Weekly commentary

May 19, 2025

BlackRock

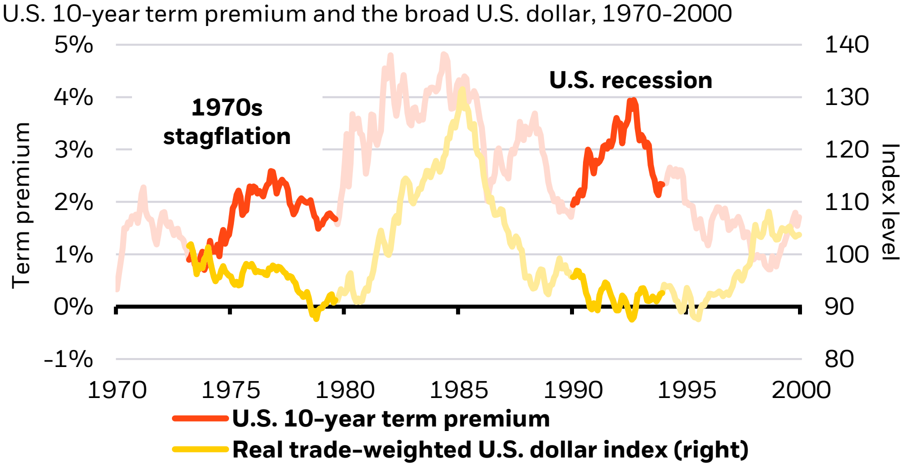
U.S. assets still core to portfolios

- Moody's U.S. debt downgrade highlights key challenges. We weigh long-term scenarios but still see U.S. assets playing a core role in global portfolios.
- U.S. stocks rose 2% last week after a tech driven rally, with the S&P 500 up 22% from its April lows. U.S. 10-year Treasury yields ticked up on the week.
- This week we watch global flash PMIs for early signs of the business sentiment impact of U.S.-China trade de-escalation. Yet the data will likely remain volatile.

U.S. stocks have soared after sliding with U.S. bonds and the dollar last month. That joint drop stoked talk of U.S. assets losing their long-term appeal. Moody's U.S. rating cut reinforces our long-held view that investors would want to see a rise in today's relatively low compensation for the risk of holding long-term U.S. bonds. We still see U.S. assets as core to portfolios. The uncertain outlook means we cannot have conviction in one central scenario alone in our strategic views.

U.S. dollar can fall again

U.S. 10-year term premium and the broad U.S. dollar, 1970-2000



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, Federal Reserve Board, NY Fed, with data from Bloomberg, May 2025. Note: The lines show the U.S. 10-year term premium and the real trade-weighted U.S. dollar index.

U.S. stocks have jumped 22% from their April lows, according to LSEG data, after the U.S. policy-driven selloff. Tech stocks have led the gains, reinforcing our preference for the artificial intelligence (AI) theme. Yet when equities slid, so did the U.S. dollar and Treasuries – spurring talk of investors losing confidence in U.S. assets. We don't think that's the case. The dollar is still historically strong. And we have long argued that investors would want more term premium, or compensation, for holding long-term U.S. bonds given persistently large fiscal deficits, sticky inflation and bond volatility. And long-term Treasuries still carry a relatively low risk premium versus the past. The tariff-driven inflation and quarterly contractions we expect this year are akin to past periods when the dollar fell and term premium rose, and investors didn't question U.S. assets then. See the chart.

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We stay overweight U.S. stocks on a six- to 12-month tactical horizon thanks to U.S. corporate strength and mega forces – big structural shifts like AI that are driving an economic transformation on a par with the industrial revolution. The end state of that transformation is unknowable, making longer-term asset allocation extremely challenging. We can no longer anchor views around a single base case and, as we've long argued, static allocations don't work in the post-pandemic world. That is why we're developing multiple sets of long-run capital market assumptions for the first time. We build our strategic allocations around a starting point scenario but now formally track others so we know how we would pivot portfolios should they come to fruition. This will allow us to move quickly as we learn more about how the transformation is evolving.

