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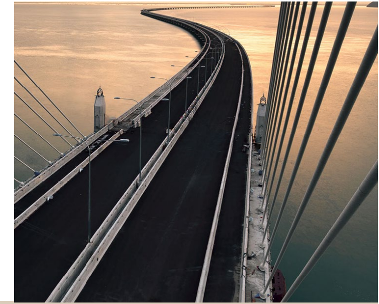
Investment Institute

Investment Strategy



Weekly guidance from our Investment Strategy Committee **January 6, 2025**

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- We think both the U.S. economy and U.S. equities will outperform their developed-market and emerging-market counterparts. We favor U.S. Large Cap Equities and are looking for opportunities to expand holdings in Mid and Small Caps.
- For income-oriented portfolios, we favor reallocating from short-term fixed income into longer-dated maturities, Commodities, Private debt and hedge fund strategies that have historically performed well when economic growth increased.

Equities: 2025 outlook 4

- We believe increasing economic growth will drive company sales while deregulation, continued cost control, and loosening credit conditions should support expanding profit margins in 2025.
- We expect equity prices to continue to march higher, driven primarily by earnings growth that broadens to more cyclically oriented areas of the market.

Fixed Income: Long-term yields to rise 5

- We believe the Federal Reserve (Fed) has flexibility to cut interest rates further, but that policymakers will proceed cautiously based on how quickly the economy and inflation rebound.
- Investment-grade corporate issuers enter 2025 with strong credit metrics and largely supportive outlooks from the major rating agencies.

Real Assets: 2025 Commodities outlook 6

- In 2025, we are expecting to see higher overall commodity prices, driven by improving global demand and sluggish supply growth.
- Our favorite sectors are Precious Metals and Energy. We are expecting both sectors to gain at least 10% in 2025, which exceeds the return we expect from the mid-point of our 250 – 270 target range for the broader Bloomberg Commodity Total Return Index.

Alternatives: Looking ahead to 2025 7

- Our alternative investment guidance is transitioning to strategies we believe are poised to benefit from lower interest rates, rising equity prices, and a gradual recovery in the economy.
- We expect to continue to shift toward less defensive strategies as we gather additional data confirming the expected gradual recovery is taking hold.

Current tactical guidance 8

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Asset Allocation Spotlight

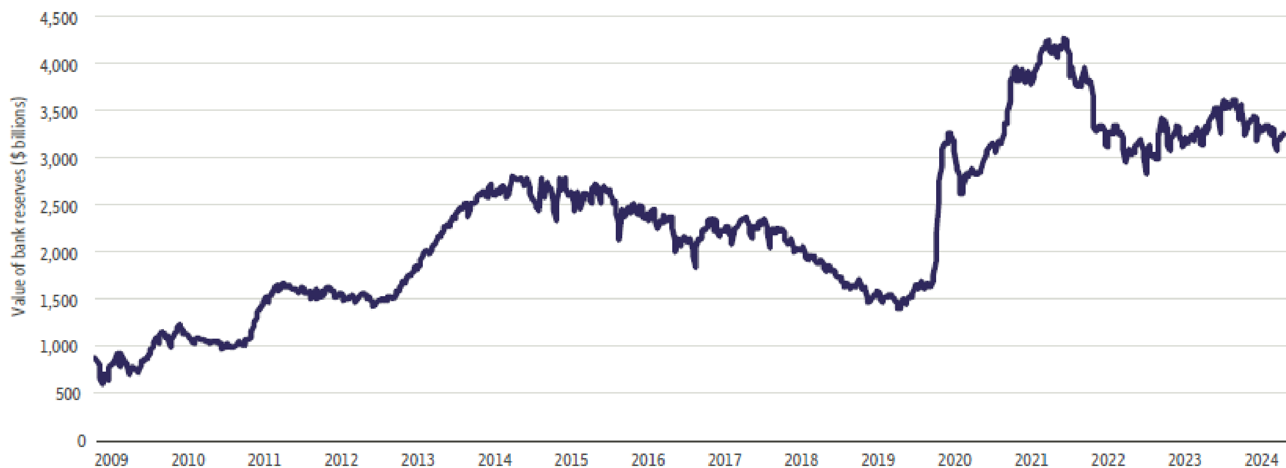
Global Asset Allocation Team

Top five portfolio ideas for 2025

1. Prepare for abundant liquidity to broaden opportunities

The potential for liquidity from government spending, Fed rate cuts, and bank lending should support consumer and corporate investment spending. That expected spending together with cash on the sidelines favors a full allocation to equities, in our view. Specifically, we think Communication Services and the Specialty Retail sub-sector will benefit from our expectations for strength in consumer spending while corporate investment spending will support the Industrials and Energy sectors. Bank reserves have declined from their peak but remain plentiful, and should drive credit growth in 2025 (see Chart 1 below). Improving net-interest margins and the potential for regulatory relief reinforce our favorable view of the Financials sector. On the other hand, we think more defensive sectors like Consumer Staples and Utilities could detract from near-term performance.

Chart 1. Cash available for banks to lend is near a 15-year high



Sources: Wells Fargo Investment Institute and Bloomberg. U.S. reserve balances with Federal Reserve Banks. Weekly data, January 7, 2009 – November 6, 2024.

2. Position for a cyclical recovery but remain tilted toward U.S. assets

Our expectations for stronger and more sustained economic growth should lead to a global recovery that is centered in the U.S. To take advantage of the next chapter in the economy, we think investors should establish positions in economically sensitive assets like small caps and be alert to opportunities to build larger positions as if economy improves as we expect. In the meantime, we favor U.S. Large Cap Equities, U.S. Intermediate Term Taxable Fixed Income, and Commodities, which should benefit from a rebound in global demand.

