

BlackRock®

2021 global outlook

 BlackRock
Investment
Institute

A new investment order



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We have entered a new investment order. The Covid-19 pandemic has accelerated profound shifts in how economies and societies operate. We see transformations across sustainability, inequality, geopolitics and macro policy. This is reflected in our 2021 investment themes: *The new nominal, Globalization rewired and Turbocharged transformations*. The new investment order is still evolving, and investors will need to adapt. Yet the features are becoming clear, and we believe this calls for a fundamental rethink of portfolio allocations – starting now.

The traditional business cycle playbook does not apply to the pandemic. We see the shock as more akin to that of a large-scale natural disaster followed by swift economic restart. Early in the crisis, we assessed that the ultimate cumulative economic losses – what matters most for financial markets – would likely prove to be a fraction of those seen in the wake of the global financial crisis (GFC).

This view was conditional on robust policy support to tide households and businesses through the income shock. The early results of Covid-19 vaccine trials give us greater confidence in this framework. They suggest the economic restart can re-accelerate significantly in 2021 as pent-up demand is unleashed. We believe markets will likely be quick to price in a full economic restart given the improved visibility on the outlook.

The U.S. and Europe face challenges in the very near term: A resurgence of virus cases may result in outright economic contraction. Risks of policy fatigue are rising, especially in the U.S., and ongoing policy support is vital to limit any permanent economic scarring. Yet positive vaccine news is a game changer in that we now know we are building a bridge to somewhere, providing clarity for policymakers, companies and markets about getting to a post-Covid stage.

As a result, we favor looking through any near-term market volatility. We increase our overall pro-risk stance by upgrading equities on a tactical basis, and take a sectoral approach. We like tech and healthcare due to the pandemic’s transformative shifts. We balance this with a preference for prime potential beneficiaries of the economic restart, such as emerging market (EM) equities and U.S. small caps. We overweight Asia ex-Japan equities and Asia fixed income on the region’s effective virus response, and favor assets exposed to Chinese growth.

The policy revolution has big implications for our strategic views as we see a more muted response of nominal yields to a higher inflation regime. Central banks appear committed to limit any rises in nominal yields even as inflation picks up. Investors will need a new playbook to navigate this. We underweight government bonds and maintain a higher strategic allocation to equities than in typical periods of rising inflation. Sustainability is a key component of our views as we see a tectonic shift to sustainable assets playing out over decades. Contrary to past consensus, we expect this shift to help enhance returns. Private market exposures are one way to pursue portfolio resilience with a sustainable lens.

A new investment order

We held our virtual 2021 Investment Outlook Forum at a critical juncture: in the midst of an intensifying pandemic and right after a historic U.S. election. Our debates focused on transformations taking place across four dimensions:

First, Covid-19 has put a spotlight on underappreciated environmental, social and governance (ESG) factors such as employee safety, while support for combating climate change has swelled amid extreme weather events. Second, rising income, wealth and racial inequalities are fueling dissatisfaction with the status quo, and could drive tax increases for the wealthy and higher minimum wages – as well as threats to central bank independence.

Third, Covid has accelerated geopolitical trends such as a bipolar U.S.-China world order and a rewiring of global supply chains. We don't see this as deglobalization – it is more about the world adapting to this new order. Lastly, the unprecedented cooperation between fiscal and monetary authorities has upended the policy landscape. We see no political appetite for fiscal austerity, even as debt ratios hit historic highs globally. The politics of inequality will likely keep deficit spending high.

New central bank policy frameworks are likely to keep interest rates low – even in the face of rising inflation. And we are already seeing signs of a risk that central banks become more politicized in the new investment order.

This comes as we expect rising production costs amid a focus on supply chain resilience and greater pricing power of large companies in this environment. Taken together, we believe markets underappreciate inflation risks – and that the coming higher inflation regime will be very different from the reflation debates of the last expansion.

This has significant implications for strategic asset allocations. Key components include a rethink of the role of nominal developed market (DM) government bonds, given the implications of the policy revolution: a drop in real yields. That implies – unusually in a more inflationary environment – a favorable backdrop for equities as discount rates are contained by policy. It also means a preference for inflation-protected bonds. We acknowledge these are big calls with much uncertainty – and we will be tracking them closely in the years ahead.

The new nominal

We see stronger growth and lower real yields ahead as the vaccine-led restart accelerates and central banks limit the rise of nominal yields – even as inflation expectations climb. Inflation will have different implications to the past.

Strategic implication: We underweight government bonds and see equities supported by falling real rates.

Tactical implication: Our low rate outlook keeps us pro-risk. We like U.S. equities and prefer high yield for income.

Globalization rewired

Covid-19 has accelerated geopolitical transformations such as a bipolar U.S.-China world order and a remaking of global supply chains – placing greater weight on resilience and less on efficiency.

Strategic implication: We favor deliberate country diversification and above-benchmark China exposures.

Tactical implication: We like EM equities, especially Asia ex-Japan, and are underweight Europe and Japan.

Turbocharged transformations

The pandemic has added fuel to pre-existing structural trends such as an increased focus on sustainability, rising inequality within and across nations, and the dominance of e-commerce at the expense of traditional retail.

Strategic implication: We prefer sustainable assets amid a growing societal preference for sustainability.

Tactical implication: We take a barbell approach, favoring tech and healthcare as well as selected cyclical exposures.

Macro landscape

Restart and reset

The timing of effective and widely available Covid-19 vaccines will be a key driver of the restart – particularly in the face of increased risks to U.S. fiscal stimulus needed to sustain households and businesses through the virus shock. Encouraging news on the vaccine front strengthens our base case of a full restart by late 2021.

The vaccine game changer is knowing we are building a bridge to somewhere. It provides more clarity for governments, companies and households about the shape of a post Covid-19 economy. This anchor should help limit any economic scarring and justify deploying further policy support. All this should make it easier for risk assets to absorb any near-term disappointments but also to quickly price in the accelerated restart, in our view.

The restart faces challenges in the near term as rising hospitalizations and fatalities trigger renewed lockdowns. See our [Covid tracker](#) for pandemic and activity trends. The euro area economy may now contract in the fourth quarter, with the U.S. close behind.

