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Monthly Letter: Decision time

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As we look ahead to the second half of the year, it is decision time—for the Federal Reserve, for US voters, and for investors. In our latest Monthly Letter, we discuss how investors can ensure their portfolios are well positioned for the months ahead.

Several key events look set to determine the investment landscape in the second half of 2024. The US will elect its next president, artificial intelligence (AI) should continue its rapid advance, and we the Federal Reserve should begin to cut interest rates.

The real focus for investors will be on how these events shape expectations for 2025: whether rate cuts will signal even lower policy rates, if AI investments will justify its hype, and how the next US administration's policies might affect the economy and markets.

We believe that maintaining a long-term core allocation to equities, bonds, and alternatives should help investors navigate this uncertainty. However, we also see opportunities to take decisive action now to ensure portfolios are well positioned for the months ahead.

Prepare for lower interest rates. We recommend that investors prepare for lower interest rates by moving excess cash holdings into quality fixed income. Interest rate cuts have already started in some major markets, and we expect more in the second half with economic growth and cooling inflation. The Fed is on track to cut rates in September. And we expect bond yields to move lower as the market's focus shifts from the timing of the Fed's first cut, to considering how far rates might fall.

In currencies, lower US rates could add to pressures on the US dollar over the medium term. So we recommend investors sell into periods of dollar strength. We move the Swiss franc to most preferred: We expect only limited further policy easing from the Swiss National Bank, and the franc is typically a good haven in times of volatility. Lower interest rates should also help create a supportive environment for equities, and we expect the UK market, select Eurozone small and midcaps, and certain US housing names to be among the beneficiaries.

Focus on opportunities in AI and quality growth. With AI likely to be a key driver of equity returns over the coming years, we recommend that investors make sure they build sufficient exposure to the industry. We like the semiconductor companies that are benefiting from high rates of AI investment, and the vertically integrated megacaps that are well positioned across the AI value chain. That said, there's a risk that fears about over-investment could lead to a correction in the second half. But we believe capital preservation strategies can help investors navigate this risk.

The idea of looking for quality growth also applies to other parts of the equity market beyond tech, in our view. Recent earnings growth has been driven mainly by firms with strong competitive advantages and exposure to major structural trends. We expect that to continue, and favor quality growth companies within equities.

Prepare portfolios for the US election. As November's US election gets closer, it is important to remember the principle that investors should vote at the ballot box, and not with their portfolio. But as the election is likely to trigger market volatility, investors should manage risks accordingly.In US equities, we recommend managing exposure to sectors like consumer discretionary and renewables, which could be vulnerable in a scenario of a Republican sweep of both the White House and Congress. On the other hand, we think financials would stand to benefit in that scenario. We also think gold can be an effective hedge against concerns about geopolitics, inflation, or the high US budget deficit.

The second half of 2024 is set to be a time of transition and volatility given advances in AI, changes in interest rates, and uncertainty around the US election. We think the decisions that investors make now will be key to navigating this period effectively. We recommend a balanced approach, diversified across bonds, equities, and alternatives, to position for long-term financial goals while navigating near-term uncertainties.

Read more in our latest Monthly Letter, "Decision time," and in our *Outlook for the second half of 2024* (published 20 June 2024). Watch a short video on these themes here.