

Weekly commentary

May 12, 2025

BlackRock

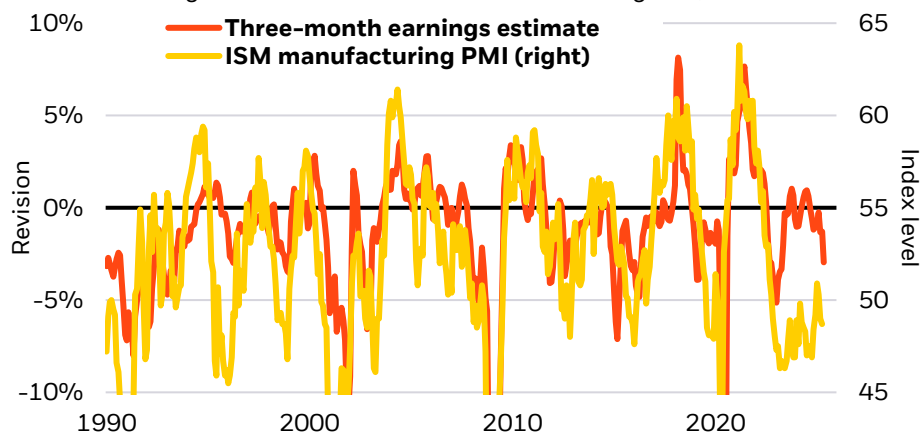
Still selective as trade conflict cools

- We still see tariffs causing further contractions in quarterly activity but the cumulative impact may be more limited. We eye opportunities from mega forces.
- U.S. stocks ticked down last week after a tech-driven rally over easing restrictions on AI chip exports. UK stocks rose on news of a U.S.-UK trade deal.
- We're looking for early signs of tariffs pushing up inflation in U.S. CPI data out this week. Sticky inflation will limit how far the Federal Reserve can cut rates.

The U.S.-China deal represents a major de-escalation in the trade conflict. Three key takeaways? First, it reaffirms that the hard economic rules we've been flagging will shape policy. Second, tariffs will likely bring more supply-driven contractions in quarterly activity, but the cumulative impact on overall 2025 activity could be more limited. Third, the deal gives a sense of where the U.S. effective tariff rate will settle. We stay risk on, monitoring corporate earnings reports for selective opportunities.

Room to fall

S&P 500 earnings estimate revisions and manufacturing PMI, 1990-2025



Forward looking estimates may not come to pass. Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index. Source: BlackRock Investment Institute, with data from LSEG Datastream, May 2025. Note: The chart shows the three-month revision in S&P 500 earnings estimates and the ISM Manufacturing PMI – below 50 indicates manufacturing activity falling, above 50 indicates activity growing.

The 90-day cut to U.S.-China tariffs shows a hard economic rule shaping policy: supply chains can't be rewired quickly without disruption. That's reflected in both nations' explicit goal of avoiding economic "decoupling." We still think tariffs will up inflation and hurt growth, with recession-like effects in coming quarters. Earnings estimates often suffer steep cuts when activity slumps. See the chart. Analysts have already cut forecasts for broad S&P 500 earnings growth from 14% in January to 8.5%, a slightly bigger drop than in an average year, per LSEG data. Yet the cumulative impact on overall 2025 activity may be more limited. The U.S. average effective tariff rate could land around 10-15%, we estimate, higher than at the start of 2025 but a more manageable economic disruption. We stay positive on developed market (DM) stocks and see mega forces creating select opportunities.



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As we track how evolving tariffs ripple out, we see three key themes in Q1 earnings reports. First, moving production to the U.S. or countries on better terms with the U.S. has, for the first time, been discussed on all Q1 earnings calls so far, per Alphasense data. Some are now giving timelines. Second, many firms look set to accept higher input costs as supply chains adjust. The latest external estimates see tariffs denting net earnings by around 5%. Third, 60% of companies updating their spending plans are now guiding below consensus forecasts – up from 40% at the start of the year but still below the 71% hit in the pandemic, Bank of America and FactSet data show. Yet opportunities persist in certain sectors. Big tech is reaffirming or upping AI-linked investment, for example. And Q1 results show U.S. companies are starting from a position of strength.

