2025 Midyear Global Outlook

Getting a grip on uncertainty

BlackRock

BlackRock **Investment** Institute

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Mega forces, like geopolitical fragmentation, are transforming the world. Elevated policy uncertainty is a manifestation of this more volatile macro regime. In Europe, the loss of long-term “macro anchors” is triggering big policy responses, like a surge in infrastructure and defense spending. We see positive momentum in Europe, but it can’t change from a structural underperformer to an outperformer overnight. We are neutral European equities but see many selective opportunities. We generally prefer Europe’s fixed income assets, including credit, to other geographies

We have long believed we are in a new macro regime shaped by supply as mega forces – or big structural shifts like the rise of artificial intelligence and geopolitical fragmentation – transform economies. This transformation has uprooted long-term “macro anchors” like stable inflation and predictable growth. In Europe, acute shocks from the pandemic and the Ukraine war are fading, but rapid technological transformation, geopolitical fragmentation and aging populations are still shaping the region. In a world where structural volatility has replaced cyclical predictability, mega forces offer the clearest guideposts to the future, we think. Europe is at the intersection of several mega forces. Sudden U.S. policy shifts have created unease in Europe, but also a sense of urgency and realization that the European growth model of past decades needs reform. Cheap energy is a thing of the past. Global demand for its exports (mostly from the U.S. and China) is waning. And it faces more competition in traditional manufacturing. That has led to major policy action targeting both supply and demand. Example: defense and related infrastructure spending is rising across Europe. Germany has de facto paused its debt brake by exempting defence spend above 1% of GDP and has approved a €500 billion infrastructure package over 12 years

This is a positive development as it addresses decades of underinvestment in fostering medium-term growth - but the key for Europe is whether it can revive competitiveness and boost productivity growth. This part of the pro-growth agenda is reliant on supply-side reforms and completion of the EU architecture. While the European institutions are fully alert to these challenges, it is still unclear to what extent the EU Commission will be able to introduce some of the reforms laid out in the Draghi and Letta reports of 2024.

Growth across the bloc has been quite uneven in recent years: Germany has been broadly stagnating, while Spain and Greece have been growing at a brisk pace. We think that could become more even going forward. Inflation has fallen close to the ECB’s 2% target, allowing it to cut policy rates to make monetary policy less restrictive. We expect policy rates to settle at, or slightly below, 2% as stronger exchange rates and lower energy prices could help inflation slow further. The ongoing recovery in real wages, record low unemployment and high saving rates (still close to record levels of around 15%) should support consumer spending and enable European economic growth to pick up in 2026.

Our macro and policy outlook, combined with current valuations, translate into a general preference for fixed income assets in Europe over other geographies. Fiscal expansion is concentrated in countries with the most fiscal space, like Germany, so we don't see it destabilizing European bond markets. And we do see upward pressure on U.S. and Japanese government bond yields: in the U.S. as investors demand more term premium, or compensation for the risk of holding long-term bonds, and in Japan as policy and inflation normalizes. Overall, we are neutral euro government bonds and tilt towards the periphery over the core given better growth and rating prospects and ongoing fiscal consolidation efforts.

We also prefer European credit to other geographies – a view we have held for a while. We still think spreads are more attractively priced versus history in Europe than in the U.S., especially when adjusting for the quality of the issuers (European corporate indices tend to be better rated than U.S. equivalents). And balance sheets are strong and fundamentals supportive. Clear evidence of that: spreads widened after the April 2 reciprocal tariff announcement, but they retraced quickly without any monetary or fiscal intervention.

We see a mixed picture in European equities, keeping us neutral – but with distinct sector and country preferences. Historically, European outperformance over the U.S. was only sustained if accompanied by a positive trend in relative earnings. Its outperformance this year has been led mostly by a compression in the very deep valuation discount. We are not yet convinced Europe's earnings can sustainably outperform given the region's competitive challenges. We still prefer U.S. and Japan stocks.

Yet we see many opportunities in European sectors and countries. We still like financials given healthy balance sheets, especially of large banks. A steeper yield curve boosts net interest margins and Europeans' greater propensity to save creates demand for investment products – driving banks' fees business. We like companies that can benefit from the rise in defense and other spending. Industrials are also an indirect way to tap into the global AI buildout and efforts to reshore key manufacturing activities. Growing energy demand and decarbonization could support utilities and infrastructure. Spain is still our preferred country: domestic fundamentals are strong and it has more favorable valuations and earnings momentum than its peers. Our preferred sectors are also well represented in Spain.

We hope you find this an informative read. All the best for the rest of 2025!

Introduction

Twice a year, BlackRock's senior portfolio managers and investment executives gather for two days to debate the outlook for the global economy and markets – and its implications for portfolios. Since the previous Forum in November, we have met even more frequently to take stock of this year's policy shifts driving financial market volatility – and elevated uncertainty. The Global Outlook is the culmination of that debate and discussion at our latest Forum and informs our macro framing: We have long argued this is a world being shaped by supply and undergoing a transformation driven by mega forces, or structural changes driving returns now and in the future. We evolve that by describing how we see the world losing long-term macro anchors that have underpinned investment processes for decades.

Our three themes spell out the investment implications of this. *Investing for the here and now* is about how we can have more certainty about the near term than long term – and why we stay pro-risk. *Taking risk with no macro anchor* highlights how macro risk needs to be managed in this environment – yet it is one of ample alpha opportunities. And *finding anchors in mega forces* highlights the important role of mega forces, such as artificial intelligence, in shaping growth trajectories and serving as a durable return driver.

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Sharp U.S. policy shifts and elevated uncertainty make it seem the world is upended. But this is an evolution of the new regime of transformation we have been in for a few years. What matters: getting a grip on uncertainty by identifying its core features. Long-term macro anchors are weaker given the many different potential outcomes. Yet macro fundamentals haven't changed much for now: Immutable economic laws prevent policy from revamping the world overnight. That keeps us positive on risk assets and U.S. stocks. Mega forces, like artificial intelligence, are the new long-term anchor for achieving durable returns.

With the many twists and turns over the first half of this year, policy uncertainty is obviously elevated. We had expected policy this year to switch from a stabilizing force for financial markets to a destabilizing force. That has played out. Yet at this midyear point, risk asset returns are also little changed so far, even with all the headline-grabbing noise.

What matters now for investors is getting a grip on this environment's defining features. We have long argued that we entered a new macro regime marked by profound transformations, shaped by mega forces that could lead to many very different potential outcomes over time – for the trajectory and makeup of the global economy, inflation, government debt and deficits or global trade. 2025 has put this new regime into sharper relief, with serious discussion about the potential for fundamental changes to the structure of global markets – including the haven role of U.S. Treasuries or the U.S. dollar as a reserve currency.

Put another way, the loss of long-term macro anchors that have underpinned long-term asset allocation for decades is a defining feature of this new regime.

But the global economy can't be revamped overnight. Immutable economic laws – on global trade and debt financing – exist that policy cannot ignore in the near term. Attempts to break them are akin to trying to break laws of physics – and defy gravity – in our view.

