Our macro outlook considers a soft landing where US inflation and growth moderate and the Fed starts cutting rates in September. We favor quality bonds and remain neutral on US equities. (UBS)

How are we positioned? 7.22.2024

22 July 2024, 4:54 pm CEST, written by UBS Editorial Team

We see a supportive backdrop for both US bonds and equities. Within equities, we are most preferred on the technology sector and industrials. In fixed income, we favor locking in yields via quality issuers, given the potential for capital appreciation in 2H24. We are most preferred in (IG) corporate bonds, AAA rated CMBS, and agency MBS.

We recommend:

1. **Position for lower rates**: Use available pockets of liquidity to fund positions in quality bonds ahead of the decline in interest rates.
2. **Seize the AI opportunity**: Strong first quarter earnings from big tech companies underline our conviction that the AI growth case remains intact.
3. **Prepare for the US election**: Investors should vote at the ballot box and not with their portfolio. However, the election will affect markets and investors should be aware of potential risks to their wealth.

Our central view:

Base case: A "soft landing," with the Fed starting to trim rates as growth and inflation cool off. Our central scenario is that Fed will cut a total of 50bps this year, with the first easing move in the September meeting.

Asset class views:

Our preferred asset class remains fixed income; we keep US equities neutral, but acknowledge that they have a constructive macro backdrop.

Fixed income: We favor quality bonds, given the potential for capital appreciation as inflation recedes and yields drift lower in 2H24. We are therefore most preferred in (IG) corporate bonds, AAA-rated CMBS, and agency MBS.

Equities: We see modest upside overall, and focus on capital preservation strategies and selectivity.

- **US equities:** We increased our year-end target to 5,900, from 5,500 previously. We believe the backdrop for US stocks is constructive, given solid earnings growth, AI tailwinds, and the potential for rate cuts before year-end.
  - **Style:** Neutral on value versus growth.
  - **Size:** We are also neutral on US small caps relative to US large caps. Having said that, we think small-cap valuations are very attractive both relative to their own history and versus large caps.
  - **Sectors:** Most preferred—information technology and industrials. Least preferred—consumer discretionary and real estate.
- **UK equities:** Most preferred. With the improving global manufacturing outlook, we have positive views on oil and industrial metal prices, which should boost profits for the UK's commodity-linked sectors. In addition, the outlook for domestic consumption is likely to improve amid a resilient labor market and normalizing inflation.
- **EM equities:** Neutral. From a macroeconomic standpoint, although activity in emerging markets remains resilient, the positive momentum has slowed, especially with China's economic data softening during 2Q24. From here until the year-end, we are penciling in mid-single-digit total returns for the MSCI EM benchmark.

Alternatives: We think alternatives should be a core component of portfolios, as these allocations can help investors navigate a shifting interest rate, technological, and political backdrop. Hedge fund strategies that offer low correlations to traditional asset classes can help reduce overall portfolio volatility. Private equity offers investors the opportunity to invest in growing companies, including those exposed to AI, that are not listed on public markets.

Cash: We expect cash to progressively deliver lower returns as interest rates fall in 2024. Investors should transition cash and money market holdings into high-quality corporate and government bonds as well as potential beneficiaries of lower rates in equities.

Currencies and commodities: We think there are interesting opportunities, but selectivity is important.

- **FX:** We are most preferred CHF. Euro zone geopolitical concerns support the Swiss franc in the short term, while declining interest rate differentials should underpin the currency over the longer term.
- **Gold:** We are most preferred. We believe the case for gold as an attractive diversifier remains strong. Central bank buying, geopolitical tensions, and likely lower US interest rates are all supportive for gold prices.
- **Oil:** We are most preferred. We see tight supply/demand balances offering support to prices.

Base case forecasts for December 2024:

- S&P 500 Index: 5,900
  - Healthy earnings growth, AI tailwinds, and potentially looser financial conditions provide a constructive backdrop for equity markets in the balance of the year.
- S&P 500 EPS: USD 250 (+11% year over year)
- 10-year US Treasury yield: 3.85%
- Brent oil: USD 87/bbl
- Gold: USD 2,600/oz
- EURUSD: 1.09

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Non-Traditional Assets

Non-traditional asset classes are alternative investments that include hedge funds, private equity, real estate, and managed futures (collectively, alternative investments). Interests of alternative investment funds are sold only to qualified investors, and only by means of offering documents that include information about the risks, performance and expenses of alternative investment funds, and which clients are urged to read carefully before subscribing and retain. An investment in an alternative investment fund is speculative and involves significant risks. Specifically, these investments (1) are not mutual funds and are not subject to the same regulatory requirements as mutual funds; (2) may have performance that is volatile, and investors may lose all or a substantial amount of their investment; (3) may engage in leverage and other speculative investment practices that may increase the risk of investment loss; (4) are long-term, illiquid investments, there is generally no secondary market for the interests of a fund, and none is expected to develop; (5) interests of alternative investment funds typically will be illiquid and subject to restrictions on transfer; (6) may not be required to provide periodic pricing or valuation information to investors; (7) generally involve complex tax strategies and there may be delays in distributing tax information to investors; (8) are subject to high fees, including management fees and other fees and expenses, all of which will reduce profits.

Interests in alternative investment funds are not deposits or obligations of, or guaranteed or endorsed by, any bank or other insured depository institution, and are not federally insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board, or any other governmental agency. Prospective investors should understand these risks and have the financial ability and willingness to accept them for an extended period of time before making an investment in an alternative investment fund and should consider an alternative investment fund as a supplement to an overall investment program.

In addition to the risks that apply to alternative investments generally, the following are additional risks related to an investment in these strategies:

- Hedge Fund Risk: There are risks specifically associated with investing in hedge funds, which may include risks associated with investing in short sales, options, small-cap stocks, "junk bonds," derivatives, distressed securities, non-U.S. securities and illiquid investments.
- Managed Futures: There are risks specifically associated with investing in managed futures programs. For example, not all managers focus on all strategies at all times, and managed futures strategies may have material directional elements.
- Real Estate: There are risks specifically associated with investing in real estate products and real estate investment trusts. They involve risks associated with debt, adverse changes in general economic or local market conditions, changes in governmental, tax, real estate and zoning laws or regulations, risks associated with capital calls and, for some real estate products, the risks associated with the ability to qualify for favorable treatment under the federal tax laws.
- Private Equity: There are risks specifically associated with investing in private equity. Capital calls can be made on short notice, and the failure to meet capital calls can result in significant adverse consequences including, but not limited to, a total loss of investment.
- Foreign Exchange/Currency Risk: Investors in securities of issuers located outside of the United States should be aware that even for securities denominated in U.S. dollars, changes in the exchange rate between the U.S. dollar and the issuer's "home" currency can have unexpected effects on the market value and liquidity of those securities. Those securities may also be affected by other risks (such as political, economic or regulatory changes) that may not be readily known to a U.S. investor.