W. Jeffrey Tryon, MS – Finance
Managing Director – Investment Officer
Senior PIM Portfolio Manager

Stefanie Strother, FPQP
Financial Advisor

I think it's fair to say that 2023 has been another frustrating year of investing and clients might be experiencing fatigue. I'm sharing a link from Vanguard to remind clients of the importance of investing for the long-term. Second, I'll explain why accounts generally aren't performing as well as the S&P 500.

Commentary Summary

- During frustrating markets, I think it's easy to lose perspective of the forest for the trees. The S&P 500 has a remarkable history of rewarding investors who don't act on emotion or allow themselves to be influenced by distractions. This takes discipline and patience and the link from Vanguard speaks for itself.
- There are many clients who own 100% stocks yet they're underperforming the S&P 500. In 2023, the S&P 500 is basically being carried by seven tech/growth stocks. If you don't own a heavier weighting of these companies, you can still be 100% in stocks and be flat or even down for the year. These seven stocks can be exciting in good markets but can be very stressful to own in volatile periods. I'll make the case for why I don't think most clients can tolerate this volatility.

If a picture is a thousand words, then perhaps this illustration is worth a million dollars

Persist while others quit. I think it's easy to conceptualize but difficult to practice. Now is a perfect moment to express this mantra. Clients know they should take a long-term investment time horizon, which we measure in years. Taking a long term view can be difficult when clients have recently lived through a pandemic, shortages, re-opening, inflation, and now interest rate hikes. The team collectively thinks that clients may be tired and would love a 'normal' year.

This video was shared with permission from Vanguard. It portrays a $10,000 investment in the markets starting on January 1, 1992 through Halloween 2022.

https://advisors.vanguard.com/insights/article/market-turbulence-is-advisors-alpha-weather

1) The yellow lines show the downside of panicking into cash at the bottom of the market. Cash might be attractive but it ultimately falls behind in purchasing power (inflation), and the opportunity cost of investing in assets that historically have been more volatile but may have also performed better.
2) I think the green line is more compelling. From 1992 $10,000 in the stock market grew to $160,137 despite four significant and unpleasant crises that triggered tremendous volatility. The most likely way to benefit from this is no small task: the upside potential exists when you persevere while others quit. I would also add not acting on emotion, or allowing outside influences to tempt us to move off course.

I would like to share three takeaways:

1) This illustration briefly charts 30 years from 1992 to 2022. While 30 years may seem like a long time, it is completely relevant to most clients' time horizons, in my view. First, remember that the default life expectancy for our planning software is 95 for women and 93 for men.
    a. For clients in their earning years a 30 year investment horizon currently puts many clients in their mid 70s or a bit older, which still means they have ~20 years or more of additional investment years for a total of a half-century.
    b. For clients already in retirement, this illustration also applies because the retirement chapter often lasts 20 to 30 years. Even clients in their mid-80's with a 10-year life expectancy fall within the "long-term" investment time horizon.
2) Stocks are volatile and cyclical. So are most businesses and many other asset classes (particularly real estate). In exchange for that volatility, stocks have historically delivered returns generally commensurate with that risk. We believe that investing in stocks is required to outpace inflation, and I think this chart is a great illustration why.

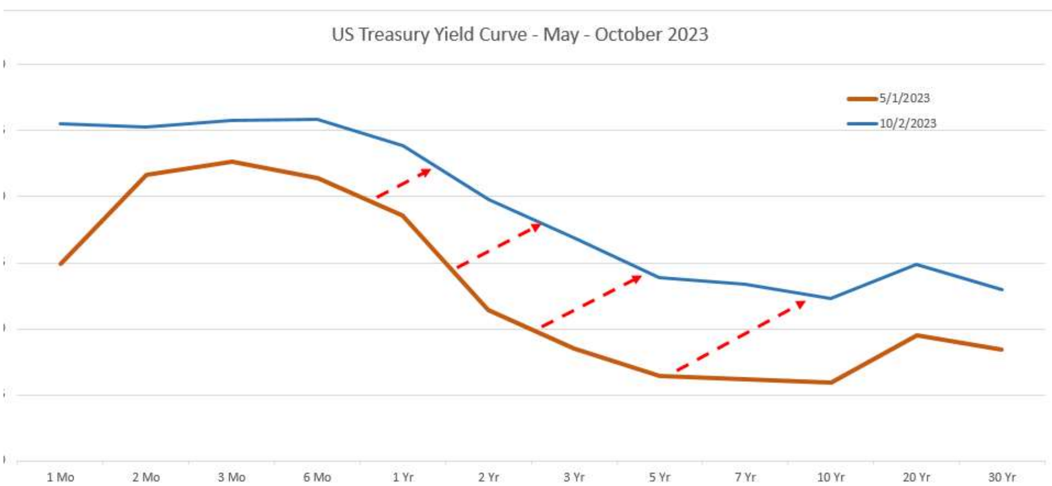
3) This chart says nothing about emotions. What clients *think* is going to happen, or what they read about *might* happen, or what they're told *could* happen often simply does not happen, or certainly not the way they expect. The markets don't care about your political views, your personal lens, what you read about, or what someone tells you. I believe that markets are inefficient in the short term, but ultimately choose the correct path over the long term. The difficult part is staying the course as we resist the temptation of allowing emotion to influence investment decisions.

