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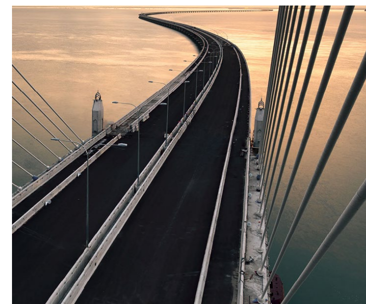
Investment Strategy



Weekly guidance from our Investment Strategy Committee **October 28, 2024**

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- As investors grow optimistic that the economy may avoid a recession, there are several encouraging trends that suggest the stage may be set for a rebound in Private Real Estate.
- We maintain our neutral guidance for Private Real Estate, yet expect to transition to a more constructive stance if financing conditions continue to ease as we expect.

Equities: Higher price targets and updated sector guidance 4

- We recently increased our year-end 2025 S&P 500 Index price target to 6200 – 6400 and our Russell Midcap Index price target to 3900 – 4100.
- We upgraded both the S&P 500 Index Real Estate and Consumer Discretionary sectors from unfavorable to neutral and downgraded the Materials sector from favorable to neutral.

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- As we approach the final months of 2024, we continue to observe how resilient U.S. credit markets remain.
- We recently upgraded the Investment-Grade (IG) Credit sector and the Corporate Securities sub-sector to favorable. We believe that strong demand for high-quality credit should potentially benefit IG corporate bonds over the next 12 months.

Real Assets: Gold extends rally to break $2,700..6

- Gold prices continued to rally to new all-time highs above $2,700 per troy ounce (as of October 18, 2024), marking the 38th time this year that gold has achieved a record high price.
- We remain favorable on Precious Metals and recently raised our 2025 year-end gold target to $2,800 – $2,900 per troy ounce.

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Alternatives Spotlight

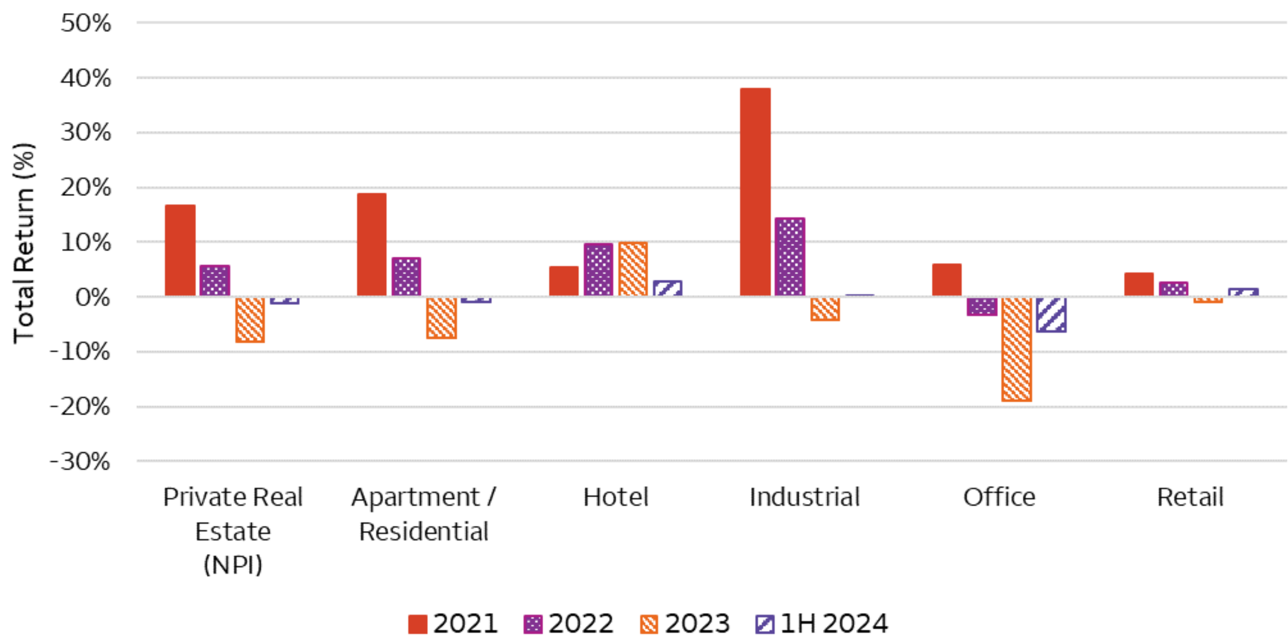
Mark Steffen, CFA, CAIA
Global Alternative Investment Strategist

Is private real estate turning a corner?

