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CREATING OPPORTUNITIES

**Global Capital Markets**
Quarterly Update
17 October 2023

# 4Q 2023 Global Markets Update

### The US economy shows resilience
In 2023, the US economy has outperformed expectations considerably. While US stocks may seem pricey, they currently have strong macro fundamentals

### Growth tech stocks are still the analyst favorites
Despite strong returns in 2023, financial analysts are still foreseeing a significant growth in tech focused companies, especially in large-cap growth style

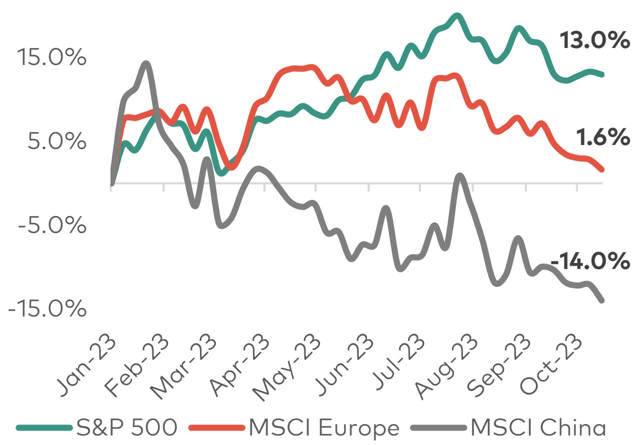
### Yields have likely peaked, time to lock in?
Bond yields in the US have reached multi-year highs, offering attractive return opportunities. However, it is likely that the yields have peaked, so now may be the time to invest

## 1. Equity Markets

**US stocks rallied, while Europe and China lagged.** Strong performance of the US economy in 2023 and Fed's ongoing success in fighting inflation has boosted US equities. In contrast, Europe and China have underperformed their initial economic growth forecasts, which has had a strong impact on markets. Chinese stocks have struggled especially this year, as lower-than-expected growth, struggling real estate sector, and risks of worsening trade relationship with the US have all played their part. Lastly, the renewed Palestine-Israeli conflict is a new headwind that capital markets have recently priced in.

**Large US growth stocks outperformed other equity styles by sizeable margins.** The real source of this year's US equity rally are large, tech-focused companies, such as Apple, Microsoft, Alphabet, and others. The differing performance of market-cap weighted and equal weighted S&P 500 indices illustrates this fact well, as former gained 13.0% YTD, while the latter declined -0.6%. As the trend of contrasting returns between the equity styles continues, investors are likely to benefit from investing in individual stocks alongside the broad markets indexes (i.e., choosing a granular approach).

**YTD performance of major equity indices**




Source: Bloomberg (data as of 16-Oct-23)

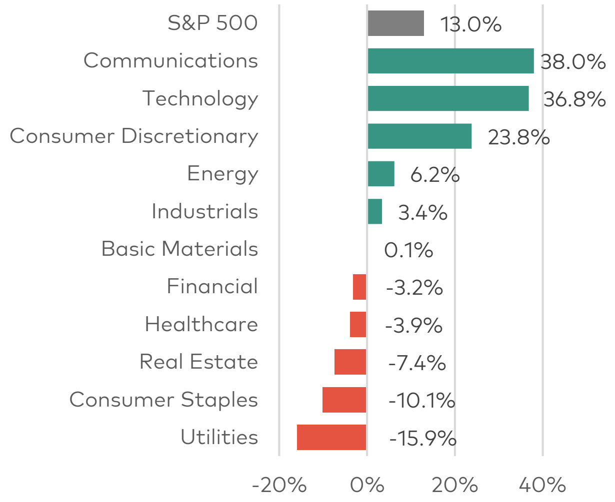
**YTD performance of US stocks by style, %**

| | Value | Blend | Growth |
|---|---|---|---|
| Large | 0.7 | 14.2 | 27.9 |
| Mid | -0.9 | 2.7 | 9.2 |
| Small | -3.8 | -1.2 | 1.0 |

