WELLS FARGO
Investment Institute

June 2024

2024 Midyear Outlook

Approaching the economy's pivot point

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Approaching the economy's pivot point

June 2024

Midyear is a time for reflection. It is a time for revisiting our annual outlook, reviewing the economic and market expectations we set in December, and recalibrating for the next 18 months. Our predominant theme for 2024 has been to pay attention to pivots.

The promise of artificial intelligence (AI), Federal Reserve (Fed) rate cuts, declining inflation, and the resumption of durable earnings growth fueled a hard pivot to positive momentum to open 2024. As we cast our eyes forward 18 months, we remain confident that these pivot points will continue to calibrate markets' path forward.

> *"Invest for the long haul. Don't get too greedy, and don't get too scared."*
>
> — Shelby M.C. Davis, investor and philanthropist

Five critical pivot points to watch

To help investors prepare for the next 18 months, our outlook examines five pivot points we are tracking closely:

- **Inflation** — Inflation has marched steadily downward from the high of 9.1% in June 2022 (as measured by the U.S. Consumer Price Index), but a funny thing happened on the way to the Fed's target. Inflation got stuck within a range of 3% to 4%, not an uncommon occurrence historically. As we look out 18 months, our base case calls for inflation to drift mildly lower but struggle to land within the Fed's 2.0% to 2.5% target range.
- **Interest rates** — Coming into 2024, markets anticipated a pivot from Fed rate hikes to as many as six or seven rate cuts,[1] while we found ourselves an outlier with much higher targets for long-term interest rates than the Wall Street consensus. Approaching midyear, the market has pivoted, backing out most of those Fed rate cuts from 2024 expectations and projecting higher long-term interest rates.
- **Liquidity** — In the first half, we saw the effect of government stimulus packages and a ballooning federal budget deficit on asset prices as large amounts of liquidity were pumped into the economic engine. That led to all-time highs in the S&P 500 Index, Japan's Nikkei 225 Index, Germany's DAX Index, bitcoin, and gold. Even strong issuance of U.S. Treasuries and U.S. investment-grade corporate bonds was met with robust demand as liquidity actively searched for a home across all asset classes.
- **Earnings** — Equity prices generally reflect expectations for future earnings growth. There is ample evidence at midyear that, after a few years of narrow growth concentrated within a few key sectors, the potential for more robust growth is broadening. It will be important for this trend to persist over the next 18 months.
- **Global** — Perhaps the greatest potential for a market-moving pivot comes on the world stage. There is a new war in the Middle East and a lingering one in Eastern Europe. Growth has slowed in China, dragging down Emerging Market Equities, and the U.S. dollar has remained stronger for longer than most expected.

Looking forward

Our guidance remains focused on high-quality investments in both equities and fixed income, as hopes for falling inflation and interest-rate cuts have faded in recent months. Geopolitical risks, market volatility, and the November elections will all have much to say about the path for markets in the back half of 2024.

In times like these, the guidance of an investment professional who understands your financial goals and the changes in your circumstances can make all the difference. Thank you for the trust you place in us, and we hope our *2024 Midyear Outlook* provides the perspective you need to make wise choices in the months ahead.

Darrell L. Cronk, CFA
President, Wells Fargo Investment Institute
Chief Investment Officer, Wealth & Investment Management

1. Bloomberg, as of December 31, 2023

What's inside

2024 and 2025 year-end targets .... *page 4*

Global economy .... *page 6*

- We believe gradually slowing U.S. economic growth should cool inflation enough to allow the Fed to cut interest rates, thereby prompting gradually accelerating growth that leads the global economy through 2025.
- We expect U.S. dollar strength to persist over the near term, supported by a comparatively stronger U.S. economy and higher U.S. interest rates.

Global equities .... *page 8*

- The stock market rally may be challenged in the near term as uncertainties surrounding inflation and interest rates dampen investor sentiment.
- We believe U.S. Large Cap Equities are best positioned to weather the shift in sentiment while an earnings recovery drives equity prices higher into 2025.

Global fixed income .... *page 13*

- U.S. Short Term Taxable Fixed Income remains our most favorable sector until the Fed pivots to interest-rate cuts. As the economy recovers, we anticipate opportunities in longer-term fixed-income securities.
- Credit quality remains paramount, and municipal bonds extend positive momentum in our outlook.

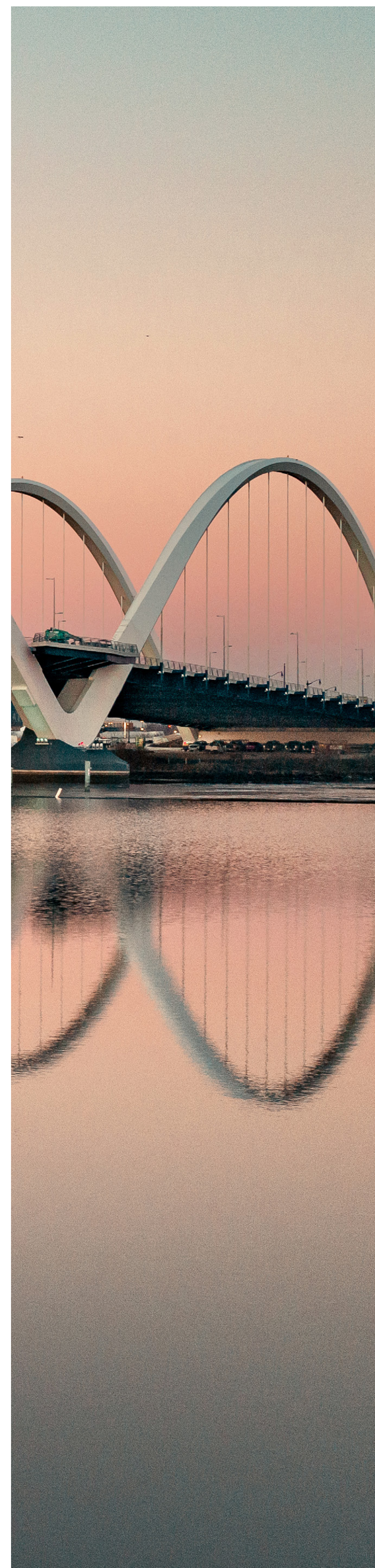
Global real assets .... *page 16*

- We believe commodity-price upside is set to resume throughout 2024 after struggling from the second half of 2022 through the end of 2023.
- Industrial metals could lead the next leg higher for commodity prices — after two years of lagging most other commodities.

Global alternative investments[2] .... *page 19*

- The gradual economic slowdown continues to guide our preference for defensive hedge funds and private capital strategies that may offer diversification benefits, generate counter-cyclical returns, or a quality bias.
- Once the economy reaccelerates, we anticipate a transition to directional strategies for their potential to track with the improved economic momentum.

Our top five portfolio ideas .... *page 22*



2. Alternative investments are not appropriate for all investors and are only open to "accredited investors" or "qualified investors" within the meaning of the U.S. securities laws. They are speculative, highly illiquid, and designed for long-term investment and not as trading vehicles.

See pages 26 – 27 for important definitions and risk considerations.

2024 and 2025 year-end targets

	Average percent change in the latest four quarters from the same year-ago period, unless otherwise noted		
Global economy	**Latest**	**2024 targets**	**2025 targets**
U.S. GDP growth	2.9% (Q1)	2.5%	2.1%
U.S. CPI inflation[3]	3.4% (Apr.)	3.0% (Dec.)	3.0% (Dec.)
U.S. unemployment rate[4]	3.9% (Apr.)	4.1% (Dec.)	4.0% (Dec.)
Global GDP growth[5]	3.6% (Q1)	2.5%	2.6%
Global inflation[5]	5.5% (Q1)	3.3%	3.3%
Developed market GDP growth[6]	1.6% (Q1)	1.5%	1.9%
Developed market inflation[6]	4.8% (Q1)	2.5%	2.6%
Eurozone GDP growth	0.2% (Q1)	0.6%	2.2%
Eurozone inflation[3]	2.6% (May)	2.3% (Dec.)	2.0% (Dec.)
Emerging market GDP growth	5.0% (Q1)	3.3%	3.1%
Emerging market inflation	6.1% (Q1)	4.0%	3.8%

Sources: Wells Fargo Investment Institute and Bloomberg. All latest numbers from Bloomberg as of May 31, 2024. Targets for 2024 and 2025 are based on forecasts by Wells Fargo Investment Institute as of June 11, 2024, and provide a forecast direction over a tactical horizon through 2025. GDP = inflation-adjusted gross domestic product. CPI = Consumer Price Index. Q1 = first quarter. The definitions of developed and emerging economies mostly follow the country groupings of the International Monetary Fund, except that we include Taiwan and South Korea in the emerging market index, consistent with our MSCI Emerging Market Equity Index benchmark. The International Monetary Fund's "Fiscal Monitor" provides details on each country grouping.
3. Latest month percent change from a year ago.
4. Three-month average as of the date indicated, percent of labor force.
5. GDP-Weighted average of developed country and emerging market forecasts.
6. Weighted average of U.S. and other developed country forecasts. **Forecasts, targets, and estimates are based on certain assumptions and on our current views of market and economic conditions, which are subject to change.**

Equities	**Latest**	**Year-end 2024 targets**	**Year-end 2025 targets**
S&P 500 Index	5,278	5,100–5,300	5,600–5,800
Earnings per share	$225	$240	$260
Russell Midcap Index	3,268	3,300–3,500	3,700–3,900
Earnings per share	$145	$165	$190
Russell 2000 Index	2,070	2,100–2,300	2,500–2,700
Earnings per share	$59	$70	$90
MSCI EAFE Index	2,356	2,200–2,400	2,400–2,600
Earnings per share	$154	$160	$170
MSCI Emerging Markets Index	1,049	950–1,150	1,100–1,300
Earnings per share	$71	$75	$85

Sources: Wells Fargo Investment Institute and Bloomberg. Latest index level data from Bloomberg as of May 31, 2024. Latest EPS (earnings per share) figures are 2023 year-end consensus estimates as of May 31, 2024. All targets for 2024 and 2025 are based on forecasts by Wells Fargo Investment Institute as of June 11, 2024, and provide a forecast direction over a tactical horizon through 2025. **Forecasts, targets, and estimates are based on certain assumptions and on our current views of market and economic conditions, which are subject to change.** An index is unmanaged and not available for direct investment.

