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Investment Institute

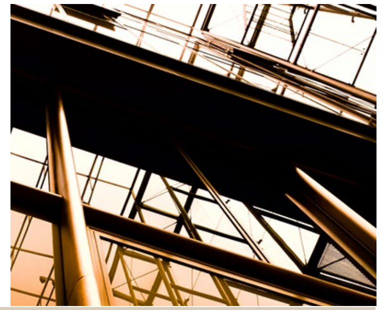
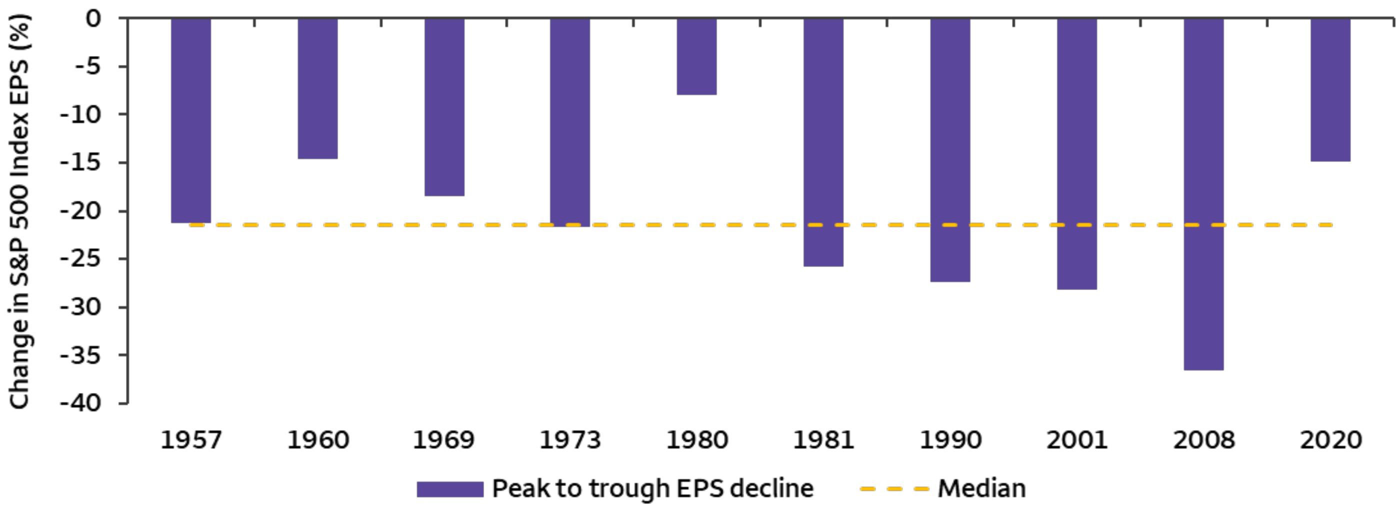


Chart of the Week

Weekly market analysis on key market indexes | **January 23, 2024**

Earnings unlikely to escape a slowdown unscathed



Sources: Bloomberg and Wells Fargo Investment Institute, as of December 31, 2023. EPS = earnings per share. Analysis uses the monthly S&P 500 index trailing 12-month EPS measured from peak trailing EPS during official recession dates to trough that occurred within 12 months of recession end. See recession dates on page 2.**Past performance is no guarantee of future results.**

The S&P 500 Index surpassed its last peak, but we expect near-term pressure on earnings

After two long years, the S&P 500 Index reached another all-time high on January 19. Much of the recent strength, however, has come as a result of markets expecting a combination of aggressive rate cuts, a still-strong economy, low inflation, and easy financial and credit conditions; those factors don't happen together all that often.

We believe the market's disappointment upon realizing that its investment case is built on hope rather than reality will lead markets to pull back. Our view is that earnings for all equity classes peaked and will move lower as the economy weakens and revenue growth stalls. In the near term, we expect pressure on earnings as well as prices with bouts of weakness and range trading. The chart provides further context from past recessions, with a median peak-to-trough contraction of -21.4%.

What it may mean for investors

In our view, investors should stay disciplined and maintain a defensive posture — we are favorable on U.S. Large Cap Equities, neutral on U.S. Mid Cap Equities, and most unfavorable on U.S. Small Cap Equities. We expect a slowing economy and tighter financial and credit conditions to pose headwinds going forward, but once the economic slowdown appears to be fully priced into market valuations, we likely will look for an opportunity to position for an emerging early cycle recovery. More cyclically oriented equities should benefit the most when the economy gains its footing and corporate earnings begin to grow again.

Sameer Samana, CFA; *Senior Global Market Strategist* Excerpted from *Investment Strategy (January 22)* and *Market Charts (January 5)*

Risk Considerations

Forecasts and targets are 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. **Stocks** may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Small- and mid-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large company stocks.

Asset allocation and diversification are investment methods used to help manage risk. They do not guarantee investment returns or eliminate risk of loss including in a declining market.

Definitions

Recession dates in chart are as follows: August 1957 to April 1958, April 1960 to February 1961, December 1969 to November 1970, November 1973 to March 1975, January 1980 to July 1980, July 1981 to November 1982, July 1990 to March 1991, March 2001 to November 2001, December 2007 to June 2009, and February 2020 to April 2020.

S&P 500 Index is a market-capitalization-weighted index considered representative of the U.S. stock market. An index is unmanaged and not available for direct investment.

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