

Investment Strategy

Weekly guidance from our Investment Strategy Committee July 10, 2023

Global Equity Spotlight: Runaway bull?2

- This year’s S&P 500 Index rally has prompted some to declare that a new bull market is upon us. We are less optimistic.
- In the near term, we see continued range-bound trading and favor a patient and disciplined approach that emphasizes quality.

Fixed Income: Why we downgraded commercial mortgage-backed securities4

- On June 13, 2023, we downgraded commercial mortgage-backed securities (CMBS) from neutral to unfavorable given our belief that conditions in commercial real estate will likely deteriorate.
- Not surprisingly, spreads on CMBS have widened notably over the past year. Our bias is that credit spreads could remain around current levels or move higher if sentiment deteriorates amid tighter credit conditions.

Real Assets: Despite turmoil in Russia, oil prices remain muted5

- In response to political turmoil in Russia, Brent crude prices rose a measly 0.45% over the weekend of June 26.
- In our view, a disruption of Russian oil production is unlikely, and we expect Russia to maintain production throughout 2023.

Alternatives: Private equity exit environment remains slow6

- While private equity markets experienced a surge of exit activity in 2021, the environment since that time has been in steady decline similar to previous downturns in 2008 and 2020.
- While the slowdown in exits may negatively impact mature funds nearing the end of their life cycle, we believe it may also result in potentially attractive buying opportunities for funds with cash to deploy.

Current tactical guidance7

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

Global Equity Spotlight

“History is a story not only of the past, but of the future.” — Grace Lee Boggs

Austin Pickle, CFA

Investment Strategy Analyst

Runaway bull?

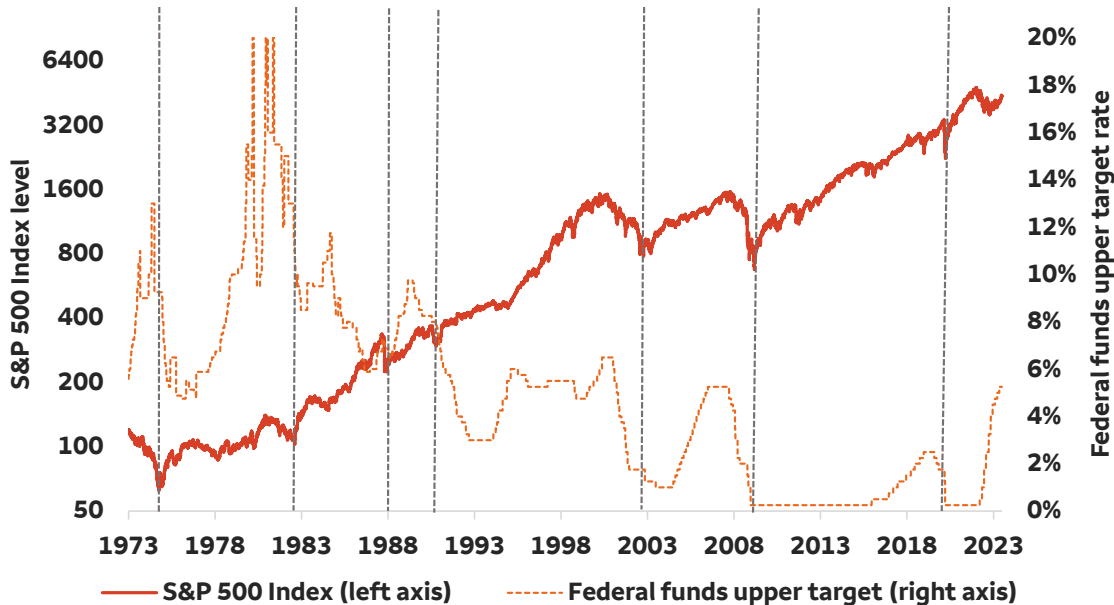
The 2023 year-to-date rally in the S&P 500 Index has been impressive. The index is up 15% so far this year and up 23% since the October 12, 2022 low. The rebound has prompted some to declare that a new bull market is upon us. We are less optimistic. While our 2024 year-end S&P 500 Index target suggests eventual upside from these levels, we expect a bumpy and range-bound ride before a sustainable and broad-based equity rally takes hold. For now, we see continued range-bound trading and favor a patient and disciplined approach that emphasizes quality.

Caution ahead

We should point out that for all the enthusiasm surrounding a new bull market, the S&P 500 Index is still well below its January 2022 peak, and there are a number of factors that argue that this year’s run seems extended including a deteriorating macro and earnings environment, full valuations, and continuing lack of breadth of gains across the index.

