Macro Monthly

Economic insights and asset class views

UBS Asset Management | December 2025

For global professional / qualified / institutional clients and investors

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Leaning in

- Recent equity volatility has coincided with concerns around Fed hawkishness and renewed debate on whether AI-related capex will generate attractive returns.
- We think the Fed is still firmly on an easing path with the downside risks to the labor market outweighing the upside risks to inflation.
- We see heightened focus on the ROI of AI investment as a healthy dynamic, as is the recent decline in correlation between stock prices of the main AI 'hyperscalers.' With market concentration a concern, active management can help diversify portfolio exposure to the AI theme.
- Underlying fundamentals remain solid and with markets having derisked, we have added some exposure to risk assets including to high yield bonds. We have also added US duration as a hedge against further labor market weakness.

Market volatility has picked up of late, which was bound to happen at some point after an almost straight-line move upward in equity markets since mid-April. The recent bout of volatility has coincided with consternation on the outlook for Fed easing and increased scrutiny on the return on investment from AI-related capital expenditures.

We believe the Fed will remain on an easing track, with downside risks to the labor market outweighing the upside risks to inflation. As a result, we have added US duration to hedge our otherwise pro-risk positioning.

Addressing concerns around AI is less straightforward, and we expect the market to grapple with this theme for some time. Nevertheless, the AI trade is becoming more nuanced, with increasing dispersion within megacap tech among perceived relative winners and losers – we view this as a healthy development. High market concentration and valuations underscore the case for balancing index and active exposure, to ensure diversification should the ROI of AI investment fail to meet lofty expectations.

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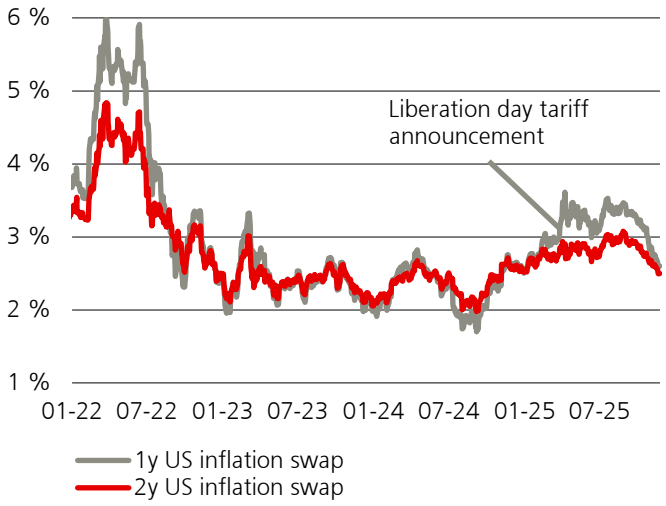
Fed easing is still on

Equity weakness essentially began around the October 29 Federal Open Market Committee meeting, where Fed Chair Powell introduced uncertainty about the likelihood of a third consecutive rate cut in December. Since then, several Fed committtee members have added to a more hawkish discourse, reducing market expectations for a December rate cut to a coin toss.

Despite this, we expect Fed Chair Powell to weigh the downside risks to employment as greater than the upside risks to inflation, and build a consensus for a December rate cut. The unemployment rate is gradually rising and inflation has generally come in lower than expectations. Meanwhile, one-year CPI swaps are trending lower, building confidence that tariff-driven inflation will be outweighed over time by disinflationary pressures elsewhere.

Exhibit 1: Inflation swaps are trending lower, signaling less market concern on inflation

US inflation swaps



Source: UBS Asset Management, Bloomberg. Data as of November 2025.
Chart description: The chart shows the one-year and two-year US inflation swap.