Nobody knows where the macro environment is ultimately headed. But understanding these policy limits has allowed us to be nimble and build the conviction to dial risk back up just one week after the April 2 tariff announcements. It makes us more comfortable staying pro-risk on a tactical horizon. We have more certainty about the near-term macro outlook than the long term – an unusual situation for investors. So we put greater weight on tactical views. That's why our first theme is *investing in the here and now*. That favors U.S. equities and themes such as artificial intelligence. We stand ready to pivot depending on the ultimate impact of U.S. policy on the economy. We don't think Europe can outperform yet without structural changes – but some of the steps Europe has taken give us optimism.

Taking risk with no macro anchor is our second theme. We believe this environment of transformation is better than the prior decade for achieving above-benchmark returns, or alpha. Yet the volatile macro environment injects risk into portfolios that needs to be actively managed. Even with the loss of long-term macro anchors, we believe mega forces are durable drivers of returns – and are *finding anchors in mega forces*, our third theme. Mega forces don't provide a clear handle on the growth and inflation outlook, unlike macro anchors, and don't map into broad return drivers. Instead, we need to track their evolution across and within asset classes, get granular with themes and constantly adapt to what's priced in.

Losing long-term macro anchors

As unusual as the first half of this year seemed, we think it is a more acute manifestation of the profound transformation we have been describing for some years now. Geopolitical fragmentation, AI and other mega forces are reshaping the trajectory and makeup of the global economy. This is not a cyclical adjustment but a structural one that can lead to many very different outcomes. Elevated uncertainty is a given. What matters is getting to grips with it. That starts with identifying this environment's core features.

Another way to put it: The loss of long-term macro anchors that markets have relied on for decades. Inflation expectations are no longer firmly anchored near 2% targets. Fiscal discipline is ebbing away. The compensation investors want for holding long-term U.S. Treasuries is rising from suppressed levels. And confidence in institutional anchors – central bank independence and the haven role of U.S. assets – has been shaken.

We think that requires a new approach to risk taking. Before the pandemic, when long-term macro anchors were mostly in place, broad asset class returns tended to converge back toward long-term averages. Stable growth, low inflation and supportive monetary policy made it easier to generate returns via static exposures to broad stock and bond indexes. And when equities sold off, bonds tended to cushion the blow. This has changed. With long-run economic trajectories now ever-evolving, one would expect investors to search data for signals about where things are headed. This is exactly what we've seen. Equity returns have become more sensitive to short-term data as investors try to infer what it means about both the near and long term. See the chart.

That does not mean investors should trim risk taking. Two other features of this environment help. First: even with an uncertain outlook, we believe immutable economic laws narrow near-term outcomes. Second: mega forces offer an alternative anchor for returns. See page 10.

Questioning the future

Equity sensitivity to macro and trade uncertainty, 2004-2025

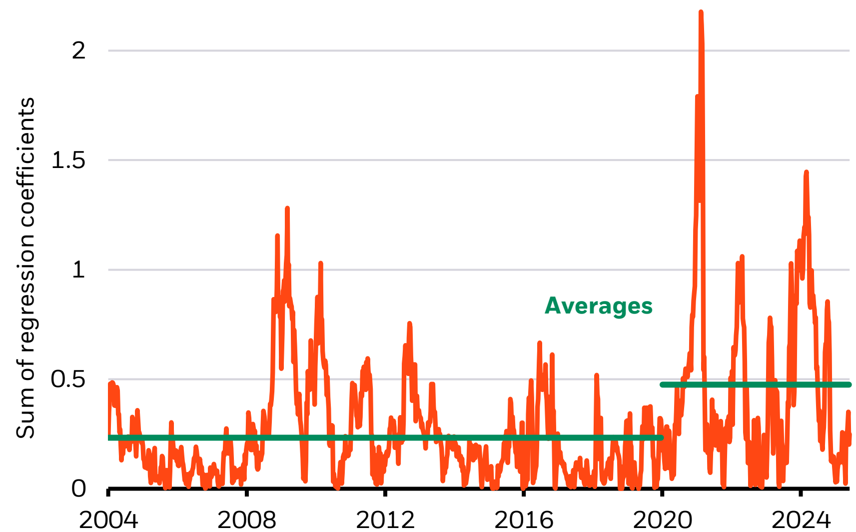

Chart takeaway: *Post-2020, equity returns have become twice as sensitive to economic and trade policy surprises, on average. We think that's because, with the loss of long-term macro anchors, they are seeking to draw signals from short-term data about the long-term outlook.*

Source: BlackRock Investment Institute, June 2025. Note: Sensitivity represents the sum of the coefficients (absolute value) in the regression of weekly equity returns on the Citi Economic Surprise index, and Trade Policy Uncertainty index by Iacovello et al. (2020). All variables enter the regression as z-scores. Trade policy uncertainty index is available from 2015 at daily/weekly frequency and backfilled (assumed zero) in the previous years.

With macro anchors weakening, investors can no longer rely on broad asset class returns converging back toward long-term averages.

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World can't change quickly

Market narratives have flip-flopped constantly this year and at times embraced rapid changes to the global financial order. Yet immutable economic laws on trade and debt are constraining U.S. policy shifts – and can help investors navigate near-term uncertainty. We believe we now have more certainty about the near-term macro outlook than the long – a big change from the past.

One law limiting trade policy: supply chains can't be rewired quickly without major disruption. Companies can't just source products and inputs from elsewhere overnight without a halt in activity. We believe that rule was behind the rapid tariff carve-outs — such as exemptions for electronics from China — and why the U.S. and China soon restarted trade talks. One goal driving U.S. trade policy is the administration's wish to fix global imbalances: The U.S. has long been a net importer, resulting in persistent current account deficits. But the causes of these imbalances are complex.

Trade flows reflect deeper forces – like the savings-investment gap – rooted in exchange rates, fiscal policy, demographics and global capital flows, not just trade policy.

That links to a second law on debt: U.S. debt sustainability relies on big, steady funding by foreign investors, who hold about a quarter of it. See chart. Any falloff in foreign demand for Treasuries could spike yields and make borrowing costs so high that it forces a policy response. We think the tariff pause soon after the April 2 announcement was likely partly due to the yield spike. We see a fragile equilibrium – elevated debt, sticky inflation and higher interest rates – making U.S. Treasuries vulnerable to investors seeing them as riskier. In March, we estimated the U.S. deficit-to-GDP ratio could reach 5-7% by 2030, based on external forecasts of the impact of proposed trade, fiscal and immigration policy. Moody's has since cut the U.S. top-notch credit rating and Congress is considering a budget bill that we think could push it to 6-7.5%. We think this will keep that rule on debt front and center.

