

# Investment Strategy

Weekly guidance from our Investment Strategy Committee August 11, 2025

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- Although there are similarities between today’s market and that of the late 1990s, we believe today’s leaders consist of higher-quality companies with strong balance sheets, and current valuations are not at extreme levels.
- Despite the positive outlook for Artificial Intelligence (AI), we are mindful about overpaying for technology stocks. We recently downgraded Communication Services to neutral and could consider downgrading the technology sector in the future as well should valuations continue to climb.

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- The S&P 500 Index recently touched a new all-time high, despite the earnings estimates dropping from the February peak.
- We believe investors could do well if they rebalance portfolios back to recommended allocations, which may include trimming equities and rotating the funds into fixed income.

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- The spread between 2-year and 30-year yields increased almost 20 basis points (.20%) on July’s discouraging jobs report as market expectations of Federal Reserve (Fed) rate cuts rose.
- We expect short-maturity yields to fall with Federal Reserve (Fed) rate cuts and long-maturity yields to stay high with rising inflation. In our view, this makes Intermediate Term Taxable Fixed Income the only attractive option and we are now favorable in that space.

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- We downgraded Commodities from favorable to neutral. Additionally, we downgraded the Energy commodity sector from favorable to neutral and upgraded the Industrial Metals sector from neutral to favorable.
- We suggest taking profits in Commodities, bringing their allocations back to strategic weight, and rotating into fixed income until markets present more compelling opportunities.

## Alternatives: Venture capital in AI continued to grow ..... 7

- With record dealmaking and resilient exits, venture capital in artificial intelligence (AI) startups continued to be a bright spot in 2025.
- Although venture capital’s increasing concentration in AI might be a risk, we believe AI’s resilience should help cushion venture capital’s current slowdown and could support a broad recovery in the future.

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# Asset Allocation Spotlight

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## Comparing the dot-com bubble and today’s market

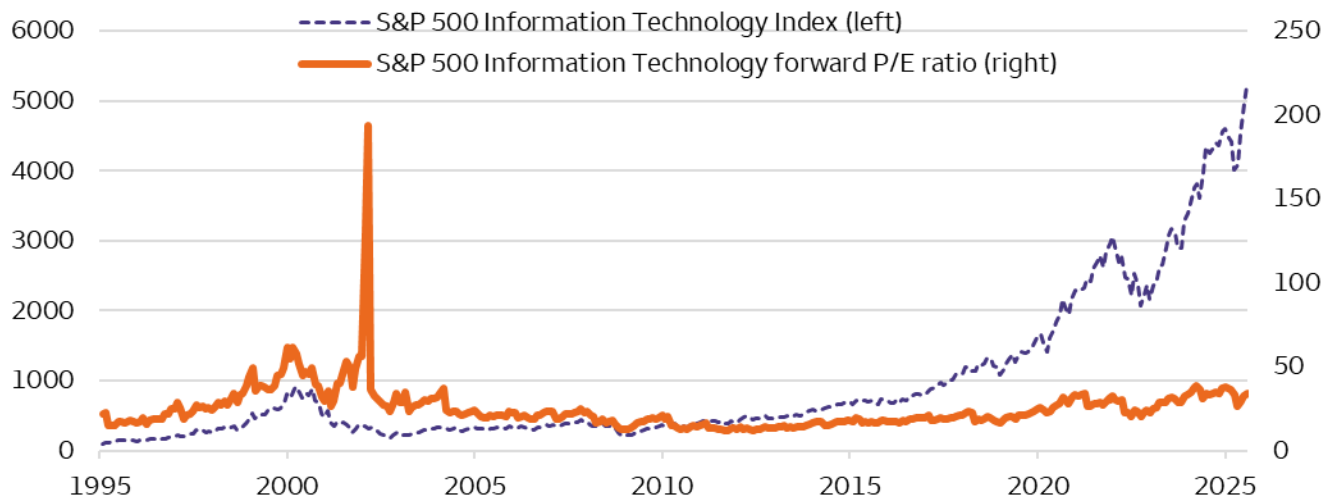
Global equity markets have rebounded sharply to new highs since the April 8 low. We see investor mentality shifting away from tariff uncertainties, to once again focus on a select group of Technology and Communication Services companies closely tied to artificial intelligence (AI). Utilities have also performed well during the rebound phase despite being a traditional defensive sector, as AI data centers are used for processing, storage, and networking.

