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Strengthening portfolios in volatile times

UBS House View - Daily US

Ulrike Hoffmann-Burchardi, Head CIO Global Equities, UBS Financial Services Inc. (UBS FS)
Mark Haefele, Global Wealth Management Chief Investment Officer, UBS AG
Solita Marcelli, GWM Chief Investment Officer Americas, UBS Financial Services Inc. (UBS FS)
David Lefkowitz, CFA, CIO Head of US Equities, UBS Financial Services Inc. (UBS FS)
Kurt Reiman, Head of Fixed Income, Americas, UBS Financial Services Inc. (UBS FS)
Frederick Mellors, Strategist, UBS Switzerland AG
Leslie Falconio, Head of Taxable Fixed Income Strategy, CIO Americas, UBS Financial Services Inc. (UBS FS)
Kiran Ganesh, Strategist, UBS AG London Branch

Thought of the day

In this note we detail why we now see US equities as Attractive, how we believe investors can strengthen and diversify their portfolios during volatile times, and we update our scenario analysis considering the "90-day" pause to tariffs on most countries announced by President Trump on 9 April.

We upgrade US equities to Attractive

We see three reasons for a more positive outlook for US stocks:

President Trump's policy shift has reduced extreme economic and market tail risks.

President Trump's 2 April "Liberation Day" tariff announcements were harsher than expected and have been followed by tit-for-tat escalation between the US and China, with US tariffs on imports from China now totaling 145%. But President Trump on 9 April also announced a 90-day pause on "reciprocal tariffs" for other countries.

We believe the demonstrated willingness from the Trump administration to change its stance in response to equity and bond market turbulence indicates some sensitivity to market stress, and points to the existence of a "Trump put" in some form.

To be sure, the significant tariffs on China will cause economic disruption if they remain in place. But while downside risks do remain, we believe the risk of a more severe economic downturn is now more limited. We have raised our downside scenario S&P 500 price target to 4,500 (which we consider to be more aligned with a "normal" recession), up from 4,000 (more consistent with a systemic crisis like the global financial crisis).

Incremental news flow is likely to improve.

We remain mindful of the greater-than-expected tariff escalation between the US and China, and the risk that incoming data could demonstrate significant supply chain and business disruption from the China tariffs. US Treasury Secretary Scott Bessent's suggestion that Chinese companies could be delisted from US stock exchanges risks further intensifying tensions. It is also not certain that the 90-day pause in "reciprocal tariffs" on other trading partners will necessarily result in more long-lasting "deals," and we

What to watch: 14 April 2025

- Further guidance on trade policy from the US and its major partners
- US auction of three- and six-month Treasury bills
- UK April house prices

do expect additional tariffs on pharmaceuticals and semiconductors to be announced.

But with many countries expressing a desire to negotiate with the US, and the Trump administration now more incentivized to demonstrate "success," we expect a variety of "deals" or sector carveouts to materialize within the 90-day "pause" period. President Trump has even expressed the view that ultimately a deal would be struck with China. We believe that progress on negotiations should provide encouragement for investors to look through near-term tariff-induced economic weakness and toward a return to earnings growth in 2026.

Equity returns after volatile periods have historically been positive. Since 1990, when the VIX index was launched, the S&P 500 has delivered 9.3% returns on average over a 12-month period. High volatility has historically been followed by higher-than-normal returns. While each case is different, levels of the VIX above 40 (the index reached a high of 60 on 7 April and trades above 40 at the time of writing) have historically been followed on average by 30% one-year returns on the S&P 500, with a 95% chance of a gain.

Additionally, the S&P 500's 9.5% rally on 9 April was the largest one-day rise since 2008, and the third-largest ever. Since 1950, there have been 13 previous one-day rallies of 6% or more; subsequent one-year returns have all been positive with gains ranging from 10-63%.

We also found that on the 12 occasions that the S&P 500 fell 20% from its peak since 1945, the index delivered a positive return over the subsequent 12 months on 67% of occasions with a mean return of 12.9%. The S&P 500 closed down almost 20% from its peak on 8 April.

Furthermore, bearish sentiment among individual investors remains elevated due to uncertainty surrounding the ongoing trade dispute. According to the latest American Association of Individual Investors (AAII) survey for the week ending 9 April, 58.9% of investors continue to hold a bearish outlook, anticipating that stock prices will decline over the next six months. This follows a surge to a one-year high of 61.9% the previous week. Notably, bearish sentiment has historically served as a contrarian indicator, with the S&P 500 averaging a 27% returns in the 12 months following instances where sentiment readings exceed 60%.