Foreign funding needed

Ownership of U.S. Treasuries, 2000-2025

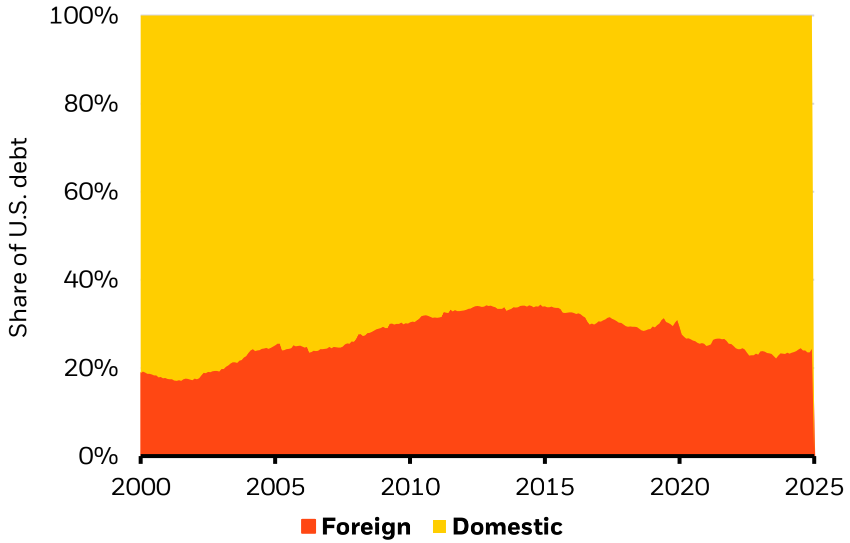

Chart takeaway: *Foreign investors own about 25% of all U.S. Treasuries, making them an important force in determining long-term U.S. yields and interest rates*

Source: BlackRock Investment Institute, U.S. Treasury, April 2025. Note: The chart shows foreign and domestic ownership of U.S. Treasury securities outstanding as a share of total U.S. Treasury securities outstanding.

Immutable economic laws limit the range of near-term outcomes. Upending decades-old trade and capital structures takes time, no matter policy intent.

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Investing in the here and now

These immutable laws limit how fast global trade and capital markets can evolve. Longer term, with macro anchors lost, no one knows where the global economy is ultimately headed. That's why, for now, we invest in the here and now – and lean more on our tactical six- to 12-month horizon. It's also why we stay positive on risk taking and overweight U.S. equities. We also stand ready to lean against sharp market swings if we think markets are overreacting to short-term news and pricing in big, fast changes to the global order.

Since 2000, European equities have had many periods of outperformance over U.S. equities – but they have become increasingly rare. See the shaded areas in the chart. Yet those rallies never spurred questions about the role of U.S. assets as we've seen this year. We think the current economic setup still supports U.S. outperformance. We see scope for overall corporate earnings to stay solid even if U.S. growth is dented by tariff-induced disruptions and corporate caution.

What would spur a change in our relative preference? Europe taking bigger steps to address structural reforms. See page 13. For now, we don't see Europe besting U.S. growth, especially given its dependency on the U.S. On corporate earnings, the U.S. still leads on profit margins and return on equity, warranting higher valuations. That's why the recent European stock outperformance has already faded. A sharp increase in expected policy rates is a risk to our positive view, but markets already reflect our higher-for-longer policy rate view. And investors demanding a higher term premium in government bonds makes equities and credit relatively more attractive.

We stay selective in European equities with sectors like financials. We prefer euro area government bonds and credit over the U.S. The potential for a further U.S. dollar retreat and brighter emerging market (EM) growth outlook make local currency EM bonds more attractive in a whole portfolio context, in our view.

Limited rebounds

Ratio of European vs. U.S. equity total returns, 2001-2025

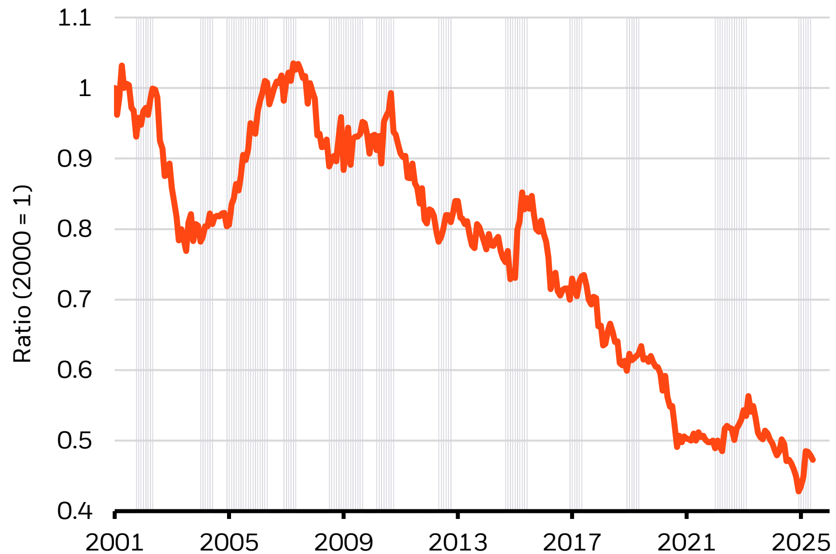

Chart takeaway: *We have seen several periods of European stocks outperforming the U.S. over the past few decades. Yet that has not previously spurred questions about the end of U.S. outperformance or the role of U.S. assets as we've seen this year.*

The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results. Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index. Source: BlackRock Investment Institute, with data from LSEG Datastream, July 2025. Note: The chart shows the ratio of total returns in local currency for the Stoxx 600 over the S&P 500, with shaded areas highlighting instances where the Stoxx 600 outperformed the S&P 500 by more than 5% over a three- to six-month period.

Investment implications

- Near-term outcomes are clearer than the long term — a reversal of usual investing logic — so we put more emphasis on tactical views.
- We are broadly risk on, stay overweight U.S. equities and see plentiful alpha opportunities.

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Taking risk with no macro anchor

This year, we see persistent U.S. inflation pressures from rising geopolitical fragmentation, slowing immigration – and eventually, the direct impact of tariffs not yet visible in the CPI. Wage growth is still too high for inflation to fall back to the Fed's 2% target, and inflation is still volatile. We expect the Federal Reserve to hold rates steady as it waits for more clarity on the tariff impact on growth. We think persistent inflation pressure, exacerbated by tariffs, and a tight labor market will limit how far the Fed can cut rates, even if tariff-driven disruptions drag on growth.

When the macro environment was more stable, persistent factor exposures – such as to growth, value or inflation – typically didn't hurt portfolios. That's no longer the case. The skill is in timing such macro risk exposures in portfolios.

Our work finds this an exceptional environment for alpha in portfolios given the greater dispersion in market and security returns.

The chart shows how top-performing portfolio managers have delivered more alpha since 2020. And the median manager is seeing a bigger drag on returns from static factor exposures. That underscores why macro risk needs to be managed.

