

BLACKROCK INVESTMENT INSTITUTE



Richard Turnill

Global Chief Investment Strategist

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

Share your feedback at
BlackRockInvestmentInstitute@blackrock.com



Isabelle Mateos y Lago

Chief Multi-Asset
Strategist
BlackRock Investment
Institute



Kate Moore

Chief Equity
Strategist
BlackRock Investment
Institute



Jeff Rosenberg

Chief Fixed Income
Strategist
BlackRock Investment
Institute

WEEKLY COMMENTARY • JULY 23, 2018

Key points

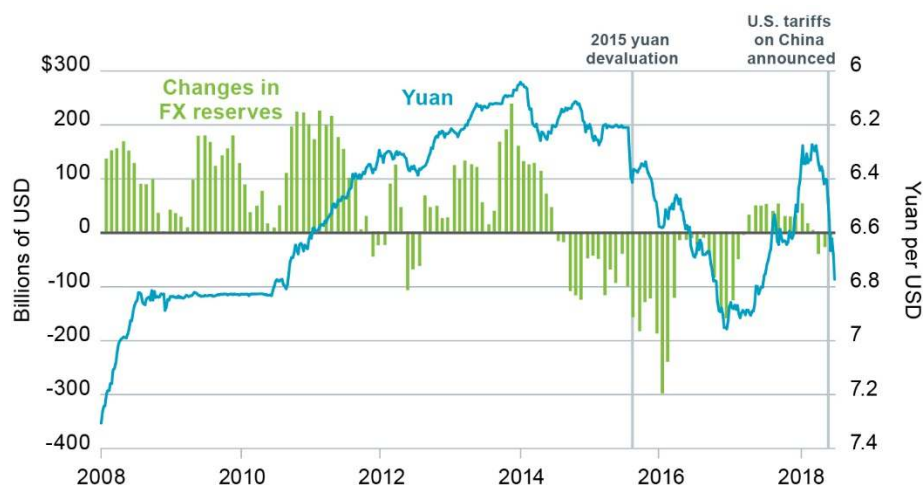
- 1 We see a moderate depreciation in the yuan in the near term, as Chinese authorities manage competing policy goals in a challenging environment.
- 2 Federal Reserve Chairman Jerome Powell gave an upbeat view of the economy while acknowledging potential risks from rising trade tensions.
- 3 This week's gross domestic product (GDP) data are likely to show strong growth momentum in the U.S. economy.

1 Should China's currency worry markets?

A slide in the Chinese yuan is sparking fears of a sharper devaluation that could rattle global markets. Are the worries justified? We see the yuan depreciating moderately in response to slower growth, financial deleveraging and escalating trade tensions. We expect China to rely mostly on fiscal and monetary tools, rather than the currency, to manage any growth slowdown in the second half.

Chart of the week

Changes in China's FX reserves vs. yuan exchange rate, 2008-2018



Sources: BlackRock Investment Institute, with data from Thomson Reuters and The People's Bank of China, July 2018. Notes: The bars show the rolling three-month change in China's foreign currency reserves. The yuan exchange rate is represented by the spot rate against the U.S. dollar.

The Chinese currency posted its biggest monthly fall against the U.S. dollar on record in June - just as the trade tussle between China and the U.S. heated up. The yuan has slid 4% so far this year, with the fall accelerating since mid-June when U.S. President Donald Trump announced a 25% tariff on \$50 billion of Chinese imports. See the blue line in the chart above. We do not see China resorting to a 2015-style devaluation to cushion the blow. Back then, a lack of market confidence in China's policy framework contributed to capital flight (see the green bars), spooking global markets. Today, China has stricter capital controls in place - and improved coordination between policymakers. We believe this should give the government confidence to allow the yuan to gradually slide lower.

