

# Stock market outlook: 3 themes for a broadening market

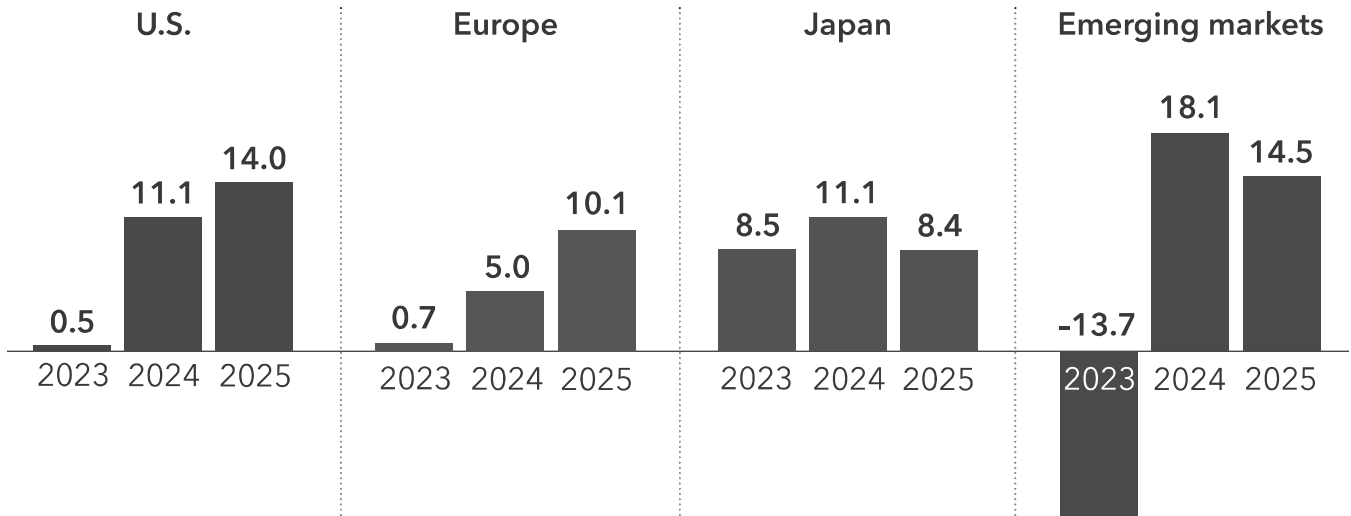
After a strong rally in the first half of the year, stocks appear to be headed into the second half with a powerful tailwind and an even brighter outlook. While the risks of a stumble remain ever present, healthy consumer spending and robust corporate earnings underpin an optimistic view at the midpoint of 2024.

In the face of lingering inflation, the U.S. economy continues to flex its muscles. Labor markets and company fundamentals remain healthy. Wall Street analysts expect earnings for companies in the S&P 500 Index to grow more than 10% this year, with further acceleration in 2025.

Outside the U.S., earnings growth in Europe is anticipated to be substantially lower, albeit still in positive territory. In emerging markets, economists are calling for a sharp rebound in profits after a decline in 2023. Even in China, where a slow economy has cast a long shadow, there are early signs of a turnaround in some industries.

## Accelerating earnings growth can boost stock returns

### Annual earnings growth (%)



### Forward P/E ratios

Current	10-year avg	Current	10-year avg	Current	10-year avg	Current	10-year avg
<b>20.3x</b>	17.8x	<b>13.6x</b>	14.3x	<b>15.3x</b>	14.2x	<b>12.1x</b>	12.2x

Sources: Capital Group, FactSet, MSCI, Standard & Poor's. Estimated annual earnings growth is represented by the mean consensus earnings per share estimates for the years ending December 2024 and December 2025, respectively, across the S&P 500 Index (U.S.), MSCI Europe Index (Europe), MSCI Japan Index (Japan) and MSCI Emerging Markets Index (emerging markets). Estimates are as of May 31, 2024. The forward price-to-earnings ratio (P/E) is computed by dividing the price of a company's stock by the company's estimated annual earnings per share over the next 12 months.

We expect solid economic growth for the remainder of this year and through 2025. This likely leads to an environment of expanding earnings growth across industries and sectors. This, in turn, should lead to a broadening market rally as profit growth is a primary driver of returns.

What's more, equity market valuations don't appear to be particularly stretched. Price-to-earnings ratios for most markets were near or modestly above their 10-year averages as of April 30, 2024.

