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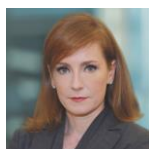
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Key points

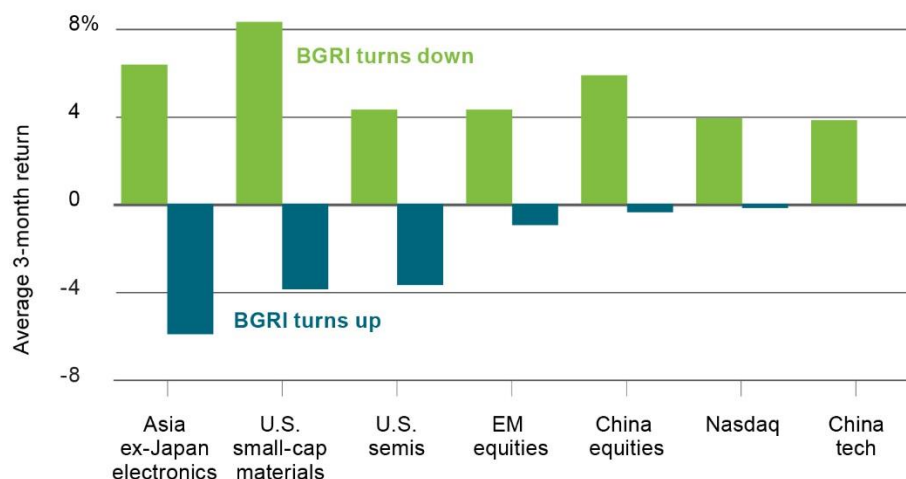
- 1 Assets sensitive to U.S-China relations have gotten a boost on hopes of a rapprochement between the two nations at the G20 summit.
- 2 A rotation out of growth-sensitive sectors and into defensive sectors of global equity markets rolled on. Oil prices slid further.
- 3 Inflation data next week is likely to confirm the divergence between rising prices in the U.S. and a subdued outlook for the eurozone and Japan.

1 Implications of a U.S.-China trade truce

Hopes of a détente in U.S-China relations have risen ahead of a President Donald Trump and President Xi Jinping meeting on the sidelines of the G20 summit. Risky assets most rattled by tit-for-tat trade actions have perked up relative to global markets. Yet we are wary of chasing any near-term bounce. The tussle between the two countries extends well beyond trade issues and is likely to endure, in our view.

Chart of the week

Asset returns around sharp changes in the U.S.-China relations BGRI, 2005-2018



Past performance is no guarantee of future results. Index performance is shown for illustrative purposes only. You cannot invest directly in an index. Sources: BlackRock Investment Institute, with data from Thomson Reuters, November 2018. Notes: The chart shows average three-month returns for selected assets relative to significant three-month changes in the BlackRock Geopolitical Risk Indicator for U.S.-China relations. We split these returns into two buckets: periods when the BGRI rises and falls by more than one standard deviation on a three-month rolling basis. Nasdaq refers to the Nasdaq Composite. All other assets represented by MSCI indexes. Full methodology for the BGRI: <https://www.blackrockblog.com/blackrock-geopolitical-risk-dashboard/?risk=4>.

Our [BlackRock Geopolitical Risk Indicator for U.S./China relations](#) shows that market attention towards risks of a flare-up between the two countries is high. Yet constructive signals from both countries in the run-up to the Trump-Xi meeting in Buenos Aires has pulled the BGRI significantly off its 2018 peaks. Our analysis shows material shifts in the U.S.-China BGRI coincide with large swings in prices of cyclically exposed assets sensitive to this risk, as shown in the chart. Among the myriad factors driving asset prices, political risks have a bigger impact when market attention to them shifts rapidly. Yet we find this relationship tends to be stronger over shorter time horizons. Over longer windows, factors beyond geopolitics reassert themselves to drive market returns.

China in the spotlight

A series of overtures from the U.S. towards several trading partners has taken some of the sting out of escalating global trade tensions. The U.S. investigation into auto imports on national security concerns is still ongoing, yet a convivial meeting between Trump and the EU's Jean-Claude Juncker helped calm fears. A revised trade deal between the U.S., Mexico and Canada will likely go before Congress next year. The U.S. signed a trade agreement with South Korea. Bilateral negotiations with Japan passed without conflict.

