



Equity Market Outlook

Q2 2026

BlackRock

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Foreword



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If 2025 was a year of mega caps and momentum, 2026 begins with refrains of reversal, rotation and recalibration.

One notable reversal is the budding leadership change in the U.S. stock market, where the super-sized stocks boosted for three years by the artificial intelligence (AI) buildout have started to cede their stronghold. Recent concerns over AI disruption have dented the technology sector overall, led by deep declines in software.

This underscores further rotations of fortune across size, style and sectors. U.S. large caps are lagging their smaller brethren year-to-date and value is ahead of growth as investors become more price sensitive. Today's top sectors are 2025's laggards, including energy, materials and staples (more on page 6).

The AI mega force is unmatched in its might, in our view, igniting large and lasting shifts in the long-term profitability outlook across economies. However, AI is also showing signs of recalibration as the opportunity set broadens beyond the prevailing leaders (pages 4, 6). This expansion ultimately means investors have greater choice for sourcing growth.

Of course, choice today extends beyond both AI and the U.S. Europe features pockets of value (page 8) while Japan, the year-to-date developed market leader, appears poised for continued strength after February elections installed a pro-growth, pro-investment government (page 10). And notwithstanding heavy geopolitical reverberations, emerging markets (EMs) are relatively strong out of the gate. Some EM countries, such as Brazil, have been unloved by global investors yet offer attractive growth prospects and compelling valuations (page 8).

All told, we see abundant equity opportunities across the globe. Bouts of volatility are all but assured amid high valuations, concentrated gains in AI-driven stocks, and elevated geopolitical uncertainties to start the year. It's a decidedly complex but exciting market — and one we believe is deserving of dynamic, active management in equities.

Senior members of our alpha-seeking equity platform assess the landscape and offer their views on factor rotation and AI expansion, U.S. market broadening and top destinations for value in our **Q2 Equity Market Outlook**.

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Investing in a fast-changing AI landscape



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Gaining an edge in fast-moving markets requires anticipating change rather than reacting to it.

Sharp rotations have defined equity markets so far in 2026.

Within the AI ecosystem, the market has moved away from treating the theme as uniformly positive for technology economics. Instead, investors are digging deeper, filtering companies through more demanding questions such as: Who captures the revenues and who bears the cost of generating them? How durable are margins as competition intensifies? Which business models are most vulnerable to disruption?

This reassessment has contributed to greater dispersion within technology and beyond, as leadership fragments and capital reallocates across sectors and companies. At the same time, geopolitical uncertainty has added volatility, contributing to reversals and the potential for a more uneven macro and market backdrop.

This marks a shift from recent years, when broad exposure to powerful secular themes such as AI was often sufficient. We believe today's environment calls for greater selectivity and adaptability, as multiple crosscurrents intersect to reshape the opportunity set.

Growth goes beyond first-order AI winners

Recent AI-related volatility reflects a recalibration in market focus rather than a weakening in underlying company fundamentals, in our view.

Earnings are broadening beyond a highly concentrated group of mega-cap technology names tied to AI. This expansion gives investors more choice in sourcing growth, increasing their ability to differentiate based on cost structures, reinvestment requirements, and the durability of competitive moats.

This contrasts with the cycle that followed the 2008 Global Financial Crisis, when earnings growth was largely confined to asset-light technology firms. Capital was abundant and scaling innovation required limited physical investment, justifying a premium for companies with long-duration growth profiles. When growth is scarce, investors tend to pay up for it.

Today, broader earnings participation coincides with rising capital intensity stemming from AI. Where prior waves of technology scaled primarily through code, the current phase scales through capital, requiring infrastructure, power, cooling and compute.

As bottlenecks shift across the AI stack, leadership is extending beyond the initial beneficiaries to additional layers of the AI value chain. In many cases, improving earnings momentum in these segments is paired with valuations that remain relatively attractive or have yet to fully reflect underlying fundamentals.

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Investing in a fast-changing AI landscape

Selectivity in a market defined by rotation

Precision in stock selection is crucial as the mix of opportunities and risks driving rotations continues to evolve. The cyclical nature of style factors — value, growth, momentum, quality, low volatility and size — offers a useful lens for assessing which types of companies may be best positioned as economic and market regimes shift. With earnings strength extending beyond a narrow group of companies and markets placing greater weight on cost discipline and competitive durability, we find the balance of opportunity increasingly favors value over growth. While it may seem counterintuitive, value tends to outperform growth when growth is abundant.

