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Investment Institute

Investment Strategy

Weekly guidance from our Investment Strategy Committee **April 13, 2026**

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- Private credit – Direct Lending fundamentals has been resilient despite areas of stress.
- While elevated redemption activity and potential artificial intelligence (AI) driven disruption in software merit attention, neither has had a material impact on credit quality to date.

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- S&P 500 Index earnings and revenues grew solidly last quarter, and we expect the first quarter earnings season to follow a similar pattern.
- Recent market pullbacks are driven by geopolitics and risk sentiment, while earnings estimates have risen and valuations compressed.

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- The U.S. government runs a large deficit and has a considerable amount of debt, which causes investor concern. However, we believe the U.S. has characteristics and options which make debt management possible.
- We do not believe the deficit warrants a widespread move away from Treasuries. We are neutral on the Treasury Securities sector, and debt sustainability factors in our current guidance as does our positive economic outlook.

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- We continue to see risks to the downside for oil prices through year-end and believe recent outperformance can provide attractive opportunities to take profits and underweight energy exposure.
- Our updated crude oil targets are $10 higher than previously but are still nearly 30% lower than current prices, reflecting our expectations for a lingering geopolitical risk premium to prevent prices from falling to pre-war levels.

Current tactical guidance 7

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Alternatives Spotlight

Mark Steffen, CFA, CAIA
Global Alternative Investment Strategist

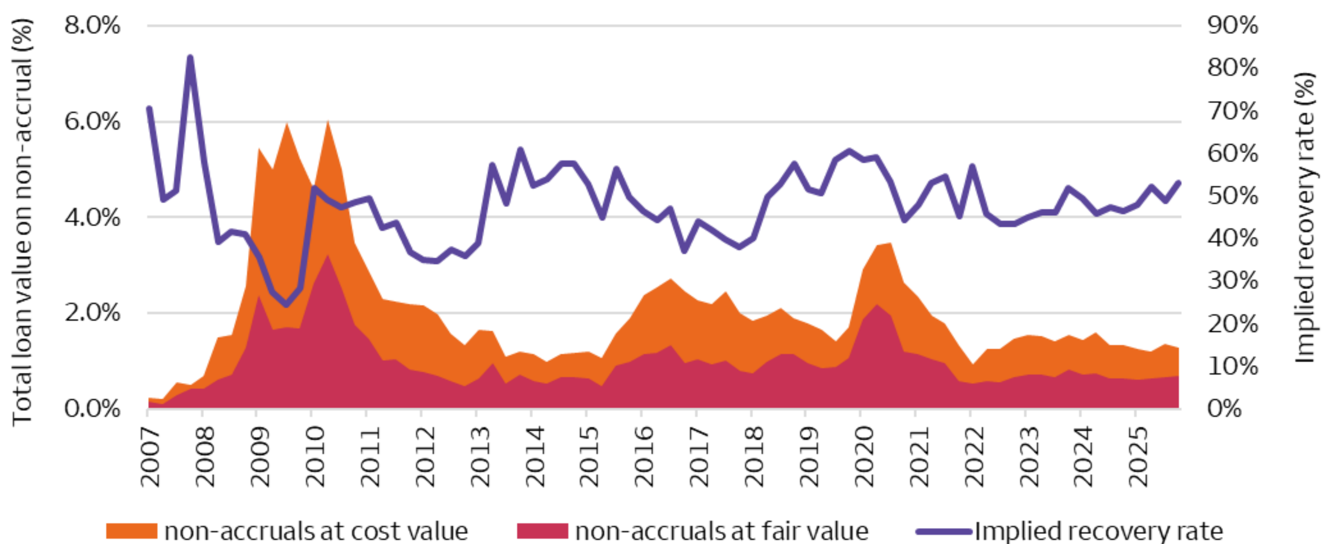
Key questions facing private credit investors

Private credit – Direct Lending plays a vital role in financing small- and mid-sized private businesses that lack access to public debt markets. These companies represent a growing segment of the economy, which has continued to drive demand for new loans.

Concerns about potential systemic risk in private credit – direct lending have remained in the public spotlight. While some stress is evident, thus far it has been more prevalent in cyclical sectors of the market.[1] At this stage, we believe the data suggests that credit issues remain contained. Non accrual loans, generally defined as those more than 90 days past due, remain within historical ranges looking back through 2007. As illustrated in the chart from data provider Cliffwater (see Chart 1), non accrual levels measured at cost and fair value are below the peaks observed in 2010 and 2020. In addition, the implied recovery rate — calculated as the fair value of non accrual loans relative to cost — has remained near 50% in recent quarters, suggesting meaningful recovery potential even in default scenarios in our view.

