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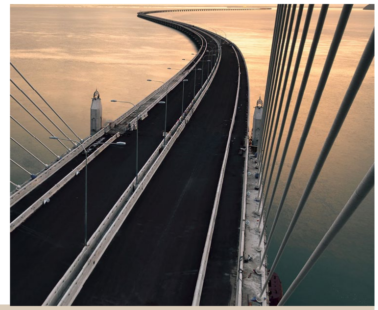


Investment Strategy

Weekly guidance from our Investment Strategy Committee **August 28, 2023**

Asset Allocation Spotlight

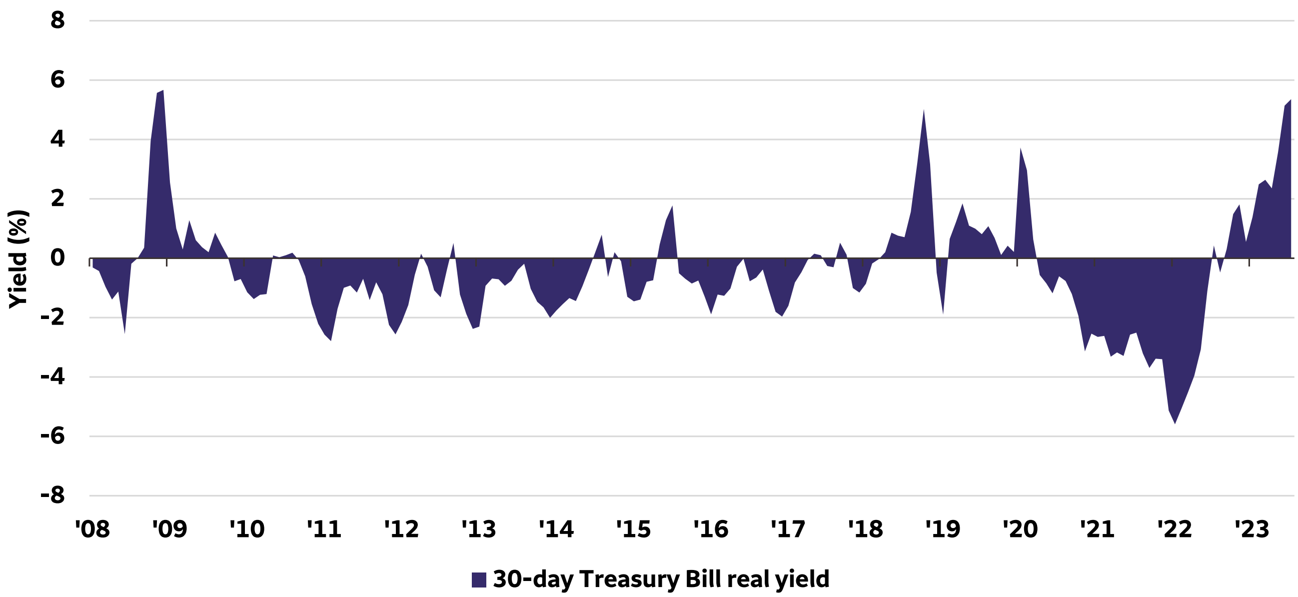
Veronica Willis
Global Investment Strategist

The cost of holding too much cash

The yield on cash alternatives has risen sharply since the beginning of 2022 as the Federal Reserve (Fed) embarked on an aggressive rate-hike campaign to combat elevated inflation. In May 2023, the yield on the 30-day U.S. Treasury bill climbed above 5%, where it has remained since. Meanwhile, inflation, as measured by the Consumer Price Index (CPI), has fallen from its mid-2022 peak (9.1% year-over-year) to 3.2% as of July 2023.

As cash yields remain elevated and inflation has cooled significantly from last year's levels, cash yields moved into positive territory on a real, inflation-adjusted basis after a few years of negative real yields. This shift to a positive real cash yield environment has prompted investors to question if now is the time to increase cash holdings or hold on to cash to wait for a better opportunity to enter the market.

