

Preparing portfolios for the fourth quarter

Weekly Global

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Deeper Dive

Equity markets are approaching the end of the third quarter in high spirits. The S&P 500 struck a new all-time high after the Federal Reserve opted for a strong start to its rate-cutting cycle while reassuring investors that the US economy appears headed for a soft landing.

That leaves global stocks on track to advance for a fourth consecutive quarter. Government bonds have also rallied, amid falling inflation and the prospect of further central bank rate cuts.

But market sentiment has also proven fragile, and investors will face a range of challenges in the final quarter of 2024.

The window of opportunity to prepare portfolios for central bank rate cuts has been narrowing. We have long been advising investors to position for the easing cycle, which is now well under way. The Fed, which was a latecomer to rate cuts, started with a larger cut than its peers, reducing rates by 50 basis points at its meeting last week. Top Fed officials are signaling they expect a further 50 basis points in the remaining two meetings of 2024, followed by another 100 basis points next year, based on the median projection in the dot plot. Meanwhile, the European Central Bank, Bank of England, and Swiss National Bank also look set to trim rates further.

This will erode returns on cash. Although we are Neutral on fixed income on a tactical basis, we believe it still makes sense for investors to shift excess cash out of deposit accounts and money market funds into assets offering more durable income. Strategies such as bond ladders, medium-duration investment grade bonds, and diversified fixed income can help maintain portfolio income.

The US election has the potential to unsettle markets, with some industries and currencies more vulnerable than others. The result of the US election could have a major impact on a range of public policy areas of interest to investors, from trade tariffs and business regulation to taxation and renewable energy. A clean sweep of power, in which one party gains control of both the White House and Congress, could lead to particularly significant policy shifts—creating a range of potential winners and losers, in terms of industry sectors and currencies. However, positioning

From the studio: Podcast — [Investors' Club: Chief Economist Paul Donovan on the Fed's cut](#) (10:45)

Will the Fed's favorite inflation measure reinforce recent economic optimism?

The Fed last week painted an upbeat picture of an economy in which growth is moderating only gradually and inflation is on track to return to the 2% target. Investors will be looking for confirmation of this outlook from the Fed's preferred gauge of inflation—the personal consumption expenditures index—which is released on Friday. Also this week, we get data on personal consumption and savings. Here investors will be hoping for reassurance that American households remain resilient and continue to spend.

Will the Swiss National Bank continue the global rate-cutting cycle?

The Swiss central bank kicked off the international trend toward lower borrowing costs back in March. There was a further cut in June. This week, policymakers meet again to decide whether to go for a third cut. We think another 25-basis-point reduction is likely.

Can equities gain further ground? The S&P 500 reached a new all-time high last week, on optimism that the Fed will act forcefully to defend growth and employment. This adds to a backdrop of robust earnings per share growth and optimism over the outlook for AI. But after a 21% return so far in 2024, many investors will be asking whether the market can rally further.

strongly for a particular outcome has the potential to backfire—especially with polls showing the two parties still neck and neck.

As a result, we advise investors manage their exposure to election-sensitive industries, especially within the US consumer discretionary and renewable energy sectors, as well as to currencies like the Chinese yuan. That said, we expect the strategic rivalry with China to continue regardless of the outcome, supporting a positive outlook for companies exposed to reshoring.

Economic uncertainty and geopolitical conflicts could add to equity volatility. The Fed made a forceful case at its September meeting that the US economy remains on solid ground, with few signs of an impending recession. However, markets are likely to remain sensitive to weak economic releases. The conflict in the Middle East, meanwhile, has the potential to undermine market sentiment in the final quarter and beyond.

We advise investors to prepare for further bouts of market volatility, starting with ensuring adequate diversification. Investors lacking adequate exposure to AI can consider using bouts of market angst to seize the longer-term opportunity presented by this theme, which we expect to be a driver of markets in coming years. Those with high exposure can consider capital preservation strategies.

