Weekly commentary

BlackRock

April 14, 2024

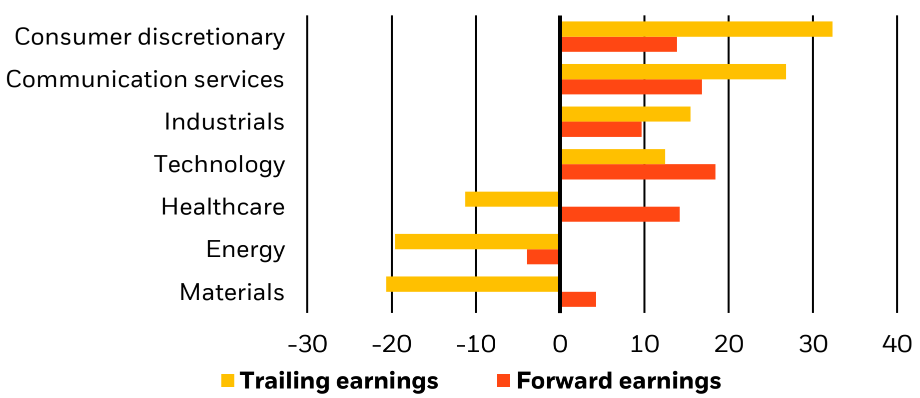
Earnings growth not just about tech

- As Q1 earnings season starts, we eye signs of earnings growth broadening beyond tech stocks to industrials and others. We stay overweight U.S. equities.
- Crude oil prices rose, partly on heightened tensions in the Middle East. We are monitoring the risk of escalation – and potential impact on oil and inflation.
- We're watching U.S. retail sales for an update on the strength of consumer spending after some signs of fatigue in recent confidence indicators.

Solid U.S. economic and corporate earnings growth have supported risk appetite, driving stocks to all-time highs – even as bond yields have jumped. We think earnings will need to deliver on high expectations, especially after last week's data showing sticky inflation spooked investors. As Q1 results start, we look for brighter earnings in sectors beyond tech, like industrials and materials, as the economy holds up. We stay overweight U.S. stocks while monitoring Middle East tensions.

Earnings rotation

U.S. corporate earnings 12-month trailing and forward, April 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. Sources: BlackRock Investment Institute, with data from LSEG Datastream, April 2024. Notes: The chart shows 12-month trailing and forward earnings growth for select sectors in the MSCI USA index.

Solid job gains have supported overall U.S. economic growth. That has helped companies maintain profit margins. Strong growth and resilient profit margins, especially in tech, have combined to help U.S. corporate earnings broadly. Yet the earnings outlook by sector is more nuanced. The consumer goods and tech sectors have driven earnings growth in the past 12 months. See the chart. For Q1 earnings results now underway, we expect further strength for tech and other artificial intelligence (AI) beneficiaries. Yet we see earnings growth broadening out as consumers start to show some signs of fatigue and demand improves in other sectors. Earnings for energy and commodity producers are picking up after a rough two years. We think higher commodity prices can persist and boost both, with the FTSE/CoreCommodity CRB index up 14% this year and near a decade high.

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This recovery in sectors beyond tech is part of the broadening out of stock index performance that we expected. That's one reason we went overweight overall U.S. stocks on a tactical horizon of six to 12 months earlier this year, while still preferring AI beneficiaries. We think market sentiment can stay upbeat if falling goods prices keep dragging down inflation – allowing the Federal Reserve to deliver one or two rate cuts. Yet the March acceleration in core services inflation, excluding housing, suggests overall core inflation could rise again sooner than we had expected. The tensions in the Middle East look contained for now but we see risks of further escalation. We could face elevated oil and commodity prices for longer, reinforcing the new regime of higher inflation – and our long-held view that we are in a higher-for-longer interest rate environment.

The question for stocks: will economic and earnings growth stay strong enough to offset that inflation and policy rate outlook? Surprisingly robust consumer spending has propped up growth. We see a switch ahead: consumer spending could slow as households exhaust pandemic savings, while companies keep investing in factories from government incentives such as the Inflation Reduction Act. We see earnings forecasts holding up this year – but companies will need to deliver on high expectations. Analysts see 2024 earnings growth of 11% – above the 7% historical average, according to LSEG data.

