

2020 Midyear Outlook

Recession, Recovery, and Resilience

June 2020

A letter to investors from Darrell L. Cronk

June 2020



When we set our 2020 investment theme of resilience last December, we foresaw market volatility and a vulnerable, late-cycle global economy. But we did not anticipate the most serious pandemic in a century—and likely the fastest to develop in human history. In 2020, we have seen:

- The S&P 500 Index follow a record high with its fastest-ever decline into a bear market.
- The first-ever negative West Texas Intermediate (WTI) oil prices caused by a perfect storm of demand destruction, excess supply, and storage limitations.
- The economy's plunge into a deep recession, sending U.S. Treasury rates to all-time lows.
- A record level of unemployed workers as the economy came to an almost complete stop.

The economic recession that officially began in February is historic for its depth, but governments are responding proportionately, and with speed and growing global coordination. These jarring events will impact portfolios far beyond the present. The task of our Midyear Outlook report is to examine the contours of change and how we believe investors should adapt.

As stay-at-home orders end globally, pent-up demand for everything from haircuts to houses should spark an economic and earnings recovery later this year. The economic recovery may have a quick start in the second half of 2020, but we expect only a gradual rebound through 2021. New protocols for social interaction may limit activities, such as sporting events or travel. Also, mortgage and rent payments delayed during the recession will begin to come due, and many businesses are likely to be close to insolvency after the months-long shutdown.

The U.S. entered the recession as the strongest world economy, and we expect it to emerge the same. In turn, we expect low interest rates, low inflation, and U.S. equity outperformance, especially in large-cap sectors in which many companies have strong balance sheets and earnings recovery prospects. Fixed income and commodities may offer select opportunities.

Our report also previews the trends that we expect three to five years ahead. Even if scientists find a COVID-19 vaccine, the threat of future pandemics likely will create new trends or accelerate existing ones. Consumers and businesses are likely to increase savings and otherwise build financial flexibility against new threats to the economy. Increasing demand and preparedness also should expand the health care system and investment opportunities.

Many risks and opportunities will arise. Therefore, a temperament of resilience and flexibility could not be more appropriate to maintain. To that end, my colleagues and I are pleased to offer this 2020 midyear report with its extended outlook. We hope that you and yours will stay well. We look forward to walking with you through these challenging times, and we are always grateful for the trust you extend to us as our clients.

“The most important quality for an investor is temperament, not intellect.”

—Warren Buffett

A handwritten signature in black ink, appearing to read 'Darrell Cronk', written in a cursive style.

Darrell L. Cronk, CFA
President, Wells Fargo Investment Institute
Chief Investment Officer, Wealth and Investment Management

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Global economypage 4

- We expect a return to moderate growth by 2021, following a solid rebound in the third quarter from the economy's free fall. A more moderate return to growth is expected in other advanced economies that continues through next year.
- We expect the dollar to slip modestly from midyear levels as falling U.S. interest rates remove support. Emerging market currency depreciation should end, but those currencies likely will struggle to recover amid weakened global trade.

Global equitiespage 6

- We continue to expect that the recovery process for equity markets will take some time, but we see opportunities for earnings and price-level improvements in 2021.
- We favor updating equity allocations to avoid overexposure to the most volatile equity asset classes, such as U.S. small-cap equities, developed market equities, and emerging market equities—and in the Energy, Materials, Real Estate, and Industrials sectors.

Global fixed incomepage 8

- A low-yield environment is likely to persist despite an avalanche of new supply.
- Credit-focused fixed-income classes (such as corporate bonds) should produce solid returns as the economy improves.

Global real assets page 10

- We suspect that commodities are primed to rebound over the coming year.
- Most commercial real estate sectors appear to be caught in the crosshairs of the global lockdown, with few clear answers on their future.

Global alternative investments* page 12

- The coronavirus crisis has disrupted many companies and simultaneously accelerated the default cycle. We foresee opportunities in strategies that provide lending and liquidity, followed by dislocation and distress.
- The economic downturn has created challenges for income-seeking investors but also opportunities in alternative investments, such as those that specialize in distressed debt.

2020 & 2021 economic and market forecasts page 14

Adapting to change—themes for the next 3 to 5 years. . . . page 16

Secular changes will emerge from the COVID-19 pandemic:

1. Shifting consumption patterns
2. Balancing business flexibility with cost control
3. Broadening government economic influence
4. Intensifying international tensions
5. Increasing importance of health care to the economy

*Alternative investments are not suitable 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.

Please see pages 22 to 23 for important notes, definitions, and risk considerations.

