Weekly commentary

June 23, 2025

BlackRock

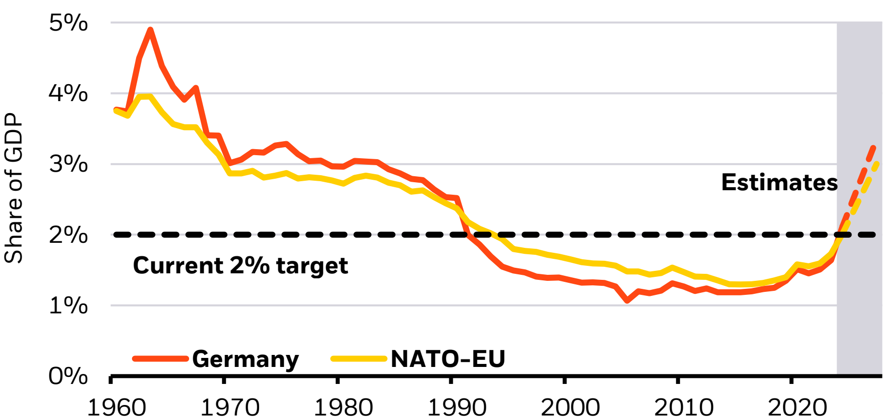
Geopolitical rifts drive defense theme

- The geopolitical fragmentation mega force is evolving, with a big focus now on rising defense spending. We refine our preferences across regions and sectors.
- Oil prices steadied after their surge on the Israel-Iran conflict. U.S. bond yields were little changed after the Fed signaled it was eyeing the impact of tariffs.
- We watch the U.S. PCE data for signs of tariff impacts, so far limited in major data. Solid wage growth is keeping core inflation above the Fed's 2% target.

Geopolitical fragmentation has deepened in the past decade through shocks like the pandemic, Russia's invasion of Ukraine, fresh conflict in the Middle East and rising trade tensions. A shifting U.S. security posture has accelerated this trend, pushing up defense spending in the EU and Asia – with this week's NATO Summit set to lift Europe's further. As the geopolitical mega force evolves, we take an active approach to the theme and get granular across regions and defense exposures.

Stepping up spending

Defense spending as a share of GDP, historic and projected, 1960-2027



Forward looking estimates may not come to pass. Source: BlackRock Investment Institute, NATO, World Bank, European Commission, July 2025. Note: The solid lines show the defense spending as a share of GDP for Germany and European NATO countries. The dotted lines assume current plans to boost defense spending are realized.

Geopolitical fragmentation and economic competition – a mega force, or big structural shift we've long tracked – is rapidly evolving across multiple fronts. First: the emergence of geopolitical blocs, evidenced by different views on the Ukraine war and alignments with the U.S. and China. Second: competition between those blocs, most evident in the U.S.-China AI race. Third: the rewiring of supply chains to build resilience and support national security. Together, these dynamics are deepening geopolitical fragmentation and sparking investment in defense globally. After undershooting for decades, defense spending in Europe has now hit its target of 2% of GDP and is set to rise further. See the chart. Many NATO members are expected to agree to up spending to 5% of GDP after this week's NATO Summit in The Hague, with an expected 3.5% for defense and 1.5% for defense infrastructure.

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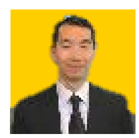

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Another mega force overlaps with these dynamics: artificial intelligence. Tech supremacy has become a national security priority — particularly for the U.S. and China, where AI leadership is seen as critical to both economic advantage and military superiority. AI is expected to revolutionize how militaries around the world organize and operate. Take the use of drones in Ukraine and the Middle East, for example. We think investors can benefit from exposure to defense, meaning companies and industries directly or indirectly involved in products, services or capabilities supporting a country's defense infrastructure. Such exposures can be a source of portfolio resilience, in our view, especially in periods of heightened geopolitical volatility.

Yet we're selective about which geographies and sectors we prefer to express the defense theme. Across regions, we eye opportunities in Europe as defense and infrastructure investment ramps up. Yet we stay selective for now given the over 60% surge in its aerospace and defense sector this year, according to LSEG data. Defense stocks in Japan and Korea look more attractive, in our view. We also favor the U.S.: it spends more than double on defense than Europe, SIPRI data shows. And it is home to the most advanced defense and defense tech firms. Many countries source key systems — especially air and missile defense — from U.S. suppliers. Among sectors, we see opportunities in defense tech. That includes not just AI and software companies, but also IT services and hardware like semiconductors that enable advanced technologies. We think many private companies in defense tech could launch initial public offerings (IPO) in coming years, allowing investors to tap this theme through public markets. We also like space tech, which we think could benefit as strategic competition intensifies.