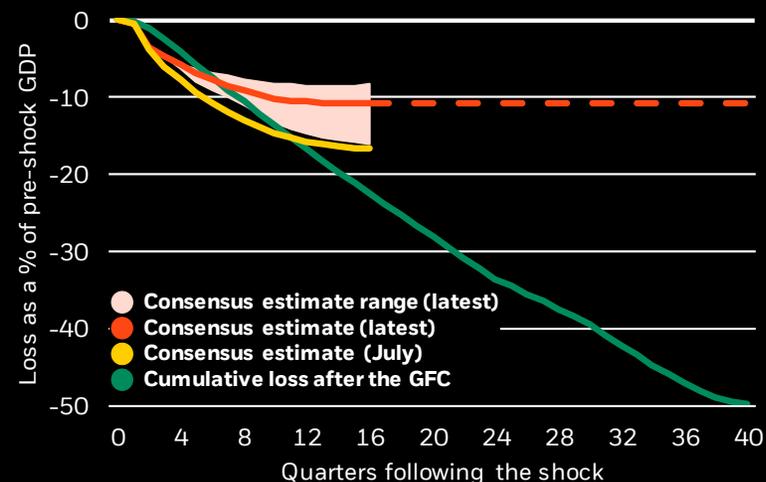
This setback would not materially increase the ultimate GDP shortfall from pre-virus levels, in our view. Consensus growth estimates suggest the shortfall – what ultimately matters for financial markets – is now on track to be a fraction of the post-GFC one and smaller than what had been expected in July. See the chart.

Traditional business cycle analysis doesn't apply in the wake of the Covid shock, in our view. We see it as akin to a natural disaster, which is typically followed by rapid economic restart with little permanent economic damage, and expect it to speed up structural changes. This is very different from the 2008 crisis, which was followed by a "lost decade" of deleveraging and declining trend growth.

This view underpins the upgrade to our overall pro-risk stance, reflected in a new tactical overweight in equities. It includes overweights in selected cyclical exposures such as U.S. small caps, and EM and Asia ex-Japan equities. We also underweight investment grade credit to fund a tilt toward more cyclical exposures such as high yield and Asia fixed income.

A less severe shortfall

U.S. GDP shortfall after the GFC vs. estimated loss from the Covid shock



Sources: BlackRock Investment Institute, with data from Reuters News, November 2020. Notes: The green line shows the cumulative economic loss, or the difference between estimated U.S. nominal GDP at the time and where it would have been had it grown at its pre-GFC trend level (3.4% a year) from end-2007 onwards. The solid orange line shows the latest estimates of the cumulative economic loss from the Covid-19 shock, measured from a starting point of end-2019 and assuming pre-crisis trend growth of 3.35% (a 20-year pre-Covid average). GDP estimates reflect the median from a Reuters poll of economists published on Sept. 25, 2020. Poll data are only available for 16 quarters. We assume a return to trend growth after this time (orange dotted line). The yellow line shows the cumulative loss estimates as of July 2020. For illustrative purposes only. There is no guarantee that any forecasts made will come to pass. The hypothetical scenario is subject to significant limitations as the pandemic is evolving and we are still trying to understand the potential for more extensive activity shutdowns.

The vaccine game changer is knowing we are building a bridge to somewhere. It provides more clarity for households, companies and governments on getting to a post Covid-19 economy.

Theme 1

The new nominal

The “new nominal” is not simply about our expectation for a higher inflation regime in the next five years. It means stronger growth in the near term, and eventually higher inflation - without the typical rise in nominal bond yields. As a result, we see very different market implications than in the past. Previous episodes of rising inflation were costly for investors, leading to higher interest rates that pressured valuations across asset classes via rising discount rates. Yet the policy revolution means any rise in inflation from today’s levels will be better for risk assets than in past episodes, in our view.

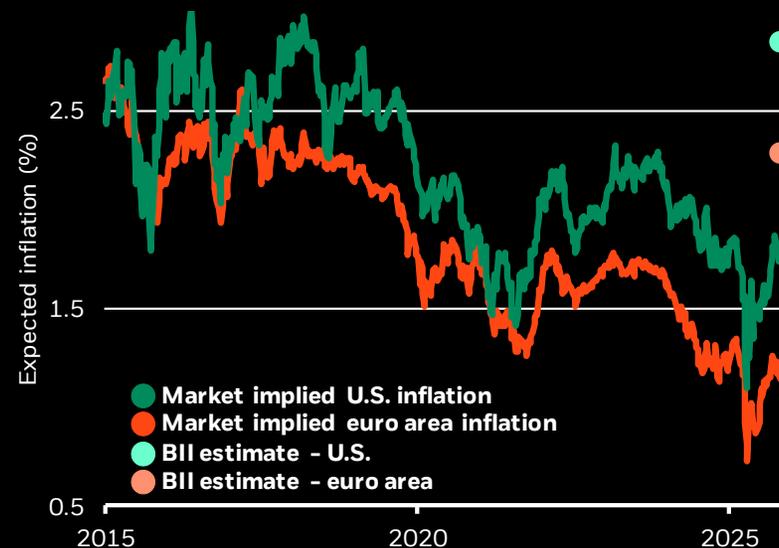
Central banks have signaled they will be more willing to let economies run hot with above-target inflation by changing their policy frameworks to make up for prior inflation undershoots. At the same time, the fiscal-monetary policy revolution – a necessary response to the Covid-19 shock – risks greater political constraints on central banks’ ability to lean against inflation. We see central banks likely curbing nominal yield rises to prevent an unwanted tightening of financial conditions.

We see other reasons for higher inflation, as detailed in [Preparing for a higher inflation regime](#). Production costs look set to rise on the rewiring of global supply chains, while we see scope for companies to exert their pricing power to protect profit margins. Corporate cost cutting may mitigate inflationary pressures in the near term. But even the moderately higher inflation in our base case – around 2.5-3% annually – would surprise markets after a decade of undershoots. See the [Under-appreciated inflation risks](#) chart.

