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# Equity Market Outlook

Q2 2025

**BlackRock**

**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.

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# Foreword



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## **A year that opened with optimism for global equities was rattled by tariff announcements that sent markets into a tailspin.**

Trade and tariff uncertainty that stoked early-year volatility was supercharged at the start of Q2 by far-reaching U.S. tariff pronouncements that set off a global market meltdown and reignited recession fears in the process.

Beyond tariffs, the second Trump presidency ushers in a broader new policy regime, with a range of yet untold macroeconomic and market implications. While tariffs are paramount today, the potential for market-supporting policies such as deregulation and corporate tax cuts leave room for emergent optimism.

Late January also brought news of DeepSeek, the small Chinese start-up that seemed to achieve AI model success on par with the major U.S. players at a fraction of the cost. Massive capital expenditure by the big-four U.S. hyperscalers was called into question on fears it was an overshoot with little potential for proportionate return on investment.

The market reeled in reaction, causing some to question if equities could power on without the propulsion of the AI trade. While concerns still linger, the hyperscalers not only reaffirmed but increased their capex spending intentions for 2025 and DeepSeek is now heralded as a catalyst to spur ever-faster progress in the race to artificial general intelligence (AGI).

What can we take away from this AI consternation? As we have said before, mega forces never move in a straight line. Even the savviest business minds have been taken by surprise during periods of disruption. Well-echoed comments across time had cast doubt on some of the most successful innovations, including desktop computers and smartphones.

Ultimately, Q1 market action reversed some of the more exceptional Q4 moves and continues to play out amid the tariff shocks. Still, we believe some of the corrections may be overdone, causing dislocations between fundamentals and current pricing — and opening some interesting entry points and attractive prospects. Caution and selectivity are key.

The path forward will likely be paved with more volatility — as well as dispersion across sectors, geographies and individual stocks. This points to the importance of an active approach to capitalize on inefficiencies and to make the most precise and intentional decisions in this time of historic change and transition.

No one can predict the results of countless bilateral tariff negotiations, but we believe having a pulse on company dynamics, especially when the macro picture is unclear, can be a differentiator for portfolios.

In our **Q2 Equity Market Outlook**, senior active equity investors offer their views on key themes they see shaping equity markets.

# Fundamentals fuel U.S. equity optimism



**Tony DeSpirito**

Global CIO, BlackRock  
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**We expect the market to continue to broaden out — not only from ‘Magnificent 7’ leadership to the rest of the U.S. but to other parts of the world as well.**

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After two consecutive calendar years in which the S&P 500 Index returned more than 20%<sup>1</sup> — a rare occurrence as we discussed in our Q1 outlook — some question whether U.S. stock market leadership will be upended, particularly amid the prevailing unease.

Our take: U.S. equity dominance exists on a continuum in which perceptions can range from overinflated to underinflated. A strong rally in Q4 2024 and dramatic pullback year-to-date offer examples of each, with both driven largely by sentiment. But such moves, whether based on macro concerns like tariffs or the natural ebbs and flows of the AI mega force, are distinctly different from the fundamental foundations that we believe give U.S. equities an enduring secular advantage. We see this in three areas:

## Supportive policy impulse

Corporate strength has long supported U.S. equity fortitude and comes through in earnings and market share. U.S. companies posted earnings growth of more than 18% year-over-year in Q4. This compared to 7%-8% in Europe.<sup>2</sup> The total market cap of public companies in the U.S. — \$63 trillion at year-end 2024 — represents more than half of global market value, according to Dow Jones Market Data. Europe, mainland China and Hong Kong together represent only 25%.

On balance, relatively pro-industry policies have long stimulated healthy free cash flow. Many companies across time have deployed that cash for future business growth. While policy uncertainty in this time of transition has some companies pausing large investment decisions, we believe potential moves toward deregulation and reshoring of supply chains once policy is settled could ignite capex spending across industries, including technology and industrials. Our data shows mentions of “deregulation” in Q4 earnings calls were up 20x in the three months relative to the average in the prior four years. Even as the word “tariffs” dominates today, we expect deregulation and other policy priorities to regain attention.

