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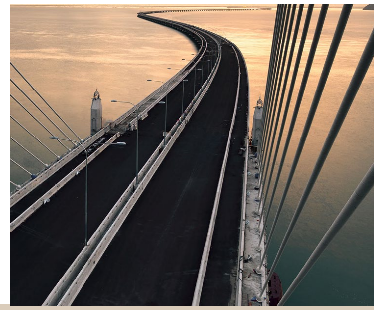
Investment Institute

Investment Strategy



Weekly guidance from our Investment Strategy Committee — April 22, 2024

Asset Allocation Spotlight

Michael Taylor, CFA
Investment Strategy Analyst

Drivers of first-quarter performance

First-quarter returns overall were positive across our favored allocations mainly thanks to an unshakeable equity rally, as a seasoned bull market continued to charge upward. Investment objectives holding significant exposure to equities, particularly sizable allocations to large-cap equities, outperformed more conservative allocations with greater bond exposure.

With the first quarter of 2024 behind us, now may be an opportune time for investors to review portfolio performance and positioning. Below we discuss key drivers of first-quarter performance and conclude with implications for markets and investors. Please see Chart 1 for specific asset-class returns.

Portfolio leaders and laggards in the first quarter

In equities, U.S. Large Cap Equities was the best-performing asset class in our allocations, largely fueled by growth-oriented stocks. While large caps outperformed, investors still enjoyed decent returns in most other equity classes. U.S. Mid Cap, Small Cap, and Developed Market (DM) ex-U.S. Equities all offered healthy returns. Although Emerging Market (EM) Equities ended the quarter in positive territory, the asset class lagged other equity classes.

In bonds, fixed-income performance was mixed in the first quarter as bond yields fluctuated amid market concerns about inflation expectations and monetary policy. Cash and cash alternatives, short-term fixed income, high yield, and emerging market fixed income all performed better than long-term bonds.

In real assets, although the Bloomberg Commodity Index (BCOM) was relatively flat for the quarter, it ended higher by 2.2% thanks to energy and precious metals constituents. Oil and Master Limited Partnerships (MLPs) were the outperformers in the first quarter, returning 15.1% and 12.9%, respectively.

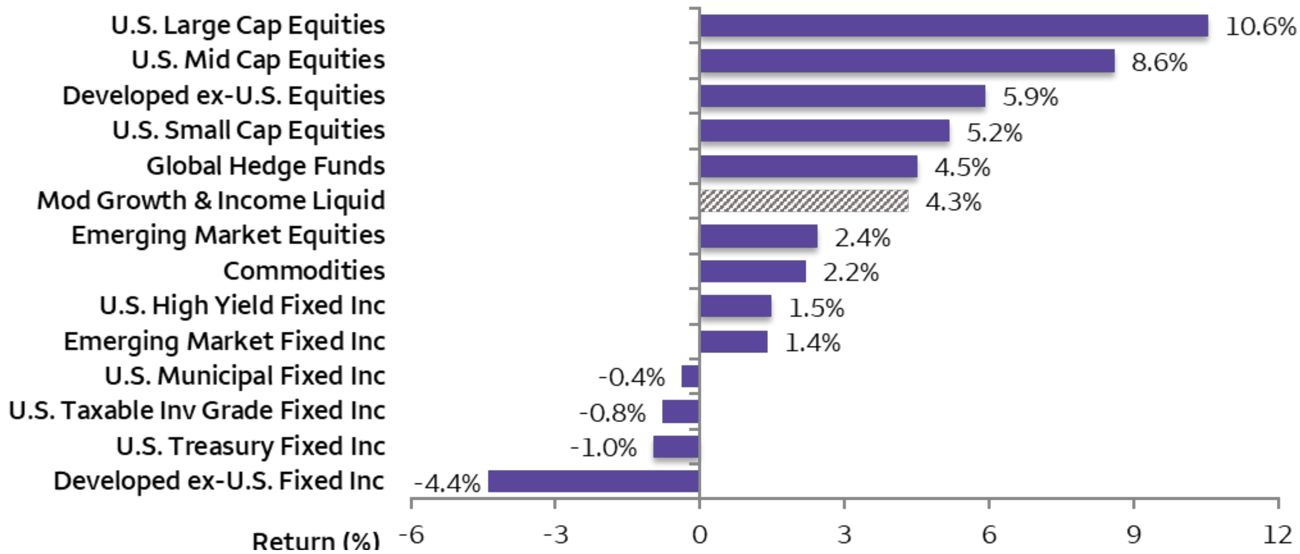
In alternative investments, Global Hedge Funds returned nearly 5% for the quarter. The best-performing Hedge Fund strategies included Macro (currently favorable) and Equity Hedge (currently neutral). Stronger and more stable trends in commodities and currencies were tailwinds for Macro. The positive return for Equity Hedge was driven by a combination of robust equity market performance and the impact from security selection.

