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Investment Institute

Market Commentary

Weekly perspective on current market sentiment **February 14, 2024**

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Last week's S&P 500 Index: +1.4%

Quality emphasis

Key takeaways

- Stocks are not cheap, but you have to respect the momentum that has carried the S&P 500 to record highs.
- We want to own quality sectors like Technology for the long term, but we want to buy at a reasonable price.

Our regular readers know that over the last couple of years we have leaned toward those asset classes and sub-sectors that our analysis suggested offered reliable cash flows and perceived lower risk. We have used the term "quality" quite frequently to broadly describe the characteristics that we have sought for the bulk of our portfolio preferences. For the purposes of equity exposures, quality, as mentioned above, also targets earnings growth consistency, low levels of debt, and strong balance sheets.

A quick comparison of the performance of the S&P 500 Index (SPX) to lesser-quality equity asset classes like U.S. small caps (as tracked by the Russell 2000 Index) and emerging markets (as tracked by the MSCI Emerging Markets Index) over the past 12 months show a dramatic difference in returns. Over that time frame, as of February 12, 2024, the SPX has rallied 22.9% while the Russell 2000 has gained 6.7% and the MSCI Emerging Markets Index has dropped 2.8% (these returns exclude dividends). The SPX has been setting new record highs, but the other two indexes are far below theirs. Quality equity assets tend to draw investor attention (and funds) during times of uncertainty due to their perceived reliability and durability.

Stocks are not cheap in our opinion, but you have to respect the momentum that has carried the SPX to a level just above the top end of our 4,800 – 5,000 year-end 2024 target range. The equity asset class and sector that have led the charge to record highs, U.S. large-cap equities (i.e., SPX) and the Information Technology sector, are among what we consider to be the highest-quality equity assets to own in the current environment.

The S&P 500 Technology sector index has also been setting record highs. And while we want to own quality sectors like Technology for the long term, we also want to buy at a reasonable price. The Technology sector appears meaningfully overvalued, and we continue to prefer trimming exposures down to reflect our neutral rating on the sector. Much of the Technology sector's rally has been based on the outlook for companies tied to artificial intelligence (AI).[1] We see risks in buying many of these highly valued equities today as the longer-term prospects and roadmaps to profitability remain unclear.

We are focused on sectors exhibiting long-run quality characteristics like Health Care, Industrials, Materials, and Energy. These sectors appear to represent a better value today than Technology, and they also should provide the key goods and services that will be necessary to rebuild and build out parts of the economy that will be needed in the coming decade.

We continue to emphasize quality in our equity preferences but anticipate downside opportunities that will allow us to move funds from short-term fixed income back into stocks.

1. "The Ascent of Generative AI — What Investors Should Know," Wells Fargo Investment Institute, September 8, 2023

Risk considerations

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. **Technology** and internet-related stocks, especially of smaller, less-seasoned companies, tend to be more volatile than the overall market. **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.

Definitions

MSCI EAFE Index is designed to represent the performance of large and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the U.S. and Canada.

MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the US stock market.

S&P 500 Information Technology Index comprises those companies included in the S&P 500 that are classified as members of the GICS® information technology sector.

An index is unmanaged and not available for direct investment.

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