Strengthening and diversifying portfolios in volatile times

"Phasing in"

We see US equities as Attractive and note that periods of market stress have historically and consistently offered long-term rewards for diversified investors who look through near-term volatility and stay the course or put fresh money to work. At the same time, investing during times of elevated volatility can be challenging, as market timing risks are also higher.

One way to mitigate market entry risks is by using a phasing-in strategy. Since 1945, phasing into a balanced 60/40 portfolio over 12 months has outperformed cash in approximately 74% of one-year periods and 83% of three-year periods. When initiated after a market decline of over 10%, this strategy outperformed cash in 82% of one-year periods and 94% of three-year periods.

Capital preservation strategies
For investors uncomfortable with volatility but looking to position for potential future gains, capital preservation strategies may offer a solution. These approaches combine investment in zero-coupon bonds with call options, providing exposure to equity market rallies while limiting potential losses. Investors can tailor these instruments to their risk tolerance, choosing between full capital preservation or accepting limited downside risk for greater participation in potential gains.

Gold
Gold prices came under some pressure after "Liberation Day" owing to investor deleveraging, but the yellow metal resumed its upward trajectory this week, trading at a record high above USD 3,200/oz on 11 April.

We believe gold prices will remain well-supported by the uncertain trade and geopolitical backdrop as well as the potential for swifter rate cuts from the Federal Reserve, which lowers the opportunity cost of holding non-yielding assets. We believe gold will continue to offer portfolio diversification benefits, particularly in adverse scenarios.

Quality bonds
10-year US Treasury yields now stand at 4.42%, compared to our year-end target of 4.0%. This anticipated bond rally should offer respectable total return potential and diversification benefits for portfolios. In a downside scenario, we would expect 10-year Treasury yields to fall to 2.5%, offering potentially significant capital gains for investors. Investors at the longer end of the yield curve need to remain mindful of volatility related to fiscal concerns and the unwinding of technical hedge fund "basis trades."

Hedge funds
By dynamically adapting to macro shifts, hedge fund strategies—like discretionary macro, equity-market neutral, select relative value or multi-strategy—can cushion portfolios in volatile and down markets, and potentially prosper amid a fast-changing macroeconomic environment.

Our updated scenarios
Base case (50% probability)
S&P 500: 5,800

US 10-year yield: 4.0%

In our base case, we believe that equities will remain volatile, but rise over the balance of the year owing to various trade "deals" and carveouts, central bank rate cuts, and progress toward a US budget reconciliation bill.

On tariffs, we expect the coming months to bring additional tariffs on sectors including pharmaceuticals and semiconductors but also negotiated carveouts for other sectors as well as the announcement of "deals" with specific countries. We also expect the "90-day pause" to be extended where necessary.

Overall, we expect the effective US tariff rate ex-China to settle in the 10-15% range, and Canada and Mexico to remain largely exempt from tariffs. While it could take some time, we also think the US and China will walk back from the recent tit-for-tat escalation, and US-China tariffs will settle around 34%. President Trump has said he would "love" to make a deal with China.

Despite the "90-day pause," the US economy is likely to experience a notable slowdown owing to weaker consumer confidence and potential disruptions related to exceptionally high tariffs on China. We expect the US economy to grow by less than 1% on average in 2025 but expect the unemployment rate to remain below 5%. Other global economies are also likely to experience weaker growth in 2025, but we expect growth rates to remain positive for the full year. Policy stimulus in Europe and China may help to partially offset the negative effect on economic activity.

Despite higher near-term inflation in the US, we expect all major central banks (except the Bank of Japan) to ease policy gradually from mid-2025. We expect the Fed to cut rates by 75-100bps in 2025 and the European Central Bank to cut rates by 25bps every meeting until mid-2025.

Downside scenario (30% probability)
S&P 500: 4,500

US 10-year yield: 2.5%

In our downside "hard landing" scenario, equities would fall further as tariff negotiations generally do not succeed, and pressure on US domestic demand triggers a US recession. High-quality bonds would appreciate as growth expectations are revised materially lower, more than offsetting fiscal concerns.

In this scenario, tariff negotiations in the weeks ahead do not prove productive, with some trading partners retaliating against the US 10% "baseline tariffs." The US and EU struggle to reach an agreement due to issues ranging from "baseline tariff" levels, defense spending, and digital services taxes. Overall, we would expect effective tariffs ex-China to settle in the 15-20% range in this scenario. Although we think the US and China could partially reduce the current extraordinary tariffs that are in excess of 100%, we think US tariffs on China would remain over 60% by year-end.