Tactical guidance complements our strategic allocations

Our tactical guidance maintains an even stronger tilt toward U.S. equities, in particular U.S. large caps, which was a key positive contributor to performance not only in the first quarter, but over the entire past year. Asset classes that we are currently unfavorable, such as Small Cap and EM Equities, have underperformed, which has also contributed to performance for tactical allocations. In hedge funds, we observed upbeat performance led by Macro strategies, upon which we currently hold a favorable view. Illiquid allocations that include hedge funds benefited as well.

We are favorable U.S. large caps, but if this rally has pushed a designated allocation above its target, now might be a good opportunity to rotate into areas below target allocations. As U.S. equities have climbed significantly higher, maintaining international exposure up to strategic weightings could provide a potential buffer, should U.S. equity markets experience a downturn. Even so, in today's macro environment, we remain cautious on emerging markets, as we continue to foresee regional challenges relative to developed markets. We do not favor overextending portfolios in EM Equities given its structural challenges and a strengthening U.S. dollar.

Chart 1. Year-to-date asset class returns



Sources: Bloomberg, Morningstar, and Wells Fargo Investment Institute. Total return as of March 31, 2024. **Index return information is provided for illustrative purposes only. Performance results for Moderate Growth & Income Liquid are calculated using blended index returns**. Index returns do not represent investment performance or the results of actual trading. Index returns reflect general market results, assume reinvestment of dividends and other distributions, and do not reflect deduction for fees, expenses, or taxes applicable to an actual investment. An index is unmanaged and not available for direct investment. Unlike most asset class indexes, HFR Index returns reflect deduction for fees. Because the HFR indexes are calculated based on information that is voluntarily provided actual returns may be higher or lower thank those reported. **Past performance is no guarantee of future results.** The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete, or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Please see the end of the report for definitions and risks.

Implications for markets and investors

As investors navigate the remaining three quarters of 2024, we favor following our core principles of portfolio construction: diversification, portfolio balance, and risk management.

- *Diversification:* Last year's significant inflows into money market funds appears to reflect a cautious attitude among investors toward riskier assets and markets more broadly. Yet, we caution investors that overexposure to cash comes with certain risk — the opportunity cost of foregoing assets with greater growth potential. So, while potentially attractive in the near term, holding large cash positions is not likely the most effective long-term investment strategy. We see prospects across asset classes, sectors, and geographical locations, and suggest that portfolios remain exposed to a variety of assets.
- *Maintain portfolio balance:* It is important to monitor a portfolio and rebalance back to strategic targets regularly. With increased volatility (markets rising and falling rapidly), a portfolio can move away from designated target allocations quickly. Instead of trying to time the markets with large allocation changes, we prefer more modest tactical adjustments. Consider making short-term adjustments to asset-class weightings based on short-term expected relative performance.
- *Mitigate risk:* Along with the risk of volatility, it also is important to understand each asset's fundamental risks (political, liquidity, transparency, etc.). We encourage you to work with your investment professional to understand what factors tend to drive returns and evaluate them from a risk-adjusted perspective.

We anticipate interest rates will remain steady in the near term. To that end, we suggest investors who are over-allocated to cash to consider using market pullbacks to reestablish or maintain strategic and tactical allocation targets.

