

Barometer: Robust earnings growth to push equities higher

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Asset allocation: earnings growth too powerful to ignore

It makes sense to ask whether stocks can add to the double-digit gains they have delivered so far this year in the face of a steady increase in government bond yields.

Rising yields lead to higher commercial borrowing costs and also reduce the present value of future corporate earnings, developments that normally weigh on equity markets. But concerns surrounding the sustainability of the stock rally look overdone, in our view.

There are strong reasons to believe equities will continue to rise over the next few months. The main argument for maintaining our overweight stance on stocks comes down to corporate profitability. Earnings are still growing at a remarkable pace, thanks in part to the broadening adoption of new technologies such as AI. According to analysts' consensus forecasts, company profits are set to grow 30% this year; we believe they could increase at an even faster rate, by some 35%.

Also in stocks' favour are economic conditions.

While the rise in bond yields can be partly attributed to a build-up in inflationary pressures and stubbornly high public-sector deficits, it is also the case that fixed-income markets are discounting reasonably healthy levels of economic growth. Indeed, as history shows, rising bond yields aren't always associated with declines in equity markets. It all depends on why yields are rising in the first place. When bonds sold off during periods when the economy was performing well, as was the case in both 1994 and 2013, equity markets did not suffer declines.

The same picture appears to be emerging today. Our business cycle indicators show that, save for a deterioration in China's consumption spending, the economic picture remains relatively positive. Europe's economy, for example, is performing better than most envisaged at the beginning of the Iran conflict. Consumer spending and business investment are both rising, while inflationary pressures are easing.

And while the US has seen consumer spending growth slow to an annual 1.8% in recent months, below its long-term rate of 2.5%, increases in capital investment are more than offsetting this slowdown.

Emerging markets are also on a sound economic footing, benefiting from high commodity prices, strong export growth, and relatively low interest rates. True, China is a concern: domestic consumption is weakening and the property market is struggling. But overall, our analysis gives positive signals for the global economy. Indeed, the economic surprises index, which tracks the extent to which data surpasses or undershoots consensus forecasts, has remained in positive territory since the tail end of 2025.

Valuations also support maintaining a higher allocation to equities. One indicator we attach great importance to is the equity risk premium, or the discount investors demand for buying riskier stocks over government bonds. Our analysis, shown in Fig. 2 and comparing stocks' earnings yields to US Treasury

yields, illustrates that the discount, while low, remains some distance from the level that would suggest stocks are vulnerable. Treasury yields would have to rise substantially for that to be the case.

S&P 500 earnings yield premium over 10-year US Treasuries yield, and index performance

Source: LSEG, Pictet Asset Management. Data covering period 25.08.1971-26.08.2026.

Elsewhere, the technical indicators we monitor are positive for stocks but less so for bonds. Although September tends to be a challenging month for stocks, surveys showing investors don't hold excessively bullish positions in equities are a positive sign.

While economic indicators, valuations and technical indicators are positive for riskier assets, liquidity is in shorter supply, which could eventually act as a brake on stock markets. The main risk is a tightening of monetary conditions in the US. In our view, US interest rates might soon need to rise to contain a government and corporate borrowing spree that would otherwise fuel inflation. Total borrowing in the US is currently running at 16% of GDP, some 4 percentage points above the longer-term average.

Equities regions and sectors: in pursuit of profits

With corporate earnings growth set to be the main driver of equity outperformance, we favour the sectors and regions that are best placed to deliver those profits.

That means maintaining an overweight position in technology stocks.

Even if the attractiveness of the semiconductor trade has likely peaked, AI earnings momentum remains very strong. According to our analysis, mega-cap AI stocks account for 27% of total global corporate earnings and 56% of earnings growth.

The AI-driven capex boom, and the need for infrastructure to support it, should support the outlook for industrials, another sector on which we have an overweight stance.

Beyond tech, financial stocks offer resilient earnings and are well placed to benefit from solid economic growth and higher interest rates.

Conversely, the recent surge in bond yields and the possibility of rate hikes bode badly for utilities. Although the sector retains defensive characteristics, higher long-term yields mean utilities' status as a bond proxy and their reliable dividend payments are less attractive. We therefore downgrade utilities to neutral.

We remain underweight consumer sectors, reflecting the fact that economic growth is primarily driven by corporate and government investment rather than household spending.

Quarterly EPS growth for US equities - actual and consensus forecasts, % y/y

Source: LSEG, IBES, Pictet Asset Management. Data and forecasts covering period 01.07.2024-31.12.2027.

Regionally, our preference is for emerging-market stocks (excluding China), which continue to benefit from strong global trade flows, elevated commodity prices, favourable growth dynamics, and extensive exposure to the AI theme. Exports from emerging economies are growing at more than double their pre-pandemic trend pace, supported by increased trade between developing countries. In particular, China's imports are increasing at an annual pace of 8.6%, with a significant share of that coming from other emerging markets.

Latin American stocks trade at especially attractive valuations, ranking as the cheapest region globally in our model.

