Weekly commentary

BlackRock

April 12, 2021

Commodities rewired

- The economic restart has lifted commodity prices. Beyond that, we see structural trends leading to a divergence of fortunes in different commodities.
- The International Monetary Fund has raised its global growth forecast to 6% in 2021. U.S. stocks hit record highs and yields traded below 14-month peaks.
- U.S. retail and consumer sentiment data will be in focus. Retail sales are expected to rebound from a cold weather-induced decline in February.

Oil and industrial metals have rallied since late-2020 on expectations for a swift economic restart, sparking talk of a new commodity “supercycle.” We see a more nuanced outlook – with a divergence across different commodities. The lift for oil from the economic restart is likely to be transitory, while some metals may benefit from structural trends such as the “green” transition for years to come, in our view.

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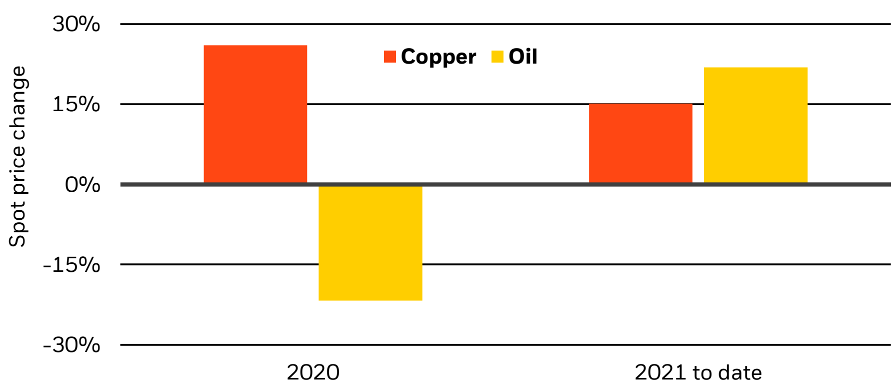
Chart of the week

Changes in crude oil and copper prices, 2020 and 2021 to date



Sources: BlackRock Investment Institute, with data Refinitiv, April 2021. Notes: Crude oil prices are represented by the spot Brent crude oil prices, and copper prices are represented by the London Metal Exchange spot copper prices.

Oil and copper are among the best-performing assets so far this year - after divergent performance last year. See the chart above. The post-pandemic restart – not a typical business cycle recovery – suggests the economy’s snapback from the Covid shock will likely be much swifter than the recoveries in the past, in our view. Growth in China – the world’s top commodity consumer – is already back to its pre-Covid trend, and the U.S. is close behind. This dynamic has buoyed commodities in recent months, yet we expect the support to fade once the economy returns to a modest growth trend. We see long-term dynamics at play too. The strength in copper (see the orange bars) partly stems from a supply crunch that is the result of years of underinvestment and increased capital discipline among major miners – and exacerbated by production disruptions caused by the pandemic. In addition, a transition to a low-carbon economy has provided long-term support for copper. In contrast, oil suffered a collapse in demand last year as travel demand dried up. Near-term demand may well return – but peak oil demand looms large.

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We see structural dynamics potentially leading to long-lasting – and divergent – impact on two groups of commodities. The first is oil and other fossil fuels. A strong economic restart may still support prices of oil and related assets in the near term. Yet the prospect of peak oil demand is now well accepted, and we see the "green" transition likely to erode oil demand over the long run. The second group – certain industrial metals including copper, nickel and lithium – looks set to enjoy structural demand from that very transition for years to come. Decarbonization of the power system and electrification of the transport sector, for example, will be massive endeavors requiring a large-scale buildout of new infrastructure. At the same time, the increased focus on sustainability could make new mining projects more expensive and time-consuming to build, potentially aggravating the supply shortage and driving prices higher to incentivize greater production.

China's commodity consumption was the key driver of the last commodities "supercycle" in the early 2000s – but this time may be different. We see more broad-based demand for industrial metals across developed and emerging markets (EM), thanks to a global policy revolution in response to the Covid shock and structural demand due to massive government spending on renewable energy and infrastructure. A remapping of global supply chains could also boost demand for raw materials as companies build facilities in new locations to increase their resilience to disruptions.