See pages 26 – 27 for important definitions and risk considerations.

Fixed income	Latest	Year-end 2024 targets	Year-end 2025 targets
Federal funds rate	5.25%–5.50%	4.75%–5.00%	4.50%–4.75%
10-year U.S. Treasury yield	4.50%	4.25%–4.75%	4.00%–4.50%
30-year U.S. Treasury yield	4.65%	4.50%–5.00%	4.25%–4.75%

Commodities	Latest	Year-end 2024 targets	Year-end 2025 targets
West Texas Intermediate crude ($ per barrel)	$77	$80–$90	$85–$95
Brent crude ($ per barrel)	$82	$85–$95	$90–$100
Gold ($ per troy ounce)	$2,327	$2,300–$2,400	$2,400–$2,500
Bloomberg Commodity Index (BCOMTR)	242	235–255	250–270

Foreign currencies	Latest	Year-end 2024 targets	Year-end 2025 targets
Dollar/euro exchange rate	$1.08	$1.06–$1.10	$1.03–$1.07
Yen/dollar exchange rate	¥157	¥156–¥160	¥152–¥156
Dollar composite exchange rate[7]	105	102–106	103–107

Sources: Wells Fargo Investment Institute and Bloomberg, as of May 31, 2024. Targets for 2024 and 2025 are based on forecasts by Wells Fargo Investment Institute as of June 11, 2024, and provide a forecast direction over a tactical horizon through 2025.

7. The ICE U.S. Dollar Index is a weighted average of the value of the U.S. dollar relative to a basket of U.S. trade partner currencies, composed of the euro, Japanese yen, pound sterling, Canadian dollar, Swedish krona, and Swiss franc. A higher index value indicates dollar appreciation. **Forecasts, targets, and estimates are based on certain assumptions and on our current views of market and economic conditions, which are subject to change.** An index is unmanaged and not available for direct investment.

See pages 26 – 27 for important definitions and risk considerations.

Shallow slowdown pivots to a mild recovery

Key takeaways

- In our view, a slowing economy should alleviate some inflation pressure in the coming months, setting the stage for Fed interest-rate cuts and a subsequent economic recovery.
- Even a slowing U.S. economy remains stronger than many other world economies, which reinforces the U.S. dollar's relative strength against other currencies.

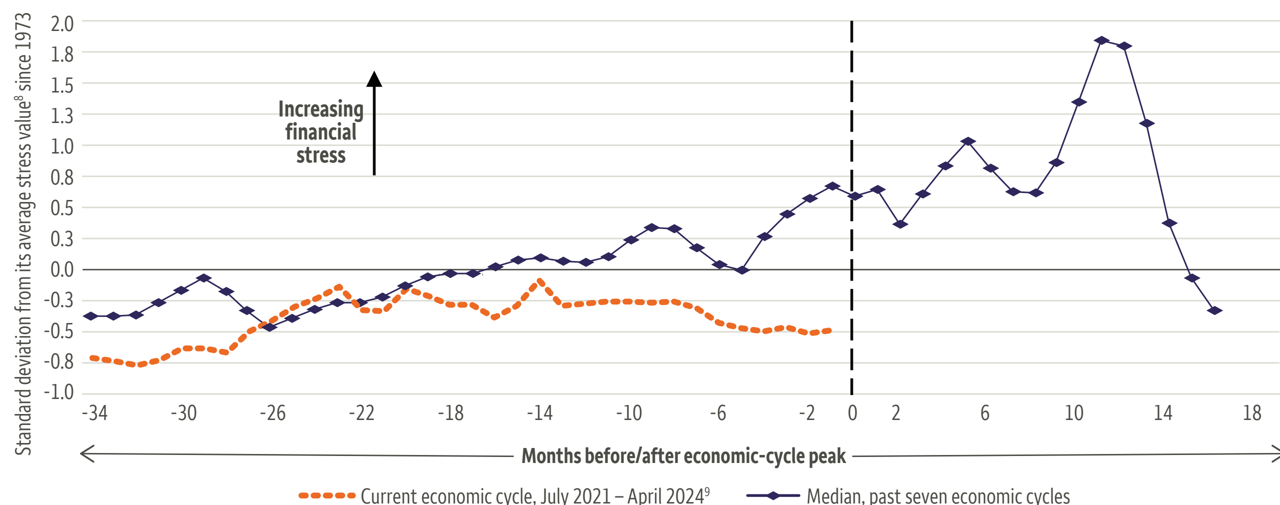
What it may mean for investors

- The comparatively stronger U.S. economy and the U.S. dollar underscore our preference for domestic U.S. assets.

The U.S. economy is slowing from its strong 3.2% average pace in 2023, based on the average of quarterly annualized changes, but we anticipate growth will still clock in at a respectable 2.5% rate for 2024. Job creation and wage growth have slowed closer to their pre-pandemic trends as the post-pandemic catch-up phase winds down. Also, some households are facing growing financial stress from credit-card debt, auto loans, and the more burdensome cost of essentials like food, gas, housing, and utilities.

However, interest rates have not yet moved high enough to increase financial stress pervasively as the economy has slowed. The chart below illustrates that financial stress historically has increased heading into an economic downturn, but the chart also shows that overall available cash and credit today (that is, liquidity) have helped drive spending and growth. We expect these trends to persist through the end of the year, mitigating this economic slowdown.

This economic cycle is cushioned by unusually low and declining financial stress[8]



Sources: Wells Fargo Investment Institute and Federal Reserve Bank of Chicago. Data as of May 15, 2024. Past economic cycles include November 1973 – March 1975, January 1980 – July 1980, July 1981 – November 1982, July 1990 – March 1991, March 2001 – November 2001, December 2007 – June 2009, and February 2020 – April 2020.

8. National Financial Conditions Index from the Federal Reserve Bank of Chicago's composite of financial risk, credit availability, and leverage indicators.

9. Month zero is estimated by us, based on our forecasts, to be the inflection point for a more sustained growth slowdown beginning mid-2024.

See pages 26 – 27 for important definitions and risk considerations.

We believe this economic "soft patch," characterized by still moderate growth, should produce lower inflation that allows the Fed to pivot to modest interest-rate cuts. In turn, this should relieve tight credit conditions and spur a modest but sustainable increase in economic growth into 2025. We expect a mild recovery, however, because the absence of a recession likely will restrain the subsequent rebound. Without the deleveraging, pent-up demand, and business inventory destocking that typically accompany a recession, we think the economy will have less room for a sharp upturn after the pivot from its slowdown.

U.S. inflation briefly ebbs before firming into 2025

Inflation began 2024 uncomfortably high, and we anticipate that should be enough to keep the overall Consumer Price Index (CPI) rate close to 3% by year's end. But over the next few months, we also expect softer consumer demand to slow inflation below this pace until the economy regains enough momentum to rekindle some pricing pressures and another 3% CPI inflation rate in 2025. Firming inflation next year likely will be propelled by rising fuel costs, supported by tight supply conditions, and by the limited buildup of excess capacity tied to a shallow economic slowdown. Residential rental inflation appears poised to be nudged higher next year by supply restraints and recent increases in competing home prices. We also anticipate further pressure on medical care, insurance, and other non-energy services inflation less closely tied to the economic cycle. The potential for structural changes, like de-globalization in goods trade and labor's increased bargaining power, could add to longer-term inflation pressures.

Global economies play catch-up with the U.S.

We expect other developed country economies to play catch-up with the U.S. into 2025 with growth and inflation restrained by less fiscal support, a sluggish world-trade recovery, and such structural weaknesses as a smaller tech sector and aging workforce. We envision that lackluster activity in China will mask economic improvement in several large emerging market economies. In our view, a Chinese economic recovery will be delayed by its weak real estate market, excessive local government debt-loads, political and regulatory uncertainty, and a population decline that collectively inhibit job growth. We anticipate global inflation will hold steady at just over 3% in 2024 and 2025, suppressed mainly by relatively weaker economic growth abroad and a tepid recovery in world trade.

U.S. dollar strength likely lingers

Our bias remains for a strong U.S. dollar through year-end 2024 and into 2025, supported by U.S.-led economic growth. We expect the global interest-rate environment will also remain favorable for the dollar as relatively firmer U.S. inflation likely will prevent significant rate cuts from the Fed compared with the European Central Bank, which faces a weaker economy and lower inflation in the eurozone. U.S. interest rates also remain notably higher than those in Japan despite recent policy tightening from the Bank of Japan.

In our view, the Fed's reluctance to aggressively reduce interest rates will be a negative driver for emerging market currencies in 2024 and 2025 as many emerging market central banks appear poised to begin cutting rates, thereby decreasing favorable interest-rate differentials. China also remains a key driver for emerging market currencies, and we believe structural weaknesses there should hamper an economic recovery, adding to a broadly negative environment for emerging market currencies.

See pages 26 – 27 for important definitions and risk considerations.

Choppy price action until economy rebounds

Key takeaways

- The many frictions of the past two years to earnings growth look to be moderating. Positive economic growth should drive sales while cost control should help anchor company profit margins.
- Our view is that the incipient earnings recovery we expect in 2024 will continue in 2025. This should allow stock prices to be driven primarily by earnings growth rather than price/earnings (P/E) multiple expansion.