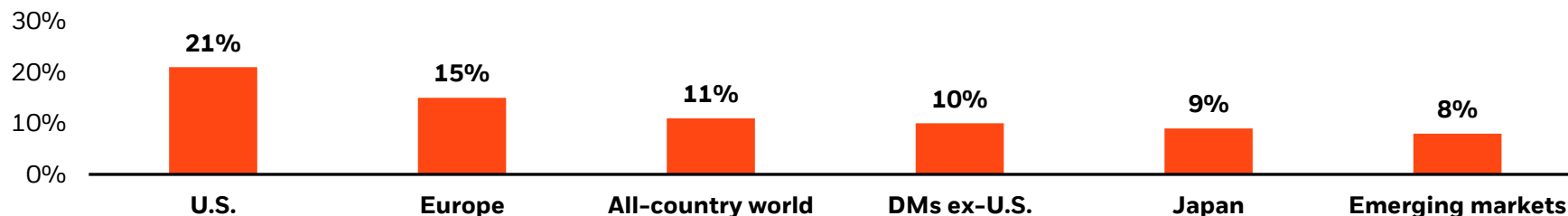
## Compelling corporate quality

We find quality and efficiency to be important hallmarks of the companies that make up the public stock universe in the U.S. Commentators will often cite the prevalence of a large number of tech companies in the U.S. as the driver of U.S. equity dominance. But our analysis points to wider breadth in U.S. quality. Current return on tangible invested capital (ROTIC), a proxy for a company’s ability to allocate capital for optimal profitability, is significantly higher in the U.S. than elsewhere in the world, suggesting quality exists not in pockets but across sectors. See chart on the following page.

# Fundamentals fuel U.S. equity optimism

## Standout profitability

Median ROTIC of select regions, 2025



**Indexes are shown for illustrative purposes only. It is not possible to invest directly in an index.** Source: BlackRock Fundamental Equities, with data from Refinitiv as of March 7, 2025. Chart shows the median ROTIC for each region with the U.S. represented by the Russell 1000 Index, Europe by the MSCI Europe Index, All-country world by the MSCI ACWI, DMs ex-U.S. by the MSCI World ex-U.S., Japan by the MSCI Japan Index and emerging markets by the MSCI EM Index.

## A thirst and thrust for innovation

A final long-term secular trend we see supporting U.S. equities: high drive for innovation. The U.S. is home to some of the largest and most innovative companies in the world. It is at the forefront of the AI infrastructure buildout, and a leader on the global stage in both R&D spending and patent applications. Intellectual property laws serve to stimulate this innovative impulse while offering federal protections for the fruits of those efforts. The U.S. has more than half the world's "unicorn" companies, private start-ups valued at more than \$1 billion.<sup>3</sup>

We believe any moves toward policy targeting deregulation could accelerate this innovative edge. At the same time, we are watchful of developments around antitrust enforcement as relates to big tech. Trade policy is more complex — in both the ongoing machinations and the ultimate end game. We believe the U.S.'s position as the world's largest net importer of goods

could blunt the economic impact relative to some global peers, and we continue to monitor developments and potential implications at an individual company level. Notably, we looked at equity returns in times of elevated economic policy uncertainty and found that markets have historically outperformed in the ensuing 12 months relative to periods with more muted policy uncertainty.<sup>4</sup> We are hopeful for history to repeat.

All of the above contributes to our positive long-run outlook for U.S. stocks. In the nearer term, we expect the market to continue to broaden out — not only from "Magnificent 7" leadership to the rest of the U.S. but to other parts of the world as well. First-quarter results may be a teaser, with developed markets ex-U.S. leading returns, followed by emerging markets and then value stocks within the U.S.<sup>5</sup> That final area is one where we see significant opportunity and one where many investors may be unintentionally underexposed as the major U.S. indexes have grown increasingly growth oriented in recent years.

**Past performance is not a reliable indicator of current or future results.** Any opinions or forecasts represent an assessment of the market environment at a specific time and is not a guarantee of future results. This information should not be relied upon by the reader as research, investment advice or a recommendation. <sup>1</sup> Source Bloomberg. <sup>2</sup> Source: BlackRock Fundamental Equities with data from Refinitiv and FactSet, March 2025. <sup>3</sup> Source: Eqvista, "Complete list of unicorn companies," January 2025. <sup>4</sup> Economic policy uncertainty is measured by the US Economic Policy Index from 1985 to present. Elevated uncertainty is represented by an index reading above 200. <sup>5</sup> BlackRock Fundamental Equities, with data from Bloomberg as of March 31, 2025. Indexes used are MSCI World ex-U.S., MSCI ACWI ex-U.S. and Russell 1000 Value.

