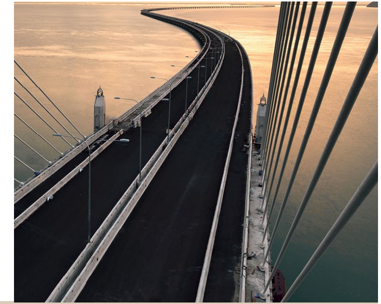
WELLS FARGO
Investment Institute



Investment Strategy

Weekly guidance from our Investment Strategy Committee **November 25, 2024**

Real Assets Spotlight: The green energy transition — Progress and headwinds 2

- In 2023, fossil fuels remained the dominant source of energy in the U.S.
- The more recent trends, however, continue to show renewables use gaining consumption share over fossil fuels.

Equities: Earnings grew for the fifth consecutive quarter 4

- Over 90% of companies in the S&P 500 have reported third-quarter earnings with a little over 75% beating estimates.
- Earnings growth is expected to accelerate next year with Bloomberg consensus projecting double-digit earnings growth for all four quarters in 2025.

Fixed Income: Narrowing corporate credit spreads — No end in sight 5

- A resilient economy, attractive yields, and declining credit spreads have allowed corporate bonds to display positive returns year to date[1], despite the volatility in interest rates.
- We expect spreads to tighten further in the near term, further supporting our favorable guidance in in the U.S investment-grade Credit sector and Corporate Securities sub-sector.

Alternatives: Hedge fund assets reached a new high 6

- Driven by a 7.4% return so far this year through October 31, hedge fund assets reached a new record of $4.5 trillion in October.
- We favor Equity Hedge – Directional, Event Driven – Distressed Credit, and Relative Value – Long/Short Credit strategies, which we believe will benefit from future economic and market recovery.

Current tactical guidance 7

1. As of November 19, 2024.

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

© 2024 Wells Fargo Investment Institute. All rights reserved.

Real Assets Spotlight

John LaForge
Head of Real Asset Strategy

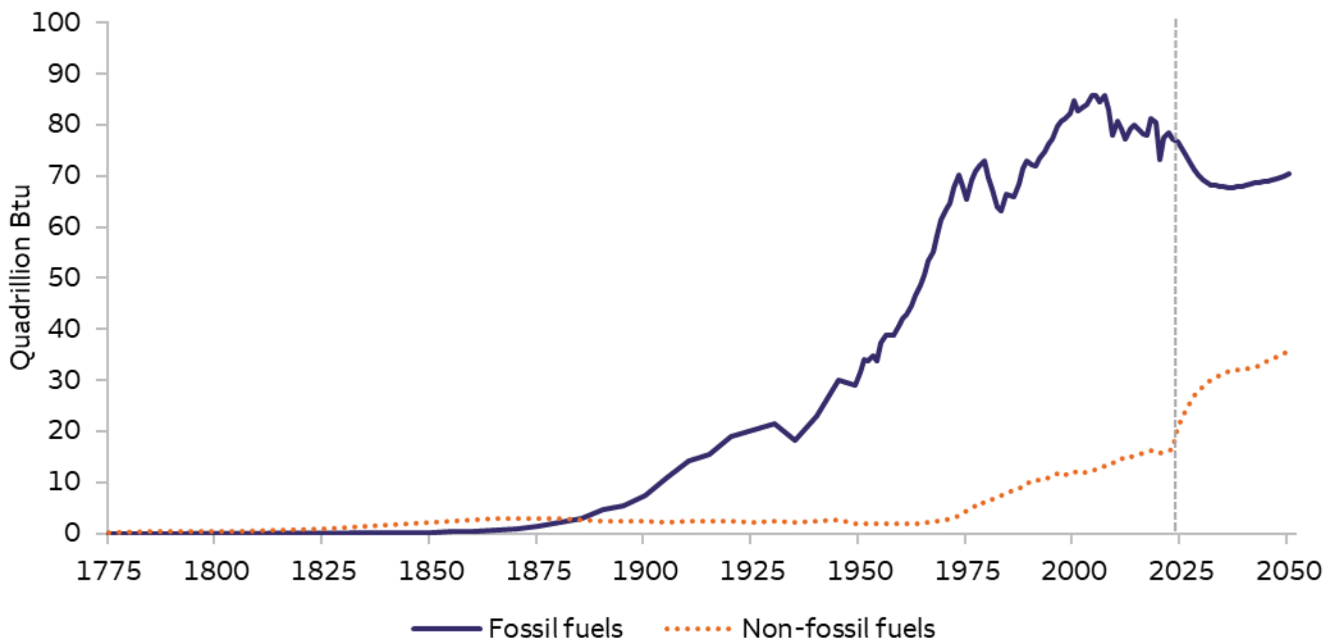
Mason Mendez
Investment Strategy Analyst

