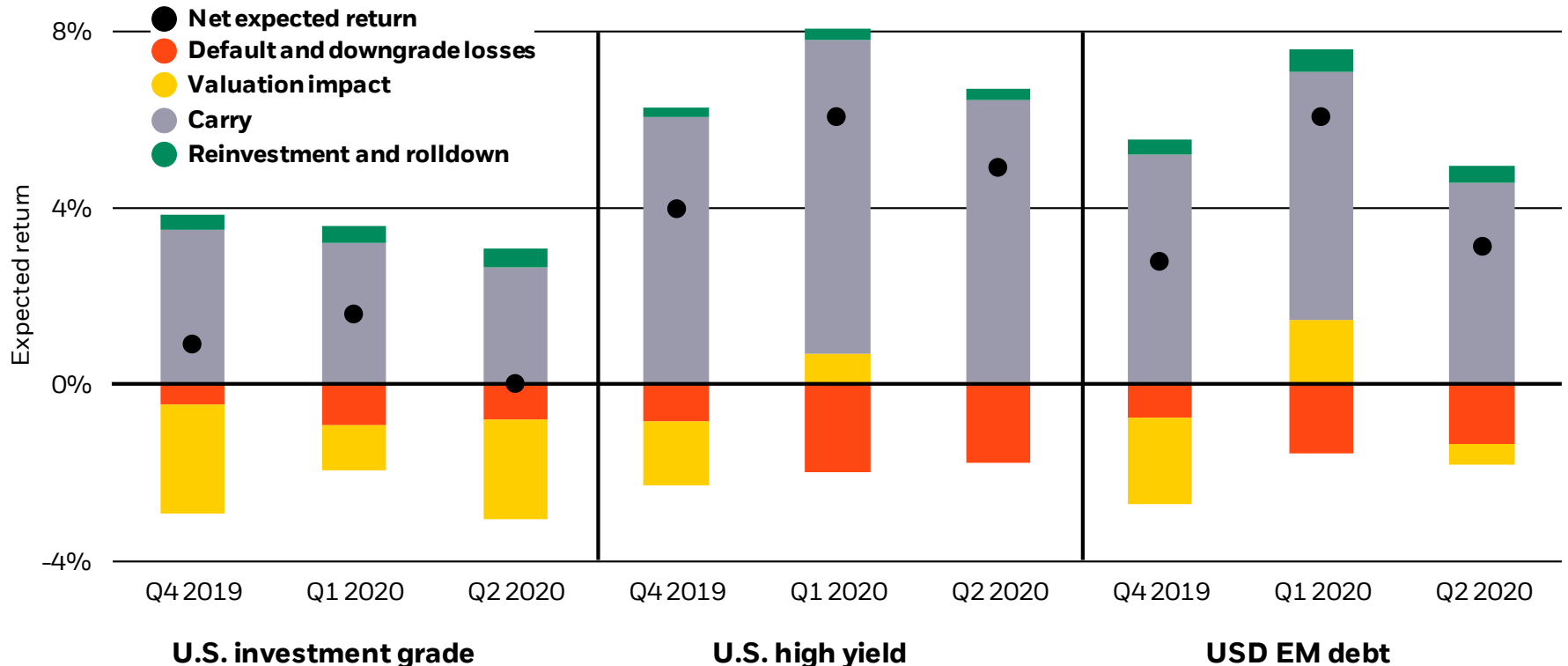


This information is not intended as a recommendation to invest in any particular asset class or strategy or as a promise- or even estimate - of future performance. Source: BlackRock Investment Institute, data as of 30 June, 2020. Notes: The chart shows a decomposition of five-year annualised expected return for MSCI USA index, as at 30 June 2020 (Q2 2020), 13 April 2020(Q1 2020) and as at 31 December 2019(Q4 2019). Full details of our methodology are available for professional investors on our [capital market assumptions](#) website. Indexes are unmanaged and not subject to fees. It is not possible to invest directly in an index. There can be no guarantee that any forecasts made will come to pass.

Investment grade credit has become less compelling

We trim our overweight on investment grade credit as the sharp tightening in spreads means they do not provide the same compensation for the rise in downgrade risk. We still like high yield for income.

Breakdown of expected credit returns by sub-sector, Q2 2020 vs Q1 2020 vs Q4 2019



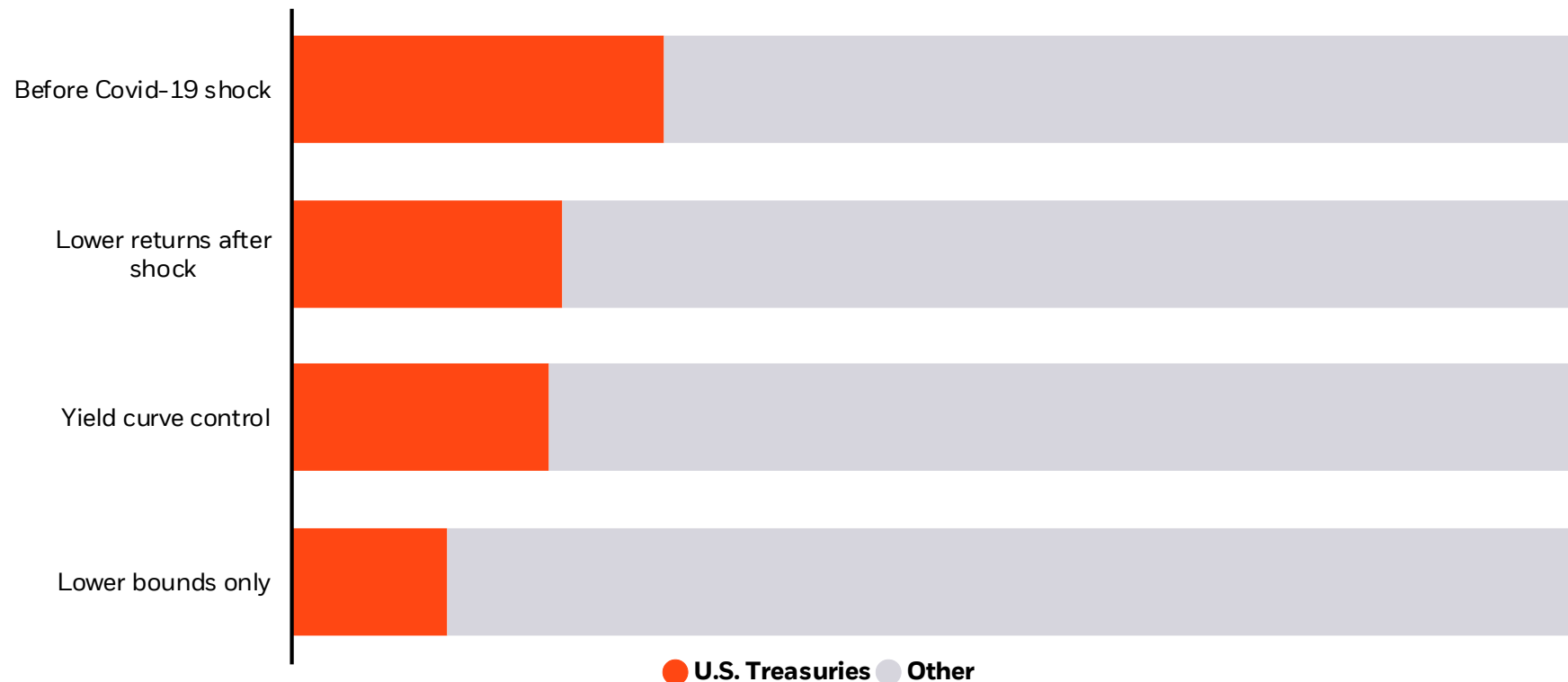
This information is not intended as a recommendation to invest in any particular asset class or strategy or as a promise - or even estimate - of future performance.