Slow and steady

The recent tumble in the yuan and China's stock market has stoked fear: A 2015-style rapid depreciation could spark big capital outflows and another rout in global markets. Yet we expect the Chinese authorities to let the yuan gradually depreciate in a controlled manner through the year end. A moderately weaker yuan may lend a hand to Beijing in its balancing act: seeking to keep the economy humming, while cracking down on financial leverage and cushioning the impact from escalating trade actions. It could boost exports, mitigating blows from reduced domestic investment as a result of the deleveraging campaign. Other factors are weighing on the yuan. U.S. dollar strength is one. Diverging monetary policies in China (easing) and the U.S. (tightening) are another.

The policy, regulatory and growth dynamics in China today are different from 2015. Authorities have become more coordinated in their approach to fiscal, monetary and FX policies; [China's economy](#) is in a better place – and so is the [global economy](#). Beijing has policy tools at its disposal to prop up the economy, with potential for more monetary easing and fiscal spending in the second half. The People's Bank of China's (PBoC) recent move to boost market liquidity is one such example. We also take comfort in the PBoC governor's pledge not to use the currency as a weapon in potential trade wars. A sharp yuan depreciation would undermine Beijing's deleveraging effort, by driving capital flight and further tightening domestic financial conditions, in our view. It could also fuel inflation and dampen foreign investors' growing interest in China's domestic stock and bond markets.

Bottom line: We see moderate yuan depreciation ahead, but are aware of rising risk from trade actions. (See our [BlackRock geopolitical risk dashboard](#) for more). We like selected opportunities in emerging market (EM) Asia equities, including China, as we think these risks are largely priced in and have resulted in attractive valuations. We see the gradual addition of China A-shares to global equity indexes as opportunities for global investors to gain exposure to China's consumer market. We are neutral on rates and credit in China.

2 Week in review

- Fed Chairman Jerome Powell was upbeat on the U.S. economy in his congressional testimony, but acknowledged potential harm from high tariffs. President Trump threatened tariffs on all Chinese imports and criticized the Fed's rate increases. The Fed's "Beige Book" business survey showed tariffs are the top worry for U.S. businesses, and Department of Commerce hearings suggested widespread opposition to car import tariffs.
- U.S. banks reported strong second-quarter earnings. Financial stocks led the U.S. market up. European equities firmed, led by autos and chemical stocks. China's onshore A-shares weakened.
- Strong U.S. retail sales underscored solid economic growth in the second quarter. UK inflation and retail data disappointed. Weak data and concerns about Brexit helped push the British pound lower against major currencies.

Global snapshot

Weekly and 12-month performance of selected assets

Equities	Week	YTD	12 Months	Div. Yield
U.S. Large Caps	0.0%	4.8%	13.3%	1.9%
U.S. Small Caps	0.6%	11.2%	19.1%	1.2%
Non-U.S. World	0.3%	-2.7%	4.8%	3.2%
Non-U.S. Developed	0.6%	-1.4%	5.2%	3.3%
Japan	1.3%	-1.7%	9.0%	2.3%
Emerging	-0.5%	-6.2%	3.3%	2.9%
Asia ex-Japan	-0.7%	-5.1%	5.1%	2.7%

Commodities	Week	YTD	12 Months	Level
Brent Crude Oil	-3.0%	9.3%	48.2%	\$73.07
Gold	-1.2%	-5.6%	-1.2%	\$1,230
Copper	-1.4%	-15.2%	3.2%	\$6,148

Bonds	Week	YTD	12 Months	Yield
U.S. Treasuries	-0.1%	-0.9%	-0.8%	2.9%
U.S. TIPS	-0.4%	0.0%	1.8%	3.0%
U.S. Investment Grade	-0.1%	-2.4%	-0.8%	4.0%
U.S. High Yield	0.1%	0.7%	2.3%	6.4%
U.S. Municipals	0.1%	0.2%	1.2%	2.6%
Non-U.S. Developed	0.2%	-1.4%	1.1%	0.9%
EM \$ Bonds	-0.2%	-3.3%	-0.3%	6.3%

Currencies	Week	YTD	12 Months	Level
Euro/USD	0.3%	-2.3%	0.8%	1.17
USD/Yen	-0.9%	-1.1%	-0.4%	111.41
Pound/USD	-0.7%	-2.8%	1.3%	1.31

