WELLS FARGO
Investment Institute

TIMELY GUIDANCE

Institute Alert

Timely guidance that may affect your investment strategy **April 15, 2024**

Global Investment Strategy Team

- ☐ **Guidance changes**
- ☑ **Forecast change**
- ☐ **Allocation changes**

Revising targets and extending our outlook through 2025

Guidance changes

- No guidance changes

Forecast changes

- **Global economy and currencies:** Consistent with accommodative financial conditions, we are upwardly revising our 2024 U.S. growth and inflation forecasts and lowering our U.S. unemployment rate forecast. For 2025, we anticipate an inflation rebound and a modest economic acceleration that strengthens as the year progresses. We have revised our expected dollar depreciation into year-end 2024 and now expect continued dollar strength through 2025. We believe the yen may see some gains against the dollar in 2025.
- **Global fixed income:** Our year-end 2025 target shows a nearly flat maturity spectrum (or yield curve) — this is a quarter-point parallel shift below the yield curve implied by our 2024 targets, which we are revising for a more cautious pace of interest rate reductions.
- **Global equities:** A boost to the U.S. economic outlook and continued easy financial market conditions have led us to rerate our 2024 U.S. equity market earnings and price targets. For 2025, we look for stronger earnings growth to develop slowly over the course of the year but to finish higher, and with correspondingly higher price targets, for all global equity asset classes.
- **Global real assets:** Our 2024 revisions and 2025 targets reflect our expectation for commodity performance to strengthen through 2025 on the back of tight global supply, low real interest rates, and improving economic conditions in the U.S. and other developed economies.

Allocation changes

- No allocation changes

Investment and Insurance Products: ➤ NOT FDIC Insured ➤ NO Bank Guarantee ➤ MAY Lose Value

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Table 1. Wells Fargo Investment Institute (WFII) 2024 and 2025 year-end forecasts and market targets

	Average percent change from the same period a year ago, unless otherwise noted		
Global economy	**2025 targets**	**New 2024 targets**	**Previous 2024 targets**
U.S. GDP growth	2.1%	**2.5%**	1.3%
U.S. CPI Inflation[1]	3.0%	**3.0%**	2.8%
U.S. unemployment rate[2]	4.0%	**4.1%**	4.7%
Global GDP growth[3]	2.6%	**2.5%**	2.4%
Global inflation[3]	3.3%	3.3%	3.3%
Developed market GDP growth[4]	1.9%	**1.5%**	1.0%
Developed market inflation[4]	2.6%	**2.5%**	2.4%
Eurozone GDP growth	2.2%	0.6%	0.6%
Eurozone inflation[1]	2.0%	**2.3%**	2.0%
Emerging market GDP growth	3.1%	3.3%	3.3%
Emerging market inflation	3.8%	4.0%	4.0%

Sources: Wells Fargo Investment Institute and Bloomberg. Targets for 2024 and 2025 are based on forecasts by Wells Fargo Investment Institute as of April 15, 2024, and provide a forecast direction over a tactical horizon through 2025. Bolded values indicate change from previously published values. **Average percent change from the same period a year ago, unless otherwise noted.** GDP = Gross Domestic Product. CPI = Consumer Price Index. 1. December-to-December change. 2. Three-month average as of the date indicated, percent of labor force. 3. Weighted average of developed country and emerging-market forecasts. 4. 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. An index is unmanaged and not available for direct investment. Past performance is no guarantee of future results.**

Foreign currency exchange rates	**Year-end 2025 targets**	**New year-end 2024 targets**	**Previous year-end 2024 targets**
Dollars per euro	$1.03 – 1.07	**$1.06 – 1.10**	$1.08 – 1.12
Yen per dollar	¥152 – 156	**¥156 – 160**	¥136 – 140
ICE U.S. Dollar Index*	103 – 107	**102 – 106**	99 – 103

