

Daily: Resilient growth should steady markets

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Thought of the day

US government bonds had a volatile session on Thursday as investors weighed competing signals on growth, inflation, and monetary policy. The 10-year Treasury yield initially climbed to 5.34%, its highest intraday level since 2002, after manufacturing activity remained firmly in expansion and initial unemployment claims fell to a 10-week low. The yield subsequently reversed course and ended around 4 basis points lower at 5.24%, as comments from senior Fed officials indicated that policymakers were not in a hurry to raise rates again.

The swings illustrate the difficulty investors face judging the outlook for rates. Resilient growth and renewed input-cost pressure could keep yields volatile, particularly if today's employment report is stronger than expected. But we think employment conditions, the broader inflation trend, and a more patient Fed should enable equities to withstand moderately higher rates.

Recent evidence has pointed to strength in the labor market ahead of today's US payroll figures. Initial unemployment claims fell to 197,000 in the week ending 26 September, their lowest level in 10 weeks, while continuing claims declined to 1.7 million, their lowest level in three and a half years. This follows August's strong employment report, when nonfarm payrolls rose by 162,000, well above expectations, while previous months were revised higher. Hiring is expected to have moderated in September, with consensus forecasts pointing to a 90,000 increase in payrolls and an unchanged unemployment rate of 4.1%. Even so, a gain in line with consensus would remain consistent with a healthy labor market, given recent estimates that the monthly pace needed to keep unemployment stable has declined substantially.

Underlying inflation should continue to moderate despite renewed pressure on input costs. The ISM manufacturing index remained firmly in expansion territory at 54.5 in September, while the employment component rose to 52.7. However, the prices-paid component climbed to 77.9, above expectations of 73.0, underlining the risk that rising costs could keep bond yields elevated. The broader inflation picture has been more reassuring: The three-month annualized rate of core PCE inflation fell to 2.05% in August, its lowest level since July 2024, while the share of products recording inflation above 3% also declined. We continue to expect further disinflation over the next six months, although a renewed broadening of price pressures would present a risk to this view.

Recent Fed commentary points to a more patient approach to further tightening. Top officials struck a notably more dovish tone in comments on Thursday and earlier in the week. Vice Chair Philip Jefferson said that policymakers would need to reach their own judgment on the appropriate path for interest rates, "which may take more time," while Governor Michelle Bowman said she did not "currently see an urgent need for further action." John Williams offered a similar message, saying that "there is no need for urgency, and we have time to gather more information." These comments helped reduce the market-implied probability of an October rate hike to around 30% on Thursday, from 70% on Monday. Our base case is for the Fed to raise rates once more in December and then to keep them steady in 2027, rather than delivering the extended tightening cycle now reflected in market pricing.

So, we expect resilient economic growth and robust earnings to support further equity gains over the

next six to 12 months. Higher yields become more concerning for stocks when economic growth begins to falter; for now, the latest activity and employment evidence point to an economy on solid footing. We forecast S&P 500 earnings growth of 25% this year and 14% in 2027, which should help equities absorb moderately higher interest rates. We recommend positioning for further equity gains through broad sector and regional diversification, while managing concentration risk.

Source: <https://www.ubs.com/global/en/wealthmanagement/insights/chief-investment-office/house-view/daily/2026/latest-02102026.html>