



Deutsche Bank
Research

Global Equity Strategy & Asset Allocation

Looking Out To Year End: Still Constructive

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Looking Out To Year End: Still Constructive



- **A broadening of the economic recovery as the long-awaited rebound in manufacturing kicked in has led to an unprecedented earnings boom that is set to continue.** The boom reflects an acceleration in AI demand just as cyclical growth picked up, while oil and commodity prices rose on the Iran war. Company guidance has been very strong on spillovers and multipliers from the broadening recovery and continues to drive analyst upgrades.
- **Earnings the anchor for equities in the face of domestic political and geopolitical risks.** We see parallels with the 1960s, when despite pulling back on a number of such developments, equities kept pace with strong earnings. They have again since the pandemic but are currently well shy (15%) of levels implied by year-end earnings.
- **Equity positioning has been cautious on a variety of concerns.** Positioning tends to align with earnings growth, but at moderately overweight levels currently is for only around 10% growth, well below recent and expected growth.
- **Key catalysts looking out to year end:**
 - **Stepping from range to range during earnings season.** The last 2 reporting seasons saw the market range-bound going in, only to rally sharply (+3%) as companies reported; followed by a post earnings lull. Equities have been following the script as we approach Q3 earnings where we look for around 30% growth.
 - **The rise in rates is a normalization back up to growth.** The rise primarily reflects that in real rates which also embody growth expectations. The lesson of the last few years has been that it is the volatility rather than the higher level of rates that is negative for equities; rates vol remains in check. Short positioning in bonds meanwhile is near extremes, levels that have coincided with near-term tops in yields.
 - **Checks and balances: the mid-term elections.** It would not be unusual for the market to go sideways into the mid-terms as investors hedge potential volatility around the event. But we see the risk/reward as very positive, with 21 of the last 23 mid-terms seeing positive returns in Q4, with an average gain of 7%.
- Our **demand-supply** framework, combining changes in positioning with inflows and buybacks net of new issuance supports our year end target for the S&P 500 of 8000 but suggests the risks are to the upside.
- **Across sectors**, with the market currently not positioned for secular or cyclical tailwinds, we are overweight MCG & Tech, Financials, Industrials, Metals & Mining; neutral Energy; selective within Consumer Cyclical; overweight Healthcare, Datacenter and Industrial REITs but underweight most bond-like defensive sectors in Staples, Restaurants, Utilities, Telecom and other REITs.



Looking Out To Year End: Still Constructive

- **The economic recovery has broadened, leading to an unprecedented earnings boom**
 - **The narrow Tech-led corporate recovery has broadened as the long-awaited rebound in manufacturing kicked in.** To be sure, the labor market (hiring) and some sectors (housing) remain in the deep freeze. But the broadening is seeing cyclical hiring pick up. Private consumption growth has been trend-like (2.5%) despite real income stagnating since the Liberation Day shock. But real wages have historically closely followed productivity and suggest the potential for a significant catch-up boost.
 - **The unprecedented earnings boom looks set to continue with several drivers stepping up.** After hovering for 2 years around 11%, typical outside recessions, growth accelerated sharply in Q1 2026 to 25%, and then to 34% in Q2, unprecedented outside of recession recoveries. Growth has not been just about AI, with AI beneficiaries (51%) and the rest (49%) contributing equally to overall growth in Q2. We look for growth to continue at these rates in H2, with growth of 28% in 2026 before decelerating in 2027 to 17%. From a macro perspective, the boom reflects the coincidence of an acceleration in AI demand with a pickup in cyclical growth, while the Iran war boosted oil and commodity prices. From a micro perspective, company guidance has been very strong as spillovers and multipliers from the broadening recovery kicked in. Guidance points to the ongoing steady upgrades to analyst estimates continuing.
- **Earnings the anchor for equities in the face of domestic political and geopolitical risks.** For historical precedent, we see parallels with the early 1960s, which saw many domestic political and geopolitical developments create pullbacks, but equity prices remained tied to rising earnings. Since the pandemic, this has once again been the case. But equity prices are currently well shy (15%) of levels implied by year-end earnings. Valuations, especially forward multiples, are at the bottom of their range of the last few years, on par with Iran-war lows and not much above Liberation Day lows, suggesting investor concerns about the sustainability of earnings growth.



Looking Out To Year End: Still Constructive

- **Sentiment and positioning remain cautious on a variety of concerns.** Equity positioning has (unsurprisingly) historically aligned with earnings growth. Presently, at moderately overweight in large cap equities, positioning is for earnings growth of around 10%, well below recent and prospective growth for the remainder of this year and next. In our reading, discretionary (fundamentals-based) investor positioning has tended to be cautious since the Liberation Day shock. While the drivers for caution have varied, currently we see concerns about geopolitical events, the sustainability of earnings growth, the move up in rates, and the mid-term elections.

Key catalysts looking out to year end

- **Stepping from range to range during earnings seasons.** Around each of the last 2 seasons, the market was range bound going in, before rallying sharply (+3% on average) as companies reported. A finer timeline over recent quarters reveals a pattern of rallying during the first 4 weeks of the season when the bulk of companies report, followed by a 4-week lull (-0.5%) as attention shifted from off-the-charts earnings to their sustainability. Equities have been following the script as we approach Q3 reporting where we look for around 30% growth.
- **Rates normalizing back up to growth**
 - **The rise in long-end yields has primarily reflected a rise in real yields which embody growth expectations.** So, the rise reflects in part higher growth expectations, which is of course positive for equities. Historically, equity valuations have been positively correlated with real rates.
 - **Rates vol not the level of rates the key for equities.** The key lesson of the last few years has been that it is rates volatility rather than the level of rates that has been negative for equities. Rates volatility has ticked up but remains in check.
 - **Crowded shorts.** Bond positioning meanwhile is nearing negative extremes (5th percentile), levels which have historically coincided with a near-term top in yields.



Looking Out To Year End: Still Constructive

- **Checks and balances: the mid-term elections.** The well-known pattern is for the incumbent President's party to lose seats in both houses. Current polling and President Trump's approval ratings suggest the Republicans lose around 40 seats in the House, with redistricting handicapping the historical pattern by 5 seats; and an even probability of losing the Senate. It would not be unusual for the market to go sideways into the mid-terms as investors hedge potential volatility around the event. But we see the risk/reward as very positive, with 21 of the last 23 mid-terms seeing positive returns in Q4, with an average gain of 7% (from Oct 1-Dec 31). With the administration preemptively questioning the integrity of the election, a lack of resolution is a risk, but if the trends in polls and approval rating continue, it may well make the issue moot.
- **Record supply more than offset by robust demand.** Our demand-supply framework, on the demand side combines changes in positioning (of existing equity money) with equity inflows (of new money); and on the supply side gross buybacks net of new issuance. On the demand side, we see upside for equity positioning as earnings growth continues strong and robust inflows as the post pandemic cross-asset inflows boom has further to run. On the supply side, we see buybacks rising with earnings. While the hyperscalers have cut buybacks to finance capex, the beneficiaries of that spending and the rest of the S&P 500 have raised them, so the pace of growth in buybacks has slowed but they are at a new high. We see the boom in equity issuance continuing. We see this supply as endogenously driven by strong equity demand, arguably slowing the rally but not derailing it. Our demand-supply framework points to the S&P 500 by year end at a little above 8000.



Looking Out To Year End: Still Constructive

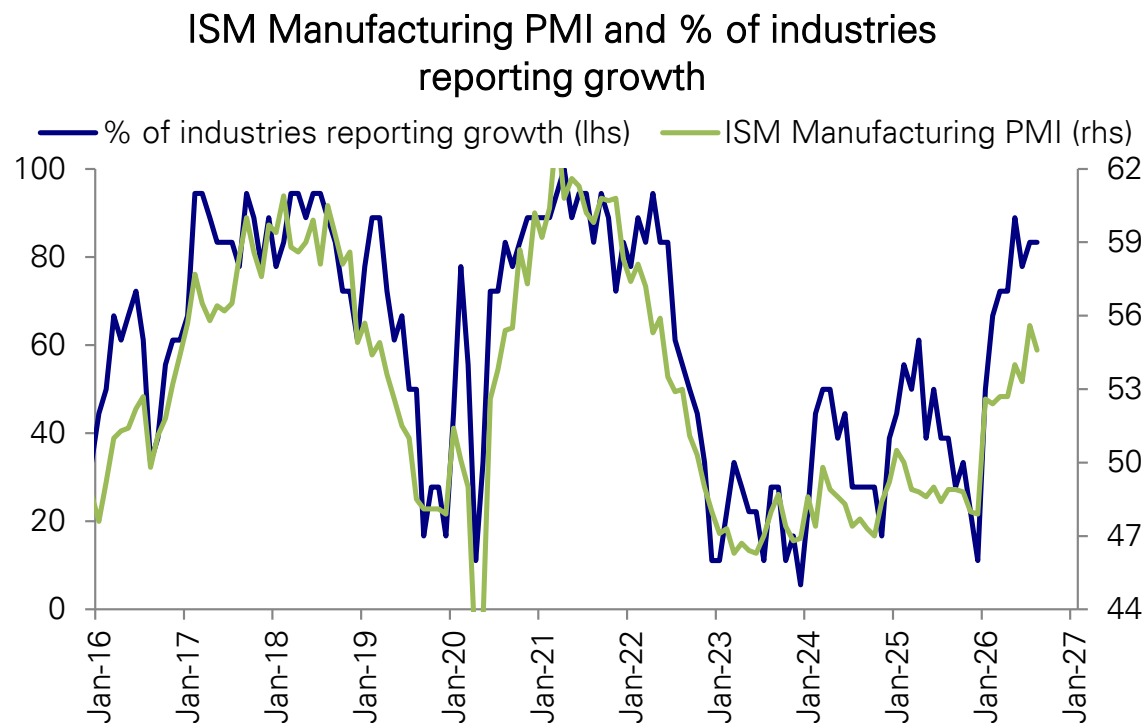
- **Across sectors.** In keeping with our view that the market is currently not positioned for secular or cyclical tailwinds, we keep our sector preferences simple: overweight MCG & Tech with positioning far below earnings growth and investor focus firmly on AI risks rather than rewards; overweight Financials with cyclical growth more important than the rates curve; overweight Industrials with secular as well as cyclical tailwinds intact; overweight Metals & Mining with an additional potential boost if a dollar downcycle kicks in; remain neutral Energy but note that downside risks are rising after benefiting from war disruption; remain highly selective within Consumer Cyclical as a rising consumer tide will not lift all boats; we are underweight most defensive sectors (Staples, Telecom, Utilities, REITs) as they are burdened with structural challenges along with a cyclical upturn away from them, and with sustained relief from interest rates unlikely; however we like those that are already showing turnarounds (Healthcare) or with idiosyncratic growth stories (Datacenter & Industrial REITs).



The economic recovery is broadening

Long-awaited manufacturing recovery has kicked in

- The narrow Tech-led corporate recovery of the last few years broadened notably this year as the manufacturing ISM, historically the best cyclical indicator for US equities and earnings, rose above 50 after a 3-year funk and has continued to rise
- As spillover and multiplier effects kick in, growth should continue to pick up

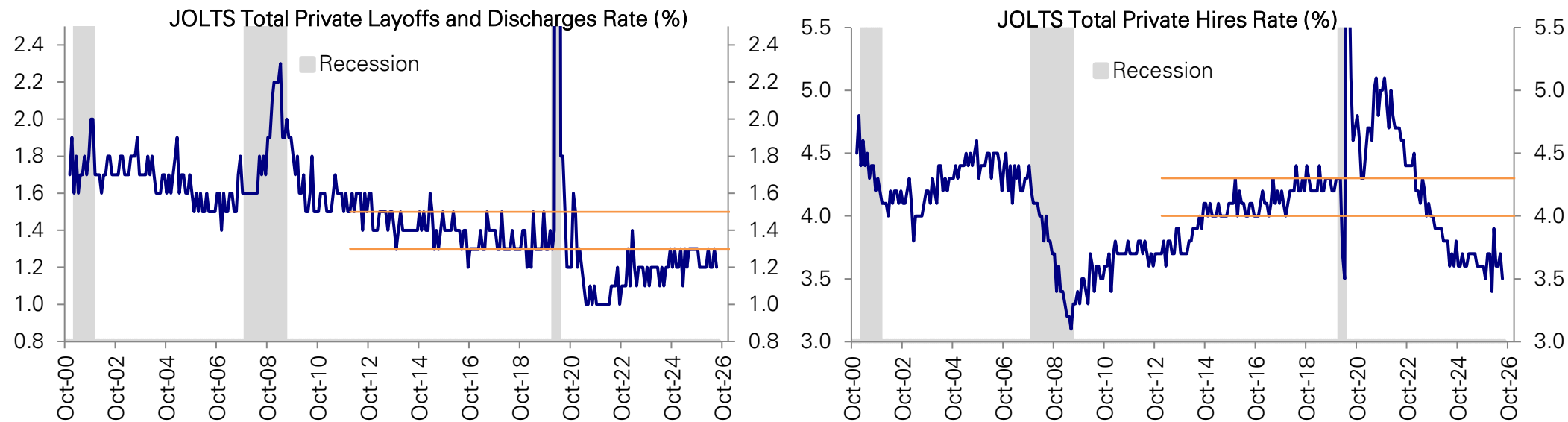


The economic recovery is broadening



Labor market coming out of deep freeze

- Layoffs rising from unusually low levels and still slightly below the pre-pandemic range
- Hiring is recession like. The hiring rate peaked in early 2022, fell through mid-2024 as companies waited first for recession; then for the election; then got hit by Liberation Day; began recovering again but then hit by the Iran war shock
- Companies are accepting and adapting to a shock-prone world, saying they look to “deal with it and get on with it” and not wait any longer

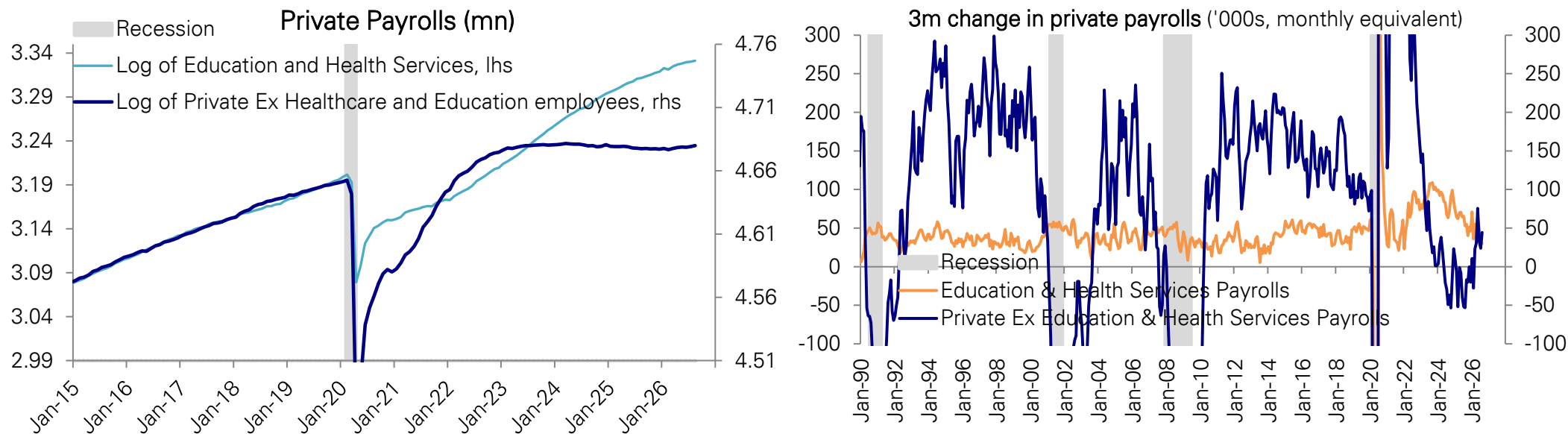




The economic recovery is broadening

Cyclical parts of payrolls picking up

- As has been well documented, growth in payrolls in the last 3 years came primarily from the education and health service sectors which tend to be relatively non-cyclical
- Payrolls for other sectors were shrinking slowly, but this was in line with the weak cyclical recovery outside of a few secular growth areas like AI
- But with a broader recovery now taking hold, cyclical areas are now inflecting higher

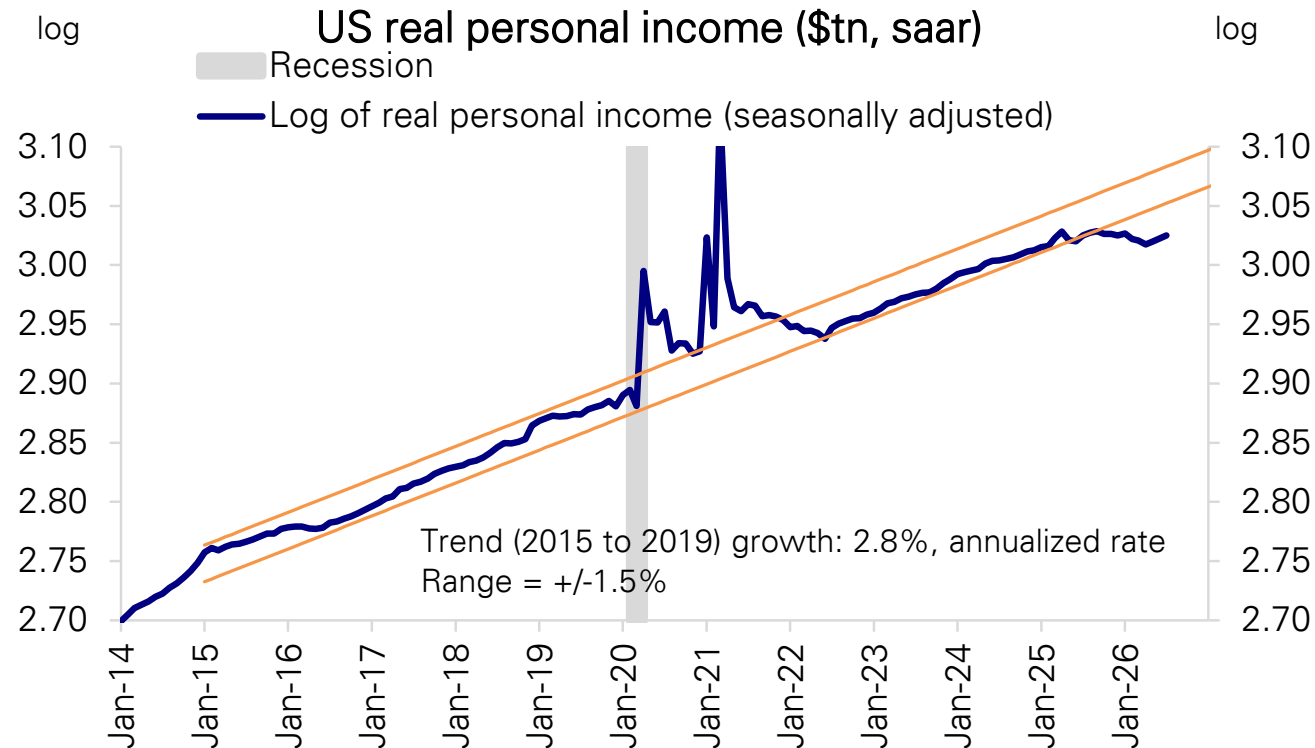


The economic recovery is broadening



Real incomes flat since Liberation Day but now perking up

- Real incomes had risen steadily within their long-run trend channel through a variety of shocks until Liberation Day but have been flat to down for over a year before starting to pick up recently

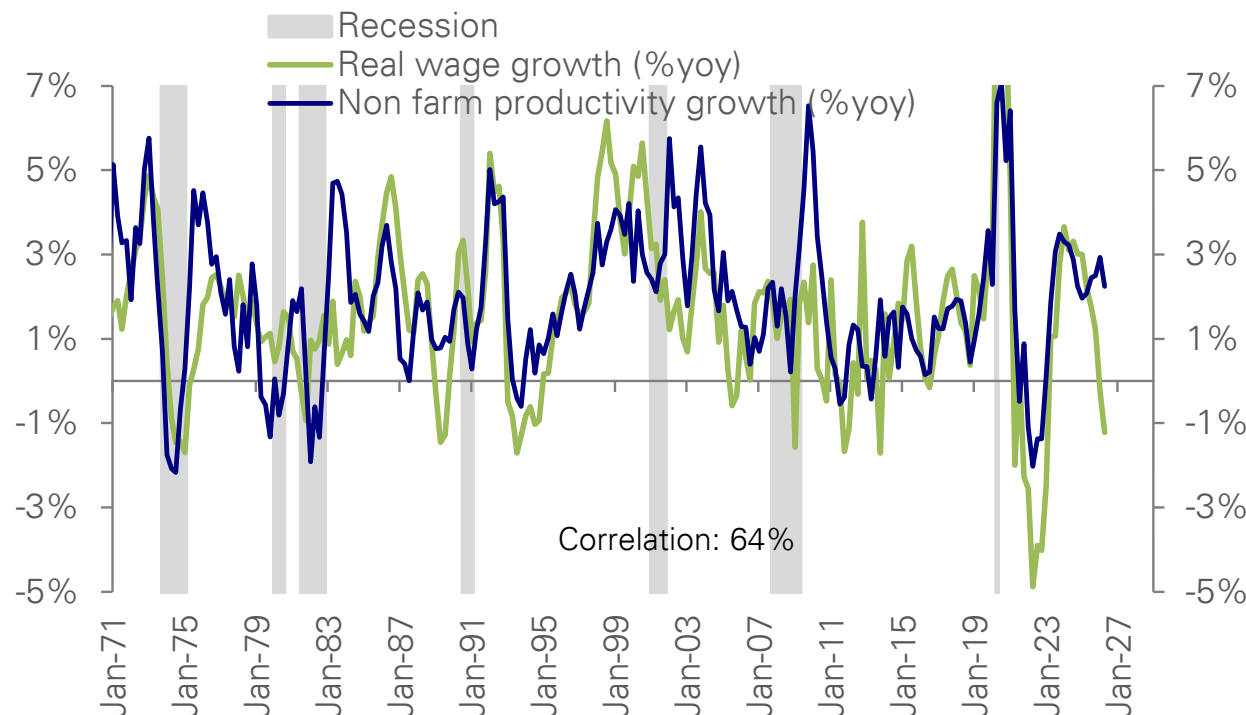


The economic recovery is broadening



Real wage growth should catch back up to productivity

- Productivity growth has been elevated for the last 3 years as is typical when the labor market is tight. Historically, real wage growth has moved in line with productivity
- However, a quick succession of shocks (tariffs, Iran war) raised inflation rapidly and there is presently a significant (3.5%) gap
- With cyclical employment growth picking up we see a catch-up in real wages and incomes

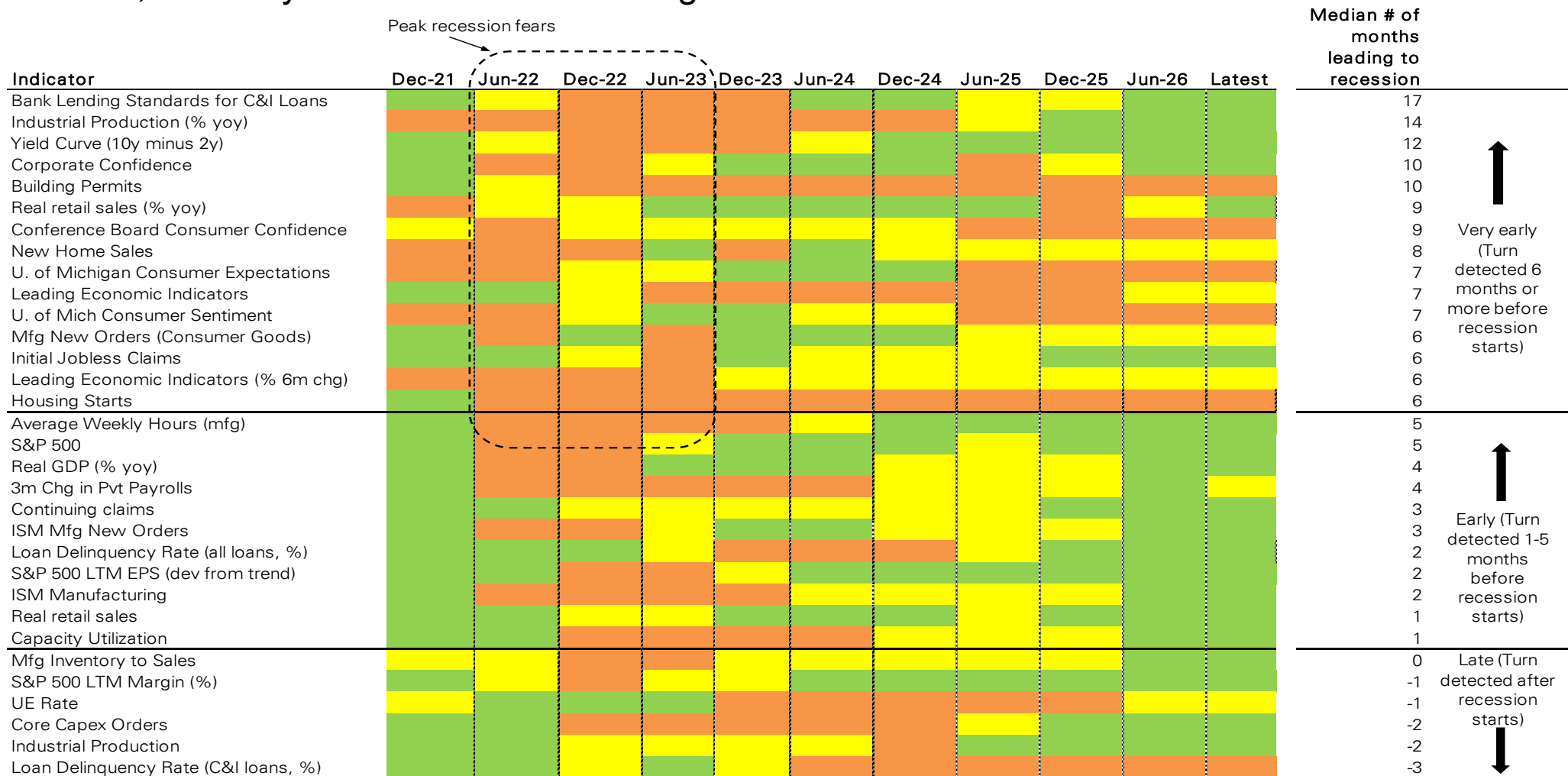




The economic recovery is broadening

Where are we in the cycle

- Cyclical indicators show no signs of an impending recession. The weakness that there is, is mostly concentrated in housing and confidence