To be sure, there are risks for markets and investors. Inflation is falling but remains uncomfortably high. The timing of any interest rate cuts by the U.S. Federal Reserve is unclear. Tensions between the U.S. and China have heightened, and war continues in Ukraine and the Middle East. Market declines are inevitable, but over time markets have trended higher, attaining multiple fresh highs in a given cycle.

That's why we focus on identifying powerful forces for growth – concepts like innovation, productivity and the reshoring of supply chains. We have always had downturns, but they

haven't changed the historical long-term trajectory. Here are three key themes we are focused on.



## Midyear Outlook webinar

Thursday, June 20, 11 AM PT/2 PM PT

CE credit available

### 1. AI opportunity is stacking up in tech and beyond

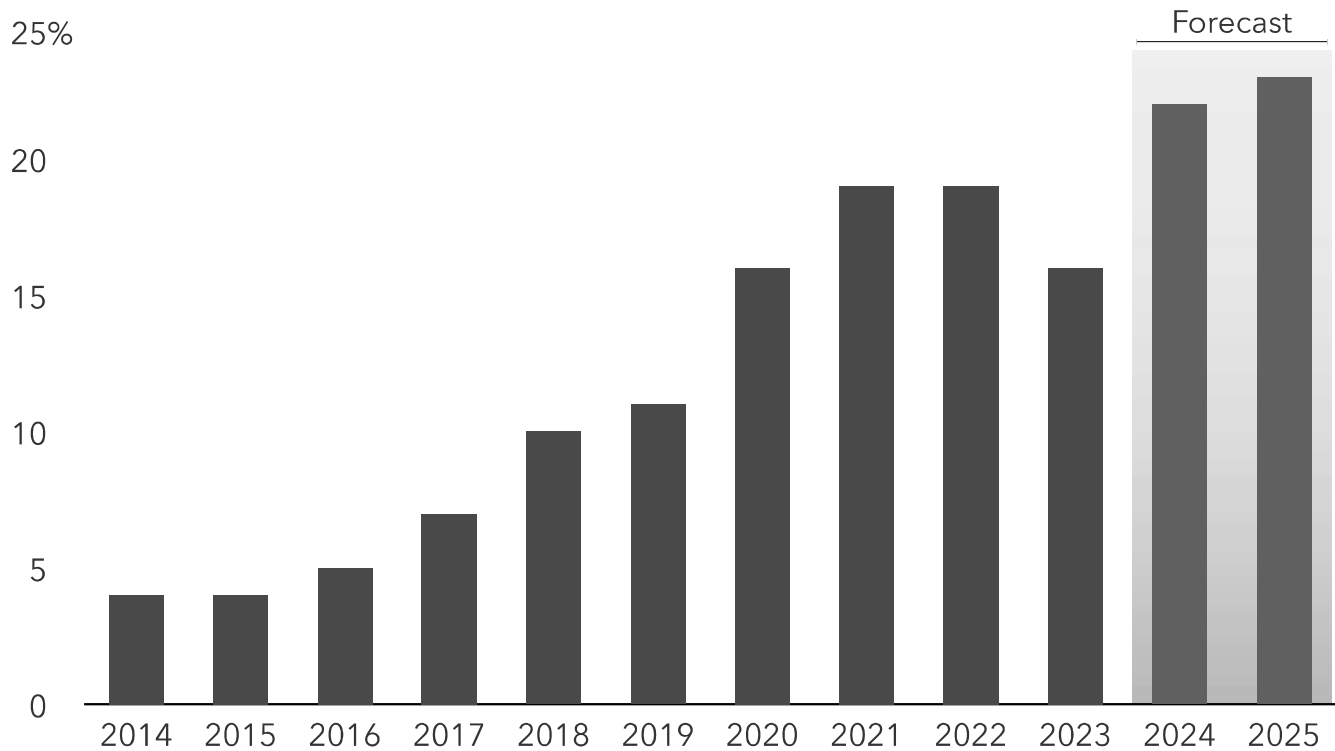
With its open-ended potential to transform industries and how people do their work, artificial intelligence represents compelling investment opportunities. This has led to great enthusiasm for the stocks of tech giants pioneering AI.

For investors, key to success will be identifying the potential winners. This starts with understanding the AI “stack” – four layers of technology that enable AI to operate. Companies are jockeying for position at each layer: semiconductors, infrastructure, applications and the AI models themselves.

