

Weekly commentary

May 28, 2024

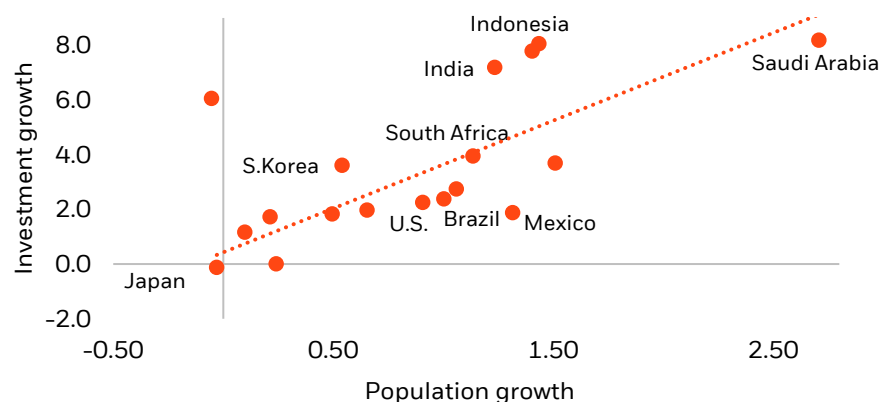
Mega forces: infrastructure required

- Mega forces are creating major infrastructure needs. We find the most investment opportunities today in places where multiple mega forces intersect.
- U.S. stocks were flat near record highs last week, with strong results from one key AI-related company helping buoy the market. U.S. 10-year yields rose.
- We watch April U.S. PCE data this week for any signs that services inflation is easing. We see it running too hot for inflation to fall to the Fed's 2% target.

Infrastructure sits at the intersection of mega forces – the structural shifts driving returns now and in the future. Take artificial intelligence (AI): AI is driving capital spending partly due to technological competition among countries, and the buildout of power-hungry data centers is now affecting the energy transition, too. We stay overweight the AI theme. The rewiring of supply chains benefits countries like India and Mexico. In private markets, we like infrastructure equity strategically.

Investment-demographic link

G20 population and investment growth, 2000-2019



Source: BlackRock Investment Institute, World Bank Development Indicators, UN, with data from Haver, March 2024.

Note: The chart shows the relationship between average population growth and average real investment growth, as measured by the gross fixed capital formation component of GDP, between 2000 and 2019. The chart includes data up to 2019 to avoid the pandemic's distortion of the data.

Demographic divergence – a mega force that most investors don't think about from a capital spending perspective – shapes infrastructure needs across economies. Typically, the faster a population grows, the faster capital investment grows. See the chart. Opportunities arise where investment has not kept up with that growth. Emerging markets (EMs), like Saudi Arabia, will need more capital spending to support their growing working-age populations. In developed markets (DMs), how countries adapt to aging will dictate investment. Many are rolling out measures to help offset stagnating or even shrinking workforces, with countries such as South Korea investing in AI-driven automation. And infrastructure demand could shift away from industries tied to a growing population. We eye potential mispricings as markets can fail to price in even predictable structural shifts – until they hit.



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Digital disruption and AI are already creating a massive and immediate need for power and data center infrastructure. AI-related data center investment could grow 60-100% annually in coming years, according to a mix of forecasters including the International Energy Agency. We don't think broad valuations fully reflect this boom. The investment implications of this buildout extend beyond first-line tech companies – reaching beneficiaries further up the supply chain like utilities, energy, materials, industrial equipment and real estate, as well as those adopting the tech. We are overweight the AI theme broadly.

AI's energy needs could magnify the already massive investment expected in the low-carbon transition. Many mega-cap tech firms doing the largest AI buildouts have net-zero targets – that could drive up demand for renewable energy. Our BlackRock Investment Institute Transition Scenario estimates energy system investment will hit \$3.5 trillion per year this decade – and \$4.5 trillion by the 2040s. Low-carbon investment would then account for up to 80% of energy spending, up from 60% now.

Geopolitical fragmentation is powering infrastructure demand across sectors and countries. Supply chains are becoming more complex as some countries increasingly act as intermediate trading partners. We get granular in EMs, preferring India and Mexico as they benefit from a rewiring of supply chains or companies bringing production closer to home.