The green energy transition — Progress and headwinds

It's that time of the year again when we like to give an update on the green energy transition. We could discuss it more throughout the year, but the transition is a process that takes years — decades even. Progress is being made, but it is often easiest to see by taking a step back once a year and seeing the big picture, such as in Chart 1 below. Chart 1 shows U.S. energy consumption separated between fossil fuels (oil, natural gas, coal) and non-fossil fuels (wind, solar, nuclear, etc.). It's the longer-term, multi-decade trends that we believe matter most to the green future, and they continue to show progress. For added perspective, we included in Chart 1 trend projections from the U.S. Energy Information Administration (EIA) through the year 2050.

Each year, we receive numerous questions on the green transition. The two most common ones, with our answers, we'll share today. The first is, why has the increase in renewables use (non-fossil fuel) not led to a steeper drop in fossil fuel use? There are a few parts to our answer. The first one is that energy sources are not created equal. Fossil fuels are dense, easy to move, and can be squeezed into small spaces. Renewables, on the other hand, are less dense and at times storage-challenged, which can make swapping them for fossil fuels tough. The main reason the reduction in fossil fuel use seems slow at times, though, is that the U.S. economy continues to grow, and growth requires energy. Most of this energy today is generated using fossil fuels, which provides a compelling incentive to continue to rely on them. To unseat fossil fuels as the main source of U.S. energy, non-fossil fuels (renewables) effectively need to do "double-time."

Chart 1. U.S. fossil fuel and non-fossil fuel consumption (with projections to 2050)



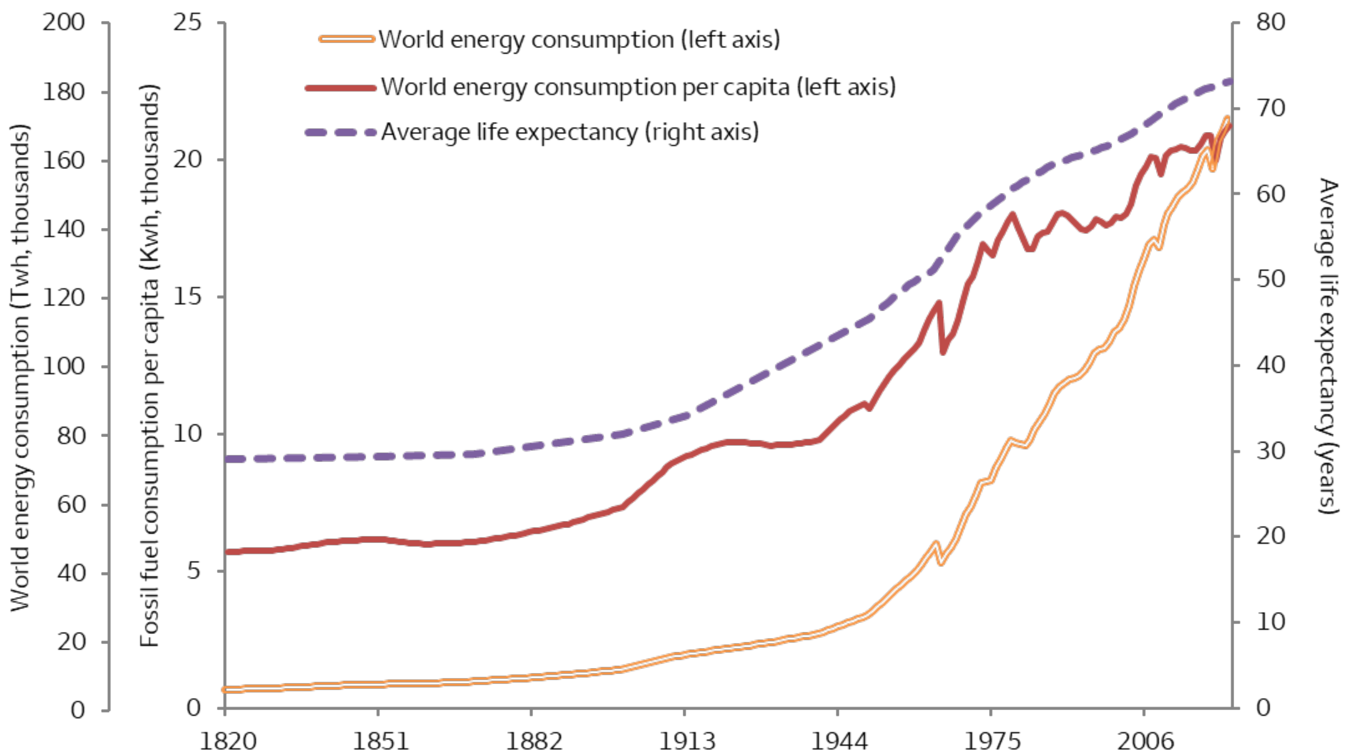
Sources: U.S. Energy Information Administration (EIA), Wells Fargo Investment Institute. Annual data is from 1775 – 2050. Btu = British thermal unit. EIA forecasts are from the 2023 Annual Energy Outlook. Fossil fuels include coal, natural gas, and petroleum and other liquids. Non-fossil includes nuclear and renewables.