What it may mean for investors

- We prefer U.S. Large Cap Equities (favorable) over U.S. Mid Cap Equities (neutral) and U.S. Small Cap Equities (most unfavorable) as well as Developed Market ex-U.S. Equities (neutral) over Emerging Market Equities (unfavorable).

Equities | Favored asset class

- U.S. Large Cap Equities

Equities | Favored sectors and sub-sectors

- Energy: Integrated Oil, Midstream Energy
- Health Care: Life Sciences Tools & Services, Managed Health Care, Health Care Equipment & Supplies
- Industrials: Aerospace & Defense, Commercial & Professional Services, Multi-Industrials[10]
- Materials: Construction Materials, Industrial Gases, Specialty Chemicals

The earnings recession looks to be over

We see many of the frictions that weighed on company earnings these past two years dissipating over the next 18 months. Supply-chain issues are mostly in the rearview mirror, wage increases are moderating, labor efficiency (that is, sales per employee) is at an all-time high and appears to be trending higher, and interest costs appear manageable for large-cap companies, such as those in the S&P 500 Index. After navigating through one of the more difficult and uncertain operating environments in recent memory, we believe these companies are likely to remain hyper-focused on efficiencies. Add in the potential for artificial intelligence (AI) adoption to broadly boost productivity, and the company profit-margin picture going forward should improve.

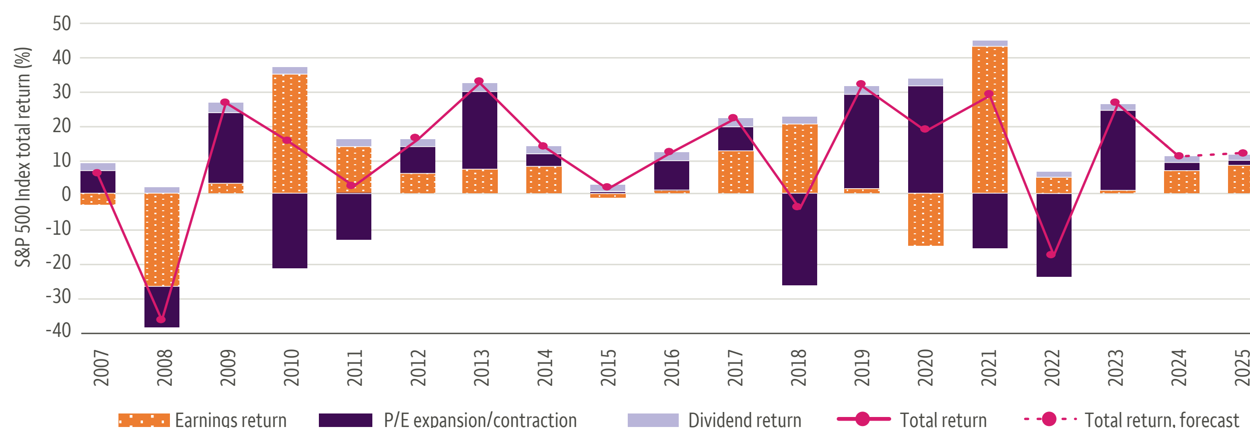
Meanwhile, our outlook for positive economic growth and gradually easing inflation should allow large companies to keep both pricing power and unit sales growth. In other words, our top-line — or revenue — outlook through 2025 is solid. Top-line strength and profit-margin improvement is likely to translate into a return of earnings growth in 2024 and 2025. After an earnings recession between 2022 and 2023, this is a long-awaited and welcome development. Specifically, we expect S&P 500 Index earnings per share (EPS) to rise from $240 in 2024 to $260 in 2025. The improved economic environment should support earnings growth as sales advance and corporations remain committed to cost cutting and improved efficiencies. However, those companies reliant on tight and expensive bank credit and those that have trouble passing on cost — for example, many small-cap companies — should have a relatively more difficult time repairing margins.

10. Multi-Industrials includes the Industrial Conglomerates, Electrical Components & Equipment, Industrial Machinery & Supplies & Components, and Trading Companies & Distributors sub-industries.

See pages 26 – 27 for important definitions and risk considerations.

The accelerating earnings recovery should allow earnings growth — instead of valuations (as measured by the ratio of price to earnings) expansion — to drive the equity rally. The chart below illustrates how we expect earnings and multiple expansion to drive returns this year and next, and how this expectation compares to history.

Earnings growth finally poised to take the wheel in driving 2024 and 2025 returns



Sources: Wells Fargo Investment Institute and Bloomberg, as of June 11, 2024. 2024 and 2025 figures are Wells Fargo Investment Institute forecasts. P/E = price-to-earnings. **Forecasts, targets, and estimates are based on certain assumptions and on our current views of market and economic conditions, which are subject to change.** An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

No clear skies yet

Equity markets may have already priced in much of this good news, however. We suspect that markets could struggle to advance past recent highs in the near term while uncertainties persist surrounding the path of inflation as well as the timing and magnitude of Fed rate cuts. Still, we would view periods of equity-market weakness as opportunities, given that our outlook through 2025 supports improved revenue growth and expanding margins, accompanied by higher equity prices.

U.S. large caps is still our favorite place to be

While the operating environment is likely to improve generally, we are not signaling the all clear to get back into the riskiest areas of the market. In fact, we reiterate our preference for quality. We view U.S. Large Cap Equities as the highest-quality major equity class with strong company balance sheets compared with other equity classes, durable pricing power, and resilient growth potential. We believe these characteristics will help U.S. Large Cap Equities manage disappointments to investor sentiment more effectively than other domestic and international asset classes. We continue to prefer U.S. Large Cap Equities (favorable) over U.S. Mid Cap Equities (neutral) and U.S. Small Cap Equities (most unfavorable).

See pages 26 – 27 for important definitions and risk considerations.

Developed markets over emerging markets

We prefer a similar lean toward quality in international equities as well, where we hold a neutral rating on Developed Market ex-U.S. Equities versus an unfavorable rating on Emerging Market Equities.

Developed Market ex-U.S. Equities offer investors access to quality companies outside the U.S. at cheaper valuations than those currently on the S&P 500 Index. Yet, we do not see a catalyst for sustained outperformance as a sluggish world-trade recovery weighs on this export-oriented asset class. Further, our resilient U.S. dollar outlook likely will be a sizable headwind for U.S.-based investor returns. For now, we are comfortable at neutral — which is a full allocation — as cheap valuations and poor market sentiment reduce downside risk and lower the bar for positive surprises while a lack of sustained tailwinds on the horizon will likely mute Developed Market ex-U.S. Equities' outsized return potential, in our view.

Emerging Market Equities, on the other hand, face headwinds that ultimately keep us unfavorable. Nearly 80% of the MSCI Emerging Markets Index is weighted toward Asia, where several China-related issues pressure the region. These include ongoing political risks from Chinese regulatory reform, U.S.-China diplomatic and economic strains, and China's slower growth potential as it shifts to emphasize domestic consumption. The greater risk of downside volatility within Emerging Market Equities during a risk-off environment is also a concern.

Shifting sector preferences

Recent market developments have provided opportunities to shift some sector recommendations. We recently upgraded the S&P 500 Energy sector from favorable to most favorable while simultaneously downgrading the Utilities sector from neutral to unfavorable.[11]

We first turned favorable on the Energy sector in January, back when the price of West Texas Intermediate (WTI) crude oil was in the low $70s per barrel. In our view, the more recent soft patch in oil prices coupled with sector performance since the near $90 per barrel April peak have provided an attractive opportunity to further upgrade the Energy sector from favorable to most favorable. The fundamental case for the Energy sector remains attractive to us as oil supply remains tight — OPEC+[12] seemingly is committed to keeping it that way — while U.S. oil producers' capital discipline and preference for shareholder returns versus production growth is likely to aid in that mission. We believe valuations are attractive and the prospect of oil prices moving back into our target range should provide a sizable tailwind.

We reallocated from Utilities to Energy as we downgraded the Utilities sector, which has seen an impressive rally over the past few months. This relative outperformance, driven by AI power demand optimism and a response to deeply oversold levels, is likely to prove fleeting, in our view. Further, our expectation for elevated interest rates beyond this year likely poses multiple headwinds to the sector, including heightened competition for yield flows from fixed-income investments, as well as elevated interest costs for the highly levered Utilities sector.

11. Adjusting equity and fixed income sector guidance," Wells Fargo Investment Institute, June 11, 2024

12. Organization of the Petroleum Exporting Countries and its allies

See pages 26 – 27 for important definitions and risk considerations.

We remain favorable the Health Care, Industrials, and Materials sectors, where we see durable demand prospects and attractive risk-reward profiles. Tailwinds for the Industrials and Materials sectors include multiple stimulus programs, the energy transition, reshoring, data-center expansion, easing input cost pressures, and continued supply-chain normalization. Meanwhile, we believe that solid demand and stable earnings will support the Health Care sector.

Our favorable sectors are balanced against our other unfavorable sectors, Consumer Discretionary, Financials, and Real Estate, where a weakening consumer, high interest rates, an inverted yield curve, a heightened regulatory environment, and ongoing commercial real estate issues weigh heavily.

Picks and shovels

We believe a number of large-scale forces are likely to continue to drive robust investment in physical plants and equipment in select areas over the medium term. Electrification, reshoring, advances in medical science, and digitization remain ongoing drivers, and many if not all, are driven by a combination of government policy and evolving technologies.

We would acknowledge that investor attention is often drawn first to those companies at the forefront of new technologies and trends. That said, we believe those that provide the “picks and shovels” are often worth a deeper look, and we are generally favorable on the sub-sectors that fit this category. The bottom line here is that these tend to be highly consolidated markets that contribute significant value to the intellectual property that their equipment and services help create. In addition, these sub-sectors can benefit from the broader adoption of new technologies with perhaps somewhat less risk of being disrupted in the process.

