GLOBAL
Insight

RBC Wealth Management

Global equity perspective

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"A stock market top is a process, while a market bottom is an event" is a frequently cited observation mostly borne out by history. The final bottoming phase of a bear market typically plays out over just a few weeks, during which most stocks are falling every day as fearful investors rush to sell to stem their mounting losses. At some point the selling is exhausted, buyers take control, and the market surges higher, usually regaining what it has lost in the unnerving, final selloff very quickly.

Tops, on the other hand, play out very differently: they are usually drawn out over several months or quarters, during which the broad averages may reach a succession of new highs, each not far above the previous one and each followed by a pullback. This traces out a trading range which bullishly inclined investors often interpret as no more than a "pause that refreshes." However, eventually a sharp drop below the bottom of that trading range seals the deal, signaling that a deeper, more prolonged market retrenchment is underway.

Very often it's not clear-cut which phase, "pause" or "top," the market is in. We watch market breadth closely to monitor whether the majority of stocks are moving in sync with the capitalization-weighted indexes like the S&P 500 and others in the U.S., as well as the closely followed major indexes in Canada, the UK, Europe, and Asia. When the S&P 500, for example, sets a new high, we look to see whether that is confirmed by a new high for the equal-weighted version of the index and by other breadth measures like the advance-decline line (which shows the difference in the number of stocks that are rising versus falling in a stock market). Such "confirmations" occurred consistently over the entire course of the 27-month powerful market advance from the last major low in the fall of 2022.

At the moment, however, the jury is out. The S&P 500 recently posted a new all-time high in early December and now another in late January, but so far the breadth measures noted above have not followed suit. They may yet do so and look to be trying. But if that breadth confirmation fails to arrive (i.e., if the advance-decline line and the unweighted S&P 500 don't also post new highs), then, in our view, the probabilities will be rising that equity markets are in the process of forming a top rather than

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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All values in U.S. dollars and priced as of market close, Jan. 31, 2025 unless otherwise stated.

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simply marking time before the long-term uptrend reasserts itself.

Another picture that should line up with the market's eventual direction is the outlook for earnings. 2024 looks to have been a very good year for S&P 500 Index earnings—up 10% y/y. The Street's earnings estimates at the start of the year usually turn out to be too optimistic, with actual achieved results by the end of the year falling short—on average by about 5%. But not so for 2024; earnings look to have come in at almost exactly where forecasts made a year ago predicted they would—a rare feat.

That may be a tough act to follow in 2025, but consensus forecasts appear undaunted as they look for earnings growth to accelerate to almost 12% to reach $273 per index share. Aggregate sales for the S&P 500 companies are unlikely to grow that fast, implying yet another year of profit margin improvement.

The GDP handoff into Q1 looks solid enough in the U.S., in our view, with manufacturing new orders strengthening and service sector revenues showing few signs of fading. However, hurdles abound. Policy uncertainty is elevated with the Trump administration's tariff salvo now underway for China, with Canada and Mexico given a 30-day reprieve, while the UK and Europe are likely to learn their fates in the coming weeks or months. So far, currency markets have borne the brunt rather than equity markets. But we think the worst has probably not yet been seen, and a quick settlement seems too much to hope for. Meanwhile, in the U.S. economy itself, inflation remains sticky, probably keeping the U.S. Federal Reserve from following through, for now, on further rate cuts. Consensus forecasts see GDP growth slowing modestly in 2025 and gearing down further in 2026. Growing earnings by 12% in a slowing economy will be a challenge.

The first big test for 2025's chunky $273 S&P 500 consensus earnings estimate is coming right now as companies report full-year 2024 earnings results, a time when many CEOs give shareholders guidance on how the business is likely to fare in the coming year. Guidance that doesn't support the Street's optimistic earnings forecasts, were that to be the case, would not be welcomed by a market trading at today's elevated price-to-earnings (P/E) multiple (25x latest 12-month earnings and 22x the consensus earnings estimate for 2025).

Markets outside the U.S. (including Canada, the UK, Europe, and Japan) are not nearly as expensive in large part because they don't contain any of the "Magnificent 7" (Alphabet, Amazon, Apple, Meta Platforms, Microsoft, NVIDIA, and Tesla), nor as much exposure to technology stocks as a group, nor do they have many of the mega-cap growth stocks, all of which have been major contributors to the S&P's rich valuation. That said, all those non-U.S. markets are trading above their long-term average P/E ratios and all have moved up by one-to-two multiples since last summer; so they too look to have priced in expectations of larger-than-average earnings gains.

That optimism is all the more remarkable because consensus forecasts see all those economies continuing to grow at what are already very subdued rates through 2026, while the impact from trade disputes could easily be somewhat worse than assumed by markets.

It's also worth noting that this latest bump up in P/E multiples for all the major indexes has occurred against a backdrop of rising bond yields—the 10-year U.S. Treasury yield has climbed from 3.60% in September to 4.80% recently. Rising bond yields would normally compress P/E multiples, not elevate them. So, stocks have not only become more expensive relative to their own historical norms but also in relation to bonds. In the latter case, perhaps more expensive than at any time in the past 23 years: the "earnings yield" for the S&P 500 (i.e., earnings per

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share divided by price) now sits at just 4.00%, below the 10-year Treasury yield (4.54%) for the first time since 2002.

“Priced for perfection” is an overused bit of stock market hyperbole, in our view. But we think it is closer to being the appropriate descriptor of the market valuation than at any time in the recent past. And that’s all the more reason to pay close attention to the equity market’s internal conditions like breadth that speak to its ability to keep advancing.

Above-average P/E ratios don’t necessarily limit the market’s upside—they can always go higher still. But when the tide eventually turns, an elevated P/E multiple tells the investor something about the near-term risks they may be facing.

We expect most major global equity markets can go on climbing the “wall of worry” into new high ground in the coming months but acknowledge that there is an element of “threading the needle” about achieving those gains. From our vantage point, another surge higher in bond yields, say beyond 5% for the 10-year Treasury, or a meaningful deterioration in earnings prospects, perhaps triggered by trade issues, might be enough to break the spell and usher in a more problematic downturn.

In our view, portfolios should stay committed to equities up to but not beyond their long-term targeted exposure.

Research resources

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As of December 31, 2024

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Hold [Sector Perform]	588	38.74	153	26.02
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