BlackRock

Q1 2025

Taking stock

Market views from BlackRock Fundamental Equities

Can equities three-peat in 2025? With U.S. stocks on pace for a second year of strongly positive returns — and one of their best years in the past three decades — we look forward to the start of 2025 and the factors that could make or break the recent trend. As Q1 nears, we see:

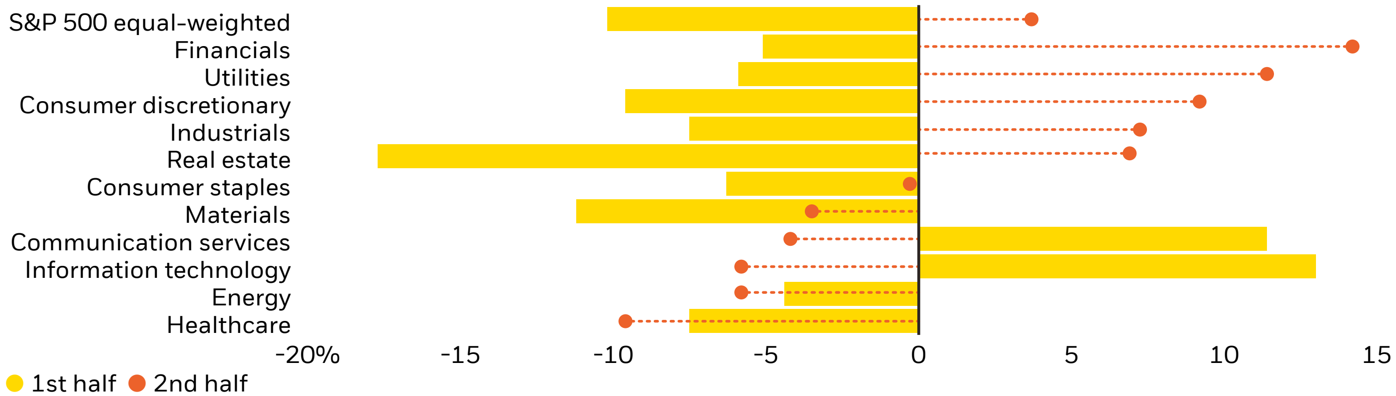
Market and economic tailwinds to start the year	Old uncertainties replaced with some new ones	A compelling case for large-cap value stocks

The S&P 500 Index posted its best month of the year in November, with a clear election result and a "no-surprise" Fed rate cut providing support. Annual performance to date rivals the index's 2023 return of 26%, a notable achievement given that U.S. stocks have posted total returns above 20% in two consecutive years only nine times since 1928 (in less than 10% of rolling two-year periods).* The composition of 2024 performance looks very different from 2023, when the "tech-plus" sectors led the charge. A mid-year sector rotation and overall market broadening in 2024 (see chart below) cut the return contribution of the top-seven S&P 500 stocks (the "Magnificent 7") from 60% in the first half to 23% in the second half through November. We see continued broadening presenting attractive stock selection opportunities as the market rewards a larger swath of fundamentally sound stocks.

Tony DeSpirito
Global Chief Investment Officer, Fundamental Equities

"We're in a period of change and transition, which makes it a particularly exciting time to be an active stock picker."

Broadening toward more balance
Sector performance versus broad market, 2024



Source: BlackRock Fundamental Equities, with data from FactSet as of Nov. 30, 2024. Chart shows total return of the equal-weighted and sector indexes relative to the market-capitalization-weighted S&P 500 Index. Data for the second half of 2024 is through Nov. 30. **Past performance is not indicative of current or future results.** Indexes are unmanaged. It is not possible to invest directly in an index.

* Based on calculations from BlackRock Fundamental Equities, with data from Damodaran for calendar years 1928 to 2023.

This bull still has legs

Investors have been generously rewarded by U.S. stocks over the past two years. What next? We enter 2025 optimistic yet balanced in our outlook, cognizant that two years of big gains and a broadening market suggests a lot of good news is priced into a growing number of stocks. At the same time, we are still seeing enough appreciation potential across individual companies to maintain a constructive, risk-on stance.

