



CIO expects the bull market to continue, with the S&P 500 reaching 6,600 by the end of the year, primarily driven by healthy profit growth of 9%. (UBS)

Adding some context to equity valuations

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With the books now closed on the very robust equity market in 2024, attention is turning to the outlook for 2025.

Based on the conversations with investors, many are concerned about current higher-than-average equity valuations. We would make a few points:

- There is no doubt that equity valuations are higher than average. The S&P 500 forward P/E stands at 21.5x, higher than the 10- and 20-year averages of around 18x and 16x.
- But as we have highlighted previously, valuations are generally a function of the macro environment. When inflation expectations and unemployment are low (as they are now), valuations tend to be higher than average. We believe these macro conditions will remain supportive in 2025.
- Furthermore, valuation historically has had very little correlation with returns over the 12 months that follow. To be fair, negative returns are more common when the forward P/E is greater than 20x. But stocks typically don't fall simply because valuations are high. Instead, stocks tend to fall when corporate profit growth disappoints.
- Forward returns are more correlated with changes in next-12-month earnings expectations. Given our view that US economic growth should remain solid, profit growth should be a key tailwind for stocks in the coming year. The relationship is even tighter if we exclude periods when the Fed is hiking rates. In other words, earnings growth is an even more important driver when the Fed is not hiking.

So in our base case, we expect the bull market to continue, with the S&P 500 reaching 6,600 by the end of the year, primarily driven by healthy profit growth of 9%. Nevertheless, there are always risks that investors will have to navigate. In the coming year, trade policy, fiscal battles in Congress, inflation, and the outlook for AI all have the potential to generate volatility. But as long as corporate America puts up the numbers, stocks should respond favorably.

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Original report: [Putting equity valuations into context, 2 January 2025.](#)

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