Equities

Chris Haverland, CFA
Global Equity Strategist

Earnings likely grew in the first quarter

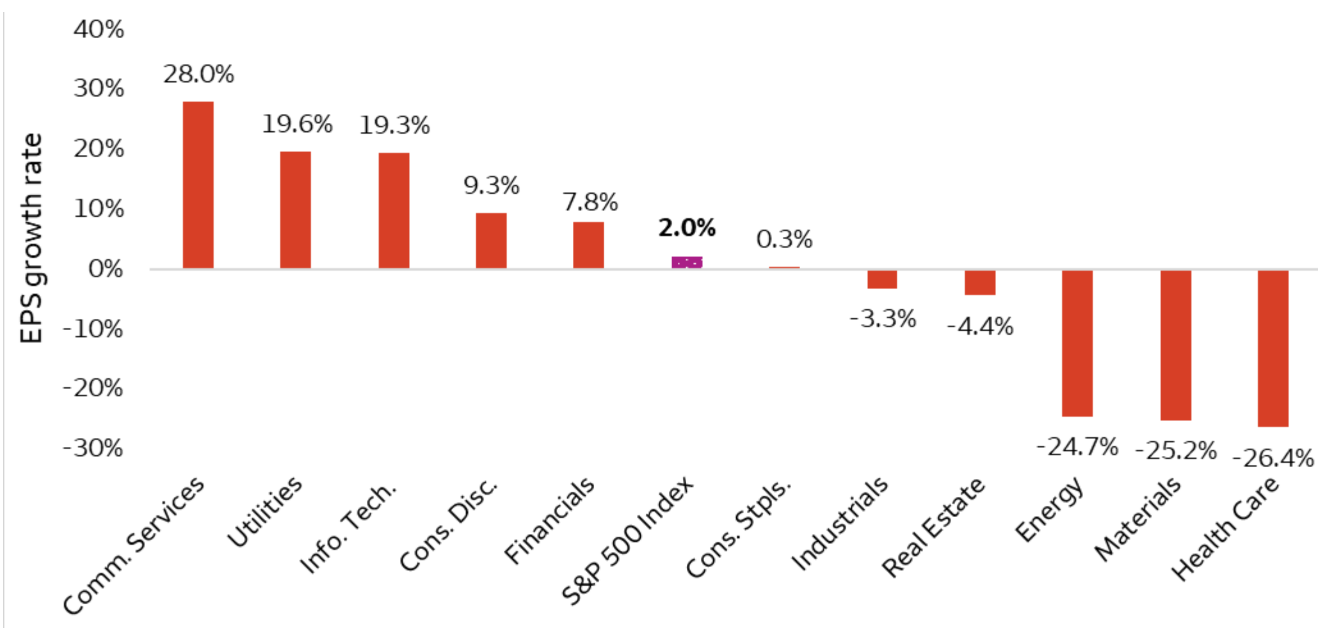
First-quarter earnings season is upon us with Bloomberg consensus calling for S&P 500 Index profits to expand 2%. While this appears to be a modest gain, if beat rates remain consistent with the past four quarters, overall earnings could end up higher than the initial estimate. Consensus shows revenue growth around 3.5% in the quarter, which implies margins will decline slightly relative to first quarter 2023.

6 of 11 sectors are expected to be positive led by Communication Services, Information Technology, and Utilities. Energy, Health Care, and Materials likely lagged in the quarter on tough comparisons. While technology-related sectors continue to dominate earnings growth, profit gains are expected to broaden as the year progresses.

Outlooks will be key as investors look for hints of an economic soft landing. Many companies are still dealing with a tight labor market, an uncertain economic environment, and interest rates that could be higher for longer than expected. The consumer remains resilient, but profits could be constrained by a rising dollar, increasing geopolitical tensions, and a higher cost of capital.

2024 S&P 500 Index Bloomberg consensus earnings estimates have been stable over the past few months and remain above our target of $240. In 2025 we see continued revenue growth and expanding margins that could take S&P 500 Index earnings to $260. We maintain our view that U.S. Large Cap Equities (represented by the S&P 500 Index) is the highest-quality major equity class, with strong company balance sheets, durable pricing power, and resilient earnings growth potential.

Bloomberg consensus suggests S&P 500 Index earnings expanded in the first quarter



Sources: Bloomberg and Wells Fargo Investment Institute. Earnings per share (EPS) growth measures consensus first quarter 2024 EPS expectations as of April 15, 2024, versus first quarter 2023 EPS. Estimates are based on certain assumptions and on views of market and economic conditions which are subject to change. An index is unmanaged and not available for direct investment.