© 2024 Wells Fargo Investment Institute. All rights reserved.

The second most common question we receive on the green transition is, "Why don't we talk more about humans using less energy as a solution to climate change?" To be clear, we do hear this solution discussed. That said, the evidence is clear that mankind continues to increase its overall energy use, even as climate change debates have intensified. The likely reason behind this can be viewed in Chart 2 below. The split orange line represents total world energy consumption, the red solid line represents world energy consumption broken down on a per-person basis, and the purple dashed line represents the world's average life expectancy. The three lines rising together suggest that life becomes easier to live the more energy is consumed, which ultimately has led to longer overall lives. Asking mankind to reverse this process is a hard sell — and not likely to gain traction.

The bottom line is that the transition to a greener energy future is making progress. It's a process, though, that can take years — decades even — as it is not only fighting an entrenched opponent in fossil fuels, but human progress too.

Chart 2. World energy consumption versus average life expectancy



Sources: Our World in Data, BP Statistical Review of World Energy, The World Bank, and Wells Fargo Investment Institute. Annual data from 1820 through 2023. Twh = terawatt hour. Kwh = kilowatt-hour. Per-capita data is calculated by taking consumption data divided by the global population.

© 2024 Wells Fargo Investment Institute. All rights reserved.

Equities

Chris Haverland, CFA
Global Equity Strategist

Edward Lee
Investment Strategy Analyst

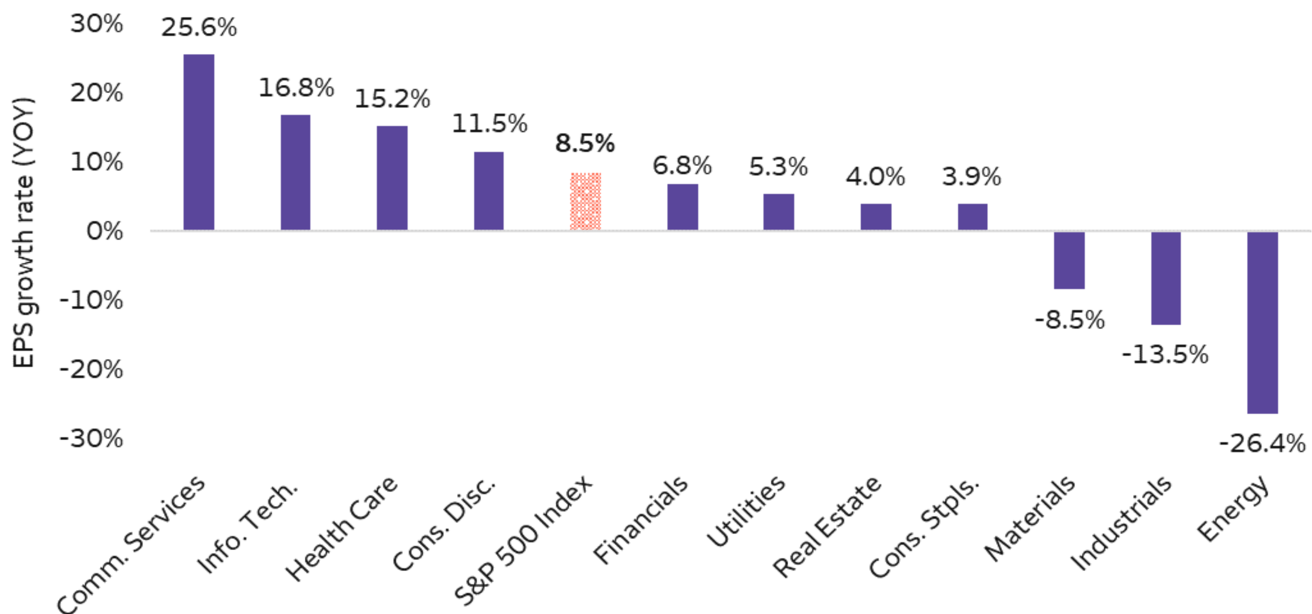
Earnings grew for the fifth consecutive quarter

