SPECIAL

# Market Update

BMO | Private Wealth

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## Thoughts on the Market Sell Off

**Markets had behaved fitfully for weeks, a trend which gained momentum after the U.S. midterm elections. The decisive nature of democratic wins, coupled with initiatives aimed at slowing datacenter buildouts in more than three dozen locales, cast a pall (in traders' minds at least) over the AI trade that has been central to markets for the past four years. Solid underlying fundamentals and a nascent broadening in healthy market participation have been overshadowed by near-term concerns, views we expect will be revisited when emotions steady. In the long-run, we see ample room for economic and earnings growth to moderate without derailing the constructive long-term underpinnings for equity markets.**

**Backdrop.** Stock market averages have moved sideways since spring, with noticeable pullbacks in November flirting with correction territory (-10%). **We see this as a normal and healthy, and an overdue cleanse within a strong, but moderating fundamental backdrop for equities.**

**Pullbacks are normal.** This is a reset on valuations that is moving to incorporate a more modest path forward for earnings and economic growth. The higher for longer fever in bond yields has broken for now as the bond market also prices a more modest growth outlook and in turn less worry over accelerating inflation. Balanced investors are benefiting from a flight to safety trade in fixed income. A healthy rotation within equity markets had been visible until this recent risk-off tone which is now an overall repricing of potentially lower growth mixed in with negative sentiment (emotions).

**Growth: Too Hot? Too Cold? or Just Right?** Fears of an overheating economy and AI buildout are being replaced with questions re how much growth may moderate under tighter financial conditions. The primary question now emerging is how tight financial conditions may become given 1) central banks tightening and 2) more constrained capital access from banks or investors at the margin. To date, investors, particularly in fixed income markets have been discerning in still absorbing increased bond issuance- but demanding higher yields for longer dated debt. Similarly, equity markets have readily absorbed the two largest equity offerings on record this year from SpaceX and Anthropic PBC.

**Will Central Banks heed what the markets are saying?** Central banks should – and we believe will – pay attention to the important signals capital markets are sending. Indeed, the Fed Chair has repeatedly said he wants to hear the markets speak. Well, they are speaking and the message they are sending is that risks have tilted to concerns re overzealous monetary policy. Do they overshoot, in an attempt to slay the inflation dragon that may not have much fire left anyway? After all, central banks cannot manufacture semiconductor chips or drill for oil. Inflation is elevated, but not dangerously high and showing few signs of contagion especially in wage growth - for now.

**All good things in moderation.** We see room for economic and earnings growth to moderate without derailing equity markets. Balanced investors should take opportunities to rebalance from bond market gains into beaten down stocks and accumulating long term investors are wise to accelerate deploying capital into this weakness.

**Additional perspective.** Our most recent *Weekly Strategy Perspectives* offers additional insights on market corrections and calming investor nerves.

English: https://privatewealth-insights.bmo.com/en/insights/weekly-strategy-perspectives-efficient-markets-and-rational-investors-fact-or-fiction/

French: https://apercus-gestionprivee.bmo.com/fr/insights/perspectives-stratgie-hebdomadaire-marches-efficients-et-investisseurs-rationnels-mythe-ou-realite/

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