BlackRock

2022 Global outlook

BlackRock **Investment** Institute

Thriving in a new market regime


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We are entering a new market regime unlike any in the past half century: We see another year of positive equity returns coupled with a down year for bonds. The powerful restart of economic activity will be delayed – but not derailed – due to new virus strains, in our view. Central banks will start to raise rates but remain more tolerant of inflation. We see inflation settling above pre-Covid trends – we're going to be living with inflation. We favor equities over fixed income as a result, but have dialed back our risk-taking given the wide range of potential outcomes in 2022.

We see 2022 heralding a new regime by delivering global stock gains and bond losses for a second year – what would be a first since data started in 1977. This unusual outcome is the next phase of our *new nominal* theme that is still playing out: Central banks and bond yields are slower to respond to higher inflation in the powerful restart than in the past. That should keep real, or inflation-adjusted, bond yields historically low and support stocks.

The big change in 2022: Central banks will be withdrawing some monetary support as the restart does not need stimulus. We see more moderate equity returns as a result. We expect the Fed to kick off rate hikes but remain more tolerant of inflation. The Fed has achieved its inflation target, so its interpretation of its employment mandate will determine the timing and pace of higher rates. The European Central Bank, facing a weaker inflation outlook, is likely to stay even easier on policy. We had flagged inflation – and now we're ***Living with inflation***. We see inflation settling at levels higher than pre-Covid even as supply bottlenecks ease.

We expect new virus strains to delay, but not derail, the restart thanks to effective vaccine campaigns. We see a short-term macro and sectoral impact, but the big picture is unchanged: Less growth now is more later.

Cutting through confusion that is gripping markets is key. A unique confluence of events – the restart, new virus strains, supply-driven inflation and new central bank frameworks – have created confusion as there are no historical parallels. Risks are rising as policymakers and investors might misread the current surge in prices. That's why we assess alternative scenarios to our base outcome and trim risk.

Climate change and the race for the world to reach net-zero emissions by 2050 play into the confusion. We view the transition as a supply shock contributing to higher inflation and playing out over decades. ***Navigating net zero*** is not just a long-term story – it's a *now* story. Supply shocks are here, and the tectonic shift toward sustainable investing is already playing out.

How to thrive in this new market regime? We prefer equities in the inflationary backdrop of the strong restart. We favor developed market (DM) stocks over emerging markets (EM) as we dial down risk slightly amid rising risks to our base case. We are underweight DM government bonds – we see yields gradually heading higher but staying historically low. We prefer inflation-linked bonds, partly as portfolio diversifiers. On a strategic horizon, we like private markets for their diversification and return potential.

A new market regime

It's rare for global stock returns to be positive and bonds negative in any one calendar year – and two years in a row has not happened over nearly five decades. See the *Rare combination* chart. This signals we are entering a new market regime – and why it's important to cut through the confusion sparked by the powerful restart this year.

Why did this happen in 2021? The restart resulted in severe inflation pressures and supply bottlenecks. Real yields stayed low even as inflation climbed and growth surged. In a stark departure from past practice of pre-emptive tightening, most DM central banks did not respond.

This was the *new nominal* in action and marked the start of a regime shift. The market started to price in higher inflation absent a central bank response, driving nominal bond prices down. Yet real yields stayed historically low, and corporate earnings surged in the restart. This drove big stocks gains.

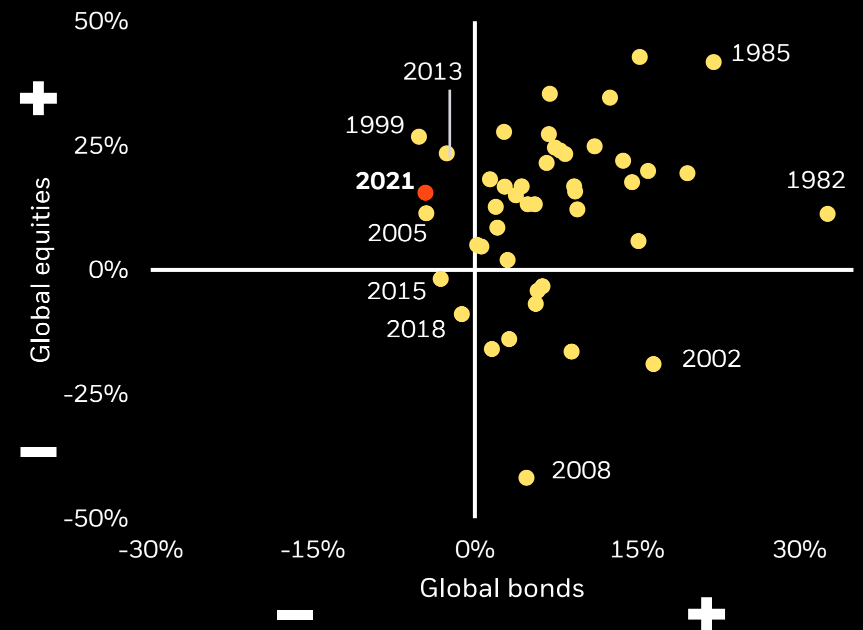
2022 is the next phase of this story. Even if new Covid strains delay the restart, central banks are poised to nudge up policy rates because the restart does not require monetary support. Yet we don't see them responding aggressively to persistent inflation.

We see real yields gradually rising, but remaining near historically low levels. We see inflation remaining persistently higher than its pre-pandemic level. Yet we see it coming off its recent highs as supply constraints ease and consumer spending rebalances away from goods and toward services.

The restart could be delayed, but weaker growth now means stronger growth later. This supports further equities gains, in our view, if more modest ones than in 2021. We also see another year of negative nominal bond returns. Reasons include slightly higher real yields, another rise in breakeven inflation rates and a return of investors demanding a term premium for the risk of holding long-term bonds.

