

Investment Strategy

Weekly guidance from our Investment Strategy Committee May 26, 2026

Equities Spotlight: Weak fundamentals limit upside for U.S. small-caps 2

- Despite U.S. small-cap equities outperforming U.S. large-cap equities year-to-date, underlying fundamentals for U.S. small-cap equities are weakening.
- U.S. large-cap equities maintain significantly stronger profitability, balance sheets, and earnings momentum, supported by scale, pricing power, technology adoption, and global diversification.

Fixed Income: Long-term rates likely to rise 4

- We believe long-term U.S. Treasury rates should remain elevated due to modest economic growth, rising inflation expectations, and upward pressure to the term premium.
- In our view, the income component of fixed income should remain a key driver of total return for investors in 2026.

Real Assets: Surging exports squeeze inventories 5

- U.S. petroleum exports have surged in recent weeks, putting pressure on already low inventories.
- While we expect elevated prices to persist, we do not recommend chasing energy returns at current prices and would rather rotate exposure into Precious or Industrial Metals.

Alternatives: Crosscurrents persist in distressed credit markets 6

- Despite a recent decline in defaults, rising levels of distressed debt suggest underlying weaknesses persist, supporting what we believe is an opportunity set for distressed credit sub-strategies to help reposition overleveraged companies.
- We continue to favor distressed credit sub-strategies, as ongoing energy supply constraints may further pressure business fundamentals and limit the Federal Reserve’s (Fed)’s ability to lower short-term interest rates.

Current tactical guidance 7

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Equities Spotlight

Alex Sagal

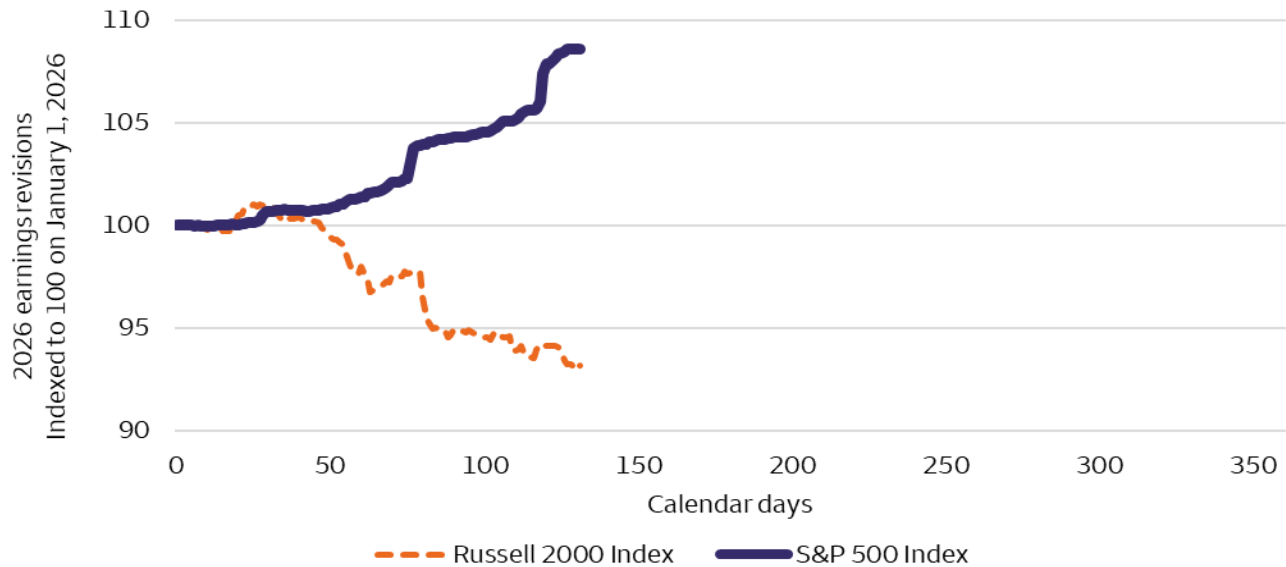
Investment Strategy Analyst

Weak fundamentals limit upside for U.S. small-cap equities

The Russell 2000 Index, our benchmark for U.S. small-cap equities, has performed well in recent months, outperforming the S&P 500 Index, our benchmark for U.S. large-cap equities, year-to-date as of May 20, 2026. While this may suggest a turning point in relative performance, we believe this recent momentum is masking weakness in underlying small-cap equity fundamentals. In our view, the divergence between price performance and fundamental trends creates an increasingly fragile backdrop for U.S. small-cap equities and reinforces our preference for U.S. large- and mid-cap equities.

A key challenge for U.S. small-cap equities is the structural decline in the Russell 2000 Index quality over time. The composition of the small-cap equities universe has shifted meaningfully over the past two decades, with a growing share of companies lacking consistent profitability. According to Bloomberg data, the percentage of non-earning companies within the Russell 2000 Index has risen dramatically from roughly 17% twenty years ago to 40% today, highlighting a broad deterioration in profitability. We believe this trend reflects multiple forces, including the rise of private capital markets, which have allowed high-quality firms to remain private, as well as increased merger and acquisition activity, which has removed profitable companies from the public small-cap universe. As a result, U.S. small-cap indices have been populated by early-stage, less profitable, and more speculative businesses, which we believe inherently limits the ability of the asset class to generate sustained earnings growth and margin expansion.

Chart 1. 2026 earnings revisions: U.S. small- and large-cap earnings forecast revisions have diverged



Sources: Bloomberg and Wells Fargo Investment Institute. Consensus forecast data as of May 18, 2026. An index is unmanaged and not available for direct investment. **Past performance does not guarantee future results.** Earnings revisions are based off Bloomberg data from analysts covering the S&P 500 Index and Russell 2000 Index.

This erosion in profitability is further reinforced by a persistent pattern of earnings disappointment. U.S. small-cap companies have historically struggled to meet initial calendar-year earnings expectations, with consensus forecasts declining by 20% from the start of the year through year-end, on average since 1995, per Bloomberg. In fact, over these 30 years (1995 – 2025), the Russell 2000 Index has met or exceeded the consensus earnings forecast at the beginning of the year only three times. We are seeing a similar dynamic unfold currently, as earnings expectations for 2026 have been revised 7% lower as the year has progressed, as of May 18. (see Chart 1) this stands in contrast to U.S. large-cap equities, where earnings forecasts have jumped 8% higher (see Chart 1). Importantly, as earnings expectations for U.S. small-cap companies are revised downward, valuation multiples rise because the “E” in the price-to-earnings ratio is deteriorating.

The gap in profitability and financial strength between U.S. small- and large-cap equities is particularly striking today. U.S. small-cap equities currently generate returns on equity of less than 1% over a trailing 12 month period through Q1 2026, compared to approximately 20% for U.S. large-cap equities. Profit margins have exhibited an equally stark divergence, with U.S. small-cap net margins around 4.4% versus roughly 14.5.8% for U.S. large-cap companies over the same period. Balance sheet quality has further compounded these challenges. U.S. small-cap companies tend to carry high leverage, with net debt-to-EBITDA¹ ratios near 4.5x compared to roughly 1.5x for U.S. large-cap firms, based on a trailing 12 month period through Q1 2026. This elevated leverage not only may increase financial risk but also may reduce flexibility in a higher interest rate environment.

