



With the current high equity valuations a reflection of positive underlying economic conditions, CIO views recent pullbacks in stocks as a buying opportunity. (UBS)

# Underlying trends remain favorable for equities

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**The S&P 500 index sits just 1% above where it was before Donald Trump was elected president, having given up over 4% of gains in recent weeks amid stronger-than-expected economic data and rising Treasury yields.**

The consumer price index (CPI) for December due today could again unsettle markets if price pressures remain sticky and further reduce expectations of Federal Reserve rate cuts.

We expect stock volatility to persist in the coming weeks and months as investors react to incoming data and Trump 2.0 policy news amid rate uncertainty. But the choppy start to this year has not been caused by any fundamentally negative economic news. Instead, the underlying trends remain favorable for equities.

**Fed cuts are still on the table, as inflation should moderate over the coming months.** December's producer price index (PPI) published Tuesday came in below consensus estimates, rising 3.3% on an annual basis. Month over month, headline prices increased by 0.2% in December, while core prices remained flat. Fed officials have recently stressed that there is "more work to do on inflation," noting the upside risks due to potential changes in trade and immigration policies. But we believe Trump's potential tariffs are more likely to cause a one-time increase in the price level instead of sustained higher inflation over the medium term. Broad disinflation, including slower shelter inflation, should allow the Fed to ease policy by a further 50 basis points later in the year, in our view.

**The strength of the economy remains a supporting factor for corporate earnings growth at the current level of yields.** The stronger-than-expected payrolls for December last week unnerved markets, but what the labor report and other recent data showcased is a fundamentally healthy economy. The strength of the US economy has historically

correlated with earnings growth, and we expect robust profit growth of 9% for S&P 500 companies this year amid resilient economic activity. With the current high equity valuations a reflection of positive underlying economic conditions, we view recent pullbacks in stocks as a buying opportunity.

**Further improvement in AI monetization should underpin renewed rally.** The Biden administration is reportedly planning to unveil more regulations that aim to keep advanced chips from going to China, following the latest export controls announced earlier this week. Set to be effective in 120 days, the new rules disclosed on Monday cap the number of AI chips that can be shipped to some 120 countries, and block exports to China, Russia, Iran, and North Korea. It remains to be seen how the Trump administration would enforce the new rules, but we expect limited impact to the fundamental growth of the AI story in the near term. We think more spending from big tech would continue to boost the investment case for AI, and the narrowing gap between capex and revenues should underpin a further rally in quality AI stocks.

So while volatility could make it an uncomfortable journey before the S&P 500 hits our year-end target of 6,600, we expect the equity bull market to continue and maintain our Attractive rating on US equities. We favor technology, utilities, and financials, and see value in utilizing structured strategies to navigate heightened volatility.

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[\*\*Original report: Stock volatility is masking still-solid fundamentals, 15 January 2025.\*\*](#)

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