Third-quarter earnings season is coming to a close, and profits for the S&P 500 Index are on track to increase over 8% year-over year, in line with the July 1 estimate. The beat rate is around 75% so far (down from 80% last quarter), and revenue grew by almost 6%. If the Energy sector was excluded, the earnings growth rate would be closer to 11%.

Eight of 11 sectors posted positive earnings growth with the Communications Services and Information Technology sectors leading the way. The Energy sector was the biggest laggard, as earnings plunged nearly 26% year-over-year. Falling oil prices drove the decline. Much of the earnings growth in the Communications Services and Information Technology sectors can be attributed to a select few companies. We expect these sectors to maintain leadership in 2025, but S&P 500 Index earnings growth should be more balanced.

Forward guidance was mixed with mentions of tariffs and weak demand rising. However, Bloomberg consensus is projecting double-digit earnings growth for all four quarters in 2025. If this were to come to pass, it would equate to the highest profit margin ever recorded for the S&P 500 Index. We believe the election outcome likely will translate into a series of policy changes that include some pro-growth policies (such as deregulation and extension of tax cuts due to expire at year-end 2025) but also others that are likely to raise input costs (such as tariffs and immigration restrictions). We expect that these policies will be a net positive for earnings and should bolster the support we expect from an economic acceleration. In this environment, we continue to prefer U.S. over international equities and favor U.S. Large Caps (favorable) over U.S. Mid Caps and Small Caps (both neutral).

S&P 500 Index earnings continue to grow this quarter (YOY)



Sources: Bloomberg and Wells Fargo Investment Institute. EPS = earnings per share. YOY = year over year. EPS growth rate measures the year-over-year earnings growth of the S&P 500 Index and each of its sectors, as of November 15, 2024. Orange bar represents S&P 500 Index. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

© 2024 Wells Fargo Investment Institute. All rights reserved.