In contrast, U.S. large-cap equities continued to benefit from a set of structural advantages that have driven sustained margin expansion over time. Profit margins for the S&P 500 Index are at historical highs and have trended upward over several decades. This expansion has been supported by a combination of favorable sector composition, technological innovation, and operational efficiency gains. The increasing weight of high-margin sectors (particularly Information Technology and Communication Services) has played a significant role, as these businesses tend to operate with asset-light models, high gross margins, and strong operating leverage.

Beyond sector mix, U.S. large-cap companies have been leaders in adopting productivity-enhancing technologies, including artificial intelligence (AI), automation, and advanced data analytics. These investments have improved efficiency, reduced labor intensity, and enhanced scalability. At the same time, economies of scale enable large companies to spread fixed costs over broader revenue bases, negotiate more favorable supplier terms, and invest more heavily in research and development. These scale advantages can create a reinforcing cycle of competitive strength and margin durability.

Taken together, these structural advantages have allowed U.S. large-cap (S&P 500 Index) profit margins to expand steadily over time, while U.S. small-cap margins have remained stagnant. Importantly, we believe the elevated margins observed in U.S. large-cap equities are not solely a function of cyclical strength but reflect enduring competitive advantages that provide insulation against macroeconomic softness. We view this resilience as important in the current environment, where growth uncertainties persist and cost pressures remain unevenly distributed across the economy.

Ultimately, while the recent performance of U.S. small-cap equities (Russell 2000 Index) may appear encouraging, we believe it is not supported by fundamentals. The combination of declining earnings quality, persistent downward consensus earnings revisions, weak profitability, and elevated leverage presents a challenging backdrop for sustained outperformance. In contrast, U.S. large-cap equities (S&P 500 Index), especially since 2024, have demonstrated strong earnings, robust margins, and structural advantages that support long-term growth and resilience. As such, we view the recent rally in U.S. small-cap equities as an opportunity to rebalance portfolios. We believe investors should consider rimming overweight exposures and reallocating toward U.S. large and mid-cap equities, where the fundamental outlook remains significantly more compelling.

1. EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization) measures a company's core operational performance by excluding financing costs, tax effects, and non-cash accounting items like depreciation and amortization.

Fixed Income

Luis Alvarado

Co-Head of Global Fixed Income Strategy

Long-term rates to likely rise

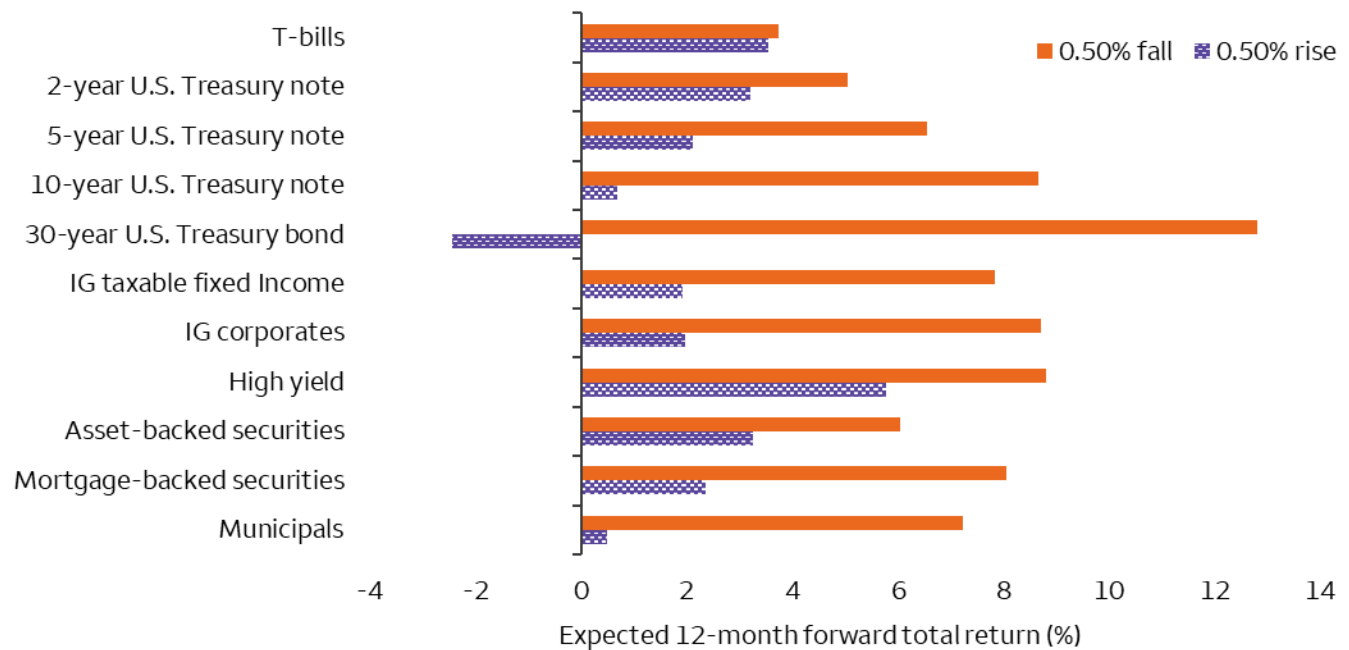
We look for the Fed to proceed cautiously, calibrating as needed but with a bias to keep the federal funds target rate on hold. We are expecting no cuts or hikes between now and the end of 2026. However, federal funds futures markets are now implying potential for hikes in 2027, especially if the Iran conflict extends for longer.

We expect the bond market to remain sensitive to geopolitical events, Fed policy announcements, and economic developments, especially around the trajectory of inflation and how the Fed adjusts policy. Also, the term premium (the extra yield investors demand for holding long-term debt in lieu of short-term debt) has also been rising. We anticipate upward pressure to remain in term premium given increasing deficits, further Treasury issuance and the potential for Fed balance sheet trimming.

These policy and economic uncertainties present return risks that are asymmetrically larger for longer-term bonds, which mathematically have the largest price impact from a change in rates (see Chart 2). Hence, we believe that investors need to remain agile — if rates rise well above our year-end 2026 stated targets, we prefer to extend maturities; if rates decline below our targets, we favor shortening duration (a measure of interest rate sensitivity) by taking shorter maturities.

We still think the income component of fixed income should remain a key driver of total return for investors in 2026, while active management is crucial, in our view, to capture relative value within fixed-income sectors and subsectors.

Chart 2. Long-maturity bonds are most sensitive to a move in interest rates



Sources: Bloomberg and Wells Fargo Investment Institute, as of May 19, 2026. T-bills (Treasury bills): Bloomberg U.S. Treasury Bills (1–3M) Index, Investment-grade (IG) taxable fixed income: Bloomberg U.S. Aggregate Bond Index. IG corporates: Bloomberg U.S. Corporate Bond Index, High yield: Bloomberg U.S. Corporate High Yield Bond Index, Asset-backed securities: Bloomberg U.S. Asset Backed Securities Index, Mortgage-backed securities: Bloomberg U.S. Mortgage-Backed Securities Index, Municipals: Bloomberg Municipal Index. For illustrative purposes only. Expected return is calculated by the income return (interest) plus the price change from the 0.50% interest rate move. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

Real Assets

Mason Mendez

Investment Strategy Analyst

Surging exports squeeze inventories

As the Iran war extends into May, pressures on U.S. petroleum inventories are beginning to emerge. Although the U.S. position as a net energy exporter provided some insulation from the immediate global supply shocks, oil markets are interconnected, meaning the U.S. is not immune to the lasting effects of higher global prices and supply disruptions.

