(UBS)

Asset Allocation: 2023's economic strength carries on

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Economic data continues to highlight the resiliency of the US economy, motivating the Fed to revise its median estimate of GDP growth up to 2.1% from 1.4% previously.

The economy's strength has been better than anticipated, while inflation has also been strong, with core CPI for February still 3.8% y/y.

The impressive resilience supports our expectation for a soft landing and no recession in the next 12 months. With inflation running below wage growth, real incomes are recovering, providing more support for the consumer.

With the economy likely to moderate and monetary policy still restrictive, inflation is unlikely to reaccelerate. The Fed agrees and held the median dot of their "dot plot" steady at the March FOMC meeting, implying three cuts this year. This is consistent with our view and market pricing.

With our macro-outlook for a soft landing, we keep bonds as most preferred and stay neutral on equities. Given the likely bumpy path of interest rates, stocks near all-time highs and many portfolios over concentrated in certain asset classes due to drift, we urge investors to **get in balance**. By diversifying across asset classes, regions and sectors, investors can hedge market risks while positioning for portfolio growth.

With the Fed likely to begin cutting rates in the coming months, investors should **manage liquidity** to ensure they aren't susceptible to reinvestment risk once rate cuts are further priced in. Additionally, investors should **buy quality bonds**, which we expect to deliver solid total returns as growth decelerates and inflation falls closer to target, with yields falling in tandem, providing a tailwind to returns. Specifically, we see value in US TIPS, IG, Agency MBS, CMBS, and sustainable bonds. Within US stocks we are neutral value vs growth and have a relative preference for small- over large-caps given the relative valuation discount for small-caps. We maintain our sector preferences this month with healthcare, industrials and tech most preferred and real estate and utilities least preferred.

With the AI revolution upon us, investors' future performance will hinge on their level of exposure to the technology sector. Thus, while we recommend that investors **optimize tech exposure** to ensure that they are appropriately exposed to the sector as a whole, they must also avoid the pitfalls of over concentration. While the "Magnificent 7" stocks already account for 18% of the global equity market (per MSCI ACWI), we expect the big to get bigger due to rapid earnings growth accreting to AI leaders.

While technology is a most preferred sector, we also suggest investors be wary of concentration and overexposure risks. We see **opportunities beyond technology** in quality companies (such as regional champions in Europe and Asia) with exposure to the energy transition, healthcare disruption, and water scarcity, as well as small- and mid-cap stocks.

Looking beyond public markets, we continue to advise investors to **diversify with alternatives**. Our future should see significant investments in realms such as healthcare, 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.

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Original report - **Yield and Income: March goes out like a dove, 28 March 2024**.

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