Source: JPMorgan Asset Management (data as of 16-Oct-23)

**Cyclical sectors rallied, defensives declined.** While cyclical sectors rallied in 2023, defensives, such as Utilities and Consumer Staples, experienced profound losses. This is partly explained by the fact that improved investor optimism around the tech-related growth stocks (especially due to the recent AI buzz) moved cash from mature, stable companies towards the likes of Alphabet, NVIDIA, and Meta Platforms. In general, when investor risk appetite increases, the sell-off in low-risk assets takes place as money starts chasing the high-risk, growth assets, such as cyclical equities.

**S&P 500 sectors YTD performance**




Source: Bloomberg (data as of 16-Oct-23)

## 2. Fixed Income Markets

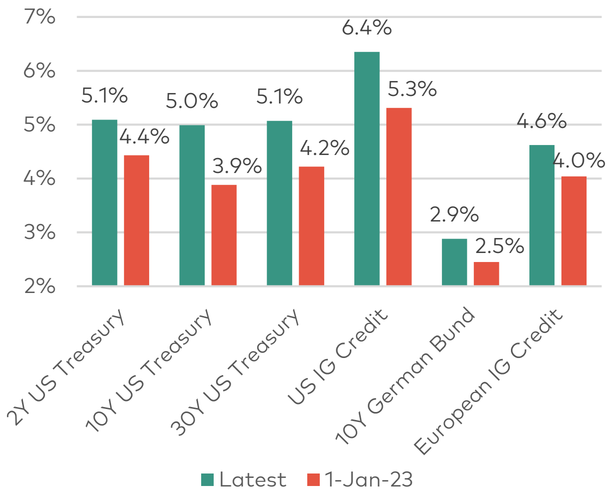
**Fixed income yields hit multi-year highs.** Since the US Federal Reserve and the European Central Bank started their hiking cycle in the early-2022, fixed income yields started to rise considerably. In October 2023, the US treasury yields reached their highest level since 2007. As a result, after years of near-zero real returns on most benchmark bonds, investors are finally offered strong real returns on risk-free* investments.

As displayed on the chart to the right, yields have increased considerably in 2023 as well and it is very likely that peaks have roughly been reached (since the Fed and the ECB have most probably neared the end of their tightening cycles).

**Fed sees rates to stay "higher for longer".** An end to interest rate increases by no means implies a swift policy easing. Perhaps the biggest market news in the past months was Fed's upwards revision of future interest rate forecasts, meaning they plan to reduce rates at a slower pace than previously expected. The ECB has followed the suit, now expecting to reach the main rate of 3.25% by the end of 2025.

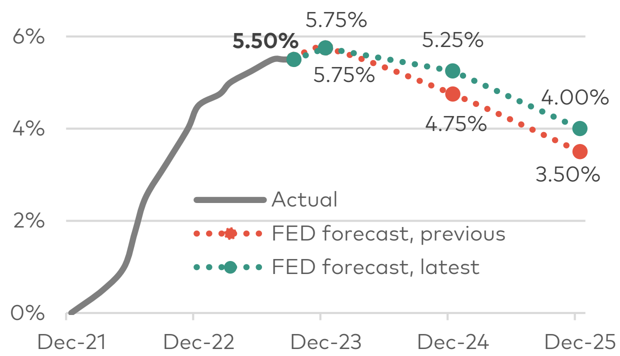
*US treasuries are regarded as "risk-free" in the world of finance. However, like every other investment instrument, they do possess certain risks.

**Fixed income yields are on the rise**




Source: Bloomberg (data as of 16-Oct-23)

**Actual and forecasted Fed rates (upper bound)**




Source: US Federal Reserve

# 3. Global Economy

**As inflation kept moderating in DMs, the US economy proved resilient, while Europe struggled.** Contrary to what many expected, the US economy withstood the most aggressive tightening cycle since 1980s quite well. In 2023, inflation kept declining with favorable pace and overall economic activity was not compromised nearly as much as initially expected. In past four quarters, the US economy grew by an average of 2.4% q/q as opposed to 0.1% for the Euro Area and the UK, each.