Chart 1. Real cash yields have moved into positive territory

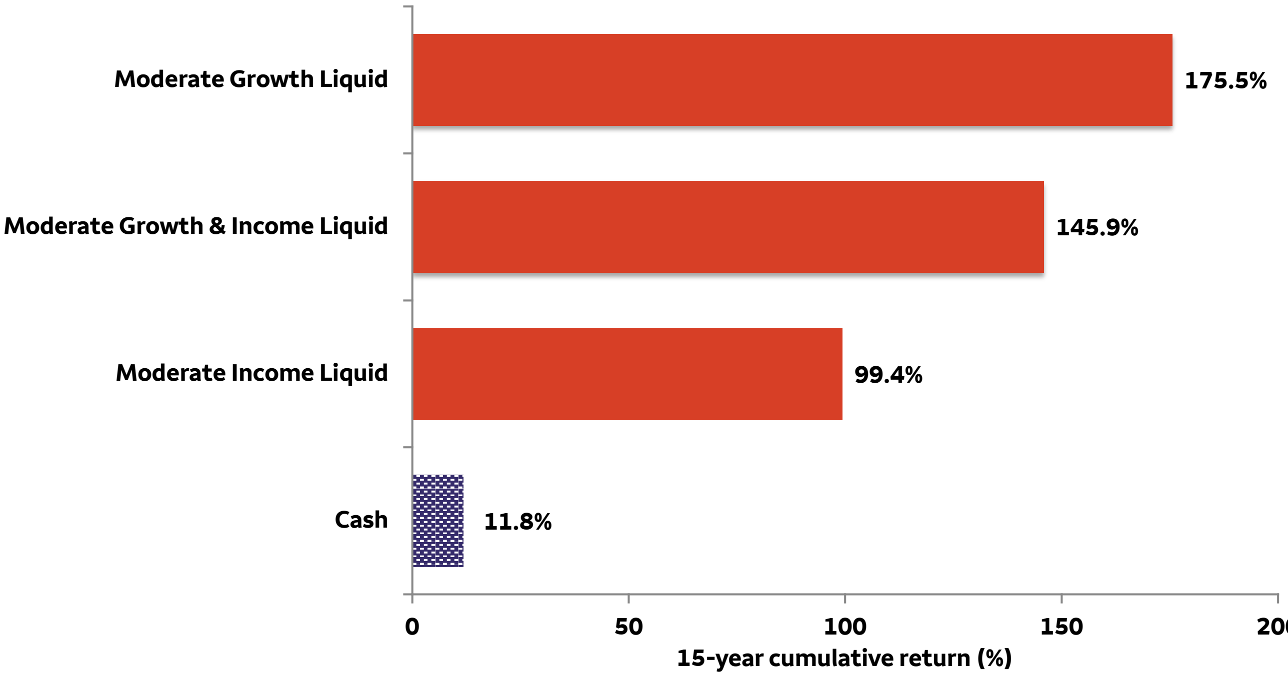


Sources: Bloomberg and Wells Fargo Investment Institute. Monthly data from January 1, 2008, to July 31, 2023. Real yield uses the 1-year breakeven inflation rate. The breakeven inflation rate is calculated by subtracting the real yield of the inflation linked maturity curve from the yield of the closest nominal Treasury maturity. The result is the implied inflation rate for the term of the stated maturity. **Past performance is no guarantee of future results.**

Investors may be tempted to move out of the market and increase cash holdings as a way to benefit from these elevated yields and to reduce portfolio volatility ahead of a potential economic slowdown and market correction. However, this can have unintended consequences. Even if cash yields remain elevated in the short term, cash will likely underperform other growth assets over the long term, putting a drag on long-term performance.

