U.S. EQUITIES: JOGGING OF THE BULLS

"The bull market in stocks isn't over yet. We're optimistic about the ongoing strength of U.S. stocks, especially when compared with other asset categories. But stock returns will slow down in 2015, going from a sprint to a jog. It's time to be selective."

– Savita Subramanian, Head of U.S. Equity and Quantitative Strategy

Our view

Slow and steady: Valuations for the Standard & Poor's 500 Index have gone from cheap to (nearly) fair value, so it's difficult to sustain the bullish outlook we've held for the past few years. Our 2015 year-end target for the S&P 500 is 2200, putting returns on a more-normal pace of 6%. Our outlook is in line with corporate earnings growth and ahead of the consensus view on Wall Street, which runs about 5%.

Respect your elders: Many investors have shunned mature U.S. companies in the S&P 500 for riskier initial public offerings (IPOs). As a result, large companies appear under-appreciated, trading at sizable discounts to the rest of the market. With strong cash balances and low leverage, the big stalwarts are capable of unlocking value through self-help. And shareholder activist campaigns could prod turnarounds at large companies.

Go against the grain: This is our highest-conviction call for 2015. We favor inexpensive, high-quality stocks that are poised to outperform. As investors flock toward bond-like assets and secular growth, "safety" has gotten expensive. Stocks with perceived risk (but not actual risk) could be the bargains of the year. Among the cheap and neglected: semiconductors, technology hardware storage and peripherals, and insurance.

Key calls

We're sticking with our long-term sector calls, as many of our economic expectations for 2014 have been pushed back to next year. Given our expectations for markets, growth and government policy, we believe the following positions will provide the strongest results in 2015:

- **Sectors we favor**: We continue to have an overweight stance in technology and industrials. These sectors should outperform the rest of the market in a mid-cycle economy, where corporate spending will replace consumption.
- **Sectors with challenges**: We are underweight in consumer discretionary, utility and telecommunications companies – just as in 2014.