WELLS FARGO
Investment Institute

Market Commentary

Weekly perspective on current market sentiment **January 4, 2024**

Scott Wren
Senior Global Market Strategist

Last week's S&P 500 Index: +0.3%

Looking forward in the new year

Key takeaways

- Our focus has been on quality, large-capitalization U.S. equities that have reliable earnings streams.
- If our anticipated scenario plays out, we envision a rotation into asset classes that are more cyclically oriented.

Our regular readers know that we have largely been defensively positioned for quite some time. Pegging the precise timing of an economic slowdown is always difficult, but the economy is clearly slowing, and we expect, first, a bumpy stock market ride in the midst of slowing economic growth followed by a recovery that takes hold in the second half of the year and into 2025. Given that outlook, we wanted to assess where were we are now in terms of portfolio positioning versus where we think exposures might be moving over the course of this year. We find it helpful to try and anticipate how portfolios might evolve and adjust should the underlying economy perform as we expect. We think it is wise for investors to do the same as they contemplate their portfolio planning.

For most of 2022 and all of last year, in terms of stocks, our focus has been on quality, large-capitalization U.S. equities that have reliable earnings streams and cash flows plus strong balance sheets. As the economy continues to slow, we suggest that investors reallocate funds from the richly valued Information Technology, Consumer Discretionary, and Communications Services sectors toward our current favorable-rated Industrials, Materials, and Health Care sectors. In addition, we have favored high-quality bonds and have suggested that portfolios slightly favor fixed income over equities.

But if our anticipated scenario plays out, at some point in the second half of this new year, we would envision a rotation into asset classes and sectors that are more cyclically oriented and better positioned to lead out in an economic recovery.

For example, asset classes that tend to outperform early in a new cycle (coming out of a slowdown or recession) are small-cap and emerging-market equities along with high-yield bonds. Once again, these asset classes tend to be more tied to the economy than a number of others. We believe it's too soon now to move into these markets, but as investors begin to sense that brighter skies are likely on the horizon, funds historically have tended to flow from more defensive asset classes toward those more leveraged to the recovery. Often these flows start to occur midway through any slowdown or recession and frequently come as the Federal Reserve is in the process of cutting interest rates.

In terms of fixed income, we anticipate higher rates as we move through the last half of the year as a recovery takes hold. The dramatic decline in yields since November 1 has generated positive returns for fixed-income investors. Now may not be the best time to add new exposure, but an economic recovery should provide more buying opportunities to lock in higher yields than are available today.

Risk considerations

Forecasts are not guaranteed and based on certain assumptions and on views of market and economic conditions which are subject to change.

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Foreign investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. These risks are heightened in emerging markets. **Small- and mid-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large company stocks. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates. **High yield (junk) bonds** have lower credit ratings and are subject to greater risk of default and greater principal risk.

Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility.

General Disclosures

Global Investment Strategy (GIS) is a division of Wells Fargo Investment Institute, Inc. (WFII). WFII is a registered investment adviser and wholly owned subsidiary of Wells Fargo Bank, N.A., a bank affiliate of Wells Fargo & Company.

The information in this report was prepared by Global Investment Strategy. Opinions represent GIS' opinion as of the date of this report and are for general information purposes only and are not intended to predict or guarantee the future performance of any individual security, market sector or the markets generally. GIS does not undertake to advise you of any change in its opinions or the information contained in this report. Wells Fargo & Company affiliates may issue reports or have opinions that are inconsistent with, and reach different conclusions from, this report.

The information contained herein constitutes general information and is not directed to, designed for, or individually tailored to, any particular investor or potential investor. This report is not intended to be a client-specific suitability or best interest analysis or recommendation, an offer to participate in any investment, or a recommendation to buy, hold or sell securities. Do not use this report as the sole basis for investment decisions. Do not select an asset class or investment product based on performance alone. Consider all relevant information, including your existing portfolio, investment objectives, risk tolerance, liquidity needs and investment time horizon. The material contained herein has been prepared from sources and data we believe to be reliable but we make no guarantee to its accuracy or completeness.

Wells Fargo Advisors is registered with the U.S. Securities and Exchange Commission and the Financial Industry Regulatory Authority, but is not licensed or registered with any financial services regulatory authority outside of the U.S. Non-U.S. residents who maintain U.S.-based financial services account(s) with Wells Fargo Advisors may not be afforded certain protections conferred by legislation and regulations in their country of residence in respect of any investments, investment transactions or communications made with Wells Fargo Advisors.

Wells Fargo Advisors is a trade name used by Wells Fargo Clearing Services, LLC and Wells Fargo Advisors Financial Network, LLC, Members SIPC, separate registered broker-dealers and non-bank affiliates of Wells Fargo & Company. PM-07032025-6192765.1.1