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Weekly Commentary

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Our market commentary is now authored by Richard Turnill, BlackRock's Global Chief Investment Strategist. Share your feedback at *blackrockinvestments@blackrock.com*.

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Key Points

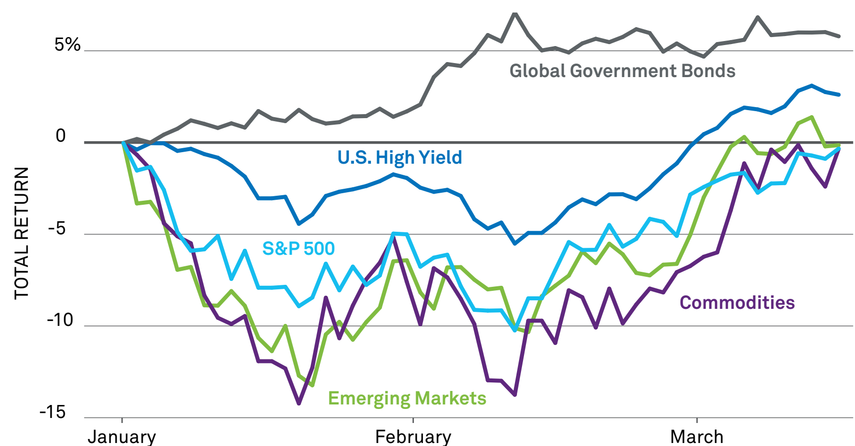
1. The risk-on rotation that began in early February looks to have legs. This supports the case for global stocks in the near term.
2. The Federal Reserve (Fed) signaled it would tolerate higher inflation in the short run, triggering a weaker dollar.
3. Economic indicators this week may show the U.S. economy experienced a mild slowdown but is not headed for a recession.

1 THIS ROTATION LOOKS REAL

Dramatic reversals in market leadership have been the story of the year. See the chart below. But the risk-on rotation that began in early February looks sustainable, at least in the short run.

CHART OF THE WEEK

Asset Performance in 2016



Sources: BlackRock Investment Institute, Barclays, MSCI and Thomson Reuters, March 16, 2016. Notes: Global government bonds represented by the Barclays Global Treasury Index, commodities by the S&P GSCI Commodity Total Return Index, U.S. high yield by the Barclays U.S. Corporate High Yield Bond Index and emerging market equities by the MSCI Emerging Markets Index.

Market swings this year have been similar to risk-on/risk-off rotations over the last five years. The latest rally has helped U.S. stocks, high yield, emerging market (EM) equities and commodities erase sharp year-to-date losses. There are signs this rotation has legs.

Stocks Have Room to Run

Market segments leading the rally still look cheap. Despite the stampede into value, global value stocks trade at around a 35% discount to the broader market, BlackRock analysis shows. This compares with an average 20% discount over the last decade. A weaker U.S. dollar, following the Fed's more tempered rate-rise outlook, should help support EM and other risk assets. Many currencies have attractive values after multi-year declines.

The rally appears to be more than a technical bounce. U.S. data have improved enough to ease recession fears, and inflation expectations have picked up. The BlackRock Business Sentiment Index, which measures what corporate managers are saying about their countries' economies, has improved since the start of the year. Flows into global equity exchange traded products accelerated in March and are now in positive territory for the year, according to BlackRock research. Investors have started to reduce long-held underweights in EM and commodity assets, our analysis shows, but we think there is more to come.

We like value, which has outperformed over the long run. Many BlackRock fund managers have raised EM allocations. Yet we are not all in. The Chinese economy and currency could slip again. U.S. growth could accelerate, forcing the Fed to tighten quicker than expected. For a hedge, we like exposure to gold and inflation-protected bonds.

2 WEEK IN REVIEW

- The Fed cut its 2016 guidance to two rate increases from four, signaling it was prepared to let the economy and inflation run a little hot.
- The U.S. dollar weakened following the Fed news, boosting EMs, stocks and other risk assets.
- Financial issuance in Europe shot up to a 15-month high, showing there is no bank funding crisis. Yet negative rates are a long-term headwind for financial institutions in the eurozone.