Selected year-end 2020 forecasts

See pages 14–15 for our complete 2020 and 2021 economic and market forecasts

-4.5%

U.S. GDP growth

0.7%

U.S. inflation
Consumer Price Index

3,150–3,350

S&P 500 Index

0.00%–0.25%

Federal funds rate

0.75%–1.25%

10-year U.S. Treasury
note yield

\$35–\$45

West Texas Intermediate
crude oil per barrel

Sources: Wells Fargo Investment Institute and Wells Fargo Securities Economics Group, June 15, 2020

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

Signs of a reawakening



Gary Schlossberg
Global Strategist



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After a strong late-year start in 2020, the economic recovery should mark a moderate 2021 pace

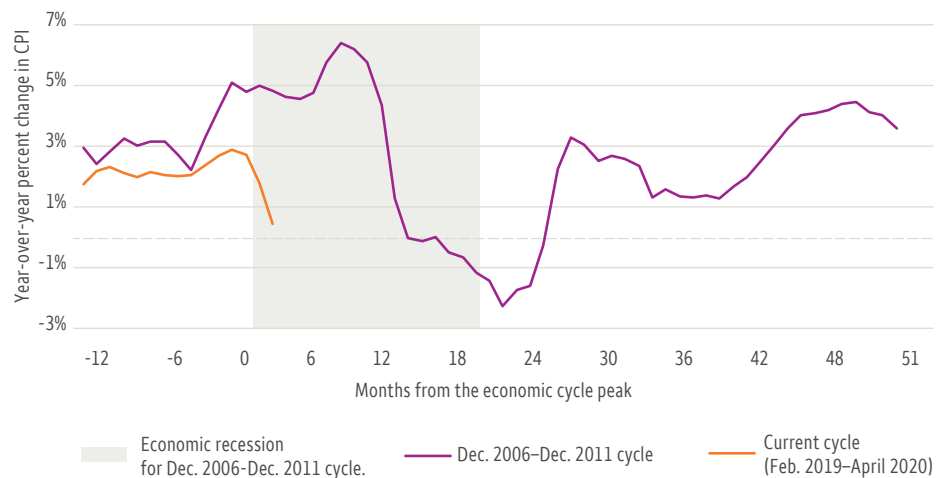
The uncertainty of the economic outlook is as epic as the preceding deep slump. Steady-to-improving weekly and daily data are laying the groundwork for growth to return during the third quarter. The economy’s likely trajectory is a strong start to the recovery in this year’s second half, before a moderate and more sustainable growth pace takes hold in 2021.

Our view of moderate growth in 2021 following a typical rebound from a deep recession is based on a gradual economic reopening, diluted by social distancing and a cautious reemergence by households. The main risks to our view are a fresh surge in infections and a self-perpetuating weakness in the economy. The lockdowns drove the economy’s slump. If the reopening fails to generate new spending, bankruptcies and unemployment could extend the contraction.

Advanced economies outside of the U.S. likely face a deeper recession and a weaker recovery because of greater exposure to slumping world trade, demographic and structural restraints on growth, and more limited policy support. Overall, emerging markets should suffer less than developed markets this year and post stronger 2021 gains in a pattern shaped largely by China’s early start and sustained recovery. Most other emerging market countries are likely to be hurt this year by trade exposure to slumping advanced economies and, in 2021, by pandemic-related disruptions at home.

Another bout of deflation?

We expect the U.S. to avoid deflation but to see inflation slow to less than half of the Federal Reserve’s (Fed’s) official 2% target rate similar to the last cycle’s declines in spending and oil prices.



Sources: U.S. Bureau of Labor Statistics and WFIL. Monthly data, December 2006–April 2020. Year-ago percent change in the Consumer Price Index (CPI), beginning 12 months before the peak in economic activity, in percent.

Inflation pressure remains muted

The inflation outlook is as important to investors as the economy's trajectory. We expect U.S. inflation to slow to less than half of the Fed's official 2% target rate similar to the last cycle's declines, which were led by lower oil prices and slower spending generally (see chart on page 4). Weaker-than-trend U.S. economic growth should maintain a low-inflation environment that blocks spot shortages of food or other goods from producing anything but temporary consumer-price-inflation pressure. Aggressive economic stimulus should pose little immediate threat to inflation for just those reasons.

We believe Europe and Japan are headed for full-year 2020 price declines, or deflation, and a return to subdued 1% inflation in 2021 amid slow growth and excess capacity. Emerging market inflation likely will steady at 4% this year and next—its lowest reading in more than 40 years—partly on shallower economic declines, cushioned by less vigorous pandemic-control measures. For investors, deflation increases the chances of negative interest rates and their distorting effects on financial markets and asset values.

