

# Macro Monthly

Economic insights and asset class views

## UBS Asset Management | February 2024

For global professional / qualified / institutional clients and investors and US individual investors.  
For marketing purposes



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## What about valuations?

### Highlights

- Equity valuations are expensive vs. long-term history, but strong macro conditions support elevated multiples.
- Earnings expectations are a good guide to how stocks will perform directionally on a three-month to one-year horizon; valuation is a much less reliable tool on this time frame.
- In addition to US large caps, we prefer some of the more inexpensive areas within global equities such as US midcaps, Europe, and Japan.

The most common pushback we hear to our optimistic view on global equities is: what about valuations? Don't high forward price-to-earnings ratios mean that all the good news is already priced in, and stocks will be hard-pressed to make further gains?

We believe high multiples are the latest brick in the wall of worry that global equities will climb on their way to fresh all-time highs. Valuation is a key pillar in our investment approach, but it is not the only consideration. The macro backdrop suggests that earnings expectations, the most important determinant of returns over the tactical investment horizon, will continue to rise. And risk appetite, while improved, has not risen to extreme levels. We acknowledge, of course, that elevated multiples on global equities may limit the speed or magnitude of any future rally and make stocks more susceptible to unforeseen shocks.

### Macro drives markets

Macroeconomic conditions in the US, the largest component of global equities, have improved meaningfully in recent quarters. Real growth has accelerated. Inflation has decelerated substantially, with core PCE running just below 2% on a six-month annualized basis. This backdrop has allowed central banks to pivot away from tightening towards easing, and for financial conditions to become more supportive of future economic growth. Consumer and business sentiment is also rising, catching up to other measures of economic activity. Consumers have positive real income growth that enables higher real spending, and businesses should be able to maintain or grow profit margins as they take advantage of increases in volume.

Risk appetite and valuations rise when an improving, solid economic outlook enhances investors' confidence that corporations will be able to deliver consistent profit growth. And stocks tend to move higher as long as earnings expectations also rise, even if forward price-to-earnings ratios are elevated. That is the environment we find ourselves in today.



**Luke Kawa**  
Director  
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**Exhibit 1: Global stock returns positively skewed if earnings estimates are rising**

	Returns when 12M forward EPS growth positive		Returns when 12M forward EPS growth negative	
	3M	6M	3M	6M
Starting forward P/E				
>18x	1.6%	2.8%	-0.8%	-3.7%
16x-18x	2.0%	4.8%	-0.8%	-1.5%
14x-16x	3.3%	5.7%	0.3%	1.5%
<14x	4.0%	8.0%	-1.5%	-2.9%

Current P/E: 18.1x  
Source: UBS Asset Management, Bloomberg. Data from 1998 - 2023.

**Same message from stocks and bonds**

Our view for 2024 is that equities will rise to all-time highs even without a meaningful decline in bond yields. Embedded in this thesis is the view that the relationship between equity multiples and bond yields is not mechanical or stable, but rather changes over time.

In theory, higher rates of return on safer assets like bonds and cash can create valuation pressure for equities. But in practice, recent data indicates that bond yields and equity valuations are currently where they are for the same reason: a medium-term growth outlook that we believe is better than it has been for the past 15 years, if not longer.

The equity risk premium – or difference between the expected earnings yield on stocks and the 10-year US Treasury yield – was more compressed before the global financial crisis of 2007-2008 than afterwards, when yields and nominal growth were much lower.