Source: BlackRock Investment Institute, data as of 30 June 2020. Notes: Chart shows 5-year expected returns for credit asset classes as at 31 Dec 2019 (Q4 2019) and as at 14 April 2020 (Q1 2020) and as at 30 June 2020 (Q2 2020). The total expected return is broken down into expected loss due to default and downgrades and expected returns due to carry, valuation and rolldown or reinvestments of coupon income. Indexes used: Bloomberg Barclays U.S. Investment Grade Credit index, Bloomberg Barclays U.S. High Yield Index and the JP Morgan EMBI Global Diversified Index. Indexes are unmanaged and not subject to fees. It is not possible to invest directly in an index. There can be no guarantee that any forecasts made will come to pass.

Future path of nominal yields key for strategic portfolios

Lower spot yields, presence of lower bounds and the resulting reduced ballast properties of nominal bonds materially reduces their attractiveness. Yield curve control could limit downside for bonds.

Illustrative U.S. Treasuries allocations in various scenarios, August 2020

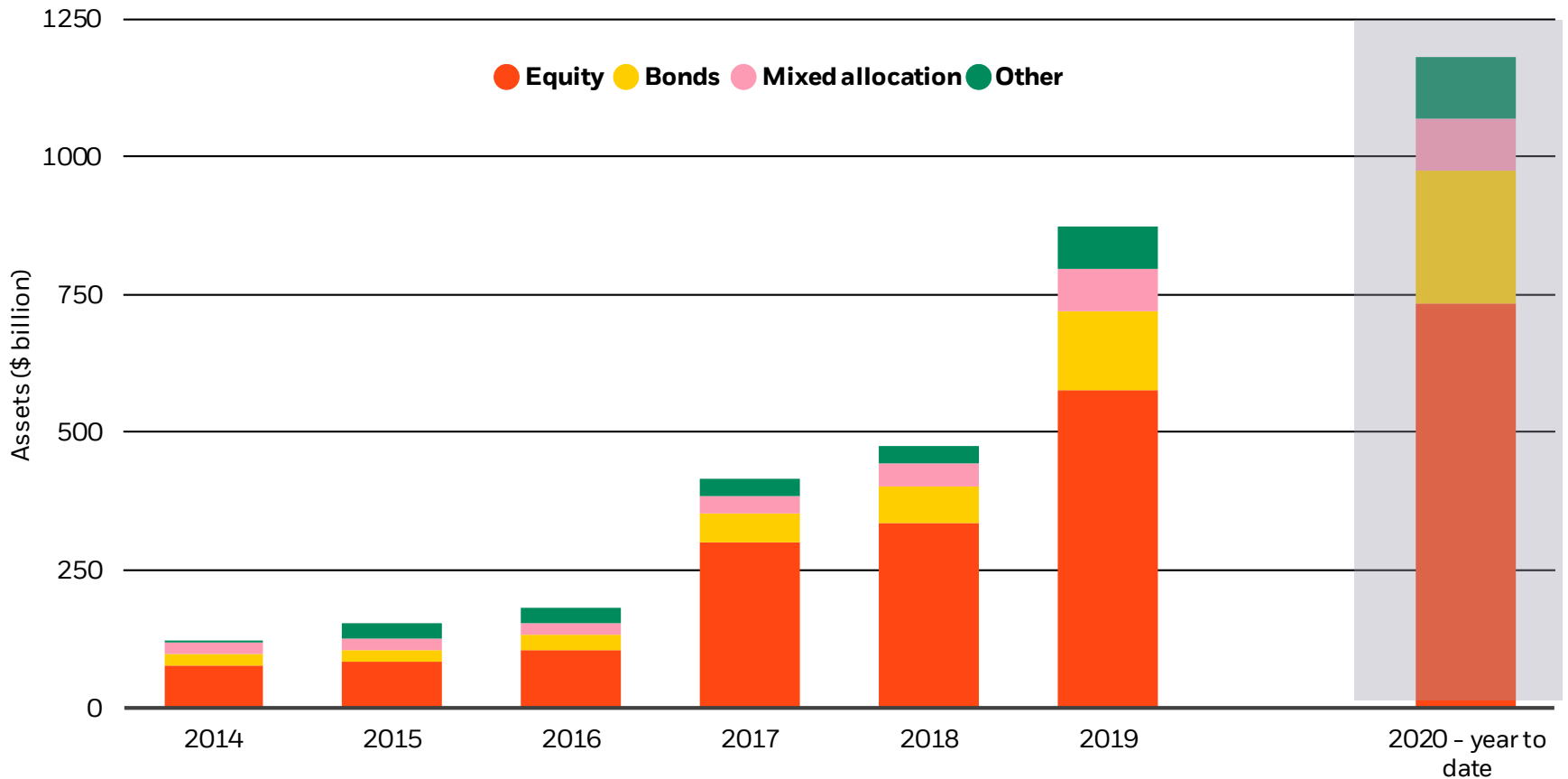


Source: BlackRock Investment Institute, September 2020. Notes: The chart shows the allocation to nominal U.S. Treasuries in an illustrative multi-asset U.S. dollar portfolio with a conservative risk target of 6%, investing on a 10-year horizon. For the “lower returns after shock” scenario we use our capital market assumptions as of April 13, 2020. For allocations under the “yield curve control” scenario, we assume the Federal Reserve is explicitly capping yields at 1.5% and providing a floor of 0% for them. For the “lower bound” allocation we assume an effective lower bound of 0% for the Bloomberg Barclays U.S. government bond index.

Tectonic shift to sustainable investing

We see funds flowing into sustainable assets for decades, rewarding sustainable investing strategies. The Covid shock has supercharged the sustainability wave.

