



Global Investment Outlook

Q2 2017



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Introduction

Many of the macro themes underpinning our second quarter Global Investment Outlook – better economic activity, an upturn in corporate earnings and fading fears of deflation – are also evident in Canada. Notably, our BlackRock GPS for the Canadian economy has risen steadily since the middle of 2016 on better retail sales, employment and wholesale trade data, and points to further modest upside to consensus forecasts.

That said, the Canadian economy remains weak in the aftermath of a substantial oil price shock and faces numerous headwinds that will likely limit its upside potential. Topping the list is the beleaguered structural outlook for industrial commodity prices. Energy and base metals prices are well above the cyclical lows posted last February, but may be range-bound from here because the price rebound has encouraged new supply, while demand is only moderate.

The potential for tectonic shifts in U.S. trade and tax policy is another force that could weigh on Canada's economy by negatively affecting the country's trade balance and competitiveness. Moreover, the persistence of record high debt levels among Canadian households and corporations poses an ongoing threat, especially if bond yields climb further and drive borrowing costs higher.



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Given these risks and considerable slack in the economy, we expect the Bank of Canada to keep monetary policy on hold for the foreseeable future. Inflation is far enough below target to preclude a rate hike, but conditions are not so terrible as to warrant a rate cut, which could even further stimulate an already overheated real estate market. We see the Canadian dollar likely coming under slight downward pressure relative to its US counterpart as the US Federal Reserve normalizes monetary policy. This downward pressure would potentially build if, as we note in our global outlook, there is a shift in expectations toward a faster pace of Fed rate hikes. The degree of weakness in the loonie will also depend on whether oil prices resume their march higher or languish at present levels.

We think bond investors face substantial, but not insurmountable, challenges amid our global outlook for higher yields and already tight spreads on corporate bonds. In our view, investors may be rewarded for holding a below-average exposure to interest rate risk and favoring credit risk. Investors may also need to remain active since the path to higher bond yields is not likely to happen in a straight line. At the same time, tight credit spreads suggest investors may want to be vigilant in response to any signs of cracks in the economic expansion.

After a stellar outcome for Canadian stocks in 2016, the tide has turned in favour of international equities in 2017. Our view coming into the year was that Canadian financial markets would deliver leaner investment returns. But even investors who had lowered their return expectations would have found first-quarter results underwhelming compared to global markets.

Any firming in commodity prices could provide a near-term boost to Canadian equities after a quarter when more modest oil price expectations weighed on the dominant energy sector. That said, we remain positive on international equities – particularly in Europe, Japan and emerging markets – where economic activity is firming, policy remains accommodative and earnings are on an upswing. We would also emphasize US equities as a way of gaining exposure to sectors that are underrepresented in Canada such as technology.



Richard Turnill
Global Chief
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Reflation is going global. The signs include a rebound in inflation expectations, a bottoming out in core inflation and wages, and a synchronised pick-up in economic activity indicators and corporate earnings estimates. Our key views:

- **Themes:** we believe the reflation trade – overweighting cyclical equities – has room to run, especially outside the US. We see global yields rising further but within limits: the US Federal Reserve (Fed) is likely to raise interest rates only gradually, and structural dynamics such as aging populations keep us in a low-return world. We believe investors need to go beyond broad equity and bond exposures to diversify portfolios in this environment, and include factor-based allocations and alternatives.
- **Risks:** sharp increases in sentiment-based indicators may fail to translate into hard data such as corporate investment. In the US, the anti-growth part of President Donald Trump's agenda (protectionism) could win out over the pro-growth part (deregulation and tax cuts). Any shift of expectations toward a faster pace of Fed rate rises could spook markets. We see upside risk in Europe, where we do not expect elections to deliver the populist outcomes feared by markets.
- **Market views:** we prefer equities over fixed income, and selected credit over government bonds. We like European and Japanese stocks amid strong global growth. We see value shares such as financials benefiting from rising yields. We are neutral on US shares because of lofty valuations and the risk that expectations for tax reform and deregulation may be too high. We like emerging market (EM) equities on reform progress in countries such as India and our view that near-term risks to China's growth are overstated. In fixed income, we prefer higher-quality corporate bonds and selected EM debt.



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THEMES 6-9

Broadening reflation
Low returns ahead
Different diversification
Risks



MARKETS 10-13

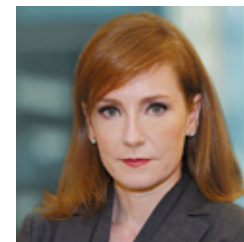
Government bonds
Credit
Equities
Assets in brief



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Setting the scene

Global growth expectations are on the rise – and we see room for more upside surprises. Our *BlackRock GPS* – which combines traditional economic indicators with big data signals such as Internet searches – points to a rise in G7 growth estimates in the months ahead. See the gap between our gauge (green line) and consensus forecasts (blue line) in the *Liftoff at last* chart. What is different since our *2017 global investment outlook* of December 2016? Reflation is becoming synchronised: non-US economies have contributed as much as the US to the rise in our G7 GPS this year. This marks a reversal from 2016, when the US was the locomotive. Our China GPS is also elevated, as detailed in *China's role in global growth* of February 2017. Yet some of us caution that China's lather, rinse and repeat cycle of credit stimulus followed by some monetary tightening is again in rinse mode. This could cause temporary hiccups in funding markets.

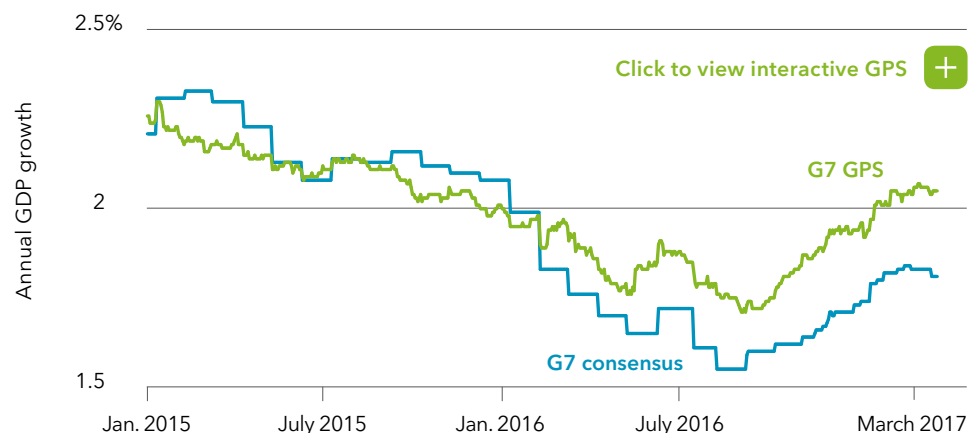
The global economic recovery is broadening, and we see room for consensus estimates to ratchet even higher as reflation gains traction.