The private real estate property market stands at over $22 trillion in total value, far surpassing the public real estate market, which registers under $1.5 trillion.[1] Despite the size advantage, the performance of private real estate market tends to lag the public markets (for example, real estate investment trusts or REITs), as the private market returns are generally based on periodic property appraisals that gradually adjust to current market conditions.

The performance of public U.S. REITs has trended upward since mid-2024, rebounding over 17% since June 1, 2024 (as of October 22, 2024, MSCI US REIT Index). While private market returns are mixed year-to-date through June 30, 2024 (see Chart 1), the advance in the public markets since June may foreshadow a turn in private markets as investors begin to account for the potential impact that lower interest rates may have on future property valuations.

Chart 1: Performance of private real estate (shown on overall composite and by individual property types)



Source: National Council of Real Estate Investment Fiduciaries (NCREIF). Data as of June 30, 2024. NPI = NCREIF Property Index. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

As investors grow optimistic that the economy may avoid a recession, we see several encouraging signs mounting for qualified private real estate investors that suggest to us that the possibility of a rebound may strengthen the coming year, including:

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1. Private real estate property market data from Blackstone and the Federal Reserve. As of June 30, 2023. Represents the US commercial real estate market, excluding "Public" real estate defined as the aggregate of all public REITs that are tracked by NAREIT Total Industry Tracker, excluding Timber, Telecommunications, and Specialty sectors as of June 30, 2023.

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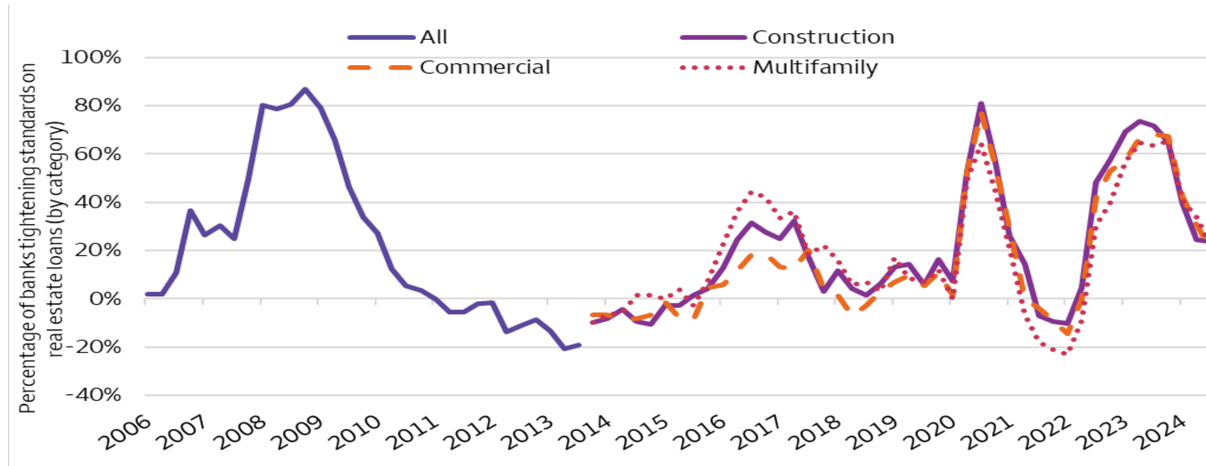
Lower interest rates: Our forecast for lower interest rates in the coming quarters supports our expectations for many borrowers and ease lending conditions overall. As interest rates rose over recent years, bank lending standards became tighter across most property types, peaking in 2023 (see Chart 2). Yet, as the Federal Reserve (Fed) pivoted and began lowering interest rates, banks began to react by easing lending standards. Today, only 20-25% of banks are tightening, down from approximately 60-70% a year earlier (as of September 30, 2024). In addition to easing lending standards, lower interest rates may act as a catalyst to spur a broad economic recovery as 2025 progresses which should contribute to greater demand for real estate in general.

Chart 2: Bank lending standards easing



Source: Federal Reserve Senior Loan Officer Survey and Wells Fargo Investment Institute, Data as of September 30, 2024.

Income generation: While the cash generated from properties fell dramatically (and subsequently rebounded) during the pandemic, it has since moderated and stabilized as measured by the net operating income growth rate, the income growth estimate for 2024 is 3.3%.[2] While not back to pre-pandemic averages, we believe recent steady (and positive) growth should lead to improved pricing if current trends continue.