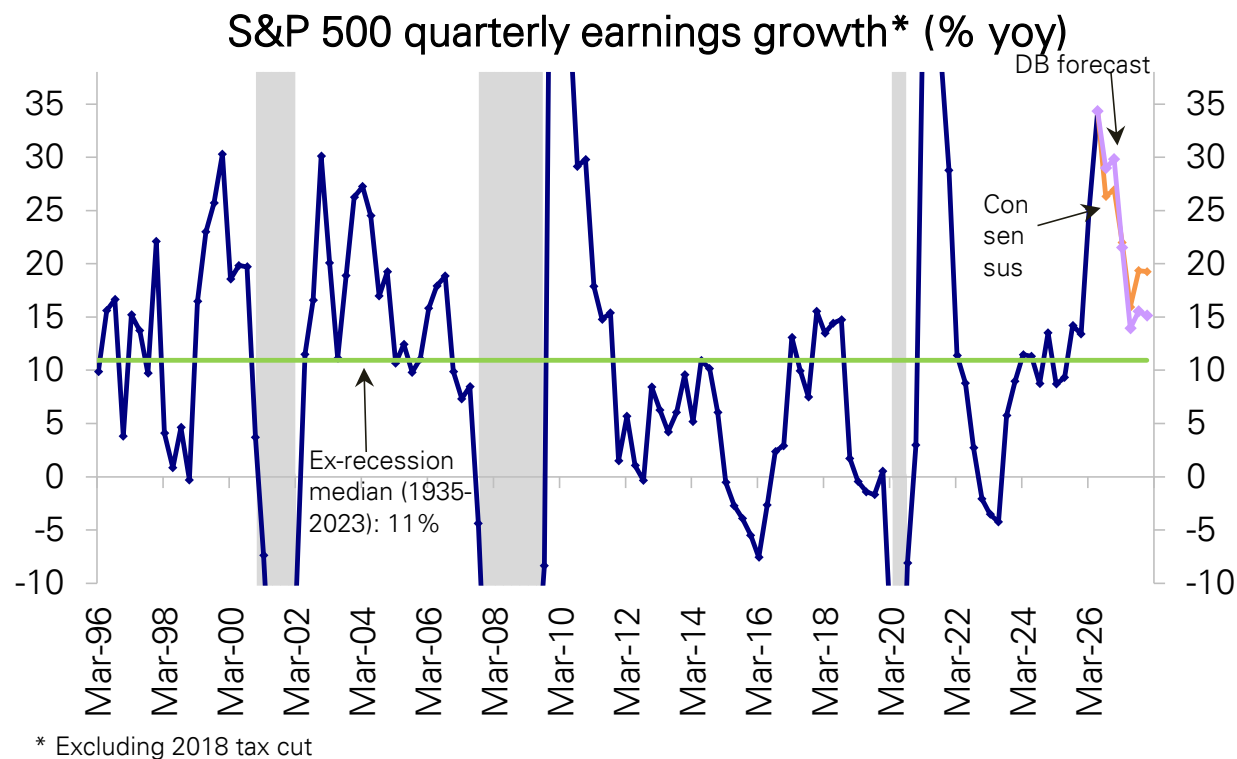


Unprecedented earnings boom set to continue



Off-the-charts earnings growth

- Earnings growth for the S&P 500 accelerated sharply from 25% in Q1 to 34% in Q2, arguably the strongest on record. Growth for the median company rose to 14%
- We see earnings growth remaining extremely strong in H2 2026 and moderating in 2027 but only to the high teens. The bottom-up analyst consensus has a similar path



Unprecedented earnings boom looks set to continue

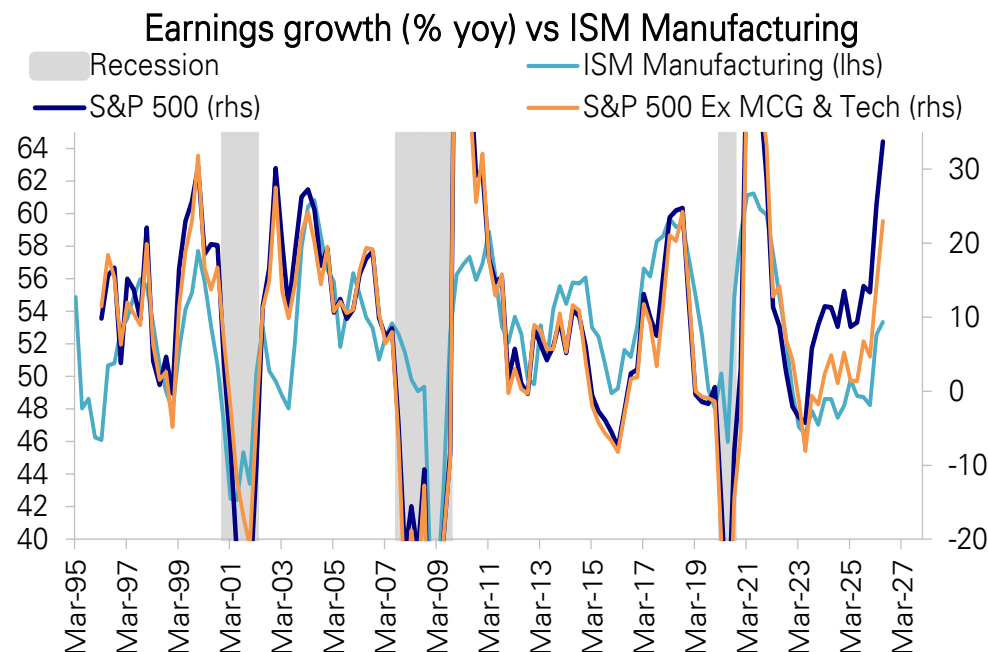


Broad-based earnings growth across sectors

- All 11 sectors delivered positive growth, with 7 of the 11 in the double digits, and 7 seeing an acceleration
- Earnings growth outside MCG & Tech jumped to 23% in Q2, after remaining negative or in the low single digits for over 3 years
- The sharp increase in earnings growth has coincided with a cyclical pick-up reflected in the rebound in PMIs, and higher oil and commodity prices



* Blended assumes companies that that report beat at the current beat rate

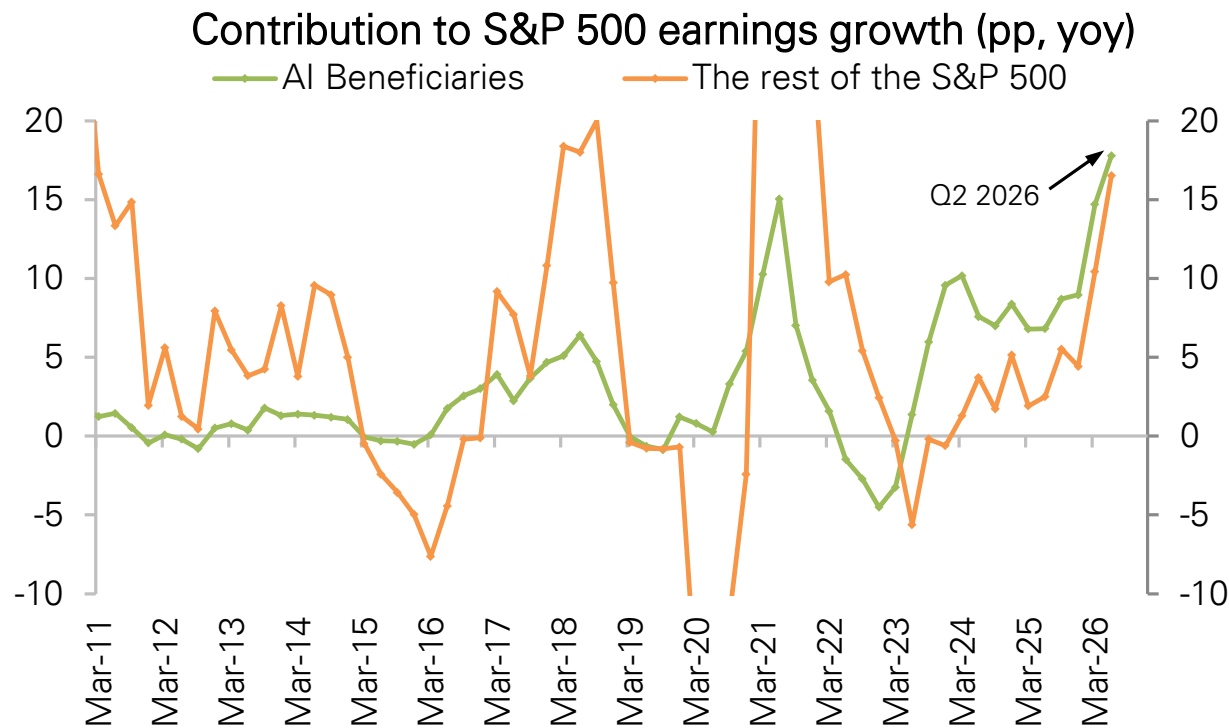


Unprecedented earnings boom looks set to continue



Strength in earnings growth goes well beyond AI

- Earnings growth has broadened notably outside MCG & Tech. The MCG & Tech contribution to S&P 500 earnings growth has fallen from 90% a year ago to 55% now
- Alternatively, splitting the S&P 500 into AI and its beneficiaries (both within and outside Tech) and the rest of the S&P 500, the contributions of AI and its beneficiaries (51%) and the rest (49%) are about even

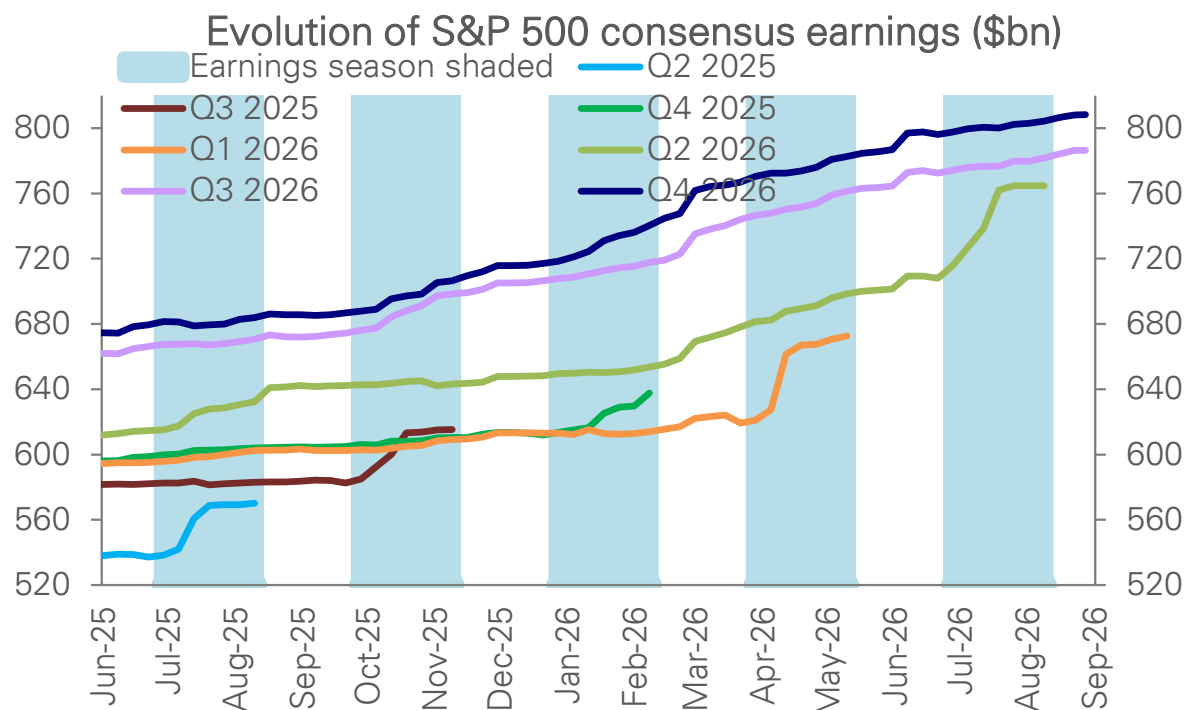


Unprecedented earnings boom looks set to continue



Consensus for forward quarters not showing any sign of peaking

- Recent earnings seasons have delivered large beats and raises despite estimates being upgraded steadily
- Consensus for Q3 and Q4 has continued to creep higher but is just slightly above the actual earnings for Q2

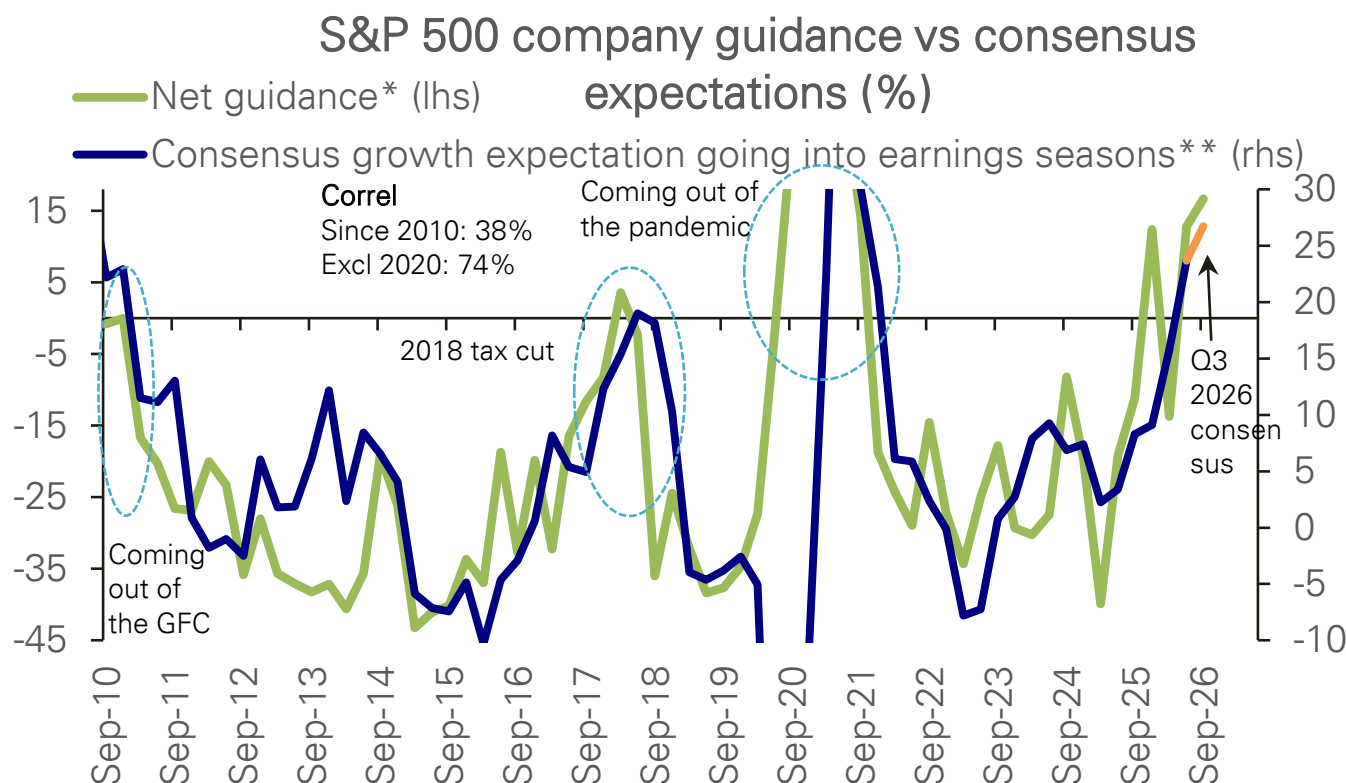


Unprecedented earnings boom looks set to continue



Rising corporate guidance suggests more upside for consensus

- Corporate guidance has been very strong, pushing consensus estimates higher
- Q3 consensus growth expectations are already strong at 27%, but guidance suggests upgrades should continue to 30%



* Net of companies guiding higher than consensus vs those guiding lower

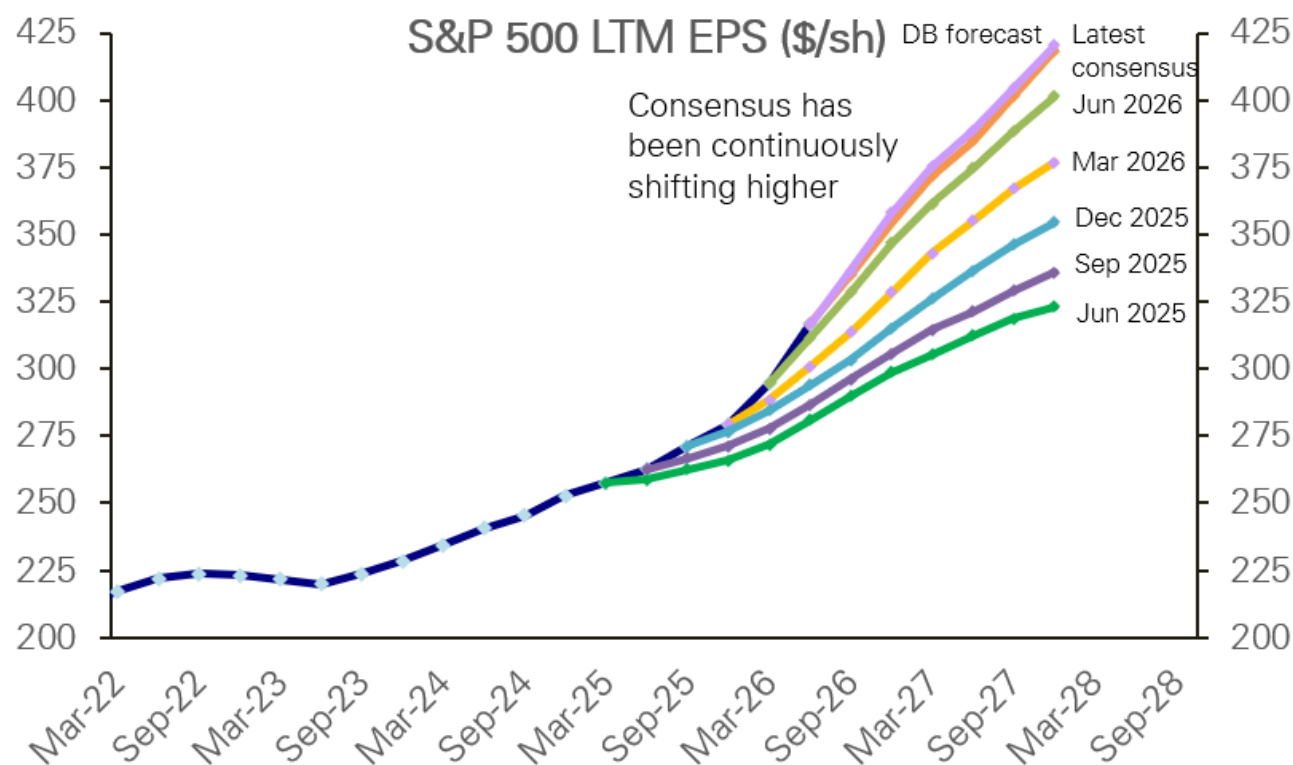
** Consensus earnings growth expectation 4 weeks before the start of an earnings season

Unprecedented earnings boom looks set to continue



Raised S&P 500 EPS forecast for 2026 from \$342 to \$358

- On the back of the solid beats in Q2, the notable pickup in PMIs recently as well as continued outsized growth in Tech, we raised our S&P 500 EPS estimate for 2026 to \$358 (from \$342), implying growth of 28%
- We also raised our forecast for 2027 to \$420 (from \$390), implying 17% growth

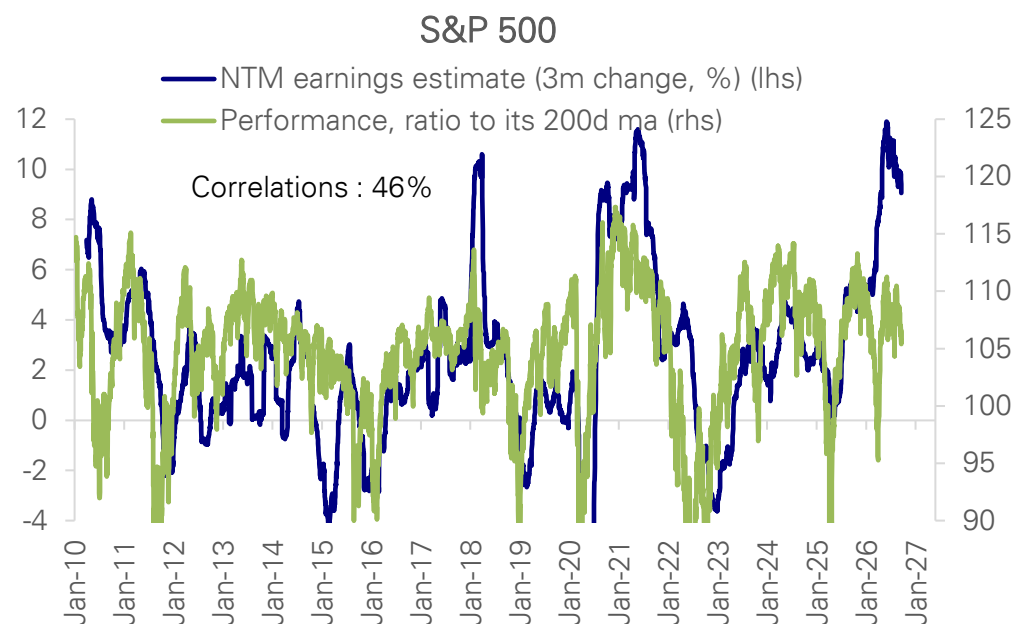
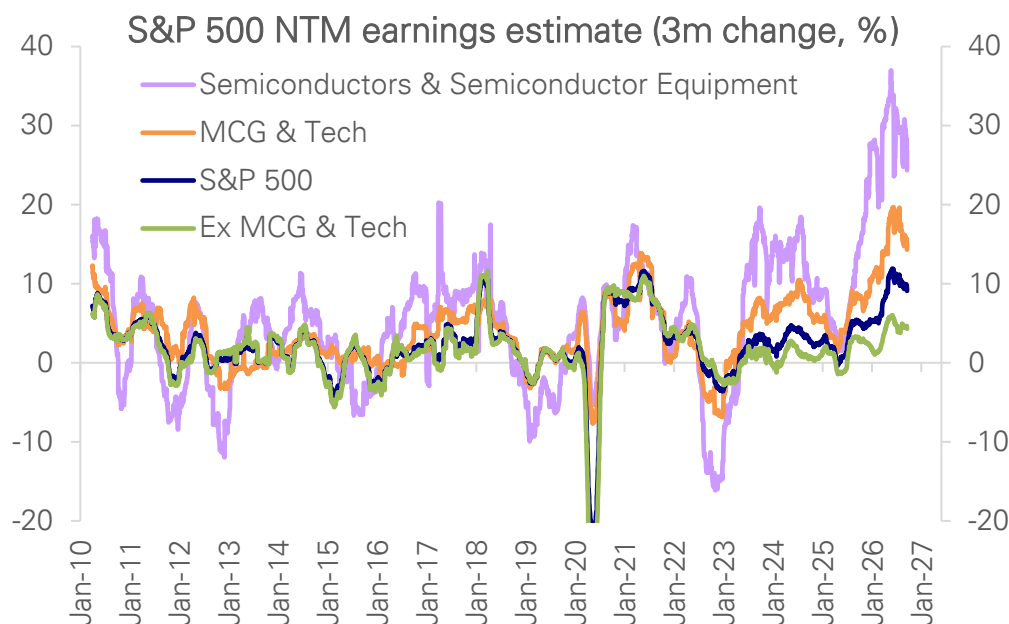


Unprecedented earnings boom looks set to continue



Market is priced for a sharp slowing in upgrades

- Substantial record upgrades to bottom-up consensus estimates (+18% ytd for 2027), especially for Tech (+37%) and Semis (+83%)
- We see high growth sustaining but look for the pace of upgrades to slow
- The market already looks priced for a very sharp slowing in earnings revisions



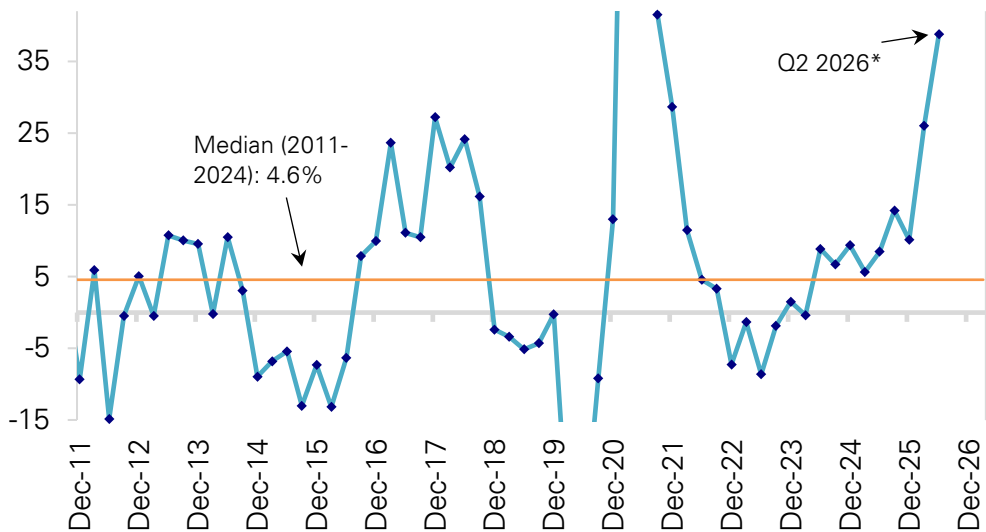
Unprecedented earnings boom looks set to continue



Global earnings growth is also strong and broad

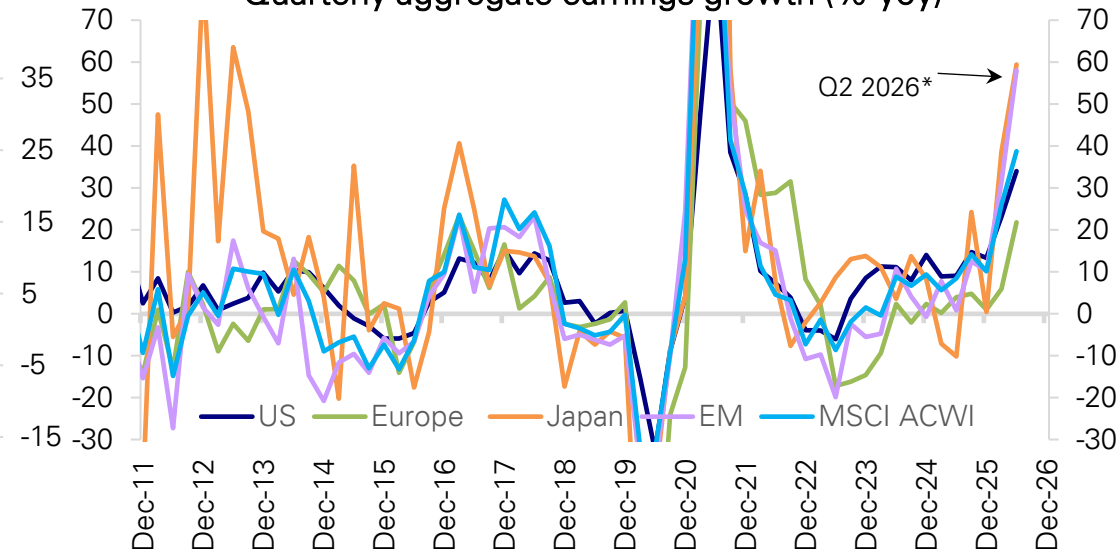
- Global earnings growth accelerated from an already exceptional 26% in Q1 to 39% in Q2, driven by broad-based strength across regions and sectors, with positive earnings growth in every sector
- The surge reflects the simultaneous tailwinds of AI-driven Tech demand, rebounding PMIs and higher oil and commodity prices that drove very strong sales growth and record-high margins
- Growth rose sharply across all regions, with the US, Japan, and EM posting exceptional growth and Europe its strongest growth in nearly four years