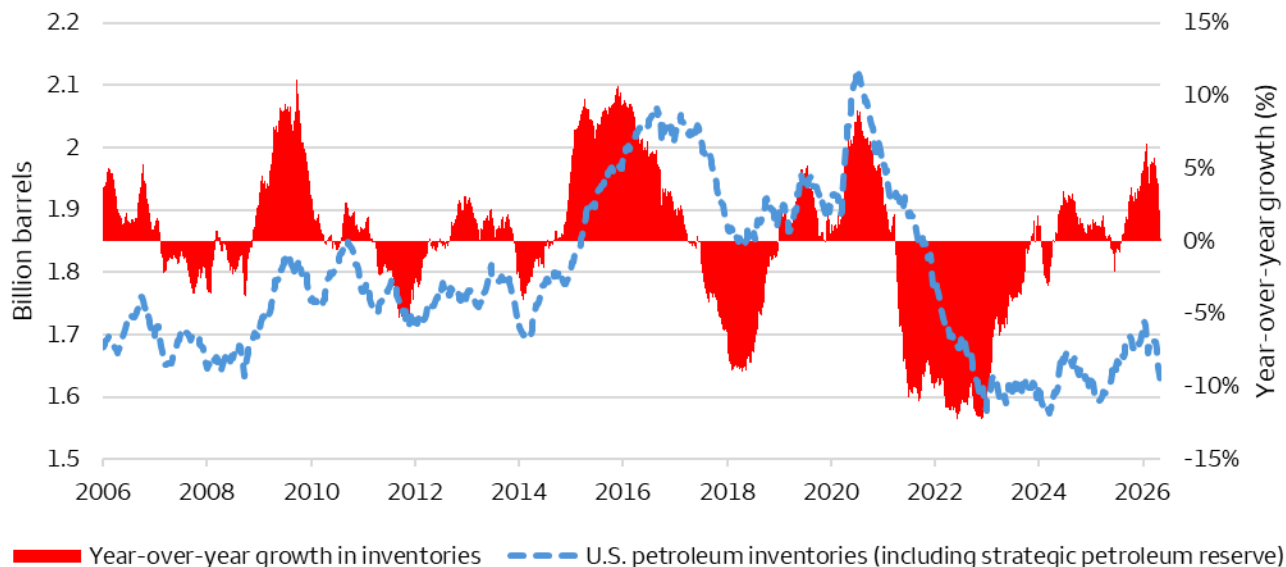
This dynamic can be seen in how trade flows have shifted and are starting to pull on U.S. inventories. The loss of Middle East energy exports left many countries seeking alternative suppliers, and the strong growth in U.S. production along with lower transportation risks make U.S. exports an attractive alternative.

These factors supported a surge in U.S. export demand from a 52 week average of 4 million barrels per day (mbpd) prior to the Iran war, to 6.4 mbpd during the week of April 24. This pressured already declining inventories, driven by heightened refining activity and an emergency 172 million-barrel release from the Strategic Petroleum Reserve earlier this year (see Chart 3). In effect, these drawdowns have reduced some of the U.S. supply buffer heading into the summer.

Upcoming seasonal demand could intensify these pressures, as inventories typically decline during the summer from increased consumption. For consumers, this will likely translate into further gasoline prices over the coming months.

As such, elevated energy prices will likely persist as inventories continue to draw down, which could lead to higher inflation and slower economic growth. For investors, however, we do not recommend chasing returns in energy with oil prices already elevated near \$100 per barrel. In our view, the risk-to-return is unattractive, and we expect supply constraints to ease over the next 12–18 months. We recommend taking profits in energy and rotating exposure to our favorably rated areas that show greater upside over the tactical horizon — such as Precious or Industrial Metals.

Chart 3. U.S. petroleum inventories pressured lower



Sources: Bloomberg and Wells Fargo Investment Institute. Weekly data is from January 5, 2006 through May 8, 2026. Petroleum inventories represent total crude oil and petroleum product inventories.

Alternatives

Mark Steffen, CFA, CAIA

Global Alternative Investment Strategist

Crosscurrents persist in distressed credit markets

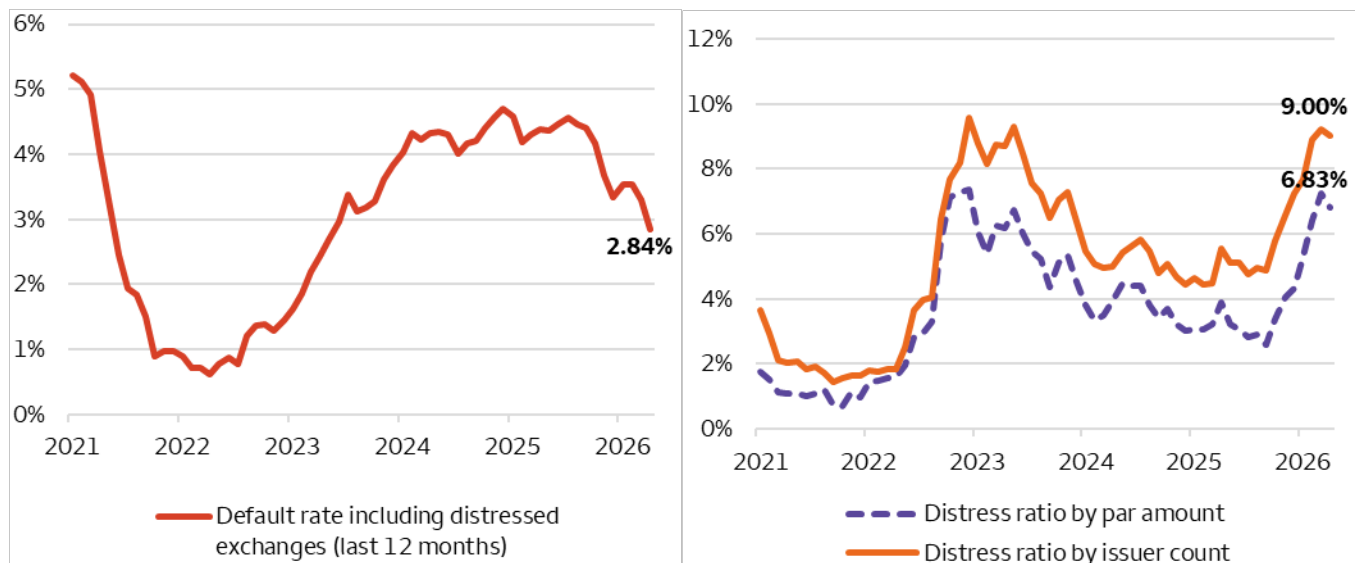
As we assess opportunities in distressed credit, signals remain mixed, raising questions about whether business conditions have truly stabilized or if the recent decline in defaults may reverse. On one hand, default rates², including distressed exchanges, have been trending lower, suggesting some easing of financial stress (see Chart 4 - left). Distressed exchanges include out-of-court restructurings that reduce debt, extend maturities, or lower interest costs, designed to help companies stabilize their balance sheets.

