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A “no landing” US economy supports equities

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In 2022, the Federal Reserve began what would become the fastest series of rate hikes since the 1980s as it tackled a US economy with strong growth and inflation at four-decade highs. The debate over whether the Fed could engineer a soft landing or would trigger a recession has preoccupied investors ever since. But there may be a third alternative: a “no landing” path, with inflation close to the Fed’s target, but growth at or above previous trend estimates.

Recent data suggest that the US economy is moving toward this “no landing” scenario.

The labor market is more resilient than expected amid an overall solid economy. The last nonfarm payrolls came in well above consensus forecast, lifting the three-month average payroll gain to 186,000, healthy enough to absorb the growth in labor supply. Recent revisions to the last five years’ data also show that GDP growth has averaged 2.5% per year since 2019, stronger than previously thought. While industrial production in September fell 0.3% month over month, reflecting the Boeing strike and two hurricanes, retail sales growth of 0.4% was above market expectations, consistent with resilient income growth and healthy household balance sheets.

Inflation continues to trend toward the Fed’s target. While month-to-month inflation data is noisy, the broad disinflationary trend remains intact in the US. The most recent reading of the personal consumption expenditures price index (PCE), the Fed’s preferred measure of inflation, showed annual inflation slowing to the lowest level since February 2021. We believeinflation will be low enough for the Fed to continue cutting rates.

The US presidential election is unlikely to derail positive fundamentals. We expect volatility to rise in the run-up to the election, as neither party holds a clear advantage in any of the key swing states that will decide the outcome. But the election is taking place against a backdrop of Fed rate cuts, US economic momentum, and supportive secular trends like artificial intelligence (AI). We would caution against knee-jerk or simplistic assumptions of equity market outcomes based on individual policies, as the potential implications will need to be viewed in the context of what can actually be implemented, and potential policy sequencing.

So the bottom line is that the improved US macroeconomic outlook increases our degree of certainty about our positive view of equities. We have upgraded US equities to Attractive from Neutral and target 6,600 for the S&P 500 by end 2025, implying 13-14% total returns from current levels. We expect those gains to drive similar returns for the MSCI All Country World index, which we have also upgraded to Attractive.

Read more in our latest Monthly Letter, "**Geostationary orbit?**," which includes our view on China's latest stimulus efforts.

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