Weekly commentary

BlackRock

March 11, 2024

Low-carbon transition themes in 2024

- We monitor battery prices, elections and market attention on climate resilience for their impact on transition-related investment opportunities and risks.
- U.S. stocks were mostly flat last week, while 10-year U.S. Treasury yields fell further. Markets still expect the first Federal Reserve rate cut around mid-2024.
- We're watching February U.S. CPI data out this week to see how much further inflation will fall in the near term. We still expect inflation to resurge in 2025.

The low-carbon transition is a mega force we track that is shaping investment returns now. We see potentially market-moving developments in three key areas this year. First, falling battery prices could boost demand for energy storage systems for power grids, and electric and hybrid vehicles. Second, elections around the globe could affect future energy and industrial policy. And third, rising physical damages could spur interest in a new investment theme: climate resilience.

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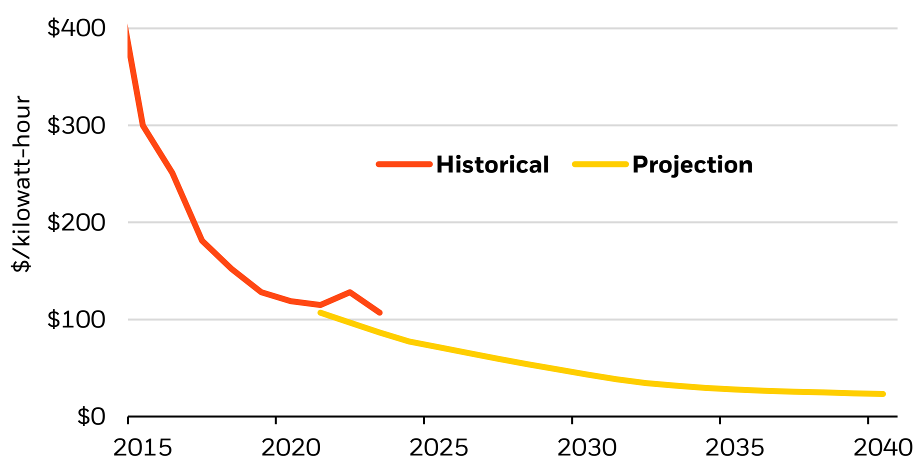
Cheaper batteries

Lithium-ion battery costs, past and projected, 2015-2040



Source: BlackRock Investment Institute, with data from BloombergNEF and INET, March 2024. Notes: The chart shows past and projected costs per kilowatt-hour for the volume-weighted average lithium-ion battery cell. This includes data from passenger cars, buses, commercial vehicles and stationary storage.

Battery prices make up a third or more of the production cost of some clean technologies, such as energy storage systems for power grids, electric and hybrid vehicles (EVs). They have slid sharply over the past decade. See the chart. The 2022 uptick looks to have been a blip, with battery producers signaling potentially sharp price cuts this year – largely due to an 80% price drop in lithium, a key input, after a surge in supply. Intense competition and rapid technological progress are helping reduce prices, too. Some companies are using artificial intelligence – another mega force – to discover new battery materials that could lower future costs. We're watching whether a further fall in battery prices will feed through to final purchase prices and boost demand for energy storage, EVs and hybrid autos – especially as their running costs are lower than for traditional internal combustion vehicles.

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This year's many elections, including in the European Union, U.S. and India, come at a time of increasing geopolitical fragmentation and as governments seek to balance decarbonization, energy security and energy affordability objectives – which can be complementary or competing. The election results could have implications for how that balance is struck – and consequently for the evolution and adoption of clean technology, and the path of the low-carbon transition more broadly.

Several governments are subsidizing their energy and clean tech industries, with non-subsidized competitors facing pricing and margin pressure. Countries could levy trade restrictions on imported tech to shield local industries. U.S. and EU investigations into the Chinese EV industry could have this outcome. We could also see changes to transition-related policy after the elections – potentially accelerating the transition in some places and slowing it in others. In India, the election could result in policy continuity, paving the way for quicker decarbonization and bolstering the country's efforts to become a bigger clean technology production hub. The U.S. election result could have implications for the Inflation Reduction Act – a 2022 law that has spurred major investment in, and demand for, energy infrastructure and technology. Changes could range from repeal or delays to complementary policy that increases its effectiveness, like land permitting reform.

A third focus: whether 2023's title as the hottest year on record – as recorded by the World Meteorological Organization – and further extreme weather events this year will spark greater investor interest in climate resilience, or society's ability to prepare for and withstand climate risks. Think early monitoring systems for floods, air conditioning to cope with heatwaves or retrofitting buildings to better withstand extreme weather. We think markets may underappreciate the prospects for firms creating and adopting resilience-boosting products and services – and see this becoming a more recognized opportunity.