Assets under management at ESG-mandated funds, 2014-2020 YTD

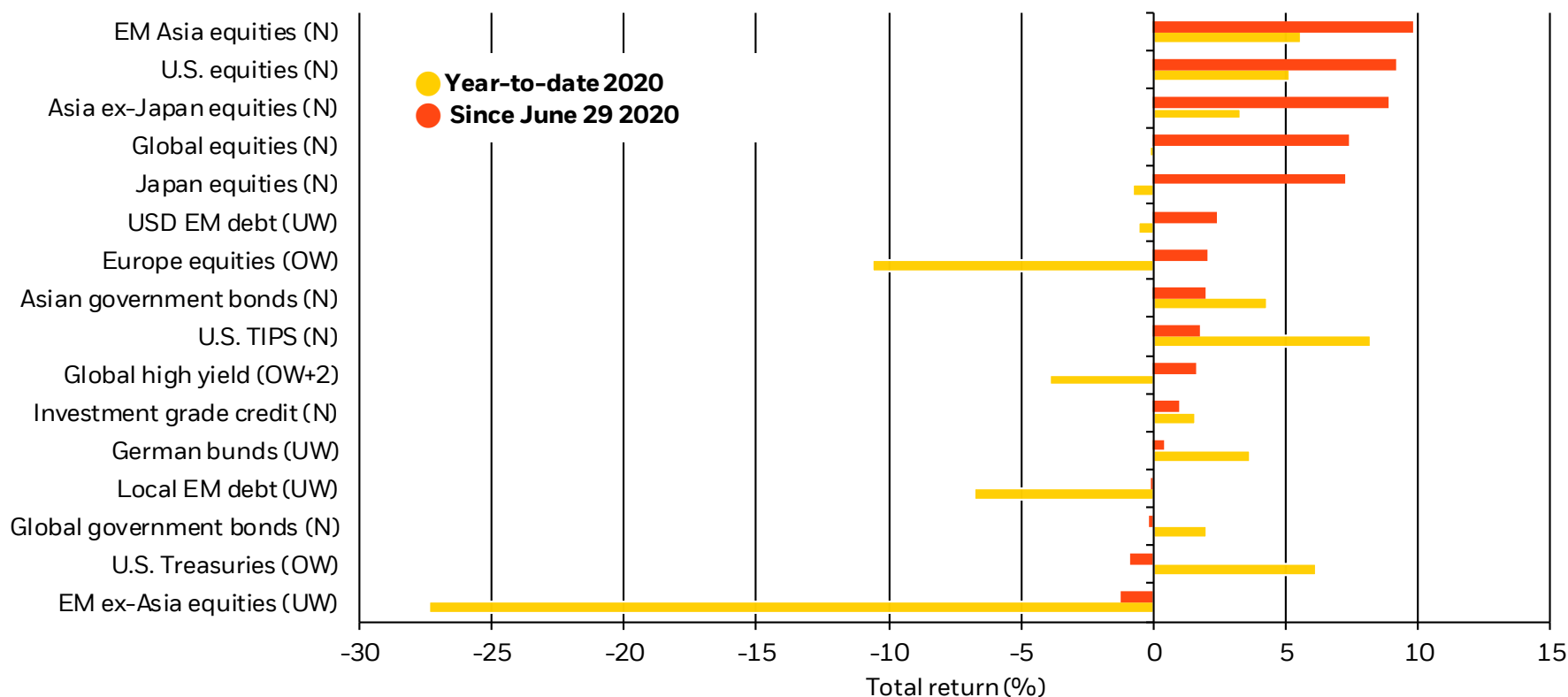


Sources: BlackRock Investment Institute with data from EPFR, September 2020. Notes: The chart shows the global total assets under management in ESG mandated funds. The “Other” category includes money-market and alternatives funds. Data for 2020 through July 31, 2020.

A strong risk rebound

Our tactical overweight on credit and U.S. Treasuries and underweight on EM ex-Asia equities have worked well. European equities have not yet seen the expected boost from the growth rebound.

Asset performance year-to-date and since our midyear outlook, September 2020



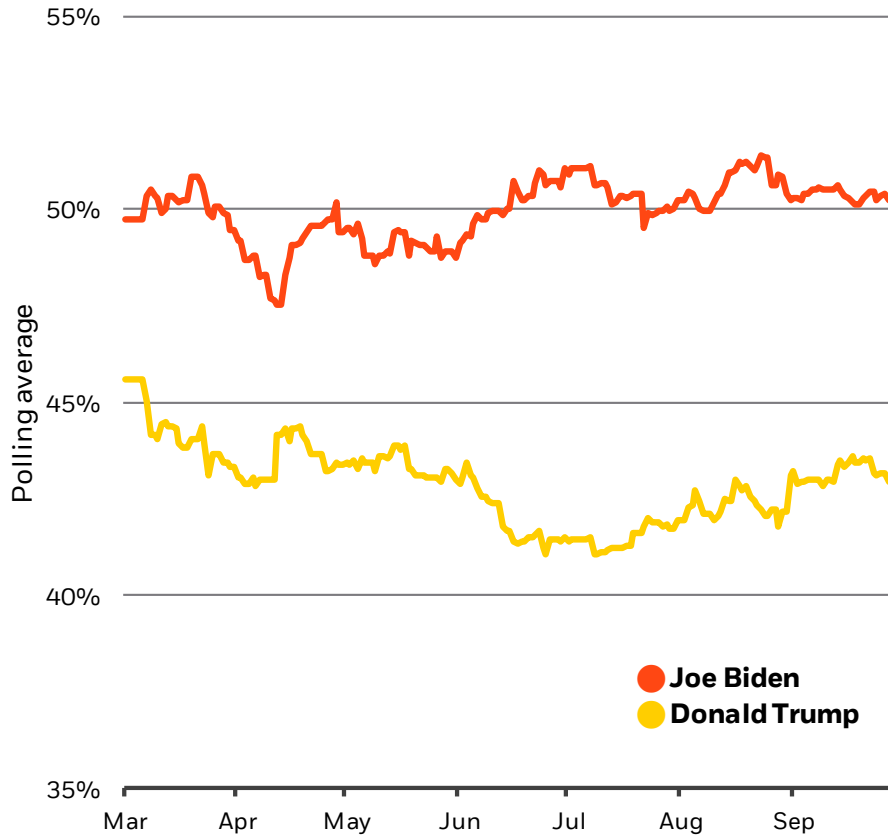
Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index.

Source: BlackRock Investment Institute, with data from Refinitiv Datastream, September 2020. Notes: Data are through 25 September 2020. The chart shows total returns year-to-date and from 29 June 2020 – the date we published our midyear investment outlook. The letters in brackets indicate our current investment view on the asset class. Indexes or prices used are MSCI EM Asia Index, MSCI AC Asia ex-Japan Index, MSCI USA Index, MSCI AC World Index, MSCI Japan Index, MSCI Europe Index, JPMEBI Global Diversified Index, Bloomberg Barclays Global High Yield Index, JPM JACI Index, MSCI EM ex-Asia Index, Bloomberg Barclays U.S. Treasury; U.S. TIPS Index, JPM GBI-EM Global Diversified Composite Index, Bloomberg Barclays Global Credit - Corporate Index, TR German 10year Bond Index, Bloomberg Barclays Global Aggregate Index, Bloomberg Barclays U.S. Treasury Index. Returns are shown in USD. Indexes are unmanaged and not subject to fees.