DM government bonds in portfolios are challenged; with yields near effective lower bounds and central banks limiting yield rises even as growth picks up, we believe they will be less effective as portfolio diversifiers. Real yields look to be headed lower – one reason why we favor inflation-linked securities on a strategic basis. Importantly, we believe *The new nominal* of constrained nominal bond yields will support risk assets. As a result, we are tactically more pro-risk and maintain a higher strategic allocation to equities than we would if higher inflation were to have its historical impact on nominal yields.

Underappreciated inflation risks

BlackRock forward inflation estimates vs market pricing, 2015-2025



Forward-looking estimates may not come to pass. Sources: BlackRock Investment Institute and the Federal Reserve with data from Refinitiv Datastream, November 2020. Notes: The chart shows market pricing of expected average inflation over the coming five-year period. 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 lines are shifted forward five years. The orange and green dots show our current estimate of average U.S. CPI and euro area inflation for the same five-year period of 2025-2030. Euro area refers to all 19 member states.

History suggests inflation risk is highest when low-inflation conviction is the strongest – and the view is entrenched in intellectual and policy frameworks.

Theme 2

Globalization rewired

Covid-19 has accelerated geopolitical trends such as a bipolar U.S.-China world order and a rewiring of global supply chains for greater resiliency – with less priority on efficiency.

Strategic U.S.-China rivalry looks here to stay, with competition and bifurcation in the tech sector at its core. We are likely to see an increased emphasis in both countries on seeking self-sufficiency in critical industries of the future. China is looking to master foundational technologies such as semiconductors, in which it has traditionally lagged the U.S.

This is why we believe investors need exposure to both poles of global growth. We may see a changing U.S. emphasis on the relationship with China: more focus on climate and human rights and less on the bilateral trade deficit. This is not a simple story of deglobalization as China is opening up its capital markets to global investors.

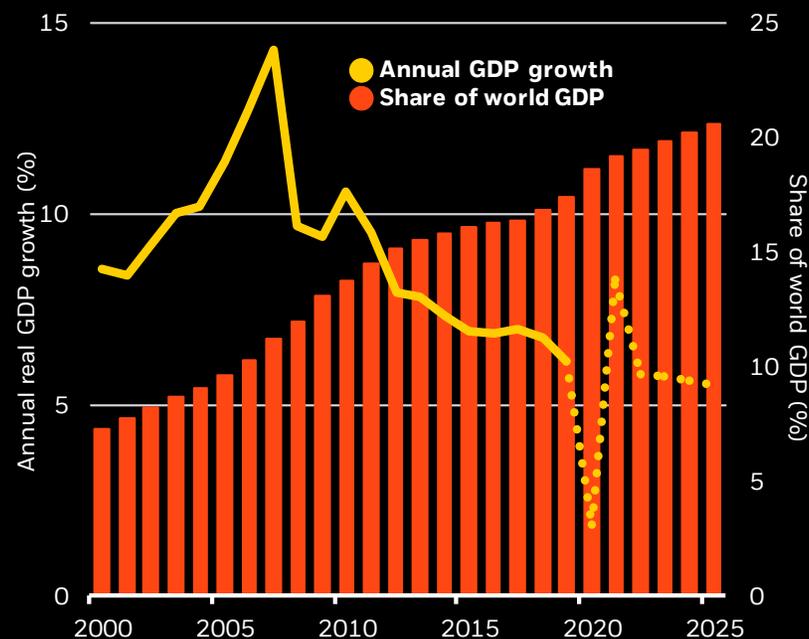
China's share of global GDP has been steadily growing even as its growth has slowly trended down as the economy matures. Growth now is on track to return to its pre-virus trend, just as it bounced back quickly in the post-GFC period. See the *China's growing share* chart.

We see assets exposed to Chinese growth as core strategic holdings that are distinct from EM exposures. There is a clear case for greater portfolio allocations to China-exposed assets for returns and diversification, in our view. We expect persistent inflows to Asian assets as many global investors remain underinvested and China's weight in global indexes grows.

Risks to China-exposed assets include China's high debt levels, yuan depreciation and U.S.-China conflicts. But we believe investors are well compensated for these. How to implement such exposures will depend on investor constraints, including political and legal ones.

China's growing share

China annual growth and share of world GDP, 2000-2025



Sources: BlackRock Investment Institute and the International Monetary Fund (IMF), with data from Haver Analytics, December 2020. Note: The yellow line shows China's annual real GDP growth rate. The dotted lines are IMF forecasts. The orange bars show China's past and expected share of global GDP. There is no guarantee any forecasts made will come to pass.

We see China as a distinct pole of global growth – and as an investment destination separate from emerging markets.

Theme 3

Turbocharged transformations

Covid-19 has acted as a great accelerator of structural trends that were already in place – an increased focus on sustainability; widening wealth, income and health inequality; and the dominance of e-commerce.

The pandemic has focused attention on underappreciated sustainability-related factors and supply chain resilience. The euro area, for example, is putting green infrastructure and digitalization spending at the center of its economic restart efforts – helping speed up the transition to a low-carbon economy.

The pandemic has heightened the focus on inequalities within and across countries due to the varying quality of public health infrastructure – particularly across EMs – and access to healthcare.

And Covid-19 has hastened the dominance of e-commerce and the demise of struggling brick-and-mortar retailers. See *the Shopping from home* chart.

The pandemic has accelerated “winner takes all” dynamics that have led a handful of tech giants to dominate equity market index performance in recent years.