We believe private credit may offer attractive income potential and can play a valuable role in a diversified portfolio where appropriate. However, risks remain, these small- and mid sized borrowers may be more vulnerable should an extended geopolitical conflict lead to weaker economic conditions overall.[2]

Chart 1. Direct Lending non-accruals (defaults) and recovery rates have been modest to historical ranges



Sources: Cliffwater Direct Lending Index (CDLI), data through December 31, 2025. Cliffwater Direct Lending Index: The CDLI seeks to measure the unlevered, gross of fees performance of U.S. middle-market corporate loans, as represented by the underlying assets of Business Development Companies (BDCs), including both exchange-traded and unlisted BDCs, subject to certain eligibility requirements. The CDLI is an asset-weighted index that is calculated on a quarterly basis using financial statements and other information contained in the U.S. Securities and Exchange Commission (SEC) filings of all eligible BDCs. Cliffwater believes that the CDLI is representative of the direct lending asset class. The index was launched on September 30, 2015, and was reconstructed using publicly available data dating back to 2004. The index encompasses approximately 21,500 loans and $549 billion in assets as of December 31, 2025. An index is unmanaged and not available for direct investment.

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1. Cliffwater Direct Lending Index database: The sector breakout of percentage of loans marked less than or equal to 90%, a common threshold that delineates stressed loans as of December 31, 2025. Cyclical sectors with greater stress levels include Consumer/Retail, Food/Beverage, Media & Telecom.
2. J.P. Morgan Chase Institute:, "Small business in times of distress: Lessons learned from the pandemic," July 28, 2025.

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What will heightened redemption levels mean for long-term investors?

While many direct lending strategies may offer periodic liquidity, investors should view them as long term non-liquid investments, especially since redemption periods may be limited or closed during market stress. Portfolio managers may restrict withdrawals to avoid selling private assets (or private direct loans) at unfavorable prices. These measures are designed in an effort to protect capital and support long term investment returns. Recently, redemptions in these strategies have increased and several managers have announced restrictions on the amount of redemptions allowed.

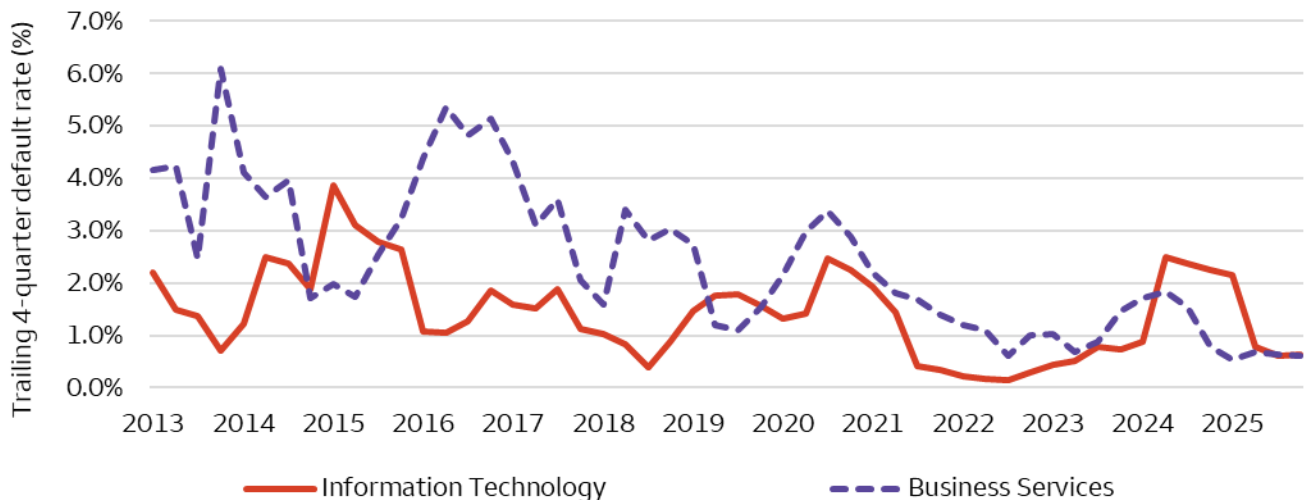
Over longer periods, sustained redemptions could gradually affect portfolio quality. This is because higher quality loans are typically repaid first, which can slowly lower the overall borrower diversity over time. In addition, if new capital is limited in a fund, fewer new loans are created and the portfolio may become increasingly concentrated in older loans, potentially increasing risk. That said, we believe current credit conditions remain manageable, and if market uncertainty becomes clearer as we expect, elevated levels of redemption activity should moderate.