**Valuation not a good short-term guide**

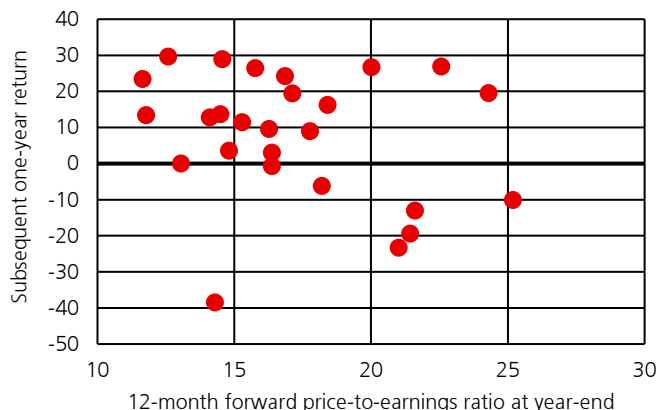
Earnings growth has been a good guide as to whether equity indexes will go up or down over the tactical time horizon of up to one year, while valuations are not. Over the past 25 years there has been no relationship between valuations and forward one-year returns for US stocks.

At the index level, global equities are undoubtedly expensive relative to history. However, elevated valuations are more concentrated in select pockets of the market, particularly US technology companies, rather than widely dispersed. And in our view, these more richly valued areas are expensive for a good reason. It is not just based upon expectations of future profit growth, but also a recent track record of delivering substantially better bottom-line performance than the rest of the investment universe at large. Such periods of operational outperformance can persist for a long period of time.

Prior to the pandemic, for instance, internet platform companies were able to post more consistent and robust profit growth than the rest of the market, which helped to explain their superior returns over the course of an entire economic cycle.

Similarly, many current market leaders are expanding earnings well above the market pace, which we expect to continue. Artificial intelligence, in our view, is the type of catalyst that

**Exhibit 2: No relationship between valuations and near-term forward returns for US stocks**



Source: UBS Asset Management, Bloomberg. Data from 1997 - 2023.

can power an extended period of earnings and market outperformance for certain industries and companies. As such, we maintain exposure to that theme – and by extension, US stocks in general.

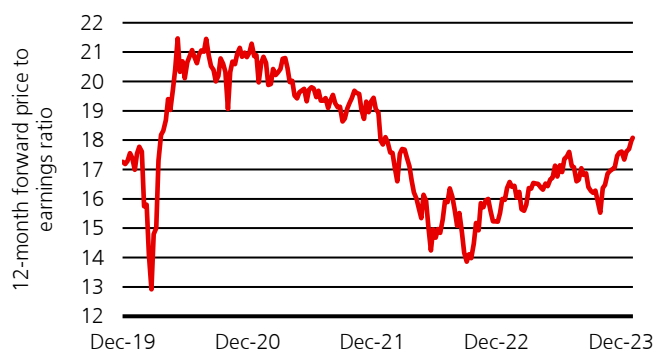
**Bargains available**

The MSCI World Index trades at a lower forward price-to-earnings multiple than at its early 2022 record high – and we believe the current economic backdrop is considerably better.

Even within the US equity market, roughly three-quarters of S&P 500 constituents trade at lower multiples than at the time of the previous index peak in January 2022.

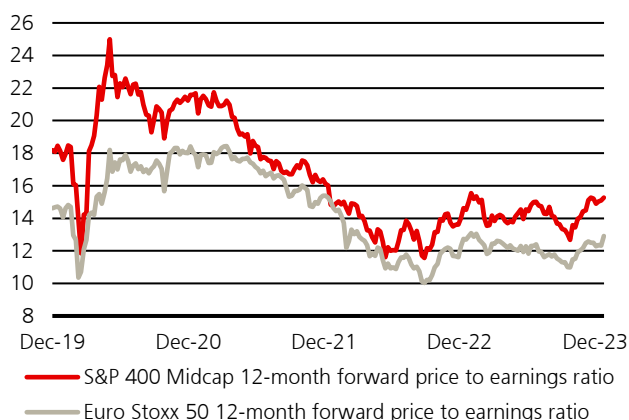
All else being equal, we would prefer to own less expensive segments of the equity market – particularly if the macro cases were equally as strong. Some of our favored areas within the market, like US midcaps and Europe, are cheap. In Japan, another of our preferred regions, equity multiples have surpassed pre-pandemic valuations but remain fairly priced on both an absolute and relative basis.

**Exhibit 3: Global stocks less expensive than January 2022 record high**



Source: UBS Asset Management, Bloomberg. As of January 2024.