Energy: We continue to favor the major integrated oil companies as a core Energy holding due to their scale, financial flexibility, and diversified exposure across the Energy value chain. For income-oriented investors, we also maintain a favorable view on high-quality midstream companies.

Health Care: We are favorable on Life Sciences Tools & Services. Companies in this area include those that produce the equipment and consumables that enabled the production of vaccines during the pandemic but over the longer term will likely remain key drivers of the expanding production of biologics and similar drugs, including the GLP-1s targeted at weight loss.

Industrials and Materials: We are favorable on Multi-Industrials. As the name entails, this area includes a wide range of end-market exposure, and we expect this space to see significant benefits from the combination of data-center investment, electricity demand growth, reshoring, physical infrastructure spending, and strong underlying growth in aerospace and defense equipment. Within Materials, we also favor Construction Materials, which we expect to benefit from many of the same themes.

Information Technology: Although we remain neutral on Information Technology, we want to highlight sub-sectors we view as most attractive given the secular importance of the broader sector. We are favorable on both Semiconductors and Semiconductor Materials & Equipment. The data-center investment wave has resulted in increasing demand for chips that sell at high price points, driving profitability higher for leading companies within Semiconductors. In turn, these leading-edge chips are very complex and produced on the most advanced equipment, resulting in strong demand for high-end machinery.

See pages 26 – 27 for important definitions and risk considerations.

Equity sector and sub-sector preferences

Sector guidance	Sector	Sub-sector guidance: Favorable	Sub-sector guidance: Unfavorable
Favorable	Energy	Integrated Oil, Midstream Energy	Refining
	Health Care	Life Sciences Tools & Services, Managed Health Care, Health Care Equipment & Supplies	Health Care Services
	Industrials	Aerospace & Defense, Commercial & Professional Services, Multi-Industrials[13]	Cargo Ground Transportation, Passenger Airlines
	Materials	Construction Materials, Industrial Gases, Specialty Chemicals	Containers & Packaging
Neutral	Communication Services	Interactive Home Entertainment, Interactive Media & Services	Alternative Carriers, Publishing
	Consumer Staples	Beverages, Consumable Staples Merchandise Retail, Household Products	Tobacco
	Information Technology (IT)	Semiconductors, Semiconductor Materials & Equipment, Software	Communications Equipment
Unfavorable	Consumer Discretionary	Broadline Retail; Hotels, Restaurants & Leisure; Specialty Retail	Leisure Products
	Financials	Capital Markets, Diversified Banks, Insurance Brokers, Multi-Sector Holdings, Property & Casualty Insurance, Transaction & Payment Processing Services	Business Development Companies, Life & Health Insurance, Mortgage Real Estate Investment Trusts (REITs), Regional Banks
	Real Estate	Data Center REITs, Industrial REITs, Self-Storage REITs, Telecommunications REITs	Diversified REITs, Lodging/Resort REITs, Office REITs, Specialty REITs, Timberland REITs
	Utilities	Electric Utilities, Multi-Utilities, Renewable Electricity	Independent Power Producers & Energy Traders

Sources: Wells Fargo Investment Institute; sub-sector guidance from Global Securities Research and sector guidance from Global Investment Strategy. As of June 11, 2024.

13. Multi-Industrials includes the Industrial Conglomerates, Electrical Components & Equipment, Industrial Machinery & Supplies & Components, and Trading Companies & Distributors sub-industries.

See pages 26 – 27 for important definitions and risk considerations.

Anticipating the pivot to rate cuts

Key takeaways

- We believe the U.S. central bank is aiming to make a pivot of its own, toward lower interest rates, but awaits more clarity from key economic indicators to gain greater confidence around disinflationary trends.
- We anticipate positive fixed-income returns for both taxable and municipal bonds for the rest of the year, supported largely by the income component and eventual rate cuts from the Fed.

What it may mean for investors

- We still envision an inverted yield curve over the next 6 to 18 months. For now, we prefer investors prioritize credit quality.

Fixed income | Favored asset classes

- U.S. Taxable Investment Grade Fixed Income
- U.S. Taxable Short Term Fixed Income

Fixed income | Favored sectors and sub-sectors

- Securitized: Residential mortgage-backed securities (RMBS)
- Municipal Bonds: State and local general obligation and essential-service revenue

We believe the U.S. central bank is aiming to make a pivot of its own, toward lower interest rates, but awaits more clarity from key economic indicators to gain greater confidence around disinflationary trends. For now, we still expect that the Fed will be able to cut in two quarter-point increments later this year and one more time in 2025, although there is still a risk that inflation runs hotter than expected and that rate cuts will continue to be delayed this year.

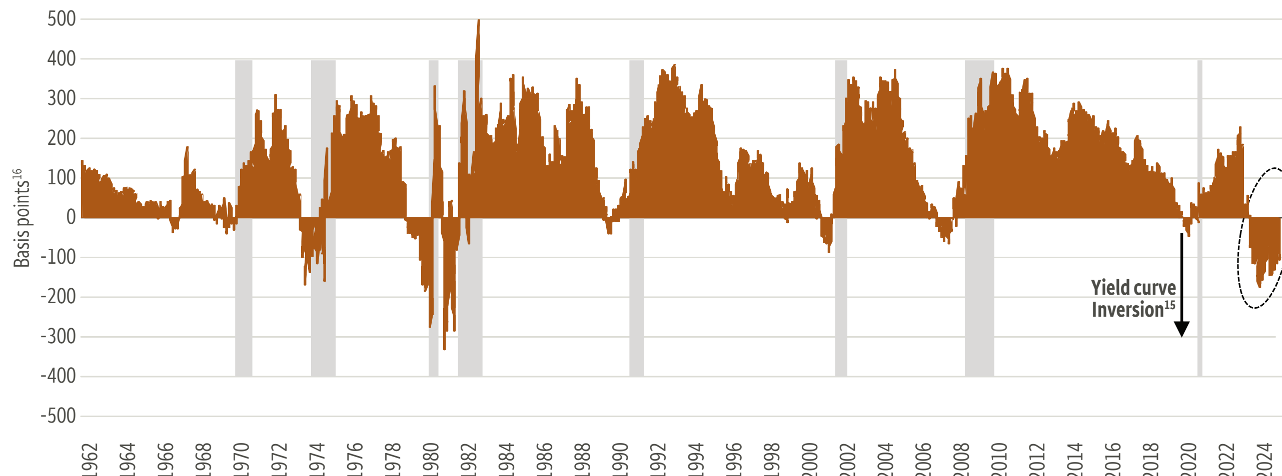
Since the Fed states that it remains data dependent, we believe that it would take a significant economic or geopolitical surprise to compel additional rate cuts beyond our expectations. Regarding quantitative tightening,[14] the Fed stated in early May its intention to begin tapering its monthly securities runoff starting in June, reducing the monthly redemption cap of U.S. Treasuries from $60 billion to $25 billion while maintaining the monthly redemption cap on agency debt and agency mortgage-backed securities at $35 billion. We believe Fed officials will provide further adjustment announcements around the balance-sheet level and continued tapering efforts later in the year.

We expect short-term fixed income to continue to perform well, especially as the Fed likely will cut interest rates at a slow and methodical pace, potentially allowing investors to continue to earn attractive yields — hence our most favorable guidance on this asset class. Our year-end 2024 10-year U.S. Treasury yield forecast stands at 4.25% to 4.75%, and we are expecting a move lower by another quarter point by year-end 2025. We remain neutral on the intermediate- and long-term portion of the yield curve, preferring investors maintain full allocations. Holding longer-term bonds over the next 6 to 18 months should benefit investors by providing stable and relatively high income (as long as the issuer does not default), regardless of near-term interest-rate movements.

14. Quantitative tightening is the gradual reduction (tightening) of the Fed's balance sheet. For example, the Fed holds U.S. Treasuries as assets on its balance sheet, and as some of those bonds mature, the Fed decides to reduce its assets and forgo reinvesting the proceeds of those bonds.

See pages 26 – 27 for important definitions and risk considerations.

As the economy regains momentum, long-term Treasury yields should rise relative to falling short-term rates



Sources: Wells Fargo Investment Institute and Bloomberg. Weekly data, January 1, 1962 – May 15, 2024.

15. An inverted yield curve occurs when shorter-term bond yields exceed longer-term bond yields. The difference between the 10-year and the 3-month Treasury yield measures the spread between short- and long-term interest rates. Shaded areas denote recessionary periods.

16. 100 basis points equal 1%. Yields represent past performance and fluctuate with market conditions. Current yields may be higher or lower than those quoted above.
Past performance is no guarantee of future results.

As the Fed cuts rates, we expect long-term yields to follow the historical pattern, whereby long-term yields rise as the economy recovers (see chart above). In that case, we anticipate new opportunities for long-term investors to lock in rising long-term yields. If short-term rates decline, as we expect, these maturing securities should provide a source of funds to switch into longer-term securities.

Neutral outlook for global bonds

We see an improving environment for Developed Market ex-U.S. Fixed Income in the second half of the year, aided largely by rate cuts from the European Central Bank. However, a growing interest-rate differential between the U.S. and the eurozone could weaken the euro further, eventually impeding total returns for unhedged Developed Market ex-U.S. Fixed Income. This balance leaves us neutral (preferring investors hold a full allocation).

For now, we also remain neutral on Emerging Market Fixed Income, but there is potential for a more positive view on this asset class, especially if the Fed eventually reduces interest rates. Emerging market U.S.-dollar-denominated sovereign debt is relatively attractive at current yields, and the wider yield differential provides both greater currency resilience and a larger cushion against capital losses if rates were to rise or credit spreads were to widen.