Utilizing a diversified allocation that is tailored to an investor's goals and risk tolerance can be a more effective way to capture the upside-return potential of growth assets while also smoothing volatility when compared to a concentrated position. And history has shown that even a very conservative allocation, such as Moderate Income, has returned more than cash over long periods of time (see Chart 2). While we do not expect a return to the ultralow cash yield environment of the past decade or so, we do expect every strategic asset class to outperform cash over the long term based on our capital market assumptions.[1]

Chart 2. Cash has been a weak relative performer over the long term



Sources: Bloomberg, © 2023 – Morningstar Direct, All Rights Reserved*, and Wells Fargo Investment Institute; showing returns for the 15 years ended August 18, 2023. Cash is represented by Bloomberg U.S. Treasury Bill (1-3 Month) Index. Performance results for Moderate Income, Moderate Growth & Income, and Moderate Growth are for illustrative purposes only and are calculated using blended index returns. The allocations are dynamic and change as needed with adjustments to the strategic allocations. Index returns do not represent investment performance or the results of actual trading. Index returns reflect general market results, assume the reinvestment of dividends and other distributions, and do not reflect deduction for fees, expenses, or taxes applicable to an actual investment. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.** See end of report for composition of the allocations, risk considerations, and definitions of indexes.

Consider a disciplined approach in today's market environment

Given today's economic and market environment, investors may be cautious about deploying cash for good reason. However, overexposure to a low-volatility asset, like cash, comes with its own risk — the opportunity cost of not investing in other assets with more growth potential. Holding on to cash, even for a short period of time with the intent to invest that cash at a later date, can only work as long as it does not develop into a long-term investment strategy. Investors who are overallocated to cash may consider using market pullbacks as opportunities to invest — to reach or maintain targeted allocation levels.

Maintaining a targeted allocation can help ensure that a portfolio behaves in alignment with an investor's risk parameters during market shocks and during market rebounds. Portfolio allocations may drift over time, and if the allocation becomes overexposed to risk assets, it may suffer a more severe downturn than the investor has the tolerance to weather. Similarly, if an allocation is underexposed to risk assets, the allocation will likely take longer to recover.

We believe developing a disciplined investing approach, such as dollar-cost averaging, to invest excess cash and rebalancing to maintain targeted allocations is prudent for long-term investors, as we expect most assets to outperform cash over the long term.

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1. *2023 Capital Market Assumptions Methodology - The Building Block Approach*, July 18, 2023.

Equities

Chris Haverland, CFA
Global Equity Strategist

Second-quarter earnings — Top takeaways for investors

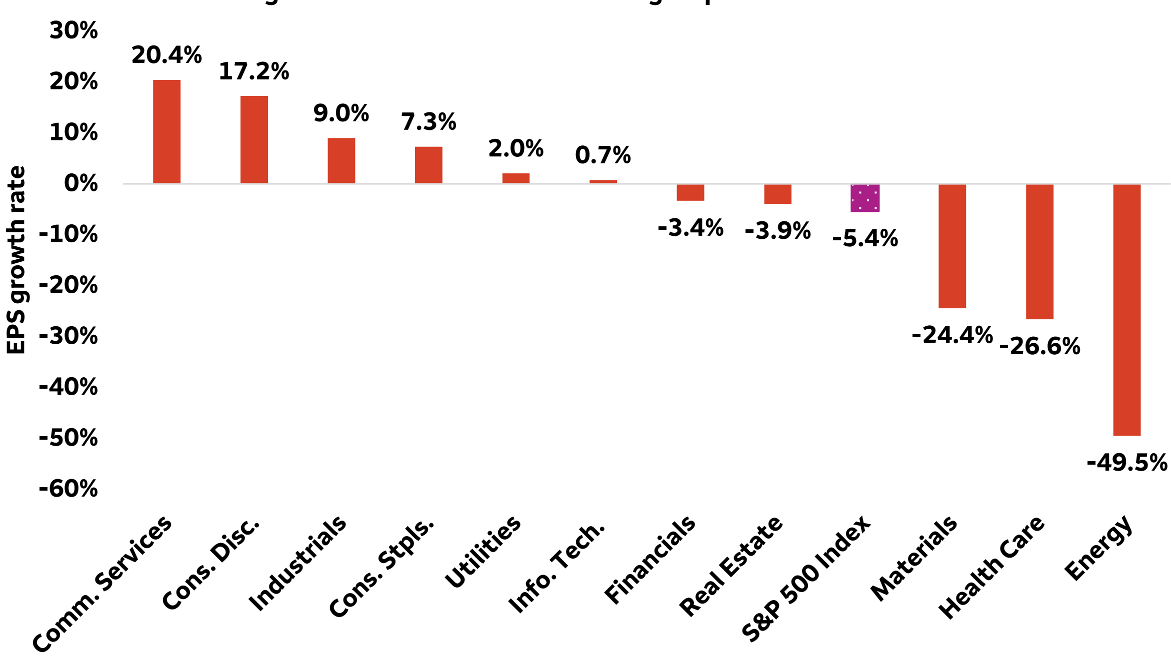
Second-quarter earnings season is coming to a close, and overall profits for the S&P 500 Index contracted for the third consecutive quarter. Although the beat rate was approximately 80%, earnings contracted between 5 – 6%, which is the worst year-over-year quarterly decline since the third quarter of 2020. Revenue grew less than 1% in the quarter, while margins fell to the lowest levels in three years.

