WELLS FARGO
Investment Institute

EXECUTIVE SUMMARY

2023 Midyear Outlook

Targets as of June 13, 2023

Navigating end-of-cycle turbulence

Economy and exchange rates

Mixed U.S. economic data are tilting increasingly toward a moderate recession. A manufacturing slowdown and housing's renewed weakness are adding to storm warnings from an inverted yield curve, steepening declines in leading indicators, and broadening geographic weakness. Pockets of strength in labor-intensive services and employment can cushion the slowdown, but they are no guarantee against a recession.

In our view, persistent credit tightening is growth's most visible threat in the next 18 months.

As inflation slows to below wage growth, we expect consumers to regain purchasing power that should help turn recession to recovery. Interest-rate cuts by the Federal Reserve (Fed) next year and inventory building also should support growth.

Our key economic forecast is for inflation to fall below 3% in 2023 and through 2024. Our forecast assumes a historically typical round of disinflation as a recession develops this year.

Our near-term bias remains for modest dollar upside within a range-trading environment. We expect the dollar to find support while the Fed keeps rates high for the rest of the year. Moreover, amid a global economic slowdown this year, additional support could come from international flows to dollar-priced assets.

	2023 targets	2024 targets
U.S. GDP growth[1]	1.1%	1.5%
U.S. CPI inflation[2]	2.9%	2.8%
U.S. unemployment rate[3]	4.4%	4.9%
Global GDP growth[1]	2.3%	2.4%
Dollar/euro exchange rate	$1.03–$1.11	$1.12–$1.20

Source: Wells Fargo Investment Institute, June 13, 2023. GDP = gross domestic product. CPI = Consumer Price Inflation. Wells Fargo Investment Institute forecast and targets. **Forecast and targets are based on certain assumptions and on our current views of market and economic conditions, which are subject to change. An index is unmanaged and not available for direct investment.**

1. Percent change in annual averages from 2022 to 2023, and from 2023 to 2024.
2. December-to-December change.
3. 3-month average as of the fourth quarter

Fixed income

We believe the next six to 18 months will present fixed income with two distinct environments, recession and recovery. Against this backdrop, we favor a barbell strategy that emphasizes short term and long term. We envision positive returns for both taxables and municipals through year-end.

Headwinds are rising in credit markets, and we prefer to stay up in quality. We favor government securities, particularly U.S. Treasuries, and investment-grade corporates should retain strength. However, we find high-yield securities too expensive while spreads are set to widen further.

	Year-end 2023 targets	Year-end 2024 targets
Federal funds rate	5.25%–5.50%	3.75%–4.00%
10-year U.S. Treasury yield	3.50%–4.00%	3.75%–4.25%
30-year U.S. Treasury yield	3.50%–4.00%	4.00%–4.50%

Sources: Wells Fargo Investment Institute, June 13, 2023. **Forecast and targets are based on certain assumptions and on our current views of market and economic conditions, which are subject to change.**

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

Equities

Our view is that corporate revenue growth will stall in the remainder of 2023 as the economy likely falls into recession. Throw in sticky input and wage costs, and we expect operating margins to continue declining toward pre-COVID-19 levels. We see these factors weighing on earnings in 2023 and early 2024.

We continue to prefer quality and playing defense, and favor U.S. Large-Cap Equities over Mid- and Small-Caps. Playing defense at the sector level includes a preference for the Materials, Health Care, and Energy sectors.

Once the recession appears fully priced in to market valuations, we expect an opportunity to position for a 2024 recovery. The timing for a broader cyclical repositioning typically comes once investors anticipate recovery but while the economy is still within the grip of recession. To this point, our 2024 targets anticipate that U.S. Small-Cap Equities will outpace U.S. Mid Cap Equities, which in turn should outpace U.S. Large Cap Equities.

For this year, our quality bias extends to international equities, where we prefer Developed Market ex-U.S. Equities (neutral) over Emerging Markets Equities (unfavorable). This defensive positioning has worked well late in the cycle, and we believe it should benefit investors early in the recession. As global recovery develops in 2024, our targets indicate that this relative performance should reverse.

