

Weekly commentary

June 10, 2024

BlackRock

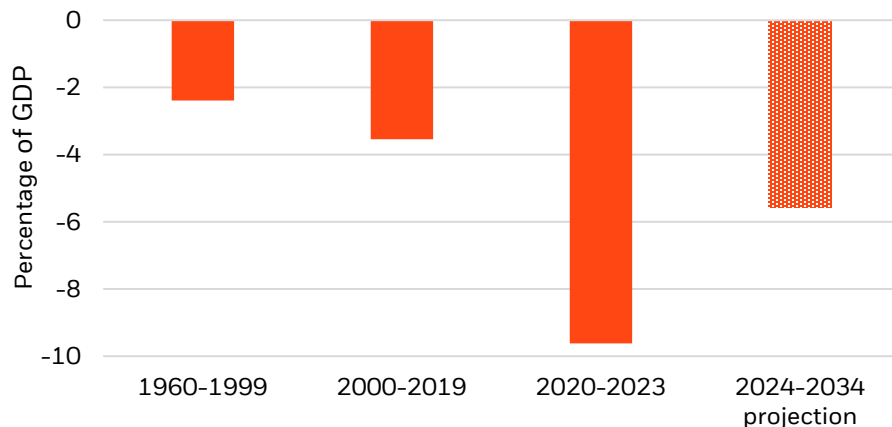
What we're watching in 2024 elections

- We stay overweight U.S. stocks ahead of the election yet are cautious on bonds given the fiscal outlook. We focus on long-term positives in India and Mexico.
- U.S. stocks notched fresh highs last week and are up nearly 13% this year. The Bank of Canada and European Central Bank cut interest rates as most expected.
- All eyes are on the Federal Reserve meeting this week. We see the Fed on hold in coming months even as other central banks start to trim policy rates.

Over half the world's population goes to the polls in 2024. We watch for investment implications. We think governments and candidates have limited solutions to key financial issues for voters. We stay overweight U.S. stocks before the U.S. election yet cautious on long-term U.S. Treasuries. No matter who wins, budget deficits are set to stay large. Elections in India and Mexico sparked market volatility, but we focus on long-term positives. A July UK election supports our UK gilts preference.

Persistently large

Average U.S. fiscal deficit as a share of GDP, 1960-2034



Past performance is not a reliable indicator of current or future results. Source: BlackRock Investment Institute, with data from the U.S. Congressional Budget Office, May 2024. Notes: The chart shows the average U.S. fiscal deficit as a share of GDP between 1960-1999, 2000-2019 and as projected for 2024-2034.

Global voters are expressing frustration about many issues but notably the rising cost of living. Yet we see many incumbent leaders or challengers constrained in any response, notably due to high public debt somewhat tying their hands. In November, U.S. President Joe Biden will face former President Donald Trump. Under both, pandemic borrowing swelled fiscal deficits – the shortfall in government revenue versus spending. No matter who wins, deficits are set to remain historically large. Neither is charting a path to a sustained reduction in deficits. See the chart. These deficits reinforce persistent inflation and our view that the Federal Reserve will need to keep rates high for longer. We think that, and markets needing to absorb large bond issuance, will spur investors to demand more term premium, or compensation for the risk of holding long-term U.S. bonds.



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We track potential changes on U.S. trade, immigration and energy policy – and see a potential inflation boost no matter who wins. On trade, Trump has suggested a more protectionist stance that would levy a 10% across-the-board tariff and a 60% tariff on Chinese goods. Biden is expected to keep his current protectionist policies, like higher tariffs for some sectors, industrial policies favoring domestic production and the use of export controls. Major changes to legal immigration during a second Trump or Biden administration would have implications for inflation as the U.S. faces a shrinking working-age population. On energy policy, the Inflation Reduction Act (IRA) and its low-carbon transition investment incentives are in focus. If Republicans control Congress, they may revise or repeal parts of the IRA to fund tax cuts.

It's already been a busy election year. In India, Prime Minister Narendra Modi secured a third term to lead the government but will need coalition support after failing to win a majority last week. That could slow some reforms – but it doesn't change the long-term benefits from the confluence of mega forces, like a young population and digitalizing economy. Mexico's election saw the ruling coalition score a resounding win that points to continuity. We see both India and Mexico benefiting from a rewiring of global supply chains. Though in Mexico, a new president and government rolling out broad reforms could weaken institutional checks and balances. Even as right-wing and populist parties performed well in the European Union elections, centrist parties are expected to keep overall control of the European Parliament. Yet the performance of governing parties will have repercussions, such as President Emmanuel Macron calling a snap election in France after his party suffered a big loss.

The UK votes in early July rather than in late 2024 as originally expected. A decisive victory for one party could create the political breathing space to address the UK's structural issues, such as weak productivity growth. Beyond potential policy changes, a July election could allow the Bank of England to start cutting rates once it's over – a reason why we like UK bonds.

Bottom line: We stay overweight U.S. stocks for now and eye the key policy areas of the presidential election. On a strategic horizon of five years and longer, we like government bonds in the euro area and UK on expectations for lower interest rates.