Inflation expectations have rebounded from lows in mid-2016, and actual inflation is slowly following. It has bounced in the UK – driven by a weak sterling – and is creeping higher in the eurozone, albeit from much lower levels. See the *An awakening of inflation* chart. Energy has driven much of the rebound, but inflation is also broadening. A rising percentage of consumer price index components is clocking increases, our analysis shows. In China, wholesale prices have shot up after sliding for five straight years. What are the risks to our reflation thesis? First would be an overshoot in expectations of monetary tightening leading to a sharp rise in the dollar, tightening global financial conditions. Second, wage growth and corporate investment could be slower to materialise than surveys have indicated. This could set markets up for disappointment, particularly in the US. Lastly, any rise in protectionism could curb growth and lift inflation.

Our reflation thesis has risks: market expectations of faster monetary tightening, lacklustre investment or wage growth, and protectionism.

Liftoff at last

BlackRock GPS vs. G7 consensus, 2015-2017

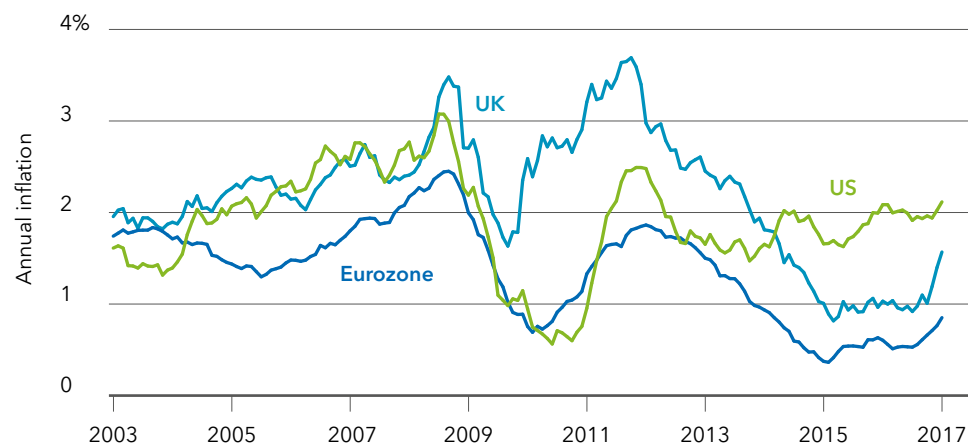


Sources: BlackRock Investment Institute and Consensus Economics, March 2017.

Notes: the BlackRock GPS shows where the 12-month consensus GDP forecast may stand in three months' time for G7 economies. The blue line shows the current 12-month economic consensus forecast that we calculate by using GDP-weighted Consensus Economics data.

An awakening of inflation

US, eurozone and UK trimmed mean inflation rates, 2003-2017



Sources: BlackRock Investment Institute and Thomson Reuters, March 2017.

Notes: the chart uses trimmed mean inflation, which aims to provide a more accurate picture of underlying inflationary pressures. We take the official CPI basket for each country and each month exclude the largest and smallest movers by price volatility.

Theme 1: broadening reflation

We see an inflection point in growth, inflation and monetary policy. Markets are catching up to these fast-changing dynamics. Case in point: a synchronised global recovery in corporate earnings is supporting equities. This is not only about reflation. Cost discipline (resources), hopes for regulatory easing (financials) and innovation (tech) are all contributing to strong 2017 earnings expectations. Earnings momentum is particularly strong in Japan and EMs, while solid in Europe. This supports our preference for stocks in those regions. See the *Earnings upswing* chart.

In the US, the 'Trump trade' appears to be taking a breather. US small caps and value stocks such as banks have been underperforming this year after a post-election run-up. Yet strong equity returns globally, including Japan small caps, suggest our reflation theme is intact.

Spreading global reflation is driving a long-awaited rebound in global corporate earnings, with the sharpest recoveries seen outside the US.

Strengthening reflation reinforces our view that we have seen the bottom in bond yields globally after a multi-decade slide. See the chart *Coming up for air*.

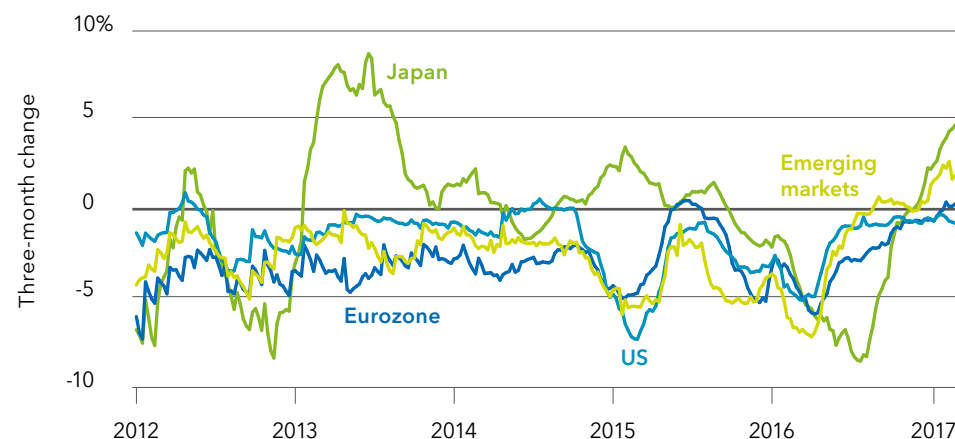
As a result, we see most government bond markets challenged this year. Many lack the buffers to defend against capital losses as yields rise. Yet we do see limits to how high yields can go. Central banks in Europe and Japan appear set to keep running ultra-easy policies. Many investors are ready to jump on higher yields to lock in income. Aging populations and historically weak rates of economic growth also act as brakes.