GLOBAL SNAPSHOT

Weekly and 12-Month Performance of Selected Assets

EQUITIES	WEEK	12 MONTHS	DIV. YIELD
U.S. Large Caps	1.4%	-0.2%	2.3%
U.S. Small Caps	1.3%	-10.7%	1.7%
Non-U.S. World	1.5%	-8.6%	3.3%
Non-U.S. Developed	1.0%	-7.6%	3.5%
Japan	0.5%	-8.2%	2.3%
Emerging	3.3%	-11.5%	2.8%
Asia Ex Japan	3.0%	-11.2%	2.8%

BONDS	WEEK	12 MONTHS	YIELD
U.S. Treasuries	0.7%	2.0%	1.9%
U.S. TIPS	1.4%	0.6%	1.8%
U.S. Investment Grade	1.3%	0.2%	3.4%
U.S. High Yield	1.0%	-2.5%	8.0%
U.S. Municipals	0.2%	3.7%	2.0%
Non-U.S. Developed	2.3%	7.5%	0.8%
Emerging Market $ Bonds	1.4%	5.7%	5.9%

COMMODITIES	WEEK	12 MONTHS
Brent Crude Oil	2.0%	-26.3%
Gold	0.5%	7.5%
Copper	1.4%	-11.1%

CURRENCIES	WEEK	12 MONTHS
Euro/USD	1.0%	3.7%
USD/Yen	-2.0%	-7.1%
Pound/USD	0.7%	-3.4%

Source: Bloomberg. As of March 18, 2016. Notes: Weekly data through Friday. Equity and bond performance are measured in total index returns in U.S. dollars. U.S. large caps are represented by the S&P 500 Index; U.S. small caps by the Russell 2000 Index; Non-U.S. world equities by the MSCI ACWI ex U.S.; non-U.S. developed equities by the MSCI EAFE Index; Japan, emerging and Asia ex Japan by their respective MSCI indexes; U.S. Treasury by the Barclays U.S. Treasury Index; U.S. TIPS by the U.S. Treasury Inflation Notes Total Return Index; U.S. investment grade by the Barclays U.S. Corporate Index; U.S. high yield by the Barclays U.S. Corporate High Yield 2% Issuer Capped Index, U.S. municipals by the Barclays Municipal Bond Index; non-U.S. developed bonds by the Barclays Global Aggregate ex USD; and Emerging Market $ bonds by the JP Morgan EMBI Global Diversified Index. Index performance is shown for illustrative purposes only. It is not possible to invest directly in an index. Past performance is not indicative of future results.

3 WEEK AHEAD

March 22	Germany IFO Business Climate Survey
March 22, 24	U.S. and Eurozone Purchasing Managers' Indexes
March 24	U.S. Durable Goods

Manufacturing and services PMI data this week should provide clues about the future trajectory of the U.S. and eurozone economies. We would like to see signs that the weak U.S. manufacturing sector has stabilized. We like to focus on inventory levels. These generally keep growing in a recession, a trend we wouldn't see if the U.S. has experienced only a late-cycle slowdown.

The eurozone economies are still expanding, but growth has slowed. This week should tell us if diverging growth trends between the U.S. and Europe are holding.

ASSET CLASS VIEWS

Views on selected asset classes over a three-month horizon.

ASSET CLASS		VIEW	COMMENTS
EQUITIES Overweight	U.S.	▲	U.S. consumer is strong. Valuations have come down. We see peak margins and pay-out ratios constraining returns.
	Europe	▲	Reasonable valuations and supportive ECB policy, but weak growth and challenged banking system.
	Japan	—	Attractive relative value and improving corporate governance are positives. But much is priced in, and the BoJ may have reached limits in weakening yen.
	EM	—	Structural challenges such as excess debt. Yet EM equities offer value for long-term investors. Fed policy is a smaller headwind.
	Asia ex Japan	—	Long-term headwinds persist as imbalances have unwound. A Chinese devaluation is unlikely but remains a tail risk. We prefer India.
FIXED INCOME Underweight	U.S. Treasuries	▼	Fully priced as rapid Fed rate rises unlikely. Stabilizing to positive economic data are short-term risks. Long bonds have a structural bid in low-rate environment.
	U.S. Municipals	▲	We like relatively attractive yields and low volatility. Potential for inflows after recent strong performance.
	U.S. Credit	▲	Fading fears of recession or rapid rate rises are near-term positives. We prefer going down in capital structure within higher-quality sectors to capture yield.
	DM Sovereigns ex U.S.	▲	Dollar has halted appreciation for now, favoring non-USD fixed income. We look for yield compression in Europe's periphery due to ECB easing.
	DM Credit ex U.S.	—	We prefer high-yielding instruments by going down in capital structure of high-quality names. We would avoid industrial and commodity issuers.
	EM Debt	—	We are neutral across EM debt with slight preference for local-currency bonds. Currencies have adjusted, yields have risen and dollar is weakening.
COMMODITIES Neutral	Commodities	—	Commodity markets oversupplied and sensitive to downward global growth revisions. Strategic allocation to gold makes sense for diversification.

▲ Overweight — Neutral ▼ Underweight

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