This alpha can be generated by other types of risk taking that can be more rewarding in this environment. One is mega forces – see page 10. Taking relative value risk, or positioning for prices of different securities to converge or diverge, is a well-established one. We categorize some others to be more deliberate about taking risk. They include potential deregulation or regulatory changes that could offer alpha opportunities – see the evolving U.S. approach to cryptocurrencies. Positioning risk is about recognizing when markets are crowded, while liquidity risk is about opportunities to provide it during periods of stress. Sharp narrative swings mean we can see near-term selloffs running counter to our tactical views – and view those as opportunities to deploy risk.

Greater potential alpha on offer

Three-year excess returns of U.S. equity fund managers, 2010-2025

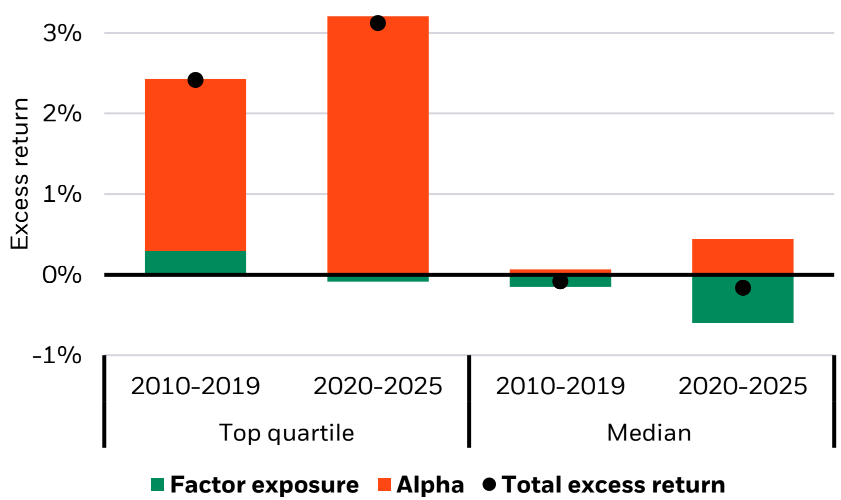

Chart takeaway: *Top-performing alpha-seeking managers are delivering more alpha in this environment. But static factor exposures are a bigger drag on returns for median managers.*

Past performance is not a reliable indicator of future performance. This information should not be relied upon by the reader as research or investment advice regarding any funds, strategy or security. Source: BlackRock Investment Institute, with data from eVestment and LSEG Datastream, July 2025. Notes: The chart compares the rolling three-year average excess return (into alpha and factor contribution) between 2010-2019 and 2020-2025 – excluding January-June 2020 for both top-quartile and median quartile U.S. large cap equity manages rin the eVestment universe. We use regression analysis to estimate the relationship between alpha-seeking manager performance and market conditions. Regression analysis is backwards-looking and is only an estimate of the relationship. The future relationship may differ.

Investment implications

- We think this is an exceptional environment for alpha. But macro risk should be deliberately managed – or neutralized.
- Other types of risk taking that can generate alpha include relative value and liquidity.

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Finding anchors in mega forces

Even with weaker long-term macro anchors, we can have conviction that mega forces will be durable drivers of returns. The importance of our mega forces framework is clear given how this year's big investment themes have been shaped by them, from AI and the energy transition to geopolitical fragmentation and the future of finance. Yet we don't know the end state of the economic transformation these mega forces are driving. That's why they require constant tracking across and within asset classes.

The transformation is grounded in surging capital spending. Big tech firms — the "hyperscalers" powering AI's expansion — are still boosting spending, according to our compilation of estimates. See the chart. Capital spending and infrastructure is at the heart of many mega forces. But big capital spending does not necessarily result in big returns, as we have seen with the energy transition and security theme, highlighting how assessing what's in the price is key. See page 10 for more on AI.

A clear example of intersecting mega forces: surging demand from technology is running up against the hard limits of power generation and grid capacity. Private markets are playing a growing role in funding infrastructure, energy systems and the AI buildout. As they grow, private and public markets are becoming more complementary — prompting new approaches to blending them in portfolios. See page 15 for more.

Geopolitical fragmentation adds another layer: Governments are steering capital with industrial policy, tightening controls on critical tech and pushing for energy security. These pressures are reinforcing mega force linkages, with national security concerns helping sustain and drive demand for all forms of power – including nuclear. We explore these cross-currents more fully on the following pages.

We are tracking these shifts through policy developments, capex pipelines and supply chain movements. That helps us to quickly adjust investment views.

Tracking the investment waves

Energy and AI-related capital spending, 2022-2030

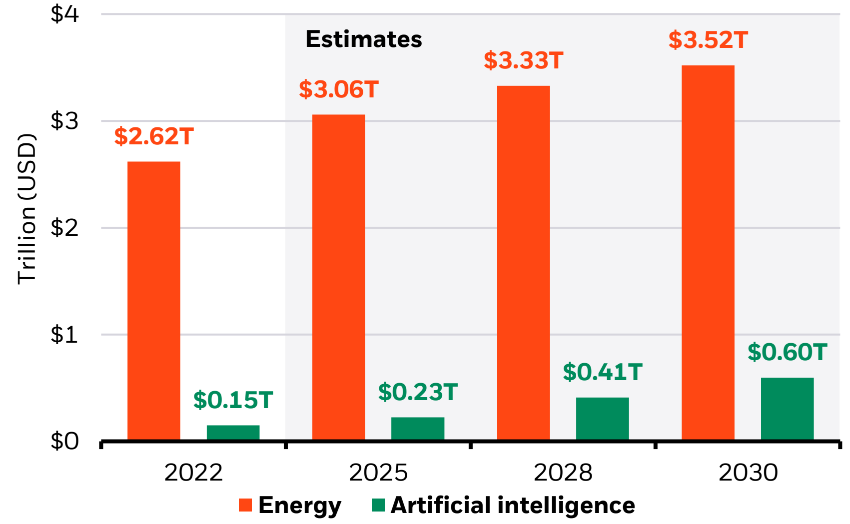

Chart takeaway: *The energy transition and the AI race are spurring massive capital spending that is likely to persist – creating opportunities across public and private markets.*

Forward-looking estimates may not come to pass. Source: BlackRock Investment Institute, Reuters and Aladdin Sustainability Analytics, with IEA data, April 2025. Note: The bars show the estimated breakdown of capital investment needs – both from supply and demand-based estimates. 2022 data is from the IEA. BlackRock estimates start in 2025.

Investment implications

- We see mega forces as a durable driver of returns in this regime.
- We favor exposures tied to the AI buildout, rising power demand and infrastructure – and see private capital taking a key role in funding.

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Deepening fragmentation

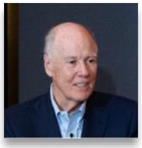
The mega force of geopolitical fragmentation is rapidly evolving. Shocks like the pandemic, the Ukraine war and rising trade tensions have deepened fragmentation over the last decade. That has sped up this year as the new U.S. administration has moved quickly to reorder U.S. geopolitical and economic relationships with the rest of the world. Volatility is high as an end to the Ukraine war appears far off and fresh conflict has arisen in the Middle East.

