



Investment Strategy

Weekly guidance from our Investment Strategy Committee January 16, 2024

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- The downtrends in private capital may moderate or even pause in 2024, given changes in the economy, interest rate policy, and public market prices.
- We believe it is important to monitor three key areas, which include private market capital activity, valuations, and secular trends.

Equities: Adjusting 2024 equity targets4

- We have increased our 2024 S&P 500 Index earnings and price targets, as well as all other asset class benchmark price targets and select earnings targets.
- These moves are supported by a somewhat improved first-half economic outlook and the increased likelihood of Federal Reserve (Fed) rate cuts this year.

Fixed Income: What to do with excess cash?5

- Investors were rewarded for holding excess cash and cash equivalents in 2023. We do not believe this trend will continue into 2024.
- We believe extending the maturity of excess cash investments should allow investors to lock in more attractive yields before interest rates fall once the Fed cuts rates.

Real Assets: Angola exits OPEC over production quotas6

- During the week of December 22, 2023, Angola announced its exit from the Organization of Petroleum Exporting Countries (OPEC) over low production quotas.
- Angola’s exit from OPEC raises concerns of a fractured OPEC, there is no indication that other members will defect, but it will be a situation to watch closely.

Current tactical guidance7

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

Alternatives Spotlight

Chao Ma, PhD, CFA, FRM

Global Portfolio and Investment Strategist

Private capital: What to watch in 2024

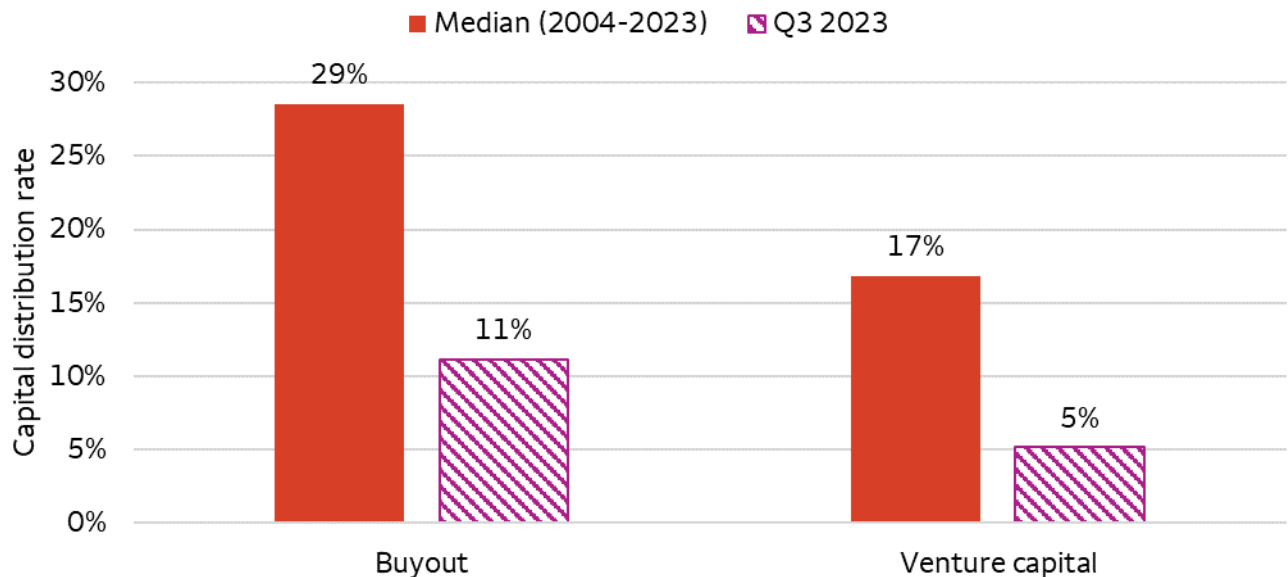
2023 will be remembered more by what was avoided than by what has happened. Despite the historic hawkish monetary policy, the U.S. economy grew 3.1% through the first three quarters of the year and the unemployment rate remained below 4%. During the past year, the Fed was able to moderate inflation without causing severe weakness in the labor market. We believe the market liquidity fueled by fiscal stimulus and government spending, the resilient corporate and household balance sheets, and improvements in supply chains were key drivers to this outcome. As a result, both stock and bond markets finished the year with positive returns.