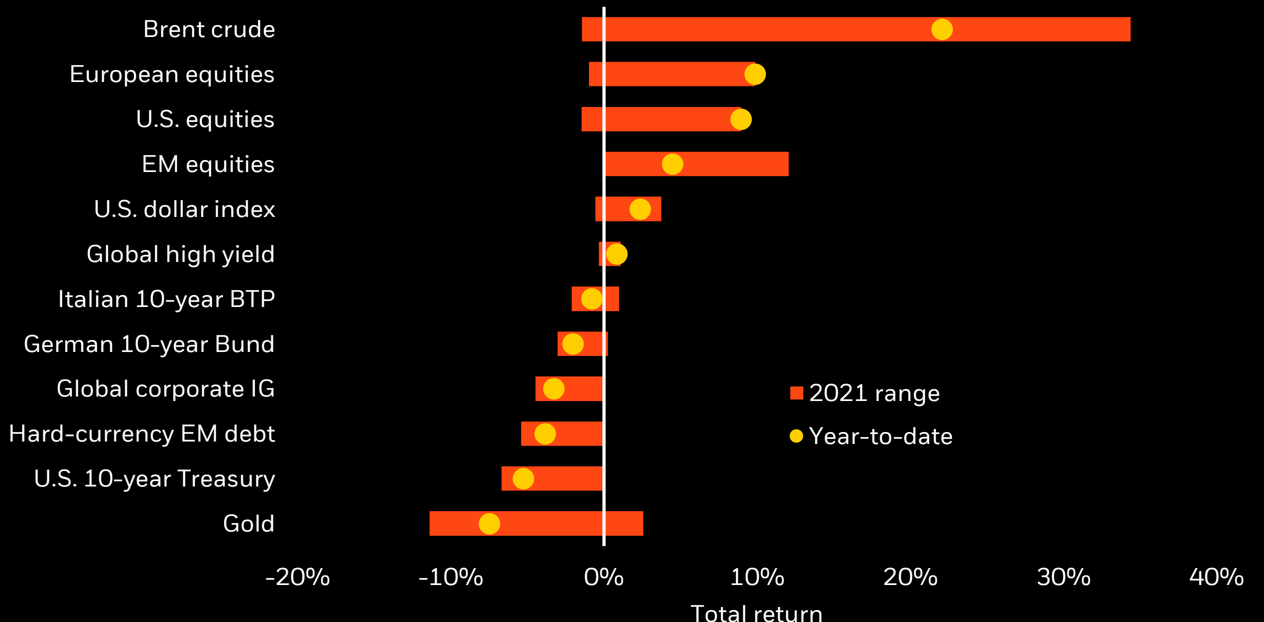
The bottom line: The powerful economic restart is likely to support many commodities in the near term, including oil. This should benefit the assets of commodity exporters, including some EMs. But the support from the powerful restart will be transitory, and we do not see a broad-based rise in global demand that buoys *all* commodities. Instead, we see a divergence story: The "green" transition will eventually erode demand for fossil fuels, potentially cutting short the duration of any price upswing. At the same time it looks likely to create structural demand for many industrial metals that may last for decades to come. Investing in commodities isn't straightforward for most individual investors. Commodity-related equities is an option, yet there are risks specific to equity markets. Overall, our climate-aware return assumptions place energy and utilities sectors as laggards in long-term performance and expect technology and healthcare to benefit the most from the "green" transition, judging by their exposure to climate risks and opportunities. Over the tactical horizon, we tilt toward cyclicality and maintain a bias for quality. We are overweight U.S., emerging market and UK equities, as well as global high yield credit.

Market backdrop

U.S. stocks hit new record highs and 10-year Treasury yields traded below the 14-month peak. The International Monetary Fund (IMF) raised its forecast for global growth to 6% for this year - the highest since the 1970s – citing unprecedented public spending especially in the U.S. We expect equities and other risk assets to be supported by the *new nominal* – a more muted response of government yields to stronger growth and higher inflation than in the past as central banks lean against any sharp yield rises.

Assets in review

Selected asset performance, 2021 year-to-date and range



Past performance is not a reliable indicator of current or 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 Refinitiv Datastream as of April 8, 2021. Notes: The two ends of the bars show the lowest and highest returns at any point this 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, in descending order: spot Brent crude, MSCI Europe Index, MSCI USA Index, MSCI Emerging Markets Index, the ICE U.S. Dollar Index (DXY), Bank of America Merrill Lynch Global High Yield Index, Refinitiv Datastream Italy 10-year benchmark government bond index,, Refinitiv Datastream Germany 10-year benchmark government bond index, Bank of America Merrill Lynch Global Broad Corporate Index, J.P. Morgan EMBI index, Refinitiv Datastream U.S. 10-year benchmark government bond index and spot gold.

