



# Investment Strategy

Weekly guidance from our Investment Strategy Committee September 9, 2024

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- The new interest-rate cutting cycle has been well telegraphed by the Federal Reserve (Fed), and it is almost certain that it will begin at the Fed’s next meeting on September 18.
- As rate cuts begin, our expectation is that the U.S. Treasury yield curve will continue to steepen, allowing bond prices to rally. We currently like the intermediate portion of the curve, which we think may still provide attractive returns while minimizing the risks that come with extending duration.

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- The S&P 500 Index has rebounded and now sits just below key resistance at previous all-time highs.
- We believe there will be additional bouts of volatility between now and the November elections, and investors should take the opportunity to rebalance and trim risk assets.

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- Since global central banks began ramping up gold purchases in 2022, gold has outperformed silver — as of September 3, 2024, this outperformance amounted to 16%.
- We expect central banks to continue to buy gold into 2025, which should continue to support gold prices over silver prices.

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- We believe hotel real estate may go through a period of softness, given our economic outlook and waning consumer spending.
- Investors should diversify their Private Real Estate holdings across property types with the goal of enhancing long-term return potential and mitigating potential downside.

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# Fixed Income Spotlight

**Luis Alvarado**

Global Fixed Income Strategist

## The fixed-income consensus view

In many of our recent interactions, we have witnessed investors' warm embrace of "the fixed-income consensus view." Investors appear mostly bullish on bonds, supported by the much-anticipated interest-rate cutting cycle from the Fed; as interest rates fall, bond prices increase. We agree. It also seems that the consensus view includes a near-term deterioration in the macroeconomic outlook. This could end up being beneficial for bonds as well, given that investors usually seek the stability of fixed income during times of uncertainty. In this cover story, we address three fixed-income topics that are in clients' minds and discuss our view on the near-term implications for investors.

### 1. The Fed beginning a new interest-rate cutting cycle

According to Fed Chair Jerome Powell, "the time has come for [monetary] policy to adjust." The new interest-rate cutting cycle has been well telegraphed by the Fed, and it is almost certain that it will begin at the Fed's next meeting on September 18. Details regarding the size of the cut and the pace of further cuts at upcoming meetings remains largely dependent on incoming economic data, the evolving outlook, and the balance of risks. In our view, the Fed is not committed to a single course of action — it will continue to calibrate between its dual mandate of price stability and a strong labor market.

On the other hand, it seems that financial markets still remain ahead of the Fed as the market is pricing the federal funds rate in the range of 3.00% – 3.25% by the end of 2025. In our view, this represents perhaps a bit too many rate cuts priced in, given that the consensus on the macroeconomic landscape assumes that the U.S. avoids a recession over the next 6 to 18 months. We also believe that the Fed's main aim is to move away from being overly restrictive while attempting to find an interest-rate level that is more in line with a continuation of a soft landing.

### 2. The U.S. Treasury yield curve beginning to steepen (that is, un-invert)

Historically, U.S. recessions have appeared once the yield curve re-steepens following periods of inversion. This has occurred mostly as a function of the Fed overshooting during the tightening cycle and then rapidly attempting to correct course by cutting rates but being too late to avoid a recession. This time it appears that the outcome will be different, at least in the near term, given the expectation that the Fed is only cutting rates as inflation has been declining and not because it needs to salvage the economy from a recession.