China stands apart. The U.S. tussle with China has so far focused primarily on tariffs. The current 10% levy on \$200 billion of Chinese goods imported to the U.S. will rise to 25% in January unless it is halted. And a threat to extend tariffs to all Chinese imports still looms large. Yet we believe trade tensions are just one facet of a competitive phase in U.S.-China relations that is in its early days. The best outcome for risk assets at next week's meeting in Buenos Aires? The U.S. hitting pause on the tariff escalations and a commitment to work toward a broader framework for trade. We believe a temporary truce will not be enough to clear longer-term clouds. Business confidence in China and in pockets of the U.S. has already taken a hit, potentially spurring caution in long-term corporate spending plans. The risk to the downside is stark: A lack of progress in the talks could reignite fears of a devaluation in the Chinese yuan. Assets sensitive to risks of worsening relations – such as broad Chinese equities, Asian tech supply chain stocks and small-cap material shares – could see another leg down.

The real issue for both sides is [the competition to dominate the technologies and industries of the future](#). Thorny relations between the world's largest economies are a source of macro uncertainty – and an important reason for seeking increased portfolio resilience, in our view. We see quality-style equities and short-dated U.S. government bonds as two ways to increase ballast within portfolios. We also look to identify areas of the market that now reflect significant downside risks, such as Chinese and other emerging market equities, where the de-rating in 2018 looks to have created an attractive entry point for long-term investors.

2 Week in review

- The sectoral rotation within global equity markets has persisted since it began in October. High-yielding sectors, such as real estate, telecoms and utilities, outperformed as tech suffered more losses. Low volatility stocks held up while the momentum factor suffered more declines. Oil prices slipped further. Government bonds rallied.
- Preliminary November PMI data broadly underwhelmed. The eurozone composite index hit its lowest since late 2014, confounding hopes of a fourth-quarter rebound. U.S. durable goods orders fell 4.4% month-on-month, the biggest drop in more than a year.
- The UK and the EU agreed a draft declaration on their future relationship post-Brexit. The UK parliament is now set to vote on this alongside the withdrawal deal in early December. The European Commission declared that an excessive deficit procedure against Italy was justified after Rome failed to address Brussels' concerns on its 2019 budget plans. ECB minutes confirmed the central bank will in all likelihood end net asset purchases in December.

Global snapshot

Weekly and 12-month performance of selected assets

Equities	Week	YTD	12 Months	Div. Yield
U.S. Large Caps	-2.9%	-0.9%	2.0%	2.1%
U.S. Small Caps	-2.3%	-2.0%	-0.8%	1.4%
Non-U.S. World	-0.6%	-11.1%	-9.0%	3.5%
Non-U.S. Developed	-0.6%	-10.1%	-7.5%	3.7%
Japan	-1.2%	-8.8%	-6.7%	2.5%
Emerging	-0.6%	-14.0%	-13.2%	3.1%
Asia ex-Japan	-0.9%	-14.2%	-14.2%	2.9%

Commodities	Week	YTD	12 Months	Level
Brent Crude Oil	-4.7%	-5.1%	1.5%	\$63.48
Gold	1.0%	-5.9%	-4.3%	\$1,226
Copper	0.8%	-14.0%	-9.8%	\$6,235

Bonds	Week	YTD	12 Months	Yield
U.S. Treasuries	0.4%	-1.5%	-1.4%	3.1%
U.S. TIPS	0.2%	-2.0%	-1.2%	3.2%
U.S. Investment Grade	0.2%	-3.8%	-3.0%	4.3%
U.S. High Yield	-0.3%	-0.2%	0.3%	7.3%
U.S. Municipals	0.3%	-0.5%	0.0%	3.0%
Non-U.S. Developed	0.3%	-4.1%	-2.8%	1.0%
EM \$ Bonds	-0.6%	-5.9%	-5.2%	7.0%

Currencies	Week	YTD	12 Months	Level
Euro/USD	0.5%	-5.2%	-3.0%	1.14
USD/Yen	-0.5%	0.3%	0.5%	113.06
Pound/USD	0.0%	-5.4%	-3.5%	1.28

Source: Bloomberg. As of Nov. 21, 2018. Notes: Weekly data through Wednesday. 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. Index performance is shown for illustrative purposes only. It is not possible to invest directly in an index. Past performance is not indicative of future results.

