Weekly commentary

BlackRock

December 2, 2024

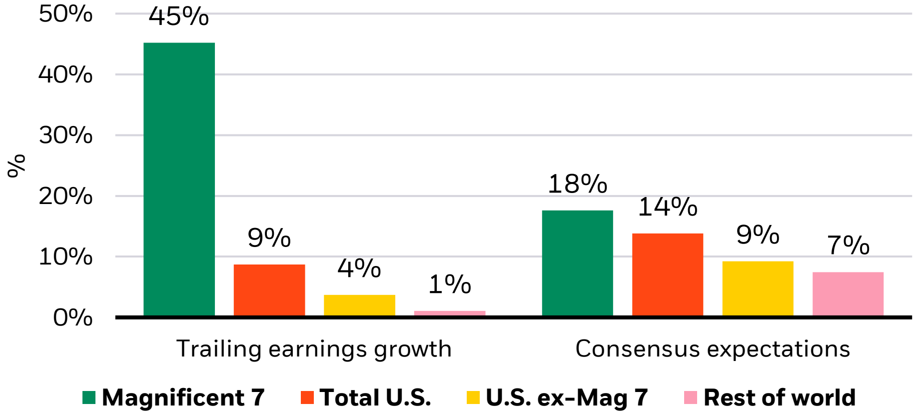
Uneven earnings call for granularity

- We see earnings growth mattering more for equity returns next year over higher valuations. We eye regional earnings themes outside the U.S. and stay selective.
- U.S. stocks hit all-time highs last week, while U.S. bond yields hit one-month lows. European stocks fell on concerns about the fragile French government.
- This week, we get U.S. payrolls for November. The recent subdued pace of job gains suggests elevated immigration may be starting to moderate, in our view.

Expectations for solid corporate earnings drove our U.S. and Japanese equity overweights this year. They have delivered, showing that fundamentals are key. Earnings strength could matter more to equity investors in 2025 over valuations. By contrast, European earnings growth remains soft due to stagnant economic activity. We get granular to find opportunities – like in European financials. We see U.S. earnings strength broadening, largely on the artificial intelligence (AI) theme.

U.S. leads the way

12-month trailing and forward earnings expectations for U.S. versus rest of world



Forward looking estimates may not come to pass. Source: BlackRock Investment Institute, with data from LSEG Datastream, November 2024. Notes: The chart shows 12-month trailing earnings and consensus 12-month forward earnings expectations for the U.S., both including and excluding "magnificent seven" stocks, and the rest of the world ex-U.S. The magnificent seven includes Alphabet, Amazon, Apple, Microsoft, Nvidia, Meta Platforms and Tesla.

Coming into 2024, we favored U.S. and Japanese equities because we expected them to deliver the strongest earnings growth. Both delivered. The U.S. has posted 9% earnings growth in the last 12 months compared with just 1% for the rest of the world, LSEG Datastream data shows. See the chart. U.S. stocks have soared on the AI theme and resilient economic growth. The earnings of "magnificent seven" mostly tech companies have surged 45% in the past year. Japanese companies have achieved 14% earnings growth in yen terms on shareholder-friendly corporate reforms plus the return of mild inflation helping drive corporate pricing power. Consensus expectations are for the U.S. to keep leading on earnings even as they are seen improving globally. We think this varied performance shows why this is not a typical business cycle – and why themes like AI and granular views matter more.

Wei Li
Global Chief Investment Strategist – BlackRock Investment Institute

Bruno Rovelli
Chief Investment Strategist for Italy – BlackRock Investment Institute

Roelof Salomons
Chief Investment Strategist for the Netherlands – BlackRock Investment Institute

Carolina Martinez Arevalo
Portfolio Strategist – BlackRock Investment Institute

Can earnings meet high consensus expectations in 2025? Even if forecasts come down over the course of the year as they tend to, we expect broad-based earnings growth as regions outside the U.S. improve from a low base – but stick with our preferences. In the U.S., the magnificent seven are still expected to drive earnings on the AI mega force – a big, structural shift. Yet their lead should narrow as easing inflation, resilient consumer spending and the prospect of looser regulation fuels sectors beyond tech. As the AI buildout progresses, it creates investment opportunities – and earnings growth potential – in the utilities, industrials, energy and real estate companies providing key AI inputs. We stay overweight U.S. equities as we think risk-on sentiment can persist thanks to the prospect of corporate tax cuts and deregulation.

