

Weekly commentary

February 3, 2025

BlackRock

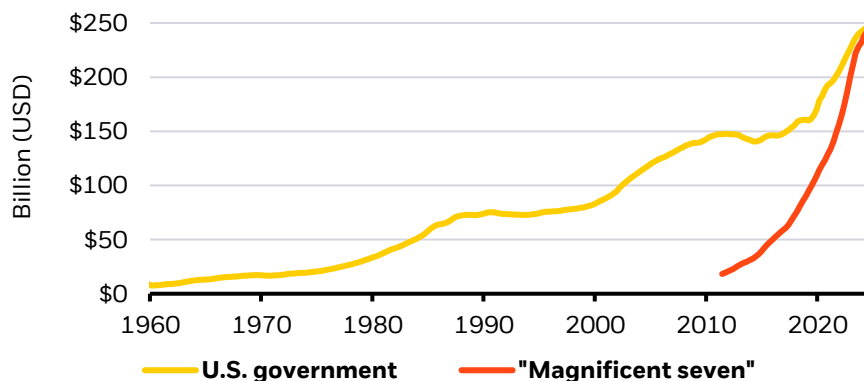
AI mega force could be accelerating

- Recent developments in artificial intelligence (AI) have forced markets to rethink their AI assumptions. We use our three-phase framework to track AI's progress.
- U.S. stocks were flat last week. Tech shares slid on AI concerns, only to reverse on solid Q4 earnings. U.S. 10-year Treasury yields fell near five-week lows.
- This week we watch for any initial disruptions from the U.S. imposing 25% tariffs on Canada and Mexico, as well as a further 10% tariff on China.

Last week's volatility in AI-related stocks shows markets are learning in real time about the transformation underway. We see having a framework as key for tracking mega forces, or big structural shifts, given a widening range of market outcomes. We use our three-phase framework – buildout, adoption, transformation – to track AI. Recent AI developments raise questions about AI investment and revenue. We see a broadening set of AI beneficiaries and stay overweight U.S. stocks.

Investment surge

Corporate investment vs. U.S. government R&D, 1960-2024



It is not possible to invest directly in an index. Indexes are unmanaged and performance does not account for fees. Source: BlackRock Investment Institute, with data from Bloomberg, February 2025. Note: The chart shows the investment in research and development from the U.S. government and corporate investment from the "magnificent seven" stocks: Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla.

We have said artificial intelligence could reshape economies and markets even as big questions remain about what exactly that will look like – in particular, who will generate the profits. We are in the AI buildout, with total capital investment by the "magnificent seven" mostly mega cap tech stocks on par with government R&D. See the chart. The release of a seemingly more efficient AI model by Chinese startup DeepSeek has renewed questions about AI capex. While these questions are valid, more spending is likely needed to unlock AI innovation – recent developments don't change our view. Broad AI adoption is still to come, and we have barely scratched the surface of all the potential AI use cases. Yet AI advances mean these models could be evolving faster than expected. That could push AI into the adoption phase sooner and is why the AI narrative and the market's reaction could change quickly.



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We are still in AI's buildout phase – and even with potential model efficiency gains, big capital spending might still be needed to unlock further innovation, like artificial general intelligence. Strong results and guidance from the magnificent seven show they can support heavy AI capex. Q4 management commentary reveals these companies are comfortable with their AI spend and have long-term conviction in the theme and expect ongoing demand. As the buildout progresses, it opens the door for the set of AI winners to broaden further beyond the magnificent seven, expanding the total AI opportunity set, in our view.

Beyond the buildout phase, we have yet to see the adoption phase begin in earnest, even with more players in the mix. Yet the rise of new AI models signals we could move through AI's phases quicker than anticipated, especially if efficiency gains from those models are indeed significant. Efficiency gains could ease earlier market fears that AI capacity won't keep up with rising demand. The spread of simpler, cheaper AI models could spur wider adoption by companies that need greater transparency over AI's output. To gauge adoption, we track sectors with a high share of jobs prone to AI-driven efficiency gains. AI's final phase may bring long-run, economy-wide productivity benefits – but only after AI tools have been built and broadly adopted.

We believe AI will generate significant revenue streams, yet how those revenues will be sliced up is the big question to track. One possible outcome: the big tech players now powering the AI buildout could reap most of the benefits. Yet last week's developments show there is another path: cheap, efficient and commoditized AI models that could benefit AI's end users instead of big tech. Across all three phases, following the revenue helps us to uncover investment opportunities.