Long-term demand trends: The Office property type continues to face significant headwinds as companies reassess their future office needs. Yet, longer-term demand drivers such a lack of housing, an aging population, the shift to online retail, and the influence of artificial-intelligence-related applications have continued to drive demand across many property types, including Multi-family, Industrials, Data Centers, and Senior Housing properties. The robust demand may contribute to higher property prices after markets digest any short-term supply/demand imbalances that exist.

Though these dynamics are encouraging for real estate investors, the re-emergence of higher inflation levels may be a risk, which in turn could limit the Fed's ability to further reduce interest rates over the coming quarters. If interest rates remain higher than investors expect, it may likely reverse any optimism derived from the expectations of lower borrowing costs.

While we remain neutral on Private Real Estate overall, we may be able to transition towards a more constructive stance on Private Real Estate in the coming quarters if the risks continue to recede.

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

2. 2024 estimate for net operating income growth rate is provided by Green Street.

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Equities

Austin Pickle, CFA
Investment Strategy Analyst

Edward Lee
Investment Strategy Analyst

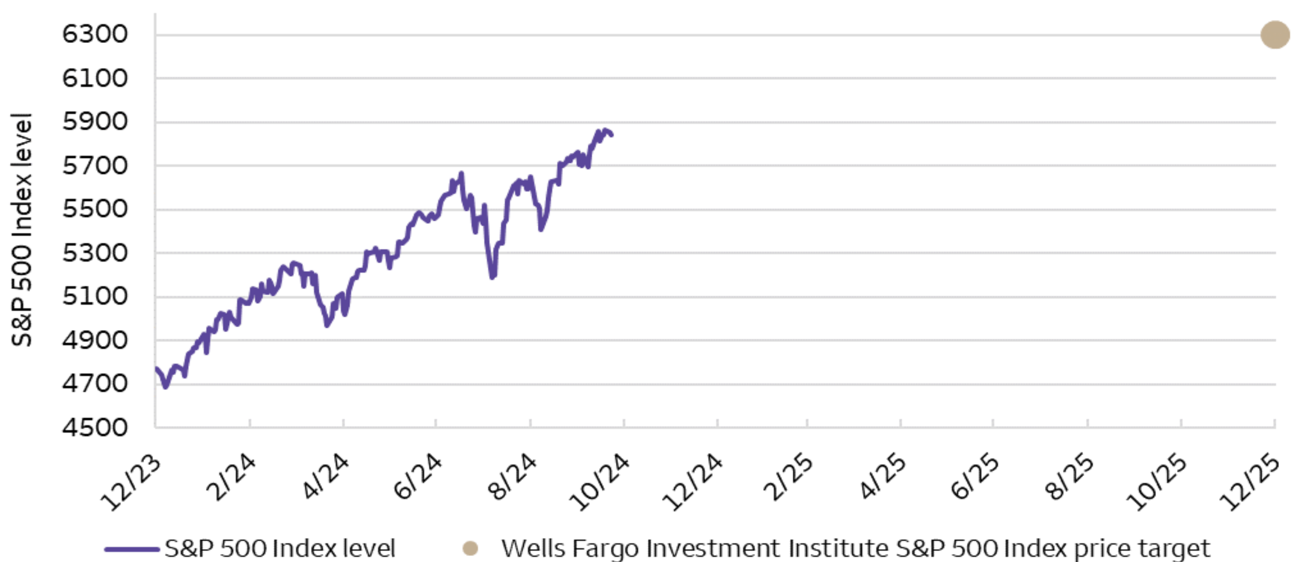
Higher price targets and updated sector guidance[3]

On October 21, we raised our 2025 S&P 500 Index price target from 5900 – 6100 to 6200 – 6400 and our Russell Midcap Index target from 3700 – 3900 to 3900 – 4100. Additionally, we upgraded the S&P 500 Index Real Estate and Consumer Discretionary sectors from unfavorable to neutral while simultaneously downgrading the Materials sector from favorable to neutral. We summarize the rationale below.

