



(UBS)

Calibrating the risks

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The US economy entered the year with good momentum and solid fundamentals, but downside risks have increased owing to heightened Trump 2.0 policy uncertainty.

While not yet clearly evident in activity data, consumer and business sentiment measures have weakened, which could weigh on spending. We believe that tariffs will be implemented aggressively on China and select industries but that universal tariffs will likely be avoided. Similarly, cuts to government spending will attract headlines, but they shouldn't materially change the economic outlook. The risk of a significant economic and market correction with a severe policy error remains low because the labor market is solid and consumption should remain supported by healthy household balance sheets. Such weakness would likely lead to more Fed rate cuts, in addition to the two we currently expect this year in June and September.

With this economic backdrop and our expectations for Trump 2.0 policies and Fed rate cuts, the macro environment should ultimately be supportive for risk assets in 2025, particularly for equities. In the near term, more volatility and downside is possible until there is policy clarity. We maintain our December 2025 price target for the S&P 500 of 6,600, with an expectation of 8% earnings growth.

This target implies that there is **more to go in equities**. Within the US, we see the largest growth drivers tied to innovations in artificial intelligence. Outside the US there is potential for a pro-growth shift in Germany or a Russia-Ukraine peace deal, either of which could positively influence sentiment in Europe. In China we like the internet sector, as it is still in the early stages of benefitting from AI tailwinds, and it has the potential to grow online penetration and deliver strong free cash flow generation. Within US equities, we remain neutral on value versus growth and make no changes to our sector preferences. We maintain our Attractive view on financials, communication services, health care, and consumer discretionary.

Additionally, we maintain our positive outlook on US technology, even as the sector has grown significantly in recent years. Specifically, we recommend investors **seize the AI opportunity**, as we expect this technology to be a key driver of equity market returns over the coming years.

The confluence of AI development, decarbonization efforts, and global economic development is boosting electricity demand. This creates opportunities to **invest in power and resources**, including in utilities, infrastructure, power equipment, and storage.

With the Fed's progress on cutting rates slowing, we believe investors holding excess cash should diversify and **seek durable income**. High-quality fixed income assets offer compelling risk reward over the next 12 months.

Lastly, as President Trump's term gets under way, investors will need to consider how to **navigate political risks**. Investors should prepare for market volatility and potential policy surprises, particularly with respect to trade policy, and should consider portfolio diversification and hedging approaches. Investors should buy market pullbacks in structural trends like AI and they should manage long-duration bond exposure, as these assets would be hurt by an unexpected rise in inflation if the market prices fewer rate cuts or potential rate hikes. We also recommend gold and oil as potential hedging options to protect against geopolitical flare-ups and inflation risks.

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