

Weekly commentary

October 28, 2024

BlackRock

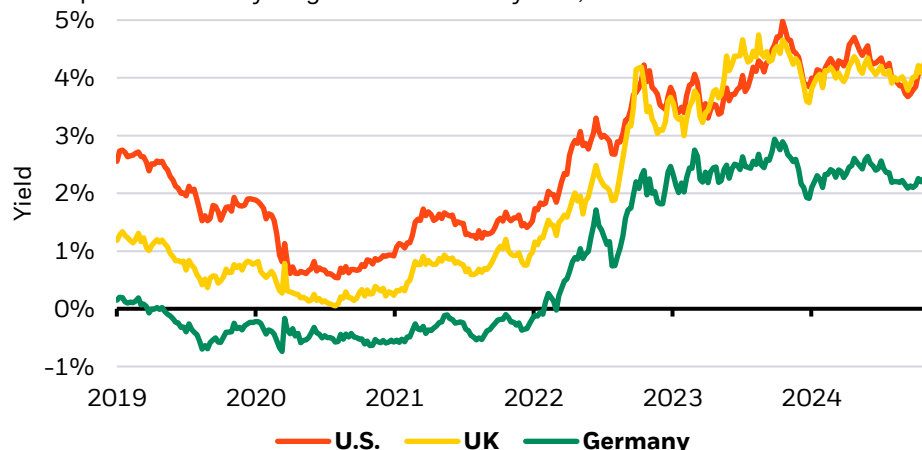
Seizing on fixed income swings

- Surging U.S. short-term Treasury yields and narrowing credit spreads support our preference for short- over long-dated credit and Europe over the U.S.
- U.S. stocks hovered near record highs last week. U.S. two-year Treasury yields hit two-month highs as markets priced out more Fed rate cuts in line with our view.
- U.S. PCE and jobs data are in focus this week. We eye whether inflation will tick up like the CPI did as services inflation starts to reflect still-high wage growth.

Recent swings in fixed income markets reinforce our preference for quality and income. U.S. high yield spreads narrowed to near their tightest in 17 years as short-dated U.S. Treasury yields surged on markets pricing out Federal Reserve rate cuts. We prefer taking risk in equities from a whole portfolio perspective, yet we see investment opportunities in fixed income – like UK gilts over U.S. Treasuries. In credit, we favor short over long maturities and Europe over the U.S.

UK yields: room to fall

Developed market 10-year government bond yields, 2019–2024



Source: BlackRock Investment Institute, with data from LSEG Datastream, October 2024. Notes: The chart shows weekly yields for benchmark 10-year government bonds in the U.S., UK and Germany.

We leaned against two big swings in recent weeks: markets pricing in sharp Fed rate cuts and a jump in UK yields. Those moves have since started unwinding, especially in short-term yields. We see room for UK gilt yields to fall further relative to other major government bond yields: A tougher UK growth outlook paves the way for the Bank of England to cut further than the Fed, in our view. After an initial dip, gilt yields rose anew along with global yields last week – reflecting jitters ahead of this week's UK budget announcement that we think are overblown. See the chart. At the same time, U.S. markets walked back recession fears that we saw as overdone as solid economic data quelled growth concerns. Markets have slashed some rate cuts they had priced in during the August stock selloff, driving short-dated bond yields up sharply. Markets are now closer to our view but have more room to run.



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Inflation will keep the Fed from cutting as much as markets expect, in our view. Services inflation has proved sticky, with wage growth running hot enough that core inflation is unlikely to cool to the Fed’s 2% target. U.S. budget deficits look set to stay large regardless of who wins the U.S. presidential election, with neither candidate prioritizing a reduction. Longer term, we see mega forces – structural shifts impacting returns now and in the future – keeping inflation persistent. Higher inflation is why we’ve been expecting investors to demand significantly more term premium, or additional compensation for the risk of holding longer-dated bonds. We’re seeing early signs of this: Term premium on U.S. 10-year Treasury yields now sits near 20 basis points, having jumped around 45 basis points in the past month alone, LSEG Datastream data show.

Over the long term, we think term premium can rise further. Near term, shifting narratives can cause bouts of volatility and sharp yield swings in either direction, as seen recently. We favor international long-dated government bonds over U.S. long Treasuries, where we stay neutral. In the U.S., we prefer intermediate maturities that offer attractive income with less interest rate risk. We stay underweight short-dated U.S. Treasuries on a near-term tactical horizon. We prefer UK gilts and recently went overweight. UK bond markets await this week’s UK budget announcement, the first since Labour’s victory in the July election. Markets are pricing in some chance of a repeat of the 2022 mini-budget disaster – an outcome we see as unlikely.

Our preference for European over U.S. fixed income extends to credit. U.S. high yield spreads are rich relative to the euro area, especially given a weaker ratings profile in the U.S. Adjusting for ratings quality, European high yield is about 60 basis points cheaper than U.S. high yield, GFI data show. We think euro area high yield and investment grade credit better compensate investors for risk than their U.S. counterparts. Tight U.S. credit spreads are largely due to strong investor demand for new issues outstripping supply, resilient corporate balance sheets and strong macro data snuffing out lingering recession fears.

