Stay calm, stay invested (in quality)

15 January 2025

Overview

- Quality stocks have characteristics of positive earnings revisions and momentum. These stocks are a bedrock for a solid portfolio.
- The recent back up in bond yields is a risk, more so since US equity valuations are stretched.
- January can be a harbinger of performance for the rest of the year. When S&P500 ends positively in January, the average full-year performance is +12%. Negative Januarys preceded negative 3-5% on average.
- We expect near-term volatility but would pick up quality stocks that could be unjustifiably sold off.

Quality stocks as the core of portfolio

Quality stocks often exhibit a few characteristics. Firstly, earnings are constantly revised upwards due to a strong product pipeline that is powered by a culture of innovation and good management. Secondly, the stocks are bought up because of positive earnings revisions. This puts them into the 'momentum' category. The table below shows that stocks in these two categories tend to have the best performance in the near and long term. Figuratively speaking, investors are advised to not move out if they are staying in a good neighbourhood.

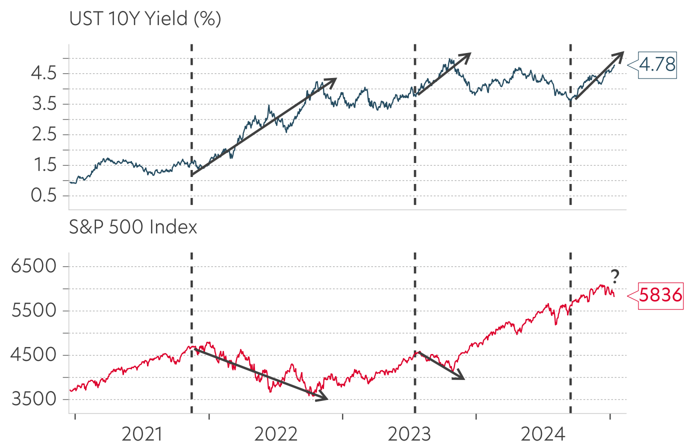
Figure 1: What type of stocks should you buy?

Style	1Yr	3Yr	10Yr
Momentum	***28 %***	***26 %***	***232 %***
EPS Revisions	***25 %***	***21 %***	***207 %***
Share Buybacks	12 %	22 %	201 %
Value	12 %	19 %	181 %
ESG	11 %	17 %	180 %
Growth	19 %	7 %	176 %
Quality	16 %	12 %	176 %
Multi-Factor	19 %	31 %	175 %
Size	17 %	18 %	173 %
Trade Activity	17 %	6 %	150 %
Dividends	13 %	13 %	124 %
Volatility	10 %	8 %	117 %
Short Interest	12 %	(8)%	79 %

Source: Bloomberg, UOB Private Bank

In the last five years, stocks tended to be weak when there was an upward momentum in US Treasury 10-year yields. The recent increase in yields was triggered by robust jobs numbers. This has led the market to price in a much slower Fed rate-cutting path. As the 10-year US treasury nears the 5% level, we expect more volatility.

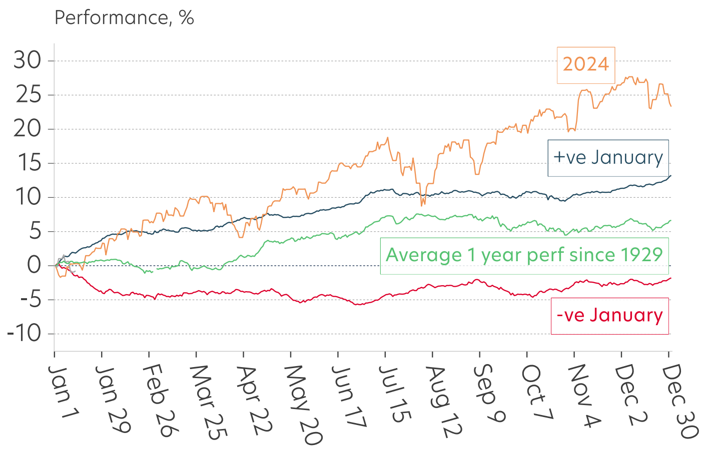
Figure 2: Rising yields are a headwind to stocks



Source: Bloomberg, UOB Private Bank

Looking ahead, January tends to be an important harbinger for the rest of year. Our analysis from data going back to 1929 shows that when the S&P500 registers a positive performance, the average full-year return is about 12%. This compares to a full-year performance of negative 3-5% if January records a negative month.

Figure 3: Januarys can define the rest of the year



Source: Macrobond, UOB Private Bank

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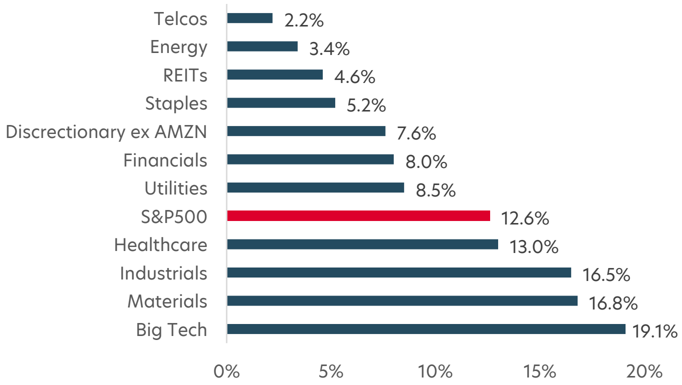
This is somewhat intuitive as January brings forth the all-important fourth quarter results season, when companies will give their initial guidance for the rest of the year. For this year, the stakes seem even higher as the Fed will give its initial take of "everything" on 30 Jan. This is after the strong jobs data (10 Jan) and the inflation print (15 Jan) in 2025.

Figure 4: More balanced 2025E earnings growth



Source: Bloomberg, UOB Private Bank

As capital market participants, we are skewed to growth and at least for 2025, it is more evident in the US as compared to the rest of the world. The S&P500 is set to grow 12.6% and encouragingly, other sectors which have lagged technology in 2024 are finding their footing for a potentially strong year of growth.

We also observe that business cycles seem to be compressing. This means that a company's ability to innovate and adapt is crucial in securing its future; companies which can execute well would ultimately lead to higher shareholder returns. In this respect, firms which fall into the quality bucket typically have these attributes.

In Asia, India remains the best proxy for now given its relatively stronger growth profile and demographic advantage in the medium and longer term. However, we do recognise that India's growth is cooling slightly in the near term. Japan is a middle-ground market in between the growth-leading US and the growth-lagging Europe. Japan's corporate reform movement appears firmly embedded; this should enhance shareholder returns for companies with the capacity and ability to execute.

Investment takeaways

What should investors do now? Looking ahead, we expect volatility, at least in the near term. This was communicated during our latest 2025 Outlook forum. Having said that, investors should stay calm and stay invested. Given our base expectations for garden-variety kind of market correction, we are inclined to buy into the weakness, especially for quality stocks.

We still like the large-cap tech stocks as they remain the biggest free cash flow generators. They are more defensive against a high-rate environment due to their robust cash holdings on their balance sheets. Investors are advised to hold on to these companies if they are currently invested and buy the dip if they do not have them. Other sectors that we like for the first half of 2025 are financials, select cyclicals, industrials, and utilities. Allocation to portfolio stabilisers like select healthcare stocks, hedge funds, gold and private assets is also recommended for investors. We would invest in fixed income for fixed income, and not capital appreciation.

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