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TIMELY GUIDANCE
Institute Alert

Timely guidance that may affect your investment strategy

November 15, 2023

Global Investment Strategy Team

☑ Guidance changes

☑ Forecast changes

☐ Allocation changes

Adjusting our 2024 targets and fixed-income guidance

Guidance changes

- **Global fixed income:** Within U.S. Municipal Bonds (Munis), we are upgrading State and Local General Obligation (G.O.) bonds from neutral to favorable and downgrading Essential Service Revenue bonds from favorable to neutral. Still, we are maintaining our overall favorable guidance on Munis, especially with current yields at the highest level in more than 14 years.

Forecast changes

- **Global fixed income:** We are upwardly revising our year-end 2024 interest rate targets to reflect a “higher for longer” rate environment. Broadly speaking, we believe rates are likely to stay high while some components of inflation remain stubbornly elevated. Furthermore, we expect an eventual economic recovery and concerns about U.S. fiscal policy to lead 10- and 30-year U.S. Treasury yields higher by year-end 2024.
- **Global equities:** We are maintaining our year-end 2024 S&P 500 Index earnings and price targets but lowering all other asset-class benchmark targets to reflect the likely challenging global economic environment in the near term.
- **Global real assets:** We are lowering our year-end 2024 targets for West Texas Intermediate (WTI) crude, Brent crude, gold, and the Bloomberg Commodity Index.
- **Currencies:** We continue to expect U.S. dollar depreciation into year-end 2024, and we are tightening our exchange-rate target ranges. Also, we introduce a target range for the Intercontinental Exchange (ICE) U.S. Dollar Index.

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Table 1. 2023 and 2024 year-end forecasts and market targets

Equity targets	2023 year-end targets	New year-end 2024 targets	Previous year-end 2024 targets
S&P 500 Index	4000-4200	4600-4800	4600-4800
S&P 500 EPS	$205	$220	$220
Russell Midcap Index	2700-2900	**2900-3100**	3200-3400
Russell Midcap EPS	$145	**$155**	$160
Russell 2000 Index	1650-1850	**1800-2000**	2000-2200
Russell 2000 EPS	$70	**$65**	$80
MSCI EAFE Index	2000-2200	**2000-2200**	2300-2500
MSCI EAFE EPS	$145	**$150**	$160
MSCI EM Index	850-1050	**900-1100**	1000-1200
MSCI EM EPS	$75	**$70**	$80

EPS=Earnings per share. EM = Emerging Markets.

Fixed Income targets	2023 year-end targets	New year-end 2024 targets	Previous year-end 2024 targets
10-year U.S. Treasury yield	4.00%-4.50%	**4.75%-5.25%**	3.75%-4.25%
30-year U.S. Treasury yield	4.00%-4.50%	**5.00%-5.50%**	4.00%-4.50%
Federal funds rate	5.50%-5.75%	**4.75%-5.00%**	3.75%-4.00%

Real Assets targets	2023 year-end targets	New year-end 2024 targets	Previous year-end 2024 targets
WTI crude oil	$80-$90	**$85-$95**	$90-$110
Brent crude oil	$85-$95	**$90-$100**	$95-$115
Gold	$2100-$2200	**$2100-$2200**	$2300-$2400
Bloomberg Commodity Index	235-255	**235-255**	255-275

Exchange Rate targets	2023 year-end targets	New year-end 2024 targets	Previous year-end 2024 targets
Dollar/euro exchange rate	$1.03-$1.11	**$1.08-$1.12**	$1.12-$1.20
Yen/dollar exchange rate	¥130-¥140	**¥136-¥140**	¥120-¥130
ICE U.S. Dollar Index**	N/A*	**99-103**	N/A*

Source: Wells Fargo Investment Institute, November 15, 2023. Bold type indicates changes. An index is unmanaged and not available for direct investment.

*We are initiating coverage of a dollar composite exchange rate index against its principal developed-market competitor currencies. Please see the following disclosure for more detail concerning the index.

**The ICE U.S. Dollar Index is a weighted average of the value of the U.S. dollar relative to a basket of U.S. trade partner currencies, comprised of the euro, Japanese yen, pound sterling, Canadian dollar, Swedish krona, and Swiss franc. A higher index value indicates dollar appreciation.