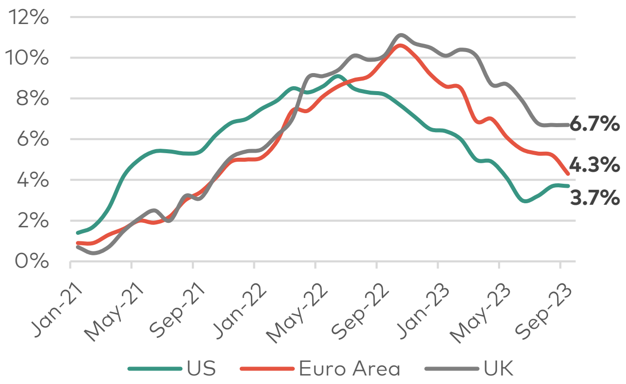
**The key driver behind the US strength is an American consumer.** The US retail sales have grown by an average of 3.3% y/y in 2023, a contrasting figure to Euro Area and UK figures of -2.1% y/y and -3.1% y/y, respectively. Savings accumulated during the pandemic and improved consumer confidence due to the resilient labor market serve as two major forces underlying such a strong demand.

**However, the battle against inflation is not yet over.** It is crucial to note that in the current context, every positive news on the activity side of the economy implies a potential upwards pressure on inflation. Therefore, having a tight labor market and resilient demand pose the risk of fueling inflation that still stands at roughly twice the target level (US core inflation was 4.1% y/y in October).

**Global growth is expected to slow from 3.5% in 2022 to 3.0% this year and 2.9% in 2024.** According to IMF, growth in developed economies is expected to almost halve from 2.6% y/y in 2022 to 1.5% (2023F) and 1.4% (2024F), yet still driven by a strong US momentum (IMF forecasts for US growth were revised upwards in 3Q23). Meanwhile, Europe is expected to lag.

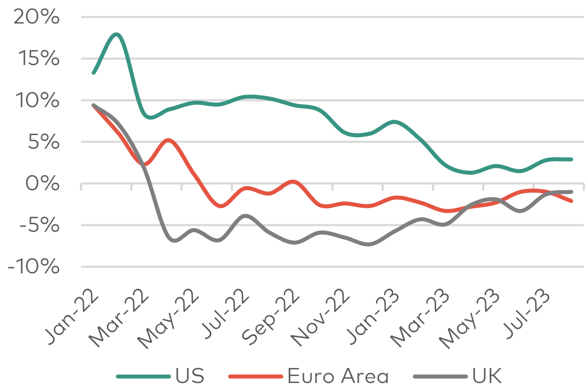
Lastly, risks to the global economy remain the same as in previous quarter. Persistent inflation, rising national debt levels, geopolitical tensions, and climate shocks may all cause the global economy to underperform existing expectations.

**Inflation rates in DMs (annual headline CPI)**




Source: Respective national statistical offices

**Retail sales since 2022 (annual % growth)**




Source: Respective national statistical offices

**IMF economic growth forecasts**

| | (October forecasts) | | (July forecasts) | |
|---|---|---|---|---|
| **Region** | **2023F** | **2024F** | **2023F** | **2024F** |
| **Global** | **3.0** | **2.9** | **3.0** | **3.0** |
| **Developed** | **1.5** | **1.4** | **1.5** | **1.4** |
| US | 2.1 | 1.5 | 1.8 | 1.0 |
| Euro Area | 0.7 | 1.2 | 0.9 | 1.5 |
| Germany | -0.5 | 0.9 | -0.3 | 1.3 |
| France | 1.0 | 1.3 | 0.8 | 1.3 |
| Italy | 0.7 | 0.7 | 1.1 | 0.9 |
| UK | 0.5 | 0.6 | 0.4 | 1.0 |
| Japan | 2.0 | 1.0 | 1.4 | 1.0 |
| **Emerging** | **4.0** | **4.0** | **4.0** | **4.1** |
| China | 5.0 | 4.2 | 5.2 | 4.5 |
| India | 6.3 | 6.3 | 6.1 | 6.3 |

