

# Weekly commentary

July 5, 2022

**BlackRock**

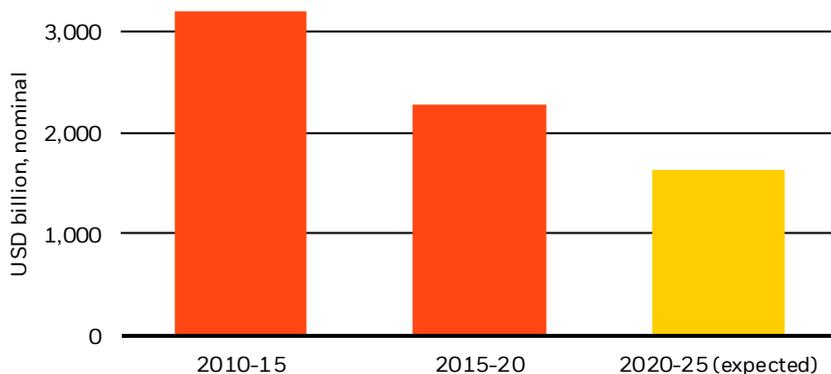
## An era of higher commodities prices

- Commodities prices have spiked as demand from the restart clashed with tightening supply. We see the war and net-zero transition keeping prices high.
- U.S. and euro area inflation data last week showed still persistent inflation. Stocks and bond yields fell as markets priced more risk of rates hitting growth.
- Labor participation and wage growth are key to watch in this week's jobs data, we think, as the Fed weighs the magnitude of its next rate rise later this month.

We see an era of structurally higher commodities prices ahead. Why? First, look back. Prices ran up because the economic restart drove demand amid abnormally low supply. The West has tried to wean itself off Russian energy after years of declining investment. Now, look forward. We see structurally higher prices amid tight supply for energy and rising demand for metals that will be critical to power the path to reach net-zero carbon emissions by 2050.

## Investment dearth

Global capex expenditure in oil and gas, 2010-2025



Forward-looking estimates may not come to pass. Source: BlackRock Investment Institute, Wood Mackenzie, June 2022

Note: The chart shows global capex expenditure in the oil and gas sector from 2010-2015 and from 2015-2020, as well as projected capex expenditure for the period 2020-2025.

Commodities prices and renewables have surged over the past two years, even with recent declines. Rate hikes choking off the restart could cause more dips. But we think prices are at structurally higher levels now. Why? The West is trying to wean itself off Russian supplies. The flow of Russian gas into Europe has fallen by two-thirds already in just a few months. This is a structural change, and we see it as part of accelerating geopolitical fragmentation. The supply crunch is rooted in years of declining investment from traditional energy companies (see the red bars in chart) and forecasters expect even less in years to come (the yellow bar). This hasn't been balanced by equally strong investment in clean energy supply. Lower capital expenditures are a result of both investors pushing for more capital discipline and concerns about long-term demand for traditional energy.



**Alex Brazier**

Deputy Head – BlackRock Investment Institute



**Wei Li**

Global Chief Investment Strategist – BlackRock Investment Institute



**Vivek Paul**

Head of Portfolio Research – BlackRock Investment Institute



**Kurt Reiman**

Senior Strategist for North America – BlackRock Investment Institute

Visit [BlackRock Investment Institute](#) for insights on the global economy, markets and geopolitics.

**BlackRock  
Investment  
Institute**

Energy commodities prices are likely to be supported by growing energy demands amid tight supply in coming decades. Even with improving energy efficiency in developed markets, global energy demand could rise significantly, especially if energy consumption in emerging markets jumps markedly as living standards improve.

And even with rapid growth of clean energy infrastructure, it would be nearly impossible to meet energy demand in coming years without fossil fuels, as we say in a recent [net-zero report](#). Some investment will likely still be needed in new fossil fuel production capacity to meet energy demand. Without capex, production generally falls as wells deplete. Current investment is below what is needed to meet demand in the short run, in our view, as capex has dropped by nearly half since 2014.