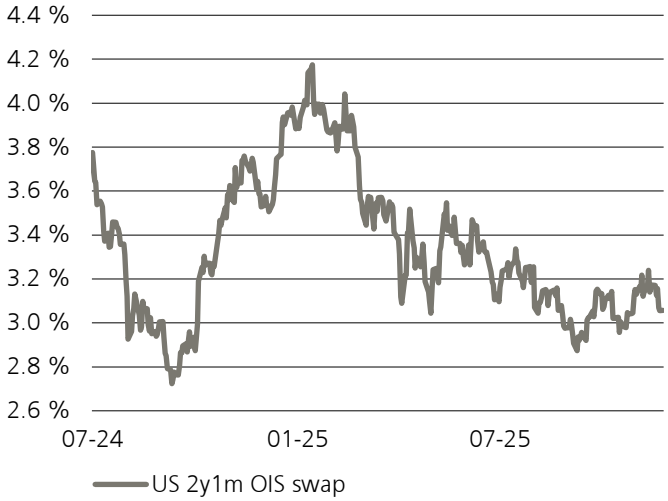
Should we be wrong and the hawks prevail in keeping the Fed on hold with no rate cut, we expect weakness in risk assets to be short lived. The Trump administration will soon announce its successor to Fed Chair Powell, whose bias will likely be to bring rates closer to 3%.

And while economic growth is likely to bounce back early next year from government shutdown induced weakness in Q4, it is highly uncertain whether the labor market will re-accelerate in kind. That a key driver of growth, AI capex, is not particularly additive to job growth (and AI may ultimately be a headwind to employment growth), suggests to us that the case for further easing is likely to remain strong. We note that despite the shift in the expected timing of Fed cuts, the market-implied terminal rate is largely unchanged.

Given our expectation for further Fed easing, and our view that the downside risks to the labor market are greater than the upside risks to inflation, we have added a long US duration position to portfolios. This should help to diversify some of our long risk positions should the labor market deteriorate more than expected.

Exhibit 2: Market pricing of the Fed's terminal rate has been stable

US 2y1m OIS swap



Source: UBS Asset Management, Bloomberg. Data as of November 2025.
Chart description: The chart shows the two-year, one-month overnight index swap from July 2025 through November 2025.

A more nuanced AI trade

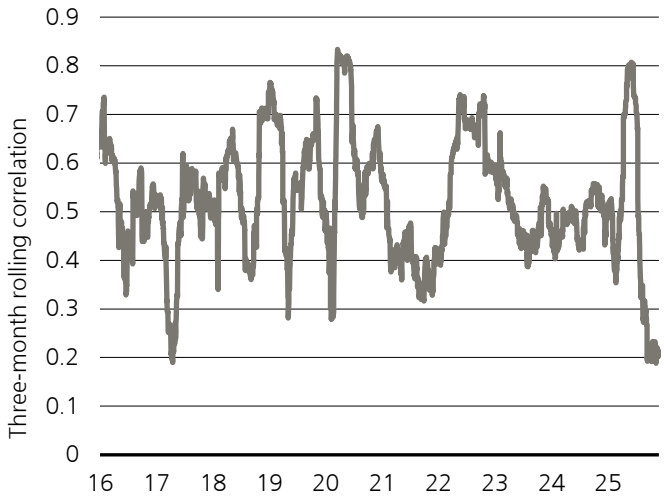
Tech has underperformed in recent market weakness, despite the megacaps posting another exceptional earnings season. The debate on whether the substantial capital expenditures in AI will ultimately deliver attractive returns has gone from simmering to super-charged.

Despite some near-term discomfort for portfolios, we actually view these dynamics as quite healthy for the sustainability of the AI investment theme. That the market is starting to punish certain companies for outsized capex plans without a commensurate revenue outlook can provide a certain 'market discipline,' much like bond market vigilantes encourage governments to rein in spending. Bubbles happen when investors completely abandon fundamentals in favor of risk seeking — this doesn't appear to be what is happening.

Indeed, the market is becoming more discerning in how it is pricing AI. The stock price correlation between publicly traded hyperscalers has fallen from near 80% in June to 20% now, the lowest since 2017. This change in stock price correlations indicates that the market is becoming more selective about potential relative winners and losers in this space, a healthy development.

