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Weekly commentary

BlackRock

October 14, 2024

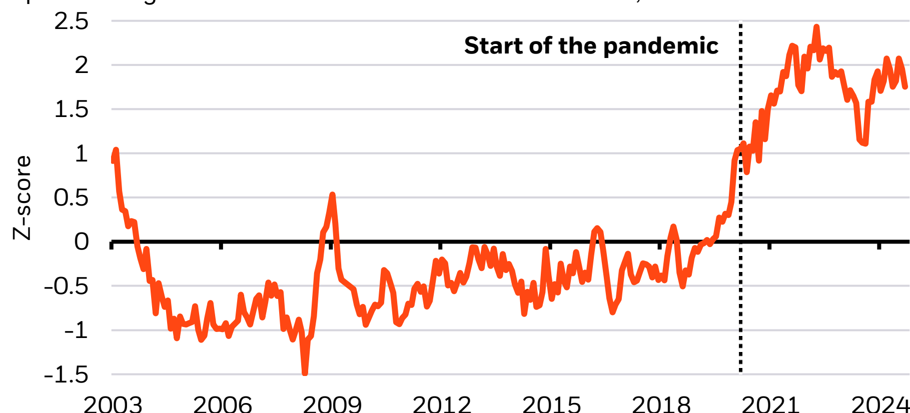
Our conviction in global stocks

- We see opportunities in global stocks trading at attractive relative valuations with potential catalysts for price appreciation – like in China and Japan.
- U.S. stocks hit all-time highs. U.S. 10-year yields rose further after the U.S. core CPI data prompted markets to trim expectations for Federal Reserve rate cuts.
- This week, we expect the European Central Bank to cut interest rates. We think it has more room to cut rates than the Fed because it tightened policy more.

China's share surge shows the upside of keying on opportunities in global stocks when clear catalysts emerge. We keep our U.S. equity overweight on the artificial intelligence (AI) theme broadening. Outside the U.S., we favor markets where we have high conviction. We're overweight Japanese stocks on a solid macro outlook and corporate reforms. We stay overweight UK stocks with less conviction. We upgrade UK gilts and see room for sharper policy rate cuts than markets expect.

Diverging valuations

Dispersion in global ex-U.S. 12-month forward valuations, 2003-2024



It is not possible to invest directly in an index. Indexes are unmanaged and index performance does not account for fees.
Source: BlackRock Investment Institute, MSCI, with data from LSEG Datastream, October 2024. Notes: The chart shows the dispersion of non-U.S. equity valuations, using 12-month forward price-to-earnings ratios. The dispersion score takes the normalized average of the standard deviation, interquartile and interdecile ranges of the valuations. Index proxies: MSCI developed and emerging market regional indexes, excluding Ireland, Greece and Peru.

China is the latest example of how cheap valuations can turn into a stock market rally once a catalyst emerges. Chinese shares have surged since the September politburo meeting on hopes that major fiscal stimulus may be on the way. A lack of details so far has disappointed some investors, so we eye policy announcements for more clarity. This potential exists elsewhere, waiting for a catalyst to give a spark, we think. But selectivity is key. We see a widening gap in economic performance and equity valuations across regions – a function of a more volatile macro backdrop and uneven restart coming out of the pandemic. See the chart. We still like U.S. stocks and the broad AI theme as corporate earnings growth expands beyond tech. Yet fears over stretched valuations can drive brief selloffs. This calls for considering global exposure where we see cheap valuations and potential catalysts.

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Staying nimble allows us to seize on opportunities in global equities when catalysts emerge. China's signal on policy stimulus prompted us to go modestly overweight, especially given depressed valuations. Details have been scant, so we could change our view if future announcements disappoint. We still think China faces long-term, structural challenges – like economic and geopolitical competition with the West, government debt and population aging. We have stayed overweight Japan stocks on a sunnier macro backdrop and corporate reforms driving strong earnings and shareholder returns. We trimmed our overweight in August due to the potential drag on earnings from a stronger yen and Bank of Japan policy missteps – yet we stay positive.

