BLACKROCK INVESTMENT INSTITUTE

Richard Turnill
Global Chief Investment Strategist

Richard Turnill is BlackRock's Global Chief Investment Strategist. He was previously Chief Investment Strategist for BlackRock's fixed income and active equity businesses, and has also led the Global Equity investment team. Richard started his career at the Bank of England.

Share your feedback at
BlackRockInvestmentInstitute@blackrock.com

Isabelle Mateos y Lago
Chief Multi-Asset Strategist
BlackRock Investment Institute

Kate Moore
Chief Equity Strategist
BlackRock Investment Institute

Jeff Rosenberg
Chief Fixed Income Strategist
BlackRock Investment Institute

WEEKLY COMMENTARY • MARCH 5, 2018

Key points

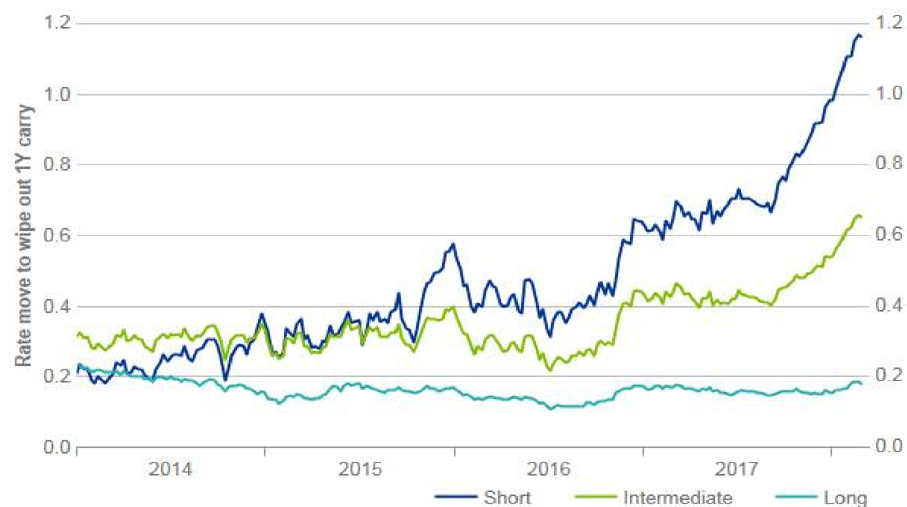
1. We see higher yields as an opportunity for investors to add exposure to shorter-term U.S. Treasuries.
2. Global stocks fell on fears over U.S.-imposed trade tariffs, while remarks from the Fed chair cemented the idea of at least three 2018 rate hikes.
3. China's National People's Congress is expected to rubber stamp a broad government overhaul that further centralizes power.

1 Long on short bonds

A rapid rise in short-term yields in U.S. government debt is restoring their appeal. This marks a major shift away from the post-crisis era of near-zero yields on such instruments. The upshot: Investors now have a viable alternative to cash with yields finally above inflation levels.

Chart of the week

U.S. Treasury yield cushion by maturity, 2014-2018



Sources: BlackRock Investment Institute, with data from Thomson Reuters, March 2018. Notes: The yield cushion is defined as the percentage point rise in yield that would cause a price decline large enough to wipe out one year's worth of income. Short, intermediate and long maturity Treasuries are represented by the Bloomberg Barclays 1-3 year, Intermediate and Long U.S. Treasury Indexes.

The steady increase in shorter-maturity bond yields provides a thicker cushion against concerns around further rises in interest rates. The light green line in the chart above shows interest rates would need to jump more than one percentage point to wipe out a year of income in the two-year Treasury note. This is nearly double the cushion on offer two years ago – and far larger than the thin insulation provided by longer-term bonds today. We believe the short end offers relatively compelling income along with a healthy buffer against the prospects of further increases in yields.

BLACKROCK®

The fruits of normalization

The rise in short-term U.S. rates reflects multiple market crosscurrents. The U.S. Treasury market is catching up with the Fed's own projection of rate hikes in 2018. This reassessment is largely driven by stronger growth expectations tied to fiscal stimulus. Fed Chair Jerome Powell's upbeat appraisal of the economy has reinforced expectations for three to four rate hikes this year.

But two important aspects are influencing rates at the short end of the curve. First, the tax overhaul and budget agreement are spurring a sharp uptick in U.S. Treasury issuance, particularly in one-month to one-year bills. We estimate net bill issuance to hit $500 billion this year, far beyond that seen in recent years. This comes as the Fed is winding down its bond holdings.

Second, U.S. companies repatriating cash following the passage of the Tax Cuts and Jobs Act are causing some ripples in the front end. Money market funds, one of the largest buyers of front-end credit, may be building liquidity in anticipation of any repatriation-related redemptions. Meanwhile, actual and anticipated selling of short-duration bonds as companies repurpose repatriated cash has led to a widening in spreads.