We expect sector performance to diverge and like the industrial, materials and energy sectors over consumer goods. Commodity production has been cut alongside better-than-expected demand. Mega forces – structural changes driving returns now and in the future – also play a role. Prices of metals key to the low-carbon transition, like copper, have rebounded and could rise further. We see AI advances stoking the buildout of data centers, resulting in major commodity demand. Companies bringing production closer to home can boost industrials. We see energy stocks as a potential portfolio buffer against geopolitical risk and think long-term U.S. bonds are less effective in this higher inflation environment.

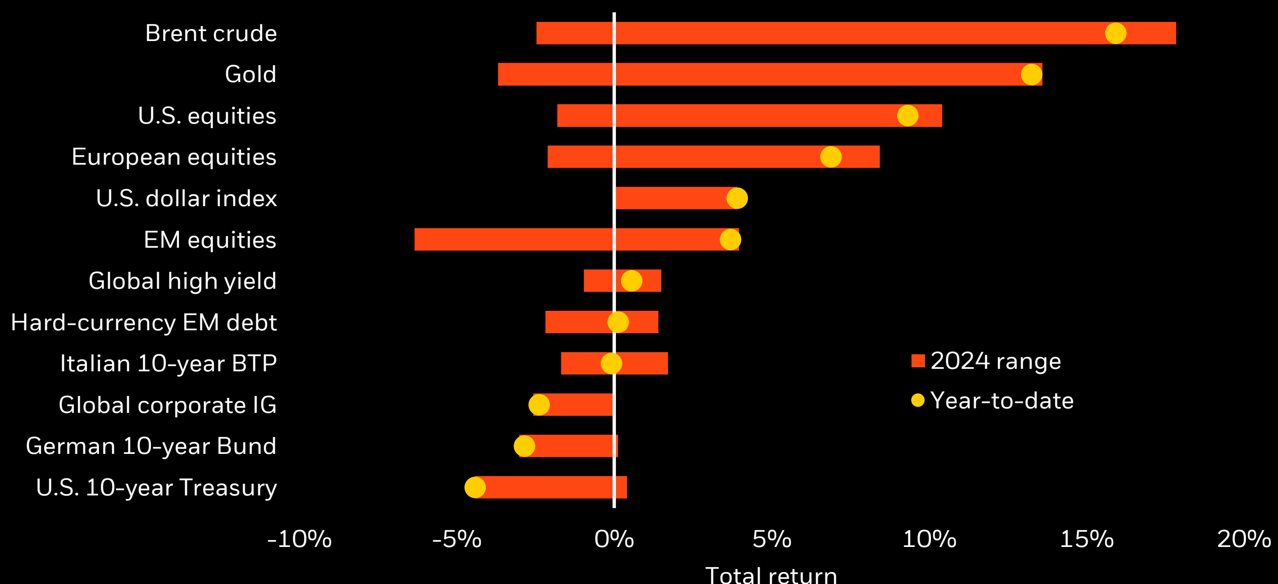
Bottom line: We expect earnings to broaden in sectors beyond tech and still like AI beneficiaries. We're overweight U.S. stocks. We look for selective sector opportunities in industrials, commodities, healthcare and energy.

Market backdrop

U.S. crude oil prices hit six-month highs, partly on heightened tensions in the Middle East. We are watching developments closely after Iran's strikes in Israel over the weekend and see heightened geopolitical risks adding to economic volatility. U.S. stocks fell nearly 2% last week and 10-year Treasury yields pulled back after hitting 2024 highs near 4.60% after the March CPI report. The reported showed services inflation may put upward pressure on overall inflation sooner than we thought.

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 April 11, 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

April 15	U.S. retail sales	**April 16**	Japan trade data, UK CPI
April 17	China Q1 GDP, UK unemployment	**April 10-17**	Japan CPI

This week, we track Q1 earnings now underway – and expect earnings growth to broaden out beyond tech. We look for Monday's U.S. retail sales to shed light on the strength of consumer spending after some signs of fatigue in sentiment data. We also eye China's Q1 GDP for any signs that growth is starting to pick up from its weak state. We also get inflation data in both Japan and the UK. Markets have trimmed expectations for multiple Bank of England rate cuts.