Five of 11 sectors were negative, with Energy sector earnings plunging nearly 50% on tough comparisons to the elevated oil price environment in 2022. Remarkably, excluding the Energy sector, S&P 500 Index earnings would have been slightly positive, and the operating margin would have expanded. Strength was seen in Communication Services, Consumer Discretionary, and Industrials.

Forward guidance was mixed, with many companies still dealing with a tight labor market and anticipating an uncertain economic environment in the coming quarters. On a positive note, company transcripts revealed that mentions of inflation, high costs, and supply chain shortages are near two-year lows. Additionally, mentions of recession have fallen dramatically after peaking in mid-2022.

However, the better-than-feared earnings results have had little impact on Bloomberg consensus estimates. Overall, 2023 earnings forecasts for the S&P 500 Index are modestly higher during earnings season. We believe earnings will be challenged in the coming quarters as companies deal with an expected U.S. recession. In this environment, we suggest focusing on quality, and we prefer U.S. Large Cap over U.S. Mid Cap and Small Cap Equities.

S&P 500 Index earnings contracted for the third straight quarter



Sources: Bloomberg and Wells Fargo Investment Institute. EPS = earnings per share. EPS growth measures actual second quarter 2023 EPS as of August 18, 2023, versus second quarter 2023 EPS. An index is unmanaged and not available for direct investment.

Fixed Income

Brian Rehling, CFA
Head of Global Fixed Income Strategy

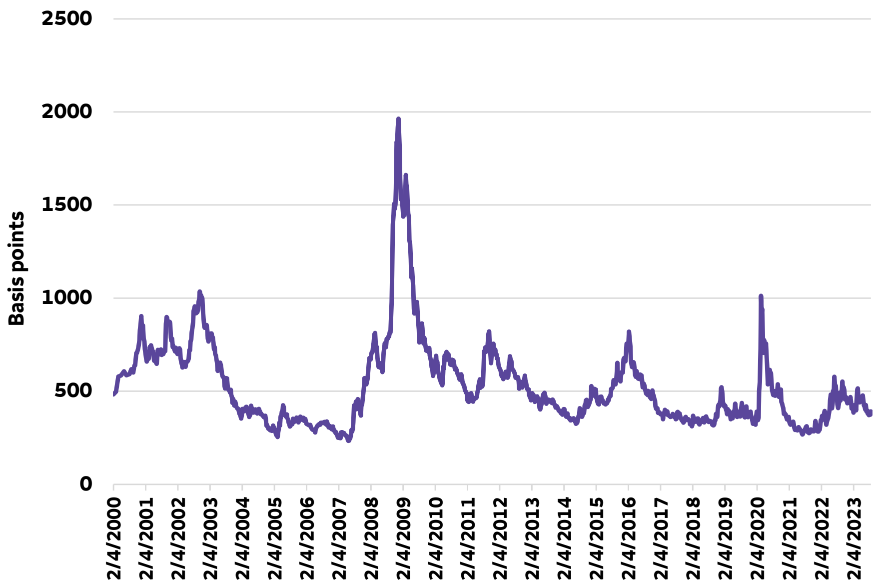
High yield not showing recessionary signals

The high-yield bond market has often been the canary in the coal mine, showing signs the economy is on unstable ground before recession strikes. While we have seen some weakness in the lowest credit quality segments of the high yield market, overall, the high yield sector has shown few signs of stress.