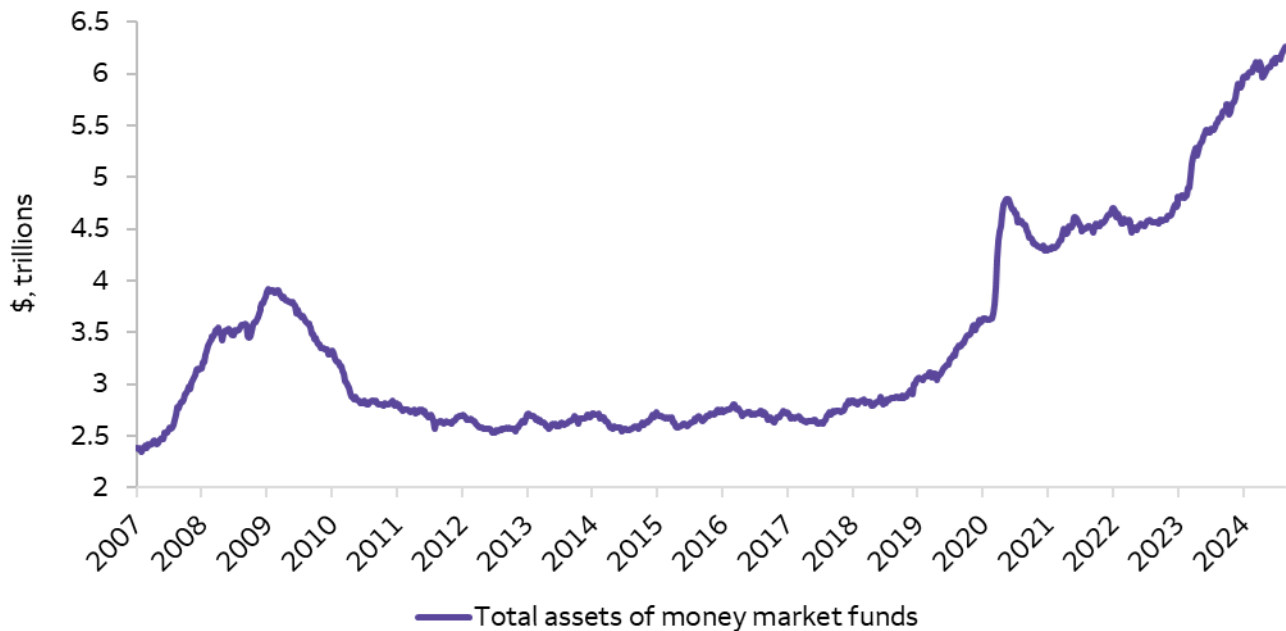
The consensus view goes something like this: bond prices are expected to rally as interest rates decline across the curve. In the near term, the short end of the curve will likely perform best as Fed rate cuts cause short-term interest rates to decline at a faster pace, but intermediate- and long-term bonds will also rally as the longer end of the curve declines as well, given the expectation for a gradual economic slowdown. However, we think the relative advantage of short-term fixed income will be short lived because once those short-term bonds mature, they will need to be reinvested at a lower rate (reinvestment risk). Investors should keep in mind that non-recessionary easing cycles could also be bearish for long-term bonds because there is no regular pattern of interest-rate moves in the long end following Fed rate cuts. Hence, we currently like the intermediate portion of the curve, which we think may still provide attractive returns (yield from income plus price appreciation if interest rates fall) while

minimizing the risks that come with extending duration if the economy avoids a recession and quickly resumes its upward economic-growth trajectory.

### 3. The great rotation — From money markets to extending out the maturity curve

Continuing with the idea of reinvestment risk mentioned above, we have been encouraging investors to prepare a plan on how to deploy their excess cash allocations into other asset classes with higher expected returns once the Fed starts the rate-cutting cycle. For now, the data is showing that investors in aggregate are not in a hurry to rotate out of ultra-short-term investments like Treasury bill (T-bills) or money market funds. On the contrary, inflows to money market funds have continued even with Fed rate cuts on the horizon.

#### Money market fund assets have continued to grow, topping all-time highs



Sources: Investment Company Institute and Wells Fargo Investment Institute. Data as of September 3, 2024. Weekly data from January 1, 2007, to August 28, 2024.