AI is at the center of the [U.S.-China strategic competition](#). The U.S. strategy has been to protect and extend its AI lead, in part by denying China access to advanced tech and hardware. DeepSeek's apparent breakthrough has raised questions for some about the effectiveness of this approach. The new administration has emphasized AI leadership is key for U.S. economic and national security. We expect a continued focus on export controls, data security and concentrating the AI buildout in the U.S.

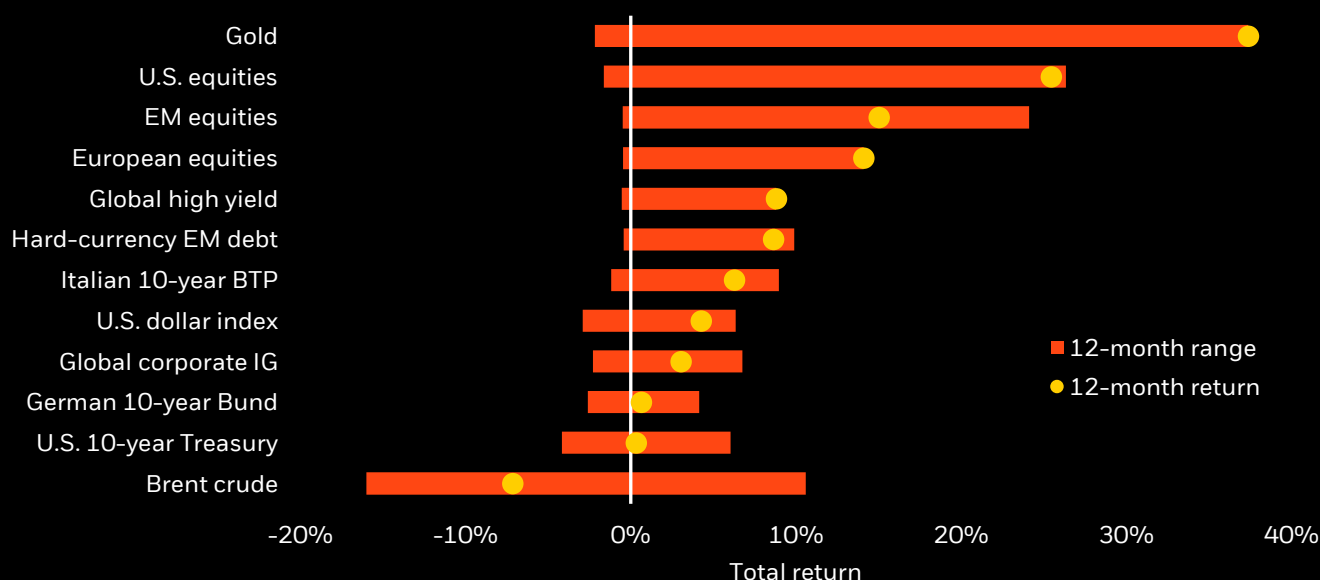
Bottom line: We keep our broad U.S. equity overweight. The emergence of new AI models shows the AI transformation could be accelerating, in our view. Across AI's three phases, we track revenue generation for identifying AI investment opportunities.

Market backdrop

U.S. stocks were flat last week. Tech shares slid, led by Nvidia, on concerns about whether the AI buildout was overdone – only to reverse on solid Q4 mega cap tech earnings, leaving the Nasdaq little changed on the week. U.S. 10-year Treasury yields fell to around 4.51%, near five-week lows. The Federal Reserve opted to hold rates steady at last week's policy meeting, while the European Central Bank cut rates 25 basis points – both moves widely expected.

Assets in review

Selected asset performance, 12-month 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 Jan. 30, 2025. Notes: The two ends of the bars show the lowest and highest returns at any point in the past 12 months, and the dots represent current 12-month 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

Feb. 3

Euro area inflation data

Feb. 7

U.S. payrolls; University of Michigan sentiment survey

Feb. 5

U.S. trade data

Feb. 8

China CPI and PPI

Markets will focus on any disruptions resulting from the U.S. imposing 25% tariffs on Canada and Mexico (10% for Canadian oil), and an extra 10% tariff on Chinese goods, all due to be implemented this week. This marks an escalation in trade protectionism, and we think that some level of tariffs is likely to remain in place over time. Uncertainty is high on how the trade dispute will play out on supply chains, growth and inflation. U.S. payrolls are also due this week.