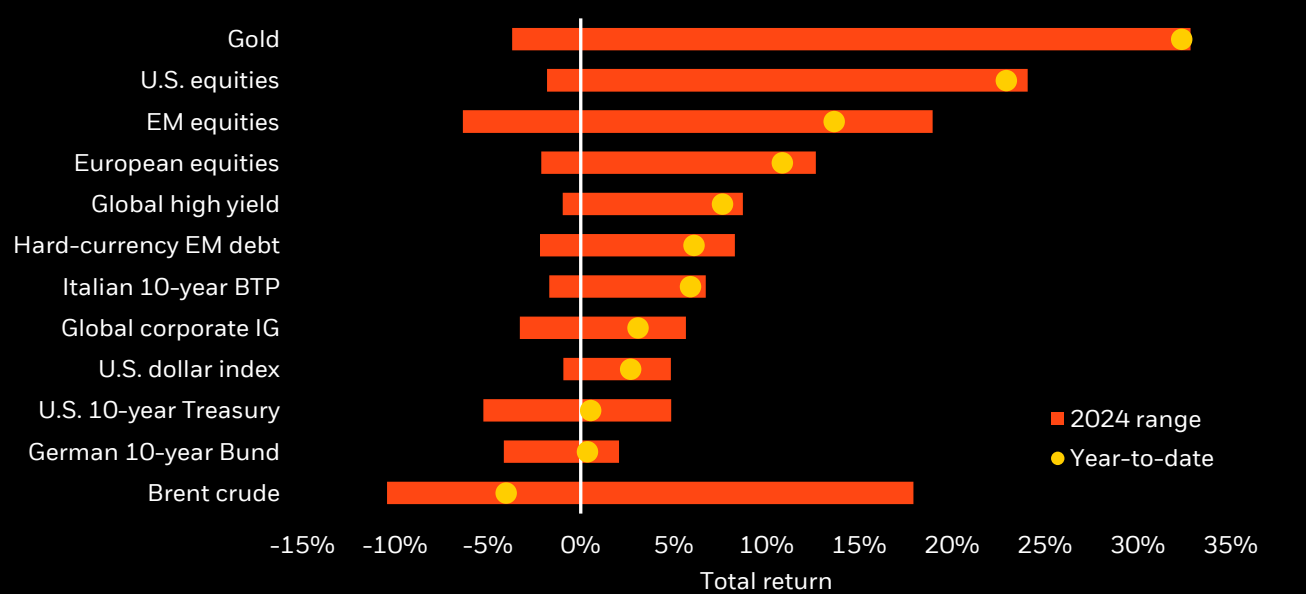
Bottom line: Macro uncertainty is driving sharp interest rate swings, making long-dated government bonds less reliable portfolio diversifiers. Yet such swings and the return of total income in bonds creates investment opportunities we seize on.

Market backdrop

U.S. stocks hovered near record highs last week. Tesla’s share surge after its Q3 corporate earnings sets the stage for mega-cap tech earnings this week. Tech shares rebounded while small caps slid nearly 2% heading into the U.S. election. U.S. two-year Treasury yields hit two-month highs as markets priced out some Fed cuts in line with our view. U.S. 10-year Treasury yields touched three-month highs to near 4.19%, up nearly 60 basis points from September’s 16-month lows.

Assets in review

Selected asset performance, 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 LSEG Datastream as of Oct. 24, 2024. Notes: The two ends of the bars show the lowest and highest returns at any point 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, LSEG 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.

Week ahead

Oct. 30	U.S. GDP; euro area GDP	Nov. 1	U.S. payrolls report
Oct. 31	U.S. PCE; Bank of Japan policy decision; flash euro area inflation data		

The focus is on the U.S. core PCE and jobs data this week. The core PCE – the Fed’s preferred inflation gauge – had been cooling as immigration has expanded the labor supply, and services inflation recently fell well below wage growth. CPI data for September suggested that services inflation measured by PCE could start to tick up given recent robust wage growth. The October jobs data should show still healthy payroll gains and still-solid wages.

Big calls

Our highest conviction views on tactical (6-12 month) and strategic (long-term) horizons, October 2024

Tactical	Reasons
AI and U.S. equities	<ul style="list-style-type: none">We see the AI buildout and adoption creating opportunities across sectors. We get selective, moving toward beneficiaries outside the tech sector. Broad-based earnings growth and a quality tilt make us overweight U.S. stocks overall.
Japanese equities	<ul style="list-style-type: none">A brighter outlook for Japan’s economy and corporate reforms are driving improved earnings and shareholder returns. Yet the drag on earnings from a stronger yen and some mixed policy signals from the Bank of Japan are risks.
Income in fixed income	<ul style="list-style-type: none">The income cushion bonds provide has increased across the board in a higher rate environment. We like quality income in short-term credit. We’re neutral long-term U.S. Treasuries.
Strategic	Reasons
Private credit	<ul style="list-style-type: none">We think private credit is going to earn lending share as banks retreat – and at attractive returns relative to public credit risk.
Fixed income granularity	<ul style="list-style-type: none">We prefer intermediate credit, which offers similar yields with less interest rate risk than long-dated credit. We also like short-term government bonds, and UK long-term bonds.
Equity granularity	<ul style="list-style-type: none">We favor emerging over developed markets yet get selective in both. EMs at the cross current of mega forces – like India and Saudi Arabia – offer opportunities. In DM, we like Japan as the return of inflation and corporate reforms brighten our outlook.