	Year-end 2023 targets	Year-end 2024 targets
S&P 500 Index	4000–4200	4600–4800
Earnings per share	$205	$220
Russell Midcap Index	2700–2900	3200–3400
Russell 2000 Index (small cap)	1650–1850	2000–2200
MSCI EAFE Index	2000–2200	2300–2500
MSCI Emerging Markets Index	850–1050	1000–1200

Sources: Wells Fargo Investment Institute and Bloomberg, June 13, 2023. **Forecast and targets are based on certain assumptions and on our current views of market and economic conditions, which are subject to change. An index is unmanaged and not available for direct investment.**

Real assets

We believe 2023 is a short-term price pause before the resumption of a long-term commodity bull super-cycle, which is a multi-year period in which commodity prices climb together, as a family. Even under the pressure of a global economic slowdown, we foresee modest upside for prices from current levels and stronger performance in 2024.

Our outlook for a weaker U.S. dollar should support gold and precious metals prices, and we recently upgraded Precious Metals to favorable. We believe the bull super-cycle is very likely to produce performance across all sectors.

Rising interest rates continue to weigh on real estate values. How bad it turns for public REITs depends in large part on the timing of future Fed policy actions. Should it cut interest rates in early 2024, public REITs may see some relief.

	Year-end 2023 targets	Year-end 2024 targets
West Texas Intermediate crude (barrel)	$80–$90	$90–$110
Brent crude (barrel)	$85–$95	$95–$115
Gold (troy ounce)	$2100–$2200	$2300–$2400
Bloomberg Commodity Index (total return)	235–255	255–275

Sources: Wells Fargo Investment Institute, June 13, 2023. **Forecast and targets are based on certain assumptions and on our current views of market and economic conditions, which are subject to change. An index is unmanaged and not available for direct investment.**

Alternative investments

Our view for equity and fixed income market volatility suggests a counter strategy of hedge fund strategies with low correlations to stocks and bonds. We favor Relative Value (especially Arbitrage and Long/Short Credit sub-strategies) and Global Macro (both Systematic and Discretionary sub-strategies).

From a private capital perspective, Small and Mid Cap Buyout, and Growth Equity could be opportunities amid recession.

Finally, we favor Distressed Credit strategies among hedge funds and private capital as sources of opportunity as credit market stress develops.

Alternative investments are not appropriate for all investors and are only open to “accredited investors” or “qualified investors” within the meaning of the U.S. securities laws. They are speculative, highly illiquid, and designed for long-term investment and not as trading vehicles.

Risk considerations

Forecasts and targets are based on certain assumptions and on our current views of market and economic conditions, which are subject to change.

All investing involve risks, including the possible loss of principal. 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. Their values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Foreign markets** have additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. These risks are heightened in emerging markets. **Mid- and small-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large-company stocks. **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. **Bonds** are subject to interest rate, credit/default, liquidity, call, inflation and other risks. Prices tend to be inversely affected by changes in interest rates. Investors should consider the stability of the issuing entity when investing in sovereign debt. **U.S. government securities** are backed by the full faith and credit of the federal government as to payment of principal and interest if held to maturity. 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. **Municipal bonds** offer interest payments exempt from federal taxes, and potentially state and local income taxes. Municipal bonds are subject to credit risk and potentially the Alternative Minimum Tax (AMT). Quality varies widely depending on the specific issuer. Municipal securities are also subject to legislative and regulatory risk which is the risk that a change in the tax code could affect the value of taxable or tax-exempt interest income. The **commodities** markets, including investments in physical commodities such as **gold**, 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 and private capital/private debt and private real estate strategies, are speculative and not appropriate for all investors. These investments are only available to persons who are "accredited investors" or "qualified purchasers" within the meaning of U.S. securities laws. Investors could lose all or a substantial amount investing in these products. Alternative investment 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.

Index definitions

Bloomberg Commodity Index is comprised of 23 exchange-traded futures on physical commodities weighted to account for economic significance and market liquidity.

Consumer Price Index (CPI) produces monthly data on changes in the prices paid by urban consumers for a representative basket of goods and services.

MSCI EAFE Index is a free-float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of developed markets, excluding the U.S. and Canada.

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

Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 8% 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 capitalization-weighted index calculated on a total return basis with dividends reinvested. The index includes 500 widely held U.S. market industrial, utility, transportation, and financial companies.

A barbell strategy allows investors to take advantage of current interest rates by investing in short-term bonds, while also benefitting from the higher yields of holding long-term bonds.

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