On the other hand, a key countersignal is the rising share of bank loans trading at distressed levels (below 80% of face value), which typically indicates borrower stress (see Chart 4 - right). This trend suggests that underlying pressures may still be building and that the recent improvement in default activity could prove temporary.

Distressed credit sub-strategies primarily invest in fundamentally strong companies that are experiencing financial strain, often due to excessive debt. Through restructuring or reducing that debt burden, these companies can emerge with stronger balance sheets and improved financial flexibility, positioning them for future growth.

While mixed signals in the credit markets suggest a transitional environment, we remain constructive on distressed credit sub-strategies. These strategies have historically performed strongest during the recovery phase following periods of significant credit dislocation, when valuations have reset and underlying fundamentals begin to stabilize.

Chart 4. Default rates (including distressed exchanges) show recent decline while distress ratios rise



Sources: Pitchbook (Leveraged Commentary and Data) and Morningstar. Data shown is from the Morningstar Loan Syndications and Trading Association (LSTA) U.S. Leveraged Loan Index. Data as of April 30, 2026.

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.

2. Default is defined as a failure to meet contractual obligations, primarily caused by missed interest or principal payments or bankruptcy filing. The default rate referenced is for the Morningstar Loan Syndications and Trading Association (LSTA) U.S. Leveraged Loan Index, inclusive of distressed exchanges. Distressed exchanges include all liability management transactions, which are typically out-of-court restructurings designed to improve the financial position of a company by reducing debt, extending maturities, or lowering debt-service obligations. S&P Global Ratings determines situations that are considered a distressed exchange or default.

Tactical guidance*

Cash Alternatives and Fixed Income

Most Unfavorable	Unfavorable	Neutral	Favorable	Most Favorable
	U.S. Long Term Taxable Fixed Income 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. Intermediate Term Taxable Fixed Income	

Equities

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

Real Assets

Most Unfavorable	Unfavorable	Neutral	Favorable	Most Favorable
		Commodities Private Real Estate	Private Infrastructure	

Alternative Investments**

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

Source: Wells Fargo Investment Institute, May 26, 2026. Please see Wells Fargo Investment Institute's Asset Allocation Strategy Report for more detailed, investable ideas in each asset group.

*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.

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. **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. **Municipal** bonds offer interest payments exempt from federal taxes, and potentially state and local income taxes. Municipal bonds are subject to credit risk and potentially the Alternative Minimum Tax (AMT). Quality varies widely depending on the specific issuer. Municipal securities are also subject to 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. 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. 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.

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

Bloomberg Municipal Bond Index represents municipal bonds with a minimum credit rating of at least Baa, an outstanding par value of at least \$3 million and a remaining maturity of at least one year. The index excludes taxable municipal bonds, bonds with floating rates, derivatives and certificates of participation.

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

Bloomberg U.S. Asset Backed Securities Index is a flagship, rules-based benchmark that measures the performance of investment-grade, U.S. dollar-denominated, fixed-rate taxable bonds. It tracks the securitized debt market and is the dedicated ABS component of the broader Bloomberg U.S. Aggregate Bond Index.

Bloomberg U.S. Corporate Bond Index includes publicly issued U.S. corporate and Yankee debentures and secured notes that meet specified maturity, liquidity, and quality requirements.

Bloomberg U.S. Corporate High Yield Index covers the universe of fixed-rate, noninvestment-grade debt.

Bloomberg U.S. MBS Index measures the performance of investment grade fixed-rate mortgage-backed pass-through securities of GNMA, FNMA and FHLMC.

Bloomberg 1-3 Month U.S. Treasury Bill Index includes all publicly issued zero-coupon U.S. Treasury Bills that have a remaining maturity of less than 3 months and more than 1 month, are rated investment grade, and have \$250 million or more of outstanding face value. In addition, the securities must be denominated in U.S. dollars and must be fixed rate and non-convertible.

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.

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 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 Morningstar Loan Syndications and Trading Association (LSTA) U.S. Leveraged Loan Index is a market value weighted index designed to measure the performance of the U.S. leveraged loan market. The legacy payment default rate includes Morningstar LSTA U.S. Leveraged Loan Index constituents where the company files for bankruptcy, the facility gets downgraded to D by S&P (excluding distressed exchanges and sub-par buybacks), or the interest payment is missed without a forbearance. Distressed exchanges include all liability management transactions considered a distressed exchange or default by S&P Global Ratings, a U.S. credit rating agency that publishes financial research and analysis on stocks, bonds, and commodities. Distress ratios represent the percentage of performing loans priced below 80% of par, a level typically associated with borrower stress.

An index is unmanaged and not available for direct investment.

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Market Commentary

Weekly perspective on current market sentiment

May 28, 2026



Tony Miano, CFA, CAIA
Investment Strategy Analyst

Last week's S&P 500 Index: +1.0%

Can higher Treasury yields upset the market rally?

Key takeaways

- Since late February, the 10-year Treasury yield has risen about 0.7 percentage points. That matters because higher Treasury yields can lead to higher borrowing costs for mortgages, credit, and business loans.
- Markets are paying attention to higher yields, but we do not think rates alone are enough to outweigh the factors that have recently supported stocks.

U.S. Treasury yields have moved up sharply since late February. The 10-year Treasury yield rose from about 3.9% on February 27 to more than 4.65% by May 19. Part of that increase reflects higher oil prices and worries that inflation may stay stubbornly elevated. Some investors are also concerned about the long-term path of U.S. government debt. Higher Treasury yields matter because they often push up borrowing costs across the economy, including mortgage rates, corporate borrowing costs, and other loan rates. Even so, the S&P 500 (the index) has continued to reach new highs. In fact, the last time long-term Treasury yields were around these levels, in mid-2025, the S&P 500 was more than 1,500 points below where it is today.

Because we see only limited room for long-term yields to fall, investors may ask when higher rates could start to weigh more heavily on stocks. For now, several forces are helping offset that pressure. Corporate earnings have generally been better than expected, the job market has stayed resilient, and enthusiasm around artificial intelligence (AI) continues to support many technology stocks. Technology and AI-related companies now make up a large share of the S&P 500 Index, so their strength can have an outsized effect on the overall index. We believe many of these companies also have strong revenue growth expectations for this year, which may help cushion some of the drag from higher borrowing costs.

Because technology companies now carry so much weight in the index, their performance can help support the broader market even when rates are rising. In our view, a large market pullback would likely require one of two things: a cooling in the AI-driven growth story or a more meaningful move higher in rates, such as the 10-year Treasury yield approaching 5%. The pace of rate moves also matters. Recently, yields have been especially volatile, and sharp swings can make investors uneasy. They can also make it harder for companies to plan financing and borrowing needs, which may add pressure to stock prices.