Rare combination

Annual returns for global equities and fixed income, 1977-2021



Past performance is not a reliable indicator of current or future results. Indexes are unmanaged and not subject to fees. It is not possible to invest directly in an index. Sources: BlackRock Investment Institute, with data from Refinitiv Datastream and Bloomberg, December 2021. Notes: The chart shows annual returns for global equities and bonds in U.S. dollar terms from 1977-2021. Index proxies are the MSCI All-Country World index for equities (MSCI World before 1988) and Bloomberg Global Aggregate index for bonds (U.S. Aggregate before 1991).

We see the forces that drove stocks up and bonds down in 2021 – the *new nominal* theme in action – to still be at play in 2022 as inflation settles at higher levels than pre-Covid.

The new regime – and alternatives

Base case: new nominal
Mildly higher inflation meets with a muted central bank response, keeping real rates historically low. Stocks can thrive, but bonds still suffer as the yield curve modestly steepens.

Safety premium questioned
The perceived safety of government bonds is questioned amid rising debt levels. Investors demand larger compensation for the risk of holding long-term bonds. The yield curve steepens sharply. Yet this is a relative asset shift: equities can still do well.

Productivity boom
Sustained capital investment boosts potential growth, keeping the macro environment disinflationary. The Fed is patient and keeps policy loose, with rates below neutral. The yield curve steepens, real yields stay low, and risk assets do well.

Slamming the brakes
Delays to the restart, perhaps due to a new vaccine-resistant virus strain, result in weaker growth but persistently higher inflation. Central banks aggressively push against inflation, initially sparking a surge in yields. Result: recession with high inflation. The yield move hits stocks hard.

Runaway inflation
Inflation expectations become unanchored in the post-Covid confusion. A messy transition to net zero could exacerbate this. 1970s-style stagflation is back. Yields surge across the curve and risk assets sell off.

Stagnation
Growth slumps. Inflation pressures abate because labor market slack holds back wage growth. Central banks are unsuccessful in reviving growth and inflation. The yield curve flattens, and equities take a hit as earnings slump.

Classic risk-off
Asset bubbles form and burst. Trade wars flare up again and hurt global activity. Central banks struggle to respond. Long-term yields fall sharply amid a flight to perceived safety and the term premium turns negative again. Risk assets suffer.

Global equities (+ / –)

Global bonds (– / +)

Sources: BlackRock Investment Institute, December 2021. Notes: The schematic shows hypothetical macro and policy outcomes. These are our views on the implications for equities and government bonds as of December 2021. For illustrative purposes only. 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 funds, strategy or security in particular.

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Theme 1

Living with inflation

Inflation jumped in 2021 on the back of supply and demand mismatches. We see inflation settling at levels higher than pre-Covid whenever these supply bottlenecks ease. The chart shows that we see inflation persisting for years to come.

One driver of this: Major central banks are living with more inflation than they would have in the past, showing a much more muted policy reaction – our core view.

The Fed has belatedly acknowledged meeting its inflation objective to make up for past misses – something we had long argued had already happened. We expect the Fed to kick off rate hikes in 2022 but don't see it reacting aggressively to inflation. We are watching how the Fed interprets its "broad and inclusive" employment objective to guide when and how quickly policy rates rise. The Fed's mandate means it will want to see further progress on the return of people to the workforce – and we expect rate hikes to be gradual.

We see the rate increases as removing some of the stimulus added during the 2020 shock as the labor market heals back near pre-Covid conditions.

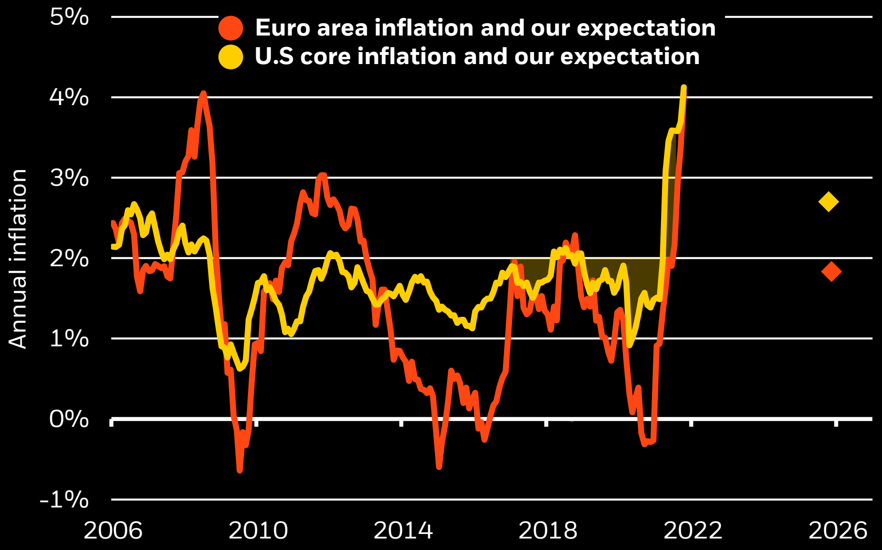
The ECB is in a different spot. It still wants to get inflation to settle at 2% rather than falling well short as it has for years. The ECB's medium-term inflation projections are likely to settle below its 2% target. That suggests ongoing policy stimulus. We don't see the ECB lifting rates for a few more years and think it will likely increase its regular asset purchases as the special pandemic program is set to end next year.

Climate change is part of the inflation story. A smooth transition to net zero is the least inflationary outcome compared with a disorderly one or business as usual, in our view. Climate change will likely mean a series of supply shocks playing out over decades.

Implication: We prefer equities over fixed income and remain overweight inflation-linked bonds.

