Weekly commentary

BlackRock

February 18, 2025

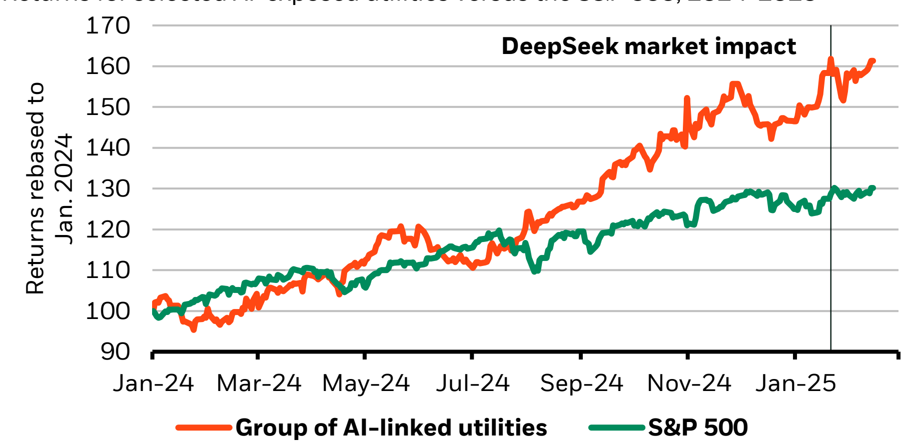
AI a key driver of the power outlook

- Expectations of rising power demand due partly to artificial intelligence (AI) are driving market volatility. We favor AI beneficiaries in utilities and infrastructure.
- U.S. stocks rose last week, with mega cap tech headlining strong Q4 corporate earnings. Bond yields spiked on the hot U.S. CPI data but ended the week flat.
- We get UK CPI this week. We think the UK's weaker growth outlook paves the way for further Bank of England policy rate cuts.

We see structural shifts like AI transforming economies and driving energy demand. Case in point: 2024's surge in typically dull utility stocks and other AI-related companies. News of a seemingly more efficient AI model by China's DeepSeek briefly interrupted this rally. We don't see DeepSeek's innovations hurting power demand, nor do the large AI builders. AI is one of many factors driving greater energy demand. We eye beneficiaries in utilities and infrastructure.

Buzz about utilities

Returns for selected AI-exposed utilities versus the S&P 500, 2024-2025



The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results. Source: BlackRock Investment Institute, with data from LSEG Datastream, February 2025. Note: The chart shows the total returns of a select group of AI-linked utilities (Constellation Energy, Vistra, Entergy and Dominion Energy) relative to the overall S&P 500 since the beginning of 2024.

We see a transformation underway potentially requiring investment on par with the industrial revolution. This can drive market volatility, as we have seen. One example: markets keying on AI's power needs triggered a surge in AI-linked stocks last year, pushing the usually staid utilities sector higher. DeepSeek briefly challenged that trade last month on fears that heavy AI capex, and estimates of AI's power needs, may be overdone. See the chart. Yet the selloff quickly reversed, a sign markets now share our view that while DeepSeek could deliver efficiency gains, new frontiers – like artificial general intelligence that matches or surpasses human abilities – will likely still require large investment. Plus, AI efficiency gains could accelerate the AI mega force, creating the need for more energy and the infrastructure to support it. That's backed up by mega cap tech's plans to stick with and even increase AI capex.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In the U.S., where AI is shaping up to be a key driver of new power demand, estimates of the scale of the nation's total power needs are huge and growing. Q4 corporate earnings season shows the mega cap tech companies driving the AI buildout are largely sticking with their AI capex, even after the DeepSeek news. Some are even increasing on last year's spend – Meta, Amazon, Microsoft and Alphabet are expected to invest nearly $320 billion in AI capex this year, up roughly 40% from 2024, according to company guidance. The AI buildout could drive power demands further afield, too: many governments are joining U.S. companies in their AI commitments – as seen in the $500 billion U.S. Stargate project and the European Union's €200 billion AI bet announced in Paris last week.