MSCI ACWI aggregate earnings growth (% yoy)



*Q2 is blended, assumes companies yet to report beat at current beat rate; growth in USD

Quarterly aggregate earnings growth (% yoy)



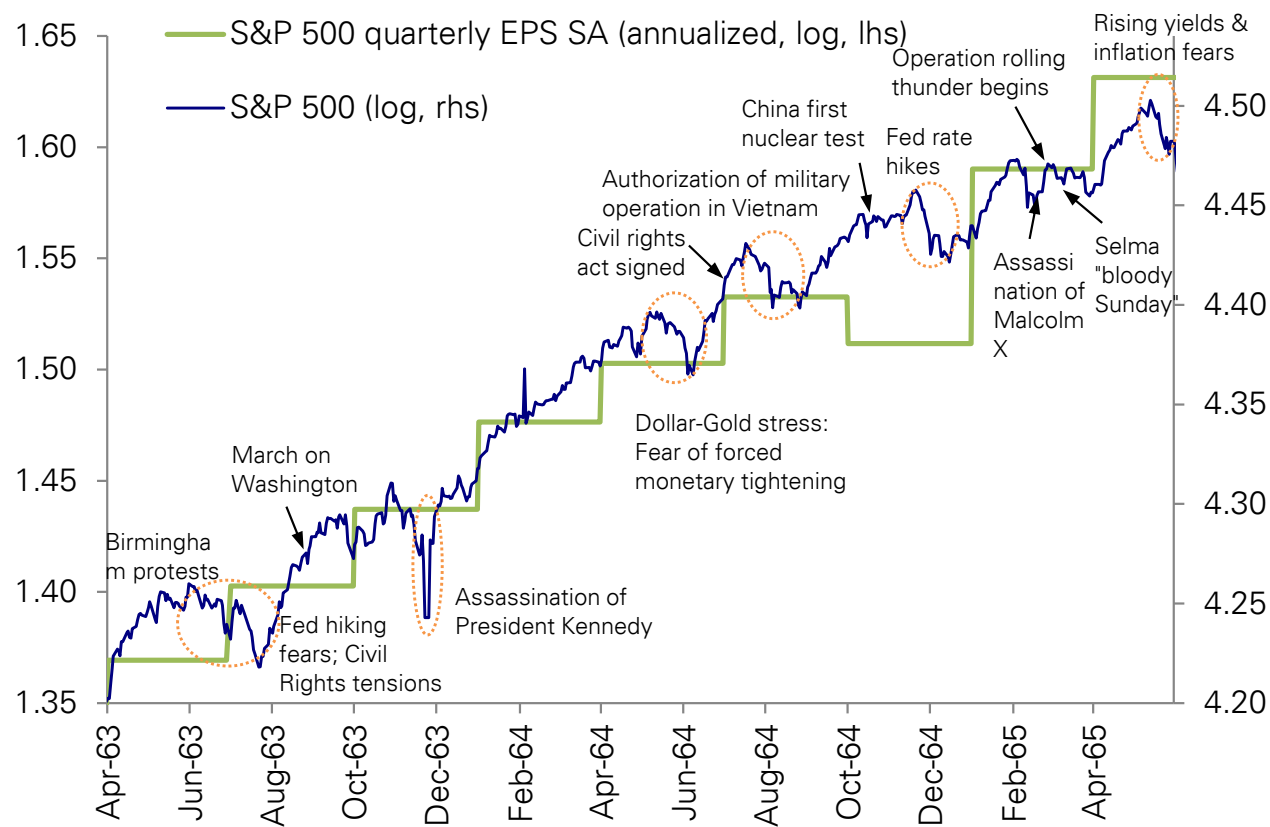
*Q2 is blended, assumes companies yet to report beat at current beat rate

Earnings the anchor for equities historically



Early 1960s historical precedent

- The 1960s saw multiple domestic political and geopolitical shocks but the equity market remained tied to rising earnings

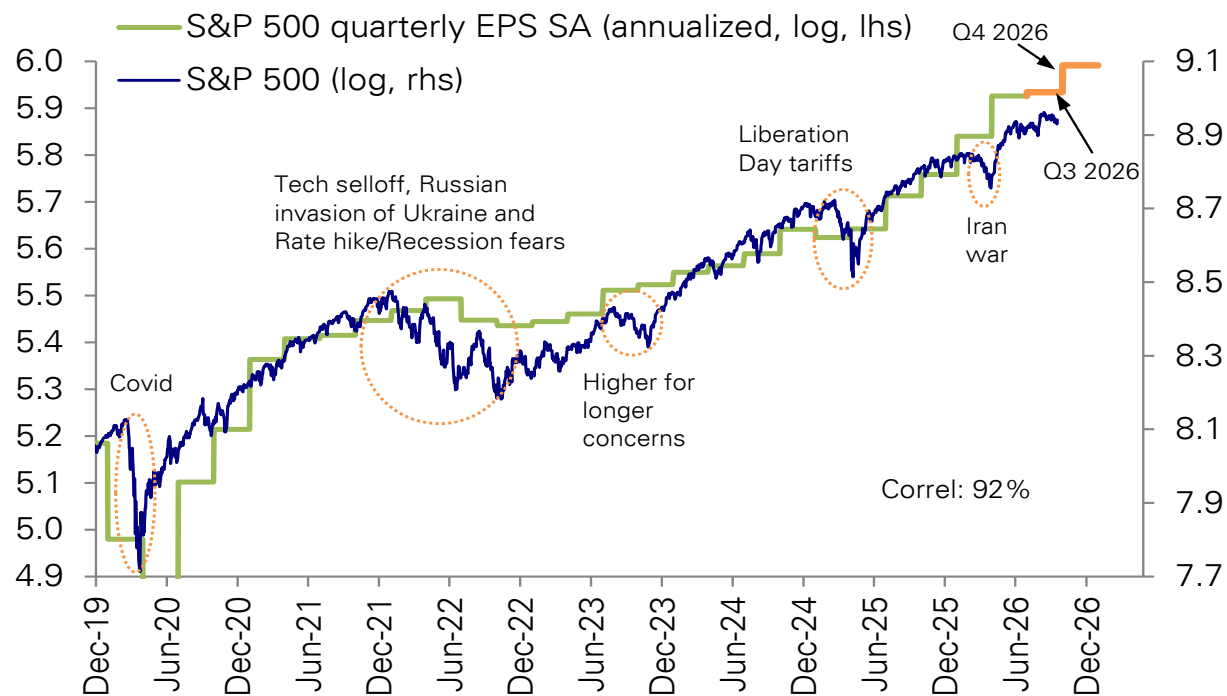


Earnings the anchor for equities historically



Since the pandemic, the market has moved up with earnings

- The market has followed a similar pattern since coming out of the pandemic and has closely tracked earnings through a variety of shocks
- The S&P 500 is currently well below (15%) levels implied by Q4 earnings estimates

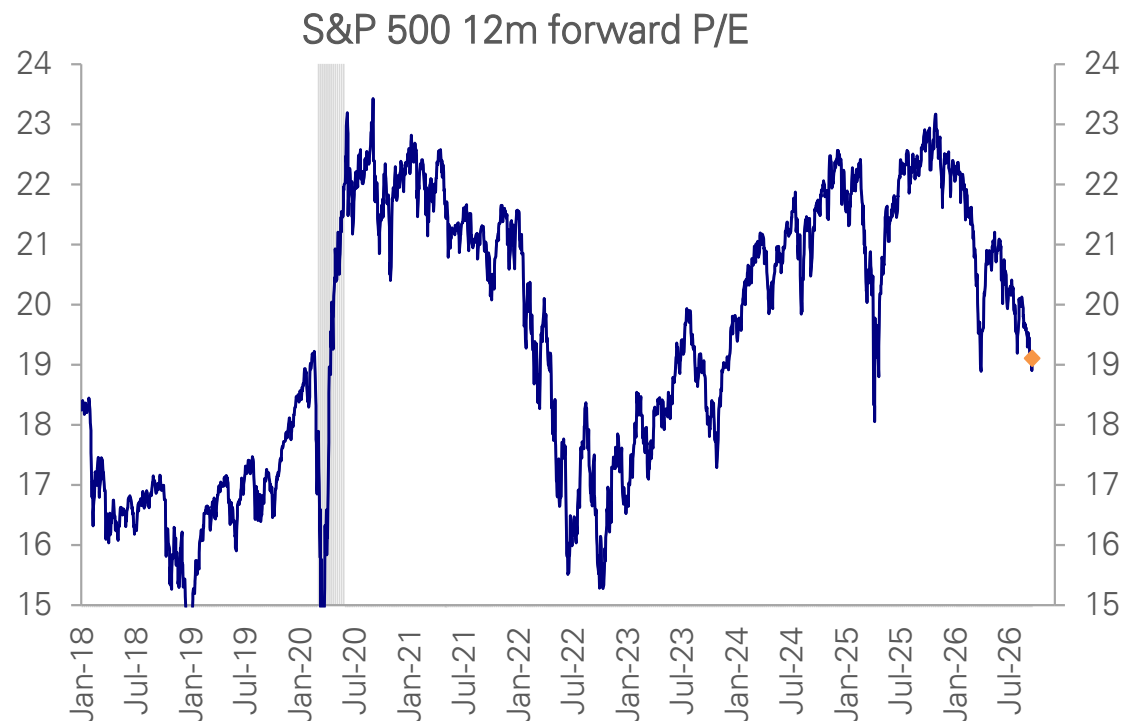


Earnings the anchor for equities historically



Forward multiples at the lower end of recent ranges

- The S&P 500 forward multiple is trading at 19.1x, at the lower end of recent ranges. This is on par with the Iran war lows and not much above Liberation Day lows

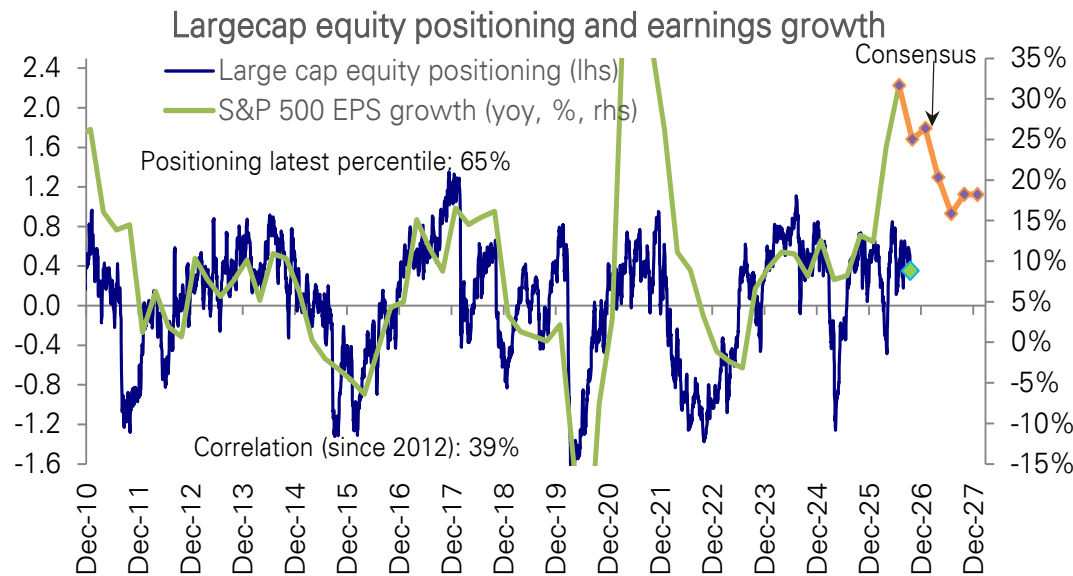


Positioning and sentiment still cautious

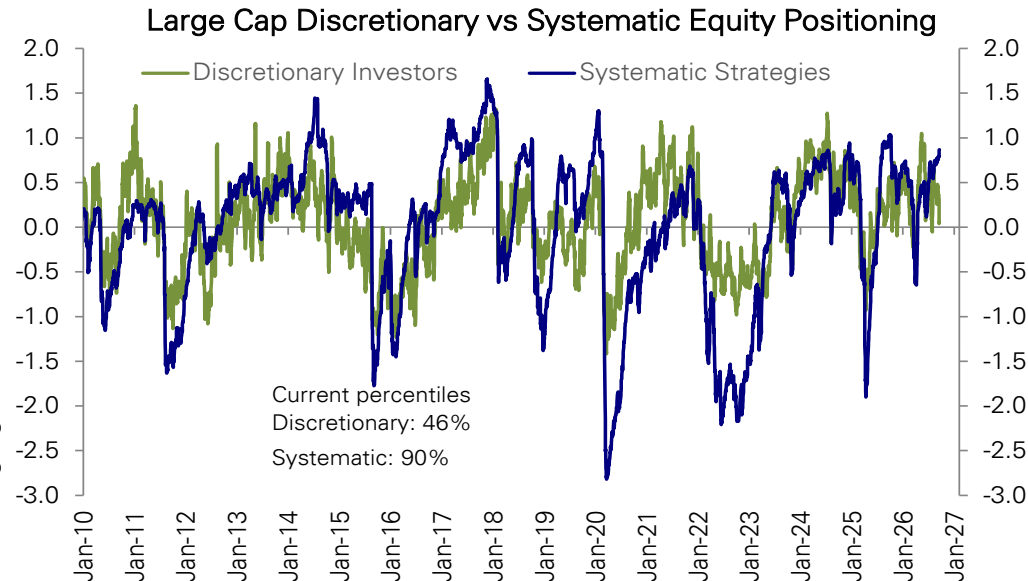


Investors are already positioned for a sharp slowing in growth

- Large-cap equity positioning is overweight but not elevated and we see room for it to rise. It is running well below levels implied by booming earnings growth and already pricing in a significant slowing
- Discretionary investors in particular are barely above neutral despite strong growth



*Excluding the impact of corporate tax cuts on earnings growth in 2018



*Wtd average of Z-scores for positioning and flows indicators, weights based on explanatory power in regression of equity performance on indicators

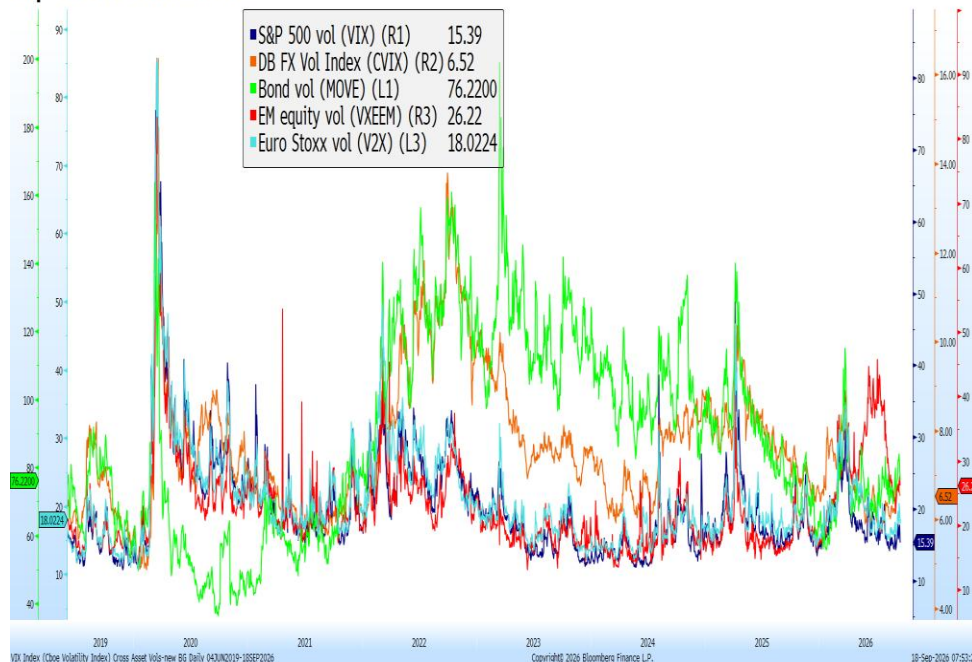
Positioning and sentiment still cautious



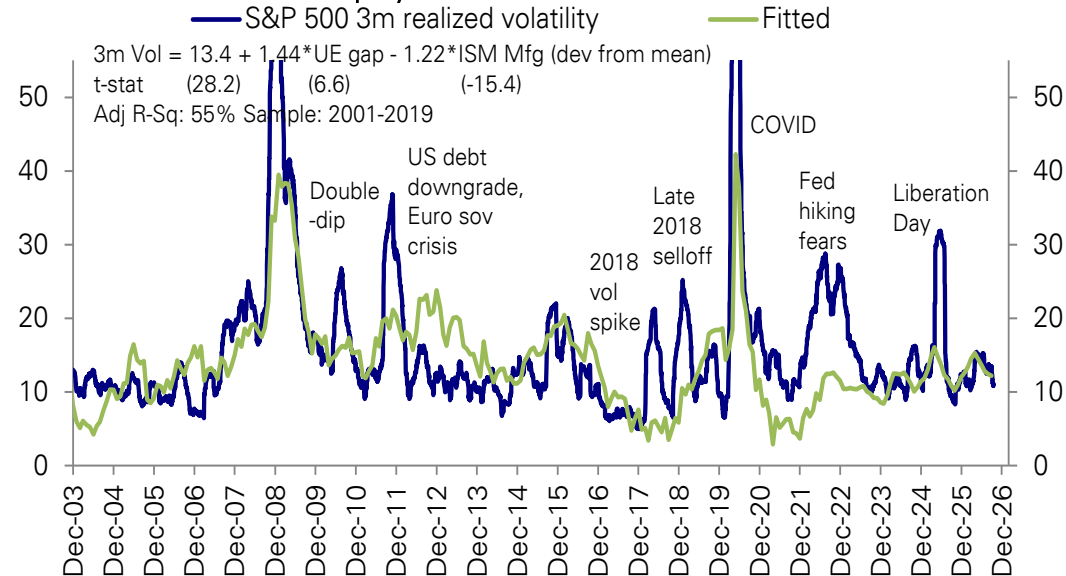
Volatility is low but very much in line with the growth cycle

- Volatility across asset classes typically has a large common component governed by the stage of the cycle
- Given low unemployment and rising cyclical growth, not a surprise that volatility is low across the board

Implied Vol across assets



Equity 3m realized vol vs fitted

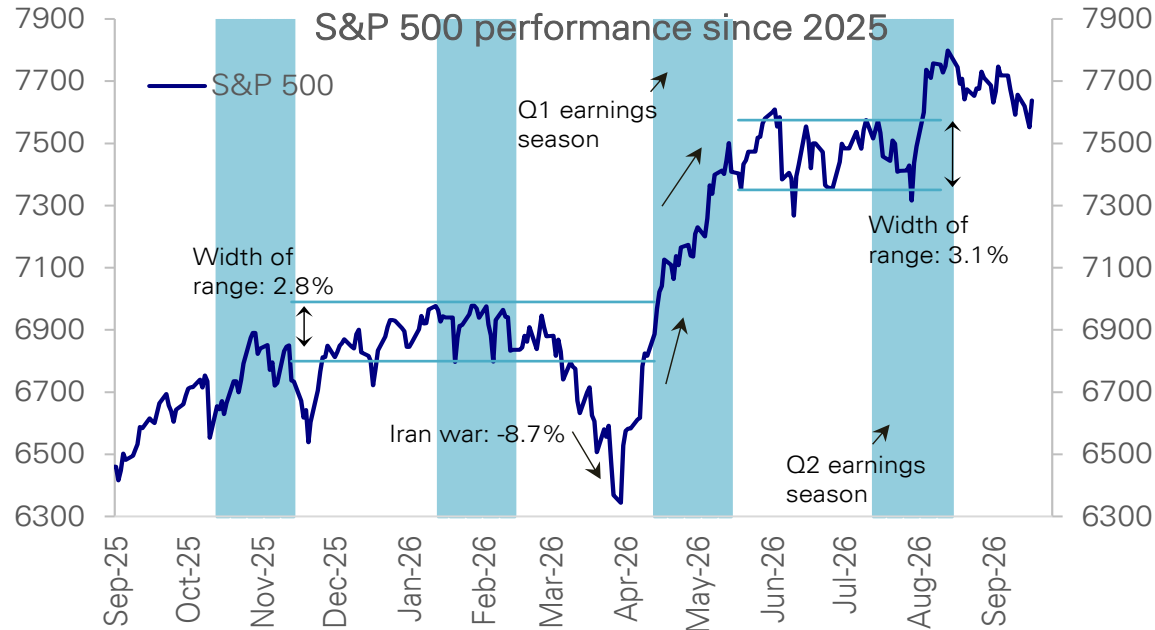


Taking stock of the rally



Stepping from one range into another

- Prior to the Iran war, the S&P 500 had been stuck in a narrow range for 5 months with large rotations across sectors. The de-escalation in Iran and an off-the-charts Q1 earnings season drove a very big rally in April and May
- Then it went into a range again in June and July, followed by a sharp bounce through the Q2 earnings season. It is back into a range again as it battles several catalysts that have historically been a drag: sharp rise in oil prices and in rates, escalations in geopolitical risks and trade wars, and concerns around AI spending

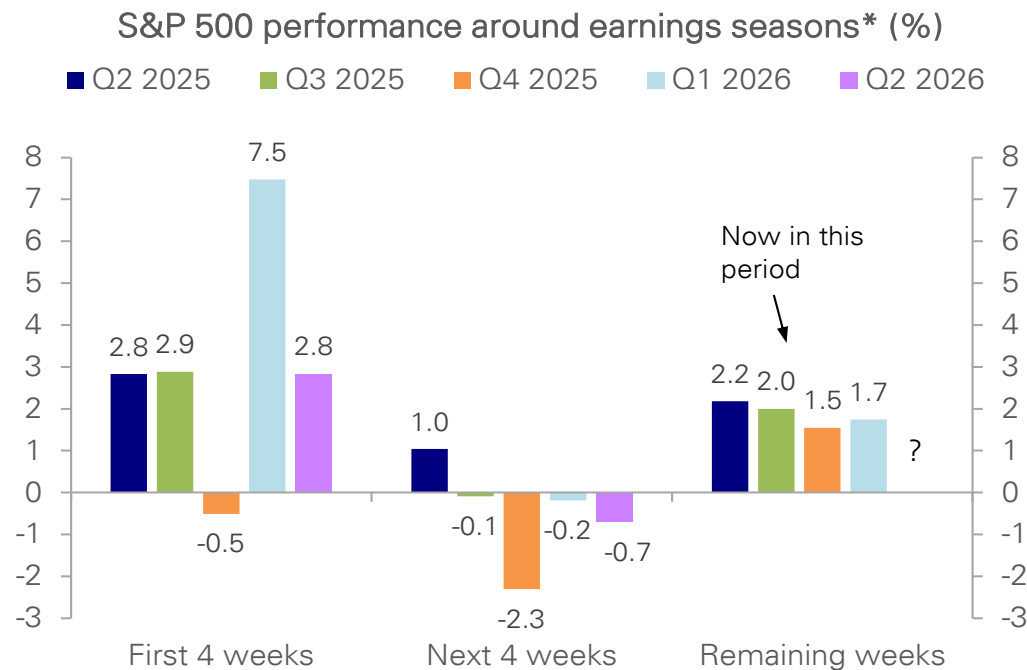


Taking stock of the rally



Earnings season rallies and post-season lulls

- Clear pattern in recent quarters of a rally for the S&P 500 in the first four weeks of the earnings season; followed by a lull; and a pickup again as the next season approaches
- Reflects the delivery during earnings season of off-the-charts earnings growth, but also the skepticism that it can be sustained, and a revival on robust corporate guidance



*Start of the season defined as when the mega-banks begin to report

Taking stock of the rally



A series of sharp catchup rallies back to the 4-year trend

- The recovery channel out of the 2022 selloff has been in place since Oct 2022 and is steep (rising almost 2% a month)
- Since Liberation Day, the S&P 500 has had several sharp selloffs followed by catchup rallies back to the bottom of the channel



Taking stock of the rally: Geopolitical risks and wars



Sharp but short-lived selloffs the norm

- The S&P 500 followed the typical trajectory around domestic political and geopolitical events has been down 6-8%. 3 weeks to find a bottom and 3 weeks to recover. This played out around Russia-Ukraine in 2022 and around Israel-Hamas in Oct 2023 ([Of Politics and Pullbacks, Sep 2017](#); [Is Geopolitical Risk Priced In? Feb 2022](#))

