CIO thinks the fundamental backdrop remains supportive for equities, driven by solid economic and earnings growth, likely interest rate cuts, and rising investment in AI. (UBS)

Can equities rally from all-time highs?

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The S&P 500 recovered from its April pullback, setting a new all-time high in May. While a range of economic and geopolitical risks remains, we believe solid economic and earnings growth, the prospect of lower interest rates, and rising investment in AI should create a supportive backdrop for equities. In our base case, we see the S&P 500 reaching 5,500 by year-end.

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- As of 31 May, the S&P 500 was up 10.6% year to date. The index set a new record closing high on 21 May.
- A strong first quarter earnings season and signs of a soft landing for the US economy have boosted equities.
- The global equity rally has broadened, with most major markets gaining ground in May.

But we believe the fundamental backdrop remains supportive for equities.

- US economic growth remains solid, and we expect inflation to continue its gradual downward trend.
- The Federal Reserve is on track to cut interest rates this year, likely starting in September.
- We expect earnings growth of 11% for the S&P 500 in 2024. Our end-2024 target for the index is 5,500.

We continue to favor tech stocks, but also see opportunities for investors looking to diversify.

- With AI-related companies likely to drive strong earnings growth in the years ahead, we recommend that investors hold strategic exposure to the tech sector.
- As the equity rally broadens, we also see opportunities to diversify beyond tech. We like US small caps, and see select opportunities in Europe (including consumer-related sectors).
- At a country level, we like UK equities, supported by our expectation of an earnings rebound this year.

Did you know?

- Historically, record highs have been no barrier to further stock market gains. Over the past 60 years, in the one-, two-, and three-year periods following a new all-time high, S&P 500 returns have averaged 12%, 23%, and 39%, respectively. This is hardly different from the 12%, 25%, and 38% average returns for all other periods over the same time frames.
- The S&P 500 set 23 all-time highs in the first quarter of 2024, the most in the first three months of the year since 1998.
- Structured strategies can help investors position for further upside while protecting against downside, or earn income while awaiting a potentially better entry point.

Investment view

We see a supportive backdrop for equities amid resilient economic and earnings growth, falling inflation, and rising AI investment. Investors should hold diversified, strategic exposure to the tech sector, in our view. For those diversifying beyond technology, we see opportunities including US small caps and UK equities. Structured strategies with capital preservation features can help investors build more defensive equity exposure.

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