

# Weekly commentary

April 5, 2021



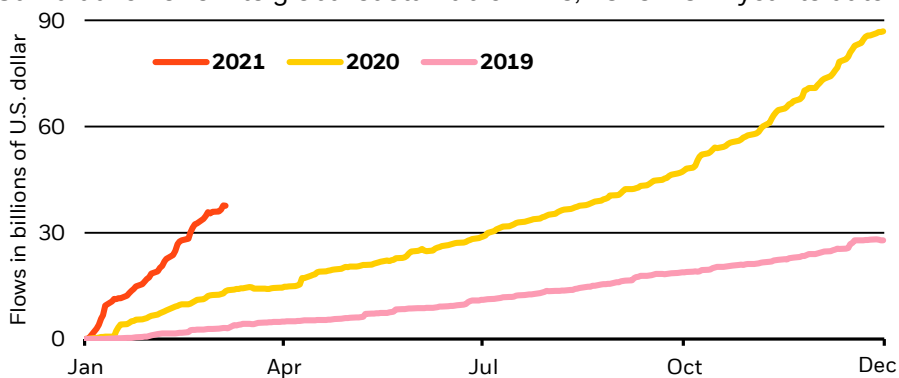
## Sustainable investing: it's a long game

- We see sustainability as a key driver of long-term asset returns even as other drivers could be more powerful in the near term, such as the economic restart.
- The White House announced a \$2.25 trillion jobs and infrastructure plan, adding to the unprecedented fiscal support since last year.
- U.S. services sector activity data will be in focus, as consumer confidence has returned to pre-Covid levels – against the backdrop of rising Covid infections.

The powerful economic restart has led to a rally in the traditional energy sector. This has raised concerns that sustainable assets may face pressure after stellar performance in 2020. We view such a short-term focus as misguided. The power of the near-term restart should not be confused with the slow transition to sustainability that we see driving long-term returns.

## Chart of the week

Cumulative flows into global sustainable ETPs, 2019-2021 year to date



Sources: BlackRock Investment Institute, with data from BlackRock ETF and Index Investment and Markit, as of March 5, 2021. Notes: The chart shows cumulative flows into sustainable exchange-traded products (ETPs) listed globally. Sustainable ETPs include a wide range of products that pursue a dedicated sustainable objective, whether using a broad ESG, exclusionary, impact, screened, sustainability-related, sustainable/environment, sustainable/ESG integration, or thematic strategy.

The Covid pandemic has accelerated structural trends including an increased focus on sustainability, and heightened attention on underappreciated sustainability-related risks and supply chain resilience. Sustainable exchange-traded products (ETPs) globally attracted record cumulative inflows of \$87 billion in 2020, and this year looks on track to significantly eclipse last year's record flows. See the chart above. An increasing political, regulatory and societal focus on sustainability across developed markets in particular means that the shift toward sustainable assets looks set to power ahead, in our view. The acceleration in sustainable fund flows has taken place in a dynamic market environment – from last year's Covid-induced economic shock and subsequent market recovery, through an economic restart that is now boosting cyclical assets such as value exposures. The persistence of the inflows speaks to our view that we are likely in the early stages of a shift in investor preferences toward sustainable assets – the full effects of which are likely not yet reflected in market prices.



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The investment case for sustainable assets is about their resilience and long-term return prospects, in our view. In 2021, we see the restart as the dominant driver of returns – and supporting assets exposed to today’s dominant energy sources. Yet this does not change our confidence in sustainability as a key driver of long-term returns. Sustainability will drive returns over time and beyond the restart, as the energy transition progresses, the economy restructures and capital is reallocated. That is why we think judging the impact of sustainability on near-term returns is wrong. We also believe sustainable exposures add potential resilience to portfolios, partly driven by a quality tilt in sustainable index methodologies toward companies with strong profitability and low leverage. Sustainable characteristics ranging from carbon efficiency to job satisfaction of employees and the effectiveness of a company’s board also add to the resilience properties, in our view.