Equity market selloffs and recoveries around geopolitical events					Returns from trough (%)				
Event*	Event date	Time to bottom**	Time to recover**	Size of selloff (%)	1w	1m	3m	6m	12m
WW-II Germany annexes Czechoslovakia	15-Mar-39	22	108	-20.5	2.3	8.3	8.5	23.2	18.9
WW-II Germany attacks France	9-May-40	22	745	-25.8	11.0	10.9	17.1	18.0	9.2
WW-II Pearl Harbor	7-Dec-41	17	201	-10.8	8.6	6.5	-3.8	-1.1	15.3
N. Korea invades S. Korea	24-Jun-50	17	43	-12.9	4.8	11.2	19.2	29.2	31.4
Suez Crisis	29-Oct-56	17	131	-6.8	5.5	4.9	-1.4	6.2	-6.0
Berlin Wall built	13-Aug-61	25	18	-3.9	1.4	4.1	8.0	6.2	-14.6
Cuban missile crisis	14-Oct-62	7	9	-6.6	5.7	15.0	22.7	30.0	36.5
Assassination of President Kennedy	22-Nov-63	2	1	-2.8	5.2	6.7	11.5	16.0	23.9
Authorization of military operations in Vietnam	7-Aug-64	15	36	-3.2	1.3	1.7	4.8	7.3	5.8
Six Day Israel Arab war	5-Jun-67	20	40	-6.5	4.1	3.3	6.5	7.7	13.0
Assassination of Martin Luther King Jr	4-Apr-68	2	2	-0.6	3.5	5.8	8.2	11.2	7.9
Israel Arab war/Oil embargo	16-Oct-73	27	1475	-17.1	1.5	7.3	5.6	-2.0	-28.2
President Nixon impeachment proceedings	6-Feb-74	9	16	-6.6	1.8	9.1	0.9	-10.8	-13.3
Shah of Iran exiled	16-Jan-79	9	34	-4.6	1.8	1.3	1.9	8.7	19.7
Iranian hostage crisis	4-Nov-79	24	51	-10.2	3.5	7.7	16.4	7.3	29.3
Soviet invasion of Afghanistan	24-Dec-79	12	6	-3.8	4.4	9.4	-2.9	11.6	29.6
Invasion of Grenada	25-Oct-83	22	304	-6.3	2.2	2.1	-3.7	-0.8	4.3
Bombing of Libya	15-Apr-86	20	7	-4.9	3.7	5.7	6.2	5.0	23.5
First Gulf War	2-Aug-90	50	87	-15.9	3.5	6.2	6.7	27.8	29.1
President Clinton impeachment proceedings	19-Dec-98	6	5	-3.9	5.4	6.2	13.4	13.4	23.0
Kosovo bombing	24-Mar-99	4	9	-4.1	3.1	7.5	5.6	1.4	21.0
9/11 attacks	11-Sep-01	6	15	-11.6	7.8	11.1	18.5	19.4	-12.5
Iraq war	20-Mar-03	7	16	-5.3	3.7	8.0	15.8	20.0	32.8
Arab spring (Egypt)	25-Jan-11	2	3	-1.8	2.7	4.0	6.6	1.9	3.1
Intervention in Libya	19-Mar-11	18	29	-6.4	3.2	5.0	0.9	-3.3	11.7
Russian invasion of Crimea	1-Mar-14	6	13	-2.0	1.4	-0.6	5.2	7.8	11.5
Intervention in Syria	22-Sep-14	21	12	-7.4	4.7	9.5	8.4	13.0	9.1
Brexit vote	23-Jun-16	14	9	-5.6	5.1	8.3	8.0	13.4	20.9
Airstrike on Syrian airbase	7-Apr-17	32	16	-2.8	1.2	2.7	5.1	9.6	14.1
Russian invasion of Ukraine	25-Feb-22	20	16	-9.1	2.2	7.6	-1.3	-3.9	-4.3
Israel-Hamas War	7-Oct-23	13	8	-5.9	5.9	10.5	18.8	23.9	41.1
Israel-Iran Airstrike	1-Apr-24	16	19	-5.5	2.7	6.8	10.8	18.1	6.4
US bombing of Iran bunkers	20-Jun-25	-	-	-	3.0	5.5	10.5	14.7	22.2
US strikes in Venezuela	2-Jan-26	-	-	-	1.1	-1.5	-4.6	8.4	-
US & Israeli strikes on Iran	27-Feb-26	24	11	-8.7	4.2	13.6	18.2	-	-
Median		17	16	-6.3	3.5	6.7	6.7	9.2	14.1
Average		16	106	-7.6	3.8	6.6	7.8	10.6	13.2

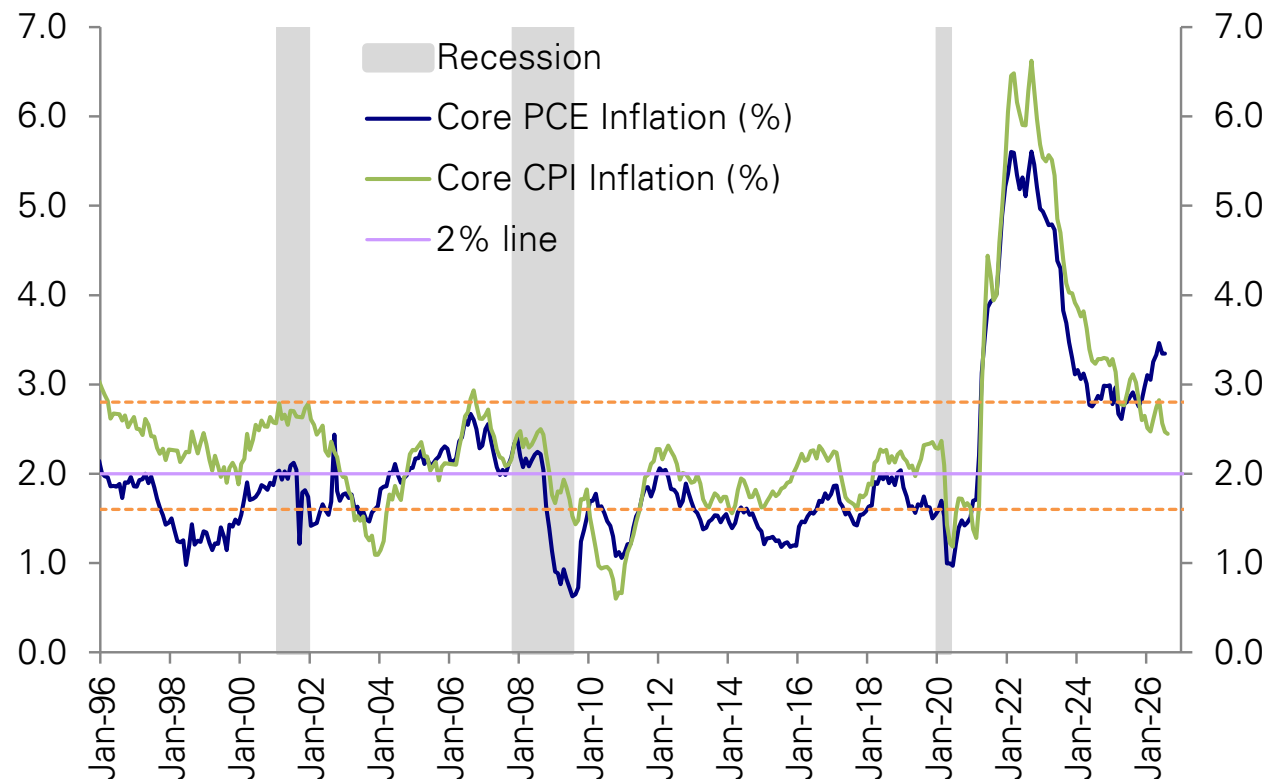
*shaded events occurred around recessions; **duration in trading days

Rates normalizing back up to growth



Core CPI - PCE wedge

- Core CPI (the benchmark for inflation indexed bonds) is at 2.4% well within its historical cyclical range. Core PCE however is elevated at 3.3% and has been rising
- Two components have had disproportionate impacts in creating the wedge: computer software & accessories; portfolio management. Neither is by itself bad for earnings

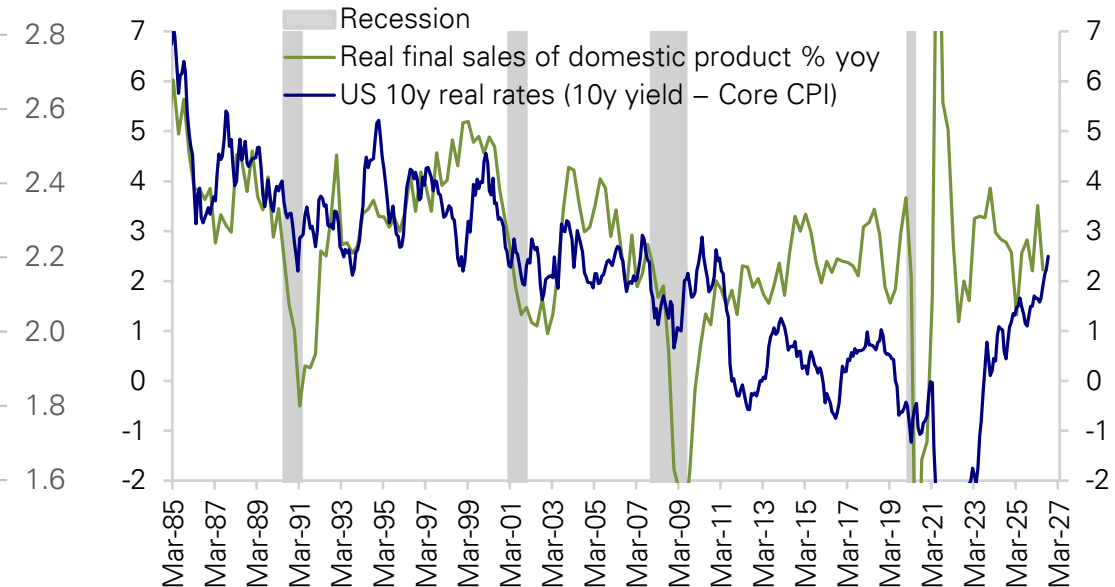
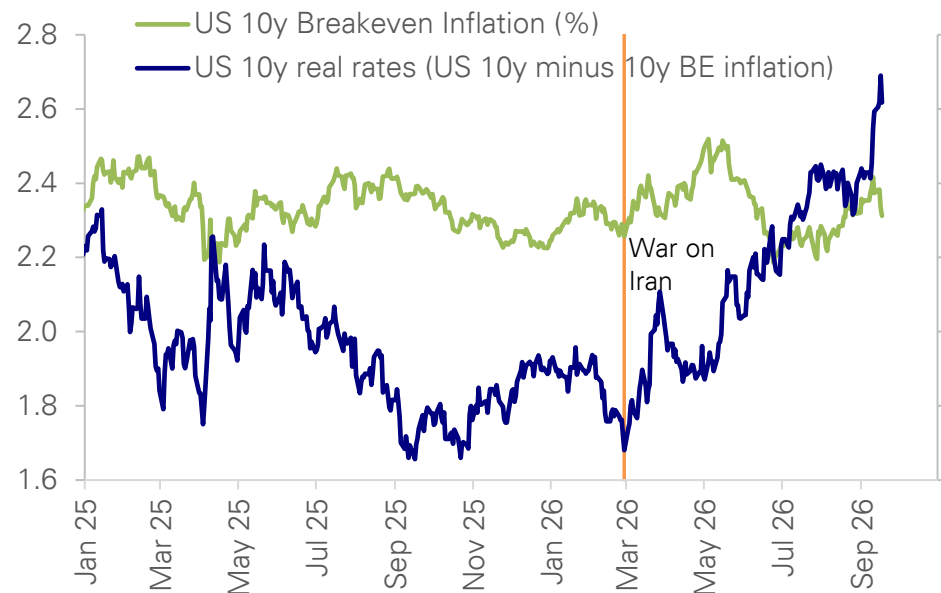


Rates normalizing back up to growth



Increase in rates this year tied to real rates which are tied to growth

- Breakeven inflation rates, which are contractually tied to the CPI index, are close to where they were just prior to the start of the Iran war
- Most of the increase in nominal rates this year has come from a rise in real rates
- Real rates are simply catching up to growth which has remained robust





Rates normalizing back up to growth

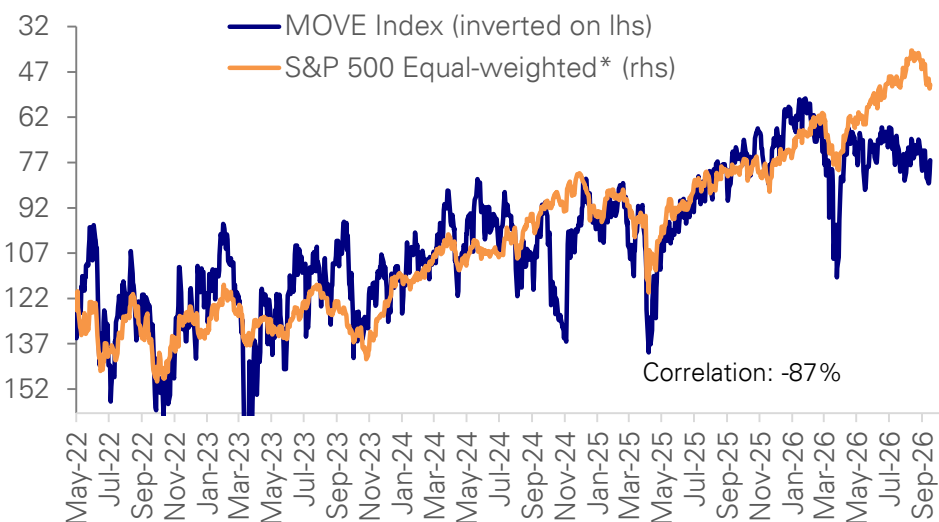
Rates vol not the level of rates the key for equities

- Over the last few years equities have been driven primarily by the volatility of rates rather than their level, typically rallying back once vol subsided even if rates remained higher ([Higher Rates or Higher Vol? Nov 2022](#))
- Even as the concern around the impact of rising rates on equities is very high, rates vol itself has remained in check. In turn, equities are in a range close to record highs

S&P 500 Equal weighted and MOVE

— MOVE Index (inverted on lhs)
— S&P 500 Equal-weighted* (rhs)

Correlation: -87%

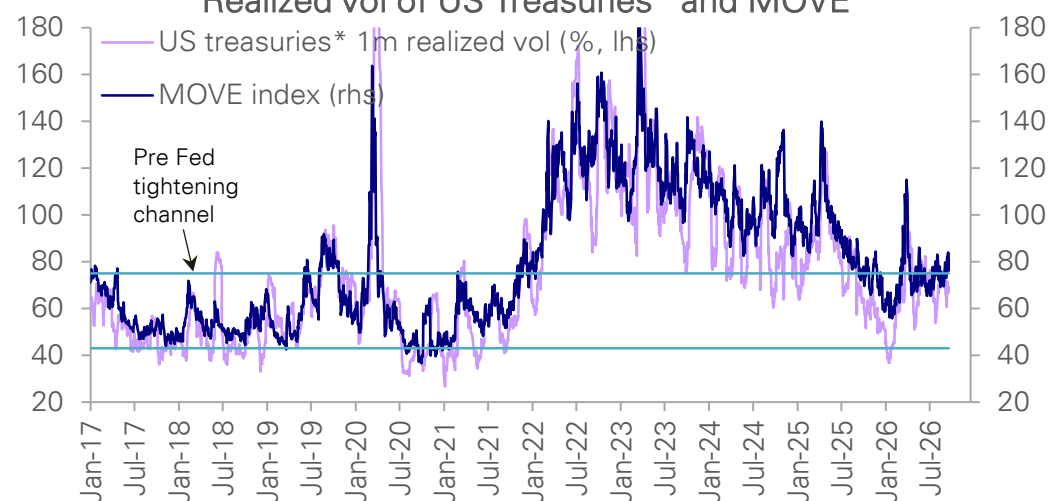


* Reindexed to 100 on May 02 2022

Realized vol of US Treasuries* and MOVE

— US treasuries* 1m realized vol (% , lhs)
— MOVE index (rhs)

Pre Fed
tightening
channel



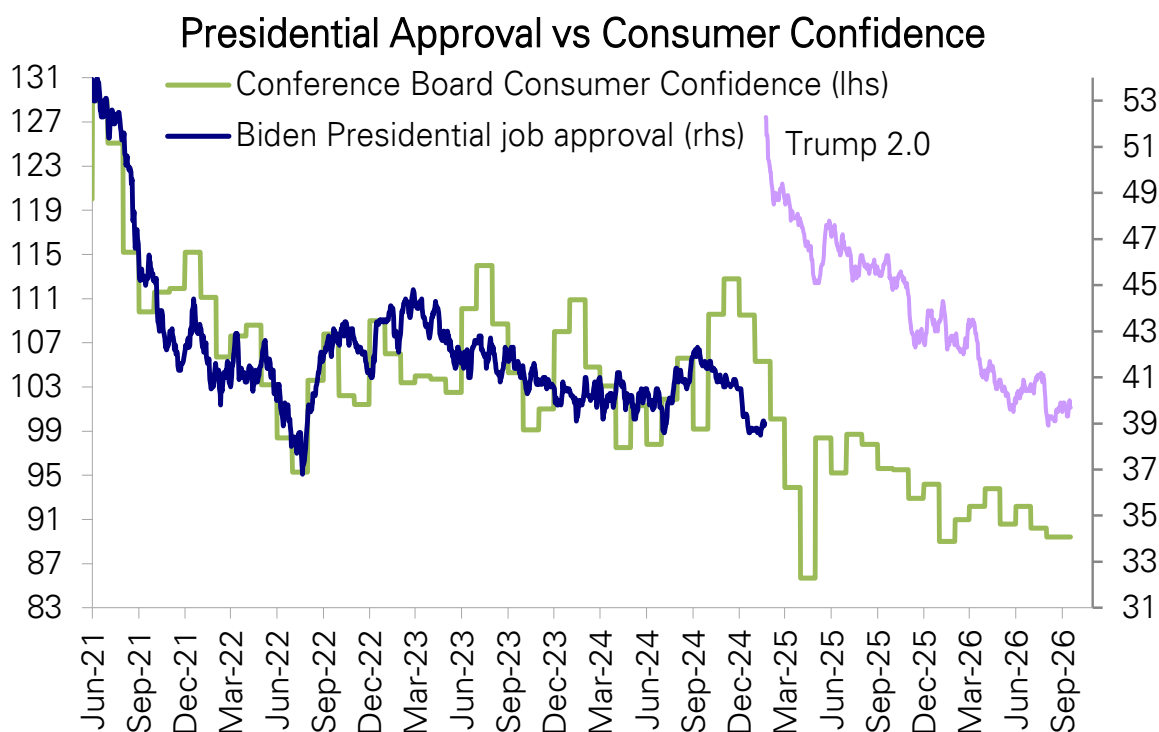
*Weighted average of annualized 21d standard deviation in the daily changes in 2y, 5y, 10y and 30y yields as per the weights in the MOVE Index (20%, 20%, 40%, 20%)

Mid-term elections: Checks and balances



Presidential approval ratings tied to perceptions of the economy

- After an initial honeymoon, approval ratings tend to align with consumer confidence
- President Trump's approval ratings have fallen steadily but consumer confidence suggests they could fall further

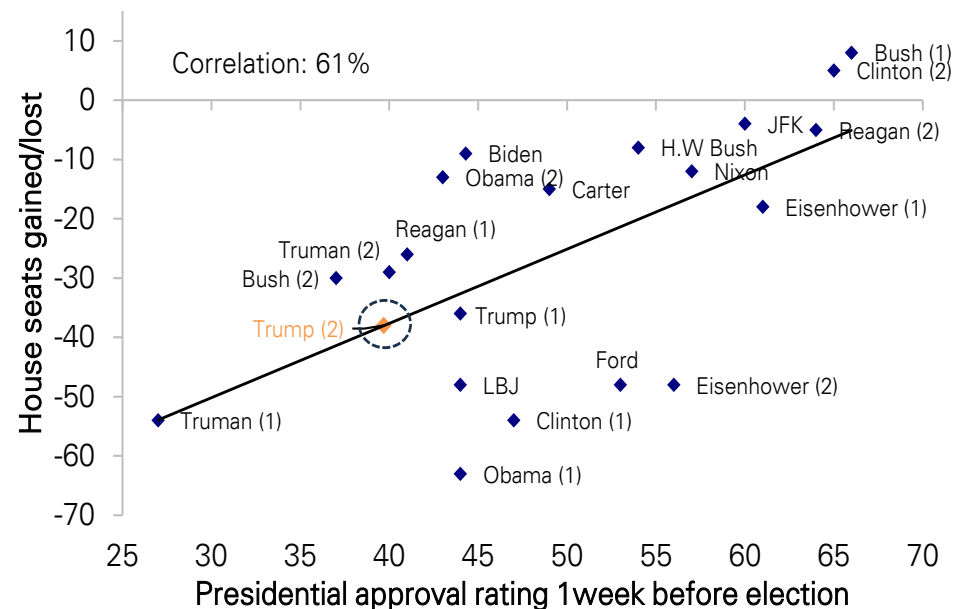
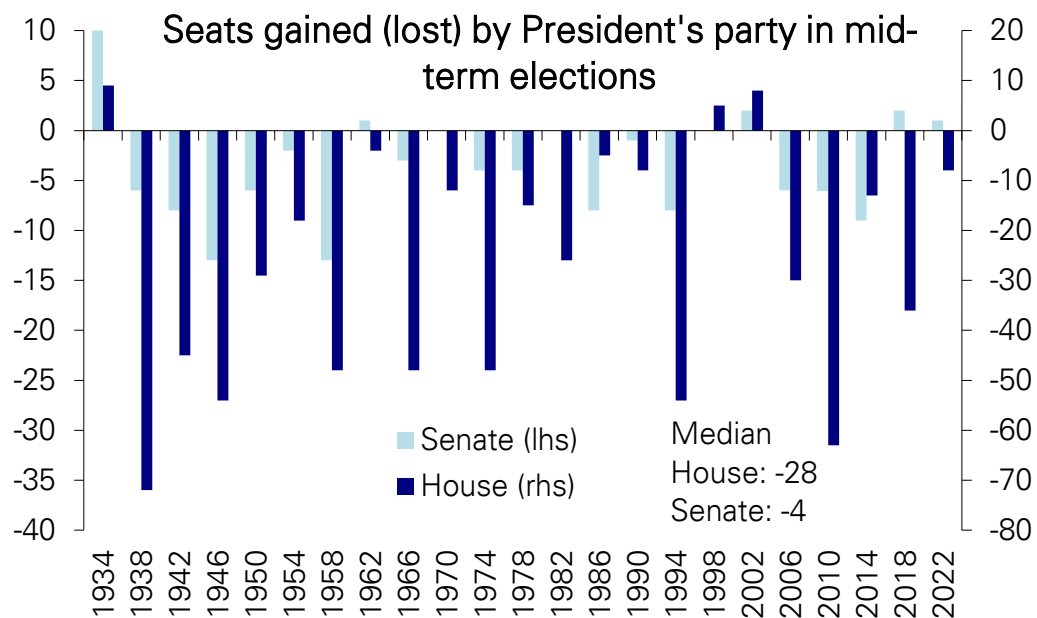




Mid-term elections: Checks and balances

Presidential approval ratings matter

- Long-standing pattern of the President's party losing seats in the House and the Senate during mid-term elections
- The extent of the midterm losses is tied to the President's approval rating going in
- Current approval ratings, point to a loss of about 40 seats in the House for the Republicans, with redistricting handicapping the historical pattern by 5 seats
- Polls and prediction markets point to large gains for Democrats in both chambers

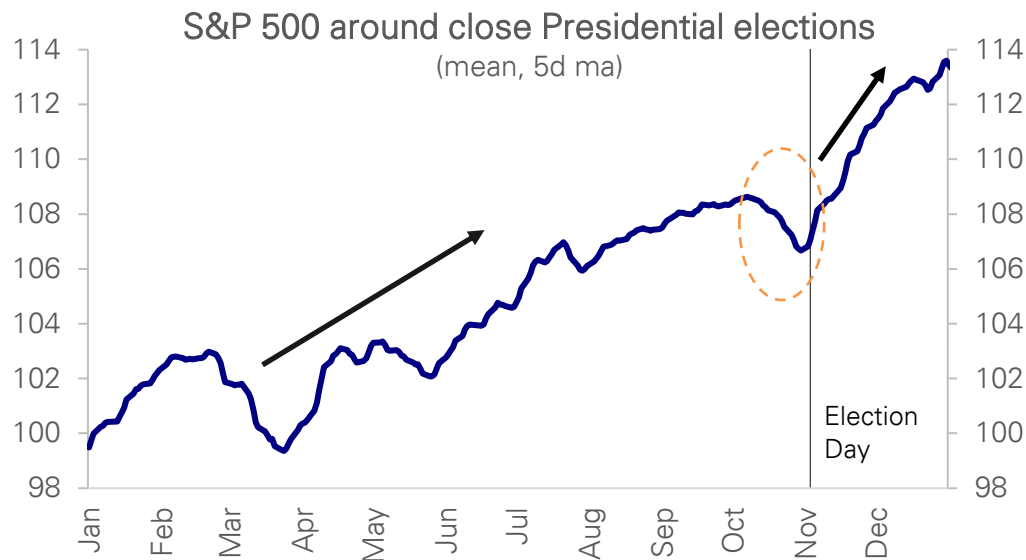


Mid-term elections: Checks and balances



Will equities treat this mid-term like a close Presidential election?