We agree that money market rates declining from 5.25% to 4.25% over the next six months is not tragic. In our view, the risk of staying overly concentrated in cash or cash-equivalent investments relative to holding other fixed-income investments across the curve is that if the economy turns sour faster than expected, cash investors will not be able to benefit from the price appreciation that bonds experience once interest rates fall across the curve. Bottom line, we believe that investors will be better rewarded by diversification across the curve rather than an overconcentration in the ultra-short-term space.

# Equities

**Sameer Samana, CFA**

Senior Global Market Strategist

## Now fairly valued

In the past few weeks, the S&P 500 Index rallied 10.3% from its low on August 5 to its high on August 30 before pulling back. The rally was due to economic data that was more consistent with a soft landing than a hard landing, reinforcement by Fed Chair Powell that it was time to start cutting interest rates, and the return of investors that had been forced to liquidate during the early August swoon. While we believe the S&P 500 Index remains in an uptrend, it now finds itself facing key resistance at the all-time high (5,670).

This recovery is even more remarkable given that almost none of the concerns that bothered markets just a few weeks ago have gone away. We still have high levels of uncertainty around geopolitics in the Middle East, the upcoming neck-and-neck U.S. elections, the cooling global economic outlook, and increasing doubts about the near-term prospects for artificial intelligence. For these reasons, we find it unlikely that the S&P 500 Index will reach meaningful new highs in the coming months. However, this presents an opportunity for dynamic investors to rebalance portfolios and trim risk assets in line with our recommended allocations, especially unfavorable areas such as Emerging Market Equities and the Consumer Discretionary, Real Estate, Consumer Staples, and Utilities sectors.

The chart below suggests the S&P 500 Index remains in an uptrend and should find support at the 50-day moving average (5,504), followed by the 200-day moving average (5,133). Resistance on the way up should be found at the all-time high (5,670) and psychologically important round numbers (5,700 and 5,800).

### S&P 500 Index close to the all-time high



Sources: Bloomberg and Wells Fargo Investment Institute. Daily data from September 3, 2021, through September 3, 2024. SPX = S&P 500 Index. SMAVG (50) = 50-day simple moving average. SMAVG (200) = 200-day simple moving average. RSI = relative strength index. Technical analysis is based on the study of historical price movements and past trend patterns. There is no assurance that these movements or trends can or will be duplicated in the future. **Past performance is no guarantee of future results.**

## Real Assets

**John LaForge**  
Head of Real Asset Strategy

**Mason Mendez**  
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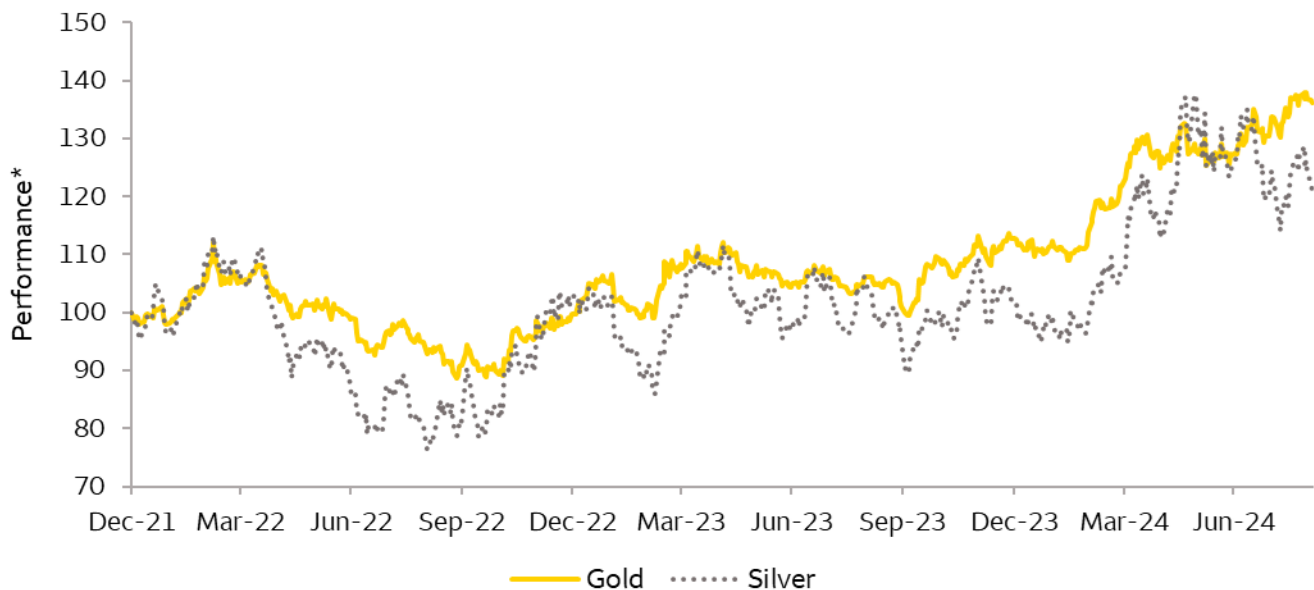
### Gold outperforming silver

