13 January 2025, 11:05AM UTC
Chief Investment Office GWM
Investment Research

Strong US data unsettle markets

Weekly Global

Mark Haefele, Global Wealth Management Chief Investment Officer, UBS AG

Deeper Dive

What happened?

US stocks and bonds both came under pressure last week after robust US economic data heightened concerns that the Federal Reserve may see little scope for cutting rates in 2025.

The S&P 500 declined 1.5% following the release of the employment data, which showed the US economy generating a net 256,000 jobs last month—far above the consensus expectation for 163,000. The unemployment rate fell to 4.1%, down from 4.2% in the prior month and the same level as in June. The yield on the 10-year US Treasury bond rose by 10 basis points to 4.77%, its highest level since 2023. For the week overall, the S&P 500 was 1.9% lower, and futures are trading 0.6% lower at the time of writing.

Friday's jobs data came after a series of resilient economic releases earlier in the week, including a JOLTS survey that showed job openings rising to the highest level in six months. The ISM survey also pointed to stronger activity than expected in the services sector, while the prices paid component of the release was the highest since 2023, raising questions about progress toward disinflation.

The recent string of data looks set to reinforce worries among top Federal Reserve officials that the task of returning inflation to its 2% target is not yet completed, and there is no rush to cut rates further. This view was reflected in the minutes of the Fed's final policy meeting of 2024, with officials indicating there was "more work to do on inflation." The median forecast of Fed officials fell to just 50bps of further easing this year at the December meeting, half the prior rate. As of the end of last week, markets were only pricing 29bps of Fed cuts, down from 39bps at the start of the week.

What do we expect?

Surprisingly strong economic data from the US were a major theme in 2024, with investors moving from fearing a recession to hoping for a soft landing and eventually no landing at all. This trend seems to be continuing into 2025.

However, while the US economy looks set to remain resilient, we still see the pace of growth moderating and progress resuming toward the Fed's inflation target. As a result, we believe there will be scope for the Fed to ease policy by a further 50bps later in the year.

Questions for the week ahead

Can easing inflation lead to quicker Fed rate cuts this year? Last week's strong labor and services activity data has dampened hopes over the outlook for monetary easing this year in the US. Might the release this week of the consumer price index for December revive it? Investors are expecting the core monthly measure, which excludes volatile food and energy prices, to slow to 0.2% from 0.3% previously. That could provide some reassurance that the fall in inflation is resuming. But markets and the Fed are likely to require more than this to assume a faster pace of easing again.

Will upcoming price data support the ECB's easing cycle? Retail sales rose in the Eurozone rose by just 0.1% in November, falling short of expectations for a 0.4% rise. The focus for European investors now turns to this week's inflation data. Markets anticipate a pickup in inflation, from 2.2% to 2.4% year over year, driven by higher energy prices and persistent service costs. But while inflation isn't easing as quickly as many had hoped, the overall trend is still expected to decline, particularly amid sluggish growth and a softening labor market.

Can upcoming economic data signal a recovery for Chinese equities? The latest inflation data showed the full-year CPI rose just 0.2%, well below the official target of around 3%. Investors are now closely watching this week's GDP figures for the fourth quarter, along with retail sales and industrial output for December, hoping for signs that deflationary pressures are easing.

On inflation, the December Fed minutes highlighted increased upside risks to the outlook, including potential impact from trade and immigration policy changes. But, disinflation across core goods and services remains evident, and housing price increases are expected to ease, which should bring down overall inflation, allowing the Fed to start cutting rates again. Next week there will be several key data releases, including the consumer price index (CPI), producer price index (PPI), retail sales, and industrial production. The Fed will also publish its Beige Book, which will provide further insight.

In fixed income, global yields have increased, led by US Treasuries and UK gilts. Investor caution stems from concerns over the UK's expansionary budget, increased bond supply, and scaled back expectations for Fed rate cuts. In the US, fears that President-elect Trump's policies could boost inflation and strain fiscal conditions, along with heavy January corporate bond issuance, have added upward pressure. However, we expect bond yields to decline as rates fall, forecasting the 10-year yield to reach 4% by mid-2025.

How do we invest?

A bout of volatility was to be expected against a backdrop of continued economic uncertainty and as investors prepare for the start of a second Trump term. Markets are also coming off the back of two consecutive annual returns of more than 20% for the S&P 500—the best run since the mid-1990s. Ultimately, however, we maintain a positive outlook for both stocks and high-quality bonds in 2025.

