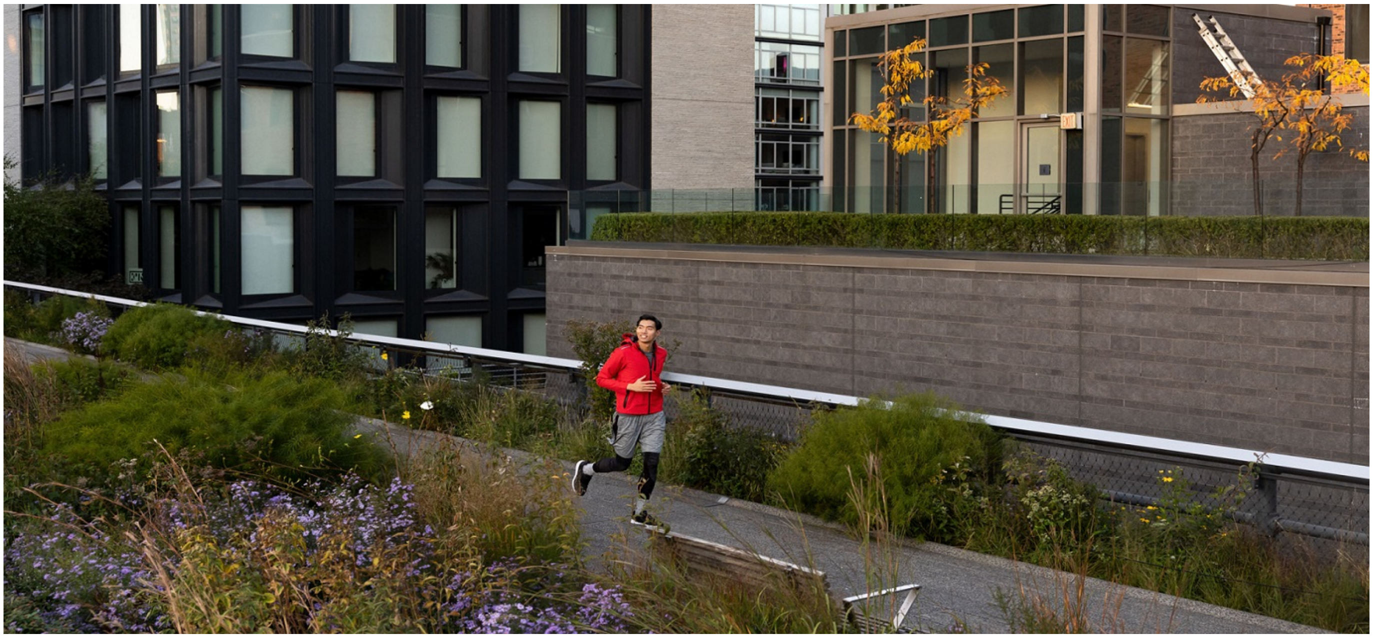

(UBS)

How we are thinking about high valuations

16 January 2025, 12:51 pm CET, written by UBS Editorial Team US Editorial Team

US equity market valuations are important, and on an absolute basis, the S&P 500 forward P/E of 21.5x is high by historical standards. This may dampen the outlook for longer-term returns. But when thinking about returns over the next year, we keep a few things in mind.

First, valuations are generally a function of the macro environment, and when inflation expectations and unemployment are low, as they are now, valuations tend to be higher than average. And second, profit growth is more important for stocks over the next 12 months and profits should be a key tailwind for stocks in 2025. Unless there is a major, unforeseen negative catalyst (such as a downgrade to earnings expectations), then valuations will not likely stand in the way of further gains.

Bull market still intact

In the coming weeks, the fourth quarter earnings season will provide investors with an opportunity to shift some attention from macro to micro data. As we enter earnings season, our views and positioning recommendations are mostly unchanged. We continue to have an attractive view on US equities with healthy upside to our 6,600 year-end S&P 500 price target, largely driven by our expectation for 9% earnings growth this year to USD 270.

Large-caps should outperform mid- and small-caps given their greater AI exposure, better earnings trends, and less dependency on Fed rate cuts. From a sector perspective, we have a Most Attractive view on information technology and Attractive views on communication services, consumer discretionary, financials, and utilities. And on style, we have Attractive views on both growth and value. While growth stock valuations are elevated, these companies continue to report impressive profit growth and benefit from AI-related trends. Our favorable view on financials—the largest sector in the value index—and utilities is supportive for value.

For more, see **S&P 500 EPS season: still good, but some noise**, published 15 January, 2025.

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