3. Rethink investment income

As the Fed cuts rates, we look for short-term yields to come down, but longer-term yields will likely rise with economic growth, tariffs, and immigration restrictions. Therefore, we favor moving investments in money market funds and U.S. Short Term Taxable Fixed Income into a laddered bond structure, suggesting U.S. Intermediate Term Taxable Fixed Income (bonds maturing in 3 – 7 years) first, then we prefer building out the longer end of the ladder as rates move toward our year-end targets. Income investors should also consider dividend-paying equities. With

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over $2.4 trillion on their balance sheets, we expect U.S. large-cap companies to continue to initiate and increase dividend payouts. For qualified investors, Private Debt may offer opportunities to increase income through exposure to often fast-growing, high-yield companies.

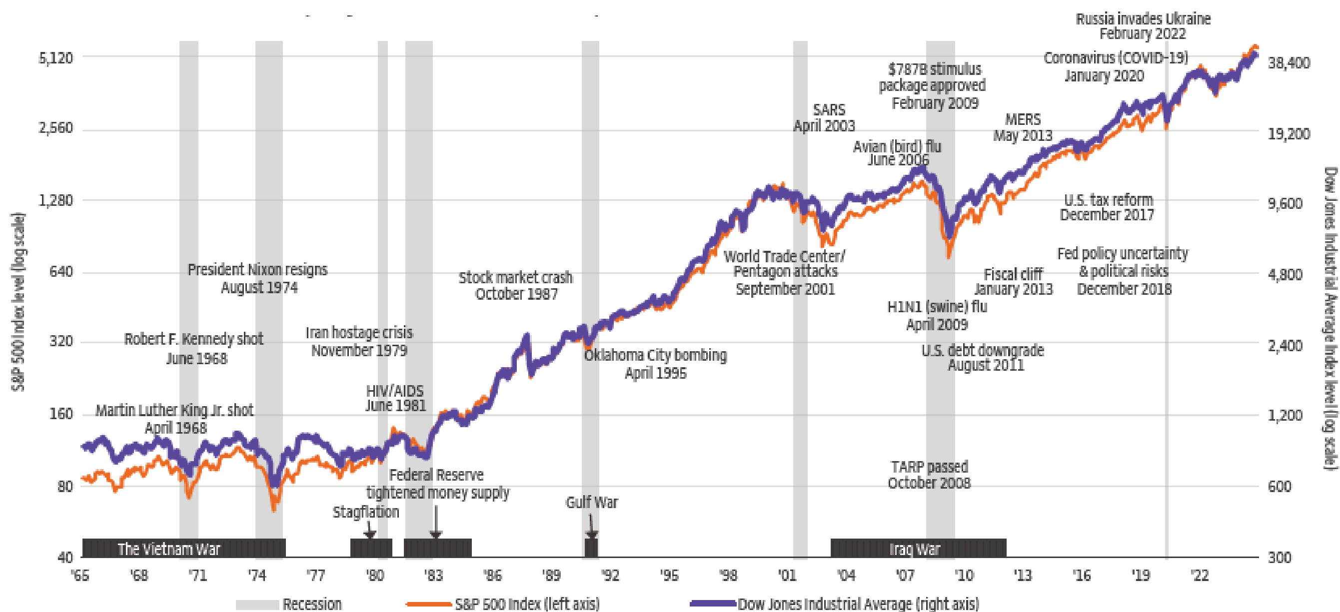
4. Consider expanding opportunities in artificial intelligence (AI)

The AI theme has underpinned the rallies in semiconductors and cloud-computing services over the past couple of years. We think direct investment to build out AI capabilities will likely slow, especially as investors begin to demand the realization of profits from corporate investments in AI technology. We believe investors may benefit from the AI theme through the Energy and Communication Services sectors and the Interactive Media & Services sub-sectors, where some tangible efficiencies are beginning to materialize. These core inputs to the growth trend in AI look more attractively priced than the big names in the Information Technology sector, where we currently favor holding a market-weight share. The next chapter for AI will be the true test of its ability to enhance real productivity. If the technology lives up to the hype, it could fuel another leg of earnings growth, capital expenditures (capex) spending, and economic growth.

5. Keep extreme risks in perspective

With two hot wars, a transition in U.S. leadership, and increasingly widespread global political change, we see 2025 shaping up to be a year where event risks are likely to garner headlines. Such an environment has the potential to unnerve investors and cause them to make costly investment mistakes. A common investor reaction to event risk is selling riskier assets in favor of cash. However, instead of holding a heavy allocation to cash, we would seek to hedge extreme risks with investments in Commodities like energy and gold and by considering alternative investments like hedge funds that can potentially deliver relatively attractive returns in a variety of market environments.