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

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Summary

Throughout 2023, we have viewed inflation as the "straw that stirs the economic and financial market drink." What has changed since early 2023 is that investors are beginning to accept that "sticky" inflation is slowing the trend of disinflation by enough that interest rates likely will remain higher for longer. The economy continues to weaken as expectations for near-term rate cuts by the Federal Reserve (Fed) fade and credit conditions deteriorate. The credit squeeze has gained strength from the sharp rise in long-term rates. Much of this increase has to do with the emergent fiscal impasse since September.

Among the myriad consequences of tighter credit in a weakening economy, our outlook now includes even stronger headwinds for small- and mid-sized companies, softer commodity prices, and a stronger U.S. dollar into the first half of 2024. The global economy also is slowing, and any U.S. recession would likely exacerbate that slowdown. However, continued economic weakening should also bring faster disinflation and eventual Fed interest rate cuts. Both of these factors historically have helped spark an economic recovery, which we continue to expect in the second half of 2024.

Our overall investment guidance has not changed. We remain defensive and oriented toward quality should the economy downshift in the coming months as we expect. But the shift to reacceleration we expect later in 2024 should offer broader opportunities across risk markets, such as equities and commodities. While we are not changing our asset class guidance, inflation's sticky components and the surge in long-term yields have triggered several modest year-end 2024 target adjustments and fixed-income sector guidance changes.

"Higher for longer" across the curve

The Fed continues its fight against inflation. While there is evidence that its actions have had some success, the fight is not yet over. We expect the Fed to remain vigilant into next year, and as a result, we are increasing our year-end 2024 interest rate targets.

If the economy contracts early in 2024, as we expect, the Fed is likely to cut its short-term interest rate target in order to support the economy. However, some sticky components of inflation have slowed the pace of disinflation, and the Fed has signaled a "higher-for-longer" path of interest rates, until disinflation resumes its prior pace. Therefore, we are increasing our year-end 2024 federal funds rate target to 4.75%-5.00% from 3.75%-4.00%. This target increase changes only the degree, not the direction, of interest rate cuts that we expect from Fed policy next year.

In the near-term, however, the path of longer-term rates depends heavily on the state of the economy. We anticipate that rates will fall in the coming months as a weakening economy bolsters investor demand for high-quality Treasury securities. However, a second-half economic recovery should then push long-term rates higher by year-end. U.S. fiscal deficit widening and correspondingly large U.S. Treasury debt issuance should add further upward pressure to yields.

Seeking higher-quality Muni sectors

At this point in the economic cycle, the potential for a slow and uneven recovery for bonds with economically sensitive revenue streams makes the broad revenue bond sector particularly susceptible to underperformance, negative ratings actions, and even payment defaults for the weakest credits — especially if the economy falls into a recession. For this reason, we are downgrading Essential Service Revenue bonds to neutral from favorable. However, we are upgrading State and Local G.O. bonds to favorable from neutral, particularly those rated in the double-A category. Given what are generally broad and diverse economies, combined with significant tax-raising

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and expense-management capabilities, individual states have historically shown significant resilience when it comes to credit quality, even during times of recession and economic uncertainty.

Equity targets reflect near-term headwinds, recovery later in 2024

We are maintaining our 2024 S&P 500 Index earnings and price targets, while adjusting lower all other asset class benchmark targets. Avoiding a recession in 2023 likely allows for S&P 500 Index earnings to come in at around $215, so our 2024 S&P 500 Index earnings per share (EPS) target of $220 reflects that the economy's pivot from a growth trough to recovery will likely raise EPS. The S&P 500 Index price target range for year-end 2024 is unchanged at 4600-4800, reflecting upside from today's levels. We expect price increases to be driven by price-to-earnings (P/E) multiple expansion, which has been typical in past early-cycle recoveries.

We have reduced our year-end 2024 earnings targets for the Russell Midcap Index and the Russell 2000 Index (small caps) to reflect lower growth potential and a greater sensitivity of U.S. mid- and small companies to economic weakness. We expect early-2024 weakness in both indexes, followed by an earnings recovery later in 2024. Our lower index targets reflect the downshift in earnings potential and accounts for market movements to date.

