

Weekly commentary

April 6, 2020

BlackRock

Upgrading credit

- We upgrade our tactical views on credit on extraordinary central bank support and substantially more attractive valuations.
- The initial market rally from historic U.S. policy actions has stalled as worsening economic data and a rising human toll dominate sentiment.
- Jobless claims and consumer sentiment data this week are likely to show more signs of economic damage caused by the coronavirus.

Unprecedented policy actions to limit the coronavirus shock and sharply lower valuations have improved the outlook for credit, in our view. Major central banks are committed to keep rates low and greatly expand their balance sheets. This underpins demand for corporate bonds and selected sovereign credit. We upgrade our view on global investment grade credit to a moderate overweight from underweight and keep high yield as an overweight.



Scott Thiel

Chief Fixed Income Strategist – BlackRock Investment Institute



Mike Pyle

Global Chief Investment Strategist – BlackRock Investment Institute



Elga Bartsch

Head of Macro Research – BlackRock Investment Institute

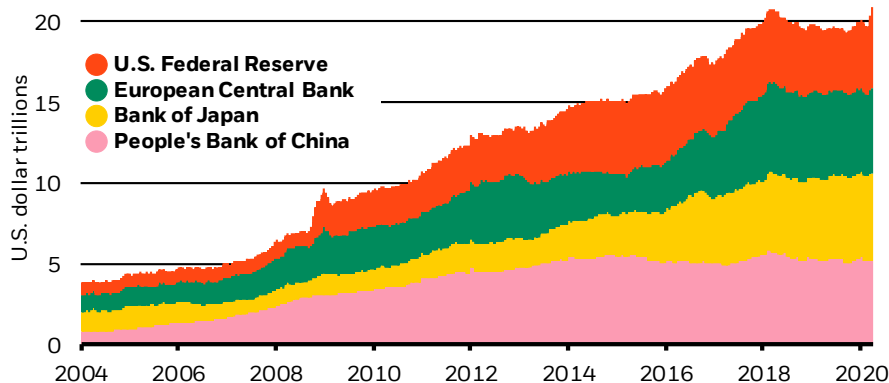


Beata Harasim

Senior Investment Strategist – BlackRock Investment Institute

Chart of the week

Central bank balance sheet in U.S. dollars, 2004-2020



Source: BlackRock Investment Institute, with data from Refinitiv Datastream, April 2020. Notes: The chart shows the size of the balance sheet of each central bank.

Global central banks have focused on alleviating the dysfunction of market pricing and tightening of financial conditions. The European Central Bank (ECB) has lifted the 750 billion euro cap on its Pandemic Emergency Purchase Program (PEPP), paving the way for potentially unlimited asset purchases. The Fed has adopted a “whatever-it-takes” approach, including a commitment to massively expand its \$4.5 trillion balance sheet, lending programs to directly support small- and medium-sized businesses, states and municipalities, and buying U.S. corporate bonds for the first time. Central bank balance sheets in key economies have reached \$20 trillion, as the chart above shows, and are poised to increase a lot further. We see coupon income as attractive amid record-low interest rates, a stabilization of markets thanks to the policy response and improved valuations after the March selloff. We find this source of income in global investment grade and high yield credit, as well as euro area peripheral government bonds and local-currency emerging market debt.

Visit [BlackRock Investment Institute](#) for insights on global economy, markets, geopolitics and portfolio construction.

BlackRock Investment Institute

Overwhelming action by fiscal and monetary authorities helps reduce downside risks to the economy – and the risk of an oversized spike in credit downgrades and debt defaults, in our view. The risk of temporary liquidity crunches remains as the economic shutdown rolls on, and sectors such as energy face severe challenges due to the collapse in oil prices. Yet overall, we believe the recent sharp widening in credit spreads means investors are to a large extent compensated for taking on these risks. We prefer credit over equities given bondholders’ preferential claim on corporate cash flows in a highly uncertain economic environment.

The history of credit performance during past periods of quantitative easing also supports our view. When central banks step in with massive asset purchases, it tends to dampen volatility in interest rates. We believe we are in a similar situation today: The Fed has effectively committed to cap the upside in long-term bond yields, while expansionary fiscal policy may put upward pressure on interest rates. A relatively stable rate environment has often led to the narrowing of the spread between yields of credit and government bonds – and a rise in prices of credit. It also helps to have central banks as committed buyers of bonds including corporate and sovereign debt.