The buildout of clean energy infrastructure will boost demand for other commodities, too. Transition essentials like wind turbine farms and electric vehicles require staggering amounts of iron ore, copper, lithium and other metals to match fossil-fuel-generated power sources' outputs. Mineral demand for clean energy technology would have to rise by at least four times by 2040 to meet climate goals, according to the International Energy Agency.

The transition path remains uncertain. Last week's Supreme Court decision means the Environmental Protection Agency now has more limited regulatory authority in requiring utilities to reduce reliance on higher carbon sources of energy, unless Congress approves legislation. This reinforces our view that the invasion of Ukraine has created a more divergent transition globally as Europe doubles down on net-zero efforts. The same impetus isn't felt elsewhere.

What does all of this mean for investments? Time horizon is key. In the near term, we expect sharp rate rises from the Federal Reserve to choke off the restart of economic activity. That typically implies bad news for commodities or commodities producers – but not if we are in a new era of higher commodities prices. We see tactical opportunities in selected energy stocks after the recent selloff. They now appear priced for some retrenchment of energy prices, and we could see rising revenues and earnings amid the race to replace Russian supply.

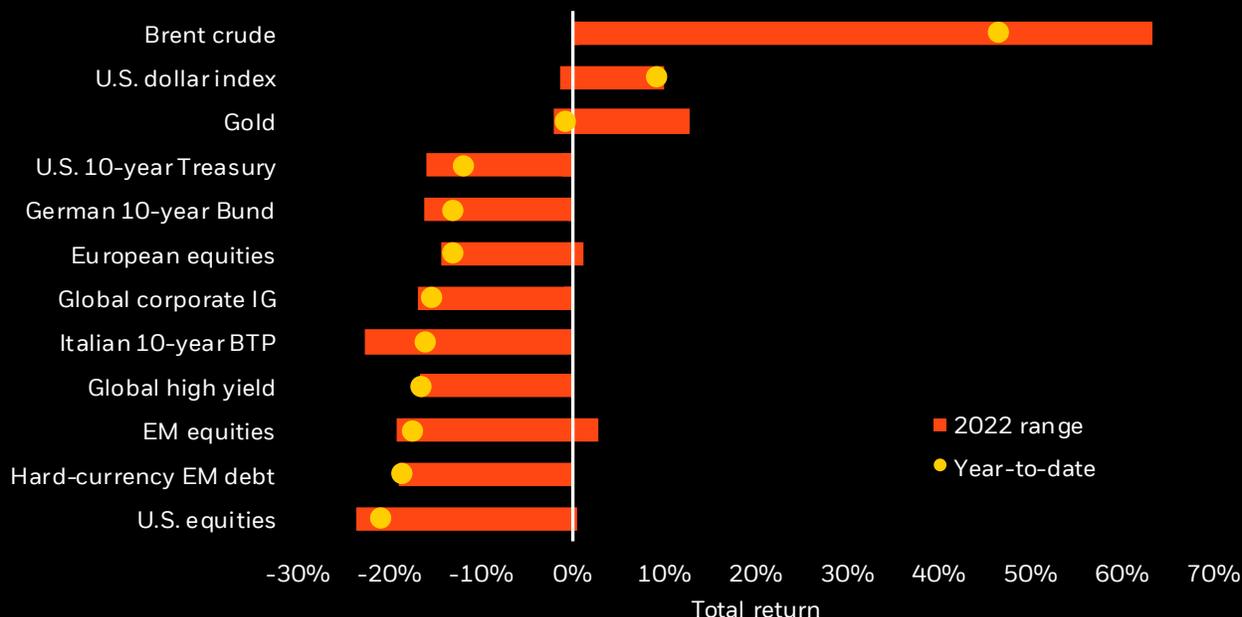
On a longer-term, strategic horizon, we believe lower-carbon sectors like tech and healthcare will benefit more than traditional energy stocks. At the same time, we think some of the greatest opportunities may be in carbon-intensive companies with credible decarbonization plans or companies supporting the transition with the supply of critical minerals.