Our expectation of higher yields underpins our overall preference for equities over bonds. Stocks have historically done well in reflationary environments because they are geared to global growth and offer diversification benefits, in our view. We do believe US Treasuries and similar government bonds still have a key role to play in helping stabilise portfolios during 'risk-off' episodes, when downside surprises roil markets.

Yields look poised to rise, but there are limits to how high they can go. We see risks to fixed income, and prefer Japanese, European and EM equities.

Earnings upswing

Changes in corporate profit estimates, 2012-2017

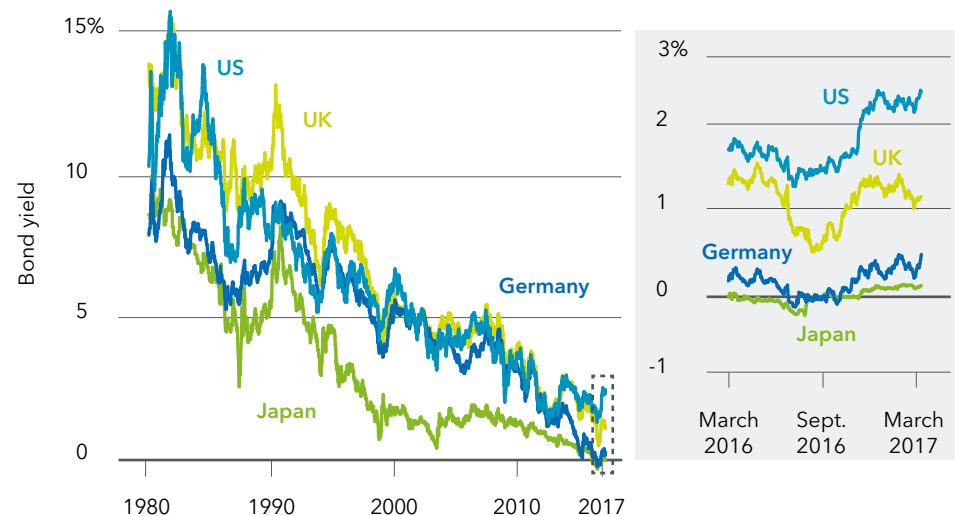


Sources: BlackRock Investment Institute, MSCI and Thomson Reuters, March 2017.

Notes: the lines show the three-month change in the aggregate 12-month forward earnings estimates. The data are based on the MSCI US, EMU, Japan and EM indexes.

Coming up for air

10-year government bond yields, 1980-2017



Sources: BlackRock Investment Institute and Thomson Reuters, March 2017.

Theme 2: low returns ahead

Our capital market assumptions point to muted returns across asset classes in the coming five years – but show investors can still be rewarded for moving out the risk spectrum into credit, equities and alternatives. We see a classic 60/40 portfolio of US equities and diversified bonds returning less than 4% annually over the next five years – far below annual returns of 10% from 2012 to 2016. See the *Relative value* chart.

Our assumptions are for market returns, or beta. Active management can potentially enhance returns, especially in asset classes where specialist knowledge is key, managers have a track record of outperformance, the opportunity set is larger than benchmark indexes, and few liquid and low-cost passive alternatives are available. Think alternatives, credit and EM assets.

Our subdued return outlook means investment strategies need a rethink.

We see a greater role for non-US and EM stocks, credit and alternatives.

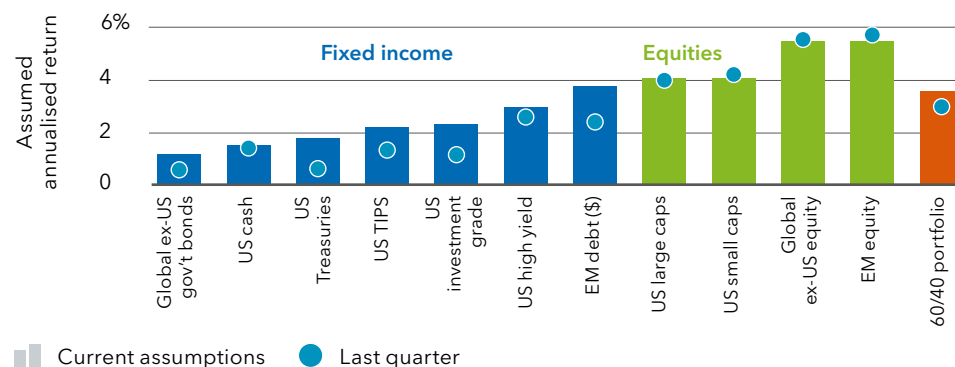
The search for yield is still on in the low-return environment – and income-producing assets are in short supply. This partly explains why yield curves have flattened, along with the Fed's lifting rates at a quickening pace. The long end of the yield curve effectively runs into a wall of demand – especially from liability-driven investors pouncing on yield spikes to lock in higher income streams.

The challenge for investors? Some of the largest fixed income sectors, such as government bonds, offer paltry or even negative yields. See the blue bubbles in the *So little yield, so much duration* chart. Many, such as Japanese government bonds, are also relatively long duration. Ultra-low yields expose holders to significant interest rate risk. Yet the few sectors offering decent yields are relatively small and becoming pricey. Examples include US high yield or EM corporate debt. This mismatch is one reason to be cautious and dynamic in fixed income and guard against the risk of sudden yield back-ups.

The fixed income universe is dominated by government bonds offering little buffer against yield rises. Investors may want to consider credit.