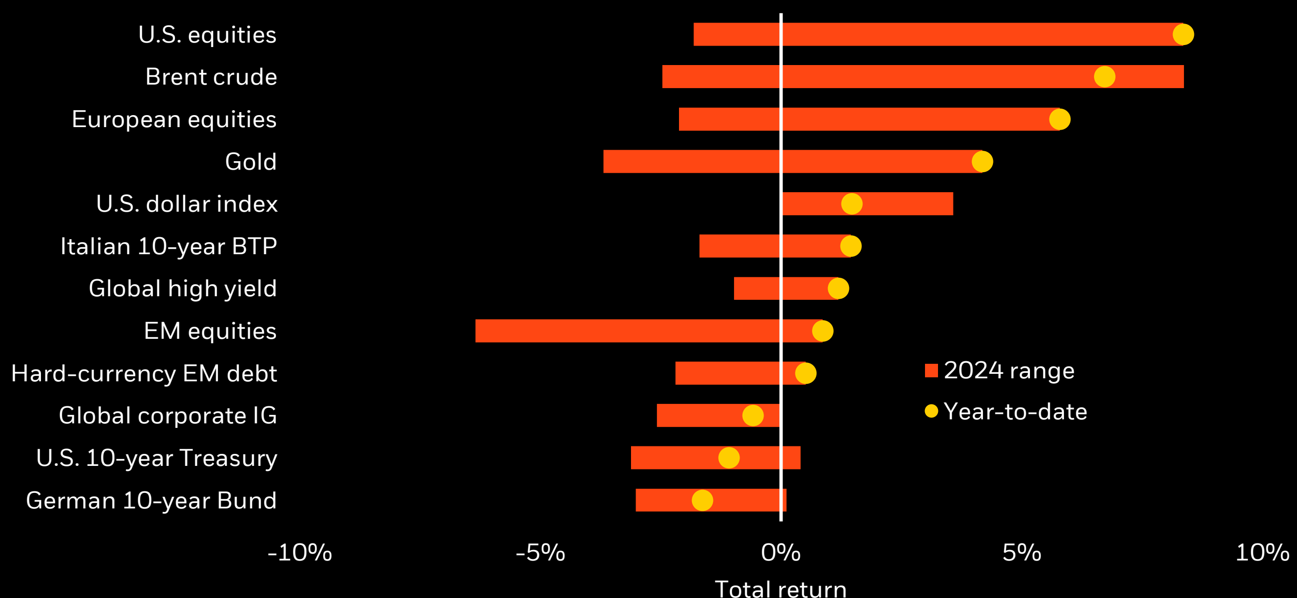
Bottom line: We think falling battery prices could boost the EV and energy storage industries this year. Much depends on the direction of global transition policy after key elections as we weigh transition-related investment opportunities and risks. As physical climate risks mount, we believe climate resilience could come to the fore as an investment theme.

Market backdrop

The S&P 500 was mostly flat on the week after pushing to new highs. U.S. 10-year Treasury yields edged lower and were about 20 basis points off their 2024 high after remarks by Fed Chair Jerome Powell did little to change expectations for a first rate cut around midyear. U.S. jobs data showed a strong if moderating labor market. Wage growth also moderated but remains at levels not consistent with inflation staying at the Fed's 2% target. We still see inflation on a rollercoaster.

Assets in review

Selected asset performance, year-to-date return and range



Past performance is not a reliable indicator of current or future results. Indexes are unmanaged and do not account for fees. It is not possible to invest directly in an index.
Sources: BlackRock Investment Institute, with data from LSEG Datastream as of March 7, 2024. Notes: The two ends of the bars show the lowest and highest returns at any point year to date, and the dots represent current year-to-date returns. Emerging market (EM), high yield and global corporate investment grade (IG) returns are denominated in U.S. dollars, and the rest in local currencies. Indexes or prices used are: spot Brent crude, ICE U.S. Dollar Index (DXY), spot gold, MSCI Emerging Markets Index, MSCI Europe Index, LSEG Datastream 10-year benchmark government bond index (U.S., Germany and Italy), Bank of America Merrill Lynch Global High Yield Index, J.P. Morgan EMBI Index, Bank of America Merrill Lynch Global Broad Corporate Index and MSCI USA Index.

Week ahead

March 12	U.S. CPI; UK jobs data	**March 15**	University of Michigan consumer sentiment survey
March 13	UK GDP	**March 11-18**	China total social financing

We're watching the release of the U.S. CPI data for February this week to gauge how much further inflation will fall in the near term after January showed stubborn inflation. Rapidly falling goods prices look set to drive inflation down near the Fed's 2% policy target this year. Yet once goods prices stabilize, we see inflation on a rollercoaster ride back up in 2025 as wage growth remains elevated and keeps services inflation higher than before the pandemic.

Big calls

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

Tactical	**Reasons**
U.S. equities	• Our macro view has us neutral at the benchmark level. But the AI theme and its potential to generate alpha – or above-benchmark returns – push us to be overweight overall.
Income in fixed income	• The income cushion bonds provide has increased across the board in a higher rate environment. We like short-term bonds and are now neutral long-term U.S. Treasuries as we see two-way risks ahead.
Geographic granularity	• We favor getting granular by geography and like Japan equities in DM. Within EM, we like India and Mexico as beneficiaries of mega forces even as relative valuations appear rich.
Strategic	**Reasons**
Private credit	• We think private credit is going to earn lending share as banks retreat – and at attractive returns relative to credit risk.
Inflation-linked bonds	• We see inflation staying closer to 3% in the new regime on a strategic horizon.
Short- and medium-term bonds	• We overall prefer short-term bonds over long term. That's due to more uncertain and volatile inflation, heightened bond market volatility and weaker investor demand.