Alphabet, Meta and Microsoft have invested tens of billions of dollars to dominate multiple layers of the stack. This includes aggressive investment to develop models, build out cloud infrastructure and develop advanced chips. Although these companies are spending money on their own processors, leading chipmakers like NVIDIA, Broadcom and Micron currently maintain their market share dominance.

## Tech giants are investing heavily in data centers and other capital projects

### Big Tech's proportion of total capex across S&P 500 companies



Sources: Capital Group, FactSet, Standard & Poor's. Big Tech's proportion of total capex represents total capital expenditures across Alphabet, Amazon, Meta and Microsoft as a percentage of total capital expenditures across the S&P 500 Index. Data as of May 30, 2024.

While we believe AI is exciting and will have a major impact on how we work and live, it is a product cycle and will be subject to the same laws of economics and investor emotions that we see in other product cycles. We saw similar patterns in the late 1990s with the expansion and explosion of the tech and telecom bubble. While we do not believe we are in a bubble today, there is a good chance we will see a pullback for some of these stocks.

We are studying each layer of the stack to determine which companies we believe have the best chance of being winners. At certain layers this is relatively straightforward because few companies have the technical and financial wherewithal to compete successfully.

The AI opportunity reaches far beyond tech companies. The need for a massive build-out of data centers is driving demand for Caterpillar's construction and engineering equipment, for example. Because AI data centers require vast amounts of electricity, the build-out will also drive demand for a range of energy sources. Because several tech giants have committed to net zero carbon emissions, the use of nuclear power could grow. In June 2023, for example, Microsoft struck a deal with Constellation Energy to supply one of its data centers with nuclear power.

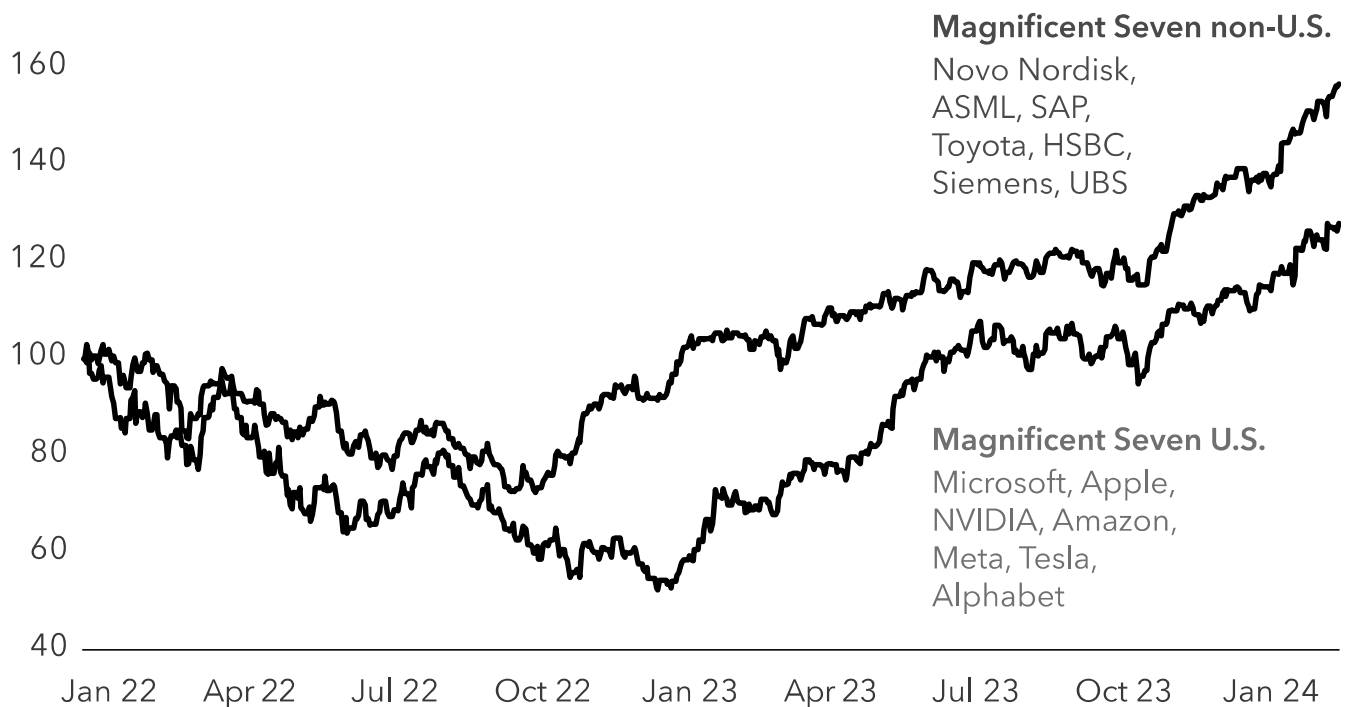
2. There is ample opportunity outside the U.S.

