

Weekly commentary

February 24, 2025

BlackRock

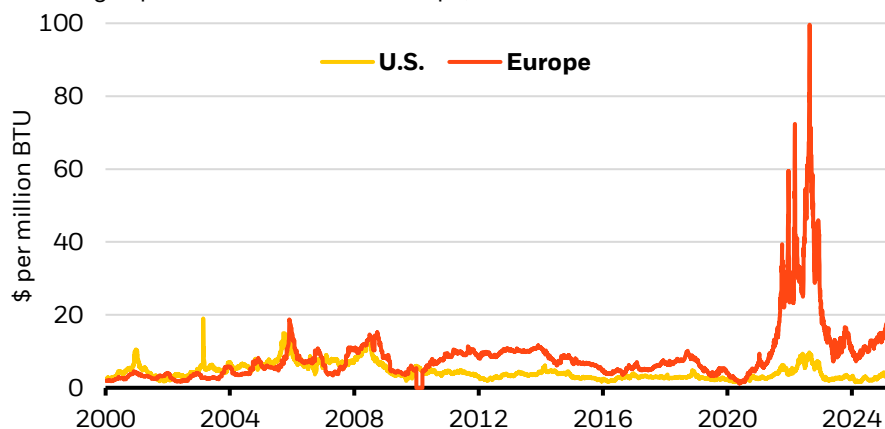
Broadening out our pro-risk view

- We still think U.S. equities can outperform in 2025, led by tech, even as Europe's start the year strong. Yet we broaden our risk-on view, upgrading Europe stocks.
- U.S. stocks tumbled last week – now up about 3% for the year, versus nearly 9% in Europe. We see markets reflecting tariff concerns and an evolving AI story.
- This week, we get U.S. PCE for January. Any pickup in inflation would provide more evidence that December's CPI moderation was an outlier, in our view.

European equity gains have outpaced the U.S. to start 2025. We had said Europe's stocks needed a catalyst to turn around poor sentiment. We now see several that – if they materialize – could boost cheap valuations, so we close our underweight on Europe's stocks. Yet we still expect the U.S. to reclaim leadership this year and stay overweight U.S. stocks as corporate earnings strength and the artificial intelligence (AI) theme broaden out. We turn more underweight long-term U.S. Treasuries.

Europe's energy crisis

Natural gas prices in the U.S. and Europe, 2000 to 2025



Source: BlackRock Investment Institute, with data from LSEG Datastream, Intercontinental Exchange and Oxford Economics, February 2025. Note: The chart shows the natural gas prices in the U.S. and Europe since 2000. British Thermal Unit (BTU) is the traditional measurement unit for natural gas and represents the amount of energy needed to cool or heat one pound of water by one degree Fahrenheit.

U.S. equities have long outperformed their global peers. Some pin that on tech's greater share in its market, bigger fiscal spend in recent years and energy independence, but we would attribute it more to deeper capital markets and relative deregulation that promote risk-taking. We think the U.S. can keep its edge, even if the S&P 500 has lagged so far this year. Yet we believe Europe can close some of the return gap. With a lot of bad news priced into European equities, even prospects of good news could help them push higher. One example: Possible de-escalation in the Ukraine war. Reduced reliance on Russian gas brought European energy prices down from 2022's highs. See the chart. A form of peace agreement could lower energy prices further, boosting European growth and lowering inflation. This is just one of several catalysts we think could broaden U.S. equity strength to Europe.



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We eye other catalysts for European equities as well. We expect more defense spending as the U.S. has stated Europe is no longer a primary security priority. The EU now has an air of urgency that typically spurs action. In Germany, the weekend's election result could herald fiscal loosening – though it's a long and uncertain road there. Still sluggish euro area growth and easing inflation gives the European Central Bank room to cut rates more this year, we think. So, we go neutral Europe's stocks and still favor European financials – a preference that also served us well last year. Yet Europe still faces multiple structural issues, from lagging competitiveness to potential U.S. tariffs – justifying some of Europe's hefty valuation discount, we think.

Our assessment of the U.S. is unchanged: we expect mega-cap tech and other AI-linked stocks to keep driving U.S. equity returns, especially as AI adoption grows. But we also see signs of earnings strength broadening beyond tech. Analysts now expect tech to deliver 18% earnings growth this year versus 11% for the broader index, LSEG data show – a smaller gap vs. 2024. We think risk assets could also weather the higher growth and higher inflation mix we see as increasingly possible. New tariffs and U.S. policy shifts aimed at boosting growth, like deregulation, carry inflationary potential. Markets have embraced our higher-for-longer rate view, yet we still see term premium rising more than currently priced as investors demand more return for the risk of holding long-term bonds – even if the administration's focus on long-term yields and talks of pausing quantitative tightening could delay some of the rise for now. We go further underweight long-term U.S. Treasuries as a result.

In China, apparent efficiency gains by AI startup DeepSeek have driven a surge in China's tech sector. President Xi Jinping's recent meeting with private sector business leaders could signal a more supportive regulatory backdrop, yet the broader environment of U.S.-China technology competition may present challenges. We evolve our tactical overweight to Chinese equities as tech excitement could keep driving returns, potentially reducing the odds of much-anticipated government stimulus. Over the longer term, we are more wary given structural challenges to China's growth and tariff risks.

Bottom line: We stay overweight U.S. equities, even with their softer start to 2025. Yet we think their lead over global peers could narrow this year. We upgrade European stocks to neutral while going further underweight long-dated U.S. Treasuries.

Market backdrop

The S&P 500 slid nearly 2% last week. The index is up 2.5% this year, but still lagging Europe's Stoxx 600, which is up 8.5% year to date. Ten-year U.S. Treasury yields ticked down to 4.43%, about 40 basis points below 2025's high. Hong Kong-listed Chinese stocks shook off a steep fall to rise 4% last week, up 22% in 2025. We think such moves reflect improving sentiment in Europe, concerns about potential U.S. policy changes and disappointing economic data, and the evolving AI theme.

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. 20, 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. 25	U.S. consumer confidence; Japan service PPI	Feb. 28	U.S. PCE; Japan CPI
Feb. 27	U.S. durable goods	March 1	China manufacturing PMI

This week, we get U.S. PCE for January. The latest U.S. CPI print came in hotter than expected, indicating that elevated wage pressures are still driving sticky inflation. We watch for whether PCE follows suit, which would point to December's CPI moderation being an outlier. In Japan CPI data out this week, we expect a pickup due to rising food prices.

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 DM government bonds over investment grade credit given tight spreads. Within DM government bonds, we favor short- and medium-term maturities in the U.S., and UK gilts across maturities.
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	
					● 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 neutral, preferring the U.S. and Japan. We see room for more European Central Bank rate cuts, supporting an earnings recovery. Rising defense spending, as well as potential fiscal loosening and de-escalation in the Ukraine war are other positives.
	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. We think AI and tech excitement could keep driving returns, potentially reducing the odds of much-anticipated government stimulus. We stand ready to pivot. We remain cautious given structural challenges to China's growth and tariff risks.
	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 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					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					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 underweight. We see emerging market currencies as especially sensitive to trade uncertainty and global risk sentiment.

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