We have upgraded our tactical view on U.S. Treasuries as an offset to the risks of an increased credit allocation. Yields sit near record lows, but Treasuries are still the highest yielding government bonds in major developed economies. This leaves more room for further yield declines than bonds in the euro area or Japan in the event of risk asset selloffs, in our view. On a longer-term horizon, we recognize the role of government bonds as portfolio ballast has come into question given the lower yield levels and a growing commitment of central banks to keep rates low across the yield curve.

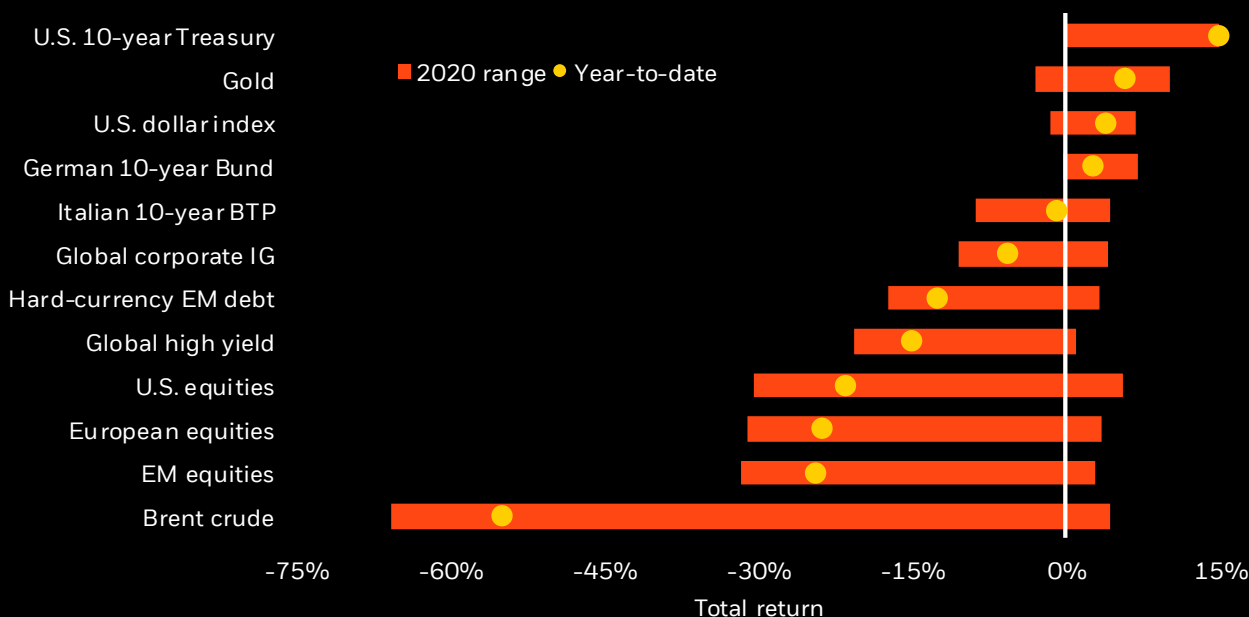
The bottom line: We see coupon income as crucial in an even more yield-starved world. The extraordinary monetary and fiscal policy action is shaping up to blunt the coronavirus shock to the economy and markets – and central banks have stepped back in as committed buyers of credit. This, coupled with substantially cheaper valuations, paves the way for outperformance in carry assets such as corporate debt and euro area peripheral sovereigns, in our view.

Market backdrop

Fiscal and monetary policy action to bridge the economic impact of the coronavirus is starting to take shape as the outbreak and related containment measures propagate across the globe. The initial boost to markets from the historic U.S. policy actions has faded as sobering economic data and a rising human toll have dominated sentiment. We still believe the strong policy actions are paving the road for an eventual – and strong – economic and market rebound, once we better understand the scale of the outbreak.