The broad market may not deliver another year of outsized double-digit gains. Our analysis finds the historical incidence of 20%+ returns three years in a row drops to 3% of all observations since 1928. In many years of consecutive outsized returns, particularly in the 1990s, both margins and valuations were starting from much lower levels. Yet we do see potential for returns to normalize toward the annual average (that being just below 11% since S&P 500 inception in 1957). We also see potential for skilled stock picking to enhance that outcome as the broadening trend continues and as winners and losers emerge across various sectors. We reiterate our view that what you don't own will be as important as what you do.

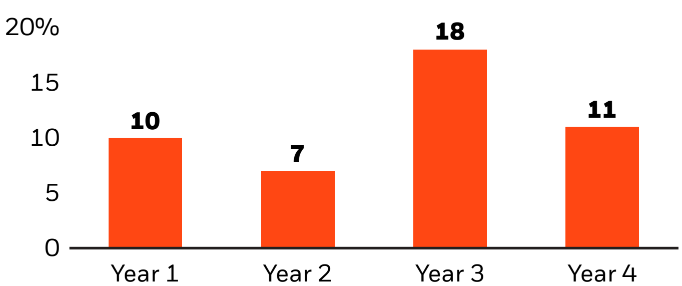
Positive drivers

As the new year begins, we see several factors supporting stocks.

Uncertainty eased. The quick and decisive election result removed a key uncertainty that had been hanging over the market. The rally that followed could have legs into the start of 2025, as the prospect of tax cuts and deregulation across key industries lends support. While the impact of some policies like tariffs and immigration is more uncertain, history augers well, with a long-term record of positive returns in the first year of a presidential term, as shown below.

History paints a positive picture

Performance through presidential terms, 1928-2023



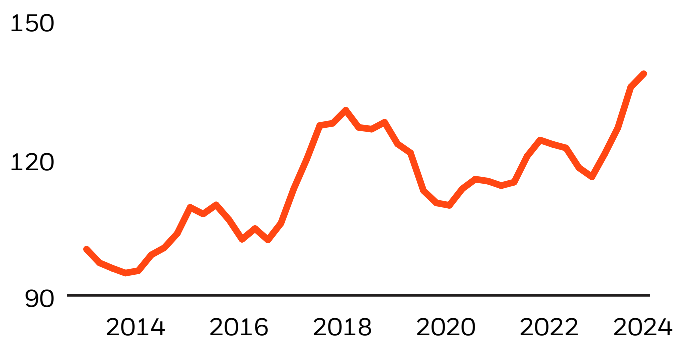
Source: BlackRock Fundamental Equities, with data from Damodaran covering calendar years 1928-2023. Chart shows average performance of U.S. stocks as compiled by Aswath Damodaran of the Stern School of Business. **Past performance is not indicative of current or future results.** Indexes are unmanaged. It is not possible to invest directly in an index.

Favorable economic backdrop. The U.S. economy appears strong on many measures. Unemployment has inched up but remains low at 4.2% as of November; consumers are showing resilience, notwithstanding some stress among the lower-income cohort; and a tight housing market is contributing to historically high home equity values and a related wealth effect.

Corporate change. We're in a period of accelerating corporate change — from new products (both AI itself and AI-inspired) to changes in company leadership and corporate strategy. Management turnover, as disclosed in company press releases, has shown a clear uptick (see chart above right), and CEO departures through

Shake-ups at the top

Rise in mentions of 'management change,' 2013-2024



Source: BlackRock Fundamental Equities, with data from AlphaSense as of Sept. 30, 2024. Chart shows a roughly 40% increase in S&P 500 company press releases that mention "management change" or related terms through the third quarter of 2024. Data is rebased to 100 as of Q4 2013.

October of this year represent the highest year-to-date total as recorded by Challenger, Gray & Christmas since 2002. We expect M&A activity also could pick up in an environment of less restrictive regulation.

Long-term structural trends (aka mega forces) are also contributing to this atmosphere of change. These include the transformative effects of AI, aging populations, energy transition, geopolitical fragmentation and shifting supply chains. Broad indexes will ride the waves of change, but we believe active investors are better equipped with the dynamism to take advantage of the opportunities and risks that this pace of change can present. Even the most potent mega forces historically have not moved in a straight line, making the ability to adapt and adjust a critical asset.

Widening market breadth. Earnings and valuations together suggest the strong potential for a continued broadening of the market. Our analysis of S&P 500 data finds that earnings for the Mag 7 stocks outgrew the broader market by 37% in 2023. This earnings gap narrowed throughout 2024 and we see it declining to 7.5% in 2025. Yet the valuation differential between these market leaders and the rest remains wide. We believe this translates into exciting stock-picking opportunities, particularly amid an organically changing roster of winners and losers.