Source: Bloomberg. As of July 20, 2018. Notes: Weekly data through Friday. Equity and bond performance are measured in total index returns in U.S. dollars. U.S. large caps are represented by the S&P 500 Index; U.S. small caps are represented by the Russell 2000 Index; non-U.S. world equity by the MSCI ACWI ex U.S.; non-U.S. developed equity by the MSCI EAFE Index; Japan, Emerging and Asia ex-Japan by their respective MSCI indexes; U.S. Treasuries by the Bloomberg Barclays U.S. Treasury Index; U.S. TIPS by the U.S. Treasury Inflation Notes Total Return Index; U.S. investment grade by the Bloomberg Barclays U.S. Corporate Index; U.S. high yield by the Bloomberg Barclays U.S. Corporate High Yield 2% Issuer Capped Index; U.S. municipals by the Bloomberg Barclays Municipal Bond Index; non-U.S. developed bonds by the Bloomberg Barclays Global Aggregate ex USD; and emerging market \$ bonds by the JP Morgan EMBI Global Diversified Index. Brent crude oil prices are in U.S. dollars per barrel, gold prices are in U.S. dollar per troy ounce and copper prices are in U.S. dollar per metric ton. The Euro/USD level is represented by U.S. dollar per euro, USD/JPY by yen per U.S. dollar and Pound/USD by U.S. dollar per pound. Index performance is shown for illustrative purposes only. It is not possible to invest directly in an index. Past performance is not indicative of future results.

3 Week ahead

July 24

Nikkei Japan manufacturing Purchasing Managers Index (PMI); Composite PMI for France, Germany, eurozone and the U.S.

July 26

European Central Bank monetary policy meeting

July 25

European Commission President Jean-Claude Juncker meets with U.S. President Donald Trump to try to defuse trade tensions

July 27

U.S. advance second-quarter GDP

The U.S. economy likely grew at a healthy clip in the second quarter. Consensus estimates point to annualized quarter-on-quarter GDP growth of 4%, as fiscal stimulus kicked in. The strong growth momentum likely will reassure the Fed to stay on its normalization path. Our [BlackRock GPS](#) points to growth well above trend, and signals that consensus may be still too cautious on U.S. growth over the coming year. This will be the busiest week in the Q2 earnings season in the U.S. and Europe. U.S. companies are expected to post exceptionally strong earnings growth thanks to tax cuts. The tech sector is seen leading in top-and bottom-line growth, extending a recent trend.

