Talking Heads with Nadia Grant

Daniel Morris
Hello, and welcome to the BNP Paribas Asset Management Talking Heads podcast. Every week, Talking Heads will bring you in-depth insights and analysis on the topics that really matter to investors. In this episode, we'll be discussing global equities. I'm Daniel Morris, chief Market Strategist, and I'm joined today by Nadia Grant, Head of Global Equities. Welcome, Nadia, and thanks for joining me.

Nadia Grant
Thank you, Daniel, I'm very pleased to be here.

DM: We're at the midpoint in the year, Nadia, and I think it's safe to say most equity investors are pleasantly surprised with the returns that we've had. No lack of things that could have gone wrong. Always worried about the lingering effects from tariffs, there's the situation in the Middle East, but through all of this, equities [are] just powering along. That said, there's always volatility, and we'll talk particularly about what's been going on in emerging market tech stocks. But could you start us out [with] how you see the return dynamics so far this year? Any highlights you want to bring out?

NG: The word I would use to describe year-to-date returns is 'concentration'. In January, we could see some tentative signs of broadening in market performance. Geopolitical uncertainty, with the closure of the Strait of Hormuz, really accelerated the outperformance of AI (artificial intelligence) at the expense of everything else, particularly software. With high quality, high ROE (return on equity) asset-light companies really penalise[d], and the picks and shovels of AI outperforming, the share of the S&P constituent outperforming the index so far this year is really low compared to [the] historical norm, about 40%.

What's more, the market has been driven by positive earnings revision[s] versus multiple expansion, so that has actually led to a derating of the S&P 500 year to date. From a sector viewpoint, the positive revisions have been driven by the technology and energy sector[s], and conversely, healthcare has seen negative revision followed by [consumer] staples.

At a market cap level, when we look at the Russell 2000, in contrast, that has seen negative earnings revision[s], and we're seeing a similar picture looking at the MSCI ACWI, the all country world index, seeing positive earnings revision of about 9% year to date, driven by [the energy, tech [and] material sectors, while consumer discretionary, healthcare and real estate sectors have seen their earnings revised downwards this year.

DM: We're at the beginning of the US earning season. The banks have reported so far with very strong results. Always, earnings are what drive equity markets. I think we know the absolute results we get this quarter are going to be likely pretty good, but that may not be enough given how high expectations are. What do you anticipate for the rest of the season?

NG: As you said, about 10% of companies by market cap should have reported by today, Friday, led by the financials, and we will expect the 'magnificent seven' earnings [results] to begin [to come out] towards the end of July.

For the second quarter of 2026, we're expecting S&P earnings to grow 22% which is well above long-term historical averages, and that's driven by a strong contribution from energy, where earnings are set to more than double for this quarter. Technology, where consensus is expecting earning[s] to grow about 60%, and materials about 30%.

On the flip side, healthcare is expected to see negative earnings growth for this quarter versus last year of about 19%; real estate -2% and consumer, excluding Amazon, +3%, which are for the three laggers well below [the] historical norm.

Consensus also expect[s] tech, energy and materials to lead from a margin expansion standpoint year-over-year, and thus we are expecting [the average] S&P profit margin to grow from 13.5% to just under 15%, while industrial healthcare and discretionary are expected to see their margin contracts. Similar picture on small cap[s], where margin[s] are expected to contract a bit.

When we look at Europe, [a] really strong picture there as well, with earnings expectations for growth of about 12%. And I would note there that EPS (earnings per share) revisions have been improving from negative earlier in the year to an inflection and improving – an improvement that has coincided with positive manufacturing data like the PMI (Purchasing Managers' Index) in Q2.

Japan, too, is on pace for about 12% earnings growth this quarter, and EM (emerging markets) is the stand-out, with earnings expected to grow over 60% this quarter, driven by tech. I would note as well that negative pre-announcements are well below [the] typical level this quarter, and that is likely symptomatic of a better economic, and therefore fundamental, backdrop globally.

So, to answer your question, Daniel, I still believe there is scope for earnings to be delivered despite the high bar this quarter.

DM: You mentioned the high results we anticipate for emerging markets, again driven primarily by the [tech] hardware sector, and that's important to keep in mind when we look at the returns that you've had for that sector year to date. The point being that the gains in the indices and the stock prices [are] largely driven by earnings growth as opposed to an increase in valuations.

That said, there's been a bit of a sell-off over the last few weeks. If you just take the [tech] hardware stocks in emerging markets, they're now down 16% at the time we're recording from the peak. That said, it still leaves those stocks up 84% year to date, so not shabby situation. What's your take on what's happening? Is it an indication that the AI boom is starting to bust?

NG: We're expecting over 60% earnings growth in EM in the second quarter, which, unsurprisingly, is driven by semis [semiconductor companies] in hardware. The concentration in market performance that we mentioned in the developed market has also been seen in EM and – as you mentioned – fundamentally driven because it's all about earnings, and that pace of earnings growth has actually surpassed that of the price action.

When you look at [South] Korea, really the best evidence of that – that's the proxy for memory and hard bandwidth memory – that really is a bottleneck within the AI supply chain. [The] Korea[n] market had doubled when we look at the picture at the end of June, while consensus for the full year [20]26 is for earnings in the country to almost quadruple. Same picture in Taiwan, but with a lesser magnitude.

So, I would note that the pace of growth is set to decelerate from H1 to H2, and this is why we lean towards a broadening of sector performance. That's something that we [have] started to see, as you mentioned, particularly in the US, we saw the equal weight index starting to outperform the cap weighted index.

However, when we talk about conviction, we don't think this is indicative of a bust. We're still very early on, and as indicated in the AI build out, valuations are not demanding as earnings have outpaced those price action[s].

DM: You mentioned you're expecting a broadening of the returns across sectors in the markets. If you look ahead, what other parts of the market, sector[s], countries do you find the most attractive?

NG: In addition to the semi[conductor]s and hardware that we like, given this historic AI infrastructure build, and post the correction that you mentioned we've had since the beginning of June, we continue to like that space. But when we look at sector contribution to earnings in the US, almost all of the sector[s] [have] contribute[d] to S&P earnings this year, and that is a stark contrast to what we witnessed the prior years.

That's why we balanced our AI conviction with other secular themes like defence that has underperformed and is becoming increasingly attractive from a valuation standpoint, particularly given the growth prospects. We like resource independence with exposure to metals like copper or aluminium that have been hard hit by the conflict in Iran and yet [are] economically sensitive and [seeing] supply constraint[s].

We also lean towards that recovering PMI that we've seen in the US, and [we] like sectors like transport, where the administration crackdown on immigration and the installation of a language test for truck driver[s] has led to a tightening of supply and therefore higher truck weights at a time when [the] demand outlook is improving.

DM: If I could summarise some of the key points you shared with us, Nadia, if we think about how the market has performed year to date, the word you highlighted was ‘concentration’ – everything very much centred around the performance of AI.

That said, you're looking for some broadening in the returns to other sectors in the year ahead. You think performance should be supported by strong earnings growth for the upcoming second quarter earnings season in the US, looking for 22% growth in the S&P [index]. And finally, other sectors beyond AI that you find attractive included defence and resource independence. Well, Nadia, thank you very much for joining me.

NG: Thank you.

DM: That's it for this week's episode of Talking Heads. If you would like more information about our capabilities in global equities, please reach out to your asset management contact or check out Viewpoint, our website for investment insights at viewpoint.bnpparibas-am.com.

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You've been listening to the BNP Paribas Asset Management Talking Heads podcast with me, Daniel Morris and Nadia Grant, Head of Global Equities.

Please do join me next week. Until then, take care.