BlackRock

Turning views into action

Three themes for winter 2025

Capital at risk. The value of investments and the income from them can fall as well as rise and are not guaranteed. Investors may not get back the amount originally invested.

Updates to our investment outlook are underpinned by two key principles. Firstly, investing is all about the long term, so we try to identify opportunities that we think can stand the test of time. Secondly, however, we need to stay alert to opportunities and risks that might develop, and adapt our outlook accordingly. Below, we outline how our existing investment themes have evolved, and introduce some new ideas to position portfolios for today's markets.

> **We expect the US economy to remain at the fore of global growth and US stocks to continue driving investor sentiment in 2025. Tech stocks have been in the limelight and we think they'll continue to benefit from strong earnings growth, partly due to the artificial intelligence (AI) mega force. But we're also seeing earnings improve across other sectors, leading us to broaden our US stock exposure. Meanwhile, sticky inflation means that central banks haven't cut interest rates very far, so investors can still earn relatively attractive levels of income from government bonds.**

Karim Chedid
Head of EMEA Investment Strategy, BlackRock Global Product Solutions

Our investment themes for winter 2025:

1. US still at the fore

The US stock market drove investor sentiment last year and we expect this to continue in 2025. While we still see opportunities among the tech companies that have dominated US stocks, earnings strength expanding to other sectors means we also look at equal weight indices for broader exposure to US firms.

2. Bonds for income

Central banks have started to cut interest rates, but they remain high relative to historical levels. This means investors can still find attractive income in government bonds, such as UK gilts. We introduce 'duration' into our bond view, highlighting relatively attractive opportunities in shorter duration bonds.

3. AI: the next leg

We see room to run for the tech companies at the forefront of the AI buildout, including companies developing semiconductors, data centres, AI models and the power systems that support them. We also look to the companies that could be set to benefit from the next stage of its evolution – particularly those adopting the technology to improve efficiency and potentially their earnings.

1. US still at the fore

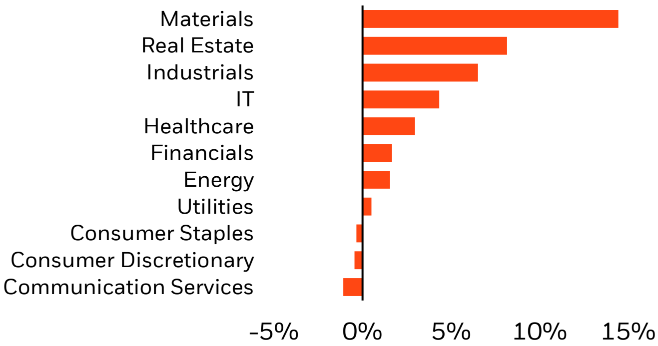
Our first theme remains centred on the US and the relative strength of its economy and stock market. As we think about investing for the long term, we believe US stocks offer opportunities that could stand the test of time. In our last update, we noted that US corporate earnings growth had started to broaden out after largely being driven by early AI winners over the past couple of years. We still like US tech companies (see theme 3). Yet with the trend of broadening earnings strength gathering pace, we see opportunity to balance tech sector allocations with increased exposure to other sectors, via equal-weight US stock market indices.

In indices such as the S&P 500 and FTSE 100, the 'weight' of a company – that is, the proportion of the index that it accounts for – is based on its valuation, otherwise known as its 'market capitalisation'. This means that very large, valuable companies account for a larger share and can have a greater influence on the performance of the 'market-capitalisation-weighted' index. For example, the five largest companies in the S&P 500 account for a total of 26.6% of the index,[1] hence changes in their share prices can significantly impact returns.

[1] Source: Bloomberg, as of 16 January 2025.

In the S&P 500 Equal Weight Index, all 500 stocks have the same weight (equal to 0.2% of the index). Therefore, the five largest companies account for a total of just 1% of the equal-weight index and the other 495 companies account for 99%, up from 73.4% in the S&P 500. As a result, the equal-weight index can give more exposure to companies and sectors beyond the giant tech firms that tend to dominate the S&P 500 – so it's more likely to benefit if earnings continue to improve in other sectors.