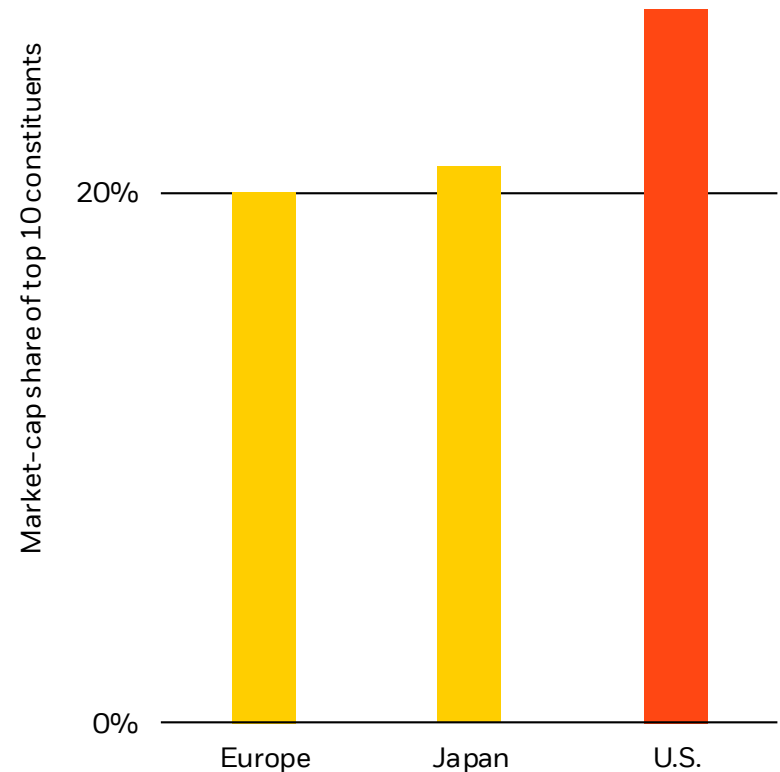
Election uncertainty, concentration risks weigh on U.S.

Uncertainty around the election – not just about the outcome but also the spectre of a contested election – as well vulnerabilities due to narrow market leadership are risks for U.S. equities.

U.S. election polling average, September 2020



Index concentration, September 2020

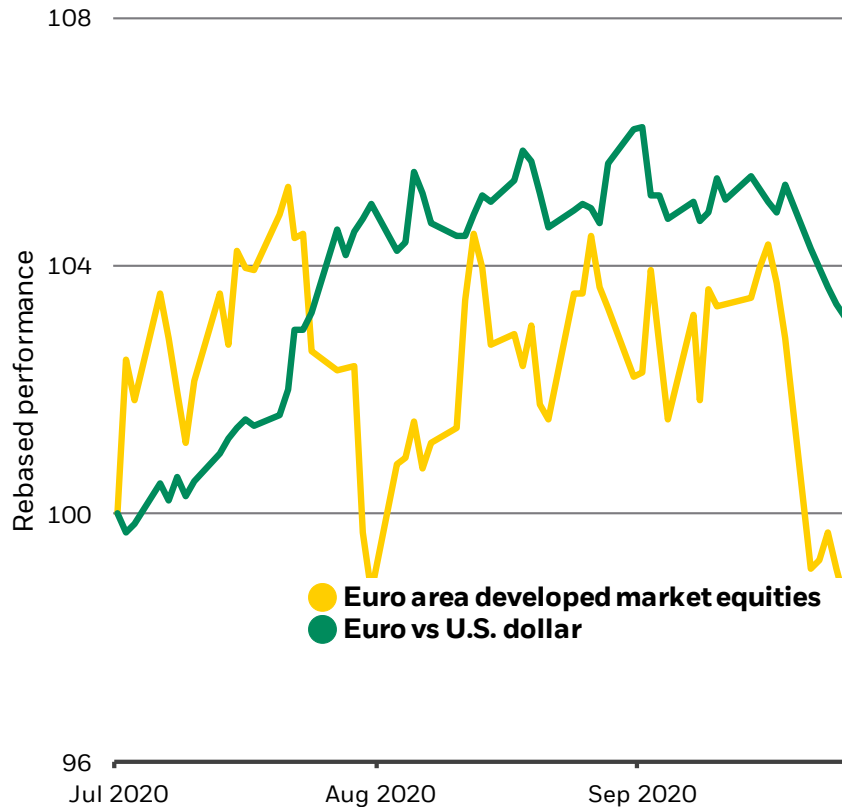


Sources: BlackRock Investment Institute, data as of 28 September 2020. Notes: The left chart shows the average of national polls showing support for Joe Biden and Donald Trump as president in the 2020 election as collated by FiveThirtyEight.com. See [here](#) for more details. The right chart shows the proportion of the overall index accounted by the top 10 securities – by market capitalization. We use MSCI indices as the proxy for the markets shown. Indexes are unmanaged. It is not possible to invest directly in an index.

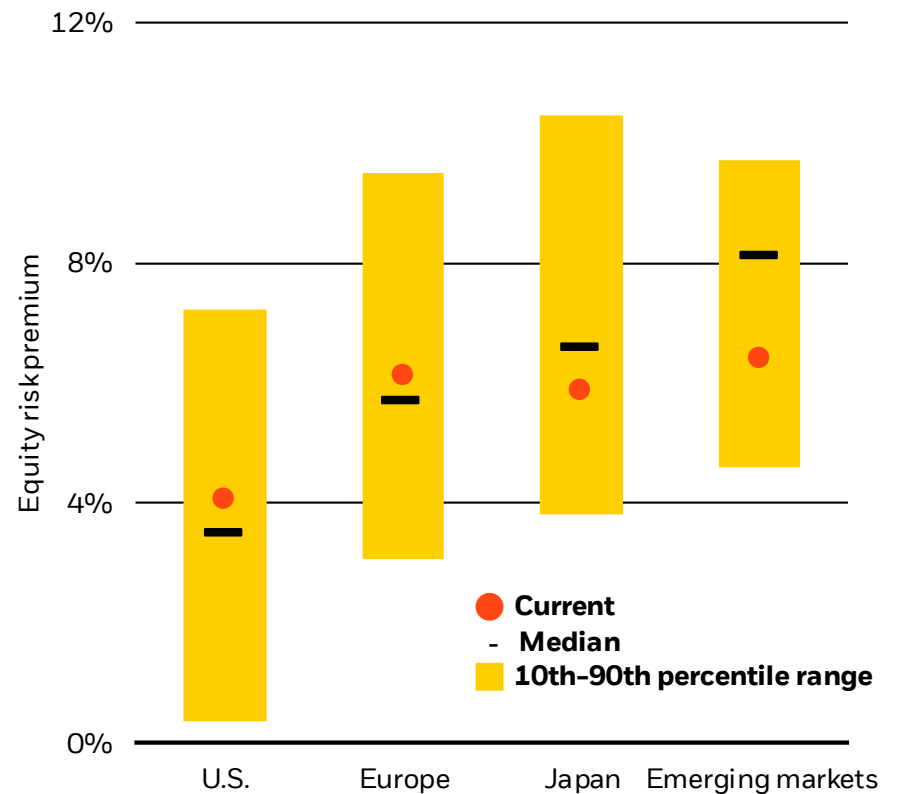
Euro optimism has not translated to European equities