Can AI disruption in the software industry significantly impact private credit?

We believe the potential impact of AI on private credit is likely to be significant. Over time, we expect AI to reshape many businesses and could make some business models seem less viable. The software industry, in particular, is often highlighted as an area where disruption could be meaningful. This matters for private credit investors because technology and software companies currently represent about 24% of the direct lending market[3], which has increased investor attention as they evaluate how AI may affect these strategies.

While AI related disruption is likely, our base case is a gradual transition rather than a sudden shift. We believe most companies, along with their lenders, will have time to adjust business models, manage costs, and realign investment priorities as new technologies are adopted. Importantly, the data we track today suggests that software borrowers remain on solid footing. The trailing four quarter default rate for the Information Technology and Business Services sectors, the two areas most closely aligned with software companies, remains low relative to historical levels at 0.60% and 0.63%, respectively (see Chart 2). This suggests that, despite uncertainty around AI, many software businesses have so far been able to generate sufficient cash flow to meet their debt obligations, supporting overall credit stability in this segment.

Chart 2. Historical private credit - direct lending default rate for Information Technology and Business Service sectors (on trailing four quarter basis)



Source: Cliffwater LLC., data through December 31, 2025. Information Technology companies are defined as those primarily engaged in hardware and software development and publishing, Information Technology services, data-driven companies, and other technology infrastructure services. Business Services companies include companies providing professional, operational, or administrative services to other businesses. Cliffwater Industry classifications are derived from BDC-reported industry data, aggregated at the index level, and are broadly consistent with standard private credit conventions.

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.

3. Cliffwater Direct Lending Index database: Industry Composition pie chart as of December 31, 2025.

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Equities

Alex Sagal
Investment Strategy Analyst

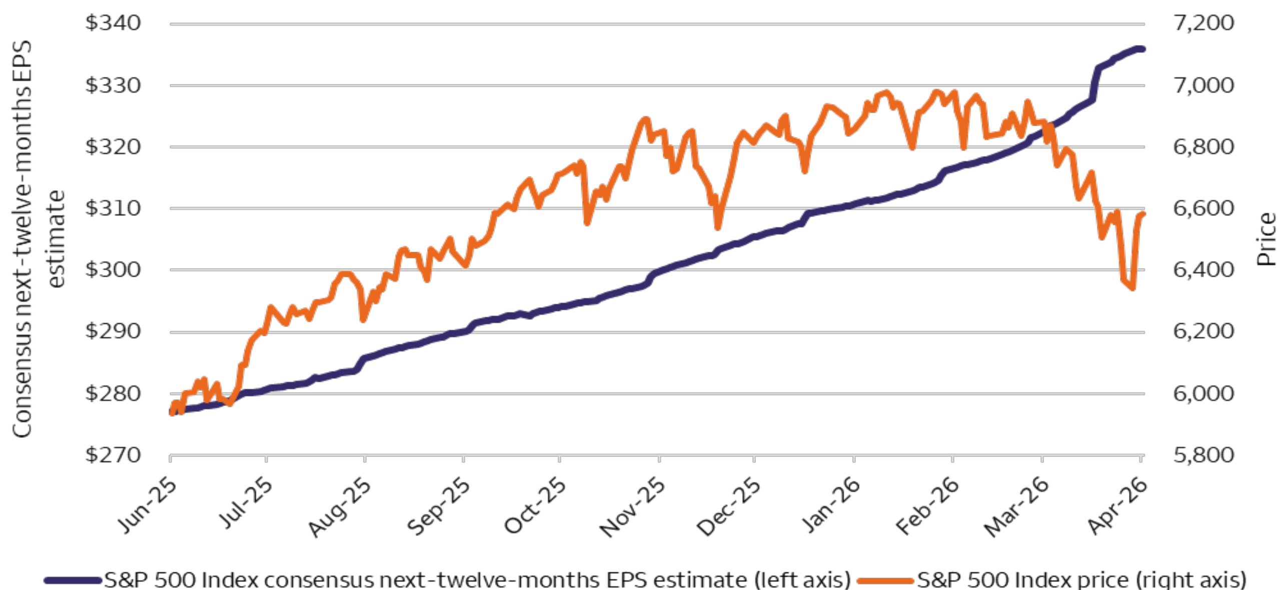
Earnings strength persists despite market volatility