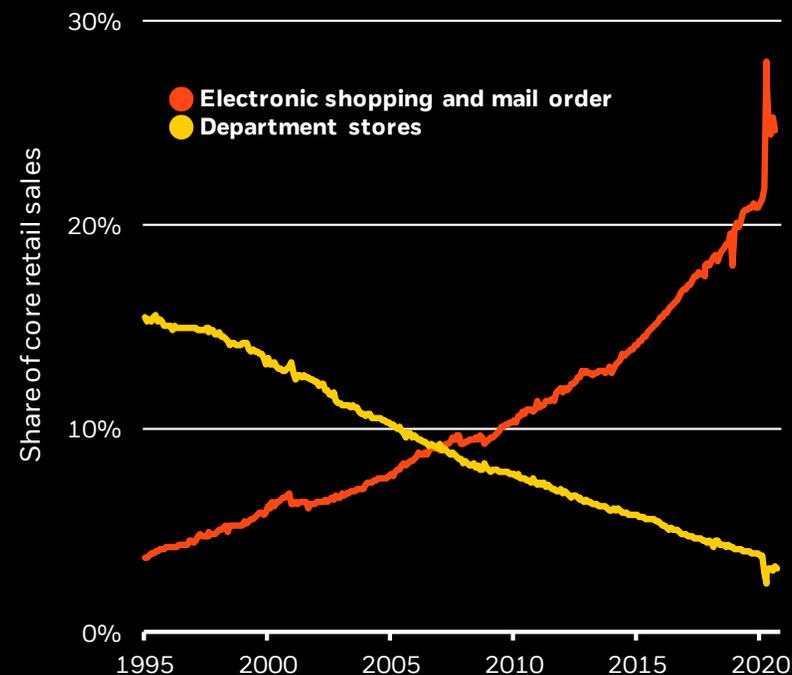
Despite this year’s runup in valuations, we see tech exposures as having long-term structural tailwinds. The quality factor, U.S. equities and Asia ex-Japan equities are ways of gaining such exposure.

Sped-up transitions also support our strategic preference for sustainable assets as portfolio building blocks. We see persistent flows into sustainable assets in the long transition to a less carbon-intensive world (see page 11).

Accelerating structural changes should trigger a wholesale reassessment of the strategic portfolio, rather than just a tweaking at the edges, in our view. We believe asset class diversification alone is not going to be sufficient: Granular analysis at the country, sector and security level is crucial.

Shopping from home

Share of U.S. core retail sales, 1995-2020



November 2020. Notes: The lines show U.S. electronic shopping and mail order and department stores retail sales as a share of core retail sales (retail sales excluding building materials, autos, gas stations and food).

The pandemic has acted as a great accelerator of structural trends such as a rising focus on sustainability and the dominance of e-commerce.

Forum focus

Bottom-up views

The Covid-19 shock is creating winners and losers across sectors. We bucket companies into three categories using a bottom-up framework: those in trouble that may fall further; those that are hurt but should recover; and strong companies getting even stronger.

Airlines are in the first bucket. Business travelers account for a disproportionate share of profits. And business travel may recover more slowly than leisure activity as many companies have discovered they can save costs by holding events virtually.

Housing, materials and autos fall in our middle bucket. Most were hit hard in the initial market selloff, but they have been among the biggest market surprises as the interest rate-sensitive parts of the U.S. economy came roaring back.

Tech is in the third category, and we see it maintaining its strengths: leveraging accelerated trends and offering scarce growth amid rock-bottom yields. The sector boasts the highest profit margins in the global equity universe. See the *Not all sectors are created equal* chart.

These high margins should stay intact amid low rates, we believe. Our base case of a divided U.S. government would make tax increases unlikely. And many technological trends, such as cloud computing, online advertising and digital payments, are still in early stages of adoption, leaving a long runway for growth ahead.

The concentration of recent market gains in tech is a risk. Yet we see potential for leadership within the sector to broaden to a wider set of beneficiaries across different themes, including 5G connectivity. Software and semiconductors could lead the charge, as they face fewer regulatory risks and enjoy long-term growth trends.

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E-commerce penetration is probably 2-3 years ahead of where anyone expected it to be.”

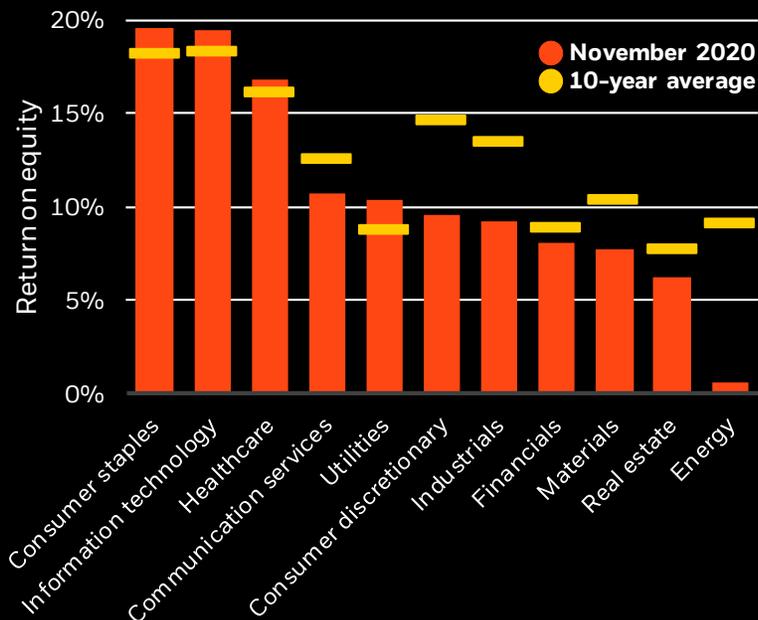


Sarah Thompson

Team member – Global Allocation

Not all sectors are created equal

MSCI All-Country World equity sector return on equity, November 2020



Past performance is no guarantee of future results. Indexes are unmanaged and do not account for fees. It is not possible to invest directly in an index. Sources: BlackRock Investment Institute with data from MSCI and Refinitiv, November 2020. Notes: The chart shows the return on equity by sector of the MSCI All-Country World Index as of November, compared with its 10-year average.

We see the tech sector maintaining its strengths – benefiting from accelerated trends and offering scarce growth amid rock-bottom yields.

Forum focus

Geopolitics

U.S. President-elect Joe Biden faces an ongoing pandemic, a weakened economy and a deeply polarized country. A Democratic Senate is not our base case: Democrats need to win two Georgia seats in a January 5 runoff election – and as of early December polls suggested both races are toss-ups.

Policy under a divided government – if Republicans retain control of the Senate – would have to reflect compromise rather than sweeping change, in our view. Big-ticket legislation – including large-scale fiscal stimulus and public investment, would face hurdles. Yet there may be some room for bipartisan compromise on issues such as R&D spending to meet the technology challenge from China.