3 Week ahead

Nov. 26 Japan manufacturing PMI, Germany IFO business sentiment

Nov. 29 U.S. PCE core inflation, FOMC minutes

Nov. 27 U.S. consumer confidence

Nov. 30 G20 leaders summit, Chinese official manufacturing PMI

Inflation data released this week are expected to confirm the ongoing divergence between price pressures in the U.S. relative to those in the eurozone and Japan. U.S. core PCE inflation is expected to stick close to the Federal Reserve's 2% target. November data for eurozone and the Tokyo metro area should show inflation trends firming up but still falling short of central bank targets. This is consistent with the signal from our [Inflation GPS indicator](#).

Asset class views

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

Asset class	View	Comments
Equities	U.S.	▲ Solid corporate earnings and strong economic growth underpin our positive view. We still like the momentum factor, but have a growing preference for quality as the 2019 macro and earnings outlooks become more uncertain. Technology tops our list of favored sectors.
	Europe	▼ Relatively muted earnings growth, weak economic momentum and political risks are challenges. A value bias makes Europe less attractive without a clear catalyst for value outperformance. We prefer higher-quality, globally-oriented names.
	Japan	— We see a weaker yen, solid corporate fundamentals and cheap valuations as supportive, but await a clear catalyst to propel sustained outperformance. Other positives include shareholder-friendly corporate behavior, central bank stock buying and political stability.
	EM	▲ Attractive valuations, along with a backdrop of economic reforms and robust earnings growth, support the case for EM stocks. We view financial contagion risks as low. Uncertainty around trade is likely to persist, though a lot of it has been priced in. We see the greatest opportunities in EM Asia on the back of strong fundamentals.
	Asia ex-Japan	▲ The economic and earnings backdrop is encouraging, with near-term resilience in China despite slower credit growth. 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	▼ Sustained growth, rising inflation and fiscal stimulus point to ongoing Fed normalization. We still prefer the short end, but longer maturities are starting to look more attractive as we see limited further upside for rates. We see improved valuations on inflation-linked debt adding to its appeal. We find reasonable longer-term value in mortgages, but see short-term challenges as the Fed winds down its mortgage holdings.
	U.S. municipals	— Solid retail investor demand and muted supply are supportive, but rising rates could weigh on absolute performance. We prefer a neutral duration stance and up-in-quality bias in the near term. We favor a barbell approach focused on two- and 20-year maturities.
	U.S. credit	— Sustained growth supports credit, but high valuations limit upside. We favor investment grade (IG) credit as ballast to equity risk. We believe higher-quality floating rate debt and shorter maturities look well positioned for rising rates.
	European sovereigns	▼ Yields are unattractive relative to global peers and vulnerable to the potential of an improving growth outlook. We see core eurozone sovereigns as ballast against ongoing political risks. Peripheral spreads reflect quite a bit of risk. Rising rate differentials have made high-quality European sovereigns more appealing for global investors with currency hedges.
	European credit	— Valuations are attractive, particularly on a hedged basis for U.S. dollar investors. We favor subordinated financial debt, where yields are more attractive. We also prefer European over UK credit as the market is not pricing in a significant Brexit premium. Industrials and financials are favored sectors. Political uncertainty is a concern.
	EM debt	— We prefer hard-currency over local-currency debt and developed market corporate bonds. Slowing supply and broadly strong EM fundamentals add to the relative appeal of hard-currency EM debt. Trade conflicts and a tightening of global financial conditions call for a selective approach.
	Asia fixed income	— Stable fundamentals, cheapening valuations and slowing issuance are supportive. China's representation in the region's bond universe is rising. Higher-quality growth and a focus on financial sector reform are long-term positives, but a sharp China growth slowdown would be a challenge.
Other	Commodities and currencies	* A reversal of recent oversupply is likely to underpin oil prices. Trade tensions add downside risk to industrial metal prices. We are neutral on the U.S. dollar. Rising global uncertainty and a widening U.S. yield differential with other economies provide support, but an elevated valuation may constrain further gains.

▲ Overweight — Neutral ▼ Underweight

*Given the breadth of this category, we do not offer a consolidated view. BIII118U/E-674001-2087735

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