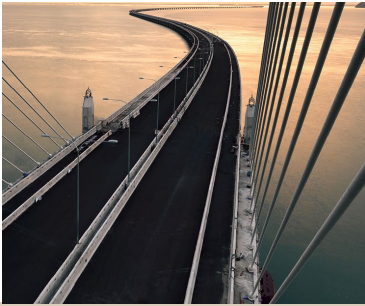


Investment Strategy



Weekly guidance from our Investment Strategy Committee

March 25, 2024

Asset Allocation Spotlight: Risk and reward2

- The equity risk premium has trended lower. We caution investors not to neglect risks by over-allocating to equities during stock market rallies.
- Reduced downside exposure matters in the long run. To completely recover the dollar amount lost corresponding to a given percentage loss requires a larger percentage gain. Diversification is a proven strategy to manage drawdown risks.

Equities: Fourth-quarter earnings beat expectations4

- Fourth-quarter earnings season is coming to a close and overall profits for the S&P 500 Index were better than expected, growing for the second consecutive quarter.
- We expect earnings growth this year, but it could be modest as the consumer weakens and rates remain elevated. In this environment, we suggest focusing on quality and prefer U.S. Large Cap over U.S. Mid Cap and Small Cap Equities.

Fixed Income: Pricing in a repricing of rate cuts5

- Market repricing of Federal Reserve (Fed) interest rate cuts for 2024 has meaningfully impacted long-term fixed-income returns year-to-date.
- We remain neutral on long-term and intermediate-term fixed income and most favorable on short-term fixed income.

Real Assets: Gold’s shining performance in 2024.....6

- Gold achieved an all-time high of \$2,182 per troy ounce, on March 11, 2024.
- Gold likely has more upside with the Fed expected to cut interest rates, and disinflation, not higher inflation, sets in.

Alternatives: Rising distress trends remain intact7

- Although traditional measures show that default rates have moderated, the inclusion of “distressed exchanges” highlights the expanding opportunity set for distressed credit strategies.
- We remain favorable on distressed credit strategies as the higher-for-longer rate environment continues to erode the liquidity buffer for many over-leveraged small and mid-sized businesses.

Current tactical guidance8

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

Asset Allocation Spotlight

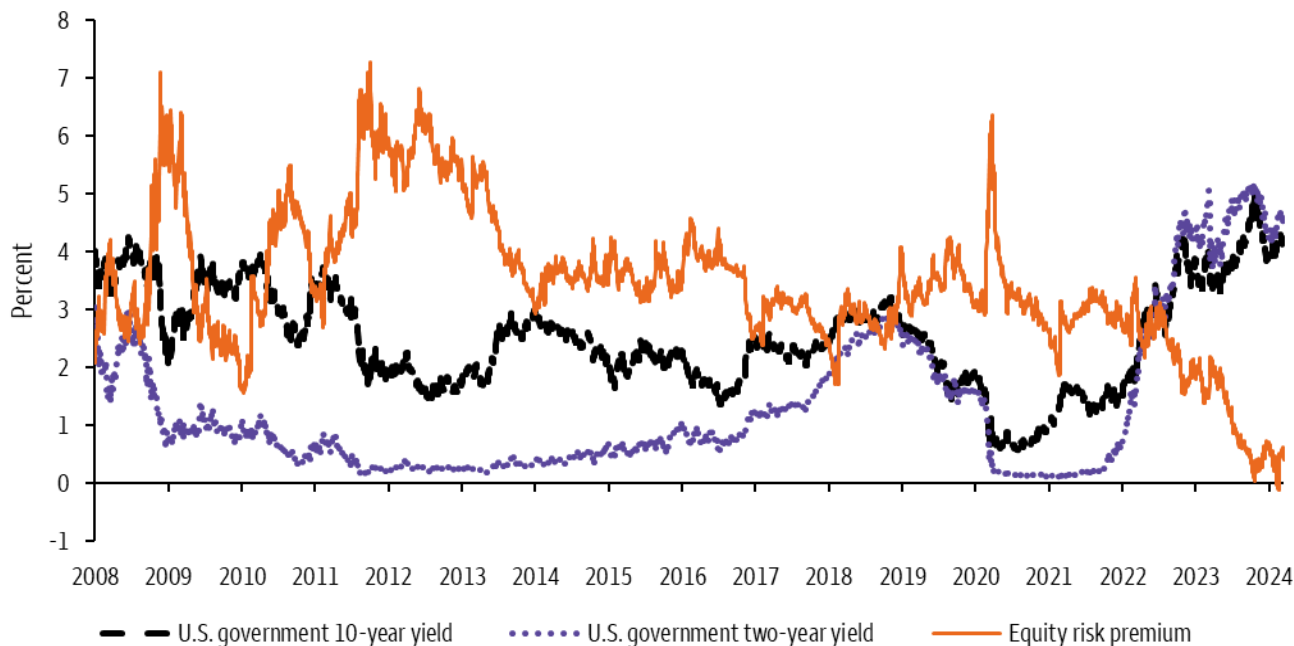
Michelle Wan, CFA
Global Investment Strategist

