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Performance leadership continues to widen beyond mega-cap technology stocks. (UBS)

Closing our "Pricing power standouts" tactical theme

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Tactical US equity themes capture opportunities that cannot be expressed through size, sector, and style allocations. Our thematic lists reflect groups of stocks that are positioned to benefit from a common set of drivers, such as macroeconomic trends, policy changes, geopolitical events, temporary mispricings (valuations), or timely factors.

Our **Tactical US Equity Themes: Monthly update report** highlights our highest-conviction tactical thematic equity ideas over a six- to 24-month time horizon.

This month, we close our "Pricing power standouts" tactical theme. We reiterate our conviction in our existing themes—"Artificial intelligence," "Housing recovery," "Diabetes and obesity," "Investing in self-help," "Made in America," and "Time for quality"—and make a few changes to our stock lists.

Stocks reclaim highs

Performance leadership continues to widen beyond mega-cap technology stocks, with five of the 11 GICS sectors now outperforming year-to-date. Surprisingly utilities, a traditionally defensive sector, tops the leaderboard on a 3-month basis—up 19% versus the broader market’s nearly 6%—and is the third best year-to-date performer behind communication services and information technology. Utilities have been able to overcome high interest rate headwinds as investors have piled into the sector as a second derivative positioning on the AI trade given expected increasing power demand from datacenters.

There are signs that some areas of the economy might be slowing, but we've seen nothing alarming and continue to look for trend-like growth—roughly 2%—for 2024. Both services and manufacturing purchasing managers’ indexes (PMIs)

—gauges on business sentiment and leading indicators—are now slightly in contraction territory. The labor market is gradually coming back into balance with April payrolls showing a 175k gain versus the prior 3-month run rate of about 265k, and the unemployment rate ticking up to 3.9%. Recent inflation readings have been mixed to hotter than expected, but we expect gradual cooling in coming months as auto insurance and shelter inflation ease.

We believe this normalization of the economy should put the Fed in a position to start cutting rates in September, followed by an additional cut in Q4.

The market is likely to remain sensitive to the macro data—particularly inflation and the labor market—given the data-dependent Fed. However, corporate fundamentals continue to improve as evident by the 1Q earnings season. The S&P 500 earnings recession that ended in 3Q 2023 was driven by a strong rebound in growth by the Magnificent 7—the largest stocks—while the rest of the S&P 493 in aggregate was still negative. However, earnings growth has since broadened out, with 1Q marking the first quarter of growth for the S&P 493 since 4Q 2022. Companies handily beat expectations during the earnings season and with over 90% of S&P 500 companies having reported, index level earnings growth is tracking around 9% y/y—adjusted for some non-cash M&A related charges by two pharma companies. Importantly, forward guidance has been constructive with upward revisions to 2Q earnings estimates. Earnings growth could be on course for double-digit growth for 2024, which should help support the market, despite elevated valuations at 21x on a forward P/E basis.

We believe the macro backdrop remains supportive for risk assets. We expect market performance to further broaden out but, at the same time, megatrend tailwinds (i.e., AI, infrastructure, etc.) remain dominant undercurrents. Many of our tactical equity themes are positioned to benefit, and we continue to advise exposure. We see opportunities in select secular growth trends, including artificial intelligence, housing, reshoring, infrastructure, energy transition, and healthcare innovation—which can be accessed through our "Artificial intelligence", “Diabetes and obesity,” "Housing recovery" and “Made in America” themes. We also advise maintaining exposure to quality stocks (“Time for quality") and taking advantage of idiosyncratic self-help stories that can improve profitability ("Investing in self-help”).

This month, we close our long-standing “Pricing power standouts” theme. While inflation remains somewhat elevated, it’s becoming more challenging for companies to pass along price increases as customers push back. With pricing power waning, the theme is showing signs of fatigue, and we believe it's less of a tactical opportunity in the current environment.

More details about all these tactical themes can be found in the **full report**.

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