The chief geopolitical implication is a more predictable U.S. approach to trade, foreign affairs, and working with allies. Tensions with Europe, particularly over trade, will likely ease. Reduced trade tensions and U.S. support for multilateral debt relief efforts should help EMs. Market attention to geopolitical risk has eased from 2018 peaks, as the *A less tense world* chart shows.

Climate looks set to play a central role in U.S. foreign policy, as flagged by the naming of former Secretary of State John Kerry as U.S. climate envoy, and a planned rejoining of the Paris Agreement on climate change.

We expect to see U.S. support for continued peacebuilding between Israel and Arab nations. The Biden administration looks set to launch a diplomatic effort to rejoin the Iranian nuclear deal, although a recent rise in tensions may complicate this. U.S.-China relations will continue to be marked by intense rivalry, particularly in the tech sector, in our view. Frictions may extend to the financial arena and human rights, even as we see room for the countries to cooperate on climate and public health policies.

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We see a more traditional U.S. leadership approach, reflecting a focus on allies and a return to multilateralism.”

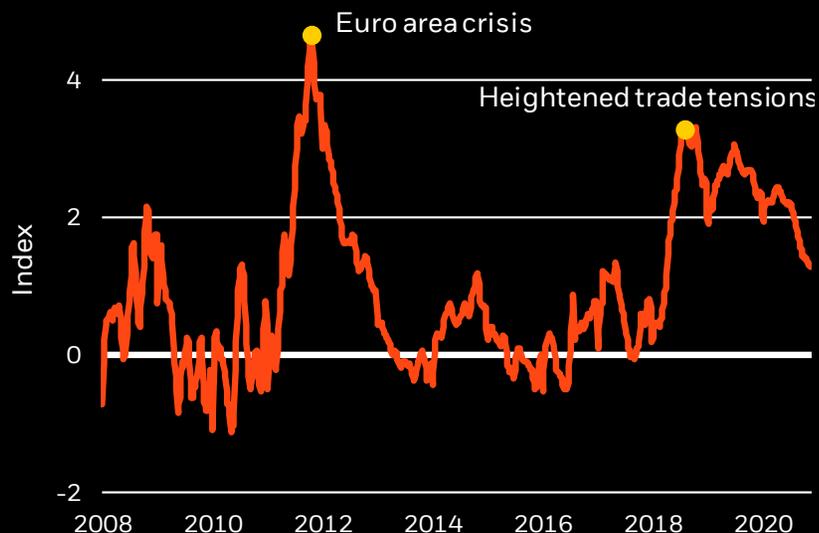


Tom Donilon

Chairman – BlackRock Investment Institute

A less tense world

BlackRock Geopolitical Risk Indicator, 2008-2020



Source: BlackRock Investment Institute, with data from Refinitiv. Data as of Nov. 13, 2020. Notes: We identify specific words related to geopolitical risk in general and to our top risks. We then use text analysis to calculate the frequency of their appearance in the Refinitiv Broker Report and Dow Jones Global Newswire databases. We then adjust for whether the language reflects positive or negative sentiment, and assign a score. A zero score represents the average BGRI level over its history. A score of one means the BGRI level is one standard deviation above the five-year average. We weigh recent readings more heavily in calculating the average.

We are likely to see a more predictable U.S. approach to foreign affairs and trade policy, benefiting export-driven emerging markets.

Forum focus

Emerging markets

The powerful stimulus delivered by developed market central banks has supported emerging markets. The policy revolution implies that it will remain in place for longer – even as inflation starts to rise. We believe this should underpin investment flows into EMs, drawn by the allure of coupon income in a yield-starved world. EMs also stand to benefit from a cyclical global uptick in 2021 – and more predictable U.S. trade policy under the Biden administration. These factors support our tactical overweight in EM equities and our upgrade of EM local and hard currency debt to neutral.

Yet differentiation between and within countries is key in such a disparate asset class. There are significant vulnerabilities that have been exacerbated by the pandemic. Much of the EM world faces structural growth challenges and rising debt levels. Some EM countries may face a day of reckoning over the next few years, in our view. We see this leading to greater dispersion in returns: EMs with stronger fundamentals may disproportionately benefit.

This is already playing out. Countries that sport the worst fiscal deficits have seen large currency depreciations. Asian currencies backed by stronger fundamentals have been more resilient. See the *EM winners and losers* chart. A stable to weaker U.S. dollar – the result of declining real yields and renewed global risk appetite, should underpin EMs in 2021, in our view.

We recognize the need for nuance because of the complexities of EM as an asset class. The lines between developed and emerging markets are also starting to blur. China and some other Asian countries have largely contained the virus – and are further ahead in the restart. This underpins our preference for Asia ex-Japan equities.

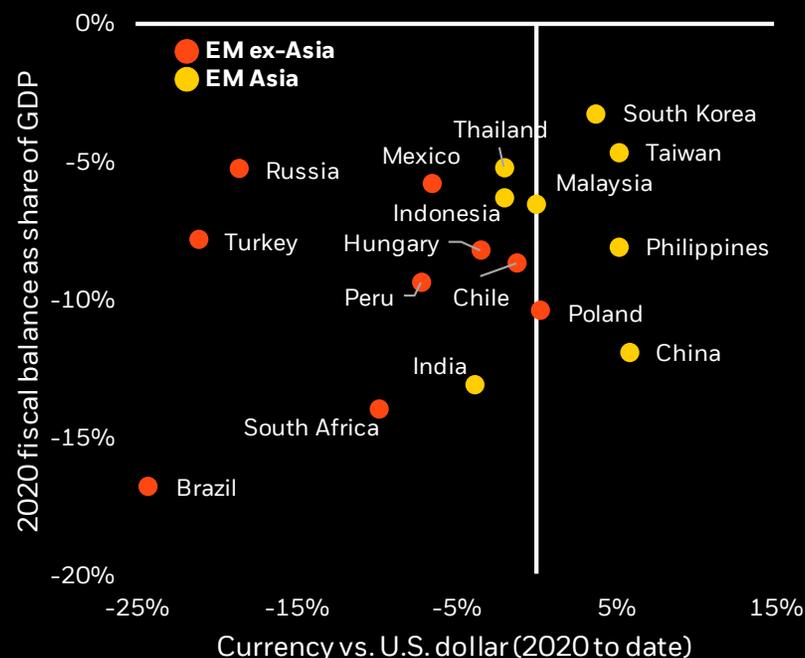
“The lines between EM and DM have blurred, and there are many shades of grey in the EM space.”



