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BlackRock.

# 2023 Global outlook

BlackRock **Investment** Institute

## A new investment playbook

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**The Great Moderation, the four-decade period of largely stable activity and inflation, is behind us. The new regime of greater macro and market volatility is playing out. A recession is foretold; central banks are on course to overtighten policy as they seek to tame inflation. This keeps us tactically underweight developed market (DM) equities. We expect to turn more positive on risk assets at some point in 2023 – but we are not there yet. And when we get there, we don't see the sustained bull markets of the past. That's why a new investment playbook is needed.**

We laid out in our 2022 midyear outlook why we had entered a new regime – and are seeing it play out in persistent inflation and output volatility, central banks pushing policy rates up to levels that damage economic activity, rising bond yields and ongoing pressure on risk assets.

Central bankers won't ride to the rescue when growth slows in this new regime, contrary to what investors have come to expect. They are deliberately causing recessions by overtightening policy to try to rein in inflation. That makes recession foretold. We see central banks eventually backing off from rate hikes as the economic damage becomes reality. We expect inflation to cool but stay persistently higher than central bank targets of 2%.

What matters most, we think, is how much of the economic damage is already reflected in market pricing. This is why *pricing the damage* is our first 2023 investment theme. Case in point: Equity valuations don't yet reflect the damage ahead, in our view. We will turn positive on equities when we think the damage is priced or our view of market risk sentiment changes. Yet we won't see this as a prelude to another decade-long bull market in stocks and bonds.

This new regime calls for *rethinking bonds*, our second theme. Higher yields are a gift to investors who have long been starved for income. And investors don't have to go far up the risk spectrum to receive it. We like short-term government bonds and mortgage securities for that reason. We favor high-grade credit as we see it compensating for recession risks. On the other hand, we think long-term government bonds won't play their traditional role as portfolio diversifiers due to persistent inflation. And we see investors demanding higher compensation for holding them as central banks tighten monetary policy at a time of record debt levels.

Our third theme is *living with inflation*. We see long-term drivers of the new regime such as aging workforces keeping inflation above pre-pandemic levels. We stay overweight inflation-linked bonds on both a tactical and strategic horizon as a result.

Our bottom line: The new regime requires a new investment playbook. It involves more frequent portfolio changes by balancing views on risk appetite with estimates of how markets are pricing in economic damage. It also calls for taking more granular views by focusing on sectors, regions and sub-asset classes, rather than on broad exposures.

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# New regime playing out

A key feature of the new regime, we believe, is that we are in a world shaped by supply that involves brutal trade-offs. This regime is playing out and not going away, in our view.

Repeated inflation surprises have sent bond yields soaring, crushing equities and fixed income. Such volatility stands in sharp contrast to the Great Moderation, 40 years of steady growth and inflation. Production constraints are driving this new regime: The pandemic shift in consumer spending from services to goods caused shortages and bottlenecks. Aging populations led to worker shortages. This means DMs can't produce as much as before without creating inflation pressure. That's why inflation is so high now, even though activity is below its pre-Covid trend.

Central bank policy rates are not the tool to resolve production constraints; they can only influence demand in their economies. That leaves them with a brutal trade-off. Either get inflation back to 2% targets by crushing demand down to what the economy can comfortably produce now (dotted green line in the chart), or live with more inflation. For now, they're all in on the first option. So recession is foretold. Signs of a slowdown are emerging. But as the damage becomes real, we believe they'll stop their hikes even though inflation won't be on track to get all the way down to 2%.

Some production constraints could ease as spending normalizes. But we see three long-term trends keeping production capacity constrained and cementing the new regime. First, aging populations mean continued worker shortages in many major economies. Second, persistent geopolitical tensions are rewiring globalization and supply chains. Third, the transition to net-zero carbon emissions is causing energy supply and demand mismatches. See pages 11-13.

Our bottom line: What worked in the past won't work now.

**Taming inflation would take deep recession**

U.S. GDP and potential supply, 2017-2025

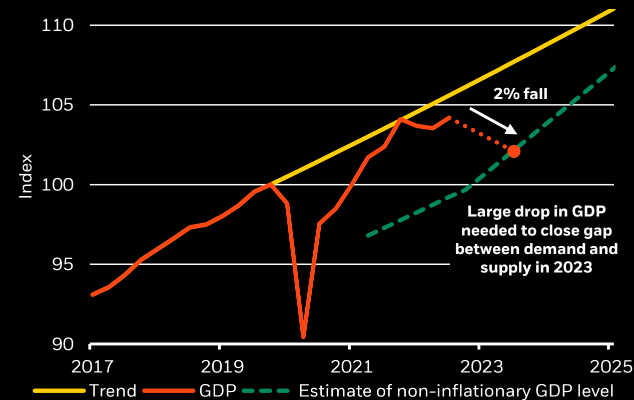


**Chart takeaway:** *Getting inflation all the way back down to target – the dotted green line – would require the Fed to deal a significant blow to the economy.*

Sources: BlackRock Investment Institute and U.S. Bureau of Economic Analysis, with data from Haver Analytics, November 2022. Notes: The chart shows demand in the economy, measured by real GDP (in orange) and our estimate of pre-Covid trend growth (in yellow). The green dotted line shows our estimate of current production capacity, derived by how much core PCE inflation has exceeded the Federal Reserve's 2% inflation target. When then gauge how far activity (orange line) would have to fall to close the gap with where production capacity (green dotted line), will be by the end of 2023 assuming some recovery in production capacity. We estimate a 2% drop in GDP between Q3 2022 and Q3 2023 (orange dotted line). Forward-looking estimates may not come to pass.

