CIO expects the S&P 500 to hit 6,600 by end-2025 and suggests that underallocated investors consider using any near-term turbulence to add to US stocks, including through structured strategies. (UBS)

Investor positioning in the new year

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Markets ended 2024 in a more cautious mood as investors scaled back expectations for the Federal Reserve's pace of rate cuts after a hawkish December policy meeting. The MSCI All Country World and the S&P 500 lost 1.6% and 2.4%, respectively, in the final month of the year. But most of the decline took place in the final three trading sessions of the year, when liquidity was thin.

Despite the retreat in December, global stocks returned 20.7% for 2024 overall. The gains were led by the S&P 500, with a return of 25%. This was the second consecutive year in which the index advanced more than 20%, with US large-cap stocks delivering their best two-year performance this century. The S&P 500 also gained ground for the fifth consecutive quarter. China also delivered its first positive annual outcome since 2020 on hopes that more forceful stimulus would end a period of subpar economic growth, with the MSCI index returning close to 20%. Optimism in Japan also contributed to a similar outcome. And while performance in Europe lagged, it was still positive.

Gold was also a standout performer for 2024, returning 27.8%, boosted by heavy central bank buying, geopolitical concerns, and a decline in the opportunity cost of holding the zero-yielding asset as US rates fell.

It was a more mixed year for fixed income. The 10-year US Treasury yield has now moved up for four consecutive years for the first time since the 1980s. And the return on the Bloomberg US Treasury index was just 0.6%, as unexpectedly resilient US GDP growth dampened the outlook for rate cuts. The Bloomberg Pan European Aggregate returned 2.7%. Returns on investment grade were solid with 2% in US dollar and 4.7% in euro terms.

The key question for investors is what comes next. The main shift in December was that the markets scaled back expectations for the pace of Fed easing in 2025, following a hawkish meeting. The median forecast from top Fed officials is now for just 50 basis points of cuts this year, half the level previously forecast.

We see several key implications for investor positioning in the new year:

In **fixed income**, we continue to believe that high grade and investment grade bonds, diversified fixed income, and equity income strategies are valuable in a portfolio context. Although our base case no longer expects materially lower US or Swiss interest rates in 2025, we see absolute fixed income yields as appealing and believe that investors should consider diverse sources of income as cash rates could still fall sharply if there are surprise weaknesses in economic data. Overall, while positioning for lower rates may no longer be as urgent, putting cash to work and seeking durable income should remain a strategic priority for investors.

In **US equities**, notwithstanding fewer likely rate cuts, we see a favorable backdrop ahead—driven by a mixture of lower borrowing costs, resilient US activity, a broadening of US earnings growth, further AI monetization, and the potential for greater capital market activity under a second Trump administration. We expect the S&P 500 to hit 6,600 by end-2025 and suggest that underallocated investors consider using any near-term turbulence to add to US stocks, including through structured strategies.

In **foreign exchange markets**, we suggest investors sell further US dollar strength. Shifting expectations for Fed and US government policy have supported the US dollar in the weeks since we published the Year Ahead, and we continue to believe its valuation is stretched. While we do not expect significant near-term weakness, we think that investors should use further strength in the greenback to diversify into other preferred currencies, including the British pound and the Australian dollar.

In **commodity markets**, if the Fed only delivers two rate cuts in 2025, we would likely need to moderate our expectations for gold demand from exchange-traded funds, which could run counter to our expectation for further gains in bullion prices. However, we note that gold prices have risen materially in recent years despite a strong USD and higher US interest rates—in part due to central bank reserve diversification and in part due to investor demand for hedges. We believe these trends will continue as political and geopolitical uncertainties persist, driving continued demand for gold.

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