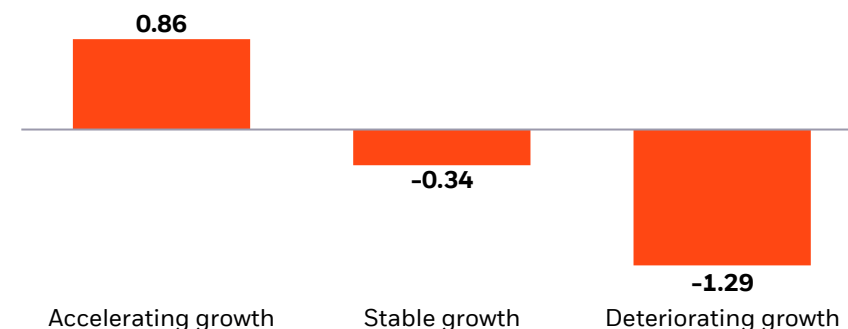
Growth remains attractive, but how it is expressed is important. Momentum has demonstrated resilience precisely because of its adaptability. While typically carrying a meaningful growth footprint, momentum's composition evolves with shifting price trends, enabling the factor to capture improving fundamentals beyond traditional growth sectors. While the correlation between momentum and value has risen from deeply negative levels in October as market leadership has evolved, it remains low, suggesting the two remain complementary and access distinct drivers of return.

Quality's outlook is more balanced in a market where capital remains plentiful, given its historical tendency to outperform in periods of capital scarcity. As markets continue to reward investment while demanding clearer evidence of returns on invested capital, differentiation within the factor is likely to depend more on capital allocation and execution than on balance sheet strength alone.

More broadly, diversification and flexibility in positioning are essential as multiple competing narratives unfold simultaneously. Geopolitical tensions, for instance, can impact markets in several ways — from headline-driven volatility and reversals to the potential for a more challenging growth and inflation backdrop. This reinforces the importance of nimble and balanced portfolio management.

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Value has delivered stronger risk-adjusted returns amid accelerating growth
U.S. value factor information ratio (IR) across growth regimes, 2000–2026



The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results. Source: BlackRock Systematic, March 12, 2026. Growth regimes are defined using the trailing three-month average of U.S. consensus economist GDP forecast revisions. The revision series is standardized using a rolling three-year time-series z-score to assess the strength of growth momentum relative to its recent history. Regimes are classified as follows: accelerating (z-score ≥ 0.5), stable (z-score -0.7 – 0.5) and deteriorating (z-score ≤ -0.7). The value factor reflects a composite portfolio constructed within BlackRock Systematic across U.S. large-cap equities. IR measures average excess return per unit of volatility; higher values indicate stronger risk-adjusted performance.

Systematic tools for staying ahead of markets

Identifying which companies may lead as market leadership rotates is inherently challenging. The signals that matter often surface first in subtle shifts across earnings calls, management commentary, broker reports and policy developments — well before they are reflected in company results or asset prices. Systematic tools designed to extract and contextualize these inputs at scale can help identify inflection points and emerging opportunities early. In rapidly evolving markets, gaining an edge often depends on combining speed, scale and depth of insight to anticipate change rather than simply react to it.

The makings of a broader U.S. stock market



Carrie King

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We expect market broadening to come not in large swaths but in a growing number of interesting pockets across sectors and industries.

Calls for market broadening are not new. But they may have been early as the mega-cap market leaders in the S&P 500 continued to drive returns for longer than many expected. From 2023 through 2025, the AI-amplified “Magnificent 7” stocks returned 222% whereas the remaining stocks in the index returned 52%.

The net result has been an ultra-concentrated market, a “growthier” index to the dilution of core and value, and crowded positioning among momentum-chasing investors. However, we see indications that the long-awaited market expansion may be taking shape.

Why do we expect broadening?

We’re seeing both rotation and greater dispersion in U.S. equity returns to start the year. This may be best illustrated in the performance of the equal-weighted versus market-capitalization-weighted S&P 500 Index.

Through February, the equal-weighted index, which allocates each S&P 500 constituent at equal measure, is outperforming the market-cap-

weighted index. The latter is heavily influenced by the top 10 stocks, which represented nearly 40% of the index as of the end of 2025, more than double the 19% at year-end 2010. This rotation in favor of the equal-weighted index illustrates greater breadth in return contribution across sectors and individual stocks.