**Production constraints are fueling inflation and macro volatility. Central banks cannot solve these constraints. That leaves them raising rates and engineering recessions to fight inflation.**



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# Our new playbook

**We are here**

Navigating markets in 2023 will require more frequent portfolio changes. We see two assessments that determine tactical portfolio outcomes: 1) our assessment of market risk sentiment, and 2) our view of the economic damage reflected in market pricing.

The matrix shows how we plan to change our views and turn more positive as markets play out in the new regime. A few key conclusions:

- We are already at our most defensive stance. Other options are about turning more positive, especially on equities.
- We are underweight nominal long-term government bonds in each scenario in this new regime. This is our strongest conviction in any scenario.
- We can turn positive in different ways: either via our assessment of market risk sentiment or our view on how much damage is in the price.

**Enough damage in the price?**

| Market risk sentiment | Asset | No | Yes |
|---|---|---|---|
| Off | | **Risk off, damage not priced** (We are here) | **Risk off, damage priced** |
| | Equities | -1 | +1 |
| | Credit | +1 | |
| | Govt. bonds – Short term | | +1 |
| | Govt. bonds – Long term | -1 | -1 |
| On | | **Risk on, damage not priced** | **Risk on, damage priced** |
| | Equities | +1 | +2 |
| | Credit | | -1 |
| | Govt. bonds – Short term | +1 | -1 |
| | Govt. bonds – Long term | -1 | -1 |

**Tactical view**

Underweight — Overweight

**Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index.** Sources: Blackrock Investment Institute, November 2022. Notes: The boxes in this stylized matrix show how our tactical views on broad asset classes would switch if we were to change our assessment of market risk sentiment or assessment of how much economic damage is priced in. The potential view changes 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.



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**Theme 1**

# Pricing the damage

Recession is foretold as central banks race to try to tame inflation. It's the opposite of past recessions: Loose policy is not on the way to help support risk assets, in our view. That's why the old playbook of simply "buying the dip" doesn't apply in this regime of sharper trade-offs and greater macro volatility. The new playbook calls for a continuous reassessment of how much of the economic damage being generated by central banks is in the price.

That damage is building. In the U.S., it's most evident in rate-sensitive sectors. Surging mortgage rates have cratered sales of new homes. See the chart. We also see other warning signs, such as deteriorating CEO confidence, delayed capital spending plans and consumers depleting savings. In Europe, the hit to incomes from the energy shock is amplified by tightening financial conditions.

The ultimate economic damage depends on how far central banks go to get inflation down.

Our approach to tactical investment views is driven by our view of market participants' risk appetite – which is based on the uncertainty of the macro environment and other inputs – and by our assessment of what damage is in the price, especially equity earnings expectations and valuations.

We expect them to stop hiking and activity to stabilize in 2023. We find that earnings expectations don't yet price in even a mild recession. For that reason, we stay underweight DM equities on a tactical horizon for now.

Yet we stand ready to turn more positive as valuations get closer to reflecting the economic damage – as opposed to risk assets just responding to hopes of a soft landing. It's not just about pricing the damage: We could see markets look through the damage and market risk sentiment improve in a way that would prod us to dial up our risk appetite. But we are not there yet.

**Damage already clear**

U.S. new home sales during policy rate tightening cycles, 1972-2022

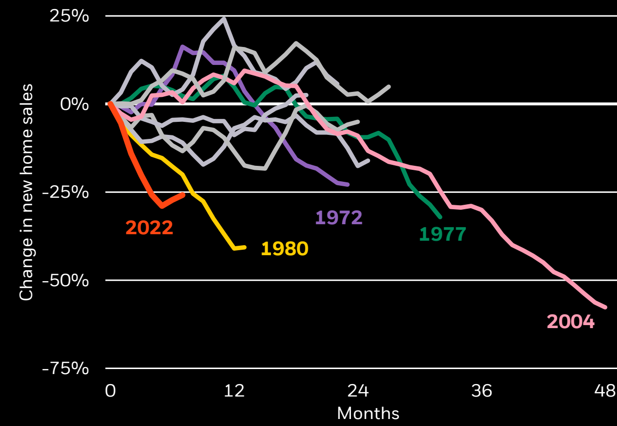


**Chart takeaway:** *The slide in housing sales this year is already steeper than past mega Fed hiking cycles, such as in the 1970s and early 1980s – as well as the unwind of the mid-2000s U.S. housing boom.*

Source: BlackRock Investment Institute and U.S. Census Bureau, with data from Refinitiv Datastream, November 2022. Notes: The chart shows how quickly in months sales of new family houses changed during policy rate tightening cycles between 1972 and 2022. The colored, labeled lines highlight 2022 and the years when housing sales fell most quickly.