We think private markets play an important role in the new regime marked by greater macro uncertainty and higher inflation. We see them bridging the gap between infrastructure needs and what governments can do on their own, given elevated debt levels in many countries coming out of the pandemic. We are overweight infrastructure equity on a strategic horizon of five years and longer. Compared with other pockets of private markets, infrastructure equity has reasonable valuations at higher interest rates, features steady earnings and offers cash flows often linked to inflation in what we expect will be a world of persistently higher inflation. Private markets are complex, with high risk and volatility, and aren't suitable for all investors.

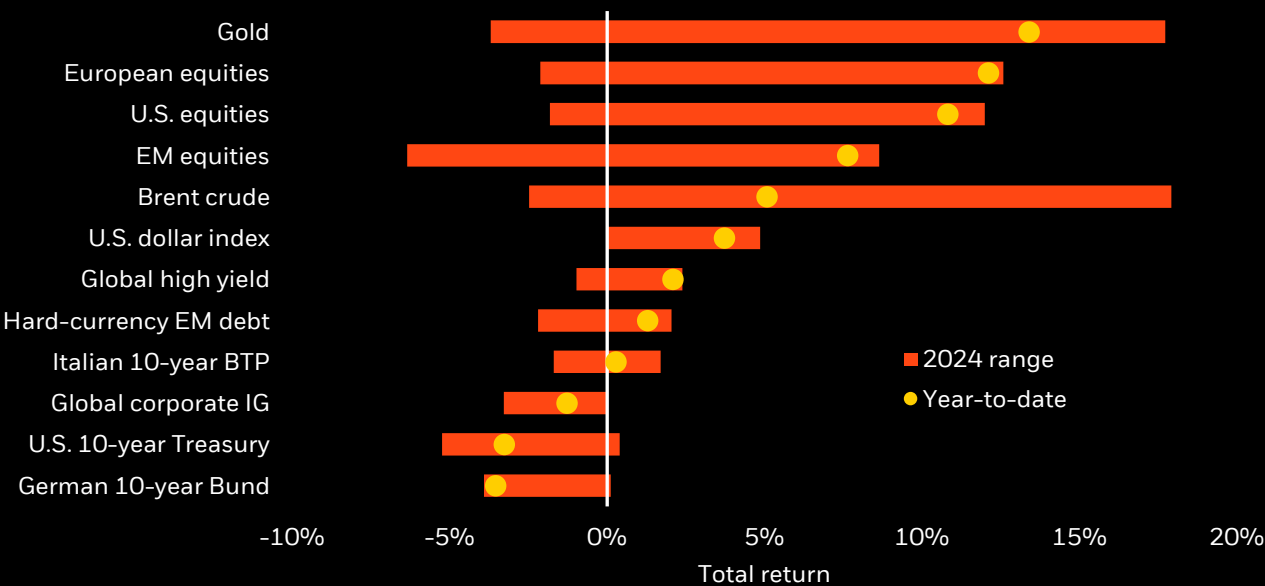
Bottom line: Infrastructure sits at the intersection of mega forces. We stay overweight the AI theme, including beneficiaries of the infrastructure boom on a tactical horizon of six to 12 months. We like infrastructure equity on a strategic horizon.

Market backdrop

U.S. stocks were flat last week near record highs, with upbeat Q1 earnings for one key AI-related company supporting equities. We keep our overweight to the AI theme. Stock market volatility is easing, with the VIX index of S&P 500 implied volatility hitting its lowest levels since 2019. U.S. 10-year Treasury yields ticked up to near 4.45% on a stronger-than-expected services PMI and a drop in weekly jobless claims – but are still down about 30 basis points from this year's highs.

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 May 23, 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

May 28	U.S. consumer confidence survey; Japan service PPI	May 31	U.S. PCE; euro area flash inflation data; China NBS manufacturing PMI
May 30	Euro area unemployment data		

The release of April U.S. PCE data – the Federal Reserve’s preferred measure of inflation – is the main data event this week. We monitor the data for any signs that services inflation is easing. The U.S. CPI data for April showed core goods prices falling further, so recent upside surprises on the PCE measure may be one-offs. Yet services inflation is proving volatile and remains well above a pace consistent with inflation settling at the Fed’s 2% target in the medium term.