We still prefer European equities over EM for cyclical exposure given relative success in tamping the spread of Covid-19, a ramped up policy response and more appealing valuations.

Euro area equities vs euro, June–Sept. 2020



Equity risk premium ranges, Sept. 2020

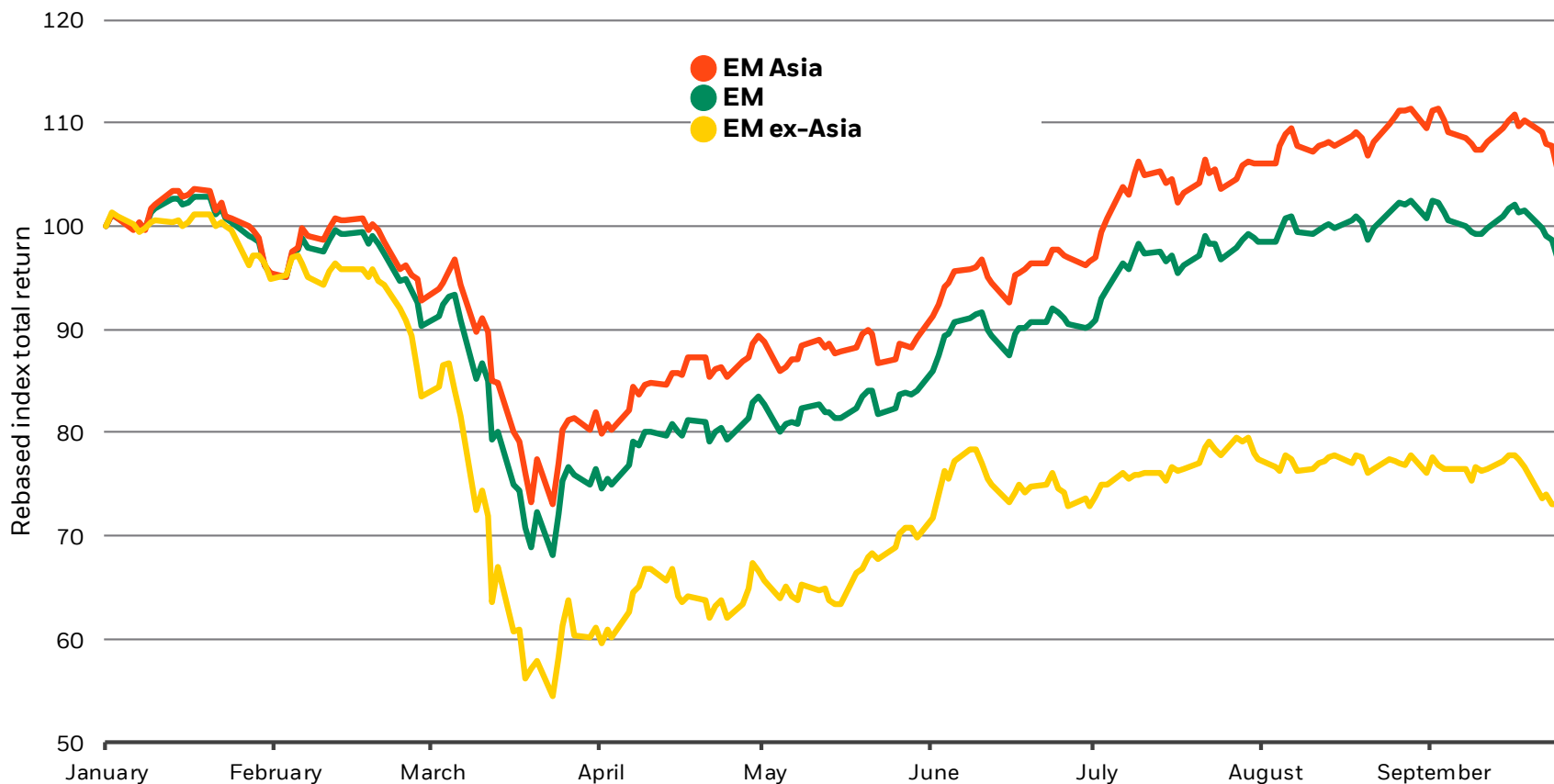


Past performance is not a reliable indicator of current or future results. Indexes are unmanaged and not subject to fees. It is not possible to invest directly in an index. There can be no guarantee that any forecasts made will come to pass. Sources: BlackRock Investment Institute, data as of 28 September 2020. Notes: The left chart shows rebased performance since 29 June 2020 for the euro exchange rate against the U.S. dollar and euro area developed market stocks. We use the MSCI EMU index as the proxy for euro area developed market equities. The chart on the right shows the equity risk premium and historical ranges since 1995 for major equity regions. We calculate the equity risk premium based on our expectations for nominal interest rates and the implied cost of capital for respective equity markets.

A tale of two EM regions

The divergence in performance within emerging markets underscores the importance of taking deliberate regional exposures and moving away from a reliance on broad indexes.