**We don't think equities are fully priced for recession. But we stand ready to turn positive via our assessment of the market's risk sentiment or how much economic damage is in the price.**



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**Theme 2**

# Rethinking bonds

Fixed income finally offers "income" after yields surged globally. This has boosted the allure of bonds after investors were starved for yield for years. We take a granular investment approach to capitalize on this, rather than taking broad, aggregate exposures.

The case for investment-grade credit has brightened, in our view, and we raise our overweight tactically and strategically. We think it can hold up in a recession, with companies having fortified their balance sheets by refinancing debt at lower yields. Agency mortgage-backed securities – a new tactical overweight – can also play a diversified income role. Short-term government debt also looks attractive at current yields, and we now break out this category into a separate tactical view.

In the old playbook, long-term government bonds would be part of the package as they historically have shielded portfolios from recession. Not this time, we think.

The negative correlation between stock and bond returns has already flipped, as the chart shows, meaning they can both go down at the same time. Why? Central banks are unlikely to come to the rescue with rapid rate cuts in recessions they engineered to bring down inflation to policy targets. If anything, policy rates may stay higher for longer than the market is expecting.

Investors also will increasingly ask for more compensation to hold long-term government bonds – or term premium – amid high debt levels, rising supply and higher inflation. Central banks are shrinking their bond holdings and Japan may stop purchases, while governments are still running deficits. That means the private sector needs to absorb more bonds. And so-called bond vigilantes are back, as seen when market forces sparked a yield surge to punish profligate UK policies.

As a result, we remain underweight long-term government bonds in tactical and strategic portfolios.

**Bonds and stocks can go down at same time**

Correlation of U.S. equity and government bond returns

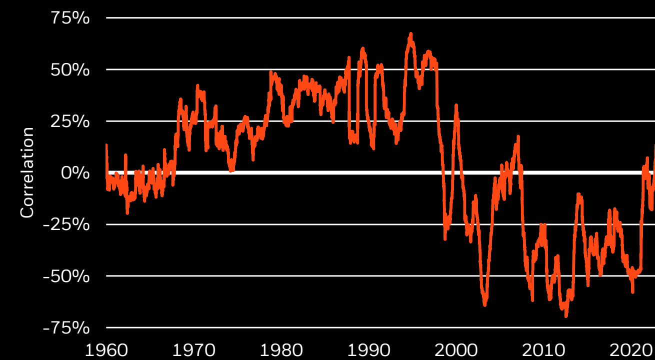


**Chart takeaway**: *A cornerstone of portfolio construction in recent decades was that bond prices would go up when stocks sold off. We think this correlation has broken down in the new regime.*

Sources: BlackRock Investment Institute, with data from Refinitiv Datastream, November 2022. Notes: The chart shows the correlation of daily U.S. 10-year Treasury and S&P 500 returns over a rolling one-year period.

**The lure of fixed income is strong as surging yields mean bonds finally offer income. Yet long-dated bonds face challenges, we believe, making us prefer short-term bonds and high-grade credit.**



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**Theme 3**

# Living with inflation

High inflation has sparked cost-of-living crises, putting pressure on central banks to tame inflation – whatever it takes. Yet there has been little debate about the damage to growth and jobs.

We think the "politics of inflation" narrative is on the cusp of changing. The cycle of outsized rate hikes will stop without inflation being back on track to return fully to 2% targets, in our view. As the damage becomes clear, the "politics of recession" will take over. Plus, central banks may be forced to stop tightening to prevent financial cracks from becoming floodgates, as seen in the UK when investors took fright of fiscal stimulus plans. Result? Even with a recession coming, we think we are going to be living with inflation.

We do see inflation cooling as spending patterns normalize and energy prices relent – but we see it persisting above policy targets in coming years. More volatile and persistent inflation is not yet priced in by markets, we think.

We stay overweight inflation-linked bonds and like real assets. The old playbook principle that recession drives below-target inflation and looser monetary policy is gone.

Beyond Covid-related supply disruptions, we see three long-term constraints keeping the new regime in place and inflation above pre-pandemic levels: aging populations, geopolitical fragmentation and the transition to a lower-carbon world.

Our strategic views have reflected the new regime, with an overweight to inflation-protected bonds for a few years now. Market expectations and economist forecasts have only recently started to appreciate that inflation will be more persistent. See the gray lines in the chart. We think the old playbook means markets underappreciate inflation. See the yellow dot. The market's wishful thinking on inflation is why we have a high conviction, maximum overweight to inflation-linked bonds in strategic portfolios and maintain a tactical overweight no matter how the new regime plays out.