Exhibit 3: The average correlation across the top five hyperscalers has fallen

Average 3m pairwise correlation for the top 5 hyperscalers

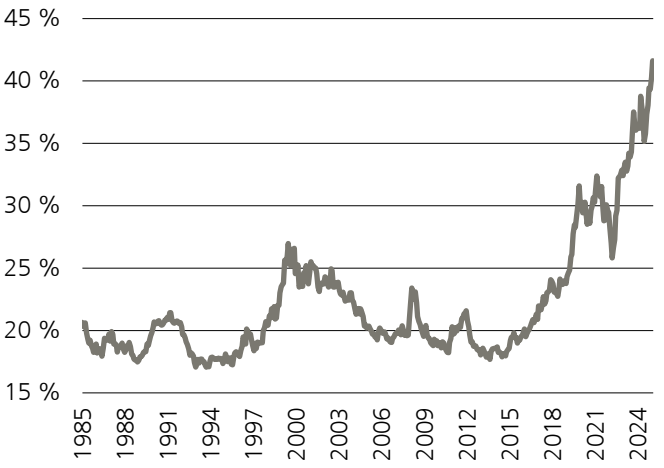


Source: UBS Asset Management, Bloomberg. Data as of November 2025.
Chart description: The chart shows the three-month rolling, pairwise correlation of Amazon, Microsoft, Google, Meta, and Oracle.

In general, we think the increased market concentration in the AI theme, along with declining correlations speaks to the growing need for investors to ensure they are actively diversified in their exposures. The Magnificent Seven now accounts for 35% of the S&P 500 by market capitalization, and about half of the index is either directly in the technology sector or closely linked to it through business models and infrastructure. Essentially, going purely 'passive' is very much an 'active' bet. Many active managers have struggled in recent years amid narrow performance in equity indexes, but as the market becomes more discerning on the AI theme and focus shifts from AI enablers to adopters, we expect diversification within equity indexes to become increasingly important.

Exhibit 4: Market concentration has increased significantly

Market cap of 10 largest companies as share of S&P 500 total



Source: UBS Asset Management, Bloomberg. Data as of November 2025.
Chart description: The chart shows the market cap of the 10 largest companies in the S&P 500 Index as a share of the total market cap of the index.

Asset allocation

Despite a garden variety pullback in equity markets, some of the measures of sentiment and positioning we track have downshifted sharply. This creates fertile ground for a rebound as the markets refocus on solid earnings, continued monetary accomodation and the $55 billion boost to US disposable income coming this spring (from the US fiscal legislation passed earlier this year).

We remain constructive on the outlook and maintain an overweight position in equities. Indeed, earnings continue to exceed expectations, with the most recent quarter delivering the largest proportion of upside surprises among S&P 500 companies since 2021. Earnings globally are showing impressive breadth, and we continue to favor regions where this is most paramount, in emerging markets and Japan.

And despite recent concerns in areas of credit, we reiterate that while there are pockets of excess, private sector leverage in aggregate is at multi-decade lows (see Macro Monthly: The key to this cycle's resilience). In this context, we have taken advantage of the recent widening in credit spreads to add high-yield US credit. Increasing leverage among AI hyperscalers is happening in the IG market, while the underlying supply-demand dynamics in high yield remain favorable.

The main economic risk still relates to the labor market. We are cognizant that softness could accelerate into something worse, and so have hedged our risk asset exposures with an increase in duration. Despite more hawkish Fed speak from some members of the FOMC, we think the Fed will not hesitate to ease more should the labor market fail to show durable signs of stabilization.

Asset class views

The chart below shows the views of our Asset Allocation team on overall asset class attractiveness as of 24 November 2025. The colored circles provide our overall signal for global equities, rates, and credit. The rest of the ratings pertain to the relative attractiveness of certain regions within the asset classes of equities, bonds, credit and currencies. Because the Asset Class Views table does not include all asset classes, the net overall signal may be somewhat negative or positive.

