CIO thinks tactical exposure to US small-caps can complement investors' core quality stock holdings. (UBS)

Tech set to lead as fourth-quarter earnings season gets underway

16 January 2024, 2:20 pm CET, written by UBS Editorial Team

Wall Street banks kicked off the fourth-quarter earnings season at the end of last week, with their shares falling amid concerns that interest income has peaked. But the S&P 500 recovered losses from the first week of 2024, with a weekly gain of 1.8% driven by the Magnificent 7.

Given a generally favorable backdrop in the last quarter—falling inflation, still-low unemployment, and strong consumer finances—we expect 4–5%year-over-year earnings growth for the S&P 500 in the fourth quarter of 2023. While this would be a slight decline from the 5.8% pace in the third quarter, we see few negative surprises for markets in this reporting cycle, with the tech space a likely bright spot.

Management guidance for 2024 is likely to be mixed. Guidance from early reporters has been mixed, with median estimates for the first quarter falling by 4% and fairly stable forecasts for full-year 2024. Overall, we expect management teams to indicate no substantial change in their outlook, but markets may have some difficulty digesting the mixed tone in guidance.

Tech results are likely to be the highlight. Global tech earnings growth already turned positive in 3Q23, and the trend is likely to accelerate in the fourth quarter and beyond, in our view. We see close to 10% growth in 4Q23, and expect stronger mid- to high-teen growth in the next few quarters. In fact, we highlight upside risks to our 16% earnings growth forecast for global tech in 2024 due to positive demand trends and currency tailwinds.

Overall earnings growth should pick up in the next two years. Based on our expectations for the fourth quarter, we bumped up our 2023 full-year S&P 500 earnings per share (EPS) estimate to USD 223, from USD 220. This reflects growth of 1% versus 2022. Looking ahead, our 2024 and 2025 forecasts, at USD 240 and USD 255, respectively, see year-on-year earnings per share growth improving to 8% and 6%. Despite a backdrop of slowing GDP growth, we think a recovery in the goods segment of the economy should help support S&P 500 earnings.

So, while markets may experience modest downside volatility through the results season after the strong rally in November and December, we think upside remains in US equities amid looser monetary policy and durable corporate profits. Any sell-off should be fairly mild, in our view, and could represent an opportunity to increase exposure to stocks. We keep our preference for quality stocks, especially the IT sector within the US market. We also think tactical exposure to US small-caps can complement investors' core quality stock holdings.

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Read the original report : **Tech set to lead as fourth-quarter earnings season gets underway, 16 January 2024.**