Diversify across equities

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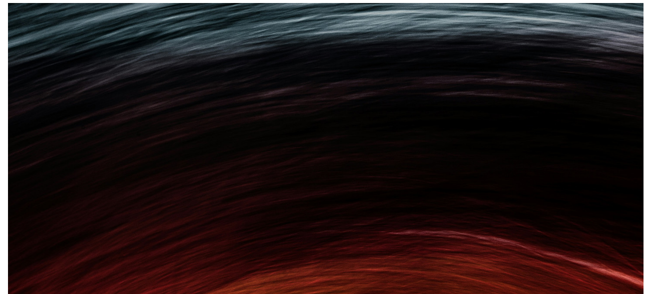
Author: Sagar Khandelwal, Strategist, UBS Switzerland AG

- **Why?** 1) Robust earnings growth and a solid macro backdrop mean we expect equity markets to move higher over the medium term. 2) High index concentration means portfolios are increasingly exposed to a narrow group of stocks, raising positioning risk. And 3), we think the next phase of returns is likely to come from broader leadership, greater rotation, and more selective exposure across the equity market.
- **Why now?** 1) With equities resilient, investors have an opportunity to rebalance from a position of strength. 2) Potentially large-scale IPOs in AI and adjacent sectors could increase competition for capital, making now a good time to reduce concentration before new supply tests market leadership. And 3), because the AI opportunity is broadening beyond megacap tech into industrials, infrastructure, power, and global supply chains, investors can diversify without stepping away from the underlying drivers of the cycle.



Broader equity diversification across sectors, regions, and styles can help investors participate in market rebounds and manage risks from higher energy prices and growing AI disruption. Source: Marek Piwnicki_Unsplash

Equities have remained resilient, supported by solid earnings growth and a macro backdrop that remains healthy. But the structure of the market warrants notice. Global indices such as MSCI ACWI have become heavily concentrated in a small number of companies, leaving portfolios more exposed to positioning risk, particularly when the next phase of the cycle is likely to introduce new competition for capital. Potentially large-scale IPOs in AI and adjacent sectors could spark further gains and optimism in the megacap tech space in the near term, but could later lead to volatility as the market needs to fund the new issuance.

High concentration and rising equity supply do not undermine the case for equities. Earnings remain supportive, and we continue to expect market indices to move higher over the medium term. But it does change how returns are likely to be generated. We think the next phase for market gains is likely to be characterized by a broadening of leadership beyond the megacaps, increased rotation within equities, and more frequent episodes of volatility as capital is reallocated. Against this backdrop, the key question is how to reduce portfolio concentration without stepping away from the underlying drivers of the cycle.

We recommend three actions:

Dilute index concentration. Investors with core exposure to global equity benchmarks should consider complementing these holdings with allocations that reduce reliance on the largest index constituents. This can be achieved by incorporating equal-weight index approaches, or by adding exposure to our preferred markets for diversification which include Japan, emerging markets, China, China's tech sector, global health care, Switzerland, and European consumer discretionary.

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Broaden exposure across the AI value chain. While megacap growth stocks remain central to earnings delivery, the impact of AI is expanding into other sectors, including infrastructure, power, and industrial supply chains. So, investors can consider broadening concentrated exposure in megacaps into these areas, which are likely to see increasing earnings support as capital expenditure related to AI continues. Preferred areas include global industrials, power and resources, enablers (semiconductors, infrastructure), and global beneficiaries in Asia and Europe.

Use megacap rallies to rebalance into structured investments and multifactor strategies. We should expect continued optimism about AI to drive periodic rallies in megacap tech. Investors can use these as an opportunity to rebalance, including by replacing a portion of their holdings with structured investments that offer more defensive exposure, or with multifactor strategies that can help diversify portfolios from overexposure to megacap tech stocks.

Global asset class preferences definitions
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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