# Sizing up the impact of U.S. policy uncertainty



**Raffaele Savi**

Global Head of Systematic; Co-CIO and Co-Head of Systematic Equities



**Jeff Shen**

Co-CIO and Co-Head of Systematic Equities

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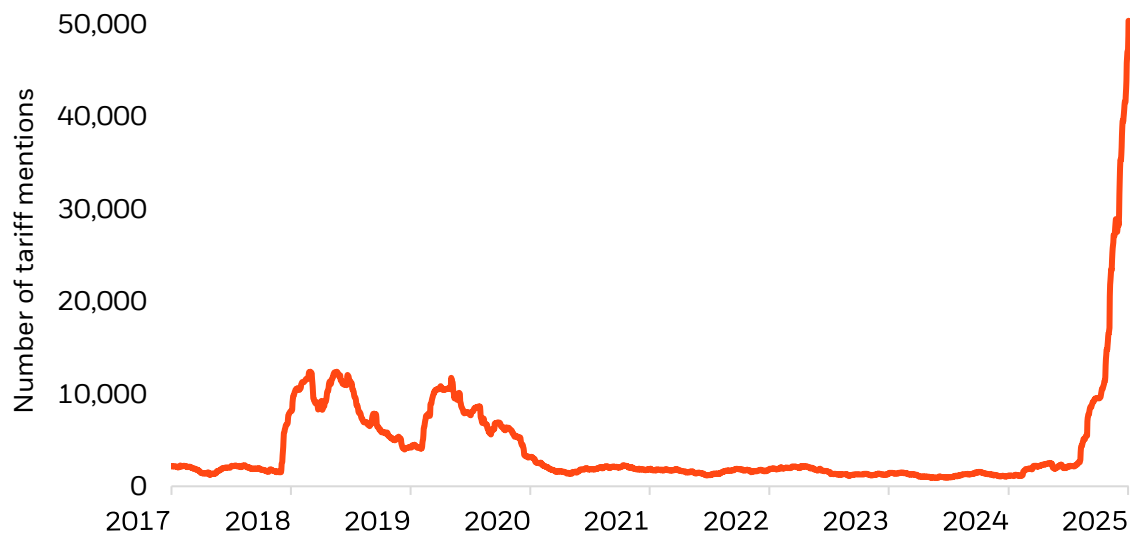
**Policy uncertainty can beget a choppy investment landscape, but it can also fuel opportunities to capitalize on the greater dispersion in company outcomes that such an environment creates.**

Recent market turbulence is fundamentally driven by uncertainty, particularly as relates to tariffs. The new U.S. administration’s policies have already started to alter the economic and market equilibrium established in recent years. This shift adds a significant layer of complexity to the balance of opportunities and risks ahead, pointing to the importance of being dynamic in making investment decisions today.

Even leading up to the early Q2 tariff announcements, the administration’s focus on trade and tariffs in the sequencing of policy priorities increasingly captured investor attention. The chart below reveals that by the end of Q1, the number of tariff mentions in news articles — a proxy for market focus on the topic — had far surpassed peak levels observed during the 2018–2019 period of tariff escalation in President Trump’s first term.

## Attention to tariffs hit new highs

Tariff mentions in news articles, 2017–2025



Source: BlackRock Systematic, with data from Dow Jones as of March 31, 2025. Chart shows number of “tariff” mentions in news articles measured on a rolling 90-day basis.

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# Sizing up the impact of U.S. policy uncertainty

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While other policy priorities, including deregulation, have the potential to drive upside in the markets ahead, we expect uncertainty surrounding the impact of tariffs, retaliatory actions, and the cumulative effect of other policy initiatives will continue to drive volatility.

Under the surface of broad market moves, tariffs can also contribute to higher return dispersion as company vulnerabilities vary widely based on the global exposure of their business models and supply chains. Successfully navigating this complex backdrop requires skilled security selection and the ability to dynamically adapt to the fast-evolving policy shifts influencing markets.

## A systematic measure of tariff sensitivity

Data-driven systematic insights can be instrumental in providing a real-time view of how companies are positioned for policy changes. Focusing on trade policy specifically, we leverage a range of inputs to gauge company sensitivity to tariffs:

**Conference calls:** Large language models and conference call transcripts are useful in assessing the evolving sentiment of management commentary related to tariffs. Our analysis of the 2018-2019 period of tariff escalation suggests companies with complex global supply chains and significant

manufacturing abroad with high U.S. revenue exposure are most vulnerable. This includes certain consumer cyclicals, autos and industrials.

**Geolocation data:** We track the physical location of company factories to identify those with a large manufacturing presence in the U.S. These may be better positioned on a relative basis. Examples include U.S. companies prioritizing domestic reshoring and non-U.S. companies with substantial U.S. manufacturing footprints, which may provide greater insulation from tariffs than many investors expect.