Focus on credit quality

Investment-grade credit quality remains strong, albeit with less of a cushion than in years past. Issuers rated single-A have seen credit metrics fall slightly below historical averages as interest expenses have risen gradually; however, limited near-term refinancing needs make further deterioration unlikely. Triple-B issuers retain strong credit metrics relative to single-A as fewer issuers than usual are at risk of falling into the high-yield (below-investment-grade) category. Thus far, we are encouraged by management decisions from some triple-B issuers to focus on retaining investment-grade credit metrics.

See pages 26 – 27 for important definitions and risk considerations.

We are favorable on the securitized space. This is largely due to our positive view of residential mortgage-backed securities (RMBS) which are still displaying a relative value advantage over investment-grade corporates, given how much credit spreads have narrowed respectively. From a technical perspective, the supply of RMBS should remain flat relative to 2023, while bank demand for RMBS should increase as loan growth decreases once the Fed begins to cut interest rates.

High-yield bonds have seen default rates rise back to historical averages, and that could remain the norm over the next few years as heavily leveraged credits need to refinance debt at much higher rates. However, we do not currently see evidence of widespread credit issues. Given the resilient credit quality of double-B issuers and the possibility of earnings growth among single-B issuers, there are select opportunities where business strength can offset the impact of accelerating interest expenses.

Consider municipal bonds

Municipal bond credit fundamentals remain favorable, and for investors in higher effective tax brackets, municipal securities remain relevant and an important part of fixed-income positioning. With most stimulus funds spent, credit pressure may emerge among lower-quality credits in certain sectors. We prefer to focus on portfolio maintenance by moving up in credit quality. Municipal credit spreads remain near recent lows because of high-yield municipal sector outperformance. We suggest that more risk-tolerant investors who are seeking to diversify into high-yield municipal bonds utilize active management, which can assist with credit selection, sector allocation, and liquidity management.

Municipal credits continue to carry an average rating that is significantly higher than corporates with a much lower default rate. Along with their tax advantages and superior credit quality, municipal bonds also have continued to outperform taxable bonds. We still favor general obligation and essential-service revenue water and sewer bonds, rated single-A or higher. We believe these securities offer an opportunity for outperformance and hold their value relative to nontraditional municipal project financings.

Fixed income | Sector and sub-sector preferences

	Sub-sectors	
Sectors	**Favorable**	**Unfavorable**
Municipal bonds (favorable)	State and local general obligation and essential-service revenue	Niche private higher-education institutions and smaller health care providers
Securitized (favorable)	Residential mortgage-backed securities	
Investment-grade corporate bonds (neutral)	Energy, Financials, Utilities	Consumer Discretionary, Information Technology

Sources: Wells Fargo Investment Institute; sub-sector guidance from Global Securities Research and sector guidance from Global Investment Strategy. As of June 11, 2024.

See pages 26 – 27 for important definitions and risk considerations.

Commodity prices show renewed upside

Key takeaways

- We believe commodity prices, stalled since mid-2022, will resume their rise.
- Energy and Precious Metals have led the commodity complex higher so far in 2024, but Industrial Metals may be the next leader.

What it may mean for investors

- We prefer holding a basket of commodities as the commodity bull super-cycle begins to reaccelerate after a lackluster 2023.

Real assets | Favored asset classes, sectors, and sub-sectors

- Commodity asset class: Energy and Precious Metals sectors
- Public Real Estate sector: Data Center Real Estate Investment Trusts (REITs), Industrial REITs, Self-Storage REITs, Telecommunication REITs sub-sectors

Commodity bull super-cycles are multiyear periods, often lasting over a decade, in which commodity prices trend higher. Though commodity prices do move significantly higher over the course of a bull super-cycle, it's historically not a straight path higher. History has shown there are often bumps, or pauses, along the way, before the super-cycle reasserts itself and pushes prices higher once again.

For the current super-cycle that began in March 2020, performance was strong at the beginning of the cycle as COVID-19 disruptions and supply shortages rocketed prices higher. The commodity ascent eventually slowed around mid-2022, lasting through the end of 2023, as global economic concerns arose. Such pauses are common during commodity bull super-cycles as commodity prices are still susceptible to short-term economic fluctuations. Commodity bulls typically reaccelerate, though, as pauses do not fix the underlying driver of higher commodity prices — stunted supply growth.

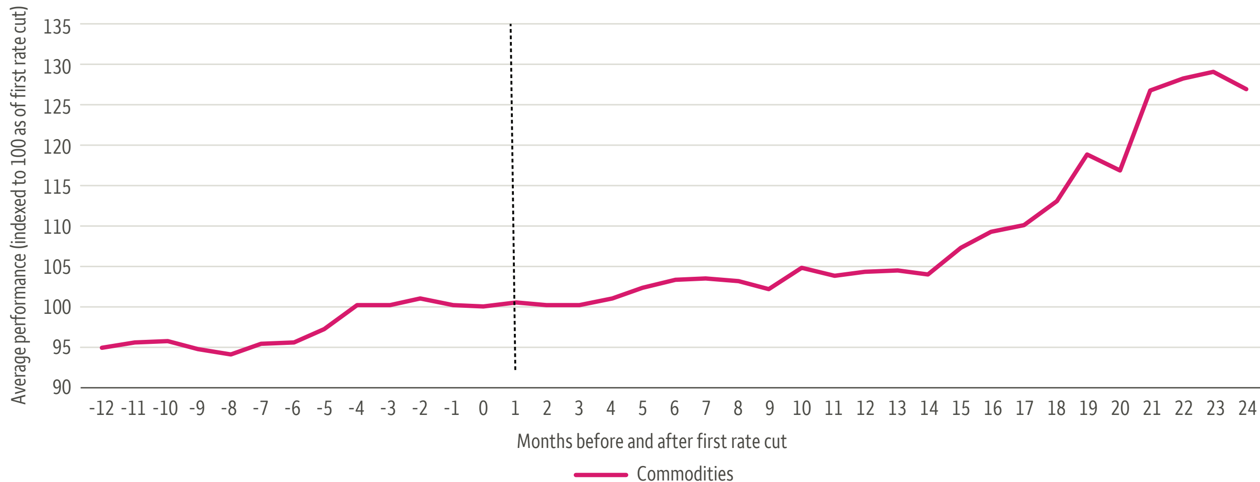
Now midway through 2024, it appears that the bull super-cycle has reasserted itself as commodity prices have broadly picked up once again. We suspect that commodity prices will continue to push higher over the next six to 18 months, led by metals, both industrial and precious. Agricultural prices appear to be bouncing too, which may help solidify the rally. Commodity consumption in the U.S. has been resilient with the economy, and economic growth outside the U.S. fuels international demand, even as supply continues to lag. We see these conditions as conducive for higher commodity prices.

Gold likely to keep shining

Gold prices have shown strong performance so far in 2024, closing at record highs numerous times through the first half of the year. Cooler inflation that brings down fixed-income yields should help boost gold prices, as should recent increases in gold purchases. Gold prices likely will be further supported later this year by Fed interest-rate cuts. Gold has historically performed quite well in the 24 months following the start of new interest-rate-cutting cycles by the Fed. The same has been the case for most other commodities too, as shown in the following chart.

See pages 26 – 27 for important definitions and risk considerations.

Average commodity performance across 12 Fed interest rate cutting cycles



Sources: Wells Fargo Investment Institute, Bloomberg, and Ned Davis Research. Data as of May 15, 2024. Monthly data, October 1969 – July 2021. Commodity performance is measured using the Bloomberg Commodity Total Return Index to 100 as of the start of the Fed easing cycle. These cycles began in November 1970, November 1971, December 1974, May 1980, November 1981, November 1984, June 1989, July 1995, September 1998, January 2001, September 2007, and July 2019. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

Crude-oil prices should remain sticky

Crude-oil prices started 2024 strong, and while upside from current prices appears limited, we believe that higher oil prices will continue. Fundamentals remain intact, and demand has proven to be resilient, even while one of the largest global consumers (China) struggles with a weak property sector. On the supply side, global supply growth remains tight as OPEC+ continues to implement its restrictive production policy and U.S. producers recommit to capital discipline. There is a risk that OPEC+ unwinds its production cuts late in 2024, but we believe this risk is low since the cartel has greatly benefited from higher oil prices by keeping global supply tight. We expect OPEC+ will maintain its tight supply policy into 2025.

See pages 26 – 27 for important definitions and risk considerations.

Industrial Metals could take the lead moving forward

After 24 months of underperforming most commodities, Industrial Metals have recently shown signs of life. Global economic growth is still subdued, but significant investment in green energy, as well as rebuilding factories returning to the U.S. from China, should support global demand into the coming years. Meanwhile, sanctions continue to limit supply. As the U.S. economy pivots to a more sustained recovery, we think metals such as copper and aluminum will find additional support.

Agricultural prices may benefit from sticky energy prices

Agricultural prices have lagged over the past few years, but we think that may change soon as a result of persistently high energy prices. For example, higher costs for fertilizer and diesel ultimately drag on the production and distribution process, increasing final food prices. The long-term correlation between energy and agricultural commodity prices remains intact. With global oil prices consistently near or above $80 per barrel for months now, we anticipate higher agricultural prices to follow. Periods of price weakness, like we have seen over the past year, are not uncommon during bull super-cycles. Historically, agricultural commodities have tended to take a breather halfway through the cycle before showing stronger performance. While we do not believe agriculture commodities are ready to lead this bull super-cycle just yet, we do expect performance to improve if the super-cycle progresses as we expect.

Public Real Estate sector and sub-sector preferences

	Sub-sectors	
Sector	**Favorable**	**Unfavorable**
Public Real Estate (Unfavorable)	Self-Storage, Data Centers, Industrials, Telecommunications	Diversified, Lodging/Resorts, Office, Specialty, Timberland

Sources: Wells Fargo Investment Institute; sub-sector guidance from Global Securities Research and sector guidance from Global Investment Strategy. As of June 11, 2024.

See pages 26 – 27 for important definitions and risk considerations.