Fixed Income

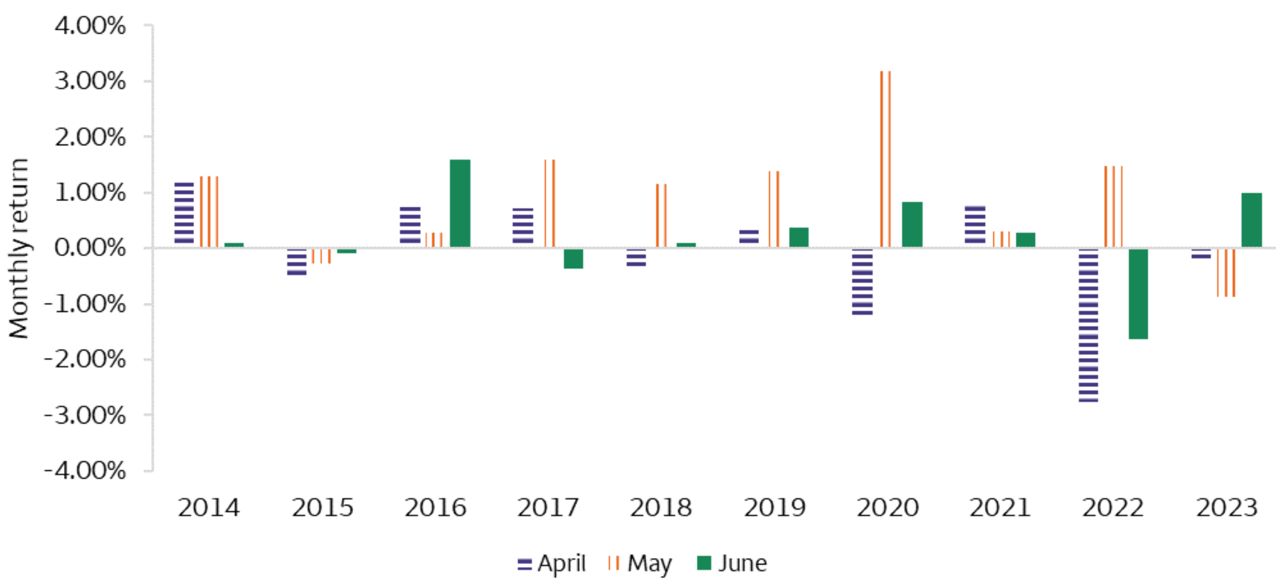
Tony Miano, CFA
Investment Strategy Analyst

April showers for municipal bonds?

April brings with it both rain and the only day worse than a rainy one: Tax Day. As April 15 approached, millions of Americans owed taxes, and many may have planned on selling assets to cover those tax bills. Investors selling assets to cover a bill may not quickly reinvest in the same asset, resulting in a rainy month for some asset prices. This can be particularly impactful to municipal bonds, which are generally held by those most exposed to heavy tax liabilities. April has historically been a difficult month for municipal bonds as investors offload them to cover tax bills and municipal bonds are already down -0.74% in April.[1]

The news isn't all bad for municipal bonds, as the headwind of selling in April has tended to bring a better May or June as investors return to the market. The chart below demonstrates that while 5 of the past 10 Aprils have had negative returns and only one has seen notably positive returns, May and June have tended to reverse this trend. We believe the positive drivers for municipal bonds still remain despite a rough April.

Historical municipal bond performance in April, May, and June



Sources: Bloomberg and Wells Fargo Investment Institute. Data as of April 15, 2024. Measured by the Bloomberg U.S. Municipal Bond Index. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

We remain favorable on municipal bonds overall and favorable on general obligation bonds. We continue to believe that demand dynamics are highly favorable to municipal bonds and that yields may still be attractive for investors with significant tax considerations.[2] A pullback in April could represent an entry point for investors looking to add to their municipal bond allocation.

1. Bloomberg as of April 16, 2024. Measured by Bloomberg U.S. Municipal Bond Index total return.
2. "Investment Strategy: Scratching the surface on municipal bonds", Wells Fargo Investment Institute, as of February 26, 2024.