Risk and reward

Since the beginning of last November, the S&P 500 Index has gained over 20%¹ in total returns, challenging prudent investors to face their fear of missing out (FOMO) on such spectacular gains. Below, we examine the risk-reward dynamics and asymmetric nature of returns in today's equity and bond markets to help investors overcome FOMO and confidently stick to their investment plans.

The stock market rally is quite visible, but risks are not always apparent in the numbers. Historically investors have used the equity risk premium (ERP), a variable that incorporates investors' views on risks, as one gauge of the relative investment attractiveness between stocks and bonds. We measure the S&P 500 Index ERP as the earnings yield for that index minus the U.S. 10-year Treasury bond yield. Typically, lower ERPs have corresponded to lower expected returns over the long run. Today, ERPs are at their lowest since 2008 (see Chart 1) largely because bond yields have risen to decades' high levels.

Chart 1: U.S. bonds offer attractive yields today



Source: Bloomberg daily data as of March 13, 2024. Equity risk premium = S&P 500 Index earnings yield minus the U.S. government 10-year yield. **Past performance is no guarantee of future results.**

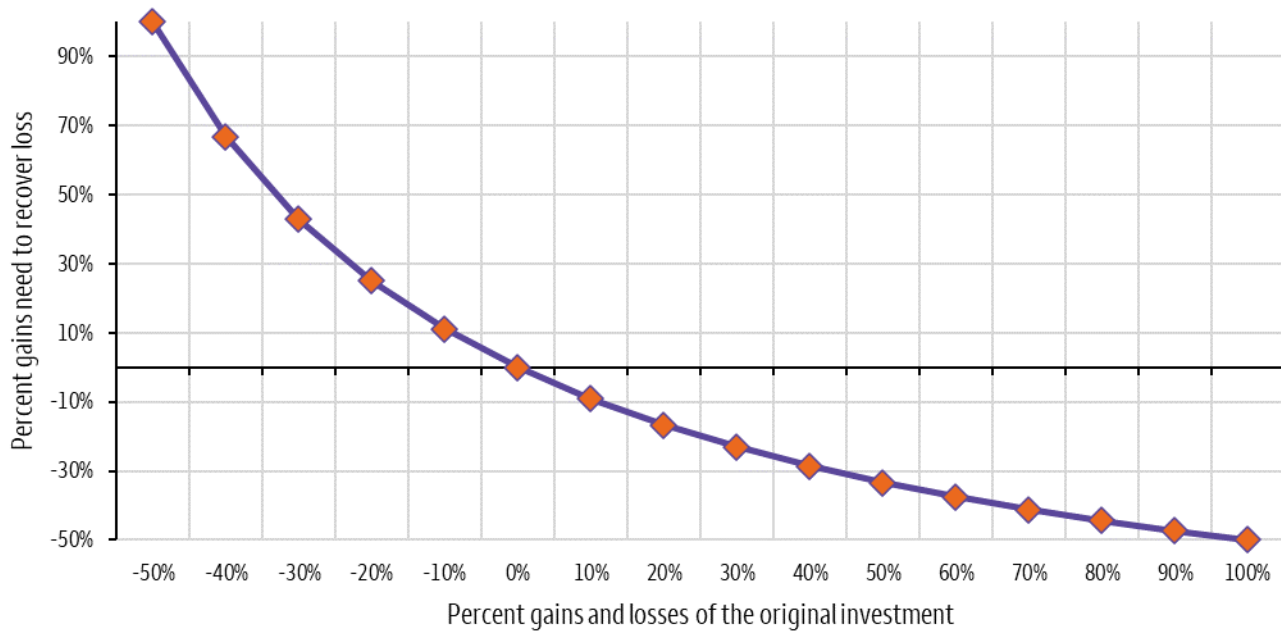
For over a decade after the great financial crisis, ERPs remained positive and mostly above bond yields, consistent with a protracted bull market period for U.S. Large Cap Equities. The post-pandemic regime of rising interest rates led to a decline in ERPs. Today's S&P 500 Index ERP near zero indicates that investors are not being paid much, if anything, for taking the greater risk of volatility in large-capitalization equities.