Fixed Income targets	**Year-end 2025 targets**	**New year-end 2024 targets**	**Previous year-end 2024 targets**
10-year U.S. Treasury yield	4.00% – 4.50%	4.25% – 4.75%	4.25% – 4.75%
30-year U.S. Treasury yield	4.25% – 4.75%	4.50% – 5.00%	4.50% – 5.00%
Federal funds rate	4.50% – 4.75%	**4.75% – 5.00%**	4.50% – 4.75%

Sources: Wells Fargo Investment Institute and Bloomberg. Targets for 2024 and 2025 are based on forecasts by Wells Fargo Investment Institute as of April 15, 2024, and provide a forecast direction over a tactical horizon through 2025. Bolded values indicate change from previously published values. *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. Past performance is no guarantee of future results.**

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Equity targets	Year-end 2025 targets	New year-end 2024 targets	Previous year-end 2024 targets
S&P 500 Index	5600 – 5800	**5100 – 5300**	4800 – 5000
S&P 500 EPS	$260	**$240**	$230
Russell Midcap Index	3700 – 3900	**3300 – 3500**	3200 – 3400
Russell Midcap EPS	$190	**$165**	$160
Russell 2000 Index	2500 – 2700	**2100 – 2300**	2000 – 2200
Russell 2000 EPS	$90	**$70**	$65
MSCI EAFE Index	2400 – 2600	2200 – 2400	2200 – 2400
MSCI EAFE EPS	$170	$160	$160
MSCI EM Index	1100 – 1300	950 – 1150	950 – 1150
MSCI EM EPS	$85	$75	$75

EPS=Earnings per share. EM = Emerging Market.

Real Assets targets	Year-end 2025 targets	New year-end 2024 targets	Previous year-end 2024 targets
WTI crude oil	**$85 – $95**	**$80 – $90**	$85 – $95
Brent crude oil	**$90 – $100**	**$85 – $95**	$90–$100
Gold	**$2,400 – $2,500**	**$2,300 – $2,400**	$2,100 – $2,200
Bloomberg Commodity Index	**250 – 270**	235 – 255	235 – 255

Sources: Wells Fargo Investment Institute and Bloomberg. Targets for 2024 and 2025 are based on forecasts by Wells Fargo Investment Institute as of April 15, 2024, and provide a forecast direction over a tactical horizon through 2025. Bolded values indicate change from previously published values. **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.**

Summary

The trajectory of our 2024 economic and market outlook has not changed. The U.S. economy has enjoyed significant resilience from the easiest financial conditions in financial markets to accompany a Federal Reserve (Fed) tightening cycle since at least 1995. Yet, the high cost and limited availability of bank credit have applied consistent financial stress on lower-income households, small businesses, regional banks, and commercial real estate.

So, on balance, we believe the economy is still slowing, which should cool inflation and allow for a modest easing of interest rates and credit conditions into 2025. We believe this dynamic offers two upshots for markets through 2025. First, we anticipate the economy's 2024 pivot into faster growth is likely to be modest — even below its post-WWII trend — because high private debt levels may constrain the rebound. Second, if the economy gains momentum through 2025 as we expect, inflation also is likely to pivot higher from its trough in 2024.

By comparison, steady gains in the S&P 500 Index accompanied market pricing in the inflation swaps market for low and steady inflation expectations, as well as fixed income market pricing for over 80% chance for lower short-term interest rates by June. This combination strikes us as overly optimistic and unrealistic. And we expect market volatility if investors eventually recalibrate their expectations as we anticipate. One might also throw in the risk of election uncertainties, which typically do not register with markets until after midyear. In any such case, we expect disappointments to register as downside risk to financial markets. Thus, for long-term investors, we are keeping our quality-oriented preferences around portfolio allocation.