Given the lagging nature of private market performance, we expect the recent downtrends to moderate or even pause potentially in 2024 as investors look for further confirmation of the soft landing narrative. However, the exact trajectory of private markets can be heavily influenced by changes in macroeconomic backdrop, interest rate policy, as well as public market price. Below, we summarize three key areas that in our mind are important to monitor in 2024.

Capital flow activity

Given the finite life of traditional private capital funds, qualified long-term investors have generally used a capital recycling approach, whereby the current year’s capital distributions are used to fund new fund vintages. However, in 2023 the soft exit market significantly constrained the amount of capital available for recycling. Due to public market volatility and economic uncertainty, private equity distribution rates dropped below long-term averages, to a level last seen during the Great Financial Crisis (see chart below).

Private equity distribution rate through the third quarter of 2023



Sources: Wells Fargo Investment Institute and Pitchbook. Data as of September 30, 2023. Q3 = third quarter. **Past performance is no guarantee of future results.** Capital distribution rate describes the amount of capital that a fund returns to investors in a given year. The chart is based on buyout and venture capital funds sourced by Pitchbook.

The difficult exit environment has acted as a headwind to fund managers' attempt to maximize their funds' performance record. However, the record level of capital commitments that private funds collected over the past few years have served as a cushion so far to avoid a sharp downturn in private markets.

Nevertheless, the soft exit benefited certain private equity strategies which are either less dependent on public markets to generate distributions or facilitate liquidity creations. These strategies include middle market buyouts and secondaries.

Valuations

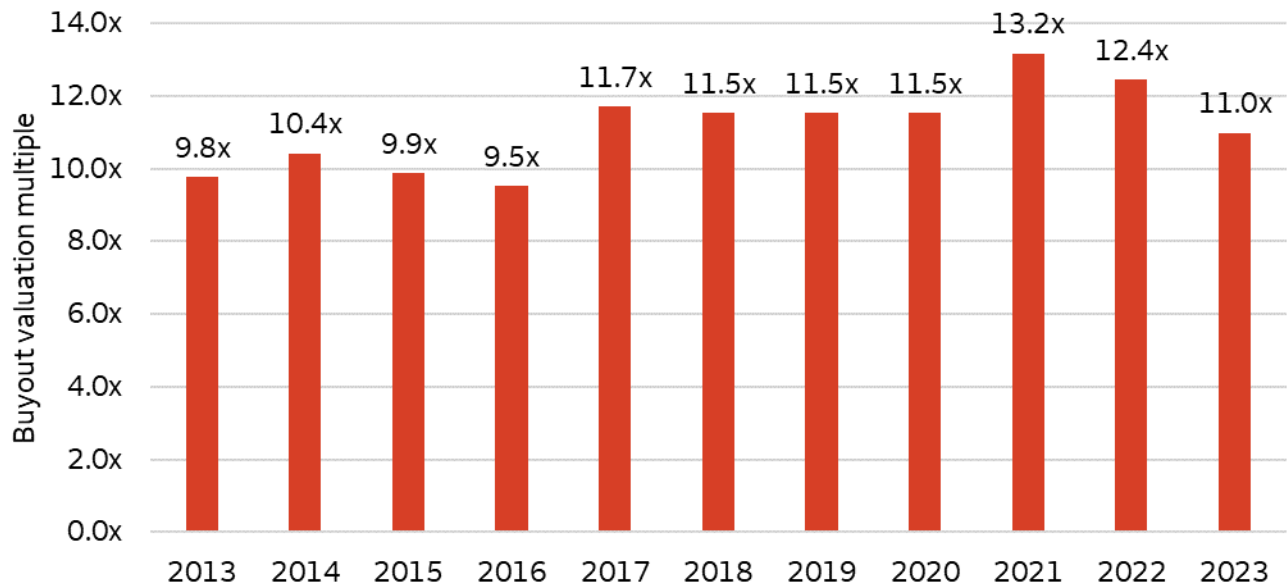
Driven by a growing number of deals priced at lower valuations as reported by Pitchbook, the median buyout valuation has normalized to long-term trends (see chart below). However, considering the impact of elevated interest rates and declines witnessed in public markets, we believe further risk to the downside in valuations remains. If this realizes, we believe lower valuations may potentially represent a good entry point as this has historically been a catalyst to an outperforming fund vintage during crisis times.