Credit spreads have tended to increase during periods of economic uncertainty, as investors question the stability of debt payments from lower-quality issuers. In general, as credit spreads increase, bond prices fall — leading to poor performance for current holders.

The average spread level of the Bloomberg U.S. Corporate High Yield Bond Index going back to 2000 is 528 basis points (100 basis points equal 1 percent). The current spread level is 392 basis points, well below historical averages. As credit spreads tighten (decline), valuations increase — all else being equal. The opposite occurs as spreads widen or increase.

Bloomberg U.S. Corporate High Yield Bond Index



Source: Bloomberg. Data as of August 22, 2023. 100 basis points equal 1 percent. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

In the past two recessions, spreads have widened to at least 1,000 basis points. While we do not expect to see the same extent of credit-spread widening during our forecasted recession, we do expect spread levels to rise from current levels and the market value of high-yield securities to fall as the economy weakens.

Portfolio implications

We believe investors should consider moving up in credit quality, while avoiding lower-quality issuers, as we expect to enter more challenging economic times. Should high-yield credit spreads widen during an anticipated recession, we then would look to upgrade the High Yield Taxable Fixed Income asset class in an effort to take advantage of better valuations and expected post-recession spread tightening.

Real Assets

"Who dares nothing, need hope for nothing." — Johann Friedrich von Schiller

John LaForge
Head of Real Asset Strategy

Mason Mendez
Investment Strategy Analyst

Silver and gold

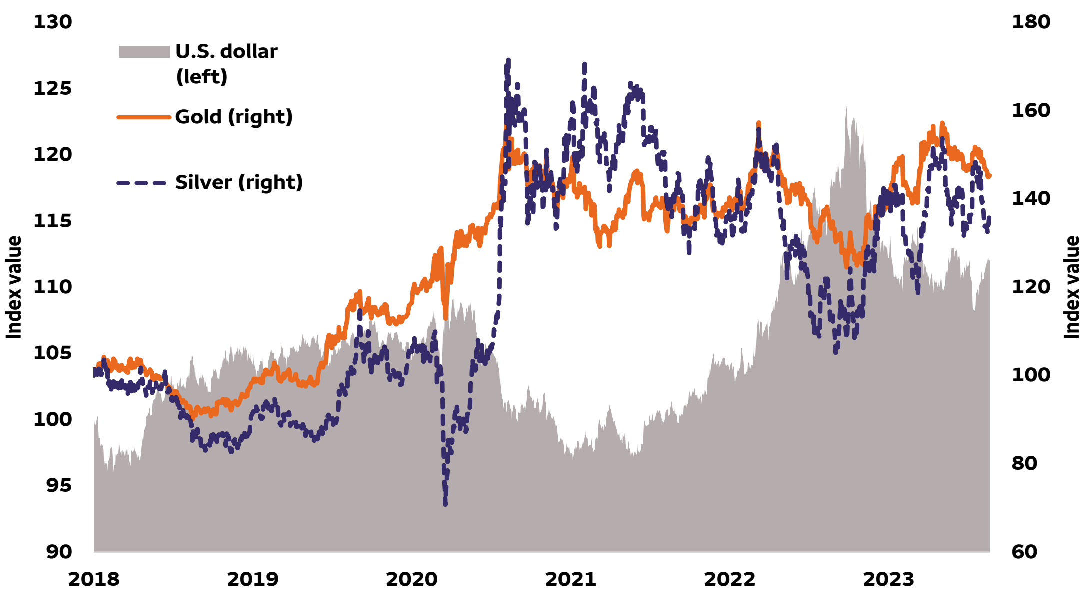
When discussing precious metals, we commonly focus on gold, as it accounts for 77% of the Bloomberg Precious Metals Index. Recently, though, we've been receiving more questions on the lesser weighted metal, silver. While silver and gold prices are influenced by many of the same factors, there are some key differences between the two.

