



(UBS)

Monthly Letter: Geostationary orbit?

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Recent US data point toward a “no landing” scenario, in which inflation is close to the Fed’s target but growth remains at or above trend estimates. Within equities, we upgrade US and global equities (MSCI ACWI) to Attractive from Neutral.

Is the US economy set to defy expectations yet again? It wouldn’t be the first time this cycle. In 2022, the Federal Reserve and other central banks began what would become the fastest set 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.

First, the labor market is more resilient than expected, with the last nonfarm payrolls picking up and the three-month average payroll gain of 186,000 healthy enough to absorb labor supply growth, with unemployment falling. Second, the economy is stronger than previously thought. Recent revisions to the last five years’ data show that GDP growth has averaged 2.5% per year since 2019. Third, inflation data, while volatile month to month, overall continue to trend toward the Fed’s target. 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.

As a result, the economic expansion appears more sustainable, with limited risk of a near-term recession. However, with the current fed funds rate of 4.75-5.0% well above the Fed’s estimate of the neutral rate (2.9%), we think inflation will be low enough for the Fed to keep cutting rates: our base case is for a further 150 basis points of cuts by the end of next

year. This improved macro outlook strengthens our confidence that US corporate earnings will remain solid; we forecast 11% S&P 500 earnings growth in 2024 and 8% in 2025.

The US presidential election, which remains too close to call, may create volatility. We now see the presidential race as a dead heat. We see a 95% chance the Senate will switch to Republican control, and a 60% probability for divided government. But this is unlikely to derail these positive equity market fundamentals. We continue to believe that investors should not make dramatic changes based on expected election outcomes and should avoid knee-jerk reactions based on individual policies. Depending on who controls Congress, either candidate may struggle to push their agenda through.

Turning to China, the government is rolling out plans to support indebted local governments, recapitalize large state banks, and stabilize the property market. Efforts to accelerate the deployment of unused funds and ease local government indebtedness are positive. However, details are still lacking, and considerable uncertainty remains around the outcome. We think a more explicit commitment to multi-year stimulus is needed to break the debt-deflation cycle and revive consumer confidence.

Where does this leave our positioning?

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. Given the risks, we remain Neutral on China equities in our Asia strategy. We believe that it will still be possible to enter the market profitably once there is greater clarity. For investors with large allocations to China, the risks illustrate the need to consider diversification, and we do see opportunity in Asia Pacific more broadly, including in India and Taiwan.

Read more in our latest Monthly Letter, "[Geostationary orbit?](#)"

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