

# Weekly commentary

January 6, 2025

BlackRock

## Three investment lessons from 2024

- 2024 reinforced this is an economic transformation, not a business cycle. We lean against market moves driven by other interpretations and expect volatility.
- U.S. stocks surged more than 20% in 2024, driven by major tech stocks. U.S. Treasury yields ended the year above 4.50% as markets priced out Fed rate cuts.
- We get U.S. payrolls for December this week. Market expectations of only two Federal Reserve cuts in 2025 seem reasonable given sticky inflation, we think.

Three interconnected lessons from 2024 help shape our [2025 outlook](#). First, this is an economic transformation, not a business cycle. We hold to that core framing. Second, as markets instead keep trying to interpret macro data as though this were a typical business cycle, that creates opportunities to lean against the resulting market moves. Third: expect the unexpected as transformation and policy changes can also create surprises, volatility – and opportunities – in these choppy waters.



**Jean Boivin**

Head – BlackRock Investment Institute



**Wei Li**

Global Chief Investment Strategist – BlackRock Investment Institute

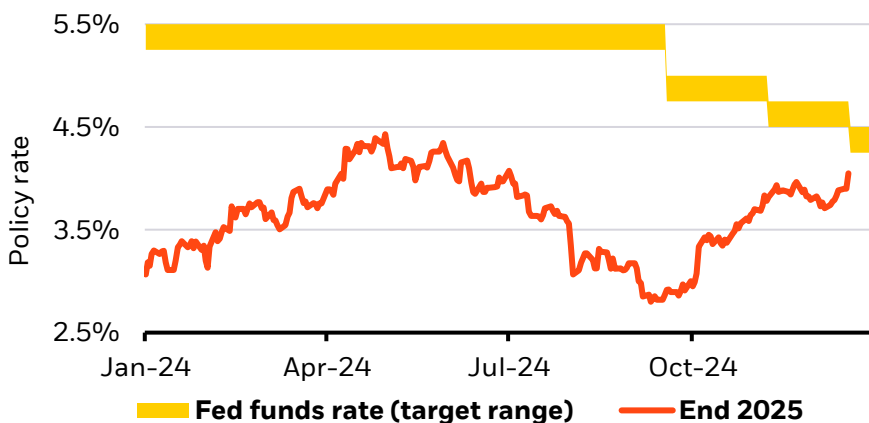


**Vivek Paul**

Global Head of Portfolio Research – BlackRock Investment Institute

## Embracing higher-for-longer

Actual fed funds rate and market pricing of the end-2025 rate last year



Forward looking estimates may not come to pass. Source: BlackRock Investment Institute, with data from LSEG Datastream, December 2024. Notes: The shaded area shows the target range of the fed funds rate and the orange line shows market pricing of the fed funds rate in December 2025 implied by SOFR futures.

We enter 2025 against an unusual macro backdrop. In 2024, time-tested recession indicators failed, inflation fell even as growth stayed above the historical trend and the Federal Reserve cut rates by 100 basis points even though financial conditions were already easy. Incoming data that didn't fit with a business cycle led to outsized market responses and abrupt shifts in narratives. This heightened market volatility creates plentiful investment opportunities, we think. Take fixed income. Fed rate cut expectations went on a historic round trip last year. See the chart. The Fed itself pivoted from talk of an easing cycle a year ago to a mere recalibration now. By year end, markets had come around to our higher-for-longer rate view. We expected inflation to cool some – as it did. Yet we long believed that sticky inflation would prevent sharp Fed rate cuts and leaned against market pricing for most of the year.

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2024's round trip in rate cut pricing shows this is not a business cycle but a transformation – our first lesson. We see mega forces, or structural shifts, reshaping economies and markets. This transformation could keep shifting the long-term activity trend, making a wide range of outcomes possible. Last year, we focused on key stock drivers: strengthening corporate earnings and free cash flow growth. This led us to stick with companies delivering on earnings even when valuation concerns flared up. We stay risk-on as we think U.S. corporate strength is the scenario most likely to play out next year. Yet we eye signposts, including greater trade protectionism, to change our view if other scenarios appear more likely. Structural changes mean rethinking long-held investment principles – like the assumption growth will eventually revert to its historical trend.

We lean against markets interpreting data through a business cycle lens, our second lesson. Such an interpretation last year spurred recession fears and brief stock selloffs. That played out in December, too, with the sharpest stock slide in decades to follow a Fed cut during a bull market, our analysis shows. Our U.S. equity overweight isn't shaken by the Fed's signal of fewer rate cuts – we had expected that. Our overweight is grounded in the artificial intelligence (AI) theme, robust economic growth and broadening earnings growth. Soaring tech valuations and the concentration of returns in just a few tech companies caused some market jitters. Yet we see market concentration as a feature, not a flaw, of transformation.