Our current view is that today's higher interest rates are not yet enough to derail the stock market. We continue to favor U.S. large-cap sector, and we still prefer equities over fixed income overall. Within fixed income, we favor investment-grade credit. Investors can consider high quality issuers with attractive yields. If stock or bond markets pull back because of rate volatility, we would view that as a possible opportunity for long-term investors.

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Definitions

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Investment Grade bonds - A rating that indicates that a bond has a relatively low risk of default. Bond rating firms, such as Standard & Poor's, 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".

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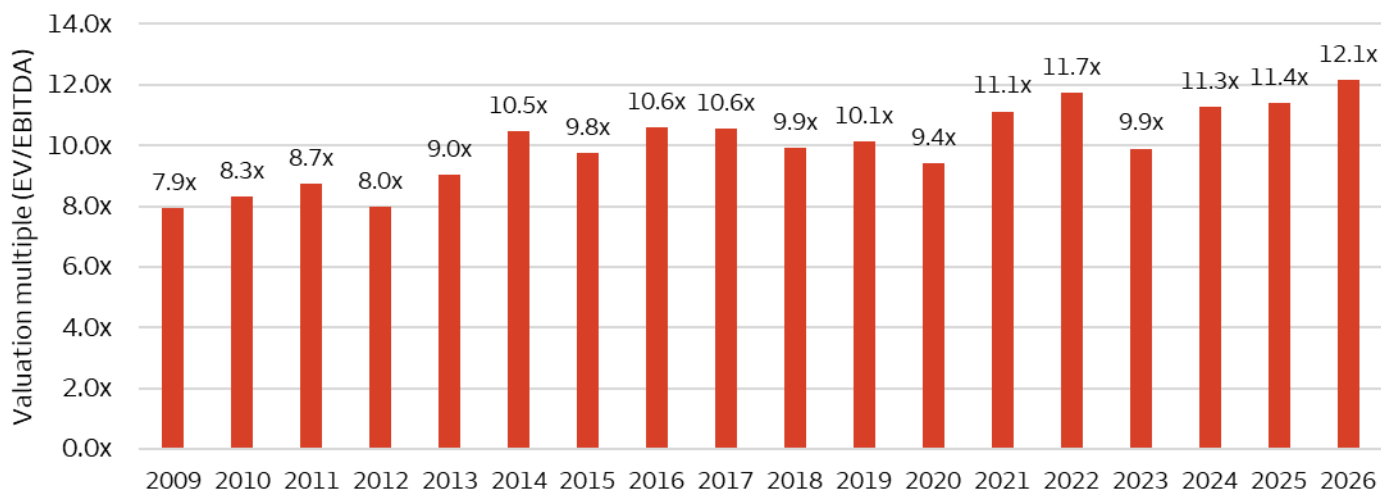


Chart of the Week

Weekly analysis of key themes in markets

May 27, 2026

M&A deal multiples witness gradual growth



Sources: Pitchbook and Wells Fargo Investment Institute. Data as of March 31, 2026. Median EV/EBITDA multiple is shown for U.S. Merger & Acquisition (M&A) transactions. EV/EBITDA stands for Enterprise Value-to-Earnings Before Interest, Taxes, Depreciation, and Amortization. It is a financial valuation ratio that measures a company's total value relative to its operational cash earnings. **Past performance is not a guarantee of future results.** For illustrative purposes only.

Valuation expansion and sector rotation define M&A growth

Global Merger & Acquisition (M&A) activity reached record levels in the first quarter, despite geopolitical headwinds, public market volatility, inflation concerns, and ongoing supply chain disruptions. The quarter remained top-heavy with megadeals driving a lot of the growth, as financing was more accessible for high-quality assets, while companies with weaker credit profiles experienced delays.

The chart above illustrates the increase in U.S. Enterprise Value-to-Earnings Before Interest, Taxes, Depreciation, and Amortization (EV/EBITDA) valuation multiples over recent years. This suggests an investor preference for large, high-quality U.S. companies. The focus has rotated away from Information Technology, Financials, and Healthcare sectors amid concerns around pronounced artificial-intelligence (AI)-driven disruption and tighter private credit conditions, and shifted toward Energy and Materials sectors, supported by increased demand for infrastructure and energy transition investments.

What it may mean for investors

We expect global M&A activity to continue its recovery trajectory, particularly as political and geopolitical uncertainties may begin to ease in the latter part of the year. Current deal concentration may broaden as macroeconomic conditions improve and participation expands. In our view, the improved deal and exit activity can help reduce the backlog of mature private companies awaiting liquidity events and enable capital to be returned to investors, supporting future investment cycles.

Chao Ma, *Global Portfolio and Investment Strategy*

Excerpted from Investment Strategy report (May 18)

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Risk Considerations

All investments are subject to market risk which means their value may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors due to numerous factors some of which may be unpredictable. Be sure to understand and are able to bear the associated market, liquidity, credit, yield fluctuation and other risks involved in an investment.

Alternative investments, such as private equity/private debt, 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.

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First analysis of issues or topics that may affect investor portfolios

May 26, 2026

Jennifer Timmerman
Investment Strategy Analyst

Gary Schlossberg
Global Strategist

Tallying tariff refunds

What matters to markets

- U.S. Customs and Border Protection (CBP) has been issuing billions of dollars in tariff refunds since early May, following the Supreme Court's February 2026 decision to strike down the Trump administration's 2025 reciprocal tariffs implemented under emergency provisions.
- As of mid-May, the federal government had validated over 86,000 applications, and CBP had finalized and processed refunds valued at roughly \$35.5 billion (including interest) for over 8.3 million entries, out of a total of \$166-\$170 billion collected under the emergency tariffs overturned by the Supreme Court.¹
- Refunds are being issued within 60 to 90 days after an entry is accepted by CBP. Some funds have been delayed in situations where importers lack up-to-date bank information on file with the U.S. Treasury.
- Refunds must be filed online and only importers of record or a licensed customs broker can file.
- The U.S. Court of International Trade in a separate, but related ruling on May 7 halted 10% across-the-board tariffs under Section 122 of the 1974 Trade Act, the Trump administration's temporary tariff patch filling the void left by the loss of the emergency reciprocal tariffs.² A federal appeals court subsequently paused that ruling, allowing the CBP to continue collecting the duties during the appeals process, or until the 150-day statutory clock runs out on July 24.³

Our perspective

- The Trump administration intends to use the temporary Section 122 tariffs as a bridge to more permanent tariff increases under Section 232 of the Trade Expansion Act of 1962 and Section 301 of the Trade Act of 1974. Section 232's mainly product-specific levies already account for most of last year's remaining tariff increases, so the administration has been relying on Section 301 tariffs to ramp up country-by-country investigations to replace the temporary Section 122 duties.
- Both laws require lengthy investigations and comment periods for country- and product-specific tariff increases, which should create a more drawn-out and piecemeal approach.

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1. "Tariff Refunds of \$35.5 Billion Cleared for Importers So Far," Bloomberg, May 12, 2026.

2. "U.S. Trade Court Rules Trump Tariffs Illegal, But Issues Narrow Block," Reuters, May 7, 2026.

3. "Trump Can Keep Collecting Global 10% Tariffs After Appeals Court Stays Decision," Barrons, May 13, 2026.