1. Bloomberg data as of March 14, 2024.
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From an asset allocation perspective, we would prefer that investors remain diversified and avoid deviations from their long-term strategic allocations which were built by incorporating risk premiums. But that does not imply never changing an allocation regardless of market conditions. While maintaining portfolio diversification, our tactical guidance advocates overweighting U.S. Large Cap Equities and underweighting riskier areas of the equity market, thus emphasizing the benefit of selecting quality assets under current market conditions. Following our strategic and tactical guidance², our preference is to maintain a diversified allocation while seeking opportunities to mitigate risk and add to return. Our underweight allocations to U.S. Small Cap and Emerging Market Equities have been reallocated to U.S. Large Cap Equities and to fixed-income assets in an effort to take advantage of the higher yields. In our view, the bond market remains resilient even as the U.S. Treasury has issued new debt.

A second reason for maintaining diversification is reducing downside participation. We agree with the legendary investor Warren Buffett on his investment principle: “The first rule of an investment is don’t lose (money). And the second rule of an investment is don’t forget the first rule. And that’s all the rules there are.”³ When investing in a broadly diversified allocation, some holdings will inevitably decline, while others will likely rise. It is this principle that helps to mitigate the downside risk and limit the likelihood of permanent loss of money. This is important because losses and recoveries do not occur in a linear fashion. This asymmetry is illustrated in Chart 2. Assuming an investor starts with \$1 million, a 30% decline would require a 43% return to recover the lost value. It requires more positive returns to break even. Our past research has shown that diversification is proven to be effective in managing drawdowns and reducing the time required to recover losses compared to simply investing in the S&P 500 Index.⁴

Chart 2: It takes more positive returns to break even



Source: Wells Fargo Investment Institute. A conceptual illustration to show that to recover the same dollar amount lost in a one-million-dollar portfolio, an investor would need to earn a higher percentage in gains than losses measured in percentage to break even. **For illustration only and does not predict actual gain and losses in a portfolio.**

2. A tactical allocation typically has a horizon of 6-18 months.
3. Warren Buffett’s first rule of investing, and what to do if an adviser breaks it. MarketWatch, January 4, 2024.
4. The Diversification and Performance presentation deck as of January 2024. Wells Fargo Investment Institute.
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Equities