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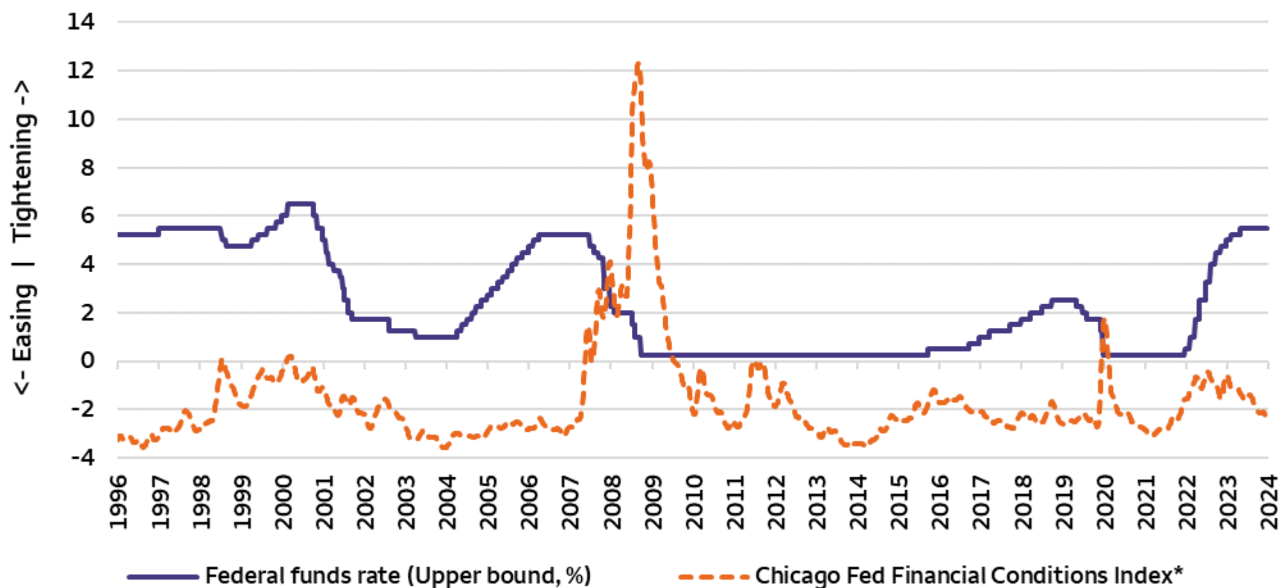
Unusually supportive financial conditions a double-edged sword for the economy

We are raising our 2024 economic growth targets, while the economy has been buoyed by unusually accommodative financial conditions, demonstrated in the chart below. Financial easing occurs when cash available for the equity and fixed income markets increases, and financial tightening occurs when the cash available decreases — in the past, tightening conditions have more typically accompanied Fed rate hike cycles. In our view, this cycle's singular easing while the Fed hiked rates was a result of rapid disinflation in 2023, and last fall's elevated interest rates have reinforced the easing conditions. We underestimated the durability of accommodative financial conditions in 2023, and their persistence is a principal reason for our 2024 economic upgrade.

Chart 1. First Fed tightening cycle in the past four where financial conditions eased consistently



Sources: Bloomberg and Wells Fargo Investment Institute. Weekly data, March 29, 1996 – March 21, 2024. *The Financial Conditions Index has been rescaled so that both series have the same standard deviation. This gives movements in the Financial Conditions Index similar magnitude to the movements in the federal funds rate.

Robust financial conditions only make the economy's 2024 slowing trend more gradual in our view. Consumer and small business finances remain under some strain while inflation and interest rates have been sticky. If the economy's softening progresses, we expect inflation to trend lower into year end, but inflation's hot start to 2024 is likely to require a slightly higher full-year target.

The important point for 2024 and 2025 is that slower growth and renewed disinflation should allow the Fed to cut interest rates. Historically, the beginning of Fed rate cuts has been an early economic recovery signal in that we anticipate workers to get new jobs, consumers satisfy pent-up demand, and businesses restock inventories. But if, as we expect, a gradual 2024 slowdown does not produce large layoffs, bankruptcies, and inventory reductions, then the recovery is likely to have a slow start. Put another way — without a recession to clear the deck for more spending, 2025 likely will start slowly, even if Fed rate cuts eventually generate economic momentum by the end of 2025.