Sergio Trigo Paz
Head of Emerging Markets Fixed Income

EM winners and losers

EM government fiscal balance and currency performance, 2020



Sources: BlackRock Investment Institute and the International Monetary Fund, with data from Refinitiv, November 2020. Notes: The chart shows the top-20 countries in the MSCI Emerging Markets Index, excluding those with currencies pegged to the U.S. dollar. The 2020 government fiscal balances are IMF estimates. Yellow dots are Asian economies; orange are other EM.

Ample global liquidity and the prospect of a cyclical upswing bode well for EMs in 2021, but fundamental fault lines make differentiation within and across countries crucial.

Strategic views

Sustainability

We have reached an inflection point in sustainability. The European Union and China recently released more ambitious targets for reaching net-zero emissions. This will require major investment to make the green transition happen.

The tectonic shift toward sustainability is reflected in shifting preferences and flows into sustainable assets. Our view is that this trend will play out over decades, as detailed in [Sustainability: the tectonic shift transforming investing](#) of February 2020. This is why sustainability has become a key component of how we think about investing – and we are incorporating it into our return expectations across asset classes.

Many argue that a costly green transition will weigh on growth, yet we believe this framing is misguided. The reason: We expect extreme weather and other effects of climate change to reduce potential growth in future decades. Efforts to mitigate the damage from climate change should boost economic growth relative to this new baseline.

We see carbon efficiency – or the volume of carbon emitted as a share of firm value – as a key differentiator that will drive a repricing across sectors and companies. See the *Seeing green* chart. High emitters may face regulatory penalties, higher taxes and financing costs. Companies that use carbon most efficiently will likely have greater resilience against risks such as carbon taxes and enjoy richer valuations as investor preferences shift toward sustainable assets.

Does sustainable investing mean giving up returns? This may become true eventually once “green” assets trade at a premium and “brown” ones at a discount. But we see a long transition period over which green assets can potentially outperform.

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This shock is a dress-rehearsal for disasters like those seen with climate change. Politics may listen more to science.”

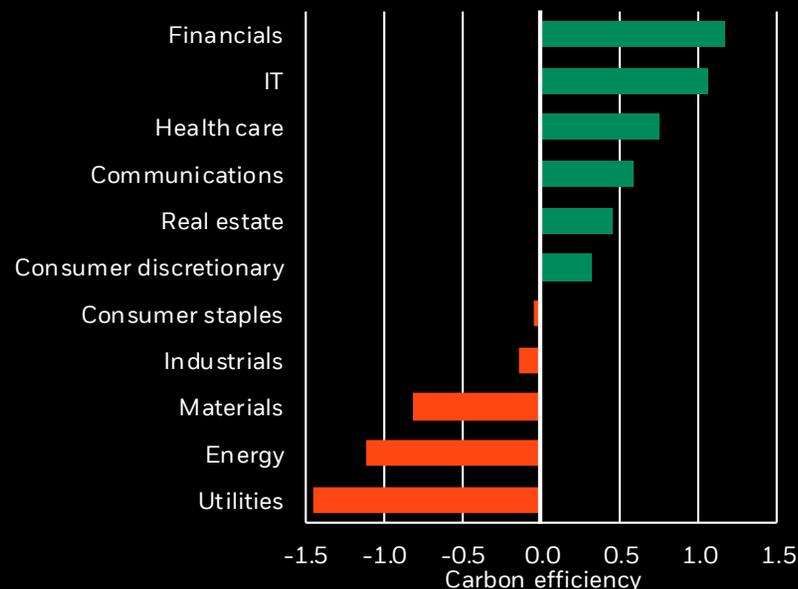


Carole Crozat

Head of Thematic Research – BlackRock Sustainable Investing

Seeing green

Estimated carbon efficiency for MSCI sectors, December 2020



Indexes are unmanaged and do not account for fees. It is not possible to invest directly in an index. Sources: BlackRock Investment Institute with data from Refinitiv Datastream and MSCI, November 2020. Notes: The chart shows the carbon efficiency – measured as total carbon emissions relative to the aggregate firm value – for the sectors of the MSCI USA index. The carbon efficiency measure is shown in Z-score terms. Both Scope 1 (direct emissions from owned or controlled sources) and Scope 2 (indirect emissions from electricity purchased) are considered. These can help gauge the exposure of companies to carbon pricing initiatives as part of climate change mitigation policies.

The debate about sustainable investing has broadened. Rather than talking about trade-offs, we are focused on return potential and alpha.

Strategic views

Private markets

Many companies may need to turn to private credit to restructure for a post-Covid world. We see potential for such investments to serve as growth assets and diversifiers. Private markets are relatively illiquid and not suitable for all investors but play a key role in strategic portfolios, in our view.

The scale of restructuring needs could exceed the previous peak after the GFC. The amount of sub-investment grade debt outstanding has more than doubled to U.S. \$5.3 trillion since 2007, as the *Restructuring opportunities* chart shows. Private credit has been an especially fast-growing segment.

As debt markets grew and the overall cost of debt fell, companies became increasingly leveraged. This has left many vulnerable as revenues come under pressure from Covid-related disruptions. This creates opportunities for restructuring and distressed debt specialists. It is vital to pick private market managers who can assess credit risk and structure resilient investments. Restructurings typically involve complex negotiations between creditors.

Many institutional investors remain under-invested in private markets, we believe, and may underappreciate their ability to take on liquidity risk. We see private markets playing an important role in portfolio resilience in a world where government bonds may no longer serve as diversifiers. They allow investors to build exposures to underlying trends not always available in public markets.

We also find that alpha opportunities can be greater in private markets than public markets. Such alpha can possibly be achieved by managers who have the ability to negotiate stronger debt covenants. So the return potential is not just about taking higher risk to receive higher returns, in our view.