EM Asia vs. EM ex-Asia performance, year-to-date 2020



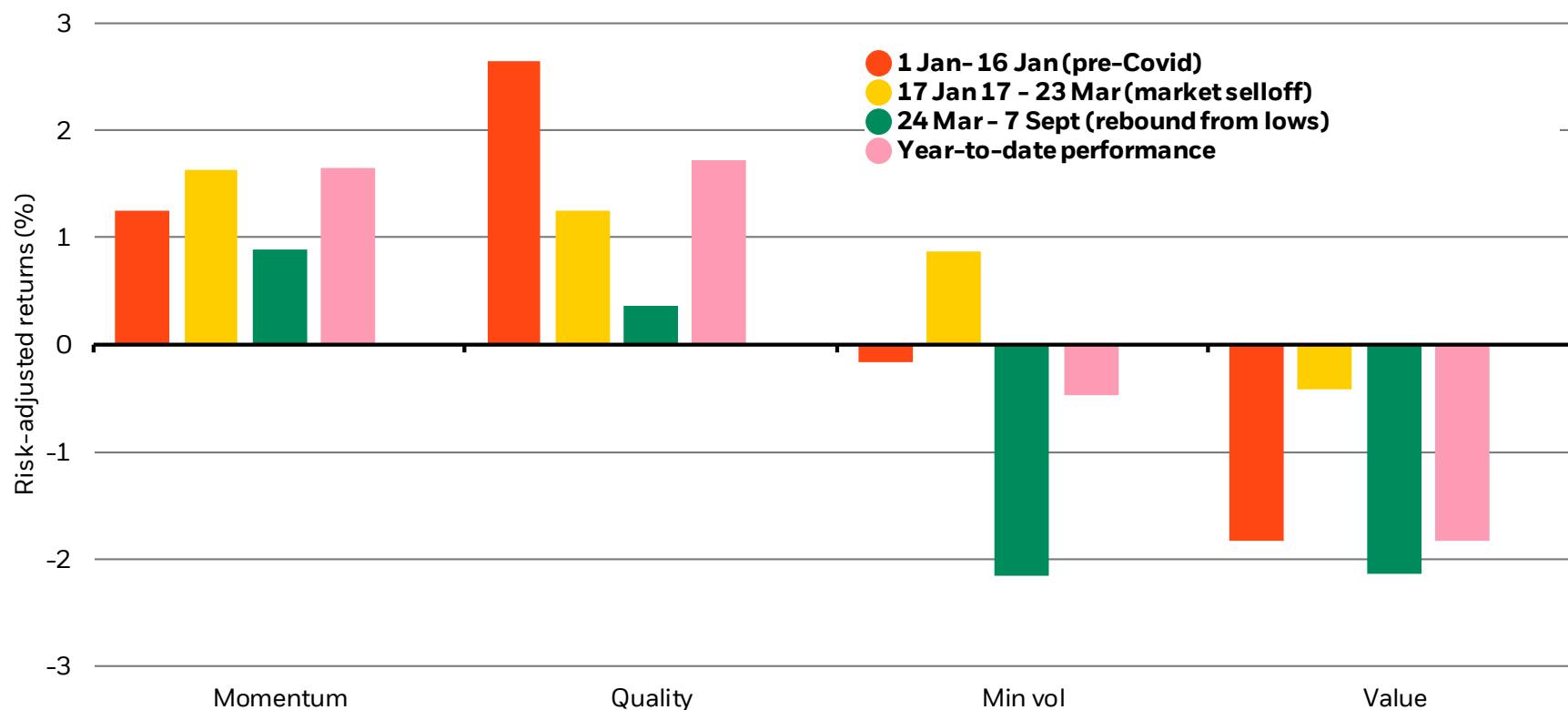
Past performance is not a reliable indicator of current or future results. Indexes are unmanaged and not subject to fees. It is not possible to invest directly in an index.

Sources: BlackRock Investment Institute, data as of 28 September 2020. Notes: The chart shows the performance of EM regions rebased to 100 as of 31/12/2019. Indexes used are: MSCI Emerging Market index, MSCI EM Asia index and MSCI EM ex-Asia index.

We maintain our overweight on the quality factor

We still favor the quality factor for its resilience against a range of economic outcomes. Stretched positioning and dominance of richly valued tech and defensive stocks leave the momentum factor vulnerable to reversals.

Risk-adjusted returns for style factors, 2019-2020



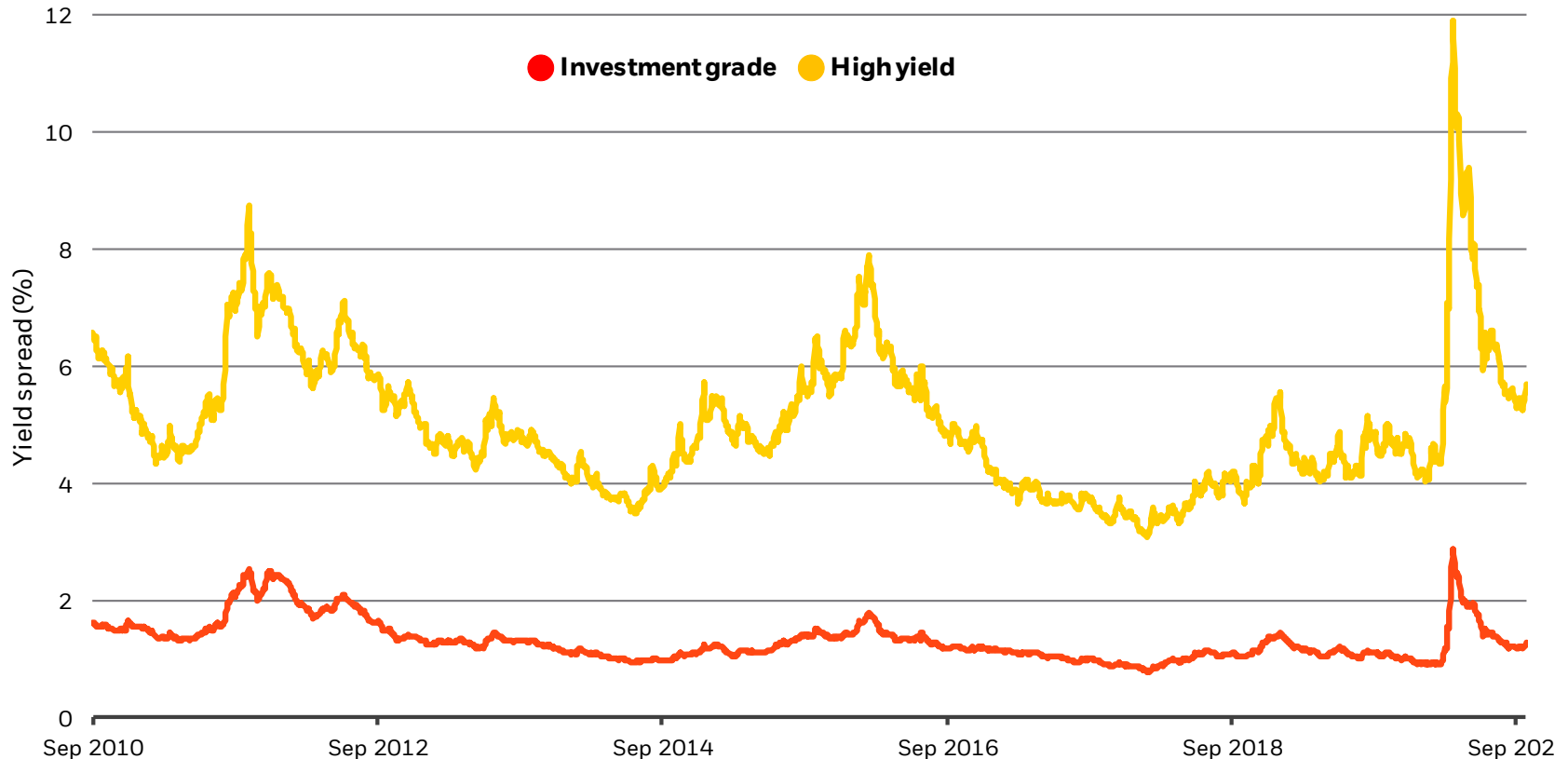
Past performance is not a reliable indicator of current or future results. Indexes are unmanaged and not subject to fees. You cannot invest directly in an index.

