



(UBS)

Monthly Letter: The next stage

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Equity markets have had a buoyant first quarter. Now, as the second quarter approaches, we think investors should prepare their portfolios for “the next stage” of two primary market drivers: major central banks’ rate-cutting cycles getting underway, and a broadening of AI adoption and implementation.

As we approach the end of the first quarter, equity markets are buoyant, and a strong US economy has diminished expectations for rate cuts. Despite geopolitical uncertainties, cross-asset volatility has remained low.

Looking ahead to the second quarter, we see the next stage of two primary market drivers playing out: the start of rate-cutting cycles by major central banks, and the broadening-out of AI adoption and implementation across a wider range of companies.

Against this backdrop, we believe investors’ key focus should be on: 1) getting their exposure to the technology sector right; 2) ensuring that portfolio income streams are sustainable; and 3) employing effective portfolio risk management techniques.

What does that look like in practice?

First, it’s important to hold a diversified strategic exposure to the technology sector and to some of the likely winners from tech disruption. We foresee 18% earnings growth for the global technology sector this year and 72% annualized growth in AI revenues over the next five years. The rising excitement over artificial intelligence and its implications could lead to a scenario in which future gains are frontloaded. Investors looking to grow wealth should ensure they have exposure to this space, balancing a focus between sector leaders and the likely beneficiaries of tech disruption.

But equally, after such a strong run in AI-related stocks, the risk of overconcentrating portfolios has risen. Structured strategies can play a role in helping investors manage downside risks in tech. For those looking to diversify their equity exposure, we see a range of opportunities beyond technology—for example, in quality stocks, including regional

champions in Europe and Asia; in alternative growth themes like the energy transition, healthcare disruption, and solutions to address water scarcity; or in small- and mid-cap stocks. Exposure to these ideas can also be built up through structured investments.

Second, although the US economy has remained strong and inflation has surprised to the upside, we still expect the Federal Reserve to cut interest rates in the coming months, likely starting in June. The Swiss National Bank has already begun cutting rates, with the announcement of a 25-basis-point reduction at its March meeting. Other major central banks—including the European Central Bank, the Bank of England, and the Bank of Canada—are also on track to start easing policy in the coming months. To prepare portfolios for lower rates, investors need to be proactive and shift their cash and money market holdings toward more durable sources of income, including fixed-term deposits, short-term bond ladders, and medium-duration high-quality bonds. We expect most major currency pairings to continue to trade in their recent ranges, presenting opportunities for investors to generate added income through tactical currency trades.

Third, effective risk management is key. The temptation to manage risk by simply cashing in on gains or retreating to the sidelines may be strong, but history favors those who pursue a more balanced approach. The UBS Global Investment Returns Yearbook, which analyzes financial markets going back to 1900, shows that an equity portfolio that is diversified across 21 countries would have 40% less risk than a single-country investment. Similarly, a portfolio with a 60/40 split between stocks and bonds has historically been less volatile than one composed solely of stocks. We believe that only by diversifying across asset classes, regions, and sectors can investors fully manage the tension between navigating short-term market dynamics and growing long-term wealth.

For more on these ideas, please refer to our latest Monthly Letter, "[The next stage,](#)" or to the [UBS House View Quarterly](#) report (both published 21 March 2024). Watch a short video on these topics [here](#).

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