## Market backdrop

Stocks slid after U.S. and euro area data last week showed persistent inflation and signs of slowing economic activity. U.S. two-year Treasury yields posted their largest weekly drop since 2020. Short-term rate markets are signaling doubts central banks, including the Fed, will hike rates as high as their projections. Central bankers' talk on fighting inflation also gave little indication they face a policy trade-off: either crush growth or live with inflation. So we don't see this as a time to buy the dip.

## Assets in review

Selected asset performance, 2022 year-to-date return 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 June 30, 2022. 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: spot Brent crude, ICE U.S. Dollar Index (DXY), spot gold, MSCI Emerging Markets Index, MSCI Europe Index, Refinitiv Datastream 10-year benchmark government bond index (U.S., Germany and Italy), Bank of America Merrill Lynch Global High Yield Index, J.P. Morgan EMBI Index, Bank of America Merrill Lynch Global Broad Corporate Index and MSCI USA Index.

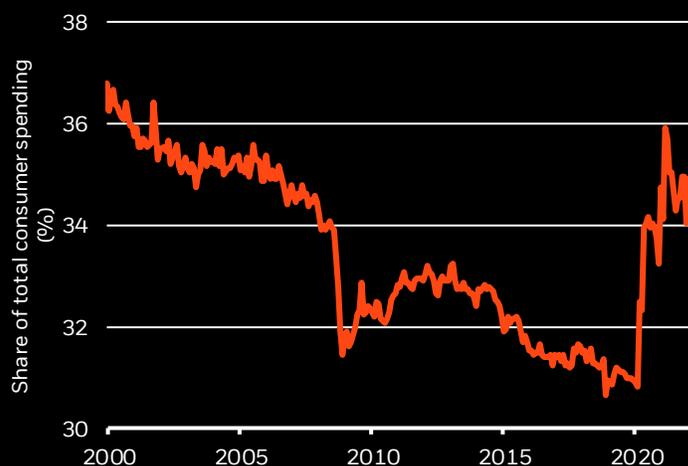
## Macro insights

Consumers significantly changed their spending in the pandemic – spending more on goods and less on services. In fact, in less than 18 months, the preceding 18 years of decline in the share of goods in consumer spending reversed. See the chart. We've long said a sign of the economy getting back to normal after the pandemic would be spending switching back towards services. U.S. data last week suggest this has started and is gaining momentum – see the recent tick back down in the chart.

Why does that matter? That spending shift has been a key driver of inflation. The surge in demand for goods created bottlenecks and supply shortages, which in turn pushed up prices. As demand normalizes again, those supply issues should ease and inflationary pressure should start to subside. The risk is that consumer spending – on both goods and services – comes to a standstill. With the Fed increasing policy rates, the cost of finance is rising rapidly in the U.S. That typically deals a blow to economic growth. See our [macro insights hub](#).

## Spending rotating back to services

Goods share in total U.S. consumer spending, 2000-2022



Sources: BlackRock Investment Institute and U.S. Bureau of Economic Analysis, with data from Haver Analytics, July 2022. Note: The chart shows U.S. goods spending as a share of total consumer spending.

