

How will Fed rate hikes impact markets?

UBS House View Briefcase

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Key message

The Federal Reserve raised rates by 25 basis points in September and signaled that further tightening is likely. We expect one further increase in December, but believe markets are pricing a longer cycle than is likely to be delivered. Resilient economic growth and robust corporate earnings should help equities absorb moderately higher yields, while the recent repricing has created selective opportunities in fixed income.

01 The Fed has started to tighten policy as economic growth remains solid and inflation stays elevated.

- The Fed unanimously raised the federal funds target range by 25 basis points to 3.75–4.00%, its first increase in three years.
- Chair Kevin Warsh said policymakers had “removed a dose of accommodation” and described economic activity as expanding at a solid pace.
- Sixteen of the 18 participants projected at least one further increase this year, while the median policy-rate projection reached 4.1% for 2026.

02 But a relatively shallow tightening cycle should not derail the economy or equity markets.

- We expect one 25-basis-point increase in December, while markets are pricing three further increases by the end of 2027.
- The Fed’s own model indicates that 50 basis points of additional tightening would reduce economic growth by only a few tenths of a percentage point.
- We forecast S&P 500 earnings to rise 25% in 2026 and 14% in 2027, while profits for the median S&P 500 company are growing by around 14%.

03 So, we retain a constructive investment outlook and see select opportunities in fixed income.

- Robust and broadening profit growth should help equities absorb moderately higher yields. Investors should maintain diversified equity exposure and review concentrated single-stock positions.
- We view fixed income as Attractive and see tactical opportunities in medium- to long-duration high-quality bonds following the recent rise in yields.
- We favor stronger investment grade issuers across medium maturities and shorter-dated exposure in higher-risk credit, while remaining cautious on the longest maturities.

New this week

The Fed raised rates by 25 basis points to 3.75–4.00%, its first increase in three years. But the S&P 500 declined only modestly after the decision. Markets are now pricing three further increases by the end of 2027, compared with our expectation for one more in December.

One liner

The Fed has started to raise rates, but resilient growth and strong earnings should help equities withstand a relatively shallow tightening cycle, while higher yields create selective opportunities in fixed income.

Did you know?

- US factory activity has remained in expansion territory for eight consecutive months. Historically, US manufacturing expansions have lasted nearly three years on average.
- US nominal GDP was growing 6.6% year over year at the end of the second quarter, comprising around 2.1% real growth and a 4.4% increase in the broad price level. This can help companies grow revenues and profits in current-dollar terms.
- Past US economic downturns generally did not begin until at least two years after the Fed started raising rates, although the timing varied with the scale of the tightening cycle.

Investment view

We expect one 25-basis-point Fed increase in December and do not believe this shallow tightening cycle will derail the US economy or equity rally. Investors should maintain diversified equity exposure and address concentration risk. In fixed income, higher yields have created selective opportunities in high-quality bonds, although investors should remain disciplined on duration and credit risk.

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