The top-performing sectors year-to-date are not the usual suspects — technology and communication services, the total return leaders from 2023 through 2025 — but energy and materials. The shift in price performance is not based on today’s fundamentals, as tech and comms services are still notching the best earnings growth while energy and materials are flat.

Some of the market reaction is sentiment-related. Tech, particularly software, sold off in February on fears of AI disruption. And geopolitical events that sent oil prices higher boosted related energy stocks. However, markets are anticipatory, and some of the rotation may reflect investor expectations of broadening fundamental strength.

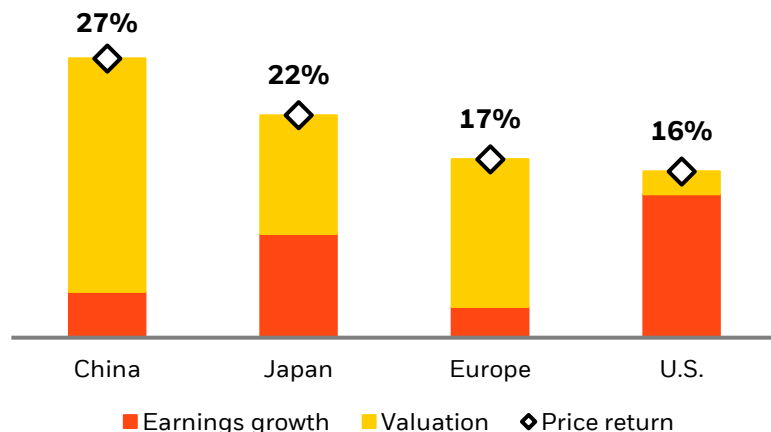
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The makings of a broader U.S. stock market

In 2025, U.S. stock market returns were driven almost entirely by earnings growth, as shown in the chart. Many international markets, even those that outperformed the U.S., were propelled higher primarily on multiple expansion and much less on fundamentals. We expect earnings growth should continue to power U.S. stocks in 2026. Our review of analyst earnings expectations finds that the large growth gaps we've seen since 2023 are looking set to narrow, with Magnificent 7 earnings growth still strong but moderating and the remaining 493 S&P 500 constituents reaching double-digit growth levels for the first time in several years. A healthy earnings outlook across most sectors should also bode well for broader stock performance.

U.S. earnings in the driver's seat

Sources of return by region, 2025



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. Indexes are unmanaged and one cannot invest directly in an index. Source: BlackRock Fundamental Equities, with data from FactSet as of Dec. 31, 2025. Chart shows the composition of returns for the MSCI China, MSCI Japan, MSCI Europe and MSCI USA indexes for calendar year 2025.

Who could benefit from broadening?

We identify three areas we believe could be well placed to gain ground:

Value. Value stocks have been a performance laggard for the past decade, but especially in the AI-powered growth market of the past three years. Value stocks are always priced below the market but we're seeing this discount at an extreme — a 43% discount as of February, compared to a historical median of 19% on data back to 1978. This implies a 43% re-rating opportunity just to return value stocks to their long-term norms.

Dividend yield. Dividend yield reflects a similar historic discount. Our data shows it is the top-performing factor year-to-date and is prevalent in the early-year outperformers (e.g., energy, materials, staples, utilities). We think dividend yield could have room to adjust even higher, especially as an outlook for lower rates could make equity dividends more attractive relative to fixed income.

AI beyond the obvious. The picks and shovels of the AI buildout, particularly semiconductors, have been well rewarded. This opportunity is not exhausted, in our view, but we see more AI-investing doors opening. This is especially true as AI is deployed throughout the economy. Across our global Fundamental Equities platform, we're finding opportunities in underappreciated areas.

One example is healthcare. We find AI use is most mature in areas such as imaging, diagnostics and documentation and are seeing early but meaningful adoption among hospitals, insurers and medical technology companies. We're looking for companies achieving tangible revenue enhancement as a result. One area to watch is drug discovery, where we're seeing AI improve early-stage work but greater biological complexity at later stages, potentially leaving room for progress.

All told, we expect market broadening to come not in large swaths but in a growing number of interesting pockets. This, combined with AI advancement, makes the coming months and years a particularly exciting time for active stock selection.

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A global tour of stock market value



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We see some surprise pockets of value within equity markets for those willing to hunt the globe.

At the start of 2025, there were regions where stock markets were available at a discount to historic valuations. After a year of impressive gains, we see few major indexes trading at a discount, even after recent pullbacks.

