WELLS FARGO
Investment Institute

FIRST QUARTER **2023**

Market Charts

Turning data into knowledge

All data shown in the charts as of fourth quarter (Q4) 2022 and reflect the most recent information available. Please see disclosures for the risks associated with the asset classes and for the definitions of market-based and economic indexes.

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

Economy highlights

Macro

- We expect a slowdown in global economic growth to gather momentum as 2023 progresses due to a combination of elevated inflation, rising interest rates, and accompanying financial stress.[1]
- We anticipate a sustained recovery in economic growth to begin by year-end and extend into next year following a likely recession. We expect slowing inflation and a slowdown in central-bank interest rate hikes eventually to lay the groundwork for a recovery in economic growth.
- We believe that China is grappling with an unbalanced economic reopening that will likely center on a domestic, consumer-led recovery, making further government stimulus less likely and limiting its support for the global growth recovery anticipated next year.

Domestic

- We expect consumer spending to join a persistent slump in housing to precipitate a moderate U.S. recession, as a response to high inflation, rising interest rates, and a drawdown of sizable cash balances.
- We believe inflation, as measured by the Consumer Price Index (CPI), will slow with the economy as supply shocks continue to unwind. Tight supplies of food and fuel, elevated rents, and inertia of the CPI's other "sticky" components will likely contribute to a bumpy disinflationary path.

International

- Emerging markets will support stronger overseas growth than in the U.S., in our view, masking a European recession and a modest growth recovery in China. Nonetheless, emerging market growth is likely to be subpar due to tighter global financial conditions, high inflation, and a strong U.S. dollar.
- An overseas growth recovery expected by 2024 will likely be supported by a moderate rebound in China but restrained by structural weakness in Europe and Japan.

1. Economic forecasts are provided by Wells Fargo Investment Institute as of March 31, 2023. Forecasts are not guaranteed and based on certain assumptions and on views of market and economic conditions which are subject to change.

Equities highlights

General

- Historically, geopolitical crises have provided reasonable entry points for long-term equity investors.
- As the Federal Reserve facilitates tighter monetary policy and the cycle matures, our view is that investors should consider moving up in quality (we favor U.S. Large and Mid Cap Equities).
- As we approach a likely upcoming recession, we would look for opportunities to tilt to more economically sensitive segments of the market in anticipation of an eventual recovery.

Domestic

- We anticipate earnings growth will experience challenges as operating margins fall while interest, labor, and input expenses rise.
- Amid the volatile market conditions, we prefer U.S. equities over international equities. We also favor increased emphasis on quality over cyclicals in our sector positioning, and selectivity at the sub-industry level.

International

- While we maintain our current preference for U.S. over international equities, we are getting more constructive on Developed Market ex-U.S. Equities.
- We believe valuations are compelling, the U.S. dollar likely peaked in 2022, and earnings growth has been more resilient than initially feared.

Fixed-income highlights

General

- Long-term yields have tended to peak before the Federal Reserve (Fed) finishes raising rates. We favor remaining nimble in bond portfolio allocations with a barbell strategy that lengthens maturities but can also take advantage of ultra-short-term yields.
- High-quality bonds have tended to provide support to investment portfolios during periods of equity market volatility; although 2022 was an exception, bonds managed to recover and help portfolios in the first quarter of 2023.

Domestic

- Yields moved lower across the yield curve during the first quarter as investors shifted into bonds. The yield curve has been inverted since July 2022 as short-term rates have remained higher than intermediate- and long-term rates.
- The Fed is committed to its aggressive tightening policies. We expect the Fed will continue hiking policy rates (albeit at a slower pace) and shrinking its balance sheet through the first half of 2023.
- Credit spreads widened during the first quarter of 2023 as credit conditions deteriorated. Looking ahead, the risk is for further widening as financial conditions tighten. We believe investors should be selective.

International

- Movements in yields were volatile as they were pushed upward by elevated inflation and hawkish central banks and pressured downward as the market moved to a risk-off environment late in the quarter.
- The European Central Bank is expected to raise policy interest rates to near 4% by the second half of 2023. Eurozone bond yields may reach a peak before the end of the hiking cycle, as recession looms.
- Emerging market (J.P. Morgan EMBI Global Index) yields have declined from yields as high as 9%, after navigating challenges from higher Treasury yields, a stronger dollar, and the threat of default from several smaller sovereigns. The market may be volatile as developed economies weaken, but higher relative yields should attract inflows once we see a clearer turn in U.S. interest rates and the dollar.

Real assets highlights

General

- Individual commodity prices have historically tended to move together over very long bull and bear cycles. These super-cycles have often lasted a decade or longer. We believe a new bull super-cycle began in 2020.
- China is the largest commodity consumer and was the main driver of two of the recent commodity super-cycles (bull: 1999 – 2008, bear: 2008 – 2020).

Oil

- Oil prices have come down to start 2023, based largely on global demand concerns and an impending economic recession.
- We're expecting, however, to see higher oil prices by year-end, as supply remains a structural problem globally. Even the slightest amount of demand recovery, which we suspect will come in the back half of the year, should begin pushing oil prices higher.

