iShares

2025 ETF implementation guide

Insights from BlackRock

Navigating Market Trends

Key Takeaways

- We expect U.S. outperformance to continue amid solid economic growth, relatively easy financial conditions, and the potential for tax cuts and deregulatory policies.
- We continue to prefer large-cap, high quality U.S. equities and see tactical opportunities in financials. In fixed income, we prioritize income over price appreciation and prefer the front and belly of the yield curve to long duration exposures.
- Uncertainty associated with both trade and immigration policy could lead to slower growth, higher inflation – or both – over the course of 2025 and beyond. We favour alternative strategies and asset classes to hedge this risk in an environment where long term bonds have been an unreliable source of diversification.

Equity

2024 was a year of U.S. exceptionalism; we expect 2025 will continue the trend. We see the best opportunity for further upside at the intersection of growth, quality, and reasonable valuations.

Fixed income

In core fixed income, we focus on income and yield rather than duration and spread, favouring the short end and belly of the curve. We also see opportunity in high yield strategies even amid tight spreads.

Biggest risks, best hedges

We have a pro-risk stance but recognize the uncertainty of diverging global growth and a new slate of U.S. policy priorities. We focus on key risks in 2025 and highlight useful hedges from across asset classes to counter each.

Authors

Gargi Pal Chaudhuri
Chief Investment and Portfolio Strategist Americas at BlackRock

Kristy Akullian, CFA
Head of GPS Investment Strategy Americas at BlackRock

Contributors

Rachel Siu

Ross Pastman

Hersi Shima, CFA

BlackRock Canada Fixed Income Strategy

Jasmine Fan, CFA
David Jones
Nick Morales
Jon Angel
Faye Witherall
Annie Khanna
GPS Investment Strategy

All figures are in US dollars, unless stated otherwise.

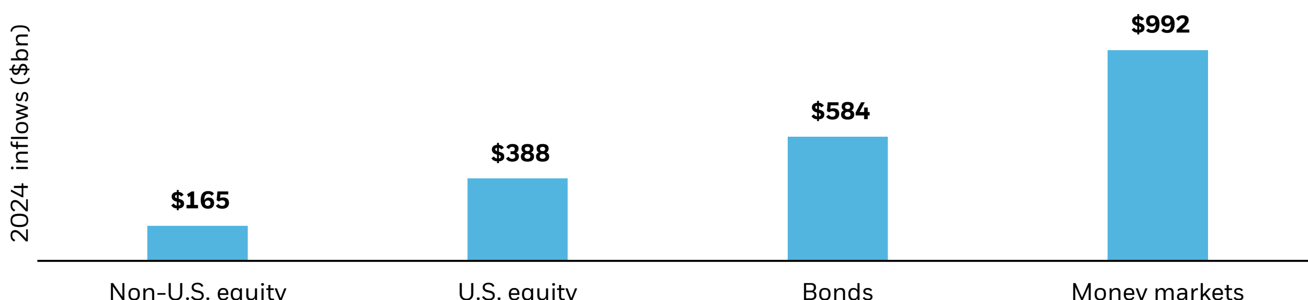
Macro

We are pro-risk heading into 2025

We take a pro-risk stance heading into 2025 but acknowledge that consensus positioning can increase the likelihood of near-term pullbacks. Even so, record amounts of cash held in money market funds suggests that such technical dips are prone to be bought. Indeed, across our investment platforms, BlackRock's portfolio managers have taken an **overweight position in U.S. equities**. We anchor our medium-term directional expectations on fundamental macroeconomic data and their flow through to corporate earnings.

Even in a banner year for equities, investors set aside record allocations to cash

U.S.-domiciled Mutual fund and ETF in/outflows in 2024



Source: Goldman Sachs Global Investment Research, Daniel Chavez. Groupings determined by Goldman Sachs Global Investment Research. As of 12/4/2024..