Even in regions where the growth outlook is more challenging, we see selective investment opportunities. With 11% gains this year, European stocks have lagged major markets – yet European banks have surged 31% and we still like the sector as we have since the start of 2024. We have less conviction in UK stocks on a soft economy and heading into the new government's budget announcement, yet we stay overweight for now. We go overweight UK gilts as we see the Bank of England having to cut policy rates more than markets are pricing given the soft economy.

We lean into risk yet monitor signposts that could cause us to change our views. Geopolitical risk is elevated as tensions flare in the Middle East. Regional escalation could drive oil prices higher, highlighting this is a world shaped by supply constraints. We have seen oil price spikes drive bond yields higher, showing long-term bonds still aren't providing reliable portfolio diversification, in our view. This makes quality key in fixed income, we think. The U.S. election will have global ramifications, especially for key trade partners like Mexico. Yet mega forces, structural shifts impacting returns now and in the future, are driving opportunities beyond the near-term risks. For example, the rewiring of supply chains is benefiting multi-aligned trading partners like Vietnam and Indonesia, both seeing a significant increase in trade and investment flows.

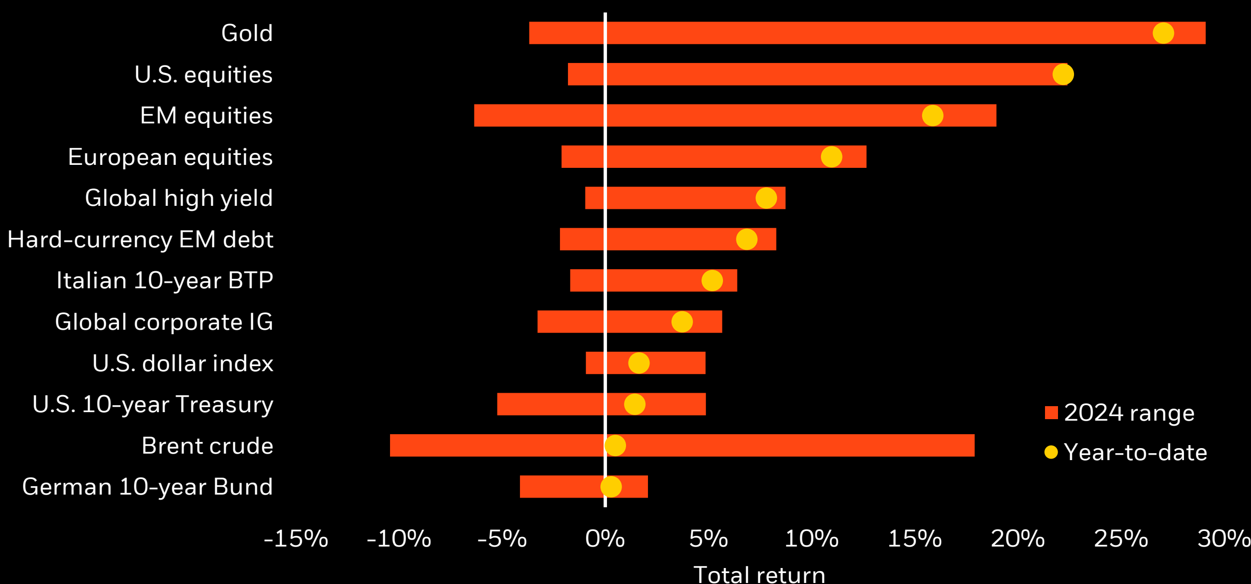
Bottom line: We stay nimble to seize high-conviction global opportunities. We recently turned modestly overweight Chinese equities and stay overweight Japanese and UK equities. We up UK gilts to overweight and stay cautious on U.S. Treasuries.