In the developed world, meanwhile, US stocks continue to generate healthy profits, with the median S&P 500 company reporting 12% year-on-year earnings growth in the second quarter (see Fig. 3). However, we are concerned about how much of that is coming from continued fiscal support and the AI capex super-cycle, while consumption, housing, and other rate-sensitive sectors remain comparatively weak. To become more positive on US equities, we would like to see signs of growth drivers broadening beyond capex and corporate investment.

Fixed income and currencies: hampered by policy uncertainty

Characterised by thin trading volumes, the months of July and August are typically volatile for financial markets. And this year is no exception, with government bonds at the centre of the storm. Yields on 30-year Treasuries have ratcheted up to their highest level since 2008 amid better-than-expected economic data, renewed inflationary pressures, a flood of corporate borrowing, and unpredictable policy shifts from US authorities.

Although the move has improved valuations for government bonds, we retain our neutral stance on both Treasuries and eurozone sovereign debt.

In the US, uncertainty over the fiscal and monetary policy outlook is keeping the term premium, the extra yield investors demand to hold longer-dated bonds, elevated. The government has shown little appetite for reducing its debt, which has just moved above the USD 40 trillion milestone. Making matters more complicated, the US Federal Reserve's recent move away from explicit forward guidance has made the path of interest rates less predictable.

The supply of debt from the private sector has increased by a significant margin, primarily, but not exclusively, to fund the buildout of AI infrastructure. The chipmaker Nvidia recently announced a funding deal worth some half a trillion dollars, or 1.5% of US GDP. According to our calculations, this race for capital is likely to push total US borrowing to 15-16% of GDP, close to levels seen in the debt build-up ahead of the financial crisis.

The US Treasury's decision to double the size of buybacks of longer-dated bonds may help contain disorderly moves in yields. But they do not address the underlying fiscal imbalance. The more serious risk is fiscal dominance, where high public debt-servicing costs and financing requirements constrain the US Federal Reserve's ability to meet its inflation objective. If that happens, investors are likely to demand still greater protection against inflation and policy risk.

Source: LSEG, Pictet Asset Management. Trend real GDP growth based on CBO forecast. Data covering period 01.01.2000-26.08.2026.

Given the central role of the US Treasury market, these pressures are spilling over into other developed-world bonds, keeping us neutral there too. The only exception is Treasury Inflation-Protected Securities (TIPS), where we see value because real yields now stand above trend growth, a historically attractive entry point for investors (see Fig. 4). TIPS also offer direct protection against unexpectedly persistent inflation and fiscal and monetary policy risks.

We also favour emerging-market local-currency debt outside China. Strong economic fundamentals, favourable terms of trade, and resilience to oil price fluctuations should support emerging nations and, by extension, their bonds.

In credit, we keep to a benchmark weight, as spreads remain tight, providing limited compensation for risks stemming from fiscal dynamics, monetary policy uncertainty, and inflation.

In currencies, the US Treasury's surprise move to increase bond buybacks suggests that policymakers may prioritise stabilising the yield curve over supporting the dollar. We think this view can be expressed most clearly through gold, the asset class least exposed to fiscal and monetary policy risks. The precious metal also benefits from persistent geopolitical tensions and central bank purchases. We're neutral on all major currencies.

Global markets overview: gold rallies as uncertainty mounts

Gold rallied while yields on longer-dated government bonds rose sharply amid growing uncertainty over the future path of monetary and fiscal policy in the US. Gold exchange-traded funds saw their strongest monthly investment inflows since January, leading to a 9% monthly gain in the precious metal (see Fig. 5). Asian central banks were also among those allocating large amounts of capital to gold.

In developed-market fixed income, yields on 10- to 30-year bonds ratcheted higher across the US, France, Germany, Japan, and the UK. Yields on 10-year Treasuries reached their highest levels since January 2025, while those on the 30-year bond hit a nine-year high.

The bond sell-off reflects broader concerns over a potential conflict in policy priorities between the Fed and the US Treasury, and worries over a deterioration in US public finances.

Source: LSEG, Pictet Asset Management. Data covering period 25.08.2025-26.08.2026.

The dollar weakened, losing around 0.5% versus a trade-weighted basket of currencies as investors started to unwind overextended long positions. Its losses were most pronounced versus emerging-market currencies. Emerging-market local bonds outperformed thanks to solid global trade and resilient domestic economies.

Commodities also held up well, boosting the mining and materials sectors.

Elsewhere, equity markets moved higher, cheered by upbeat corporate reports from the likes of chipmaker Nvidia and cloud-computing firm Salesforce. The tech-heavy US market gained almost 3%, with the S&P 500 setting a new record high during August and the Nasdaq technology index recording its strongest month since May with a 4% gain.

We think the equity rally has further to run, with resilient economic conditions supporting corporate earnings. We remain neutral on bonds and underweight cash.

We favour equity regions and sectors with the best earnings growth prospects: emerging markets, IT, industrials and financials.

With policy uncertainty putting pressure on developed market government bonds, we see better opportunities in emerging market local currency debt.

Source: <https://www.pictet.com/us/en/insights/am/september-barometer-financial-markets-outlook>