Chris Haverland, CFA
Global Equity Strategist

Fourth-quarter earnings beat expectations

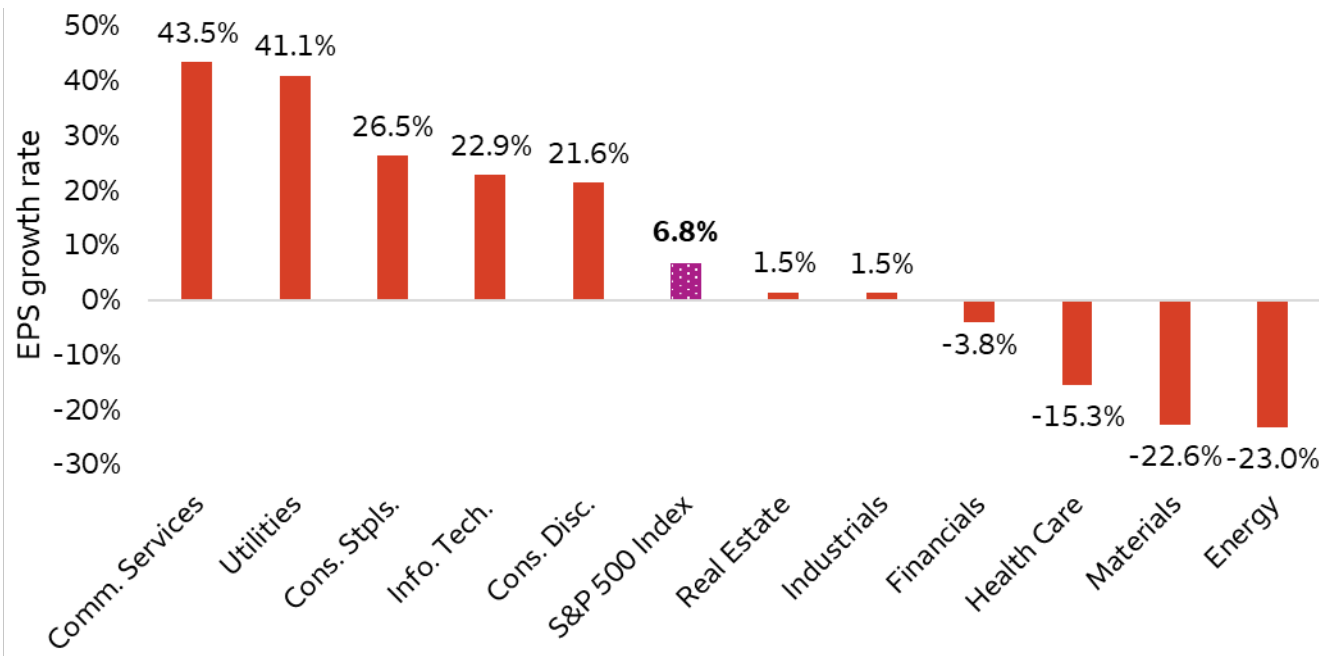
Fourth-quarter earnings season is coming to a close and overall profits for the S&P 500 Index grew by approximately 7% as of March 18, 2024. That is significantly higher than the Bloomberg consensus estimate at the start of the quarter of 1.5%. The beat rate was approximately 76%, above the long-term average. Revenue increased more than 4% in the quarter, while margins expanded compared to the fourth quarter of 2022.

Seven of 11 sectors were positive with Communication Services and Utilities leading the way. Energy sector earnings fell more than 20% on tough comparisons to the elevated oil price environment in 2022. Much of the earnings growth and margin expansion continued to come from artificial-intelligence-related sectors such as Communication Services, Consumer Discretionary, and Information Technology.

Forward guidance was stable, with 2023 Bloomberg consensus earnings estimates barely moving throughout the quarter. Company transcripts revealed mentions of recession, inflation, and shipping costs declined from the prior quarter. Meanwhile, mentions of artificial intelligence, capital expenditures, and buybacks surged in the quarter.

Our forecast for 2024 S&P 500 Index earnings of \$230 remains conservative relative to consensus. While we do expect earnings growth this year, it could be modest as the consumer weakens and rates remain elevated. In this environment, we prefer high-quality assets, favoring U.S. Large Cap over U.S. Mid Cap and Small Cap Equities.

S&P 500 Index earnings grew in the fourth quarter 2023



Sources: Bloomberg and Wells Fargo Investment Institute. EPS growth measures actual fourth-quarter 2023 earnings per share (EPS) as of March 18, 2024, versus fourth-quarter 2022 EPS. Past performance is no guarantee of future results.