Among our key recommendations for investors are the following:

Put capital to work: Although rate cuts from the Fed are likely to be shallower than expected prior to the Fed's hawkish December meeting, we now believe the markets are underestimating the likely pace of easing. We remain confident that returns on cash in the US will continue to fall. Much of the world is now firmly back in a low-interest-rate environment, with the policy rate in Switzerland at just 0.5% after a 50bps cut in December. We also expect the European Central Bank to trim rates by 100bps this year.

We continue to advise investors to put excess cash deposits to work in the market. The recent rise in US Treasury yields has created a more attractive entry point, in our view, and we also favor investment grade credit. We moved tactically long duration late last year by taking exposure to the 5-year part of the US curve, and maintain our Attractive asset class recommendations on high grade and investment grade bonds. We forecast lower rates from here over the course of the year, and given the recent curve steepening, yield pickup is now available by switching out of cash.

Key Messages

Jobs report caps a week of robust US data

Along with enthusiasm over AI, the resilience of the US economy was a major contributor to the 25% return of the S&P 500 last year. Last week, however, economic data appeared to be too strong for the comfort of many investors.The JOLTS report pointed to the highest level of job openings in six months. The ISM survey of services activity came in higher than expected, with the prices paid component at the highest level since 2023.

And on Friday, the December employment report showed nonfarm payrolls growing by 256,000 in December, higher than all but one forecast in a Bloomberg survey of economists. For 2024 overall, the US economy added 2.2 million jobs. While that is slower than the 3 million increase in 2023, it is still above the pre-pandemic rate of 2 million in 2019. The jobless rate also fell to 4.1% from 4.2%, and has been relatively stable since the middle of last year.

The releases added to recent skepticism that the Federal Reserve was likely to cut rates anytime soon. The S&P 500 ended the week 1.9% lower, the worst performance since the week ending 20 December after the Fed's final hawkish policy meeting of the year.

Takeaway: We agree that the data give the Fed little reason to cut rates in the first half of the year unless there is a marked softening of both jobs and inflation data in coming months. However, we expect inflation to moderate sufficiently to permit 50 basis points of easing in the latter part of 2025. Despite last week's setback, we believe the backdrop for stocks remains positive, with healthy US growth, Fed cuts, broadening earnings growth, and continued enthusiasm over AI. As a result, we still believe the S&P 500 likely to end the year around 6,600, compared to Friday's close of 5,827.

Global government bond sell-off intensifies

The yield on the 10-year US Treasury rose around 18 basis points last week to 4.77%, the highest level since late 2023, and edged higher at the start of this week. This partly reflects the strength of US economic releases last week, especially Friday's payrolls, which have cemented market expectations that Fed will be cautious about further easing. Concerns that US President-elect Donald Trump’s policies could push up inflation and worsen the already challenging government fiscal position have also weighed on sentiment.

Worries about the stability of the UK budgetary position and greater government bond supply led to an even more pronounced rise in the 10-year UK gilt yield, which was up around 25 basis points on the week to 4.84%, a yield last seen in 2008. The UK move also contributed to the global move higher in yields.

But we forecast lower rates from here over the course of 2025. Our rationale is based on our view that the Fed will cut rates more than the market currently expects. The market ended the week priced for just 29 basis points of easing this year, and we think 50 is more likely. Interest rates remain in restrictive territory. There continues to be cyclical weakness in the interest-rate sensitive parts of economies such as housing. Market-based inflation expectations remain stable. And the growth-unfriendly, rather than friendly, policy items appear to be first on the agenda from the new US administration.

Takeaway: We moved tactically long duration late last year by taking exposure to the 5-year part of the US curve, and maintain our Attractive asset class recommendations on high grade and investment grade bonds. Given recent curve steepening, yield pickup is now available by switching out of cash.

How to ride the AI wave in 2025

The market’s focus on AI from last year has continued into 2025. The Biden administration's planned AI tech export restrictions have impacted companies like NVIDIA, which saw a 6% stock decline after a lukewarm reaction to an announcement of its product pipeline. Conversely, Samsung Electronics rallied despite missing profit estimates, buoyed by a focus on profitability and NVIDIA's endorsement of its AI-friendly memory chips. Strong US economic data and concerns over the incoming Trump administration's policies have pushed US yields higher, affecting rate-sensitive tech stocks and raising valuation concerns after two years of over 20% gains for the S&P 500. The FANG+ index, which tracks the top 10 most traded US tech companies, fell 2% on Friday following the strong payroll release, for a 2.6% weekly decline.