Our U.S. economic growth and earnings targets are unchanged, and we continue to expect a notable S&P 500 Index earnings-per-share (EPS) increase from our year-end 2024 forecast of $245 to $270 in 2025. Our S&P 500 Index EPS target remains unchanged, but our constructive outlook on investor sentiment and the economy as well as a post-election reduction in policy uncertainties make the current price-to-earnings (P/E) market multiple a reasonable expectation for year-end 2025, in our view. When we apply the 2025 EPS target of $270 to the P/E multiple for the S&P 500 Index, we arrive at our new target range of 6200 – 6400. A similar exercise gets us 3900 – 4100 for the Russell Midcap Index.

We also took the opportunity to shift some sector rankings. We upgraded the S&P 500 Real Estate and Consumer Discretionary sectors from unfavorable to neutral and downgraded the S&P 500 Materials sector from favorable to neutral. We expect the Fed's easing cycle to benefit the credit-hungry Real Estate sector, while our anticipated economic reacceleration and a re-energized consumer should boost Consumer Discretionary stocks. Meanwhile, factors in our sector-ranking framework have deteriorated for Materials, and our shift to forecasting additional U.S. dollar strength should be a considerable headwind for the sector most exposed to foreign sales.

Our new 2025 S&P 500 Index target shows continued stock-market gains



Sources: Bloomberg and Wells Fargo Investment Institute. Daily data from December 29, 2023 – October 22, 2024. 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. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

3. For more detail, see "Institute Alert: Revising guidance to lengthen fixed-income maturities," Wells Fargo Investment Institute, October 21, 2024.

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Fixed Income

Luis Alvarado
Global Fixed Income Strategist

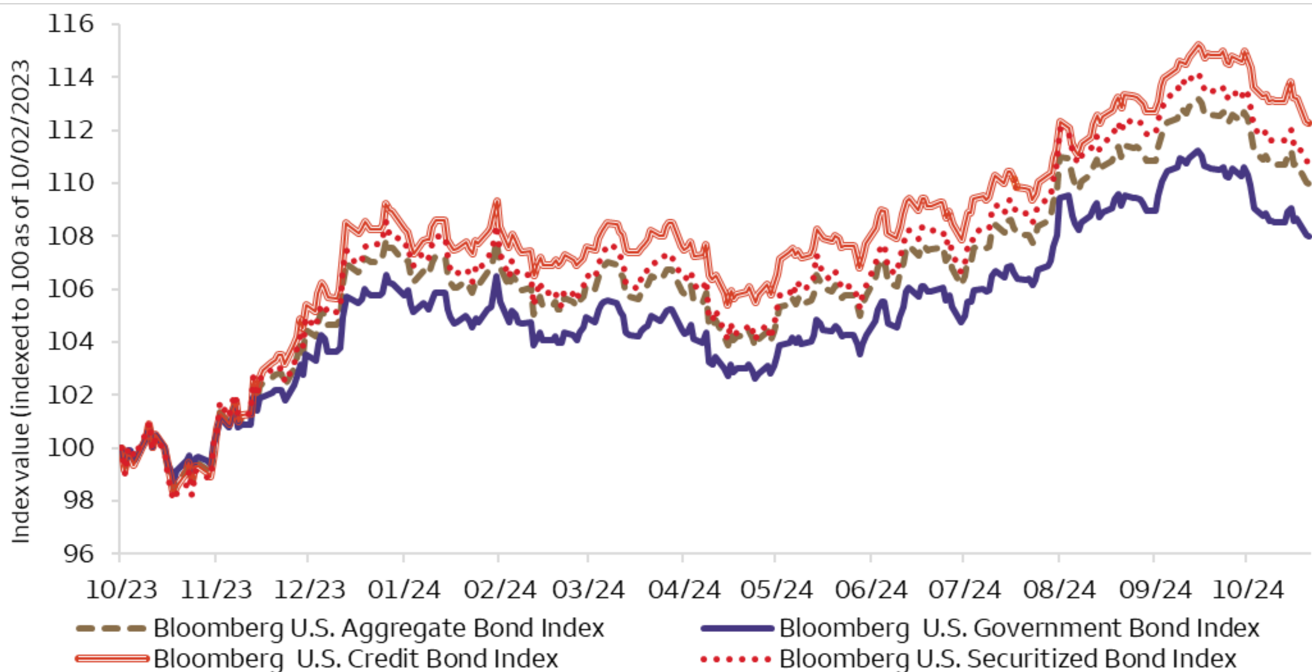
Quality corporate bonds should benefit from yield hunt

As we approach the final months of 2024, we continue to observe how resilient U.S. credit markets have been. With few major signs of stress in the near term, U.S credit markets have outperformed both the aggregate bond market and the U.S. government and securitized sectors, as many investors continue to seek the higher yields available in credit markets without much hesitation over credit risks. So far this year, IG corporate bond issuance has already surpassed $1.3 trillion, with an expectation for issuance to finish 2024 at around $1.5 trillion.[4] We see few signs of a slowdown in issuance from these levels in 2025.

