

BLACKROCK INVESTMENT INSTITUTE



Richard Turnill

Global Chief Investment Strategist

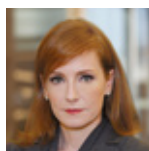
Richard Turnill is BlackRock's Global Chief Investment Strategist. He was previously Chief Investment Strategist for BlackRock's fixed income and active equity businesses, and has also led the Global Equity investment team. Richard started his career at the Bank of England.

Share your feedback at
blackrockinvestments@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 • FEB. 13, 2017

Key points

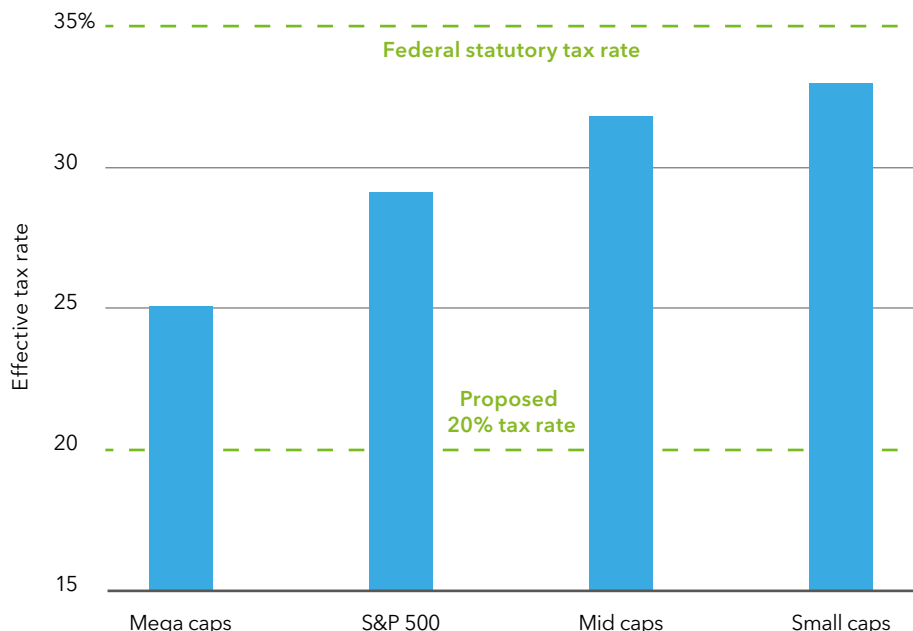
- 1 U.S. corporate tax reforms could reinforce a reflationary environment already in place before last November.
- 2 Some "Trump trades" partly unwound early last week, while political uncertainty sent French and Italian bond spreads wider.
- 3 Fed Chair Janet Yellen's testimony before Congress this week could raise market expectations of a March Fed rate increase.

1 Tax reform and the reflation trade

Our preference for reflation beneficiaries - or assets likely to benefit from rising growth and inflation - isn't contingent on U.S. corporate tax reform. Yet such reform does have the potential to amplify this market theme.

Chart of the week

Median effective U.S. corporate tax rates, 2016



Sources: BlackRock Investment Institute and Bloomberg, February 2017.

Notes: The bars show median effective corporate tax rates based on firms' latest fiscal-year earnings releases. Mega caps are the top-10 largest firms in the S&P 500 as measured by market cap. Mid caps are represented by the Russell Mid Cap Index and small caps by the Russell 2000 Index.

One example: We see reflation supporting more gains in U.S. small cap stocks. They typically outperform during periods of rising rates, as we note in our [Global Equity Outlook](#). Tax cuts would be an extra boost disproportionately benefiting small caps, given those corporations' higher effective tax rates.

Tax reform winners and losers

The reflation trade has waxed and waned since November along with expectations for U.S. tax reform. But any tax reforms this year should only reinforce a reflationary environment already in place before the U.S. presidential election. Significant uncertainty shrouds the final tax plan, and the need to find offsetting revenue means tax reform will create winners and losers.

The border tax adjustment would effectively subject imports to a 20% tax to help pay for any corporate tax cut. Proponents argue the U.S. dollar should rise in response, offsetting the impact on trade or consumer prices. We see only a partial currency adjustment, which could help exporters and hurt retailers and consumers. How the U.S. dollar behaves in such a scenario will be key for markets and the U.S. economy.

We also believe another proposed reform, scrapping the deductibility of interest expense, would ultimately hurt highly leveraged companies and have major implications for how companies finance themselves in capital markets. Without offsetting revenue, large corporate tax cuts would increase the deficit, creating a reflationary stimulus that could lead to higher interest rates. We see potential for volatility in the coming months as more reform details emerge.