- An often-observed pattern in close Presidential elections has been the buying of protection late that saw equities go sideways or pull back, then rally strongly in the aftermath regardless of which party won. Predictable elections have been non-events ([Equities and the Presidential Election Premium, Aug 2020](#); [Positioning For The Election, Nov 2016](#); [Financial Markets and the US Election, Oct 2012](#))
- In prior close elections, equities sold off for about a month going into election day with a rally after the result putting the market back in line with its prior trend



*Elections since 1948. Excludes 1948 election as it was a surprise election and coincided with a recession year, 1960, 1980, 2000 and 2008 recession years

S&P 500 performance around close Presidential elections

Election	Peak	Trough	Selloff (%)	Rally from trough to year end (%)
1952	8-Aug	22-Oct	-6.8	11.6
1968	21-Oct	1-Nov	-1.8	0.8
1976	21-Sep	2-Nov*	-5.5	4.2
2004	6-Oct	25-Oct	-4.1	10.7
2012	17-Oct	6-Nov*	-4.5	-0.2
2016	10-Oct	4-Nov	-3.6	7.4
2020	12-Oct	30-Oct	-7.5	14.9
2024	18-Oct	31-Oct	-2.7	3.1
Median	11-Oct	30-Oct	-4.3	5.8

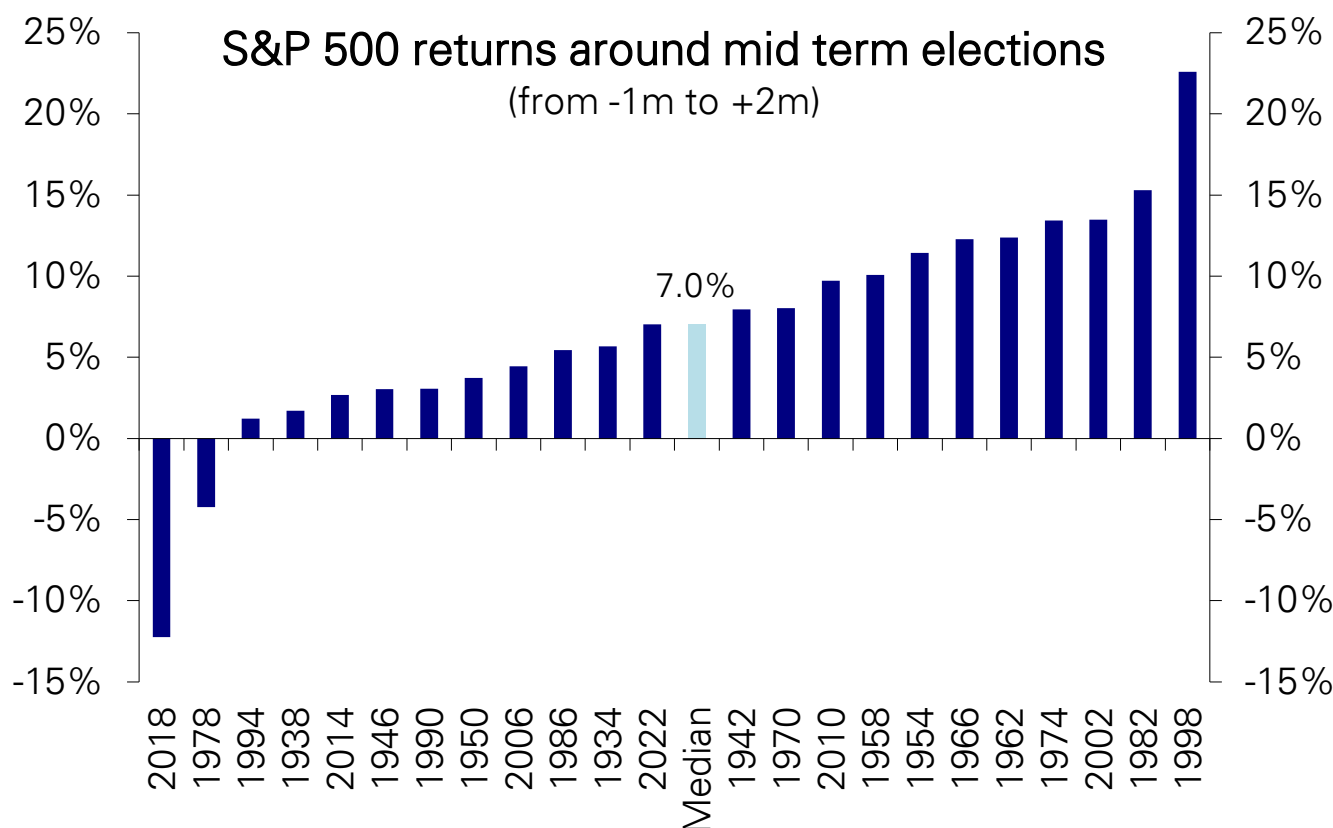
*Election day considered as trough, as the selloff continued beyond election day

Mid-term elections: Checks and balances



Returns around mid-term elections have historically been strong

- 21 of the last 23 mid-term election years have seen the S&P 500 rally in the last quarter by an average 7%
- Excluding years that saw large fluctuations in growth unrelated to the mid-terms, the average rally was about 5%, about half of which stems from seasonality

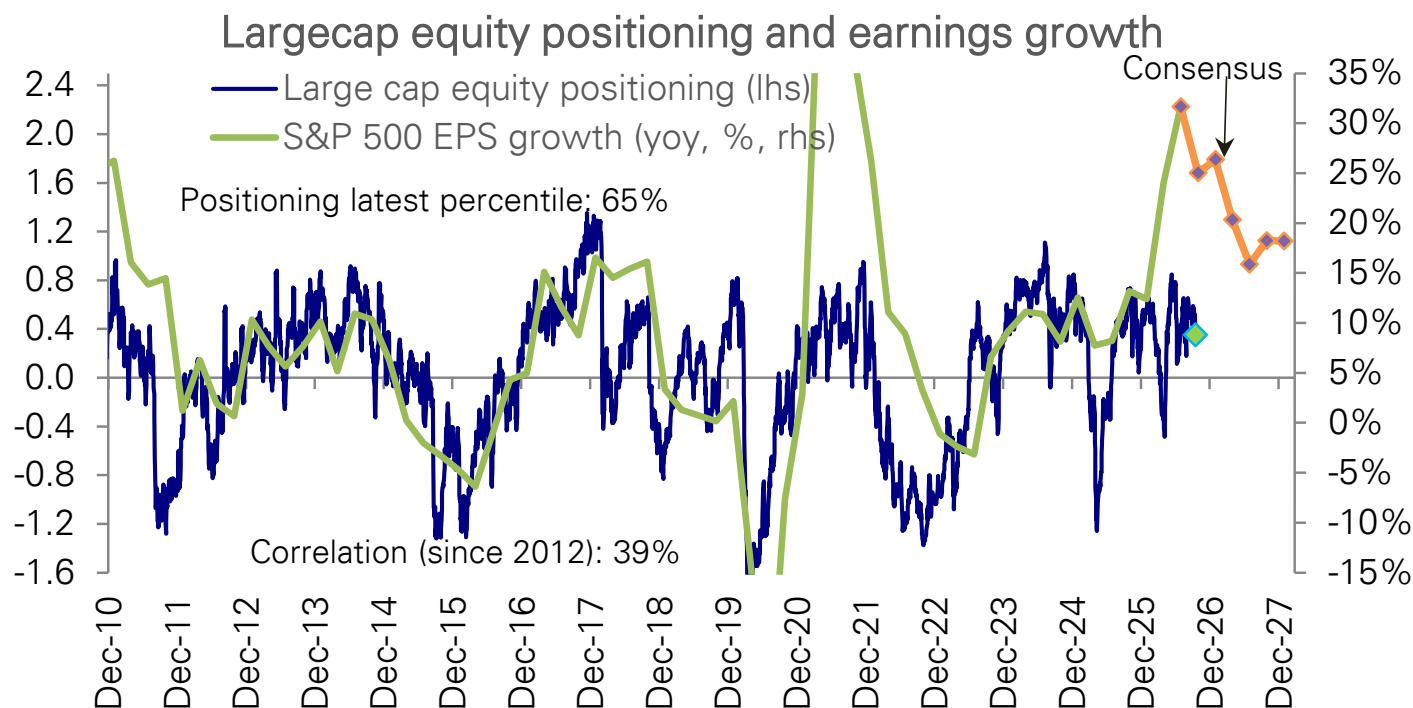


Robust demand-supply: room for positioning to rise



Positioning is well below levels implied by earnings growth

- Large-cap equity positioning is overweight but not elevated and we see room for it to rise
- It is also running well below levels implied by booming earnings growth and already pricing in a significant slowing



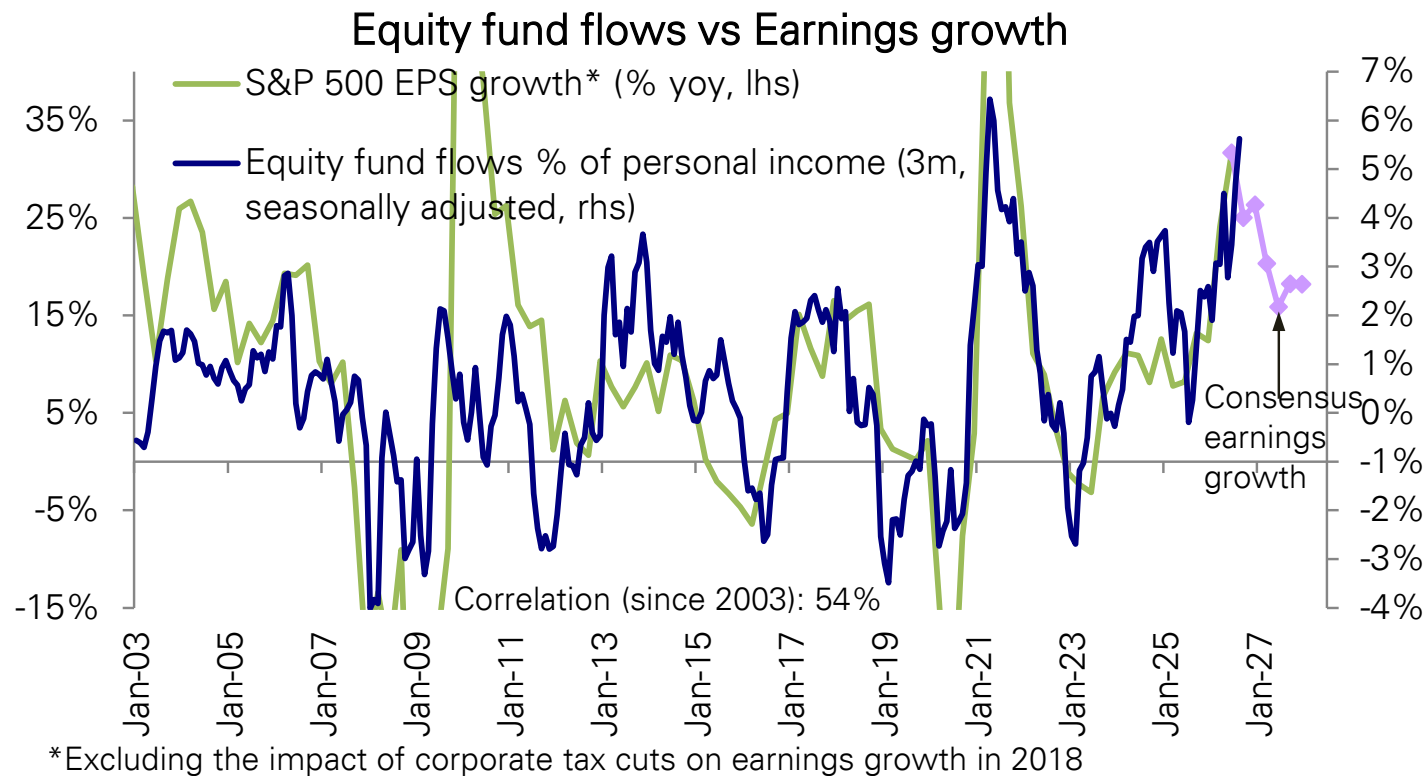
*Excluding the impact of corporate tax cuts on earnings growth in 2018

Robust demand-supply: the cross-asset inflows boom



Equity inflows surging in line with earnings growth

- Equity inflows have been extremely strong for 3 straight years
- The boom in inflows is running in line with strong earnings growth

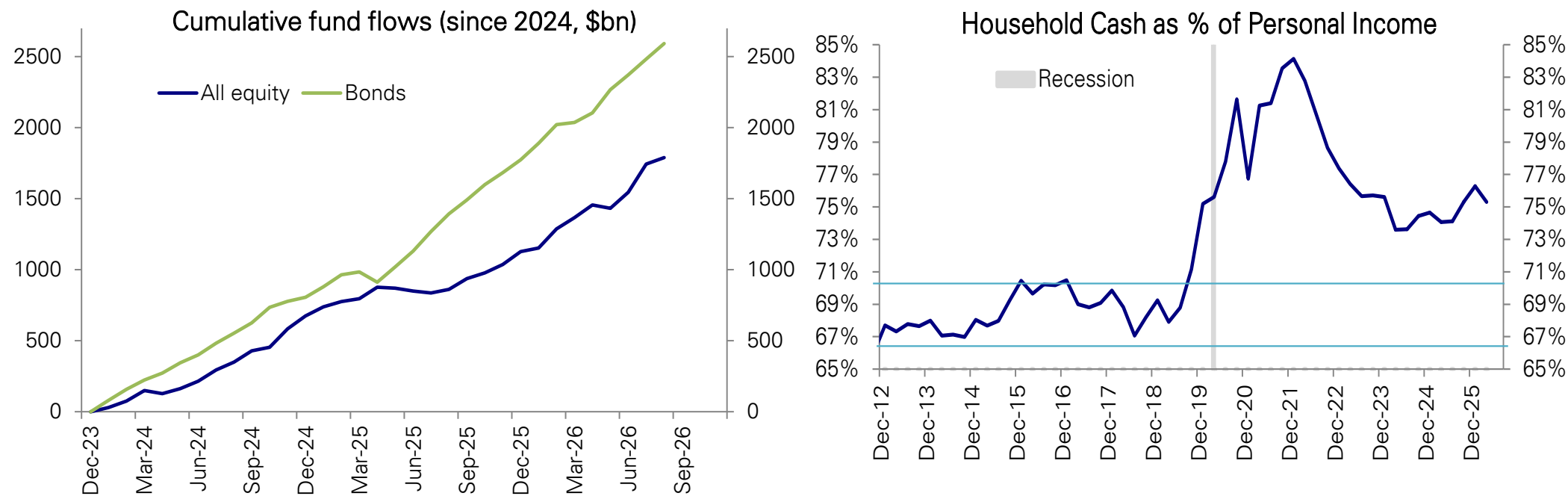


Robust demand-supply: the cross-asset inflows boom



The cross-asset inflows boom continues

- We note that the boom in inflows is not just in equities but also bonds
- It stems from pandemic-era accumulation of cash which is allowing households to put *new* savings disproportionately into financial assets

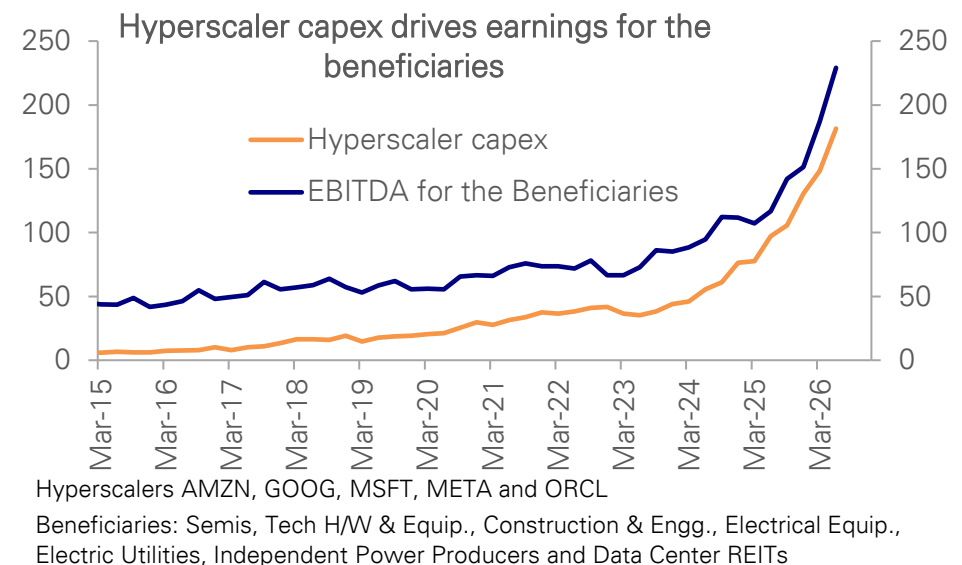
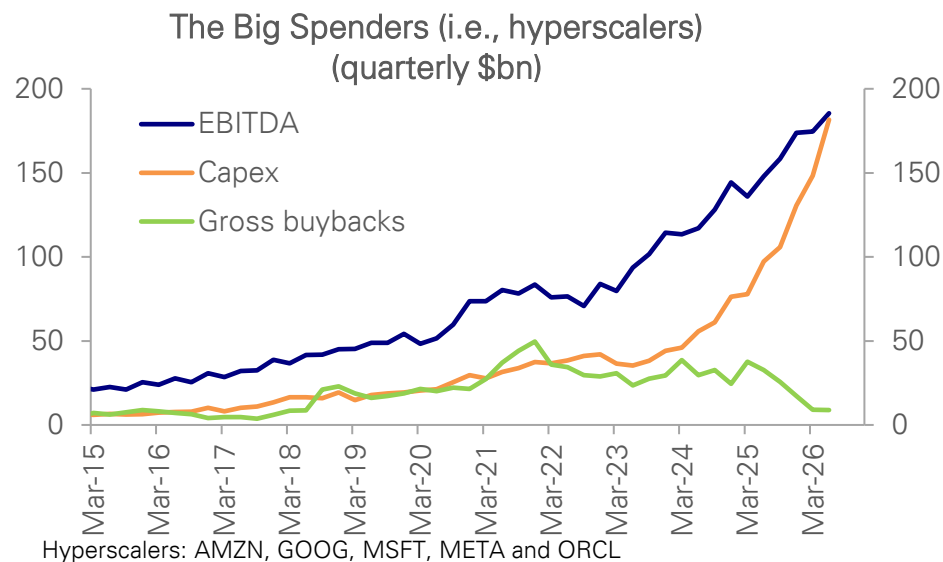




Robust demand-supply: will capex crowd out buybacks?

Hyperscalers are slashing buybacks ...

- Capex for the hyperscalers is surging much faster than their earnings and they are slashing their buybacks as a result
- The beneficiaries of this spending however are seeing earnings rise rapidly

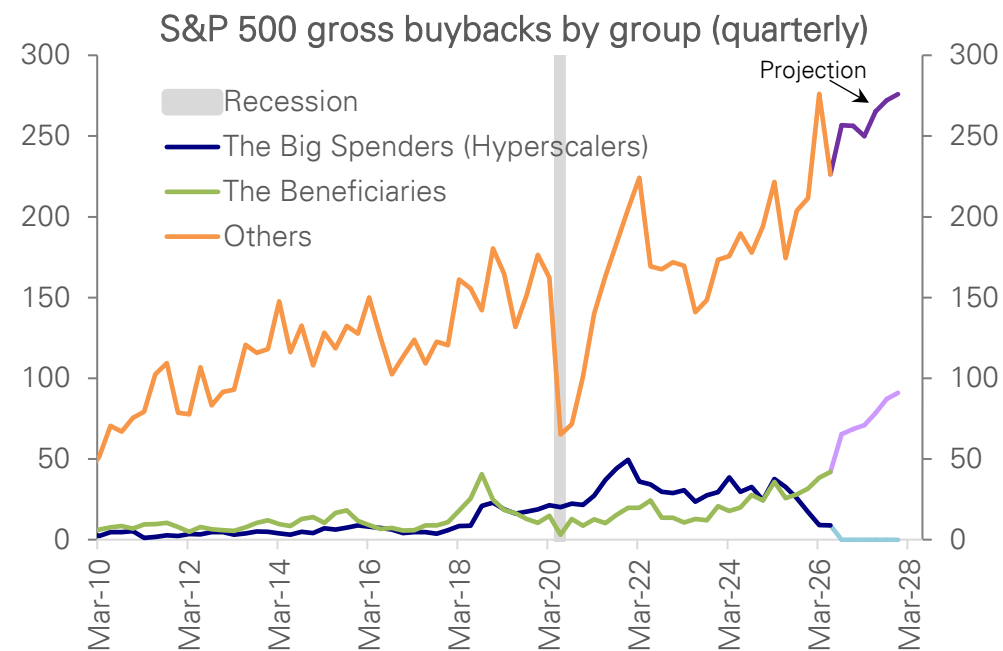
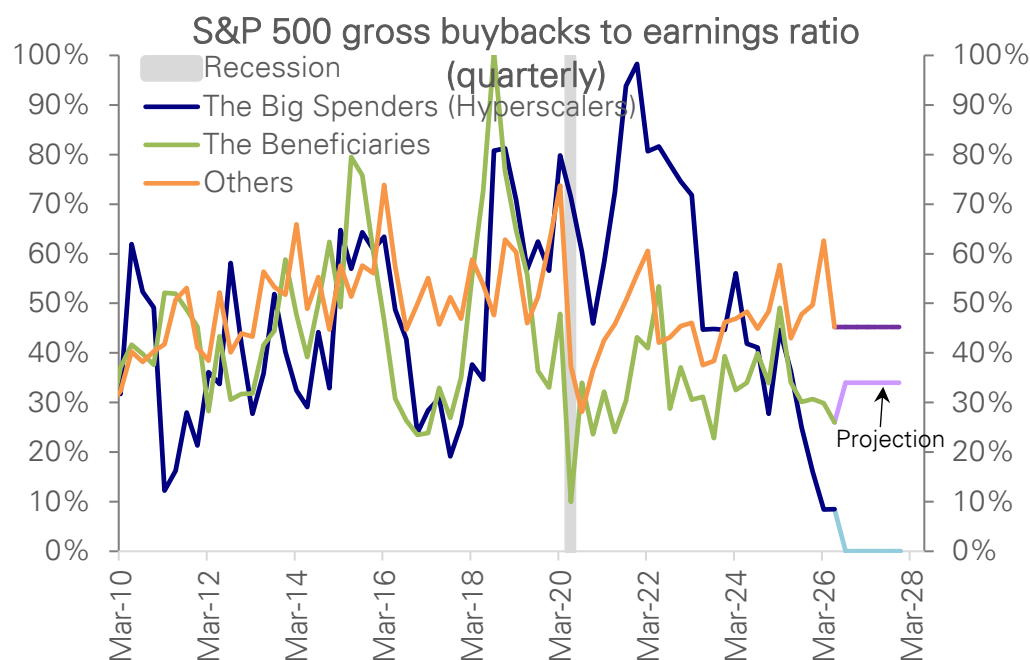




Robust demand-supply: will capex crowd out buybacks?

... but others are ramping buybacks higher

- The beneficiaries are gradually raising their buybacks as their earnings rise. Buybacks are also growing strongly for the rest of the S&P 500, i.e., those who are neither big AI spenders nor direct beneficiaries

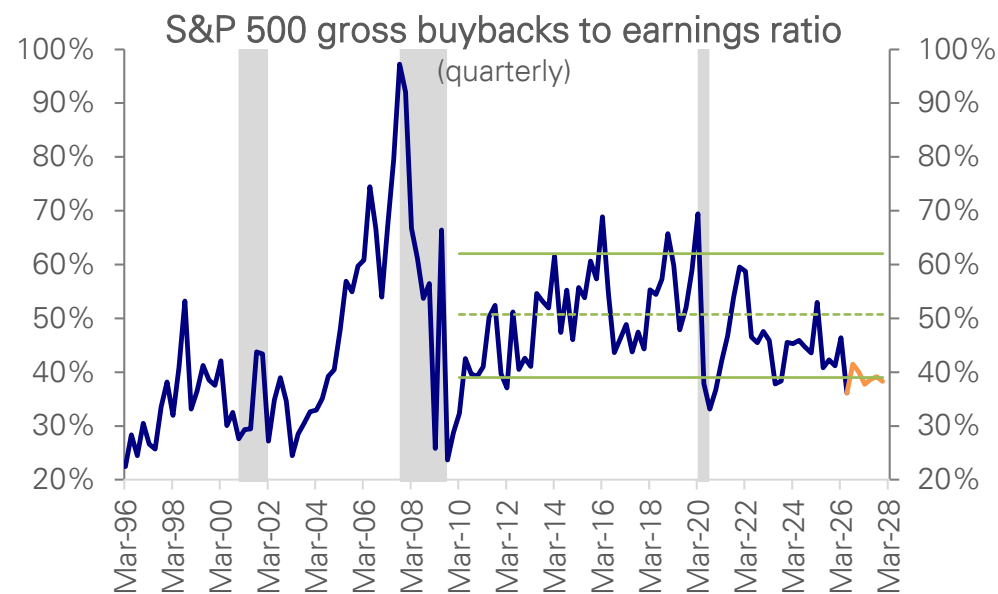
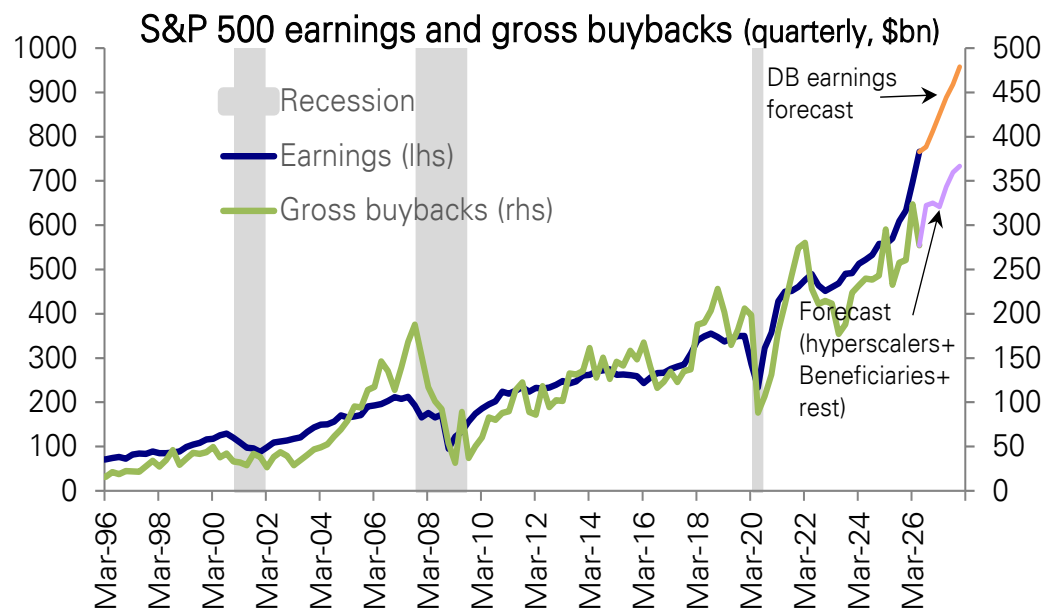




Robust demand-supply: will capex crowd out buybacks?

Buybacks for the S&P 500 at new record highs

- Gross buybacks for the S&P 500 are at record highs. The drop in buybacks for the hyperscalers has been more than offset by a rise for the rest
- We see the proportion of earnings going towards buybacks remaining at the lower end of the historical range

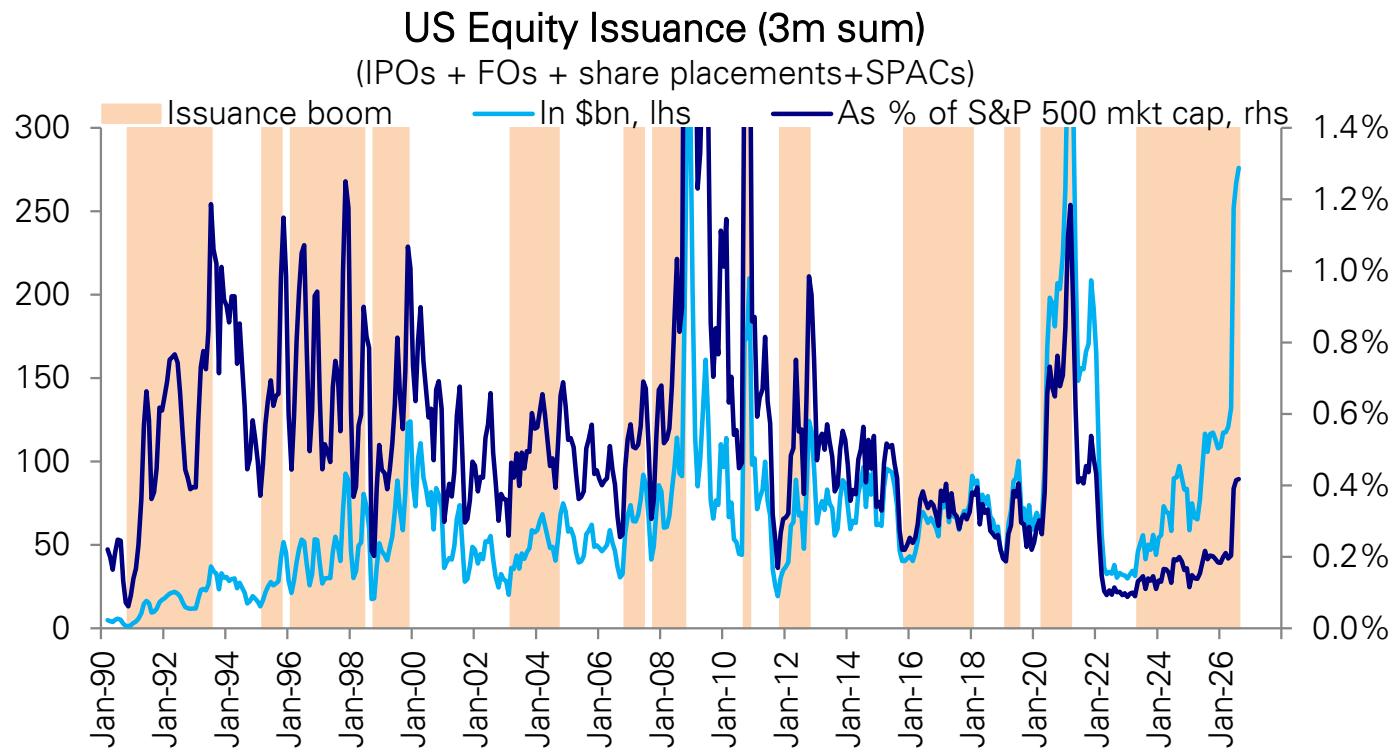




Robust demand-supply: will issuance derail the market?