Chart 2. U.S. markets have displayed resilience despite uncertain events



Sources: Bloomberg and Wells Fargo Investment Institute, as of October 31, 2024. Monthly data, January 1965 – October 2024. Representative indexes include the S&P 500 Index and the Dow Jones Industrial Average. An index is not managed and not available for direct investment. **Past performance is not a guarantee of future results.**

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Equities

"Yesterday is gone. Tomorrow has not yet come. We have only today. Let us begin." — Mother Teresa

Austin Pickle, CFA
Investment Strategy Analyst

Edward Lee
Investment Strategy Analyst

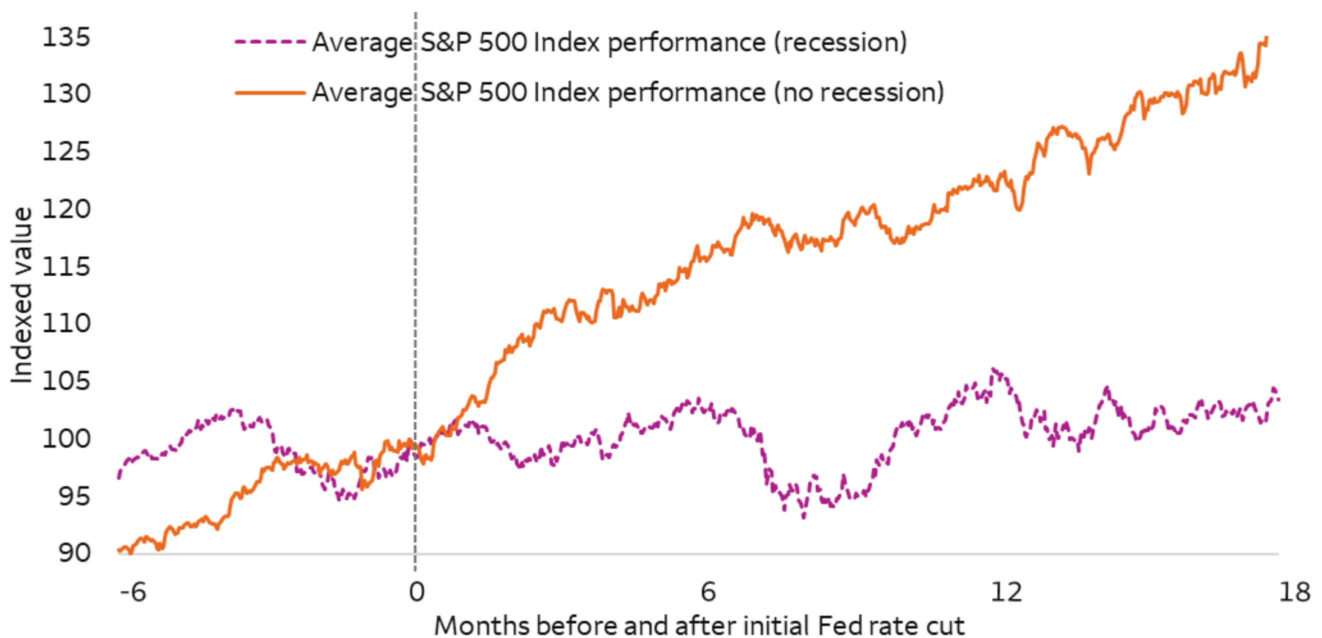
2025 outlook

Earnings should be the primary driver of 2025 prices across equity asset classes. We expect that a broadening and rising economic growth, spurred on by a Fed easing cycle and resilient consumer, should fuel healthy top-line sales growth while the past two years' focus on cost control should help turn revenue growth into profit growth. Our year-end 2025 S&P 500 Index earnings per share target is $275 and price target range is 6500 – 6700.

Our forecast for higher equity prices under a Fed easing cycle and a supportive macro environment is consistent with history. In fact, of the four easing-cycle cases absent a recession since 1980, the average S&P 500 Index return 12 months following the first cut was over 22%, with the single worst return still an impressive 16% (see chart below).

Positionally, we remain tilted toward quality and prefer U.S. over international and U.S. Large Cap Equities, which we rate as favorable, over U.S. Mid-Cap Equities (neutral rating) and U.S. Small Cap Equities (neutral rating). Overseas, we prefer Developed Market Ex-U.S. (neutral rating) over Emerging Markets (unfavorable rating). Sector positioning for an economic recovery, long-term interest rates that remain elevated, a resilient consumer, improving sentiment, and long-term secular growth themes can be summed up in the theme "anything but defensives." In other words, we generally prefer more cyclical and growth-oriented sectors over the typically defensive ones. Currently, we hold a most favorable ranking on Energy and favorable rankings on Communication Services, Financials, and Industrials. Meanwhile, we are unfavorable on Consumer Staples and Utilities.

Favorable stock-return track record when Fed has cut rates while avoiding recession



Sources: Ned Davis Research, Bloomberg, and Wells Fargo Investment Institute. Indexed to 100 at time "0", the initial rate cut, to measure performance. Recession cases include the cutting cycles that began 5/30/1980, 11/2/1981, 1/3/2001, 9/18/2007, and 7/31/2019. No recession cases include the cutting cycles that began 11/21/1984, 6/6/1989, 7/6/1995, and 9/29/1998. An index is not managed and not available for direct investment. **Past performance is not a guarantee of future results.**

