While risk sentiment is likely to remain fragile, CIO continues to see a favorable macro backdrop for equities and bonds, and believes that market fundamentals should benefit these asset classes. (UBS)

Fundamentals should continue to support equities and bonds

08 January 2025, 1:54 pm CET, written by UBS Editorial Team US Editorial Team

US equities and Treasuries fell on Tuesday following the release of stronger-than-expected economic data.

US job openings in November rose to a six-month-high, with available positions increasing to 8.1 million, from an upwardly revised 7.8 million in October, according to the Job Opening and Labor Turnover Survey (JOLTS) from the Bureau of Labor Statistics. In addition, the ISM services index for December rose to 54.1, with the sub-index for prices paid surging to its highest level since early 2023. Markets took these data points as an indication of a resilient labor market and inflationary pressures within the service sector, and further scaled back expectations for how much the Federal Reserve will lower rates this year.

But while risk sentiment is likely to remain fragile, we continue to see a favorable macro backdrop for equities and bonds, and believe that market fundamentals should benefit these asset classes.

Further Fed cuts remain in store this year. The labor report for December due this Friday and inflation data next week will provide more details on the state of the US economy. While the Fed is unlikely to cut interest rates at its first policy meetings of 2025, we expect data in the coming months to show slowing inflation and a softening labor market, allowing the US central bank to start cutting again by the June policy meeting. In line with the Fed’s latest economic projections, we expect a second rate reduction to follow later this year, most likely in the third quarter.

Healthy corporate profit growth should continue to support equities. While US equity valuations are higher than the historical average, we believe they reflect the current positive economic conditions. Valuations historically have also had little correlation with returns over the next 12 months. Instead, with lower borrowing costs, resilient US economic activity, further AI monetization, and the potential for greater capital markets activity under a second Trump administration, we expect healthy profit growth of 9% for S&P 500 companies in 2025. This should help equities gain further ground.

So while volatility is likely to persist in the year ahead, potentially driven by tariffs, fiscal battles in Congress, inflation trends, Fed actions, and the outlook for economic growth, we believe the fundamentals should continue to support equities and bonds. Our year-end S&P 500 price target of 6,600 would represent a near 12% gain versus Tuesday's index close. We also believe quality bonds and diversified fixed income strategies remain valuable in a portfolio context as cash returns fall.

Main contributors: Solita Marcelli, Mark Haefele, David Lefkowitz, Vincent Heaney, Daisy Tseng, Christopher Swann

Original report: **Market fundamentals remain supportive, 8 January 2025.**