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WELLS FARGO ADVISORS

Equity Strategy | Weekly analysis and outlook for the equity market

December 16, 2014

Domestic Homebuilding Poised for More Expansion

While energy price declines are causing stock market disturbances across many sub-industries throughout the global equity marketplace, we continue to believe the heavy decline in oil and gasoline prices will likely work like a tax cut in domestic consumers' pockets. This is particularly true given that we also anticipate ongoing moderate job growth, rising consumer confidence, increasing consumer spending, and rising retail store sales over the course of the next year. Additionally, November U.S. industrial production was also stronger than expected by macroeconomists on the "Street".

While building permits (one economic leading indicator) have registered a softer year-to-year growth rate during the last two years, such is not unusual at mid-cycle. Actually, building permits hit a new high for the current cycle in October 2014. Of course, that new high is still far below the average level for the timeframe back to January 1976 (1080 today versus a 1407 average). The new 1080 cyclical high also sits below the 1328 average level for the period back to January 2000. Yet, building permits continue on a persistent rise. Low inflation expectations and continuing job growth should boost permits in coming quarters.

As shown in the accompanying chart, we have plotted building permits back to January 1976 (in blue) and have added our own projective work for the indicator through summer 2015 (in red). Our analysis shows continuing upside for permits, which would suggest continuing forward-looking economic growth for the 6-12 months following mid-2015. This finding is in line with our work on many other leading indicators and a basket of other analyses. Our mid-2015 projection for building permits is 1207. This estimate represents the indicator's highest level since late 2007 as building permits were on their slide into the 2008 recession.

Overall, our analyses suggest the following:

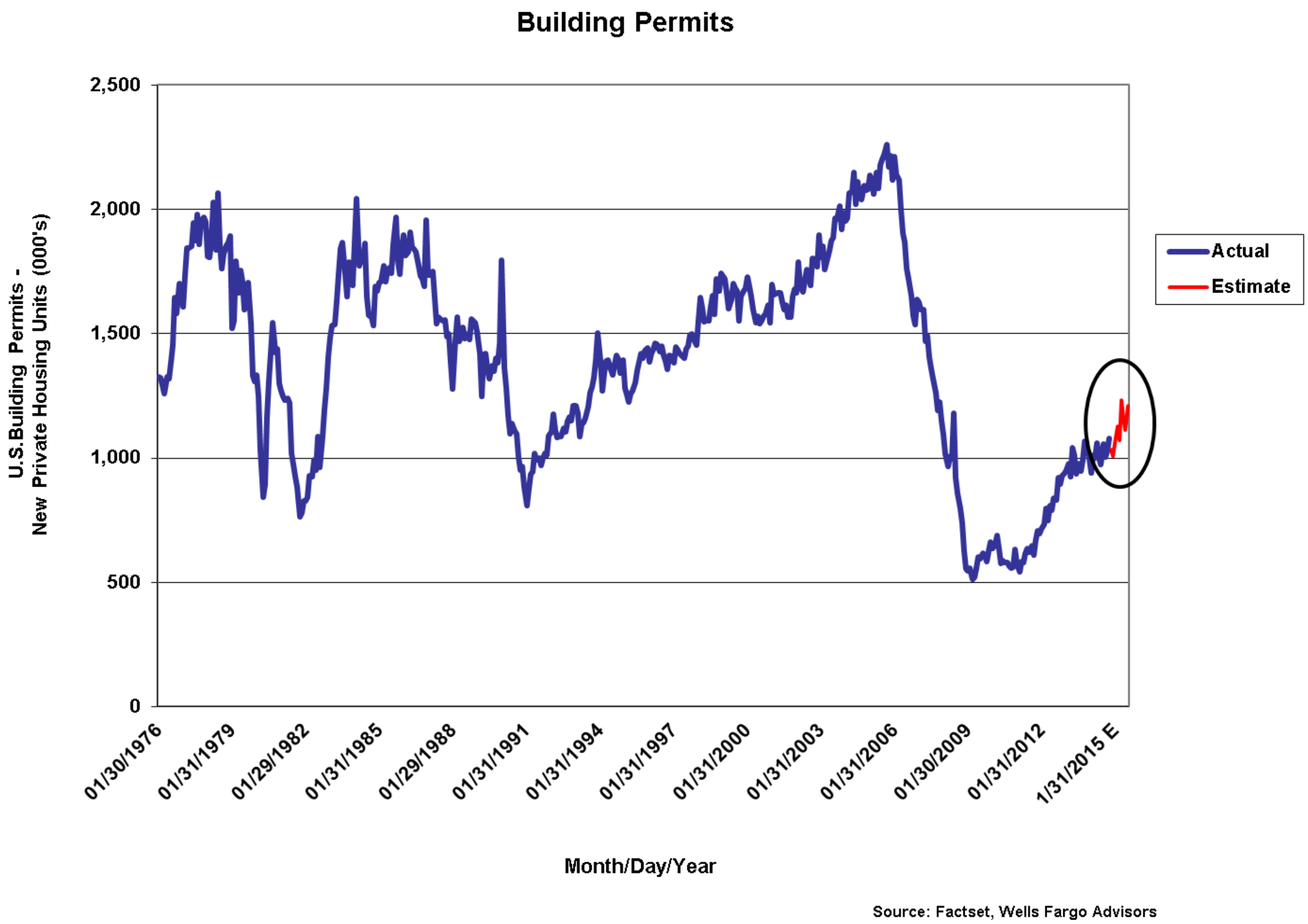
--This leading indicator is likely to show roughly a 15% increase for the year between July 2014 and July 2015.

