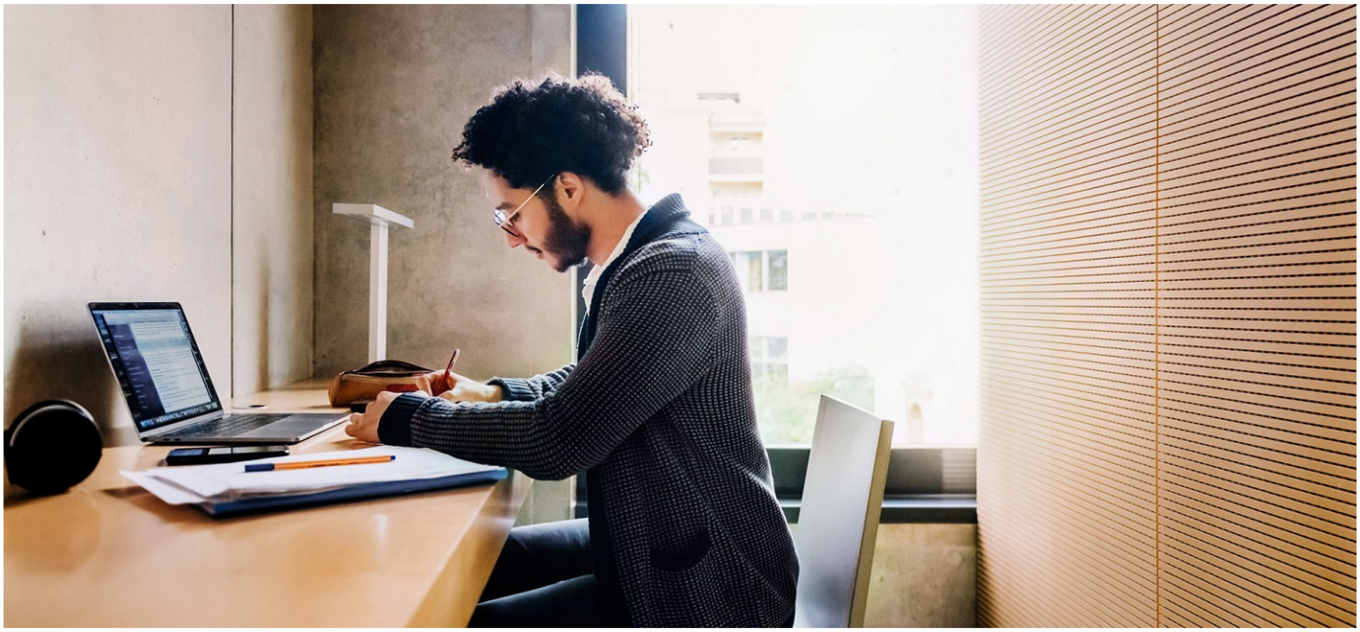
CIO advises investors to prepare for further bouts of market volatility, starting with ensuring adequate diversification. (UBS)

How to prepare portfolios for the fourth quarter

30 September 2024, 10:38 am CEST, written by UBS Editorial Team

Equity markets are approaching the end of the third quarter in high spirits. The S&P 500 struck a new all-time high after the Federal Reserve opted for a strong start to its rate-cutting cycle while reassuring investors that the US economy appears headed for a soft landing. That leaves global stocks on track to advance for a fourth consecutive quarter. Government bonds have also rallied, amid falling inflation and the prospect of further central bank rate cuts.

Market sentiment has also proven fragile, and investors will face a range of challenges in the final quarter of 2024.

The window of opportunity to prepare portfolios for central bank rate cuts has been narrowing. We have long been advising investors to position for the easing cycle, which is now well under way. The Fed, which was a latecomer to rate cuts, started with a larger cut than its peers, reducing rates by 50 basis points at its meeting last week. Top Fed officials are signaling they expect a further 50 basis points in the remaining two meetings of 2024, followed by another 100 basis points next year, based on the median projection in the dot plot. Meanwhile, the European Central Bank, Bank of England, and Swiss National Bank also look set to trim rates further.

This will erode returns on cash. Although we are Neutral on fixed income on a tactical basis, we believe it still makes sense for investors to shift excess cash out of deposit accounts and money market funds into assets offering more durable income. Strategies such as bond ladders, medium-duration investment grade bonds, and diversified fixed income can help maintain portfolio income.

The US election has the potential to unsettle markets, with some industries and currencies more vulnerable than others. The result of the US election could have a major impact on a range of public policy areas of interest to investors, from trade tariffs and business regulation to taxation and renewable energy. A clean sweep of power, in which one party gains control of both the White House and Congress, could lead to particularly significant policy shifts—creating a range of potential winners and losers, in terms of industry sectors and currencies. However, positioning strongly for a particular outcome has the potential to backfire—especially with polls showing the two parties still neck and neck.

As a result, we advise investors manage their exposure to election-sensitive industries, especially within the US consumer discretionary and renewable energy sectors, as well as to currencies like the Chinese yuan. That said, we expect the strategic rivalry with China to continue regardless of the outcome, supporting a positive outlook for companies exposed to reshoring.

Economic uncertainty and geopolitical conflicts could add to equity volatility. The Fed made a forceful case at its September meeting that the US economy remains on solid ground, with few signs of an impending recession. However, markets are likely to remain sensitive to weak economic releases. The conflict in the Middle East, meanwhile, has the potential to undermine market sentiment in the final quarter and beyond.

We advise investors to prepare for further bouts of market volatility, starting with ensuring adequate diversification. Investors lacking adequate exposure to AI can consider using bouts of market angst to seize the longer-term opportunity presented by this theme, which we expect to be a driver of markets in coming years. Those with high exposure can consider capital preservation strategies.

Alternative investment classes can also help cushion volatility and bolster long term returns—though they are only appropriate for those able to tolerate lower liquidity and less transparency, among other risks. Hedge funds with low correlations to traditional assets can help reduce overall portfolio volatility. Private equity and infrastructure can help diversify exposure to public equity markets, while private credit can offer an attractive alternative source of portfolio income.

So, despite continued uncertainty, we see a range of opportunities heading into the final months of the year. We still expect gains for stocks, bonds, and alternative assets over the next six to 12 months. For more details, read our **4Q outlook: Get ready.**

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