CIO continues to expect equity gains ahead, recommending investors consider ways to manage potential volatility, including structured strategies and hedge funds. (UBS)

Consider ways to manage potential volatility

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Investors' risk appetite has continued to improve in recent days. The S&P 500 index has hit fresh highs in three of the past four trading sessions. The VIX index of implied stock volatility, a popular measure of fear in US markets, has fallen below its long-term average of 20.

Brent crude oil has also subsided back below USD 75 per barrel, having climbed over USD 80 earlier in the month after news reports suggested Israel would avoid targeting Iranian oil or nuclear facilities. Safe haven demand for gold also appears to be moderating slightly.

We maintain our view that risk assets have further room to run amid an overall supportive macro environment. But volatility could increase again as a range of economic and market uncertainties return to focus.

Uncertainty over the Federal Reserve's policy path has the potential to lead to market swings. Fed Governor Christopher Waller signaled on Monday that the pace of further interest rate cuts should proceed with "more caution" compared to the 50-basis-point reduction in September, noting that recent labor, inflation, and growth data suggested that the economy may not be slowing as much as desired. Minneapolis Fed President Neel Kashkari also said "further modest reductions" in the US central bank's benchmark interest rate will be appropriate in the coming quarters. We think these remarks are consistent with the Fed's data-driven stance, but expect market swings as investors continue to debate over the Fed's next move.

Geopolitical tensions in the Middle East are unlikely to abate in the near future. While Israel may decide not to target oil or nuclear facilities in Iran, tensions in the region remain elevated. Benjamin Netanyahu's offices said the country would decide its actions according to its own national interest, as it further expanded the fighting with Hezbollah militants in Lebanon on Monday. Our base case remains that an all-out war between Israel and Iran can be avoided, but the risks for further deterioration has increased after Iran launched a barrage of missiles earlier this month in response to Israel's assaults on Lebanon.

The US presidential election remains a tight race. With just three weeks to go to Election Day, campaign rhetoric is likely to heat up amid a tightening competition. Both ABC News/Ipsos and CBS News/YouGov polls of likely voters showed a narrow two- to three-point lead for Vice President Kamala Harris, while an NBC News survey of registered voters nationwide reveals a dead heat between the two candidates. We anticipate uncertainty and volatility to rise until the next US administration is settled.

So while we continue to expect equity gains ahead, we recommend investors consider ways to manage potential volatility, including structured strategies and hedge funds. We also think exposure to gold and oil can be effective portfolio hedges.

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Original report: **Prepare for volatility despite improving risk sentiment, 15 October 2024.**