WELLS FARGO
Investment Institute

Investment Strategy

Weekly guidance from our Investment Strategy Committee **November 11, 2024**

Equity Spotlight: Post-election reminders for equity investors 2

- Overall equity returns are most heavily influenced by the economy's long-term growth trend and the associated fundamental supports that drive earnings growth.
- There are definite policy priorities and trends that investors should be watching, but their complexity and timing means is now a time to watch for investment signals as the policy path evolves.

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- Deficit spending remains a concern for fixed income investors. The spending priorities that the new administration and Congress pursue are likely to impact fixed-income markets.
- The recent increase in yields in longer-term maturities offers investors an opportunity to move out in fixed income maturities. We reiterate our most unfavorable rating on U.S. Short Term Taxable Fixed Income, a favorable rating on U.S. Intermediate Term Taxable and a neutral rating on U.S. Long Term Taxable.

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- Historically, low levels of crude inventories have supported higher crude oil prices.
- Today, crude oil inventories remain low amid tight global supply, and we expect these tight supply conditions to persist in 2025.

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- Individual private capital fund performance often varies widely within each category, and selecting top-tier managers is essential to pursuing above-average performance over time.
- Within Wells Fargo Investment Institute, our Global Manager Research (GMR) team employs a disciplined process to increase the probability of identifying managers that perform near the top of their peer group.

Current tactical guidance 7

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

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Equities Spotlight

"You will never win if you never begin." — Helen Rowland

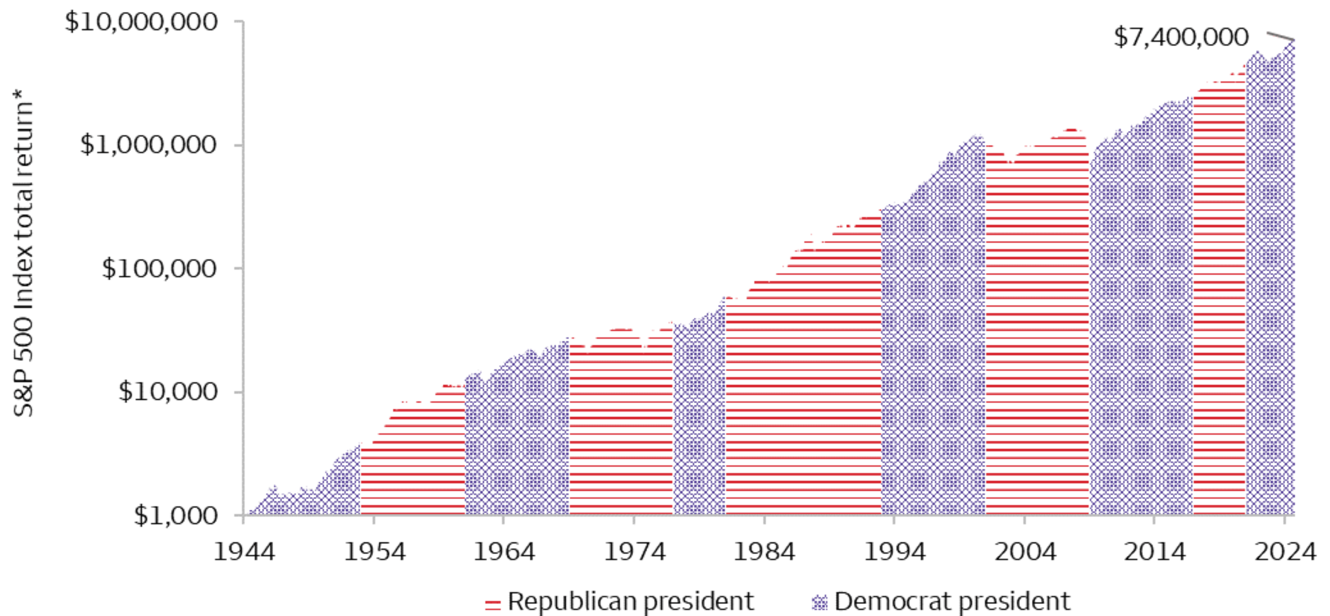
Austin Pickle, CFA
Investment Strategy Analyst