The success and run-up of mega-cap tech stocks associated with AI has understandably led to comparisons with the dot-com bubble of 1999 — 2000. Indeed, there are significant similarities between the two occurrences. Key examples include:

- **Transformative technologies** – The development of the internet 30 years ago and the current and future potential of AI today to increase efficiencies for businesses.
- **Performance** – Significant outperformance of U.S. large-cap growth stocks, particularly a handful of tech stocks associated with the internet (1995 — 2000) and AI (2023 — present).
- **Valuation** – Both periods have produced the two highest price-to-earnings multiples (PE) on record for the S&P 500, with the dot-com bubble episode (25x) exceeding today’s market valuation (22.7x) based on forward 12-month earnings.
- **Concentration** – Based on the top 5 and 10 stocks, as a percent of the S&P 500 weight, year-end 1999 registered 17% and 27% versus the latest reading of 28% and 38%, respectively.
- **Top performing stock** – The relative performance of the top-performing equity over Jan. 2019 - Jul. 2025 is similar to the gain in the top performers over 1993-1999.

Although these similarities exist, there are crucial differences to consider. For example, today's AI market leaders consist largely of mega-tech companies that are highly profitable with new capex expenditures mostly funded by free cash flow (amount of cash left over after expenses). In contrast, stock market drivers of the dot-com era had far more exposure to consistently negative earning companies, including startups and smaller companies, and were primarily funded by debt and venture capital (see Chart 1).

**Chart 1: S&P 500 Information Technology sector's performance largely driven by earnings, not multiple expansion**



Sources: Bloomberg and Wells Fargo Investment Institute. Monthly data, January 1995-June 2025. The forward P/E ratio is based on Bloomberg estimates of 12-month forward sector earnings. **Past performance is no guarantee of future results.** An index is unmanaged and not available for direct investment.

Our study of earlier historically disruptive technologies reveals that investors often focus their willingness to pay on future earnings potential. Yet, their earnings expectations may not develop as quickly or completely as needed to support higher future prices. For this purpose, we see both positive and potentially negative factors impacting the AI sector going forward.

### Positive factors

- **Enhancing technologies versus replacing** - Unlike other technological breakthroughs, all of which replaced existing technologies (electricity from steam power, advances in transportation, and personal computers with the internet), AI allows the user to enhance existing technologies that should result in higher productivity gains for nearly all business and personal applications.
- **Broadening beyond hyperscalers** – AI has been dominated by a group of top performing mega tech companies but there are signs that the technology is spreading to other areas of the economy, such as finance, health care, and manufacturing.
- **Future growth potential** – Surveys from major consulting firms project a massive increase in AI spending. For example, Gartner forecasts Generative AI worldwide spending to reach \$644 billion in 2025, up 162% from 2024.
- **One Big Beautiful Bill Act (OBBBA)** – The new tax law, with 100% bonus depreciation and research & development (R&D) expensing, will significantly lower effective tax rates and benefit AI related sectors, such as technology, communication services, and utilities.
- **Tariffs** – With new tariffs coming online, AI is potentially even more valuable to businesses, as we believe tariffs won't bring back manufacturing to the U.S. without significant increases in automation.

### Potential risks

- **Concentration** – In terms of market cap, the largest company based on market capitalization share of total investment expenditures is projected to be around 15% in 2026 according to Bloomberg, similar to levels of previous companies that succumbed to severe market corrections due to overvaluation or obsolete technologies.
- **Valuation** – Although forward price-to-earnings (PE) multiples of AI related hyperscalers are not excessive in our view, their price-to-cash flow multiples are near record levels.
- **Power consumption** – AI is heavily reliant on data centers that are expected to substantially increase global electricity consumption, potentially accounting for up to 20% of total electricity demand. The surge in energy demand due to AI is expected to strain power grids and impact the environment as a significant portion of electricity generated globally still comes from fossil fuels.

### What it means for investors

The current equity market environment has many similarities but is not analogous to a late 1990s dot-com bubble. Most importantly, today's leaders have real businesses with pristine balance sheets that are benefitting from a new transformative technology. Current valuations on the technology sector of 33x future earnings are high but not at the extreme levels of 40x or 50x during 1999 — 2000. However, we are mindful about overpaying for these stocks and recently downgraded Communication Services to neutral, as this high-quality sector and AI beneficiary is up over 30% from the April stock market low. Likewise, we could consider taking profits and downgrading the Technology sector in the future, as well, should valuations continue to climb.

