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# Stock market monitor

Q4 2024 equity market outlook from BlackRock Fundamental Equities

**Opportunities beyond AI.** We retain conviction in artificial intelligence (AI) as a theme that will shape markets for many years to come. Yet we also believe market leadership may continue to broaden out in the near term, providing a greater pool of companies from which winners may emerge. As we enter Q4 we see:

**A positive yet volatile picture for equities with broadening market leadership**

**Resilient earnings for structural winners within AI and healthcare**

**Short- and long-term reasons to consider infrastructure stocks**



**Helen Jewell**

Chief Investment Officer, BlackRock Fundamental Equities, EMEA

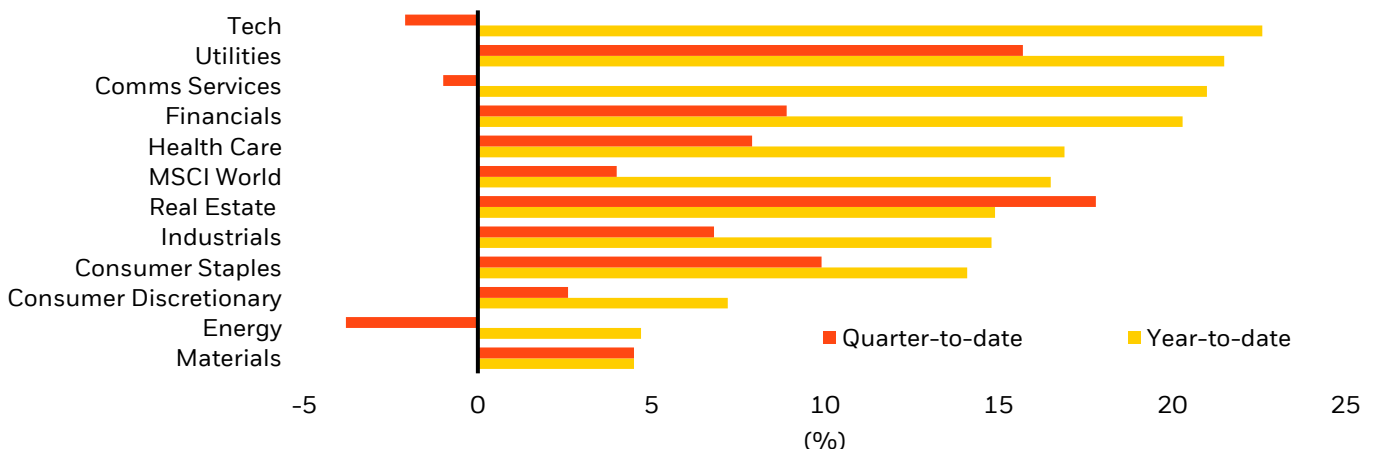
The third quarter of 2024 was tumultuous. Even though overall market levels remained relatively flat, we saw volatility and rotations from cyclical stocks into more defensive names, particularly in Europe. This turbulence was caused by recession fears combined with concerns around whether vast investments in AI will take longer to generate returns than expected. We believe central bank rate cuts are likely to create a supportive environment for equities as 2024 draws to a close – but the same worries around recession and AI may result in more volatility and further broadening in market leadership as investors seek to diversify portfolios.

Sectors such as financials and utilities rose up the performance rankings as global market leadership extended beyond tech in the third quarter. See the chart below. And more than 60% of European stocks have outperformed the benchmark over the past six months – the highest for any six-month period in 20 years.<sup>1</sup> Central bank rate cuts and further volatility may be the catalyst for this broadening to continue, in our view, so we see opportunities in the kinds of companies that may benefit from lower rates. We also believe it's sensible to stick with “structural winners” – companies that have long-term earnings resilience linked to forces of change – amid potential volatility. We explore both of these areas on the next page.

“Some parts of the market were priced for perfection, but now they are priced for a range of outcomes – which is normal.”

**A broader set of leaders**

Global sector performance in 2024



Source: BlackRock Investment Institute, Sept. 17, 2024. The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.

<sup>1</sup> Morgan Stanley, September. 2024.

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# Rate-cut beneficiaries and structural winners

## Rate-cut rebounds

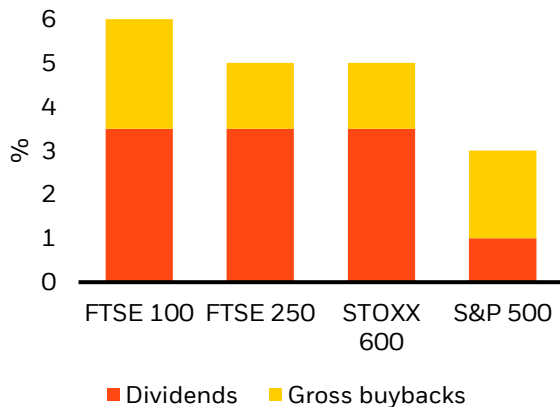
One reason we believe that developed markets should avoid major recessions in the next 12 months is that inflation pressure has subsided and central banks can continue to cut rates. Areas heavily impacted by borrowing costs and mortgage rates, such as construction and housing, are well placed for a rebound, in our view. Some recent earnings calls in these sectors highlight green shoots of activity in both the U.S. and parts of Europe, including areas such as the Nordics where construction was severely impacted by higher rates. We see opportunities in the UK as political stability and a policy focus on housebuilding should support companies in these areas. And within the UK and Europe, small- and medium-sized companies remain attractive given their cheap valuations and a propensity to benefit from falling rates.