Historically, silver and gold prices have tended to mirror one another (see chart below). They share many of the same performance drivers, such as changes in monetary policy, real interest rates, and the value of the U.S. dollar. Also, both metals are generally priced in U.S. dollars globally. Therefore, a stronger U.S. dollar makes it more expensive for those outside the U.S. to purchase, which can weaken overall demand and ultimately gold and silver prices. This inverse relationship between the U.S. dollar and gold and silver prices can be seen in the chart below.

Outside the impacts of monetary policy, there are other key differences between the two metals. For starters, silver prices are historically more volatile than gold. Over the past 10 years, as an example, silver's daily volatility was double that of gold. This is at least in part due to the numerous industrial uses for silver. In fact, industrial uses were the largest single component of silver demand in 2022, accounting for 44% of total demand; that compares to gold where only 6% of total demand came from industrial use.

Overall, silver and gold prices do tend to mirror one another, but we believe investors should be aware of the differences between the two. We expect both to perform well as the commodity super-cycle bull continues to march on. (If you look at commodity prices over the very long term (hundreds of years), it becomes evident that they tend to move in overall bull and bear cycles, some lasting decades. These are super-cycles.) We view recent weakness as an attractive opportunity for long-term investors looking to add portfolio diversification.

The dollar's impact on silver and gold



Sources: Bloomberg and Wells Fargo Investment Institute. Daily data is from January 1, 2018 - August 21, 2023. Prices are indexed to 100 as of January 1, 2018. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

Alternatives

Mark Steffen, CFA, CAIA
Global Alternative Investment Strategist

Diversifying across private market strategies

It is well known that alternatives can help diversify a portfolio comprised of stocks and bonds. Yet it is lesser known that by diversifying across the distinct types of alternative strategies, investors can realize even greater portfolio diversification and potentially risk-reducing benefits. The return experience of the various alternative sub-categories can differ greatly from year to year. A well-diversified portfolio that includes many diverse types of private capital strategies can offer a less volatile return experience over time.

While Venture Capital strategies achieved a chart-topping 62% horizon internal rate of return (IRR) in 2021, the sub-strategy faced significant headwinds in 2022 and registered a -17.6% horizon IRR. This wild ride could have been partially offset by including an allocation to Infrastructure investments, which achieved more consistent horizon IRRs of 18.9% and 13.0% in 2021 and 2022, respectively.

The various sub-strategies have performed very differently across the evolving stages of the economic cycle. Investors who can allocate across the entire spectrum of private market strategies can potentially reduce the impact of a poor-performing sub-strategy and achieve a less volatile return experience over time. As the chart below shows, the performance over a 15-year investment horizon ranged from top-performing 16.2% for Private Equity – Growth Equity ("Growth equity" in the table) to a low of 5.7% for Natural Resources. However, an allocation that included all the underlying strategies produced a horizon IRR of 10.8% over the entire span.

Investors should avoid the common temptation to only allocate to the strategies that performed well in recent periods, in our view, and maintain a disciplined approach to building a well-rounded alternatives portfolio.

Annual performance of various private capital strategies (2016 – 2022)

