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Chief Investment Office GWM
Investment Research

What does Fed policy mean for investors?

UBS House View Briefcase

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Key message

Despite near-term risks that reduce the likelihood for imminent easing, we believe the Federal Reserve's medium-term policy trajectory still points toward lower rates. Investors with excess cash looking to "phase in" markets can consider utilizing periods of volatility.

01 The Fed is likely to hold rates steady in the near term.

- The Federal Reserve left interest rates unchanged at 3.50-3.75% this month, with Chair Jerome Powell stressing that officials would need to see more progress in moderating inflation in the US to ease further.
- The US central bank also raised its inflation and GDP growth projections for 2026.
- Powell added that it was too soon to know the scope and duration of the Iran war's potential effects on the economy.

02 But we think the Fed's policy easing bias remains intact.

- We expect slowing core goods inflation in the US in the second half of the year to help clear the path for the next cut.
- Growth is likely to downshift to a near trend pace amid higher oil prices.
- AI advancement with fast adoption poses a structural risk to the labor market.

03 Lower interest rates strengthen the case for investors to put excess cash to work.

- Investors should consider phasing excess liquidity into diversified portfolios.
- To achieve alternative sources of portfolio income to cash, we see short- to medium-duration quality bonds and equity income strategies as appealing.

New this week

Fed Governor Lisa Cook said inflation risk is greater right now because of the Iran war, and that the labor market is in balance, but precariously so. Governor Michael Barr and Vice Chair Philip Jefferson said they preferred to keep rates on hold as they assessed how the war might affect inflation and growth.

One liner

The Fed's policy easing bias remains intact, and investors with excess cash should consider phasing into diversified portfolios.

Did you know?

- Analysis by the Dallas Fed shows that the incremental price pressure due to rises in energy prices tends to fade quickly after a few months, with core inflation little changed.
- We think bond markets are currently too focused on the short-term inflationary impact of higher energy prices, and not enough on the potential medium-term negative growth impact which could drive interest rate cuts, nor on the potential for de-escalation.
- Cash tends to underperform other assets over time: Stocks have outperformed cash in 86% of all 10-year periods and 100% of all 20-year periods since 1926.

Investment view

Lower interest rates reduce potential returns on cash. Investors can consider phasing excess liquidity into diversified portfolios. We also like quality bonds, which can offer a more durable source of income.

Non-Traditional Assets

Non-traditional asset classes are alternative investments that include hedge funds, private equity, real estate, and managed futures (collectively, alternative investments). Interests of alternative investment funds are sold only to qualified investors, and only by means of offering documents that include information about the risks, performance and expenses of alternative investment funds, and which clients are urged to read carefully before subscribing and retain. An investment in an alternative investment fund is speculative and involves significant risks. Specifically, these investments (1) are not mutual funds and are not subject to the same regulatory requirements as mutual funds; (2) may have performance that is volatile, and investors may lose all or a substantial amount of their investment; (3) may engage in leverage and other speculative investment practices that may increase the risk of investment loss; (4) are long-term, illiquid investments, there is generally no secondary market for the interests of a fund, and none is expected to develop; (5) interests of alternative investment funds typically will be illiquid and subject to restrictions on transfer; (6) may not be required to provide periodic pricing or valuation information to investors; (7) generally involve complex tax strategies and there may be delays in distributing tax information to investors; (8) are subject to high fees, including management fees and other fees and expenses, all of which will reduce profits.

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