Without taking any single-name views, we believe the AI tech cycle is in its early stages, with robust demand and increased capital expenditure expected. The Big 4's capex is projected to grow to USD 280bn in 2025, a 25% rise after a roughly 50% increase last year. We see a broader rise in capex amid higher AI spending by industries like automotive and robotics.

Geopolitical factors will continue to inject volatility into the tech sector. The Biden administration's tiered AI chip export rules could impact global tech dynamics, while President-elect Trump's focus on tariffs may also influence market sensitivity.

AI remains a hot area for venture capital, with Anthropic's valuation soaring from USD 8bn to USD 60bn. AI accounted for nearly half of US venture capital flow in 2024, with a high success rate for startups reaching later funding rounds.

Takeaway: We maintain a positive stance on AI, focusing on semiconductors, software, and memory makers. Early-stage AI offers attractive returns, particularly in natural language interfaces and AI platforms, though investors must be prepared for long-term commitments and high failure rates.

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.

Appendix

UBS Chief Investment Office's ("CIO") investment views are prepared and published by the Global Wealth Management business of UBS Switzerland AG (regulated by FINMA in Switzerland) or its affiliates ("UBS"), part of UBS Group AG ("UBS Group"). UBS Group includes former Credit Suisse AG, its subsidiaries, branches and affiliates. Additional disclaimer relevant to Credit Suisse Wealth Management follows at the end of this section.

The investment views have been prepared in accordance with legal requirements designed to promote the **independence of investment research**.

Generic investment research – Risk information:

This publication is **for your information only** and is not intended as an offer, or a solicitation of an offer, to buy or sell any investment or other specific product. The analysis contained herein does not constitute a personal recommendation or take into account the particular investment objectives, investment strategies, financial situation and needs of any specific recipient. It is based on numerous assumptions. Different assumptions could result in materially different results. Certain services and products are subject to legal restrictions and cannot be offered worldwide on an unrestricted basis and/or may not be eligible for sale to all investors. All information and opinions expressed in this document were obtained from sources believed to be reliable and in good faith, but no representation or warranty, express or implied, is made as to its accuracy or completeness (other than disclosures relating to UBS). All information and opinions as well as any forecasts, estimates and market prices indicated are current as of the date of this report, and are subject to change without notice. Opinions expressed herein may differ or be contrary to those expressed by other business areas or divisions of UBS as a result of using different assumptions and/or criteria.

In no circumstances may this document or any of the information (including any forecast, value, index or other calculated amount ("Values")) be used for any of the following purposes (i) valuation or accounting purposes; (ii) to determine the amounts due or payable, the price or the value of any financial instrument or financial contract; or (iii) to measure the performance of any financial instrument including, without limitation, for the purpose of tracking the return or performance of any Value or of defining the asset allocation of portfolio or of computing performance fees. By receiving this document and the information you will be deemed to represent and warrant to UBS that you will not use this document or otherwise rely on any of the information for any of the above purposes. UBS and any of its directors or employees may be entitled at any time to hold long or short positions in investment instruments referred to herein, carry out transactions involving relevant investment instruments in the capacity of principal or agent, or provide any other services or have officers, who serve as directors, either to/for the issuer, the investment instrument itself or to/for any company commercially or financially affiliated to such issuers. At any time, investment decisions (including whether to buy, sell or hold securities) made by UBS and its employees may differ from or be contrary to the opinions expressed in UBS research publications. Some investments may not be readily realizable since the market in the securities is illiquid and therefore valuing the investment and identifying the risk to which you are exposed may be difficult to quantify. UBS relies on information barriers to control the flow of information contained in one or more areas within UBS, into other areas, units, divisions or affiliates of UBS. Futures and options trading is not suitable for every investor as there is a substantial risk of loss, and losses in excess of an initial investment may occur. Past performance of an investment is no guarantee for its future performance. Additional information will be made available upon request. Some investments may be subject to sudden and large falls in value and on realization you may receive back less than you invested or may be required to pay more. Changes in foreign exchange rates may have an adverse effect on the price, value or income of an investment. The analyst(s) responsible for the preparation of this report may interact with trading desk personnel, sales personnel and other constituencies for the purpose of gathering, synthesizing and interpreting market information.

Different areas, groups, and personnel within UBS Group may produce and distribute separate research products **independently of each other**. For example, research publications from **CIO** are produced by UBS Global Wealth Management. **UBS Global Research** is produced by UBS Investment Bank. **Research methodologies and rating systems of each separate research organization may differ**, for example, in terms of investment recommendations, investment horizon, model assumptions, and valuation methods. As a consequence, except for certain economic forecasts (for which UBS CIO and UBS Global Research may collaborate), investment recommendations, ratings, price targets, and valuations provided by each of the separate research organizations may be different, or inconsistent. You should refer to each relevant research product for the details as to their methodologies and rating system. Not all clients may have access to all products from every organization. Each research product is subject to the policies and procedures of the organization that produces it.