What is the impact of geopolitical fragmentation in Europe? Defense and industrial competitiveness are back in focus. The Ukraine war had already exposed structural weaknesses in industry and logistics. Now, a shifting U.S. security posture is driving up defense spending in the European Union (EU). After undershooting for over 20 years, it has hit its target of 2% of GDP. See the chart. That is set to keep rising after many NATO members committed to a target of 5% of GDP – 3.5% to defense and 1.5% to defense infrastructure.

Technology is also now a key part of national security. Europe has so far prioritized regulation over industrial support. That may shift. The U.S. sees AI as a "force multiplier," a tool to enhance intelligence, military capability and autonomous systems.

On trade, the U.S. and EU are yet to reach a trade deal. And Chinese competition is challenging some of Europe's core sectors, notably autos. Yet Europe's competitiveness is an issue that runs deeper than this mega force. The Draghi report last year called for faster decision-making – so far difficult with 27 member states – as well as coordinated industrial policy and large-scale investment. Jean Monnet may be right again that "Europe will be forged in crisis."

> **"Rebuilding industrial capacity to plug shortfalls in defense is a strategic priority for Europe."**



Tom Donilon
Chairman, BlackRock Investment Institute

Boosting spending

Defense spending as a share of GDP, historic and projected, 1960-2027

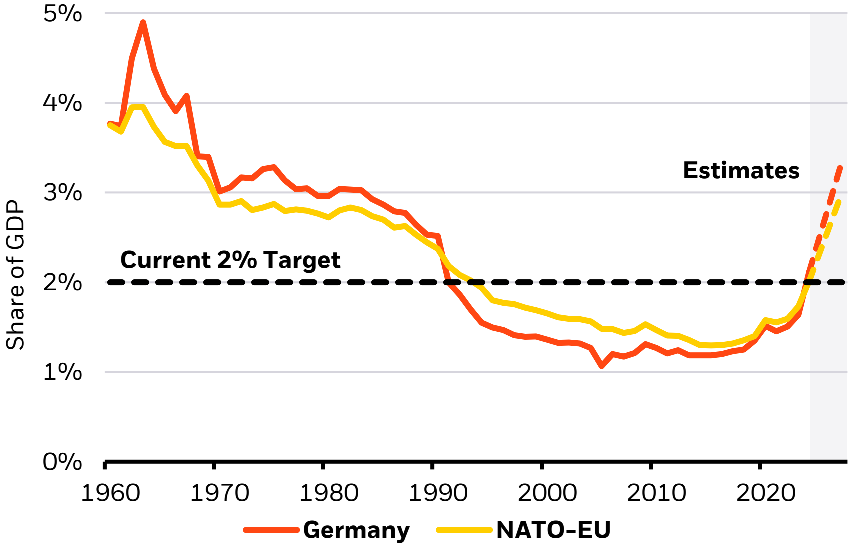


Chart takeaway: *Germany and other European nations are planning to ramp up defense spending after years of underinvestment. If realized, these plans would lift defense spending above 2% of GDP – a long-held target.*

Forward-looking estimates may not come to pass. Source: BlackRock Investment Institute, NATO, World Bank, European Commission, July 2025. Note: The solid lines show the defense spending as a share of GDP for Germany and European NATO countries. The dotted lines assume current plans to boost defense spending are realized.

Investment implications

- Geopolitical fragmentation is pushing Europe to reorient policy and capital toward security, resilience and competitiveness.
- We see opportunities in defense, infrastructure and financials.

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Taking stock of AI’s phases

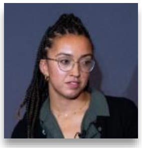
We’ve laid out how we see the AI mega force evolving over three phases. Phase 1 is the buildout – the race to build AI’s infrastructure needs. Phase 2 is adoption – with AI packaged into different apps and software. Phase 3 is transformation – where AI adoption potentially boosts productivity, creating new business models and industries.

The AI buildout powers ahead. The competition among the mega cap tech hyperscalers rushing to advance their AI models is as intense as ever. The U.S. tech sector is still delivering strong earnings growth: Overall S&P 500 Q1 earnings growth was twice what was expected at the start of the earnings reporting season and led by tech, LSEG data show. And tech is among the few sectors seeing earnings expectations revised higher. Valuations of “magnificent 7” companies have recovered from their lows this year, yet are still below levels seen before Chinese DeepSeek’s seemingly low-cost model raised questions about hefty capital spending on data centers.

The hyperscalers are sticking with increased capital spending – and being rewarded for it. We still like the hardware makers and those sectors benefitting from the buildout, including the utility sector. Utilities and companies linked to AI power demand are seeing many more mentions of AI than the S&P 500 average. See the chart.

We stay overweight the tech sector broadly to get exposure to the AI theme. Yet for those with insights into potential individual company winners in the AI race, an alpha-seeking approach is better suited. AI intersects with multiple mega forces, including the energy transition, geopolitical fragmentation and the healthcare needs of aging societies.

> **“Uneven monetization of AI tools is creating mispricings across the value chain.”**



Rowan Palmour
Research analyst, BlackRock Fundamental Equities

AI leans on utilities

Mentions of AI in Q1 2025 earnings calls of S&P 500 companies

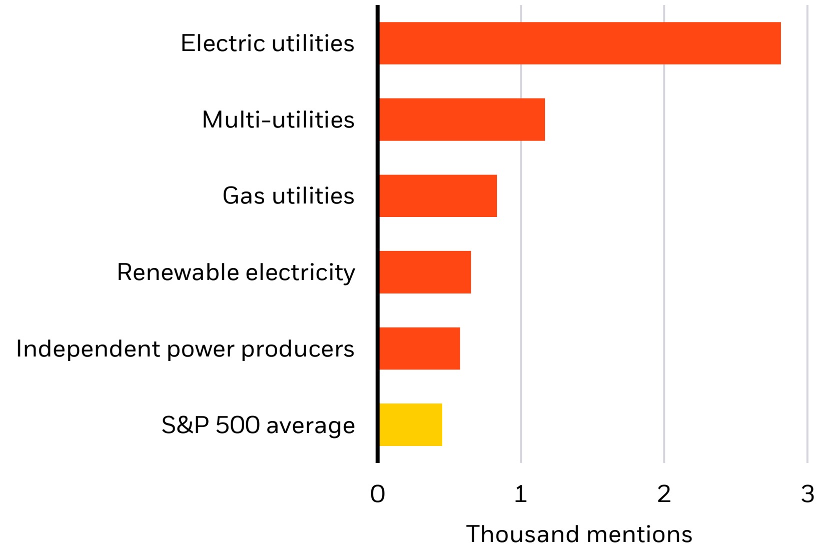


Chart takeaway: *Utilities are key AI beneficiaries, with AI mentions in earnings calls far outpacing the S&P 500 average. We see this interest persisting as data centers drive soaring power demand and a greater need for flexible, reliable supply.*

Indices are unmanaged and one cannot invest directly in an index. Source: BlackRock Investment Institute, with data from CapIQ, July 2025. Notes: The bars show how often AI was mentioned by various U.S. large cap utility companies, proxied by the MSCI USA Utilities index, in their Q1 2025 earnings calls.