The Magnificent Seven stocks – Microsoft, Apple, Alphabet, Amazon, NVIDIA, Meta and Tesla – closely associated with AI and other tech trends aren't the only place to find solid investment opportunities. Outside the U.S., there's a growing list of rivals with leading businesses.

For example, the seven leading contributors in 2023 within the MSCI EAFE Index, a broad measure of developed markets in Europe and Asia, have outpaced their U.S.-based cohort since the beginning of 2022, rising more than 40%. The non-U.S. companies represent a wide range of industries, including health care company Novo Nordisk, computer chip equipment maker ASML, software titan SAP and banking giant HSBC, among others.

### Seven top non-U.S. companies have outpaced the Magnificent Seven since 2022

Cumulative returns (indexed to 100)



Sources: Capital Group, FactSet, Morningstar. Magnificent Seven stocks were the top seven contributors to returns for 2023 in the S&P 500 Index. The Magnificent Seven non-U.S. are the top seven contributors to returns for 2023 in the MSCI EAFE Index. Cumulative returns are indexed to 100 on January 1, 2022, and shown through March 31, 2024, and are calculated on an equal-weighted basis for the seven stocks within each group. Past results are not predictive of results in future periods.

We have seen a market that is expanding beyond the Magnificent Seven. The re-rating, or increasing share prices, of industries is broadening and rolling through the global equity markets. But with re-rating comes higher valuations, so as active investors we must be wary of groups of stocks associated with market trends and focus on the prospects of individual companies to deliver top-line growth. And, rather than concentrate on one admittedly

dynamic region such as the United States, it makes sense to think globally in the hunt for companies with dominant market positions and strong potential demand for their offerings.

Dutch semiconductor equipment maker ASML, for example, is seeking to tap into rising global demand for semiconductors in support of the build-out of cloud and AI infrastructure. Pharmaceutical giant AstraZeneca has invested aggressively in research and development, resulting in a deep pipeline of cancer and rare disease therapies in late-stage development. Aerospace manufacturer Airbus and jet engine maker Safran are seeking to tap into soaring global demand for air travel.