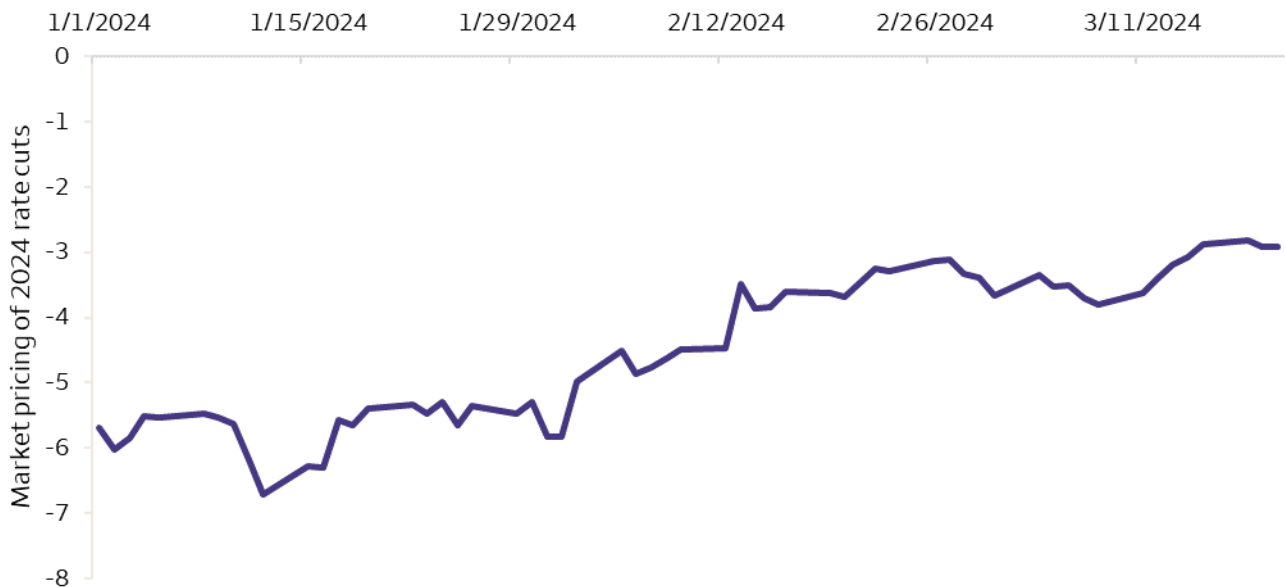
Fixed Income

Tony Miano
Investment Strategy Analyst

Pricing in a repricing of rate cuts

Market expectations of Fed interest rate cuts for 2024 have seen a drastic fall since January, moving from almost seven in early January to three in late March. The chart below demonstrates the significant shift in market expectations of rate cuts this year. In early January, we made the decision to downgrade our guidance on long-term fixed income from most favorable to neutral and at the same time we moved duration⁵ from favorable to neutral. In our January 2024 Institute Alert, we forecast three interest rates cuts for the year, as it appears the market has adjusted back closer to our expectation for rate cuts. Meanwhile, longer-term interest rates have moved higher, thus resulting in a negative impact to long-term fixed-income returns. We believe further downward repricing of Fed rate cuts is possible if inflation remains sticky or climbs higher than our expectations, but this is not our base case for now.

Market pricing of 2024 Fed rate cuts YTD



Sources: Wells Fargo Investment Institute and Bloomberg. Data as of March 19, 2024. Pricing is calculated using 30 day Fed Funds futures. YTD = year to date.

If further repricing may occur, how should fixed-income investors position portfolios? While we expect the Fed to begin cutting rates this summer, we look for the Fed to move the federal funds rate lower at a somewhat slow pace; thus, short-term interest rates are likely to stay elevated for some time. As a result, we remain most favorable short-term fixed income as we believe investors are rewarded with relatively low risk while waiting for more compelling opportunities to present themselves. We currently favor a neutral position in both intermediate- and long-term fixed income for tactical investors.