Market backdrop

U.S. stocks notched fresh highs last week and are up nearly 13% this year. The Bank of Canada and the European Central Bank both cut rates for the first time since the start of pandemic. Markets are focused on how far central banks can cut rates – and are now split on whether the Fed will cut once or twice this year after the strong U.S. payroll gains last week. We don't see these rate cuts as the start of a cycle of multiple cuts given sticky inflation holding above central bank targets.

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 June 6, 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

June 11

UK payroll data

June 14

U.S. trade data; University of Michigan consumer sentiment survey

June 12

Fed policy decision; U.S. CPI; UK GDP

June 10-17

China total social financing

All eyes are on the Fed policy meeting this week. We expect key data – like last week’s U.S. payrolls and this week’s U.S. CPI – to drive Fed decision-making. Even with easing likely on the horizon for the Fed and already underway elsewhere, this is not your typical rate-cutting cycle, in our view. The red-hot U.S. payroll data reinforces what an unusual environment this is for the start of a global easing cycle. We don’t see central banks cutting far and fast.

Big calls

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

Tactical	Reasons
U.S. equities	<ul style="list-style-type: none"> Our macro view has us neutral at the benchmark level. But the AI theme and its potential to generate alpha – or above-benchmark returns – push us to be overweight overall.
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 short-term bonds and are now neutral long-term U.S. Treasuries as we see two-way risks ahead.
Geographic granularity	<ul style="list-style-type: none"> We favor getting granular by geography and like Japan stocks in DM. Within EM, we like India and Mexico as beneficiaries of mega forces even as relative valuations appear rich.
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 inflation-linked bonds as we see inflation closer to 3% on a strategic horizon. We also like short-term government bonds, and the UK stands out for 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 Mexico, 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, June 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.

- 1. Demographic divergence:** The world is split between aging advanced economies and younger emerging markets – with different implications.
- 2. Digital disruption and artificial intelligence (AI):** Technologies that are transforming how we live and work.
- 3. Geopolitical fragmentation and economic competition:** Globalization is being rewired as the world splits into competing blocs.
- 4. Future of finance:** A fast-evolving financial architecture is changing how households and companies use cash, borrow, transact and seek returns.
- 5. 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, June 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	Benchmark Neutral	We are neutral in our largest portfolio allocation. Falling inflation and coming Fed rate cuts can underpin the rally’s momentum. We are ready to pivot once the market narrative shifts.
	Overall +1	We are overweight overall when incorporating our U.S.-centric positive view on artificial intelligence (AI). We think AI beneficiaries can still gain while earnings growth looks robust.
Europe	-1	We are underweight. While valuations look fair to us, we think the near-term growth and earnings outlook remain less attractive than in the U.S. and Japan – our preferred markets.
UK	Neutral	We are neutral. We find attractive valuations better reflect the weak growth outlook and the Bank of England’s sharp rate hikes to fight sticky inflation.
Japan	+2	We are overweight. Mild inflation and shareholder-friendly reforms are positives. We see the BOJ policy shift as a normalization, not a shift to tightening.
Emerging markets		
China	Neutral	We are neutral. We see growth on a weaker trajectory and see only limited policy stimulus from China. We prefer EM debt over equity.
Fixed Income		
Short U.S. Treasuries	+1	We are overweight. We prefer short-term government bonds for income as interest rates stay higher for longer.
Long U.S. Treasuries	Neutral	We are neutral. The yield surge driven by expected policy rates has likely peaked. We now see about equal odds that long-term yields swing in either direction.
U.S. inflation-linked bonds	Neutral	We are neutral. We see higher medium-term inflation, but cooling inflation and growth may matter more near term.
Euro area inflation-linked bonds	Neutral	We are neutral. Market expectations for persistent inflation in the euro area have come down.
Euro area govt bonds	Neutral	We are neutral. Market pricing reflects policy rates in line with our expectations and 10-year yields are off their highs. Widening peripheral bond spreads remain a risk.
UK gilts	Neutral	We are neutral. Gilt yields have compressed relative to U.S. Treasuries. Markets are pricing in Bank of England policy rates closer to our expectations.
Japanese govt bonds	-2	We are underweight. We find more attractive returns in equities. We see some of the least attractive returns in Japanese government bonds, so we use them as a funding source.
China govt bonds	Neutral	We are neutral. Bonds are supported by looser policy. Yet we find yields more attractive in short-term DM paper.
U.S. agency MBS	Neutral	We are neutral. We see agency MBS as a high-quality exposure in a diversified bond allocation and prefer it to IG.
Global IG credit	-1	We are underweight. Tight spreads don’t compensate for the expected hit to corporate balance sheets from rate hikes, in our view. We prefer Europe over the U.S.
Global high yield	Neutral	We are neutral. Spreads are tight, but we like its high total yield and potential near-term rallies. We prefer Europe.
Asia credit	Neutral	We are neutral. We don’t find valuations compelling enough to turn more positive.
Emerging hard currency	+1	We are overweight. We prefer EM hard currency debt due to its relative value and quality. It is also cushioned from weakening local currencies as EM central banks cut policy rates.
Emerging local currency	Neutral	We are neutral. Yields have fallen closer to U.S. Treasury yields. Central bank rate cuts could hurt EM currencies, dragging on potential returns.

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