Companies that offer stable sources of income are also set for a period of popularity, in our view, as this income becomes more attractive relative to declining bond yields. This is another reason we believe the UK is worth a look – the FTSE 100 has a current shareholder yield (dividends plus buybacks) of 6%, versus 3% for the S&P 500. See chart. The sectors known for stable income include healthcare (see below) and utilities (see page 3).

Finally, a word on banks. Higher rates mean they can charge more interest on loans. Yet we believe earnings should remain supported even as rates fall – because we don't see a near-term return to zero or negative rates. In Europe, we believe rates may eventually settle at around 2%. European banks remain historically cheap, and some of them plan to return 40%-50% of their total market cap to shareholders over the next three years.<sup>2</sup>

## Regional cash returns

Current shareholder yield for global indices



Source: Goldman Sachs Global Investment Research, September 2024

<sup>2</sup> Fundamental Equities Analysis, September 2024

<sup>3</sup> Goldman Sachs, April 2024

<sup>4</sup> Fundamental Equities, using data from: FactSet, BlackRock - Risk & Quantitative Analysis, August 31, 2024

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## Set for structural success

We remain enthusiastic about the earnings of large technology and semiconductor companies that profit from the spending on AI. High valuations in places mean that volatility is likely, but this may provide attractive entry points for investors. There are also companies in more cyclical areas of the market, such as construction and industrials, that could benefit from falling rates as well as long-term support from forces such as a transition to a low-carbon economy. This emphasizes the importance of selectivity. There's a clear divide between those companies that have exposure to energy efficiency, electrification, data centre demand and automation, and those that don't – and are therefore more vulnerable to an economic slowdown.

## How about healthcare?

One sector we believe is particularly well suited to the current environment is healthcare. In addition to the stable income on offer, we see three reasons to consider the sector:

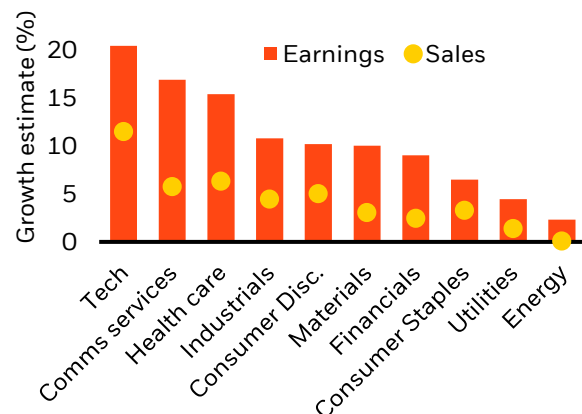
**1) Innovation.** Obesity medications are now one of the most significant trends in healthcare, and could be worth more than \$100 billion in sales in the U.S. by 2030.<sup>3</sup> We are seeing an increasing number of pharmaceutical companies developing drugs in both early and late-stage trials. There is also rapid innovation in atrial fibrillation treatments and oncology drugs.

**2) Structural demand.** The percentage of the global population aged 65 and above is expected to rise from 10% in 2022 to 16% in 2050, according to the United Nations this year. We believe this underpins earnings for the sector over the long term, and adds resilience through market cycles or periods of geopolitical tension.

**3) Cyclical recovery.** Companies that benefited from COVID-related demand – such as vaccine makers – faced difficult year-over-year comparisons in 2023 as the pandemic ended, resulting in negative earnings growth. Many of these companies are now establishing new earnings baselines while demonstrating healthy fundamentals in businesses unrelated to COVID. And those companies hit by delayed procedures and supply chain constraints during COVID continue to recover. As a result, healthcare earnings are expected to lead most sectors over the next 12 months (see chart), while the sector is available at a 5% discount global stocks.<sup>4</sup>

## Tech and healthcare well placed to deliver

Global sector 12 month forward earnings estimates



Source: BlackRock Investment Institute, Sept. 2024. Forecasts may not come to pass. Any opinions or forecasts represent an assessment of the market environment at a specific time and is not a guarantee of future results. This information should not be relied upon by the reader as research, investment advice or a recommendation.

# A spotlight on infrastructure

Infrastructure is the physical backbone of any economy. Assets within the sector include electric and gas transmission and distribution lines, toll roads, railroads, airports, power plants, oil and gas pipelines, cell towers and data centres. In the near-term, we believe the sector's valuation may benefit from a decline in interest rates. And over the longer term infrastructure assets may benefit from several structural tailwinds, in our view.

## Short-term momentum

Our analysis indicates that infrastructure stock valuations are inversely correlated to bond yields.<sup>5</sup> Infrastructure securities are often capital intensive and a significant amount of equity value is driven by long-term cash flows. And given these highly visible cash flows, income investors are drawn to infrastructure. As a result, moderating inflation and a more benign interest rate backdrop are positives for the sector.