- In our view, the tariff refund process will take time and so the benefit to corporate cash flow and profit margins are limited. We view U.S.-based retailers, automakers, manufacturers, and consumer goods and electronics companies as likely to benefit most in the near term.
- Some U.S. businesses likely will maintain price increases to boost profit margins unless successfully challenged by customers seeking refunds in the courts.
- We foresee other uses for the refunds: (i) pass along refunds voluntarily to customers, (ii) boost working capital needed to finance inventory building, or (iii) save the rebates as an offset to the cost of future tariffs. Some may plan to ease financial stress by paying off suppliers or to pay down credit lines.⁴
- We believe the refund claims process disadvantages small businesses, which typically purchase from wholesalers documented as importers of record and eligible for direct rebates. Further, many smaller firms lack the resources to file claims for the refunds.
- Tariff refunds marginally and temporarily increase the federal budget deficit, until new tariffs begin generating revenue.

Implications for investors

- We view the limited impact on the budget deficit as unlikely to have a material impact on Treasury yields.
- Larger companies likely will benefit most from the tariff refund process, thereby reinforcing our preference for U.S. Large Cap Equities and U.S. Mid Cap Equities over U.S. Small Cap Equities.
- Looking ahead, we believe tariff refunds can boost corporate cash flow and strengthen the rotation toward investment-led economic growth through the remainder of 2026.
- We continue to believe the gradual, piecemeal approach to tariff implementation will mute its impact on core goods inflation, adding to other trends, like productivity growth, restraining underlying inflation and tempering the impact from the energy-driven price spike tied to the Iran war.

4. "Companies Make Plans for Tariff Refunds," The Wall Street Journal, May 11, 2026.
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Risks 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. 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.

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Policy, Politics & Portfolios

What federal budget, regulatory, and trade decisions could mean for investors

May 28, 2026

Our base case is that geopolitics, fiscal pressure, and artificial intelligence (AI)-related infrastructure demand are combining to potentially keep inflation and long-term yields structurally firmer than consensus expects¹, reinforcing our preference for financials, selective AI-related companies, and intermediate over long-duration fixed income.

The Iran war's enduring impact 2

- We see fallout reverberating across the global economy well after the Iran war ends, including elevated fossil fuel and food prices, despite a gradual unwind of economic distortions.
- Looking beyond the war's end, ongoing geopolitical uncertainties may reinforce demand for military and security tools driven by AI, while persistent oil price volatility likely dilutes OPEC+² influence over crude oil prices.

New chair unlikely to change the Fed quickly 4

- Federal Reserve (Fed) Chair-designate Kevin Warsh has been confirmed by the Senate and will succeed Jerome Powell. While Warsh may hold some unconventional views, we believe policy changes are unlikely to occur quickly or without majority approval from other Fed officials.
- Regardless of Fed action and policy, we see long-term yields rising, supporting our unfavorable view on U.S. Long Term Taxable Fixed Income and most favorable view on Financials within Equities.

The evolving regulatory landscape for data centers in the U.S. 6

- Despite regulatory pushbacks, the momentum behind AI remains strong, with capital expenditure (capex) related to AI projected to reach an all-time high of \$750 billion in 2026.
- We are favorable on the AI theme, while closely monitoring valuations. In early April, we upgraded the Information Technology sector within Equities to favorable following a market pullback. We also see continued upside potential for Utilities and Industrials as beneficiaries of ongoing AI-driven investment.

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1. As of May 21, 2026, the Bloomberg weighted average of consensus estimates for the year-end 2026 10-year U.S. Treasury yield was 4.17%, versus our year-end 2026 target range of 4.25-4.75%.

2. The Organization of Petroleum Exporting Countries and its allies.

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The Iran war's enduring impact

Gary Schlossberg

Global Strategist

Jennifer Timmerman

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Not quite over 'til it's over for the global economy

The Iran war is the latest in a series of conflicts in a strategically important region. This conflict stands out for its duration and the disruption to global trade from the extended closure of the Strait of Hormuz. The impact has also been uneven across countries. The U.S. has been more insulated due to its role as an energy exporter, while both the U.S. and north Asian economies have been more insulated from ongoing AI investment.

We expect the global economic effects to linger even after the war ends. In our view, fossil-fuel prices — and to a lesser extent food prices — are likely to remain elevated while energy-supply disruptions should gradually fade in a lagged response to the reopening of the Strait of Hormuz. Some emerging-market governments may also face added fiscal and political strain as they increase subsidies to offset cost-of-living pressures. After the war, we anticipate a gradual normalization that could include businesses drawing down elevated inventories and consumers shifting spending back toward travel and other discretionary purchases deferred during the conflict.

Longer-term impacts to watch

We note the potential longer-term geopolitical, financial, and trade effects of the conflict:

1. **More global economic fragmentation:** The pandemic-driven switch to redundant supply chains is well along, but the war adds a new wrinkle. We see more countries, such as the U.S., Brazil, and Nigeria, potentially expanding their energy production, while energy importers seek that kind of diversification. The search may extend to other natural resources (like rare earth metals) and international payment systems to compete with the U.S. SWIFT system.³ The reliance on multiple ways to do business globally may increase production costs.
2. **Sometimes alliances must evolve to stay healthy:** Relationships on occasion need time and a reason to catch up to events, and the catch-up can feel disorienting. Likewise, clear challenges from Russia, China, and Iran in recent years have pushed the U.S. to review how it participates in its international alliances. While we expect the NATO⁴ and other alliances to endure, some political uncertainty may persist while the changes develop.
3. **New — but limited — competition for the U.S. dollar:** Trade fragmentation and loud but limited opposition from China and others to the U.S.-guided international order are likely to elevate the use of some other currencies with narrow international circulation. At the margin, this may accelerate some erosion of the U.S. dollar's payment role, however, we believe the competition is unlikely to replace the U.S. dollar as the world's main reserve currency.

2. The Society for Worldwide Interbank Financial Telecommunications (SWIFT) system is a global messaging network that enables secure and efficient international money and securities transfers.

3. The North Atlantic Treaty Organization (NATO) is a political and military alliance of countries from Europe and North America.

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4. **Potential diversion of foreign capital away from the U.S.:** If Gulf governments redirect financial surpluses toward reconstruction and defense, they may invest less in U.S. assets at a time when U.S. Treasury borrowing needs are already high. Gulf states held about \$315 billion in U.S. Treasury debt at the end of 2025 (just over 1% of total U.S. Treasury debt held domestically and abroad); however, U.S.-dollar assets account for approximately \$2 trillion of the more than \$5 trillion managed by Gulf sovereign wealth funds.⁵

Investment implications of the Iran war

Even after the Strait of Hormuz reopens, it may take two to three months for shipping flows to fully recover in Asia and elsewhere. We expect markets will remain sensitive to headlines while supply chains normalize. In equities, we continue to prefer areas that have historically tended to benefit from steady economic activity, including Financials and Industrials.

Outside the U.S., economies are already feeling the effects of the disruption more directly. For example, Indian Prime Minister Modi recently advised his country to work from home as much as possible and to avoid travel, and some European airlines have limited the number of short-hop flights.⁶ If conditions improve as we expect, we still view Emerging Market Equities as appropriate at a neutral, or full, portfolio allocation — particularly markets tied to the AI investment cycle (notably in north Asia). In fixed income, we believe moderating inflation later this year could help support shorter-maturity, higher-quality bonds and keep credit spreads relatively contained. We still view intermediate-term fixed income (3-7 year maturities) as offering the most value with attractive coupons and less duration (a measure of interest rate sensitivity) risk than longer-dated bonds.