**Wishful thinking on inflation**

U.S. core CPI inflation, forecasts and breakeven rates, 2020-2025

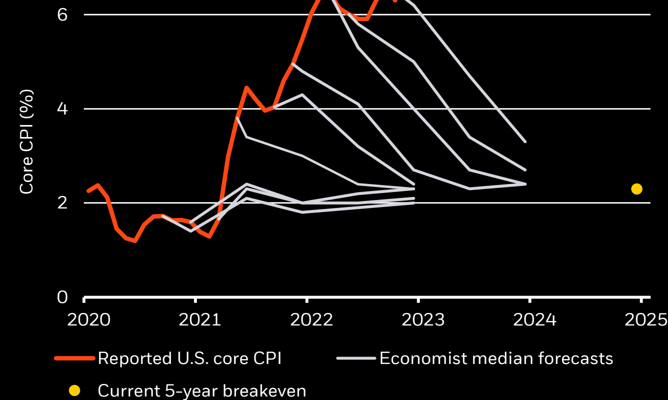


**Chart takeaway:** *Consensus forecasts have kept underestimating how high inflation would go – and at first overestimated how quickly it would return closer to pre-pandemic levels. We think inflation will be persistently higher, unlike market pricing.*

Sources: BlackRock Investment Institute, with data from Refinitiv Datastream, November 2022. Note: The gray lines show consensus economist projections of CPI inflation polled by Reuters. The yellow dot shows current market implied five-year-ahead inflation expectations. Forward looking estimates may not come to pass.

**We see central banks pausing rate hike campaigns once the damage becomes clearer. Long-term drivers of the new regime will keep inflation persistently higher, in our view.**



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**Tactical views**

# A new playbook

Our 2023 playbook is ready to quickly adjust depending on how markets price economic damage and our risk stance evolves.

We prefer short-term government bonds for income: The jump in yields reduces the need to take risk by seeking yield further out the curve. U.S. two-year Treasury yields have soared above 10-year yields. See the chart. We break out short-term Treasuries as a neutral.

We add to our overweight to investment grade credit. Higher yields and strong balance sheets suggest to us investment grade credit may be better placed than equities to weather recessions.

We like U.S. agency mortgage-backed securities (MBS) for their higher income and because they offer some credit protection via the government ownership of their issuers. And our expectation for persistent inflation relative to market pricing keeps us overweight inflation-linked bonds.

Long-term government bonds remain challenged as we have described, so we stay underweight.

In equities, we believe recession isn't fully reflected in corporate earnings expectations or valuations – and we disagree with market assumptions that central banks will eventually turn supportive with rate cuts. We look to lean into sectoral opportunities from structural transitions – such as healthcare amid aging populations – as a way to add granularity even as we stay overall underweight. Among cyclicals, we prefer energy and financials. We see energy sector earnings easing from historically elevated levels yet holding up amid tight energy supply. Higher interest rates bode well for bank profitability. We like healthcare given appealing valuations and likely cashflow resilience during downturns.

**"A bottom-up look at what our companies are telling us is probably the best lens we have into the future."**

**Carrie King**
Global Deputy Chief Investment Officer, Blackrock Fundamental Equities

**Short over long**
U.S. Treasury yields, 2000-2022

**Chart takeaway**: *We see long-term yields rising further as term premium returns. Yet we expect less room for short-term yields to climb given the limited scope we see for a further jump in expected policy rates.*

**Past performance is not a reliable indicator of current or future results.** Source: BlackRock Investment Institute, with data from Refinitiv Datastream, November 2022. Notes: The chart shows U.S. 10-year and two-year Treasury yields.

**We expect views to change more frequently than in the past. Our stance heading into 2023 is broadly risk-off, with a preference for income over equities and long-term bonds.**



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# A new strategic approach

The Great Moderation allowed for relatively stable strategic portfolios. That won't work in the new regime: We think they will need to be more nimble.

We don't see a return to conditions that will sustain a joint bull market in stocks and bonds of the kind we experienced in the prior decade. The asset mix has always been important, yet our analysis posits that getting the mix wrong could be as much as four times as costly as versus the Great Moderation. See the difference between the orange bar and yellow markers on the chart. Zero or even positive correlation between the returns of stocks and bonds means it will take higher portfolio volatility to achieve similar levels of return as before.

We see private markets as a core holding for institutional investors. The asset class isn't immune to macro volatility and we are broadly underweight as we think valuations could fall, suggesting better opportunities in coming years than now. See more on page 13.

Our strategic views stay modestly overweight DM equities as we estimate the overall return of stocks will be greater than fixed-income assets over the coming decade. Staying invested in stocks is one way to get more granular with structural trends impacting sectors.

We stay overweight inflation-linked bonds and underweight nominal DM government bonds. Within government bonds, we like short maturities to harvest yield for income and avoid interest rate risk. Within fixed income, we prefer to take risk in credit – and we prefer public credit to private.

