WELLS FARGO
Investment Institute

Weekly perspective on current market sentiment **November 24, 2021**

Scott Wren
Senior Global Market Strategist

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

Main themes remain intact, part 2

Key takeaways

- We adjusted our year-end 2022 interest rate targets modestly higher and now expect one Federal Reserve (Fed) rate hike next year.
- While we favor stocks over bonds, we believe fixed income exposure remains an important piece of a diversified portfolio.

Last week we discussed some of our recent adjustments to targets and guidance looking out through year-end 2022, focusing on equities. This week let's look into some of the other adjustments, specifically in the fixed income asset class.

Importantly, as a reminder, while we did announce a number of changes in a variety of asset classes, the big-picture takeaway remains: We look for above-average gross domestic product (GDP) growth here at home as we look out over the next 13 months with only modest interest rate increases. Another key to our forward outlook is that we think inflation will decelerate from recent high levels as we move through the end of next year. While we do look for inflationary pressures to slow as we look forward, readers should know that Consumer Price Index (CPI) readings will likely stay higher as we move through the next year relative to the prepandemic period. In other words, we believe the disinflation much of the world experienced in the decade before COVID-19 is unlikely to return over our forecast period.

From a high level, fixed income has been in a relatively stable trading environment for some time. Both high-yield and investment-grade credit spreads have been hovering at low levels this year. The market appears comfortable with a continuation of the economic recovery and the credit worthiness of bond issuers. Given the tightness of these spreads to Treasury yields, we currently rate the high-yield and investment-grade credit segments of the bond market as neutral.

Rising inflation, at this point, has pushed yields up only modestly. For example, the 10-year Treasury currently yields 1.65%, which is very near the highs seen earlier this year. However, this month the Fed is beginning the process of tapering the amount of bonds (Treasuries and mortgage backed securities) it has been purchasing in the open market each month. Given that process, the current level of CPI, and the above-average economic growth we expect looking out through year-end 2022, we have adjusted our 10-year Treasury yield target slightly higher. The mid-point of our year-end 2022 target range projection has been boosted up to 2.25% versus the prior 2%. In addition, we do now look for one Fed rate hike next year.

But as we did last week, we want to drive home our main message: We believe growth in the U.S. will be well above average as we look out through the end of next year while inflation slowly decelerates from current levels. We look for the labor market to improve and consumer spending to continue to drive the economy. We expect new all-time record highs in the S&P 500. And we continue to favor equities over bonds.

While our adjustments were modest, we believe fixed income remains an important piece of a diversified portfolio, even when taking into account anticipated interest rate increases.

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. **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. **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. 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.

Definitions

Consumer Price Index (CPI) produces monthly data on changes in the prices paid by urban consumers for a representative basket of goods and services.

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

An index is unmanaged and not available for direct investment.

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. CAR 1121-04938