



(UBS)

May is starting out with flowers

06 May 2024, 4:26 pm CEST, written by UBS Editorial Team

After a rather hectic and disappointing April, the information over the past few days suggests that May could be a more rewarding month for investors.

The latest Federal Reserve meeting clarified that interest rate hikes are not on the table and reaffirmed the need for patience before starting to loosen monetary conditions. Moreover, the April jobs report showed that we are approaching a better balance in labor conditions, which should help loosen demand-side pressures on prices.

Let's add duration

It's important to not miss the forest for the trees. Yes, the data throughout April was somewhat negative for financial assets. Yet, we were clear all through the recent volatility that the fundamental trend of the economy had not changed whatsoever. If anything, the information at hand kept suggesting that the domestic demand continues to hum along, coupled with robust labor conditions.

Note that the recent upside CPI surprises may prove to be largely due to one-time factors in selected items, such as medical and auto insurance, along with unexpected stickiness in housing rents. In fact, a large bulk of inflation components are converging to the target, with annual goods inflation actually in negative terrain. That's even without mentioning the qualitative survey data which has been showing for months that firms are reluctant to enact further price increases. As such, given the seemingly excessive uncertainty to the rates outlook that set in last month, and our base case of further disinflation, we have been favoring adding duration. We recommend extending 5-year TIPS allocations further out the curve to the 7–10-year area, where we see better relative value. While stronger economic data has drastically impacted short-end inflation expectations, the longer end has remained anchored. The rise in real yields further out the curve offers a good opportunity to lock in attractive real rates ahead of the expected decline in nominal rates later in the year.

May is starting out with flowers—partly, thanks to Fed Chair Powell

At the last Fed meeting, Chair Jerome Powell was very clear in reassuring the FOMC considers the current policy stance restrictive enough to accomplish its dual mandate. At the press conference, he underlined that the Fed was prepared to sit tight at its current rate level as long as needed, until the data provides enough confidence to loosen conditions.

Meanwhile, the jobs report for April showed a deceleration in non-farm payrolls to +175,000, below expectations of +240,000 and relative to the +315,000 print of the preceding month. Moreover, wage data was also encouraging, lowering upside inflation risks from the labor side. Thus, the recent information supports our thesis that economic growth and inflation will moderate and that the Fed is biased toward rate cutting.

These developments should also allow the market to re-embrace the soft landing outlook after concerns of no-landing/stagflation took hold in April.

Moreover, companies' quarterly earnings last week continued to put on a solid performance. For instance, in the case of Apple, earnings exceeded analysts' forecasts, with the firm announcing a record-setting USD 110bn stock buyback program. Similarly, Amazon reported revenue and earnings beats for 1Q24, with its cloud-computing services (key in AI) becoming a fundamental source of the revenue growth. Overall, with more than 50% of the S&P 500 companies having reported their earnings, we think that corporate fundamentals remain largely solid. Note that nearly 60% of companies beat sales estimates and 75% exceeded earnings estimates.

The bottom line

In our view, data dependence will define the Fed's near-term policy rate levels, which we believe will be lower and should start to show later this year. We therefore continue to favor investment grade corporates, agency MBS, CMBS, and high-quality municipal bonds.

On the equity front, we maintain our year-end S&P 500 price target of 5,200. More specifically, we still favor the tech sector. We balance this position with a most-preferred view on healthcare, our favorite defensive sector due to faster earnings growth expectations relative to other defensives, and with industrials, which should benefit from an improvement in manufacturing business sentiment. From a size standpoint, we still like small caps, which have scope to rebound once rates eventually trend lower and as earnings growth broadens.

Main contributor: Solita Marcelli

See the full report: [Macro and market outlook: April showers followed by May flowers](#), published 5 May, 2024.

Important information

As a firm providing wealth management services to clients, UBS Financial Services, Inc is registered with the U.S. Securities and Exchange Commission (SEC) as an investment adviser and a broker-dealer, offering both investment advisory and brokerage services. Advisory services and brokerage services are separate and distinct, differ in material ways and are governed by different laws and separate contracts. It is important that you carefully read the agreements and disclosures UBS provides to you about the products or services offered. For more information, please visit our website at www.ubs.com/workingwithus.

© UBS 2023. All rights reserved. UBS Financial Services Inc. is a subsidiary of UBS AG. Member FINRA/SIPC.

There are two sources of UBS research. Reports from the first source, UBS CIO Global Wealth Management, are designed for individual investors and are produced by UBS Global Wealth Management (which includes UBS Financial Services Inc. and UBS International Inc.). The second research source is UBS Group Research, whose primary business focus is institutional investors. The two sources operate independently and may therefore have different recommendations. The various research content provided does not take into account the unique investment objectives, financial situation or particular needs of any specific individual investor. If you have any questions, please consult your Financial Advisor. UBS Financial Services Inc. is a subsidiary of UBS AG and an affiliate of UBS International Inc.