As Darrell Cronk explained in the June 20 State of the Markets report “Sand in the gears of growth”, history tells us that the equity market has typically bottomed after the economy already entered a recession, not before, and after the first Federal Reserve (Fed) interest rate cut (see chart 1). Unfortunately for the most optimistic of market observers, in our view we are nowhere near the first Fed rate cut — and in fact see a high probability of additional rate hikes — while the recession we forecast has not yet arrived.

Chart 1. Stocks historically bottom after the Fed starts cutting rates

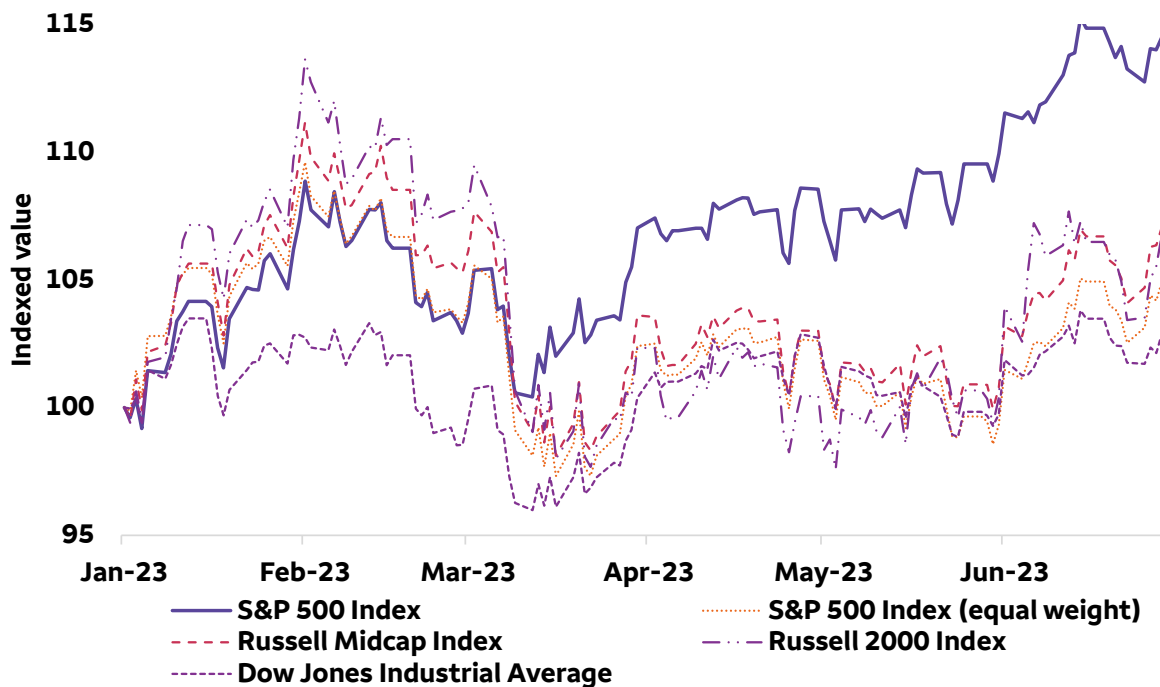


Sources: Bloomberg and Wells Fargo Investment Institute. Daily data: January 1, 1973 – June 29, 2023. Dashed vertical lines indicate major market bottoms. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

Looking closer at the details of this year’s stock market rally does little to inspire confidence that it may have the resiliency to buck these historical teachings. In fact, upon closer inspection, we believe it does not look like much of a rally at all. Yes, the S&P 500 Index is up nicely on the year. Yet mid caps, small caps, other large-cap indexes like the Dow Jones Industrial Average, have all bounced a less encouraging 3% – 8% year to date and find themselves still below the first-quarter 2023 peak (see Chart 2), let alone the all-time highs observed in early 2022.

The market cap weighted S&P 500 Index has so far outperformed the smaller-cap indexes as well as the equal weighted S&P 500 Index (see Chart 2) because this rally has been driven almost entirely by a small number of large companies. This has not been a characteristic of a durable bull market. We discussed this rally’s narrow market breadth in more detail in the June 12 Investment Strategy equity section titled “Narrow market rally: What does it mean?”

Chart 2. Outside of a few large-cap names, 2023 stock returns have been uninspiring



Sources: Bloomberg and Wells Fargo Investment Institute. Daily data: January 1, 2023 – June 29, 2023. Indexed to 100 as of the start date. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

What now?

