WELLS FARGO
INVESTMENT INSTITUTE

WEEKLY PERSPECTIVE ON CURRENT MARKET SENTIMENT

Born on pessimism? Check. Grown on skepticism? Check.

January 10, 2018

Scott Wren
Senior Global Equity Strategist

Last Week's S&P 500 Index:
2.6%

Key takeaways

- *For much of this bull market, general pessimism has been the mood of many investors, but now sentiment has improved.*
- *While we think the bull market is not over, we will be closely watching sentiment as more and more investors can now be categorized as optimistic.*

Famous investor and stock market guru Sir John Templeton once stated that "bull markets are born on pessimism, grow on skepticism, mature on optimism, and die of euphoria." That short 15-word quote, in this strategist's opinion, summarizes volumes of financial market experience. Sure, it doesn't address the details of price-to-earnings ratios, Federal Reserve monetary policy, or any of the other topics equity strategists write about on a regular basis. But to many seasoned market veterans, no truer words have ever been uttered.

Time and time again, cycle after cycle, the stock market follows along a similar path. Investors see the stock market suffer through a meaningful correction. Normally, of course, this is part and parcel of the economy slipping into recession. Typically, the deeper the recession, the worse the fall in corporate earnings and the lower the major equity indices drop. The most recent example was the financial crisis of the last decade. From top to bottom, over the course of 18 months, the S&P 500 tumbled nearly 57%. That is severe in anyone's book. Toward the end, complete fear gripped the market and panic set in. Unfortunately, many investors, as is nearly always the case, sold stocks well off their highs—and many probably closer to their lows than they would like to admit. During a bear market, many investors reach the point where they can't take the "pain" any more. They just want out. But they frequently end up selling, in hindsight, at the wrong time.

After an experience like that, it is safe to say that many, if not most, investors would be hesitant to jump back into the stock market. The typical thought is to wait until the economy has bottomed out and is looking better. The problem is the stock market is usually a good leading indicator and starts to turn up well before the skies clear and the recession is "officially" declared over.

The current bull market has followed the usual path but has done so over a longer period of time, historically speaking. When the S&P 500 finally bottomed out in March of 2009, few investors believed the worst was over. A far fewer number actually had the nerves to step in and buy equities thinking they were cheap. A year later the index was nearly 70% higher, but most investors were still pessimistic. That pessimism lasted for much of the next six years while the stock market continued to move higher in a mostly steady manner. Then it seemed, in the fall of 2016, the pessimism eased a bit and shifted toward general skepticism. In the wake of the U.S. presidential election, the stock market took off and has continued to persistently make a series of record highs over the last year. The skepticism began to ease, and some investors actually shifted into being outright optimists.

And that, in this strategist's opinion, is where we stand now. The current bull market was born on pessimism, grew on skepticism, and, after a huge run higher, is moving toward a general feeling of optimism.

We do not believe the bull market is over. But we are closely watching, in addition to the fundamentals, investor sentiment. Because the eventual euphoria, which will come at some point, will likely be at the top.

Risks 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.

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 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.

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 0118-01447