A slow start to 2025 also implies that disinflation may continue early in the year. However, as interest rate cuts continue, both economic activity and inflation should gain momentum through the year. One area that may lead to higher year-end inflation is rental inflation, which accounts for almost a third of the CPI. Chart 2 shows that rents follow home prices with a long lag, and the recent upturn in home prices may presage higher rental inflation by year-end 2025. This is why our 2025 inflation target remains above the Fed's 2% long-term target.

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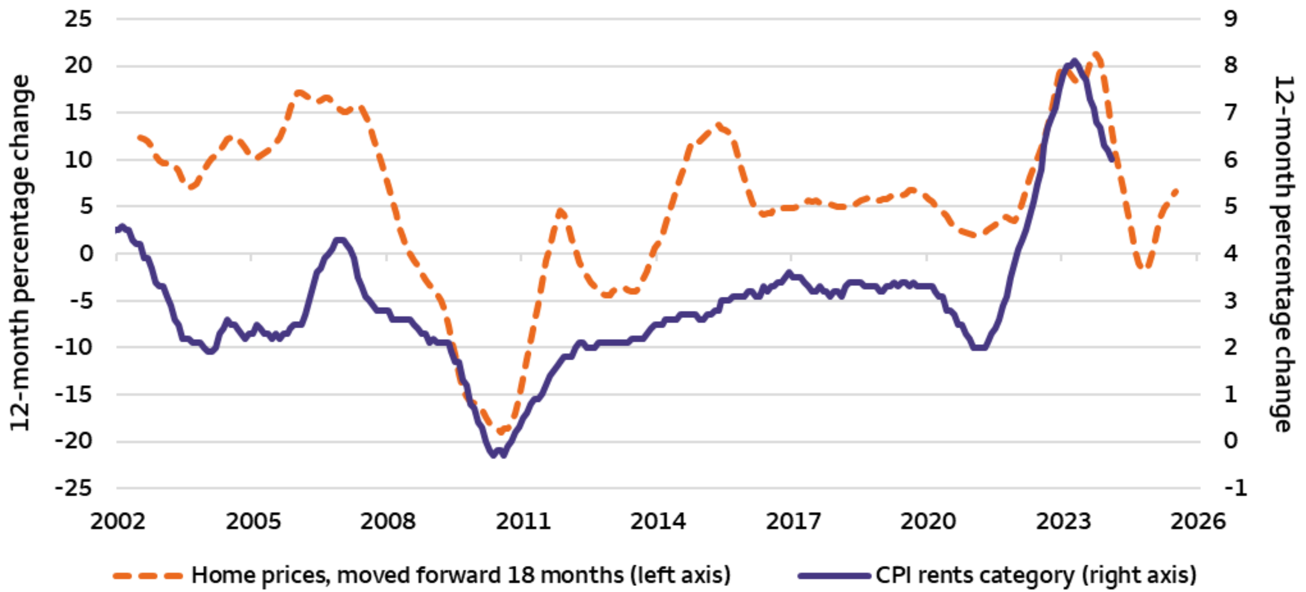
Chart 2. Home prices lead rental inflation and suggest an inflation upturn later in 2025



Sources: Bloomberg and Wells Fargo Investment Institute. Monthly data, January 2002 – February 2024. Home prices are measured by the S&P Case-Shiller U.S. home price index composite for 20 cities.

International growth outlook

Overseas, we expect that a U.S.-led recovery will spill over into other developed countries and outweigh a loss of emerging-market momentum. Developed economies may still trail the U.S., however, restrained by less fiscal support, a sluggish world-trade recovery, and a smaller technology sector along with demographic and other structural restraints. We envision that China's lackluster economy will struggle under various domestic issues and will mask more significant economic improvement in several large emerging-market economies (notably India and Brazil). We are adjusting our 2024 eurozone inflation target higher on expectations for energy price increases relative to 2023.