Investment implications

- The AI mega force keeps us overweight U.S. equities and positive on infrastructure.
- AI winners lie at the intersection of other mega forces as well, including the energy transition and geopolitical fragmentation.

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U.S. assets still core

The joint drop in U.S. stocks, bonds and the dollar in April spurred questions about the long-term appeal of U.S. assets. We don't think those concerns are justified. We still see U.S. assets as core to portfolios – but with greater selectivity – and see opportunities across regions and asset classes.

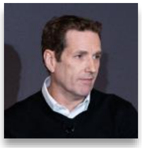
U.S. stocks have outperformed for a decade, driven by economic resilience, tech leadership and robust corporate earnings. That strength has sustained a valuation premium, underpinned by high profitability: U.S. return on equity remains well above historical averages and global peers. See the chart. Can this persist?

European equities outperformed the U.S. for much of the first half of the year, according to LSEG data, sparking debate about whether U.S. return strength is fading. Yet strong U.S. corporate profitability — with return on equity holding well above Europe — highlights why global investors have kept favoring the U.S. relative to other regions.

Europe may offer upside as fiscal support lifts revenues in aerospace, defense and financials. Yet as we noted earlier, we think Europe needs reforms to be able to outperform on a sustained basis.

One question is whether the weak U.S. net international investment position (NIIP) – the difference between its international liabilities and its assets – is a threat to U.S. equity valuations. Yet the steady decline of the U.S. NIIP need not be a problem, in our view. It reflects a historically strong dollar and ongoing global demand for U.S. risk assets – rather than worsening contributions from current account deficits. Rising fiscal deficits could pose a bigger challenge, we think.

> **"We've seen volatility in markets — but not in U.S. earnings. That consistency still counts."**



Alister Hibbert
Chief Investment Officer and Head of BlackRock's Strategic Equity Team

Delivering better returns

Regional return on equity, 2003-2025

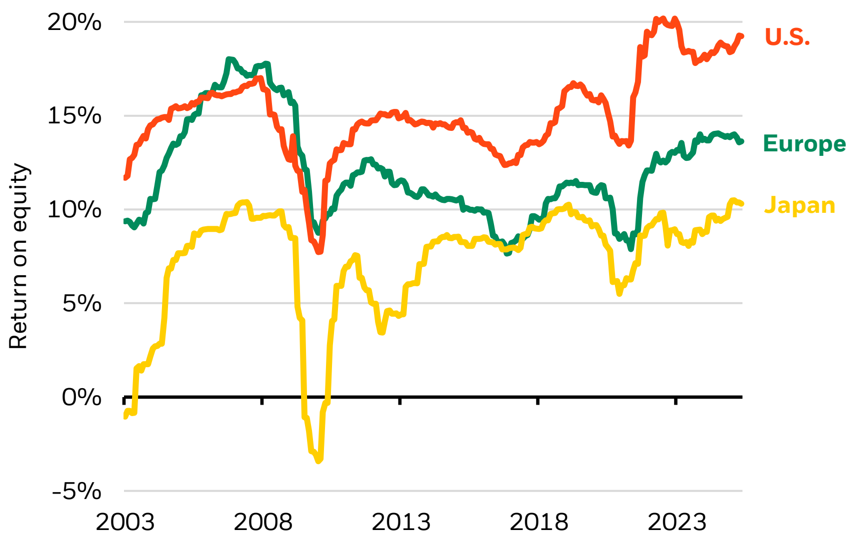


Chart takeaway: *Europe's stocks historically lag U.S. equities but have rebounded so far this year. U.S. equity valuations remain elevated but are backed by strong profitability compared to global peers.*

The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results. Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index. Source: BlackRock Investment Institute, MSCI with data from LSEG Datastream, July 2025. Note: The chart shows the return on equity for U.S., Europe and Japan equity. Index proxies used: MSCI USA, MSCI Europe, and MSCI Japan.

Investment implications

- We are tactically overweight U.S. equities, backed by strong earnings and AI strength.
- We think U.S. assets remain core to portfolios given their historical outperformance.

BIIM0625U/M-4617917-13/20

U.S. dollar's dominant role

The U.S. dollar's 10% slide against major currencies this year has raised questions about its historical global haven and reserve role. We think it would take a lot – and some time – to change the dollar's role as the backbone in the global financial system.

It took decades and world wars for the dollar to replace sterling and gold as the top reserve asset. The dollar's central role has been reinforced since the global financial crisis. The dollar appears on one side of nearly 90% of all foreign exchange (FX) transactions. See the chart. Another change in the global financial system has been the use of FX swaps among financial institutions – which has more than doubled since 2009 according to the Bank for International Settlements. While these instruments enhance global dollar liquidity, they also illustrate how central the U.S. dollar is in cross-border finance as institutions borrow and lend in dollars synthetically through FX markets.

The dollar's drop this year comes as investors have started to demand more term premium for holding long-term U.S. bonds. We think those moves are consistent with each other – and the rise in term premium is only starting to bring it closer to historical averages from its very low levels over the past decade. A further rise could also coincide with further dollar weakness.

Increased hedging of the currency risk of U.S. assets could add to downside pressure on the U.S. dollar. We don't have strong conviction in currency views but now see the potential to harvest higher yields in EM – one reason we've upgraded EM local currency bonds.

"We expect more investors are going to adjust FX hedges against a weaker U.S. dollar."

Michel Aubenas
Head of Emerging Market Debt, BlackRock Fundamental Fixed Income

Greenback the backbone

Share of major currencies in global transactions, 2024

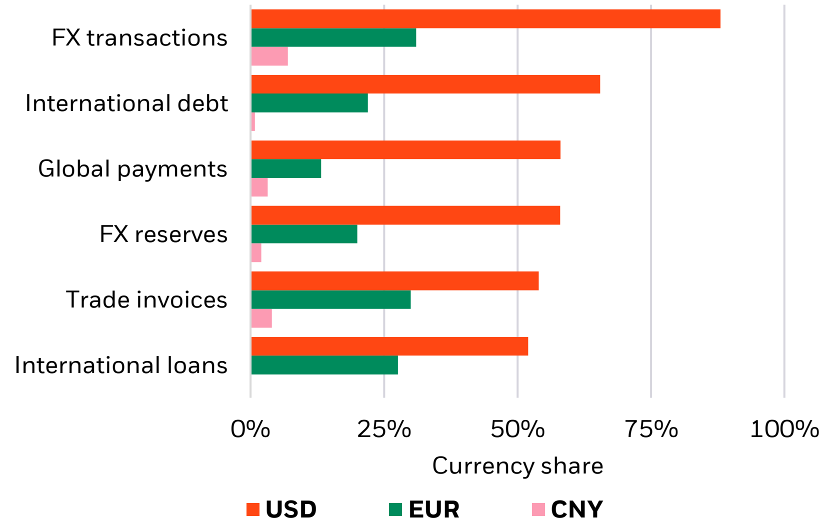


Chart takeaway: *The U.S. dollar remains the dominant currency for global transactions and finance, with the euro a distant second. The rise of FX swaps illustrate how dominant the U.S. dollar is to cross-border finance.*

Source: BlackRock Investment Institute, with data from the Bank for International Settlements (BIS), July 2025. Note: The chart shows the share of major currencies in global transactions, including the U.S. dollar (USD), the euro (EUR), the Chinese yuan (CNY) also known as the renminbi (RMB).

