CIO advise investors keep a core allocation to US large-cap stocks in their equity portfolios, complemented with a mixture of small-caps, European quality names, and emerging market equities. (UBS)

US equity outlook remains positive

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US equities took a breather at the start of the week, with the S&P 500 down 0.1% on Monday after hitting yet another record high at the end of last week. The benchmark has gained in 16 of the last 18 weeks for the first time since 1971. If the index gains ground again this week, that would mark 17 out of 19 for the first time since 1964.

Whether US stocks pass this milestone is likely to depend on the outcome of key events this week, including the tone of Federal Reserve Chair Jerome Powell's testimony to Congress and US jobs data for February. Investors will also be monitoring political developments in the wake of today's Super Tuesday, the busiest day in the US primaries. Meanwhile, some investors have become more concerned over concentration risk, as a handful of mega-cap tech stocks continue to lead the rally. So far this year, the FANG+ index, which tracks the top 10 most traded US tech firms, is up 14.5% compared to 7.6%for the S&P 500 and 3.9% for the equal-weighted version of the index.

But while there are always economic and market risks, and the climb higher for risk assets may slow, we see evidence that supports a positive near- and medium-term outlook. We believe investor euphoria isn’t close to what it was in the late 1990s, before the dotcom bubble burst.

Growth outlook has improved. Recent economic data have been mixed, and the 3% growth rate in 2023 is unlikely to be sustained. But market pricing implies investors are confident in the outlook, with consensus 2024 GDP growth now at 2%, compared with below 1% during second half of 2023. The better growth outlook means equities have been much more immune to the prospect of higher-for-longer rates now compared to last year. The S&P 500 fell in September and October 2023 when market pricing for the fed funds rate at the end of 2024 rose above 4.5%. But it has made a string of all-time highs this year when market pricing for the December fed funds rate repeated the same rise.

High dispersion in stock performance indicates lower speculation. Artificial intelligence (AI) related spending and adoption has been a major driving force of equity performance this year, but it has also contributed to stark performance differentiation. Among the Magnificent 7 stocks, three have actually recorded negative year-to-date returns. There have also been huge and varied stock price reactions to fourth-quarter 2023 earnings—Dell, NVIDIA, Meta, and Netflix were all up at least 10% the day after their announcements, while Tesla, Snow, and Snap were all down more than 10%. Such high return dispersion contributes to low correlations among the S&P 500 stocks, and we believe this means stock prices are moving for idiosyncratic or micro reasons, instead of indicating that macro risks are being underpriced.

The current market for initial public offerings (IPOs) looks nothing like 1999. A hallmark of the late 1990s bubble was the IPO frenzy and elevated first-day returns, which are absent today. In 2020–21, the average first-day returns were the highest since the dotcom era, but that ended once rates started to rise, and the IPO market has yet to really come back. This is also evident in an index of recent IPOs, which is at about half of its 2021 peak, while the Magnificent 7 are above their 2022 peak. This divergence between mega-cap tech and small speculative companies didn't occur during the dotcom bubble, and it appears to reflect investors' willingness to pay up for high-quality companies with strong earnings potential, but not for those with more uncertain futures.

So, while there could well be some slip-ups in the near term for US equities if macro data disappoint, we still expect the direction of travel for the rest of the year to be higher against the generally positive economic backdrop and AI tailwinds. We advise investors keep a core allocation to US large-cap stocks in their equity portfolios, complemented with a mixture of small-caps, European quality names, and emerging market equities.

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Read the original report : **US equity outlook remains positive after strong rally, 5 March 2024.**