	Underweight			Overweight		
Global Equities				●		We remain overweight global equities, supported by strong earnings, solid growth and expectations for further policy easing. We prefer the US, Japan, and EM vs. Europe, the UK, and Australia.
US				●		We remain overweight US equities. We still believe the Fed is in a cutting cycle, and think growth is set to improve early next year. Furthermore, earnings growth is strong among high-quality stocks, and US corporates continue to show adaptability to shocks.
Europe		●				We are underweight European equities, as earnings growth remains weaker than other regions. We like European banks, which should benefit from strong earnings.
Japan				●		We are overweight Japanese equities, which we believe should benefit from high domestic nominal GDP growth and improving earnings. More stimulative policy combined with a weak JPY may also support future earnings growth.
Emerging Markets				●		We are overweight EM equities as earnings are strong across most regions. The MSCI EM index is heavily weighted toward North Asian tech giants – which, while under pressure now, should still benefit from the AI capex cycle over the medium-term.
Global Government Bonds				●		We moved overweight duration as we believe short-tenor bonds offer protection for risk assets should growth weaken. The labor market still looks soft, and we are more concerned with downside risks to growth than upside risks to inflation.
US Treasuries				●		We have upgraded US Treasuries, as we expect Fed easing to continue and value the hedging properties in case the labor market surprises to the downside.
Bunds		●				We are underweight bunds as we believe German growth is on the precipice of picking up amid increased fiscal spending which is set to support growth through 2027. The ECB has signalled it is on hold; a further recovery should cause hikes to be priced in out years.
Gilts				●		We remain overweight gilts as we find valuations are attractive, with decent fiscal premium already imbedded into the curve. While the BoE continues to deliver a gradual easing cycle, downside risks to employment may accelerate the pace of rate cuts.
JGBs			●			We are neutral on Japanese government bonds. Although the BoJ is likely to raise interest rates further, we expect it will act slowly, while carry costs of shorting JGBs are elevated due to the low BoJ policy rate.
Swiss			●			We are neutral on Swiss bonds. While the domestic economy remains lackluster, valuations are expensive, as the market is pricing in some chance that the SNB will cut rates into negative territory.
Global Credit				●		We turned constructive on credit on recent spread widening. Several fundamental and technical factors support tight spreads, including low default rates, steady upgrades, resilient corporate earnings, and strong inflows. Asia HY continues to offer the most attractive risk-reward.
Investment Grade Credit			●			IG spreads remain exceptionally tight, while earnings and balance sheets remain solid, helping limit downside risks. The US IG market will have to increasingly absorb supply related to AI capex financing needs.
High Yield Credit				→		We expect spreads to remain range-bound amid sub-2% default rates, ongoing rating migration toward higher-quality buckets and persistent yield-seeking behavior. HY now trades at an average coupon close to current YTW, indicating that the refinancing cycle has likely passed its most challenging phase. Together, these factors create a favorable backdrop for carry-driven returns.
EMD Hard Currency			●			We are neutral on EMD in hard currency but overweight local currency EM debt, as we expect EM currencies to strengthen.

FX						
USD						We remain bearish on the USD, as we believe US rates have room to compress relative to the rest of the world, even if the Fed slows in its pace of easing. Also, the USD has a renewed negative correlation with equities – which we expect will strengthen next year.
EUR						The EUR remains range-bound; however, we think risks are tilted toward a move higher as the ECB remains on hold next year, and further Fed cuts are expected. We also favor long EUR against GBP, with UK rates likely to decline amid weakening employment data.
JPY						We stay underweight JPY as we think interest rates remain too low relative to inflation and wages. The initial spending plans of PM Takaichi's cabinet point to more expansive fiscal policy, which is likely to worsen this imbalance if passed in its current form.
CHF						We are neutral on the CHF, as an expensive valuation and low yield are counteracted by strong balance of payment inflows.
EM FX						We favor high carry EM currencies, including BRL and HUF, which both offer high real interest rates and attractive valuations.
Commodities						We are neutral on gold tactically as the rally has caused the asset's behavior to become increasingly volatile and correlated with risk assets. That said, we do think gold plays a strategic role in portfolios as a real asset amid still elevated inflation and rising government debts.

Source: UBS Asset Management Investment Solutions Macro Asset Allocation Strategy team as of 24 November 2025. Views are provided on the basis of a 3-12 month investment horizon, are not necessarily reflective of actual portfolio positioning, and are subject to change.

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