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Investment Research

Stocks bounce at end of volatile week

UBS House View - CIO Alert

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What happened?

Stocks ended a volatile week on a positive note, with the S&P 500 rising 2.1% and Nasdaq advancing 2.5% on news that a government shutdown might be avoided.

Senate Minority Leader Chuck Schumer indicated he would not block a Republican funding bill. If approved by the Senate, the bill would provide funding for government operations until the end of September.

US President Donald Trump also stated on Friday that there is a "very good chance" that the war between Russia and Ukraine will end, following "productive" discussions with Russian President Vladimir Putin on Thursday.

Despite today's market optimism, the S&P 500 and Nasdaq saw their fourth consecutive negative week amid elevated political and economic uncertainty. Indeed, in economic news on Friday, the University of Michigan's consumer confidence survey showed a drop in consumer sentiment to 57.9, below the expected 63.2.

Investors will now look ahead to the Federal Reserve policy meeting next week, where futures indicate a greater likelihood of interest rates remaining unchanged.

What do we think?

Today's Senate vote will likely mean a government shutdown will be averted. This is not in itself an economic positive but should provide some optimism about the ongoing reconciliation process that will decide on tax cuts and spending decisions for the years to come.

The passage of the government funding bill in the House of Representatives, where the Republicans have a very narrow majority, points to unity within the party.

Historically, the Senate has often forced the House to capitulate on larger bills, but the House acted first and delivered a bill that a bipartisan majority in the Senate found difficult to oppose. Were this sentiment to be carried over into future debates over government spending, it could mean swifter resolutions on funding issues, though it remains to be seen whether this will be the case.

Outside of domestic politics, business sentiment surveys have pointed to deteriorating confidence in the economy, and the Atlanta Fed's closely watched GDPNow is now pointing to a 1Q contraction in activity of 2.4%.

However, we note that this reading has been distorted by a surge in gold imports. The Atlanta Fed has pointed out that actual GDP will not be affected by the gold imports, and GDPNow would be 2 percentage points higher if the gold effect were stripped out.

We believe that a resilient labor market should continue to underpin economic growth, despite recent signs of weaker confidence. February's jobs report highlighted solid payroll growth, historically low unemployment, and rising wages, all of which should help support consumer spending.

Meanwhile, slowing inflation should allow the Federal Reserve to cut rates later in the year. February's CPI report further reinforced the broader disinflationary trend as both headline and core prices increased less than expected. We expect the Fed to deliver two further 25bps rate cuts this year, in June and September.

The threat of further tariff escalation remains a key concern for investors. In our base case, we expect aggressive trade policy to weigh on US economic growth, but not so much as to drive the US toward recession or to prevent a recovery for equity markets. That said, this week we changed our scenarios to reflect that the risks around our central scenario are now skewed to the downside. We see a 20% chance of a stagflationary market outcome caused in large part by highly aggressive US tariff policies and a 10% probability of a cyclical bear market.

How to invest?
Our core message remains to stay invested in stocks, but also hedging equity exposures to manage ongoing tariff-related and geopolitical volatility. Investors should ensure portfolios are well diversified with assets such as quality bonds, gold, and alternatives to effectively navigate current challenges.

Navigate political risks. Tariff-related uncertainty and trade policy shifts reinforce the need for portfolio diversification and risk management. In equities, capital preservation strategies can help manage downside risks. We continue to favor high-quality fixed income like investment grade corporate bonds, which may provide a hedge against trade risks.

More to go in stocks. In our base case, we expect US equities to end the year meaningfully higher than today's levels, with a December 2025 S&P 500 target of 6,600. US policy uncertainty could lead to short-term volatility, but we believe that continued structural AI tailwinds and solid earnings growth should drive markets higher once policy uncertainty peaks.

Seize the AI opportunity. The 4Q24 results season demonstrated that AI fundamentals remain intact. Although economic and policy uncertainty are likely to contribute to near-term volatility, we continue to see broad-based long-term investment opportunities across the value chain, particularly in AI infrastructure with strong pricing power and megacap platform beneficiaries. Near-term volatility should present an opportunity to build strategic, long-term AI exposure.

Appendix

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