Post-election reminders for equity investors

As investor attention turns back to portfolios after the tightly contested election, we believe it is important not to let election outcomes and emotions drive investing decisions. While policy can certainly influence impacted businesses, policy promises during a campaign typically give way to prioritization and give-and-take with Congress and the legal system. Overall equity returns are most heavily influenced by the economy's long-term growth trend as well as fundamental supports that drive earnings growth. We discuss further below.

The chart below plots the total return of the S&P 500 Index, with periods of Democrat and Republican presidents highlighted. Zooming out like this reminds us of two key points: 1) market turbulence has occurred during both Democrat and Republican administrations, but overall, stocks have tended to advance regardless of who is in the White House; and 2) the power of time spent in the market and reinvested dividends is staggering. A hypothetical $1,000 invested in the S&P 500 Index in 1944 would have turned into over $7 million today with reinvested dividends. In other words, it has paid to stay invested whether one's preferred political party wins the White House or not.

Chart 1. Stay invested



Sources: Bloomberg and Wells Fargo Investment Institute. Monthly data is from January 1944 - October 2024. *Indexed to $1000 as of January 1944. Returns calculated using the total return of the S&P 500 Index. Log scale. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

For those investors hoping campaign promises translate into policy-targeted asset outperformance, we would urge caution. There are several instructive examples where investors put too much emphasis on perceived benefits of potential policy changes, only to see policy fail to materialize or policy benefits fail to translate into anticipated returns. For instance, when President-Elect Donald Trump won the 2016 election, the common thought was that

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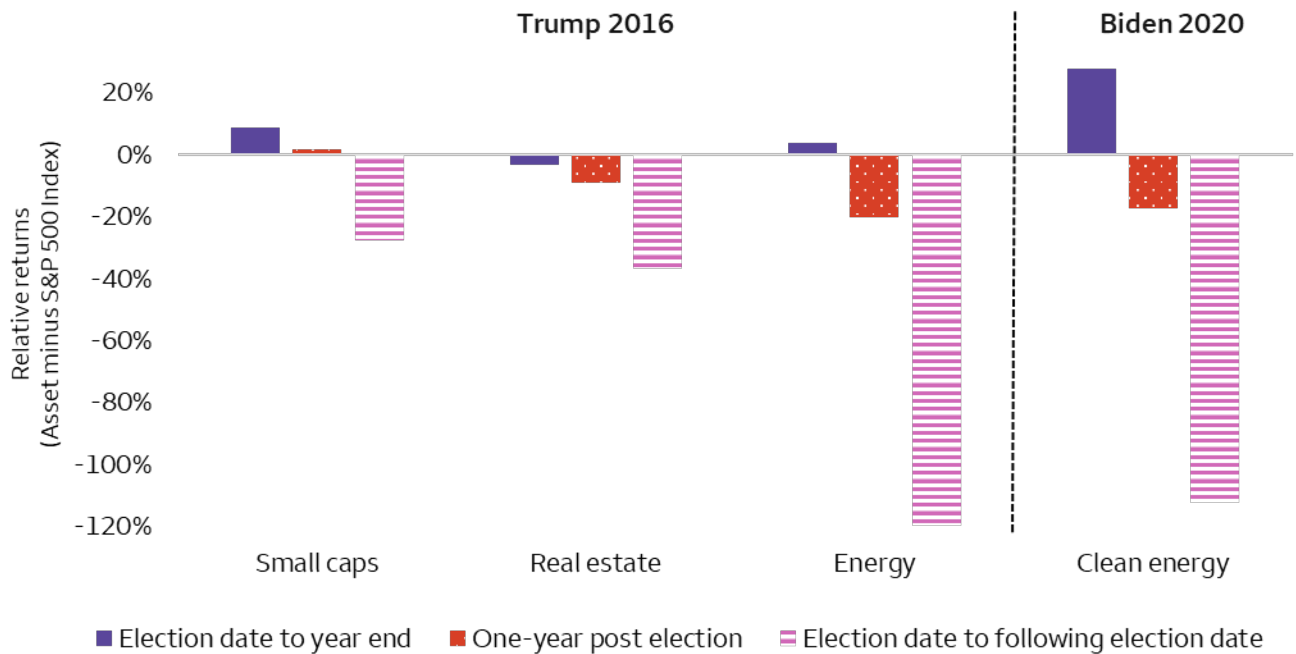
the incoming administration would enact policies that would benefit areas like small caps, real estate, and traditional energy companies. Each of these saw a post-election pop that was near or above the broad S&P 500 Index through year-end 2016. However, this enthusiasm ended up being short lived as the fundamental supports for these investments were lacking, and each underperformed considerably through the following 2020 election. A similar reaction and result occurred after President Joseph Biden took office with enthusiasm for clean-energy friendly policies. This encouraged short-term outperformance of related companies, only to have the group considerably underperform over the next four years (see chart below).