Market backdrop

U.S. stocks hit all-time highs, with tech shares leading gains, as the Q3 earnings season kicked off. U.S. 10-year Treasury yields climbed further to their highest since July near 4.10%, up about 50 basis points in the past month. U.S. core inflation topped expectations in September, showing sticky services inflation and leading markets to trim expected Federal Reserve rate cuts. China onshore shares fell 3% last week, forfeiting some recent gains as investors eye fiscal stimulus details.

Assets in review

Selected asset performance, year-to-date return and range



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Sources: BlackRock Investment Institute, with data from LSEG Datastream as of Oct. 10, 2024. Notes: The two ends of the bars show the lowest and highest returns at any point year to date, and the dots represent current year-to-date returns. Emerging market (EM), high yield and global corporate investment grade (IG) returns are denominated in U.S. dollars, and the rest in local currencies. Indexes or prices used are: spot Brent crude, ICE U.S. Dollar Index (DXY), spot gold, MSCI Emerging Markets Index, MSCI Europe Index, LSEG Datastream 10-year benchmark government bond index (U.S., Germany and Italy), Bank of America Merrill Lynch Global High Yield Index, J.P. Morgan EMBI Index, Bank of America Merrill Lynch Global Broad Corporate Index and MSCI USA Index.

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Week ahead

Oct. 14	China trade data	**Oct. 16**	UK CPI
Oct. 15	UK employment data	**Oct. 17**	ECB policy decision; Philly Fed business index; Japan trade data

We expect the European Central Bank (ECB) to cut interest rates at its policy meeting this week. September core inflation was below ECB projections, indicating inflation is still on track to hit the central bank's 2% target. We think the euro area's substantially weaker growth and employment indicators will push the ECB to cut rates again in October. The ECB will likely remain focused on incoming data but it has more room to cut than the Fed because it tightened policy more, in our view.

Big calls

Our highest conviction views on tactical (6-12 month) and strategic (long-term) horizons, October 2024

Tactical	**Reasons**
AI and U.S. equities	• We see the AI buildout and adoption creating opportunities across sectors. We get selective, moving toward beneficiaries outside the tech sector. Broad-based earnings growth and a quality tilt make us overweight U.S. stocks overall.
Japanese equities	• A brighter outlook for Japan's economy and corporate reforms are driving improved earnings and shareholder returns. Yet the drag on earnings from a stronger yen and some mixed policy signals from the Bank of Japan are risks.
Income in fixed income	• The income cushion bonds provide has increased across the board in a higher rate environment. We like quality income in short-term credit. We're neutral long-term U.S. Treasuries.
Strategic	**Reasons**
Private credit	• We think private credit is going to earn lending share as banks retreat – and at attractive returns relative to public credit risk.
Fixed income granularity	• We prefer intermediate credit, which offers similar yields with less interest rate risk than long-dated credit. We also like short-term government bonds, and UK long-term bonds.
Equity granularity	• We favor emerging over developed markets yet get selective in both. EMs at the cross current of mega forces – like India and Saudi Arabia – offer opportunities. In DM, we like Japan as the return of inflation and corporate reforms brighten our outlook.

Note: Views are from a U.S. dollar perspective, October 2024. 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.

Tracking five mega forces

Mega forces are big, structural changes that affect investing now – and far in the future. As key drivers of the new regime of greater macroeconomic and market volatility, they change the long-term growth and inflation outlook and are poised to create big shifts in profitability across economies and sectors. This creates major opportunities – and risks – for investors. See our web hub for our research and related content on each mega force.

1. **Demographic divergence:** The world is split between aging advanced economies and younger emerging markets – with different implications.
2. **Digital disruption and artificial intelligence (AI):** Technologies are transforming how we live and work.
3. **Geopolitical fragmentation and economic competition:** Globalization is being rewired as the world splits into competing blocs.
4. **Future of finance:** A fast-evolving financial architecture is changing how households and companies use cash, borrow, transact and seek returns.
5. **Transition to a low-carbon economy:** The transition is set to spur a massive capital reallocation as energy systems are rewired.