Note: Views are from a U.S. dollar perspective, October 2024. 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.

Tracking five mega forces

Mega forces are big, structural changes that affect investing now – and far in the future. As key drivers of the new regime of greater macroeconomic and market volatility, they change the long-term growth and inflation outlook and are poised to create big shifts in profitability across economies and sectors. This creates major opportunities – and risks – for investors. See our [web hub](#) for our research and related content on each mega force.


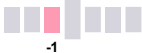





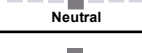
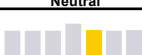







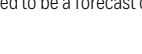

- Demographic divergence:** The world is split between aging advanced economies and younger emerging markets – with different implications.
- Digital disruption and artificial intelligence (AI):** Technologies are transforming how we live and work.
- Geopolitical fragmentation and economic competition:** Globalization is being rewired as the world splits into competing blocs.
- Future of finance:** A fast-evolving financial architecture is changing how households and companies use cash, borrow, transact and seek returns.
- Transition to a low-carbon economy:** The transition is set to spur a massive capital reallocation as energy systems are rewired.

Granular views

Six- to 12-month tactical views on selected assets vs. broad global asset classes by level of conviction, October 2024

Our approach is to first determine asset allocations based on our macro outlook – and what’s in the price. **The table below reflects this and, importantly, leaves aside the opportunity for alpha, or the potential to generate above-benchmark returns.** The new regime is not conducive to static exposures to broad asset classes, in our view, but is creating more space for alpha.

Underweight **Neutral** **Overweight** ● Previous view

Asset	View	Commentary
Developed markets		
United States		We are overweight given our positive view on the AI theme. Valuations for AI beneficiaries are supported as tech companies keep beating high earnings expectations. We think upbeat sentiment can broaden out. Falling inflation is easing pressure on corporate profit margins.
Europe		We are underweight relative to the U.S., Japan and the UK – our preferred markets. Valuations are fair. A growth pickup and European Central Bank rate cuts support a modest earnings recovery. Yet political uncertainty could keep investors cautious.
UK		We are overweight. Political stability and a growth pickup could improve investor sentiment, lifting the UK's low valuation relative to other DM stock markets.
Japan		We are overweight. A brighter outlook for Japan's economy and corporate reforms are driving improved earnings and shareholder returns. Yet the drag on earnings from a stronger yen and some mixed policy signals from the Bank of Japan are risks.
Emerging markets		
China		We are modestly overweight. Major fiscal stimulus may be coming and prompt investors to step in given Chinese stocks are at a deep discount to DM shares. Yet we stay ready to pivot. We are cautious long term given China's structural challenges.
Fixed Income		
Short U.S. Treasuries		We are underweight. We don't think the Fed will cut rates as sharply as markets expect. An aging workforce, persistent budget deficits and the impact of structural shifts like geopolitical fragmentation should keep inflation and policy rates higher over the medium term.
Long U.S. Treasuries		We are neutral. Markets are pricing in sharp Fed rate cuts and term premium is close to zero. We think yields will keep swinging in both directions on incoming data. We prefer intermediate maturities less vulnerable to investors demanding greater term premium.
Global inflation-linked bonds		We are neutral. We see higher medium-term inflation, but cooling inflation and growth may matter more near term.
Euro area govt bonds		We are neutral. Market pricing reflects policy rates in line with our expectations and 10-year yields are off their highs. Political uncertainty remains a risk to fiscal sustainability.
UK gilts		We are overweight. Gilt yields offer attractive income, and we think the Bank of England will cut rates more than the market is pricing given a soft economy.
Japanese govt bonds		We are underweight. Stock returns look more attractive to us. We see some of the least attractive returns in JGBs.
China govt bonds		We are neutral. Bonds are supported by looser policy. Yet we find yields more attractive in short-term DM paper.
U.S. agency MBS		We are neutral. We see agency MBS as a high-quality exposure in a diversified bond allocation and prefer it to IG.
Short-term IG credit		We are overweight. Short-term bonds better compensate for interest rate risk. We prefer Europe over the U.S.
Long-term IG credit		We are underweight. Spreads are tight, so we prefer taking risk in equities from a whole portfolio perspective. We prefer Europe over the U.S.
Global high yield		We are neutral. Spreads are tight, but the total income makes it more attractive than IG. We prefer Europe.
Asia credit		We are neutral. We don't find valuations compelling enough to turn more positive.
Emerging hard currency		We are neutral. The asset class has performed well due to its quality, attractive yields and EM central bank rate cuts. We think those rate cuts may soon be paused.
Emerging local currency		We are neutral. Yields have fallen closer to U.S. Treasury yields, and EM central banks look to be turning more cautious after cutting policy rates sharply.

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