## Investment themes

### 1 Living with inflation

- Central banks are facing a growth-inflation trade-off. Hiking interest rates too much risks triggering a recession, while not tightening enough risks causing unanchored inflation expectations. It's tough to see a perfect outcome.
- The Fed has made clear it is ready to dampen growth. It has projected a large and rapid increase in rates, raising rates by 0.75% in June in the largest increase since 1994. We ultimately think reality will come knocking and a stall in the restart will make the Fed change course.
- Normalization means that central banks are unlikely to come to the rescue to halt a growth slowdown by cutting rates. The risk of unanchored inflation expectations has increased as inflation becomes more persistent.
- The Bank of England warned of the poisonous combination of recession and high inflation as it has raised interest rates further to 1.25% in June. This may indicate the start of a dovish pivot, in our view.
- The European Central Bank (ECB) announced plans to end asset purchases and implement a rapid series of rate hikes in an effort to stabilize peripheral bond yields. We think the ECB and markets underappreciate the risk of the energy crunch pushing the euro area into recession. We expect the ECB to accept this at some point and rethink its rate path.
- We believe the eventual sum total of rate hikes will be historically low given the level of inflation but brace for volatility in the short run.
- **Investment implication:** We are neutral DM equities after having further trimmed risk.

### 2 Cutting through confusion

- We had thought the unique mix of events – the restart of economic activity, virus strains, production-driven inflation and new central bank frameworks – could cause markets and policymakers to misread the current surge in inflation.
- We saw the confusion play out with the hawkish repricing in markets this year – and central banks have sometimes been inconsistent in their messages and economic projections, in our view.
- The Russia-Ukraine conflict has aggravated inflation pressures and has put central banks in a bind. Trying to contain inflation will be more costly to growth and jobs. Central banks can't cushion the growth shock.
- We see a worsening macro outlook because of persistently high inflation, the commodities price shock and the spillovers from a growth slowdown in China.
- **Investment implication:** We remain underweight U.S. Treasuries and overweight inflation-linked bonds.

### 3 Navigating net zero

- Climate risk is investment risk, and the narrowing window for governments to reach net-zero goals means that investors need to start adapting their portfolios today. The net-zero journey is not just a 2050 story; it's a now story.
- The West's decision to reduce reliance on Russian energy will encourage fossil fuel producers elsewhere to increase output, but we don't expect an overall increase in global supply and demand. We see the drive for greater energy security accelerating the transition in the medium term, especially in Europe.
- The green transition comes with costs and higher inflation, yet the economic outlook is unambiguously brighter than a scenario of no climate action or a disorderly transition. Both would generate lower growth and higher inflation, in our view. Risks around a disorderly transition are high – particularly if execution fails to match governments' ambitions to cut emissions.
- We favor sectors with clear transition plans. Over a strategic horizon, we like sectors that stand to benefit more from the transition, such as tech and healthcare, because of their relatively low carbon emissions.
- **Investment implication:** We favor equity sectors better positioned for the green transition.

# Week ahead

**July 5**

China services PMI; U.S. factory orders

**July 9**

China inflation data

**July 8**

U.S. jobs report

The key focus in next week’s U.S. jobs report will be signs the labor market is gradually healing – especially a recovery in labor participation. Labor shortages have added to U.S. inflation’s march up to 40-year highs. We think wage growth may help the labor market normalize by enticing people back to the workforce and incentivizing them to stop hopping jobs for higher pay.

## Directional views

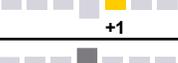
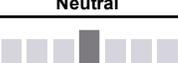
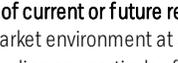
Strategic (long-term) and tactical (6-12 month) views on broad asset classes, July 2022