On October 21, we upgraded the IG Credit sector and Corporate Securities sub-sector to favorable from neutral.[5] Although IG corporate credit spreads have compressed and are hovering below long-term averages, we believe that they will most likely remain near current levels for a while, or compress further toward new cycle lows. The reason behind this is that there is still plenty of demand available for IG corporate bonds, especially as we expect capital to rotate out of ultra-short investments like money market funds (cash alternatives) and U.S. Treasury bills in search for attractive yield.

In addition, the duration (a measure of interest rate sensitivity) profile of IG corporates aligns well with our current view of extending duration. Given the relative steepness of the IG corporate yield curve relative to the U.S. Treasury yield curve today, we see incremental value in intermediate-term corporate bonds.

Credit has outperformed other major fixed-income sectors over the past year



Sources: Bloomberg and Wells Fargo Investment Institute, as of October 22, 2024. Daily data from October 2, 2023 to October 22, 2024. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results**.

4. SIFMA, U.S. Corporate Bonds Statistics as of October 18, 2024.
5. For more detail, see "Institute Alert: Revising guidance to lengthen fixed-income maturities," Wells Fargo Investment Institute, October 21, 2024.

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Real Assets

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Head of Real Asset Strategy

Gold extends rally to break $2,700

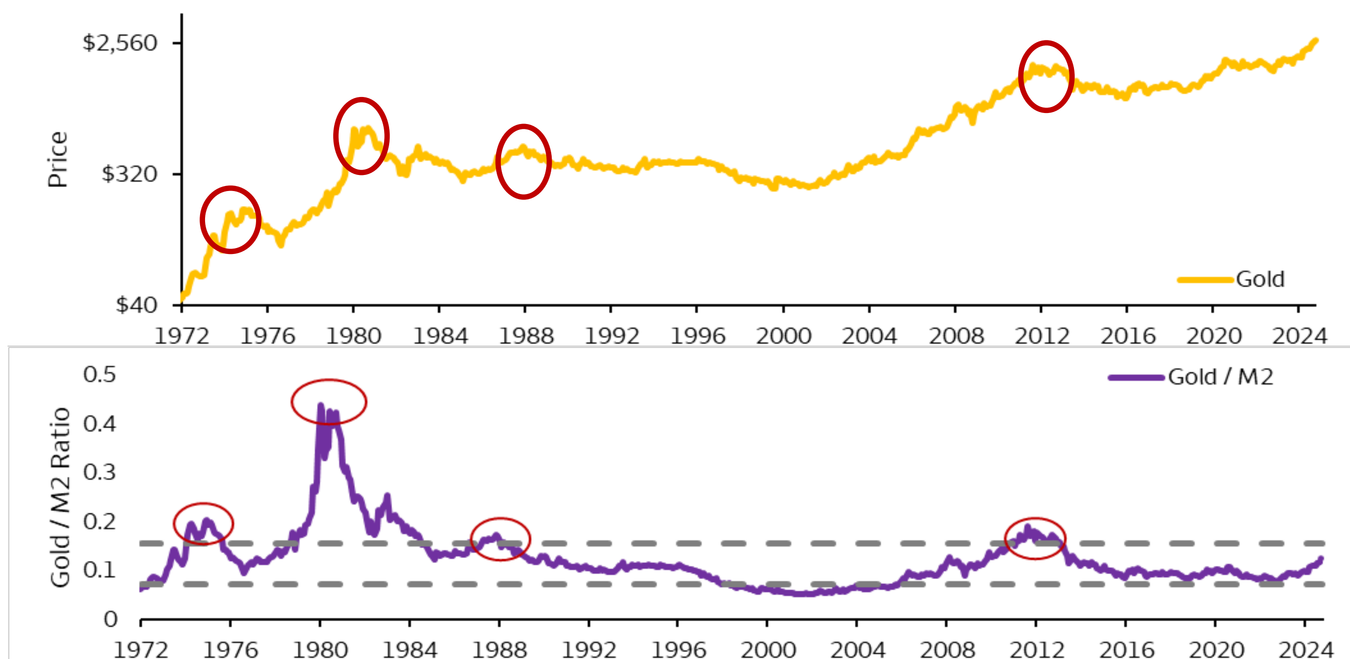
Gold continued to show strength as prices climbed on October 18 above $2,700 per troy ounce, up 32% year-to-date. Impressively, this marks the 38th time this year that gold prices have achieved new all-time highs, and we suspect that they will continue to show strength in 2025, powered by strong demand and monetary easing cycles by global central banks. Therefore, we recently raised our 2025 year-end gold target range from $2,500 – $2,600 per troy ounce to $2,800 – $2,900[6].