**Shipping data:** Real-time monitoring of U.S. import activity helps us identify companies with a high proportion of U.S. imports relative to earnings, making them more sensitive to tariffs. Some examples include a European chemical company, European automaker, and certain U.S. retail and industrial firms. This data also helps inform our view of earnings implications by adjusting the effective tariff rates currently paid by companies for estimated future increases.

These datasets, and thousands more inputs like them, can help to uncover unique insights — and potential alpha opportunities — across the breadth of the equity market. While policy uncertainty can beget a choppy investment landscape, we believe it also fuels opportunities for skilled active investors to capitalize on the greater dispersion in company outcomes that such an environment creates.

# All eyes — and a selective hand — on Europe



**Helen Jewell**  
EMEA CIO, BlackRock  
Fundamental Equities

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**We believe European stocks are supported by a unique set of tailwinds in 2025, although it's important to be selective as not all sectors and companies may benefit equally.**

The outperformance of Europe versus U.S. equities was the greatest in any January for a decade,<sup>1</sup> and the trend continued for much of Q1.

Many of the catalysts for that move remain in place and could support a resumption of positive momentum as tariff shocks fade. These include: the perception that a potential Ukraine peace deal may bring lower energy prices to Europe; historic plans in Germany to unleash spending on defense and infrastructure amid U.S. policy changes and the broader mega force of geopolitical fragmentation; muted inflation that allows for European Central Bank (ECB) interest rate cuts; hopes that stimulus in China will boost the economy and benefit Europe's exporting companies; and most important, in our view, robust earnings — growing by more than 7% in the fourth quarter of 2024 versus the same period a year earlier.<sup>2</sup>

In all, we believe European stocks are supported by a unique set of tailwinds in 2025, although it's important to be selective as not all sectors and companies may benefit equally.

The valuation gap between U.S. and European stocks has narrowed from a record-wide level, yet the European discount remains historically large. See chart on the following page. We see potential for the Europe convergence to continue, even in the face of tariffs. Investor flows into European equities have only just started to return after the enormous outflows that followed the start of the Ukraine war, so we believe still underweight positioning supports further rebalancing toward Europe.<sup>3</sup>

Risks remain. First, tariff machinations cloud the outlook and could hit Europe's large auto sector especially hard. Second, a Ukraine peace deal may not actually bring much lower gas prices to Europe given the EU's desire to move permanently away from Russian fossil fuels by 2030. And third, while Germany has the capacity to spend more money and boost growth, some other European countries are constrained by high debt levels.

## A time for portfolio balance

We believe a balanced approach in portfolios makes sense amid this uncertainty, with an element of value stocks that are cheap relative to their fundamentals, as well as stocks that are set to benefit from the huge, long-term shifts around AI and energy efficiency.

On the value side, we still back the banks even after recent volatility. An impressive 12-month run<sup>4</sup> was followed by a big tariff-induced pullback that we believe opened some attractive entry points. Many market participants are concerned about ECB rate cuts, and European banks remain cheap — at a roughly 25% discount to their long-term average valuation.<sup>5</sup> We believe earnings can remain resilient even if rates fall to around 2% in Europe. Costs are coming down, asset quality is improving and many banks surprised the market with their net-interest income levels in the most recent earnings season. This puts them in a position to return lots of cash through dividends and buybacks. On average, European banks plan

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# All eyes — and a selective hand — on Europe