Asset	Strategic view	Tactical view
<b>Equities</b>	<p>+2</p>	<p>Neutral</p> <p>We are overweight equities in our strategic views, yet trimmed our overall tilt as the relative appeal versus bonds diminished. 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 indices. Tactically, we are neutral DM equities due to a higher risk of central banks overtightening policy and a deteriorating growth backdrop in China and Europe.</p>
<b>Credit</b>	<p>-1</p>	<p>Neutral</p> <p>We are underweight credit on a strategic basis against a backdrop of rising interest rates. We prefer to take risk in equities instead. Tactically, we had upgraded credit to neutral as the dramatic selloff this year restored value in areas such as investment grade. We overweight local-currency EM debt on attractive valuations and potential income. A large risk premium compensates investors for inflation risk, in our view.</p>
<b>Govt bonds</b>	<p>-1</p>	<p>-1</p> <p>We are strategically underweight nominal government bonds, with a preference for shorter-dated maturities over long-dated bonds. We see yields broadly climbing higher. We stay firmly underweight the long-end as we see investors demanding higher compensation for holding government bonds amid rising inflation and debt levels. We prefer inflation-linked bonds instead. Tactically, we also underweight government bonds as we see the direction of travel for long-term yields as higher – even as yields have surged in 2022. We prefer inflation-linked bonds as portfolio diversifiers in the higher inflation regime.</p>
<b>Private markets</b>	<p>Neutral</p>	<p>—</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 and not suitable for all investors.</p>

Note: Views are from a U.S. dollar perspective. 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

Six- to 12-month tactical views on selected assets vs. broad global asset classes by level of conviction, July 2022

Asset	View	Commentary
<b>Developed markets</b>	 Neutral	We are neutral DM stocks due to uncertainty over policy amid a worsening macro picture. Their appeal relative to bonds has also diminished. The risk has risen that central banks slam the policy brakes as they focus solely on inflation without fully acknowledging the high costs to growth and jobs.
United States	 Neutral	We are neutral U.S. equities. The Fed's hawkish pivot has raised the risk that markets see rates staying in restrictive territory. The year-to-date selloff partly reflects this, yet we see no clear catalyst for a rebound.
Europe	 Neutral	We are neutral European equities as the fresh energy price shock in the aftermath of the tragic war in Ukraine puts the region at risk of stagflation.
UK	 Neutral	We are neutral UK equities. We see the market as fairly valued, and we are not looking to chase the rally in the energy sector as transition to net zero unfolds.
Japan	 Neutral	We are neutral Japan stocks as part of a broader push to take more caution across DM equities.
<b>China</b>	 Neutral	We are neutral Chinese equities on a worsening macro outlook. China's ties to Russia also have created a new geopolitical concern that requires more compensation for holding Chinese assets, we think.
<b>Emerging markets</b>	 Neutral	We are neutral EM equities given challenged restart dynamics, high inflation pressures and tight policies.
Asia ex-Japan	 Neutral	We are neutral Asia ex-Japan equities. China's deteriorating macro outlook is a worry, and policymakers have yet to fully deliver on promises of easing.
U.S. Treasuries	 -1	We underweight U.S. Treasuries even with the yield surge. We see long-term yields moving up further as investors demand a greater term premium. We prefer short-maturity bonds instead and expect a steepening of the yield curve.
Treasury Inflation-Protected Securities	 +1	We overweight U.S. TIPS as we see inflation as persistent and settling above pre-Covid levels. We prefer TIPS as diversifiers in the inflationary backdrop.
European government bonds	 Neutral	We are neutral European government bonds. Market pricing of euro area rate hikes is too hawkish, we think, given the energy shock's hit to growth.
UK gilts	 Neutral	We are neutral UK Gilts. We see market expectations of rate hikes as overdone amid constrained supply and weakening growth.
China government bonds	 Neutral	We are neutral Chinese government bonds. Policymakers have been slow to loosen policy to offset the slowdown, and yields fell below U.S. Treasuries.
Global investment grade	 Neutral	We are neutral investment grade credit as this year's selloff has made valuations more attractive. Coupon income is the highest in about a decade.
Global high yield	 Neutral	We are neutral high yield. We do not expect credit spreads to tighten but find the income potential attractive.
Emerging market – hard currency	 Neutral	We are neutral hard-currency EM debt. We expect it to gain support from higher commodities prices but remain vulnerable to rising U.S. yields.
Emerging market – local currency	 +1	We are modestly overweight local-currency EM debt on attractive valuations and potential income. Higher yields already reflect EM monetary policy tightening, in our view, and offer compensation for interest rate risk.
Asia fixed income	 Neutral	We are neutral Asia fixed income. A worsening macro outlook and geopolitical concern about China's Russia ties make Chinese assets riskier, in our view. Outside China, we like Asian sovereigns and credit for income.

Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index. Note: views are from a U.S. dollar perspective. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast or guarantee of future results. This information should not be relied upon as investment advice regarding any particular fund, strategy or security.

# BlackRock Investment Institute

The BlackRock Investment Institute (BII) leverages the firm's expertise and generates proprietary research to provide insights on the global economy, markets, geopolitics and long-term asset allocation – all to help our clients and portfolio managers navigate financial markets. BII offers strategic and tactical market views, publications and digital tools that are underpinned by proprietary research.

**General disclosure:** This material is intended for information purposes only, and does not constitute investment advice, a recommendation or an offer or solicitation to purchase or sell any securities to any person in any jurisdiction in which an offer, solicitation, purchase or sale would be unlawful under the securities laws of such jurisdiction. The opinions expressed are as of July 5, 2022 and are subject to change without notice. Reliance upon information in this material is at the sole discretion of the reader. Investing involves risks.

In the **U.S. and Canada**, this material is intended for public distribution. **In EMEA** Until 31 December 2020, issued by BlackRock Investment Management (UK) Limited, authorized and regulated by the Financial Conduct Authority. Registered office: 12 Throgmorton Avenue, London, EC2N 2DL. Tel: +44 (0)20 7743 3000. Registered in England and Wales No. 2020394, has issued this document for access by Professional Clients only and no other person should rely upon the information contained within it. For your protection telephone calls are usually recorded. Please refer to the Financial Conduct Authority website for a list of authorized activities conducted by BlackRock. From 1 January 2021, in the event the United Kingdom and the European Union do not enter into an arrangement which permits United Kingdom firms to offer and provide financial services into the European Union, the issuer of this material is: (i) BlackRock Investment Management (UK) Limited for all outside of the European Union; and (ii) BlackRock (Netherlands) B.V. for in the European Union, BlackRock (Netherlands) B.V. is authorized and regulated by the Netherlands Authority for the Financial Markets. Registered office Amstelplein 1, 1096 HA, Amsterdam, Tel: 020 – 549 5200, Tel: 31-20-549-5200. Trade Register No. 17068311 For your protection telephone calls are usually recorded. **In Switzerland**, for qualified investors in Switzerland: This document is marketing material. Until 31 December 2021, this document shall be exclusively made available to, and directed at, qualified investors as defined in the Swiss Collective Investment Schemes Act of 23 June 2006 ("CISA"), as amended. From 1 January 2022, this document shall be exclusively made available to, and directed at, qualified investors as defined in Article 10 (3) of the CISA of 23 June 2006, as amended, at the exclusion of qualified investors with an opting-out pursuant to Art. 5 (1) of the Swiss Federal Act on Financial Services ("FinSA"). For information on art. 8 / 9 Financial Services Act (FinSA) and on your client segmentation under art. 4 FinSA, please see the following website: [www.blackrock.com/finsa](http://www.blackrock.com/finsa). **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 South Africa**, please be advised that BlackRock Investment Management (UK) Limited is an authorized financial services provider with the South African Financial Services Board, FSP No. 43288. **In the DIFC** this material 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). This material is only directed at 'Professional Clients' and no other person should rely upon the information contained within it. BlackRock Advisors (UK) Limited - Dubai Branch is a DIFC Foreign Recognised Company registered with the DIFC Registrar of Companies (DIFC Registered Number 546), with its office at Unit 06/07, Level 1, AlFattan Currency House, DIFC, PO Box 506661, Dubai, UAE, and is regulated by the DFSA to engage in the regulated activities of 'Advising on Financial Products' and 'Arranging Deals in Investments' in or from the DIFC, both of which are limited to units in a collective investment fund (DFSA Reference Number F000738). **In the Kingdom of