Weekly commentary

BlackRock

January 27, 2025

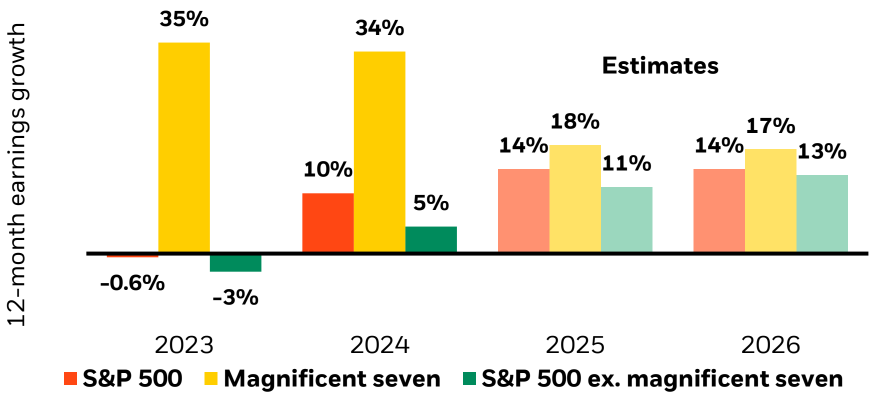
U.S. earnings key for our overweight

- We stay overweight U.S. stocks for now, and corporate earnings strength is likely to broaden to sectors beyond tech. Yet we watch for triggers to change our view.
- A strong start to Q4 earnings season sent U.S. stocks to record highs last week, led by the tech sector. U.S. 10-year Treasury yields were mostly steady.
- Central bank meetings take center stage this week, with the Federal Reserve likely to hold rates steady. Markets have warmed to our higher-for-longer view.

Corporate earnings beats have set the tone for the Q4 season in swing. Even with higher-for-longer interest rates, we think U.S. stocks can keep outperforming this year. We stay overweight. Resilient economic growth is helping sectors beyond tech. That's partly driven by artificial intelligence (AI) spurring earnings beyond the initial winners during an economic transformation and policy change, we think. Yet we eye risks to risk appetite changing this year depending on earnings and policy.

Broadening out

12-month change in earnings, historical and estimated, 2023-2026



Past performance is not a reliable indicator of current or future results. Forward looking estimates may not come to pass. It is not possible to invest in an index. Indexes are unmanaged and do not account for fees. Source: BlackRock Investment Institute, with data from Bloomberg and Bloomberg US Large Cap Magnificent 7 index, January 2025. Note: The chart shows the historical and estimated 12-month change in earnings for the S&P 500, magnificent seven and S&P 500 ex. the magnificent seven. We've switched indexes to reduce volatility from rebalances, better align with sell-side estimates and include a longer history.

The surge in long-term bond yields highlighted how markets have embraced our view that interest rates will stay above pre-pandemic levels. Even as markets have priced out some rate cuts, strong corporate earnings growth has pushed U.S. stocks higher. The "magnificent seven" of mostly mega cap tech companies have driven earnings growth in recent years. Yet policy shifts, a low earnings base for the rest of the market and more non-tech contributors to the AI buildout over time could spur strength to broaden. Analyst forecasts reflect that: The gap between magnificent 7 earnings and those for the rest of the market is expected to shrink in 2025. See the chart. Yet our U.S. equity overweight is not contingent on broadening. We see concentration in mega cap tech as a feature of the economic transformation driven by mega forces like AI – a reason we still like the magnificent seven.

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Companies are beating expectations so far, with overall S&P 500 earnings expected to grow roughly 11% for Q4 2024, LSEG Datastream data show. Analysts see earnings jumping 14% this year. That number may tick down as typically happens in most years as early optimism fades, but all sectors – even the struggling energy, materials and healthcare sectors – are expected to see growth. That's powered by resilient economic growth as consumer spending has held up.

Looking ahead, we're tracking how U.S. policy could affect different sectors and potentially cause earnings strength to broaden further. The financial sector could get a boost from expected deregulation if it spurs more corporate dealmaking. President Donald Trump's executive orders also aim to ramp up energy production, including making it easier to gain permits for building energy infrastructure. Policy changes could bolster sticky inflation, reinforcing our view of higher-for-longer rates and potentially driving the dollar toward its 2022 peaks. That would put pressure on profit margins for big U.S. exporters.

Even as earnings strength broadens, we still favor the AI theme. A pledge by big tech companies to spend billions of dollars building data centers highlights the ongoing buildout. We think big tech can keep delivering on earnings, but misses could revive concerns that big capital spending on AI won't pay off – one of three triggers to dial down our pro-risk view. Metrics like capex-to-sales ratios and free cash flows suggest that, for now, mega cap tech firms are not overextended. Overinvestment should be assessed in aggregate, in our view, given AI's potential to unlock new revenue streams across the economy.

Earnings are broadening in Europe, but more slowly. They're forecast to grow 2% in Q4 and 8% for 2025. We still prefer U.S. stocks over Europe's. Political strains in the region, potential U.S. tariffs and a weak Chinese economy remain risks. Yet weak investor sentiment sets a low bar for positive surprises to lift the market. We like quality companies with strong free cash flow and global operations better shielded from tariffs. Industrial and semiconductor companies benefit from structural shifts.