Source: International Monetary Fund

# 4. Outlook for Markets

**Fixed income yields are expected to fall over time.** As inflation retreats in developed economies and monetary authorities start to gradually cut rates, yields on sovereign debt as well as corporate credit will very likely follow the suit and decline. Therefore, it may be a good time for investors to lock in the high rates currently available in the market.

**Analysts favor cyclical sectors, despite an uncertain outlook for general DM equity markets.** Interestingly, some of the top performing tech stocks of 2023 (still have the highest upside potential according to the consensus forecasts from Wall Street analysts). However, BlackRock has maintained a negative view on US and European equity markets, as they may seem pricey now (this does *not* mean they should be excluded from the portfolio. BlackRock itself has the highest allocation in US stocks). Lastly, make sure to keep an eye on Japan and AI-related stocks.

## FIXED INCOME

Bloomberg Consensus Forecasts for Yields, %

| Rate | Latest | 4Q23F | 1Q24F | 2Q24F | 3Q24F |
|---|---|---|---|---|---|
| **US treasuries** | | | | | |
| 30-year | 5.12 | 4.65 | 4.51 | 4.34 | 4.16 |
| 10-year | 4.97 | 4.46 | 4.28 | 4.09 | 3.91 |
| 5-year | 4.91 | 4.50 | 4.29 | 4.05 | 3.83 |
| 2-year | 5.12 | 4.93 | 4.63 | 4.28 | 3.94 |
| SOFR* | 5.40 | 5.42 | 5.32 | 5.07 | 4.73 |
| **German bunds** | | | | | |
| 10-year | 2.92 | 2.57 | 2.48 | 2.38 | 2.32 |
| 2-year | 3.12 | 2.85 | 2.69 | 2.48 | 2.33 |
| EURIBOR* | 3.97 | 3.98 | 3.95 | 3.82 | 3.62 |

Source: Bloomberg (data as of 16-Oct-23)
*SOFR and EURIBOR are given in 3 month maturities

## EQUITIES

12mo Consensus Analyst Forecasts*

| S&P Sectors | ETF | Outlook |
|---|---|---|
| GT Tech 50 | N/A | Positive |
| Real Estate | XLRE | Positive |
| Discretionary | XLY | Positive |
| Materials | XLB | Positive |
| Financials | XLF | Neutral |
| Communications | XLC | Neutral |
| Technology | XLK | Neutral |
| Healthcare | XLV | Neutral |
| Energy | XLE | Neutral |
| Industrials | XLI | Neutral |
| Staples | XLP | Negative |
| Utilities | XLU | Negative |

Source: Tipranks

BlackRock 6-12mo Views on Equity Markets

| Markets | ETF | Outlook |
|---|---|---|
| Japan | EWJ | Positive |
| DM AI mega force | BOTZ | Positive |
| UK | EWU | Neutral |
| Emerging Markets | EEM | Neutral |
| China | MCHI | Neutral |
| APAC ex. Japan | AAXJ | Neutral |
| US | SPY | Negative |
| Europe | IEUR | Negative |

Source: BlackRock Investment Institute

Positive Neutral Negative

*12 month consensus analyst forecasts correspond to average growth forecasts from the best performing financial analysts (mainly from the Wall Street). Outlook mark is determined with respect to the overall growth forecast for S&P 500 (i.e., if the sector has a higher growth forecast than S&P 500, then it is assigned a positive outlook mark and vice versa).

# Disclaimer



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