Dollar strength should be capped versus the euro, but emerging market currencies may struggle

We believe that the dollar has peaked against developed market currencies but will slide only modestly further through 2021. Expected U.S. economic outperformance during the recovery should support the dollar and limit depreciation. The main risk is a deeper dollar slide --this could happen, for example, if the U.S. were to move toward a new policy to promote dollar depreciation, or if more coordinated eurozone fiscal and monetary crisis responses prove effective in practice.

Emerging market currencies may stabilize after significant early 2020 declines. While a weaker dollar may allow them to take back much of their early 2020 losses, it is hard to foresee sustained emerging market currency recoveries outside Asia; emerging economies face headwinds that predate the coronavirus crisis, including slow growth in global demand, depressed commodity prices, and contracting trade. Lower interest rates may further undercut any recovery in currencies.

Key takeaways:

- We believe a moderate economic recovery is the most likely outcome. We also expect a return to positive international growth in the second half of 2020.
- We expect low, but positive, U.S. inflation. Deflation (falling prices) is likely in other developed economies.

What it means for investors:

- We expect the dollar to slip further from midyear 2020 levels. However, U.S. leadership in the global economic recovery should moderate the dollar's dip and remains the basis for a tilt toward U.S. assets. A slow recovery through 2021 would continue to favor higher-quality, more-liquid assets.

Earnings should rebound, but only partially



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Our forecast continues to favor U.S. equities over international equities

We have reduced our 2020 full-year earnings per share (EPS) targets for all major equity indices due to the COVID-19 pandemic. We estimate that S&P 500 Index 2020 EPS will decline by 30% to just \$115. Our 2020 year-end median price target for that index is 3,250, implying a price/earnings (P/E) ratio of 28x. Nevertheless, we believe worldwide reopenings, improving economic data, and bullish investor sentiment support further 2020 gains. Broadening market participation, a steepening yield curve, and a softening U.S. dollar add support. Even so, the ongoing uncertainty surrounding the pandemic and the November elections may lead equity global markets at times to trade in ranges around our targets.

For 2021, investors should focus on the potential for both earnings improvement and higher equity prices. Our preliminary 2021 EPS target for the S&P 500 Index is \$145, with a 2021 year-end median target of 3,500. Our 2021 earnings target assumes a short-lived economic downturn followed by a gradual recovery in corporate revenues and profits in the coming quarters. The 2021 price target implies a trailing P/E ratio of 24x, which is a reasonable level seen in previous market and earnings recoveries.

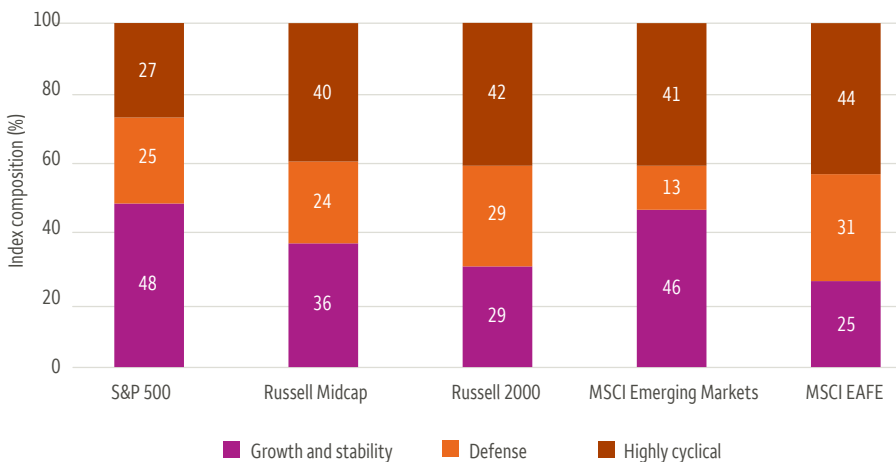
For well over a year, we have guided investors to move up in quality within their equity exposure. This includes a focus on U.S. equities over international equities and large-cap and mid-cap stocks over small-cap equities. We believe that this remains the appropriate positioning, given economic and earnings uncertainty, limited upside to our 2020 year-end targets, and our expectation for the U.S. economy to lead the global recovery.

We favor high-quality asset classes and sectors

The more cyclical an asset class, the more likely it is to underperform during a recession. Large-cap and mid-cap equities tend to have the lowest exposure to highly cyclical sectors and the highest exposure to growth, stability, and defense—reinforcing our favored view of these asset classes in this weak economic environment.

Sector composition matters

Large-cap and mid-cap equities generally have the lowest exposure to highly cyclical sectors—reinforcing our favored view of these asset classes in a weak economic environment.