Persistent inflation

U.S. and euro area inflation and our expectations, 2006-2026



Forward-looking estimates may not come to pass. Sources: BlackRock Investment Institute, U.S. Bureau of Economic Analysis and Eurostat, with data from Haver Analytics, December 2021. Note: The chart lines shows U.S. core personal consumption expenditure (PCE) inflation and euro area headline inflation. The yellow triangle shows our expectation of U.S. PCE – the Fed's preferred gauge of inflation - in five years' time. We derive this from our estimate of the consumer price index in five years' time, which currently stands at 3%. We assume a 0.3 percentage point wedge between PCE and CPI inflation based on the historical relationship and estimates of the factors that influence both. The orange triangle shows our estimate of euro area HICP (Harmonized Index of Consumer Prices) inflation in five years' time.

Higher inflation has arrived. We expect central banks to be more tolerant of higher inflation – and think they would already have hiked rates if the old response to inflation had prevailed.

Theme 2

Cutting through confusion

Our *cutting through confusion* theme is about keeping the big picture in mind – but also acknowledging the risks around our base case shown on page 4. We've never had an economic restart like this. Add repeated, outsized data surprises to the mix – both to the upside and downside – and confusion is natural among policymakers and markets adapting to a new reality.

At the same time, central banks are implementing new frameworks that change how they react to inflation. The risks arising from new Covid-19 strains only add to the confusion. We cut through many possibilities to ask: What would it take for us not to be in this new market regime?

We see two key ways our new market regime view could be wrong. First, central banks might react differently. They could – in the face of persistent inflation pressures, perhaps tied to new Covid-19 strains – revert to their old response to inflation.

The chart shows how different our and the market's view of future Fed rate hikes is from how the Fed might have reacted historically to the current mix of slack and inflation. In the past, we believe the Fed would have been pushing up rates in 2021 – again helping confirm this is a new regime.

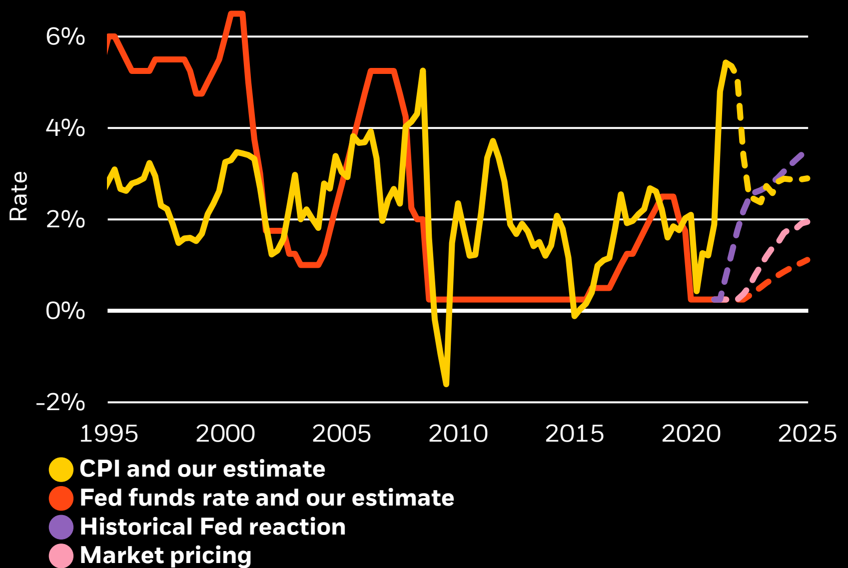
Central banks could also be forced to be more aggressive if inflation expectations become de-anchored. We would be faced with inflation significantly above target, rising interest rates and falling growth: a classic stagflation scenario that is bad for both bonds and equities.

Second, we could be wrong about growth prospects. On the downside, perhaps a threat of repeated Covid-19 waves derails the restart – and leads to stagnation. Or on the upside, an investment and productivity boom could lift potential growth and keep the macro environment disinflationary.

Implication: We trim risk amid an unusually wide range of outcomes.

It's different this time

U.S. CPI inflation, federal funds rate and expectations, 1995-2025



Forward-looking estimates may not come to pass. Source: BlackRock Investment Institute, Federal Reserve and U.S. Bureau of Labor Statistics, with data from Bloomberg and Haver Analytics, December 2021. Notes: The chart shows the U.S. nominal federal funds rate (orange line), year-on-year headline CPI inflation (yellow) and some projected paths of the nominal federal funds rate. The U.S. CPI shown from 2022-2025 is our estimate embedded in our Capital Market Assumptions. The dotted red line shows our own projection of the federal funds rate. The purple line shows the path that would have been implied by a simple monetary policy rule linking the choice of policy rate to the rate of inflation and the level of the output gap. The pink line shows the current market-implied path.

There is no playbook for the restart of economic activity – and what lies beyond. Confusion around restart dynamics and high inflation could lead to policy errors and market volatility.

Theme 3

Navigating net zero

There is a popular notion that tackling climate change may lead to higher economic costs and inflation. We don't agree. Yes, the outlook would be better if climate change didn't exist. But that's not an option; climate change is real. A smooth net-zero transition, therefore, has to imply higher growth and lower inflation than any alternative, in our view. No climate action or a disorderly transition suggest lower growth and even higher inflation.

We believe the transition will be an ongoing driver of asset returns over coming years thanks to the tectonic shift of capital to retool economies. Sudden divestment from carbon-heavy companies and sectors could be disruptive, adding to inflation pressures. Carbon-heavy companies changing business models to reduce emissions will also require capital. This – plus the huge investment needed in new technologies and clean energy infrastructure – may provide opportunities for investors.

EM countries excluding China account for around a third of global emissions – see the chart – making them essential to a successful global transition. But they lack the finance to pay for it.

We estimate EMs will need at least US$1 trillion per year – more than six times current investment, as detailed in our recent publication. We believe the only way to mobilize the required private capital is through greater public sector financing by DM governments that can afford it. We see this as essential in the global transition.

