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WEEKLY COMMENTARY • APRIL 16, 2018

Key points

1 Investor risk appetite appears dented but not broken — the steady economic backdrop should support further rewards for equity risk taking.

2 Global equities rose last week, Brent crude prices rallied and firming U.S. core inflation data sent U.S. 10-year inflation expectations higher.

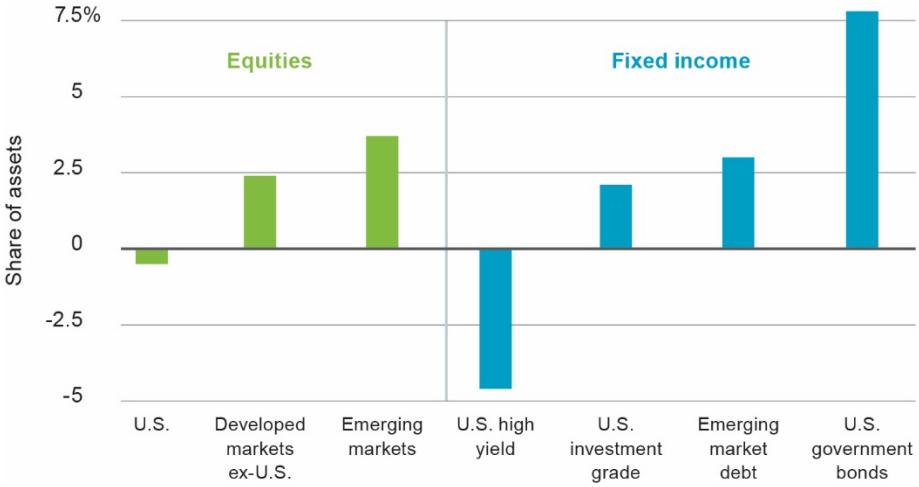
3 First-quarter earnings for U.S. companies will begin to flood in this week. Tax cuts should boost bottom lines, but wage pressures pose a risk.

1 A change in risk appetite

Record-setting equity inflows in January lost steam after the February market rout and double-whammy of trade tensions and tech worries since. Yet investors appear to be revising their risk exposures rather than abandoning risk entirely. We see a conducive backdrop for risk taking ahead, despite higher economic uncertainty.

Chart of the week

Fund flows year-to-date for selected assets, 2018



Sources: BlackRock Investment Institute, with data from EPFR, April 2018.
Notes: The bars show cumulative flows to mutual funds and exchange traded funds in 2018 year-to-date as a percentage of starting assets under management. 2018 data are through April 10.

Investors' appetite for risk assets has been dented of late but looks to be generally holding up. The story is more about a rotation of positioning, we believe, based on our observation of EPFR fund flow data. U.S. equities gave back their sizeable January inflows, but flows into non-U.S. developed market and emerging market (EM) equities have more than offset the loss. See the chart above. In fixed income, high yield funds have bled assets, while U.S. investment grade, EM debt and U.S. government bonds have attracted inflows.

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A conducive backdrop

Markets have been choppy in 2018 and gauges from our Systematic Active Equity team suggest investor appetite for risk has faded somewhat. Yet we see the supportive economic and earnings backdrop underpinning the reward for risk. The BlackRock Growth GPS shows a sustained global economic expansion, even amid recent economic data disappointments. The tax overhaul has juiced the U.S. corporate earnings outlook — and earnings momentum is rising across the world. We expect a mostly solid first-quarter U.S. earnings season will help support stocks, easing some of the negative pressure from concerns about trade tensions and economic deceleration.

This backdrop should support risk assets, even as we expect more muted returns and higher volatility than in 2017. Key risks this year to the global expansion and risk assets – including the risk of a full-blown U.S.-China trade war, which we see as unlikely – have added uncertainty to the economic outlook. This uncertainty is behind the recent rise in risk premiums. See our Q2 Global Investment Outlook.

Where should investors consider taking risk? We believe equities offer better compensation relative to credit. We are negative on government bonds but see short-maturity Treasuries offering a compelling risk/reward proposition. See our latest Fixed income strategy piece. We are neutral on U.S. credit amid tight spreads and increasing sensitivity to rate rises, while we are negative on European credit. Within equities, we prefer the U.S. and EMs, as well as technology, financials and the momentum style factor. Flows and our proprietary data on investor positioning show U.S. equities have taken a particularly hard hit since January, suggesting some room for a rebound. Investors seeking to play defense in equities should look to companies with strong free cash flow and the ability to boost dividends rather than seek high dividends alone, we believe. See our April 2018 Global equity outlook.

2 Week in review

- Global equities rose, with energy and tech stocks leading. Market fears over U.S.-China trade tensions eased after President Xi Jinping reiterated his pledge to open up the Chinese market. Sentiment toward tech stocks improved.
- The U.S. and some of its allies threatened to take action against Syria, sending Brent oil prices to a 40-month high. The ruble fell sharply after the U.S. implemented new sanctions against Russia but recovered somewhat later in the week as U.S. rhetoric softened.
- The March U.S. Consumer Price Index (CPI) report confirmed firming U.S. inflation. U.S. 10-year inflation breakevens matched their highest levels in four years. Minutes from the Fed's March meeting showed a central bank confident in its positive growth and inflation outlooks. March inflation data in China came in below expectations.