The first quarter earnings season for U.S. large cap companies kicks off this week. The previous earnings season showed many areas of strength as the aggregate earnings for the S&P 500 Index grew 13.4%, with about 75% of companies beating earnings per share (EPS) estimates, a beat rate above long-term averages. Additionally, revenues grew 9.4%, beating consensus forecasts that called for 7.5% growth before the season began. The Information Technology sector was a standout, with 93% of companies beating consensus earnings estimates while sporting a 33% earnings growth rate. We expect the current earnings season to rhyme with the last one as earnings growth is expected to be 12.4% with sales growing 9.2%, similar to what played out in the fourth quarter. From a sector perspective, Energy and defense-exposed Industrials may benefit from stronger top-line dynamics, while Information Technology earnings remain supported by AI-related investment and capital expenditure (capex) follow-through.

The earnings season arrives against a backdrop where market attention has drifted away from fundamentals like earnings growth and towards geopolitical risks. The accompanying chart underscores this divergence. While the S&P 500 Index's price has pulled back from highs reached in late January, consensus next 12-month EPS estimates continued to move higher, mechanically lowering valuations meaningfully. In other words, recent volatility reflects a repricing driven by risk sentiment and geopolitics, not a deterioration in fundamentals. History suggests that over intermediate horizons, it is fundamentals rather than headlines that ultimately anchor returns.

From a positioning perspective, we favor Information Technology, Financials, Industrials (including aerospace and defense) and Utilities, using Energy, Health Care, and consumer-oriented sectors as a source of funding. Dollar-cost averaging remains a prudent approach, as it systematically deploys capital through volatility rather than attempting to time short-term swings. We believe by spreading entry points, investors can mitigate timing risk and potentially take advantage of market dislocations when price volatility outpaces changes in underlying fundamentals.

Chart 3. Earnings rise as market prices pull back



Sources: Bloomberg and Wells Fargo Investment Institute. Data as of April 2, 2026. EPS = earnings per share. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

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Fixed Income

Tony Miano, CFA, CAIA
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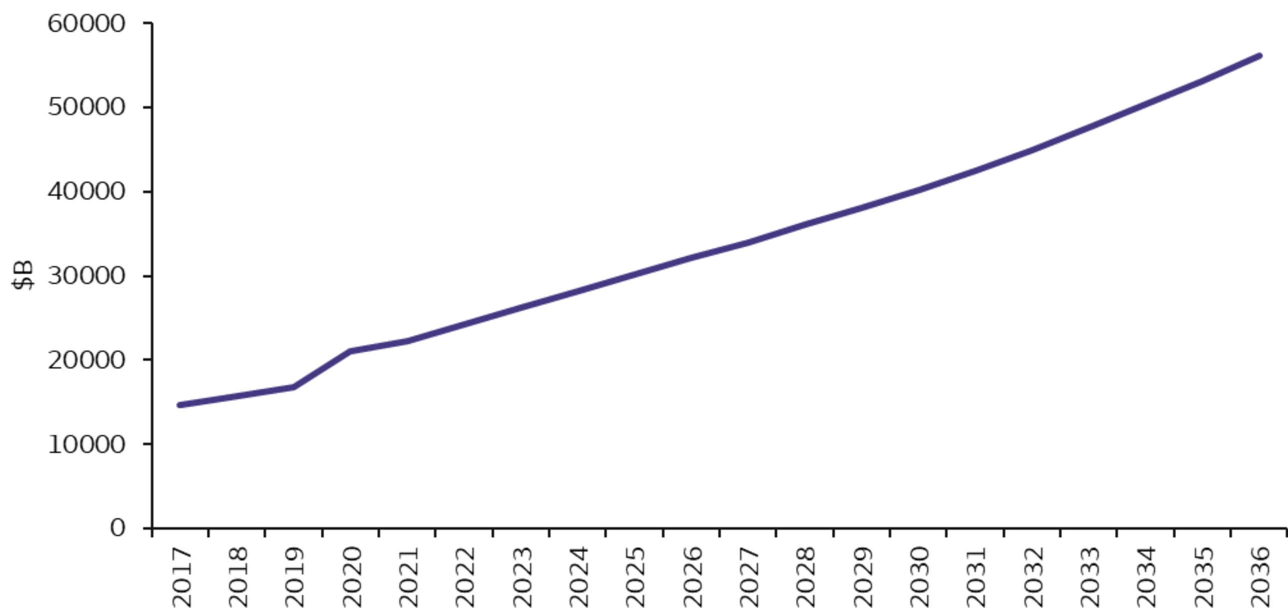
U.S. debt sustainability not a reason to abandon Treasuries