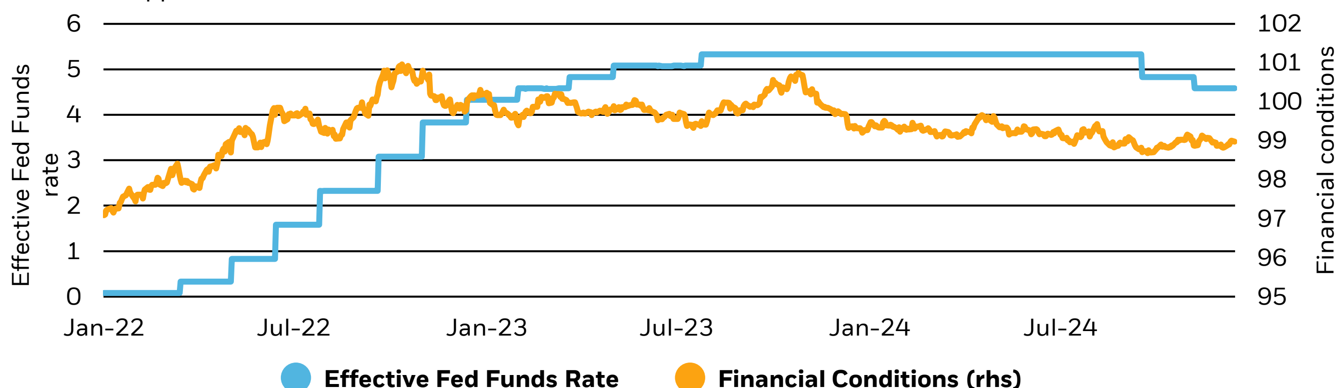
Solid U.S growth, healthy consumer balance sheets, relatively easy financial conditions, and the possibility of deregulation and tax cuts underpin our positive view of risk assets. We continue to favour U.S. equities over the rest of the world, leaning into strong recent momentum, with a preference for quality in a highly uncertain global landscape. The flip side of solid U.S. growth and low unemployment, even with U.S. Federal Reserve (Fed) funds above 4%, is that further large cuts are unlikely.[1] Within fixed income, we favour income over duration and seek higher yields outside of core bond allocations – a view shared by many of our fixed income portfolio managers.

But the uncertainty associated with both trade and immigration policy could lead to slower growth, higher inflation – or both. As a result, we pair our pro-risk stance with a set of targeted hedges to help counter these risks, cautioning that the antidote may need to be specific to the ailment. Stock/bond correlation in U.S. assets has become less reliably negative, so we see expanded scope for alternative diversifiers within a portfolio.[2]

AI is a mega force that could fundamentally reshape economies. And markets have been more sensitive to data surprises than in the past. As detailed by the BlackRock Investment Institute in the Global Outlook, this is an environment in which dynamism and granularity are both essential. We see it as motivating greater use of ETFs, active strategies and a broad range of diversifiers.

Financial conditions have eased even though rates remain high

Fed Funds (upper bound) and GS U.S. Financial Conditions Index



Source: Bloomberg. Reference indexes are the U.S. Federal Funds Rate and the Goldman Sachs U.S. Financial Conditions Index. As of 12/12/2024.

Equity

U.S. equities

2024 was a year of U.S. exceptionalism; we expect 2025 will continue the trend. While many equity benchmarks cleared fresh highs in 2024 – the Nikkei 225, FTSE 100, S&P/TSX Composite – U.S. gains led the way, outpacing ACWI ex-U.S. by double-digits. Positioning reflected the divergence, with investors overweight U.S. equities.[3] We see reasons to continue to lean into the positive momentum.

- **Corporate earnings support relative U.S. outperformance:** 12-month forward earnings growth projections for the S&P 500 have been revised higher from 1-month, 3-months, and 6-months ago, with growth expected to broaden further.[4] Bottom-up consensus looks for all sectors to deliver positive earnings growth in 2025, compared to just four of the 11 in 2024. By contrast, forward EPS growth estimates for both Europe and Asia have been revised lower as regional growth slows more sharply.

Rich valuations and high concentration in U.S. equity benchmarks are frequently cited concerns but may not represent the near-term risks many investors fear. Rather than reducing exposure to U.S. equities, we prefer managing around these risks, leveraging a combination of targeted exposures, active management and explicit hedges.

- **We entered 2024 with equity market concentration a chief – though not a new - concern.** Performance has broadened out from narrow leadership – in 2024, 80% of S&P 500 names were positive, a sizeable pick up from 2022's 34%, and above the longer-term average of 70%, with the average name up 17% on the year.[5]

We focus on basics. Looking at cash flow, looking at profitability, looking at earnings growth – it is stronger in the U.S."