Chart 2. Past election trades lacking fundamental support reversed sharply



Sources: Bloomberg and Wells Fargo Investment Institute. Bars represent total returns of the asset minus the total return of the S&P 500 Index. Positive bars indicate that the asset outperformed the S&P 500 Index and vice versa. Small caps are represented by the Russell 2000 Index, Real estate by the S&P 500 Real Estate Index, Energy by the S&P 500 Energy Index, and Clean energy by the. The Election date to year end bars show the relative returns from November 8, 2016 to December 31, 2016, on the Trump side and from November 3, 2020 to December 31, 2020, for Biden. The One-year post election bars show returns from November 8, 2016 to November 8, 2017, for Trump and November 3, 2020, to November 3, 2021, for Biden. The Election date to following election date bars show the relative returns from November 8, 2016 to November 3, 2020, for Trump and November 3, 2020 to November 5, 2024, for Biden. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

This is not to say that policy is inconsequential. In our October 29 Policy, Politics & Portfolios report, we detail how potential policy could impact specific sectors following the 2024 election depending on who is president, how they prioritize the policy agenda, and how cooperative Congress will be. However, policy should be weighed along with fundamental supports such as the economy, earnings prospects, and interest rates as well as idiosyncratic characteristics to develop a complete view of an asset's risk-reward profile.

What it may mean for investors

Many proposals put forward during election campaigns often evolve differently, if at all, into eventual policy following elections. The complexity and timing make it challenging to predict in an exacting way. That said, there are definite policy priorities and trends that investors should be watching closely for portfolio impacts. We outlined some key ones in the November 7 Institute Alert, 'Caution for investors — Market reaction may shift', and will continue to provide timely guidance as the policy path evolves.

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Fixed Income

Brian Rehling, CFA
Head of Global Fixed Income Strategy

Fiscal discipline? Don't count on it

Debt and deficits have been increasing for years. Both Democratic and Republican administrations have had a propensity to deficit spend — after all, it has always been easier to sell tax cuts and spending priorities to your constituents than fiscal discipline. There tend to be fewer spending roadblocks when a single party controls both branches of government and the presidency.

In our view, it is unrealistic to believe the new government will aim to reduce the debt outright; ideally for fixed income investors, it would find a way to manage the debt in a way in which debt grows the deficit at a slower pace than the economy. If the U.S. remains on its current spending path, at some point financial markets could press the Treasury for a higher premium (higher rates) to hold U.S debt, especially those bonds with longer maturities. This will make long-term yields increase to higher levels than they otherwise would. But for now, as long as nominal economic growth outpaces the growth of the deficit, demand for U.S. Treasury debt should remain healthy.

