A diversified, balanced portfolio remains the best way to preserve and grow wealth. (UBS)

Investors should stay invested despite all-time high

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A rally in tech companies, optimism over the health of the US economy, and confidence in the Federal Reserve's rate cuts this year have propelled US equities to an all-time high.

The S&P 500 is now 1.2% higher than the previous peak reached in January 2022 and almost 18% higher than the low three months ago.

However, while all-time highs often generate concerns that markets have peaked, our analysis shows that such worries are not typically warranted. We see reasons investors should maintain equity allocations in line with long-term strategic targets.

Returns following all-time highs are positive. 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 very similar to the 12%, 25%, and 38% average returns for all other periods over the same time frames. In addition, the S&P 500 trades within 5% of a record high 60% of the time, and only 12% of the time more than 20% below its last all-time high. The cost of waiting for a pullback can be quite high.

A diversified, balanced portfolio remains the best way to preserve and grow wealth. Markets usually trend higher and often trade at levels that would never be revisited. Well-diversified portfolios' rallies are even more persistent, with rarer losses and gains that usually prove more durable. For example, since 1945, a 60:40 stock/bond portfolio would have spent about 34% of the time setting "never-seen-again" levels, versus about 28% of the time for the US large-cap stock market. Separately, with US rates likely to fall this year, and potentially sharply, the reinvestment risk of holding too much cash has become very clear.

The current rally has further potential. The fourth quarter US earnings season is off to a solid start, with over 80% of companies that have reported so far beating profit estimates and forward guidance largely unchanged. This bucks the normal trend whereby companies typically guide analysts to lower estimates. Separately, recent releases have continued to point to a soft landing for the US economy, while core inflation is trending steadily lower. All of this is in line with our base case scenario for modest further gains for US equities. Our December 2024 target for the S&P 500 is 5,000, up from 4,850 as of 23 January, with scope for higher index levels if US economic growth proves even stronger than expected.

So, we continue to favor quality as a core theme in portfolios overall, as companies with strong balance sheets and high profitability should be best positioned to generate earnings in an environment of slowing but still positive growth. For those looking to capture more upside in a Goldilocks scenario, we think US small-cap stocks, European and Swiss small- and mid-caps, and emerging market equities would be particular beneficiaries.

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