Fixed Income

Luis Alvarado
Global Fixed Income Strategist

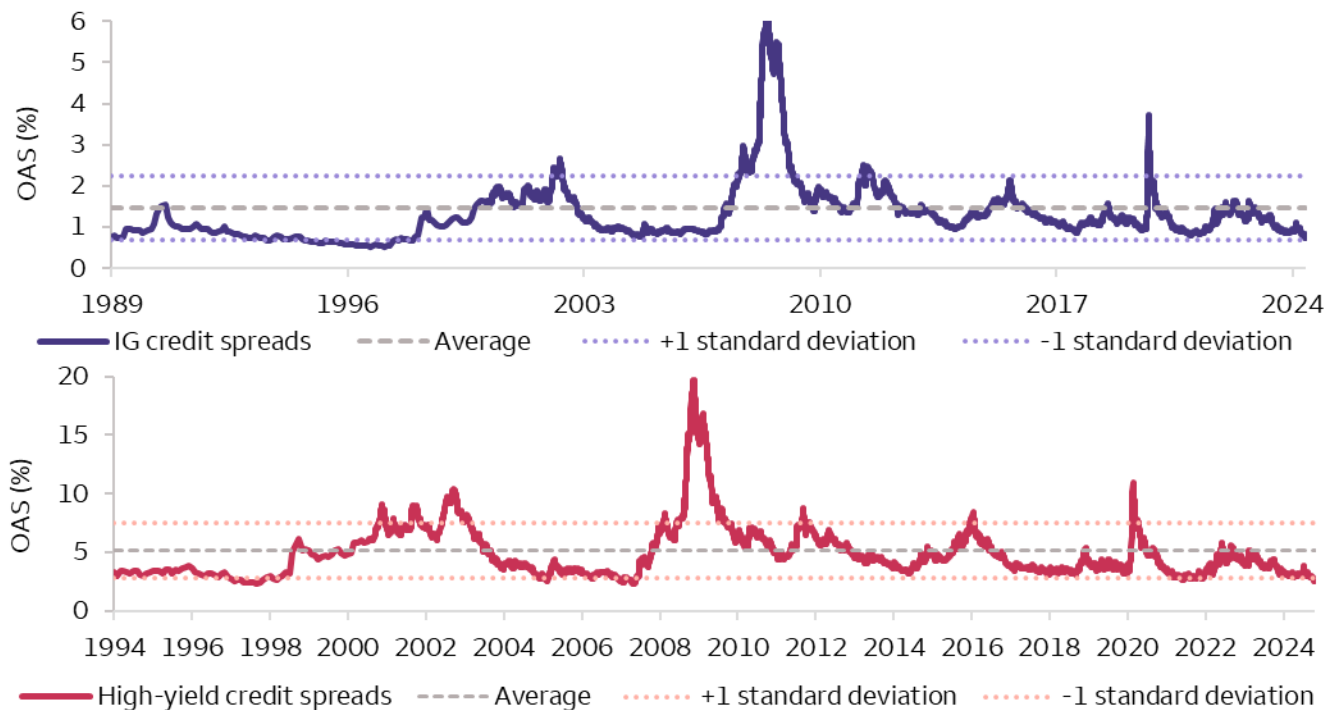
Narrowing corporate credit spreads — No end in sight

Strong issuance in the investment-grade (IG) and high-yield (HY) corporate bond space has been evident throughout 2024. We expect issuance to remain on par in 2025 and investor demand to keep up with new supply. A resilient economy, attractive yields, and declining credit spreads have allowed corporate bonds to display positive returns despite the volatility in interest rates.

Credit spreads refer to the extra yield that investors demand from corporate bonds over lower-risk bonds, such as U.S. Treasuries, to compensate for their implied default risk. Investors monitor the level of credit spreads as they are typically a good measure of sentiment and valuation. Although we are in a "higher-for-longer" interest-rate environment, our belief is that the ample liquidity in the system has allowed credit spreads to continue to narrow toward all-time lows. Although spreads are tight from a historical perspective, we believe that IG and HY spreads could continue to tighten further, supported by solid fundamentals and the expectations for positive corporate earnings growth in 2025.

In addition, we expect a rotation from excess cash parked in money market funds into risk assets, especially if yields continue to move higher. We currently maintain a favorable view of the U.S. investment-grade Credit sector and Corporate Securities sub-sector and a neutral view on High Yield Taxable Fixed Income.

Investment-grade and high-yield credit spreads have tightened in 2024



Sources: Wells Fargo Investment Institute and Bloomberg, as of November 19, 2024. Option-adjusted spread (OAS) is the spread relative to a risk-free interest rate. Investment grade (IG) credit spreads represented by Bloomberg U.S. IG Corporate Bond OAS Index. High-yield credit spreads represented by Bloomberg U.S. Corporate High Yield Bond OAS Index. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

© 2024 Wells Fargo Investment Institute. All rights reserved.