Big calls

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

Tactical	Reasons
U.S. equities	<ul style="list-style-type: none">Our macro view has us neutral at the benchmark level. But the AI theme and its potential to generate alpha – or above-benchmark returns – push us to be overweight overall.
Income in fixed income	<ul style="list-style-type: none">The income cushion bonds provide has increased across the board in a higher rate environment. We like short-term bonds and are now neutral long-term U.S. Treasuries as we see two-way risks ahead.
Geographic granularity	<ul style="list-style-type: none">We favor getting granular by geography and like Japan equities in DM. Within EM, we like India and Mexico as beneficiaries of mega forces even as relative valuations appear rich.
Strategic	Reasons
Private credit	<ul style="list-style-type: none">We think private credit is going to earn lending share as banks retreat – and at attractive returns relative to public credit risk.
Inflation-linked bonds	<ul style="list-style-type: none">We see inflation staying closer to 3% in the new regime on a strategic horizon.
Short- and medium-term bonds	<ul style="list-style-type: none">We overall prefer short-term bonds over long term. That’s due to more uncertain and volatile inflation, heightened bond market volatility and weaker investor demand.

Note: Views are from a U.S. dollar perspective, May 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 that 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, May 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	Benchmark	<div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div></div> <div>Neutral</div>	We are neutral in our largest portfolio allocation. Falling inflation and coming Fed rate cuts can underpin the rally’s momentum. We are ready to pivot once the market narrative shifts.
		Overall	<div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div></div> <div>+1</div>	We are overweight overall when incorporating our U.S.-centric positive view on artificial intelligence (AI). We think AI beneficiaries can still gain while earnings growth looks robust.
	Europe	<div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div></div> <div>-1</div>	We are underweight. While valuations look fair to us, we think the near-term growth and earnings outlook remain less attractive than in the U.S. and Japan – our preferred markets.	
	UK	<div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div></div> <div>Neutral</div>	We are neutral. We find attractive valuations better reflect the weak growth outlook and the Bank of England’s sharp rate hikes to fight sticky inflation.	
	Japan	<div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div></div> <div>+2</div>	We are overweight. Mild inflation and shareholder-friendly reforms are positives. We see the BOJ policy shift as a normalization, not a shift to tightening.	
	Emerging markets			
	China	<div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div></div> <div>Neutral</div>	We are neutral. We see growth on a weaker trajectory and see only limited policy stimulus from China. We prefer EM debt over equity.	
	Fixed Income	Short U.S. Treasuries	<div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div></div> <div>+1</div>	We are overweight. We prefer short-term government bonds for income as interest rates stay higher for longer
		Long U.S. Treasuries	<div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div></div> <div>Neutral</div>	We are neutral. The yield surge driven by expected policy rates has likely peaked. We now see about equal odds that long-term yields swing in either direction.
U.S. inflation-linked bonds		<div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div></div> <div>Neutral</div>	We are neutral. We see higher medium-term inflation, but cooling inflation and growth may matter more near term.	
Euro area inflation-linked bonds		<div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div></div> <div>Neutral</div>	We are neutral. Market expectations for persistent inflation in the euro area have come down.	
Euro area govt bonds		<div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div></div> <div>Neutral</div>	We are neutral. Market pricing reflects policy rates in line with our expectations and 10-year yields are off their highs. Widening peripheral bond spreads remain a risk.	
UK gilts		<div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div></div> <div>Neutral</div>	We are neutral. Gilt yields have compressed relative to U.S. Treasuries. Markets are pricing in Bank of England policy rates closer to our expectations.	
Japanese govt bonds		<div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div></div> <div>-2</div>	We are underweight. We find more attractive returns in equities. We see some of the least attractive returns in Japanese government bonds, so we use them as a funding source.	
China govt bonds		<div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div></div> <div>Neutral</div>	We are neutral. Bonds are supported by looser policy. Yet we find yields more attractive in short-term DM paper.	
U.S. agency MBS		<div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div></div> <div>Neutral</div>	We are neutral. We see agency MBS as a high-quality exposure in a diversified bond allocation and prefer it to IG.	
Global IG credit		<div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div></div> <div>-1</div>	We are underweight. Tight spreads don’t compensate for the expected hit to corporate balance sheets from rate hikes, in our view. We prefer Europe over the U.S.	
Global high yield		<div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div></div> <div>Neutral</div>	We are neutral. Spreads are tight, but we like its high total yield and potential near-term rallies. We prefer Europe.	
Asia credit		<div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div></div> <div>Neutral</div>	We are neutral. We don’t find valuations compelling enough to turn more positive.	
Emerging hard currency		<div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div></div> <div>+1</div>	We are overweight. We prefer EM hard currency debt due to its relative value and quality. It is also cushioned from weakening local currencies as EM central banks cut policy rates.	
Emerging local currency		<div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div><div></div></div> <div>Neutral</div>	We are neutral. Yields have fallen closer to U.S. Treasury yields. Central bank rate cuts could hurt EM currencies, dragging on potential returns.	

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