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Fixed Income

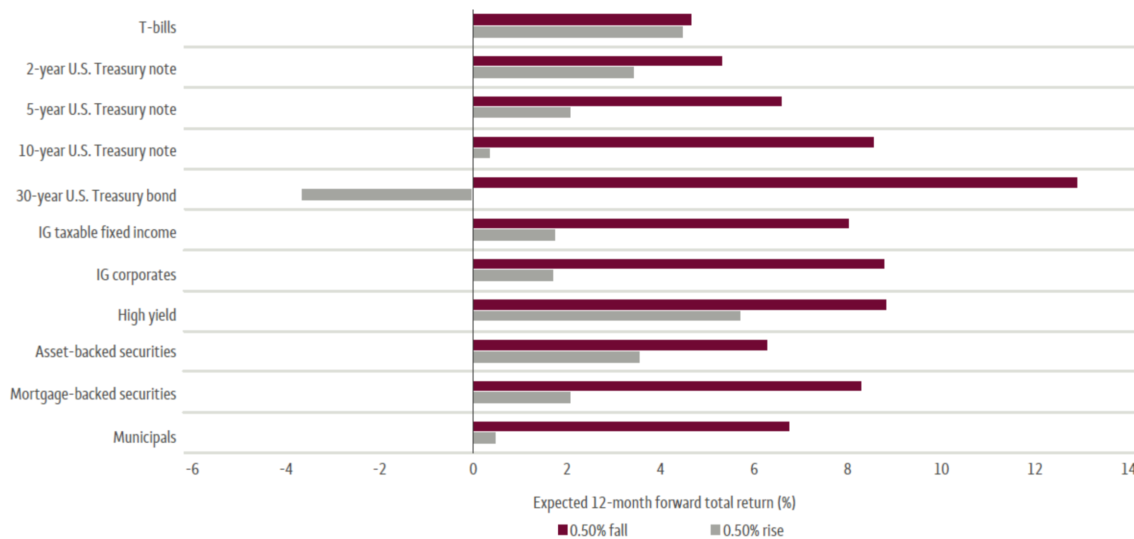
Brian Rehling, CFA
Head of Global Fixed Income Strategy

Long-term yields to rise

In our view, the Fed has leeway to cut interest rates further in the early months of 2025 while inflation permits. However, we look for the Fed to proceed cautiously, calibrating as needed but with a bias to keep the policy rate on hold. We are expecting just one additional cut between now and the end of 2025.

We expect the bond market to remain sensitive to policy announcements and economic developments, especially around the trajectory of inflation and how the Fed adjusts policy. These policy and economic uncertainties present return risks that are asymmetrically larger for longer-term bonds, which mathematically have the largest price impact from a change in yield, as shown in the chart. Hence, our belief that investors need to remain agile — if yields move above our stated year-end 2025 targets, we prefer to extend maturities to lock in attractive yields; if yields decline below our targets, we favor shortening the duration (a measure of interest rate sensitivity) profile of a portfolio.

Long-maturity bonds are most sensitive to a half-point move in interest rates



Sources: Bloomberg and Wells Fargo Investment Institute, as of November 12, 2024. T-bills (Treasury bills): Bloomberg U.S. Treasury Bills (1–3M) Index, Investment-grade (IG) taxable fixed income: Bloomberg U.S. Aggregate Bond Index. IG corporates: Bloomberg U.S. Corporate Bond Index, High yield: Bloomberg U.S. Corporate High Yield Bond Index, Asset-backed securities: Bloomberg U.S. Asset Backed Securities Index, Mortgage-backed securities: Bloomberg U.S. Mortgage-Backed Securities Index, Municipals: Bloomberg Municipal Index. For illustrative purposes only. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results**.

Opportunities in corporate bonds

We expect corporate high-yield credit quality to hold up well. Credit strength can be seen in declining debt leverage, and recent Moody's Ratings data indicating the number of issuers with potential to be upgraded to investment grade (rising stars) is the highest in over a decade.

Consider municipal bonds

Overall municipal-credit fundamentals remain favorable; however, credit pressure may emerge among lower-quality credits in certain sectors following the drawdown of stimulus funds. We expect overall municipal supply to continue to trend above the annual 10-year average of $390 billion. We expect demand to keep up with supply because of the tax advantages and superior credit quality that municipal bonds generally offer, making the municipal market more balanced, in our view.

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Real Assets

Mason Mendez
Investment Strategy Analyst

John LaForge
Head of Real Asset Strategy

2025 Commodities outlook

Commodities performed modestly in 2024, with the Bloomberg Commodity Total Return Index (BCOMTR) up 4.5% year to date (as of December 26, 2024). While supply conditions remained supportive of higher prices, commodity demand was held back by global economic headwinds.

The first three quarters of 2024 looked a lot like 2023, with commodity prices hampered by economic uncertainties and higher interest rates. In the fourth quarter of 2024, though, these trends began to reverse and have become tailwinds as we enter 2025. A particularly important trend to watch next year will be our expectations for a global liquidity uptrend, which should benefit commodities. Historically speaking, commodity prices have often moved higher with expanding global money supply (see chart below).

While we believe that improved commodity demand will be the spark that ignites higher commodity prices in 2025, the supply side should not be forgotten. After two years of lackluster commodity prices, many commodity producers have slowed production growth. This could become a particularly acute point in 2025 in the event that demand recovers at a stronger pace than most expect. The reason is that new commodity production often lags by months, and sometimes years.

For individual sectors, we like Precious Metals and Energy the most. Precious Metals, such as gold, have often performed well during periods of low interest rates. Energy, on the other hand, we suspect should benefit from greater demand as global macro conditions improve.

Overall, we remain favorable on Commodities as an asset class, and our favorite sectors are Precious Metals and Energy. Our 2025 target ranges are: 250 – 270 for the BCOMTR; $2,700 – $2,800 per troy ounce for gold; $85 – $95 per barrel for West Texas Intermediate crude oil (WTI); and $90 – $100 per barrel for Brent crude oil.

Commodities versus global money supply

Sources: Bloomberg and Wells Fargo Investment Institute. Daily data is from January 1, 2018 – December 26, 2024. Commodity Index = Bloomberg Commodity Total Return Index. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results**.