Risk aware

The outlook is not without risks. Clarity in some areas is offset by uncertainty in others. New policies around trade and immigration could be inflationary across time. More broadly, there are undertones of consternation over the prospect for future inflation. These concerns are not without merit. In prior cycles when inflation was 6% or higher, a second wave of 6% inflation followed in nine out of 10 instances, according to a 2024 Strategas study of 23 developed market countries across more than 2,000 years of data. We saw this in the 1970s in the U.S.

Other policy changes under a new administration are yet to be determined, and geopolitical risks remain elevated. We have a constant eye on the equity risk premium (ERP), which measures the value of stocks relative to bonds. While the ERP is low for some of the priciest areas of the market, including the mega-caps, we find that it remains well in line with historical averages for the equal-weighted S&P 500 Index.

SPOTLIGHT TOPIC

Revisiting value stocks

One notable development amid the expanding market breadth we've observed since mid-2024 has been the neck-and-neck performance of value and growth stocks. This comes after two exceptional years for growth that punctuated more than a decade of leadership versus value.

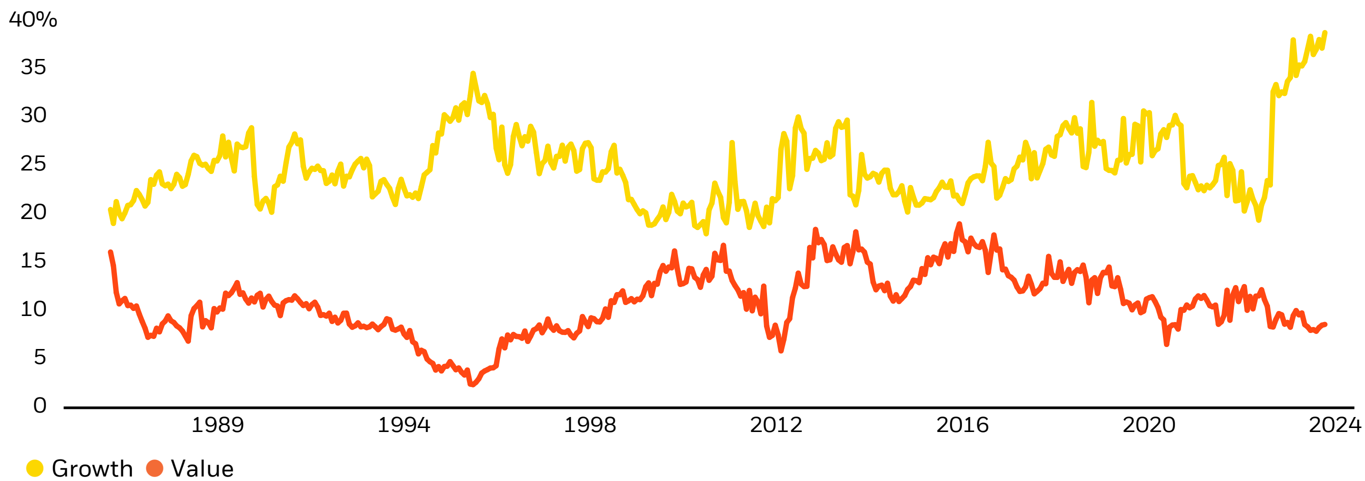
While we don't believe growth momentum is exhausted, we do see several reasons why investors should consider revisiting — and potentially increasing — their exposure to large-cap value stocks.

Portfolios may be unintentionally underweight value

One consequence of recent market dynamics favoring growth and tech stocks has been the diminishing representation of value within U.S. large-cap indexes as growth dominates. Growth made up 37% of the S&P 500 Index as of Nov. 30 compared to a historical average of 24%, as shown in the chart below. This concentration may inadvertently leave many portfolios lacking in diversification and underexposed to value stocks — and, therefore, at risk of missing the potential upside of value rallies such as the one we've seen since July. Value also can contribute a potential element of portfolio insulation should market winds change. The most recent example of this was in the broad market decline of 2022 when a deep growth dive was offset by modest losses in value.

A growing share of growth

S&P 500 style representation, 1989-2024



Source: BlackRock Fundamental Equities, with data from Refinitiv as of Nov. 30, 2024. Chart shows the representation of growth and value stocks (top quintile of each category) in the S&P 500 Index across time.