Yet infrastructure sector valuations remain discounted versus global stocks — currently at levels comparable with those during the Global Financial Crisis.<sup>6</sup> We believe this represents an attractive entry point for investors.

## Long-term support - the four Ds

The long-term case for infrastructure is encapsulated by the four Ds:

### Digitalisation

The training and developing of AI tools requires significant computational power and data storage. This makes data centres one of the fastest growing infrastructure asset classes. We also expect utilities to benefit from a rise in electricity needs driven in part by the increased power demand from AI data centres. It is estimated that U.S. and European electricity demand will grow at a 2.4% and 3.6% compound annual growth rate through 2030 and 2033, respectively.<sup>7</sup>

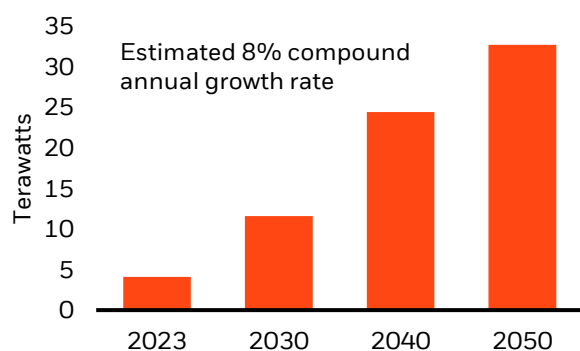
Growth in 5G technology and greater mobile penetration, particularly in emerging markets, is resulting in a significant increase in wireless data demand. We expect an acceleration in the investment needs of mobile cellular carriers, which may benefit cell tower infrastructure operators.

### Decarbonisation

Utilities can facilitate the decarbonisation of power generation. The sector's investment in renewable energy may result in significant long-term earnings growth. The left chart below shows how much renewable energy may grow by 2050. The electrification of various fossil-fuel powered processes (such as oil drilling and driving) is

### A renewables roll-out

Global renewable energy installed capacity, 2023-2050



also supportive of electric utility growth. In addition, the expansion of grid infrastructure is pivotal to the low-carbon transition. Grid investment may have to double to over \$600 billion per year to hit net zero emissions by 2050. See the right chart below.

### Deglobalisation

The pandemic exposed the fragility of global supply chains. Rising geopolitical tensions added to the pressure for countries to bring networks closer to home. This realignment in global commerce is contributing to the need for more infrastructure. New production capacity and transportation networks need to be built. The shift toward regionalisation will require a range of infrastructure projects, from highways, ports and railways to new logistics hubs. The expansion of domestic manufacturing capacity may also increase the utilisation of existing infrastructure assets, including utility power plants, transmission and distribution lines, railroads and gas pipelines.

### Demographics

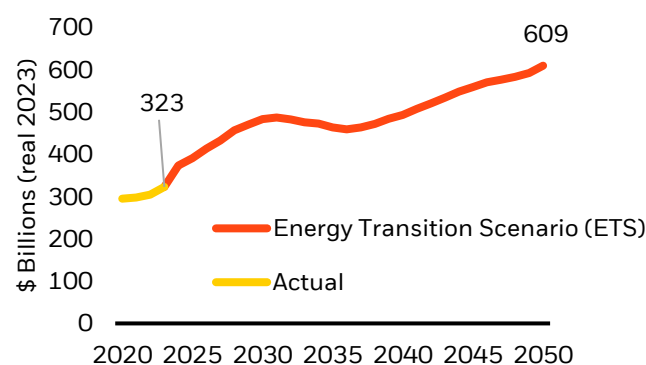
According to the United Nations, the global population will increase to 9.7 billion people by 2050, up from 8 billion in 2022. This may require urban expansion, more electricity, more telecoms networks and water and sanitation systems. Transportation infrastructure outside of cities including airports, ports, toll roads and railroad networks will also need to be expanded. These growing infrastructure needs are supportive of the long-term earnings and cash flow growth in the sector.

We believe these short- and long-term shifts can be supportive of infrastructure sector outperformance. Yet a selective approach is key. Infrastructure assets are governed by regulations that differ across geographies. And the economic activity that drives infrastructure investment will differ across regions. We believe skilled active managers who can identify the stocks that will benefit the most from these regional dynamics can more consistently achieve above-market returns.

**Balfe Morrison, portfolio manager on the Global Real Assets team, contributed to this report.**

### Grid investment set to soar

Estimated global annual grid investment, 2020-2050



Source: BloombergNEF Energy Outlook, May 2024. Left chart: Forecasts may not come to pass. Right chart: In USD on a real basis, which takes inflation into consideration. Forecasts/estimates may not come to pass. Any opinions or forecasts represent an assessment of the market environment at a specific time and is not a guarantee of future results. This information should not be relied upon by the reader as research, investment advice or a recommendation.

<sup>5</sup> BlackRock Fundamental Equities, July 2024 <sup>6</sup> BlackRock Fundamental Equities, Sept 2024 <sup>7</sup> Goldman Sachs Investment Research, April 2024

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