We believe both these factors are technical and the back-up in yields opens up opportunities. Short-dated Treasury debt now provides an attractive real return as yields now stand firmly above realized and target levels of inflation. And as the market has adjusted to an outlook of three to four Fed rate hikes, we see limited downside from price erosion as we see pricing in more than four hikes as very unlikely.

Traditionally "safe" and liquid assets can now better compete for investor capital. Broadly, we still prefer equities over credit due to strong earnings growth, modestly cheaper valuations following last month's swoon and market's pricing in expectations of Fed rate increases. And repatriation of corporate cash may lead to more share buybacks. Our preference leans firmly toward pro-cyclical stocks. Within fixed income, we see higher yields as an opportunity for investors to add short-end exposure that avoids duration risks further out the curve.

2 Week in review

- Global equities suffered another setback as U.S. President Donald Trump said the United States will impose tariffs on steel and aluminum imports — a move likely to increase tensions with major trading partners, including China. Fed Chair Powell's first testimony to Congress briefly pushed benchmark Treasury yields back near four-year highs.
- Renewed uncertainty about the path ahead for Brexit negotiations drove the British pound lower. Germany's Social Democratic Party (SPD) membership approved a coalition with Chancellor Angela Merkel.
- A string of manufacturing data underwhelmed around the world, with figures showing some payback from previous strength. U.S. consumer confidence hit a 17-year high in February. U.S. core PCE prices rose as expected in January and incomes posted a surprisingly strong gain.

Global snapshot

Weekly and 12-month performance of selected assets

Equities	Week	YTD	12 Months	Div. Yield
U.S. Large Caps	-2.0%	0.7%	13.0%	2.0%
U.S. Small Caps	-1.0%	0.0%	11.3%	1.2%
Non-U.S. World	-2.9%	-1.3%	19.0%	3.2%
Non-U.S. Developed	-2.9%	-2.0%	17.0%	3.4%
Japan	-2.0%	0.6%	19.2%	2.1%
Emerging	-2.8%	2.2%	29.0%	2.7%
Asia ex-Japan	-2.1%	1.2%	30.5%	2.5%

Bonds	Week	YTD	12 Months	Yield
U.S. Treasuries	0.1%	-2.0%	0.3%	2.9%
U.S. TIPS	0.3%	-1.6%	1.0%	2.9%
U.S. Investment Grade	-0.2%	-2.8%	2.7%	3.7%
U.S. High Yield	-0.2%	-0.7%	3.4%	6.2%
U.S. Municipals	0.1%	-1.4%	3.1%	2.7%
Non-U.S. Developed	0.3%	3.0%	13.3%	0.9%
EM $ Bonds	0.0%	-2.2%	4.5%	5.7%

Commodities	Week	YTD	12 Months	Level
Brent Crude Oil	-4.4%	-3.7%	16.9%	$64.37
Gold	-0.4%	1.5%	7.2%	$1,323
Copper	-2.8%	-4.8%	16.3%	$6,898

Currencies	Week	YTD	12 Months	Level
Euro/USD	0.2%	2.6%	17.2%	1.23
USD/Yen	-1.1%	-6.2%	-7.6%	105.75
Pound/USD	-1.2%	2.1%	12.5%	1.38

Source: Bloomberg. As of March 2, 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

March 5 China National People's Congress; U.S. ISM non-manufacturing PMI

March 7 China trade balance; U.S. trade data

March 8 European Central Bank policy meeting

March 9 Bank of Japan policy meeting; U.S. February jobs data

China's National People's Congress (NPC) next week will unveil a broad overhaul of the government's structure. The changes point to more centralized leadership within the Communist Party, tighter financial regulation and a smoother path for President Xi Jinping's flagship reforms. Among the changes expected are a status upgrade for the People's Bank of China (PBOC) to bolster its independence. A new PBOC governor is set to be named shortly as well. A decision is also expected to be made on a proposed constitutional amendment removing the term limits on the president and vice president.