Assets in review

Selected asset performance, 2020 year-to-date and range



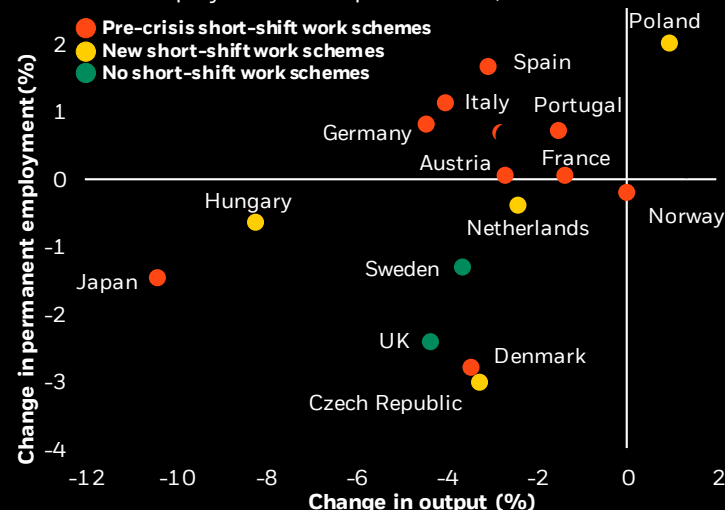
Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index. Sources: BlackRock Investment Institute, with data from Refinitiv Datastream, April 2020. Notes: The two ends of the bars show the lowest and highest returns versus the end of 2019, and the dots represent 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, MSCI USA Index, the ICE U.S. Dollar Index (DXY), MSCI Europe Index, Bank of America Merrill Lynch Global Broad Corporate Index, Bank of America Merrill Lynch Global High Yield Index, Datastream 10-year benchmark government bond (U.S., German and Italy), MSCI Emerging Markets Index, spot gold and J.P. Morgan EMBI index.

Macro insights

Labor market resilience will be key to how quickly economies bounce back from the coronavirus shock. Early indications point to a surge in the number of unemployed – but short-shift work programs similar to those during the global financial crisis (GFC) could limit job losses. In the GFC, countries with existing or new short-shift policies fared better than those without in terms of change in permanent employment. The short-shift policies enabled firms to adjust by reducing their workers’ average hours by much more than in other economies. This provides context to the fiscal packages that we have seen proposed over the past few weeks. The German short-shift scheme is expected to attract 2.5 million new participants, versus a peak of 1.5 million during the GFC. The UK has offered to guarantee up to 80% of wages for employees in affected sectors, subject to a monthly cap. In the U.S., the coronavirus stimulus bill includes capacity for work sharing and a program that turns loans into grants for small firms retaining payroll.

The short shift effect

Permanent employment vs output in OECD, 2008 to 2009



Sources: BlackRock Investment Institute, with data from the OECD, April 2020. Notes: The change in permanent employment and output for OECD countries between Q3 2008 and Q3 2009.

Investment themes

1 Activity standstill

- Public health measures to combat the coronavirus outbreak are bringing economic activity to a near standstill and look set to cause a sharp contraction in economic growth in the second quarter.
- The coronavirus shock is unprecedented and much sharper than what we saw in 2008 – but its cumulative hit to growth is likely to be much less than total economic impact of the financial crisis as long as authorities deliver an overwhelming fiscal and monetary policy response to bridge businesses and households through the shock.
- The U.S. will likely prove more resilient than many other developed economies because of a smaller share of manufacturing in its GDP, a relatively high share of healthcare spending and an aggressive policy response.
- We expect a recovery in activity once disruptions dissipate, but their depth and duration are highly uncertain. This could weigh on consumption and investment.
- The main risk to our view: a broadening of the outbreak is not met with a decisive policy response, causing lasting damage to the economy.
- **Market implication:** We are mostly sticking to benchmark holdings on an asset class level and favor rebalancing into the risk asset decline.

2 Bold policy action

- U.S. policymakers have announced a fiscal package of more than \$2 trillion and the Federal Reserve has launched extraordinary measures to cushion the economic and market impact. The fiscal package exceeds that of the global financial crisis and includes measures we had advocated: “going direct”, or relieving the cash flow pressures facing households and businesses with direct cash payments. Read our bulletin on the historic policy response.
- Fiscal policy is on the frontlines and should focus on boosting public health measures and alleviating potential cash flow crunches through liquidity bridges. The U.S response follows coordinated fiscal and monetary action in Australia, Canada and the UK, and a patchwork of fiscal relief supported by monetary policy in the euro area.
- The critical focus of central banks is alleviating the dysfunction of market pricing and tightening of financial conditions. Besides the Fed, The European Central Bank put together a bold response after its communication mishap earlier, lifted the 750 billion euro limit on the pandemic emergency bond buying program. European officials may also activate the European Stability Mechanism on relaxed terms to free up even more bond-buying capacity.
- **Market implication:** Coupon income is crucial in an even more yield-starved world, including corporate credit and dividend income in selected equity sectors.

