Weekly commentary

BlackRock

July 27, 2026

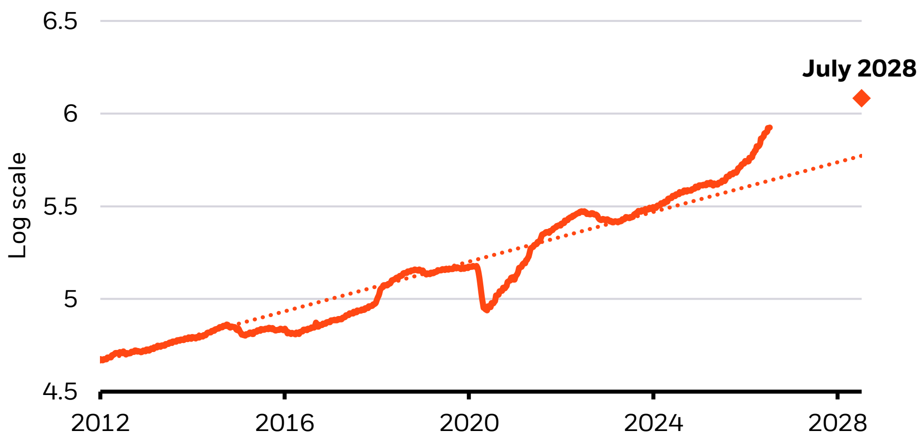
Cheaper AI, new earnings questions

- U.S. earnings remain exceptionally strong. But the focus should also be on AI profit durability, not just another round of earnings beats.
- Geopolitics drove markets last week. Renewed Middle East supply risks and U.S. tariff tensions pushed oil briefly above $100 a barrel and Treasury yields higher.
- The Federal Reserve takes center stage this week. Its rate decision, alongside U.S. GDP and PCE inflation data, could reinforce our high-for-longer rate view.

This earnings season comes with unusually high expectations. Consensus expects a second consecutive quarter of more than 20% S&P 500 earnings growth, driven largely by the AI buildout. Early results have again exceeded forecasts. Yet the bigger question is whether today's extraordinary profit levels can be sustained as cheaper models reshape the economics of AI, a key theme in our Midyear Outlook. The clues are more likely to come from earnings calls than from headline results.

High expectations

S&P 500 12-month forward earnings, 2012-28



Forward-looking estimates may not come to pass. Source: BlackRock Investment Institute with data from LSEG Datastream, July 24, 2026. Notes: The dotted line shows the 20-year linear trend on a logarithmic scale, representing the long-run compound earnings growth path. The July 2028 projection is based on the latest 12-month forward earnings estimate and consensus expected earnings growth from months 12 to 24.

U.S. equities do not look especially expensive on a forward price-to-earnings basis, but cyclically adjusted (Shiller CAPE) valuations remain historically rich. The difference reflects consensus expectations that today's extraordinary earnings growth, supported by the unprecedented speed and scale of the AI buildout, will persist rather than revert to historical norms. See the chart. Whether that assumption holds is the question. The emergence of powerful Chinese AI models, including Moonshot's Kimi K3, could put it to the test. As competition intensifies, the debate is no longer just who will build the best model, but who will capture the economic rent. We think cheaper AI changes the winners, not the investment case. Instead, it reinforces our preference for AI infrastructure over the increasingly competitive model layer.

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The cost of AI is emerging as a key concern for companies deploying it. Gartner expects worldwide spending on AI models and platforms to reach $64 billion in 2026, up 63% from 2025. As enterprise AI bills rise, companies have a stronger incentive to contain costs through model routing and lower-cost models. Reflecting that shift, OpenRouter data on the 10 most widely used AI models show Chinese models processing roughly 23 trillion tokens a week, compared with about 12 trillion tokens for U.S. rivals. Together, these trends could erode the pricing power of frontier model developers even as AI adoption accelerates. Meanwhile, AI sovereignty is encouraging countries and companies to build their own AI capabilities, reinforcing demand for open-weight models and the infrastructure needed to train, host, and deploy AI at scale.