Transformation can happen quickly. That is why our third lesson is to expect more volatility and surprises than usual as transformation widens the range of market outcomes in real time. A year ago, the word “hyperscalers” – or large tech firms investing billions in AI – had barely entered the public lexicon. Public policy is another area we expect to see swift change. We think policymaking could itself become a source of disruption and surprises – in an already more fragile world given heightened strategic competition between the U.S. and China. Trade protectionism is shaping up to be a key risk in 2025.

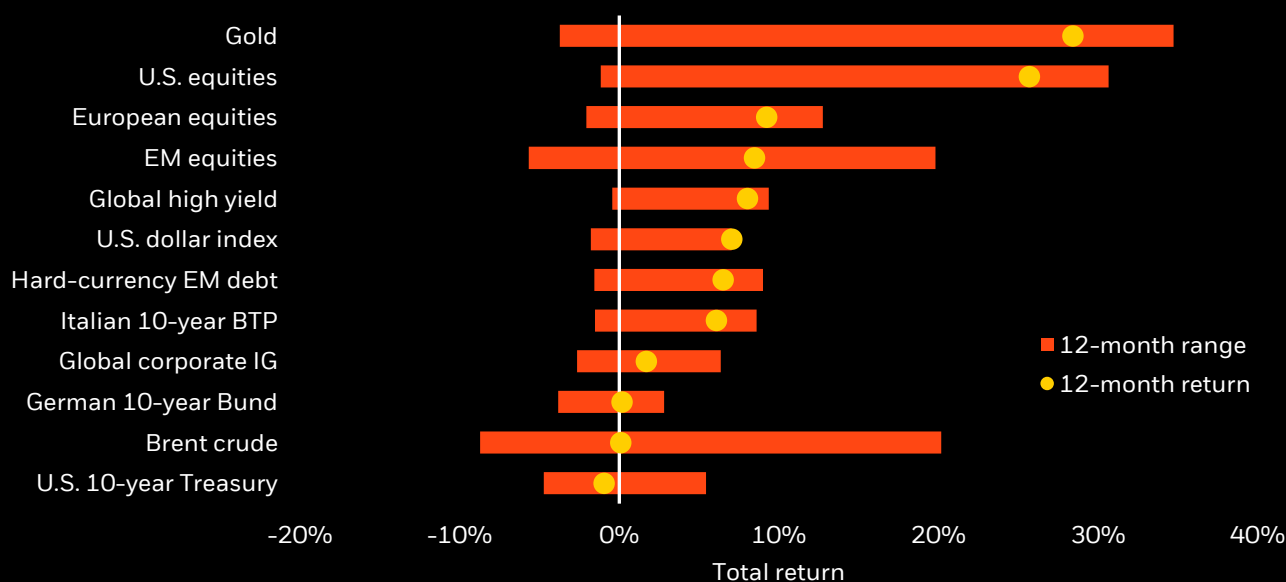
Bottom line: We carry 2024's lessons into 2025. We got clear evidence this is a transformation, not a business cycle. And we found it helps to lean against markets adopting a business cycle lens, eyeing more surprises as the transformation unfolds.

## Market backdrop

U.S. stocks surged more than 20% over the course of 2024. Mega cap tech names led the way on the AI theme – even as stocks finished the year on a down note overall after the Fed signaled a slower pace of cuts ahead at its December meeting. Markets have brought up their year-end 2025 rate expectations to nearly 4%, in line with our higher-for-longer view. U.S. 10-year Treasury yields swung in a range of nearly 100 basis points during the year, closing out 2024 near 4.58%.

## 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. 2, 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

Jan. 6

Global PMIs

Jan. 10

U.S. payrolls; University of Michigan sentiment survey

Jan. 7

U.S. trade data; euro area CPI

We get U.S. payrolls for December this week. Wage growth remains elevated due to an unexpected rise in immigration, in our view. While wage pressures have cooled some as immigration has slowed, they remain above the level that would allow inflation to fall to the Fed's 2% target. Given the risk of resurging inflation from potential trade tariffs and the immigration slowdown continuing, market expectations of only two more Fed policy rate cuts in 2025 now seem reasonable, we think.

## Big calls

Our highest conviction views on tactical (6-12 month) and strategic (long-term) horizons, January 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, January 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, January 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	
					●	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.
	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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