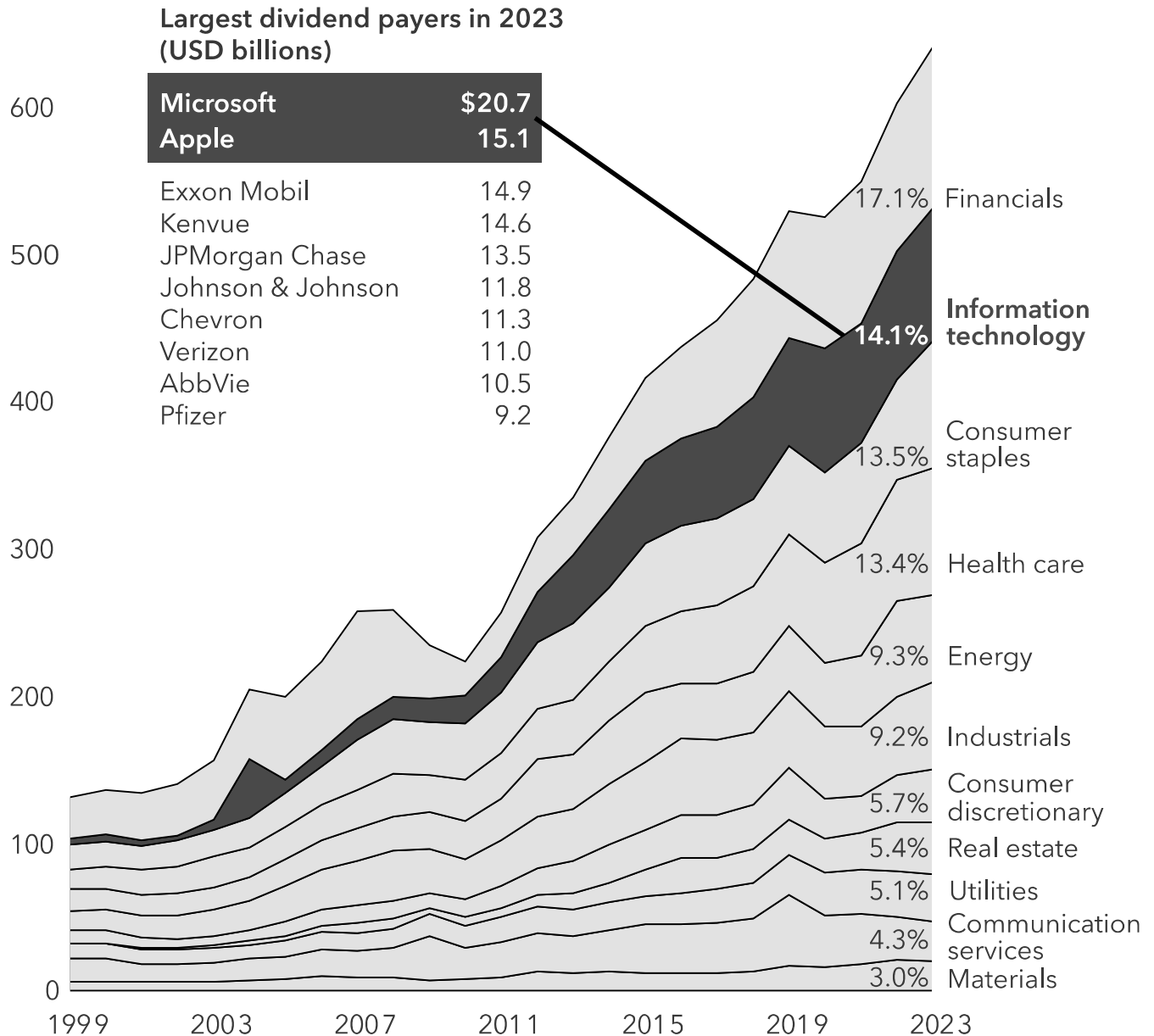
### 3. Tech leaders are reshaping the dividend landscape

Long regarded as the domain of mature industries with slowing growth prospects, dividends are gaining favor among information technology giants. Meta, Alphabet and Salesforce all introduced dividends in the first half of 2024, and those announcements appear to be shifting the narrative.

Meta and Alphabet's dividends can be viewed as a signal of capital discipline among tech innovators and a commitment to shareholder returns. Tech companies accounted for 14.1% of total cash dividends paid by S&P 500 companies in 2023, making them the second largest contributor by sector in dollar terms.

## The tech sector ranks second in cash dividend payments

Value of total cash dividends paid by S&P 500 companies (USD billions)



Sources: Capital Group, FactSet, Standard & Poor's. As of December 31, 2023. Past results are not predictive of results in future periods.

Although dividend yields for many tech firms are modest, the dollar amounts are massive, and we expect continued strong earnings growth both this year and in 2025. Going forward, a broadening opportunity for economic growth should create the potential for improved earnings growth among dividend-paying companies. That can create opportunities for dividend-oriented strategies to generate income and to participate more fully in market appreciation.

For investors seeking current income, technology, aerospace and energy companies have been introducing or increasing dividends. Semiconductor makers Broadcom and Texas

Instruments, and General Electric, which makes and services jet engines, all boosted their dividends since the end of 2023. Similarly, energy company Canadian Natural Resources has increased its dividend, despite volatile oil prices.

## Bottom line

Given the prospects for solid global growth and healthy fundamentals, equity markets are broadening. While U.S. stock markets are likely to do well, they likely won't be the only source of superior returns. But with questions lingering over inflation, rates and global trade, selective investing will be critical.

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Past results are not predictive of results in future periods.

Investing outside the United States involves risks, such as currency fluctuations, periods of illiquidity and price volatility, as more fully described in the prospectus. These risks may be heightened in connection with investments in developing countries.

The market indexes are unmanaged and, therefore, have no expenses. Investors cannot invest directly in an index.

**MSCI EAFE (Europe, Australasia, Far East) Index** is a free float-adjusted market capitalization-weighted index designed to measure developed equity market results, excluding the United States and Canada.

**MSCI Emerging Markets Index** captures large- and mid-cap representation across 27 emerging markets (EM) countries.

**MSCI Japan Index** is designed to measure the performance of the large- and mid-cap segments of the Japanese market.

**S&P 500 Index** is a market capitalization-weighted index based on the results of approximately 500 widely held common stocks.

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