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Granular views

Six- to 12-month tactical views on selected assets vs. broad global asset classes by level of conviction, October 2024

Our approach is to first determine asset allocations based on our macro outlook – and what's in the price. **The table below reflects this and, importantly, leaves aside the opportunity for alpha, or the potential to generate above-benchmark returns.** The new regime is not conducive to static exposures to broad asset classes, in our view, but is creating more space for alpha.

Underweight | Neutral | Overweight | ● Previous view

	Asset	View	Commentary
Equities	**Developed markets**		
	United States	+1	We are overweight given our positive view on the AI theme. Valuations for AI beneficiaries are supported as tech companies keep beating high earnings expectations. We think upbeat sentiment can broaden out. Falling inflation is easing pressure on corporate profit margins.
	Europe	-1	We are underweight relative to the U.S., Japan and the UK – our preferred markets. Valuations are fair. A growth pickup and European Central Bank rate cuts support a modest earnings recovery. Yet political uncertainty could keep investors cautious.
	UK	+1	We are overweight. Political stability and a growth pickup could improve investor sentiment, lifting the UK's low valuation relative to other DM stock markets.
	Japan	+1	We are overweight. A brighter outlook for Japan's economy and corporate reforms are driving improved earnings and shareholder returns. Yet the drag on earnings from a stronger yen and some mixed policy signals from the Bank of Japan are risks.
	Emerging markets	Neutral	We are neutral. The growth and earnings outlook is mixed. We see valuations for India and Taiwan looking high.
	China	+1	We are modestly overweight. Major fiscal stimulus may be coming and prompt investors to step in given Chinese stocks are at a deep discount to DM shares. Yet we stay ready to pivot. We are cautious long term given China's structural challenges.
Fixed Income	Short U.S. Treasuries	-1	We are underweight. We don't think the Fed will cut rates as sharply as markets expect. An aging workforce, persistent budget deficits and the impact of structural shifts like geopolitical fragmentation should keep inflation and policy rates higher over the medium term.
	Long U.S. Treasuries	Neutral	We are neutral. Markets are pricing in sharp Fed rate cuts and term premium is close to zero. We think yields will keep swinging in both directions on incoming data. We prefer intermediate maturities less vulnerable to investors demanding greater term premium.
	Global inflation-linked bonds	Neutral	We are neutral. We see higher medium-term inflation, but cooling inflation and growth may matter more near term.
	Euro area govt bonds	Neutral	We are neutral. Market pricing reflects policy rates in line with our expectations and 10-year yields are off their highs. Political uncertainty remains a risk to fiscal sustainability.
	UK gilts	+1 (● previous view: Neutral)	We are overweight. Gilt yields offer attractive income, and we think the Bank of England will cut rates more than the market is pricing given a soft economy.
	Japanese govt bonds	-2	We are underweight. Stock returns look more attractive to us. We see some of the least attractive returns in JGBs.
	China govt bonds	Neutral	We are neutral. Bonds are supported by looser policy. Yet we find yields more attractive in short-term DM paper.
	U.S. agency MBS	Neutral	We are neutral. We see agency MBS as a high-quality exposure in a diversified bond allocation and prefer it to IG.
	Short-term IG credit	+1	We are overweight. Short-term bonds better compensate for interest rate risk. We prefer Europe over the U.S.
	Long-term IG credit	-1	We are underweight. Spreads are tight, so we prefer taking risk in equities from a whole portfolio perspective. We prefer Europe over the U.S.
	Global high yield	Neutral	We are neutral. Spreads are tight, but the total income makes it more attractive than IG. We prefer Europe.
	Asia credit	Neutral	We are neutral. We don't find valuations compelling enough to turn more positive.
	Emerging hard currency	Neutral	We are neutral. The asset class has performed well due to its quality, attractive yields and EM central bank rate cuts. We think those rate cuts may soon be paused.
	Emerging local currency	Neutral	We are neutral. Yields have fallen closer to U.S. Treasury yields, and EM central banks look to be turning more cautious after cutting policy rates sharply.

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