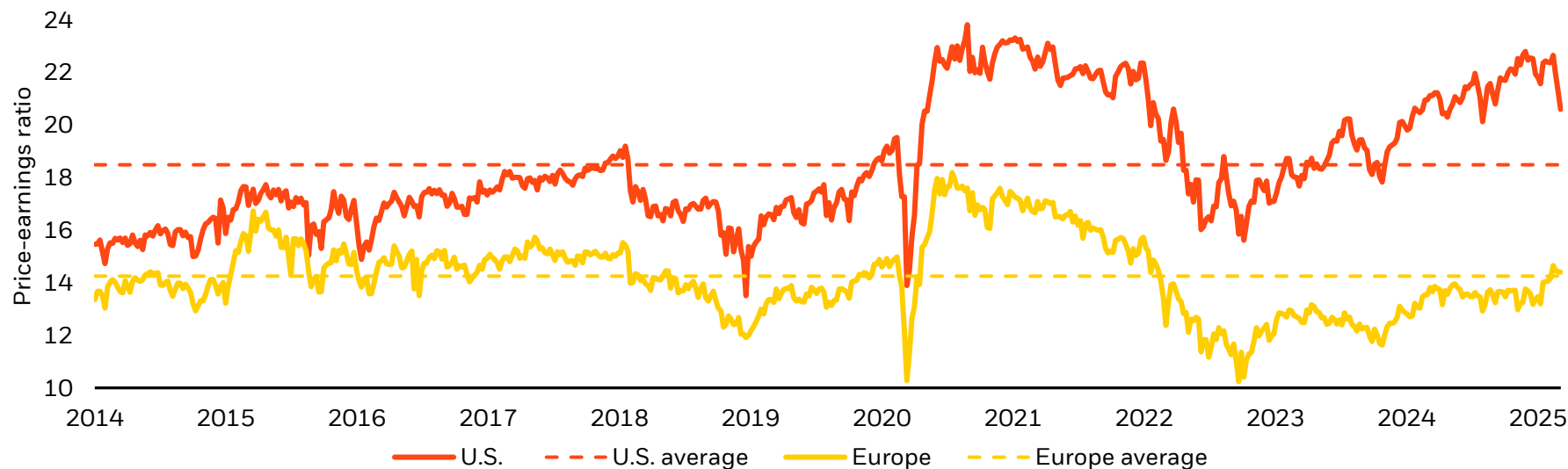
to return 30% of their market cap to shareholders over the next three years.<sup>6</sup> And for growth, we like several industrial companies set to benefit from long-term spending trends. Europe is home to world-leading businesses that can facilitate both the construction and the cooling of data centers; implement factory automation as supply chains are brought closer to home; improve the energy efficiency of buildings; and drive the process of electrification.

We also retain conviction in companies in the civil aerospace industry that can benefit from deep supply-demand imbalances, in part the result of a steep rebound in travel following COVID shutdowns.

Differentiated investment opportunities exist in Europe, in our view, and we continue to believe in the investment case for 2025. Yet selectivity and balance are key amid volatile and uncertain markets.

## Mind the (very wide) gap

Europe vs. U.S. stock market valuations, 2014-2025



Indexes are shown for illustrative purposes only. It is not possible to invest directly in an index. Source: BlackRock Investment Institute, with data from LSEG Datastream and MSCI as of March 11, 2025. The lines show each market's current 12-month forward price-to-earnings ratio, calculated using I/B/E/S earnings estimates for the next 12 months. Regions based on MSCI indexes.

Any opinions or forecasts represent an assessment of the market environment at a specific time and is not a guarantee of future results. This information should not be relied upon by the reader as research, investment advice or a recommendation. **1** CNBC, FactSet, Feb. 18, 2025. **2** Source: LSEG Data & Analytics, March 2, 2025. **3** Source: BoA Global Research. For every \$100 of European equity outflows since the start of the Russia/Ukraine/NATO war (\$255 billion in outflows since February 2022), there have been just \$4 of inflows in the past four weeks (March 6, 2025). **4** Source: Bloomberg. European banks up 45% over past 12 months, versus 7% for global equities. **5** Source: BNP Paribas Exane, March 2025. Index used is the SX7P European banks index, looking at valuations going back 30 years. **6** BlackRock Fundamental Equities analysis, March 2025.

# Asia's diverse AI universe



**Belinda Boa**  
CIO of Emerging Markets,  
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**We believe a global approach to AI investing could gain from Asia's ample breadth, liquidity and potential for sector and currency diversification.**

Artificial intelligence (AI) seemingly moves at two speeds: fast and faster, blurring the lines between buildout and adoption and fast-tracking productivity gains many anticipated could take years to realize. We believe Asia's technology titans and intellectual capital are contributing to the time squeeze and, in the process, expanding potential investment opportunities.

