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Investment Institute

FROM THE DESK OF DARRELL L. CRONK

State of the Markets

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Darrell L. Cronk is the president of Wells Fargo Investment Institute, which is focused on delivering the highest quality investment expertise and advice to help investors manage risk and succeed financially.
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Spring in our step

"The trouble is, if you don't risk anything, you risk even more." – Erica Jong

One year ago, Saturday morning March 21, I sat in my New York City office and penned a *State of the Markets* titled "**4 Reasons for Optimism**." The stock market had just finished its worst four-week performance since 2008, with the S&P 500 Index declining 32% from its February 19 peak to the March 20 close, commodity prices in free fall, face masks and toilet paper equally scarce, and large sectors of the economy shutting down for the first time since the Great Depression. On our daily market volatility calls, investors asked whether equity markets could go to zero and if they should exit markets altogether.

I had little intuition that morning as I packed up my papers that it would be the last time I would see my office in a year, or that when we published the piece on Monday, March 23, the stock market would reach its final climactic trough on that very afternoon.

It has been said that there are moments in history best grasped by silence. This could not be one of those moments. We needed to apply lessons learned from history and logic to market fundamentals, and investors needed to see — through the fog of fast-falling markets and economic uncertainty — the offsetting factors at work. While there are certainly others who have more eloquently said what I felt that Saturday morning, a year later we can confidently say that we did adapt, markets did work, policymakers did respond with fervor and speed, and indeed there was undeniable opportunity on the other side. A year later, we have three approved COVID-19 vaccines, a rapid acceleration in vaccine distribution, and a return in the kind of consumer spending that cranks the gears of the U.S. economy.

We have spilled a lot of ink between that day and this writing about high-conviction portfolio ideas we thought investors should consider implementing. The alpha within our business is almost always captured at a time when we don't have the benefit of absolute clarity or certainty. Many investors who stayed invested in stocks through last year's uncertainty can see the proof in their portfolios. The potential alpha opportunities have clearly changed over the past year, however, and investors need to pay attention to how substantially the landscape has altered.

A new landscape

Many of the previous decade-long secular trends have shifted. We expect the U.S. to print its strongest annual gross domestic product growth since the early 1980s; value stocks are seven months into sizably outperforming growth; U.S. small caps have outperformed large caps; interest rates and inflation are once again rising; we are seeing decade-high prices on base metals and agricultural commodities; we expect earnings growth to race this year to catch up with valuations; and we remain close to record highs on the S&P 500, Russell 2000, and MSCI Emerging Markets indexes. We remain early in this new business cycle, checking all the boxes for a strong early-cycle recovery, and market action is reflecting this recovery, reflation, and reopening theme.

Optimism is high, but big market tops rarely, if ever, form when market breadth is this strong. Investors would be wise to pay attention to these shifts within secular themes and position portfolios accordingly.

I will end where I began — with the first of those core tenets from a year ago. We adapt. I generally believe that it's a bad idea to bet against human ingenuity or our ability to mobilize around large problems and create a path to a solution. If you are fortunate enough to work in this great industry of ours for many decades, as has been my privilege, you realize years like this past one come along infrequently and there are countless lessons to be embraced. I am not talking about once-in-a-century global health pandemics, but rather 30%-40% declines in asset prices that create prodigious opportunities. The origins of every market crisis are different — that has been the case throughout history and likely will be the case in the future — but the capitulation and intense fear that comes with them and the rallies that follow can be innately predictable. For investors, enduring market scares like the one last spring turns into experience, and that experience becomes wisdom.

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