Real Assets

Mason Mendez
Investment Strategy Analyst

John LaForge
Head of Real Asset Strategy

Supply risks remain amid tensions in the Middle East

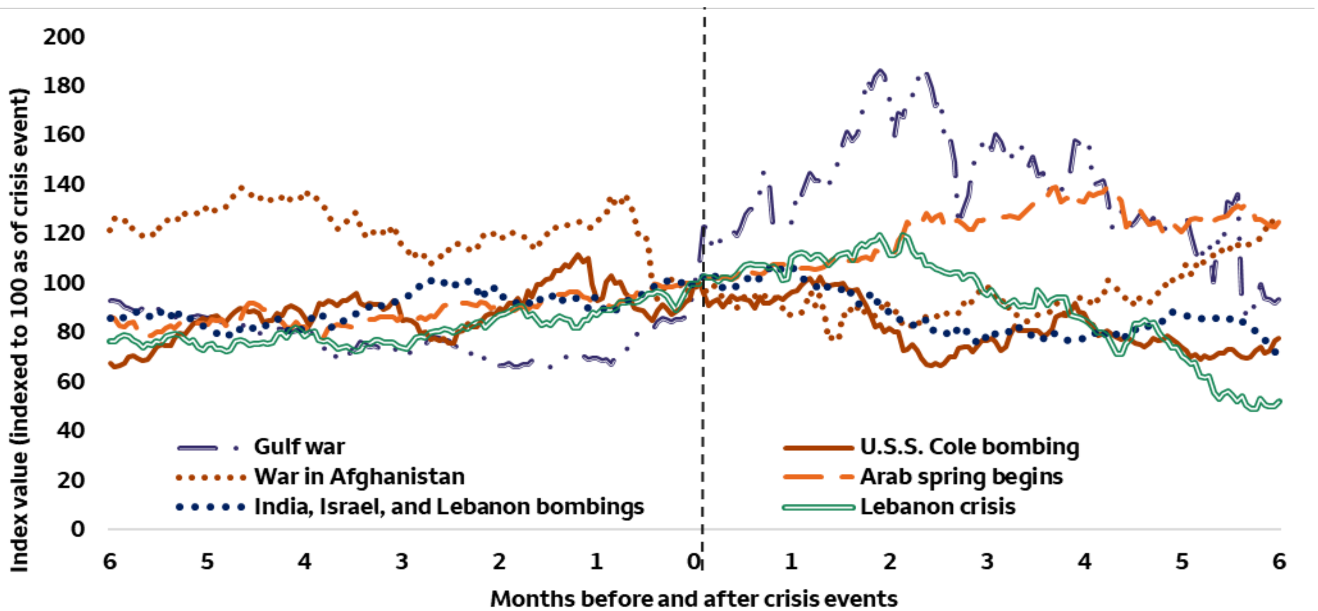
Rising tensions in the Middle East over the past week have investors concerned about how high crude oil prices could go. It is a legitimate concern as roughly 20 million barrels of crude oil per day (20% of daily global demand) move through the Strait of Hormuz — located between Iran and Oman — making it a crucial choke point for global oil trade.

In the days following Iran's attack on Israel, crude oil's performance was fairly tame – which may seem odd given the supply risk at hand. Markets had already priced in much of this anticipated risk leading up to the strike, as Iran made its intentions known well ahead of its April 12 attack. This is shown by a 7.3% rise in Brent crude prices between the April 1 strike on Iran's Damascus compound and Iran's well anticipated April 12 strike on Israel. We believe this gave traders enough information and time to price in the supply risks ahead of the actual strike, which is why prices barely budged in the days after.

However, as seen in the chart below, no two crisis events have been the same, especially the unprecedented events between Israel and Iran that we are seeing today. We have noticed, though, that of the 22 events studied since 1990, those that posed a direct risk to oil supply typically had the biggest effect on prices.

So far, oil prices have been tame, but given Iran's proximity to the Strait of Hormuz, risks of supply disruptions remain, along with the risk of prices moving higher if the conflict escalates. This uncertainty and risk premium is one reason we remain favorable on commodities and energy.