The Government Accountability Office (GAO) once again raised concerns on the U.S. government's path of debt sustainability in an April report. The U.S. currently owes more than $38 trillion (T) in debt, with early reports projecting an average of $2T a year added through 2036, numbers that can sound alarming. Our view is this debt is still manageable today and does not warrant a widespread move away from Treasuries, but it is growing fast and could become a serious problem over time. The main issue is not the size of the debt but difficulty addressing its rise in the years ahead.

Chart 4. Projected U.S. debt held by the public from 2017-2036



Sources: Congressional Budget Office (CBO), data as of February 2026. Debt held by the public includes both debt owned by U.S. investors and debt owned by foreign investors or governments. B = billions.

Government spending has consistently exceeded tax revenue in recent decades, creating large annual deficits. Much of this spending is tied to programs such as Social Security and Medicare, while changes to these programs could have a significant impact, they tend to be politically difficult to cut. In addition, as interest rates have increased from historic lows, interest costs to finance the debt are expected to take up a growing share of the federal budget. Tax increases, spending cuts, or higher economic growth are levers that can be used to address the deficit in the long term.

The U.S. is not the only country with debt concerns, but it does have somewhat unique strengths that support its ability to manage debt. Our economy is the largest in the world, and the U.S. dollar remains the main currency used globally (a feature which we do not believe will change anytime soon). These factors help keep demand for U.S. Treasury bonds strong and have supported increasing debts. However, if debt continues to grow faster than the economy, borrowing could become more expensive and limit the government's ability to respond to future crises. We reiterate that these concerns are more long-term in nature, and we maintain a neutral rating on Treasury Securities.

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Real Assets

Mason Mendez
Investment Strategy Analyst

Time to consider taking profits in energy

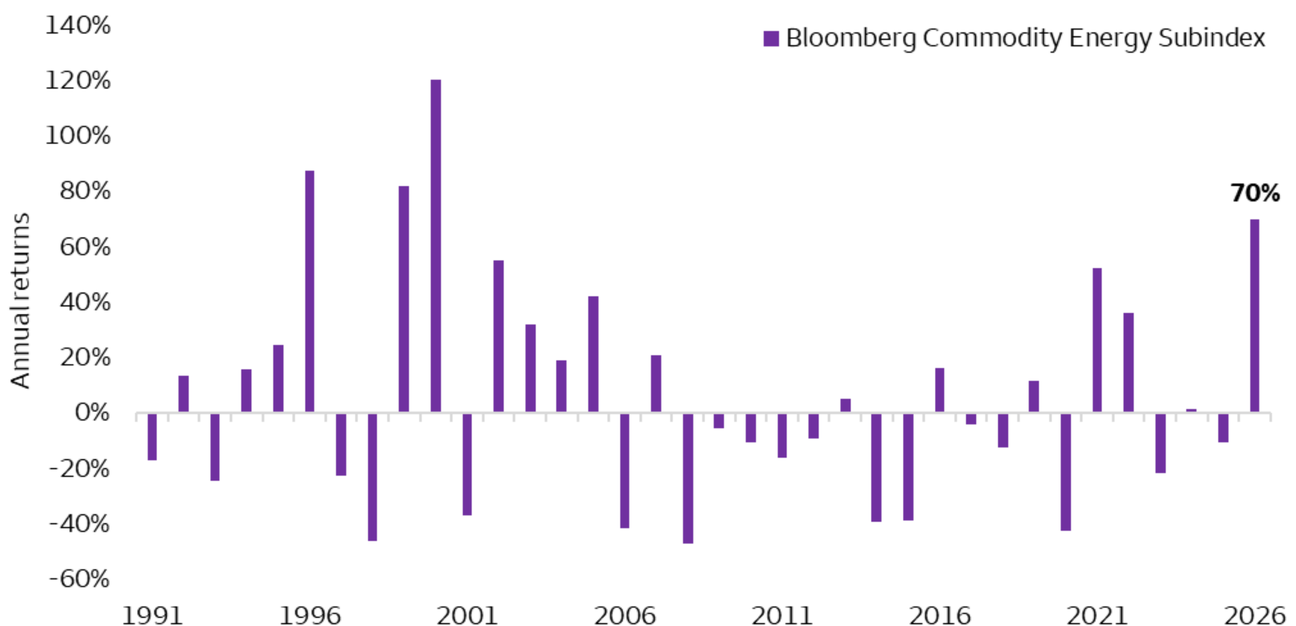
Commodities have performed exceptionally well in 2026, outperforming U.S. Large Cap Equities and the Bloomberg U.S. Aggregate Bond Index by 30% and 26%, respectively (as of December 31, 2025 through April 6, 2026). Within commodities, energy has emerged as the strongest outperformer. In fact, when compared against the sector's annual returns, today's year-to-date performance would be the strongest since 2000 (see Chart 5). We see the risk to prices as the downside through year-end rather than to the upside.