What is our starting point scenario for our strategic views? We believe it has to be the current structure of the global capital market – with U.S. assets still core to portfolios. That's because hard economic rules limit how quickly the structure can change. The recent 90-day pause on many U.S.-China tariffs illustrates one such rule: Supply chains can't be rewired quickly without disruption. Moody's decision to downgrade the U.S. government's top-notch credit rating last week shines a light on a second rule: keeping U.S. debt sustainable relies on large and steady funding by foreign investors. The downgrade reinforces the U.S. fiscal sustainability challenge that we've long flagged, especially persistent U.S. budget deficits at a time when higher interest rates are boosting debt servicing costs. If these dynamics dent the confidence of foreign bond holders, rising term premium could push up bond yields and debt servicing costs even more.

That's why our starting point also includes our expectation of rising term premium for U.S. Treasuries and persistent inflation pressure. We go overweight inflation-linked bonds and neutral global investment grade credit given wider spreads. We lean into private markets and like infrastructure equity, such as stakes in airports and data centers, as it benefits from mega forces. Private markets are complex and not suitable for all investors. We keep this scenario under review as we learn more.

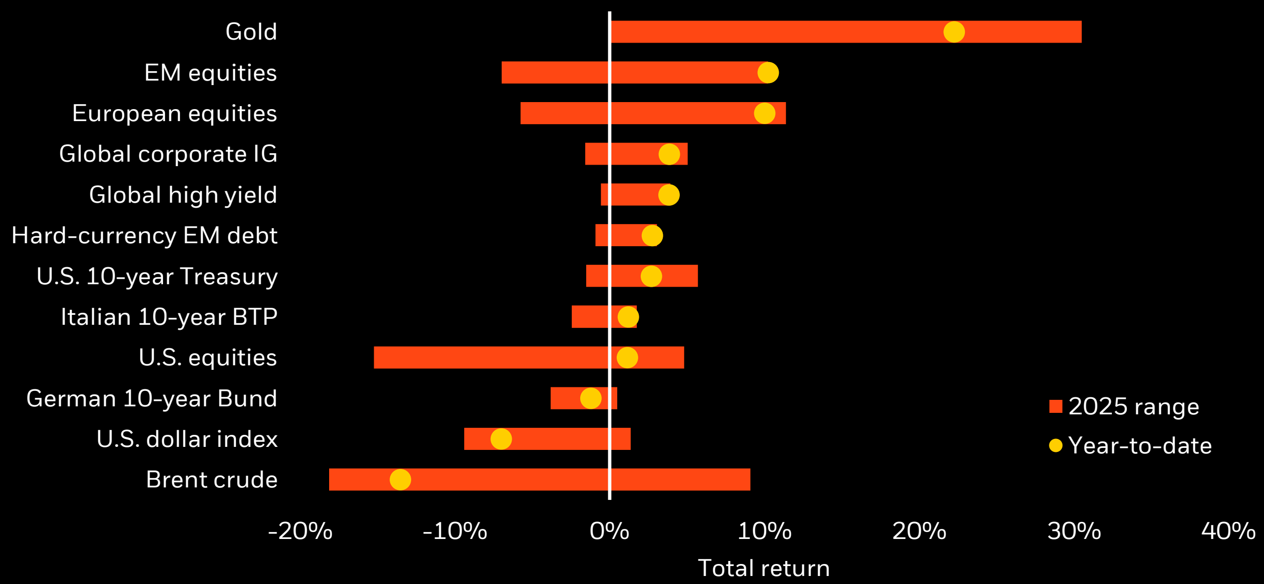
Bottom line: Economic transformation makes long-term portfolio construction more challenging. We now use a starting point scenario in our strategic views and formally track others. U.S. assets are still core to portfolios, in our view.

Market backdrop

The S&P 500 rose 2% last week in a tech-led recovery after policy-driven pullbacks in April. That put the index 22% above its April lows. U.S. 10-year Treasury yields ticked up to 4.45%, up more than 50 basis points since early April. Market are pricing in two rate cuts by the Federal Reserve for the rest of the year. U.S. CPI data for April showed easing wage pressures and don't yet reflect the tariff impact. Yet we think the tight labor market will keep inflation sticky, limiting how much the Fed can cut.

