(UBS)

Where to invest in equities?

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US equities have been off to a decent start in March, driving the S&P 500 to its 15th all-time high of the year, fueled by optimism about AI commercialization. The index has risen in 16 of the past 18 weeks for the first time since 1971, with a nearly 25% increase since October.

The FANG+ index, a gauge for the 10 most traded US technology firms, is up more than 35% over the same period. With AI poised to be the next decade's growth theme and US tech giants leading, we continue to believe that US tech stocks should make up a substantial portion of investors' equity allocation. Although investors should avoid missing the upside in tech, ensuring diversification and considering downside protection is imperative. We also think that ex-US equities, small-caps, and emerging market equities should be the other core building blocks of investors' portfolios.

The UBS Chief Investment Office highlights why these are three areas are where you should invest in equities:

- Tech due to robust earnings growth
- US small-caps due to appealing valuations
- Attractive ex-US opportunities like emerging market equities

Tech: Despite the recent strength of the tech sector, we believe the rally can go further amid rising optimism over the potential to commercialize AI. Recent company product and earnings announcements in the software sector have provided a peek into AI's monetization potential. For example, new "copilots" are being rolled out rapidly. We also think large-cap tech shares have more room to run, and we now rate US IT as most preferred. This partly reflects our bias for quality, with the sector offering a combination of strong returns, robust balance sheets, and swift earnings growth, in our view.

US small-caps: Relative valuations for small-caps are attractive, in our view, and the Fed's clear pivot to rate cuts increases our conviction in a likely improvement in key indicators such as the ISM Manufacturing New Orders index, which typically corresponds to small-cap outperformance. Nearly half of Russell 2000 debt is floating-rate, offering these companies a clear benefit from potential Fed rate cuts. In addition, valuations for small-caps are very appealing.

EM equities: We keep emerging market (EM) equities as most preferred in our global tactical asset allocation. EM stocks rallied close to 5% in February, with the majority of markets posting positive returns. We expect EM stocks to outperform UK equities, thanks to better earnings growth prospects in the coming months and undemanding valuations. In terms of geography, we keep India, Indonesia, and China as most preferred. We expect further policy rate cuts by EM central banks to support the cyclical recovery in many emerging economies. In our view, EM companies look set to deliver solid mid-teens earnings growth in 2024.

Despite recent mixed economic signals, we think the backdrop for US equities remains supportive, driven by healthy economic growth, moderating inflation, a Fed pivoting to rate cuts, and a strong surge in AI investment. With some sentiment and positioning measures looking elevated, a modest pullback is possible; however, with key equity market drivers still largely in place, we expect further upside through year-end. Our June and December S&P 500 price targets are 5,100 and 5,200, respectively.

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For more on this, see **UBS House View Monthly Letter: Four things no great portfolio can do without**.