The U.S. dollar's dominance has persisted through shifts in the global financial system. We don't see that changing soon.

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Tapping private capital

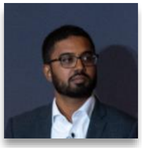
Public and private markets are coming closer together to fund the large-scale investment needed for the economic transformation. Private capital is playing a bigger role in financing infrastructure, energy and AI. That is blurring the distinction between asset classes as private and public markets increasingly complement each other in portfolios.

The opportunity in private markets is often seen as stemming from private capital providing funding where fiscally constrained governments can't. It's also linked to how companies are financing themselves today. Companies are staying private for longer – see the chart – tapping both public and private markets for financing more often, regardless of their size. U.S. private credit assets have surged to $1.7 trillion as of 2024, Preqin data show, as part of a shift away from bank loans toward more diversified financing. We think that shift reduces systemic risk, or the risk of one financial institution's failure spreading to others.

The growth of private markets transforms how investors build their entire portfolio, not just the allocations to private assets. Only about a fifth of U.S. companies are public, and the number of listed U.S. companies has shrunk by 35% since 2000 according to Pitchbook data, making public stocks even more concentrated.

But private markets are complex and not suitable for all investors. Holding private assets brings some factor exposure that is less rewarded now – see page 9. Including private assets requires more explicit and dynamic management of factor exposures elsewhere in the portfolio. Private assets are less liquid, too, and that will always need to be managed.

"Increased use of private capital warrants moving beyond 'public' and 'private' asset class labels."



Vivek Paul
Head of Portfolio Research – BlackRock Investment Institute

Staying private for longer

Average company age at initial public offering, 2004-2024

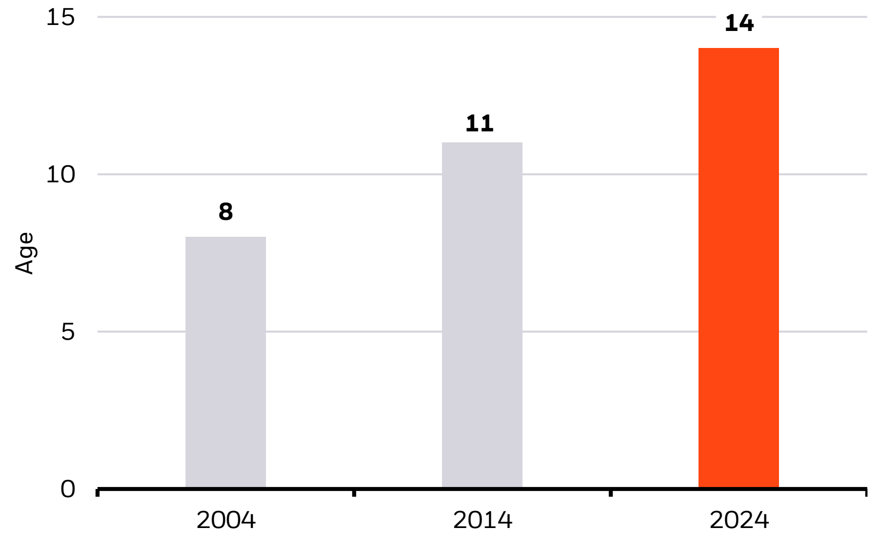


Chart takeaway: *Companies are spending more time as private companies before going public today – with the average age of companies at initial public offerings almost doubling over 20 years. The upshot? Companies tapping private capital for longer.*

Source: BlackRock Investment Institute, University of Florida, with data from Jay R. Ritter July 2025. Note: The bars show the median age when companies launch initial public offerings.

Investment implications

- Private capital is playing a growing role in financing infrastructure, energy and AI.
- We see the blending of public and private markets gaining traction.

BIIM0625U/M-4617917-15/20

Transformation = infrastructure

Infrastructure assets sit at the intersection of the mega forces driving returns today and accelerating the economic transformation. Fragmenting supply chains, the AI buildout and growing demand for energy support the investment case for infrastructure globally, we think.

We think indebted governments will struggle to directly finance their infrastructure needs and will need private capital. But the opportunity in infrastructure goes beyond just that.

Big companies are partnering with private investors more often, using joint ventures and asset-backed structures to unlock capital tied up in infrastructure. That turns those types of infrastructure assets into financial assets, forging a new way to raise long-term funding and create an additional supply of infrastructure assets. With that, private infrastructure has grown rapidly. Assets under management in infrastructure funds now tops $1 trillion, with Europe rivalling North America in size. See the chart.

We find private infrastructure pricing relatively attractive to other growth private market assets. Opportunities transcend geographies – and even asset class labels. Though the size, breadth and diversity of private infrastructure dominates listed infrastructure assets, public assets directly tied to infrastructure offer opportunity for investors without the governance or liquidity allowances to tap private markets. Valuations are slightly lower in public infrastructure than private, according to GLIO and FTSE data.

Infrastructure helps tap directly into mega forces and transformation while providing access to stable cash flows and yields that typically track inflation.

> **“Infrastructure is not just about real assets – it is a financing tool to unlock transformation.”**

Raj Rao
President and COO of Global Infrastructure Partners

Climbing higher

Infrastructure assets under management, 2010-2029

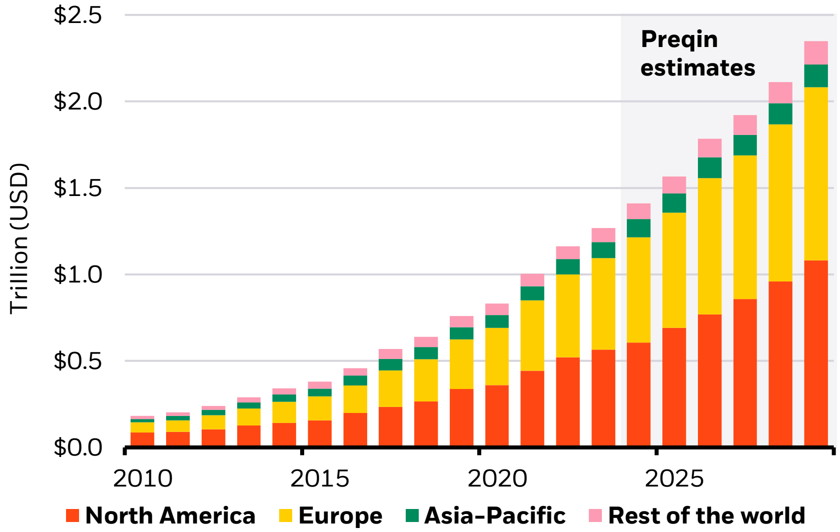


Chart takeaway: *Private infrastructure assets are estimated to grow past $2 trillion by 2028, with most of the assets concentrated in America and Europe. We see infrastructure capital benefitting from a confluence of mega forces driving the transformation.*

Forward-looking estimates may not come to pass. Source: BlackRock Investment Institute, with data from Preqin, July 2025. Note: The bars show the assets under management in private infrastructure funds, excluding Chinese yuan denominated funds.