3 Resilience rules

- The valuations of developed government bonds look stretched in light of our economic outlook, but we still see them providing diversification – albeit less so with some yields near levels we consider to be their lower bounds. The recent bounce in Treasury yields off record lows illustrates the risk of snapbacks.
- A focus on sustainability can help make portfolios more resilient. We believe the adoption of sustainable investing is a new phenomenon that will carry a return advantage over years and decades.
- **Market implication:** We prefer U.S. Treasuries to lower-yielding peers as portfolio ballast and see a strong case for integrating sustainability into investment processes.

Week ahead

- | | | | |
|-----------------|-------------------------------------|----------------|---------------------------------------------|
| Apr. 6-7 | German industrial orders and output | Apr. 9 | University of Michigan Surveys of Consumers |
| Apr. 8 | Japan machinery orders | Apr. 10 | China inflation |

Markets will try to gauge the pandemic’s disruption to the economy. The University of Michigan survey will indicate the short-term impact of the outbreak on U.S. consumers – a key pillar of the U.S. economy – after weekly jobless claims hit record highs and private payrolls contracted for the first time since 2017. February factory activity data from Germany and Japan should shed light on the impact from China’s lockdown on other parts of the global manufacturing supply chain.

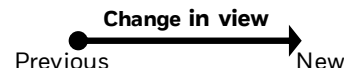
Directional views

Six to 12-month tactical views on major global assets from a U.S. dollar perspective, April 2020

Asset	Underweight	Neutral	Overweight
Equities	<p>We previously downgraded global equities to neutral. The coronavirus outbreak is disrupting economic activity and supply chains. The outbreak also poses risks to corporate earnings, in our view. Accommodative monetary policy is a support. We now favor rebalancing back toward benchmark weights as markets fall.</p>		
Credit	<p>We have upgraded credit to modestly overweight. Extraordinary measures by central banks – including purchases of corporate debt – provide a favorable backdrop. Developed market central bank actions should pave the way for lower volatility in interest rates, providing a stable environment for credit spreads to narrow. The risk of temporary liquidity crunches remains. Yet valuations have cheapened and coupon income is crucial in a world starved for yield.</p>		
Government bonds	<p>We stay neutral overall on global government bonds. They act as ballast against risk-off episodes. Additional easing by major central banks has become more likely, in our view. We favor U.S. Treasuries over government bonds in other regions, but see risks of a diminishing buffer against equity market selloffs and a snap-back in yields from historically low levels.</p>		
Cash	<p>We maintain our neutral position on cash for risk mitigation. We also see cash as a robust buffer against risks around regime shifts, especially those triggered by a negative supply shock that could drive both stocks and bonds lower together.</p>		

Note: 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.