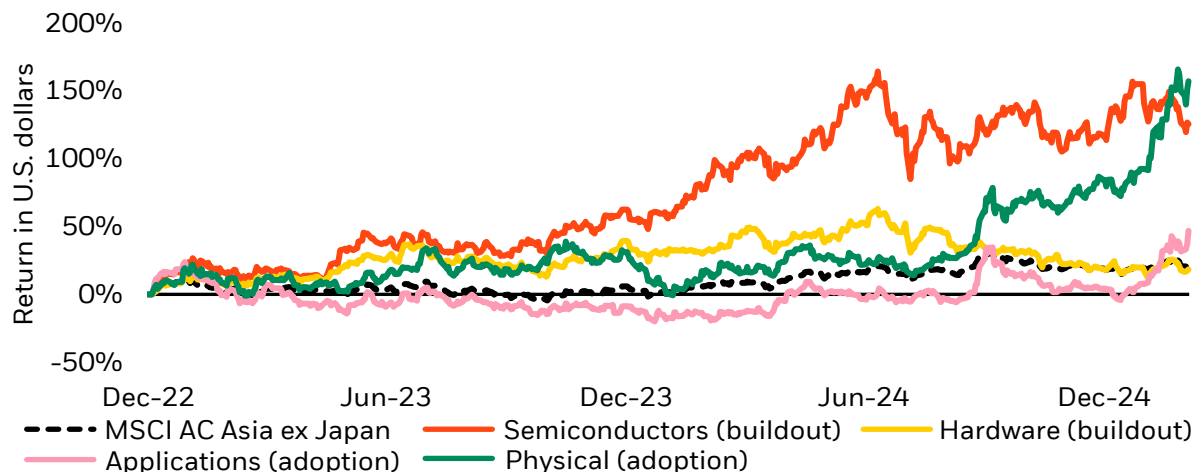
For investors looking past policy uncertainty to the AI mega force, we find Asia's robust AI ecosystem offers diversification potential within a single

theme. Correlations have varied significantly among the semiconductors and hardware that are the building blocks of AI infrastructure and the applications and physical manifestations of AI adoption, with the latter potentially more insulated from tariff-related concerns.

Beyond that, we see opportunity for geographic and currency diversification — South Korea, Taiwan, China offshore (H-shares) and China onshore (A-shares). Yet industry dynamics change and find their way into performance, as shown below.

## A dynamic ecosystem

Performance of AI-related industries in Asia, 2022–2025



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# Asia's diverse AI universe

We believe such diversification opportunities and performance variations underscore the potential advantage of an active approach.

Where are the opportunities? On the hardware side, Asia's chip companies, as well as suppliers of servers/storage and related materials and manufacturing processes, are aiding the buildout.

In software, companies in AI-generated content technologies (e.g., natural language processing, large language models, computer vision) and applications for end users (e.g., chatbots, video/game engines, virtual humans/assistants) are speeding up adoption. The same can be said of companies with technologies that interact with the physical world (e.g., autonomous driving, humanoid robotics, AI of things).

## China clouds

China's economic outlook remains foggy. U.S./China tariffs are key to watch. In addition, China's property sector needs more fixing, consumers aren't spending enough, society is aging fast, geopolitical and economic tensions have risen and fiscal reforms continue to underwhelm. While all of this undermines short-term equity market performance, AI is about the long term.

DeepSeek's large language models advanced the conversation on AI, stressing efficiency in technology and capital deployment. The buildout to general purpose AI will still require massive investment over multiple years. In the short horizon, China's AI-empowered tech companies could stimulate consumer and business demand in ways monetary and fiscal policies have not. We see three reasons for this:

First, these companies, particularly the internet commerce giants, have a pulse on people's wants and incentives to spend. Second, both enterprises and individuals in China are known for their strong impulse to adopt new technology. Third, tenuous geopolitical and global trade dynamics compel policymakers to focus on domestic growth engines, and private enterprises appear optimally positioned. President Xi Jinping's recent meetings with company executives could signal a new era of cooperation.

Our analysis finds that the pre-tariff surge in China-listed shares of diversified internet commerce giants with cloud services was well-grounded in fundamentals. An optimistic view could see the positive momentum broadening in the market, yet caution and a selective approach is warranted as China's economic story continues to evolve and geopolitical factors, including those related to U.S. policy, feature heavily.

## A growing AI ecosystem

AI proliferation outside traditional tech sectors has accelerated thanks to easier and cheaper ways to access it, and as more efficient use of computing power maximizes the capabilities of existing hardware. Asian countries are embracing the AI revolution, from the big infrastructure build to adoption via applications and automation. Japan, for example, has led in efforts to use technology to address societal problems such as the aging population and labor shortages.

Since Chat GPT came out at the end of 2022, correlations across the AI opportunity set have varied widely within Asia. They've also shown differentiation relative to their U.S. counterparts in the NASDAQ 100. Our calculations show correlations in the area of 64% for hardware and semiconductors and about 38% for application and physical AI.<sup>1</sup>

For investors looking forward to the long-term AI opportunity, we believe a global approach to investing in the theme could gain from Asia's ample breadth, liquidity and potential for sector and currency diversification.

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