Brent crude oil's performance around select Middle East crisis events



Sources: Bloomberg and Wells Fargo Investment Institute. Daily data is from February 2, 1990 - June 22, 2011. Please see the end of the report for the dates of the crisis events. **Past performance is no guarantee of future results.**

Alternatives

Chao Ma, PhD, CFA, FRM
Global Portfolio and Investment Strategist

State of liquidity in private capital

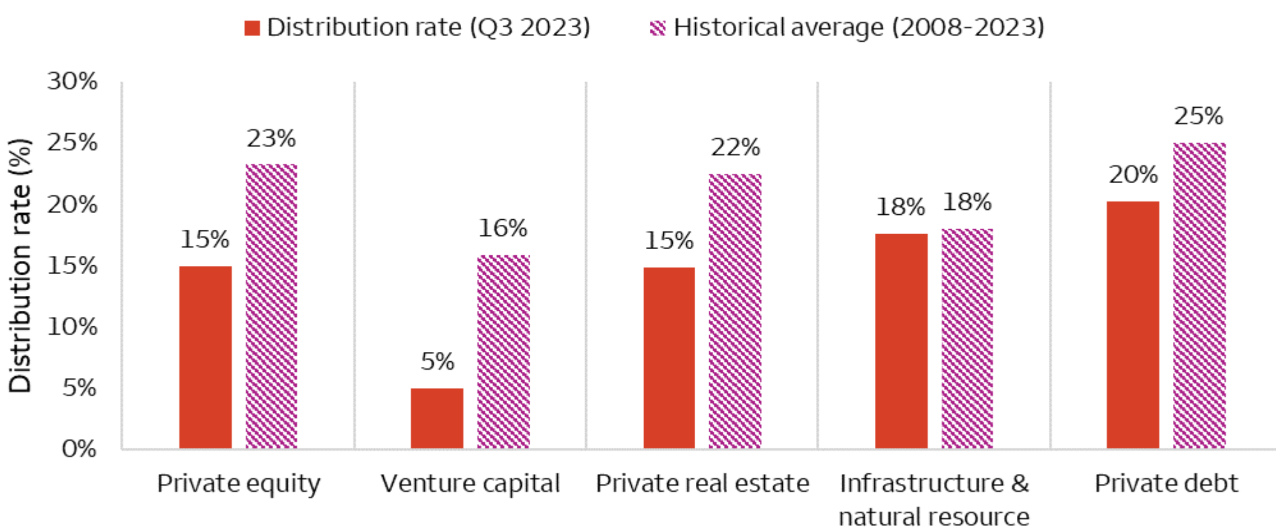
Since late 2022, the combined effect of elevated interest rates, recession fears, and public market volatilities have kept private capital exit and dealmaking activities soft. Overall, the private capital fund distribution rate has dropped from its 2021 high to below historical averages (see chart below). Infrastructure and Private Debt exits fared better and were the bright spots, whereas the Venture Capital distribution rate fell to its lowest level last seen during the Great Financial Crisis.

Significant pullbacks in dealmaking were similarly observed in private markets, as shown in the lower amount of capital called by managers in 2023. Private Real Estate and Venture Capital deal activities were most impacted, coming in 30% to 40% below their long-term averages, according to Pitchbook. This decline was driven by a dwindling opportunity set and lower manager confidence amid rising costs of debt, a largely closed initial public offering (IPO) market, and lower public market prices. However, Infrastructure and Private Debt deal flow remained largely healthy, benefiting from their longer-term growth trends, attractive yields, and, for Infrastructure, policy support.

Another encouraging development more recently is that the declines in distribution and dealmaking have slowed. Investors and fund managers are regaining confidence, with public market recovery, resilient growth, and the prospective of lower interest rates in sight.

We remain cautious and prefer to observe more green shoots in private markets before turning assertive. In the meanwhile, we continue to favor strategies that can prove resilient in the current environment, including Secondaries, Infrastructure, Small and Mid Buyout, and Growth Equity.

Private capital distribution rate



Sources: Wells Fargo Investment Institute and Pitchbook. Data as of September 30, 2023. Distribution rate is calculated as 12-month fund distribution divided by fund net asset value. Historical average is the average between 2008 to 2023. Q3 = third quarter. **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.

Tactical guidance*

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, April 22, 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.