The persistent disruption to global trade in this scenario leads to sustained downward pressure on US domestic demand, and the US economy enters a recession (c. -2% peak to trough), with unemployment rising by around 2pps. At the same time, we think that policy flexibility from the Trump administration would limit potentially more severe economic downside scenarios.

In this scenario, central banks may adopt a cautious approach to monetary easing in the near term for fear of de-anchoring inflation expectations. However, we think rates would be cut sharply later in the year as central banks try to revive growth and remain mindful of risks to financial stability. The Fed lowers its policy interest rate by around 300bps by year-end.

Upside scenario (20% probability)
S&P 500: 6,500

US 10-year yield: *4.75%*

While an upside scenario may be hard to envisage, we think investors should remain cognizant that equity markets could rally very significantly if trade agreements are reached more quickly and comprehensively than expected, including with the EU or China.

In this scenario, growth would still prove uneven in the immediate future, but lower tariff risks and healthy consumption would allow the US economy to surprise positively thereafter, with residual negative tariff effects also potentially offset by policy support from deregulation and a potential US fiscal package.

Caught our attention

Unexpected slowing in US CPI overshadowed by tariff fears. An unexpected month-over-month fall in US consumer prices failed to buoy markets on Thursday, as investors focused on the uncertainty and potential next steps for US trade policy. The S&P 500 fell 3.5% following its 9.5% rally on Wednesday, while EURUSD (+2.3%) registered its biggest gain since 2015, and 30-year Treasury yields (+13bps) made their biggest jump since 1982.

The US consumer price index declined 0.1% month-over-month in March thanks to lower gasoline and used-car prices. The release marked the first monthly decline in prices in nearly five years, and led the year-over-year rate to moderate to 2.4% (from 2.8% in February). Core inflation that omits the volatile food and energy components came in at 0.1% month-over-month in March, the smallest monthly gain since June 2024, while the year-over-year rate slowed to 2.8% in March, the softest pace since March 2021 and below February's 3.1%.

Our view: While the deceleration in US price pressures is heartening at first glance, fast-evolving conditions warrant some caution on interpreting its meaning for investors. Some investors argued the release commanded less attention given it likely captured only a fraction of the first wave of President Trump's tariffs, namely the initial 20% tariff on Chinese goods and levies on steel and aluminum. Despite a 90-day pause and temporary reduction to 10% on many US "reciprocal" tariffs, ongoing 145% tariffs on China remain potential inflationary pressures. Fed Chair Powell has suggested the Fed may take a cautious approach to interest rate cuts, remarking that "while tariffs are highly likely to generate at least a temporary rise in inflation, it is also possible that the effects could be more persistent."

Market update

11.04.2025

Percent change. For volatility indices, net change in points. For valuation, change in price to earnings per share. For yields, net change in bps

	Current (*)	1D	5D	1M	YTD
VIX Index	40.4	-0	-5	+14	+23
MOVE Index	128	-0	+3	+14	+30
S&P 500	5268	-3.5%	-2.4%	-5.5%	-10.4%
S&P 500 trailing P/E (**)	21.6x		-1.2x	-2.0x	-3.0x
S&P 500 forward P/E (**)	19.4x		-1.1x	-1.7x	-2.1x
S&P 500 forward P/E ex-Mag 7 (**)	18.2x		-0.8x	-1.3x	-0.7x
Russell 2000	1831	-4.3%	-4.1%	-9.5%	-17.9%
Euro Stoxx 600	489	+0.4%	-1.4%	-8.9%	-3.6%
Shanghai Composite	3238	+0.5%	-3.1%	-4.2%	-3.4%
US 10-year Treasury	4.44	+2	+45	+16	-13
US 2-year Treasury	3.85	-1	+20	-10	-39
Germany's 10-year Bund	2.63	+5	+5	-27	+26
Germany's 2-year Bund	1.81	+3	-2	-39	-27
EURUSD	1.136	+1.4%	+3.7%	+4.0%	+9.7%
EURCHF	0.93	-0.5%	-1.7%	-3.7%	-0.2%
USDCHF	0.82	-1.0%	-5.2%	-7.6%	-10.1%
USDJPY	143	-1.0%	-2.7%	-3.2%	-9.0%
Brent crude, USD/bbl	64	+0.9%	-2.6%	-8.1%	-14.4%
Gold, USD/oz	3205	+1.6%	+6.4%	+9.7%	+21.4%

(*) or last close if not available, (**) weekly update

Source: Bloomberg, Factset, UBS

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