Saudi Arabia**, issued in the Kingdom of Saudi Arabia (KSA) by BlackRock Saudi Arabia (BSA), authorized and regulated by the Capital Market Authority (CMA), License No. 18-192-30. Registered under the laws of KSA. Registered office: 29th floor, Olaya Towers – Tower B, 3074 Prince Mohammed bin Abdulaziz St, Olaya District, Riyadh 12213 – 8022, KSA, Tel: +966 11 838 3600. The information contained within is intended strictly for Sophisticated Investors as defined in the CMA Implementing Regulations. Neither the CMA or any other authority or regulator located in KSA has approved this information. The information contained within, does not constitute and should not be construed as an offer of, invitation or proposal to make an offer for, recommendation to apply for or an opinion or guidance on a financial product, service and/or strategy. Any distribution, by whatever means, of the information within and related material to persons other than those referred to above is strictly prohibited. **In the United Arab Emirates** this material is only intended for –natural Qualified Investor as defined by the Securities and Commodities Authority (SCA) Chairman Decision No. 3/RM. of 2017 concerning Promoting and Introducing Regulations. Neither the DFSA or any other authority or regulator located in the GCC or MENA region has approved this information. **In the State of Kuwait**, those who meet the description of a Professional Client as defined under the Kuwait Capital Markets Law and its Executive Bylaws. **In the Sultanate of Oman**, to sophisticated institutions who have experience in investing in local and international securities, are financially solvent and have knowledge of the risks associated with investing in securities. **In Qatar**, for distribution with pre-selected institutional investors or high net worth investors. **In the Kingdom of Bahrain**, to Central Bank of Bahrain (CBB) Category 1 or Category 2 licensed investment firms, CBB licensed banks or those who would meet the description of an Expert Investor or Accredited Investors as defined in the CBB Rulebook. The information contained in this document, does not constitute and should not be construed as an offer of, invitation, inducement or proposal to make an offer for, recommendation to apply for or an opinion or guidance on a financial product, service and/or strategy. **In Singapore**, this is issued by BlackRock (Singapore) Limited (Co. registration no. 200010143N). This advertisement or publication has not been reviewed by the Monetary Authority 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. **In South Korea**, this material is for distribution to the Qualified Professional Investors (as defined in the Financial Investment Services and Capital Market Act and its sub-regulations). **In Taiwan**, independently operated by BlackRock Investment Management (Taiwan) Limited. Address: 28F., No. 100, Songren Rd., Xinyi Dist, Taipei City 110, Taiwan. Tel: (02)23261600. **In Japan**, this is issued by BlackRock Japan, Co., Ltd. (Financial Instruments Business Operator: The Kanto Regional Financial Bureau. License No 375, 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). **In Australia**, issued by BlackRock Investment Management (Australia) Limited ABN 13 006 165 975 AFSL 230 523 (BIMAL). The material provides general information only and does not take into account your individual objectives, financial situation, needs or circumstances. **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). **In Latin America**, for institutional investors and financial intermediaries only (not for public distribution). This material is for educational purposes only it is your responsibility to inform yourself of, and to observe, all applicable laws and regulations of your relevant jurisdiction. The securities regulators of any country within Latin America have not confirmed the accuracy of any information contained herein. No information discussed herein can be provided to the general public in Latin America. **In Mexico**, these materials are being shared in the understanding that the addressee is an Institutional or Qualified investor as defined under Mexican Securities (Ley del Mercado de Valores).

©2022 BlackRock, Inc. All Rights Reserved. **BLACKROCK** is a trademark of BlackRock, Inc., or its subsidiaries in the United States and elsewhere. All other trademarks are those of their respective owners.

**BlackRock**

Not FDIC Insured • May Lose Value • No Bank Guarantee