



CIO thinks the US central bank will find sufficient evidence of cooling in both inflation and the labor market to start cutting rates by mid-year. (UBS)

# Find durability in portfolio income

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**The case for US growth resilience remains firm. The US ISM manufacturing gauge—a key survey of US factory sentiment—rose to 50.3 in March, up from 47.8 in February and well above the market's forecast of a 48.3 print. The release marked the first reading above the 50 threshold that separates contraction from expansion since September 2022.**

Investors scaled back their expectations for Federal Reserve rate cuts this year in response to more upbeat manufacturing sentiment. Yields on the 10-year US Treasury rose 11 basis points to 4.32%, while a measure of the US dollar against major trading peers' currencies strengthened to its highest level since November 2023.

Details of the report were mostly solid, with the production subindex (54.6 versus 48.4 in February) and new orders (51.4 versus 49.2) both indicating expansion. The prices paid component climbed to its highest level since July 2022, somewhat clouding the outlook for falling goods prices to bring down overall inflation further (at least at the retail level) in the months ahead.

With a fairly substantial increase in the production subindex and mostly positive comments from the survey respondents, we do expect to see some improvement in US manufacturing output in the months ahead.

However, from an economic perspective, we do not want to overstate the significance of a PMI slightly above 50 as opposed to slightly below 50. Other key economic data, including the ISM services PMI and the labor report released later this week, are necessary to assess the holistic health of the world's largest economy.

We maintain the view that US growth should moderate to a more sustainable pace amid high prices and high interest rates, and inflation should recede as the year progresses. Last week, the personal consumption expenditure (PCE) index

pointed to easing price pressures, and Federal Reserve Chair Jerome Powell described the data as being “along the lines of what we would like to see.”

We think the US central bank will find sufficient evidence of cooling in both inflation and the labor market to start cutting rates by mid-year. We also expect cuts around the same time from the European Central Bank, following the Swiss National Bank’s first move last month. This means that cash will progressively deliver lower returns amid falling rates, creating a risk for investors who do not proactively manage their liquidity.

In addition to a combination of fixed-term deposits, bond ladders, and certain structured investment strategies, we see several ways for income-focused investors to generate durable yield from their portfolios:

**Buy quality bonds.** Robust economic growth and elevated inflation have kept bond yields high in recent months, but we still expect the 10-year US yield to fall to 3.5% by year-end. We therefore think that now is an attractive time to lock in yields of quality bonds, benefiting from potential capital gains if yields fall, and as a means of diversifying portfolios against risks. We also like sustainable bonds and actively managed fixed income strategies—the latter as a way potentially to invest across all corners of the fixed income spectrum in a risk-controlled way through professional management.

**Sell the risk of falling Brent crude oil prices.** Resilient oil demand and lower supply from OPEC+ countries should keep the market undersupplied, in our view, creating favorable conditions to sell the risk of falling Brent prices. Investors with more of a focus on capital appreciation—and a higher risk tolerance—can alternatively add exposure to longer dated Brent oil contracts.

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Original report - [Find durability in portfolio income amid data noise, 2 April 2024.](#)

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