Granular views



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

Asset	Underweight	Overweight	
Equities			We are overweight U.S. equities for their relative quality bias and the sizable policy response to the outbreak: large fiscal stimulus coupled with the Federal Reserve's commitment to keep rates low and markets functioning.
			We stay underweight on European equities. We see greater upside elsewhere in an eventual recovery. Europe is more dependent on foreign trade.
			We are underweight Japanese equities. The country has limited monetary and fiscal policy space to offset the outbreak's impact.
			We are neutral on EM equities. Valuations have cheapened, but the global economic slowdown and cheaper oil challenge many EM economies. The outbreak also is a big test for weak public health systems.
			We are overweight Asia ex-Japan equities on prospects of an eventual growth uptick. We see China as in the early stages of restarting its economy and having more policy space to revive activity.
			We are neutral on momentum. The factor has outperformed in the growth slowdown, partly due to its exposure to "secular growers" in the tech industry as well as dividend paying bond proxies.
			We remain underweight value. Value has historically performed best in periods of accelerating growth, and we now see the coronavirus outbreak posing downside risks to the economy.
			We like min-vol for its defensive properties in a growth slowdown. The factor has historically performed well late in the cycle.
			We hold quality as an overweight. We like that it has been resilient in late-cycle periods, despite relatively high valuations.
Fixed Income			We have upgraded U.S. Treasuries to overweight. Low rates reduce their ability to cushion against risk asset selloffs, but we see greater room for long-term yields to fall further in the U.S. than in other developed markets.
			We are neutral on TIPS. After a huge decline in rates that makes the entry point less attractive. We still see potential for higher inflation over time and like TIPS in strategic allocations.
			We remain underweight bunds. They provide little cushion against major risk events, but would not add to our underweight after recent underperformance versus U.S. Treasuries.
			We have upgraded euro area peripheral government bonds to overweight. Renewed asset purchases by the European Central Bank are a major support, and valuations have cheapened.
			We have upgraded global investment grade credit. Renewed asset purchases by central banks as well as the prospect of a stable rates backdrop support the sector at a time when valuations have cheapened.
			We stay overweight high yield as a source of income, despite recent underperformance. We avoid energy as a lower-for-longer oil price challenges the ability of issuers to refinance near-term maturities.
			We stay neutral on hard-currency EM debt due to the heavy exposure to energy exporters and limited policy space among some EMs. We prefer to take our risk in local currency EM debt. Default risks may be underpriced.
			We remain overweight, despite recent underperformance driven by a stronger U.S. dollar. Yields above 5% look attractive – and currency depreciation appears excessive in many markets.
			We stay overweight based on a slowdown in the spread of the virus, Chinese monetary easing, low energy exposure and reasonable relative value. We see demand from Chinese and regional investors.

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. BIIM0420U-1139390-5/6

BlackRock Investment Institute

The BlackRock Investment Institute (BII) leverages the firm's expertise and generates proprietary research to provide insights on the global economy, markets, geopolitics and long-term asset allocation – all to help our clients and portfolio managers navigate financial markets. BII offers strategic and tactical market views, publications and digital tools that are underpinned by proprietary research.

General Disclosure: This material is not intended to be relied upon as a forecast, research or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy. The opinions expressed are as of April 6, 2020 and may change. The information and opinions are derived from proprietary and non-proprietary sources deemed by BlackRock to be reliable, are not necessarily all-inclusive and are not guaranteed as to accuracy. As such, no warranty of accuracy or reliability is given and no responsibility arising in any other way for errors and omissions (including responsibility to any person by reason of negligence) is accepted by BlackRock, its officers, employees or agents. This material may contain 'forward looking' information that is not purely historical in nature. Such information may include, among other things, projections and forecasts. There is no guarantee that any forecasts made will come to pass. Reliance upon information in this material is at the sole discretion of the reader.