Equity issuance has risen sharply

- Equity issuance has been trending up since 2023 but has now inflected sharply higher with a wave of mega-IPOs as well as secondaries expected
- However, even the largest proposed IPOs are only about 0.1% of S&P 500 market cap



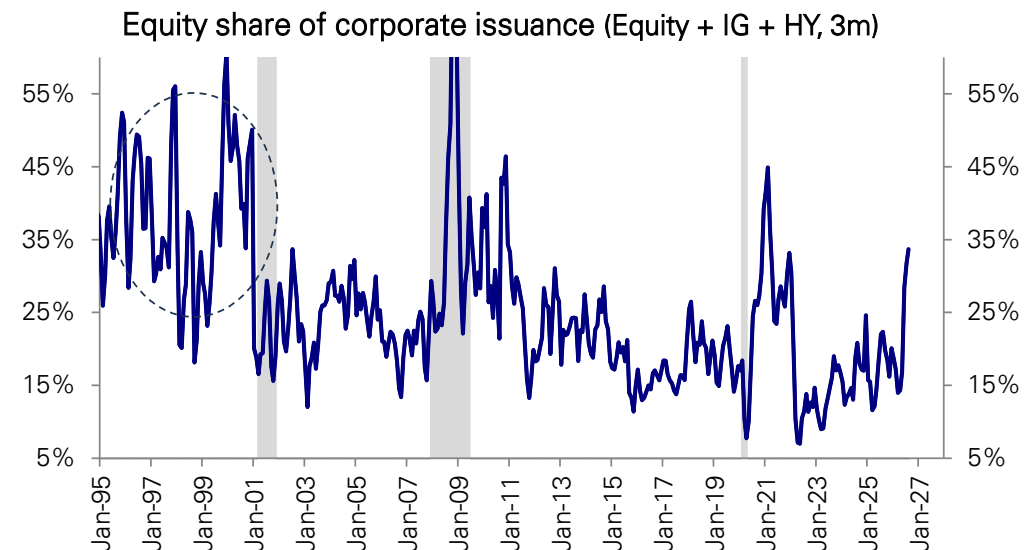
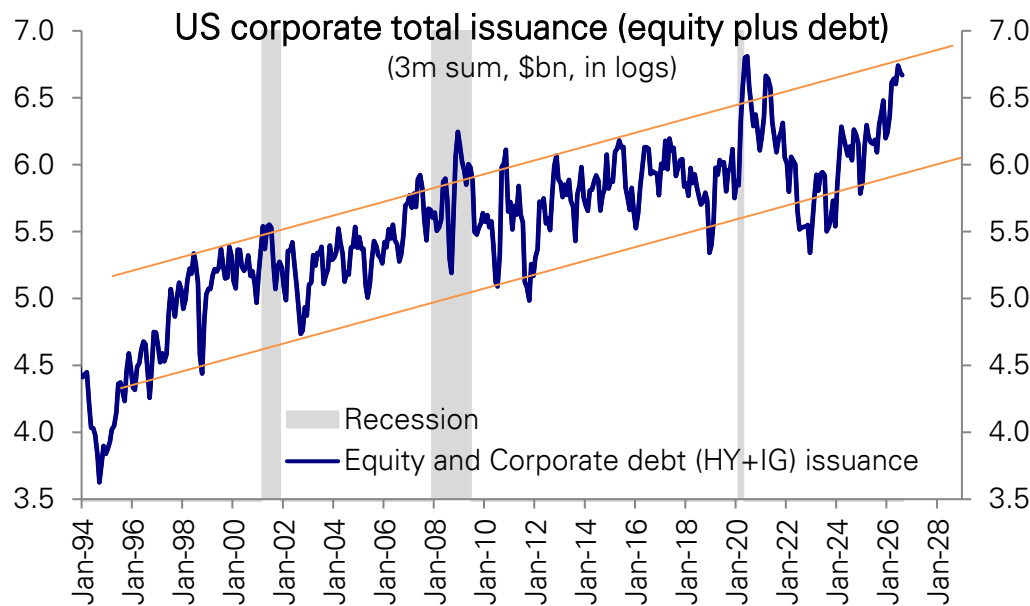
*Issuance data till August 2026



Robust demand-supply: will issuance derail the market?

Issuance is high and rising

- Overall corporate issuance (equity plus debt) has already surged to the top of its long-run trend channel. We expect it to continue rising along the top. It could break out higher, but we think that's likely accompanied by delivered ROI on AI capex
- The share of equity issuance in total corporate issuance is already high but can also go higher

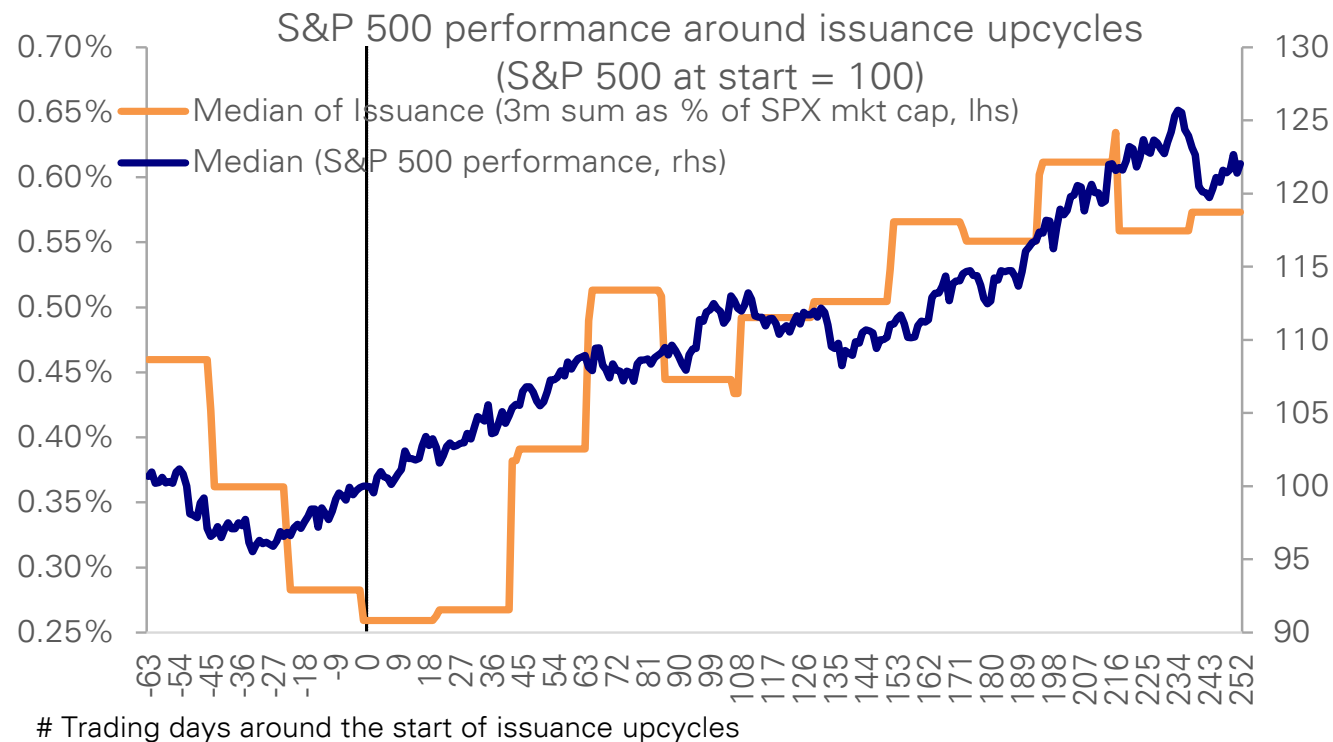




Robust demand-supply: will issuance derail the market?

Issuance waves typically see very strong equity markets

- The academic literature points to the causality running from market conditions to issuance rather than the other way round, i.e., stronger equity markets and higher expected profitability lead to issuance waves
- Empirically, equity returns in past waves were very strong as demand more than offset the increased supply

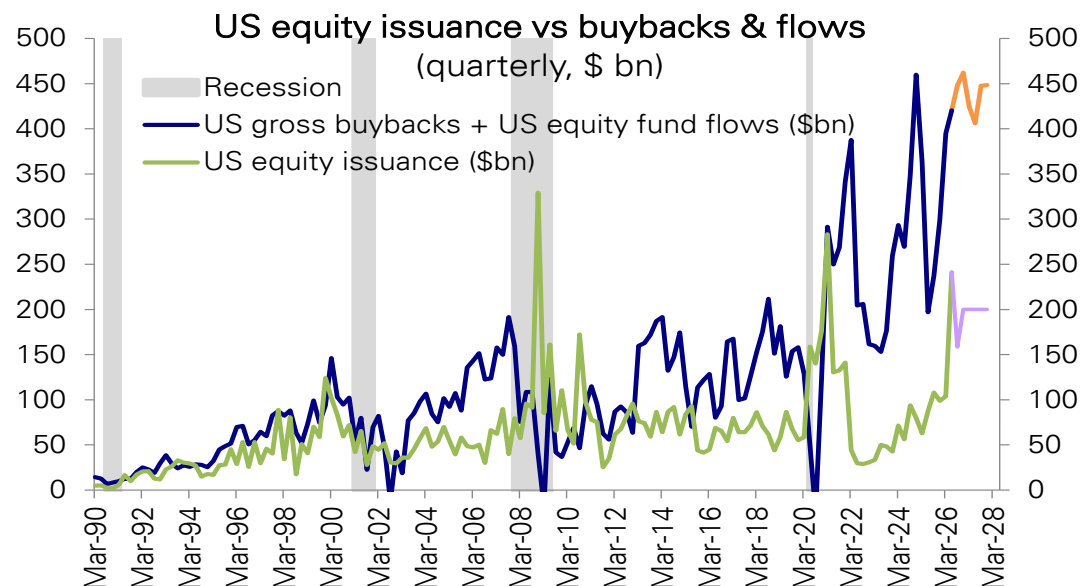




Robust demand-supply: will issuance derail the market?

Buybacks and flows should outpace the surge in issuance

- We see issuance remaining at current elevated levels for several quarters. Issuance in isolation, i.e., all else equal, is indeed negative for equities. But history strongly suggests that issuance and strong equity demand go hand in hand. Indeed, issuance and flows surged in lockstep during the 2H of the 1990s and again in 2020-2021. Forced issuance during the GFC in the absence of demand saw equities collapse
- We see gross buybacks for the S&P 500 running significantly higher, and the total of buybacks and flows even more so. Indeed, we expect the gap to be about \$1 trillion. That is, higher issuance could slow the gains for equities but not reverse them

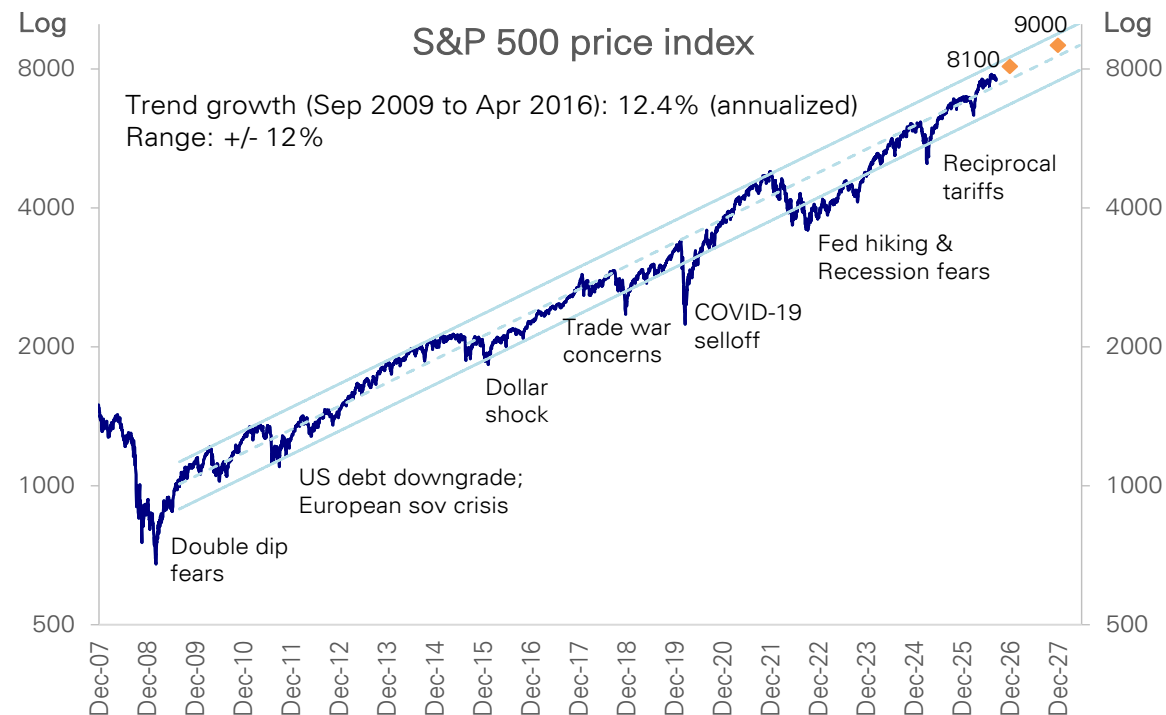


Robust demand-supply backdrop



Points to S&P 500 slightly above 8000 by end 2026

- Our demand-supply framework, combining changes in positioning with inflows, buybacks and issuance, points to continued strong returns out to year-end and high-single-digit returns next year. This would keep the S&P 500 within the upper-half of the trend channel in place since the GFC



Sectors



Summary of sector allocations

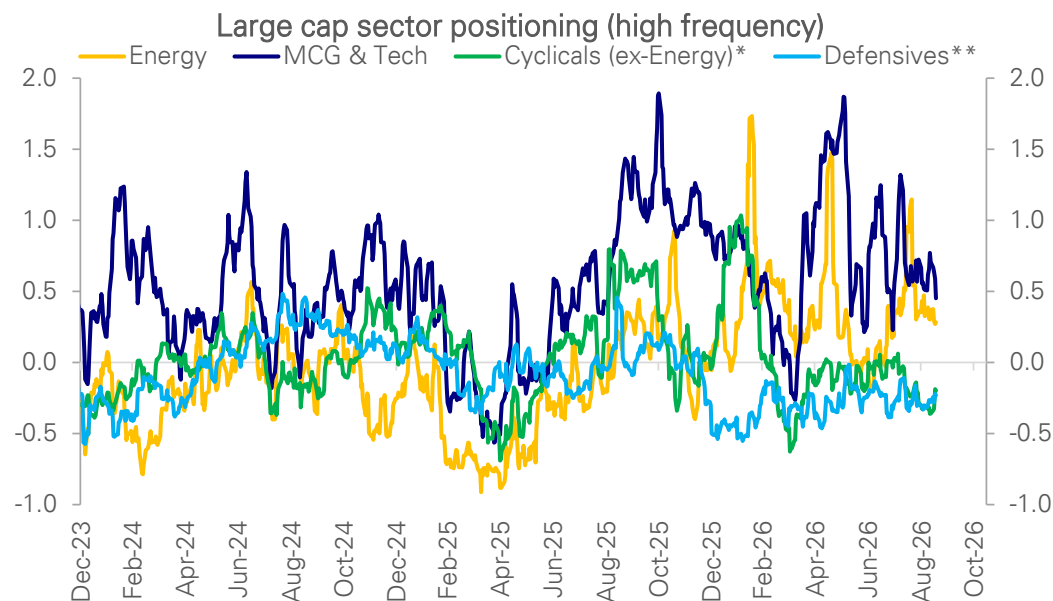
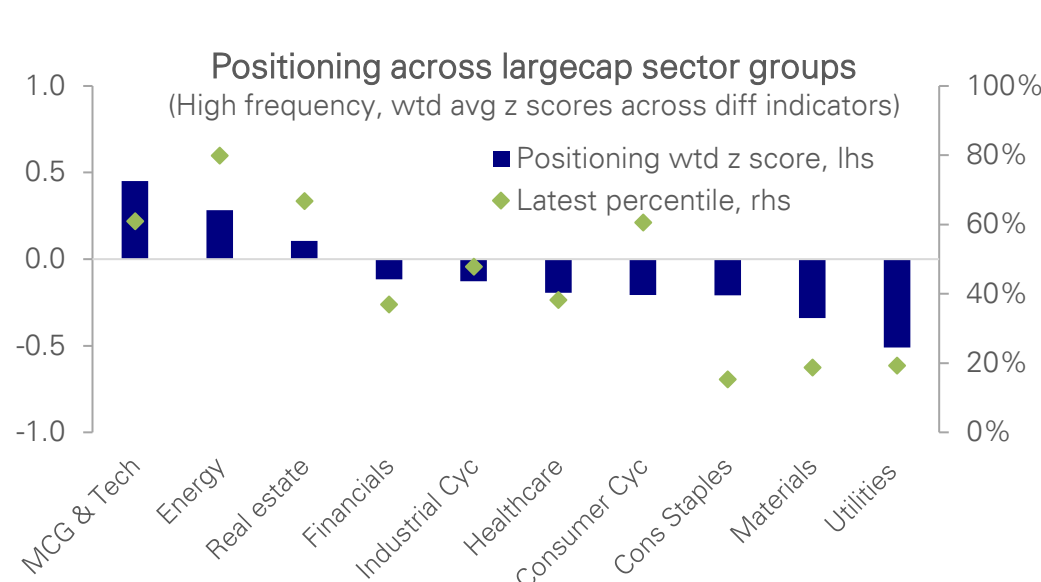
Sector allocations			
	O/W	Neu	U/W
MCG & Tech	●		
Financials	●		
Industrials	●		
Energy		●	
Materials		●	
Consumer Cyclicals			●
Consumer Staples			●
Healthcare	●		
Telecom			●
Utilities			●
Real Estate			●

Sectors



Investor positioning is neutral or underweight most sectors

- Large-cap Tech positioning is overweight but has eased since June and is significantly below levels implied by strong earnings growth
- Energy positioning continues to gyrate sharply and is now modestly overweight
- All other sectors are underweight either on growth concerns for the cyclicals or due to rising rates for the bond-like defensives



MCG is Mega-cap Growth; Financials excludes MA & V which are under MCG; Industrial cyc: Industrials ex pandemic-hit cos; Cons cyc: Cons Disc & Media ex MCG ex Restaurants ex pandemic-hit cos.

Data as of Sep 17 2026

*Z score avgs of Industrial Cyclical, Consumer Cyclical, Financials, Materials

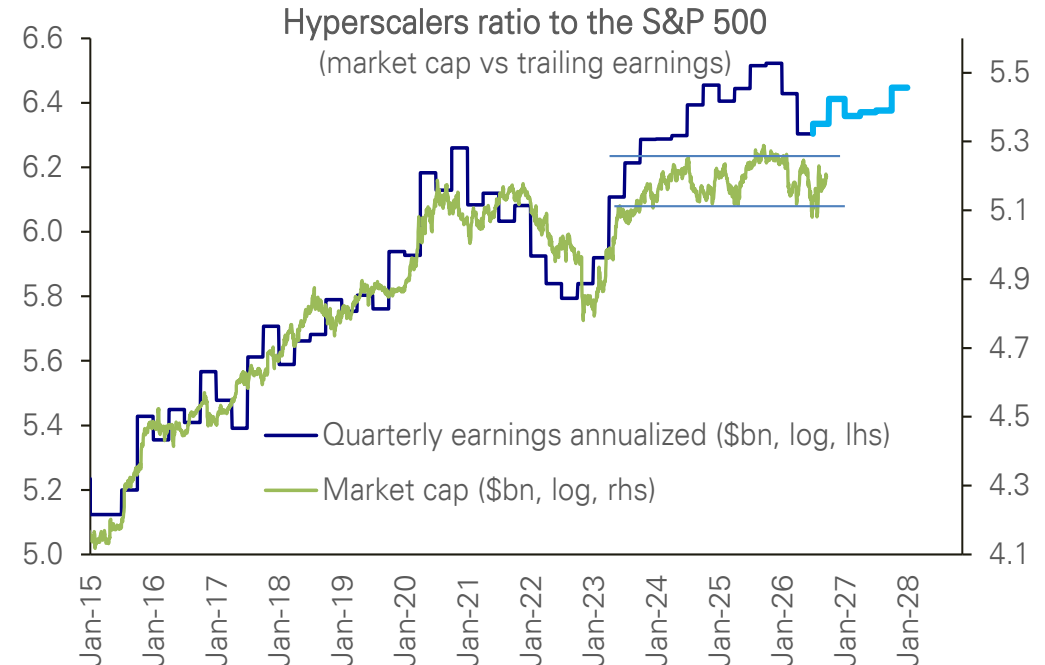
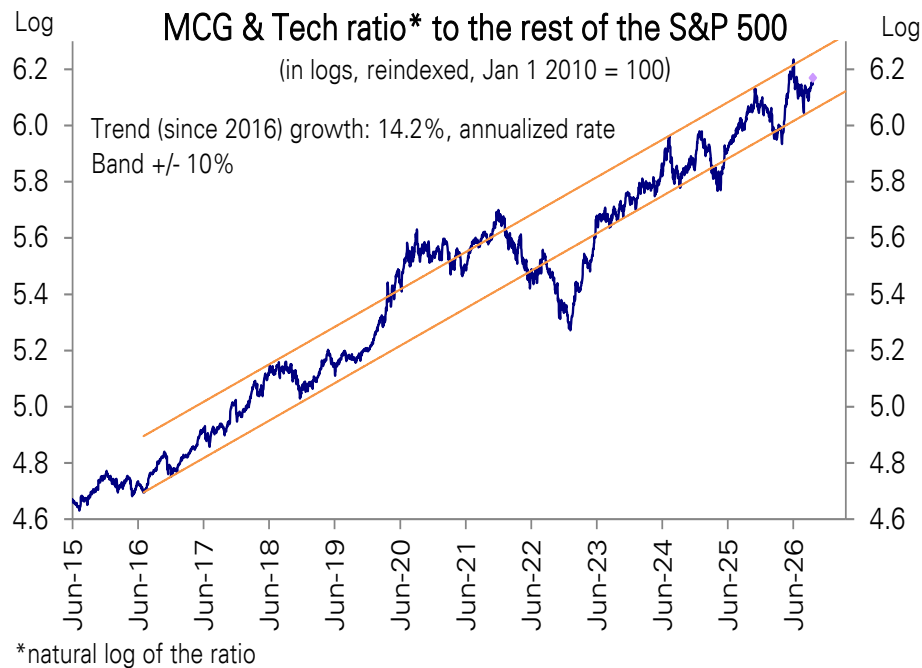
**Z score avgs of Utilities, Real Estate, Healthcare, Telecom, Consumer Staples+Restaurants;

Sectors



Overweight MCG & Tech: rotation on cue again

- The relative performance of MCG & Tech is back to the middle of its long-run trend channel after bouncing off the bottom for the 5th time in the last 3 years, with the market focus repeatedly swinging between stellar growth and bubbles fears
- We see the rotation into Tech having further to go
- Within Tech, we see a favorable risk/reward in the hyperscalers whose relative performance to the S&P 500 has been range-bound for 3 years and has room to catch up to earnings

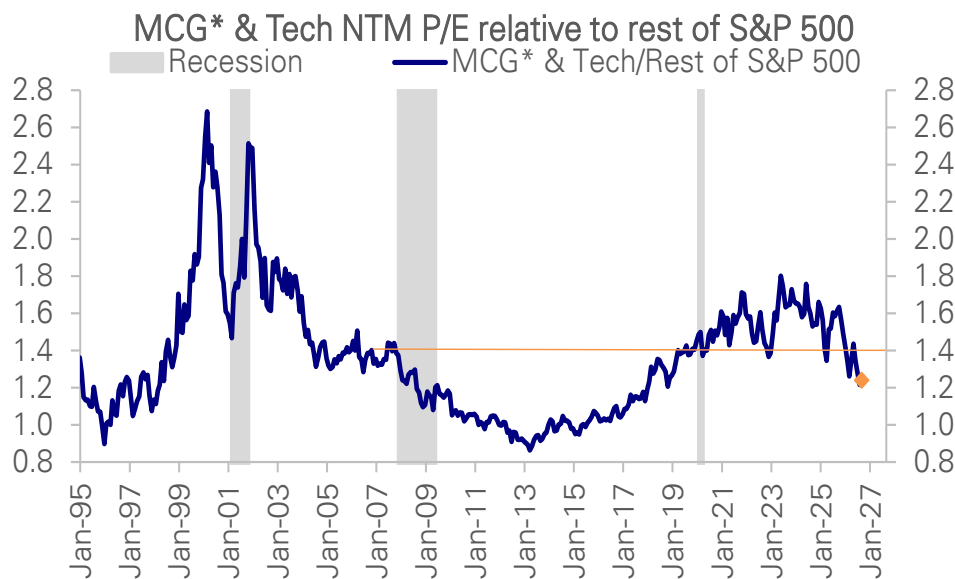


Sectors

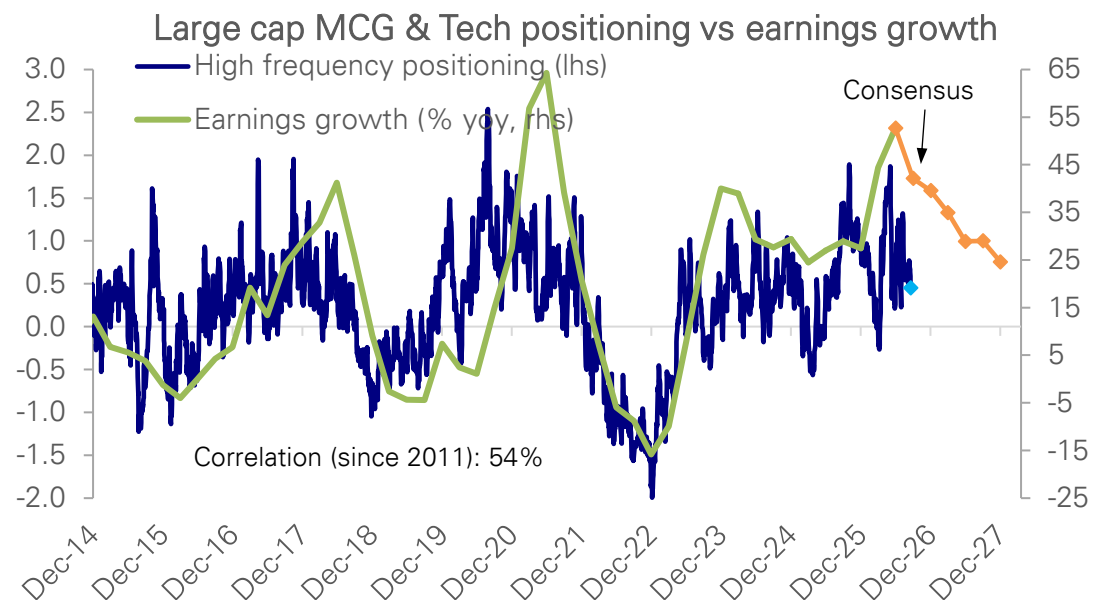


Overweight MCG & Tech: positioning well below booming earnings

- MCG & Tech relative valuations are at 8-year lows and even below pre-pandemic levels
- Positioning in large-cap Tech is overweight, but well below levels implied by booming earnings growth