It is too early for this quarter's reported earnings to reveal the impact of lower-cost and open-weight AI models. Instead, the first clues are likely to come from management commentary on earnings calls. We will be listening for two sets of signals. From hyperscalers, we want to know whether they remain committed to the AI buildout through their capital spending plans, how they balance capital discipline in a higher cost of capital environment, and whether those investments are generating returns. Alphabet's earnings last week sharpened that focus after free cash flow turned negative for the first time. Decisions on whether and how to deploy lower-cost models on cloud platforms also matter because hyperscaler cash flows — and increasingly, debt financing — fund much of today's AI ecosystem. From companies across the broader economy, we will look for comments on how they are responding to rising AI costs and the increasing importance of AI sovereignty, including how that is shaping model routing, model choice, and returns on AI adoption. Together, these discussions could offer clues about whether greater competition changes the winners rather than the investment case.

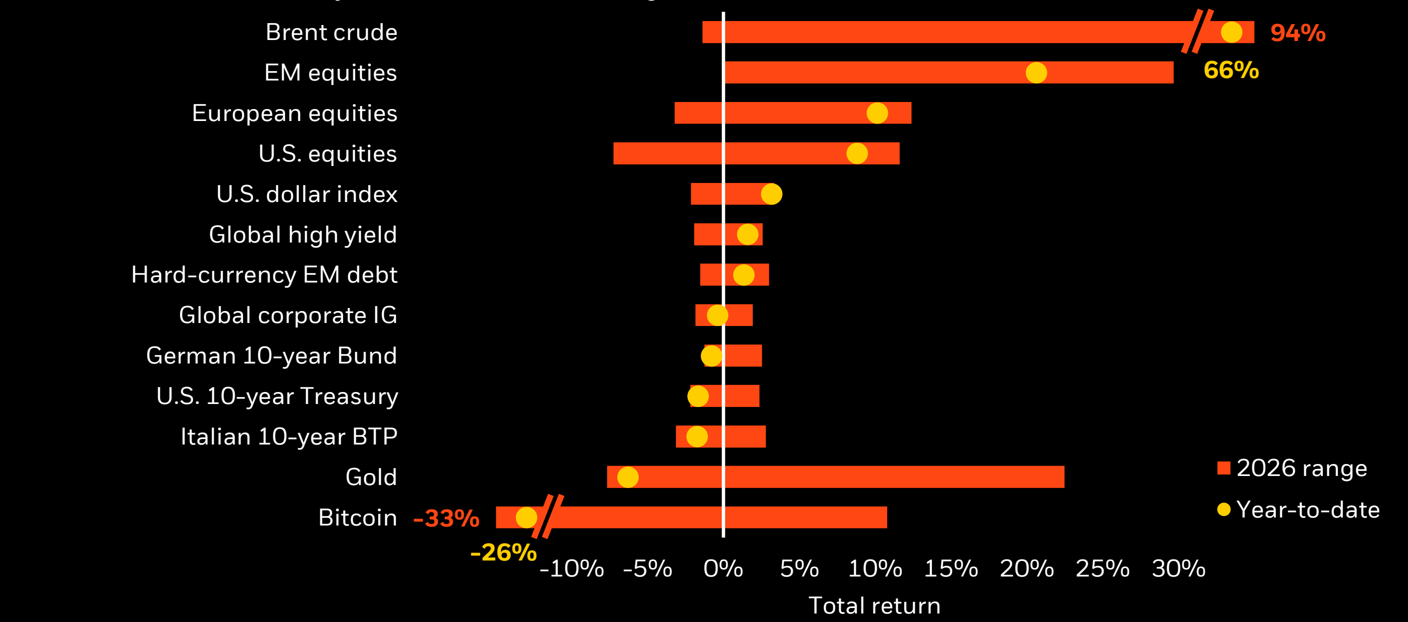
Bottom line: Recent developments may shift where AI's economic rent is captured. But cheaper models could also broaden AI adoption while AI sovereignty reinforces demand for AI infrastructure. We remain overweight on the AI theme, but it requires increasingly selective and active positioning. Rather than trying to identify long-term winners in the increasingly competitive model layer, we prefer investing around AI scarcity. More broadly, the U.S. still stands out for resilient corporate earnings, even outside the AI ecosystem.