“We see a historic opportunity for the private markets to fund post-Covid restructuring.”

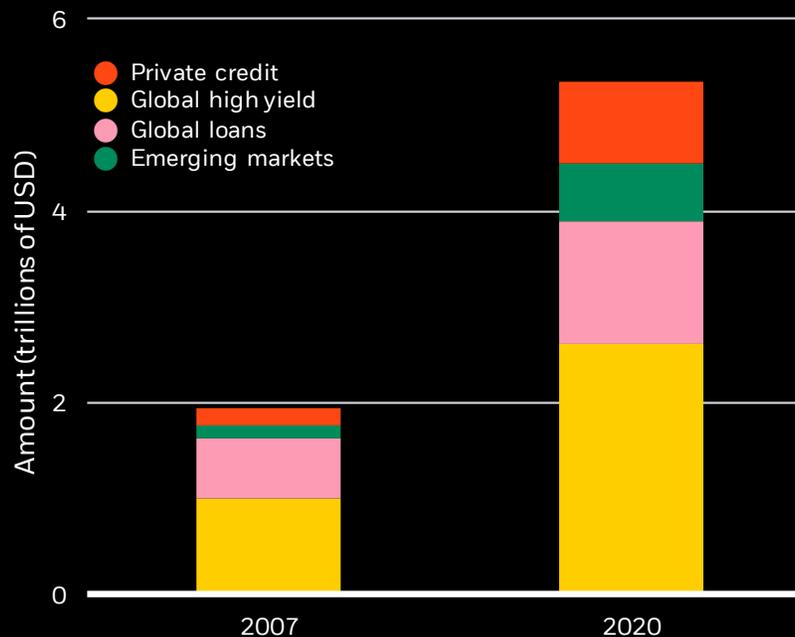


Mark Everitt

Head of Investment Research and Strategy – BlackRock Alternative Investors

Restructuring opportunities

Sub-investment grade debt outstanding, 2007 and 2020

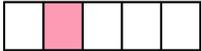


Sources: BlackRock Investment Institute, October 2020. Notes: Private credit data are from Preqin. Indexes used are Bloomberg Barclays Global High Yield Index, S&P/LSTA Leveraged Loan Index + S&P European All Loans Index, and JP Morgan CEMBI Index (emerging markets). Index data are as of June 30, 2020, and the private credit data as of Dec. 31, 2019. Indexes are unmanaged and do not account for fees. It is not possible to invest directly in an index.

We see private markets playing an important role in portfolio resilience in a world where government bonds may no longer serve as diversifiers.

Directional views

Strategic (long-term) and tactical (6-12 month) views on broad asset classes, December 2020

Asset	Strategic view	Tactical view
Equities	 <p>Neutral</p>	 <p>+1</p> <p>We are neutral on equities on a strategic horizon given increased valuations and a challenging backdrop for earnings and dividend payouts. We tilt toward EM equities. Tactically, we have upgraded equities to overweight as we expect the restart to re-accelerate and rates to stay low. We like a barbell approach: quality stocks balanced with selected cyclical exposures.</p>
Credit	 <p>Neutral</p>	 <p>+1</p> <p>We are 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 see the economic restart and ongoing policy support helping credit perform, even amid tighter yield spreads and the wind-down of some emergency credit support.</p>
Govt Bonds	 <p>-1</p>	 <p>Neutral</p> <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 policy accommodation suppresses yields.</p>
Cash		 <p>Neutral</p> <p>We are neutral and use cash to fund overweights in equities and credit. Holding some cash makes sense, in our view, as a buffer against the risk of supply shocks that could drive both stocks and bonds lower.</p>
Private Markets	 <p>Neutral</p>	<p>Non-traditional return streams, including private credit, have the potential to add value and diversification. Our neutral view is based on a starting allocation that is much larger than what most qualified investors hold. Many institutional investors remain underinvested in private markets as they overestimate liquidity risks, in our view. Private markets are a complex asset class not suitable for all investors.</p>

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Directional views

Adding to risk in 2021

We are turning more pro-risk tactically in 2021 by adding equities to our overweight in credit as we see the economic restart re-accelerate. The equity risk premium looks reasonable to us – and lower real rates may allow it to compress further, supporting valuations. We advocate a balanced approach. We like tech companies with structural tailwinds, as expressed in the quality factor. We see such exposures providing resilience early in the new year, particularly if fiscal support disappoints or vaccine rollouts are delayed. We also favor selected cyclical exposures that we see thriving as the timeline for widespread vaccine deployment advances.

On a strategic horizon, the policy revolution and our view of higher inflation over the medium term warrant a rethink of government bond allocations. We see nominal bond yields as staying relatively rangebound, further diminishing the role of government bonds as portfolio ballast. We prefer inflation-linked bonds. Importantly, we maintain a higher allocation to equities than we would in typical periods of rising inflation. The policy revolution has diminished the risk of a rapid rise in discount rates hitting valuations across asset classes. We like sustainable assets as the tectonic shift toward sustainability is just getting started. We also see a greater role for China-exposed and private market assets for yield, potential appreciation and exposure to unique growth trends.

Tactical views

Barbell approach

Our expectation for an accelerated economic restart in 2021 underpins a pro-risk stance. Which risk exposures are likely to lead to outperformance in the new year? We advocate a barbell approach.

On the one hand, we like U.S. equities, Asia ex-Japan and tech companies tied to structural growth trends. These exposures have a quality bias – and we see them as resilient to potentially volatile markets in the first quarter, while benefiting from long-term technological trends.

The tech and healthcare sectors now make up a large share of the U.S. equity market, as the *Sectoral lens is key* chart shows. A divided U.S. government may benefit large-cap tech and healthcare as it likely takes corporate tax increases and big legislative changes off the table, in our view.

On the other hand, we see cyclical exposures without structural challenges showing durable outperformance in 2021. We favor selected cyclical exposures such as broad EM and Asia ex-Japan equities, as well as U.S. small caps.