2016	2017	2018	2019	2020	2021	2022	15-year IRR (2007-2022)
Natural resources 16.6%	Growth equity 19.3%	Growth equity 22.4%	Growth equity 22.1%	Growth equity 40.4%	Venture capital 62.0%	Natural resources 27.1%	Growth equity 16.2%
Buyout 14.2%	Buyout 18.1%	Venture capital 19.0%	Venture capital 16.5%	Venture capital 37.9%	Growth equity 57.4%	Infrastructure 13.0%	Buyout 12.6%
Growth equity 11.1%	Secondaries 16.3%	Secondaries 14.8%	Buyout 16.2%	Buyout 21.8%	Buyout 50.2%	Value-add real estate 11.6%	Secondaries 12.2%
All private capital 10.7%	All private capital 14.0%	Value-add real estate 13.2%	Secondaries 12.4%	All private capital 16.0%	Secondaries 47.9%	Opportunistic real estate 10.5%	Venture capital 11.3%
Opportunistic real estate 9.8%	Opportunistic real estate 11.4%	Buyout 11.3%	All private capital 11.3%	Secondaries 13.2%	All private capital 43.6%	Private debt 4.0%	All private capital 10.8%
Private debt 9.2%	Value-add real estate 11.3%	All private capital 10.9%	Private debt 8.9%	Infrastructure 6.4%	Natural resources 33.8%	Secondaries 2.8%	Infrastructure 8.4%
Value-add real estate 9.2%	Private debt 11.0%	Infrastructure 10.1%	Value-add real estate 7.8%	Value-add real estate 5.9%	Opportunistic real estate 33.5%	All private capital 0.9%	Private debt 8.3%
Secondaries 6.2%	Venture capital 9.8%	Opportunistic real estate 6.9%	Opportunistic real estate 5.4%	Opportunistic real estate 3.1%	Value-add real estate 29.9%	Buyout 0.4%	Opportunistic real estate 7.8%
Infrastructure 6.1%	Natural resources 9.1%	Private debt 5.0%	Infrastructure 4.0%	Private debt 2.3%	Infrastructure 18.9%	Growth equity -5.6%	Value-add real estate 6.0%
Venture capital -0.4%	Infrastructure 9.1%	Natural resources 4.6%	Natural resources -9.7%	Natural resources -16.9%	Private debt 18.6%	Venture capital -17.6%	Natural resources 5.7%

Source: Pitchbook. Data as of December 31, 2022. Horizon IRRs are a capital-weighted pooled calculation that shows the internal rate of return (IRR) at a certain point in time. The horizon IRRs listed in the chart are one-year pooled IRRs by strategy type of funds available in the Pitchbook database. Note: The various strategy groupings listed in the chart include all fund information available in the Pitchbook private capital database that are classified under the specified strategy types. **Past performance is no guarantee of future results.** See the end of the report for the strategy type definitions. 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.

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, August 28, 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

Asset allocation and diversification are investment methods used to help manage risk. They do not guarantee investment returns or eliminate risk of loss including in a declining market.

A periodic investment plan such as dollar cost averaging does not assure a profit or protect against a loss in declining markets. Since such a strategy involves continuous investment, the investor should consider his or her ability to continue purchases through periods of low price levels.

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. 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. **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.

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Allocation compositions

Moderate Income: 2% Bloomberg U.S. Treasury Bill (1–3 Month) Index, 58% Bloomberg U.S. Aggregate Bond Index, 4% Bloomberg U.S. Corporate High Yield Bond Index, 5% JPMorgan EMBI Global Index, 16% S&P 500 Index, 5% Russell Midcap Index, 4% Russell 2000 Index, 4% MSCI EAFE Index, 2% Bloomberg Commodity Index.

Moderate Growth & Income Liquid: 2% Bloomberg U.S. Treasury Bill (1–3 Month) Index, 30% Bloomberg U.S. Aggregate Bond Index, 6% Bloomberg U.S. Corporate High Yield Bond Index, 5% JPMorgan EMBI Global Index, 24% S&P 500 Index, 10% Russell Midcap Index, 6% Russell 2000 Index, 8% MSCI EAFE Index, 5% MSCI Emerging Markets Index, 4% Bloomberg Commodity Index.

Moderate Growth: 2% Bloomberg U.S. Treasury Bill (1–3 Month) Index, 8% Bloomberg U.S. Aggregate Bond Index, 3% Bloomberg U.S. Corporate High Yield Bond Index, 3% JPMorgan EMBI Global Index, 31% S&P 500 Index, 14% Russell Midcap Index, 10% Russell 2000 Index, 12% MSCI EAFE Index, 12% MSCI Emerging Markets Index, 5% Bloomberg Commodity Index.

Definitions

An index is unmanaged and not available for direct investment.

Bloomberg Commodity Index is a broadly diversified index of commodity futures on 20 physical commodities, subdivided into energy, U.S. agriculture, livestock, precious metals, and industrial metals sectors. Commodity weights are derived in a manner that attempts to fairly represent the importance of a diversified group of commodities to the world economy.