--When permits expanded at this rate (looking back to January 1976), the median increase in the S&P 500 Index was 11.7% over the following year (in this case, between mid-2015 and mid-2016). From a total of 13 historical instances, 12 offered positive S&P500 Index returns over the next year.

--All of the studied historical periods showing 15% building permit growth represented early to mid-cycle periods. Those timeframes included the twelve-month periods ending as follows: ending in early 1984, in much of 1992, mid-1993, early 1994, mid 1996, in much of 1998, late 2002, and ending in early 2004.

New private housing unit expansion has represented a meaningful portion of domestic economic growth over time. Our forward-looking building permits projection offers support to our expectation for stronger GDP growth in 2015 versus 2014 and for new highs for the S&P 500 Index next year.

Please see page 4 of this report for Disclaimers



Weekly wrap and look ahead

The three major indices suffered meaningful losses in last week's trading.

Index	Last week's performance*	2014 YTD performance
S&P 500	-3.5%	+8.3%
DJIA	-3.8%	+4.2%
NASDAQ	-2.7%	+11.4%

**for the week of December 8 – December 12*

Looking at S&P sector performance, six of ten outperformed the Index but only one sector showed a positive return for the week.

Best Performing Sectors	Last week's performance*	Worst Performing Sectors	Last week's performance*
Utilities	+0.02%	Energy	-8.1%
Consumer Staples	-2.0%	Materials	-6.2%
Consumer Discretionary	-2.3%	Telecom Services	-5.8%

**for the week of December 8 – December 12*

This week's focus will be the two-day FOMC (Federal Open Market Committee) meeting beginning on Tuesday. We are not expecting any change in the federal funds target rate until the second half of next year but some market participants are looking for the language in the post-meeting press release to hint that the Fed is closer to the time when rates will rise.

In our opinion, it is unlikely the Fed will adjust a significant portion of the guidance in the wake of this week's meeting. In particular, we expect our central bankers to continue to state that the target rate will likely remain near zero for a "considerable time". Fed watchers are honed in on the use of those two words in the press release and there is much speculation and conversation in the media over whether or not that phrase will be dropped.

While we expect the domestic economy to grow at a 2.8% rate in 2015, other parts of the world are having growth problems. China is slowing down, Japan is technically in a recession and the Euro zone is registering barely-positive growth. Additionally, the dramatic fall in the price of oil will likely translate into a slower pace of wholesale and consumer inflation in the United States. We suspect the Fed is taking all of this into account when debating any changes in domestic monetary policy.

The U.S. stock market has been more volatile over the last several months and we look for global uncertainties to contribute to further volatility in coming quarters along with speculation surrounding the timing of a tightening in monetary policy.

Sector	S&P Weighting *	Wells Fargo Advisors Guidance	
Consumer Discretionary	12.1%	Overweight	12.5%
Consumer Staples	9.9%	Underweight	8.2%
Energy	8.0%	Evenweight	9.9%
Financials	16.6%	Evenweight	16.3%
Health Care	14.6%	Evenweight	13.8%
Industrials	10.4%	Overweight	12.0%
Information Technology	19.8%	Overweight	21.4%
Materials	3.1%	Evenweight	3.5%
Telecommunications Services	2.3%	Evenweight	2.4%
Utilities	3.2%	Underweight	0.0%
S&P 500 Earnings Estimate for 2015:			$128.00
S&P 500 Year-End 2015 target range:			2,150-2,250

Source: Wells Fargo Advisors
Sector Weightings May Not Add To 100% Due To Rounding
Weightings as of 12/15/14 close

Disclaimers

Past performance is not a guarantee of future results.

An index is unmanaged and unavailable for direct investment.

Technology and Internet-related stocks, especially of smaller, less-seasoned companies, tend to be more volatile than the overall market.

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