The Precious Metals sector was the best-performing Commodities sector in 2023 and is once again so far in 2024, up 19% year to date (as of September 3). The sector has benefited from persistent economic uncertainties and heightened geopolitical risks, which have driven investors toward safe-haven assets. It has also benefited in recent months as it has become clearer that the Fed will likely begin cutting interest rates soon.

Within the sector, gold has emerged as the shining star, largely outperforming other precious metals since 2022 (see chart). Gold's outperformance can largely be attributed to one specific demand driver — central banks. Central banks have been aggressively purchasing gold over the past two years. Over the past 12 months alone, central banks have purchased 1,053 metric tons of gold, which is roughly double the amount purchased in 2021 (that is, 450 metric tons).

Looking into 2025, we believe that many of these same trends will remain intact — we expect the Precious Metals sector to continue outperforming with gold continuing to best the other precious metals. For year-end 2024, our price target range for gold remains \$2,400 – \$2,500 per troy ounce, and for year-end 2025, the range is \$2,500 – \$2,600 per troy ounce.

### Gold versus silver performance since 2022



Sources: Bloomberg and Wells Fargo Investment Institute. Daily Data is from December 31, 2021 – September 3, 2024. \*Performance indexed to 100 as of December 31, 2021. **Past performance is no guarantee of future results.**

# Alternatives

**Chao Ma, PhD, CFA, FRM**

Global Portfolio and Investment Strategist

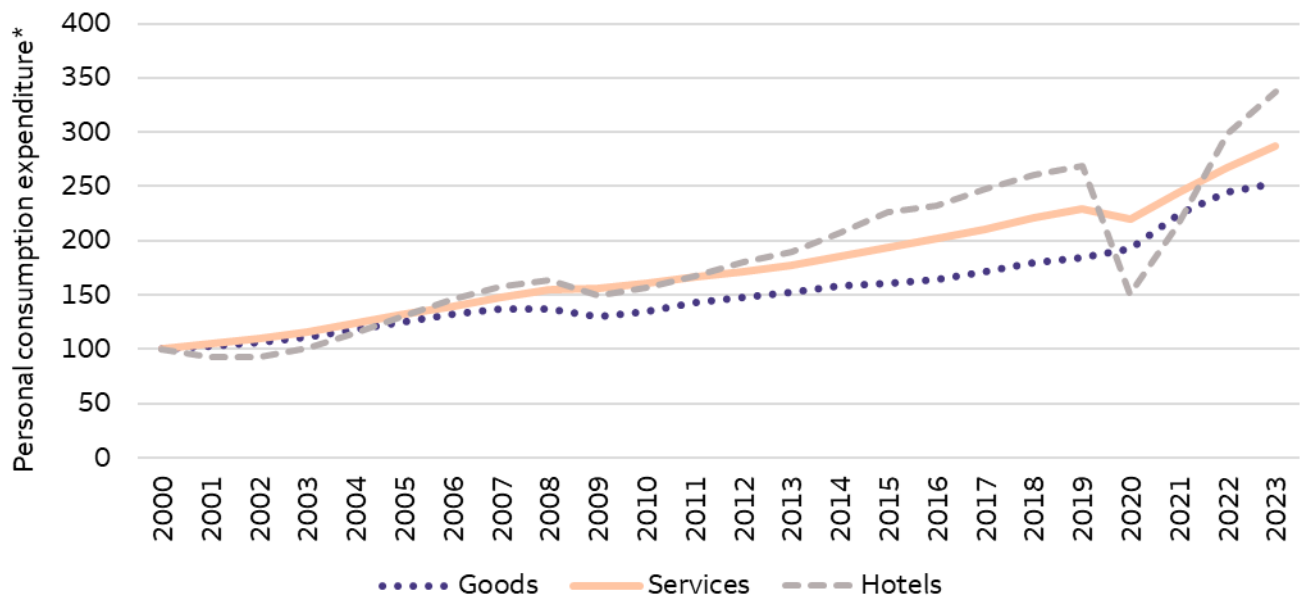
## Recalibrating expectations for hotels