Secular trends

In our view, multi-year secular trends may align well with the long-term nature of private capital fund commitments. On this front, we believe infrastructure and certain real estate sectors, such as data center, multi-family housing, and logistics may continue to benefit from digital transformations, demographic trends, and policy supports. Further, we believe direct lending should continue to gain traction, given private companies' growing need for financing capital. However, successful direct lending funds need to show resilience in weathering potential future credit downturns as well as increased competition from new entrants.

We believe it is important to monitor new developments in private market capital activity, valuations, and secular trends in 2024 and build out diversified alternative allocations with an emphasis on our preferred strategies.

Buyout valuations between 2013 and 2023



Sources: Wells Fargo Investment Institute and Pitchbook. Data as of December 31, 2023. Median buyout enterprise value to earnings before interests, tax, depreciation and amortization (EBITDA) multiple is shown in the chart.

Secondary investments are interests in existing private equity funds that are acquired in privately negotiated transactions after the end of the private equity fund's fundraising period. Typically these funds have portfolios of existing investments as well as capital available for new investments. 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.

Equities

“The beginning is the most important part of the work.” —Plato

Austin Pickle, CFA

Investment Strategy Analyst

Adjusting 2024 equity targets

Last week we updated a number of our economic, fixed income, and equity 2024 forecasts. In equities, we increased our 2024 S&P 500 Index earnings and price targets, as well as all other asset-class benchmark price targets and select earnings targets. These moves were in response to a somewhat improved first-half economic outlook and the increased likelihood of Fed rate cuts this year.

We raised our S&P 500 Index earnings target from \$220 to \$230, and the price target range for year-end 2024 is now 4800 – 5000, reflecting upside from today’s levels (as of January 9, 2024). The table below details the updated targets for the other equity asset classes. We expect price increases to be driven by modest earnings growth and well-supported price-to-earnings multiples.

All year-end 2024 index price targets show upside from current levels. However, the path could be choppy with earnings and sentiment likely tested as the global economy weakens into the first part of 2024 before the eventual recovery. We remain defensively positioned, preferring high-quality assets and believe investors should continue to favor U.S. Large Cap Equities. However, we will look to position for the eventual early cycle rebound we forecast as we believe opportunities present themselves.

Wells Fargo Investment Institute (WFII) 2024 year-end equity targets

Equity targets	New year-end 2024 targets	Previous year-end 2024 targets
S&P 500 Index	4800-5000	4600-4800
S&P 500 EPS	\$230	\$220
Russell Midcap Index	3200-3400	2900-3100
Russell Midcap EPS	\$160	\$155
Russell 2000 Index	2000-2200	1800-2000
Russell 2000 EPS	\$65	\$65
MSCI EAFE Index	2200-2400	2000-2200
MSCI EAFE EPS	\$160	\$150
MSCI EM Index	950-1150	900-1100
MSCI EM EPS	\$75	\$70

Source: Wells Fargo Investment Institute, January 9, 2024. Bolded values indicate changes from previously published values. EPS = earnings per share. EM = emerging markets. An index is unmanaged and not available for direct investment. **Forecasts, targets, and estimates are not guaranteed and are based on certain assumptions and on our current views of market and economic conditions, which are subject to change.**