Japan is another bright spot – and its broad earnings growth has even outpaced the U.S. over the past year. A sunnier macro picture due to inflation's return and shareholder-friendly corporate reforms are reasons for optimism. November's pickup in core inflation is less of a concern given Japan is still only seeing a return of mild inflation. We think a solid domestic outlook can keep driving earnings even as the yen's pickup from recent lows can be a drag. Japan's domestic resurgence could also mitigate the hit from threats like rising U.S. protectionism, in our view. We stay overweight Japanese equities as a result.

In regions with a more challenging outlook, getting granular is key. Europe is still struggling, with Q3 marking just its second straight quarter of earnings growth. Earnings for around half of European sectors are still in decline, LSEG Datastream data shows. Yet we eye selective opportunities like financials, the top performing sector due to higher interest rates. We also like European utilities, one of the few non-U.S. AI beneficiaries. In the UK, we went tactically overweight UK equities earlier this year on attractive valuations and political stability following the Labour Party's landslide victory in the UK election. Yet that hasn't spurred the renewed investor interest in the country we expected, while earnings in the UK are outright contracting.

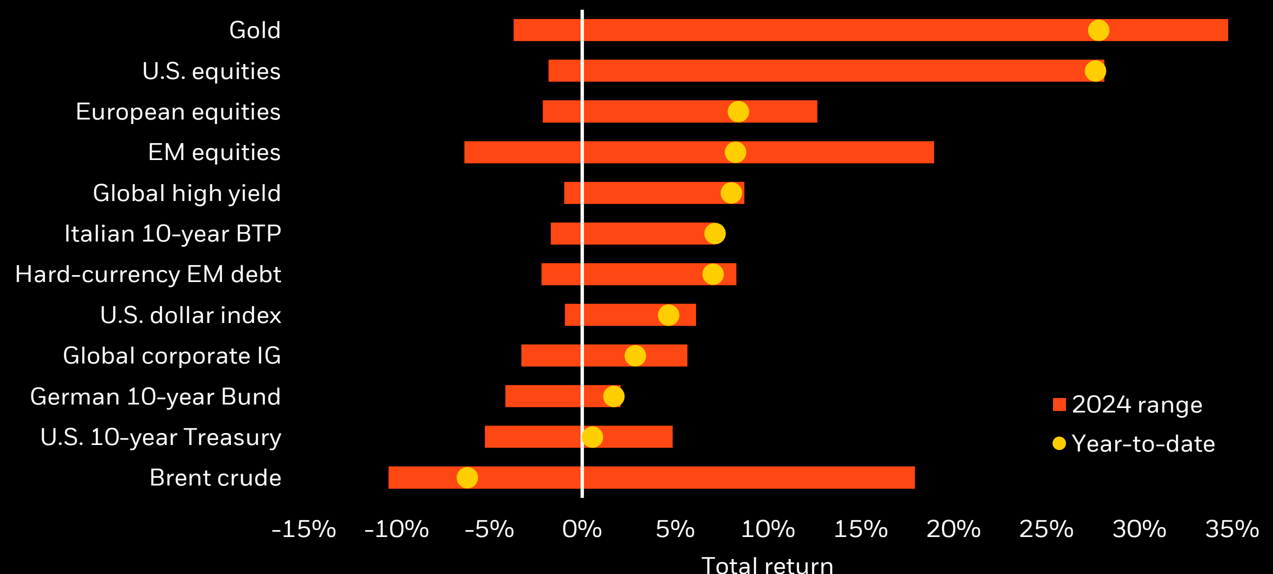
Bottom line: Earnings are delivering on our overweight to U.S. and Japanese equities where we see solid earnings growth holding up. Even with pockets of weakness elsewhere, getting granular reveals opportunities such as in European banks.

Market backdrop

U.S. stocks rose to record highs in holiday-shortened trading last week. European stocks slipped on concerns about the fragile French government losing a confidence vote. The Mexican peso and Canadian dollar fell against the U.S. dollar on worries about potential tariffs. Markets have been moving closer to our view that sticky inflation could limit Fed rate cuts, reinforced by the U.S. PCE data. U.S. 10-year yields hit a one-month low near 4.20%.

