With inflation slowing, CIO expects 50 basis points of Fed easing for the last two meetings of 2024 and a further 100 basis points of cuts in 2025. (UBS)

Resilient US jobs market lifts market spirits

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Fears that worsening tensions in the Middle East could lead to an all-out war between Israel and Iran—potentially disrupting oil supplies—boosted the price of Brent crude oil, weighed on equities, and helped assets considered safe-havens, such as gold. Our base case remains that a full-scale war can be avoided, although the risk of a miscalculation by either side has increased.

But while investors remain concerned about the potential for further escalation, the focus shifted back to economic fundamentals at the end of last week with further evidence that the US economy remains resilient.

Concerns over rising US unemployment have eased. Investor worries over the jobless rate among investors peaked following the release of the July payroll data, which showed unemployment climbing from 4.1% in June to 4.3%. A year before, just 3.5% of Americans had been unemployed. This sparked anxious conversations about the Sahm rule, according to which the US would be headed for recession when the three-month average unemployment rate rose 0.5 percentage points or more from its low during the previous 12 months.

The September report has laid such concerns to rest for now. Unemployment fell to 4.1%, from 4.2% in August. The consensus forecast had been for the jobless rate to hold steady.

Continued job creation and solid wage growth should increase confidence over the outlook for consumer spending. The resilience of US consumers has helped the US economy avoid recession. This resilience has been supported by growth in employment and wages. Both were stronger than expected in September.

The US generated a net 254,000 jobs over the month, well above the consensus forecast of 150,000 and the strongest monthly increase since January. Upward revisions added another 72,000 jobs to the prior two months. Average hourly earnings rose by 0.4% month over month, versus a consensus expectation for a 0.3% increase. The annual rate rose to 4%, from 3.8%.

Inflation is unlikely to stand in the way of Fed rate cuts to bolster US growth. The latest personal consumption expenditure data, the central bank's favorite measure of price pressures, showed annual inflation slowing to 2.2% in August, the lowest since February 2021. While the consumer price index (CPI) measure of inflation for the same month was less reassuring, this measure places a greater emphasis on owners' equivalent rent, which has remained higher than expected despite evidence of more modest rises in rents. Data for September will be released this week.

With inflation slowing, we expect 50 basis points of Fed easing for the last two meetings of 2024 and a further 100 basis points of cuts in 2025. Although the pace of cuts could shift if progress on inflation stalls or the labor market remains strong, this is not our base case.

So, our view remains that the rally in the equity market remains well supported. After weakness earlier in the week, the S&P 500 gained 0.9% on Friday after the employment data, taking the index to its fourth consecutive weekly advance.

Our base case is that the combination of a soft economic landing and Fed rate cuts will help the index rise to around 5,900 by the end of the year and to 6,200 by the middle of next year, from 5,751 as of Friday's close. As economic growth moderates, however, we expect the stocks of quality companies—those with robust balance sheets and solid earnings growth—to outperform. We have long been recommending investors to brace for further Fed rate cuts, shifting excess holdings in cash into more durable sources of income—including investment grade bonds and stocks with high and sustainable dividends.

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