Macro insights

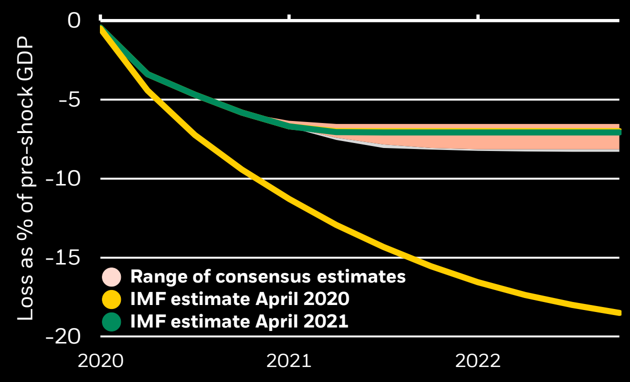
The IMF turned more bullish on global growth in its April update to its World Economic Outlook. Its U.S. forecast now implies a cumulative GDP loss – what matters to financial markets – at just over 7% for the U.S. This is less than half the loss it expected a year ago, as the chart shows.

The updated estimates once again underscore why risk assets have done so well over the past year. The Covid shock is more akin to a natural disaster than a regular business cycle recession, in our view. We see this distinct nature and unprecedented policy support leading to a much smaller activity shortfall, especially compared with that after the global financial crisis. Permanent scarring of productive capacities was likely avoided due to the comprehensive policy response, in our view. Consensus estimates now call for U.S. growth to return to its pre-Covid trend by the end of the year.

The IMF outlook is less optimistic on emerging markets, where slower rollout of vaccines, more limited policy space and greater reliance of tourism could weigh on activity in the longer term. See our macro insights hub for more.

A smaller shortfall

Estimated U.S. GDP shortfall from Covid shock, 2020-2022



Sources: BlackRock Investment Institute, IMF, with data from the IMF and Reuters News, April 2021. Notes: The green line shows an estimate for the cumulative U.S. GDP shortfall compared with the pre-Covid trend, based on the IMF forecast of April 2021. The yellow line shows an estimate based on the IMF forecast of April 2020. The shaded orange area shows the range o f cumulative losses per the latest Reuters consensus . There is no guarantee that any forecasts made will come to pass.

Investment themes

1 The new nominal

- Our *new nominal* theme – that nominal yields will be less sensitive to expectations for higher inflation – has been confirmed by the Fed's March policy meeting. The Fed made it clear that the bar for reassessing its policy rate path was not met and that it was too soon to talk about tapering bond purchases, while embracing a material improvement in its outlook. We believe this clear reaffirmation of its commitment to be well "behind the curve" on inflation and to wait to see it move above target has helped the Fed regain control of the narrative – for now.
- We believe the recent rise in nominal government bond yields, led by real yields, is justified and reflects markets awakening to positive developments on the faster-than-expected activity restart combined with historically large fiscal stimulus – all helped by a ramp-up in vaccinations in the U.S.
- We expect short-term rates will stay anchored near zero, supporting equity valuations. The Fed could be more willing to lean against rising long-term yields than the past, yet the direction of travel over the next few years is clearly towards higher long-term yields. We see important limits on the level of yields the global economy can withstand.
- **Market implication**: We favor inflation-linked bonds amid inflationary pressures in the medium term. Tactically we prefer to take risk in equities over credit amid low rates and tight spreads.

2 Globalization rewired

- Covid-19 has accelerated geopolitical transformations such as a bipolar U.S.-China world order and a rewiring of global supply chains, placing greater weight on resilience.
- The Biden administration is engaging in strategic competition with China, particularly on technology, and has criticized Beijing on human rights issues. The tensions were on display in a bilateral diplomatic meeting in Alaska.
- We see assets exposed to Chinese growth as core strategic holdings that are distinct from EM exposures. There is a case for greater exposure to China-exposed assets for potential returns and diversification, in our view.
- We expect persistent inflows to Asian assets as we believe many global investors remain underinvested and China's weight in global indexes grows. Risks to China-exposed assets include China's high debt levels and U.S.-China conflicts, but we believe investors are compensated for these risks.
- **Market implication**: Strategically we favor deliberate country diversification and above-benchmark China exposures. Tactically we like Asia ex-Japan equities, and see UK equities as an inexpensive, cyclical exposure.

3 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.
- The pandemic has focused attention on underappreciated sustainability-related factors and supply chain resilience.
- It has also accelerated "winner takes all" dynamics that have led to the strong performance of a handful of tech giants in recent years. We see tech as having long-term structural tailwinds despite its increased valuations, yet it could face challenges from higher corporate taxes and tighter regulation under a united Democratic government.
- 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.
- **Market implication**: Strategically we see returns being driven by climate change impacts, and view developed market equities as an asset class positioned to capture the opportunities from the climate transition. Tactically we favor tech and healthcare as well as selected cyclical exposures.

