WELLS FARGO
Investment Institute

Market Commentary

Weekly perspective on current market sentiment | **December 6, 2023**

Scott Wren
Senior Global Market Strategist

Last week's S&P 500 Index: +0.8%

Reiterating a couple of headwinds

Key takeaways

- There are a number of headwinds building that will likely result in a continuation of the slowing economic trend.
- We believe these headwinds will turn the economy, consumer spending, and earnings lower.

The S&P 500 Index (SPX) has had a nice bounce off the late-October lows over the last five weeks. In addition, after hitting 5% in late October, the highest yield in 15 years, the price of the 10-year Treasury note also surged, pushing the yield down to just below 4.2% last week (remember, when bond prices rise, yields generally fall). Price moves in equities and bonds of that magnitude in such a short period of time have happened infrequently. The bottom line is market participants appear to be quite enthusiastic about the potential for a soft economic landing (no recession), a noticeable rise in earnings next year, and a Federal Reserve (Fed) that might cut rates as early as May. We are not optimistic these events will play out the way investors expect.

Our analysis suggests there are a number of headwinds building that will likely result in a continuation of the slowing economic trend, little SPX earnings growth in 2024, and a Fed that keeps rates higher for longer than the market is expecting. Our regular readers have been aware of some, if not all, of these headwinds for much of this year. But as stocks have rallied and yields have fallen, some investors have been questioning whether or not these headwinds will be enough to deter stock prices from a further rise as we move into the early-to-middle portion of next year. Let's take a look at some headwinds.

Perhaps most importantly for the financial markets, we see investors being ultimately disappointed that the Fed does not start cutting rates as soon as expected. For reference, at the time of this writing, the federal funds futures market is pricing in a slightly more than 50% probability of a rate cut at the March Federal Open Market Committee (FOMC) meeting and nearly a 70% chance of another cut in May. Then, the market is pricing in a minimum 60% chance of a cut at each of the remaining FOMC meetings next year. Expectations for this level of aggressive rates cuts is far too optimistic in our view. Core inflation (which excludes the effects of food and energy) remains well above the Fed's long-term 2% target. The Fed's likely path is higher for longer rates until inflation is confidently lower.

We also believe investors are discounting the effects of tightening credit conditions across the economy. Per the Fed's October quarterly Senior Loan Officer Survey, businesses and consumers are having a tougher time obtaining credit for everything from operating and equipment loans to auto and home loans. The American economy runs on credit. When less credit is available, spending is typically hindered.

While stocks and bonds have staged robust rallies over the last five weeks, we believe these meaningful headwinds will turn the economy, consumer spending, and earnings lower. It does not appear these risks are priced in. We recommend that investors remain defensively positioned.

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** are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **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. Although **Treasuries** are considered free from credit risk, they are subject to other types of risks. These risks include interest rate risk, which may cause the underlying value of the bond to fluctuate.

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-06052025-6140603.1.1