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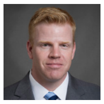
U.S. Equities Are Back in Favor

July 2023

Asset Allocation Insights

KEY INSIGHTS

- Tailwinds that have boosted equities outside the U.S.—including low energy prices in Europe and the post-COVID reopening in China—are expected to fade.
- Given the improved earnings outlook for U.S. companies, our Asset Allocation Committee recently increased the allocation to U.S. stocks from underweight to neutral.



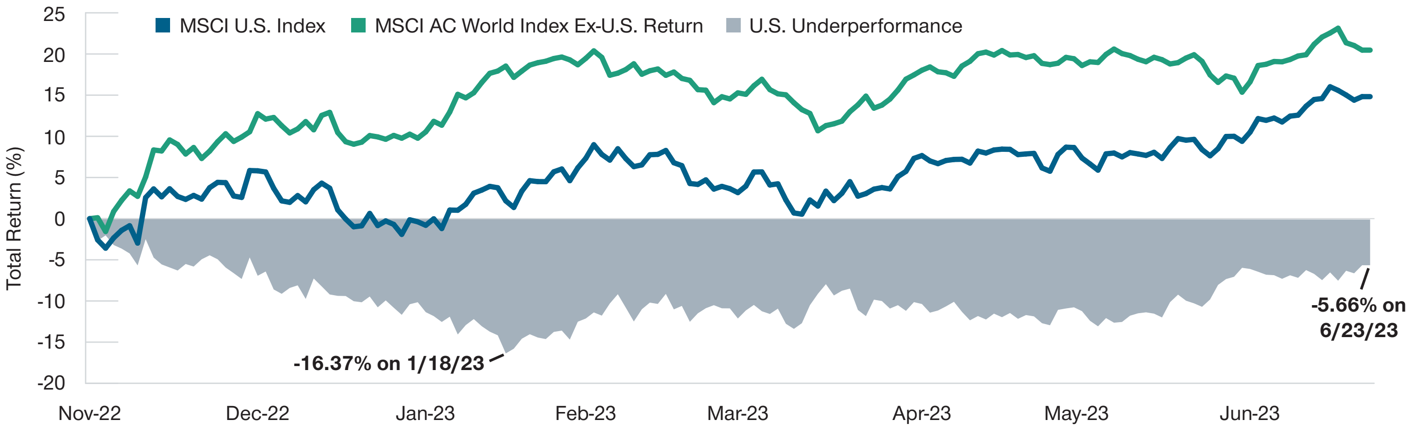
Tim Murray
Capital Markets Strategist, Multi-Asset Division

From late 2022 into 2023, non-U.S. equities—especially in Europe and China—significantly outpaced U.S. stocks. However, the tailwinds that drove outperformance in those regions may be peaking.

Meanwhile, U.S. company earnings have rebounded after an extended period of deterioration. The gap in their performance relative to other global equities has narrowed by more than half (Figure 1).

U.S. Equities Bounce Back

(Fig. 1) U.S. equities vs. the rest of the world



November 1, 2022, through June 22, 2023.
Past performance is not a reliable indicator of future performance.
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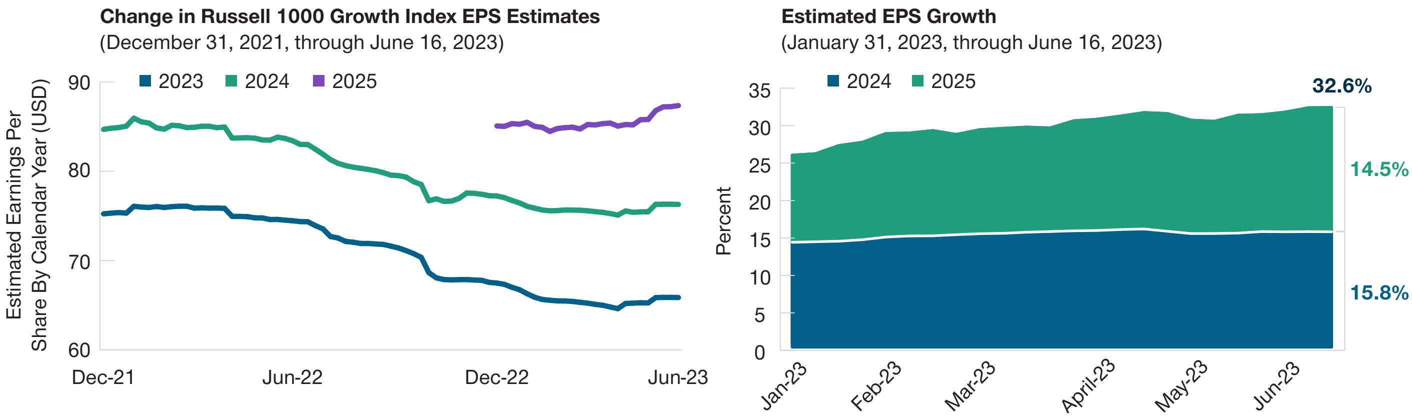
U.S. Growth Stocks Earnings Estimates Have Inflected Higher

(Fig. 2) Earnings outlook for U.S. growth stocks



Actual outcomes may differ materially from estimates. Estimates are subject to change.

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European stocks rallied in early 2023, supported by sharply lower energy prices amid an unseasonably warm winter. But this price relief is likely to reverse as energy demand increases during the summer months. Colder temperatures in the coming 2023–2024 winter season also could boost energy consumption.

In China, robust economic activity driven by the post-COVID reopening appears to have faded, and stimulus measures to shore up economic weakness are unlikely to match prior levels given the government's focus on financial deleveraging and ensuring that the benefits of economic growth are shared more widely.

Meanwhile, despite looming headwinds, the U.S. economy has remained resilient, and the U.S. earnings outlook is trending positive (Figure 2). U.S. growth stocks, technology stocks in particular, have been boosted by recent developments in artificial intelligence. Companies in the U.S. industrials sector also have benefited from higher demand spurred by the Creating Helpful Incentives to Produce Semiconductors (CHIPS) and Science Act, the Inflation Reduction Act, and corporate reshoring.

Notably, valuations for U.S. stocks far exceed other global stocks. However, this valuation gap can be justified by differences in company profitability. U.S. stocks are more expensive because they have enjoyed a sizable advantage in profitability—a gap that has been expanding gradually for nearly 15 years.

Given this improved outlook for U.S. stocks, our Asset Allocation Committee moved its allocation to U.S. stocks from underweight to neutral relative to the rest of the world.

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ID0006124 (07/2023)
202307-2984664