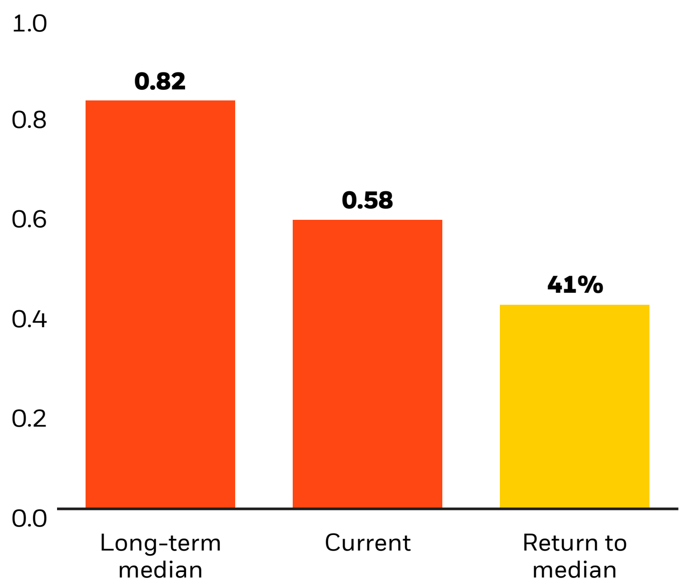
Value is inexpensive relative to history

By their very nature, value stocks are priced below growth counterparts, but the degree of discount has varied across time. Our analysis of growth versus value stocks in the S&P 500 Index finds that valuations would have to rise more than 40% to return to long-term median levels (see chart below). We believe that means potential for ample upside should value stocks begin to climb back toward historic norms, particularly as lofty growth stock valuations may draw investors toward value as the market begins to broaden and reward company fundamentals beyond the mega-cap leaders.

While history does not necessarily repeat, it is worth noting that the last time the valuation gap between the Russell Growth and Russell Value indexes was as wide as it is today, in December 2000, value stocks significantly outperformed growth over the subsequent one-, three- and five-year periods.*

Historically big value in value stocks

Value stock valuation metrics, 1978-2024



Source: BlackRock Fundamental Equities, with data from Refinitiv as of Oct. 31, 2024. The orange bars show the relative forward price-to-earnings (PE) ratio of the top quintile of value stocks in the S&P 500 Index. Long-term median is measured from 1978-2024. Current is as of Oct. 31, 2024.

The case for active value

Intra-year rotations between growth and value leadership are common but difficult to predict. This underscores the importance of maintaining a balance between growth and value in a portfolio to position for changing markets. Yet, as noted above, owning the major large-cap indexes today means owning an outsized share of growth stocks. We believe increasing a portfolio's value proposition is best achieved through an actively managed, disciplined value strategy as even commonly used value benchmarks are leaning more toward core and growth than they have historically.

Generating alpha, or above-market return, can be especially challenging in an environment where market performance is driven by a few dominant stocks. But for active value managers, the landscape is slightly different. With 869 constituents in the Russell 1000 Value Index as of Nov. 30, more than double the number of companies in the Russell 1000 Growth Index, value managers have more alpha-generating possibilities. Concentration is also less of an obstacle, with the top three stocks by market cap making up 34% of the Growth index versus just 8% of the Value index.† This allows value managers greater latitude to pursue differentiated investment strategies without the pressure of holding the top names in the interest of benchmark alignment.

Bottom line

Across styles, sectors and geographies, we believe nimbleness and selectivity will be important to navigating markets in the coming months. If change will be a hallmark of 2025, we expect this will be a pivotal period for active managers with the flexibility and expertise to navigate the vagaries and opportunities ahead.

* Analysis from BlackRock Fundamental Equities with Russell index data sourced from FactSet as of Sept. 30, 2024.
† BlackRock Fundamental Equities analysis as of Nov. 30, 2024.

Fundamental Equities

Expert insight

People	Profound curiosity, deep conviction
Purpose	Active edge, sustainable outcomes
Perspective	Astute, diverse, panoramic
Performance	Long-term lens, risk-aware results

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Unless otherwise noted, analyses cited within are conducted by BlackRock Fundamental Equities with data sourced from Bloomberg, FactSet and Refinitiv.

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