As the lagged impact of the most aggressive Fed rate hiking campaign in nearly a half century increasingly tightens financial conditions and more forcefully bites into economic growth, corporate profitability will likely suffer. With stock valuations full, we believe prices are unlikely to sustain recent highs as the economy rolls over. In our view, equity markets should continue to reside within this wide trading range that has been in place since April 2022.

We urge investors to be proactive and diligent during these trying times. Be ready to trim exposures at the top end of the trading range while also having a shopping list ready for when we, as we expect, approach the lower end.

Fixed Income

Luis Alvarado

Global Investment Strategist

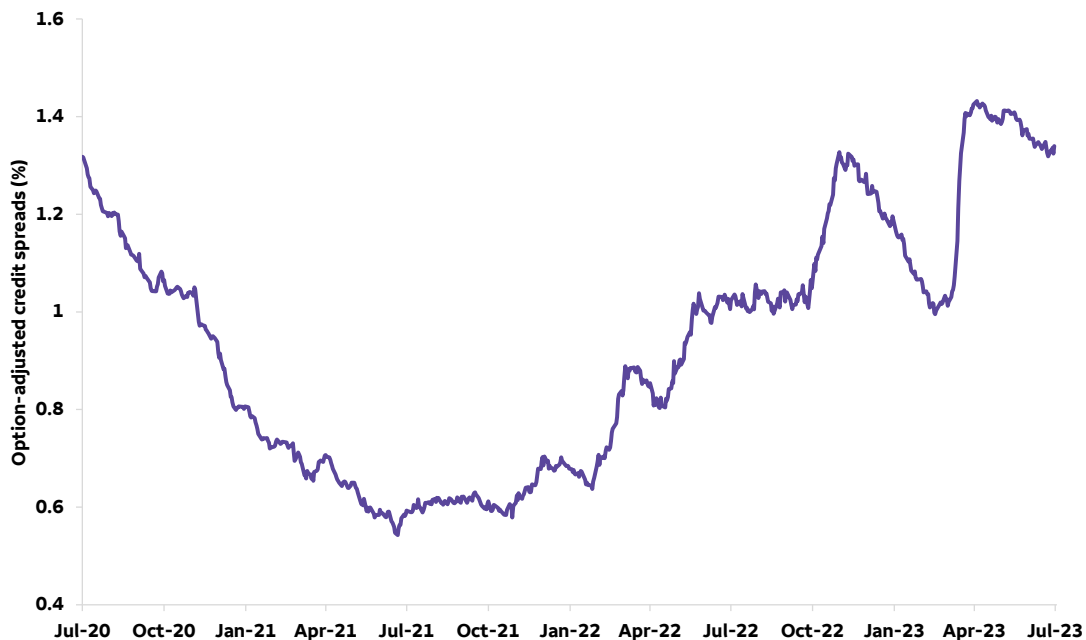
Why we downgraded commercial mortgage-backed securities

Headwinds in the commercial real estate space (CRE) are widely known and our belief is that the conditions in CRE will most likely continue to deteriorate, despite a still resilient economic growth. On June 13, 2023, we downgraded CMBS from neutral to unfavorable.¹ We believe the prospects of a recession toward the end of the year remain, especially since the Fed will most likely continue to raise interest rates and keep them higher for longer.

Not surprisingly, spreads on CMBS have widened notably over the past year. But the CMBS market is starting to differentiate among the various credits. Although the triple-A (AAA) and double-A (AA) spreads have declined slightly since May, after the regional banking crisis, the spreads on triple-B (BBB) remain elevated and near the top of their one-year ranges. Our bias is that credit spreads could remain around current levels or could move higher if sentiment deteriorates amid tighter credit conditions.

Also, rating agencies have started to downgrade credit ratings and they are preparing to apply renewed scrutiny to CMBS in reaction to pressures converging around cash flows, the demand for CRE space (especially in the office and multifamily sector), and ultimately around property valuations themselves. For investors willing to bear the risk, we prefer higher-quality and short-to-intermediate duration in the AAA CMBS sectors. CMBS represent less than 2% of the Bloomberg U.S. Aggregate Bond Index hence investors should be aware that these investments can be somewhat illiquid.