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**Exhibit 4: US midcaps, European stocks still fairly cheap**

Source: UBS Asset Management, Bloomberg, Macrobond. As of January 2024.

**Why valuations matter**

To be sure, valuation plays a crucial role in our strategic asset allocation decisions on how to best structure portfolios for the long term. And even though valuations are not a good guide to how equities perform directionally in the short term, Exhibit 1 also shows that high multiples can be a reason to expect lower – but still positive – future returns, as long as earnings expectations are rising.

In addition, valuation is useful in assessing when there is upside asymmetry. When an asset has reached multi-year lows in both price and valuation, it can often be a sign that selling pressure has been exhausted and the risk-reward proposition has improved on a tactical basis. But the same holds true in the opposite direction: because equities are expensive at the index level, there is more potential downside in the event of an unexpected shock.

**Asset allocation**

Valuation is and will remain an important tool when evaluating investment opportunities. But in our view, macroeconomic conditions are what will typically dominate market movements over the tactical investing horizon. Right now, the macro backdrop is strong.
























This environment should be supportive of continued gains in global stocks and a broadening out of the equity rally as the outlook for earnings is improving and positioning is not stretched.

We do not see signs of euphoria in equity markets. Measures of positioning have normalized over the past three months, but have not ascended to levels that imply an elevated near-term risk of a meaningful drawdown. And we have yet to see an exodus from the nearly USD 6 trillion in money market funds into riskier assets.

In our view, yields on government debt are likely to remain rangebound, with subdued bond volatility supporting risk assets.

## Asset class views

The chart below shows the views of our Asset Allocation team on overall asset class attractiveness as of 1 February 2024. The colored squares on the left provide our overall signal for global equities, rates, and credit. The rest of the ratings pertain to the relative attractiveness of certain regions within the asset classes of equities, rates, credit and currencies. Because the Asset Class Views table does not include all asset classes, the net overall signal may be somewhat negative or positive.

	Underweight	Overweight	
	  	 	
<b>Global Equities</b>			Profits growing, lower rate volatility should help support multiples.
US			Room to advance as earnings grow and rate volatility calms; prefer midcaps on rising breadth.
Europe			Cheap valuations and leading indicators tentatively turning up.
Japan			Still inexpensive after recent gains, with solid earnings and ongoing corporate reform.
Emerging Markets			EM outperformance requires USD weakness, more evidence of China strength. Asia ex China supported by tech goods rebound.
<b>Global Government Bonds</b>			Too much easing is priced in given solid growth. Bonds = recession hedge.
US Treasuries			Growth is solid, inflation falling far faster than Fed anticipated. Expect volatility to calm.
Bunds			Sharp decline in inflation but a lot of easing is priced for 2024. Faster end to PEPP possible.
Gilts			Growth headwinds to accumulate and drive inflation lower.
<b>Global Credit</b>			Attractive all-in yields amid decent growth and disinflation, but limited room for spread compression.
Investment Grade Credit			Spreads relatively narrow, so risk-reward confined to carry.
High Yield Credit			Slight preference for IG versus HY. Moving up in quality in context of broader risk-on positioning.
EMD Hard Currency			Valuations and macro data have become less supportive relative to DM credit.
<b>FX</b>			
USD			Bullish against G10 as US economy remains relative outperformer.
EUR			Core inflation slowing quickly, along with weak growth. Expect rate differentials to stay in USD's favor.
JPY			Bank of Japan is moving towards tightening at slow, methodical pace. Better currencies to be long.
EM FX			Bullish high carry LatAm FX, cautious on Asia ex Japan on China, geopolitical risks.
<b>Commodities</b>			Prefer oil to industrial metals on China property weakness, manufacturing softness, Middle East risks.

Source: UBS Asset Management Investment Solutions Macro Asset Allocation Strategy team as of 1 February 2024. Views are provided on the basis of a 3-12 month investment horizon, are not necessarily reflective of actual portfolio positioning and are subject to change.

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**Americas**

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