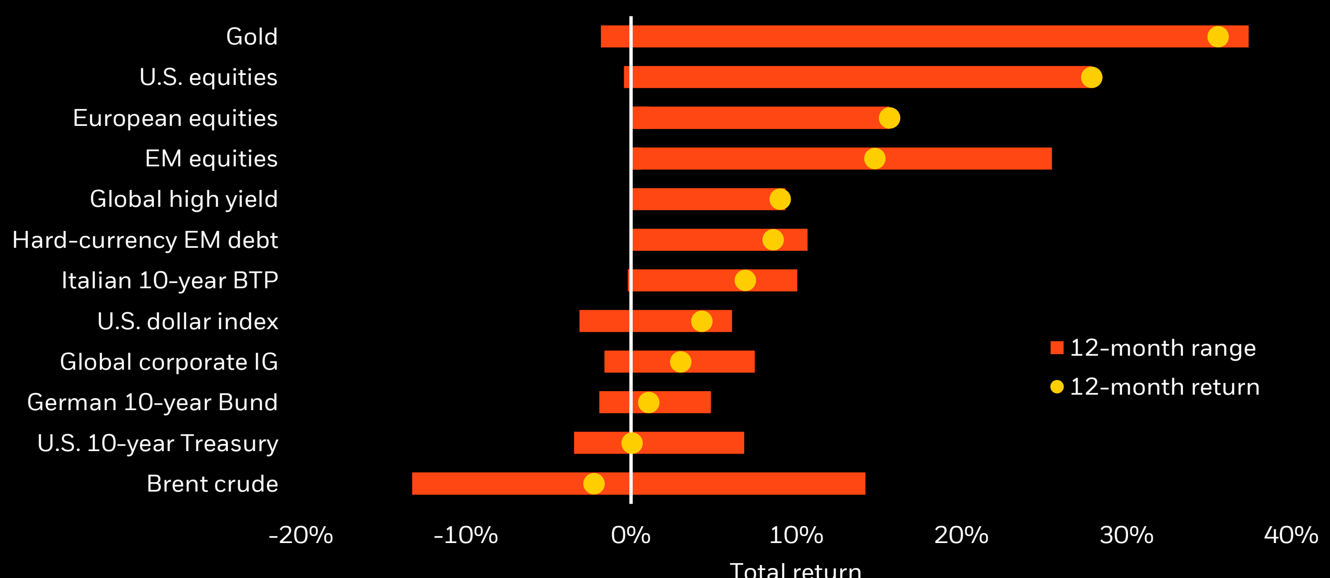
Bottom line: Earnings growth has helped U.S. stocks climb even with higher interest rates. We think U.S. stocks can keep outperforming as earnings strength broadens beyond tech. We stay overweight U.S. stocks in our six- to 12-month views.

Market backdrop

A strong start to Q4 earnings season pushed U.S. stocks to new record highs last week, with tech stocks leading and taking the S&P 500 up nearly 4% for the year. U.S. 10-year Treasury yields were mostly steady around 4.60% before this week's Federal Reserve policy meeting. The Japanese yen was also broadly steady after the Bank of Japan raised its policy rate to a 17-year high yet failed to commit to further hikes. We expect the BOJ to be cautious on policy.

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. 23, 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. 28	U.S. durable goods; U.S. consumer confidence; Japan service PPI	**Jan. 30**	U.S. Q4 GDP; European Central Bank (ECB) policy decision; euro area flash GDP
Jan. 29	Federal Reserve policy decision	**Jan. 31**	U.S. PCE; Japan CPI

Global central bank meetings take center stage this week. The Fed is likely to keep rates steady, and markets have embraced our view of higher-for-longer rates – with the next quarter-point cut not priced in until June. We think the ECB has more room for further cuts than the Fed even after three consecutive policy rate cuts. Yet like in the U.S., we see structural constraints keeping inflation and rates higher than pre pandemic.

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

	Asset	View	Commentary
Equities	**Developed markets**		
Equities	United States	+2	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.
Equities	Europe	-1	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.
Equities	UK	Neutral	We are neutral. Political stability could improve investor sentiment. Yet an increase in the corporate tax burden could hurt profit margins near term.
Equities	Japan	+1	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.
Equities	**Emerging markets**	Neutral	We are neutral. The growth and earnings outlook is mixed. We see valuations for India and Taiwan looking high.
Equities	China	+1	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.
Fixed Income	Short U.S. Treasuries	Neutral	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.
Fixed Income	Long U.S. Treasuries	-1	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.
Fixed Income	Global inflation-linked bonds	Neutral	We are neutral. We see higher medium-term inflation, but cooling inflation and growth may matter more near term.
Fixed Income	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. Political uncertainty remains a risk to fiscal sustainability.
Fixed Income	UK gilts	+1	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.
Fixed Income	Japanese govt bonds	-2	We are underweight. Stock returns look more attractive to us. We see some of the least attractive returns in JGBs.
Fixed Income	China govt bonds	Neutral	We are neutral. Bonds are supported by looser policy. Yet we find yields more attractive in short-term DM paper.
Fixed Income	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.
Fixed Income	Short-term IG credit	+1	We are overweight. Short-term bonds better compensate for interest rate risk.
Fixed Income	Long-term IG credit	-1	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.
Fixed Income	Global high yield	Neutral	We are neutral. Spreads are tight, but the total income makes it more attractive than IG. We prefer Europe.
Fixed Income	Asia credit	Neutral	We are neutral. We don't find valuations compelling enough to turn more positive.
Fixed Income	Emerging hard currency	Neutral	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.
Fixed Income	Emerging local currency	Neutral	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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