# Equities

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## Fully Valued?

The S&P 500 Index climbed to 28.24% from April 8 to its all-time high on July 28, which is about 4% above its February 19 peak. This rebound was driven by delays in tariff implementation and, in some cases, lower rates than those set in early April. U.S. economic data and corporate earnings are continuing to come in better-than-expected, which we believe has also helped calm the market’s nerves. However, these positive developments are unlikely to reverse the damage that could be done by the fact that tariff rates are now significantly higher than they were at the beginning of the year — which are expected to have negative impacts on both economic and earnings growth.

In fact, our earnings estimate for the S&P 500 Index actually sits below the level it was during the market peak in February (current estimate is \$265 versus \$270 on February 19). The higher index level on a lower expected earnings base means that the price-to-earnings multiple has expanded, and in our view, leaves the S&P 500 Index priced close to full valuation. Given the negative historic seasonality that tends to manifest during the fall months, we recommend investors rebalance portfolios, which may involve opportunistically trimming equities and rotating funds into fixed income.

The chart shows the S&P 500 Index (6330) is in an uptrend, with the 50-day moving average (6139) now trading above the 200-day moving average (5903). It should find support at the 50-day moving average (6139) followed by the 200-day moving average (5903). Resistance sits at the recent high (6390).

### S&P at new highs and close to overbought



Sources: Bloomberg and Wells Fargo Investment Institute. Daily data from August 4, 2022, through August 4, 2025. SPX = S&P 500 Index. SMAVG (50) = 50-day simple moving average. SMAVG (200) = 200-day simple moving average. RSI = relative strength index. **Past performance is no guarantee of future results.** An index is unmanaged and not available for direct investment.

## Fixed Income

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### Decoding the yield curve's signals

The last week of July was filled with developments that influenced fixed-income yields. The July 31 comments from Fed Chairman Jerome Powell reinforced the view that tariff-driven inflation remains a threat while the jobs report for the month surprised to the downside. The chart shows that the U.S. Treasury yield curve has been steepening more aggressively since April. The difference between 2-year and 30-year Treasury yields has increased from 60 basis points (bps; 100 bps equal 1.00%) to over 100 bps.

#### Steepness of the U.S. Treasury yield curve (30-year – 2-year spread)



Sources: Bloomberg and Wells Fargo Investment Institute as of August 5, 2025. 30-year – 2-year spread is represented by the difference in yields of the 30-year U.S. Treasury bond and 2-year U.S. Treasury bill. **Past performance is no guarantee of future results.**

Is there a message embedded in the shape and steepness of the U.S. Treasury yield curve? In our view, there is. However, much has to do with the reasons causing the steepening. Is it because short-term yields are falling, long-term yields are rising, or a combination of both? In the past two weeks, market expectations of Fed rate cuts have risen and have been pushing short maturity yields lower while concerns around inflation expectations moving higher due to tariffs have muted the downward movement in long-term yields. Furthermore, term risk premium in long-term yields could continue to move higher given the amount of U.S. debt outstanding, the anticipated Treasury issuance and the projected increase on the fiscal deficit.

The steepening of the yield curve impacts opportunities in the fixed-income markets. We remain unfavorable on both Short Term Taxable Fixed Income and Long Term Taxable Fixed Income. We believe investors are better rewarded in the intermediate portion of the curve, offering attractive income opportunities and the potential for price appreciation once the Fed decides to cut rates.