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 Nov. 28, 2024. 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

Dec. 2	Euro area unemployment	**Dec. 5**	U.S. trade data
Dec. 3	U.S. job openings	**Dec. 6**	U.S. payrolls

The U.S. payrolls report for November is the key release. We watch for whether job growth rebounds from October's unexpected drop due to weather-related disruptions. The recent path of job creation still supports our view that the labor market remains strong, fueled by elevated immigration. As immigration falls back, we see employment growth dropping to a slower pace than pre-pandemic – reflecting an aging population, rather than weakness in activity.

Big calls

Our highest conviction views on tactical (6-12 month) and strategic (long-term) horizons, December 2024

Tactical	**Reasons**
AI and U.S. equities	We see the AI buildout and adoption creating opportunities across sectors. We get selective, moving toward beneficiaries outside the tech sector. Broad-based earnings growth and a quality tilt make us overweight U.S. stocks overall.
Japanese equities	A brighter outlook for Japan's economy and corporate reforms are driving improved earnings and shareholder returns. Yet the drag on earnings from a stronger yen and some mixed policy signals from the Bank of Japan are risks.
Income in fixed income	The income cushion bonds provide has increased across the board in a higher interest rate environment. We like quality income in short-term credit. We're neutral long-term U.S. Treasuries.
Strategic	**Reasons**
Private markets	We see opportunities in infrastructure equity due to attractive relative valuations and mega forces. For income, we prefer direct lending given more attractive yields than in public credit.
Fixed income granularity	We prefer intermediate credit, which offers similar yields with less interest rate risk than long-dated credit. We also like short-term government bonds, and UK long-term bonds.
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 our outlook.

Note: Views are from a U.S. dollar perspective, December 2024. 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, December 2024

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	+1	We are overweight given our positive view on the AI theme. Valuations for AI beneficiaries are supported as tech companies keep beating high earnings expectations. We think upbeat sentiment can broaden out. Falling inflation is easing pressure on corporate profit margins.
	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	+1	We are overweight. Political stability and a growth pickup could improve investor sentiment, lifting the UK's low valuation relative to other DM stock markets.
	Japan	+1	We are overweight. A brighter outlook for Japan's economy and corporate reforms are driving improved earnings and shareholder returns. Yet the drag on earnings from a stronger yen and some mixed policy signals from the Bank of Japan are risks.
	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 economic growth, but we think stocks are at attractive valuations to DM shares. We stand ready to pivot. We are cautious long term given China's structural challenges.
Fixed Income	Short U.S. Treasuries	-1	We are underweight. We don't think the Fed will cut rates as sharply as markets expect. An aging workforce, persistent budget deficits and the impact of structural shifts like geopolitical fragmentation should keep inflation and policy rates higher over the medium term.
	Long U.S. Treasuries	Neutral	We are neutral. Markets are pricing in sharp Fed rate cuts and term premium is close to zero. We think yields will keep swinging in both directions on incoming data. We prefer intermediate maturities less vulnerable to investors demanding greater 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	Neutral	We are neutral. Market pricing reflects policy rates in line with our expectations and 10-year yields are off their highs. Political uncertainty remains a risk to fiscal sustainability.
	UK gilts	+1	We are overweight. Gilt yields offer attractive income, and we think the Bank of England will cut rates more than the market is pricing given a soft economy.
	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. We prefer Europe over the U.S.
	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	Neutral	We are neutral. Yields have fallen closer to U.S. Treasury yields, and EM central banks look to be turning more cautious after cutting policy rates sharply.

Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index. Note: Views are from a U.S. dollar perspective. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast or guarantee of future results. This information should not be relied upon as investment advice regarding any particular fund, strategy or security.

BlackRock Investment Institute

The BlackRock Investment Institute (BII) leverages the firm's expertise and generates proprietary research to provide insights on macroeconomics, sustainable investing, geopolitics and portfolio construction to help BlackRock's portfolio managers and clients navigate financial markets. BII offers strategic and tactical market views, publications and digital tools that are underpinned by proprietary research.

BlackRock.

Not FDIC Insured • May Lose Value • No Bank Guarantee