WELLS FARGO Investment Institute

Market Commentary

Weekly perspective on current market sentiment **June 23, 2022**

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Last week's S&P 500 Index: -5.8%

Sacrificing growth

Key takeaways

- Market bottoms are usually marked by some form of capitulation. So far that has not occurred.
- We would caution against selling into this downturn as we believe a good amount of negative news is already priced into the market.

This weekly piece has discussed the Federal Reserve (Fed) and the rate-hiking process numerous times in recent months. We are going to do it again this week. The reasoning is clear as our central bank is in the thick of the process of attempting to cool the highest domestic inflation readings in more than 40 years. That is no easy task when dealing with a $22 trillion economy that has enjoyed easy monetary policies and low interest rates since the Great Financial Crisis more than a decade ago. More recently, the COVID pandemic pushed governments around the world to implement dramatic fiscal stimulus policies and central banks to push interest rates lower and money supplies higher. The U.S. led the charge in this endeavor.

So now it is time to unwind these efforts. The effects of $7-plus trillion in fiscal stimulus is fading. However, some are speculating that a smaller "Build Back Better" package in the range of $600 billion to $1 trillion is in the works. Some in Congress will likely argue that additional stimulus does not need to be pumped into the economy at this time. Additional stimulus could very well increase demand for everything from goods and services to energy. Keep in mind that inflation and high gasoline prices are at the top of the list of concerns in most of the consumer/electorate polls we have seen.

One of the questions we are getting most frequently is whether or not the stock market is near a bottom. We will say that history shows most dependable market bottoms were marked by some form of capitulation. One example would be a high reading on the Chicago Board Options Exchange (CBOE) put-to-call ratio.[1] Meaningful bottoms are likely near when the put-to-call ratio registers readings above 95% and particularly at or above 110%. So far this ratio has not indicated that a bottom is likely to occur in the very near term.

We began our process of reducing risk in portfolios in early March of this year. Broken down into a handful of adjustments over the last 3½ months, the goal has been to reduce exposure to more cyclical asset classes and sectors in favor of areas we believe will hold up better during the economic slowdown we are anticipating. We would caution against selling into this downturn, especially given that this is the worst start to any calendar year in history. We believe a good amount of negative news is already priced into both the equity and fixed-income markets. With patience and the proper portfolio positioning, we believe long-term investors will be able to ride out the volatility that is likely to occur in the near to intermediate term.

The bottom line is we think a recession is coming. We believe the Fed is willing to sacrifice economic growth in the near term to tame inflation. There will likely be attractive entry points where long-term investors can take advantage of further downside volatility as the market tries to stabilize and eventually find a bottom.

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1. The CBOE equity put-call ratio is calculated by taking the overall number of equity (individual stock and equity index) put options sold each day on the Chicago Board Options Exchange and dividing by the overall number of call options sold.

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