Relative value

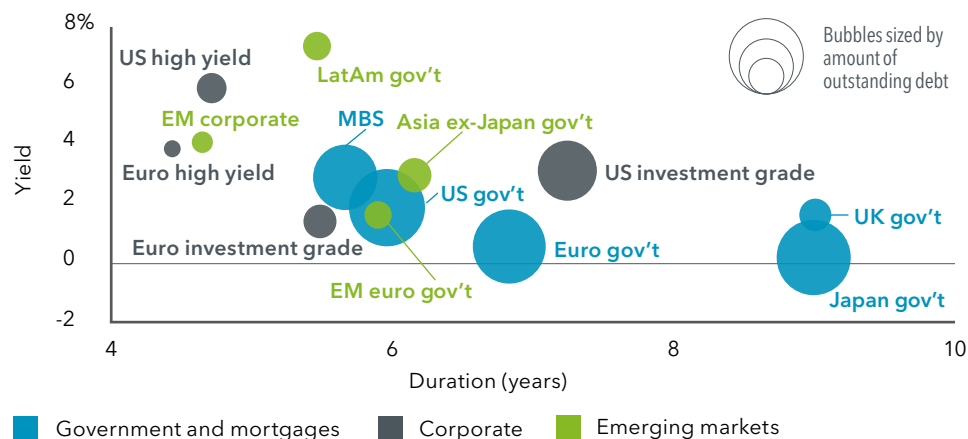
BlackRock's five-year asset class return assumptions, January 2017



Sources: BlackRock Investment Institute, BlackRock Solutions, Citigroup, MSCI, JPMorgan, March 2017. Notes: the bars show BlackRock's annualised nominal return assumptions for the next five years in US dollar terms. Indexes used for fixed income are the respective Bloomberg Barclays indexes, except for EM debt (JPMorgan EMBI Global Diversified Index). Equities use the respective MSCI indexes. The assumed return of the 60/40 equity/government bond portfolio uses the MSCI USA Index for equities and the Bloomberg Barclays US Aggregate Index for bonds. This information is not a recommendation to invest in any particular asset class or strategy or a promise of future performance. Indexes are unmanaged and used for illustrative purposes only. They are not intended to be indicative of any fund's or strategy's performance. It is not possible to invest directly in an index.

So little yield, so much duration

Global fixed income yields and duration, March 2017



Sources: BlackRock Investment Institute and Bloomberg Barclays, March 2017. Notes: all data are based on the Bloomberg Barclays Multiverse Index. Asset classes are defined and selected by the Barclays POINT database.

Theme 3: different diversification

Equity market volatility is historically low despite persistent political

uncertainty. See the *What, me worry?* chart. In fact, volatility looks unusually depressed across asset classes, with the exception of foreign exchange. Global reflation and ample liquidity have consistently trumped politics in recent years. Yet a lot is now brewing under the surface. Correlations between stocks and equity sectors, for example, have declined markedly in the US and Europe, our research shows.

Volatility is subject to sporadic outbursts that can catch investors unawares. We still see bonds acting as effective shock absorbers in portfolios in such times of market stress. But they offer little safety cushion at today's still-low yields. We believe investors should consider a broader diversification approach than a traditional bond/equity mix, including adding factor exposures and asset classes such as private credit and property.

We brace for sporadic spurts of volatility. Bonds are still effective shock absorbers, but we also see room for factors and alternatives as diversifiers.

Depressed volatility is also covering up falling correlations across asset classes.

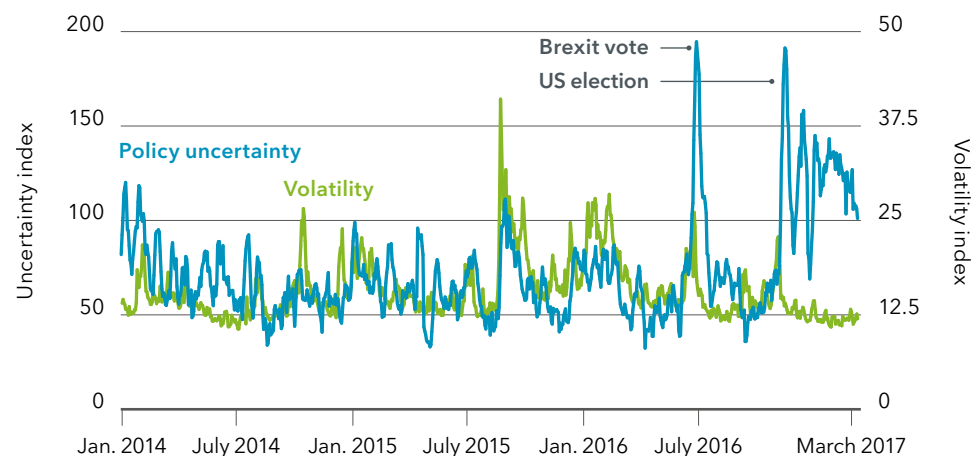
Our multi-asset concentration index – a measure of correlations across 14 global asset classes – is hovering well below its post-crisis average, according to our Risk and Quantitative Analysis group. See the *Go your own way* chart. This is a break from recent years, when many asset classes rode a wave of central bank liquidity and moved in near lock-step.

To be sure, correlations can change quickly – especially under a scenario of a downward jolt to growth expectations. Yet weakening correlations, low volatility and room for animal spirits to improve further all point to an environment where risk-taking is likely to be rewarded, in our view. We see the investment landscape increasingly being dominated by the differentiated effects of reflation, and, in economies such as the US, by politics and policy.

We see weakening correlations, low volatility and still-muted risk appetite favouring risk taking and putting a premium on security selection.

What, me worry?

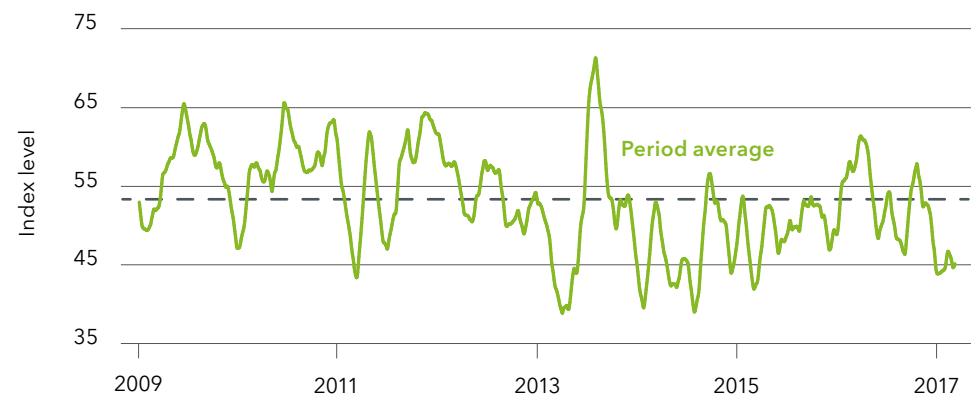
US economic policy uncertainty and equity volatility, 2014-2017



Sources: BlackRock Investment Institute, Baker Bloom and Davis Economic Policy Uncertainty Index and Thomson Reuters, March 2017. Notes: the economic policy uncertainty index measures policy-related economic uncertainty based on newspaper coverage of related terms. The CBOE Volatility Index, or VIX, is a measure of the implied volatility of S&P 500 Index options.