Bloomberg Precious Metals Index is composed of futures contracts on gold and silver. It reflects the return on fully collateralized futures positions and is quoted in USD.

Bloomberg U.S. Aggregate Bond Index is composed of the Bloomberg U.S. Government/Credit Index and the Bloomberg U.S. Mortgage-Backed Securities Index and includes Treasury issues, agency issues, corporate bond issues, and mortgage-backed securities.

Bloomberg U.S. Corporate High Yield Bond Index covers the U.S.-dollar-denominated, non-investment-grade, fixed-rate, taxable corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB= or below. Included issues must have at least one year until final maturity.

Cash: Bloomberg U.S. Treasury Bill (1-3 Month) Index includes all publicly issued zero-coupon U.S. Treasury Bills that have a remaining maturity of less than 3 months and more than 1 month, are rated investment grade, and have $250 million or more of outstanding face value. In addition, the securities must be denominated in U.S. dollars and must be fixed rate and non-convertible.

JPMorgan EMBI Global Index is a U.S.-dollar-denominated, investible, market-cap-weighted index representing a broad universe of emerging market sovereign and quasi-sovereign debt. While products in the asset class have become more diverse, focusing on both local currency and corporate issuance, there is currently no widely accepted aggregate index reflecting the broader opportunity set available, although the asset class is evolving. By using the same index provider as the one used in the developed market bonds asset class, there is consistent categorization of countries among developed international bonds (ex. U.S.) and emerging market bonds.

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

MSCI Emerging Markets Index is a free-float-adjusted market-capitalization-weighted index designed to measure equity market performance of emerging markets.

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 Midcap Index measures the performance of the 800 smallest companies in the Russell 1000 Index, which represent approximately 25% of the total market capitalization of the Russell 1000 Index.

S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market-value-weighted index with each stock's weight in the index proportionate to its market value.

Strategy type definitions (page 7)

All private capital: The index provides pooled return for private capital funds sourced by Pitchbook that are classified as Private Capital. The underlying fund return data is primarily sourced from individual LP reports and serves as the baseline for estimates of activity across the entire fund.

Buyout: The index provides pooled return for private capital funds sourced by Pitchbook that are classified as Buyout. The underlying fund return data is primarily sourced from individual LP reports and serves as the baseline for estimates of activity across the entire fund.

Growth equity: The index provides pooled return for private capital funds sourced by Pitchbook that are classified as Growth Equity. The underlying fund return data is primarily sourced from individual LP reports and serves as the baseline for estimates of activity across the entire fund.

Infrastructure: The index provides pooled return for private capital funds sourced by Pitchbook that are classified as Infrastructure. The underlying fund return data is primarily sourced from individual LP reports and serves as the baseline for estimates of activity across the entire fund.

Natural resources: The index provides pooled return for private capital funds sourced by Pitchbook that are classified as Natural Resources. The underlying fund return data is primarily sourced from individual LP reports and serves as the baseline for estimates of activity across the entire fund.

Opportunistic real estate: The index provides pooled return for private capital funds sourced by Pitchbook that are classified as Opportunistic Real Estate. The underlying fund return data is primarily sourced from individual LP reports and serves as the baseline for estimates of activity across the entire fund.

Private debt: The index provides pooled return for private capital funds sourced by Pitchbook that are classified as Private Debt. The underlying fund return data is primarily sourced from individual LP reports and serves as the baseline for estimates of activity across the entire fund.

Secondaries: The index provides pooled return for private capital funds sourced by Pitchbook that are classified as Secondaries. The underlying fund return data is primarily sourced from individual LP reports and serves as the baseline for estimates of activity across the entire fund.

Value-add real estate: The index provides pooled return for private capital funds sourced by Pitchbook that are classified as Value-add Real Estate. The underlying fund return data is primarily sourced from individual LP reports and serves as the baseline for estimates of activity across the entire fund.

Venture capital: The index provides pooled return for private capital funds sourced by Pitchbook that are classified as Venture capital. The underlying fund return data is primarily sourced from individual LP reports and serves as the baseline for estimates of activity across the entire fund.

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