2 Week in review

- Some “Trump trades” partly unwound amid policy uncertainty. Emerging market assets outperformed, U.S. Treasury yields fell sharply mid-week and U.S. value stocks underperformed a flat market.
- Political uncertainty sent French and Italian government bond yields to multi-year highs relative to their German peers. Half of the European firms that have reported earnings have beaten estimates.
- Oil fell to a near three-week low under the pressure of growing U.S. crude inventories, but pared some losses. China’s PMI data showed expansion in both services and manufacturing sectors.

Global snapshot

Weekly and 12-month performance of selected assets

Equities	Week	YTD	12 Months	Div. Yield
U.S. Large Caps	0.9%	3.5%	25.1%	2.1%
U.S. Small Caps	0.8%	2.4%	46.3%	1.5%
Non-U.S. World	0.3%	4.6%	22.5%	3.1%
Non-U.S. Developed	0.0%	3.5%	18.5%	3.3%
Japan	1.0%	4.4%	24.8%	2.0%
Emerging	1.2%	7.9%	30.3%	2.7%
Asia ex-Japan	1.5%	8.4%	25.3%	2.6%

Commodities	Week	YTD	12 Months	Level
Brent Crude Oil	-0.2%	-0.2%	83.9%	\$56.70
Gold	1.1%	7.5%	3.0%	\$1,234
Copper	5.5%	10.0%	37.0%	\$6,090

Bonds	Week	YTD	12 Months	Yield
U.S. Treasuries	0.4%	0.5%	-1.8%	2.4%
U.S. TIPS	0.5%	1.0%	4.0%	2.1%
U.S. Investment Grade	0.5%	0.6%	5.9%	3.3%
U.S. High Yield	0.1%	2.0%	24.5%	5.8%
U.S. Municipals	0.2%	0.9%	-0.5%	2.5%
Non-U.S. Developed	-0.9%	0.9%	-1.9%	0.8%
EM \$ Bonds	0.6%	2.7%	14.0%	5.5%

Currencies	Week	YTD	12 Months	Level
Euro/USD	-1.3%	1.2%	-5.7%	1.06
USD/Yen	0.5%	-3.2%	-0.1%	113.22
Pound/USD	0.1%	1.2%	-14.0%	1.25

Source: Bloomberg. As of Feb. 10, 2017. 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

Feb. 13-17 European firms, mainly defensives and financials, report earnings

Feb. 14 U.S. NFIB Small Business Optimism Index; China Consumer Price Index (CPI)

Feb. 14-15 Fed Chair Janet Yellen gives her semiannual monetary policy testimony before Congress

Feb. 15 U.S. retail sales, U.S. CPI

Markets are likely to react to any signals from Yellen regarding a March Federal Reserve rate rise, the odds of which we believe markets may be underpricing. NFIB's report will show if small business owners' economic confidence remains at a 12-year high.

Asset class views

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

	Asset class	View	Comments
Equities	U.S.	–	A shift toward fiscal expansion and deregulation are supportive, but uncertainties about the timing and implementation abound. Valuations are elevated. We like value, financials, health care and dividend growers.
	Europe	▲	Signs of global reflation, an improving earnings outlook and a weak euro support cyclicals and exporters. We see near-term political risk as overstated, and an unlikely global slump as the key risk.
	Japan	▲	Positives are a weaker yen, improving global growth and more shareholder-friendly corporate behavior. We see the BoJ anchoring 10-year yields near zero as supportive. Risks are renewed yen strength and rising wages eating into margins.
	EM	▲	Economic reforms, improving corporate fundamentals and reasonable valuations support EM stocks, we believe. Reflation and growth in the developed world are another positive. Risks include shifts in currency policies and trade conflicts.
	Asia ex-Japan	▲	Financial sector reform and rising current account surpluses are encouraging. China's economic transition is ongoing, but we believe lower growth rates are priced in. We like India and selected Southeast Asian markets.
Fixed income	U.S. government bonds	▼	A reflationary outlook challenges longer-term bonds. We favor TIPS over nominal debt. Widening in agency mortgage spreads improves valuations, yet changes to the Fed's reinvestments are a longer-term concern.
	U.S. municipals	–	Higher rates have restored value to the asset class, renewing inflows since the start of the year. We favor the short to intermediate part of the curve ahead of a seasonal period of higher issuance and uncertainty around tax reform.
	U.S. credit	▲	Stronger growth favors credit over Treasuries. We generally prefer up-in-quality exposures and investment grade bonds due to elevated credit market valuations. Floating-rate bank loans appear to offer insulation from rising rates but we find them pricey.
	European sovereigns	–	The recent improvement in economic data and underperformance of the sector keep us neutral. Political risks in Italy and France make us cautious on semi-core and peripheral government bonds.
	European credit	–	Elevated valuations keep us neutral. Steepening yield curves and rising bank share prices should bolster the outlook for selected financials, including subordinated debt, but Italian banking sector woes pose a risk.
	EM debt	–	Economic reflation should benefit EMs. Risks include a rising U.S. dollar and global rates, and threats to free trade. Strong post-U.S. election performance versus other risk assets makes us cautious. We still see selected opportunities, mostly in hard-currency debt.
	Asia fixed income	–	Valuations have become less compelling as spreads have compressed along with the recent rise in yields. We are positive on the cyclical outlook for China, but see rising U.S. trade protectionism as a risk.
Other	Commodities and currencies	–	Supply rationalization and reflation are underpinning oil and industrial metals in the near term. We see the U.S. dollar strengthening, especially against the yen and EM currencies, on stronger growth expectations and interest rate differentials.

