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Key points

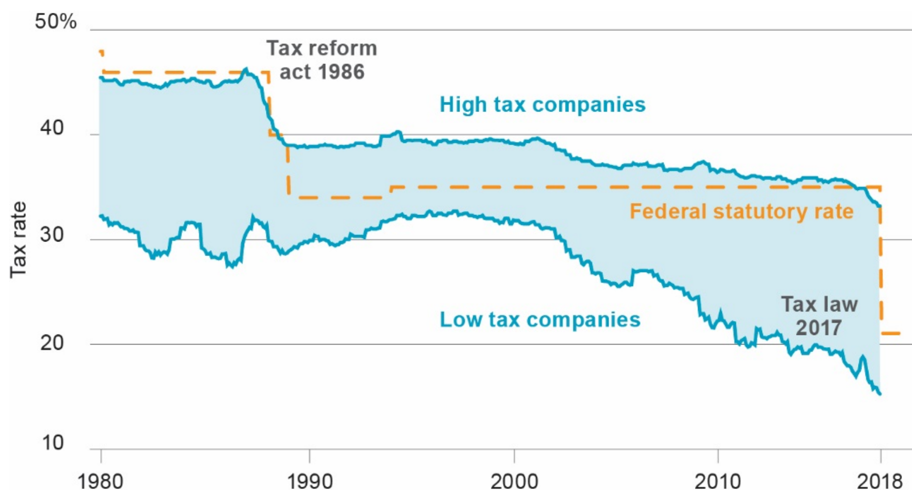
1. We see the U.S. tax overhaul boosting growth, lifting interest rates and creating winners and losers from lower top rates and closing of loopholes.
2. U.S. Treasury yields hit 10-month peaks and equity markets notched more record highs. Oil prices rose on signs of tightening supply.
3. Chinese fourth-quarter gross domestic product (GDP) data will set the tone for the country's growth expectations and policy priorities for 2018.

1 Tax overhaul winners and losers

The Tax Cuts and Jobs Act is poised to boost a U.S. economy already running at full capacity. A windfall from lower taxes and incentives for capex could spur more consumer and business spending and corporate deal-making. A likely convergence in tax rates could create winners and losers, rippling across sectors and companies.

Chart of the week

U.S. equities effective corporate tax rates, 1980-2017



Sources: BlackRock Investment Institute, with data from Thomson Reuters and Compustat, January 2018.
Notes: We take data from financial statements for Russell 1000 companies to arrive at an effective corporate tax rate at the company level (tax expense divided by pretax income). The lines show the effective tax rates of 75th percentile of tax payers and 25th percentile over time. The dotted line shows the federal statutory rate.

A 30-year rewind is informative. In the decade following the 1986 U.S. tax reforms, companies paying a relatively high share of their income in taxes saw their effective tax rates drop. Low effective tax payers saw a small rise as reforms leveled the playing field and closed loopholes. Effective tax rates started diverging again in the late 1990s as globalization, the adoption of territorial tax systems and relatively high top U.S. tax rates encouraged tax avoidance schemes. We believe something similar may play out today. The top quartile of U.S. companies currently pay an effective tax rate of 34% or more, our analysis shows. This leaves plenty of room for relief as the top rate is slashed to 21%. Lightly taxed companies, by contrast, may see their rates go up over time.

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Looking beneath the surface

The overhaul of the U.S. tax code includes supply-side reforms and injects significant near-term demand stimulus into a U.S. economy running at near-full employment. A faster-growing U.S. may accelerate global growth, and result in rising inflation, higher Treasury yields and steeper yield curves. Look for a deep dive into how the tax changes and potentially higher U.S. government spending may affect the economy and interest rates in our upcoming *Global macro outlook*.

The tax cuts create winners and losers in the corporate sector. The drop in the top statutory rate will broadly benefit U.S. companies with high effective tax rates. But some of the benefits for these companies appear to be priced in already, suggesting investors need to look beneath the surface to identify the longer-term winners. There is significant dispersion within industries, sub-sectors and companies. The sustainability of increased corporate profitability derived from tax cuts will also vary. Companies in highly competitive industries, for example, will likely see a temporary profit boost that is quickly competed away. Changes to companies' spending and investment plans because of the tax law are key details to watch through the fourth-quarter earnings season. We expect U.S. global corporations to scrutinize the new tax code's complex international rules in an effort to manage any rises in their effective tax rates.