Big calls

Our highest conviction views on tactical (6-12 month) and strategic (long-term) horizons, February 2025

Tactical	Reasons
U.S. equities	We see the AI buildout and adoption creating opportunities across sectors. We tap into beneficiaries outside the tech sector. Robust economic growth, broad earnings growth and a quality tilt underpin our conviction and overweight in U.S. stocks versus other regions. We see valuations for big tech backed by strong earnings, and less lofty valuations for other sectors.
Japanese equities	A brighter outlook for Japan's economy and corporate reforms are driving improved earnings and shareholder returns. Yet the potential drag on earnings from a stronger yen is a risk.
Selective in fixed income	Persistent deficits and sticky inflation in the U.S. make us more positive on fixed income elsewhere, notably Europe. We are underweight long-term U.S. Treasuries and like UK gilts instead. We also prefer European credit – both investment grade and high yield – over the U.S. on cheaper valuations.
Strategic	Reasons
Infrastructure equity and private credit	We see opportunities in infrastructure equity due to attractive relative valuations and mega forces. We think private credit will earn lending share as banks retreat – and at attractive returns.
Fixed income granularity	We prefer short- and medium-term investment grade credit, which offers similar yields with less interest rate risk than long-dated credit. We also like short-term government bonds in the U.S. and euro area and UK gilts overall.
Equity granularity	We favor emerging over developed markets yet get selective in both. EMs at the cross current of mega forces – like India and Saudi Arabia – offer opportunities. In DM, we like Japan as the return of inflation and corporate reforms brighten the outlook.

Note: Views are from a U.S. dollar perspective, February 2025. 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 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, February 2025

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				We are overweight as the AI theme and earnings growth broaden. Valuations for AI beneficiaries are supported by tech companies delivering on earnings. Resilient growth and Fed rate cuts support sentiment. Risks include any long-term yield surges or escalating trade protectionism.	
	Europe				We are underweight relative to the U.S., Japan and the UK – our preferred markets. Valuations are fair. A growth pickup and European Central Bank rate cuts support a modest earnings recovery. Yet political uncertainty could keep investors cautious.	
	UK				We are neutral. Political stability could improve investor sentiment. Yet an increase in the corporate tax burden could hurt profit margins near term.	
	Japan				We are overweight. A brighter outlook for Japan’s economy and corporate reforms are driving improved earnings and shareholder returns. Yet a stronger yen dragging on earnings is a risk.	
	Emerging markets				We are neutral. The growth and earnings outlook is mixed. We see valuations for India and Taiwan looking high.	
Fixed Income	China				We are modestly overweight. China’s fiscal stimulus is not yet enough to address the drags on economic growth, but we think stocks are at attractive valuations to DM shares. We stand ready to pivot. We are cautious long term given China’s structural challenges.	
	Short U.S. Treasuries				We are neutral. Markets are pricing in fewer Federal Reserve rate cuts and their policy rate expectations are now roughly in line with our views.	
	Long U.S. Treasuries				We are underweight. Persistent budget deficits and geopolitical fragmentation could drive term premium up over the near term. We prefer intermediate maturities less vulnerable to investors demanding more term premium.	
	Global inflation-linked bonds				We are neutral. We see higher medium-term inflation, but cooling inflation and growth may matter more near term.	
	Euro area govt bonds				We are neutral. Market pricing reflects policy rates in line with our expectations and 10-year yields are off their highs. Political uncertainty remains a risk to fiscal sustainability.	
	UK gilts				We are overweight. Gilt yields offer attractive income, and we think the Bank of England will cut rates more than the market is pricing given a soft economy. But we are monitoring any government response to the recent fiscal concerns.	
	Japanese govt bonds				We are underweight. Stock returns look more attractive to us. We see some of the least attractive returns in JGBs.	
	China govt bonds				We are neutral. Bonds are supported by looser policy. Yet we find yields more attractive in short-term DM paper.	
	U.S. agency MBS				We are neutral. We see agency MBS as a high-quality exposure in a diversified bond allocation and prefer it to IG.	
	Short-term IG credit				We are overweight. Short-term bonds better compensate for interest rate risk.	
	Long-term IG credit				We are underweight. Spreads are tight, so we prefer taking risk in equities from a whole portfolio perspective. We prefer Europe over the U.S.	
	Global high yield				We are neutral. Spreads are tight, but the total income makes it more attractive than IG. We prefer Europe.	
	Asia credit				We are neutral. We don’t find valuations compelling enough to turn more positive.	
	Emerging hard currency				We are neutral. The asset class has performed well due to its quality, attractive yields and EM central bank rate cuts. We think those rate cuts may soon be paused.	
	Emerging local currency				We are neutral. Yields have fallen closer to U.S. Treasury yields, and EM central banks look to be turning more cautious after cutting policy rates sharply.	

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