▲ Overweight – Neutral ▼ Underweight

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 policy makers.

BLACKROCK VICE CHAIRMAN

Philipp Hildebrand

GLOBAL CHIEF INVESTMENT STRATEGIST

Richard Turnill

HEAD OF ECONOMIC AND MARKETS RESEARCH

Jean Boivin

EXECUTIVE EDITOR

Jack Reerink

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 Feb. 13, 2017, 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 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 Australia and New Zealand** by BlackRock Investment Management (Australia) Limited ABN 13 006 165 975 AFSL 230 523 (BIMAL) for the exclusive use of the recipient who warrants by receipt of this material that they are a wholesale client and not a retail client as those terms are defined under the Australian Corporations Act 2001 (Cth) and the New Zealand Financial Advisers Act 2008 respectively. This material contains general information only and does not constitute financial product advice. This material has been prepared without taking into account any person's objectives, financial situation or needs. Before making any investment decision based on this material, a person should assess whether the information is appropriate having regard to the person's objectives, financial situation and needs and consult their financial, tax, legal, accounting or other professional advisor about the information contained in this material. This material is not intended for distribution to, or use by any person or entity in any jurisdiction or country where such distribution or use would be contrary to local law or regulation. BIMAL is the issuer of financial products and acts as an investment manager in Australia. BIMAL does not offer financial products to persons in New Zealand who are retail investors (as that term is defined in the Financial Markets Conduct Act 2013 (FMCA)). This material does not constitute or relate to such an offer. To the extent that this material does constitute or relate to such an offer of financial products, the offer is only made to, and capable of acceptance by, persons in New Zealand who are wholesale investors (as that term is defined in the FMCA). BIMAL is a part of the global BlackRock Group which comprises of financial product issuers and investment managers around the world. This material has not been prepared specifically for Australian or New Zealand investors. It may contain references to dollar amounts which are not Australian or New Zealand dollars and may contain financial information which is not prepared in accordance with Australian or New Zealand law or practices. BIMAL, its officers, employees and agents believe that the information in this material and the sources on which the information is based (which may be sourced from third parties) are correct as at the date specified in this material. While every care has been taken in the preparation of this material, no warranty of accuracy or reliability is given and no responsibility for this information is accepted by BIMAL, its officers, employees or agents. Except where contrary to law, BIMAL excludes all liability for this information. Past performance is not a reliable indicator of future performance. Investing involves risk including loss of principal. No guarantee as to the capital value of investments nor future returns is made by BIMAL or any company in the BlackRock Group. 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. **In Singapore**, this is issued by BlackRock (Singapore) Limited (Co. registration no. 200010143N) for use only with institutional investors as defined in Section 4A of the Securities and Futures Act, Chapter 289 of Singapore. **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. This material is for distribution to "Professional Investors" (as defined in the Securities and Futures Ordinance (Cap.571 of the laws of Hong Kong) and any rules made under that ordinance) and should not be relied upon by any other persons or redistributed to retail clients in Hong Kong. **In Korea**, this material is for Professional Investors only (or "professional clients", as such term may apply in local jurisdictions). Investments involve risks. Past performance is not a guide to future performance. This material is intended for information purposes only 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 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 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 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.

©2017 BlackRock, Inc. All Rights Reserved. **BLACKROCK** is a registered trademark of BlackRock, Inc. All other trademarks are those of their respective owners.

Prepared by BlackRock Investments, LLC, member FINRA.

Not FDIC Insured • May Lose Value • No Bank Guarantee