For a closer look at the non-partisan facts relating to the debt and deficit, please ask your investment professional for our report Paying America's Bills (September 2024).

As the new presidential administration and the new Congress take shape, we believe investors should monitor the spending priorities that may make it into law. We believe an imminent U.S. debt crisis is very unlikely. Yields on Treasury securities have been higher than they were a decade ago but have been well within historical ranges.

We see the recent increase in long-term yields as an opportunity for investors to lock in yields, moving from short-term maturities into intermediate- and longer-term maturities. We currently favor corporate bonds for investors looking for income. We favor investment-grade issuers, but income-focused investors may also consider below-investment-grade issuers, as well. We currently have a neutral rating on High Yield Taxable Fixed Income. We believe that investors should emphasize sound credit analysis, with a strong focus on selectivity among issuers and sectors. We favor using active management when purchasing lower-quality investments.

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Real Assets

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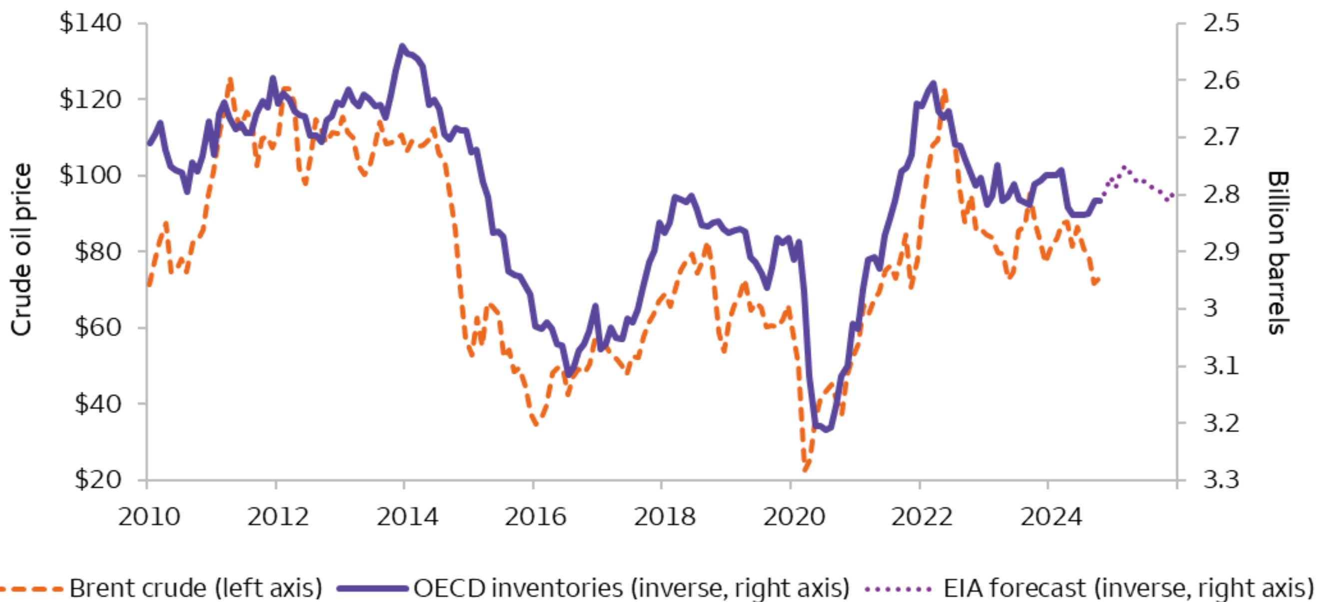
Low crude oil inventories may support higher 2025 prices

Crude oil prices have been fairly lackluster this year amid a host of uncertainties on global demand growth and weak economic conditions. These demand concerns have weighed on prices, but only mildly as global supply growth has remained low. As a result, crude oil prices have essentially gone nowhere year to date and remain only 2% lower than they were at the start of the year (as of November 4).