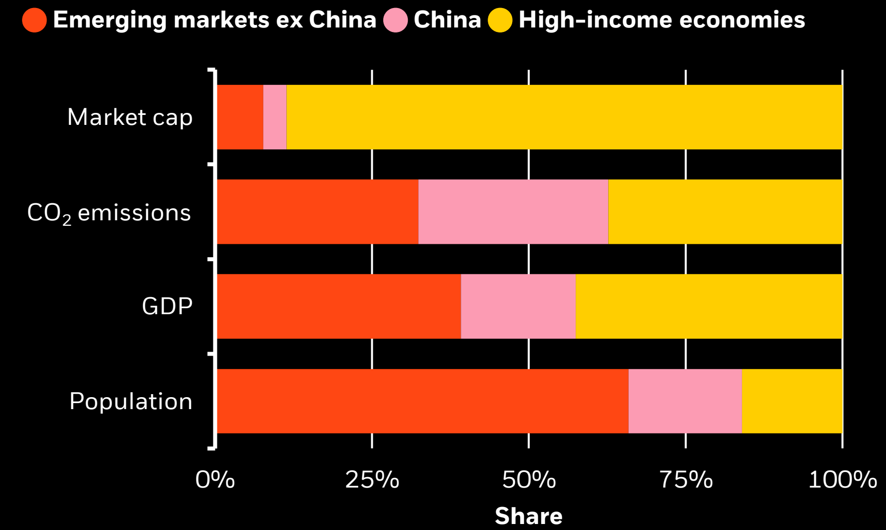
Implication: We favor DM equities over EM.

"Without a successful green transition everywhere, climate risk is unmanageable anywhere."

Paul Bodnar
Global Head of Sustainable Investing, BlackRock

Mismatched resources

Global distribution of resources and assets, latest available data



Sources: BlackRock Investment Institute, IMF, World Bank, MSCI, using data from Haver Analytics and Refinitiv DataStream, December 2021. Notes: The chart shows the shares in different concepts of EMs (excluding China), China and high-income economies (i.e. rest of the world). EMs are those classified as low and middle-income countries by the World Bank. For market cap, this is the share of each group/country in total world stock market capitalization measured by the MSCI all-country world stock market capitalization, as of Dec. 6, 2021. For CO_2 emissions, this is the share of each group/country in total world CO_2 emissions in 2018. For GDP this is the share of each group/country in world GDP measured using Purchasing Power Parity exchange rates, as of 2020. For population this is the share of each group/country in world population in 2020.

The journey to net zero is not just a strategic story, it's a *now* story. The global transition to a more sustainable world will require a massive retooling of economies, in our view.

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Forum focus

Bumpy transition

We view the transition to net zero as a supply shock playing out over decades, helping reinforce persistently higher inflation.

A disorderly transition – where policy measures to reduce emissions are imposed suddenly – could result in energy shortages and mismatches across companies and sectors. A smooth transition is even more important to the path of inflation than monetary policy, in our view.

The energy crunch in late 2021 has provided a glimpse of a disorderly transition. When weather and geopolitical factors suddenly cut coal and renewable energy supply, other power sources struggled to offset the drop. With governments looking to minimize carbon emissions, natural gas prices surged even more than coal, as the chart shows.

This episode revealed that the transition has so far been lopsided: reduced investment in fossil fuels has not been offset by a boost to investment in alternative energy and its infrastructure.

A smoother and more balanced transition will not only need clean energy but also new technologies to store and distribute it. If it is not smooth, we'll likely see greater volatility in inflation and activity in response to energy shocks.

We favor sectors with clear transition plans. Over a strategic horizon, we like the sectors that stand to benefit more from the transition, such as tech and healthcare, because of their relatively low carbon emissions.

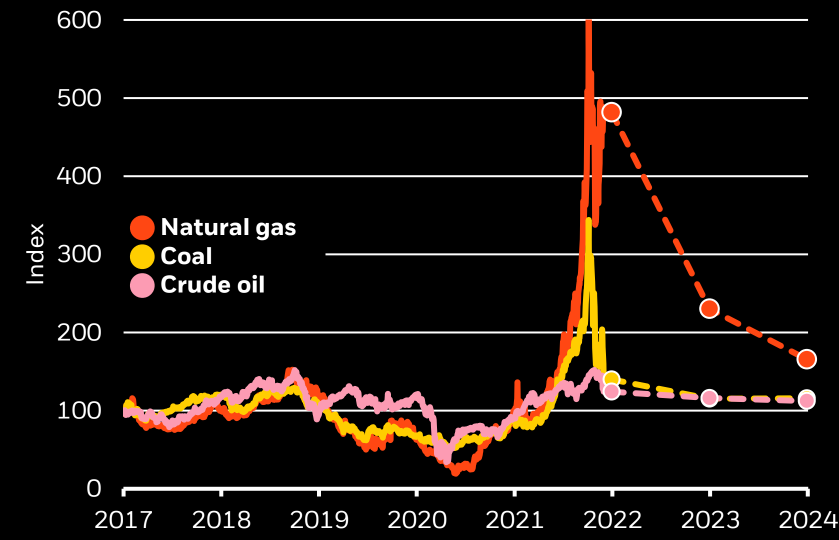
Given our view of persistently higher inflation, we prefer inflation-linked bonds over their nominal counterparts. Real assets within private markets can play a role in driving the transition.

"Not all companies can beat inflation by raising prices – that's why this is a stock selection environment."

Olivia Treharne
Portfolio manager, BlackRock Fundamental Equity

Volatile prices

Futures prices of oil, coal and natural gas, 2017-2024



Past performance is not a reliable indicator of current or future results. Sources: BlackRock Investment Institute, with data from Refinitiv, December 2021. Notes: The chart shows natural gas, coal and crude oil prices rebased to 100 at the start of 2017. We use the European Energy Derivatives Exchange natural gas futures, ICE Rotterdam coal futures and Brent crude oil futures to represent natural gas, coal and oil respectively. The dots show futures prices for contracts that expire in December 2022, December 2023 and December 2024.