Historically, oil markets have been highly volatile, prices can swing rapidly as risks emerge or fade. While no two periods are the same, past instances, such as in the 1990s Gulf War and more recently Russia's invasion of Ukraine in 2022, have shown that high prices were fairly short lived, and they tended to decline after the risk to oil supplies had passed.

That said, we do suspect that a geopolitical risk premium will linger for the foreseeable future, especially if energy infrastructure is targeted over the coming weeks, which in effect will limit prices from falling to the lows seen last year.

Therefore, we are concurrently downgrading the commodities energy sector from neutral to unfavorable and raising our 2026 year-end crude oil targets to $70-$80 per barrel for West Texas Intermediate (WTI) and $75-$85 per barrel for Brent crude. We view Energy's recent outperformance as an opportunity to lock in profits and reallocate to Industrial Metals and Precious Metals — which we rate as favorable.

Chart 5. Energy's performance is the strongest in years



Sources: Bloomberg and Wells Fargo Investment Institute. Annual data is from 1991 – 2025. 2026's returns are based off the year-to-date return through April 6, 2026. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

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Tactical guidance*

Cash Alternatives and Fixed Income

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

Equities

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

Real Assets

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

Alternative Investments**

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

Source: Wells Fargo Investment Institute, April 13, 2026. Please see Wells Fargo Investment Institute's Asset Allocation Strategy Report for more detailed, investable ideas in each asset group.

*Tactical horizon is 6-18 months

**Alternative investments are not appropriate for all investors. They are speculative and involve a high degree of risk that is appropriate only for those investors who have the financial sophistication and expertise to evaluate the merits and risks of an investment in a fund and for which the fund does not represent a complete investment program. Please see end of report for important definitions and disclosures.

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Risk considerations

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Foreign investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. These risks are heightened in emerging markets. **Small- and mid-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large company stocks. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates. **High yield (junk) bonds** have lower credit ratings and are subject to greater risk of default and greater principal risk. Although **Treasuries** are considered free from credit risk they are subject to other types of risks. These risks include interest rate risk, which may cause the underlying value of the bond to fluctuate. The **commodities** markets are considered speculative, carry substantial risks, and have experienced periods of extreme volatility. Investing in a volatile and uncertain commodities market may cause a portfolio to rapidly increase or decrease in value which may result in greater share price volatility. Investing in **gold, silver** or other **precious metals** involves special risk considerations such as severe price fluctuations and adverse economic and regulatory developments affecting the sector or industry.

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. 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. There is increased risk investing in the **Industrials** sector. The industries within the sector can be significantly affected by general market and economic conditions, competition, technological innovation, legislation and government regulations, among other things, all of which can significantly affect a portfolio's performance. Risks associated with the **Technology** sector include increased competition from domestic and international companies, unexpected changes in demand, regulatory actions, technical problems with key products, and the departure of key members of management. Technology and Internet-related stocks, especially smaller, less-seasoned companies, tend to be more volatile than the overall market. **Utilities** are sensitive to changes in interest rates, and the securities within the sector can be volatile and may underperform in a slow economy.

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

A periodic investment plan such as dollar cost averaging does not assure a profit or protect against a loss in declining markets. Since such a strategy involves continuous investment, the investor should consider his or her ability to continue purchases through periods of low price levels.

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

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

Definitions

Bloomberg Commodity Energy Subindex tracks the performance of a diversified basket of energy commodity futures—such as crude oil, natural gas, and refined products—as part of the broader Bloomberg Commodity Index framework.

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.

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

Cliffwater Direct Lending Index (CDLI) is an asset-weighted, quarterly index measuring the unlevered, gross-of-fees performance of U.S. middle-market corporate loans. It tracks over 20,000 loans held by business development companies (BDCs) through SEC filings.

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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