Market backdrop

Geopolitical risks returned to the fore last week. A sharp escalation in the Middle East conflict, alongside new global tariffs announced by U.S. President Donald Trump, pushed Brent crude oil prices briefly back above $100 a barrel and lifted 10-year Treasury yields to their highest levels since early 2025 as markets priced in a greater inflation risk. Technology shares also came under pressure after Alphabet raised its capital spending plans, with the Nasdaq ending the week down more than 1%.

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 July 23, 2026. Notes: The two ends of the bars show the lowest and highest res at any point year to date, and the dots represent current year-to-date res. Emerging market (EM), high yield and global corporate investment grade (IG) res 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, spot bitcoin, MSCI Emerging Markets Index, MSCI Europe Index, LSEG Datastream 10-year benchmark government bond index (U.S., Germany and Italy), Bloomberg Global High Yield Index, J.P. Morgan EMBI Index, Bloomberg Global Corporate Index and MSCI USA Index.

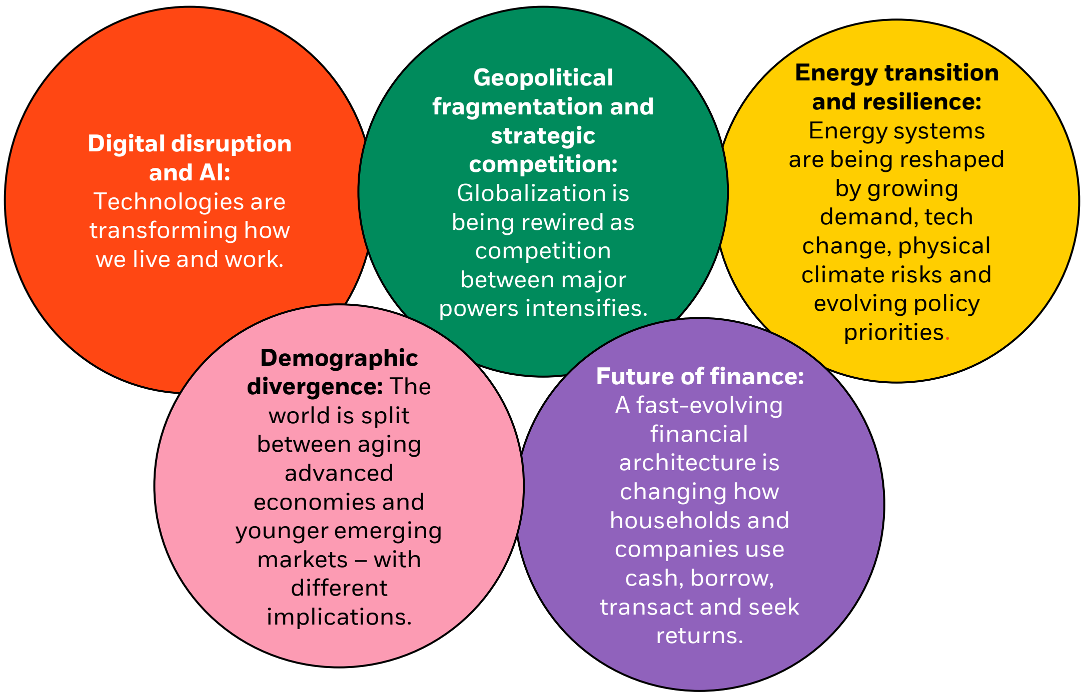
Week ahead

July 27	Japan services PPI	**July 30**	U.S. GDP and PCE; EU GDP and unemployment; BoE rate decision
July 29	Fed rate decision	**July 31**	BoJ rate decision; EU HICP; UMich sentiment; China PMI

Markets face a packed week against a backdrop of escalating Middle East tensions and President Trump's new global trade tariffs. Investors will watch policy decisions from the Federal Reserve, Bank of England, and Bank of Japan, alongside U.S. GDP and PCE inflation data. Together, they will test whether resilient growth and sticky inflation still support our high-for-longer rate view.

Intersecting mega forces

Since we launched our mega forces framework it has become clearer how their intersection shapes almost all our investment views and opens up alpha opportunities. They cut across asset class labels, spurring a rethink of portfolio construction. Investors need to be deliberate about the economic or thematic exposures they own, the vehicles they use to implement them and their investment horizons.