We see climate change in particular as a key driver of returns – one that will boost growth and risk asset returns against a “no action” baseline. After a long transition to a low-carbon economy, assets backed by high sustainability will likely be more expensive – while other assets will have become cheaper, in our view. Sustainable assets should earn a return benefit during this transition, in addition to providing greater resilience against risks such as the physical disruptions from climate change. We believe the long-term effect of sustainability on asset performance has yet to be efficiently priced in, and see an opportunity today to position long-term portfolios to capture the potential historic return opportunity.

Our updated, climate-aware return assumptions for strategic portfolios have included the effect of climate change – and of the “green” transition to a net-zero world. Using a sectoral lens, we see technology and healthcare benefiting the most, and carbon-intensive sectors with less transition opportunities such as energy and utilities lagging. This in turn increases our strategic preference for developed market (DM) equities, at the expense of high yield and some emerging market (EM) debt.

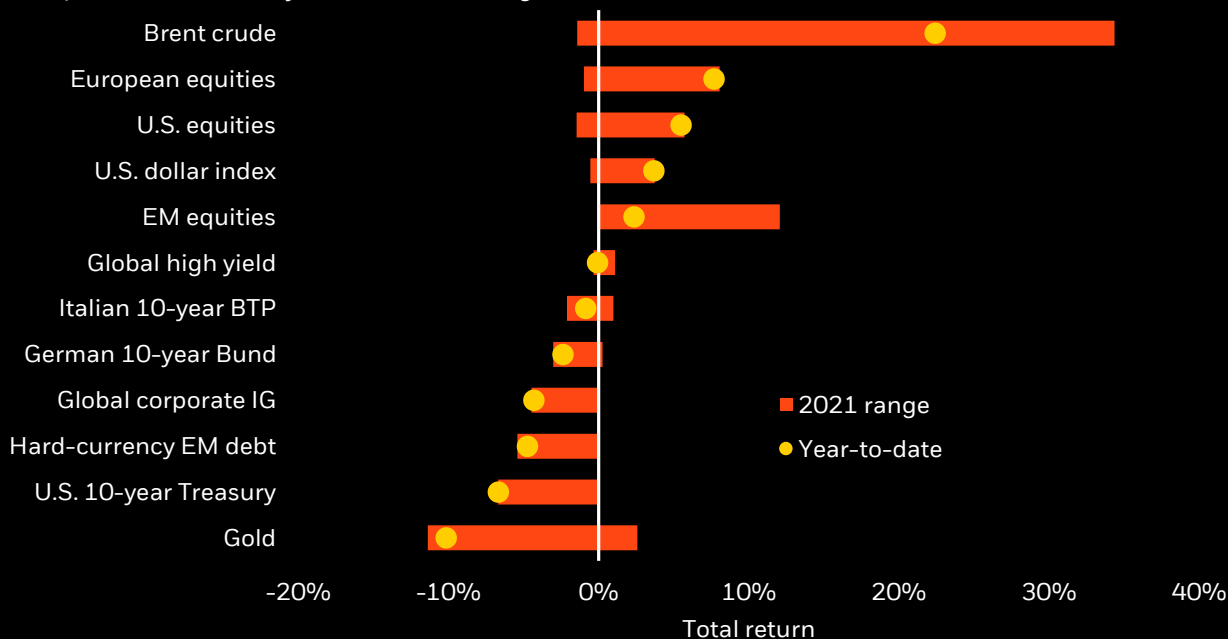
The bottom line: We see the tectonic shift toward sustainability as still in its early stages. Other drivers of asset performance, such as the powerful economic restart, could dominate in the near term. But we believe the shift in investor preferences toward sustainable assets will be persistent, accelerated by political and regulatory changes. This is why we have a strategic preference for companies and sectors positioned to potentially benefit from the transition to a more sustainable future.