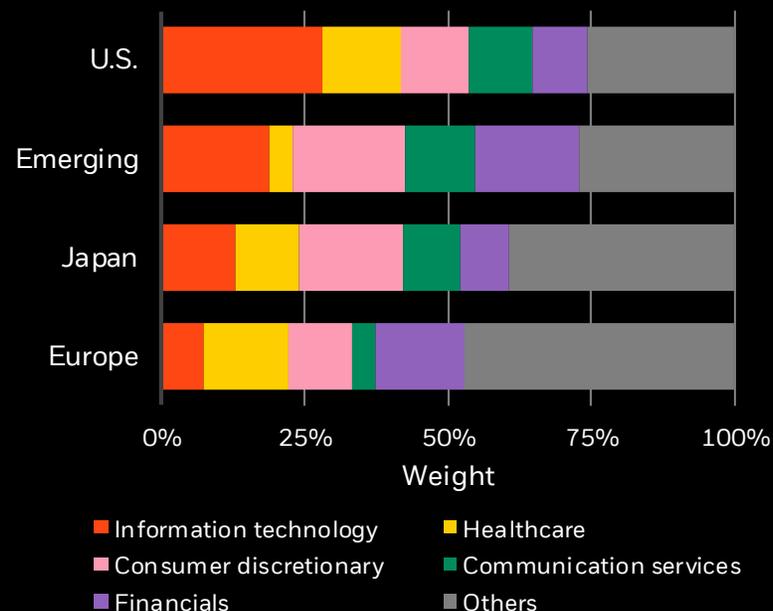
In credit, we like Asia fixed income and high yield. We have upgraded EM hard- and local-currency debt to neutral, and downgraded IG credit to underweight to fund these tilts.

We underweight more structurally challenged cyclical exposures. This includes European and Japanese equities. The European market has a relatively high exposure to financials, which we see pressured by low rates. Japan may not benefit as much as other Asian countries from a cyclical upswing, because of the risk of a weaker U.S. dollar – a result of increased risk appetite and declining real rates. This would lead to a stronger yen, pressuring the country's exporters.

In summary, we seek more quality out of our regional equity exposures, and more cyclical in our credit exposures. Overall, we see *both* sides of our barbell outperforming cyclical exposures with structural headwinds in 2021. Which side will win the race? Two key drivers: 1) the timeline of widespread vaccine rollout (the earlier the better for cyclicals); 2) the amount of additional fiscal support (the less the better for quality and large caps on a relative basis).

Sectoral lens is key

Sector composition of MSCI regional indexes, November 2020



Indexes are unmanaged and do not account for fees. It is not possible to invest directly in an index. Sources: BlackRock Investment Institute, with data from MSCI, November 2020. Notes: Information technology, healthcare, consumer discretionary, communication services and financials are top five sectors on the MSCI ACWI Index by weight. Others include industrials, consumer staples, utilities, real estate, materials and energy.

Low government bond yields and ample liquidity make the equity risk premium reasonable and support a tactical pro-risk stance, in our view.

Tactical granular views

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

Change in view


Asset	Underweight	Overweight		
Equities	United States			We have upgraded U.S. equities to overweight. We see the tech and healthcare sectors offering exposure to structural growth trends, and U.S. small caps geared to an expected cyclical upswing in 2021.
	Europe			We have downgraded European equities to underweight. The market has relatively high exposure to financials pressured by low rates. It also faces structural growth challenges, even given potential for catch-up growth in a vaccine-led revival.
	Japan			We are underweight Japanese equities. Other Asian economies may be greater beneficiaries of more predictable U.S. trade policy under a Biden administration. A stronger yen amid potential U.S. dollar weakness may weigh on Japanese exporters.
	Emerging markets			We are overweight EM equities. We see them as principal beneficiaries of a vaccine-led global economic upswing in 2021. Other positives: our expectation of a flat to weaker U.S. dollar and more stable trade policy under a Biden administration.
	Asia ex-Japan			We are overweight Asia ex-Japan equities. Many Asian countries have effectively contained the virus – and are further ahead in the economic restart. We see the region’s tech orientation allowing it to benefit from structural growth trends.
	Momentum			We keep momentum at neutral. The factor could face challenges in the near term as a resurgence in Covid-19 cases and risks of fading fiscal policy support create potential for choppy markets.
	Value			We are neutral on value. The factor could benefit from an accelerated restart, but we believe that many of the cheapest companies – across a range of sectors – face structural challenges that have been exacerbated by the pandemic.
	Minimum volatility			We are underweight min vol. We expect a cyclical upswing over the next six to 12 months, and min vol tends to lag in such an environment.
	Quality			We are overweight quality. We like tech companies with structural tailwinds and see companies with strong balance sheets and cash flows as resilient against a range of outcomes in the pandemic and economy.
	Size			We are overweight the U.S. size factor. We see small- and mid-cap U.S. companies as a key place where exposure to cyclical is likely to be rewarded amid a vaccine-led recovery.
Fixed income	U.S. Treasuries			We are underweight U.S. Treasuries. We see nominal U.S. yields as staying rangebound, but real yields declining amid rising inflation expectations. This leads us to prefer inflation-linked over nominal government bonds.
	Treasury Inflation-Protected Securities			We are overweight TIPS. We see potential for higher inflation expectations to get increasingly priced in on the back of structurally accommodative monetary policy and increasing production costs.
	German bunds			We are neutral on bunds. We see the balance of risks shifting back in favor of more monetary policy easing from the European Central Bank as the regional economic rebound shows signs of flagging.
	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 have downgraded investment grade credit to underweight. We see little room for further yield spread compression and favor more cyclical exposures such as high yield and Asia fixed income.
	Global high yield			We have trimmed our overweight in global high yield. Spreads have narrowed significantly, but we believe the asset class remains an attractive source of income in a yield-starved world.
	Emerging market – hard currency			We have upgraded hard-currency EM debt to neutral. We expect it to gain support from the vaccine-led global restart and more predictable U.S. trade policies.
	Emerging market – local currency			We have upgraded local-currency EM debt to neutral. We see catch-up potential as the asset class has lagged the risk asset recovery. Easy global monetary policy and a stable-to-weaker U.S. dollar should also underpin EM.
	Asia fixed income			We are overweight Asia fixed income. We see the asset class as attractively valued. Asian countries have done better in containing the virus and are further ahead in the economic restart.

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