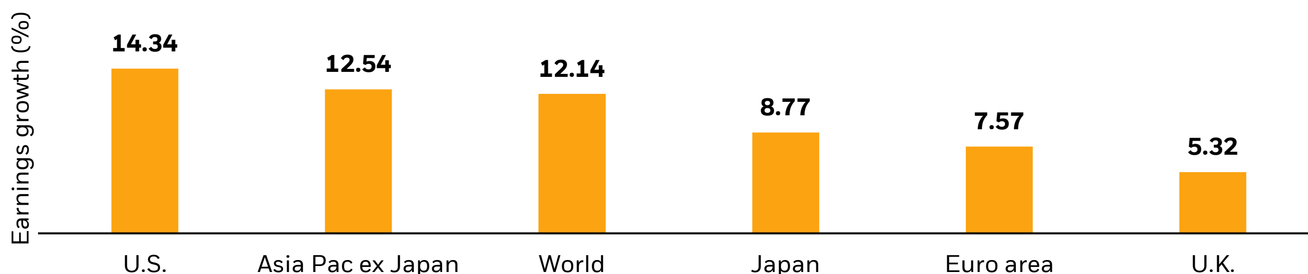
Russ Koesterich, CFA, JD
Portfolio Manager of the Global Allocation Team and lead Portfolio Manager of the GA Selects Model Portfolios

While earnings growth was the key driver of 2024's equity rally, multiple expansion also played a part. The market's 12-month forward PE currently trades at a 22% premium relative to its 10-year average.[6]

- But today's growth-skewed index makes it difficult to compare to history's more value-oriented one. The rapid growth in the Magnificent 7, and their investment in future revenues, also help justify index-level multiples. Consider that the Mag 7 companies re-invest 60% of their cash flow from operations back into growth capex and R&D - triple the rate of the other 493 names in the index.[7]
- Even pockets that have contributed the most to equity market outperformance trade at reasonable valuations relative to expected growth. The tech sector's current PEG (price-to-earnings-to-growth) ratio is in-line with the broader index.[8]
- We see the best opportunity for further upside at the intersection of growth, quality, and reasonable valuations. While select, high quality multiples can be justified by their investment in future growth, we keep an eye on lofty valuations elsewhere. We maintain our constructive outlook on growth exposures but prefer screening out companies with unsupported valuations.

12-month equity earnings growth estimates

2025 expected EPS growth (%)



Source: BlackRock, Reuters, MSCI. Earnings estimates by LSEG. U.S. as represented by MSCI USA Index, Asia Pac ex Japan as represented by MSCI Asia ex Japan Index, World as represented by MSCI World Index, Japan as represented by MSCI Japan Index, Euro area as represented by MSCI Europe Index, UK as represented by MSCI United Kingdom Index. As of 12/10/2024. Forward-looking estimates may not come to pass.

We continue to prefer quality and growth at the core of U.S. equity allocations but see tactical opportunities in select cyclicals and value. We continue to **expect the AI trade to be a growth engine**, but we also like adding to value via sector and industry allocations and maintain our positive view on financials. Steeper yield curves, a shallower path of Fed easing, and heightened deregulation provide continued tailwinds to the sector, especially amid positive earnings expectations. Deal flow beneficiaries continue to post strong results as confidence builds in the M&A cycle, and we expect stronger capital markets activity on easier policy under the new administration.[9] Indeed, Goldman Sachs forecasts that M&A activity will jump by 25% in 2025, a change that could continue to benefit broker dealers in particular.

While small caps outperformed in Q3, that performance has started to reverse, and we stay neutral. The post-election small cap rally reflected risk-on sentiment, but we expect fundamentals to potentially cap performance from here. Just 1% of S&P 500 companies are unprofitable vs. 43% of the Russell 2000, the second largest spread since 1988.[10] As rates stay high and translate to higher funding costs, we see further headwinds ahead.

U.S. equities

XUS	iShares Core S&P 500 Index ETF
XUSC	iShares S&P 500 3% Capped Index ETF
XQQU	iShares NASDAQ 100 Index ETF
XQLT	iShares MSCI USA Quality Factor Index ETF

Canadian equities

While the inflation and consumption pictures have improved in Canada, we remain neutral on Canadian equities as we see a variety of headwinds in 2025. Political uncertainty and ongoing trade negotiations with the U.S. could add pressure on the country's economic momentum. The Bank of Canada is likely to slow down its rate cutting path, providing less fuel to the stock market compared to last year. Therefore, we prefer a selective approach in Canadian equity investments, favouring high quality companies with consistency in dividend growth, and sectors like materials and energy that could benefit from higher commodity prices.

