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CIO sees a favorable backdrop for equities and believe that macro and micro factors alike should support markets to keep grinding higher. (UBS)

Stocks may grind higher against favorable backdrop

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Since the recent low in mid-April, the S&P 500 has risen nearly 7% and the Nasdaq has climbed almost 10%. The latest leg of the rally was aided by renewed hopes for Federal Reserve policy easing this year after the publication of encouraging inflation prints last week.

Markets are now looking to NVIDIA's earnings on Wednesday as the next potential catalyst. But whether the chipmaker beats expectations or not, we believe US equities are supported by several fundamental factors.

The US economy remains solid amid a modest deceleration toward a soft landing. Aggregate economic data over the past month have fallen short of consensus expectations, raising some concerns about whether the US economy is at risk of slowing rapidly. However, data that measure actual economic activity, rather than consumer sentiment, suggest that growth—while moderating from an elevated level—is still relatively strong and is unlikely to deteriorate rapidly. This is good news for risk assets, as a comfortable soft landing for the US economy should allow the Fed to start cutting interest rates later this year and at the same time support healthy corporate profits.

First quarter earnings showed a broadening of profit growth. One of the encouraging trends during the recent US reporting season is the broadening of profit growth beyond mega-cap tech stocks. In fact, excluding some one-off impacts in the healthcare sector, the first three months of this year would mark the first quarter of positive year-over-year earnings growth for S&P 500 companies ex-Magnificent 7 (i.e., the S&P 493) since the fourth quarter of 2022. Continuous improvement in the S&P 493's earnings growth should support equity performance in the coming months.

The structural growth prospects of artificial intelligence remain appealing. AI is disrupting traditional industries, from video-making and music, to education, to name a few. Recently, a startup showcased how an AI assistant can conduct job interviews, including giving feedback on candidates. With big tech looking to spend over USD 200bn in capex this year, we believe further innovation is in store for the technology. We see strong earnings growth ahead for AI-related names and the broader global tech sector, forecasting earnings growth of 20% this year and 16% in 2025.

So, we see a favorable backdrop for equities and believe that macro and micro factors alike should support markets to keep grinding higher. We think it is key for investors to hold a healthy strategic allocation to technology stocks, and see opportunities in small- and mid-cap stocks, as well as growth themes like the low-carbon transition, healthtech, and ocean economy.

Read more in the latest blog by Jason Draho, Head of Asset Allocation, CIO Americas:**"Hard over soft"** (20 May 2024).

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