Sources: BlackRock Investment Institute, with data from Refinitiv Datastream, September 2020. Notes: The bars show risk-adjusted returns of MSCI World Momentum, Quality, Minimum volatility and Value indexes from 1 Jan 2020 to 19 June 2020. This is split as: 1 Jan to 16 January (Pre-Covid), 17 Jan to 23 March (Covid-19 Market selloff), 24 Mar to 19 June (rebound from the lows) and year-to-date as of 25 Sept 2020. We use the MSCI World Index as the benchmark in this analysis. The risk-adjusted returns are calculated by subtracting a factor index's return for a given period from the total return of the benchmark, then dividing that result by the tracking error, or the standard deviation of the difference between individual index and benchmark returns.

Increasing our tactical overweight on high yield

We see scope for high yield spreads to tighten further as the economic recovery gathers steam. Risk-reward on IG spreads looks less appealing spurring a tactical downgrade of the asset class.

Investment grade and high yield credit spreads, 2010-2020

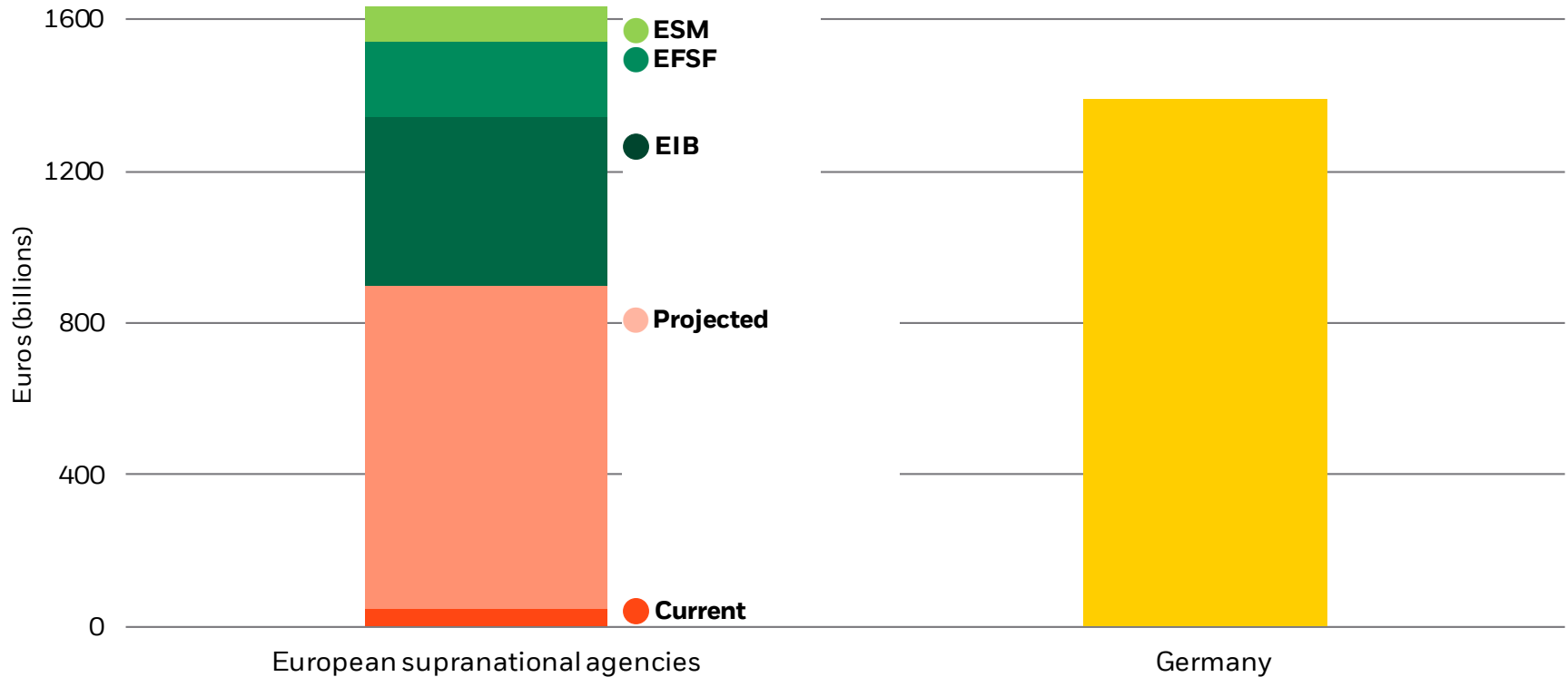


Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index. Sources: BlackRock Investment Institute, with data from Refinitiv, September 2020. Notes: The lines show yield spread of investment grade and high yield credit over the past 10 years, represented by the option-adjusted spread of Bloomberg Barclays Global Aggregate Total Return Index and Bloomberg Barclays Global High Yield Total Return Index.

EU bonds may become a viable complementary asset to bunds

Planned issuance to support the recovery fund and other plans in coming years will likely see the EU become one of the largest single issuers of highly rated, euro-denominated bonds.


Actual and expected volume of outstanding debt from select euro area entities, September 2020



Sources: BlackRock Investment Institute, with data from the European Central Bank, Bloomberg, Haver Analytics, September 2020. Notes: The chart compares the total outstanding debt stock for Germany to that of the cumulative outstanding debt issued by the largest euro area supranational issuers such as the European Investment Bank (EIB), the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM), and to the total current and projected volume of bonds to be issued by the European Union as a single entity. The projected issuance (light orange) comprises the nearly 850 billion euros of funding agreed upon related to the EU's Support to mitigate Unemployment Risks in an Emergency (SURE) loan programme and the Next Generation EU (NGEU) recovery fund.