Go your own way

BlackRock Multi-Asset Concentration index, 2009-2017



Source: BlackRock Investment Institute, March 2017.

Notes: the line shows the 30-day average of the Multi-Asset Concentration index created by BlackRock's RQA team. It shows the strength of cross-asset correlations based on principal component analysis. A higher index signals stronger correlations (prices moving in the same direction) driven by a single common factor across multiple markets. The index is based on rolling daily returns on 14 assets.

Risks

A lot is hinging on the new US administration's growth agenda. Many US stocks that sprinted ahead on prospects of tax reform, deregulation and stimulus have already fallen back. To be sure, fundamentals also have driven US equity performance, with the tech sector benefiting from rising demand and high oil inventories sapping sentiment in the energy sector. Yet failure to pass a new health care bill has revealed a fractured Congress, calling into question meaningful pro-growth reforms and raising risks of protectionism. This could set up stocks for more policy disappointments.

By contrast, we believe European elections risks are overstated as we find it hard to see populist candidates gaining actual power in the near term. We see demand for perceived safe-haven bonds weakening and investors rediscovering European equities: flows into European equity funds are lagging a spurt in economic activity. See the *European disconnect* chart.

We see Europe's political risks as overstated. European stocks could benefit as investors wake up to the region's economic recovery.

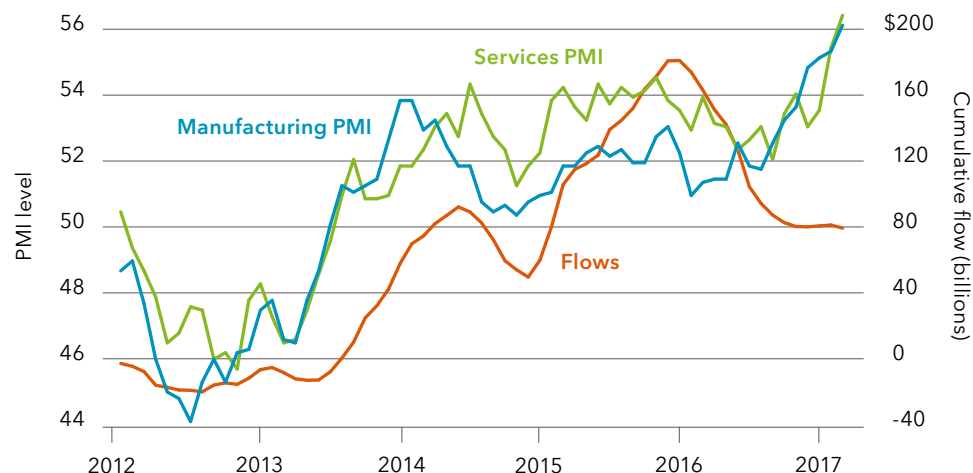
A key risk is that expectations of monetary tightening catch up to those of the Fed – or even overshoot them. Markets today are pricing in a much gentler pace of rate rises than Fed officials. See the *Managing expectations* chart. Hawkish Fed rhetoric or expectations of tax cuts boosting growth could be catalysts for a repricing. To be sure, any repricing would happen in the context of a slower pace of tightening and lower peak fed funds rate than in the past because of aging populations and subdued growth.

A likely shake-up to the Fed's leadership adds to policy uncertainty. And narrow credit spreads leave little room for error. Higher rates eventually make cash more attractive and could bite into demand for risk assets, as detailed in *Normalizing normalization* of March 2017. Lastly, any overshoot in Fed tightening expectations could boost the dollar, hurt commodity prices and tighten financial conditions.

The quickening pace of Fed rate rises could upset the benign market backdrop; low volatility and tight spreads exacerbate this risk.

European disconnect

Eurozone PMIs and Europe ex-UK equity flows, 2012-2017

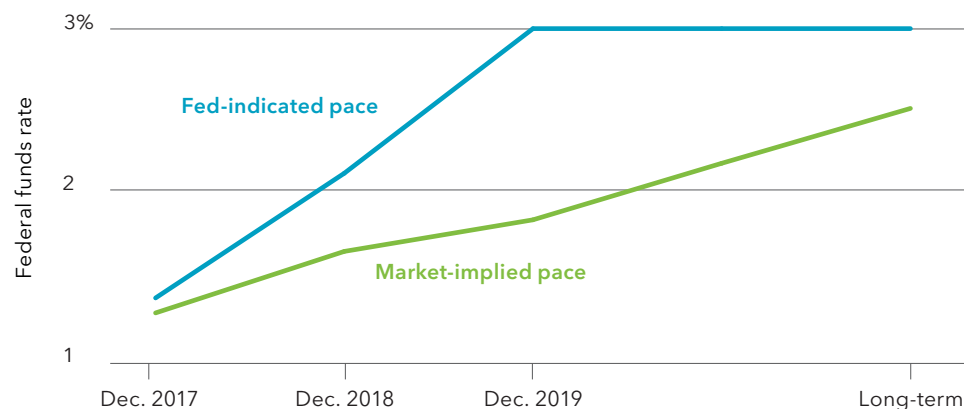


Sources: BlackRock Investment Institute, Markit and EPFR, March 2017.

Notes: PMI stands for purchasing managers' index. A level above 50 indicates expansion. Flows are cumulative net investments into equity funds.

Managing expectations

Rate expectations of policymakers and markets, 2017 to long run



Sources: BlackRock Investment Institute and Bloomberg, 16 March 2017. Notes: the chart shows the market's projection and the Fed's outlook for the fed funds rate. The market outlook is based on overnight indexed swap rates, while the Fed's is the median projections from policymakers on the Federal Open Market Committee.