Given gold's record performance this year, investors have voiced concerns that the rally could lose steam. While certainly possible, we believe that gold still has more upside due to increasing global liquidity, falling interest rates, compounding global debts, and strong demand from both consumers and emerging-market central banks.

One way to see the historical impact of increasingly global liquidity, or money supplies, on the price of gold denoted, is illustrated in the chart below. The line in the top panel is the price of gold, while the line in the bottom panel shows the price of gold divided by U.S. M2 money supply. Historically, the ratio shown in the bottom panel has been effective at identifying periods of stretched gold prices in the top panel, such as in 1974, 1980, 1987, and 2011.

Today, the ratio is rising, but it does not appear stretched as M2 money growth has been rising, too. With global liquidity continuing to rise as we approach 2025, we suspect that the price of gold would have to rise significantly higher from here to appear stretched. We remain favorable on the Precious Metals sector and expect gold prices to reach $2,800 – $2,900 by year-end 2025.

Gold valuation doesn't yet appear stretched



Sources: Bloomberg and Wells Fargo Investment Institute. Monthly data is from January 1972 – October 2024. Dashed lines represent the top 20% and bottom 20% of historical readings since 1970. For September and October 2024, we assumed zero M2 growth and overlayed the respective gold prices to give a conservate estimate of the Gold/M2 ratio. **Past performance is no guarantee of future results**.

6. For more detail, see "Institute Alert: Revising guidance to lengthen fixed-income maturities," Wells Fargo Investment Institute, October 21, 2024.

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Tactical guidance*

Cash Alternatives and Fixed Income

Most Unfavorable	Unfavorable	Neutral	Favorable	Most Favorable
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. Long Term Taxable Fixed Income	U.S. Intermediate Term Taxable Fixed Income	

Equities

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

Source: Wells Fargo Investment Institute, October 28, 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.

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Risk considerations

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.

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. Other risks associated with investing in listed **REITs** include the use of leverage, unexpected reductions in common dividends, increases in property taxes, and the impact to listed REITs from new property development

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. 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.

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.

Definitions

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

Bloomberg US Government Bond Index includes U.S.-dollar-denominated, fixed-rate, nominal U.S. Treasury securities and U.S. agency debentures.

Bloomberg US Credit Index includes investment-grade, U.S.-dollar- denominated, fixed-rate, taxable corporate- and government-related bonds.

Bloomberg US Securitized Index includes agency mortgage backed pass-through, investment-grade market of US Agency and US Non-Agency conduit and fusion CMBS deals and asset-backed securities.

MSCI US REIT Index is a free float-adjusted market capitalization weighted index that is comprised of equity Real Estate Investment Trusts (REITs).

NCREIF Property Index (NPI): The National Council of Real Estate Investment Fiduciaries (NCREIF) operates a quarterly, unleveraged composite total return for private commercial real estate properties held for investment purposes only. All properties in the NPI have been acquired, at least in part, on behalf of tax-exempt institutional investors and held in a fiduciary environment. All properties are operating properties, defined as at least 60% leased. The index is unmanaged and not available for direct investment. Apartment / Residential uses the NPI apartment sector for 2021 - Q1 2024 data, and the Residential sector for the Q2 2024 data.

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

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

Russell 3000® Index measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market.

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the US stock market.

An index is unmanaged and not available for direct investment.

Investment Grade bonds - A rating that indicates that a municipal or corporate bond has a relatively low risk of default. Bond rating firms, such as Standard & Poor's, use different designations consisting of upper- and lower-case letters 'A' and 'B' to identify a bond's credit quality rating. 'AAA' and 'AA' (high credit quality) and 'A' and 'BBB' (medium credit quality) are considered investment grade. Credit ratings for bonds below these designations ('BB', 'B', 'CCC', etc.) are considered low credit quality, and are commonly referred to as "junk bonds".

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