Tactical granular views

Six to 12-month tactical views on selected assets vs. broad global asset classes by level of conviction, September 2020

Change in view

 Previous → New

Asset	Underweight	Overweight	
Equities	United States		We are neutral on U.S. equities. Risks of fading fiscal stimulus and an extended epidemic are threatening to derail the market's strong run. Renewed U.S.-China tensions and a divisive election are also likely to weigh on the asset class.
	Europe		We are overweight European equities. The region is exposed to a cyclical upside as the economy restarts, against a backdrop of solid public health measures and a galvanizing policy response.
	Japan		We keep Japanese equities at neutral. We see strong fiscal policy and public health measures allowing for rapid normalization.
	Emerging markets		We are underweight emerging market equities. We are concerned about the pandemic's spread and see less room or willingness for policy measures to cushion the impact in many – but not all – countries.
	Asia ex-Japan		We hold Asia ex-Japan equities at neutral. Renewed U.S.-China tension is a risk. China's goal to balance growth with financial stability has led to relatively muted policy measures to cushion the virus fallout.
	Momentum		We keep momentum at neutral. The sectoral composition of the factor provides exposure to both growth (tech) and defensive stocks (pharma). Yet momentum's high concentration poses risks as recovery takes hold.
	Value		We are neutral on value. We see the ongoing restart of economies likely benefiting cyclical assets and potentially helping value stage a rebound after a long stretch of underperformance.
	Minimum volatility		We hold min vol at neutral. The restart of economies is likely to benefit cyclical assets and reduce the need for defensive exposures.
	Quality		We keep our strong overweight on quality. We see it as the most resilient exposure against a range of outcomes in terms of developments in the pandemic and economy.
Fixed income	U.S. Treasuries		We still like U.S. Treasuries. Long-term yields are likely to fall further than other developed market peers, even as low rates reduce their ability to cushion against risk asset selloffs.
	Treasury Inflation-Protected Securities		We are neutral on TIPS. A huge decline in rates makes the entry point less attractive. We still see potential for higher inflation over time and like TIPS in strategic allocations.
	German bunds		We remain underweight bunds as current yield levels provide little cushion against major risk events. Also, potential issuance related to the proposed EU recovery fund could compete with bunds for investment.
	Euro area peripherals		We are overweight euro area peripheral government bonds despite recent outperformance. We see further rate compression due to stepped-up quantitative easing by the European Central Bank and other policy actions.
	Global investment grade		We downgrade investment grade credit to neutral. We see little room for further yield spread compression, as we see deeper rate cuts and more asset purchases as unlikely as a policy response. Central bank asset purchases and a broadly stable rates backdrop still are supportive.
	Global high yield		We increase our overweight on high yield. We see the very high implied default rates as overly pessimistic and believe high yield remains an attractive source of income in a yield-starved world.
	Emerging market – hard currency		We are underweight hard-currency EM debt due to the pandemic's spread, heavy exposure to energy exporters and limited policy space in some emerging economies. Default risks may be underpriced.
	Emerging market – local currency		We have downgraded local currency EM debt to underweight. We see many EM countries as having insufficient capacity to rein in the virus spread and limited policy space to cushion the shock from the pandemic.
	Asia fixed income		We are neutral on Asia fixed income. The pandemic's containment in many countries and low energy exposure are positives. Renewed U.S.-China tensions and China's relatively muted policy fallout are risks.

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.

Appendix

Indexes

Global government bonds = Bloomberg Barclays Global Treasury index

Japan government bonds = Bloomberg Barclays Global Treasury Japan Index

Euro area credit = ICE BofA Merrill Lynch 10+ Year Euro Corporate Index

Global high yield = ICE BofA Merrill Lynch Global High Yield Index

Euro area government bonds = Bloomberg Barclays Euro Aggregate Treasury Index

U.S. credit = Bloomberg Barclays U.S. Credit Index

Global IG credit = Bloomberg Barclays Global Aggregate - Corporate

Inflation-linked bonds = ICE BofA Merrill Lynch Global Inflation-Linked Government Index

Euro area inflation-linked bonds = ICE BofA ML EMU Direct Government Inflation Linked Index

U.S. TIPS = Bloomberg Barclays US Government Inflation-Linked Bond Index

EM debt, local = JP Morgan GBI-EM Index

EM debt, hard = JP Morgan EMBI Global Diversified Index

Japan equities = MSCI Japan index

European equities = MSCI Europe index

DM equities = MSCI World index

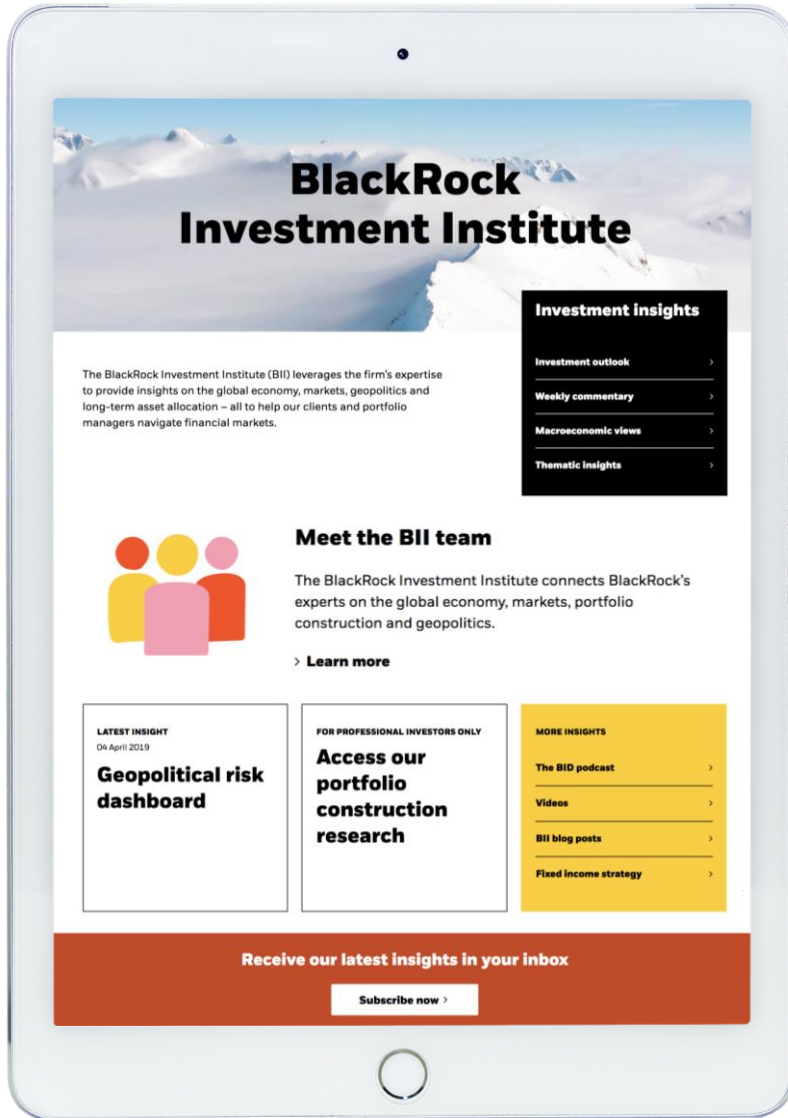
EM equity = MSCI Emerging Markets Index

Onshore Chinese equities = MSCI China A Inclusion NET Index

Private equity = BlackRock proxy

U.S. Real estate = BlackRock proxy

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.



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