



(UBS)

Why equity valuations are a poor predictor of near-term returns

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Global stocks are expensive after three years of rallies, raising concerns that it is a bad time to add exposure. We disagree. Valuations are a poor predictor of near-term returns, and the increased weighting of richly valued sectors like IT over recent decades may justify higher multiples.

CIO expects equities to gain further ground amid evidence of fresh momentum behind AI, supportive US monetary policy, and the resilience of US economic growth.

Stocks are trading above historical valuations

- The MSCI All Country World Index of global equities is trading around 19 times 12-month forward earnings, roughly 25% above its average over the past two decades.
- The S&P 500's forward price-to-earnings ratio of around 22 times is close to the top of the range over the past 20 years.

But we believe high valuations are justified and expect markets to rally further.

- Valuations have historically been a poor indicator of 12-month returns, with the strength of earnings growth and the outlook for Fed rate cuts the more important drivers.

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- There are grounds for optimism on both fronts: resilient US GDP growth is supporting profits and the Fed is likely to cut rates by another 25 basis points.
- The increased weighting of higher-multiple sectors over the past two decades—such as IT—at the expense of cyclical industries, could help sustain higher valuations.

So, we rate global equities as Attractive and prefer exposure consistent with or modestly higher than strategic targets.

- Earnings growth for the MSCI AC World looks likely to reach around 10% this year, according to our forecasts.
- We rate global equities as Attractive. If investors are currently under-allocated, we believe they should reallocate excess cash, bond, or high yield credit holdings to stocks.

Investment view

We prefer areas that are exposed to secular growth, like the US and China; global technology; transformational innovations (AI, Power and resources, and Longevity); and pockets with clear catalysts that could drive earnings upgrades (Japan and global banks). We also like European equities, based on our outlook for accelerating earnings growth.

Did you know?

- Richly valued sectors, such as IT and communications services, have increased their weighting over the past 20 years versus lower-rated cyclicals like energy and banking. IT has gone from around 11% of the MSCI All Country World Index to around 27%, while energy has fallen to around 3% from 9%. If we assumed the same weightings as 20 years ago, the forward P/E ratio would be around 17 times, rather than close to 19 times.
- The P/E ratios for today's tech giants are far lower than for the tech firms at the peak of the dotcom bubble—currently around 30 times forward earnings, compared to over 80 times for market leaders in 1999.

Original report: [Are equity valuations too high?, 26 January 2026.](#)

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