

Weekly commentary

June 24, 2024

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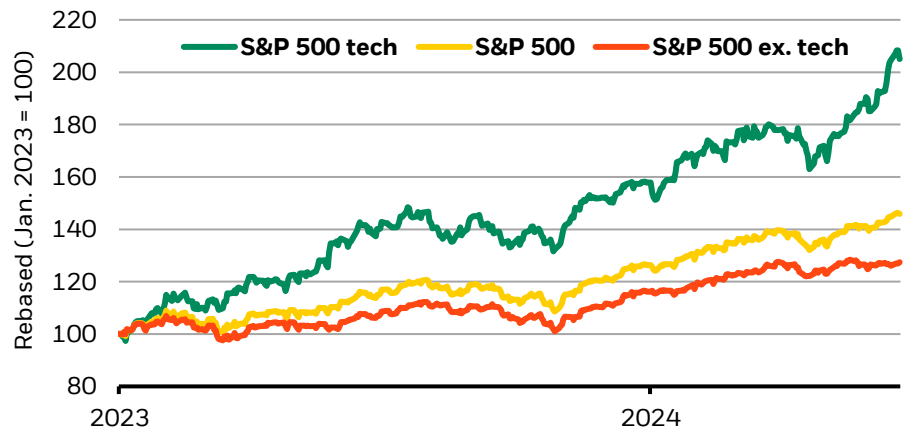
Sticking with U.S. tech surge

- We see a small group of tech winners leading stock gains as a feature of the artificial intelligence (AI) theme – not a flaw. We stay overweight U.S. stocks.
- The S&P 500 notched a fresh all-time high last week, led by tech stocks. U.S. 10-year Treasury yields held steady near 4.25% during the holiday-shortened week.
- We're eyeing to what extent U.S. PCE inflation for May shows a slowing of services inflation after upside surprises earlier in the year.

U.S. stocks have climbed to all-time highs thanks to the technology sector. We're less concerned than some in the market about the small group of tech stocks driving gains. Why? First, excitement over AI is being met by tech firms delivering on and beating high earnings expectations. Second, profit margins for tech are leading the market, but they're also recovering in other sectors as cooling inflation eases costs pressures on margins. We stay overweight U.S. stocks on the AI theme.

Tech strength rolls on

S&P 500 performance, tech vs. the rest, 2023-2024



Past performance is no guarantee of future results. Index returns do not account for fees. It is not possible to invest directly in an index. Source: BlackRock Investment Institute, with data from LSEG Datastream, June 2024. Notes: The chart shows the index performance for the S&P 500, for the information technology (IT) sector of the S&P 500 and the S&P 500 excluding the IT sector. The data has been rebased so that January 2023 = 100.

We think strong gains for tech stocks have been fueled by market focus on AI and investors preferring quality given high macro and market uncertainty. The sector is up 30% this year, nearly four times higher than the rest of the S&P 500, according to LSEG Datastream data. See the green and orange lines in the chart. Looking back to 2023, tech's dominance is even clearer: The sector has soared 100% since then, while the rest of the index rose 24%. AI has helped drive that outperformance by brightening corporate earnings for tech firms. Analysts expect they'll rise 20% in the next 12 months – well above forecasts for the rest of the market. Tech firms have so far delivered on lofty expectations: Their earnings grew 23% year over year in Q1. In a world where mega forces – big structural shifts – drive returns now and in the future, we eye the short- and long-term impacts of AI on earnings.



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Strong balance sheets are also a reason we like tech, and we are less concerned about valuation metrics. Free cash flows – excluding operational costs – as a share of sales are nearly double for tech than for the broader market, and tech has the largest profit margins across sectors, LSEG Datastream data show. Plus, many top tech names are highly profitable and cash-flush, allowing them to fund the buildout of AI infrastructure such as data centers. A search for such quality may have spurred investors to flock to U.S. stocks even more in recent weeks as their European counterparts have retreated. Much of the slide in European stocks came after the results of the [European Union elections](#) and news of a snap election in France.

U.S. tech strength is overshadowing gains that are broadening out to other sectors – up about 8% so far this year. Eight of 11 of the S&P 500 sectors saw higher margins in Q1 versus the same period last year. The reason: support from nominal GDP growth that looks set to remain above the pre-pandemic average due to higher inflation. That outlook seems likely even as the pace of real, or inflation-adjusted, growth slows. Inflation falling from its pandemic peaks – though remaining high – has eased pressure on margins by lowering costs. Guided by mega forces, we see sectoral opportunities as risk appetite broadens out. We still favor healthcare given support from recovering earnings, drug innovation and aging populations. We also like the industrial sector because it will help build out the infrastructure needed for AI and the low-carbon transition. Supply chains rewiring along geopolitical lines will also affect the sector as companies and countries bring production closer to home.

What could halt the climb in tech stocks? Markets could lose favor for the sector if hopes for AI are dampened, such as if they feel corporate spending on AI hasn't paid off in a boost to earnings or margins. Any regulatory changes limiting adoption could also affect AI's potential to keep supporting tech. In a less likely scenario, other sectors could jump ahead of tech if growth accelerates, and inflation falls enough to allow the Federal Reserve to cut interest rates more than expected.

Bottom line: The concentration in U.S. tech stocks is a feature, not a flaw, of the AI theme. We stay overweight U.S. stocks on a six- to 12-month, tactical horizon and still prefer the AI theme. We like industrials and healthcare as stock gains broaden.

Market backdrop

The S&P 500 notched a fresh all-time high last week, led by tech stocks. U.S. 10-year Treasury yields held steady near 4.25% during the holiday-shortened week. Since France's snap parliamentary election was announced, spreads of 10-year French government bond yields over German bunds have hovered near their widest levels since the euro area crisis. The Bank of England left rates unchanged – but we think it will likely start rate cuts in August after the early July election.

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 20, 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

June 25	U.S. consumer confidence	June 28	U.S. PCE; Japan unemployment data
June 27	U.S. durable goods	June 30	China NBS manufacturing PMI

We’re eyeing May U.S. PCE data – the Fed’s preferred inflation measure – for signs that services inflation is easing. Cooler-than-expected U.S. CPI data for May showed falling core goods prices. But sticky services prices mean inflation will continue to outpace the Fed’s 2% goal in the medium term.

Big calls

Our highest conviction views on tactical (6-12 month) and strategic (long-term) horizons, June 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 stocks 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.
Fixed income granularity	<ul style="list-style-type: none">We prefer inflation-linked bonds as we see inflation closer to 3% on a strategic horizon. We also like short-term government bonds, and the UK stands out for long-term bonds.
Equity granularity	<ul style="list-style-type: none">We favor emerging over developed markets yet get selective in both. EMs at the cross current of mega forces – like Mexico, 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, June 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.

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