CMBS credit spreads remain elevated



Source: Wells Fargo Investment Institute and Bloomberg as of June 30, 2023. CMBS spreads are represented by the Bloomberg Commercial Mortgage-Backed Securities Index. An index is not available for direct investment. **Past performance is no guarantee of future results.**

1. See Institute Alert from June 13, 2023: "Updating guidance ahead of a likely volatile season."

Real Assets

“Do not seek after the sages of the past. Seek what they sought.” — Basho

Mason Mendez

Investment Strategy Analyst

John LaForge

Head of Real Asset Strategy

Despite turmoil in Russia, oil prices remain muted

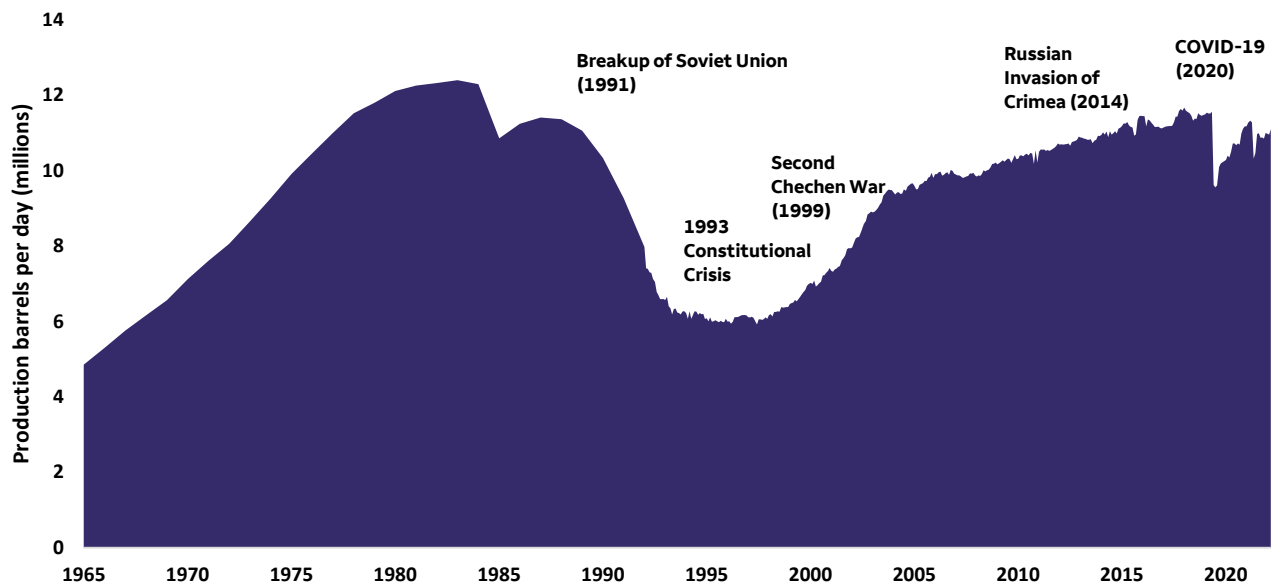
Despite political turmoil in Russia, we believe that oil prices appear to be shrugging off the risk of a potential supply disruption, as prices increased less than 1% over the weekend of June 26. Considering that Russia is a major oil producer, accounting for around 12% of global production, such a muted response in oil prices may come as a surprise to investors. As we will explain, though, Russian oil production has been relatively resilient to political turmoil in the past, and we suspect it will once again be in 2023.

Leading up to the collapse of the Soviet Union in 1991, Russian oil production grew steadily from 4.8 million barrels per day in 1965 to 10.3 million barrels per day in 1990 (see chart). It was not until the breakup of the Soviet Union, though, that Russia experienced its first large supply disruption – since the Second World War.

Since 1990, though, supply disruptions have largely been avoided, despite multiple political and military conflicts over the years (see chart). Outside the global effects of COVID-19, Russian oil production has been surprisingly resilient. For example, following the Russia-Ukraine war in 2022, widespread economic sanctions were imposed on Russia’s oil industry. One year later, though, Russian oil production was holding up — down only 2% year over year. This effect was in stark contrast to market expectations at the time, which called for a significant decline in oil production.

In our view, those sanctions posed a more serious risk to production than June’s attempted mutiny. Therefore, we believe that a major supply disruption is unlikely, in reaction to the military uprising. And markets appear to be agreeing with our stance as oil price volatility has remained quite low.

Soviet Union / Russian oil production



Source: Bloomberg, Energy Institute, and Wells Fargo Investment Institute. Annual data was used from 1965 - 1992, and monthly data was used from January 1993 - February 2023.

