CIO sees room for US equities to rise further in a constructive environment driven by Fed rate cuts, the growth story around artificial intelligence, and healthy earnings growth. (UBS)

Corporate earnings reflect healthy growth ahead

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US equities ended last week on a high note, as Federal Reserve Chair Jerome Powell signaled the central bank's intention to cut interest rates next month for the first time since the pandemic. The S&P 500 now sits at just 0.6% below its all-time high set in July.

Volatility could rise again. Fears of further escalation in the Middle East are mounting after Israel and Hezbollah exchanged missile attacks over the weekend. In the US, growth uncertainty and the elections in November could also contribute to investor anxiety.

Still, we see room for US equities to rise further in a constructive environment driven by Fed rate cuts, the growth story around artificial intelligence (AI), and healthy earnings growth. We forecast the S&P 500 to rise to 5,900 by year-end and 6,200 by June 2025, from 5,635 as of Friday's close.

Powell's Jackson Hole Symposium speech has solidified rate cut expectations. In flagging that the "time has come for policy to adjust," Powell confirmed "confidence has grown that inflation is on a sustainable path" back to the US central bank's 2% target. He added that the Fed does "not seek or welcome further cooling in labor market conditions," as policymakers shift their focus from taming inflation to defending maximum employment. While the pace of easing remains to be seen, we note that Fed rate cuts in non-recessionary periods have historically been favorable for equity markets. Historically, the S&P gained 17% on average in the 12 months following the first Fed rate cut of a cycle.

Despite the potential for near-term volatility in tech, we believe the AI growth story remains intact. Following the quick rebound in global tech stocks in recent weeks, the sector may face volatility in the near term from US macroeconomic data or further news on semiconductor export controls. However, the fundamentals for the broader AI growth story remain intact, in our view, and NVIDIA's results this week as well as Apple's upcoming iPhone launch will be key catalysts to watch. Without taking any single name views, we maintain our positive outlook for quality AI beneficiaries in the semiconductor and software industries.

Corporate earnings reflect healthy growth ahead. US second quarter results in aggregate showed corporate earnings remain resilient, with guidance revisions tracking in line with normal seasonal patterns. We continue to expect S&P 500 companies to grow earnings by 11% this year and 8% in 2025.

Within equities, we recommend focusing on quality companies as investors navigate potential periods of market turbulence, as they should benefit from strong competitive positions, resilient earnings streams, and exposure to structural growth drivers. In addition to quality AI beneficiaries, where investors can consider structured strategies to prepare for periods of volatility, we also see opportunities in companies involved in the energy transition and in select quality stocks in Japan and Europe.

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Original report - **Stocks near all-time high amid positive outlook, 26 August 2024.**

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