The coronavirus pandemic has led to a transition in the hotel real estate sector, with leisure-oriented demand starting to gain an increasing share relative to business-oriented reservations. According to Green Street, corporations focused on expense optimization in recent years and utilized virtual engagements to replace at least some in-person meetings. The pandemic also accelerated the shift toward experience-oriented spending, as evidenced in consumers' growing expenditures in leisure-related hotel bookings relative to physical goods and service consumptions (chart below). Over the long term, this shift to leisure-oriented demand may present a favorable backdrop for hotel real estate as hotel operators generally retain greater pricing power in leisure-oriented stays relative to business reservations.

However, we believe the continued economic softness and waning discretionary spending (especially by lower-income consumers) may suggest slowing hotel demand in the short run. Further, hotel real estate's cyclical and capital-expenditure-heavy nature will likely continue to limit its upside potential. In particular, any slowdown in demand triggered by economic weakness can impact operating results relatively quickly and materially deteriorate the property's profit margin. The silver lining this time may be the limited growth in hotel inventory and the recovery in business travel, which may help to cushion the negative impacts.

Overall, we believe hotel real estate may go through a period of weakness, given our economic outlook and softening consumer spending. As a result, we believe investors should diversify their Private Real Estate holdings across property types with the goal of enhancing long-term return potential and mitigating potential downside.

### Consumer spending on hotels has grown at a faster rate than goods and services consumptions in recent years



Sources: Green Street and Wells Fargo Investment Institute. Data as of December 31, 2023. \*Indexed to 100 in 2000.

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.

# Tactical guidance\*

## Cash Alternatives and Fixed Income

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

## Equities

Most Unfavorable	Unfavorable	Neutral	Favorable	Most Favorable
	Emerging Market Equities	Developed Market Ex-U.S. Equities  U.S. Mid Cap Equities  U.S. Small Cap 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, September 9, 2024.

\*Tactical horizon is 6-18 months

\*\*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

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. 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.

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. This can result in greater price volatility. Risks associated with the **Consumer Discretionary** sector include, among others, apparel price deflation due to low-cost entries, high inventory levels and pressure from e-commerce players, reduction in traditional advertising dollars, increasing household debt levels that could limit consumer appetite for discretionary purchases, declining consumer acceptance of new product introductions, and geopolitical uncertainty that could affect consumer sentiment. **Consumer Staples** industries can be significantly affected by competitive pricing particularly with respect to the growth of low-cost emerging market production, government regulation, the performance of the overall economy, interest rates, and consumer confidence. **Utilities** are sensitive to changes in interest rates, and the securities within the sector can be volatile and may underperform in a slow economy.

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.

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## Definitions

An index is unmanaged and not available for direct investment.

**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.

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