Big calls

Our highest conviction views on tactical (6-12 month) and strategic (long-term) horizons, April 2024

Tactical	Reasons
U.S. equities	• 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	• 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	• We favor getting granular by geography and like Japan equities in DM. Within EM, we like India and Mexico as beneficiaries of mega forces even as relative valuations appear rich.
Strategic	**Reasons**
Private credit	• We think private credit is going to earn lending share as banks retreat – and at attractive returns relative to public credit risk.
Inflation-linked bonds	• We see inflation staying closer to 3% in the new regime on a strategic horizon.
Short- and medium-term bonds	• We overall prefer short-term bonds over long term. That's due to more uncertain and volatile inflation, heightened bond market volatility and weaker investor demand.

Note: Views are from a U.S. dollar perspective, April 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 that 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, April 2024

Our approach is to first determine asset allocations based on our macro outlook – and what's in the price. **The table below reflects this and, importantly, leaves aside the opportunity for alpha, or the potential to generate above-benchmark returns.** The new regime is not conducive to static exposures to broad asset classes, in our view, but is creating more space for alpha**.**

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

	Asset	View	Commentary
Equities	**Developed markets**		
	United States – Benchmark	Neutral	We are neutral in our largest portfolio allocation. Falling inflation and coming Fed rate cuts can underpin the rally's momentum. We are ready to pivot once the market narrative shifts.
	United States – Overall	+1	We are overweight overall when incorporating our U.S.-centric positive view on artificial intelligence (AI). We think AI beneficiaries can still gain while earnings growth looks robust.
	Europe	-1	We are underweight. While valuations look fair to us, we think the near-term growth and earnings outlook remain less attractive than in the U.S. and Japan – our preferred markets.
	UK	Neutral	We are neutral. We find attractive valuations better reflect the weak growth outlook and the Bank of England's sharp rate hikes to fight sticky inflation.
	Japan	+2	We are overweight. Mild inflation, strong earnings growth and shareholder-friendly reforms are all positives. We see the BOJ policy shift as a normalization, not a shift to tightening.
	Emerging markets	Neutral	We are neutral. We see growth on a weaker trajectory and see only limited policy stimulus from China. We prefer EM debt over equity.
	China	Neutral	We are neutral. Modest policy stimulus may help stabilize activity, and valuations have come down. Structural challenges such as an aging population and geopolitical risks persist.
Fixed Income	Short U.S. Treasuries	+1	We are overweight. We prefer short-term government bonds for income as interest rates stay higher for longer
	Long U.S. Treasuries	Neutral	We are neutral. The yield surge driven by expected policy rates has likely peaked. We now see about equal odds that long-term yields swing in either direction.
	U.S. 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 inflation-linked bonds	Neutral	We are neutral. Market expectations for persistent inflation in the euro area have come down.
	Euro area govt bonds	Neutral	We are neutral. Market pricing reflects policy rates in line with our expectations and 10-year yields are off their highs. Widening peripheral bond spreads remain a risk.
	UK gilts	Neutral	We are neutral. Gilt yields have compressed relative to U.S. Treasuries. Markets are pricing in Bank of England policy rates closer to our expectations.
	Japanese govt bonds	-2	We are underweight. We find more attractive returns in equities. We see some of the least attractive returns in Japanese government bonds, so we use them as a funding source.
	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	Neutral	We are neutral. We see agency MBS as a high-quality exposure in a diversified bond allocation and prefer it to IG.
	Global IG credit	-1	We are underweight. Tight spreads don't compensate for the expected hit to corporate balance sheets from rate hikes, in our view. We prefer Europe over the U.S.
	Global high yield	Neutral	We are neutral. Spreads are tight, but we like its high total yield and potential near-term rallies. We prefer Europe.
	Asia credit	Neutral	We are neutral. We don't find valuations compelling enough to turn more positive.
	Emerging hard currency	+1	We are overweight. We prefer EM hard currency debt due to its relative value and quality. It is also cushioned from weakening local currencies as EM central banks cut policy rates.
	Emerging local currency	Neutral	We are neutral. Yields have fallen closer to U.S. Treasury yields. Central bank rate cuts could hurt EM currencies, dragging on potential returns.

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