Risk considerations

Forecasts and targets are based on certain assumptions and on views of market and economic conditions which are subject to change. Asset allocation and diversification are investment methods used to help manage risk. They do not guarantee investment returns or eliminate risk of loss including in a declining market.

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. 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. **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. 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.

Dates of the crisis events for chart on page 6

- Gulf War
  - 8/2/1990
  - 2/2/1990 – 1/29/1991
- War in Afghanistan
  - 10/7/2001
  - 4/11/2001 – 4/4/2002
- India, Israel, and Lebanon bombings
  - 7/11/2006
  - 1/12/2006 – 1/8/2007
- U.S.S. Cole bombing
  - 10/12/2000
  - 4/13/2000 – 4/11/2001
- Arab Spring
  - 12/18/2010
  - 6/21/2010 – 6/22/2011
- Lebanon crisis
  - 5/7/2008
  - 11/2/2007 – 11/4/2008

Definitions

Moderate Growth and Income Liquid: 2% Bloomberg U.S. Treasury Bill (1–3 Month) Index, 30% Bloomberg U.S. Aggregate Bond Index, 6% Bloomberg U.S. Corporate High Yield Bond Index, 5% JPMorgan EMBI Global Index, 24% S&P 500 Index, 10% Russell Midcap Index, 6% Russell 2000 Index, 8% MSCI EAFE Index, 5% MSCI Emerging Markets Index, 4% Bloomberg Commodity Index.

Fixed Income

U.S. Taxable Inv Grade Fixed Inc: **Bloomberg U.S. Aggregate Bond Index** is a broad-based measure of the investment grade, US dollar-denominated, fixed-rate taxable bond market.

U.S. Municipal Fixed Inc: **Bloomberg U.S. Municipal Bond Index** covers the USD-denominated long-term tax-exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds.

U.S. High Yield Fixed Inc: **Bloomberg U.S. Corporate High Yield Bond Index** covers the universe of fixed rate, non-investment grade debt.

U.S. Treasury Fixed Inc: **Bloomberg U.S. Treasury Index** measures the total return US dollar-denominated, fixed-rate, nominal debt issued by the U.S. Treasury.

Developed ex-U.S. Fixed Inc: **JPMorgan Global ex-U.S. Government Bond Index** measures the performance of non-U.S. government bonds.

Emerging Market Fixed Income: **JPMorgan Emerging Markets Bond Index (EMBI Global)** covers 27 emerging market countries. Included in the EMBI Global are U.S.-dollar-denominated Brady bonds, Eurobonds, traded loans, and local market debt instruments issued by sovereign and quasi-sovereign entities.

Bloomberg U.S. Treasury Bill (1-3 Month) 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.

Equities

U.S. Large Cap Equities: **S&P 500 Index** is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the U.S. stock market.

U.S. Mid Cap Equities: **Russell Midcap Index** measures the performance of the 800 smallest companies in the Russell 1000 Index.

U.S. Small Cap Equities: **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.

Developed Market ex-U.S. Equities: **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.

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

Hedge Funds

Global Hedge Funds: **HFRI Fund Weighted Composite Index** is a global, equal-weighted index of over 2000 single-manager funds that report to HFR Database. Constituent funds report monthly net-of-all-fees performance in U.S. dollars and have a minimum of $50 Million under management or a 12-month track record of active performance. The HFRI Fund Weighted Composite Index does not include Funds of Hedge Funds.

Note: HFRI Indices have limitations (some of which are typical of other widely used indices). These limitations include survivorship bias (the returns of the indices may not be representative of all the hedge funds in the universe because of the tendency of lower performing funds to leave the index); heterogeneity (not all hedge funds are alike or comparable to one another, and the index may not accurately reflect the performance of a described style); and limited data (many hedge funds do not report to indices, and, therefore, the index may omit funds, the inclusion of which might significantly affect the performance shown. The HFRI Indices are based on information self-reported by hedge fund managers that decide on their own, at any time, whether or not they want to provide, or continue to provide, information to HFR Asset Management, L.L.C. Results for funds that go out of business are included in the index until the date that they cease operations. Therefore, these indices may not be complete or accurate representations of the hedge fund universe and may be biased in several ways. Returns of the underlying hedge funds are net of fees and are denominated in USD.

Real Assets

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

An index is unmanaged and not available for direct investment.

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