With economic growth and inflation slowing, central banks may accelerate interest rate cuts. (UBS)

How should I position for lower interest rates?

26 August 2024, 4:01 pm CEST, written by UBS Editorial Team

With economic growth and inflation slowing, central banks may accelerate interest rate cuts. Cash yields could drop sharply from here, so we believe investors should act to invest excess cash and money market holdings.

Fixed income yields have fallen in recent weeks, but relative to cash, we think the risk-return profile is attractive for investment grade bonds, diversified fixed income portfolios, and "quality" equities with high and sustainable dividends. In fixed income, we like durations between one year and 10 years and target an average portfolio duration of around five years.

The Fed is expected to start policy easing in September.

- Fed Chair Jerome Powell said at the Jackson Hole Symposium that the "time has come for policy to adjust."
- Minutes of the Fed’s July meeting showed that most officials were strongly inclined toward a rate cut in September, with several even open to an immediate reduction last month.

Investors need to act as returns on cash are eroded around the world.

- Historically, cash has only outperformed bonds early in the hiking cycle, with global bonds starting to outperform even before rates peaked.
- We see the 10-year US Treasury yield falling to 3.50% by March 2025, as rate cuts gain traction.
- Switzerland, Sweden, Canada, the UK, and the European Central Bank have all started their rate-cutting cycles. We expect more to join in the coming months.

We see several strategies to position for lower rates.

- Quality bond ladders and structured investments can help investors manage their liquidity.
- We recommend investors shift excess cash into quality fixed income, including investment grade corporate bonds. Diversified fixed income strategies can also help enhance portfolio yield.
- Equity income strategies, including dividends and volatility-selling strategies, are increasingly attractive alternatives to cash.

Did you know?

- A 60/40 portfolio of US large-cap securities and bonds beat cash around 80% of the time over a five-year period, based on data going back to 1926.
- To cover net expected portfolio withdrawals over the next one to three years, investors can consider buying a series of individual short-duration bonds of varying maturities (bond ladders), staggering their expiry to provide a steady stream of income.
- For cash currently earmarked for longer-term spending needs, investors should consider structured investment strategies that provide exposure to market gains.

Investment view

We believe investors should act to invest excess cash and money market holdings as cash yields could fall quickly. Quality bond ladders and structured investment strategies can offer investors some of the certainty provided by cash, but with higher return potential as rates fall. Investors should also consider investment grade bonds, diversified fixed income strategies, and equity income strategies to deploy cash.

Main contributors - Daisy Tseng, Alison Parums

Original report - **How should I position for lower interest rates?, 26 August 2024.**

Important information

As a firm providing wealth management services to clients, UBS Financial Services, Inc is registered with the U.S. Securities and Exchange Commission (SEC) as an investment adviser and a broker-dealer, offering both investment advisory and brokerage services. Advisory services and brokerage services are separate and distinct, differ in material ways and are governed by different laws and separate contracts. It is important that you carefully read the agreements and disclosures UBS provides to you about the products or services offered. For more information, please visit our website at www.ubs.com/workingwithus.
© UBS 2024. All rights reserved. UBS Financial Services Inc. is a subsidiary of UBS AG. Member FINRA/SIPC.
There are two sources of UBS research. Reports from the first source, UBS CIO Global Wealth Management, are designed for individual investors and are produced by UBS Global Wealth Management (which includes UBS Financial Services Inc. and UBS International Inc.). The second research source is UBS Group Research, whose primary business focus is institutional investors. The two sources operate independently and may therefore have different recommendations. The various research content provided does not take into account the unique investment objectives, financial situation or particular needs of any specific individual investor. If you have any questions, please consult your Financial Advisor. UBS Financial Services Inc. is a subsidiary of UBS AG and an affiliate of UBS International Inc.