Weekly commentary

July 14, 2025

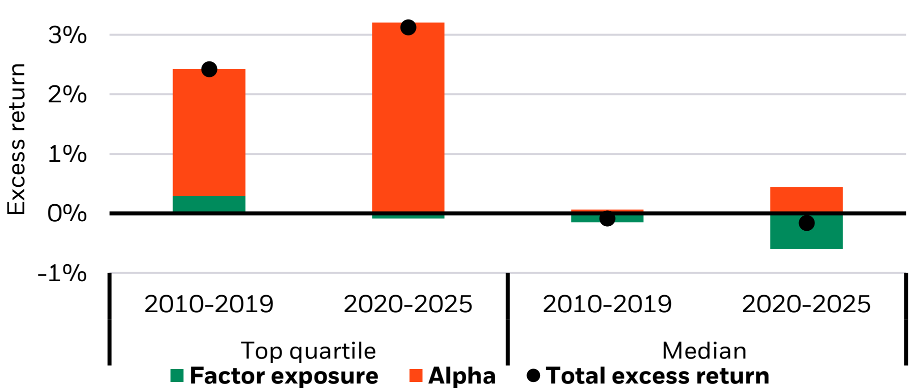
Why now is a great time for alpha

- U.S. tariffs may drive more dispersion in market and security returns, creating yet more opportunity to earn alpha. We stay risk on and overweight U.S. equities.
- U.S. stocks ticked down and European stocks rose 1% last week after the U.S. tariff pause was extended. U.S. 10-year Treasury yields edged higher.
- We're eyeing global inflation data this week. We see early signs of tariff impacts in some parts of U.S. CPI but watch for more price hikes as inventories run out.

The muted market reaction to last week's extension of the U.S. tariff pause shows what we've long argued: immutable economic laws limit how fast the world can change. We stay overweight U.S. stocks, but don't rule out more sharp near-term market moves. Uncertainty on who will bear tariff costs means yet more dispersion in returns – and more opportunity to earn alpha, or above-benchmark returns. Two ways to do so: dynamically managing macro risk and taking security-specific risk.

Greater potential alpha on offer

Three-year excess returns of U.S. equity fund managers, 2010-2025



Past performance is not a reliable indicator of future performance. This information should not be relied upon by the reader as research or investment advice regarding any funds, strategy or security. Source: BlackRock Investment Institute, with data from eVestment and LSEG Datastream, July 2025. Notes: The chart compares the rolling three-year average excess return (into alpha and factor contribution) between 2010-2019 and 2020-2025 – excluding January-June 2020 for both top-quartile and median quartile U.S. large cap equity managers in the eVestment universe. We use regression analysis to estimate the relationship between alpha-seeking manager performance and market conditions. Regression analysis is backwards-looking and is only an estimate of the relationship. The future relationship may differ.

We've long said that immutable economic laws – like supply chains can't be rewired fast without major disruption – will prevent U.S. tariffs rising back to April 2 levels. The extension of the tariff pause to August supports that thesis. Yet wherever tariffs land, it's not yet clear who will bear the cost: companies, consumers or exporters. That uncertainty will heighten already elevated dispersion. Before the pandemic, when the macro environment was more stable, persistent factor exposures – such as to growth, value or inflation – typically didn't hurt portfolios. That's no longer so. For investors, we think this requires watching for unintended static factor exposures and deploying active strategies to capture the additional alpha on offer. Since 2020, top-performing portfolio managers have delivered more alpha. For median managers, static factor exposures now drag more on returns. See the chart.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One way to capture that alpha? Reduce the potential drag from static factor exposures by deliberately managing macro risk. That requires assessing the current macro environment. If your assessment of it changes, it means pivoting quickly. And if it hasn't changed, it means looking through the noise and leaning against sharp market swings – a particularly rewarding strategy this year, as macro fundamentals are little changed so far. In both cases, it is about being decisive about whether to "stick or twist" with current allocations. Our approach now is to "stick." Though the joint drop in U.S. stocks, bonds and the dollar in April spurred questions about the long-term appeal of U.S. assets, we think the current economic setup still supports U.S. outperformance. We've seen volatility in markets, but it hasn't shown up in U.S. earnings. That consistency still counts.

Another approach to capturing alpha: avoiding macro factor risk in favor of security-specific risk. We see the AI mega force continuing to power U.S. earnings growth – yet think some sectors and companies within that theme are positioned to perform better than others. After ChatGPT emerged, virtually any stock aligned with the AI theme got a boost – but now, we're seeing outperformance concentrated among an increasingly small group of companies. The "Magnificent Seven" of mostly big tech companies are expected to post 14.8% growth in the second quarter, versus just 1.9% for other S&P 500 companies. And even within the Mag 7, we're starting to see increased dispersion as certain companies capture the greatest benefits from the AI buildout (the race to build the infrastructure it needs) while others lead the way on AI adoption (with AI packaged into different apps and software). This creates alpha opportunities for those with insight into potential winners.