Alternatives

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

Hedge fund assets reached a new high

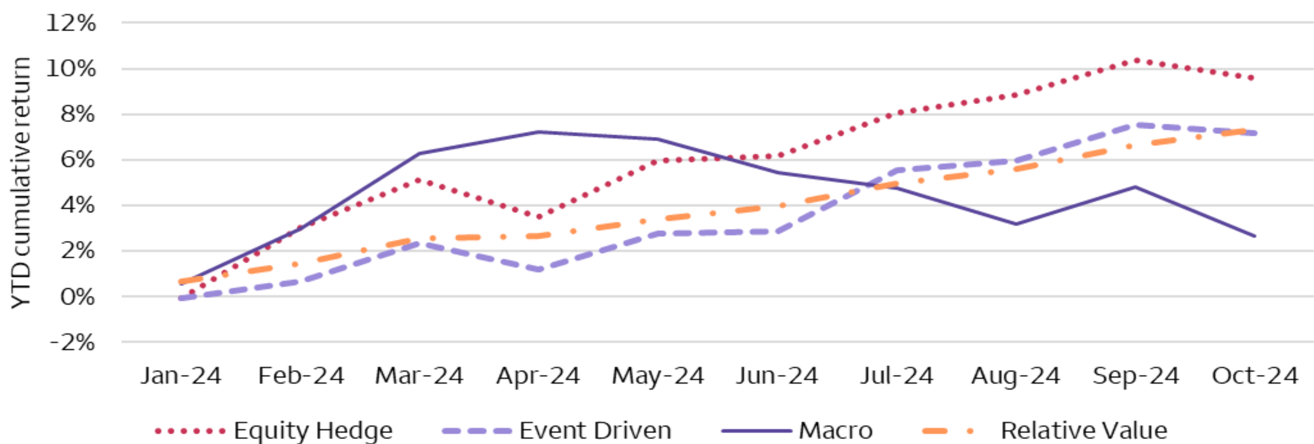
Over the first 10 months of the year, the hedge fund HFRI Fund Weighted Composite Index ascended by 7.4%, with strength seen across Equity Hedge, Event Driven, and Relative Value strategies. Driven by this accretive performance, hedge fund assets have reached a new record of $4.5 trillion in October, according to Hedge Fund Research.

Equity Hedge strategies were the top performers so far this year and posted a 9.6% gain (see chart below). This strong performance was driven both by managers' increased public market exposure as well as a positive contribution from stock selection. The elevated stock price dispersion, resulting from higher interest rates and economic slowdowns, continued to provide a favorable environment for stock selection, which many Equity Hedge managers focused on.

Distressed Credit and Long/Short Credit strategies took the top spots in year-to-date performance for Event Driven and Relative Value categories, respectively. Throughout 2024, Distressed Credit managers posted gains, as underlying companies made progresses through recapitalization and restructurings, and as credit conditions and market sentiment improved. By capitalizing on security-specific asset pricing dislocations, the Long/Short Credit strategy generated consistent gains with a low correlation to public markets. Nevertheless, Macro strategies, especially Systematic managers, have had a challenging time this year (see chart below). Since May, Systematic strategies have suffered from frequent price trend reversals across fixed income, currency, stock, and commodity markets, as investors recalibrated expectations of future monetary policy.

Looking forward, we favor Equity Hedge – Directional, Event Driven – Distressed Credit, and Relative Value – Long/Short Credit strategies, which we believe will benefit from future economic and market recovery.

Hedge funds posted positive returns so far this year, with Equity Hedge leading the way up



Sources: Wells Fargo Investment Institute, HFRI. Data as of October 31, 2024. YTD = year to date. Equity Hedge = HFRI Equity Hedge (Total) Index. Event Driven = HFRI Event Driven (Total) Index. Macro = HFRI Macro (Total) Index. Relative Value = HFRI Relative Value (Total) Index. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

Alternative investments, such as hedge funds, private equity, private debt, and private real estate funds are not appropriate for all investors and are only open to "accredited" or "qualified" investors within the meaning of U.S. securities laws.

© 2024 Wells Fargo Investment Institute. All rights reserved.

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, November 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.

© 2024 Wells Fargo Investment Institute. All rights reserved.

Risk considerations

Forecasts and targets are based on certain assumptions and on 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. 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. **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.

Definitions

Bloomberg U.S. IG Corporate Bond OAS Index measures the option adjusted spreads of USD-denominated, investment grade, fixed-rate corporate bond market.

Bloomberg U.S. Corporate High Yield Bond OAS Index measures the option adjusted spreads of USD-denominated, high yield, fixed-rate corporate bond market.

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

Equity Hedge. HFRI Equity Hedge (Total) Index. Equity Hedge: Investment Managers who maintain positions both long and short in primarily equity and equity derivative securities. A wide variety of investment processes can be employed to arrive at an investment decision, including both quantitative and fundamental techniques; strategies can be broadly diversified or narrowly focused on specific sectors and can range broadly in terms of levels of net exposure, leverage employed, holding period, concentrations of market capitalizations and valuation ranges of typical portfolios. EH managers would typically maintain at least 50% exposure to, and may in some cases be entirely invested in, equities, both long and short.