Fixed Income

Tony Miano

Investment Strategy Analyst

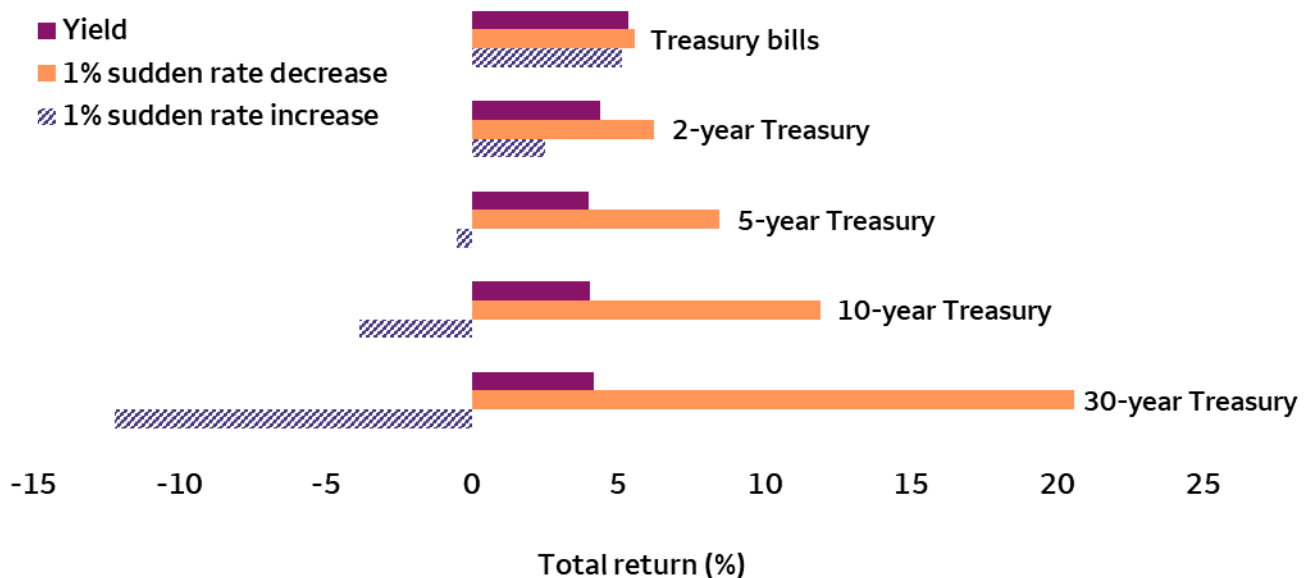
What to do with excess cash?

According to Lipper¹, investors continued to be net purchasers of money market funds but net sellers of fixed income overall in the first week of 2024. Money market funds displayed positive performance last year, supported by elevated interest rates but with less risk from interest rate volatility. However, at the beginning of 2024, some investors may find themselves with an excess allocation to money market funds or cash equivalent investments. We recently downgraded our guidance on U.S. Long Term Taxable Fixed Income to neutral but maintain our most favorable rating on U.S. Short Term Taxable Fixed Income. Hence, we believe now is a good time to reposition excess cash into slightly longer maturity bonds in the short term range.

The chart below demonstrates the impact to returns that interest rate changes could have on ultra-short-term bonds, like money market bonds or Treasury bills, and on bonds with longer maturities. We believe that interest rates may drop in the first half of 2024 and fixed income with slightly longer maturities may benefit more in that scenario relative to money market funds while still having similar yields in the 1 – 3 year maturity range.

Keep in mind that the bonds inside money market bond funds have a maturity, and thus lock in an interest rate payment, which is usually measured in weeks or months as opposed to years. Hence, when the Fed cuts interest rates, the interest paid on money market funds tends to follow. We believe that moving out slightly on the yield curve (even to maturities of 1 – 3 years) ahead of any potential Fed rate cuts can potentially benefit portfolios as investors are locking in attractive rates.

Impact of a sudden 1% rise or fall in interest rates



Sources: Bloomberg and Wells Fargo Investment Institute as of January 7, 2024. Data represents the hypothetical return of the Bloomberg U.S. Treasury Bills 1-3 Month Index, the 2-year U.S. Treasury note, the 5-year U.S. Treasury note, the 10-year U.S. Treasury note, and the 30-year U.S. Treasury bond assuming an instantaneous 1% rise or fall in interest rates across the yield curve.

¹ Lipper U.S. Weekly FundFlows Insight report, January 4, 2024.
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Real Assets

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Angola exits OPEC over production quotas

In the final weeks of 2023, Angola announced its exit from the OPEC in response to disagreements over low production quotas. Despite Angola's intentions to produce more crude oil, we suspect that its production growth will stay tepid in 2024, impacted by low levels of spare capacity (see chart below). Beyond 2024, production growth seems likely to stay low too, after years of underinvestment in aging oil fields.

