Be Selective for a Bumpier Ride

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Markets may press even higher this year, but some areas may fall behind.

Markets continued to rally, with U.S. stocks posting their best August performance since 1986. Investors were encouraged by better-than-feared economic releases and optimism around vaccine and treatment developments, while global central banks continued to provide ample liquidity. Credit markets also produced positive returns, albeit less so than equities. Interest rate-sensitive sectors lagged due to higher rates and robust issuance.

The Federal Reserve announced their new long-run monetary policy framework sooner than expected. Notably, the Fed’s more flexible approach to inflation targeting indicates a more accommodative stance for years to come.

The global economy has continued to recover with broad data beating expectations in recent months by the widest margins in nearly a decade. That said, a recovery to pre-COVID levels likely won’t occur until at least 2021 and partially hinges on the development of an effective and widely distributed vaccine, which remains uncertain. A plethora of political risks also dot the horizon, including the U.S. election, fiscal cliff and tensions with China.

The early September weakness in certain tech names that had been fueling the bulk of the U.S. rally reminds us that the recovery is not cemented, and downside asymmetry exists in many areas. While we continue to favor credit, a similar comment could be made where chasing higher yields in lower quality areas may lead to disappointment if volatility and uncertainty rises. As such, we maintain a high level of scrutiny in our credit selection.

Despite these risks, we believe the path for risk assets is probably headed higher, supported by abundant global stimulus and a nascent economic recovery. However, the upside is more limited from here after a record run in markets, and we expect a bumpier ride going into the final quarter of the year. Overall, we prefer to maintain balanced exposure in the BlackRock Multi-Asset Income Fund, favoring select credit sectors, while owning some downside protection via cash and long-term Treasuries.

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