**"It's undeniable the new regime requires a new approach to portfolios. The strategic asset mix will matter more."**

**Simona Paravani-Mellinghoff**
Global CIO of Solutions, BlackRock Multi-Asset Strategies & Solutions

## Asset mix matters more in new regime

Estimated returns in new regime vs. Great Moderation

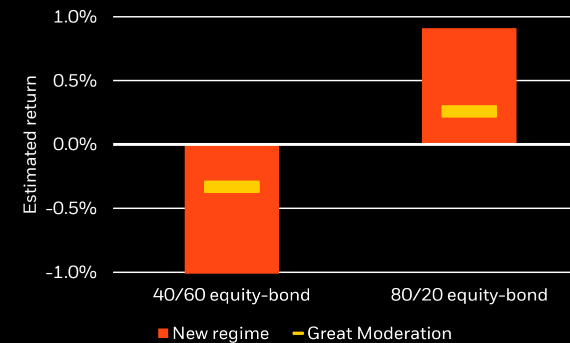


**Chart takeaway:** *The cost of getting the asset mix wrong is likely to be much higher in the new regime – as much as four times versus the Great Moderation – by our estimates.*

**For illustrative purposes only. These do not represent actual portfolios and do not constitute investment advice.** Source: BlackRock Investment Institute, with data from Refinitiv Datastream and Morningstar, November 2022. Notes: The chart illustrates the contrast between estimated average annual relative performance of two hypothetical portfolios against a 60-40 global equity-global bond portfolio over the coming decade where we see a regime of higher macro and market volatility (orange) and estimated performance over the Great Moderation era (1990-2019) of stable growth and inflation (yellow bars). We show hypothetical performance of portfolios comprising a 40%-global equity-60% global bond split and an 80% global equity-20% global bond mix. Index proxies: MSCI AC World for equities and the Bloomberg Global Aggregate Index for bonds. An inherent limitation of hypothetical results is that allocation decisions reflected in the performance record were not made under actual market conditions. They cannot completely account for the impact of financial risk in actual portfolio management. Indexes are unmanaged and do not account for fees. It is not possible to invest directly in an index.

**Our strategic views are positioned for the new regime. We think even strategic portfolios need to be more dynamic – and getting the asset mix wrong can be even more costly.**



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# Aging workforces

We have laid out three long-term drivers of production constraints in the new regime. The first is aging populations. The effects are long in the making but are becoming more binding now.

Why? Aging populations mean shrinking workforces. An ever-increasing share of the U.S. population is aged 65 or older when most leave the workforce. This is one key reason the supply of U.S. labor is currently struggling to keep up with demand for labor.

Just like students and stay-at-home parents, retirees are “outside the labor force.” That’s mainly why the share of the adult population that’s inside the labor force – meaning in work or looking for work – is still well below where it was when the pandemic began. That share is also referred to as the participation rate. See the orange line on the chart.

The initial sharp drop was driven by Covid shutdowns: Many who lost their job didn’t look for another one right away given healthcare worries or care-giving responsibilities.

Some of that drop in the workforce has now unwound. But the yellow line shows that the part not made up is almost entirely down to aging – the increasing share of the population that is of retirement age – rather than pandemic-specific effects. That’s why we don’t expect an improvement in the participation rate from here, and so no material easing of the worker shortage that is contributing to inflation.

Aging is bad news for future economic growth, too. The available workforce will expand much more slowly in coming years than it has in the past. Economies won’t be able to produce as much. And we don’t think aging populations consume substantially less either, particularly when you factor in healthcare demand. That means continued inflation pressure, as reduced production capacity struggles to keep up with demand. We also see rising government spending on care for the elderly adding to debt.

Within equities, we like healthcare as a sector developing medicine and equipment to help meet aging population needs.

**A workforce not recovered**

Contribution of aging to U.S. labor force participation rate drop, 2008-2022

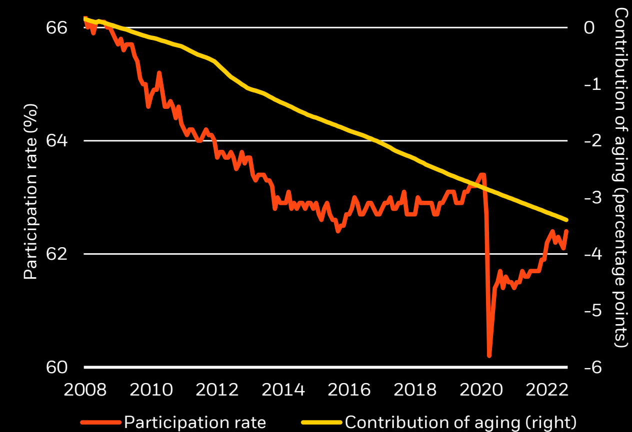


**Chart takeaway:** *The labor force participation rate fell dramatically in the pandemic as the economy shut down. Many people who left the workforce haven’t come back – and won’t.*

Sources: BlackRock Investment Institute, U.S. Bureau of Labor Statistics, October 2022. Notes: The orange line shows the U.S. labor force participation rate, defined as the share of the adult population (aged 16 and over) that is in work or actively looking for work. The yellow line shows how much the aging population has contributed to the decline in the participation rate since 2008. It is calculated by fixing participation rates for each age group and changing the weights as observed in the population data over the chart sample period.

**Aging populations are negative for economic growth. Production capacity will grow less quickly in the future as an ever-larger share of the population is past retirement age and not working.**



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# A new world order

We've entered into a new world order. This is, in our view, the most fraught global environment since World War Two – a full break from the post-Cold War era. We see geopolitical cooperation and globalization evolving into a fragmented world with competing blocs. That comes at the cost of economic efficiency. Sourcing more locally may be costlier for firms, and we could also see fresh mismatches in supply and demand as resources are reallocated.