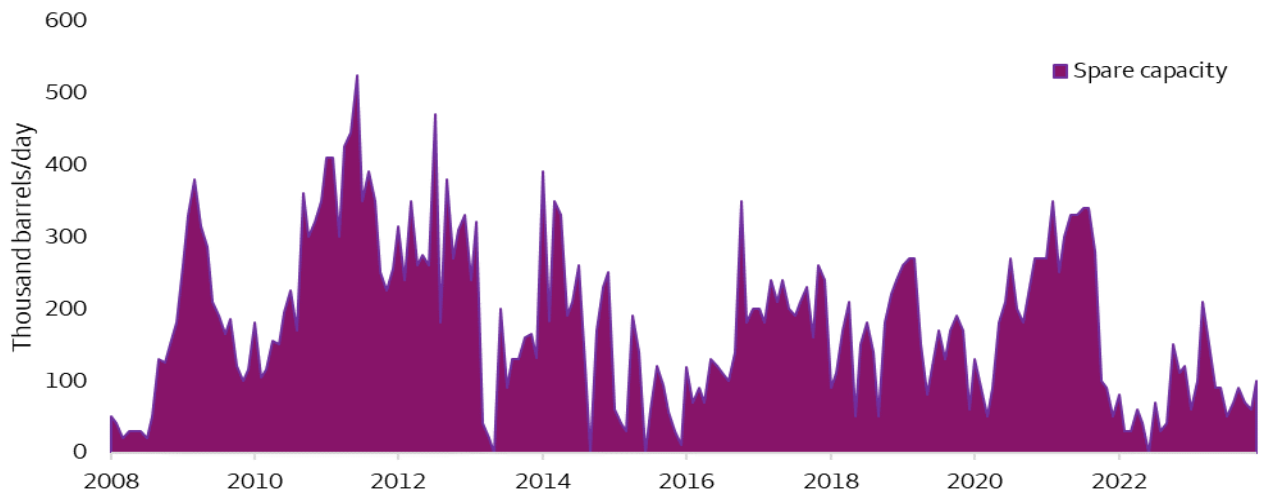
Angola has been a part of OPEC since 2007. Its average daily production in 2023 was 1.1 million barrels per day, which amounted to roughly 3.9% of OPEC's total production, or 1.07% of total world production². When Angola first joined OPEC, however, Angola produced closer to 1.9 million barrels per day, or roughly 2.2% of total global production at the time. Notably, 2.2% is a more meaningful number with global supply growth limited like it is today.

We are skeptical, however, that the country can increase production to prior levels, which could have some impact on global oil prices. The reason is that the country has a history of underinvestment in its aging oil fields. As a result, shown in the chart below, Angola's spare capacity (production capacity minus actual production) was only 100,000 barrels per day as of December 2023.

The more meaningful question for global oil prices is if Angola's exit from OPEC was the first of many. We have no reason to suspect that more defections are coming, but it is something that would be a concern. OPEC is the largest producer of oil in the world, and often a source of price stability. A fractured OPEC would likely add more volatility to already volatile oil markets.

The bottom line is that we do not see Angola's oil production mattering much to global oil prices in 2024. What could roil oil markets, however, is if more countries defect from OPEC. To be clear, we do not have any evidence of more defections to come. Still, we are watching the situation closely.

Angola's diminishing production capacity



Sources: Bloomberg and Wells Fargo Investment Institute. Monthly data is from January 2008 – December 2023.

² Bloomberg crude oil production output data, as of December 31, 2023.

Current guidance over tactical horizon (6-18 months)

Cash Alternatives and Fixed Income

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

Equities

Most Unfavorable	Unfavorable	Neutral	Favorable	Most Favorable
U.S. Small Cap Equities	Emerging Market Equities	U.S. Mid Cap Equities Developed Market Ex-U.S. 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—Event Driven Hedge Funds—Equity Hedge Private Equity Private Debt	Hedge Funds—Relative Value Hedge Funds—Macro	

Source: Wells Fargo Investment Institute, January 16, 2024.

*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

Forecasts are not guaranteed and 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.

Secondary investments – the purchase of existing partnership interests in private fund vehicles. At the most fundamental level, secondary transactions involve the sale and transfer of an existing limited partnership interest in a private equity fund, or a portfolio of funds, from one investor to another. As a result, sellers receive liquidity for their stake in the investment and are released from any unfunded portion of their capital commitment. The buyer agrees to pay a predetermined price for the interest, often at a discount to Net Asset Value (NAV). By so doing, the buyer agrees to take on future funding obligations in exchange for future distributions from the investment. The most basic – and common – type of secondary transaction involves the sale of a limited partnership interest in a single private equity fund. However, transaction characteristics can take on more complex structures involving portfolios of funds, general partnership interests, direct investments and structured or deferred payment arrangements.

Definitions

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.

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

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

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

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

Russell 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.

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