An orderly net-zero transition may foster inflation – but not as much as a disorderly transition or no climate action at all.

Forum focus

Geopolitics

We see geopolitics in 2022 driven by domestic polarization, U.S.-China competition, divergence between developed and emerging markets, and dynamics relating to the bumpy energy transition.

Market attention to geopolitical risk has started to tick up, but our BlackRock geopolitical risk gauge is still near four-year lows, as the chart shows. As a result, geopolitical shocks could catch investors more off guard than usual. Two risks in particular need monitoring in this context.

First, the U.S.-China relationship. It remains confrontational, with seemingly little interest on either side to make any concessions. Military tensions are increasing over China's nuclear capabilities and Taiwan.

Yet we see the two countries generally seeking to lower the temperature in 2022 as both focus on domestic priorities. In the U.S., the focus is on managing the pandemic, implementing the administration's spending plans, reining in high inflation and preparing for midterm elections.

For China, it's slowing growth, an ambitious regulatory and social agenda, and President Xi Jinping's likely re-election and party leadership changes.

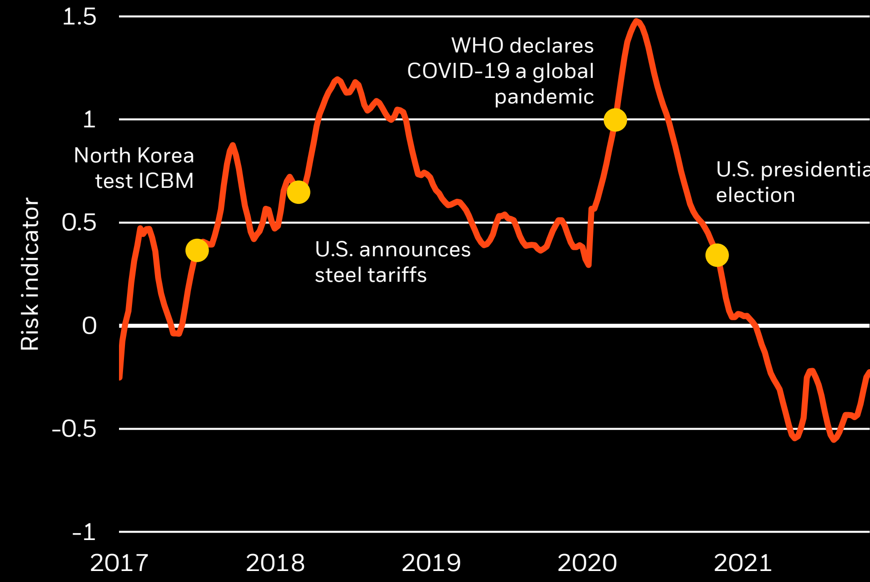
Second, the Middle East. Tensions among Gulf oil producers have de-escalated, driven in part by the U.S. pivot to Asia. High oil prices benefit the region, and we see efficient Gulf producers having pricing power during the green transition. Of increasing concern is a low likelihood of a U.S. return to the existing Iran nuclear deal. As Iran's nuclear capability increases and talks fail to progress, the risk of military action in the region rises. Other conflict risks are the stand-off in the Ukraine and North Korea's nuclear production.

> **The steps Iran has taken demonstrate it is moving closer to attaining nuclear capability."**

Tom Donilon
Chairman – BlackRock Investment Institute

Geopolitical risk underappreciated

BlackRock Geopolitical Risk Indicator, 2017-2021



Source: BlackRock Investment Institute, with data from Refinitiv, December 2021. Note: We identify specific words related to geopolitical risk in general and to our top risks. We then use text analysis to calculate the frequency of their appearance in the Refinitiv Broker Report and Dow Jones Global Newswire databases. We then adjust for whether the language reflects positive or negative sentiment, and assign a score. A zero score represents the average level of the BlackRock Geopolitical Risk Indicator (BGRI) over its history. A score of one means the BGRI level is one standard deviation above the five-year average. We weigh recent readings more heavily in calculating the average.

Market attention to geopolitical risk is relatively low, meaning that any flareups could catch investors more off guard. Specific risks that need monitoring are U.S.-China competition and tensions over Iran's nuclear capabilities.

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China

We see a significant shift in China's overall policy stance toward greater state intervention and social objectives, even at the occasional expense of growth. The regulatory clampdown and tighter policy stance that rattled global investors in 2021 made that shift clear.

Yet we believe the low starting point of global investor allocations to Chinese assets is at odds with the economy's growing heft in the world. We estimate current allocations in global portfolios point to an overly negative economic outlook in coming years - such as a long-lasting growth shock akin to Japan in the 1990s.

We maintain our long-term overweight to Chinese assets relative to low global allocations. We assume greater regulation over a strategic horizon as China balances social and economic objectives – one reason we bake in materially higher uncertainty and risk premia for China compared with DM markets. We recognize the risks, yet see current valuations as offering eligible investors adequate compensation for them. See the chart *China's risk premium*.

Over the near term, we see a relatively brighter backdrop for Chinese assets. We expect stricter regulation in China to persist but think it's unlikely to intensify in the politically significant year of 2022 given slowing growth. We expect Beijing to gradually loosen monetary and fiscal policies – that remain very hawkish relative to DMs – to shore up growth. Policymakers have taken advantage of strong post-Covid growth to push through reforms. Yet risks to growth from new Covid-19 variants would further warrant more easing.