Government bonds

Global reflation has led markets to start contemplating a normalisation of monetary policies – even outside the US. Treasuries have led the rise in global yields. This rise has been a 'healthy' one driven by two key factors: inflation and real interest rates. It contrasts with the 'taper tantrum' of 2013, when the move was driven by increased risk premiums. See the *A good rate rise* chart. We see global yields rising further, with long-term bond yields remaining somewhat capped by subdued growth expectations and demand for yield from investors seeking to match long-term liabilities.

Yet depressed volatility across asset classes points to market complacency. Any signs of a more hawkish Fed – or signals that the European Central Bank (ECB) is getting ready to tighten policy or the Bank of Japan (BoJ) is shifting its yield target – could lead to turbulence.

Global yields are rising on improved growth. This is fuelling expectations of an eventual pull-back in global monetary policy accommodation.

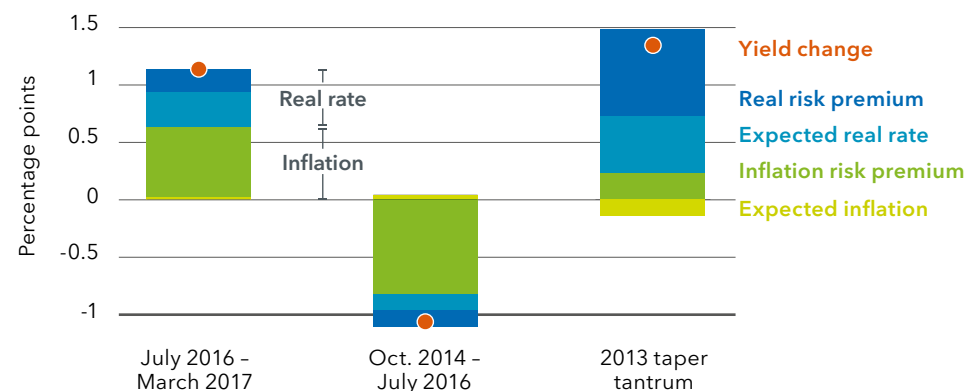
Inflation expectations have sprung back to life around the world. The recovery has been from a low base – particularly in Europe and Japan – but the direction of travel since mid-2016 is clear. See the *Deflating deflation fears* chart. This represents a move away from the obsession over weak growth that had many investors fretting about deflation and 'secular stagnation' just a year ago. It is effectively a return to normal, mostly driven by a rise in the inflation risk premium, our research shows. Yet we do see risks in the near term as markets may be too hopeful about the speed at which signs of wage growth arrive. A potential slide in oil prices is another risk as the energy rebound has been a big factor in the reassessment.

We still see reasons to favour inflation-protected over nominal bonds in the medium term, especially in the eurozone. Our base case is that the ECB and BoJ will likely keep policy accommodative to ensure that inflation moves closer to target – market jitters about policy shifts notwithstanding.

We see medium-term opportunities in inflation-linked bonds, but some risk of disappointment in the near term as wage growth remains elusive.

A good rate rise

Drivers of US Treasury yield changes, 2013-2017

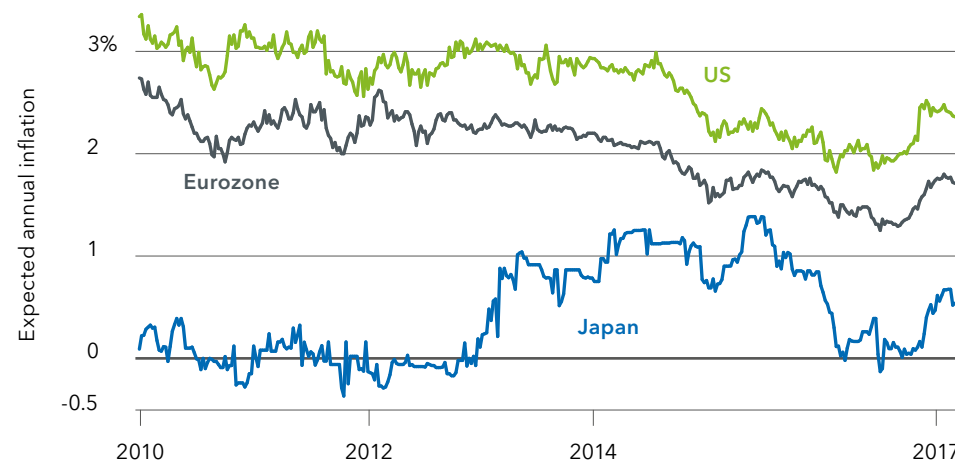


Sources: BlackRock Investment Institute and US Federal Reserve, March 2017.

Notes: the chart shows the breakdown of the four components driving the change in US Treasury yields across three periods. The first period represents the current rise in yields. The second period shows the plunge in oil prices that reduced rates of inflation compensation. The third period covers the seven months after then-Fed Chairman Ben Bernanke first mentioned curbing bond purchases, precipitating the 'taper tantrum.' Our analysis uses the methodology detailed in the [San Francisco Fed research paper by Andreasen, Christensen, Cook, Riddell \(2016\)](#).

Deflating deflation fears

US, eurozone and Japanese medium-term inflation expectations, 2010-2017



Sources: BlackRock Investment Institute and Bloomberg, March 2017.

Note: the lines show the market expectations for five-year forward inflation in five-years' time. Inflation expectations are based on five-year/five-year forward inflation swaps.

Credit

We see opportunities in credit. Investment grade corporate debt offers higher yields than long-end Treasuries at less than half the volatility, our five-year capital market assumptions show. See the *Fixated on fixed income* chart. We see it as attractive in the trade-off between yield and risk.

Within riskier fixed income areas, we believe EM hard-currency debt offers value in the medium term with relatively high expected yields at moderate volatility. We also like selected local-currency EM debt due to higher yields, easing concerns about rapid dollar gains and diversification benefits.

Unusually low volatility and relatively rich valuations across credit markets leave little margin for error, however. This is why we prefer to take risk in equities, rather than in EM debt and equity-like bonds such as high yield.

We favour US credit and EM debt over government bonds, but prefer to take risk in equities due to elevated credit valuations across the board.