# Real Assets

*“However beautiful the strategy, you should occasionally look at the results.” — Sir Winston Churchill*

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## Downgrading Commodities

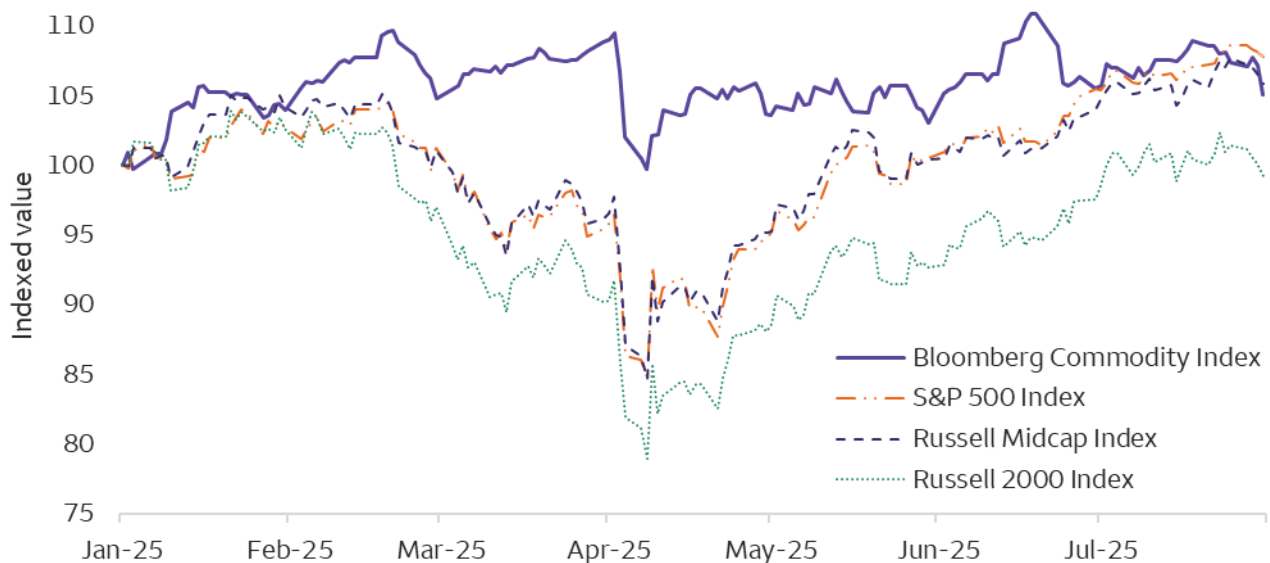
Last week we downgraded Commodities from favorable to neutral. This note recaps the rationale of that update. For more details, please see the Institute Alert released August 5, 2025.

Commodity prices held up better than some other traditional asset classes through much of the year (see chart), providing a portfolio diversifier and hedge against the multiple geopolitical and policy risks equity markets faced in 2025. Looking ahead, we still see value in the diversification benefits of Commodities, but we also expect limited upside through year-end 2025.

While our forecast for a modest reacceleration in U.S. economic conditions in 2026 should still be a tailwind for commodity performance, we see better opportunities in our other favored asset groups. We suggest taking profits in Commodities, bringing their allocations back to strategic weight, and rotating into fixed income until markets present more compelling opportunities.

Both Energy and Industrial Metals commodity sectors should benefit from a modest economic rebound in the latter part of 2026, lower short-term interest rates, and economic stimulus in China. However, OPEC+’s<sup>1</sup> accelerated production quota reduction is a considerable headwind to oil prices, as well as the return potential of the Energy sector. Meanwhile, Industrial Metals should benefit from sluggish global mined copper production as demand grows. Additionally, the recent sharp collapse in copper prices — as tariffs announced proved to be less severe than anticipated — provided an attractive tactical opportunity to overweight the Industrial Metals sector, in our view. As a result, we downgraded Energy from favorable to neutral while simultaneously upgrading Industrial Metals from neutral to favorable.

### Commodities insulated portfolios from stock market drawdowns



Sources: Bloomberg and Wells Fargo Investment Institute. Daily data: January 1, 2025 – July 31, 2025. Indexed to 100 as of the start date. **Past performance is no guarantee of future results.** An index is unmanaged and not available for direct investment.

1. The Organization of the Petroleum Exporting Countries (OPEC), plus allied non-OPEC countries.  
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## Alternatives

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### Venture capital in AI continued to grow