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Alternatives

Mark Steffen, CFA, CAIA
Global Alternative Investment Strategist

Looking ahead to 2025

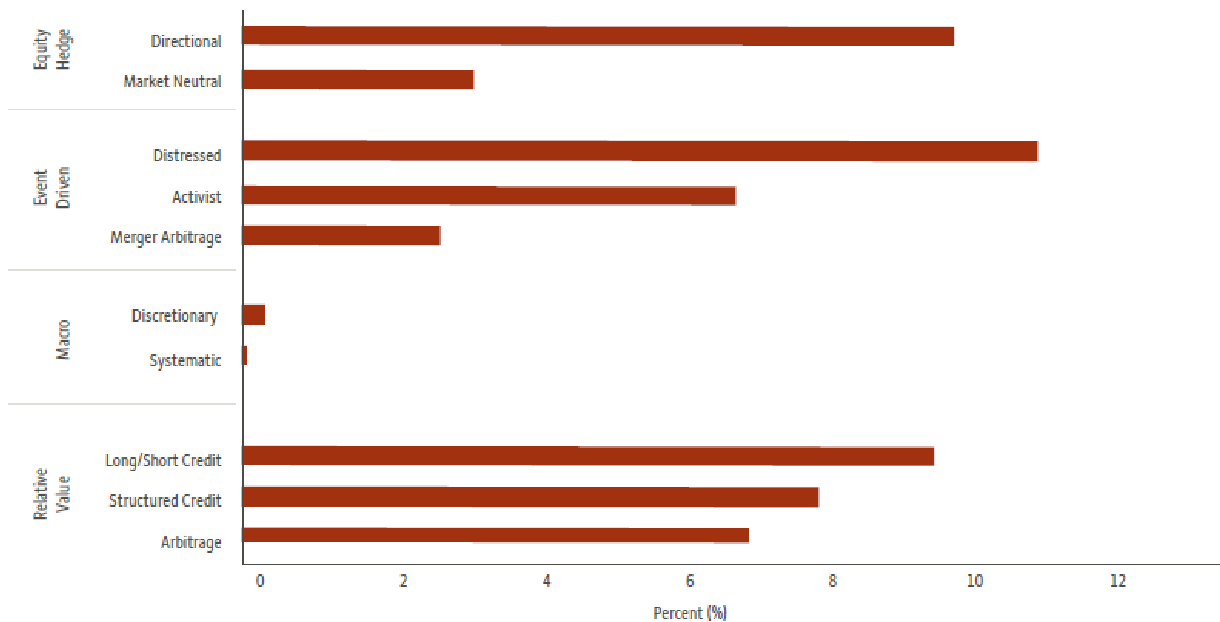
As we start the new year, a renewed sense of optimism prevails as the economy remains on track for a soft landing. As investors prepare their portfolios for the year ahead, we believe the best approach is to reduce exposure to more defensive strategies while increasing exposure to strategies that can benefit from lower interest rates, a rise in equity prices, and a gradual recovery in the economy.

For hedge funds, we favor increasing exposure to Equity Hedge – Directional (favorable) and Event Driven – Activist (neutral) strategies as both equity-oriented strategies should benefit from a broadening of the equity rally expected over the coming quarters. We also favor Relative Value – Long/Short Credit strategies as the category should offer the ability to participate in an improving credit environment yet limit exposure to the market pullbacks that are likely to occur.

In private markets, we have continued to favor higher-quality opportunities that are less reliant on debt financing (Growth Equity), or areas where financing is more readily available (Small/Mid Buyout). For Private Debt, we continue to believe the opportunity set for Distressed Credit/Special Situations strategies will remain robust into the initial stages of the recovery in late 2025.

During past periods characterized by gradual growth and average equity price returns, several economically sensitive strategies registered above-average returns relative to the broad hedge fund universe (see chart). Of course, past performance is not a guarantee of future results. As many investors have yet to incorporate alternative strategies in their portfolios, our hope is that more investors learn about alternative strategies in 2025 and how these strategies may help enhance returns, diversify income streams, and build a more resilient portfolio in the years ahead.

Historical performance of hedge fund strategies during periods of gradual growth and average equity returns



Sources: Wells Fargo Investment Institute and Hedge Fund Research. Quarterly data, March 2008 – October 2024. The chart shows average annualized return of HFRI indexes (see definitions at the end of this report) during historical periods when the S&P 500 Index generated 7% to 15% annualized returns and real gross domestic product (GDP) growth was between 1.8% and 2.8%. Those periods are January 2013 – March 2013, January 2016 – September 2016, January 2017 – March 2017, and January 2018 – March 2018. **Past performance is no guarantee of future results**. An index is unmanaged and not available for direct investment.

Alternative investments, such as hedge funds, private equity, private debt and private real estate funds are not appropriate for all investors and are only open to "accredited" or "qualified" investors within the meaning of U.S. securities laws.

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Tactical guidance*

Cash Alternatives and Fixed Income

Most Unfavorable	Unfavorable	Neutral	Favorable	Most Favorable
U.S. Short Term Taxable Fixed Income		Cash Alternatives Developed Market Ex-U.S. Fixed Income Emerging Market Fixed Income High Yield Taxable Fixed Income U.S. Long Term Taxable Fixed Income	U.S. Intermediate Term Taxable Fixed Income	

Equities

Most Unfavorable	Unfavorable	Neutral	Favorable	Most Favorable
	Emerging Market Equities	Developed Market Ex-U.S. Equities U.S. Mid Cap Equities U.S. Small Cap Equities	U.S. Large Cap Equities	

Real Assets

Most Unfavorable	Unfavorable	Neutral	Favorable	Most Favorable
		Private Real Estate	Commodities	

Alternative Investments**

Most Unfavorable	Unfavorable	Neutral	Favorable	Most Favorable
		Hedge Funds—Equity Hedge Hedge Funds—Relative Value Private Equity Private Debt	Hedge Funds—Event Driven Hedge Funds—Macro	

Source: Wells Fargo Investment Institute, January 6, 2025.