A prime example is the response to Russia's invasion of Ukraine. Western sanctions have triggered a pursuit of economic self-sufficiency. Energy security is now a priority: As Europe weans itself off Russian oil and gas, we've seen energy shortages and higher prices. In the U.S., we see a push to favor trading partners when sourcing the metals and materials needed in the net-zero transition.

Strategic competition between the U.S. and China has intensified. A tough stance toward China has bipartisan support in Washington. The U.S is trying to restrict China's access to high-end technology.

China's recent party congress was a pivotal event, both politically and economically, in our view. China looks set to de-emphasize economic growth as it pursues self-sufficiency in energy, food and technology. We see slower growth compounded by the effects of an aging population over time.

Geopolitical fragmentation is likely to foster a permanent risk premium across asset classes, rather than have only a fleeting effect on markets as in the past. Market attention is likely to stay fixated on geopolitical risks. See the chart.

All this will likely contribute to the new regime of greater macro and market volatility – and persistently higher inflation.

**"We're in a new world order of geopolitical fragmentation, a full break with the post-Cold War era."**

**Tom Donilon**
Chairman, BlackRock Investment Institute

**Geopolitical risk grabs market attention**
BlackRock Geopolitical Risk Indicator (BGRI), 2018-2022

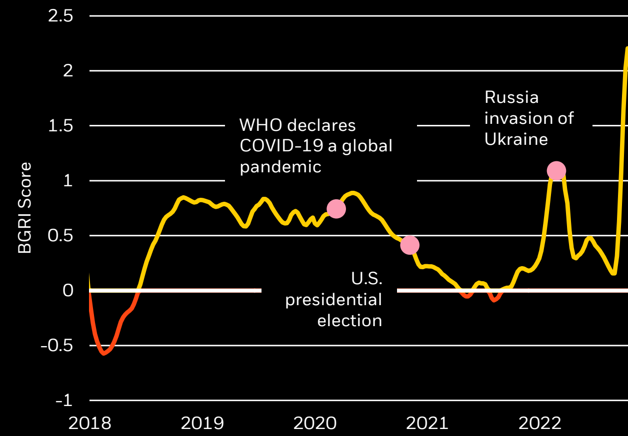


**Chart takeaway:** *We have seen a surge in market interest in geopolitical risk in recent months, highlighting how fraught the current environment is.*

**Forward-looking estimates may not come to pass.** Source: BlackRock Investment Institute. October 2022. The BlackRock Geopolitical Risk Indicator (BGRI) tracks the relative frequency of brokerage reports (via Refinitiv) and financial news stories (Dow Jones News) associated with specific geopolitical risks. We adjust for whether the sentiment in the text of articles is positive or negative, and then assign a score. This score reflects the level of market attention to each risk versus a five-year history. We use a shorter historical window for our COVID risk due to its limited age. We assign a heavier weight to brokerage reports than other media sources since we want to measure the market's attention to any particular risk, not the public's.

**This is the most fraught geopolitical environment since WW II, in our view. The world is splitting up into competing blocs that pursue self-reliance.**



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# Faster transition

We track the transition to net-zero carbon emissions like we track any other driver of investment risks and opportunities, such as monetary policy. We take a view on how it is likely to play out, not how it *should* play out. We assess its implications for financial risks and returns.

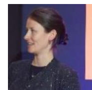
Our research suggests the global transition could accelerate, boosted by significant climate policy action, by technological progress reducing the cost of renewable energy and by shifting societal preferences as physical damage from climate change – and its costs – become more evident.

Europe has intensified its efforts to build clean energy infrastructure as it seeks to wean itself off Russian energy. The clearest example of that is the European Commission's RePowerEU Plan. Further impetus is likely to come from higher traditional energy prices, which are exacerbating the cost-of-living crisis and have shifted the economics decisively in favor of cleaner energy sources. In the U.S., the Inflation Reduction Act is poised to unleash enormous investment.

We see it cutting clean technology costs and spurring domestic manufacturing.

We see opportunities in transition-ready investments. Infrastructure is one way to play into that. See page 13. Yet the transition is set to add to production constraints, in our view. It involves a huge reallocation of resources. Oil and gas will still be needed to meet future energy demand under any plausible transition. If high-carbon production falls faster than low-carbon alternatives are phased in, shortages could result, driving up prices and disrupting economic activity. The faster the transition, the more out of sync the handoff could be – meaning more volatile inflation and economic activity.