Canadian equities

XDIV	iShares Core MSCI Canadian Quality Dividend Index ETF
XEG	iShares S&P/TSX Capped Energy Index ETF
XBM	iShares S&P/TSX Global Base Metals Index ETF

International equities

Despite U.S. exceptionalism and potential tariff risks, selective international exposures can provide differentiated returns and enhance equity portfolio diversification. In developed markets, we continue to prefer companies with quality characteristics as higher margins may better weather potential trade-shocks from U.S.-enacted or retaliatory tariffs. We also see opportunities in high quality international companies that pay attractive and growing dividends as both a unique income source and potential portfolio diversifier amid volatile markets.

- **We prefer Japanese equities for a more targeted exposure to a developed market economy outside of the U.S.** We are constructive on Japan's economy as inflation and growth continue to embed in the economy. Further, shareholder reforms are working - companies are returning cash to investors via buybacks and dividends, which they were incentivized to do. In the third quarter earnings season, stock buybacks totaled 3 trillion yen, extending the 2 trillion yen of buybacks from one year prior. [11]
- **We continue to believe in the structural trends that may drive long-term economic growth in India.** India is on the path to becoming the world's third largest economy by 2030, with real GDP expected to grow at a 6%-7% annual rate, lifted by the country's expanding formal labour market and mature digital infrastructure.[12] We like India on a stable political backdrop and strong growth prospects, and the recent equity market pullback providing a more attractive near-term entry point.

U.S. exceptionalism does not mean only allocating to the U.S."

Helen Jewell
Chief Investment Officer for Fundamental Equities (FE), EMEA

International equities

XDG	iShares Core MSCI Global Quality Dividend Index ETF
CJP	iShares Japan Fundamental Index ETF (CAD-Hedged)
XID	iShares India Index ETF

Fixed income

For core fixed income exposure, we favour the short end and belly of the curve, focusing on income and yield rather than duration and spread. Staying active in duration management and seeking opportunity in "plus" categories could be a good way to earn additional income.

Owning longer duration rates exposure looks risky to us in 2025 – a view shared by BlackRock's fixed income portfolio managers. First, we anticipate persistent U.S. federal deficits to require additional new Treasury issuance. Much of this issuance will occur in longer-dated maturities, helping to keep rates firm. Secondly, we anticipate that term premium could continue to normalize, potentially taking 10-year rates as much as 1.3% higher than they would have otherwise been.[13] Finally, the anticipated end of the Fed's quantitative tightening (QT) may not be as positive for longer-duration yields as some have speculated. The Fed may choose to reinvest funds from maturing mortgage-backed securities disproportionately into shorter maturities. In Canada, government bonds are supported by a softer growth outlook and more stable fiscal trajectory, but longer-end yields may edge higher as structural forces like geopolitical fragmentation and the threat of tariffs put pressure on inflation.

Investment grade corporate investors will likely need to move down in credit quality to generate income. Investment grade credit return will most likely be driven by carry over price appreciation in 2025. However, perhaps reflecting the uncertainty in long-term Treasury rates, the investment grade curve only offers a significant spread over Treasuries for 10+ year maturities.

Tight high yield credit spreads can stay tight or even creep tighter. High yield spreads are at levels last seen in 2007 on strong corporate fundamentals and a benign default outlook.[14] Even so, positive supply dynamics, the improved credit profile of high yield issuers, and the growth of high yield ownership by longer term investors such as insurance, pensions and foreigners could take spreads even tighter in 2025.

The interest coverage ratio for high yield companies has deteriorated from the record highs of 2023 but remains healthy relative to its longer-term range. High yield bonds typically have shorter duration than investment grade credits, but investors who worry about duration can also gain exposure to high yield via floating-rate leveraged loans or collateralized loan obligations (CLOs). We believe that active management and seeking opportunity in "plus" categories can outperform in 2025.

Fixed income performance in 2025 will be much more about yield and carry than a boost from duration or spread compression."