From drivers to portfolio expressions

Our highest conviction views, July 2026

Driver	What we think	Portfolio expression
Growth and AI scarcity	The AI buildout is speeding up, making bottlenecks binding.	Overweight U.S. equities; focus on AI bottleneck opportunities: power, chips and data centers.
Duration and diversification	Long bonds carry high rate sensitivity and are less reliable diversifiers.	Prefer short- and medium-term government bonds over long bonds for income.
Credit spreads and liquidity	Selectivity is crucial amid tight spreads and uneven fundamentals.	Credit with clear cash flows, lender protections and recovery value; higher-rated high yield.
Inflation and scarcity	Scarcity, secure supply and power demand carry inflation risks.	Infrastructure, energy bottlenecks, EM local debt and real-asset-linked exposures.
Alpha opportunity	Macro outcomes matter again in the new regime.	Macro hedge funds, venture capital, market-neutral strategies, and selected private credit and non-U.S. alpha.

Note: Views are from a U.S. dollar perspective, July 2026. 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.

Asset class implications

Six- to 12-month tactical positioning, July 2026

This shows the implementation of our key investment views from the previous page through an asset class lens.

Underweight | **Neutral** | **Overweight** | ● Previous positioning

	Asset	Positioning	Commentary
Equities	**Developed markets**		
	United States	+1	We are overweight. Strong corporate earnings, fueled by the AI buildout and a favorable macro backdrop, are outpacing higher interest rate expectations.
	Europe	Neutral	We are neutral. We would need to see more business-friendly policy and deeper capital markets for Europe to outperform. We favor financials, infrastructure, and industrials.
	UK	Neutral	We are neutral. Valuations remain attractive relative to the U.S., but we see few near-term catalysts to trigger a shift.
	Japan	Neutral	We are neutral. Strong corporate balance sheets and governance reforms remain supportive. We prefer targeted exposures to physical AI and the buildout's bottlenecks.
	Emerging markets	Neutral	We are neutral. We see opportunities where the AI buildout drives demand for infrastructure, particularly in Latin America.
	China	Neutral	We are neutral. We see opportunities in physical AI. Cheap, open-source AI could drive adoption, but that doesn't necessarily translate into AI-provider profitability.
Fixed Income	Short U.S. Treasuries	Neutral	We are neutral. We prefer short- and medium-term Treasuries, given the attractive risk-adjusted income on offer.
	Long U.S. Treasuries	-1	We are underweight. We see investors wanting more compensation for holding long-term bonds amid persistent inflation and high debt loads. Long-duration bonds also are a less reliable portfolio diversifier in the new regime.
	Global inflation-linked bonds	Neutral	We are neutral. We see inflation settling above pre-pandemic levels, but markets may not price this in the near term as economic growth could slow.
	Euro area govt bonds	+1	We are overweight short- and medium-term bonds. Markets are pricing restrictive policy rates of about 3% for several years. We think that's overdone.
	UK gilts	Neutral	We are neutral. We expect periods of elevated volatility given political uncertainty, longer-term bonds making up a larger market share, and buyers becoming more price-sensitive.
	Japanese govt bonds	-2	We are underweight. Rate hikes, higher global term premium and heavy bond issuance will likely drive yields up further.
	China govt bonds	Neutral	We are neutral. China bonds offer stability and diversification but developed market yields are higher. A shift in investor sentiment toward equities limits upside.
	U.S. agency MBS	+1	We are overweight. Agency MBS offer higher income than Treasuries with similar risk and may offer more diversification amid fiscal and inflationary pressures.
	Short-term IG credit	Neutral	We are neutral. Spreads are tight due to corporate strength; they could widen if issuance increases or risk appetite shifts.
	Long-term IG credit	-1	We are underweight. We prefer short-term bonds less exposed to interest rate risk over long-term bonds.
	Global high yield	Neutral	We are neutral. High yield offers attractive income. We prefer higher-rated U.S. and European high yield over investment grade and see dispersion of returns increasing.
	Asia credit	Neutral	We are neutral. Overall yields are attractive and fundamentals are solid, but spreads are tight.
	Emerging hard currency	Neutral	We are neutral. Fundamentals have improved, but we see a more attractive risk-reward profile in EM local debt.
	Emerging local currency	+1	We are overweight. We like the yield relative to its volatility and improving fundamentals.

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