GLOBAL Insight

Wealth Management

Global equity perspective

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Good, but not as good

Key points

- **Earnings prospects for this year and next have risen markedly after a much stronger-than-forecast first half, setting the stage for more new highs in the coming months.**
- **Reasonable price-to-earnings (P/E) levels, makeable GDP growth forecasts, and the powerful earnings setup sit beside a well-thumbed list of concerns ranging from the Strait of Hormuz predicament to extreme policy uncertainty, the U.S. midterm election, currency volatility, and the difficulty of gauging just where things stand or are headed next in the headlong AI race.**
- **We expect the worry list could generate bouts of volatility but are unlikely to seriously knock earnings or equity markets off course over our one-year forecast horizon.**

With very few exceptions, global equity markets moved into new high ground over the past couple of months. And they did so in style: participation broadened further with advance-decline lines and unweighted versions of the major indexes all posting new highs. Some did so days or weeks ahead of the more closely followed capitalization-weighted indexes such as the S&P 500. Strong breadth is a hallmark of a healthy market.

So too is the fact that the move higher in share prices has been driven by broad-based gains in reported and projected earnings for this year and next. As we discussed in last month's Global Insight, the direction and magnitude of equity market travel over the course of a year is largely determined by the change in index earnings.

In this case, earnings growth has been extremely good for much of the Information Technology sector, elevated for Energy, and more moderate for most other sectors. There are other aspects of the investment landscape that argue for a further advance for equity markets over the coming 12 months.

Valuations have moderated

At the start of this year, the S&P 500 (at 6,846) was trading at 22x forward earnings (of $313). Today, with the index at 7,660, the price-to-earnings (P/E) multiple on estimated earnings 12 months out has reached a somewhat more comfortable 20x. In other words, while equity prices have risen over the past eight months, earnings have risen even faster, allowing P/Es to subside from "rich" to "less worrying" levels. And that boost

Equity views

Region	Current
Global	=
United States	=
Canada	=
Continental Europe	=
United Kingdom	=
Asia (ex Japan)	=
Japan	=

+ Overweight; = Market Weight; – Underweight
Source - RBC Wealth Management

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GLOBAL EQUITY

in forward estimated earnings was in large part due to the earnings for the first half of this year being up a much-better-than-forecast 32% based on Bloomberg data, while guidance for rest of 2026 and for 2027 was generally upbeat.

We note that while P/Es for the large-cap S&P 500 are slightly north of 20x, they are markedly lower for Canada, the UK, Europe, and Japan (in the mid-teens), while China, Hong Kong, and South Korea are lower still.

Positive projections

RBC Capital Markets' multi-model S&P 500 forecast projects moderate positive returns over the coming 12 months.

RBC Capital Markets, LLC's Head of U.S. Equity Strategy Research, Lori Calvasina, projects the S&P 500 will trade at 8,150 in Q3 2027. Assumptions include two interest rate hikes by the Federal Reserve, a 10-year Treasury yield of 4.75%, and Consumer Price Index inflation at 3%. Consensus index earnings estimates 12 months out currently sit at $374 for the S&P 500. Calvasina points out that, on average, year-ahead estimates typically erode by 8% over those 12 months. She has applied a more conservative 10% "haircut" utilizing $337 for forward earnings in her forecast.

The model-derived index target of 8,150 equates to a 6.2% return (7.3% including dividends), which Calvasina characterizes as "higher but not heroic."

One of the factors figuring into RBC Capital Markets' approach looks at what S&P returns, on average, have been delivered by different levels of U.S. GDP growth. RBC Economics is estimating that growth will come in at 2.0% over the coming 12 months, while the consensus figure is slightly higher at 2.2%. Historically, GDP growth in that range has been associated with S&P 500 returns between 5% and 10%.

Investor sentiment is neither here nor there

Measures of investor sentiment are mostly useful at extremes. No such extreme readings are present today. Equity positioning of asset managers is elevated but well below past peaks and has been sliding downward for several months.

The proportion of respondents to the University of Michigan Consumer Sentiment Survey who expect stocks to move up over the next year jumped noticeably higher from moderately depressed levels in the most recent report, but sits well short of satisfying levels. Meanwhile, the widely followed American Association of Individual Investors Sentiment Survey has been oscillating between slightly bullish and slightly bearish for some time.

Things look great … what could possibly go wrong?

Corrections can happen at any time, are unpredictable, and are a regular part of the investment landscape. Longer, deeper declines usually happen in response to a more serious economic/financial market dislocation, for which one can read "recession."

At the moment, a U.S. recession is not appearing in any of our forecasts. And, historically speaking, we think it would take a lot to get from here to there. First, at least 100 basis points (bps) of Fed tightening would be needed to get short-term interest rates above today's 10-year Treasury yield, thereby "Inverting" the yield curve—a precursor to every recession of at least the past 80 years. And it would probably take a lot more than 100 bps, because bond yields would likely be rising at the same time. At some point, the federal funds rate would also have to climb above the nominal growth rate of GDP (currently 6.5%).

Other indicators we follow are also some way from recessionary levels.

GLOBAL EQUITY

Unemployment claims would need to surge dramatically higher from the very low range in which they've traveled the past five years. And the unemployment rate would need to climb to at least 5% over just three or four months. These last two shifts are unlikely to arrive soon in an environment where profits are growing and labor shortages remain an issue for many businesses.

Volatility on the way to higher ground

So, investors are left to navigate the potentially problematic issues equity markets have been contending with for some time: shipping through the Strait of Hormuz; uncertainties around U.S. trade/tariff policies; the historical propensity of U.S. midterm elections to induce corrections, usually before election day; the potentially destabilizing impact of yen weakness on the bond market; and, the possibility that something could seriously alter the trajectory of the AI spending wave.

All of the above have the potential to roil equity markets from time to time over the next 12 months as the major indexes work their way toward eventual higher ground. Some could act to alter the economic and interest rate backdrop in ways that materially change the return prospects for equities in either direction. As things stand, in our view, the probabilities favor higher share prices enabled by reasonable revenue and earnings growth.

We recommend portfolios retain a full, targeted commitment to equities but not an over-commitment. As always, we believe a plan for becoming more defensive if/when conditions warrant, would be a useful adjunct.

Research resources

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