Gold

- Gold was hampered by U.S. dollar strength and tight Federal Reserve monetary policy during the first two months of the year. Both headwinds, however, appear set to lose strength for the remainder of 2023, which we feel should help gold prices move higher.
- Also likely to support gold prices in 2023 are persistent investor concerns about inflation, the equity bear market, and fears surrounding continued banking turmoil.

REITs (Real Estate Investment Trusts)

- REITs come in all shapes and sizes — a REIT that specializes in data centers differs wildly from a REIT that specializes in malls or office buildings — and returns can vary widely as a result.
- Monitoring the fundamentals, valuations, trends, and performance of these different REIT subsectors can provide opportunities for investors in REITs.

Alternative investments highlights

Hedge funds

- Over a full market cycle, we believe hedge funds can help decrease risk and improve diversification.
- At this point in the cycle, we prefer strategies like Relative Value and Macro that can help reduce volatility by being less correlated to risky assets.
- Given the likely economic recession later this year, we expect Merger Arbitrage may struggle as deal activity slows, spreads widen, and lead times for deal closings become extended. Conversely, we believe the opportunity set for Distressed Credit strategies to expand as over-leveraged companies adjust to rising debt service levels.

Private capital

- Private Equity valuations generally lag the public market by six to nine months. Therefore, we anticipate a reduction in valuations over the next several quarters, as private markets narrow the gap to public market prices.
- While exit and initial public offering is slowing as the risks to economic growth rise, we also recognize that we may experience more attractive entry points for Private Equity as managers generally invest committed capital over a three- to five-year time frame.
- Private Debt strategies focused on distressed and special situations are becoming more attractive as lending conditions tighten and credit stress builds.
- While Private Real Estate has historically performed well over a full market cycle, we are cognizant of slowing economic growth potentially offsetting the gains from higher inflation.

Alternative investments, such as hedge funds and private equity/private debt funds, are not appropriate for all investors and are only open to accredited or qualified investors within the meaning of the U.S. securities laws. 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. While investors may potentially benefit from the ability of alternative investments to potentially improve the risk/reward profiles of their portfolios, the investments themselves can carry significant risks. There may be no secondary market for alternative investment interests, and transferability may be limited or even prohibited. Hedge fund strategies, such as Equity Hedge, Event Driven, Macro, and Relative Value, may expose investors to risks such as short selling, leverage, counterparty, liquidity, volatility, the use of derivative instruments, and other significant risks.

Currencies highlights

U.S. dollar

- The U.S. Dollar Index traded in a range for much of the first quarter, bouncing from the lows after a slowing in the decline of U.S. inflation raised market expectations for the peak federal funds rate and pushed U.S. yields higher.
- Emerging market (EM) currencies mirrored the dollar's move versus developed market (DM) currencies. The Chinese yuan led many oil- and commodity-related currencies, rising sharply then falling back as hopes of China's rapid post-reopening recovery faded.

Developed currencies

- The euro struggled to extend its gains in the first quarter, as the late-2022 boost from lower natural gas prices and hopes of China's economic recovery faded. In the context of stubbornly high inflation and fears of impending recession, even the sharp move up in European Central Bank rate expectations did not provide much support.
- The steady recovery in the yen that began in the fourth quarter with the Bank of Japan's (BOJ) successful dollar-selling intervention, stalled early in the year, as the BOJ looked set to disappoint expectations of rapid policy normalization after its surprise December move. A cooling of China recovery euphoria and the weaker yuan also weighed on the currency.

Emerging currencies

- EM currencies were mixed but in aggregate stronger, mirroring the dollar's weakness late in the first quarter. Asian countries and commodity exporters globally saw their currencies weaken with the yuan on the rapid reversal in sentiment on the Chinese economy.
- We expect that EM currencies may follow the dollar's range trading in 2023, although higher rates may give better support than for some of the dollar's DM counterparts.

Asset allocation highlights

Background

- Historical performance may serve as a useful guide for investors, but markets frequently trade on factors outside of fundamental valuations for long periods of time.

Potential benefits of diversification and rebalancing

- Regularly rebalancing a portfolio can add value.
- Because each asset class has unique risk, return, and correlation characteristics, a diversified allocation has the potential to provide more consistent returns with lower volatility.
- Attempting to reduce downside volatility can be critical to long-term performance, as it can allow a portfolio to recover more quickly after a crisis event.
- It is important to recognize that the more a portfolio loses in a downturn, the longer it takes to recoup those losses.
- Diversification has tended to reduce the time it takes to break even from a downside event.

Dangers of market timing

- Missing even a handful of days when the market achieves its best gains can dramatically reduce returns.
- Exiting the market after a bad day could be costly. The stock market's best days have often been preceded by the worst days.
- We do not advocate market timing, but we do believe that modest tactical shifts have the potential to take advantage of short-term investment opportunities or help mitigate short-term risks.

General disclosures

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