Asset class views

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

Asset class		View	Comments
Equities	U.S.	▲	Unmatched earnings momentum, corporate tax cuts and fiscal stimulus underpin our positive view. We like momentum. We prefer quality over value amid steady global growth but rising uncertainty around the outlook. Financials and technology are our favored sectors.
	Europe	▼	Relatively muted earnings growth, weak economic momentum and heightened political risks are challenges. A market dominated by value sectors also makes the region less attractive in the absence of a growth upswing.
	Japan	—	The market's value orientation is a challenge without a clear growth catalyst. Yen appreciation is another risk. Positives include shareholder-friendly corporate behavior, solid company earnings and support from Bank of Japan stock buying.
	EM	▲	Economic reforms, improving corporate fundamentals and reasonable valuations support EM stocks. Above-trend expansion in the developed world is another positive. Risks such as a rising U.S. dollar, trade tensions and elections argue for selectivity. We see the greatest opportunities in EM Asia.
	Asia ex-Japan	▲	The economic backdrop is encouraging, with near-term resilience in China and solid corporate earnings. We like selected Southeast Asian markets but recognize a worse-than-expected Chinese slowdown or disruptions in global trade would pose risks to the entire region.
Fixed income	U.S. government bonds	▼	We see rates rising moderately amid economic expansion and Fed normalization. Longer maturities are vulnerable to yield curve steepening but should offer portfolio ballast amid any growth scares. We favor shorter-duration and inflation-linked debt as buffers against rising rates and inflation. We prefer 15-year mortgages over their 30-year counterparts and versus short-term corporates.
	U.S. municipals	—	Solid retail investor demand and muted supply are supportive, but rising rates could weigh on absolute performance. We prefer a neutral duration stance and up-in-quality bias in the near term. We favor a barbell approach focused on two- and 20-year maturities.
	U.S. credit	—	Sustained growth supports credit, but high valuations limit upside. We favor investment grade (IG) credit as ballast to equity risk. A temporary surge in M&A-related issuance has cheapened IG valuations. Higher-quality floating rate debt and shorter maturities look well positioned for rising rates.
	European sovereigns	▼	The ECB's negative interest rate policy has made yields unattractive and vulnerable to the improving growth outlook. We expect core eurozone yields to rise. We are cautious on peripherals given tight valuations, political risks in Italy and the upcoming end to the ECB's net asset purchases.
	European credit	▼	Increased issuance and political risks have widened spreads and created some value. Negative rates have crimped yields — but rate differentials make currency-hedged positions attractive for U.S.-dollar investors. We are cautious on subordinated financial debt despite cheaper valuations.
	EM debt	—	Valuations of hard-currency debt have become more attractive relative to local-currency bonds and developed market corporates. Further valuation support comes from slowing supply and strong EM fundamentals. Trade disputes and a tightening of global financial conditions are downside risks.
	Asia fixed income	—	Stable fundamentals, cheapening valuations and slowing issuance are supportive. China's representation in the region's bond universe is rising. Higher-quality growth and a focus on financial sector reform are long-term positives, but a sharp China growth slowdown would be a challenge.
	Commodities and currencies	*	Declining global crude inventories underpin oil prices, with geopolitical tensions providing further support. We are neutral on the U.S. dollar. Rising global uncertainty and a widening U.S. yield differential with other economies provide support, but an elevated valuation may constrain further gains.

▲ Overweight — Neutral ▼ Underweight

*Given the breadth of this category, we do not offer a consolidated view.

BII0718U/E-553509-1736862

BlackRock Investment Institute

The [BlackRock Investment Institute](#) (BII) provides connectivity between BlackRock's portfolio managers, originates market research and publishes insights. Our goals are to help our fund managers become better investors and to produce thought-provoking content for clients and policymakers.

General disclosure: *This material is prepared by BlackRock and is not intended to be relied upon as a forecast, research or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy. The opinions expressed are as of July 23, 2018, and may change as subsequent conditions vary. The information and opinions contained in this material are derived from proprietary and nonproprietary sources deemed by BlackRock to be reliable, are not necessarily all inclusive and are not guaranteed as to accuracy. As such, no warranty of accuracy or reliability is given and no responsibility arising in any other way for errors and omissions (including responsibility to any person by reason of negligence) is accepted by BlackRock, its officers, employees or agents. This material may contain 'forward looking' information that is not purely historical in nature. Such information may include, among other things, projections and forecasts. There is no guarantee that any forecasts made will come to pass. Reliance upon information in this material is at the sole discretion of the reader.*