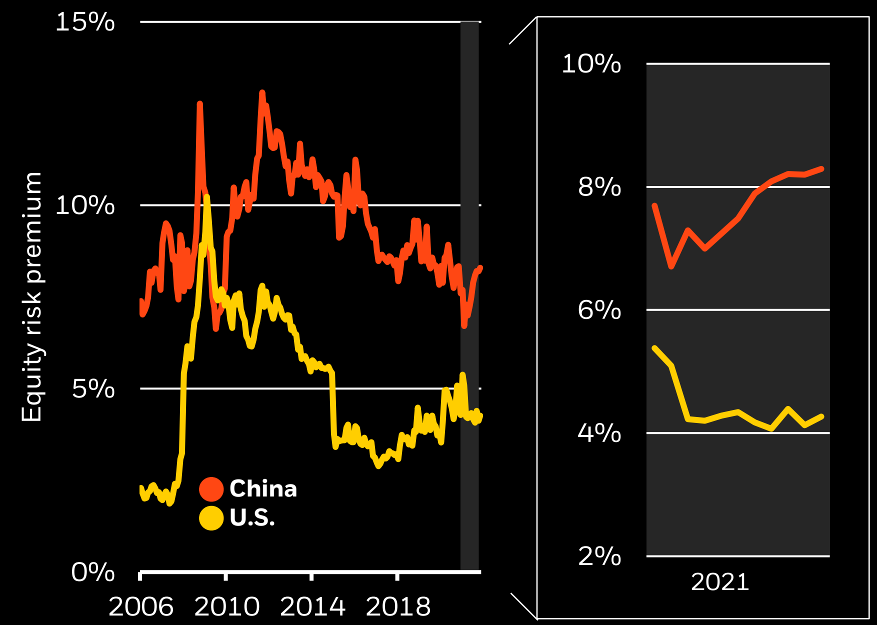
We maintain our small tactical overweight to Chinese equities. We like Chinese government bonds for their higher yields and relative stability in an income-starved world.

“Markets may be underappreciating that policy in China is poised to loosen from this year's tight stance.”

Yu Song
Chief China Economist, BlackRock Investment Institute

China's risk premium

China vs. U.S. equity risk premium, 2006-2021



Past performance is no guarantee of 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 Refinitiv, December 2021. Notes: The chart shows our estimate of the equity risk premium for MSCI China and MSCI USA . We calculate the equity risk premium based on our expectations for nominal interest rates and the implied cost of capital for respective equity markets.

China's policymakers are prioritizing quality of growth over quantity – a shift that raises near-term risks but is a positive in the long run, in our view.

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Directional views

Staying invested

Our strategic asset views – a broad preference for equities over nominal government bonds and credit – have been stable through the noisy economic restart. Key views that we have held for the last 18 months are playing out: the interest rate path has been shallower than in previous tightening cycles given the inflationary environment, supporting our overweight to inflation-linked bonds. The low interest rate environment supports our DM equity overweight. Equity valuations remain reasonable, in our view. Incorporating climate change in our expected returns brightens the appeal of DM equities relative to EM given large weights of less carbon-intensive sectors, such as tech and healthcare. We believe private markets keep playing an important role in strategic allocations – our neutral view is based on a starting point that is much larger than what most qualified investors hold.

The backdrop for risk assets is favorable on a tactical horizon, yet less so than it was a year ago, in our view. We are trimming our tactical risk stance to one that is still pro-equities yet more balanced. This still means a modest equities overweight – with a preference for DM over EM – amid strong growth and low real yields. We balance our equity exposure with some duration, but prefer inflation-linked bonds over nominal government bonds. This is because we see inflation persisting and nominal yields rising more than real yields. We find valuations and coupon income of EM local debt attractive in a world of low yields.

Directional views

Strategic (long-term) and tactical (6-12 month) views on broad asset classes, December 2021

Asset	Strategic view	Tactical view	
Equities	+1	+1	We keep our overweight on equities on a strategic horizon. We see the combination of low real rates, strong growth and reasonable valuations as favourable for the asset class. Incorporating climate change in our expected returns brightens the appeal of developed market equities given the large weights of sectors such as tech and healthcare in benchmark indices. Tactically, we are overweight equities amid solid economic fundamentals and historically low real rates.
Credit	-1	Neutral	We stay underweight credit on a strategic basis as valuations are rich, and we prefer to take risk in equities instead. On a tactical horizon, we are neutral credit given low spreads across sectors and prefer EM local markets to high yield.
Govt Bonds	-1	-1	We are strategically underweight nominal government bonds given their diminished ability to act as portfolio ballasts with yields near lower bounds. Within the underweight on nominal DM government bonds, we prefer shorter-dated over long-dated maturities. Rising debt levels may eventually pose risks to the low rate regime. We prefer inflation-linked bonds. Tactically, we keep our significant U.S. Treasuries underweight on expectations of rising yields into the Fed's taper and rate kick-off. We prefer inflation-linked bonds for interest rate exposure and as a portfolio diversifier.
Private Markets	Neutral		We believe non-traditional return streams, including private credit, have the potential to add value and diversification. Our neutral view is based on a starting allocation that is much larger than what most qualified investors hold. Many institutional investors remain underinvested in private markets as they overestimate liquidity risks, in our view. Private markets are a complex asset class and not suitable for all investors.

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

Note: Views are from a U.S. dollar perspective, December 2021. 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.

Strategic views

Steeper curve ahead

Greater central bank tolerance for inflation has kept short-term rates low. Rates rises – that we expected to kick-off in 2022 – will likely be gradual as we explain on the *Living with inflation* page.

At the same time, we see long-term yields rising for two reasons. First, central banks' greater tolerance of inflation has cleared the way for higher inflation over the medium term. We expect inflation to settle at a higher level post-Covid than it was pre-pandemic. Our strategic asset views have been positioned for a shift to higher inflation over the medium-term for some time, supporting a long-held overweight in inflation-linked bonds.

Second, rising inflation and continued fiscal spending in DM economies mean we expect a revival in term premia - the extra compensation investors demand for holding long-term government bonds. The upshot: we see a steeper yield curve than market expectations as seen in the chart.