⁵ Duration measures a bond's interest rate sensitivity
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Real Assets

Mason Mendez

Investment Strategy Analyst

John LaForge

Head of Real Asset Strategy

Gold's shining performance in 2024

Gold has been a shining star over the past 12 months, outperforming the Bloomberg Commodity Index by 6.1%, as of March 18. Recently, it even hit an all-time high of \$2,182 on March 11, 2024. Moving forward, we expect gold to continue outperforming. For the remainder of 2024, specifically, gold will likely benefit from interest rate cuts from the Fed. Gold, in the past, has often been seen as an attractive investment alternative to high-quality interest-bearing assets when the Fed is cutting interest rates. Secondly, markets appear to be signaling upcoming disinflation versus higher inflation, which gold reacted positively to with a breakout to all-time highs.

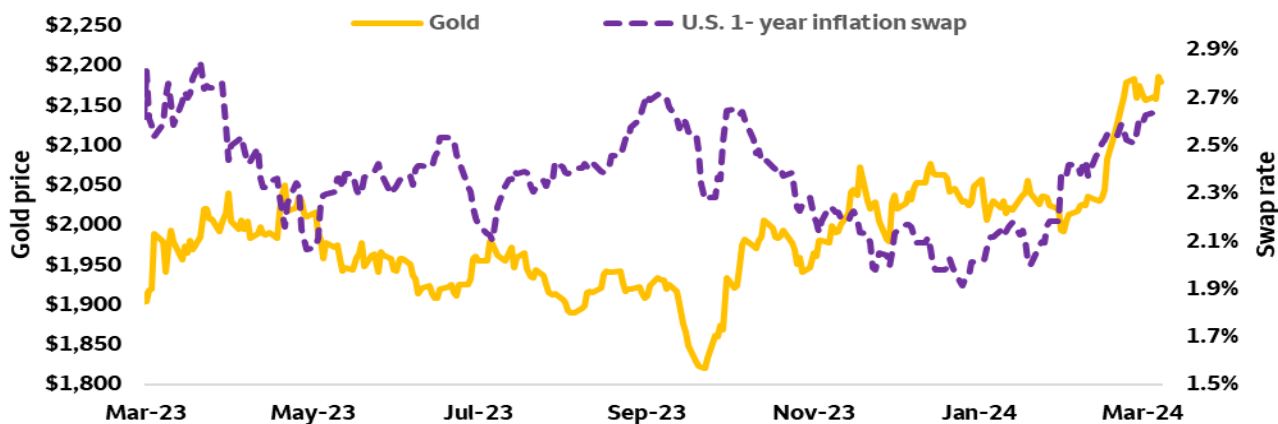
Gold's recent performance is a noticeable change from the early years of the commodity bull super-cycle,⁶ that began in March 2020. While most commodities rallied in 2021 and 2022, gold underperformed. Clearly things have changed in the past 12 months. Behind the strength has been a range-bound U.S. dollar, heightened geopolitical risks, record purchases from emerging market central banks, and near record purchases from consumers in emerging markets.

As we move through 2024 and into 2025, we are expecting most of these tailwinds to remain. We also expect new tailwinds to emerge in 2024 — such as interest rate cuts by the Fed. In past Fed rate cutting cycles, investors have often viewed gold as an attractive investment alternative. The reason is that gold is a non-interest-bearing asset. As interest rates fall, yields on competing high-quality interest-bearing assets, such as U.S. Treasuries, often fall too, making gold an attractive investment alternative.

A second potential tailwind is broad market acceptance that disinflation, not higher inflation, is the likely path forward over the next year. The chart tracks the price of gold versus one-year inflation expectations. Notice that gold broke out to new all-time highs (rising solid gold line) roughly at the same time that one-year inflation expectations stopped moving higher (flattening dashed purple line). Should one-year inflation expectations begin to fall, which is consistent with disinflation, gold prices could continue pushing to even higher highs. Notice that during the two periods of disinflation last year (falling dashed purple line), gold performed quite well.

Overall, gold has been a strong performer in 2024. We're expecting more of the same in 2024 as the Fed likely embarks on a new interest rate cutting cycle, and disinflation, not higher inflation, sets in.

Gold prices per ounce versus 1-year inflation swaps



Sources: Bloomberg, and Wells Fargo Investment Institute. Daily data is from March 14, 2023 – March 21, 2024. 1-year inflation swap is a derivative used to transfer inflation risk from one party to another through an exchange of cash flows. Past performance is no guarantee of future results.