Diversify with defensive alternatives

Key takeaways

- The gradual economic slowdown continues to guide our preference for defensive hedge funds and private capital strategies that we believe offer diversification benefits, generate counter-cyclical returns, or offer a quality bias.
- Once the economy reaccelerates, we anticipate a transition to directional strategies for their potential to track with the improved economic momentum.

What it may mean for investors

- Our current favored strategies and sub-strategies are more defensive and historically do not correlate to traditional stock and bond markets.

Hedge funds | Favored strategies and sub-strategies

- Event Driven: Distressed Credit
- Relative Value: Arbitrage
- Relative Value: Long/Short Credit
- Macro: Systematic
- Macro: Discretionary

Private capital | Favored strategies and sub-strategies

- Private Debt: Distressed/Special Situations
- Private Equity: Small- and Mid-Cap Buyout
- Private Equity: Growth Equity

Searching for green shoots

Our alternative investment guidance continues to focus on strategies that we believe offer greater diversification benefits, provide counter-cyclical opportunities, or offer a quality bias. We are maintaining this defensive posture while we await the U.S. economy's pivot to what we believe will be a sustainable recovery.

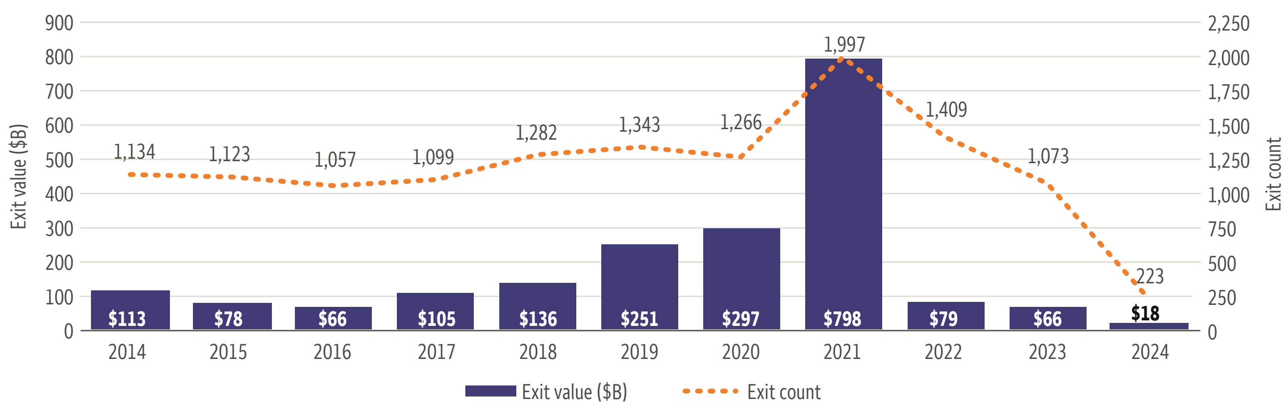
Yet, we are also witnessing many green shoots within alternative investments that may signal an improved outlook lies ahead. These positive developments include increasing merger and acquisition activity, a rebound in public equity markets, a narrowing of credit spreads, and a bottoming of valuations in select areas of private capital markets. Once the economy reaccelerates, we anticipate a transition to directional strategies for their potential to track with the improved economic momentum.

See pages 26 – 27 for important definitions and risk considerations.

Private capital playbook

In Private Equity, we are seeing capital migrate toward higher-quality opportunities with proven business models, and we reiterate our favorable guidance on Growth Equity strategies. However, we hold a neutral rating on Venture Capital as it has suffered significant declines in fundraising, exit volumes, and valuations. Mature funds seek to harvest gains in their portfolio positions through a variety of exit strategies, including a sale to other private equity investors, a public listing through an initial public offering (IPO), or a sale to management or another company (public or private). The exit environment for Venture Capital strategies has declined dramatically since the peak in 2021 (see chart below). However, as confidence returns and valuations bottom, we expect activity levels to increase quickly. Ultimately, we see a balance between the risks and the long-term opportunities, and this drives our neutral rating.

Venture Capital exit environment remains subdued



Sources: Wells Fargo Investment Institute and Pitchbook, as of March 31, 2024. Calendar-year data 2014 – 2024. 2024 represents partial-year data represented by the first quarter of 2024. Note: Venture Capital universe is represented by all activity reported to the Pitchbook database that is classified in the venture capital stage.
Past performance is no guarantee of future results.

Buyout strategies focus on acquiring a controlling stake in more mature, cash-flow-generating businesses, often with the goal of taking a public company private, divesting a portion of the business, or combining with competitors to achieve scale, improve operational efficiencies, or upgrade leadership teams. We continue to favor Small-Mid Buyout strategies (favorable) over Large Buyout (neutral). The elevated cost of capital has restricted activity in deals with larger debt financings, yet we have witnessed a moderate resurgence in late 2023/early 2024. Still, we prefer to see further confirmation of a sustained improvement in activity and improved visibility in the future path of interest rates before considering an upgrade.

Private equity funds have very limited liquidity options, but institutional investors are increasingly selling their fund stakes on the secondary market. Many funds are dedicated to buying secondary fund interests, as they offer improved visibility in the underlying portfolio holdings, a shorter life span, and the ability to capitalize on pricing dislocations that often arise during market slowdowns.

See pages 26 – 27 for important definitions and risk considerations.

Secondary strategies have defied the lackluster private equity fundraising environment and have experienced an increase in fundraising of over 65% in 2023 (versus the prior year). We believe these strategies represent a compelling opportunity for investors today.

In Private Debt, we have maintained our neutral stance on Direct Lending strategies. Our concerns involve higher debt service costs and their impact on lower-quality, over-leveraged small and midsize businesses. Thus far, the strategy's resilience has exceeded expectations as lenders with disciplined underwriting standards and a focus on higher-quality credits have been able to navigate this slowdown successfully.

We also maintain our neutral guidance in Private Real Estate. Valuations remain under pressure in select property types, such as lower-quality Office and Multifamily. The stalled "return to work" trend, higher financing costs, and the continued shift to online retail continue to create uncertainty around the timing of any future inflection point.

See pages 26 – 27 for important definitions and risk considerations.

Our top five portfolio ideas

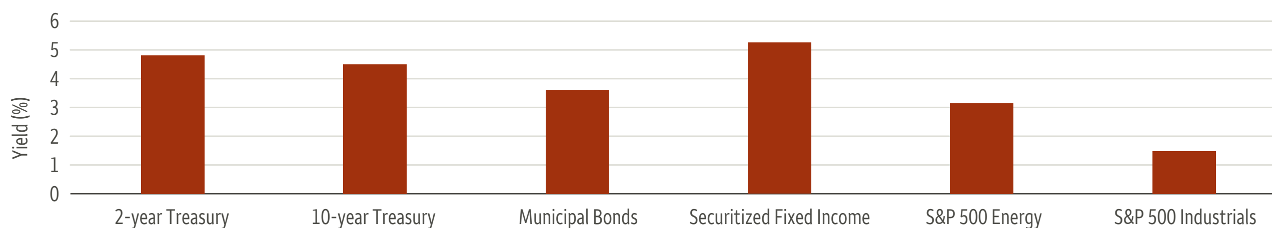
1 Broaden equity exposure during market pullbacks

In the first half of this year, U.S. mega-cap tech-company share prices began showing signs of fatigue, and equity markets experienced a rotation of leadership into widening sector breadth. In the months ahead, events such as the November elections and any delays in inflation's renewed decline may prompt episodes of market volatility. However, if the Fed pivots to rate cuts and the economy moves to a new and sustained growth improvement phase as we expect, pullbacks should provide opportunities to add sector breadth in U.S. Large Cap Equities. U.S. Large Caps continue to be our only favored equity asset class as we believe it is too early to add aggressively to riskier areas of the equity markets, such as U.S. Small Caps and Emerging Markets. However, market pullbacks may open opportunities to broaden exposure to those equity asset classes.

2 Prepare to extend duration and generate yield[17]

Interest rates near their highest levels since 2007 potentially offer investors some of the best opportunities in decades to generate income and support our most favorable rating on U.S. Short Term Taxable Fixed Income. The U.S. 10-year Treasury yield has fluctuated between 3% and 5% since January 2023, significantly higher than the past decade. We believe that when longer-term yields are in the upper end of this range (4.25% to 5.00%), investors may consider locking in these attractive rates for extended periods of time by moving into longer maturities. But once the Fed begins to cut short-term interest rates, income-oriented investors who remain in short-term maturities may forego opportunities in income generation.

Take advantage of elevated yields by diversifying income sources



Sources: Wells Fargo Investment Institute and Bloomberg. Data as of May 14, 2024. Representative indexes include the Bloomberg Municipal Bond Total Return Index, the Bloomberg U.S. Securitized Fixed Income Total Return Index, the S&P 500 Energy Index, and the S&P 500 Industrials Index. An index is unmanaged and not available for direct investment.
Past performance is no guarantee of future results.

Other areas of the fixed-income markets that we currently favor include Securitized and Municipal Bonds. These assets can add to portfolio yield, and for highly taxed investors, municipal bonds can provide an attractive investment to incorporate tax efficiency into a portfolio (see chart above). Additionally, some of our favored equity sectors can augment portfolio income with attractive dividend yields. For example, the Energy sector is currently paying around 3% and the Industrials sector offers about 1.5%, as of this writing.

17. Duration is a measure of interest-rate sensitivity.

See pages 26 – 27 for important definitions and risk considerations.

