(UBS)

# Rate-cutting cycle starts with a bang

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**The Federal Reserve's interest rate decision was a key point of investor focus, with market pricing gyrating between a cut of 25 and 50bps in the run-up to the decision. While officials opted to go "big" and deliver a 50bp cut to start the easing cycle, in our view the more important consideration is whether the Fed is viewed by the market as being ahead of the curve.**

If these cuts are seen as insurance for an extended soft landing, the market risk rally is likely to continue. This interpretation is consistent with our view that the Fed is going to engineer an economic soft landing in the US, and this rate decision would only increase our confidence.

Our economic view is unchanged and is largely driven by expectations that growth and inflation will continue to moderate, because: (1) consumer spending is likely to cool but not crack; (2) real-time rent data points to a decline in the lagging indicator of shelter inflation, which is roughly a third of the CPI basket; and (3) the labor market is getting back into balance with almost all indicators of wage growth continuing to decline, which makes the threat of an inflation re-acceleration a low risk.

With our macro outlook for a soft landing, we remain neutral on equities and fixed income. As we expect another 50bps of cuts this year, we advise investors to **position for lower rates**. As rates continue to decline, cash and money market funds will offer lower yields, so investors need to manage their liquidity more actively. We prefer higher-quality fixed income versus riskier credit and see value in IG corporate bonds, Agency MBS, municipals and sustainable bonds.

Beyond fixed income, we believe investors should **seek quality growth** throughout their portfolio. Recent earnings growth has been largely driven by firms with competitive advantages and exposure to structural drivers that enable them to

grow and reinvest earnings. Within US equity sectors, we remain Most Preferred on financials, industrials and technology, and Least Preferred on real estate and materials.

While the US tech sector has grown significantly over the past year, we remain Most Preferred. With AI representing a key driver of growth, we see upside for the sector in both the short and long term. It is critical for investors to **seize the AI opportunity,** as we expect it to be a key driver of market returns over the coming years.

Looking beyond public markets, we continue to advise investors to **diversify with alternatives**. Our future should see significant investments in realms such as health care, digitalization, and energy efficiency. But already-high government debt levels suggest public spending for innovative solutions will be constrained. Private market managers that can provide debt or equity capital at different company lifecycle stages will have a key role to play. And with the majority of firms in the US now privately held, accessing private markets is essential to achieve enhanced portfolio diversification and improve longer-term risk-adjusted returns.

Lastly, we recommend investors **prepare for US elections**. As the election nears, we expect an increase in volatility across markets. For investors concerned about protecting their portfolio from election-related volatility, we recommend hedging strategies like gold and structured solutions with capital preservation features. We advise against selling risk assets ahead of the election while waiting for the outcome, and suggest investors express their political preferences at the ballot box, not in their portfolios.

For more, see **Yield & Income: At last**, published 26 September, 2024.

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