Equities or bonds: Where do investors see the best returns through to year-end?

And what do they expect the Fed to do with rates at its final two meetings?

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By Steve Randall

Investors are feeling confident that the US economy is headed in the right direction, with **the Fed now cutting rates** and data such as the recent PCE stats adding weight to confidence.

As the third quarter of 2024 draws to a close today, the S&P 500 is expected to post a 5% increase over the three month period and is up more

than 20% for the year-to-date, with new highs delighting market participants.

While some express concern of a correction, most investors taking part in Bloomberg's MLIV Pulse Survey are confident in the market and 60% expect returns from US equities to outperform government and corporate bonds through to the end of the year.

There is also growing confidence that the Fed can aid the economy to a soft landing and 59% of respondents expect two quarter-point rate cuts at the last two FOMC meetings of 2024.

Asked about the riskiest trades for the remainder of the year, more than one third of respondents said they will avoid oil (36%) followed by **Treasuries** (29%), and gold (24%).

Treasuries are expected to post gains for a fifth consecutive month but there are concerns that Fed cuts could spark a resurgence of inflation, impacting long-term bonds.

"Term premium of longer-dated Treasuries is set to rise, while liquidity risks — already heightened as the government runs persistently large fiscal deficits — is likely to deteriorate," said Simon White, Blomberg macro strategist on MLIV.

INFLATION RISK

Inflation is seen as less risky though with last week's PCE data revealing slowing personal consumption of 1.8% annualized rate in August.

Greg Wilensky, head of US Fixed Income at Janus Henderson Investors, says that the stats give the Fed room for choices, but labor market data will be key when it's released later this week.

"[The] slightly better-than-expected PCE inflation data leaves the Fed in a position of maximum flexibility as they decide on the speed of rate cuts. We see this flexibility as helping to reduce the magnitude of the

downside scenarios for riskier assets such as stocks and high yield bonds if the labor market data were to weaken further. If that weakening occurs, it would be easier for the Fed to continue to aggressively cut policy rates given that Core PCE over the last 3 months is basically at the Fed's 2% annual target, reducing the blow to these markets," Wilensky said.

The firm's base case is for two cuts of 25 basis points each but weaker jobs data could prompt at least one of 50bps.

However, José Torres, senior economist at Interactive Brokers, says that there is another factor that should be carefully watched.

"One thing market bulls aren't focusing on is that households flipped the spending switch south last month, as folks took a break from July's purchasing momentum to recover and replenish cash levels," Torres noted in his latest IBKR Economic Landscape commentary. "The detail is significant because the number must remain positive for a soft landing to occur. Yields are moving south as a result, as the odds of further consumption weakness increase."