An important investment implication of our views is our large underweight to DM nominal government bonds. Yet breaking down exposures across the yield curves allows for a more deliberate asset preference than simply taking a view on the entire asset class.

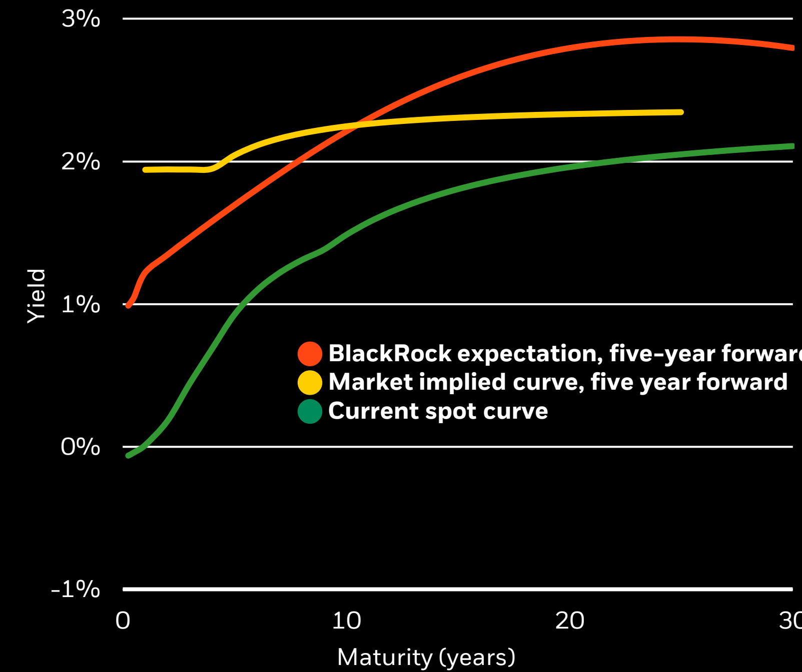
Within our large underweight, we prefer shorter-dated nominal government bonds over longer-term ones, where we expect yields to rise by more than what markets are currently pricing. Our view of a structural shift to higher medium-term inflation means we prefer longer-dated inflation-linked bonds over shorter-dated counterparts.

"The interest rate environment lends itself to more granular bond allocations by varying views across the yield curve."

Natalie Gill
Portfolio Strategist,
BlackRock Investment Institute

Steeper curves ahead

U.S. yield curve vs. our expectations, December 2021



Forward looking estimates may not come to pass. Past performance is no guarantee of future results. Source: BlackRock Investment Institute, with data from Refinitiv Datastream, December 2021. Note: the chart shows our estimate of the shape of the U.S. yield curves in five years' time with a market-pricing implied projection and the spot yield curve as of Dec. 6, 2021.

We see short-term yields staying low as central banks keep policy relatively accommodative, and expect longer-term yields to gradually rise on the back of higher medium-term inflation and a revival of term premia.

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Strategic views

Playing themes in private markets

The pandemic has accelerated structural trends that are changing the investment landscape. We see our themes applying equally to private markets, complementing our public market views. Private investments are typically hand-picked and actively managed, offering potential long-term value and diversification. Yet they are more complex than public markets and may not be suitable for all investors. Lack of historical data also warrants caution.

Take the transition to net zero. We see opportunities for private markets financing technologies for energy resilience, power innovation, electric vehicles, among others. The evolution of climate technologies in private markets is likely to remain a dominant theme.

Sectoral positioning, granularity and relative value opportunities will be key. In real estate, the wide divergence between favored sectors (logistics) and unfavored sectors (offices) is likely to continue, in our view.

Demographic drivers are also at work - creating opportunities such as child care in Australia and senior living in Japan, within real estate.

We expect mergers and restructurings to stay busy as companies adapt to megatrends at play, creating potential opportunities for private equity and credit.

More broadly, we see private markets as a core strategic holding for their diversification properties and potential returns, and believe many institutional investors are still underinvested in this area.

“Private markets should be part of investors’ thinking for their return and diversification properties.”

Mark Everitt
Head of Investment Research and Strategy, BlackRock Alternative Investors

Structural opportunities

Key themes we see shaping the private markets landscape

1	**Beyond the restart** Potential opportunities from accelerating structural change. We see an increased focus on healthcare provision and acceleration of telemedicine.
2	**Net-zero transition** The transition to a decarbonized world has consequences for all asset classes from real assets to manufacturing supply chains and beyond.
3	**China** The role of China in the world economy and the growth of renewable power in Asia are just two of the growth drivers for private markets in the region.

Sources: BlackRock Investment Institute and BlackRock Alternative Investors, December 2021.
Note: The table is for illustrative purposes only.

We see private assets – from private equity and credit to infrastructure debt and real assets – as complementary to public markets for eligible investors and core holdings in their strategic asset allocations.

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Tactical views

Equities over fixed income

The macro backdrop leaves us positive on equities. Valuations are not stretched relative to history when viewed through equity risk premiums – our preferred metric that takes into account the prevailing interest rate backdrop. The chart shows the premiums are near their long-term averages.

We see negative returns for nominal government bonds. Yet the sizeable dislocations in fixed income markets through 2021 have opened up more relative value opportunities. We like U.S. inflation-linked bonds, Chinese government bonds and EM local debt. We see U.S. TIPS as our preferred way to keep interest rate exposure to balance our modest equities overweight.

We stay firmly underweight U.S. Treasuries and downgrade European government bonds to underweight as we see DM yields heading higher and offering a reduced buffer against equity selloffs. We see credit valuations as stretched given tight spreads.