Event Driven. HFRI Event Driven (Total) Index. Maintains positions in companies currently or prospectively involved in corporate transactions of a wide variety including mergers, restructurings, financial distress, tender offers, shareholder buybacks, debt exchanges, security issuance or other capital structure adjustments. Security types can range from most senior in the capital structure to most junior or subordinated and frequently involve additional derivative securities. Exposure includes a combination of sensitivities to equity markets, credit markets and idiosyncratic, company-specific developments.

Macro. HFRI Macro (Total) Index. Encompass a broad range of strategies predicated on movements in underlying economic variables and the impact these have on equity, fixed income, hard-currency, and commodity markets. Managers employ a variety of techniques, both discretionary and systematic analysis, combinations of top-down and bottom-up theses, quantitative and fundamental approaches and long- and short-term holding periods. Although some strategies employ RV techniques, Macro strategies are distinct from RV strategies in that the primary investment thesis is predicated on predicted or future movements in the underlying instruments rather than on realization of a valuation discrepancy between securities. In a similar way, while both Macro and equity hedge managers may hold equity securities, the overriding investment thesis is predicated on the impact movements in underlying macroeconomic variables may have on security prices, as opposed to Equity Hedge (EH), in which the fundamental characteristics on the company are the most significant are integral to investment thesis.

© 2024 Wells Fargo Investment Institute. All rights reserved.

Relative Value. HFRI Relative Value (Total) Index. Strategy is predicated on realization of a valuation discrepancy in the relationship between multiple securities. Managers employ a variety of fundamental and quantitative techniques to establish investment theses, and security types range broadly across equity, fixed income, derivative or other security types. Fixed income strategies are typically quantitatively driven to measure the existing relationship between instruments and, in some cases, identify attractive positions in which the risk adjusted spread between these instruments represents an attractive opportunity for the investment manager. Relative Value (RV) position may be involved in corporate transactions also, but as opposed to Event Driven (ED) exposures, the investment thesis is predicated on realization of a pricing discrepancy between related securities, as opposed to the outcome of the corporate transaction.

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

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

An index is unmanaged and not available for direct investment.

General disclosures

Global Investment Strategy (GIS) is a division of Wells Fargo Investment Institute, Inc. (WFII). WFII is a registered investment adviser and wholly owned subsidiary of Wells Fargo Bank, N.A., a bank affiliate of Wells Fargo & Company.

The information in this report was prepared by Global Investment Strategy. Opinions represent GIS' opinion as of the date of this report and are for general information purposes only and are not intended to predict or guarantee the future performance of any individual security, market sector or the markets generally. GIS does not undertake to advise you of any change in its opinions or the information contained in this report. Wells Fargo & Company affiliates may issue reports or have opinions that are inconsistent with, and reach different conclusions from, this report.

The information contained herein constitutes general information and is not directed to, designed for, or individually tailored to, any particular investor or potential investor. This report is not intended to be a client-specific suitability or best interest analysis or recommendation, an offer to participate in any investment, or a recommendation to buy, hold or sell securities. Do not use this report as the sole basis for investment decisions. Do not select an asset class or investment product based on performance alone. Consider all relevant information, including your existing portfolio, investment objectives, risk tolerance, liquidity needs and investment time horizon. The material contained herein has been prepared from sources and data we believe to be reliable but we make no guarantee to its accuracy or completeness.

Wells Fargo Advisors is registered with the U.S. Securities and Exchange Commission and the Financial Industry Regulatory Authority, but is not licensed or registered with any financial services regulatory authority outside of the U.S. Non-U.S. residents who maintain U.S.-based financial services account(s) with Wells Fargo Advisors may not be afforded certain protections conferred by legislation and regulations in their country of residence in respect of any investments, investment transactions or communications made with Wells Fargo Advisors.

Wells Fargo Advisors is a trade name used by Wells Fargo Clearing Services, LLC and Wells Fargo Advisors Financial Network, LLC, Members SIPC, separate registered broker-dealers and non-bank affiliates of Wells Fargo & Company. PM-05212026-7368747.1.1

© 2024 Wells Fargo Investment Institute. All rights reserved.