*Tactical horizon is 6-18 months

**Alternative investments are not appropriate for all investors. They are speculative and involve a high degree of risk that is appropriate only for those investors who have the financial sophistication and expertise to evaluate the merits and risks of an investment in a fund and for which the fund does not represent a complete investment program. Please see end of report for important definitions and disclosures.

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Risk considerations

Forecasts, estimates, and projections are not guaranteed and are based on certain assumptions and 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. **Foreign investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. These risks are heightened in emerging markets. **Small- and mid-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large company stocks. **Dividends** are not guaranteed and are subject to change or elimination. **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. **Municipal bonds** offer interest payments exempt from federal taxes, and potentially state and local income taxes. Municipal bonds are subject to credit risk and potentially the Alternative Minimum Tax (AMT). Quality varies widely depending on the specific issuer. Municipal securities are also subject to legislative and regulatory risk which is the risk that a change in the tax code could affect the value of taxable or tax-exempt interest income. The **commodities** markets are considered speculative, carry substantial risks, and have experienced periods of extreme volatility. Investing in a volatile and uncertain commodities market may cause a portfolio to rapidly increase or decrease in value which may result in greater share price volatility.

Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility. **Communication services** companies are vulnerable to their products and services becoming outdated because of technological advancement and the innovation of competitors. Companies in the communication services sector may also be affected by rapid technology changes; pricing competition, large equipment upgrades, substantial capital requirements and government regulation and approval of products and services. In addition, companies within the industry may invest heavily in research and development which is not guaranteed to lead to successful implementation of the proposed product. There is increased risk investing in the **Industrials** sector. The industries within the sector can be significantly affected by general market and economic conditions, competition, technological innovation, legislation and government regulations, among other things, all of which can significantly affect a portfolio's performance. The **Energy** sector may be adversely affected by changes in worldwide energy prices, exploration, production spending, government regulation, and changes in exchange rates, depletion of natural resources, and risks that arise from extreme weather conditions. Investing in the **Financial** services companies will subject an investment to adverse economic or regulatory occurrences affecting the sector. Risks associated with the **Technology** sector include increased competition from domestic and international companies, unexpected changes in demand, regulatory actions, technical problems with key products, and the departure of key members of management. Technology and Internet-related stocks, especially smaller, less-seasoned companies, tend to be more volatile than the overall market.

Investing in gold, silver or other precious metals involves special risk considerations such as severe price fluctuations and adverse economic and regulatory developments affecting the sector or industry.

Alternative investments, such as hedge funds, private equity/private debt and private real estate funds, are speculative and involve a high degree of risk that is appropriate only for those investors who have the financial sophistication and expertise to evaluate the merits and risks of an investment in a fund and for which the fund does not represent a complete investment program. They entail significant risks that can include losses due to leveraging or other speculative investment practices, lack of liquidity, volatility of returns, restrictions on transferring interests in a fund, potential lack of diversification, absence and/or delay of information regarding valuations and pricing, complex tax structures and delays in tax reporting, less regulation and higher fees than mutual funds. Hedge fund, private equity, private debt and private real estate fund investing involves other material risks including capital loss and the loss of the entire amount invested. A fund's offering documents should be carefully reviewed prior to investing.

Hedge fund strategies, such as Equity Hedge, Event Driven, Macro and Relative Value, may expose investors to the risks associated with the use of short selling, leverage, derivatives and arbitrage methodologies. Short sales involve leverage and theoretically unlimited loss potential since the market price of securities sold short may continuously increase. The use of leverage in a portfolio varies by strategy. Leverage can significantly increase return potential but create greater risk of loss. Derivatives generally have implied leverage which can magnify volatility and may entail other risks such as market, interest rate, credit, counterparty and management risks. Arbitrage strategies expose a fund to the risk that the anticipated arbitrage opportunities will not develop as anticipated, resulting in potentially reduced returns or losses to the fund.

Definitions

Bloomberg U.S. Aggregate Bond Index is a broad-based measure of the investment grade, US dollar-denominated, fixed-rate taxable bond market.

Bloomberg U.S. Treasury Bills (1–3 Month) Index is representative of money markets.

Bloomberg Municipal Bond Index is a U.S. dollar denominated long-term tax-exempt bond index. It is unhedged and current has 57,947 members.

Bloomberg U.S. Asset Backed Securities Index measures the investment-grade market of U.S. Credit Card, Auto and Student Loan asset backed securities deals.

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Bloomberg U.S. Corporate Bond Index measures the performance of the investment-grade corporate bond market.

Bloomberg U.S. Corporate High Yield Bond Index covers the U.S. dollar-denominated, non-investment grade, fixed-rate, taxable corporate bond market.

Bloomberg U.S. Mortgage-Backed Securities Index includes agency mortgage-backed pass-through securities (both fixed-rate and hybrid ARM) guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

Bloomberg Commodity Total Return Index reflects the returns that are potentially available through an unleveraged investment in the futures contracts on 19 physical commodities comprising the Index plus the rate of interest that could be earned on cash collateral invested in specified Treasury Bills. The Index is a rolling index rebalancing annually.

Dow Jones Industrial Average is an unweighted index of 30 "blue-chip" industrial U.S. stocks.

HFRI Event Driven Index maintains positions in companies currently or prospectively involved in corporate transactions of a wide variety including but not limited to mergers, restructurings, financial distress, tender offers, shareholder buybacks, debt exchanges, security issuance or other capital structure adjustments. Security types can range from most senior in the capital structure to most junior or subordinated, and frequently involve additional derivative securities. Event Driven exposure includes a combination of sensitivities to equity markets, credit markets and idiosyncratic, company-specific developments. Investment theses are typically predicated on fundamental characteristics (as opposed to quantitative), with the realization of the thesis predicated on a specific development exogenous to the existing capital structure.