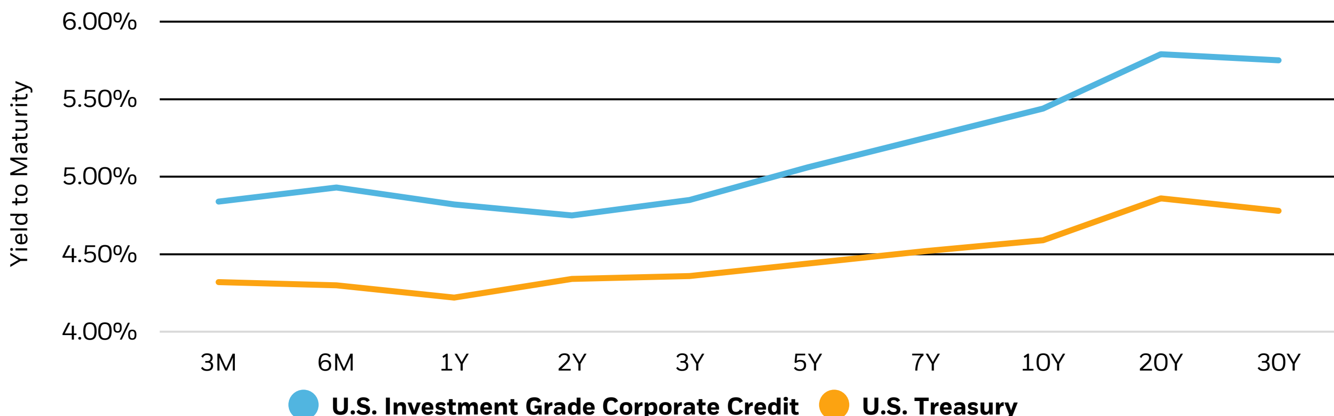
Amanda Lynam
Head of Macro Credit Research – Portfolio Management Group

Fixed income

Ticker	Fund
XFLX	iShares Flexible Monthly Income ETF (CAD-Hedged)
XHY	iShares U.S. High Yield Bond Index ETF (CAD-Hedged)
XSB	iShares Core Canadian Short Term Bond Index ETF
RCOR	RBC Core Bond Pool

IG curve only offers a significant spread over Treasuries for 10+ year maturities

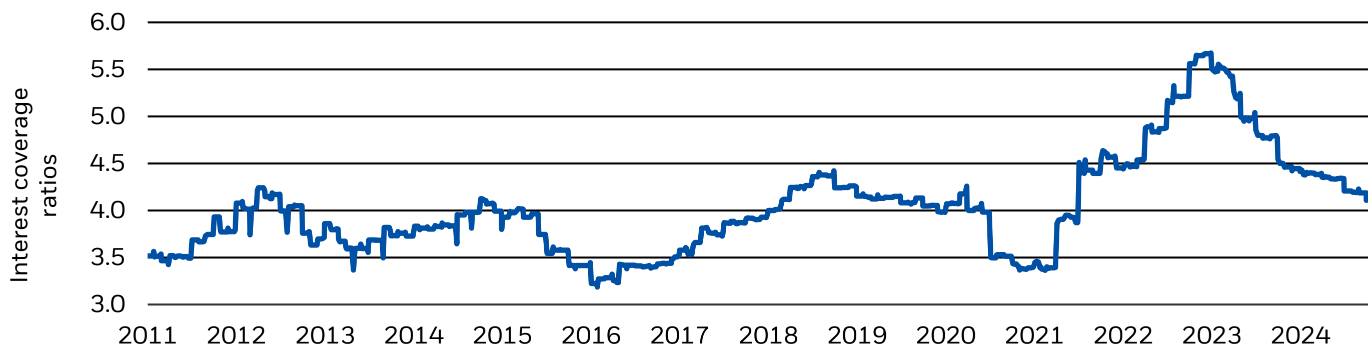
U.S. Treasury and U.S. IG Yield to Maturity



Source: Bloomberg. Yield to maturity for key tenors are represented by the U.S. Treasury active curve and the U.S. Investment Corporate Credit active curve. Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results. As of 12/10/2024.

High yield companies remain healthy relative to their long-term history

High yield interest coverage ratios



Source: Bank of America. High yield as represented by Ice Bank of America US High Yield Index. Interest coverage ratio measures a companies ability to pay its debt by dividing earnings over interest expenses. As of 12/10/2024. Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results.

Hedges

Biggest risks, possible hedges

We have a pro-risk stance but recognize the uncertainty of diverging global growth and a new slate of U.S. policy priorities. We focus on key risks in 2025 and highlight useful hedges from across asset classes to counter each.