Dollar strength should continue into 2025

Our revised economic forecasts for stronger U.S. economic growth reinforce a stronger dollar against the other major, developed-market currencies. Meanwhile, other factors remain neutral or continue to favor the greenback. Among these other factors, we expect fewer 2024 interest rate reductions in the U.S. than in the eurozone. We expect a weaker eurozone economy is likely to trigger more reductions compared to the U.S. during 2025. We also expect modest interest rate hikes in Japan but, as in Europe, fewer than in the U.S. Finally, we expect weak global trade growth in 2024 and 2025 because of soft economic growth in China, Europe, and Japan as well as new U.S. tariffs from whichever presidential candidate controls the White House in 2025.

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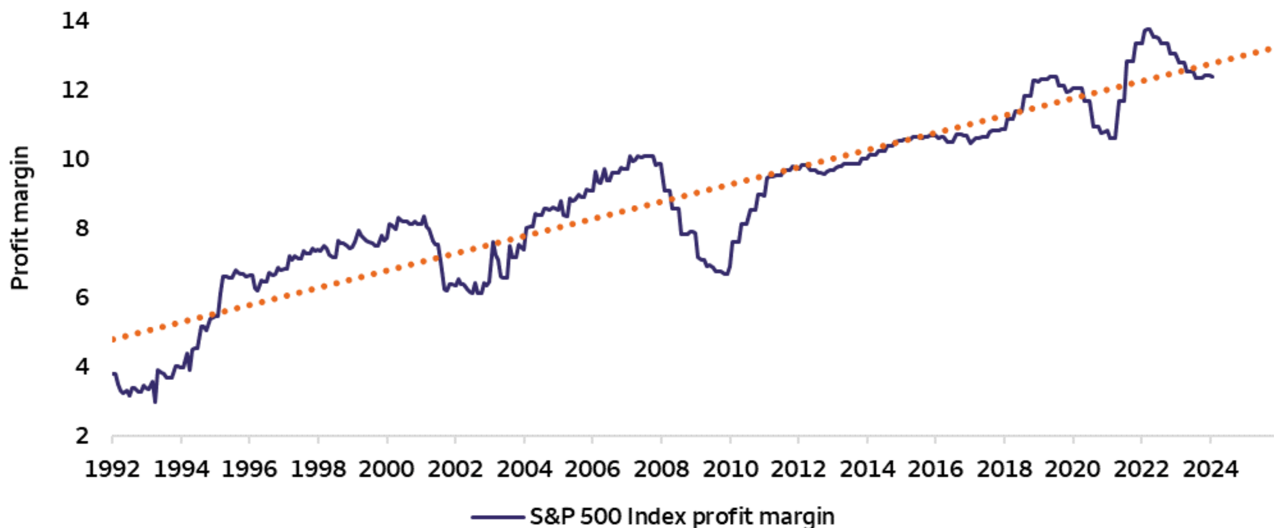
Equity targets reflect near-term choppiness, but we expect calmer waters in 2025

Our 2025 equity earnings and price targets as well as our revised 2024 targets reflect our modestly improved economic outlook. We expect that equity markets have priced in much of 2024's good news. Markets may struggle to advance meaningfully past recent highs while uncertainties persist surrounding the path of inflation as well as the timing and magnitude of Fed rate cuts. Still, we would view any periods of equity market weakness as opportunities given that our outlook through 2025 supports improved revenue growth and expanding margins.

Positive economic growth should drive sales while cost control should also help anchor profit margins. For S&P 500 Index constituents we believe: supply chain issues are mostly in the rearview mirror; wage increases are moderating; labor efficiency (that is, sales per employee) is at all-time highs and trending higher; and interest costs appear manageable. Artificial intelligence is also expected to help produce cost savings, but it has yet to be completely integrated across the economy. These factors drive our view that S&P 500 Index profit margins are steadying before moving back above their trend (Chart 3).