Within the Industrials sector, we see mixed but overall positive implications for Aerospace and Defense. In our view, the conflict reinforces higher military spending and multi-year procurement programs. Over time, an eventual improvement in travel conditions could also support demand for commercial aircraft and related equipment. We remain cautious on Airlines, where elevated fuel costs may pressure earnings. We also see potential benefits for Machinery and Electrical Equipment as inventories rebuild and longer-term supply-chain shifts support demand.

The Middle East is an important link in the AI supply chain, producing about 30% of the world's helium and acting as a conduit for 30% of the total transmitted internet traffic worldwide.

Source: "AI, Iran and the Gulf 101," Deutsche Bank Research Institute, April 13, 2026.

5. "Should We Worry About Gulf Countries Reducing Investments in the U.S.?" Forbes, March 7, 2026.

6. BBC, "Modi urges Indians to WFH and limit foreign travel as Iran war continues," May 11, 2026.

New chair unlikely to change the Fed quickly

Tony Miano, CFA, CAIA

Investment Strategy Analyst

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A long-awaited transition in leadership

Kevin Warsh recently was confirmed by the Senate and will succeed Jerome Powell as chair of the Fed. While markets are focused on what this leadership change could mean, we believe investors should look beyond the headlines. We believe key drivers of interest rates — like inflation, economic growth, and government borrowing — are likely to matter more than who leads the Fed.

A Fed insider with unconventional plans

Warsh is a Fed veteran, having served as a governor from 2006 to 2011, including during the Global Financial Crisis. At the same time, some of his views differ from the current consensus. He has signaled support for lower interest rates and has suggested that AI-driven productivity could help cool inflation over time. He also strongly supports shrinking the Fed's "balance sheet," meaning reducing the U.S. Treasury and mortgage-backed securities the Fed holds after years of bond buying both during and after crises.

Warsh argues that reducing those bond holdings could support the case for lower short-term rates. But it can also push in the opposite direction for long-term yields. If the Fed owns fewer bonds, private investors may need to absorb more Treasury issuance and may demand higher yields. In his view, a smaller balance sheet and lower interest rates can work together to support the economy in a healthier way, without the market distortions and asset bubble created by years of bond buying.

The Fed was not built in a day

Even with a new chair, the Fed typically changes direction slowly. Policy decisions are made by the Federal Open Market Committee (FOMC), which has 12 voting members. Meaningful shifts usually require a majority, not just the chair's preference. Recent Fed communications suggest limited appetite for near-term rate cuts given a resilient labor market and still-elevated inflation. As a result, we expect any change in policy stance to take time and to depend on broader agreement across the committee.

Another factor that could support Fed policy continuity is that Jerome Powell intends to remain on the Fed's Board of Governors through 2028. While uncommon, we think this could add stability during the leadership transition and may reduce the odds of abrupt policy shifts.

Table 1. Fed decision-makers at a glance

Name	Position	April 2026 Vote	Notes
Jerome H. Powell	Chair (Expired in May)	Neutral	Remaining on the Board of Governors after his term as chair ended
Philip N. Jefferson	Board of Governors Vice Chairman	Neutral	
Stephen I. Miran	Board of Governors	Dovish	Replaced by Warsh as chair
Christopher J. Waller	Board of Governors	Neutral	
Michelle W. Bowman	Board of Governors	Neutral	
Lisa D. Cook	Board of Governors	Neutral	Under federal investigation
Michael S. Barr	Board of Governors	Neutral	
Beth M. Hammack	Cleveland Federal Reserve	Hawkish	In April, voted to remove easing bias
Lorie K. Logan	Dallas Federal Reserve	Hawkish	In April, voted to remove easing bias
Neel T. Kashkari	Minneapolis Federal Reserve	Hawkish	In April, voted to remove easing bias
John C. Williams	New York Federal Reserve	Neutral	
Anna Paulson	Philadelphia Federal Reserve	Neutral	

Source: Wells Fargo Investment Institute as of May 11, 2026.

What it may mean for investors

We believe investors should focus less on headline noise around leadership changes and more on the broad forces driving interest rates and yields — especially inflation, economic growth, and the federal government’s borrowing needs. Inflation remains elevated amid the ongoing Iran war, and the U.S. Treasury is expected to issue substantial debt (to fund the deficit and refinance maturing bonds). We believe these forces can keep upward pressure on longer-term yields regardless of who chairs the Fed. One key driver is the *term premium* — the extra yield investors demand to hold longer-maturity bonds — which we expect to rise.

We remain unfavorable on U.S. Long Term Taxable Fixed Income and prefer the intermediate portion of the yield curve where we see a potentially better balance of risk and return. A change in Fed leadership cannot, by itself, offset the volume of Treasury issuance that is required to meet growing deficit needs. When coupled with inflation readings above the Fed’s 2% target, we think these factors are likely to push long-term yields higher over time. As the yield curve remains steep (longer maturity yields higher than shorter maturity yields), we believe the Financials sector within Equities should benefit from the greater spread between short-term deposit rates being paid on deposits and long-term rates being received on loans. As a result, we are most favorable on the S&P 500 Index Financials sector.

Chair Powell intends to stay on as a governor after his term as Fed chair ends. Powell is the first chair to do this in almost 80 years.

Source: The Wall Street Journal, “Why Jerome Powell Decided to Stay at the Fed,” May 3, 2026.

Since the Fed began lowering interest rates in 2024, the Federal Funds rate has fallen by 169 basis points (or bps, 100 bps equals 1%) while the 10-year Treasury yield has risen by 70 bps.

Source: Bloomberg, May 6, 2026.
The Federal Funds rate is measured by the Federal Funds effective rate.

The evolving regulatory landscape for data centers in the U.S.

Awsaf Tamjid Arko

Investment Strategy Analyst

Doug Beath

Global Equity Strategist

Regulators are challenging the AI buildout, but momentum remains strong

Data centers — the buildings and equipment that power cloud computing and many AI applications — are expanding across the United States quickly. That growth is drawing attention from state and local policymakers, especially around electricity costs, grid reliability, and how limited power is allocated. By early 2026, more than 300 data-center-related bills had been filed across 30-plus states; as of early May, none had been enacted into law. We expect companies to keep making the case for data centers by addressing local cost concerns and emphasizing broader economic benefits.

How the industry is responding

One example is the Ratepayer Protection Pledge, signed in March 2026 by seven of the largest cloud providers (often called “hyperscalers,” or companies representing the largest providers and users of computing capacity). In this pledge, the signers commit to fund the full cost of the new power generation needed to support their projects. In our view, that directly addresses a core concern — that households and small businesses could end up subsidizing data center demand through higher utility rates.

