



Although rate cuts from the Fed are likely to be shallower than expected prior to the Fed's hawkish December meeting, CIO now believes the markets are underestimating the likely pace of easing. (UBS)

# A bout of volatility was to be expected

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**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% on Friday following the release of the December labor report, 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.

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 Fed 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 release of 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 was 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.

On inflation, the December Fed minutes highlighted increased upside risks to the outlook, including 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. This 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 insights.

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 Treasury 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 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 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 five-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.

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Original report: [Strong US jobs data adds headwind to markets, 13 January 2025.](#)

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