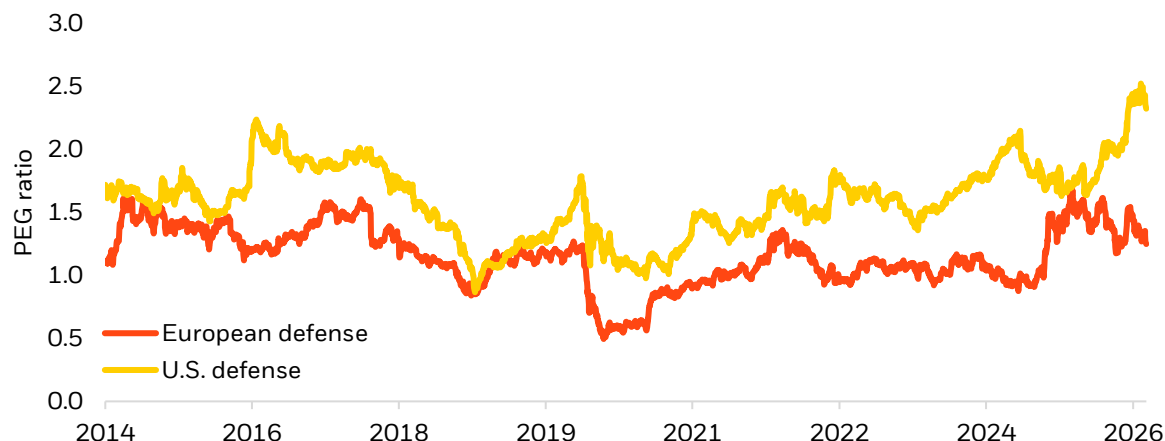
Yet we see some surprise pockets of value for those willing to hunt the globe. These areas may be attractive for investors in a world where geopolitical shocks can often lead to sell-offs in areas that have recently gained the most. Here is a global tour of what we see as potential equity market “bargains.”

In Europe

Geopolitical tensions have kept defense in focus. The European defense sector has gained around 350% over the past three years,¹ starting with the Ukraine war and as NATO countries committed to higher military spending. We still see value, especially after investor profit-taking amid recent volatility. When adjusting for the expected strength of earnings growth, European defense valuations don’t look too lofty and appear far cheaper than U.S. peers, which sit at long-term highs (see chart).

A relative value

Valuations of U.S. and European defense stocks, 2014–2026



Sources: Datastream, FactSet, Goldman Sachs Investment Research, March 2026. Chart shows price/earnings-to-growth (PEG) ratio for U.S. and European defense stocks as represented by Goldman Sachs baskets. PEG ratio is 12-month forward PE divided by next 12 months EPS growth.

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¹ STOXX, using STOXX Europe Targeted Defence Index, <https://stox.com/index/sweutdv/>

A global tour of stock market value

Elsewhere, we still see value in Europe's banks, even after gaining nearly 300% over the past five years. Valuations on a price-to-earnings basis remain below their long-term average and are undervalued relative to U.S. and Japanese peers.

In the UK

The UK's FTSE 100 reached record highs at the start of 2026, after outperforming the U.S. in 2025 by more than five percentage points. This was achieved without any big-tech or pure AI plays. UK stocks may be an attractive option for investors seeking portfolio diversification to balance out exposures to the U.S. and tech. The kicker: They are available at a meaningful discount to the U.S. The UK large-cap index is heavy with banks, which have many of the same qualities as European counterparts, and mining companies, which we believe could continue to benefit from high precious metals prices and a renewed focus on energy and materials independence.

Meanwhile, UK small caps offer unique value relative to their 20-year history, with only Mexican stocks at a bigger discount to their own past.² We believe potential for further Bank of England rate cuts could be a catalyst to get these domestic UK stocks moving again, though potential for higher inflation is a risk.

In emerging markets

Latin America is out of favor with investors. The region accounts for 7% of global gross domestic product (GDP), according to January 2026 data from the International Monetary Fund, but is just 0.7% of the MSCI ACWI.³ We believe parts of the region may be ripe for a rebound.

While broad EM valuations currently sit roughly 17% above their 20-year average, Brazil is at a 10% discount. Yet there are reasons for optimism. Economic signs look healthy, with the composite PMI rising to a level that indicates growth.⁴ And interest rates of 15% — at the highest levels in 20 years — are forecast to come down by as much as 300 basis points in 2026. This will likely benefit highly leveraged domestic companies in the retail and finance sectors — areas unloved by global investors.

