Daily: Strong earnings and easing geopolitical risks lift S&P 500 to record high

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From the studio

Podcast: Signal over Noise | AI trade at a crossroads, on Apple or Spotify (6 mins)Video: Big Tech earnings and the sell-off in semis (4 mins)

Thought of the day

What happened? The S&P 500 rose 1.8% on Tuesday to close at a record high of 7,737, as corporate earnings supported confidence in AI-related demand. Software company Palantir raised its annual revenue forecast, while Caterpillar lifted its revenue growth outlook, as data-center construction boosted demand for its power-generation and construction equipment.

The Nasdaq Composite gained 2.6% and the Philadelphia Semiconductor Index (SOX) rose 6.6%. Since its recent low on 29 July, the S&P 500 has rallied by 5.75%.

Signs of diplomatic progress around the Strait of Hormuz added to positive equity sentiment. Qatar said a proposal has been drafted and both US and Iranian officials sounded hopeful about reopening the waterway. Brent crude oil was trading below USD 80/bbl at the time of writing after a 5.3% drop on Tuesday, helping ease concerns about the effect of energy prices on inflation. The US one-year inflation swap fell to 1.80%, its lowest since 2024, and the yield on 10-year US Treasuries fell below 4.60%.

What do we think? Without taking any single-security views, we believe the drivers of the equity market rally remain in place.

First, easing geopolitical tensions have allowed investors to refocus on fundamental drivers. Even if an agreement has yet to be finalized, progress toward reopening the Strait of Hormuz has lowered oil prices and helped reduce concerns that energy prices could lead to higher inflation.

Second, corporate earnings continue to validate the investment case for AI, even if investors are becoming more selective about where value is being created. Palantir's results follow last week's earnings reports from hyperscalers that helped restore investor confidence in the AI trade after a volatile July exposed a widening divide between companies generating returns on AI investment and those facing mounting cash-flow pressures. Last week, Microsoft shares rose sharply after it reported that cloud growth accelerated to its fastest pace in four years, while Meta shares fell after its free cash flow dropped 91% to its lowest level since late 2022.

Third, a resilient US economy is providing a favorable backdrop for a broader equity rally. The ISM Manufacturing PMI rose to 55.6 in July from 53.3 in June, above expectations of 54.0, and marked a seventh consecutive month of expansion. Output accelerated, new orders grew solidly, and cost pressures eased, while strong AI-related investment helped offset the effect of import tariffs. The continued pickup in sentiment supports our view that cyclical sectors can contribute to a broadening of the equity rally.

Fourth, earnings growth is becoming more broad-based, reducing reliance on a narrow group of megacap technology stocks. Around 80% of S&P 500 companies have beaten earnings expectations, compared with 73% normally, while the median earnings beat of 5.8% is above the historical average of 3.5%. Guidance has also been better than usual. Overall, second-quarter earnings per share growth is on course to reach or exceed 30% on an underlying basis, ahead of our initial estimate of 28%.

Finally, a patient Federal Reserve remains an important support for risk assets. The Fed kept the federal funds rate unchanged at 3.50-3.75% last week, with Chair Kevin Warsh describing the central bank as being in a period of “watchful thinking.” Core CPI inflation slowed to 2.6% in June, while labor-income growth is consistent with more moderate consumer spending. We believe these developments give the Fed room to remain patient while it assesses whether inflation is returning sustainably toward target. Our base case is that policy will remain on hold unless the decline in core inflation stalls or energy and tariff-related risks intensify.

How do we invest? Strong AI investment, resilient economic data, broad earnings growth, and a patient Fed support our constructive view on equities. But widening gaps in company performance reinforce the need to address portfolio concentration risks.

Against this backdrop, we recommend several key strategies.

Diversify across equities. Strong earnings and decent economic activity support our expectation of upside in equity indices. But wide gaps in performance between individual stocks mean portfolio outcomes depend more than ever on what investors own. To manage risks, investors should ensure their core equity allocation is broadly diversified across our preferred regions, sectors, and return drivers, and can use periods of market strength to rebalance concentrated positions into those diversified exposures.

Invest in transformational innovation. We remain constructive on AI but believe diversified exposure across the value chain is key. The recent divergence between AI-related companies underlines investors’ increasing focus on whether capital expenditure is translating into revenue.

We still see strong near-term AI spending, robust compute demand, and encouraging monetization signals. But rising capital expenditure increases the importance of selectivity and raises the risk of slower spending beyond 2027. As the opportunity becomes more differentiated, simply owning companies linked to AI infrastructure spending is unlikely to capture the full potential of the next phase.

We note how Caterpillar’s positive results illustrate that the AI investment cycle is creating opportunities beyond technology, with data-center construction supporting demand for power-generation and construction equipment. Access to electricity and grid connections remains a constraint on AI development, reinforcing our positive view on the Power and resources theme.

Lock in yields. The Federal Reserve kept interest rates unchanged last week, and recent inflation and labor data have given policymakers room to remain patient. Markets are nevertheless pricing a more hawkish policy path than our baseline. The decline in oil prices has eased near-term energy-related inflation concerns and supported bonds, although broader inflation pressures could remain persistent. We continue to favor quality short- and medium-maturity bonds, where current yields offer attractive income and the potential for gains if inflation cools and yields decline.

Source: https://www.ubs.com/global/en/wealthmanagement/insights/chief-investment-office/house-view/daily/2026/latest-05082026.html