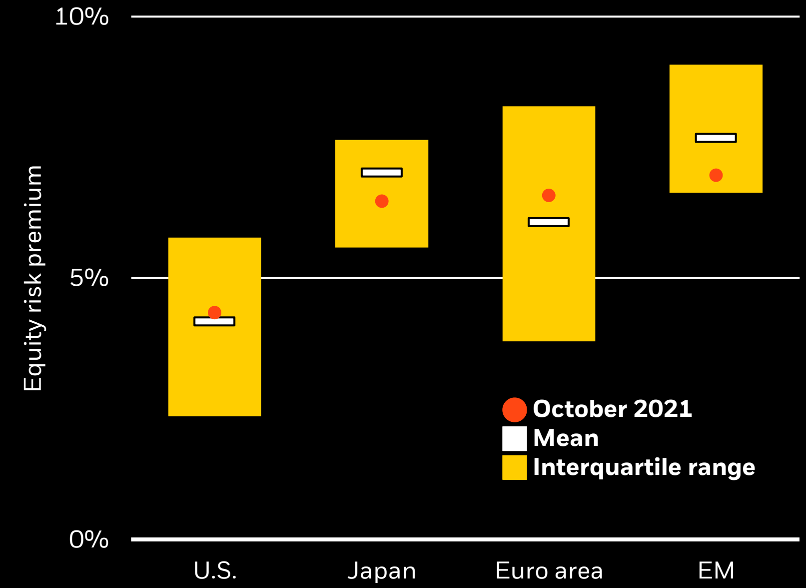
The overall appeal of stocks has diminished slightly since our midyear outlook, and we expect only modest gains. Reasons include decelerating growth, central banks starting to normalize, a likely peak in profit growth and potential earnings disappointments. Yet we still see broad equities as well-positioned for an environment of low real yields and still-robust growth, keeping us tactically overweight, with a preference for DM over EM.

We have collapsed the preference of European over U.S. stocks since the midyear outlook and now prefer to diversify our DM equity exposure over both regions and Japan We believe the quality factor in the U.S. resilient to a broad range of economic scenarios, brightening its appeal from a risk-reward view.

We maintain our modest overweight on Chinese equities as we see policies incrementally turning dovish to stave off a slowdown. We expect the regulatory clampdown that has weighed on stocks to last but lessen in intensity in 2022.

Equities still reasonably valued

Equity risk premium relative to history, 1995-2021



Past performance is not a reliable indicator of current or future results. Indexes are unmanaged and not subject to fees. It is not possible to invest directly in an index.
Sources: BlackRock Investment Institute with data from Refinitiv Datastream and Bloomberg, November 2021. Note: the chart shows the equity risk premium and historical ranges since 1995 for major equity regions based on MSCI indices and the credit spreads for the U.S. Investment Grade and High Yield markets based on Bloomberg indices. We calculate the equity risk premium based on our expectations for nominal interest rates and the implied cost of capital for respective equity markets. Index proxies: MSCI USA, MSCI Japan, MSCI Europe ex-UK and MSCI Emerging Markets.

Equities and inflation-linked bonds are our preferred asset classes amid higher inflation, low real yields and still-strong growth. The backdrop for nominal government bonds remains challenging.

Tactical granular views

Six to 12-month tactical views on selected assets vs. broad global asset classes by level of conviction, December 2021

Equities	View	Commentary
Developed markets	+1	We are overweight developed market equities. We see still solid growth and low real yields supporting valuations. We prefer to diversify our exposure.
United States	+1	We are overweight U.S. equities on still strong earnings momentum. We do not see gradual policy normalization posing significant headwinds.
Europe	+1	We stay modestly overweight European equities given attractive valuations. We believe the rise in Covid infections may stall but not derail the restart.
UK	Neutral	We are neutral UK equities. We see the market as fairly valued and prefer European equities.
Japan	+1	We have a small overweight in Japanese equities. We see a global cyclical rebound boosting earnings growth following underperformance in 2021.
China	+1	We stay moderately positive on Chinese equities as we see a shift to a slightly easier policy. We expect the regulatory clampdown to last but not intensify.
Emerging markets	Neutral	We are neutral EM equities and prefer DM equities, given more challenged restart dynamics and tighter policies in EM.
Asia ex-Japan	Neutral	We are neutral Asia ex-Japan equities. We prefer more targeted exposure to China relative to the broad region.

Fixed income	View	Commentary
U.S. Treasuries	-2	We are underweight U.S. Treasuries primarily on economic fundamentals and valuations. We see risks tilted toward higher yields into the Fed taper and subsequent lift-off.
Treasury Inflation-Protected Securities	+1	We stay overweight U.S. TIPS as we expect inflation to be persistent and settle at a higher level than pre-Covid. We prefer TIPS for interest rate exposure and diversifiers.
European government bonds	-1	We turn underweight European government bonds. We see yields heading higher. Current market pricing points to no substantive change in monetary policy for several years.
UK Gilts	Neutral	We are neutral UK Gilts. We see UK policy rates rising before DM peers, yet believe market expectations of the subsequent pace are overdone amid constrained supply.
China government bonds	+1	We are overweight Chinese government bonds. Potentially easier monetary policy alongside the relative stability of interest rates and potential income brighten their appeal.
Global investment grade	-1	We stay underweight investment grade credit. We see little room for further yield spread compression and remain concerned about interest rate risk.
Global high yield	Neutral	We are neutral high yield. We do not see compression in high yield spreads yet still find the carry attractive. We prefer to take risk in equities.
Emerging market – hard currency	Neutral	We are neutral hard-currency EM debt. We expect it to gain support from the vaccine-led global restart and more predictable U.S. trade policies.
Emerging market – local currency	+1	We are modestly overweight local-currency EM debt on attractive valuations and potential income. Higher yields already reflect EM monetary policy tightening, in our view.
Asia fixed income	+1	We stay overweight Asia fixed income. We find valuations in China compelling relative to risks. Outside China, we like Asian sovereigns and credit for income and carry.

Underweight | Neutral | Overweight | ● Previous view

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