We have also lowered our MSCI EAFE Index and MSCI Emerging Markets (EM) Index earnings and price targets for year-end 2024 to better align with our near-term global economic forecast. Even with the downward adjustments, all year-end 2024 index price targets show upside from current levels. However, the path is likely to be choppy. Earnings and sentiment could be tested should the global economy weaken into the first part of 2024 as we expect.

Commodity target revisions point to consolidation in prices

Throughout 2023, crude oil has shown strong performance, but prices will likely soften should demand drop off amid an economic slowdown. Despite the weaker demand outlook, supply growth is still limited, which we believe will support prices by year-end 2024. So far, OPEC's (The Organization of the Petroleum Exporting Countries) supply cuts have been effective in tightening global supply, and we believe the group will be slow to unwind its production cuts as the economy weakens. This, combined with limited capital expenditures from U.S. producers, should restrict global supply growth and support prices by year-end 2024.

Gold's price has risen in 2023, especially in the past few months, as the precious metal has attracted buyers who anticipate recession, a less hawkish Fed, lower interest rates, heightened geopolitical risk, and ultimately, a lower U.S. dollar. We, too, suspect that these trends will soon emerge, but we wonder how much of gold's 2023 strength has already anticipated at least some of the magnitude of these trends. We remain positive on gold, but to be prudent, our year-end 2024 target reduction reflects less additional upside than our prior target range.

In light of higher interest rates and deteriorating economic conditions, we are lowering our year-end Bloomberg Commodity Index price target range for year-end 2024, as seen in Table 1. Should economic activity slow further, we suspect that commodity prices will soften on weaker demand. Should economic growth rebound later in 2024 as we expect, we believe demand will reaccelerate on already tight supply. Despite the lower year-end 2024 target, we remain favorable on Commodities as a broad asset class.

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Dollar strength should give way to a modest depreciation by year-end 2024

The U.S. dollar's strength against major developed-market currencies, as reflected in the rise of the ICE U.S. Dollar Index since mid-July, reflects a trend that we believe will persist into early 2024. The factors that have supported the dollar's run-up appear to remain in place and have exceeded our previous expectations. However, we believe that these factors will likely fade — and weaken the dollar — as the global economy reaccelerates later in 2024. While we expect global risk appetite to improve, and U.S. interest rates to fall faster than European and Japanese rates, a lower dollar should allow the yen and euro to stage a rebound by year-end 2024. More specifically:

- **Euro exchange rate target**: We believe a European recession and recovery will precede those in the U.S., which may be a negative for the euro through mid-year 2024 but positive by year-end 2024 in a European economic recovery. Policy rates in Europe currently are lower than those in the U.S., but the Fed may be more active next year, by comparison, in cutting rates.

- **Japanese yen exchange rate target**: The Japanese economy has held up well, supported by accommodative monetary policy from the Bank of Japan (BOJ). The yen has depreciated significantly, as U.S. interest rates have risen much faster in 2022 – 2023 than the rates that BOJ policy has created. However, we expect BOJ policy to become less accommodative in 2024, while U.S. yields begin to fall. These two changes point to a stronger yen by year-end 2024.

- **ICE U.S. Dollar Index**: In our view, these same factors support a broader depreciation in the dollar by year-end 2024, which we reflect in our inaugural year-end target range for a composite exchange rate of the dollar.

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Risk considerations

Forecasts, targets, and estimates are based on certain assumptions and on our current 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. **Currency risk** is the risk that foreign currencies will decline in value relative to that of the U.S. dollar. Exchange rate movement between the U.S. dollar and foreign currencies may cause the value of a portfolio's investments to decline. **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. **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. 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.

Definitions

Bloomberg Commodity Index is comprised of 22 exchange-traded futures on physical commodities and represents 20 commodities weighted to account for economic significance and market liquidity.

ICE U.S. Dollar Index is a weighted average of the value of the U.S. dollar relative to a basket of U.S. trade partner currencies, comprised of the euro, Japanese yen, pound sterling, Canadian dollar, Swedish krona, and Swiss franc. A higher index value indicates dollar appreciation.

MSCI EAFE Index is designed to represent the performance of large and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the U.S. and Canada.

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

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

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 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 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.

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