WELLS FARGO
Investment Institute

Market Commentary

Weekly perspective on current market sentiment | November 17, 2021

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

Main themes remain intact

Key takeaways

- We have made a number of adjustments to our recommendations in terms of targets and guidance.
- However, we continue to prefer stocks over bonds and believe the S&P 500 will hit further record highs next year.

Earlier this week we announced a number of target and guidance adjustments in a variety of asset classes and subasset class segments as we looked out through year-end 2022. Global growth and the continuing rebound from the pandemic-induced recession have been uneven at times. Still-lingering COVID-19 effects and the massive supply chain disruptions have created headwinds in a wide swath of industries. Everything from semiconductor chips to raw materials to labor has been in short supply with the situation unlikely to see much improvement in the near term. Looking ahead, we believe supply chain issues should start to ease sometime in the second half of next year. In terms of the virus and related mandates and lockdowns, a little more than half the world's population has at least one COVID-19 vaccine shot, and the total is on pace to hit 9 billion by year-end 2022. This progress should help push the recovery forward.

But the key point we want to drive home is that our overall thesis calling for U.S. growth to remain well above the historical average as inflation decelerates next year is intact. In this type of macro environment, we continue to believe the S&P 500 will trade to new all-time record highs next year as interest rates move modestly higher. We continue to favor equities over bonds. We also believe the dollar will likely be stronger than initially anticipated.

From a high level, some of the more noteworthy adjustments to our outlook include increasing our 2022 inflation and interest rate targets while lowering our estimates for U.S. and global growth. We have modestly increased some equity index targets for next year, including the S&P 500. In a move to add quality to portfolios, we have downgraded U.S. small caps to neutral and upgraded U.S. mid caps to favorable. In addition, we downgraded the Energy sector to neutral after a big run higher and brought Information Technology up to favored status.

Specifically, in terms of equities, we have chosen to step up our focus on higher-quality equity asset classes as we begin to move beyond the early stages of the economic cycle. Small-cap U.S. equities have tended to perform well in the early portions of a recovery as investors are willing to take on more risk. That has certainly been the case in the post-recession recovery period. But now our work suggests moving further up on the quality scale by taking small caps down to a neutral rating and bringing mid caps up to favorable. Mid-cap companies tend to be higher quality with a broader array of products or services, stronger balance sheets, easier access to credit, good cash balances, and a more attractive return on equity than smaller-capitalization companies. The Russell Midcap Index also has a larger allocation to the higher-quality Information Technology sector.

Our current allocations, taking our recent adjustments into account, reflect our belief that the recovery still has legs as we move into a more sustainable growth pattern. Our advice is to stay invested.

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. **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.

Definitions

Russell Midcap Index measures the performance of the 800 smallest companies in the Russell 1000 Index.

Russell 1000 Index measures the performance of the 1,000 largest companies in the Russell 3000 Index, which represents approximately 90% of the total market capitalization of the Russell 3000 Index.

Russell 3000 Index measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market.

An index is unmanaged and not available for direct investment.

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