In private markets, we see both near- and long-term opportunity, especially in infrastructure. Private markets are well suited for the capital-intensive, long-term nature of defense and infrastructure projects. Private markets can also fill in the gaps created by constraints on public funding that make it more difficult to get large infrastructure projects over the line without external funding. That is especially the case as worries about government debt and fiscal deficits mount.

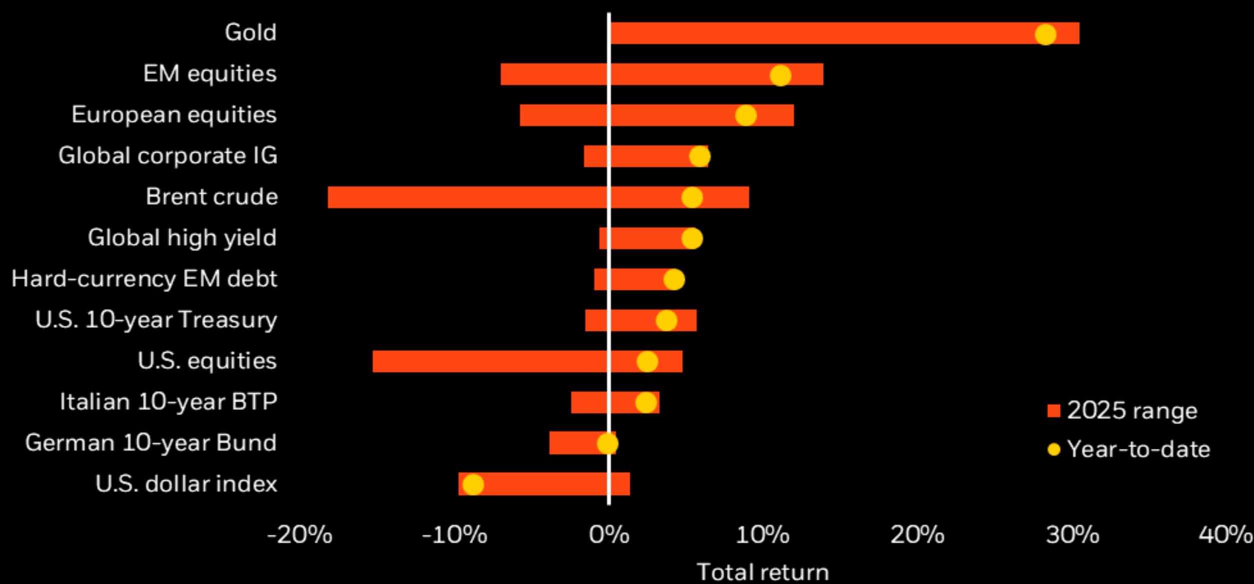
Bottom line: Growing geopolitical fragmentation and strategic competition in AI are reinforcing the global focus on national security and resilience – creating opportunities in defense. But as both mega forces evolve, they call for a selective approach.

Market backdrop

Oil prices added to gains to be up about 10% to near $75 a barrel since June 12 on concerns about potential energy supply disruptions as the conflict between Israel and Iran persisted. Stocks moved sideways, with the S&P 500 ticking down. U.S. 10-year Treasury yields were also mostly steady near 4.40%. The Federal Reserve kept policy rates unchanged, as expected. We still see a tight labor market and the eventual impact of tariffs limiting the Fed's scope to cut rates.

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 June 19, 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

June 23	Global flash PMI	**June 27**	U.S. PCE; Japan unemployment
June 26	U.S. durable goods		

We watch U.S. PCE data for signs of tariffs feeding through to consumer prices. Inflation data has been noisy since the pandemic, with big month-to-month swings making it difficult to draw conclusions. Wage growth has remained elevated, likely preventing inflation from settling at the Federal Reserve's 2% target. We also watch early surveys for June activity to gauge how tariffs are impacting global manufacturing sentiment.

Big calls

Our highest conviction views on six- to 12-month (tactical) and over five-year (strategic) horizons, June 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 short-term inflation-linked bonds over nominal developed market (DM) government bonds, as U.S. tariffs could push up inflation. Within DM government bonds, we favor UK gilts over other regions.
Equity granularity	We favor emerging over developed markets yet get selective in both. Emerging markets (EM) at the cross current of mega forces – like India – 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, June 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, June 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	+1	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	Neutral	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	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 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	Neutral	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	Neutral	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.
Fixed Income	Short U.S. Treasuries	+1	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	-2	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 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	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	-1	We are underweight. Yields have surged, yet stock returns still look more attractive to us.
	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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