Chart 3. Margins anticipated to turn higher after recent declines



Sources: Bloomberg and Wells Fargo Investment Institute. Monthly data, January 31, 1992 – February 29, 2024. An index is not managed and not available for direct investment. **Past performance does not guarantee future results.**

A point of emphasis is that these year-end targets still allow for potential market disappointments related to the track of inflation and the federal funds rate. Thus, we believe it is too early to tilt toward a broad-based rally — we continue to prefer a quality-based approach and view U.S. Large Cap Equities as the highest-quality major equity class due to strong company balance sheets compared to other equity classes, durable pricing power, and resilient growth potential. We believe these characteristics will help U.S. Large Cap Equities manage disappointments to sentiment more effectively than other domestic and international asset classes. Our preference for quality extends to our view of international equities, where we prefer Developed Market ex-U.S. Equities (neutral) over Emerging Market Equities (unfavorable). At the sector level, we favor Industrials, Materials, Energy, and Health Care — in our view, these sectors fit the quality definition, look attractively valued, and have good long-term earnings prospects.

"Higher for longer"

We believe the U.S. central bank is aiming to make a pivot of its own, toward lower interest rates, but wants to wait for more clarity on the track of disinflation. We look for the Fed to begin cutting interest rates by midyear and to continue doing so through the first half of 2025. By then, we expect inflation to tick higher and offer the Fed fewer

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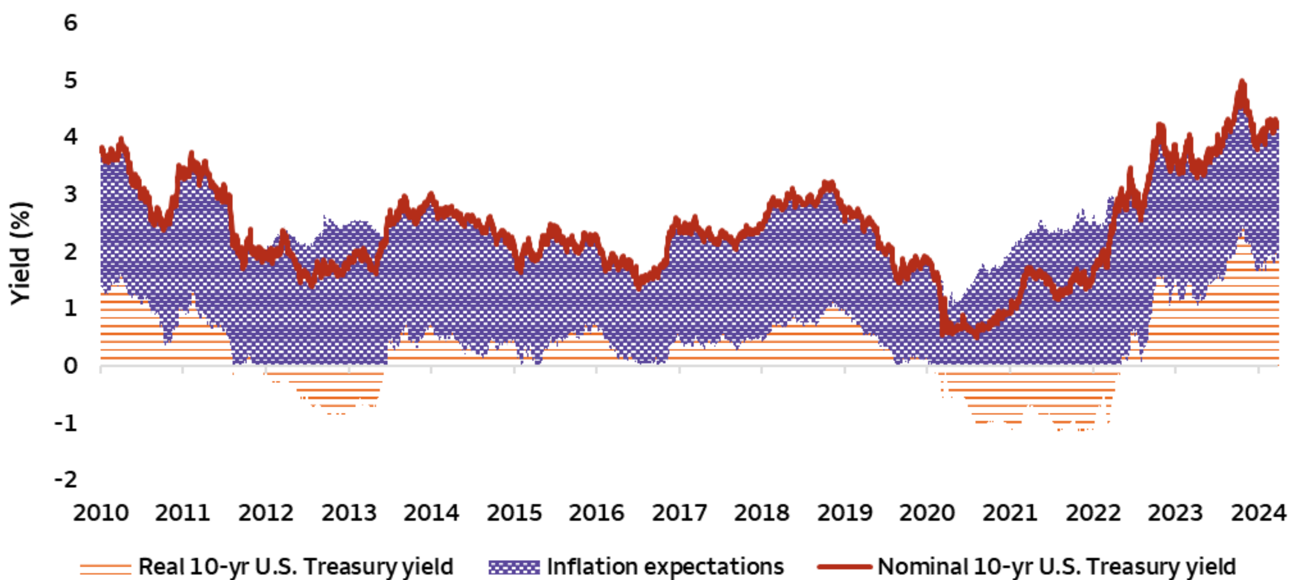
chances to reduce rates. Therefore, we are adjusting our year-end 2024 federal funds target rate to 4.75% – 5.00%. We expect to see one additional cut in 2025, putting our year-end 2025 target rate at 4.50% – 4.75%. Overall, we would say that the Fed will remain relatively higher than what we had expected and higher than current financial market pricing.