In Europe, infrastructure and defense spending plans have led us to upgrade European equities to neutral. Yet execution of those plans is key – and the new German chancellor's limited coalition support highlights potential obstacles. Europe's Stoxx 600 has performed broadly on par with the S&P 500 since the April 2 tariff announcement and European earnings estimates for 2025 have fallen to 3.5% from 8% in January. Yet that masks divergence. Financials are up over 20% this year, thanks to persistently high yields and strong company and household balance sheets. We've preferred Spain since the start of 2025 due to strong growth and exposure to financials, utilities and infrastructure – sectors that benefit from mega forces. Spanish stocks are also less exposed to U.S. tariffs: only 5% of its exports are U.S.-bound, less than the EU average, trade data show. Japanese equities offer another bright spot: Ongoing corporate reforms keep us overweight on a currency-unhedged basis.

Structural shifts also call for selectivity in other asset classes. Gold has been a better buffer against geopolitical risks than other traditional safe-haven assets since April 2. It has soared, while long-term U.S. Treasuries and the U.S. dollar have – unusually – slid alongside stocks, Bloomberg data show. Under new regulation, U.S. banks will soon be able to treat gold as a high-quality asset on their balance sheets. That could drive demand and make gold a core holding.

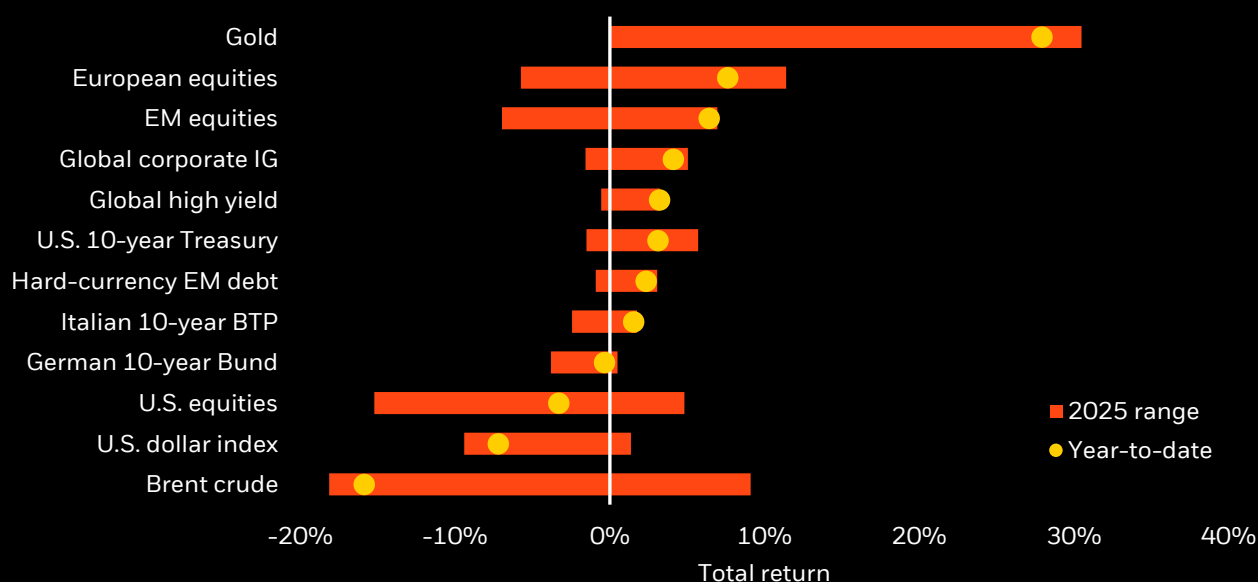
Bottom line: We still see supply disruptions upping inflation and hitting growth, but also a path to avoiding a U.S. contraction over 2025 as a whole. Mega forces, greater fiscal spending and higher interest rates are driving select opportunities.