More broadly, we believe these mega forces are transforming the global economy. But no one yet knows the end state of that transformation. So, it will be key to quickly adapt portfolios – on both the tactical and longer-term, strategic horizon – as we learn more about that future world. Based on what we know now, and applying a granular lens, we like EU and U.S. financials, EU and U.S. industrials as domestic production and defense spending increase and U.S. healthcare given population aging.

Bottom line: U.S. tariffs could intensify already elevated dispersion, making this a more rewarding environment for alpha. Dynamically managing macro risk and taking security-specific risk can help capture it. We eye selective global opportunities.

Market backdrop

The S&P 500 ticked down last week. Tech stocks and U.S.-EU trade deal hopes had briefly driven the index to new highs even after the U.S. tariff pause extension. Europe's Stoxx 600 rose over 1%, near three-month highs. U.S. 10-year Treasury yields ticked up to 4.42% after easing earlier in the week due to a strong bond auction. We're watching the market's ability to absorb heavy bond supply, as the U.S. "Big Beautiful Bill" could widen fiscal deficits and trade tensions could cool foreign demand.

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 July 10, 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), Bloomberg Global High Yield Index, J.P. Morgan EMBI Index, Bloomberg Global Corporate Index and MSCI USA Index.

Week ahead

July 14	China trade balance	**July 16**	UK CPI
July 15	U.S. CPI; China GDP	**July 18**	Japan CPI

This week, we're watching inflation data across the world, focusing on the U.S. Core CPI rose slightly less than expected in May but showed some signs of tariffs feeding through to some consumer prices, like in appliances. We believe most of the impact is yet to come and will build up after companies run through the inventories they imported before tariffs were set.

Big calls

Our highest conviction views on six- to 12-month (tactical) and over five-year (strategic) horizons, July 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.
Using FX to enhance income	FX hedging is now a source of income, especially when hedging euro area bonds back into U.S. dollars. For example, 10-year government bonds in France or Spain offer more income when currency hedged than U.S. investment grade credit, with yields above 5%.
Seeking alpha sources	We identify sources of risk taking to be more deliberate in earning alpha. These include the potential impact of regulatory changes on corporate earnings, spotting crowded positions where markets could snap back and opportunities to provide liquidity during periods of stress.
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, July 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, July 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**		
Equities	United States	+1	We are overweight. Policy-driven volatility and supply-side constraints are pressuring growth, but we see AI supporting corporate earnings. U.S. valuations are backed by stronger earnings and profitability relative to other developed markets.
Equities	Europe	Neutral	We are neutral. Greater unity and a pro-growth agenda across Europe could boost activity, yet we are watching how the bloc tackles its structural challenges before turning more optimistic. We note opportunities in financials and industries tied to defense and infrastructure spending.
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 given the return of inflation and shareholder-friendly corporate reforms. We prefer unhedged exposures as the yen has tended to strengthen during bouts of market stress.
Equities	**Emerging markets**	Neutral	We are neutral. Valuations and domestic policy are supportive. Yet geopolitical tensions and concerns about global growth keep us sidelined for now.
Equities	China	Neutral	We are neutral. Trade policy uncertainty keeps us cautious, and policy stimulus is still limited. We still see structural challenges to China's growth, including an aging population.
Fixed Income	Short U.S. Treasuries	+1	We are overweight. We view short-term Treasuries as akin to cash in our tactical views. We would still lean against the market pricing of multiple Fed rate cuts over the next year.
Fixed Income	Long U.S. Treasuries	-2	We are underweight. Persistent budget deficits and inflation pressures could drive term premium up over the long term, but we see scope for lower yields near term. We prefer intermediate maturities.
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. Yields are attractive, and term premium has risen closer to our expectations relative to U.S. Treasuries. We prefer peripheral bonds such as in Italy and Spain.
Fixed Income	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.
Fixed Income	Japanese govt bonds	-1	We are underweight. We see room for yields to rise further on Bank of Japan rate hikes and a higher global term premium.
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	+1	We are overweight. We find income in agency MBS compelling and prefer them to U.S. Treasuries for high-quality fixed income exposure.
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. We favor Europe over the U.S.
Fixed Income	Global high yield	Neutral	We are neutral. Spreads are tight, but corporate fundamentals are solid. The total income makes it more attractive than IG.
Fixed Income	Asia credit	Neutral	We are neutral. We don't find valuations compelling enough to turn more positive.
Fixed Income	Emerging hard currency	-1	We are underweight. Spreads to U.S. Treasuries are near historical averages. Trade uncertainty has eased, but we find local currency EM debt more attractive.
Fixed Income	Emerging local currency	Neutral	We are neutral. Debt levels for many EMs have improved, and currencies have held up against trade uncertainty. We prefer countries with higher real interest rates.

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