3 Invest in the building blocks of growth

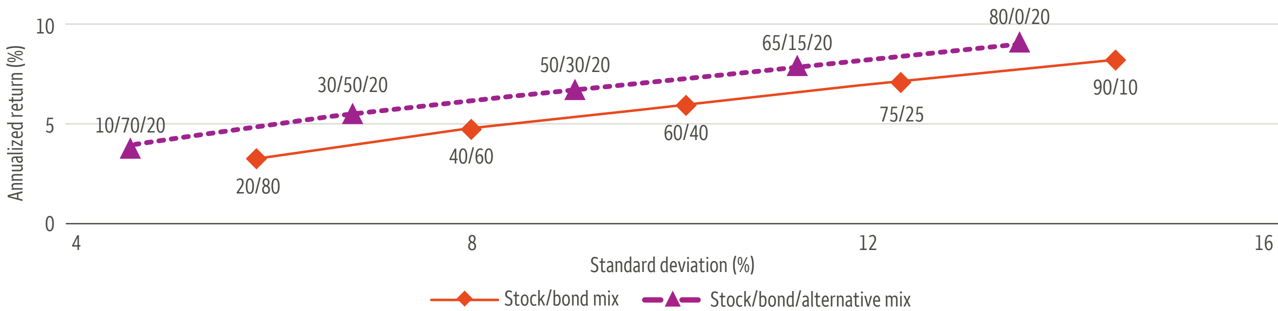
The drive for greater labor efficiency and government fiscal policy are fueling increased infrastructure spending that should foster stronger economic growth in the years to come. These drivers cross sectors and asset classes. We believe investors can potentially benefit from overweighting allocations to the Energy, Industrials, and Materials sectors (particularly to electrical equipment and industrial machinery) along with commodities.

The rapid growth in generative AI could transform the economy beyond the Information Technology sector through improved productivity across industries. AI requires enormous amounts of data storage, computing power, and energy. We think data-center construction and electrical requirements to support AI will benefit select REITs as well as energy and industrial companies.

4 Offset macro uncertainty with alternatives

Over the longer term, alternative investments may enhance returns and hedge portfolio volatility when added to a mix of equity and fixed-income asset classes (see chart below). In today's environment, Relative Value strategies should continue to benefit from their defensive characteristics and increases in credit dispersion as the economy cools. Event-driven securities can provide a hedge during unexpected events, while Macro strategies should profit from persistent trends, including those in commodities and currencies. Looking ahead, we believe emergent investment trends like AI and weakening valuations are likely to make for compelling opportunities for private capital.

Historical portfolio return and risk profile with and without alternative investments



Sources: Wells Fargo Investment Institute, Pitchbook, and Bloomberg. Data as of December 31, 2023. Average annualized returns depicted are calculated over a 10-year period spanning Q1 2013 to Q4 2023. The figures along the lines represent the respective weights of the stock/bond or stock/bond/alternative index return mix. The 20% alternatives added are equally distributed across the four alternative asset classes, specifically 5% in private equity, 5% in private debt, 5% in private real estate, and 5% in hedge funds.

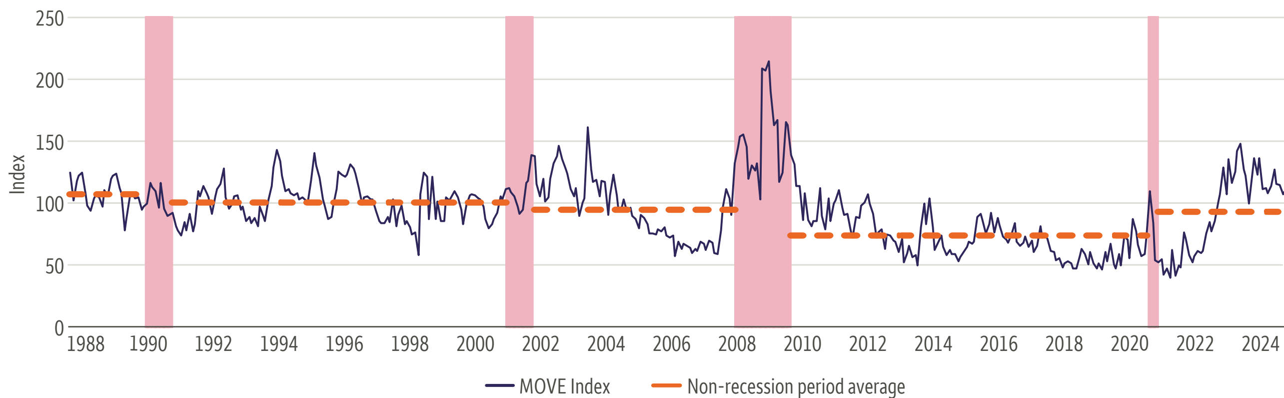
Private equities: Pitchbook Private Equity Index. Private debt: Pitchbook Private Debt Index. Private real estate: Pitchbook Private Real Estate Index. Hedge fund: HFRI Fund Weighted Composite Index. Stocks: MSCI All-Country World Index. Bonds: Bloomberg U.S. Aggregate Bond Index. An index is unmanaged and not available for direct investment. Results are calculated using blended index returns, and do not represent actual trading or the experience of any individual investor. **Past performance is no guarantee of future results.**

See pages 26 – 27 for important definitions and risk considerations.

5 Hedge economic and geopolitical risks

Some of the greatest potential drivers for a market-moving pivot are disruptive global economic or political events. Economic uncertainty and global conflict have increased sharply since 2022, and the chart below illustrates the attendant increase in financial market volatility since the U.S. economy's last expansion period, from 2009 to 2020. Some of our favored asset classes and sectors may help hedge these risks. Global threats have tended to benefit the U.S. dollar (notably against emerging-market weakness) and encourage overseas demand for U.S. equities and investment-grade fixed income, both principal favorites in our quality focus. Similarly, our preference for the Industrials sector in equities includes the Aerospace & Defense sub-sector, electrical equipment, and industrial machinery, which also should benefit from ongoing reshoring of U.S. manufacturing from Asia. In addition, we favor commodities (including precious metals) for their potential to hedge inflation and against the risk that intensifying global conflicts may further limit raw-material supplies in the coming 12 to 18 months.

Bond price volatility points to the potential for market uncertainty



Sources: Wells Fargo Investment Institute and Bloomberg. Monthly data, April 1988 – April 2024. Shaded areas denote recession periods. The Intercontinental Exchange - Bank of America Merrill Lynch MOVE Index measures the level of volatility in U.S. Treasury futures prices. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

See pages 26 – 27 for important definitions and risk considerations.

Contributors

Darrell L. Cronk, CFA
President, Wells Fargo Investment Institute
Chief Investment Officer, Wealth & Investment Management

Global Investment Strategy

Paul Christopher, CFA
Head of Global Investment Strategy

Luis Alvarado
Global Fixed Income Strategist

Chris Haverland, CFA
Global Equity Strategist

John LaForge
Head of Real Asset Strategy

Edward Lee
Investment Strategy Analyst

Sam Lombardo
Investment Strategy Analyst

Chao Ma, PhD, CFA, FRM
Global Portfolio and Investment Strategist

Mason Mendez
Investment Strategy Analyst

Tony Miano, CFA
Investment Strategy Analyst

Austin Pickle, CFA
Investment Strategy Analyst

Brian Rehling, CFA
Head of Global Fixed Income Strategy

Sameer Samana, CFA
Senior Global Market Strategist

Gary Schlossberg
Global Strategist

Mark Steffen, CFA, CAIA
Global Alternative Investment Strategist

Jennifer Timmerman
Investment Strategy Analyst

Scott Wren
Senior Global Market Strategist

Global Asset Allocation Strategy

Tracie McMillion, CFA
Head of Global Asset Allocation Strategy

Douglas Beath
Global Investment Strategist

Jeremy Folsom
Investment Strategy Analyst

Michael Taylor, CFA
Investment Strategy Analyst

Michelle Wan, CFA
Global Investment Strategist

Veronica Willis
Global Investment Strategist

Global Securities Research

Dorian Jamison
Municipal Analyst

Eric M. Jasso, CFA
Corporate Analyst

Lawrence Pfeffer, CFA
Equity Sector Analyst

See pages 26 – 27 for important definitions and risk considerations.

Definitions

Bloomberg Commodity Total Return Index (BCOMTR) reflects the total return on U.S. Treasuries, and 23 commodity futures weighted to account for economic significance and market liquidity.

Bloomberg Municipal Bond Total Return Index is a U.S. dollar denominated long-term tax-exempt bond index. It is unhedged and current has 57,947 members.

Bloomberg U.S. Aggregate Bond Index is a broad-based measure of the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market.

Bloomberg U.S. Securitized Fixed Income Total Return Index includes mortgage-backed, asset-backed and commercial mortgage- backed securities.

Consumer Price Index (CPI) produces monthly data on changes in the prices paid by urban consumers for a representative basket of goods and services.

DAX German Stock Index represents 30 of the largest and most liquid German companies traded on the Frankfurt Stock Exchange.

Federal Reserve Bank of Chicago's Adjusted National Financial Conditions Index (NFCIADJ) is constructed to have an average value of zero and a standard deviation of one over a sample period extending back to 1973 and isolates a component of financial conditions uncorrelated with economic conditions to provide an update on how financial conditions compare with current economic conditions. Positive values indicate financial conditions that are tighter than on average, while negative values indicate financial conditions that are looser than on average.

FTSE NAREIT All Equity REITs Index is designed to represent all U.S. commercial real estate sectors and contains all tax-qualified REITs with more than 50% assets in real estate.

HFRI Fund Weighted Composite Index is a global, equal-weighted index of single-manager funds that report to HFR Database.

ICE U.S. Dollar Index is a weighted average of the value of the U.S. dollar relative to a basket of U.S. trade partner currencies, composed of the euro, Japanese yen, pound sterling, Canadian dollar, Swedish krona, and Swiss franc. A higher index value indicates dollar appreciation.

Intercontinental Exchange - Bank of America Merrill Lynch MOVE Index measures U.S. bond market volatility by tracking a basket of OTC options on U.S. interest rate swaps. The Index tracks implied normal yield volatility of a yield curve weighted basket of at-the-money one-month options on the 2-year, 5-year, 10-year, and 30-year constant maturity interest rate swaps.