We see this source of value as a compelling counterweight to the EM benchmark's tech-heavy influence from countries like South Korea and Taiwan, where many companies are direct beneficiaries of the vast global spending on AI hardware.

These are just some of the areas where we see outright value, or where we think markets may be underestimating the power of future earnings.

Taking an active approach and allocating to some of these areas may result in more balanced portfolios capable of withstanding some of the geopolitical gyrations of the sort we have already seen at the start of 2026.

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An election boost for Japan's equity outlook



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As Japan undergoes important transformations, pro-growth government adds another layer of support for equities.

Japanese equities have outperformed global markets over the past five years, and this trend was accelerated after the recent election. Japanese equities jumped to record highs after Japan's ruling party, led by Prime Minister Sanae Takaichi, won a majority of seats in the February general election.

Why the enthusiasm, and can the momentum be sustained? We remain positive on Japan for three key reasons:

Supportive politics and policy

The new prime minister comes with a pro-growth, pro-investment agenda that was welcomed by markets, as was the potential for a period of political stability that often accompanies a strong election victory.

Before the election, the ruling party had already passed the largest supplementary budget since the COVID-19 pandemic. Key initiatives include investments in strategic sectors such as artificial intelligence, defense and energy, alongside measures to address inflation pressures. These should underpin medium-term market strength. If the new prime minister can signal to the market that the government intends to be fiscally responsible while still investing in key areas, then

we believe politics could remain a source of support for equities.

In addition to these fiscal measures, monetary policy is also supportive. The Bank of Japan is gradually raising rates after decades of ultra-loose settings, with markets pricing policy rates approaching 1% in 2026. Despite this tightening, rates remain accommodative and well below inflation, leaving real interest rates in negative territory. Taken together, we believe a high-approval government pursuing pro-growth reforms, fiscal expansion targeted at strategic sectors, and a carefully managed monetary normalization path create a constructive backdrop for Japanese equities.

Corporate transformation

Japanese companies have made meaningful progress to improve return on equity and balance sheet quality. The decline in the number of Tokyo Stock Exchange (TSE)-listed companies trading below book value is evidence of this transformation. In 2022, half of companies in the TSE prime market, which represents large- and mid-cap companies, were trading below book value. Today, that figure sits at just 29%⁵ — with scope for even more improvement, in our view.

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An election boost for Japan's equity outlook

One of the most important catalysts, in our view, is the upcoming revision to Japan's Corporate Governance Code, expected to take effect in early 2026. These changes aim to enhance capital efficiency by encouraging companies to deploy excess cash and underutilized assets rather than hoarding them on balance sheets. We believe this shift is critical because Japanese firms have historically maintained high cash reserves and cross-shareholdings, which can depress return on equity and limit shareholder value creation.

Continued government, investor and regulator focus on improving shareholder returns has resonated with Japanese companies over the past decade. Those companies that have pursued corporate transformation have delivered better share price performance in recent years, as shown in the chart at right. We aim to identify companies that can continue to lead in this process.

Earnings momentum

We believe political support and corporate transformation can underpin continued earnings growth in Japan. Japanese earnings strength has been driven by companies growing revenue in key areas globally as well as where they have competitive and unique strengths domestically. Examples include hybrid cars, energy-efficient materials and factory automation solutions. In addition, margin improvement has accelerated with the end of deflation in Japan and thanks to a growing presence in global sectors.

We believe earnings momentum can continue across a range of sectors. Japan's market is far less concentrated in technology than the U.S. and offers a balanced sector composition spanning industrials, financials, consumer goods and healthcare. This diversification is attractive at a time of increased AI-related volatility, in our view.

All told, we believe this is an exciting time for Japanese equities. The 17 strategic industries outlined by the Japanese government, which include resource and energy security, shipbuilding, aviation/space and defense, to name just a few, provide a solid foundation for generating stock investing ideas. And indeed, we believe individual stock selection that scans across sectors and sizes can reveal companies that may benefit most from the transformations taking place.

When change is good

Performance of companies disclosing vs. not disclosing change, 2024-2025



Source: BofA Global Research, as of Dec. 16, 2025. Chart shows the performance gap between companies that have disclosed to the Tokyo Stock Exchange their plans for driving corporate change versus those that have not provided such disclosure.

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