In the U.S. and Canada, this material is intended for public distribution. **In the UK and outside the EEA:** Issued by BlackRock Investment Management (UK) Limited, authorized and regulated by the Financial Conduct Authority. Registered office: 12 Throgmorton Avenue, London, EC2N 2DL. Tel: +44 (0)20 7743 3000. Registered in England and Wales No. 2020394. For your protection telephone calls are usually recorded. BlackRock is a trading name of BlackRock Investment Management (UK) Limited. Please refer to the Financial Conduct Authority website for a list of authorized activities conducted by BlackRock until 31 December 2020, this is issued by BlackRock Investment Management (UK) Limited, authorized and regulated by the Financial Conduct Authority. Registered office: 12 Throgmorton Avenue, London, EC2N 2DL. Tel: +44 (0)20 7743 3000. Registered in England and Wales No. 2020394. For your protection telephone calls are usually recorded. Please refer to the Financial Conduct Authority website for a list of authorized activities conducted by BlackRock. From 31 December 2020: In the event the United Kingdom and the European Union do not enter into an arrangement which permits United Kingdom firms to offer and provide financial services into the European Union, the issuer of this material is: BlackRock Investment Management (UK) Limited for all outside of the European Union; and BlackRock (Netherlands) B.V. (1) for in the European Union, BlackRock (Netherlands) B.V. is authorized and regulated by the Netherlands Authority for the Financial Markets. Registered office Amstelplein 1, 1096 HA, Amsterdam, Tel: 020 – 549 5200, Tel: 31-20-549-5200. Trade Register No. 17068311. For more information, please see the website: www.blackrock.com. For your protection, telephone calls are usually recorded. BlackRock is a trading name of BlackRock (Netherlands) B.V. **In Switzerland,** this document is marketing material. This document shall be exclusively made available to, and directed at, qualified investors as defined in the Swiss Collective Investment Schemes Act of 23 June 2006, as amended. **For investors in Israel:** BlackRock Investment Management (UK) Limited is not licensed under Israel's Regulation of Investment Advice, Investment Marketing and Portfolio Management Law, 5755-1995 (the "Advice Law"), nor does it carry insurance thereunder. **In South Africa,** please be advised that BlackRock Investment Management (UK) Limited is an authorized financial services provider with the South African Financial Services Board, FSP No. 43288. **In the DIFC** this material can be distributed in and from the Dubai International Financial Centre (DIFC) by BlackRock Advisors (UK) Limited – Dubai Branch which is regulated by the Dubai Financial Services Authority (DFSA). This material is only directed at 'Professional Clients' and no other person should rely upon the information contained within it. **In the Kingdom of Saudi Arabia** this information is only directed to Exempt Persons, Authorized Persons or Investment Institutions, as defined in the relevant implementing regulations issued by the Capital Markets Authority (CMA). **In the United Arab Emirates** this material is only intended for –natural Qualified Investor as defined by the Securities and Commodities Authority (SCA) Chairman Decision No. 3/R.M. of 2017 concerning Promoting and Introducing Regulations. Neither the DFSA or any other authority or regulator located in the GCC or MENA region has approved this information. **In Singapore,** this is issued by BlackRock (Singapore) Limited (Co. registration no. 200010143N). In Hong Kong, this material is issued by BlackRock Asset Management North Asia Limited and has not been reviewed by the Securities and Futures Commission of Hong Kong. **In South Korea,** this material is for distribution to the Qualified Professional Investors (as defined in the Financial Investment Services and Capital Market Act and its sub-regulations). **In Taiwan,** independently operated by BlackRock Investment Management (Taiwan) Limited. Address: 28F., No. 100, Songren Rd., Xinyi Dist., Taipei City 110, Taiwan. Tel: (02)23261600. **In Japan,** this is issued by BlackRock Japan Co., Ltd. (Financial Instruments Business Operator: The Kanto Regional Financial Bureau. License No375, Association Memberships: Japan Investment Advisers Association, the Investment Trusts Association, Japan, Japan Securities Dealers Association, Type II Financial Instruments Firms Association.) For Professional Investors only (Professional Investor is defined in Financial Instruments and Exchange Act). **In Australia,** issued by BlackRock Investment Management (Australia) Limited ABN 13 006 165 975 AFSL 230 523 (BIMAL). The material provides general information only and does not take into account your individual objectives, financial situation, needs or circumstances. **In China,** this material may not be distributed to individuals resident in the People's Republic of China ("PRC", for such purposes, excluding Hong Kong, Macau and Taiwan) or entities registered in the PRC unless such parties have received all the required PRC government approvals to participate in any investment or receive any investment advisory or investment management services. **For Other APAC Countries,** this material is issued for Institutional Investors only (or professional/sophisticated/qualified investors, as such term may apply in local jurisdictions) and does not constitute investment advice or an offer or solicitation to purchase or sell in any securities, BlackRock funds or any investment strategy nor shall any securities be offered or sold to any person in any jurisdiction in which an offer, solicitation, purchase or sale would be unlawful under the securities laws of such jurisdiction. **In Latin America,** for institutional investors and financial intermediaries only (not for public distribution). This material is for educational purposes only and does not constitute investment advice or an offer or solicitation to sell or a solicitation of an offer to buy any shares of any fund or security. If any funds are mentioned or inferred in this material, such funds may not have been registered with the securities regulators of any Latin American country and thus, may not be publicly offered in any such countries. The provision of investment management and investment advisory services is a regulated activity in Mexico thus is subject to strict rules. No securities regulator within Latin America has confirmed the accuracy of any information contained herein.

The information provided here is neither tax nor legal advice. Investors should speak to their tax professional for specific information regarding their tax situation. Investment involves risk including possible loss of principal. International investing involves risks, including risks related to foreign currency, limited liquidity, less government regulation, and the possibility of substantial volatility due to adverse political, economic or other developments. These risks are often heightened for investments in emerging/developing markets or smaller capital markets.

© 2020 BlackRock, Inc. All Rights Reserved. **BlackRock** is a registered trademark of BlackRock, Inc. or its subsidiaries in the United States and elsewhere. All other trademarks are those of their respective owners.