6. Bull super-cycles are an extended period of time, historically between 15-20 years where commodity prices tend to appreciate together.

Alternatives

Mark Steffen, CFA, CAIA

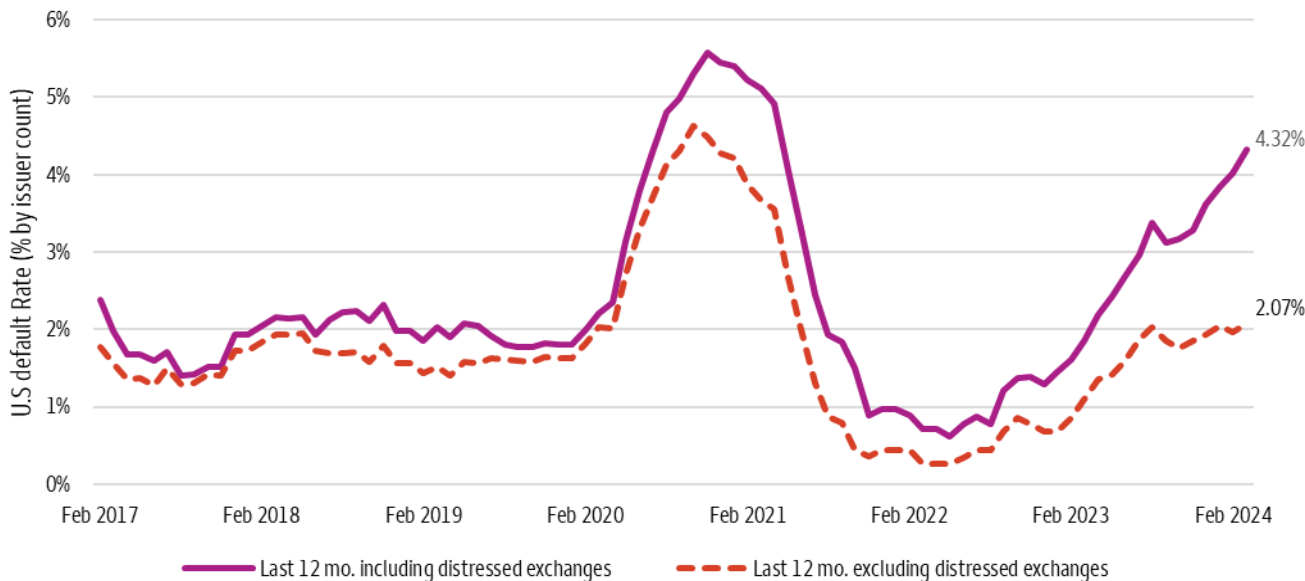
Global Alternative Investment Strategist

Rising distress trends remain intact

By traditional measures, the rising trend of companies defaulting on their debt has moderated in recent months. Yet, this easing in the conventional default rate may not accurately reflect the growing stress that continues to build under the surface. While conventual debt defaults and bankruptcies have historically accounted for the majority share of defaults, many struggling companies are instead opting to avoid the courts and preemptively restructure their liabilities. These deals, termed distressed exchanges, include a variety of transactions including buybacks, tender offers, and exchange offers where the goal is to improve the overall liquidity profile and financial health of the company. Distressed exchanges may include several types of restructurings aimed at reducing debt, extending maturities, or reducing regular debt service payments. While still considered a “default” by the rating agencies given the negative impact to certain creditors, there are significant benefits for the companies and owners. The growing popularity of these transactions stems not only in avoiding the costly Chapter 11 bankruptcy process, but from the ability of owners (often private equity firms) to potentially preserve their equity stakes throughout the restructurings.

As shown in the chart below, the default rate that includes distressed exchange transactions is more than double the conventional default rate. While conventional default rate trends suggest that stress levels may be moderating in recent quarters, traditional measures have partially masked the expanding levels of stress highlighted by distressed exchanges. We remain favorable on Distressed Credit strategies given the expanding opportunity set and the macroeconomic outlook that rates will remain higher for longer, thereby continuing to erode the liquidity buffer for many over-leveraged small to mid-sized businesses.