Market backdrop

U.S. stocks ticked down last week after a tech-driven rally on reports the U.S. plans to lift restrictions on AI chip exports. The S&P 500 remains 8% below February's record high. The UK's FTSE 250 rose more than 1% last week and hit a two-month high after the Bank of England cut rates by 25 basis points and the U.S. signed a trade deal with the UK. U.S. two-year and 10-year Treasury yields were largely steady at 3.89% and 4.39% respectively as the Federal Reserve left rates unchanged.

Assets in review

Selected asset performance, year-to-date return and range



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index. Sources: BlackRock Investment Institute, with data from LSEG Datastream as of May 8, 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

May 13

U.S. CPI

May 16

University of Michigan
consumer sentiment survey

May 15

Japan GDP; Philly Fed
Business index

U.S. CPI data for April is in focus this week. While it's probably too soon to see the early April tariffs pushing up directly on inflation, we're watching for signs of an uptick in core goods prices. We think sticky inflation will make it difficult for the Fed to cut interest rates much this year as it grapples with a now sharper trade-off between protecting growth and reining in inflation.

Big calls

Our highest conviction views on six- to 12-month (tactical) and over five-year (strategic) horizons, May 2025

Tactical	Reasons
U.S. equities	Policy uncertainty and supply disruptions are weighing on near-term growth, raising the risk of a contraction. Yet we think U.S. equities will regain global leadership as the AI theme keeps providing near-term earnings support and could drive productivity in the long term.
Japanese equities	We are overweight. Ongoing shareholder-friendly corporate reforms remain a positive. We prefer unhedged exposures given the yen's potential strength during bouts of market stress.
Selective in fixed income	Persistent deficits and sticky inflation in the U.S. make us underweight long-term U.S. Treasuries. 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, May 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.

- Demographic divergence:** The world is split between aging advanced economies and younger emerging markets – with different implications.
- Digital disruption and artificial intelligence (AI):** Technologies are transforming how we live and work.
- Geopolitical fragmentation and economic competition:** Globalization is being rewired as the world splits into competing blocs.
- Future of finance:** A fast-evolving financial architecture is changing how households and companies use cash, borrow, transact and seek returns.
- 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, May 2025

We have lengthened our tactical investment horizon back to six to 12 months. The table below reflects this and, importantly, leaves aside the opportunity for alpha, or the potential to generate above-benchmark returns – especially at a time of heightened volatility.

		Underweight	Neutral	Overweight	Previous view	
					●	
Asset	View	Commentary				
Equities	Developed markets					
	United States					We are overweight. Policy-driven volatility and supply-side constraints are pressuring growth, but we see AI supporting corporate earnings in the near term and driving productivity over the long run.
	Europe					We are neutral, preferring the U.S. and Japan. We see structural growth concerns and uncertainty over the impacts of rising defense spending, fiscal loosening and de-escalation in Ukraine. Yet room for more European Central Bank rate cuts can support an earnings recovery.
	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 given the return of inflation and shareholder-friendly corporate reforms. We prefer unhedged exposure as the yen has tended to strengthen during bouts of market stress.
	Emerging markets					We are neutral. U.S. tariffs and trade tensions are likely to drag on growth in China and emerging markets more broadly, even with potential policy support.
	China					We are neutral. The uncertainty of trade barriers makes us more cautious, with potential policy stimulus only partly offsetting the drag. We still see structural challenges to China's growth.
	Short U.S. Treasuries					We are overweight. We view short-term Treasuries as akin to cash in our tactical views – but we would still lean against the market pricing of multiple Fed rate cuts this year.
	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.
Fixed Income	Euro area govt bonds					We are underweight. Growth and inflation risks are balanced. Trade uncertainty may hurt growth more than it boosts inflation, allowing the ECB to cut rates more. Greater defense and infrastructure spending will support growth in the medium term but might boost term premia.
	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. Yields have surged, yet stock returns still look more attractive to us.
	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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