In the U.S., this material is for public distribution. **In the EU** issued by BlackRock Investment Management (UK) Limited (authorised and regulated by the Financial Conduct Authority). Registered office: 12 Throgmorton Avenue, London, EC2N 2DL. Registered in England No. 2020394. Tel: 020 7743 3000. For your protection, telephone calls are usually recorded. BlackRock is a trading name of BlackRock Investment Management (UK) Limited. This material is for distribution to Professional Clients (as defined by the FCA Rules) and Qualified Investors and should not be relied upon by any other persons. For qualified investors **in Switzerland**, this material shall be exclusively made available to, and directed at, qualified investors as defined in the Swiss Collective Investment Schemes Act of 23 June 2006, as amended. Issued **in the Netherlands** by the Amsterdam branch office of BlackRock Investment Management (UK) Limited: Amstelplein 1, 1096 HA Amsterdam, Tel: 020 - 549 5200. **In South Africa**, please be advised that BlackRock Investment Management (UK) Limited is an authorised Financial Services provider with the South African Financial Services Board, FSP No. 43288. **In Dubai:** This information can be distributed in and from the Dubai International Financial Centre (DIFC) by BlackRock Advisors (UK) Limited – Dubai Branch which is regulated by the Dubai Financial Services Authority ("DFSA") and is only directed at 'Professional Clients' and no other person should rely upon the information contained within it. Neither the DFSA or any other authority or regulator located in the GCC or MENA region has approved this information. This information and associated materials have been provided for your exclusive use. This document is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution would be unlawful under the securities laws of such. Any distribution, by whatever means, of this document and related material to persons other than those referred to above is strictly prohibited. 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 Singapore**, this is issued by BlackRock (Singapore) Limited (Co. registration no. 200010143N). **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 Korea**, this material is for Professional Investors only. **In Taiwan**, independently operated by BlackRock Investment Management (Taiwan) Limited. Address: 28/F, No. 95, Tun Hwa South Road, Section 2, Taipei 106, Taiwan. Tel: (02)23261600. **In Japan**, this is issued by BlackRock Japan. Co., Ltd. (Financial Instruments Business Operator: The Kanto Regional Financial Bureau. License No375, Association Memberships: Japan Investment Advisers Association, the Investment Trusts Association, Japan, Japan Securities Dealers Association, Type II Financial Instruments Firms Association.) For Professional Investors only (Professional Investor is defined in Financial Instruments and Exchange Act) and for information or educational purposes only, and does not constitute investment advice or an offer or solicitation to purchase or sells in any securities or any investment strategies. **In Australia**, issued by BlackRock Investment Management (Australia) Limited ABN 13 006 165 975, AFSL 230 523 (BIMAL). This material is not a securities recommendation or an offer or solicitation with respect to the purchase or sale of any securities in any jurisdiction. The material provides general information only and does not take into account your individual objectives, financial situation, needs or circumstances. BIMAL, its officers, employees and agents believe that the information in this material and the sources on which it is based (which may be sourced from third parties) are correct as at the date of publication. While every care has been taken in the preparation of this material, no warranty of accuracy or reliability is given and no responsibility for the information is accepted by BIMAL, its officers, employees or agents. No guarantee as to the repayment of capital or the performance of any product or rate of return referred to in this material is made by BIMAL or any entity in the BlackRock group of companies. **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) and does not constitute investment advice or an offer or solicitation to purchase or sell in any securities, BlackRock funds or any investment strategy nor shall any securities be offered or sold to any person in any jurisdiction in which an offer, solicitation, purchase or sale would be unlawful under the securities laws of such jurisdiction. **In Canada**, this material is intended for permitted clients only. **In Latin America and Iberia**, this material is for educational purposes only and does not constitute investment advice nor an offer or solicitation to sell or a solicitation of an offer to buy any shares of any fund (nor shall any such shares be offered or sold to any person) in any jurisdiction in which an offer, solicitation, purchase or sale would be unlawful under the securities law of that jurisdiction. If any funds are mentioned or inferred to in this material, it is possible that some or all of the funds have not been registered with the securities regulator of Brazil, Chile, Colombia, Mexico, Panama, Peru, Portugal, Spain, Uruguay or any other securities regulator in any Latin American country and thus might not be publicly offered within any such country. The securities regulators of such countries have not confirmed the accuracy of any information contained herein. The information provided here is neither tax nor legal advice. Investors should speak to their tax professional for specific information regarding their tax situation. Investment involves risk including possible loss of principal. International investing involves risks, including risks related to foreign currency, limited liquidity, less government regulation, and the possibility of substantial volatility due to adverse political, economic or other developments. These risks are often heightened for investments in emerging/developing markets or smaller capital markets.

©2018 BlackRock, Inc. All Rights Reserved. **BLACKROCK** is a registered trademark of BlackRock, Inc.

All other trademarks are those of their respective owners.

Not FDIC Insured • May Lose Value • No Bank Guarantee

BLACKROCK®

BII0718U/E-553509-1736862