Alternative investment classes can also help cushion volatility and bolster long term returns—though they are only appropriate for those able to tolerate lower liquidity and less transparency, among other risks. Hedge funds with low correlations to traditional assets can help reduce overall portfolio volatility. Private equity and infrastructure can help diversify exposure to public equity markets, while private credit can offer an attractive alternative source of portfolio income.

So, despite continued uncertainty, we see a range of opportunities heading into the final months of the year. We still expect gains for stocks, bonds, and alternative assets over the next six to 12 months. For more details, read our [4Q outlook: Get ready](#).

Key Messages

Fed fuels optimism over a US soft landing

The S&P 500 struck a fresh record high last week, after the Federal Reserve launched its easing cycle with a 50-basis-point cut while expressing confidence that the economy remains resilient. Fed Chair Jerome Powell framed the cut, which was larger than the 25-basis-point steps taken by other top central banks, as a move designed to support growth and employment rather than suggesting elevated concern over the risk of a recession.

But the Fed also signaled that rate cuts had considerably further to go before monetary policy hit a neutral rate—the level at which borrowing costs are neither suppressing growth nor boosting it. The median forecast from top Fed officials is now for 150 basis points of further easing by the end of 2025.

This is part of a broader global easing cycle that will further erode returns on cash. The Swiss National Bank this week looks set to trim borrowing costs for the third time in 2024. Meanwhile, we expect both the European Central Bank and Bank of England to ease policy by another 100 basis points by September 2025.

Takeaway: We have long been advising investors to position for the easing cycle, which is now well underway. Investors should shift excess cash out of deposit accounts and money market funds into assets such as bond ladders, medium-duration investment grade bonds, and diversified fixed income strategies, which can help maintain portfolio income.

Get ready for the fourth quarter

As the third quarter nears its end, investors have been in an upbeat mood overall. Global and US stocks struck all-time highs after the Federal Reserve opted for a strong start to its rate-cutting cycle. Government bonds have also rallied, amid falling inflation and the prospect of further central bank rate cuts.

But while we remain positive on the outlook, investors look likely to confront a variety of challenges and risks in the final three months of the year.

The period of the largest gains for fixed income may have passed after the strong rally over recent months, as investors have braced for further central bank rate cuts. However, while we are Neutral on fixed income on a tactical basis, it still makes sense for investors to shift excess cash reserves into assets offering more durable income as the easing cycle continues.

Second, the final stages of the US election campaign could unsettle markets, with some industries and currencies more vulnerable than others. Instead of positioning aggressively for a particular outcome, we advise investors to manage exposure to election-sensitive markets and consider broader hedges, such as gold and the Swiss franc.

Takeaway: While we see a positive outlook for the final quarter of the year, investors should expect bumps in the road. In addition to preparing for lower rates and election-related swings, we favor considering exposure to alternatives to mitigate volatility—though only for those willing and able to tolerate lower liquidity and less transparency. A range of hedge fund strategies are well-placed to navigate turns in the monetary policy cycle along

with geopolitical uncertainties. Private markets have the potential both to dampen volatility and lift long-term returns.

The rally in gold looks well-supported

The price of the precious metal hit at a record high of USD 2,630 an ounce on Monday, and is now up more than 27% since the start of the year. That puts gold on track for its largest annual gain in 14 years. The Fed's decisive start to monetary easing has added extra momentum to the rally in gold by lowering the opportunity cost of holding zero-yielding assets.

Despite the extent of recent gains, we believe the rise in gold is well-supported and could go further. The Fed is just at the start of its cycle and the median estimate of top officials is for a further 150 basis points of easing by the end of 2025.

Investment demand is strong. Inflows into gold exchange-traded funds rose in August for the fourth consecutive month, according to data from the World Gold Council. Hedging demand for gold should also remain elevated, amid heightened political uncertainty in the US and the conflict in the Middle East. Israel's military on Monday carried out new strikes on southern Lebanon, following exchanges of fire between the Israeli Defense Force and Hezbollah on Sunday.

Takeaway: Our base case is for gold to trade around USD 2,700 an ounce by mid-2025. We continue to recommend gold as a hedge, with a Most Preferred stance in our global asset strategy.

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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.

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