Yet AI is only part of a broader trend of growing power needs globally. Other drivers include rising global incomes, reshoring, industrial growth and building cooling needs. Extreme heat is driving air conditioning use, particularly in emerging markets where it is not yet widespread. Electrification of buildings and vehicles is expanding, though unevenly across regions. We expect speedbumps as soaring demand runs up against power supply constraints, potentially adding to inflation pressures. This calls for upping allocations to equities, infrastructure and inflation-linked bonds as an inflation hedge, we think.

Assessing what type of power will meet this spiking power demand is key, we think. Already huge investment expected in the energy transition could grow further, in our view. The companies driving the AI buildout prefer power supplies that are always on, cost-effective, immediately available and low carbon, a difficult combination. That could drive U.S. demand for natural gas and renewables. Yet we still see a role for traditional energy as policymakers seek affordable and reliable power alongside low-carbon goals. Longer term, demand could rise for nuclear and other low-carbon, available-when-needed energy sources. We eye investment opportunities across power generation, grid infrastructure and the electrical equipment value chain. We like utilities and power producers in this environment and get granular to identify opportunities along the supply chain.

Bottom line: We see soaring power demand driving bouts of market volatility. We get active to find investment opportunities – like in utilities, grids and electrical equipment supply chains – and value selectivity as performance dispersion grows.

Market backdrop

U.S. stocks rose last week, taking the year's gains to 4%. Yet they again lagged European shares – now up 9% this year, led by financials. Q4 earnings season stayed strong on solid results and AI capex guidance by mega cap tech. U.S. CPI pointed to sticky inflation, causing U.S. 10-year Treasury yields to spike before settling back near 4.47%. Persistent inflation reduces the odds of more Federal Reserve rate cuts this year, we think. Hong Kong-listed Chinese shares surged largely on AI optimism.

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 Feb. 13, 2025. 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

Feb. 18	Japan trade data	**Feb. 20**	Japan CPI; Philly Fed business index; euro area consumer confidence
Feb. 19	UK CPI	**Feb. 21**	Global flash PMIs

UK CPI is the main macro event on tap this week. Markets will be looking for signs of progress in the Bank of England's (BOE's) fight against inflation following last week's 25-basis point policy rate cut. Even as UK inflation remains above the BOE's 2% target, we think the UK's weak growth outlook gives the BOE further room to cut policy rates this year. Japan trade data will also be in focus given the Trump administration's plans to implement reciprocal tariffs, including on Japan.

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 euro area government bonds instead. We also prefer European credit – both investment grade and high yield – over the U.S. on more attractive spreads.
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	+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.
	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.
	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.
	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.
	Emerging markets	Neutral	We are neutral. The growth and earnings outlook is mixed. We see valuations for India and Taiwan looking high.
	China	+1	We are modestly overweight. China's fiscal stimulus is not yet enough to address the drags on growth and tariff risks could hurt sentiment. But we see stocks as attractively valued versus DMs. We stand ready to pivot. We are cautious long term given 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.
	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.
	Global 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 govt bonds	+1	We are overweight. Trade uncertainty may hurt euro area growth more than it boosts inflation, potentially allowing the European Central Bank to cut rates more. Political uncertainty remains a risk to fiscal sustainability.
	UK gilts	Neutral	We are neutral. Gilt yields are off their highs, but the risk of higher U.S. yields having a knock-on impact and reducing the UK's fiscal space has risen. We are monitoring the UK fiscal situation.
	Japanese govt bonds	-2	We are underweight. Stock returns look more attractive to us. We see some of the least attractive returns in JGBs.
	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.
	Short-term IG credit	+1	We are overweight. Short-term bonds better compensate for interest rate risk.
	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.
	Global high yield	Neutral	We are neutral. Spreads are tight, but the total income makes it more attractive than IG. We prefer Europe.
	Asia credit	Neutral	We are neutral. We don't find valuations compelling enough to turn more positive.
	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.
	Emerging local currency	-1	We are underweight. We see emerging market currencies as especially sensitive to trade uncertainty and global risk sentiment.

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