CIO sees a supportive backdrop for equities amid resilient economic and earnings growth, falling inflation, and rising AI investment. (UBS)

Supportive backdrop for equities amid resilient economic and earnings growth

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The S&P 500 rallied to a new all-time high in mid-July, but has come under pressure amid concerns about potential US trade policy toward chipmakers.

While various economic and geopolitical risks remain, we believe solid economic and earnings growth, the prospect of lower interest rates, and rising investment in AI create a supportive backdrop for equities. We favor quality growth stocks, including the US IT sector.

US equities have pulled back from all-time highs.

- The S&P 500 fell 2% in the week ending 19 July.
- Tech stocks—which have led the rally this year—came under pressure amid concerns about potential US trade restrictions on chipmakers.
- However, the S&P 500 is still up 15% year to date and remains close to its record high.

But we believe the fundamental backdrop remains constructive.

- US economic and earnings growth is solid, and inflation continues to cool.
- The Federal Reserve is on track to cut interest rates this year, likely starting in September.
- Rising investment in AI should also create a supportive environment for equities, in our view.

We continue to favor tech stocks, but also see opportunities for investors looking to diversify.

- We think it is important that investors hold sufficient long- term exposure to AI. We also favor quality growth stocks more broadly, including "Europe's Magnificent 7" and select benchmark heavyweights in Asia.
- At a country level, we like UK equities, supported by our expectation of an earnings rebound this year.
- Capital preservation strategies can help investors manage potential volatility (e.g., around the US election).

Did you know?

- The S&P 500 set its 38th record closing high of the year on 16 July.
- Historically, record highs have not been a barrier to further stock market gains. 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 hardly different from the 12%, 25%, and 38%average returns for all other periods over the same time frames.
- Structured strategies can help investors position for further upside while defending against downside, or earn income while awaiting a potentially better entry point.

Investment view

We see a supportive backdrop for equities amid resilient economic and earnings growth, falling inflation, and rising AI investment. We think investors should ensure they build sufficient exposure to AI, and also seek quality growth opportunities beyond tech. Structured strategies with capital preservation features can help investors build more defensive equity exposure. In our base case, we see the S&P 500 at around 5,900 by December 2024.

Main contributors: Vincent Heaney, Alison Parums, Daisy Tseng

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