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 amid a stable yen outlook. We see BoJ policy and domestic investor buying as supportive. 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, and like Brazil and India. We are cautious on Mexico.
	Asia ex-Japan	▲	The economic backdrop is encouraging. China's growth and corporate earnings appear 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 more compelling risk/reward, and rising inflation gives TIPS an edge over nominal Treasuries. We are neutral on agency MBS given full valuations and the uncertain effect of the Fed's balance sheet unwind.
	U.S. municipals	—	Solid retail investor demand and muted supply are supportive of munis, but rising rates weigh on performance. A more defensive stance is warranted near term, though material weakness 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 appear increasingly well positioned for rising rates.
	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, and spreads of semi-core and selected peripheral government bonds to narrow.
	European credit	▼	Ongoing ECB purchases have compressed spreads across sectors and credit-quality buckets. Negative rates have crimped absolute yields – and rising rate differentials make currency hedged positions increasingly attractive for U.S. dollar investors. Subordinated financial debt is less alluring versus equities after a strong 2017.
	EM debt	—	Gradual Fed rate increases favor local-currency exposures – especially their higher yields relative to major bond markets. A shift by EM central banks towards tighter policy reduces our return expectations. Solid fundamentals and inflows should limit EM currency volatility.
	Asia fixed income	—	Regional growth and inflation dynamics are supportive of credit. China's rising representation in the region's bond landscape 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	*	A reduction in global oil inventories is supporting oil prices. 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.

BII0318U/E-440250-1393145

BlackRock Investment Institute

The BlackRock Investment Institute (BII) provides connectivity between BlackRock's portfolio managers, originates market research and publishes insights. Our goals are to help our fund managers become better investors and to produce thought-provoking content for clients and policymakers.

General disclosure: *This material is prepared by BlackRock and 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 March 5, 2018, and may change as subsequent conditions vary. The information and opinions contained in this material are derived from proprietary and nonproprietary 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., this material is for public distribution. **In the EU** issued by BlackRock Investment Management (UK) Limited (authorised and regulated by the Financial Conduct Authority). Registered office: 12 Throgmorton Avenue, London, EC2N 2DL. Registered in England No. 2020394. Tel: 020 7743 3000. For your protection, telephone calls are usually recorded. BlackRock is a trading name of BlackRock Investment Management (UK) Limited. This material is for distribution to Professional Clients (as defined by the FCA Rules) and Qualified Investors and should not be relied upon by any other persons. For qualified investors **in Switzerland**, this material 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. Issued **in the Netherlands** by the Amsterdam branch office of BlackRock Investment Management (UK) Limited: Amstelplein 1, 1096 HA Amsterdam, Tel: 020 - 549 5200. **In South Africa**, please be advised that BlackRock Investment Management (UK) Limited is an authorised Financial Services provider with the South African Financial Services Board, FSP No. 43288. **In Dubai**: This information 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") and is only directed at 'Professional Clients' and no other person should rely upon the information contained within it. Neither the DFSA or any other authority or regulator located in the GCC or MENA region has approved this information. This information and associated materials have been provided for your exclusive use. This document is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution would be unlawful under the securities laws of such. Any distribution, by whatever means, of this document and related material to persons other than those referred to above is strictly prohibited. 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 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 Korea**, this material is for Professional Investors only. **In Taiwan**, independently operated by BlackRock Investment Management (Taiwan) Limited. Address: 28/F, No. 95, Tun Hwa South Road, Section 2, Taipei 106, 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) and for information or educational purposes only, and does not constitute investment advice or an offer or solicitation to purchase or sells in any securities or any investment strategies. **In Australia**, issued by BlackRock Investment Management (Australia) Limited ABN 13 006 165 975, AFSL 230 523 (BIMAL). This material is not a securities recommendation or an offer or solicitation with respect to the purchase or sale of any securities in any jurisdiction. The material provides general information only and does not take into account your individual objectives, financial situation, needs or circumstances. BIMAL, its officers, employees and agents believe that the information in this material and the sources on which it is based (which may be sourced from third parties) are correct as at the date of publication. While every care has been taken in the preparation of this material, no warranty of accuracy or reliability is given and no responsibility for the information is accepted by BIMAL, its officers, employees or agents. No guarantee as to the repayment of capital or the performance of any product or rate of return referred to in this material is made by BIMAL or any entity in the BlackRock group of companies. **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 Canada**, this material is intended for permitted clients only. **In Latin America and Iberia**, this material is for educational purposes only and does not constitute investment advice nor an offer or solicitation to sell or a solicitation of an offer to buy any shares of any fund (nor shall any such shares be offered or sold to any person) in any jurisdiction in which an offer, solicitation, purchase or sale would be unlawful under the securities law of that jurisdiction. If any funds are mentioned or inferred to in this material, it is possible that some or all of the funds have not been registered with the securities regulator of Brazil, Chile, Colombia, Mexico, Panama, Peru, Portugal, Spain, Uruguay or any other securities regulator in any Latin American country and thus might not be publicly offered within any such country. The securities regulators of such countries have not 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.

©2018 BlackRock, Inc. All Rights Reserved. **BLACKROCK** is a registered trademark of BlackRock, Inc.
All other trademarks are those of their respective owners.

Not FDIC Insured • May Lose Value • No Bank Guarantee

BLACKROCK®

BII0318U/E-440250-1393145