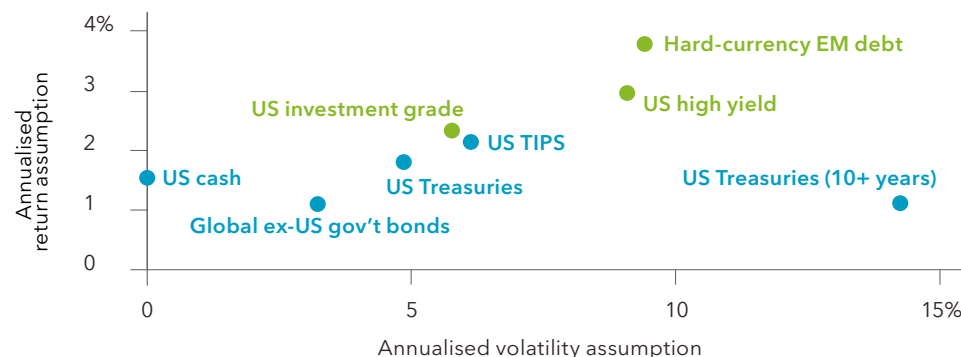
Credit is attractive for its income and ability to buffer a portfolio from higher rates. Yet the asset class's past success in having done so leaves credit spreads with less room to tighten further. As a result, we are starting to see more downside risks from any negative shocks than upside potential from global reflation. Eurozone credit looks particularly vulnerable against a backdrop of heady valuations and rebound in growth and inflation expectations. Eurozone investment grade spreads have compressed more than those on US peers. See the *Vanished value* chart. Credit is not cheap across the board, so we focus on quality. Example: at the beginning of 2016, US high yield spreads were among the widest versus investment grade since the financial crisis. A year later, that ratio is back near post-crisis lows, making investment grade relatively attractive. Our bottom line: reflation favours equity over debt. Within a world of tight credit spreads, we prefer higher-quality corporates.

We favour US investment grade credit and an up-in-quality stance in high yield.

We are underweight European credit due to heady valuations.

Fixated on fixed income

BlackRock's five-year return and long-term volatility assumptions, January 2017

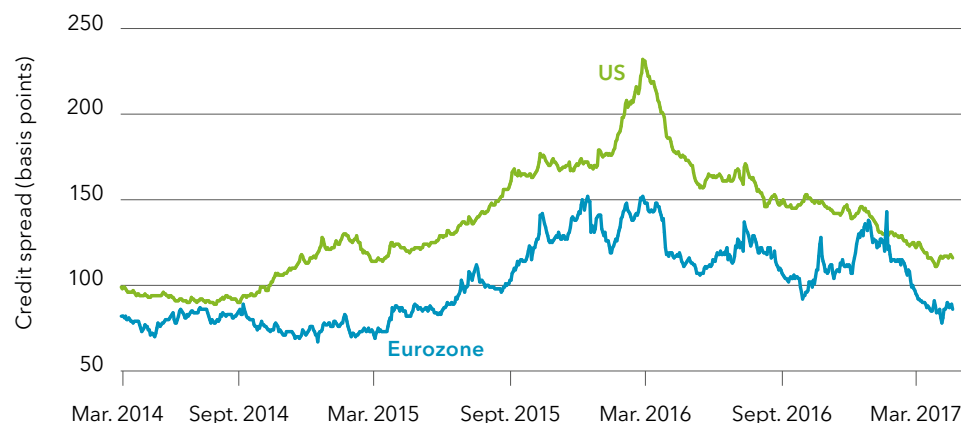


Sources: BlackRock Investment Institute and BlackRock Solutions, January 2017.

Notes: this information is not intended as a recommendation to invest in any particular asset class or strategy or as a promise of future performance. The dots show our annualised nominal return assumptions for the next five years from a US dollar perspective versus our long-term annualised volatility assumptions. Indexes used are the Citigroup 3-Month Treasury Bill Index for US cash; JPMorgan EMBI Global Diversified Index for EM debt; and the respective Bloomberg Barclays indexes for the remaining asset classes. Indexes are unmanaged and used for illustrative purposes only. They are not intended to be indicative of any fund or strategy's performance. It is not possible to invest directly in an index.

Vanished value

US vs. eurozone investment grade credit spreads, 2014-2017



Sources: BlackRock Investment Institute and Bloomberg Barclays, March 2017.

Notes: the chart shows the option-adjusted spread over LIBOR for US and euro investment grade credit, from the perspective of a US dollar investor. We use the three-month EUR/USD cross-currency basis swap spread as a proxy for the funding cost faced by the US investor. Indexes used are the Bloomberg Barclays US Corporate Index and EuroAgg Corporate Index.

Equities

US equities do not look cheap, and gains since the presidential election have been powered mostly by multiple expansion. This explains our preference for European, Japanese and EM equities, where valuations look more reasonable and gains have been driven more by expected earnings growth. See the *Odd man out* chart. To be sure, forward earnings expectations have a dismal track record year drags on.

Yet we see reason for optimism in 2017. Non-US markets tend to have greater leverage to growth in global industrial production, our research suggests. We see this pointing to an even bigger earnings boost from stronger global activity. We expect small caps, cyclicals and banks to benefit as reflation broadens. As a result, we like the size and value factors. The latter still looks cheap to us globally despite solid post-election performance.

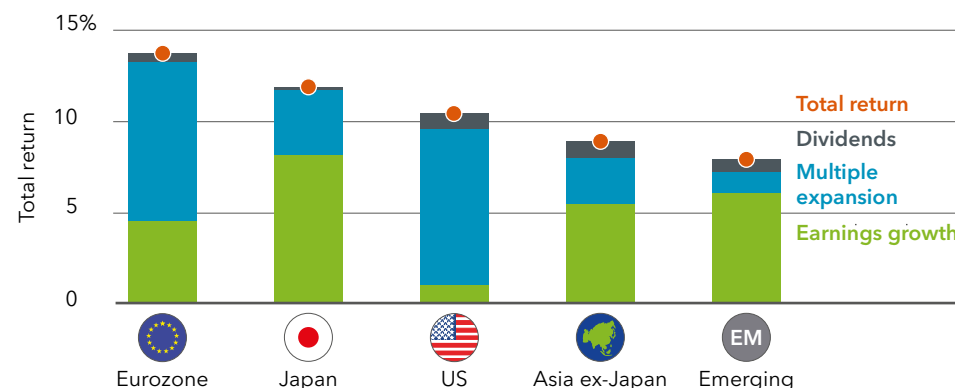
Non-US equities look attractive to us. We see them playing a role in creating more diversified portfolios for the medium term.