**"We find good opportunities by getting ahead of where the green investments are going."**



**Hannah Johnson**
Portfolio Manager, Natural Resources, BlackRock Fundamental Equity

**Policy helping accelerate the transition**
Total annual green investment, past and planned, 2015-2030

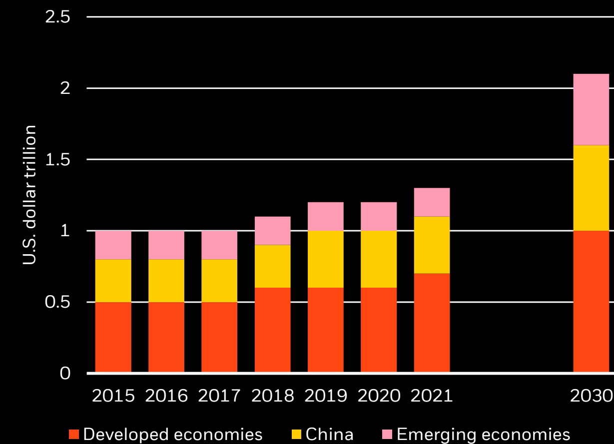



**Chart takeaway:** *Global investment in the net-zero transition is set to step up notably in coming years – largely thanks to key policy action.*

Source: BlackRock Investment Institute and International Energy Agency (IEA), November 2022. Notes: The chart shows IEA estimates of past and planned annual green investment, in trillions of U.S. dollars. Forward-looking estimates may not come to pass.

**We track the transition to net-zero carbon emissions as we track any other driver of investment risks and opportunities.**



BIIM1222U/M-2612935-12/16

**Private markets**

# The long view on infrastructure

In private markets, valuations have not caught up with the public market selloff, reducing their relative appeal. We are underweight private markets in our strategic views, particularly segments such as private equity that have seen heavy inflows. But we think private markets – a complex asset class not suitable for all investors – should be a larger allocation than what we see most qualified investors hold.

We see some opportunities in infrastructure. From roads to airports and energy infrastructure, these assets are essential to industry and households alike. Infrastructure has the potential to benefit from increased demand for capital over the long term, powered by structural trends such as the energy crunch and digitalization.

The chart shows World Bank data pointing to a gap of about $15 trillion between existing investments and what's needed to meet global infrastructure demand over coming decades.

The U.S. Inflation Reduction Act alone earmarks nearly $400 billion of investment and incentives in sustainable infrastructure and supply chains.

We believe infrastructure can help diversify returns and provide stable long-term cashflows – even with risks such as governments imposing artificial price caps amid political pressure. Infrastructure earnings are often less tied to economic cycles than corporate assets. Contracts can be long-term and span decades. And infrastructure assets can help hedge against inflation, with fixed costs and prices linked to inflation.

**"Asset selection is vital, in our view, given the high dispersion of performance even within the infrastructure asset class."**

**Anne Valentine Andrews**
Global Head, BlackRock Alternatives, Infrastructure and Real Estate

## Investment gap

Infrastructure investment, 2007-2040

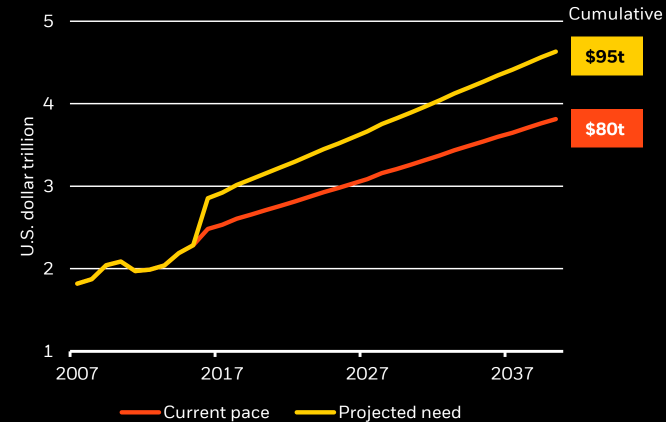



**Chart takeaway:** *Structural trends – the reshaping global energy supply, digitalization and decarbonization – entail a sizeable step-up in the pace of infrastructure investments.*

Sources: BlackRock Investment Institute and World Bank, 2017. Notes: The chart shows estimated infrastructure investment for 50 countries through 2040. The yellow line shows investment needed annually. The orange line shows investment trends assuming countries invest in line with current trends, according to the World Bank. The cumulative total of $95 trillion is for investment needed vs. $80 trillion in current trends. Forward looking estimates may not come to pass.

**Private markets are not immune to macro volatility. Yet for strategic investors, asset classes such as infrastructure could provide a way to play into structural trends.**



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**Directional views**

# Getting granular

Our new investment playbook – both strategic and tactical – calls for greater granularity to capture opportunities arising from greater dispersion and volatility we anticipate in coming years.

Take equities. We are tactically underweight DM equities. We break this down as an underweight in the U.S., Europe and UK and a neutral on Japan. But we take it a step further via sectoral preferences that we think will be key in the new regime. We like energy, financials and healthcare over staples, utilities and consumer discretionary. On a strategic horizon, we are overweight equities with a preference for DM. We think DM equities are one way to get more granular and benefit from structural trends. We believe DM equity indexes are better positioned for the net-zero transition, for instance, with heavier weights in lower carbon-intensive sectors such as tech and healthcare.

In fixed income, the return of income and carry has boosted the allure of certain bonds, especially short term. We don't think leaning into broad indexes or asset allocation blocks is the correct approach. We stay underweight long-term nominal bonds as we see term premium returning due to persistent inflation, high debt loads and thinning market liquidity. For those reasons, they won't play the same safe-haven role as in the old playbook. These factors matter less for short-term bonds, in our view. We also have a high conviction overweight to investment grade credit – relative to a neutral on high yield – and we still like inflation-linked over nominal bonds in both tactical and strategic views.



