CIO maintains its positive outlook for US equities, supported by healthy economic and profit growth, the Fed’s easing cycle, and AI’s growth story. (UBS)

CIO expects S&P 500 profit growth to continue broadening out

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US equities entered the third quarter earnings season on a high note, with the S&P 500 hitting its 45th all-time high this year on Friday after making gains for five consecutive weeks. The benchmark is now nearly 22% higher than at the start of this year.

Volatility can be expected in the coming weeks as investors assess company financials and future guidance. In the meantime, the US election is just three weeks away, and geopolitical risks remain elevated in the Middle East.

We expect headline S&P 500 earnings per share (EPS) growth to be 5-7% for the September quarter, compared with 11% in the second quarter due to lower oil and gasoline prices. But our 2024 full-year earnings growth forecast of 11% remains unchanged, and we believe the third-quarter results should confirm that large-cap corporate profit growth is solid against a resilient macro backdrop.

The US economy is on a solid footing. Despite some slowdown in lower-end consumer spending, overall economic activity in the US remains solid, and we believe healthy economic growth will continue. Job layoffs remain low, with an encouraging level of unfilled jobs relative to the number of unemployed. The most cyclical parts of the labor market—construction and manufacturing—are not flashing warning signs. With the Federal Reserve having started its rate-cutting cycle, the US economy should get a further boost from lower interest rates, with improving credit card debt and business loans.

Company profit growth should continue to broaden out beyond recent top performers. Similar to second-quarter results, we expect S&P 500 profit growth to continue broadening out beyond the largest growth companies. Still, growth rates for the Magnificent 7 should remain healthy at around 20% year over year, as many of them benefit from continued strong investment and monetization in artificial intelligence (AI).

Executives are unlikely to provide unusually downbeat guidance on the outlook. As always, management team guidance will be a key driver of share-price performance during earnings season, and we believe the risks of guidance disappointments are not higher than normal. We expect executives to sound a positive note on the prospects for profit growth, consistent with the recent easing in bank lending standards, which tends to be a good leading indicator for profit growth.

So we maintain our positive outlook for US equities, supported by healthy economic and profit growth, the Fed's easing cycle, and AI's growth story. While valuations are high, we think they are reasonable against the favorable backdrop. In addition, valuations have historically been a poor predictor of returns over the following 12 months, so we wouldn't expect this to be a significant drag on markets in the near term. We reiterate our S&P 500 price target of 6,200 by June 2025, and continue to like AI beneficiaries and quality stocks.

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Original report: **Healthy profit growth should drive further US stock gains, 14 October 2024.**