Short-term yields move lower while long-term yields stay put

The near-term path of interest rates is highly dependent on the state of the economy, the cash available in financial markets, and subsequent Fed decisions. We expect short-term U.S. Treasury rates to decline in tandem with the federal funds rate. However, longer-term interest rates may steady near current levels. Cash (or liquidity) plays its role by reducing volatility and narrowing the differences between private and government securities. Our expected economic growth and inflation levels over the next two years imply that long-term rates will tend to stay above 4%. With this outlook, we are keeping our year-end 2024 10-year and 30-year U.S. Treasury yield targets unchanged, but we do envision slightly lower long-term yields next year if the Fed continues to cut rates.

Some investors may wonder why our interest rate forecasts for year-end 2024 and 2025 are consistently above 4%, especially because the majority of consensus estimates are below this figure. The arithmetic can help illustrate why we hold this view. We first observe that an investor who buys a 10-year Treasury note expects to be compensated for future inflation as well as opportunities foregone in other financial markets. This latter component we refer to as the real yield. Chart 4 breaks out the nominal 10-year yield into these components based on prices available in the fixed income markets. What we observe is that real yields are typically positive and recently have approached 2%. If our economic growth forecasts of 2% are accurate, and if inflation stays above 2%, then we believe it reasonable for investors to demand at least 4% for a 10-year Treasury yield.

Chart 4. We expect a 10-year U.S. Treasury yield above 4% through 2025



Sources: Bloomberg and Wells Fargo Investment Institute. Daily data from January 1, 2010 to March 27, 2024. The real yield is proxied by the yield on the 10-year U.S. Treasury Inflation Protected (TIP) note. The inflation expectations component is proxied by the implied inflation rate on the TIP note. For illustrative purposes only. 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. 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.

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Commodity upside potential from an improved economic outlook

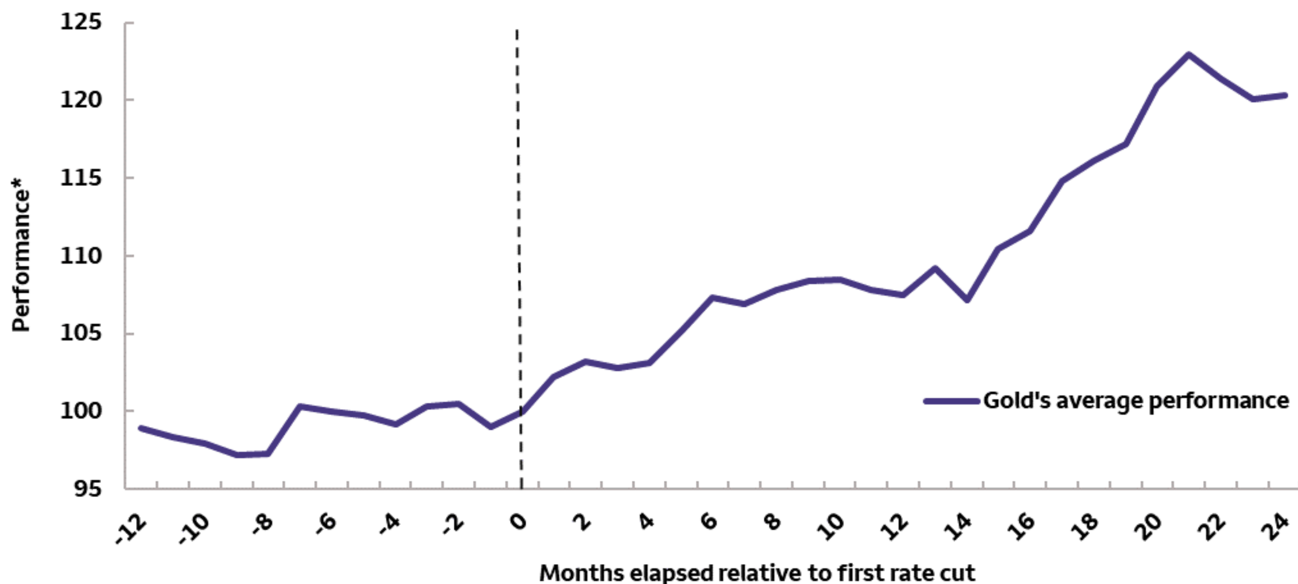
Gold prices rose sharply in the first quarter of 2024, reaching record-high levels and outperforming the broad-based Bloomberg Commodity Index. Looking ahead, our expectation for the Fed to begin cutting interest rates later in the year support higher prices (see Chart 5). We expect ongoing tailwinds to persist, namely the ongoing purchase of gold by global central banks. Gold prices recently hit all-time highs, and we also expect strong price action to continue.