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## Directional views

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

| Asset | Strategic view | Tactical view | |
|---|---|---|---|
| Equities | +1 | -1 | We are overweight equities in our strategic views as we estimate the overall return of stocks will be greater than fixed-income assets over the coming decade. Valuations on a long-horizon do not appear stretched to us. Tactically, we're underweight DM stocks as central banks look set to overtighten policy – we see recessions looming. Corporate earnings expectations have yet to fully reflect even a modest recession. |
| Credit | +2 (previous view: +1) | +1 | Strategically, we add to our overweight to global investment grade credit on attractive valuations and income potential given higher yields. We turn neutral high yield as we see the asset class as more vulnerable to recession risks. Tactically, we're also overweight investment grade and neutral high yield. We prefer to be up in quality. We cut EM debt to neutral after its strong run. We see better opportunities for income in DMs. |
| Govt Bonds | -1 | -1 | The underweight in our strategic view on government bonds reflects a big spread: max underweight nominal, max overweight inflation-linked and an underweight on Chinese bonds. We think markets are underappreciating the persistence of high inflation and the implications for investors demanding a higher term premium. Tactically, we are underweight long-dated DM government bonds as we see term premium driving yields higher, yet we are neutral short-dated government bonds as we see a likely peak in pricing of policy rates. The high yields offer relatively attractive income opportunities. |
| Private Markets | -1 | — | We're underweight private growth assets and neutral on private credit, from a starting allocation that is much larger than what most qualified investors hold. Private assets are not immune to higher macro and market volatility or higher rates, and public market selloffs have reduced their relative appeal. Private allocations are long-term commitments, however, and we see opportunities as assets reprice over time. Private markets are a complex asset class not suitable for all investors. |

Underweight | Neutral | Overweight | ● Previous view

Note: Views are from a U.S. dollar perspective, November 2022. 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.

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## Tactical granular views

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

| Equities | View | Commentary |
|---|---|---|
| Developed markets | -1 | We are underweight. Neither earnings expectations nor valuations fully reflect the coming recession. We prefer to take a sectoral approach – and prefer energy, financials and healthcare. |
| United States | -1 | We are underweight. The Fed is set to raise rates into restrictive territory. Earnings downgrades are starting, but don't yet reflect the coming recession. |
| Europe | -1 | We are underweight. The energy price shock and policy tightening raise stagflation risks. |
| UK | -1 | We are underweight. We find valuations expensive after the strong relative performance versus other DM markets thanks to energy sector exposure. |
| Japan | Neutral | We are neutral. We like still-easy monetary policy and increasing dividend payouts. Slowing global growth is a risk. |
| China | Neutral | We are neutral. Activity is restarting, but we see China on the path to lower growth. Tighter state control of the economy makes Chinese assets riskier, in our view. |
| Emerging markets | Neutral | We are neutral. Slowing global growth will weigh on EMs. Within the asset classes, we lean toward commodity exporters over importers. |
| Asia ex-Japan | Neutral | We are neutral. China's near-term cyclical rebound is a positive, yet we don't see valuations compelling enough to turn overweight. |

Underweight | Neutral | Overweight | ● Previous view

| Fixed income | View | Commentary |
|---|---|---|
| Long U.S. Treasuries | -1 | We are underweight. We see long-term yields moving up further as investors demand a greater term premium. |
| Short U.S. Treasuries | Neutral | We are neutral. We remain invested in the front end due to attractive income potential. |
| Global inflation-linked bonds | +1 | We are overweight. We see breakeven inflation rates underpricing the persistent inflation we expect. |
| European government bonds | -1 (previous view: Neutral) | We turn underweight the long end. We expect a return of term premium to push long-term yields up. We see higher inflation persisting and sharp rate hikes as a risk to peripheral spreads. |
| UK gilts | -1 (previous view: Neutral) | We are underweight. Perceptions of fiscal credibility have not fully recovered. We prefer short-dated gilts for income. |
| China govt bonds | Neutral | We are neutral. Policymakers have been slow to loosen policy to offset the slowdown, and they are less attractive than DM bonds. |
| Global IG credit | +2 (previous view: +1) | We add to our overweight. High-quality corporates' strong balance sheets imply IG credit could weather a recession better than stocks. |
| U.S. agency MBS | +1 | We are overweight. We see the asset class as a high-quality exposure within a diversified bond allocation. Soaring U.S. mortgage rates have boosted potential income. |
| Global high yield | Neutral | We are neutral. We prefer up-in-quality credit exposures amid a worsening macro backdrop. |
| EM hard currency | Neutral | We are neutral. We see support from higher commodities prices yet it is vulnerable to rising U.S. yields. |
| EM local currency | Neutral (previous view: +1) | We cut EM debt to neutral after its strong run. We see better opportunities for income in DMs. |
| Asia fixed income | Neutral | We are neutral amid a worsening macro outlook. We don't find valuations compelling enough yet to turn more positive on the asset class. |

**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.

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