1. Curbed immigration leads to rising wages.

Curbed immigration leads to rising wages. From a peak of 9.1% year-over-year headline inflation in 2022 to five consecutive months of sub-3% YoY price changes, the worst of the pandemic era inflation appears to be behind us.[15] However, if growth continues at solid rates and restrictive immigration policy spurs a tighter labour market, wage growth and broader inflation could reaccelerate.

Within fixed income, investors could look to short-dated TIPS to help hedge against rising prices. Allocations to high growth U.S. technology firms may also serve as an inflation hedge, particularly if declining immigration is met with adaptation through greater automation. Optimizing for income via dividends or options strategies may also help guard against price increases by pulling cash flows forward. Limiting exposure to consumer staples and discretionary firms can also make sense if already tight margins are further compressed by rising labour costs.

2. Across-the-board tariffs spark retaliation.

We looked to the Trade Uncertainty Index, a gauge that measures media attention to trade policy, to find exposures with the lowest sensitivity to trade disruptions as a potential hedge. Since 2006, aerospace and defense exposures have seen the highest monthly correlation with the TPU, meaning the industry historically rallies during times of rising trade uncertainty.[16]

3. Concerns over rising deficits mount.

The ratcheting up of geopolitical uncertainty has punctuated the post-COVID global economy. That has been accompanied by persistently high government deficits, particularly in the U.S., where interest payments on the U.S. debt have gone from approximately $1bn per day in 2019 to $3bn today.[17] Taken together, both have eroded confidence in fiat currencies.

Scarcity serves as a key component of value creation in a world of possible currency debasement. Gold may be in greater demand if concerns over rising deficits or increased money supply mount. Additionally, central banks have been a key tailwind, increasing their gold purchases by 20% year-over-year.[18] That dynamic played out in gold ETPs, which swelled to $50 billion in net assets in 2024.[19]

A portfolio leveraging a broader investment toolkit has delivered more attractive risk-adjusted returns, and that improvement comes from both higher total returns and lower overall portfolio volatility."

Tom Becker
Portfolio Manager, Global Tactical Asset Allocation Team

Hedges

XSTH	**iShares 0-5 Years TIPS Bond Index ETF (CAD-Hedged)**
XAD	**iShares U.S. Aerospace & Defense Index ETF**
CGL.C	**iShares Gold Bullion ETF**

Sources & Notes

1 Source: Bloomberg. With expectations of strong U.S. growth and low unemployment, further cuts unlikely to spur the economy. As of 12/19/2024.
2 Source: Bloomberg. Stock/bond correlation as represented by rolling 60-day correlation between S&P 500 Index and Bloomberg US Agg. As of 12/10/2024.
3 Source: BlackRock Advisor Center based on bottom-up holdings of 2.2k unique advisor portfolios. Data is based on equity allocations. As of 9/30/2024.
4 Source: BlackRock, LSEG. As of 12/10/2024.
5 Source: Bloomberg, BlackRock. As of 12/10/2024.
6 Source: BlackRock, LSEG. As of 12/10/2024. The price-to-earnings ratio is the price of the stock divided by the company's earnings per share, aggregated to the index level.
7 Source: Goldman Sachs Research. As of 12/14/2024.
8 Source: LSEG. PEG ratio as defined by LSEG, tech sector as represented by S&P 500 Information Technology Sector Index, broader market as represented by S&P 500 Index. As of 12/10/2024
Source: Source: LSEG Datastream, MSCI, as of 17 September 2024
9 Source: BlackRock, Bloomberg, LSEG. As of 12/10/2024.
10 Source: BlackRock Fundamental Equities, with data from Bloomberg and LSEG. As of 12/10/2024.
11 Source: Bloomberg, FactSet. As of 12/12/2024.
12 Source: Bloomberg, S&P. India growth projection provided by S&P Global. As of 9/19/2024.
13 Source: 10-year term premium given by the Adrian, Crump and Moench term premium model was 0.1053%. Assuming term premium returns to its long-term historical average of 1.4% could add another 1.3% to 10-year yields. As of 12/10/2024.
14 Source: Bloomberg. High yield as represented by ICE Bank of America US High Yield Index. As of 12/10/2024.
15, 17, 18 Source: Bloomberg. As of 12/10/2024.
16 Source: BlackRock, Bloomberg. TPU as represented by Trade Policy Uncertainty Index, correlations as represented by rolling 30-day correlations. Exposures as represented by GICS Level 4 Sub Industry groupings. As of 12/10/2024.
19 Source: BlackRock, Markit. ETP groupings determined by Markit. As of 12/12/2024.

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