In credit markets, we see investment grade companies benefiting from lower tax rates. Yet we see most of the impact going to shareholders rather than toward paying down debt. High yield companies benefit from lower tax rates and immediate expensing of capex. But we expect more bifurcation between higher- and lower-quality issuers, as ones with large debt loads face limits to interest expense deductibility. This reinforces our up-in-quality credit stance. Municipal bonds emerged relatively unscathed, even as advanced-refunding bonds lost their tax-exempt status. This is set to shrink issuance, a factor we see supporting valuations.

2 Week in review

- Global bond yields climbed, with 10-year U.S. Treasuries hitting 10-month highs. U.S. interest rate volatility picked up, partly on reports, later denied, that China was planning to slow its Treasury purchases. Strong retail sales and inflation data in the U.S. also pushed yields higher.
- Global equities marched on as U.S. banks kicked off the earnings season. Banks' projected tax rates were lower than expected, but trading revenues remained sluggish. A breakthrough in German coalition talks and hawkish minutes from the European Central Bank (ECB) underpinned euro strength.
- Oil prices rose to 2014 highs on U.S. inventory reductions and OPEC commitments to maintain cuts through 2018.

Global snapshot

Weekly and 12-month performance of selected assets

Equities	Week	YTD	12 Months	Div. Yield
U.S. Large Caps	1.6%	4.2%	22.7%	1.9%
U.S. Small Caps	2.1%	3.7%	18.5%	1.1%
Non-U.S. World	0.9%	3.7%	28.4%	3.0%
Non-U.S. Developed	1.2%	3.7%	26.7%	3.1%
Japan	1.6%	4.8%	25.7%	1.9%
Emerging	0.6%	4.3%	37.7%	2.6%
Asia ex-Japan	0.7%	4.2%	41.5%	2.4%

Bonds	Week	YTD	12 Months	Yield
U.S. Treasuries	-0.3%	-0.7%	1.1%	2.5%
U.S. TIPS	-0.4%	-0.6%	1.5%	2.4%
U.S. Investment Grade	0.0%	-0.4%	5.3%	3.3%
U.S. High Yield	0.0%	0.7%	7.1%	5.6%
U.S. Municipals	-0.4%	-0.5%	3.7%	2.4%
Non-U.S. Developed	0.7%	0.8%	10.2%	0.8%
EM $ Bonds	-0.4%	0.2%	8.7%	5.3%

Commodities	Week	YTD	12 Months	Level
Brent Crude Oil	3.3%	4.5%	24.7%	$69.87
Gold	1.4%	2.7%	11.9%	$1,338
Copper	-0.2%	-1.9%	21.7%	$7,110

Currencies	Week	YTD	12 Months	Level
Euro/USD	1.4%	1.6%	15.0%	1.22
USD/Yen	-1.8%	-1.4%	-3.2%	111.06
Pound/USD	1.2%	1.6%	12.9%	1.37

Source: Bloomberg. As of Jan. 12, 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.

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3 Week ahead

Jan. 17	U.S. industrial production
Jan. 18	China Q4 GDP, fixed-asset investment, retail sales
Jan. 19	International Energy Agency report

We are watching fourth-quarter Chinese GDP closely for hints on the country's growth trajectory and policy priorities. The latest set of manufacturing and services data suggests China ended the year on a high note. Official Purchasing Managers' Index (PMI) readings have caught up with the BlackRock Growth GPS. We expect a mild deceleration in China to a more sustainable growth pace. Inflation remains stable, leaving the central bank enough room to maintain its monetary stance while curbing credit growth and pushing for deleveraging within the economy.

Asset class views

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

Asset class		View	Comments
Equities	U.S.	—	Earnings momentum is strong heading into 2018. U.S. corporate tax cuts should boost earnings. We like the momentum and value style factors, financials, technology and dividend growers.
	Europe	▲	We see sustained above-trend economic expansion and a steady earnings outlook supporting cyclicals. Euro strength is still playing out in company results and could cause more 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 expect rates to move moderately higher amid a sustained economic expansion and a tightening Fed. Rising inflation and lower valuations give TIPS an edge over nominal Treasuries. We are neutral on agency mortgages, given full valuations and the uncertain effect of the Fed's unwinding its balance sheet.
	U.S. municipals	—	Increased issuance driven by tax reform expectations should reverse in 2018, creating a more supportive supply/demand balance. This, plus solid appetite for tax-exempt income, underpins the asset class. We favor maturities of 0-2 and 20+ years.
	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	*	Oil prices are underpinned by supply-and-demand rebalancing. The U.S. dollar has scope to strengthen against the euro and the yen in coming months, as the Fed's normalizing ahead of its peers looks to be underpriced for now.

▲ Overweight — Neutral ▼ Underweight

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

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