Note: Views are from a U.S. dollar perspective, March 2024. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice regarding any particular funds, strategy or security.

Tracking five mega forces

Mega forces are big, structural changes that affect investing now – and far in the future. As key drivers of the new regime of greater macroeconomic and market volatility, they change the long-term growth and inflation outlook and are poised to create big shifts in profitability across economies and sectors. This creates major opportunities – and risks – for investors. See our web hub for our research and related content on each mega force.

1. **Demographic divergence:** The world is split between aging advanced economies and younger emerging markets – with different implications.
2. **Digital disruption and artificial intelligence (AI):** Technologies that are transforming how we live and work.
3. **Geopolitical fragmentation and economic competition:** Globalization is being rewired as the world splits into competing blocs.
4. **Future of finance:** A fast-evolving financial architecture is changing how households and companies use cash, borrow, transact and seek returns.
5. **Transition to a low-carbon economy:** The transition is set to spur a massive capital reallocation as energy systems are rewired.

Granular views

Six- to 12-month tactical views on selected assets vs. broad global asset classes by level of conviction, March 2024

Our approach is to first determine asset allocations based on our macro outlook – and what's in the price. **The table below reflects this and, importantly, leaves aside the opportunity for alpha, or the potential to generate above-benchmark returns.** The new regime is not conducive to static exposures to broad asset classes, in our view, but is creating more space for alpha**.**

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

	Asset		View	Commentary
Equities	**Developed markets**			
	United States	Benchmark	Neutral	We are neutral in our largest portfolio allocation. Falling inflation and coming Fed rate cuts can underpin the rally's momentum. We are ready to pivot once the market narrative shifts.
		Overall	+1	We are overweight overall when incorporating our U.S.-centric positive view on artificial intelligence (AI). We think AI beneficiaries can still gain while earnings growth looks robust.
	Europe		-1	We are underweight. The ECB is holding policy tight in a slowdown. Valuations are attractive, but we don't see a catalyst for improving sentiment.
	UK		Neutral	We are neutral. We find attractive valuations better reflect the weak growth outlook and the Bank of England's sharp rate hikes to fight sticky inflation.
	Japan		+1	We are overweight. We see stronger growth helping earnings top expectations. Stock buybacks and other shareholder-friendly actions are positives. Policy tightening is a near-term risk.
	Emerging markets		Neutral	We are neutral. We see growth on a weaker trajectory and see only limited policy stimulus from China. We prefer EM debt over equity.
	China		Neutral	We are neutral. Modest policy stimulus may help stabilize activity, and valuations have come down. Structural challenges such as an aging population and geopolitical risks persist.
Fixed Income	Short U.S. Treasuries		+1	We are overweight. We prefer short-term government bonds for income as interest rates stay higher for longer
	Long U.S. Treasuries		Neutral	We are neutral. The yield surge driven by expected policy rates has likely peaked. We now see about equal odds that long-term yields swing in either direction.
	U.S. inflation-linked bonds		Neutral	We are neutral. We see higher medium-term inflation, but cooling inflation and growth may matter more near term.
	Euro area inflation-linked bonds		-1	We are underweight. We prefer the U.S. over the euro area. We see markets overestimating how persistent inflation in the euro area will be relative to the U.S.
	Euro area govt bonds		Neutral	We are neutral. Market pricing reflects policy rates in line with our expectations and 10-year yields are off their highs. Widening peripheral bond spreads remain a risk.
	UK gilts		Neutral	We are neutral. Gilt yields have compressed relative to U.S. Treasuries. Markets are pricing in Bank of England policy rates closer to our expectations.
	Japanese govt bonds		-1	We are underweight. We see upside risks to yields from the Bank of Japan winding down its ultra-loose policy.
	China govt bonds		Neutral	We are neutral. Bonds are supported by looser policy. Yet we find yields more attractive in short-term DM paper.
	U.S. agency MBS		Neutral	We are neutral. We see agency MBS as a high-quality exposure in a diversified bond allocation and prefer it to IG.
	Global IG credit		-1	We are underweight. Tight spreads don't compensate for the expected hit to corporate balance sheets from rate hikes, in our view. We prefer Europe over the U.S.
	Global high yield		Neutral	We are neutral. Spreads are tight, but we like its high total yield and potential near-term rallies. We prefer Europe.
	Asia credit		Neutral	We are neutral. We don't find valuations compelling enough to turn more positive.
	Emerging hard currency		+1	We are overweight. We prefer EM hard currency debt due to its relative value and quality. It is also cushioned from weakening local currencies as EM central banks cut policy rates.
	Emerging local currency		Neutral	We are neutral. Yields have fallen closer to U.S. Treasury yields. Central bank rate cuts could hurt EM currencies, dragging on potential returns.

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