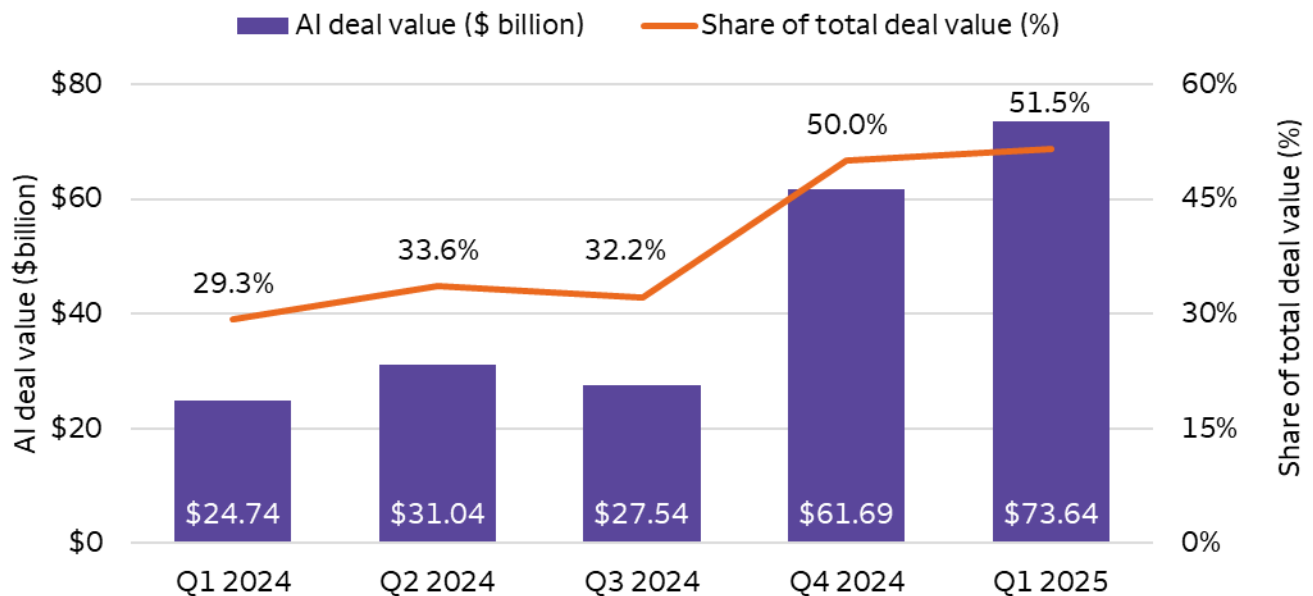
Venture capital investments in AI startups set a record for deal values in the first quarter of 2025. According to Pitchbook, the strong quarter boasted a 20% growth over the prior quarter, bringing the 12-month figure to over \$190 billion. As a result, the AI sector accounted for over half of venture capital’s total deal value for the quarter, continuing to grow its share (see chart).

The vibrant activity level is also reflected in the wide variety of AI deals. Foundational AI model and infrastructure development deals accounted for 70% of the transactional value, yet the number of deals in industry-specific applications significantly outpaced other categories. We believe this breadth reflects investors’ confidence in the prospect of AI’s growth, adoption, and potential commercialization.

The AI-related theme has been a bright spot for Venture-Capital sub-strategies since 2024. During this period, leading AI startups received multiple funding rounds and saw rapid valuation growth (see chart). This contrasted with the challenging environment in the broad venture-capital arena, where many startups struggled to complete even one funding round. The significant amount of AI-related strategic acquisitions also resulted in a continued flow of exits for the AI sector through the first quarter of 2025.

Although venture capital’s growing concentration in AI could be a potential longer-term risk, we believe AI’s resilience should cushion venture capital’s current slowdown and help support a broad future recovery in venture capital once macro clarity reemerges.

### AI continues to grow its share in venture capital



Sources: Pitchbook and Wells Fargo Investment Institute. Data as of March 31, 2025.

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
	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
	Emerging Market Equities U.S. Small Cap Equities	Developed Market Ex-U.S. Equities	U.S. Large Cap Equities U.S. Mid Cap Equities	

## Real Assets

Most Unfavorable	Unfavorable	Neutral	Favorable	Most Favorable
		Commodities Private Real Estate		

## Alternative Investments\*\*

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

Source: Wells Fargo Investment Institute, August 11, 2025.

\*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 are not guaranteed and 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. 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.

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.

### Definitions

An index is unmanaged and not available for direct investment.

**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.

**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.

**Russell 2000 Energy Index** comprises those companies included in the Russell 2000 Index that are classified as members of the energy sector.

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

**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 500 Information Technology Index** comprises those companies included in the S&P 500 that are classified as members of the GICS® information technology sector.

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