One way to see the lack of global supply growth is through low global inventories, shown as the solid purple line in the chart below. In this look, we have inverted the global inventories line so we can show how it tends to inversely follow oil prices, which is the orange line. What the chart is essentially showing is that when global inventories are low or moving lower, oil prices have tended to move higher. Interestingly, global inventories have been moving lower in recent months, yet oil prices have not risen. We suspect that soon oil prices will begin rising in reaction to the low global inventory levels.

Looking ahead into 2025, we believe oil prices will benefit from low global inventories as well as improved macroeconomic outlooks in many parts of the world. Even recent efforts by China to stabilize its property sector could lead to better overall demand growth for commodities and oil. As demand begins to pick up globally, we suspect that oil prices will begin moving higher once again. We remain favorable on the Energy sector within commodities and are maintaining our year-end 2025 forecasts of $85 – $95 per barrel for West Texas Intermediate crude and $90 – $100 for Brent crude.

OECD crude oil inventories versus Brent crude prices



Sources: Bloomberg, Energy Information Administration (EIA), and Wells Fargo Investment Institute. Monthly data from January 2010 – December 2025. OECD = Organization for Economic Co-operation and Development; reflects commercial inventories.

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Alternatives

Mark Steffen, CFA, CAIA
Global Alternative Investment Strategist

The importance of manager selection in private markets

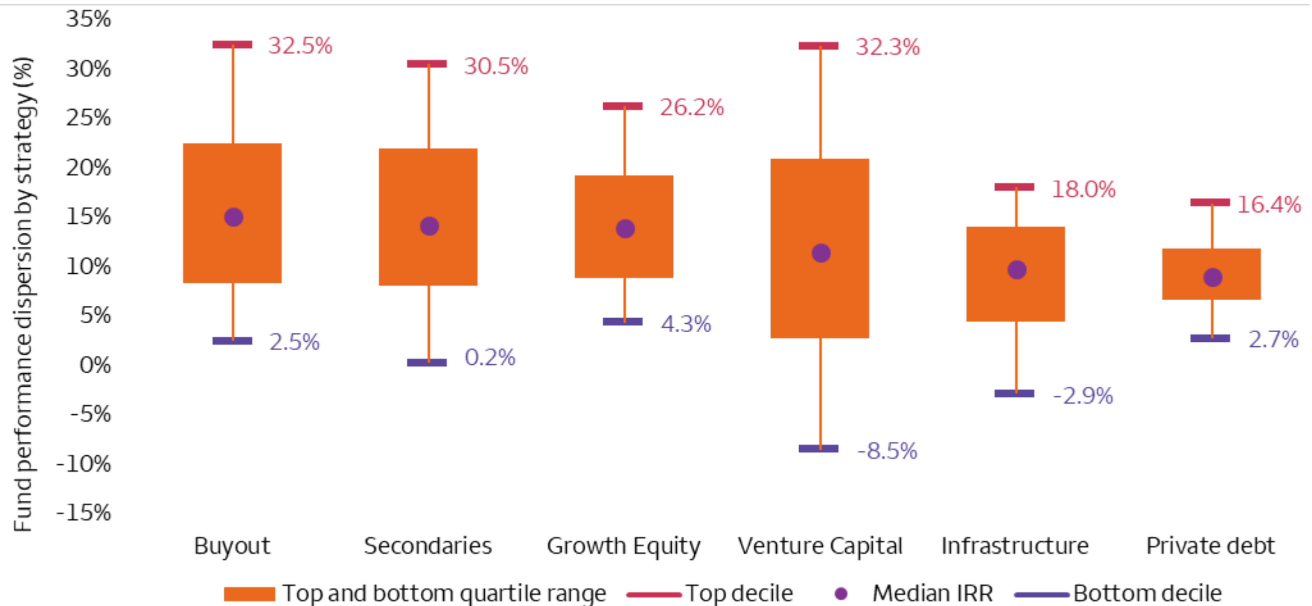
Unlike public markets, private market strategies often exhibit above-average return dispersion, where the performance can vary widely from fund to fund. Identifying managers with unique sourcing capabilities and extensive experience in evaluating (and investing in) the most attractive investment opportunities is a key facet in pursuing above-average performance results over time.