## Market backdrop

U.S. 10-year Treasury yields held below the 14-month peak hit earlier last week. President Joe Biden’s \$2.25 trillion jobs and infrastructure plan is likely more medium-term in nature. Yet over the short term the prospect of even more stimulus may reinforce the cyclical rotation that is underway. 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 March 31, 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, the ICE U.S. Dollar Index (DXY), MSCI Emerging Markets Index, 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

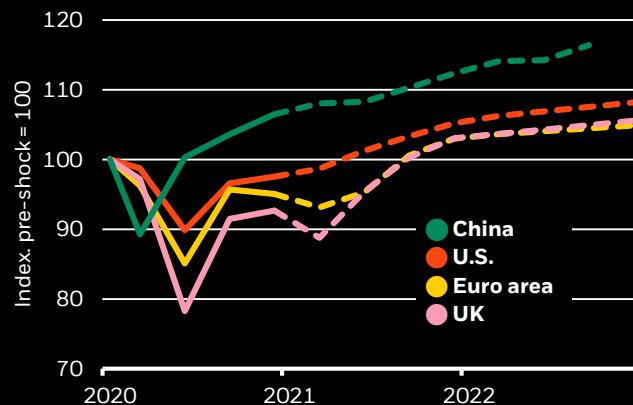
Many European countries are postponing their economic reopening amid rising infection rates and a sluggish vaccine rollout. These disruptions will likely delay the region’s activity restart – but not derail it – in our view.

We see euro area activity returning to its pre-Covid levels before the year-end – slightly later than earlier expectations, and about six months behind the U.S. See the chart. Renewed restrictions are likely to weigh on activity in the near term. Countries more reliant on tourism are likely more vulnerable as restrictions on international travel threaten the tourist flows in summer, in our view.

Yet we expect pent-up demand to fuel a swift restart once economies open up over the fall. We estimate the euro area households have accumulated excess savings equivalent to about 8% of annual consumer spending over the past year. The expected consumption boost and the global restart led us to broaden our cyclical investment tilt last month, including upgrading European equities to neutral. See our [macro insights hub](#) for more.

## Activity restart intact

Actual and estimated GDP post-Covid shock, 2020-2023



Sources: BlackRock Investment Institute, Markit, with data from Refinitiv Datastream and Haver Analytics, April 2021. Notes: The chart shows the actual (solid lines) and projected paths (dotted lines) of real GDP in the U.S., euro area, UK and China. Projections are based on the latest available Reuters consensus and include the estimated impact of U.S. fiscal stimulus and European vaccine rollout delays.

## 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 5**

U.S. ISM services purchasing managers' index, factory orders




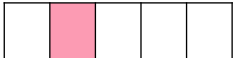

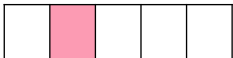
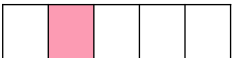


**April 6**

China Caixin services PMI

U.S. services PMI will be in focus this week. Investors are eager to gauge the status of the restart in the services sector – the most affected by the pandemic. U.S. consumer confidence has rebounded to the highest level since March 2020 and consumer spending on key services has been rising – against the backdrop of rising Covid infections. We still see the broad vaccine-led restart intact and expect the U.S. to beat on restart expectations as its vaccine rollout accelerates.


## Directional views

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














Asset	Strategic view	Tactical view	Change in view 
			Previous <span style="margin-left: 100px;">New</span>
<b>Equities</b>	 <p style="text-align: center;"><b>+1</b></p>	 <p style="text-align: center;"><b>+1</b></p> <p>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 cyclical and maintain a bias for quality.</p>	
<b>Credit</b>	 <p style="text-align: center;"><b>-1</b></p>	 <p style="text-align: center;"><b>Neutral</b></p> <p>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.</p>	
<b>Govt bonds</b>	 <p style="text-align: center;"><b>-1</b></p>	 <p style="text-align: center;"><b>-1</b></p> <p>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.</p>	
<b>Cash</b>		 <p style="text-align: center;"><b>Neutral</b></p> <p>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.</p>	
<b>Private markets</b>	 <p style="text-align: center;"><b>Neutral</b></p>	<p>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.</p>	

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

Asset	Underweight	Overweight		
Equities			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.	
			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.	
			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.	
			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.	
			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.	
			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.	
			We keep momentum at neutral. The factor has become more exposed to cyclicity, 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.	
			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.	
			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.	
				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.
				We are overweight the U.S. size factor. We see small- and mid-cap U.S. companies as a key place where exposure to cyclicity may be rewarded amid a vaccine-led recovery.
	Fixed Income			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.
				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.
				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.
				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.
				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.
				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.
				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.
				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.
			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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