Where new data centers are being built

The buildout is geographically flexible. When regulations or permitting become more restrictive in one area, companies are likely to shift projects to states with more supportive policies and available power. Today, Texas and the Midwest account for roughly one-third of operational hyperscale capacity and are projected to absorb 53% of new builds over the next few years.⁷

Momentum check

Despite the policy debate, we still see strong underlying momentum. Technology remains a key driver of U.S. growth, and much of the next leg of investment is tied to AI and the data centers that support it (see Chart 1). Recent quarterly corporate earnings results from several large operators exceeded expectations, including capital expenditures (capex). As of early May, estimates suggest AI-related capex could reach roughly \$750 billion in 2026 — an all-time high.

At the same time, the basic “plumbing” needed for the buildout is getting tighter — including limited supply of new power generation, grid connections, and key electrical equipment. Even with these constraints, demand for AI-related infrastructure continues to rise.

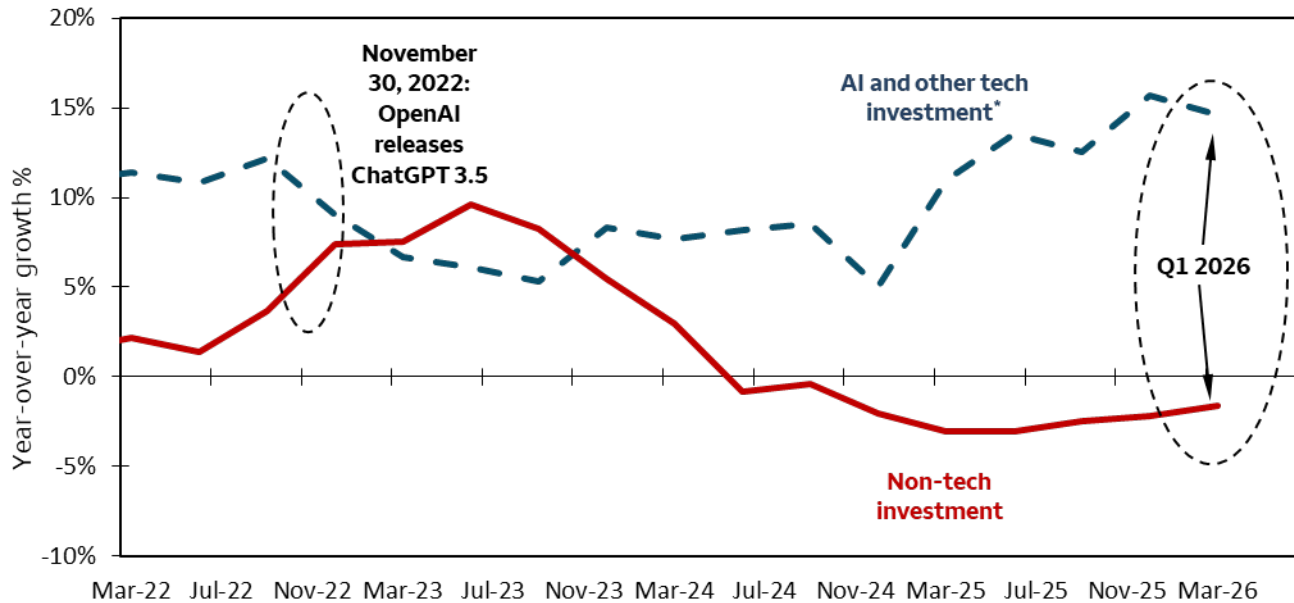
Key constraint: power

The most immediate constraint has been power. Data centers require large, steady electricity supply, and new grid connections and power contracts often depend on state and local approvals. When the grid cannot keep up, the largest cloud providers (hyperscalers) are increasingly turning to on-site, off-grid generation — most commonly natural-gas turbines. Demand has been strong enough that major turbine manufacturers now report order backlogs extending into 2029 and beyond.⁸ For now, suppliers appear able to increase production to meet demand.

7. Synergy Research Group, “U.S. Hyperscale Investment Shifts Decisively Inland,” 2026.

8. Utility Dive, “GE Vernova Expects to End 2025 With an 80-GW Gas Turbine Backlog That Stretches Into 2029,” December 11, 2025.

Chart 1. AI driving investment spending in U.S. GDP growth



* Data centers, power, tech and other electronic structures, info-processing equipment & software.

Sources: Wells Fargo Investment Institute, U.S. Census Bureau, and U.S. Department of Commerce. Quarterly data as of March 31, 2026. GDP = Gross Domestic Product. For illustrative and educational purposes only.

What it may mean for investors

Why it matters: If new rules meaningfully slow AI-related capex, they could weigh on U.S. growth. For example, AI-related spending supported first-quarter real gross domestic product (GDP) growth, contributing nearly 1.3 percentage points of the 2.0% total.

What markets are signaling: Hyperscaler capex has continue to exceed expectations, and the Information Technology sector has outperformed the S&P 500 since the Middle East conflict began. To us, that suggests markets do not view AI regulation as a near-term, high-probability threat.

What to watch next: The industry is increasing engagement with policymakers. A newer group, the National AI Association (NAIA), has been meeting with lawmakers, and major technology firms have increased lobbying and advertising aimed at positioning data centers as economic drivers for local communities.

Portfolio positioning: We remain favorable on the AI theme while closely monitoring valuations. We believe U.S. large- and mid-cap equities are well positioned to benefit from sustained AI demand. In early April, we upgraded the Information Technology sector to favorable, which we viewed as well supported by strong fundamentals and more attractive valuations following an early-year pullback. We also see continued upside potential for Utilities and Industrials as possible beneficiaries of ongoing AI-driven investment.

Following first-quarter earnings results, capex from major hyperscalers is projected to approach \$750 billion in 2026, largely directed toward AI chips, servers, and data centers.

Source: Forbes, "Big Tech's AI Spending Spree Could Reach \$750 Billion This Year," April 30, 2026; Bloomberg NEF, "AI Data Center Build Advances at Full Speed: Five Things to Know," March 24, 2026.

Risk considerations

Forecasts are not guaranteed and based on certain assumptions and on views of market and economic conditions which are subject to change.

Different investments offer different levels of potential return and market risk. 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.

Equity securities are subject to market risk which means their value may fluctuate in response to general economic and market conditions and the perception of individual issuers. Investments in equity securities are generally more volatile than other types of securities.

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. Investing in the **Financial** services companies will subject an investment to adverse economic or regulatory occurrences affecting the sector. 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. 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, especially 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.

Investments in fixed-income securities are subject to interest rate, credit/default, liquidity, inflation, and other risks. Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can result in the decline in the bond's price. Credit risk is the risk that an issuer will default on payments of interest and principal. This risk is higher when investing in high yield bonds, also known as junk bonds, which have lower ratings and are subject to greater volatility. If sold prior to maturity, fixed income securities are subject to market risk. All fixed income investments may be worth less than their original cost upon redemption or maturity.

U.S. government securities are backed by the full faith and credit of the federal government as to payment of principal and interest. Unlike U.S. government securities, agency securities carry the implicit guarantee of the U.S. government but are not direct obligations. Payment of principal and interest is solely the obligation of the issuer. If sold prior to maturity, both types of debt securities are subject to market 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.

In addition to the risks associated with investment in debt securities, investments in mortgage-backed securities will be subject to prepayment, extension and call risks. Changes in prepayments may significantly affect yield, average life and expected maturity.

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