*MSFT, AAPL, AMZN, GOOGL, GOOG, FB, V, MA, NVDA, NFLX, ADBE, TSLA (since Dec 2020)

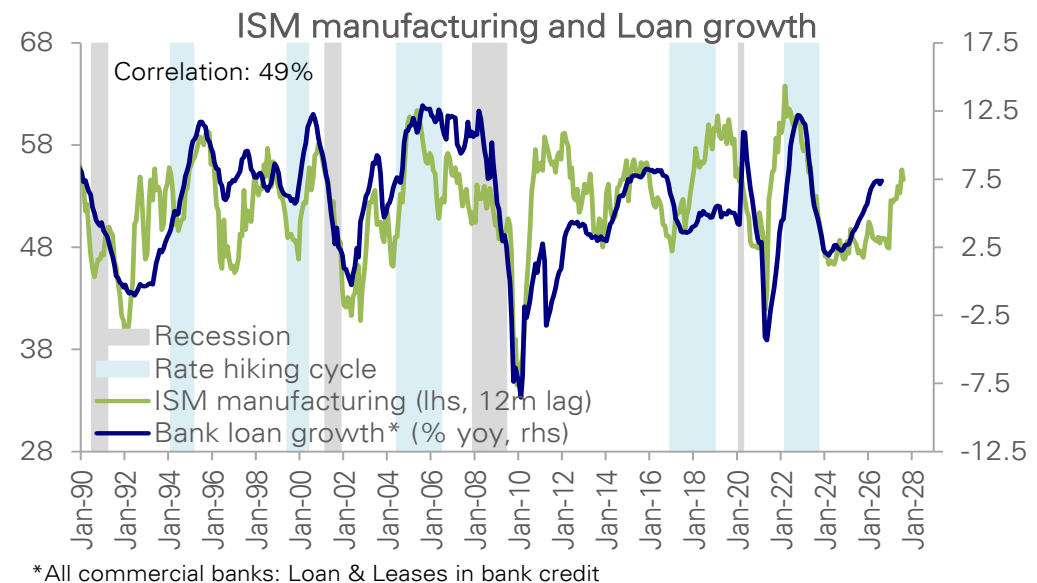
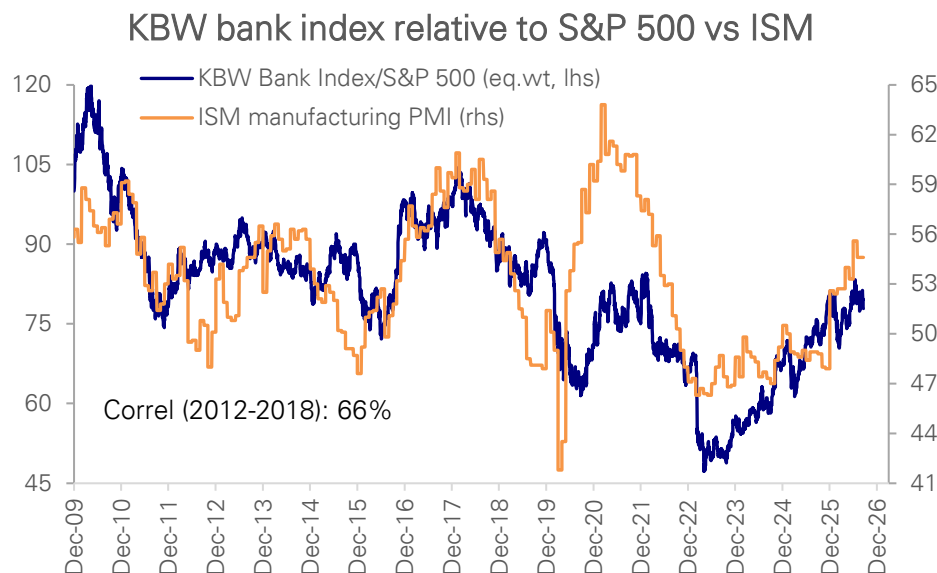


Sectors



Overweight Financials: cyclical recovery still has legs

- A continued pickup in cyclical growth in our view is more important for the Financials than the rates curve
- Loan growth has picked up but we think can go further

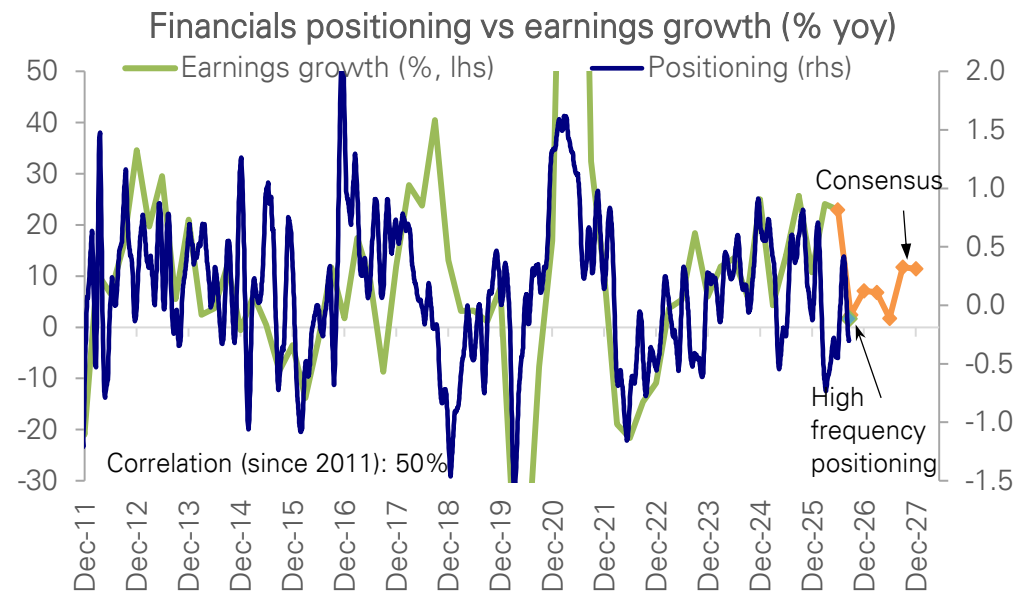
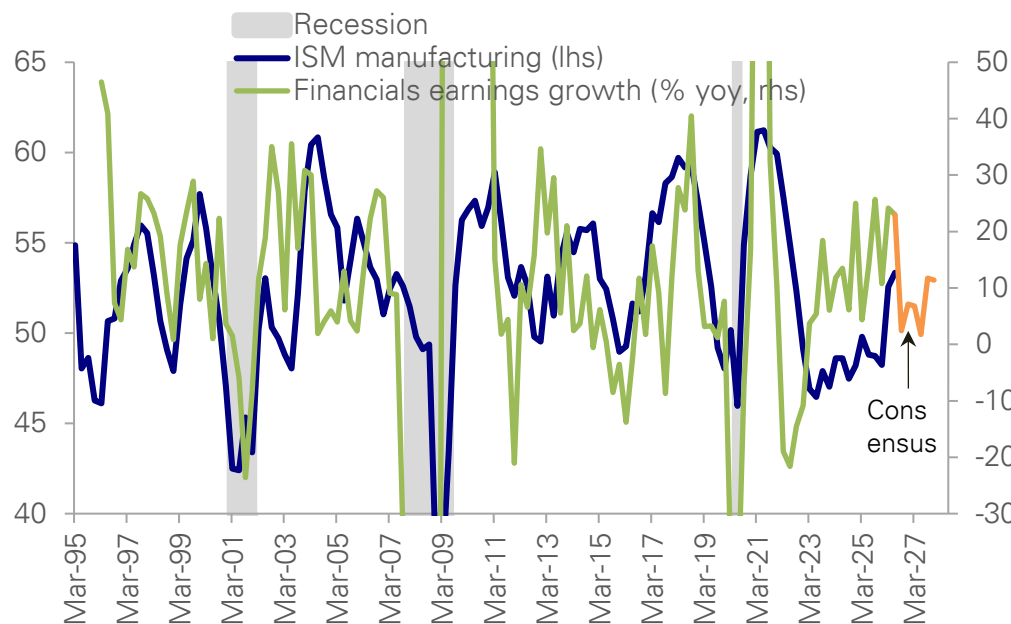


Sectors



Overweight Financials: positioning is underweight

- Financials should benefit from broader growth, strong capital markets issuance and M&A deal activity
- The consensus has built-in a sharp slowing in growth for the Financials next year and positioning is even lower



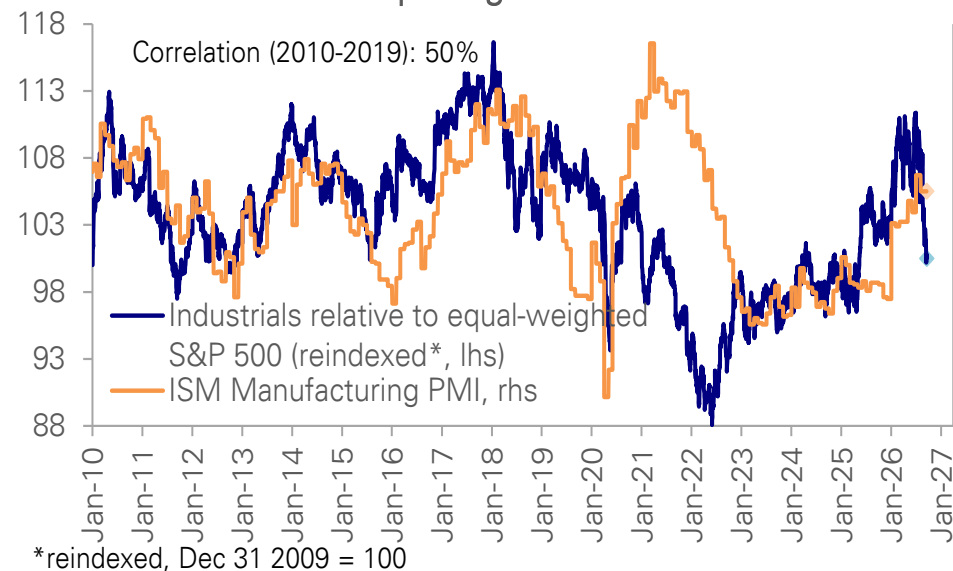
Sectors



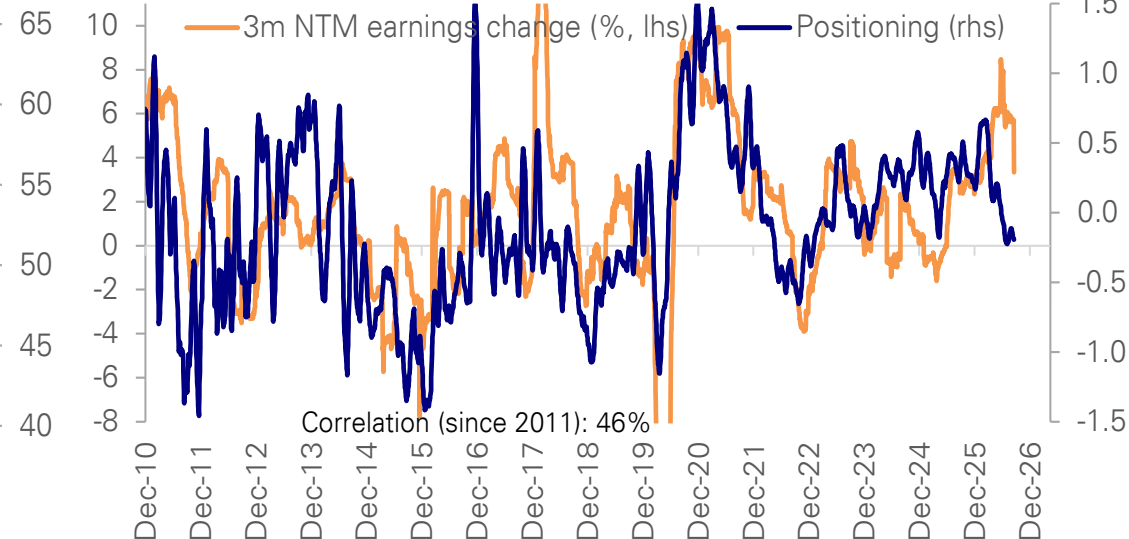
Overweight Industrials: secular tailwind and cyclical recovery intact

- The Industrials sector has sold off sharply in the 2H of this year with questions around secular tailwinds as well as the cyclical recovery
- Investor positioning in Industrials has declined sharply to slightly below neutral, pricing in a sharp slowing in the pace of estimate revisions albeit not a cut

Market Cap weighted Industrials vs ISM



Industrial cyclicals positioning vs 3m change in NTM earnings

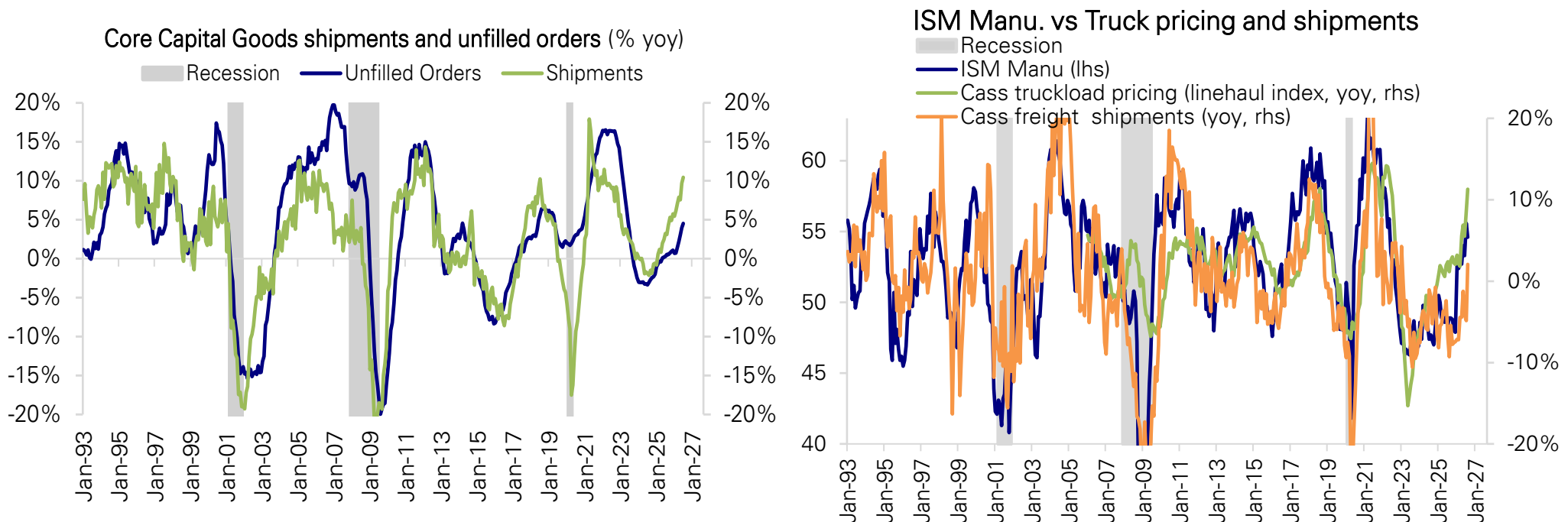


Sectors



Overweight Industrials: secular tailwind and cyclical recovery intact

- We see tailwinds from secular themes such as power demand and aerospace & defense remaining intact with demand still exceeding supply. Despite the surge in capital goods shipments, unfilled orders keep rising and surveys point to more upside
- In cyclical industries like Transports, most of the revenue gains this year have come from pricing via supply squeezes, while demand is just starting to pick up with a lag to the improvement in the ISM

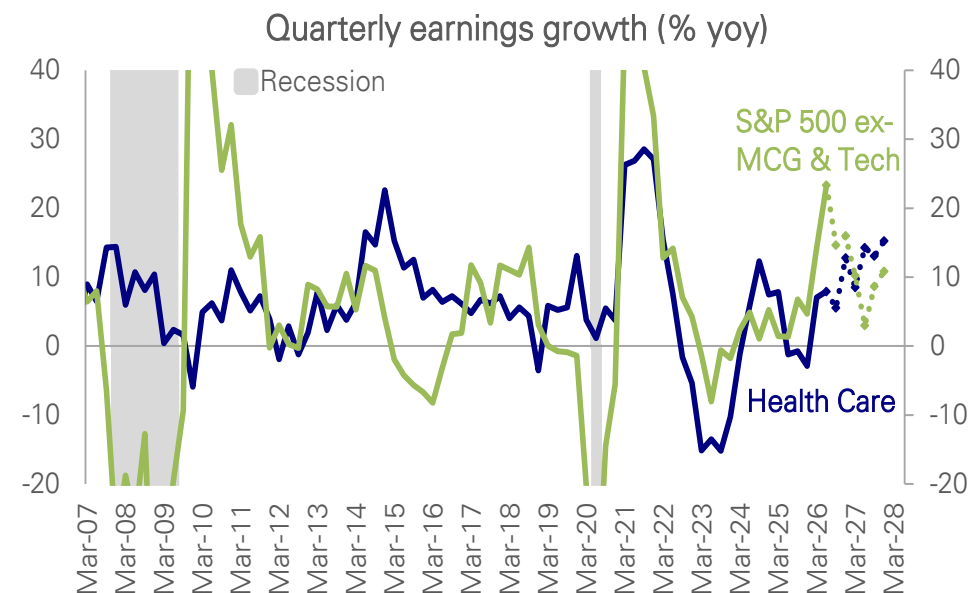
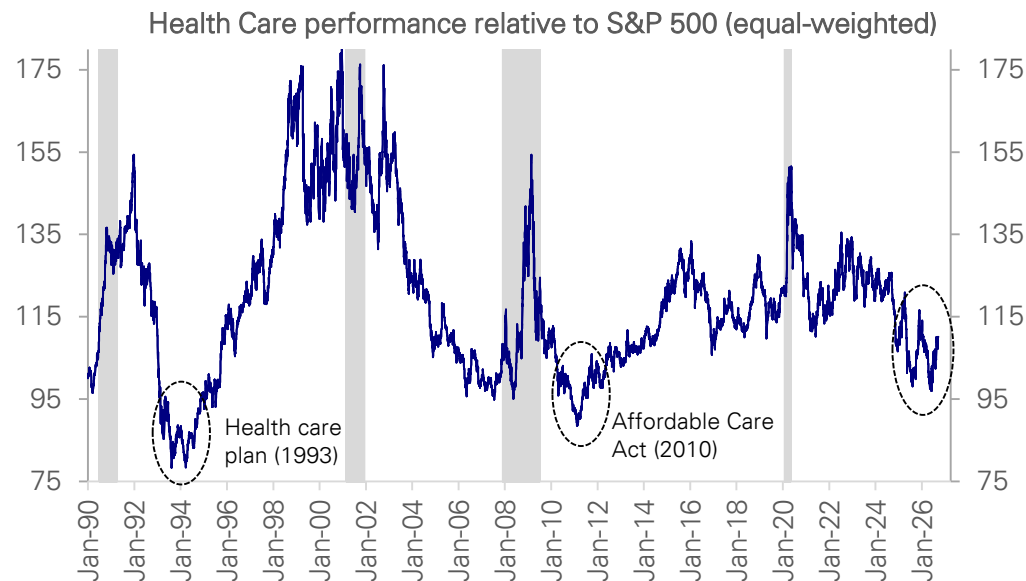


Sectors



Overweight Healthcare: growth picking up, headwinds priced in

- Healthcare faced headwinds first when the pandemic boost faded, followed by a pandemic hangover as costs rose faster than pricing, and then a hostile political environment after the election. In past episodes around major healthcare reform attempts, Healthcare rallied strongly once the headwinds were priced in
- Valuations still look cheap, while relative earnings growth prospects are improving

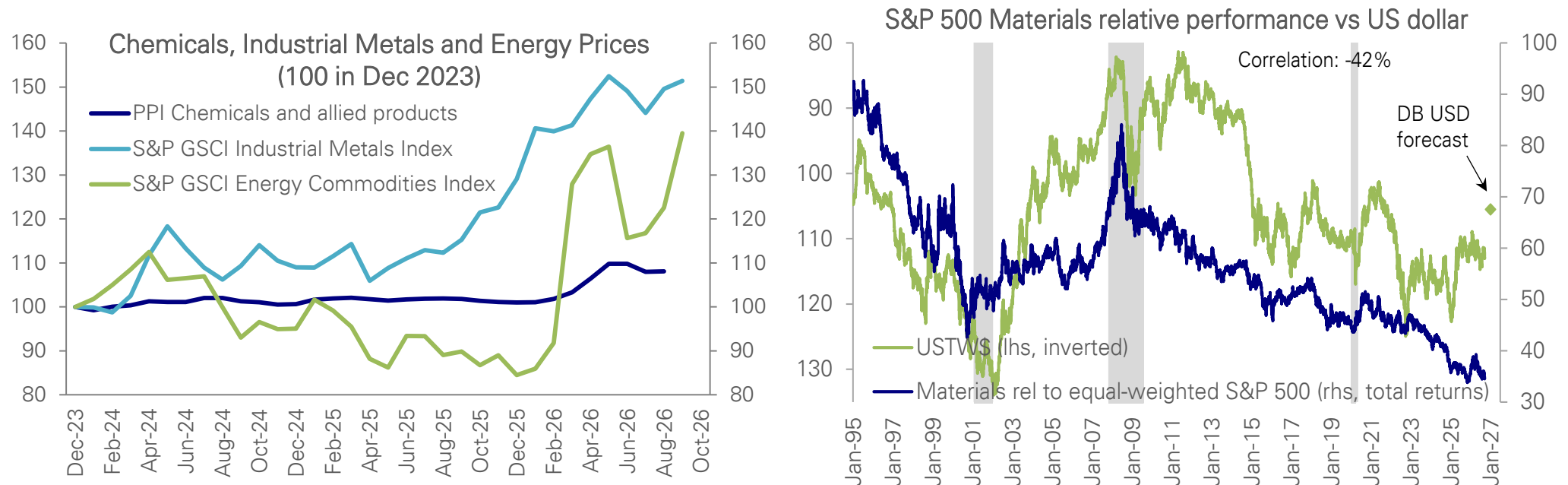


Sectors



Neutral Materials: Metals & Mining attractive, Chemicals pressured

- Industrial metal prices are tied to cyclical growth and have been trending up on long-run imbalances in demand-supply. Energy and chemicals prices meanwhile had been drifting sideways or lower and jumped massively only on the onset of the Iran war
- The medium-term cycle for Materials performance broadly is tied (inversely) to the US dollar which currently presents an asymmetric risk/reward with the dollar still near the top of its long-run valuation band



Sectors

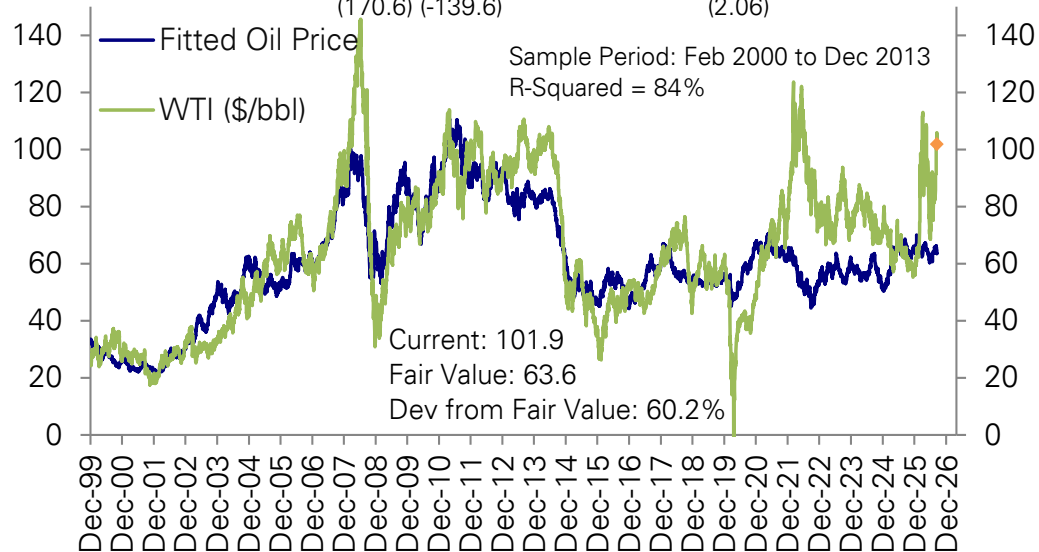


Neutral Energy: at the mercy of oil prices which are currently well above fair value

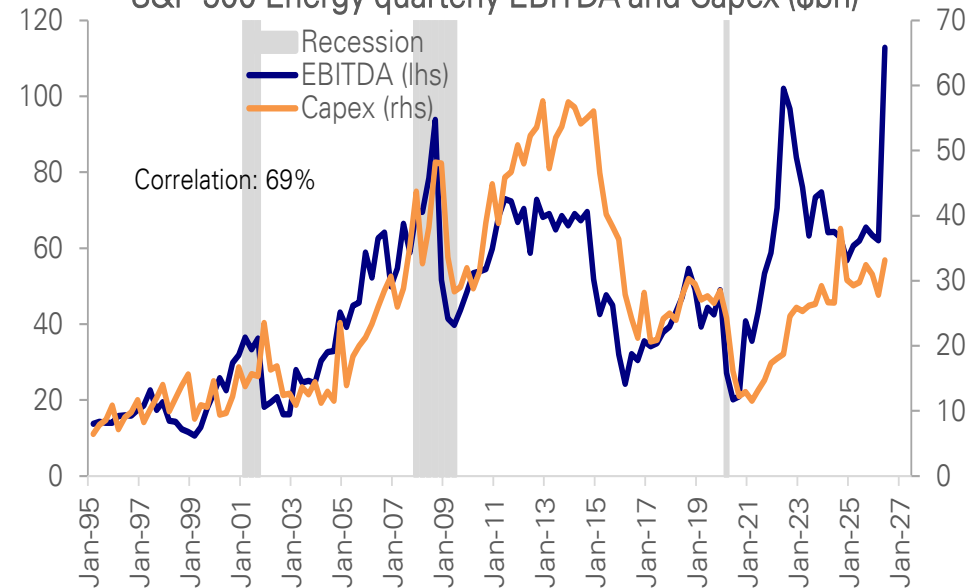
- Oil prices are well above our estimate of medium-term fair value based on the US dollar and global growth. The extent of backwardation in the futures curve also suggests acute supply risks are priced in
- Energy sector valuations remain low as earnings are still heavily tied to swings in oil prices

Oil price fair value

Fitted (Real log Oil Price) = $16.9 - 2.90 * (\ln \text{USDTWI}) + 0.0011 * (\text{Global Mfg PMI})$
 (170.6) (-139.6) (2.06)



S&P 500 Energy quarterly EBITDA and Capex (\$bn)