U.S. loan default rates by issuer count



Sources: Pitchbook, LCD and Morningstar LSTA U.S. Leveraged Loan Index. Data as of Feb 29, 2024.

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.

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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, March 25, 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

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. The **commodities** markets are considered speculative, carry substantial risks, and have experienced periods of extreme volatility. Investments in **gold** and gold-related investments tend to be more volatile than investments in traditional equity or debt securities. Such investments increase their vulnerability to international economic, monetary and political developments. 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.

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. **Communication Services** companies are vulnerable to their products and services becoming outdated because of technological advancement and the innovation of competitors. Companies in the Communication Services sector may also be affected by rapid technology changes, pricing competition, large equipment upgrades, substantial capital requirements and government regulation and approval of products and services. In addition, companies within the industry may invest heavily in research and development which is not guaranteed to lead to successful implementation of the proposed product. Risks associated with the **Consumer Discretionary** sector include, among others, apparel price deflation due to low-cost entries, high inventory levels and pressure from e-commerce players, reduction in traditional advertising dollars, increasing household debt levels that could limit consumer appetite for discretionary purchases, declining consumer acceptance of new product introductions, and geopolitical uncertainty that could affect consumer sentiment. **Consumer Staples** industries can be significantly affected by competitive pricing particularly with respect to the growth of low-cost emerging market production, government regulation, the performance of the overall economy, interest rates, and consumer confidence. The **Energy** sector may be adversely affected by changes in worldwide energy prices, exploration, production spending, government regulation, and changes in exchange rates, depletion of natural resources, and risks that arise from extreme weather conditions. Investing in the **Financial** services companies will subject an investment to adverse economic or regulatory occurrences affecting the sector. Some of the risks associated with investment in the **Health Care** sector include competition on branded products, sales erosion due to cheaper alternatives, research and development risk, government regulations and government approval of products anticipated to enter the market. 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. **Materials** industries can be significantly affected by the volatility of commodity prices, the exchange rate between foreign currency and the dollar, export/import concerns, worldwide competition, procurement and manufacturing and cost containment issues. **Real estate** investments have special risks, including possible illiquidity of the underlying properties, credit risk, interest rate fluctuations, and the impact of varied economic conditions. 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.

Investing in distressed companies is speculative and involves a high degree of risk. Distressed companies most likely will declare bankruptcy shortly, could currently be in bankruptcy proceedings or are just emerging from bankruptcy. Because of their distressed situation, these securities may be illiquid, have low trading volumes, and be subject to substantial interest rate and credit risks.

Alternative investments, such as hedge funds, private equity/private debt and private real estate funds, are speculative and involve a high degree of risk that is appropriate only for those investors who have the financial sophistication and expertise to evaluate the merits and risks of an investment in a fund and for which the fund does not represent a complete investment program. They entail significant risks that can include losses due to leveraging or other speculative investment practices, lack of liquidity, volatility of returns, restrictions on transferring interests in a fund, potential lack of diversification, absence and/or delay of information regarding valuations and pricing, complex tax structures and delays in tax reporting, less regulation and higher fees than mutual funds. Hedge fund, private equity, private debt and private real estate fund investing involves other material risks including capital loss and the loss of the entire amount invested. A fund's offering documents should be carefully reviewed prior to investing.

Hedge fund strategies, such as Equity Hedge, Event Driven, Macro and Relative Value, may expose investors to the risks associated with the use of short selling, leverage, derivatives and arbitrage methodologies. Short sales involve leverage and theoretically unlimited loss potential since the market price of securities sold short may continuously increase. The use of leverage in a portfolio varies by strategy. Leverage can significantly increase return potential but create greater risk of loss. Derivatives generally have implied leverage which can magnify volatility and may entail other risks such as market, interest rate, credit, counterparty and management risks. Arbitrage strategies expose a fund to the risk that the anticipated arbitrage opportunities will not develop as anticipated, resulting in potentially reduced returns or losses to the fund.

Definitions

An index is unmanaged and not available for direct investment.

Morningstar 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.

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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