The 2023 stock market is mostly like dead butterflies.

This is a wonky analogy but I feel it fits this year's markets perfectly. A friend shared a video of a wedding she attended this summer. After the ceremony, everyone gathered in the reception area outside and each was given a very small box and told to keep it closed. As the newlyweds and guests gathered in front of the photographer, the wedding planner asked everyone to open their boxes on the count of three. Amid cries of surprise and joy, some butterflies took flight. Some happily flew away, others briefly ascended then sadly crashed, and the rest never left their boxes at all. I feel like this has mimicked the trajectory of the 2023 stock market.

The stocks that successfully took flight are Nvidia, Amazon, Google, Meta, Tesla, Apple, and Microsoft.[3] The butterflies that crashed or never flew at all represent the rest of the market. The S&P 500 is a market-weighted index, meaning the bigger the company, the more influence/weight it carries in the index. As of market close on October 5, 2023, the S&P 500 has increased by +11.8%.[1] However, if you carve out the aforementioned seven stocks, then the S&P 500 is only up 0.31%.[2]

So what happened? Interest rates! Readers who follow each newsletter may remember this chart from last month:



Source: Federal Reserve bank of St. Louis (FRED), US Treasury Yield Curve

This is a chart of interest rate yields for the US Treasury market. The red line is from back in May and is the bond market's prediction of interest rates at that time. The bond market predicted that interest rates would peak sometime in Q3 of 2023, and then the Fed would cut rates over the next 1 – 3 years. The blue line is as of October 2nd, and reflects what the bond market thinks will happen now. Interest rates stay at the same levels for the next year. They eventually drop but not by as much as before. The red dotted lines point to a critically important concept: interest rates will be higher, and they'll be higher for longer.

Higher rates are tough on stocks and even tougher on bonds. Tech and growth stocks jumped this year because the bond market thought rates would be cut this year and those stocks reflected that prediction of a softening interest rate environment. After the Federal Reserve meeting in Jackson Hole, the Fed made it clear that higher rates were sticking

W. Jeffrey Tryon, MS – Finance
Managing Director – Investment Officer
Senior PIM Portfolio Manager

Stefanie Strother, FPQP
Financial Advisor

around which meant that the stocks that grew based on predicted rate cuts were overpriced. This is why, in my view, that the stock market sold off in August and September: the broader market hasn't done much this year, but it was being carried by the seven tech stocks. When those seven tech stocks sold-off, the impact to the S&P 500 wasn't pretty. I have said repeatedly that 2022 was going to be a potentially volatile year and unfortunately I've been right.

If the S&P 500 is up 11.8%, why aren't my accounts doing as well?

We're not fielding many questions about performance but I know this question may be on client's minds as they view accounts online, read quarterly statements, or when we discuss in review meetings. I present two answers:

1) The agony of diversification.
2) Risk tolerance: clients may like the idea of tech stocks, but many probably won't tolerate the potential downside.

The agony of diversification

Clients know that diversification is important. We should own many asset classes to distribute risk but also benefit from the return potential of various asset classes. Below is a simple portfolio of 60% stocks, and 40% bonds. The S&P 500 may have risen by 11.8% but other stocks (medium, small, European, and emerging markets) weren't invited to the same party. Meanwhile, if the bond market had its worst year ever in 2022, then 2023 is a bad hangover. On a weighted average, this portfolio has increased +1.3%, a far cry from the 11.8%. The only clients this year enjoying returns even close to 11.8% are those with a high enough risk tolerance to own a 100% stock portfolio.

			YTD Performance	Weight
Stocks				
	Index	**Description**		
	S&P 500	Large Cap Stocks	11.8%	15.0%
	S&P 400	Mid Cap Stocks	3.0%	10.0%
	S&P 600	Small Cap Stocks	-0.3%	8.0%
	Vanguard Europe Index	European Developed stocks	4.5%	5.0%
	MSCI Emerging Markets	Emerging Markets Stocks	0.1%	2.0%
Bonds				
	Bloomberg Barclays US Bond Index	Bonds	-3.0%	40.0%
Weighted Performance				**1.3%**

Source: Factset, Bloomberg, as of market close on October 5, 2023.