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 15, 2025. 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 21	UK CPI; Japan trade balance	**May 23**	Japan CPI
May 22	Global flash PMIs		

This week, we're watching global flash PMIs for May for any signs of improvement following the 90-day pause on U.S.-China tariffs. Trade and inflation data from Japan and the UK should shed light on how the U.S. tariff shock is rippling out to the rest of the world.

Big calls

Our highest conviction views on six- to 12-month (tactical) and over five-year (strategic) horizons, May 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.
Japanese equities	We are overweight. Ongoing shareholder-friendly corporate reforms remain a positive. We prefer unhedged exposures given the yen's potential strength during bouts of market stress.
Selective in fixed income	Persistent deficits and sticky inflation in the U.S. make us underweight long-term U.S. Treasuries. We also prefer European credit – both investment grade and high yield – over the U.S. on more attractive spreads.
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, May 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.

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.

Granular views

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

We have lengthened our tactical investment horizon back to six to 12 months. The table below reflects this and, importantly, leaves aside the opportunity for alpha, or the potential to generate above-benchmark returns – especially at a time of heightened volatility.

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

	Asset	View	Commentary
Equities	**Developed markets**		
Equities	United States	+1	We are overweight. Policy-driven volatility and supply-side constraints are pressuring growth, but we see AI supporting corporate earnings in the near term and driving productivity over the long run.
Equities	Europe	Neutral	We are neutral, preferring the U.S. and Japan. We see structural growth concerns and uncertainty over the impacts of rising defense spending, fiscal loosening and de-escalation in Ukraine. Yet room for more European Central Bank rate cuts can support an earnings recovery.
Equities	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.
Equities	Japan	+1	We are overweight given the return of inflation and shareholder-friendly corporate reforms. We prefer unhedged exposure as the yen has tended to strengthen during bouts of market stress.
Equities	**Emerging markets**	Neutral	We are neutral. U.S. tariffs and trade tensions are likely to drag on growth in China and emerging markets more broadly, even with potential policy support.
Equities	China	Neutral	We are neutral. The uncertainty of trade barriers makes us more cautious, with potential policy stimulus only partly offsetting the drag. We still see structural challenges to China's growth.
Fixed Income	Short U.S. Treasuries	+1	We are overweight. We view short-term Treasuries as akin to cash in our tactical views – but we would still lean against the market pricing of multiple Fed rate cuts this year.
Fixed Income	Long U.S. Treasuries	-2	We are underweight. Persistent budget deficits and geopolitical fragmentation could drive term premium up over the near term. We prefer intermediate maturities less vulnerable to investors demanding more term premium.
Fixed Income	Global inflation-linked bonds	Neutral	We are neutral. We see higher medium-term inflation, but cooling inflation and growth may matter more near term.
Fixed Income	Euro area govt bonds	-1	We are underweight. Growth and inflation risks are balanced. Trade uncertainty may hurt growth more than it boosts inflation, allowing the ECB to cut rates more. Greater defense and infrastructure spending will support growth in the medium term but might boost term premia.
Fixed Income	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.
Fixed Income	Japanese govt bonds	-1	We are underweight. Yields have surged, yet stock returns still look more attractive to us.
Fixed Income	China govt bonds	Neutral	We are neutral. Bonds are supported by looser policy. Yet we find yields more attractive in short-term DM paper.
Fixed Income	U.S. agency MBS	Neutral	We are neutral. We see agency MBS as a high-quality exposure in a diversified bond allocation and prefer it to IG.
Fixed Income	Short-term IG credit	+1	We are overweight. Short-term bonds better compensate for interest rate risk.
Fixed Income	Long-term IG credit	-1	We are underweight. Spreads are tight, so we prefer taking risk in equities from a whole portfolio perspective. We prefer Europe over the U.S.
Fixed Income	Global high yield	Neutral	We are neutral. Spreads are tight, but the total income makes it more attractive than IG. We prefer Europe.
Fixed Income	Asia credit	Neutral	We are neutral. We don't find valuations compelling enough to turn more positive.
Fixed Income	Emerging hard currency	Neutral	We are neutral. The asset class has performed well due to its quality, attractive yields and EM central bank rate cuts. We think those rate cuts may soon be paused.
Fixed Income	Emerging local currency	-1	We are underweight. We see emerging market currencies as especially sensitive to trade uncertainty and global risk sentiment.

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