Looking beyond the obvious in stocks

Investment strategy insights

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- While expect the S&P 500 to deliver more gains by year-end, we also believe investors should not overlook the attractive opportunities across European and Asian markets.
- We explore the potential for gains in European, Japanese, and Asia Pacific equities—while underscoring the real risks of holding a concentrated portfolio.

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At the time of writing, global stocks as measured by the MSCI All Country World Index were trading close to all-time highs. Despite higher oil and gas prices as hopes for a sustainable US-Iran deal waver, a mix of moderating US inflation and robust earnings in both the AI value chain and beyond have buoyed stocks. US equities (the S&P 500 Index) have touched fresh record highs this year.

But the rally has not been confined to US equities. And while we expect the S&P 500 to deliver more gains by year-end, we also believe investors should not overlook the attractive opportunities across European and Asian markets.

This is especially important in an environment where the US markets' dependence on AI remains high, with elevated concentration risks. Now may be the right time to position for a broadening stock rally.

First, European investors should look close to home. We believe European equities have room to rise and break new highs. Stoxx Europe 600 companies are on track for the strongest second-quarter profit growth in four years. The region is not just a beneficiary of near-term tailwinds, but also a more durable investment cycle underpinned by rising spending on defense, infrastructure, AI, automation, electrification, and energy security. European stocks remain more exposed than the US to energy-market disruption. But with improving business activity, stronger order trends, and Germany's fiscal impulse likely to broaden the recovery, we believe any dips or consolidation because of heightened geopolitical tensions present an opportunity to "buy on dips"—either based on a financial plan or systematically using tools like structured strategies. Within the market, we favor banks, health care, industrials, consumer discretionary, Germany, and companies in our "European Leaders" theme.

Second, we like Japanese equities. Corporate earnings are resilient, with operating profit growth in the second quarter running at more than 20% year over year and positive earnings surprises supporting the outlook. We believe the market has likely established a cyclical bottom, and the recent valuation reset has created attractive entry points in high-quality companies with durable earnings growth. We favor balanced exposure to AI-related companies, including semiconductor equipment, as well as companies positioned to benefit from rising power demand linked to electrification, digitalization, and AI infrastructure investment. But aligned with our broadening theme, we also like cyclical recovery beneficiaries such as banks and machinery. Investors who do not want to buy single stocks themselves can consider actively managed vehicles focused on the largest Japanese companies, including those whose valuation metrics may underappreciate their earnings growth potential.

Third, look afresh at the wider Asia-Pacific region. Our positive view on Asia ex-Japan is based on our earnings growth forecast of 72% this year and 20% the next, supported by the region's AI hardware supply chain and a recovery in cyclical segments. Within regions, we remain constructive on mainland Chinese equities, favoring A-shares over H-shares. Improving earnings momentum—driven by IT and health care—alongside policy support, resilient exports, and ongoing AI adoption should underpin growth, while valuations remain attractive, particularly in offshore markets. In India, an improving macro backdrop, accelerating earnings growth, and more compelling valuations support our upgrade to Attractive, with the potential for a relative recovery as earnings growth returns to a stronger trajectory. Investors may want to look at building block approaches that focus on emerging markets in general (as Asia makes up a majority of the MSCI Emerging Market Index) or at actively managed approaches that delegate the deep research and portfolio construction to others, especially in less well-researched corners of Asian markets.

In the prevailing environment where the movement of stocks within many major indexes is especially divergent and where the difference between the top- and bottom-performing stocks is high, diversification is especially important. And this holds even truer for many self-directed investors. Wide gaps in performance between stocks mean portfolio outcomes depend more than ever on what investors own. Excluding strategic holdings, our analysis shows nearly 40% of self-managed equity investors on our platform hold more than half their portfolio in just 10 stocks or fewer, amplifying risk. To balance opportunity and concentration, investors should ensure their core equity allocation is broadly diversified across our preferred regions, sectors, and instruments.

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The asset class preferences provide high-level guidance to make investment decisions. The preferences reflect the collective judgement of the members of the House View meeting, primarily based on assessments of expected total returns on liquid and commonly known indices, House View scenarios, and analyst convictions over the next 12 months. Note that the tactical asset allocation (TAA) positioning of our different investment strategies may differ from these views due to factors including portfolio construction, concentration, and borrowing constraints.
Attractive: We consider this asset class to be attractive. Consider opportunities in this asset class.
Neutral: We do not expect outsized returns or losses. Hold longer-term exposure.
Unattractive: We consider this asset class to be unattractive. Consider alternative opportunities
Note: For equities, we have a five-tier rating system with two additional preferences
Most Attractive: We consider this asset class to be among the most attractive. Investors should seek opportunities to add exposure.
Least Attractive: We consider this asset class to be among the least attractive. Seek more favorable alternatives opportunities.
When equities are included with the other asset classes in the three-tier rating system, we collapse "Most Attractive" with "Attractive" and "Least Attractive" with "Unattractive."

Appendix

Risk Information
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