HFRI Macro Index: Investment Managers which trade a broad range of strategies in which the investment process is predicated on movements in underlying economic variables and the impact these have on equity, fixed-income, hard currency and commodity markets. Managers employ a variety of techniques, both discretionary and systematic analysis, combinations of top-down and bottom-up theses, quantitative and fundamental approaches and long and short term holding periods. Although some strategies employ RV techniques, Macro strategies are distinct from RV strategies in that the primary investment thesis is predicated on predicted or future movements in the underlying instruments, rather than realization of a valuation discrepancy between securities. In a similar way, while both Macro and equity hedge managers may hold equity securities, the overriding investment thesis is predicated on the impact movements in underlying macroeconomic variables may have on security prices, as opposes to EH, in which the fundamental characteristics on the company are the most significant are integral to investment thesis.

HFRI Equity Hedge Index consists of Investment Managers who maintain positions both long and short in primarily equity and equity derivative securities. A wide variety of investment processes can be employed to arrive at an investment decision, including both quantitative and fundamental techniques; strategies can be broadly diversified or narrowly focused on specific sectors and can range broadly in terms of levels of net exposure, leverage employed, holding period, concentrations of market capitalizations and valuation ranges of typical portfolios. EH managers would typically maintain at least 50%, and may in some cases be substantially entirely invested in equities, both long and short.

HFRI Relative Value Index maintains positions in which the investment thesis is predicated on realization of a valuation discrepancy in the relationship between multiple securities. Managers employ a variety of fundamental and quantitative techniques to establish investment theses, and security types range broadly across equity, fixed-income, derivative, or other security types.

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.

Note: HFRI Indices have limitations (some of which are typical of other widely used indices). These limitations include survivorship bias (the returns of the indices may not be representative of all the hedge funds in the universe because of the tendency of lower performing funds to leave the index); heterogeneity (not all hedge funds are alike or comparable to one another, and the index may not accurately reflect the performance of a described style); and limited data (many hedge funds do not report to indices, and, therefore, the index may omit funds, the inclusion of which might significantly affect the performance shown. The HFRI Indices are based on information self-reported by hedge fund managers that decide on their own, at any time, whether or not they want to provide, or continue to provide, information to HFR Asset Management, L.L.C. Results for funds that go out of business are included in the index until the date that they cease operations. Therefore, these indices may not be complete or accurate representations of the hedge fund universe, and may be biased in several ways. Returns of the underlying hedge funds are net of fees and are denominated in USD.

An index is unmanaged and not available for direct investment.

Bond rating firms, such as Moody’s, Standard & Poor's and Fitch, use different designations consisting of upper- and lower-case letters 'A' and 'B' to identify a bond's credit quality rating. 'AAA' and 'AA' (high credit quality) and 'A' and 'BBB' (medium credit quality) are considered investment grade. Credit ratings for bonds below these designations ('BB', 'B', 'CCC', etc.) are considered low credit quality, and are commonly referred to as "junk bonds".

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WELLS FARGO
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Market Commentary

Weekly perspective on current market sentiment **January 8, 2025**

[Scott Wren](#)
Senior Global Market Strategist

Last week's S&P 500 Index: -0.5%

New year thoughts

Key takeaways

- A casual observer likely looks at the state of the economy and world events and wonders how 2025 will play out.
- We expect opportunities in both equites and fixed income to broaden as the economy grows in 2025.

As the calendar turned to the new year, investors looked back and almost certainly were happy with the results as the S&P 500 Index (SPX) notched its second consecutive year of gains in excess of 20% (+23.3%). We are looking for another year of positive, if more modest, returns for stocks and see the SPX finishing this year in the 6,500 – 6,700 range. Not bad at all by historical standards.

A casual observer likely looks at the state of the domestic economy and all that is happening around the world and wonders how 2025 will play out. Is inflation going to further impact my personal spending? Will jobs be easy or hard to find? Will any of the various conflicts happening around the world, particularly in Eastern Europe and the Middle East, turn into a more widespread concern? Those are just a few of the questions that may have been asked and discussed at holiday gatherings over the last couple of months. Many of our regular readers may have those same questions.

This week we are going to attempt to tackle the big picture: the economy. Growth last year came in stronger than we anticipated, and we see the domestic economy turning in a year of modest growth in 2025. Note that relative to the rest of the world, particularly the developed world (i.e., the eurozone and Japan), we see the U.S. as the global growth leader in 2025. That will likely keep the U.S. dollar stronger than might otherwise be the case and should bode well for domestic assets (stocks and bonds) relative to international equities and fixed income. Hence our preferred overweight to the U.S.

Inflation is sure to be a hot topic this year. We believe the Consumer Price Index (CPI) will rise 3.3% in 2025. Note that this estimate is well above the current 2.5% increase the consensus on Wall Street is expecting. Sources of higher inflation as we move through 2025 include commodity prices (i.e., oil) and increased consumer and/or business activity, especially in services, which have been the main driver of inflation since 2022. In particular, we see continued inflation in the price of health care, insurance (auto and home), and housing/shelter costs. New tariffs should increase the prices of imported goods. Higher-for-longer inflation and better economic growth in 2025 are also likely to help push interest rates somewhat higher. For example, we see the yield on the 10-year Treasury note ending the year in the 4.5% to 5% range. The current 10-year yield has recently breached the lower end of that range.