Investment implications

- Infrastructure assets are core to the economic transformation underway, linked to big structural shifts driving returns now.
- We see infrastructure's stable cash flows as a tool to protect portfolios from volatile inflation.

BIIM0625U/M-4617917-16/20

Leaning on themes

As we have argued, we think this environment is a uniquely good one for achieving alpha in portfolios. We had previously laid out scenarios to help guide us on a tactical investing horizon. Yet we think macro outcomes are likely more contained in the near term than in the long term. For that reason, we are now using scenarios to guide how we speak to a medium-term outlook in strategic allocations of five years and beyond. See our *Capital markets assumptions* (CMAs) website for details (for professional investors only).

On a tactical horizon, we stay overweight U.S. equities and think the AI theme has more room to run. That has been evident in the sharp rebound of AI-related names since the April selloff. U.S. corporate earnings have also proved resilient so far, but we stand ready to pivot if that changes. We prefer short-term U.S. bonds and euro area credit for income. We stay underweight long-term Treasuries and Japanese government bonds but are neutral euro area bonds.

Mega forces are a key driver of asset allocation across tactical and strategic horizons – and highlight how the opportunity set is becoming more thematic in nature. These structural drivers shape our CMAs and strategic preferences. AI's role as a return driver is why we hold U.S. technology at a greater-than-benchmark size. India stands out for its demographic dividend, in our view. And infrastructure is a preferred exposure given its role in multiple mega forces.

Big calls

Our highest conviction views on six- to 12-month (tactical) and over five-year (strategic) horizons, July 2025

Tactical	**Reasons**
U.S. equities	• Policy uncertainty and supply disruptions are weighing on near-term growth, raising the risk of a contraction. Yet we think U.S. equities will regain global leadership as the AI theme keeps providing near-term earnings support and could drive productivity in the long term.
Using FX to enhance income	• FX hedging is now a source of income, especially when hedging euro area bonds back into U.S. dollars. For example, 10-year government bonds in France or Spain offer more income when currency hedged than U.S. investment grade credit, with yields above 5%.
Seeking alpha sources	• We identify sources of risk taking to be more deliberate in earning alpha. These include the potential impact of regulatory changes on corporate earnings, spotting crowded positions where markets could snap back and opportunities to provide liquidity during periods of stress.
Strategic	**Reasons**
Infrastructure equity and private credit	• We see opportunities in infrastructure equity due to attractive relative valuations and mega forces. We think private credit will earn lending share as banks retreat – and at attractive returns.
Fixed income granularity	• We prefer short-term inflation-linked bonds over nominal developed market (DM) government bonds, as U.S. tariffs could push up inflation. Within DM government bonds, we favor UK gilts over other regions.
Equity granularity	• We favor emerging over developed markets yet get selective in both. Emerging markets (EM) at the cross current of mega forces – like India – offer opportunities. In DM, we like Japan as the return of inflation and corporate reforms brighten the outlook.

Note: Views are from a U.S. dollar perspective, July 2025. 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.

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Tactical granular views

Six- to 12-month tactical views on selected assets vs. broad global asset classes by level of conviction, July 2025

The table below reflects our views on a tactical horizon and, importantly, leaves aside the opportunity for alpha, or the potential to generate above-benchmark returns – especially at times of heightened volatility.

Underweight **Neutral** **Overweight** ● Previous view

Equities	View	Commentary
United States	+1	We are overweight. Policy-driven volatility and supply-side constraints are pressuring growth, but we see AI supporting corporate earnings. U.S. valuations are backed by stronger earnings and profitability relative to other developed markets.
Europe	Neutral	We are neutral. Greater unity and a pro-growth agenda across Europe could boost activity, yet we are watching how the bloc tackles its structural challenges before turning more optimistic. We note selective opportunities in financials and industries tied to defense and infrastructure spending.
UK	Neutral	We are neutral. Political stability could improve investor sentiment. Yet an increase in the corporate tax burden could hurt profit margins near term.
Japan	+1	We are overweight given the return of inflation and shareholder-friendly corporate reforms. We prefer unhedged exposures as the yen has tended to strengthen during bouts of market stress.
Emerging markets	Neutral	We are neutral. Valuations and domestic policy are supportive. Yet geopolitical tensions and concerns about global growth keep us sidelined for now.
China	Neutral	We are neutral. Trade policy uncertainty keeps us cautious, and policy stimulus is still limited. We still see structural challenges to China's growth, including an aging population.

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.

Fixed income	View	Commentary
Short U.S. Treasuries	+1	We are overweight. We view short-term Treasuries as akin to cash in our tactical views. We would still lean against the market pricing of multiple Fed rate cuts over the next year.
Long U.S. Treasuries	-2	We are underweight. Persistent budget deficits and inflation pressures could drive term premium up over the long term, but we see scope for lower yields near term. We prefer intermediate maturities.
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. Yields are attractive, and term premium has risen closer to our expectations relative to U.S. Treasuries. We prefer peripheral bonds such as in Italy and Spain.
UK gilts	Neutral	We are neutral. Gilt yields are off their highs, but the risk of higher U.S. yields having a knock-on impact and reducing the UK's fiscal space has risen. We are monitoring the UK fiscal situation.
Japanese govt bonds	-1	We are underweight. We see room for yields to rise further on Bank of Japan rate hikes and a higher global term premium.
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	+1	We are overweight. We find income in agency MBS compelling and prefer them to U.S. Treasuries for high-quality fixed income exposure.
Short-term IG credit	+1	We are overweight. Short-term bonds better compensate for interest rate risk.
Long-term IG credit	-1	We are underweight. Spreads are tight, so we prefer taking risk in equities. We favor Europe over the U.S.
Global high yield	Neutral	We are neutral. Spreads are tight, but corporate fundamentals are solid. The total income makes it more attractive than IG.
Asia credit	Neutral	We are neutral. We don't find valuations compelling enough to turn more positive.
EM hard currency	-1	We are underweight. Spreads to U.S. Treasuries are near historical averages. Trade uncertainty has eased, but we find local currency EM debt more attractive.
EM local currency	Neutral	We are neutral. Debt levels for many EMs have improved, and currencies have held up against trade uncertainty. We prefer countries with higher real interest rates.

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