

Daily: Resilient growth should underpin equity gains

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Thought of the day

The sell-off in US Treasuries deepened on Tuesday, with the 30-year yield briefly rising above 5.6% for the first time in 24 years. The move came against a backdrop of deteriorating consumer confidence, with the Conference Board's gauge for September pointing to the lowest level since 2014 amid inflation worries and worsening views of business and labor-market conditions.

Ahead of Friday's September employment report, the Job Openings and Labor Turnover Survey (JOLTS) for August showed a decline in available positions. At 7.1 million, the reading fell short of consensus estimates of 7.2 million and marked a five-month low.

But while sentiment has been under pressure, we believe the broader data remain consistent with a resilient US economy, which should continue to support further equity gains, driven by solid earnings growth and accelerating AI adoption.

Labor market resilience should sustain US growth. While job openings dropped in August, hiring edged up and layoffs were subdued. A roughly balanced ratio of job vacancies to unemployed workers, along with historically low jobless claims, also indicate that the US labor market remains resilient. This should support household income and economic activity. While elevated inflation remains a concern, we expect incoming data to show steady disinflation over the next six months. Favorable base effects in the first half of next year should also weaken the case for a long sequence of interest rate hikes by the Federal Reserve and allow US GDP growth to remain near 2%. New York Fed President John Williams said this week there was "no need for urgency" after the Fed's September hike, supporting a patient approach.

Solid earnings growth should offset the valuation headwind from higher yields. The resilience in the macroeconomic backdrop offers a favorable environment for companies to grow revenues and profits, and we expect earnings growth of 25% for the S&P 500 this year, followed by a further 14% increase in 2027. This means that while higher yields may pressure stock valuations, we expect solid earnings growth to drive equities higher. Looking at the 16 hiking cycles since 1954, the S&P 500's average gain one year after the first Fed hike was 10.8%. Also, economic growth indicators have historically been more important for equity market performance than the rate hikes themselves.

AI adoption should support further profit growth. With higher interest rates increasing the cost of capital, financing massive data center projects may become more difficult. But we believe financing conditions would become a meaningful constraint only if Fed policy were substantially tighter than the current level. Additionally, the rise of consumer AI agents could create a new revenue stream through transaction economics, potentially improving hyperscalers' returns on AI investments. With continued evidence of accelerating AI adoption and monetization, we think growing AI investment spending should drive further profit growth across parts of the AI ecosystem, providing an ongoing tailwind for the broader market.

So, we recommend investors position for further equity upside and forecast gains of around 10% for the

S&P 500 by mid-2027. Investors should ensure their exposures are broadly diversified across sectors and consider allocations to other global markets such as the Eurozone, Asia, and Japan.

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