In addition to our updated gold targets, we are slightly lowering our targets on Brent and West Texas Intermediate (WTI) crude oil by $5 per barrel. We are still expecting higher prices in 2024, but the revision reflects two emerging risks. The first is the potential for OPEC+[1] to end its 18-month long supply-cutting strategy if the global economy begins to improve. Not even strong emerging market demand could absorb the extra 2.2 million barrels per day OPEC+ has been holding back. While we are not expecting OPEC+ to change its supply cut course anytime soon, it is a risk worth watching later in 2024.

The second emerging risk worth noting is the potential for U.S. oil producers to aggressively ramp up production should oil prices continue to trend higher and approach the $90 – $100 per barrel level. The last time this happened, in the fall of 2023, U.S. oil production proceeded to surge to new all-time highs which ultimately led to lower oil prices by year end 2023. We remain favorable on the Energy sector as we are still expecting higher oil prices in 2024 and 2025.

For 2025, we expect economic conditions to continue to improve, potentially leading to stronger demand for most commodities and higher prices. For this reason, we are raising our year-end 2025 Bloomberg Commodity Index target to 250 – 270. Also for year-end 2025, we are also raising our Brent and WTI oil targets.

Chart 5: Gold spot price performance around Federal Reserve easing cycles



Sources: Bloomberg, Ned Davis Research, and Wells Fargo Investment Institute. Monthly data, November 1, 1969 – June 30, 2021. *Performance indexed to 100 as of first rate cut. **Past performance is not a guarantee of future results.**

1. Organization of the Petroleum Exporting Countries and other oil producing countries.

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Risk Considerations

Each asset class has its own risk and return characteristics. 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. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Foreign investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. These risks are heightened in emerging markets. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates. **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. The **commodities** markets 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. Investing in **gold** or other precious metals involves special risk considerations such as severe price fluctuations and adverse economic and regulatory developments affecting the sector or industry. **Real estate** has special risks including the possible illiquidity of underlying properties, credit risk, interest rate fluctuations and the impact of varied economic conditions.

Definitions

Bloomberg Commodity Index is comprised of 22 exchange-traded futures on physical commodities and represents 20 commodities weighted to account for economic significance and market liquidity.

Chicago Fed's National Financial Conditions Index (NFCI) provides a comprehensive weekly update on U.S. financial conditions in money markets, debt and equity markets and the traditional and "shadow" banking systems. The NFCI is a weighted average of 105 indicators of risk, credit, and leverage in the financial system — each expressed relative to its sample average and scaled by its sample standard deviation. As such, a zero value for the NFCI can be thought of as the U.S. financial system operating at historical average levels of risk, credit, and leverage. Positive values of the NFCI indicate financial conditions that are tighter than on average, while negative values indicate financial conditions that are looser than on average.

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.

MSCI EAFE Index is designed to represent the performance of large and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the U.S. and Canada.

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

Russell 1000® Index measures the performance of the 1,000 largest companies in the Russell 3000 Index, which represents approximately 90% of the total market capitalization of the Russell 3000 Index.

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.

Russell 3000® Index measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market.

Russell Midcap® Index measures the performance of the 800 smallest companies in the Russell 1000 Index.

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.

An index is unmanaged and not available for direct investment.

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