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As the volatility dust settles, and market participants regain focus on the fundamentals, investors seem to realize that recessionary fears earlier this month were somewhat overblown (UBS).

Recent macro data defies the pessimists

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Over the past few days, US stocks have nearly fully recouped the losses posted earlier this month. This should serve as a reminder that while market hiccups may occur, the macro fundamentals continue to support our view of further US equity upside.

A review on the recent indicators — inflation and consumer demand

CPI and PPI figures were encouraging in July. Headline inflation fell to 2.9% year over year, down from 3.0% in June and reaching its lowest level since early 2021. Moreover, the PPI ex. food and energy print was lower than expected last month, a positive sign since this data feeds into core PCE, which happens to be the Fed's preferred inflation measure.

On its part, consumer spending data was robust last month, more than doubling median market expectations. Notably, retail sales at the control group, which are key for GDP estimates, showed growth of 0.3% m/m, also higher than market consensus of 0.1% m/m. Thus, although consumption growth has slowed compared to 2023, it remains rather robust and well above levels that would be aligned with recession concerns.

The market rally is being powered by data rather than the ever-changing headlines

As the disinflation trend deepens, along with healthy private consumption demand, it is difficult to justify recessionary fears. The recent market selloff, fueled by the uptick in unemployment rate and the triggering of the Sahm rule[1], may ultimately prove to be, like in the past few quarters, a lot of noise and little substance.

In our view, the macro context continues to be one in which inflation comes down, consumers are spending, and the Fed has room to cut in the near term. As the volatility dust settles, and market participants regain focus on the fundamentals, risk appetite is recovering. Unsurprisingly, the S&P 500 is up roughly 7% relative to its post-payrolls low earlier this month.

Bottom line

At this point, we think the risk reward for stocks is compelling, which is why our price targets suggest healthy upside. We forecast the S&P 500 to close the year at 5,900 and to be at 6,200 by June 2025. We are most preferred the information technology sector and industrials, while we are least preferred on consumer discretionary and real estate. Finally, we highlight that even though we are neutral in terms of size, we acknowledge that the looming easing cycle should benefit small-caps balance sheets, given these firms dependence on short-term variable interest rate financing.

For more on this please see — UBS Trending: The data is in...

Also, please see — Key data argues against aggressive rate cuts

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[1] The Sahm Rule, developed by economist Claudia Sahm, signals the start of a recession when the three-month average unemployment rate rises by 0.5 percentage points or more relative to its low over the previous 12 months.

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