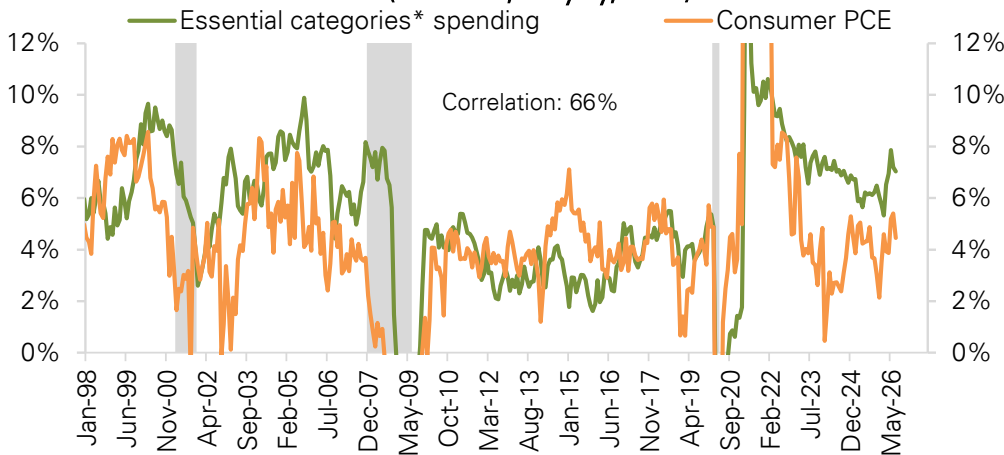
Sectors



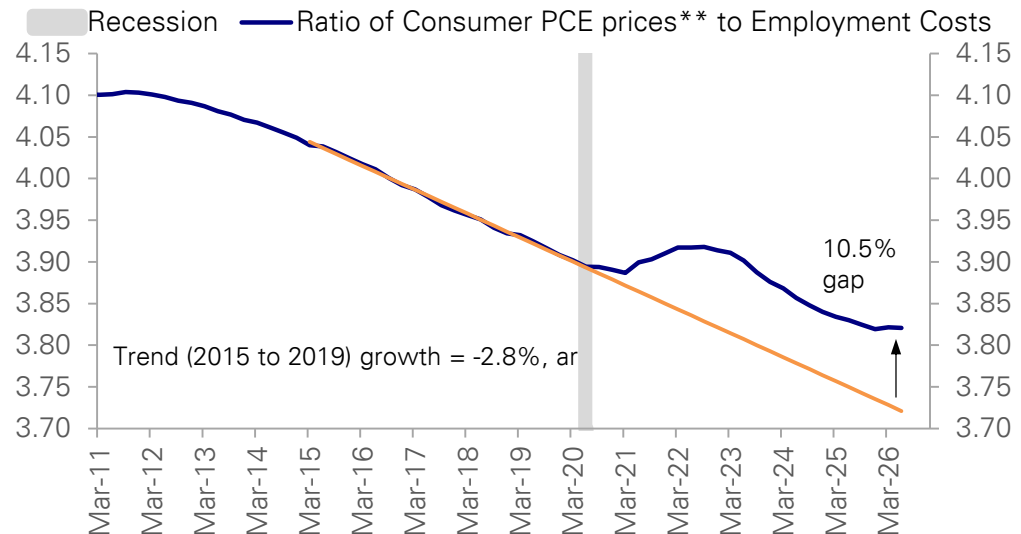
A rising consumer tide will not lift all consumer-sector boats

- Aggregate real incomes have been flat since Liberation Day but look to be picking up as the labor market and wages warm up
- Meanwhile, consumer businesses raised product prices much faster than wages and the gap isn't closing
- An increasing share of household spending has been going to 'essential categories' like healthcare, utilities and education

Spending on essential categories* and consumer PCE**
(nominal, % yoy, saar)



*Gasoline + Natural Gas, Pharma, Healthcare services, Housing & Utilities, Financial Services, Higher Education (not including Education till K-12 as it is largely paid out of property taxes which are already included in Personal Taxes)
 **Streaming, Cables, Autos, Durable HH Gds, Clothing & F/W, Recreational Gds & Vehicles, Luggage, Gambling, Hotels, Club Memberships, Phones, Taxicabs & Ride Sharing, Car Rental, Package Tours, Telecom, Restaurants, Food, Bev & Tobacco, HH Supplies, and Pers Care Prdts



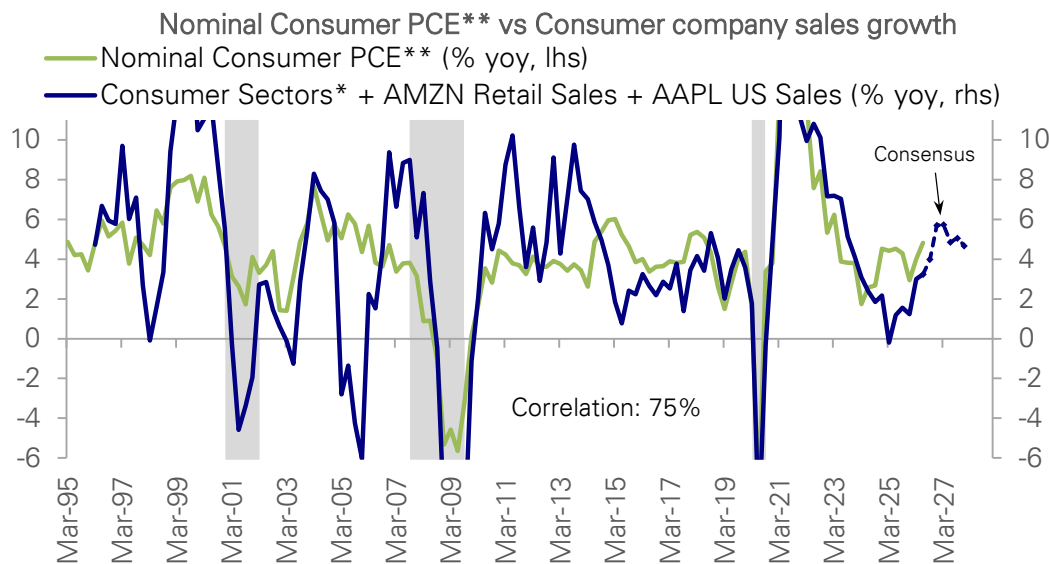
* reflects S&P 500 consumer group
 **Streaming, Cables, Autos, Durable HH Gds, Clothing & F/W, Recreational Gds & Vehicles, Luggage, Gambling, Hotels, Club Memberships, Phones, Taxicabs & Ride Sharing, Car Rental, Package Tours, Telecom, Restaurants, Food, Bev & Tobacco, HH Supplies, and Pers Care Prdts

Sectors



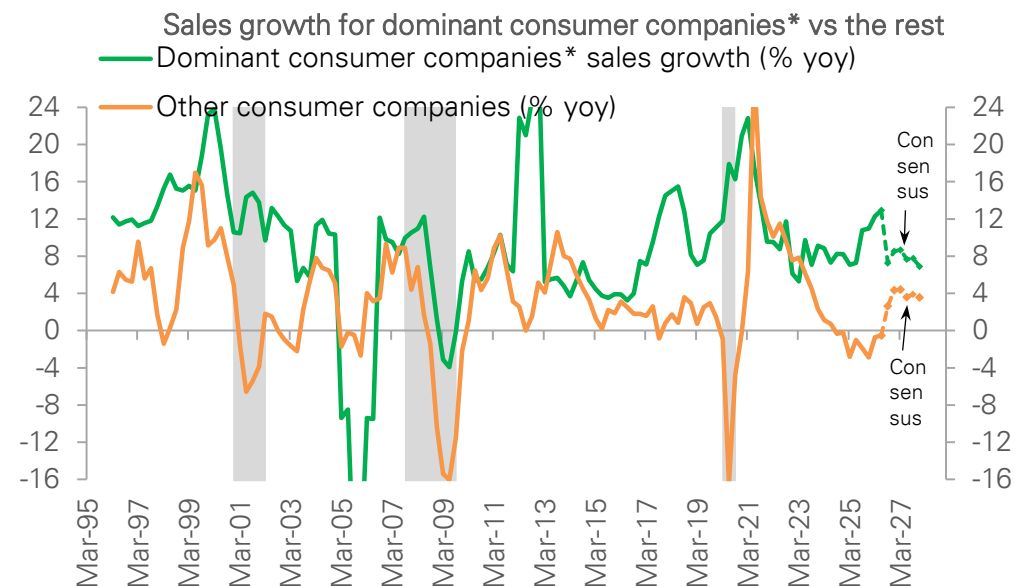
A rising consumer tide will not lift all consumer-sector boats

- Moreover, publicly listed companies in aggregate have been losing share within their categories
- And, within that, a handful of dominant companies are further grabbing the bulk of growth



*Consumer Staples, Consumer Discretionary ex Broadline retail, Communication Services ex-Online adv, Airlines

**Streaming, Cables, Autos, Durable HH Gds, Clothing & F/W, Recreational Gds & Vehicles, Luggage, Gambling, Hotels, Club Memberships, Phones, Taxicabs & Ride Sharing, Car Rental, Package Tours, Telecom, Restaurants, Food, Bev & Tobacco, HH Supplies, and Pers Care Prdts



*WMT, COST, NFLX, AMZN Retail, AAPL US

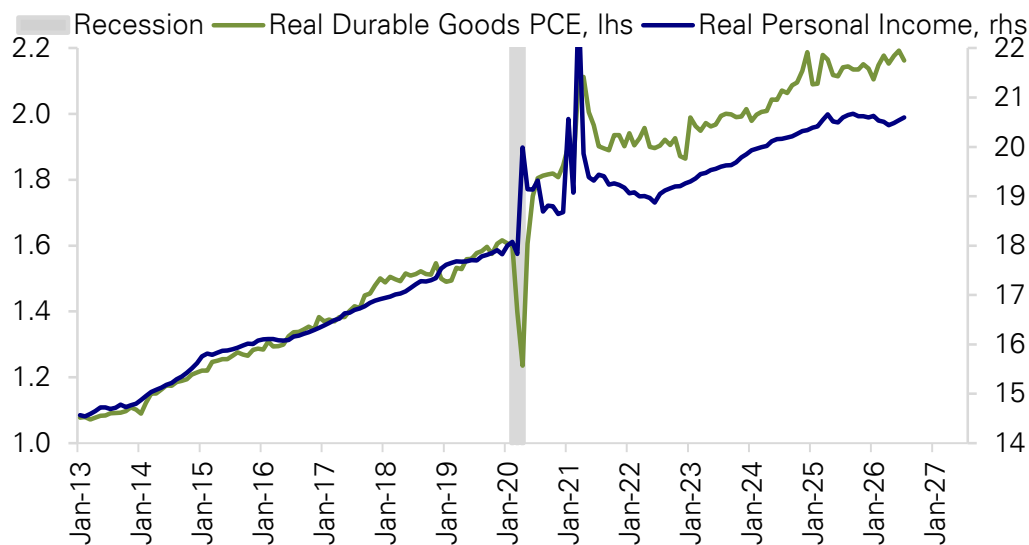
Sectors



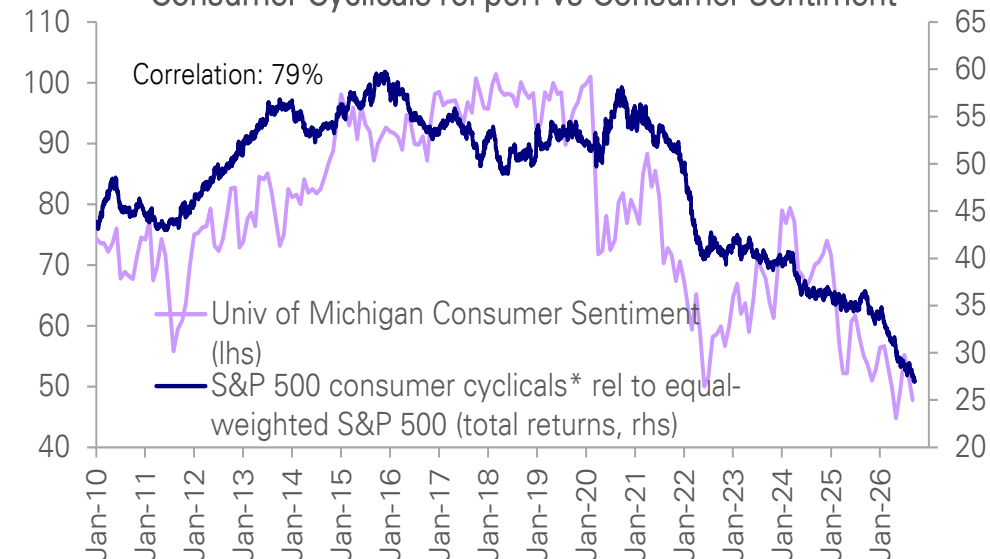
A rising consumer tide will not lift all consumer-sector boats

- Rates positioning is very negative and at levels that have historically coincided with a near-term top in bond yields; likewise oil prices are already pricing in severe disruption
- If the pressure from oil prices and rates eases, and real household incomes start to rise, it may see consumer confidence rise which should spark a short-run counter-trend rally in consumer cyclicals
- We favor cyclical services with the least pricing overhangs, such as travel and leisure

Real PCE and personal income (\$tn, saar)



Consumer Cyclical rel perf vs Consumer Sentiment

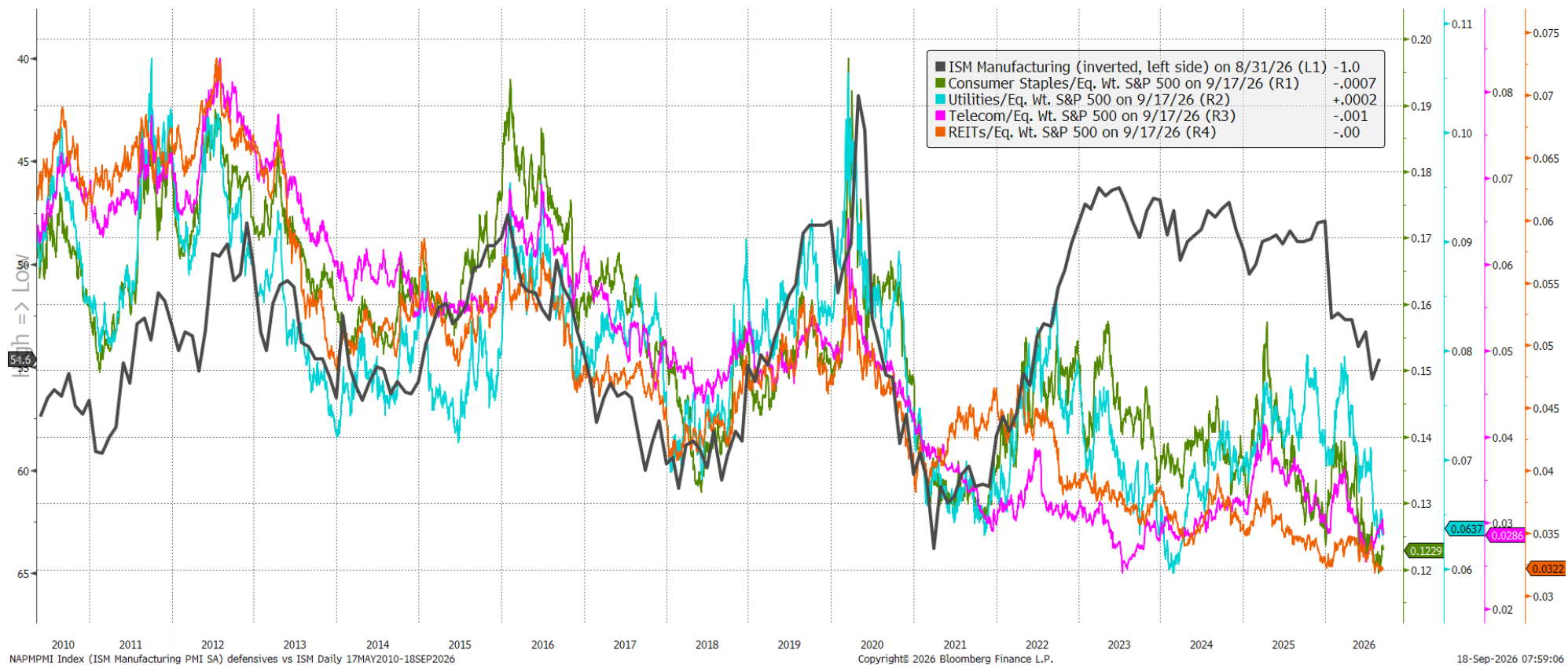


Sectors



Underweight most defensives: they struggle during cyclical pickups

- As is intuitive, defensives struggle when cyclical growth is picking up and when rates are rising. Defensive sectors have been hit with both this year
- We see cyclical growth having plenty of legs. Rates positioning is extremely short, and rates may find a near-term top, but a significant and sustained decline is unlikely

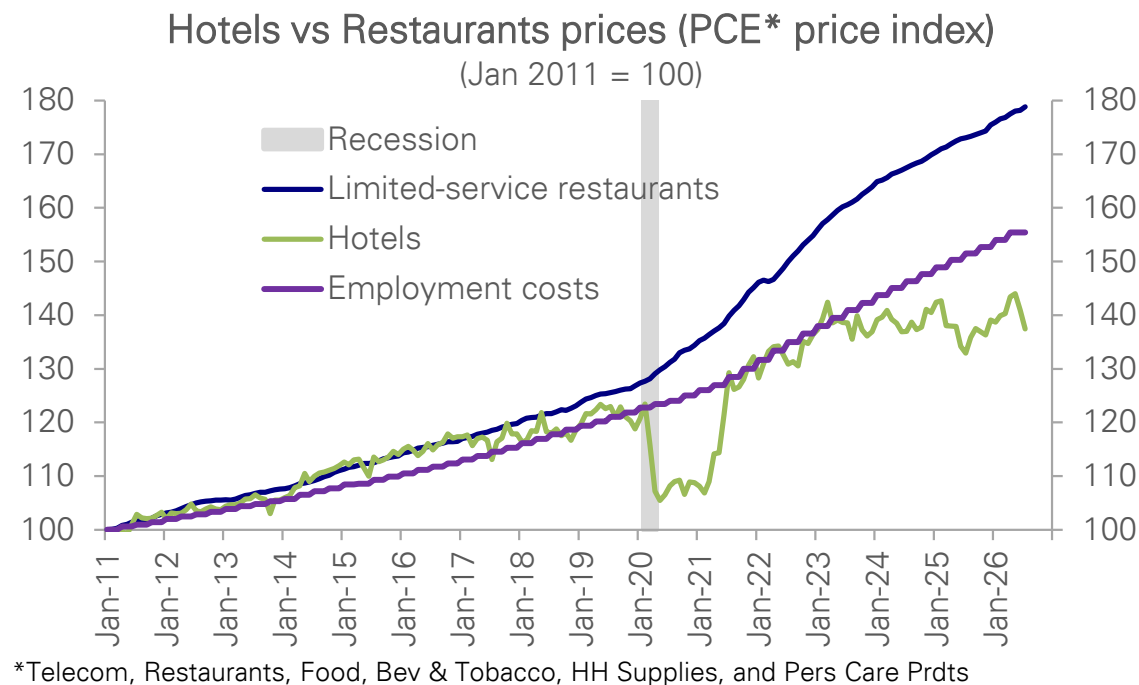


Sectors



Underweight consumer defensives: prices remain way too high

- Prices for defensive products and services remain very high in comparison to their pre-pandemic trend versus household wages. This contrasts with some other categories like hotels. This explains, for example, why consumers are pushing back against food and restaurant prices, but are willing to spend on travel. Margins remain pressured despite these higher prices

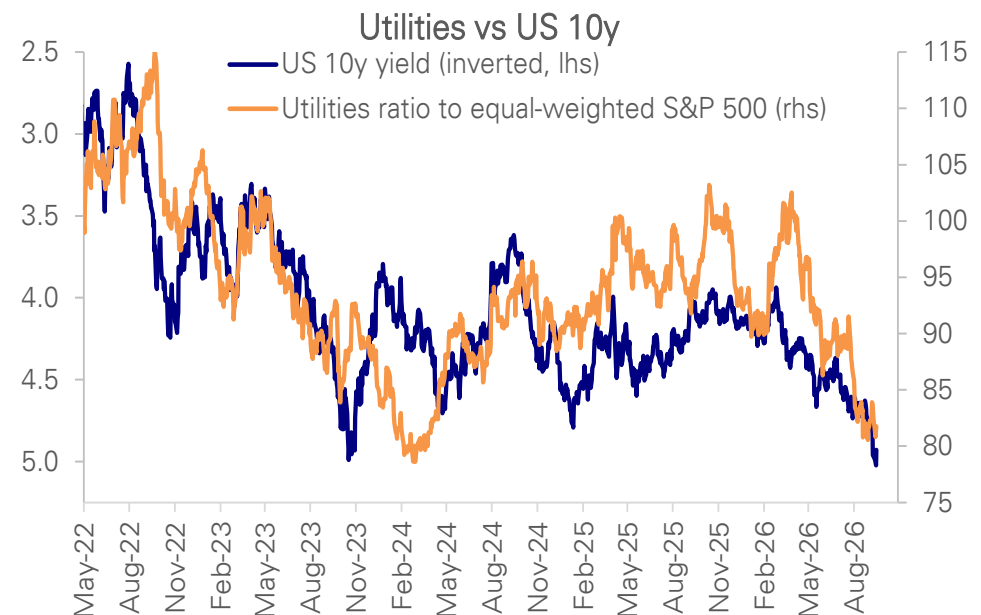
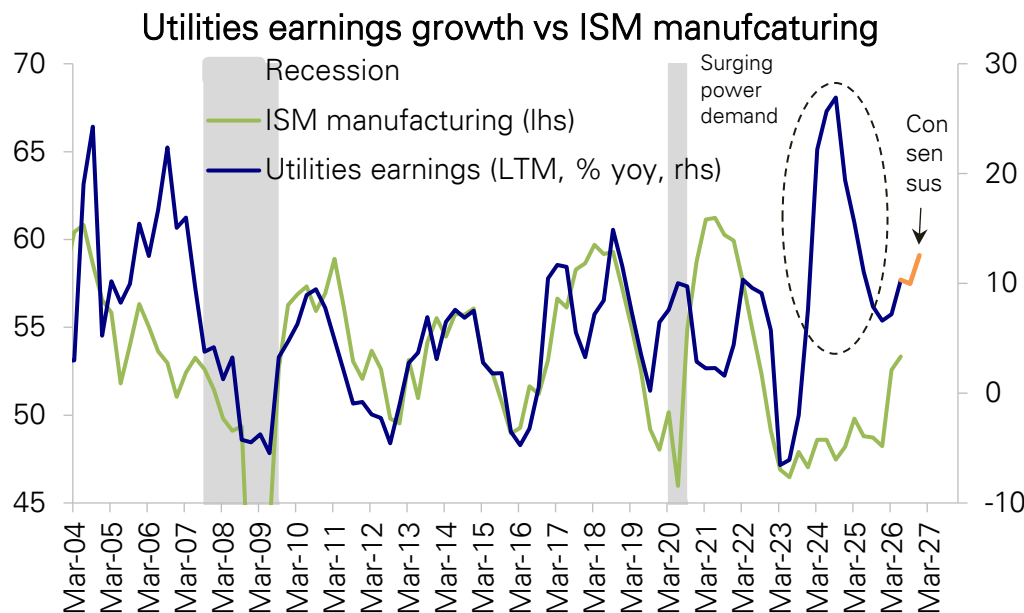


Sectors



Underweight Utilities: need macro downturn and lower rates

- Fundamental tailwind to earnings due to surging power demand but Utilities are still a bond-like defensive

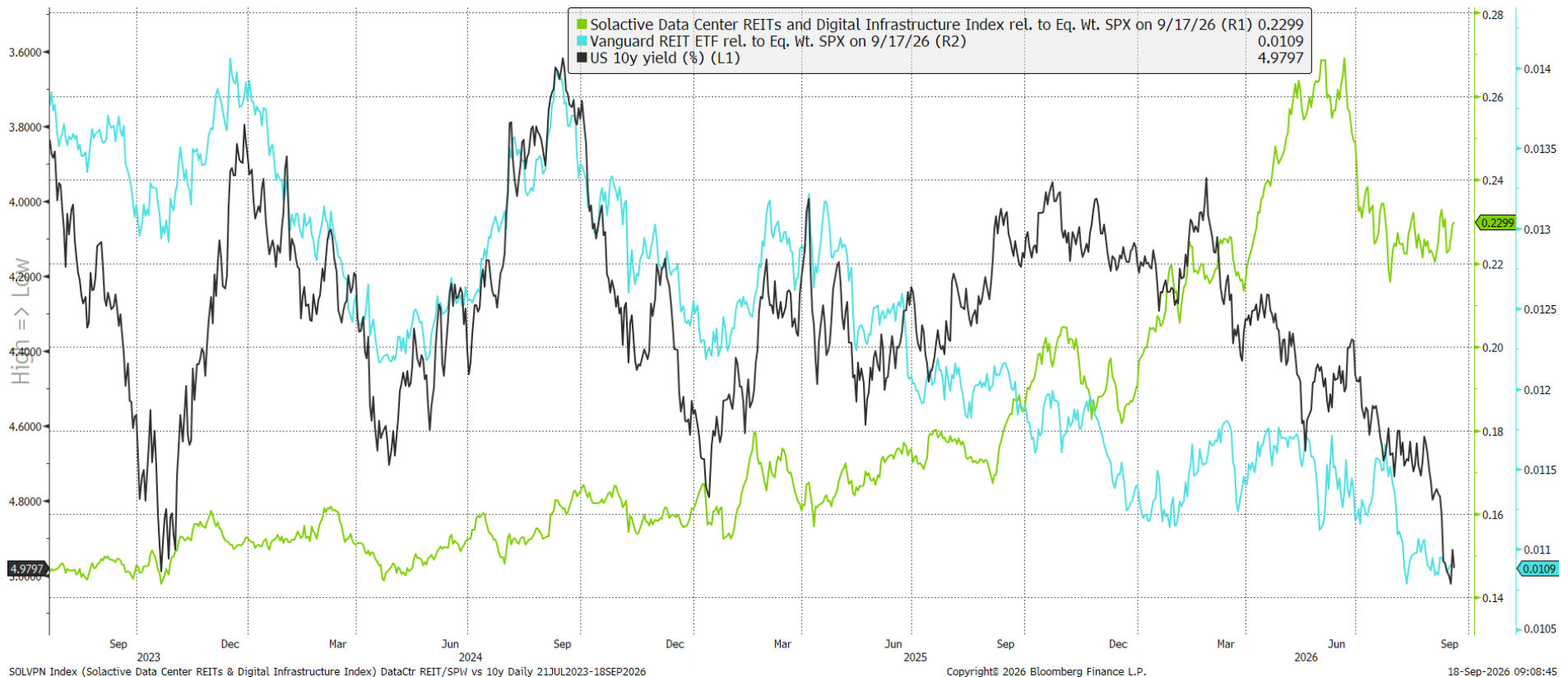


Sectors



Underweight REITs: higher growth areas like data centers, industrial and healthcare REITs should still outperform

- The REITs sector remains very sensitive to bond yields. But groups with idiosyncratic growth stories catering to data centers, industrials and healthcare spaces should fare well



Appendix 1

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