Week ahead

April 12-19	China total social financing and new yuan loans
April 13	Germany ZEW Indicator of Economic Sentiment
April 15	U.S. Philly Fed business survey, retail sales, industrial production
April 16	University of Michigan Surveys of Consumers; China industrial output

U.S. retail and consumer sentiment data will be in focus. Retail sales were expected to rise 4.7% in March after falling in the previous month, partly due to cold weather, according to a Reuters poll. The University of Michigan survey could shed light on consumer sentiment, after the lifting of restriction in some states and additional relief payment from the government.

Directional views

Strategic (long-term) and tactical (6-12 month) views on broad asset classes, April 2021

Change in view: Previous → New

Asset	Strategic view	Tactical view	
Equities	+1	+1	We are overweight equities on a strategic horizon. We see a better outlook for earnings amid moderate valuations. Incorporating climate change in our expected returns brightens the appeal of developed market equities given the large weights of sectors such as tech and healthcare in benchmark indexes. Tactically, we stay overweight equities as we expect the restart to re-accelerate and interest rates to stay low. We tilt toward cyclicality and maintain a bias for quality.
Credit	-1	Neutral	We are underweight credit on a strategic basis as valuations are rich and we prefer to take risk in equities. On a tactical horizon, credit, especially investment grade, has come under pressure from tightening spreads, but we still like high yield for income.
Govt bonds	-1	-1	We are strategically underweight nominal government bonds as their ability to act as portfolio ballasts are diminished with yields near lower bounds and rising debt levels may eventually pose risks to the low-rate regime. This is part of why we underweight government debt strategically. We prefer inflation-linked bonds as we see risks of higher inflation in the medium term. We are underweight duration on a tactical basis as we anticipate gradual increases in nominal yields supported by the economic restart.
Cash		Neutral	We use cash to fund overweight in equities. Holding some cash makes sense, in our view, as a buffer against supply shocks driving both stocks and bonds lower.
Private markets	Neutral		We believe 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.

Notes: Views are from a U.S. dollar perspective, April 2021. 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.

Granular views

Change in view
Previous New

Six to 12-month tactical views on selected assets vs. broad global asset classes by level of conviction, April 2021

	Asset	Underweight	Overweight	
Equities	United States		■	We are overweight U.S. equities. 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.
Equities	Euro area			We are neutral European equities. We believe the broad economic restart later in the year will help narrow the performance gap between this market and the rest of the world.
Equities	Japan	■		We are underweight Japanese equities. Other Asian economies may be greater beneficiaries of a more predictable U.S. trade policy under a Biden administration. A stronger yen amid potential U.S. dollar weakness may weigh on Japanese exporters.
Equities	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.
Equities	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.
Equities	UK		■	We are overweight UK equities. The removal of uncertainty over a Brexit deal should see the risk premium on UK assets attached to that outcome erode. We also see UK large-caps as a relatively attractive play on the global cyclical recovery as it has lagged peers.
Equities	Momentum			We keep momentum at neutral. The factor has become more exposed to cyclicality, could face challenges in the near term as a resurgence in Covid-19 cases and a slow start to the vaccination efforts create potential for choppy markets.
Equities	Value			We are neutral on value despite recent underperformance. 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.
Equities	Minimum volatility	■		We are underweight min vol. We expect a cyclical upswing over the next six to 12 months, and min vol has historically lagged in such an environment.
Equities	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.
Equities	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 cyclicality may be rewarded amid a vaccine-led recovery.
Fixed Income	U.S. Treasuries	■■		We are underweight U.S. Treasuries. We see nominal U.S. yields rising but largely due to a repricing higher of inflation expectations. This leads us to prefer inflation-linked over nominal government bonds.
Fixed Income	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.
Fixed Income	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.
Fixed Income	Euro area peripherals			We are neutral euro peripheral bond markets. Yields have rallied to near record lows and spreads have narrowed. The ECB supports the market but it is not price-agnostic - its purchases have eased as spreads have narrowed.
Fixed Income	Global investment grade	■		We are underweight investment grade credit. We see little room for further yield spread compression and favor more cyclical exposures such as high yield and Asia fixed income.
Fixed Income	Global high yield		■	We are moderately overweight global high yield. Spreads have narrowed significantly, but we believe the asset class remains an attractive source of income in a yield-starved world.
Fixed Income	Emerging market – hard currency			We are neutral hard-currency EM debt. We expect it to gain support from the vaccine-led global restart and more predictable U.S. trade policies.
Fixed Income	Emerging market – local currency			We are neutral local-currency EM debt. 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.
Fixed Income	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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