W. Jeffrey Tryon, MS – Finance
Managing Director – Investment Officer
Senior PIM Portfolio Manager

Stefanie Strother, FPQP
Financial Advisor

If tech stocks can be exciting on the upside, the downside might be more scary…

Pretend clients are asking themselves, "well tech stocks are doing better than everything else, if you can't beat them, why not join them?" We didn't know last year how poorly tech stocks would perform, and there's no guarantees that the current performance is repeatable. Below is a chart of the "Magnificent Seven" a nickname for the stocks carrying the S&P 500 this year.

These stocks have the upside potential, but in my view, the downside and volatility is what matters because most of these stocks demand a greater tolerance for risk than many clients are comfortable with. Average YTD performance is a +87.6% which sounds a lot better than +11.8% for the S&P 500 or +1.3% for a diversified stock/bond portfolio. However, rewind to 2022 when tech and growth stocks got hammered, the "Magnificent Seven" probably could have been called the "Nauseating Seven" because they fell on average -46%. To put this in context, $100,000 invested in these companies at the beginning of 2022 would have been worth $53,943 by year end, and worth $101,207 now. For the pleasure of this rollercoaster, clients would have made $1,207 in 2 years. I believe few clients would have tolerated this level of volatility.

	Performance	
"Magnificent Seven"	**2022**	**2023 YTD**
AMZN	(49.6)	51.3
AAPL	(26.3)	31.8
GOOGL	(39.1)	48.3
META	(64.2)	149.5
NVDA	(50.3)	197.6
MSFT	(27.9)	31.7
TSLA	(65.0)	103.1
Average	**(46.1)**	**87.6**
Impact of investing $100,000	*$ 53,943*	*$ 101,207*
S&P 500 Market Weight (traditional)	(18.2)	11.8
S&P 500 Equal Weight	(11.6)	0.3

Source: Factset, Morningstar, as of market close on October 5, 2023.

Closing thoughts

Investing is difficult. It requires patience, a stomach for some risk and an acceptance of volatility as there are many pitfalls of investment behavior that can cause poor outcomes. I'll reiterate my belief that clients have been exposed to an unusually high number of stresses in the markets over the past three years and may be fatigued. I follow eight rules in our business when making investment decisions for clients:

1. Keep emotions in check
2. Disregard short-term forecasts
3. Put click-bait headlines in perspective
4. Recognize that market dips and corrections are inevitable
5. Correlation does not equal causation
6. Invest in stocks as if you're buying businesses, not lottery tickets
7. Recognize risks in the "safe" areas of the markets
8. Invest systematically

I think volatility will continue this year, and if the Federal Reserve keeps interest rates higher for longer as they've broadcast, then 2024 could be more of the same, in my view. Ultimately, I feel like the best client experiences come from simply having a plan, being flexible, exercising patience, and never making investment decisions based on emotion.

Questions and comments are welcome.

W. Jeffrey Tryon, MS-Finance
Managing Director – Investment Officer
Senior PIM Portfolio Manager
303-804-7668
jeff.tryon@wfa.com

Stefanie Strother, FPQP
Financial Advisor

303-200-9516
stefanie.strother@wfa.com

Sources & Disclosures

[1] *Factset, Standard & Poors.*

[2] *Measured as the S&P 500 equal weight index, or the S&P 500 removing the "Magnificent Seven". Results are largely identical.*

[3] *Discussion of these stocks is for illustrative purposes and is not a solicitation or recommendation to purchase, sell, or hold these or any security.*

The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market value weighted index with each stock's weight in the Index proportionate to its market value.

The S&P Midcap 400 Index is a capitalization-weighted index measuring the performance of the mid-range sector of the U.S. stock market, and represents approximately 7% of the total market value of U.S. equities. Companies in the Index fall between the S&P 500 Index and the S&P SmallCap 600 Index in size: between $1-4 billion.

The S&P SmallCap 600 Index consists of 600 domestic stocks chosen for market size, liquidity (bid-asked spread, ownership, share turnover and number of no trade days) and industry group representation. It is a market value-weighted index (stock price times the number of shares outstanding), with each stock's weight in the index proportionate to its market value.

The MSCI Europe Index currently consists of the following 16 developed market countries: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and United Kingdom. The Index is designed to broadly and fairly represent the full diversity of business activities in the markets detailed above. Source: MSCI. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, reviewed or produced by MSCI.

The MSCI Emerging Markets Index is designed to represent the performance of large- and mid-cap securities in 24 Emerging Markets.

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

US Treasury bonds are guaranteed by the full faith and credit of the U.S. Government for the timely payment of interest and principal if held to maturity.

The opinions expressed in this report are those of the authors and are not necessarily those of Wells Fargo Advisors or its affiliates. The material has been prepared or is distributed solely for information purposes and is not a solicitation or an offer to buy any security or instrument or to participate in any trading strategy.

Wells Fargo Advisors is a trade name used by Wells Fargo Clearing Services, LLC. , Member SIPC, a registered broker-dealer and non-bank affiliate of Wells Fargo & Company.

PM-04122025-6018655.1.1