Our outlook on the economy also results in opportunities for large, diversified companies with robust cash flows and strong balance sheets to grow earnings. We see earnings for the SPX rising at a double-digit rate this year, and accounting for the gains, we believe that will take the S&P 500 Index into our target range.

We expect opportunities in both equites and fixed income to broaden as the economy grows in 2025.

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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. **Foreign investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. These risks are heightened in emerging markets. **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.

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.

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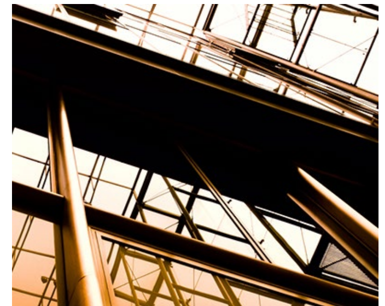
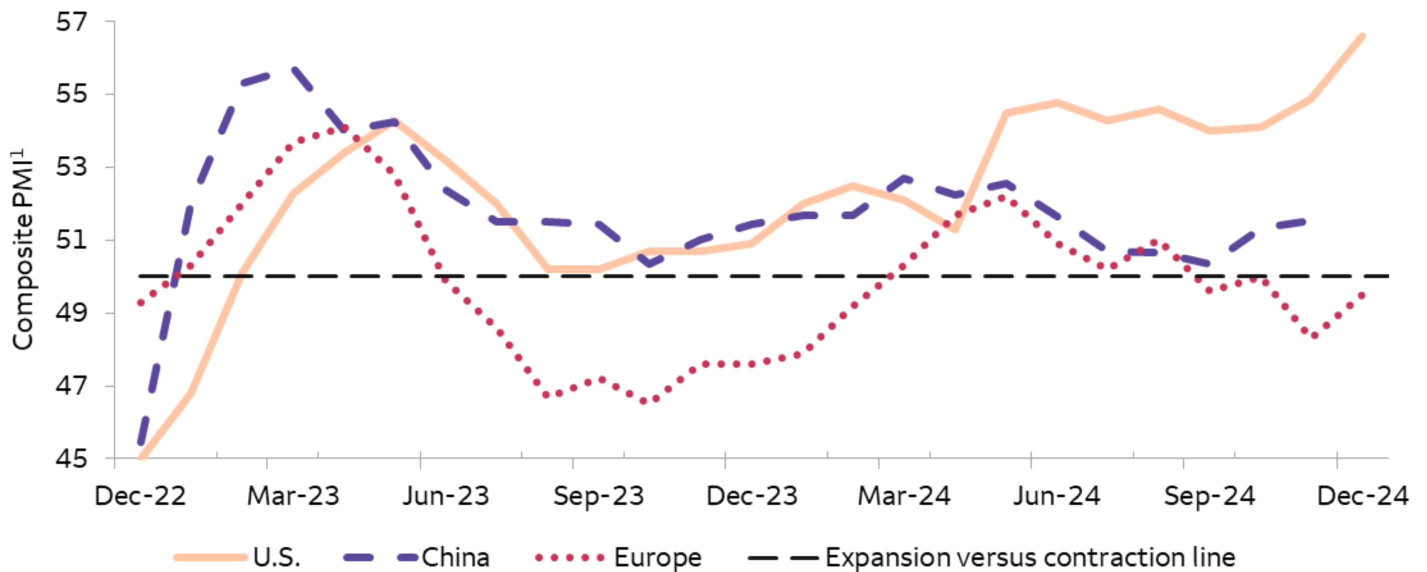
Chart of the Week



Weekly analysis of key themes in markets — January 7, 2025

Positioning for more U.S. exceptionalism in 2025



Sources: Wells Fargo Investment Institute, S&P Global, Inc., China Federation of Logistics & Purchasing, and Caixin Global. Data as of December 19, 2024. U.S. and eurozone data available through December 2024; China data available through November 2024. 1. Percentage of respondents reporting increased economic activity, based on the composite purchasing managers' indexes (PMIs).

We expect U.S.-led global economic growth to extend into 2025

Looking back on 2024, U.S. economic growth once again surprised to the upside while overseas economies saw another challenging year. The chart above illustrates this dichotomy, showing that a broad measure of economic activity in the U.S. was firmly in expansionary territory throughout 2024. Elsewhere, recent stimulus initiatives helped stabilize China's economy into year-end while the eurozone remained weighed down by a weak manufacturing sector.

Turning ahead to 2025, we expect the U.S. to sustain its leading-edge role in global growth, supporting our preferred tilt toward U.S. assets in diversified portfolios. We believe the U.S. economy and markets will continue to outperform the rest of the world due to relatively stronger demographics, more potent fiscal stimulus, less regulation, and a more dynamic technology sector fueling greater investment spending growth.

What it may mean for investors

We favor Communication Services, Energy, Financials, and Industrials, and, more generally, cyclical and growth-oriented sectors over defensive stocks. Meanwhile, our preference in fixed income is to consider adding intermediate (3 – 7 years) and longer maturities as yields rise. Lastly, we still believe exposure to a broad basket of commodities is prudent and can serve as a hedge against inflation as tight supply-demand conditions support price gains in 2025.

Jennifer Timmerman, *Investment Strategy Analyst* — Excerpted from Investment Strategy (December 30, 2024)

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Definitions

Purchasing Managers' Indexes (PMIs) track sentiment among purchasing managers at manufacturing, construction, and/or services firms. An overall sentiment index is generally calculated from the results of queries on production, orders, inventories, employment, prices, etc.

An index is unmanaged and not available for direct investment.

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