The compensation of the analyst(s) who prepared this report is determined exclusively by research management and senior management (not including investment banking). Analyst compensation is not based on investment banking, sales and trading or principal trading revenues, however, compensation may relate to the revenues of UBS Group as a whole, of which investment banking, sales and trading and principal trading are a part.

Tax treatment depends on the individual circumstances and may be subject to change in the future. UBS does not provide legal or tax advice and makes no representations as to the tax treatment of assets or the investment returns thereon both in general or with reference to specific client's circumstances and needs. We are of necessity unable to take into account the particular investment objectives, financial situation and needs of our individual clients and we would recommend that you take financial and/or tax advice as to the implications (including tax) of investing in any of the products mentioned herein.

This material may not be reproduced or copies circulated without prior authority of UBS. Unless otherwise agreed in writing UBS expressly prohibits the distribution and transfer of this material to third parties for any reason. UBS accepts no liability whatsoever for any claims or lawsuits from any third parties arising from the use or distribution of this material. This report is for distribution only under such circumstances as may be permitted by applicable law. For information on the ways in which CIO manages conflicts and maintains independence of its investment views and publication offering, and research and rating methodologies, please visit www.ubs.com/research-methodology. Additional information on the relevant authors of this publication and other CIO publication(s) referenced in this report; and copies of any past reports on this topic; are available upon request from your client advisor.

Important Information About Sustainable Investing Strategies: Sustainable investing strategies aim to consider and incorporate environmental, social and governance (ESG) factors into investment process and portfolio construction. Strategies across geographies approach ESG analysis and incorporate the findings in a variety of ways. Incorporating ESG factors or Sustainable Investing considerations may inhibit UBS's ability to participate in or to advise on certain investment opportunities that otherwise would be consistent with the Client's investment objectives. The returns on a portfolio incorporating ESG factors or Sustainable Investing considerations may be lower or higher than portfolios where ESG factors, exclusions, or other sustainability issues are not considered by UBS, and the investment opportunities available to such portfolios may differ.

External Asset Managers / External Financial Consultants: In case this research or publication is provided to an External Asset Manager or an External Financial Consultant, UBS expressly prohibits that it is redistributed by the External Asset Manager or the External Financial Consultant and is made available to their clients and/or third parties.

USA: Distributed to US persons only by UBS Financial Services Inc. or UBS Securities LLC, subsidiaries of UBS AG. UBS Switzerland AG, UBS Europe SE, UBS Bank, S.A., UBS Brasil Administradora de Valores Mobiliarios Ltda, UBS Asesores Mexico, S.A. de C.V., UBS SuMi TRUST Wealth Management Co., Ltd., UBS Wealth Management Israel Ltd and UBS Menkul Degerler AS are affiliates of UBS AG. **UBS Financial Services Inc. accepts responsibility for the content of a report prepared by a non-US affiliate when it distributes reports to US persons. All transactions by a US person in the securities mentioned in this report should be effected through a US-registered broker dealer affiliated with UBS, and not through a non-US affiliate. The contents of this report have not been and will not be approved by any securities or investment authority in the United States or elsewhere. UBS Financial Services Inc. is not acting as a municipal advisor to any municipal entity or obligated person within the meaning of Section 15B of the Securities Exchange Act (the "Municipal Advisor Rule") and the opinions or views contained herein are not intended to be, and do not constitute, advice within the meaning of the Municipal Advisor Rule.**

For country information, please visit ubs.com/cio-country-disclaimer-gr or ask your client advisor for the full disclaimer.

Additional Disclaimer relevant to Credit Suisse Wealth Management

You receive this document in your capacity as a client of Credit Suisse Wealth Management. Your personal data will be processed in accordance with the Credit Suisse privacy statement accessible at your domicile through the official Credit Suisse website https://www.credit-suisse.com. In order to provide you with marketing materials concerning our products and services, UBS Group AG and its subsidiaries may process your basic personal data (i.e. contact details such as name, e-mail address) until you notify us that you no longer wish to receive them. You can optout from receiving these materials at any time by informing your Relationship Manager.

Except as otherwise specified herein and/or depending on the local Credit Suisse entity from which you are receiving this report, this report is distributed by UBS Switzerland AG, authorised and regulated by the Swiss Financial Market Supervisory Authority (FINMA).

Version D/2024. CIO82652744