EM equities are showing signs of life again. An encouraging sign is a bottoming out of the return on equity in EM markets relative to that of the developed world. See the *Performance improvement* chart. Investors have been slow to shift funds into EM equities, but we believe they are too cautious. Reasons include global reflation accelerating and broadening, solid consumer demand across the EM world and cost discipline boosting earnings in the resource sector. Recent recessions in Brazil and Russia as well as worries about trade protectionism have kept many investors away. Potential for an unexpectedly strong US dollar also looms as a risk. Yet if the worldwide expansion powers ahead and trade keeps recovering as PMIs suggest, we expect EM equities to be among the biggest beneficiaries. We see opportunities in Chinese equities, as detailed in *Warming up to China* of February 2017, and like EM financials.

We like EM equities because we see companies improving profitability and benefiting from global reflation.

Odd man out

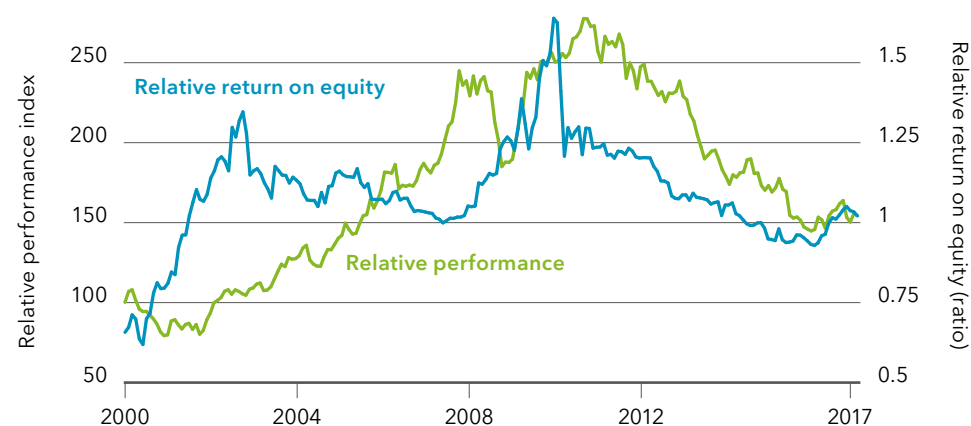
Sources of equity total return since US election, March 2017



Sources: BlackRock Investment Institute, MSCI and Thomson Reuters, March 2017. Notes: equity markets are represented by MSCI indexes for Japan, EMU ex-UK, USA, Asia ex-Japan and EM. Earnings growth is based on aggregate 12-month forward earnings forecasts. The dividend contribution is based on the difference between the index total and price returns. Multiple expansion is represented by the total return minus earnings growth and dividends. All returns are in local currency except for emerging markets and Asia ex-Japan, which are in US dollars.

Performance improvement

EM equities relative performance and profitability, 2000-2017



Sources: BlackRock Investment Institute and MSCI, March 2017.

Notes: relative performance is based on the MSCI Emerging Markets Index (total return) divided by the MSCI World Index (total return), indexed to 100 at the year 2000. Relative return on equity (ROE) measures the ratio of the ROE of these two indexes.

Assets in brief

Views on assets for Q2 from a US dollar perspective

Asset class		View	Comments
Equities	US	—	Prospects of tax reform and deregulation are supportive. Timing and implementation are uncertain, however, and valuations have risen. We like value, financials, selected health care, dividend growers and shale oil companies.
	Europe	▲	We see global deflation and an improving earnings outlook supporting cyclical and exporters, particularly industrials and multinationals with EM exposures. We believe the risk of populist outcomes in upcoming elections is overstated in the near term.
	Japan	▲	Positives are improving global growth, more shareholder-friendly corporate behaviour and earnings upgrades amid a stable yen outlook. We see BoJ policy and domestic investor buying as supportive. Risks are yen strength and rising wages.
	EM	▲	Economic reforms, improving corporate fundamentals and reasonable valuations support EM stocks. Deflation and growth in the developed world are other positives. Risks include shifts in currency policies and trade conflicts.
	Asia ex-Japan	▲	Financial sector reform and rising current account surpluses are encouraging. China's economic growth momentum and corporate earnings outlook look strong in the near term. We like India, China and selected Southeast Asian markets.
Fixed income	US government bonds	▼	A deflationary outlook challenges nominal bonds. TIPS valuations have risen, but we still favour them for the long run. A widening of agency mortgage spreads has improved valuations, yet changes to the Fed's reinvestment policy are a longer-term concern.
	US municipals	—	Higher rates post election and muted issuance have restored value, and investor interest has perked up amid positive performance and market expectations that tax reform may be delayed or watered down. We are neutral on duration and favour 7-10 year bonds.
	US credit	▲	Stronger growth favours credit over Treasuries. We generally prefer up-in-quality exposures and investment grade bonds due to elevated credit market valuations. Floating-rate bank loans appear to offer insulation from rising rates, but we find them pricey.
	European sovereigns	▼	Improvement in economic data and high valuations make us cautious. We see political risks waning after key elections. This should cause core eurozone yields to rise, and spreads of semi-core and selected peripheral government bonds to narrow.
	European credit	▼	Risks are tilted to the downside amid heady valuations and the possibility of shifting market expectations for central bank support. We are defensive and prefer selected subordinated financial debt.
	EM debt	—	We see broadening of growth beyond the US benefiting EMs and limiting risks from dollar appreciation. This makes local-currency debt more attractive to us. We see selected opportunities, but high valuations keep us neutral overall.
	Asia fixed income	—	We like markets with positive fundamentals and reform momentum, such as India. The upside is limited as spreads have compressed. A positive cyclical outlook for China is supportive, but US trade protectionism is a risk.
Other	Commodities and currencies	—	We see oil prices as range-bound amid stabilising US inventory growth. We expect the US dollar to rebound from recent weakness in the medium term due to higher growth expectations and interest rate differentials with many other economies.

▲ Overweight — Neutral ▼ Underweight

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