Alternatives

Mark Steffen, CFA, CAIA

Global Alternative Investment Strategist

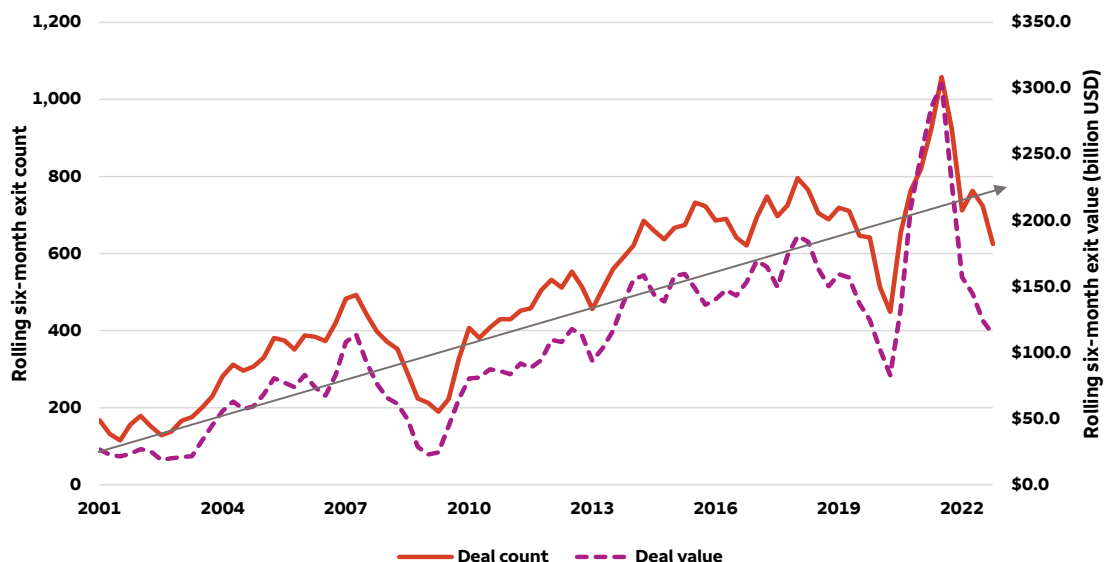
Private equity exit environment remains slow

The economic slowdown and continued macro headwinds have resulted in a difficult exit environment for private equity funds. Mature private equity funds seek to harvest gains in their portfolio through a variety of exit strategies, including a sale to other private equity investors, a public listing through an initial public offering (IPO), or a sale to management or another company (public or private).

Private equity markets experienced a surge of activity in 2021 as managers rushed to capitalize on favorable market dynamics that included a robust IPO market. However, the exit market has softened dramatically since the peak in late 2021 where it witnessed a decline in magnitude similar to the previous downturns in 2008 and 2020 (see chart). As the chart shows, the number and value of exits has declined below its long-term trend line. Factors contributing to this decline include a less favorable fundraising environment for private equity funds, declining confidence amongst corporate leaders, and an IPO market that remains tepid.² Private equity managers faced with the prospect of selling positions below their perceived values are instead opting to pursue other routes, including extending hold times in the hopes that a more favorable environment returns in the not-so-distant future. Extending hold times will push out distributions and may cause limited partners to sell fund stakes on the secondary market in an effort to generate liquidity.

While we expect that the slowdown may negatively impact mature funds nearing the end of their life cycle, it may also result in potentially attractive buying opportunities for funds with cash to deploy. Within private equity, we remain favorable on Small / Mid Cap Buyout and Growth Equity strategies as they look to invest cash over the next several years.

Exit activity declines below long-term trend



Source: Pitchbook. Data as of March 31, 2023. **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.

2. Pitchbook, “US CEO Confidence.” May 4, 2023.

Current tactical guidance

Cash Alternatives and Fixed Income

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

Equities

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

Source: Wells Fargo Investment Institute, July 10, 2023.

*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.

Risk considerations

Forecasts are not guaranteed and 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. 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. **Real assets** are subject to the risks associated with real estate, commodities and other investments and may not be appropriate for all investors.

In addition to the risks associated with investment in debt securities, investments in mortgage-backed and asset-backed securities will be subject to prepayment, extension and call risks. Changes in prepayments may significantly affect yield, average life and expected maturity. Extension risk is the risk that rising interest rates will slow the rate at which mortgages are prepaid. Call risk is the risk that if called prior to maturity, similar yielding investments may not be available for purchase. These risks may be heightened for longer maturity and duration securities. Commercial Mortgage Backed Securities (CMBS) are a type of mortgage-backed security backed by commercial mortgages rather than residential real estate. CMBS tend to be more complex and volatile than residential mortgage-backed securities due to the unique nature of the underlying property assets.

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

Bloomberg Commercial Mortgage-Backed Securities Index measures the market of US Agency and US Non-Agency conduit and fusion CMBS.

Dow Jones Industrial Average is an unweighted index of 30 "blue-chip" industrial U.S. stocks.

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.

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

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".

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-01062025-5793120.1.1