Chart 1: US tech has driven recent corporate earnings growth, but other sectors are starting to contribute
Change in 12-month forward earnings per share forecasts for US sectors, January 2025 minus January 2024

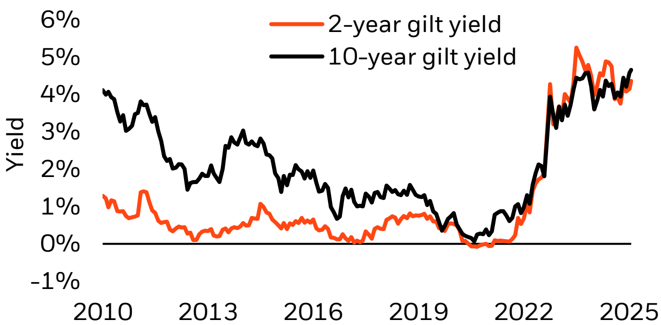


Source: LSEG Datastream, MSCI and BlackRock Investment Institute, as of 31 December 2024.

2. Bonds for income

Our second theme is also an evolution of an existing story, about the opportunity in bonds. Developed market (DM) central banks, such as the Bank of England, started cutting interest rates in 2024. However, because inflation has remained sticky, they haven't lowered interest rates very far, meaning they're still quite high compared to recent years. That means investors can still earn attractive levels of interest from bonds issued by DM governments, such as UK gilts. These bonds also tend to be relatively low risk, because these governments usually have a good track record of repaying interest when it's due and repaying the value of the bond when it matures.

Chart 2: the gap between 2-year and 10-year UK gilt yields has narrowed
2-year and 10-year gilt yields, 2010-2025



Source: LSEG Datastream and BlackRock Investment Institute, as of 20 January 2025.

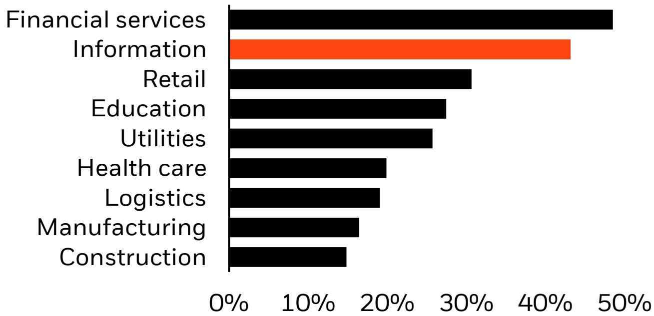
We introduce another element to our bond view, which is 'duration'. The greater the length of time until a bond matures, the longer its duration, and the higher the uncertainty around interest rates, economic growth and various other factors that could impact the value of the bond. Investors therefore tend to view long duration bonds as higher risk than short duration bonds, and they usually demand a higher interest rate, or 'yield', for taking on this additional risk. However, the difference in yield between short duration and long duration UK gilts is currently quite small, making short duration gilts relatively attractive for investors seeking income with minimal risk.

3. AI: the next leg

In our third theme, we look to take advantage of developing trends, in particular AI and the companies that could be set to benefit from the next stage of its evolution. This is about staying alert to opportunities and risks that might develop and adapting our outlook accordingly. We still see significant potential for the companies involved in what we call the buildout of AI – that is, those developing semiconductors, data centres, AI models and the power systems that support them. We also look ahead to the adoption phase and the companies that could benefit from using AI to potentially improve efficiency, lower costs, increase revenues and grow profit margins, or from rolling out AI-powered applications and services.

Some of the most significant beneficiaries of the AI mega force so far have been US-based tech companies, many of which have seen their earnings rise sharply over the past couple of years. Some investors are questioning whether this trend has further to go, or whether these stocks now look too expensive. We lean towards the former view, given that AI is still such a nascent technology with significant longer-term potential. We believe there's still plenty of room to run for companies at the cutting edge of this mega force. As we look for companies that could benefit from the adoption phase outlined above, we find that many of them are also in the technology sector, which increases our conviction.

Chart 3: Information-related industries – including IT – are set to be key beneficiaries of AI adoption
Share of tasks where AI may halve the time taken



Source: BlackRock Investment Institute, Eloundou et al (2023), November 2024. Note: The chart uses industry-level AI exposure measure from Eloundou et al (2023) defined as the average share of tasks where access to a large language model (LLM) or LLM-powered system would reduce the time required for a human to perform a specific task by 50%. We group their results into 2-digit North American Industry Classification System industry groups and show a selection of most and least exposed industries.

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