MSCI All Country World Index (MSCI ACWI) is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of 23 developed and 26 emerging markets.

MSCI EAFE Index (Europe, Australasia, Far East) Index is a free float-adjusted market capitalization index designed to measure the equity market performance of developed markets, excluding the U.S. and Canada.

MSCI Emerging Markets Index is a free float-adjusted market capitalization index designed to measure equity market performance of emerging markets.

Nikkei 225 Index is the leading and most-respected index of Japanese stocks. It is a price-weighted index comprised of Japan's top 225 blue-chip companies on the Tokyo Stock Exchange. The Nikkei is equivalent to the Dow Jones Industrial Average Index in the U.S.

Pitchbook Private Debt Index is based on the pool of private debt closed end funds sourced by Pitchbook and is asset weighted.

Pitchbook Private Equity Index is based on the pool of private equity closed end funds sourced by Pitchbook and is asset weighted.

Pitchbook Private Real Estate Index is a quarterly return benchmark built with Pitchbook's fund cash flow and net asset value data. The index includes private real estate funds classified by Pitchbook. The index is capital weighted and provides estimates of asset class performance that are subject to updates by Pitchbook.

Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index, which measures the performance of the 3,000 largest U.S. companies based on total market capitalization.

Russell Midcap Index measures the performance of the 800 smallest companies in the Russell 1000 Index, which represent approximately 25% of the total market capitalization of the Russell 1000 Index, which measures the performance of the 1,000 largest U.S. companies based on total market capitalization.

S&P 500 Energy Index comprises those companies included in the S&P 500 that are classified as members of the GICS energy sector.

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the US stock market.

S&P 500 Industrials Index comprises those companies included in the S&P 500 that are classified as members of the GICS industrials sector.

Bond rating firms, such as Moody's, Standard & Poor's, and Fitch, use different designations consisting of upper- and lower-case letters 'A' and 'B' to identify a bond's credit quality rating. 'AAA' and 'AA' (high credit quality) and 'A' and 'BBB' (medium credit quality) are considered investment grade. Credit ratings for bonds below these designations ('BB', 'B', 'CCC', etc.) are considered low credit quality, and are commonly referred to as "junk bonds".

Risk considerations

Forecasts and targets are based on certain assumptions and on our current views of market and economic conditions, which are subject to change.

All investing involves risks, including the possible loss of principal. There can be no assurance that any investment strategy will be successful and meet its investment objectives. Investments fluctuate with changes in market and economic conditions and in different environments due to numerous factors, some of which may be unpredictable. Asset allocation and diversification do not guarantee investment returns or eliminate risk of loss. Each asset class has its own risk and return characteristics, which should be evaluated carefully before making any investment decision. 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. Some of the risks associated with the representative asset classes include:

General market risks

Stock markets, especially foreign markets, are volatile. A **stock's** value may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **International investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. This may result in greater share price volatility. These risks are heightened in emerging and frontier markets. Investing in **small- and mid-cap companies** involves additional risks, such as limited liquidity and greater volatility.

Investments in **fixed-income securities, including municipal securities**, are subject to market, interest rate, credit, liquidity, inflation, prepayment, extension, and other risks. Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can result in a decline in the bond's price. **High-yield fixed-income** securities are considered speculative, involve greater risk of default, and tend to be more volatile than investment-grade fixed-income securities. **Municipal securities** may also be subject to the alternative minimum tax and legislative and regulatory risk, which is the risk that a change in the tax code could affect the value of taxable or tax-exempt interest income.

U.S. government securities are backed by the full faith and credit of the federal government as to payment of principal and interest if held to maturity. Although free from credit risk, they are subject to interest rate risk. Although Treasuries are considered free from credit risk, they are subject to other types of risks. These risks include interest rate risk, which may cause the underlying value of the bond to fluctuate.

Although **Treasuries** are considered free from credit risk they are subject to other types of risks. These risks include interest rate risk, which may cause the underlying value of the bond to fluctuate.

Mortgage-related securities are subject to prepayment and call risks in addition to the risks of investing in debt securities. Call risk is the risk that the issuer will redeem the issue prior to maturity. This may result in reinvestment risk, which means the proceeds will generally be reinvested in a less favorable environment. Changes in prepayments may significantly affect yield, average life, and expected maturity.

Currency risk is the risk that foreign currencies will decline in value relative to that of the U.S. dollar. Exchange rate movement between the U.S. dollar and foreign currencies may cause the value of a portfolio's investments to decline.

Sector investing

Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. **Communication services** companies are vulnerable to their products and services becoming outdated because of technological advancement and the innovation of competitors. Companies in the communication services sector may also be affected by rapid technology changes, pricing competition, large equipment upgrades, substantial capital requirements and government regulation and approval of products and services. In addition, companies within the industry may invest heavily in research and development which is not guaranteed to lead to successful implementation of the proposed product. Risks associated with the **Consumer Discretionary** sector include, among others, apparel price deflation due to low-cost entries, high inventory levels and pressure from e-commerce players; reduction in traditional advertising dollars, increasing household debt levels that could limit consumer appetite for discretionary purchases, declining consumer acceptance of new product introductions, and geopolitical uncertainty that could affect consumer sentiment. **Consumer Staples** industries can be significantly affected by competitive pricing particularly with respect to the growth of low-cost emerging market production, government regulation, the performance of the overall economy, interest rates, and consumer confidence. The **Energy** sector may be adversely affected by changes in worldwide energy prices, exploration, production spending, government regulation, and changes in exchange rates, depletion of natural resources, and risks that arise from extreme weather conditions. Investing in the **Financial** services companies will subject an investment to adverse economic or regulatory occurrences affecting the sector. Some of the risks associated with investment in the **Health Care** sector include competition on branded products, sales erosion due to cheaper alternatives, research and development risk, government regulations and government approval of products anticipated to enter the market. There is increased risk investing in the **Industrials** sector. The industries within the sector can be significantly affected by general market and economic conditions, competition, technological innovation, legislation and government regulations, among other things, all of which can significantly affect a portfolio's performance. **Materials** industries can be significantly affected by the volatility of commodity prices, the exchange rate between foreign currency and the dollar, export/import concerns, worldwide competition, procurement and manufacturing and cost containment issues. **Real estate** investments have special risks, including possible illiquidity of the underlying properties, credit risk, interest rate fluctuations, and the impact of varied economic conditions. Risks associated with the **Technology** sector include increased competition from domestic and international companies, unexpected changes in demand, regulatory actions, technical problems with key products, and the departure of key members of management. Technology and Internet-related stocks smaller, less-seasoned companies, tend to be more volatile than the overall market. **Utilities** are sensitive to changes in interest rates, and the securities within the sector can be volatile and may underperform in a slow economy.

Alternative investments

Alternative investments, such as **hedge funds, private equity/private debt, and private real estate funds** are speculative and involve a high degree of risk that is appropriate only for those investors who have the financial sophistication and expertise to evaluate the merits and risks of an investment in a fund and for which the fund does not represent a complete investment program. They entail significant risks that can include losses due to leveraging or other speculative investment practices, lack of liquidity, volatility of returns, restrictions on transferring interests in a fund, potential lack of diversification, absence and/or delay of information regarding valuations and pricing, complex tax structures and delays in tax reporting, and less regulation and higher fees than mutual funds. Hedge fund, private equity, private debt, and private real estate fund investing involve other material risks, including capital loss and the loss of the entire amount invested. A fund's offering documents should be carefully reviewed prior to investing.

Private debt strategies seek to actively improve the capital structure of a company, often through debt restructuring and deleveraging measures. Such investments are subject to potential default, limited liquidity, the creditworthiness of the private company, and the infrequent availability of independent credit ratings for private companies. Investing in distressed companies is speculative and involves a high degree of risk. Because of their distressed situation, these securities may be illiquid, have low trading volumes, and be subject to substantial interest rate and credit risks. **Private capital investments** are complex, speculative investment vehicles not appropriate for all investors. They are not subject to the same regulatory requirements as registered investment products and engage in leverage and other aggressive investment practices. There is often limited (or even nonexistent) liquidity and a lack of transparency regarding the underlying assets.

Hedge fund strategies, such as **Event Driven, Equity Hedge, Global Macro, Relative Value, Structured Credit, and Long/Short Credit**, may expose investors to the risks associated with the use of short selling, leverage, derivatives, and arbitrage methodologies. Short sales involve leverage and theoretically unlimited loss potential because the market price of securities sold short may continuously increase. The use of leverage in a portfolio varies by strategy. Leverage can significantly increase return potential but create greater risk of loss. Derivatives generally have implied leverage, which can magnify volatility and may entail other risks, such as market, interest rate, credit, counterparty, and management risks. Private capital investments are complex, speculative investment vehicles not appropriate for all investors. They are not subject to the same regulatory requirements as registered investment products and engage in leverage and other aggressive investment practices. There is often limited (or even nonexistent) liquidity and a lack of transparency regarding the underlying assets.

Real assets

Real assets are subject to the risks associated with **real estate, commodities,** and other investments and may not be appropriate for all investors. The **commodities markets,** including investments in **gold and other precious metals**, are considered speculative, carry substantial risks, and have experienced periods of extreme volatility. Investing in a volatile and uncertain commodities market may cause a portfolio to rapidly increase or decrease in value, which may result in greater share price volatility. Investments in commodities may be affected by changes in overall market movements, commodity index volatility, changes in interest rates, or factors affecting a particular industry or commodity. Products that invest in commodities may employ more complex strategies, which may expose investors to additional risks. Investment in **real estate securities** includes risks, such as the possible illiquidity of the underlying properties, credit risk, interest rate fluctuations, and the impact of varied economic conditions.

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