Global snapshot

Weekly and 12-month performance of selected assets

Equities	Week	YTD	12 Months	Div. Yield
U.S. Large Caps	2.0%	-0.6%	14.1%	2.0%
U.S. Small Caps	2.4%	1.3%	16.7%	1.2%
Non-U.S. World	1.3%	0.2%	18.6%	3.2%
Non-U.S. Developed	1.5%	0.4%	17.8%	3.4%
Japan	0.4%	0.5%	20.4%	2.3%
Emerging	0.7%	1.4%	24.3%	2.8%
Asia ex-Japan	1.7%	1.5%	26.2%	2.6%

Bonds	Week	YTD	12 Months	Yield
U.S. Treasuries	-0.3%	-1.6%	-0.9%	2.8%
U.S. TIPS	0.2%	-0.6%	0.2%	2.9%
U.S. Investment Grade	-0.1%	-2.4%	1.5%	3.8%
U.S. High Yield	0.8%	0.2%	4.5%	6.1%
U.S. Municipals	0.2%	-0.9%	2.0%	2.7%
Non-U.S. Developed	0.3%	3.5%	10.7%	0.8%
EM $ Bonds	-0.3%	-1.6%	3.6%	5.8%

Commodities	Week	YTD	12 Months	Level
Brent Crude Oil	8.2%	8.5%	29.9%	$72.58
Gold	1.0%	3.3%	4.5%	$1,346
Copper	0.9%	-5.8%	20.0%	$6,830

Currencies	Week	YTD	12 Months	Level
Euro/USD	0.4%	2.7%	16.2%	1.23
USD/Yen	0.4%	-4.7%	-1.6%	107.35
Pound/USD	1.0%	5.4%	13.9%	1.42

Source: Bloomberg. As of April 13, 2018. Notes: Weekly data through Friday. 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

April 16 U.S. retail sales

April 17 China Q1 GDP, industrial production, fixed asset investment, retail sales; U.S. industrial production; Germany ZEW Economic Sentiment Index

April 18 UK CPI, Producer Price Index (PPI); eurozone Harmonised Index of Consumer Prices (HICP)

April 20 Japan CPI; eurozone consumer confidence flash; G20 minister/central banker meeting

This week is the first big one of the latest earnings season. Companies representing 15% of the S&P 500 market cap are scheduled to report first-quarter results. Analysts broadly expect a solid quarter as tax cuts boost bottom lines. They see average year-over-year growth of 16% for earnings and 7% for sales. Early reporters are beating expectations. We see strong quarterly results supporting stocks, though higher labor costs are a potential risk to results. What to look for? Signs of non-tax-related measures of corporate strength, such as sales; and how corporations are spending their cash windfalls and adapting to trade tensions.

Asset class views

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

Asset class		View	Comments
Equities	U.S.	▲	Extraordinarily strong earnings momentum, corporate tax cuts and fiscal stimulus underpin our positive view. We like the momentum and value style factors, as well as financials and technology.
	Europe	—	We see economic expansion and a steady earnings outlook supporting cyclicals. Our neutral stance acknowledges that earnings momentum lags other regions. Euro strength also is a source of pain.
	Japan	▲	Positives are improving global growth, more shareholder-friendly corporate behavior and solid earnings. We see Bank of Japan policy and domestic investor buying as supportive. Further yen strengthening would be a risk.
	EM	▲	Economic reforms, improving corporate fundamentals and reasonable valuations support EM stocks. Above-trend expansion in the developed world is another positive. Risks include a sharp rise in the U.S. dollar, trade tensions and elections. We see the greatest opportunities in EM Asia. We like Brazil and India, and are cautious on Mexico.
	Asia ex-Japan	▲	The economic backdrop is encouraging. China's growth and corporate earnings appear likely to remain solid in the near term. We like selected Southeast Asian markets but recognize a faster-than-expected Chinese slowdown would pose risks to the entire region.
Fixed income	U.S. government bonds	▼	We see rates rising moderately amid economic expansion and Fed normalization. Shorter maturities offer a more compelling risk/reward tradeoff. They and inflation-linked securities can be buffers against rising rates and inflation. We like 15-year mortgages relative to their 30-year counterparts and to short-term corporates.
	U.S. municipals	—	Solid retail investor demand and muted supply are supportive of munis, but rising rates weigh on absolute performance. A more defensive stance is warranted near term, we believe, though any material weakness due to supply may represent a buying opportunity. 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 prefer up-in-quality exposures as ballast to equity risk. Higher-quality floating rate instruments and shorter maturities are well positioned for rising rates, in our view.
	European sovereigns	▼	The ECB's negative interest rate policy has made yields unattractive and vulnerable to the improving growth outlook. We expect core eurozone yields to rise. We are cautious on peripherals given tight valuations and the prospect of the ECB reducing its asset purchases.
	European credit	▼	Recent spread widening driven by increased issuance has created some value, while ongoing ECB purchases should support the asset class. Negative rates have crimped absolute yields — but rising rate differentials make currency-hedged positions increasingly attractive for U.S.-dollar investors. Subordinated financial debt looks less compelling versus equities.
	EM debt	—	Gradual Fed rate rises favor local-currency exposures — particularly given their higher yields relative to major bond markets. A shift by EM central banks toward tighter policy reduces our return expectations. We see solid fundamentals and investor inflows limiting EM currency volatility.
	Asia fixed income	—	Regional growth and inflation dynamics are supportive of credit. China's rising representation in the region's bond universe reflects its growing credit market. Higher-quality growth and a focus on financial sector reform are long-term positives, but any China growth slowdown would be a near-term challenge.
Other	Commodities and currencies	*	Declining global crude inventories underpin oil prices, with geopolitical tensions providing further support. We are neutral on the U.S. dollar. The factors driving its recent slide are likely temporary, but it's unclear when the U.S. yield differential with other economies will reassert itself as the main driver.

▲ Overweight — Neutral ▼ Underweight

*Given the breadth of this category, we do not offer a consolidated view.

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