Often, top-tier managers may possess unique competitive advantages that allow them to gain access to the most sought-after deals. These advantages may take many forms, which may include the development of a wide network of industry relationships, superior in-house expertise in a particular segment of the market, and the ability to apply a disciplined approach to underwriting and pricing deals across market cycles.

As shown in the chart, the performance of the best and worst funds within each category can vary quite dramatically. For example, in Venture Capital, the performance of the top decile of funds registered an internal rate of return (IRR) of 32.3%, while the bottom decile recorded an IRR of -8.5%. The over 40% gap between the top and bottom decile is an extreme example of the critical role that manager selection can play in private market investing.

Within Wells Fargo Investment Institute, our Global Manager Research (GMR) team conducts thorough research and due diligence on investment managers, aiming to increase the probability of selecting managers that perform at or near the top of their peer universe. This experienced group of analysts works to ensure that qualified investors have access to many top tier managers across the private capital spectrum.

Private fund net internal rate of return (IRR) dispersion by strategy (vintages 2002 to 2008)[1]



Source: PitchBook. Data as of December 31, 2023. **Past performance is no guarantee of future results.**

Alternative investments, such as hedge funds, private equity, private debt and private real estate funds are not appropriate for all investors and are only open to "accredited" or "qualified" investors within the meaning of U.S. securities laws.

1. A fund's vintage year is generally the year the fund was formed or began investing capital.

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Tactical guidance*

Cash Alternatives and Fixed Income

Most Unfavorable	Unfavorable	Neutral	Favorable	Most Favorable
U.S. Short Term Taxable Fixed Income		Cash Alternatives Developed Market Ex-U.S. Fixed Income Emerging Market Fixed Income High Yield Taxable Fixed Income U.S. Long Term Taxable Fixed Income	U.S. Intermediate Term Taxable Fixed Income	

Equities

Most Unfavorable	Unfavorable	Neutral	Favorable	Most Favorable
	Emerging Market Equities	Developed Market Ex-U.S. Equities U.S. Mid Cap Equities U.S. Small Cap Equities	U.S. Large Cap Equities	

Real Assets

Most Unfavorable	Unfavorable	Neutral	Favorable	Most Favorable
		Private Real Estate	Commodities	

Alternative Investments**

Most Unfavorable	Unfavorable	Neutral	Favorable	Most Favorable
		Hedge Funds—Equity Hedge Hedge Funds—Relative Value Private Equity Private Debt	Hedge Funds—Event Driven Hedge Funds—Macro	

Source: Wells Fargo Investment Institute, November 11, 2024.

*Tactical horizon is 6-18 months

**Alternative investments are not appropriate for all investors. They 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. Please see end of report for important definitions and disclosures.

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Risk considerations

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

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. **Small- and mid-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large company stocks. **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. **High yield (junk) bonds** have lower credit ratings and are subject to greater risk of default and greater principal risk. 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. **Real estate** has special risks including the possible illiquidity of underlying properties, credit risk, interest rate fluctuations and the impact of varied economic conditions.

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. This can result in greater price volatility.

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, less regulation and higher fees than mutual funds. Hedge fund, private equity, private debt and private real estate fund investing involves 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.

Hedge fund strategies, such as Equity Hedge, Event Driven, Macro and Relative Value, 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 since 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. Arbitrage strategies expose a fund to the risk that the anticipated arbitrage opportunities will not develop as anticipated, resulting in potentially reduced returns or losses to the fund.

Definitions

An index is unmanaged and not available for direct investment.

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 Global Clean Energy Index is designed to measure the performance of companies in global clean energy-related businesses from both developed and emerging markets.

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

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. The 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.

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