



The US labor market remains strong but demand for labor is cooling and quits have fallen. It is time to lock in yields in high quality bonds. (UBS)

# Quality bonds - your soft landing gear

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**The US labor market has remained strong, yet demand for labor is cooling as job openings and the quit rate have declined. Fed policy will continue to be higher for longer but the plan for cutting rates is intact. Our base case view remains a soft landing. It is time to lock in attractive yields in high quality bonds.**

On the eve of the Federal Reserve's decision last week, the release of the Employment Cost Index (ECI) report showed the ECI, a data series for US labor costs, remained hotter-than-expected in the first quarter even as most other measures of US wage growth have shown moderation in recent months (e.g., average hourly earnings, Atlanta Fed wage tracker, NFIB compensation plans). We believe the quarterly ECI data report identified the continued challenges of volatile data.

The ECI report was followed by the May FOMC decision to keep rates unchanged in a 5.25-5.5% target range, in line with expectations, since inflation remains sticky. At the press conference Fed Chair Jerome Powell seemed to largely dismiss the weaker 1Q GDP growth rate of 1.6%, the lowest since 2Q22, with the statement "economic activity remains strong." He said that a further hike was unlikely and didn't rule out cuts this year. While the labor market remains tight, "supply and demand conditions have come into better balance." Additionally, he did not seem overly concerned about the higher-than-expected 1.2% quarter-over-quarter rise in the 1Q Employment Cost Index, noting that it was steady at 4.2% in year-over-year terms. "Inflation has eased notably" but remains too high for the Fed to feel confident inflation will slow toward the Fed's 2% target.

The April jobs report at the end of the week showed the US added fewer jobs than expected, and average hourly earnings growth was the lowest since June 2021. The report also showed the quit rate declined alongside a softening in perceptions of labor market conditions, but Fed Chair Powell highlighted the cooling in demand for labor which was shown through the quits and hiring rates "have essentially normalized." This data reinvigorated hopes for Fed rate cuts this year.

We believe this data is consistent with our base case view for a soft landing for the US economy, even if this outcome isn't without an occasional speed bump, as has occurred in April. We expect growth and inflation to both cool this year, allowing the Fed to start cutting rates once a quarter, with the first cut most likely in September. We maintain a preference for quality bonds, including investment grade, given our expectations for Fed rate cuts. We forecast 10-year US Treasury yields will decline to 3.85% by year-end.

So we see it as time to lock in attractive yields in high quality bonds. Current yields offer a good entry point into quality bonds, and in our base case we expect yields on 10-year US Treasuries to decline to 3.85% by the end of this year. High quality bonds also offer the potential for capital gains when the economy slows down, and should be part of a well-diversified portfolio.

We also expect further modest gains for equities at the index level and forecast the S&P 500 to end the year at 5,200. This supports our most preferred view on quality stocks and our focus on finding equity opportunities both within and beyond the technology sector.

For additional information, please read our recent reports: [Labor report softer in April](#) and [Fixed Income: Impatiently patient](#), and [Summer sequel](#).

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