Sources: Wells Fargo Investment Institute and Bloomberg, June 1, 2020. Growth and stability: Communication Services, Consumer Discretionary, Information Technology. Defense: Consumer Staples, Health Care, Real Estate, Utilities. Highly cyclical: Energy, Financials, Industrials, Materials. Please see the end of this report for definitions of indices and descriptions of asset-class and sector risks.

From a tactical perspective, we continue to lean toward quality, growth, and stability while we remain unfavorable on the most highly cyclical sectors. Specifically, we continue to favor the Communication Services, Consumer Discretionary, Financials, and Health Care sectors, and we are most favorable on Information Technology. We remain unfavorable on the Industrials and Real Estate sectors and are most unfavorable on Energy and Materials. As we enter the recovery phase, we will consider increasing our cyclical exposure.

International equities are expected to underperform in the near term

While the U.S. was on strong economic footing heading into the coronavirus crisis, many international economies were stagnating or already contracting. Moreover, earnings growth rates for non-U.S. stocks had been faltering prior to 2020, and the coronavirus pandemic only added to the weakness.

We believe that corporate earnings will be challenged in 2020, with earnings for the MSCI EAFE Index expected to decline by more than 33% and EPS for the MSCI Emerging Markets Index expected to plunge by nearly 40%, compared to 2019. While we expect earnings growth to resume in 2021, which should support non-U.S. equity prices, international market fundamentals will likely remain at a relative disadvantage. We continue to believe that U.S. equities will outperform over our tactical horizon (6 to 18 months).

Key takeaways

- Corporate earnings will be impaired in 2020; however, we expect profits to rebound in 2021.
- Higher-quality U.S. equity classes and sectors should continue to outperform during the recession and while economic and earnings uncertainty persists.

What it means for investors

- Investors who are not at their target allocations for U.S. large- and mid-cap equities might consider rebalancing from potentially riskier equity classes, especially U.S. small-cap equities and developed and emerging market equities.

Favored asset classes

- U.S. Large-Cap Equities
- U.S. Mid-Cap Equities

Favored equity sectors

- Most-favored equity sector
 - Information Technology
- Favored equity sectors
 - Communication Services
 - Consumer Discretionary
 - Financials
 - Health Care

Expect rates to stay low



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Head of Global Fixed
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Historic amounts of liquidity continue to support fixed-income prices

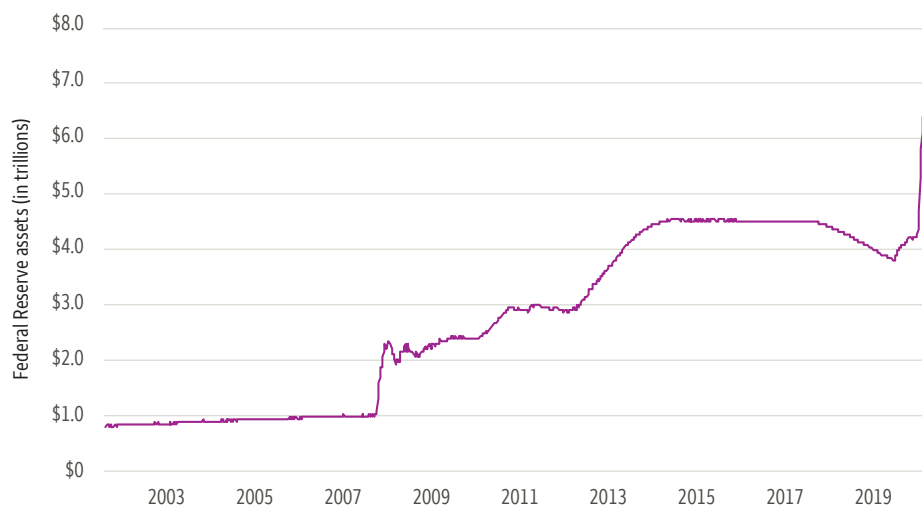
Fiscal policymakers and the Fed have taken unprecedented steps to support the economy and financial markets. The liquidity that has been (and will continue to be) injected into fixed-income markets is historic. Significant Fed balance-sheet expansion and new lending facilities have provided needed liquidity and support for fixed-income prices, leading to a low-yield environment that we expect to continue through at least the end of 2021.

The Fed has committed to keeping the federal funds rate at the current zero lower bound until it is on target to reach its goals of maximum employment and price stability. We thus expect no Fed rate hikes through year-end 2021; our federal funds rate target is unchanged from current levels, at 0.00%–0.25%. Despite significant new Treasury issuance, we foresee only modestly higher rates and yield-curve steepening in the second half of this year and through all of 2021 as Fed buying and global demand keep longer-term rates relatively low. Our year-end 2020 10-year Treasury yield target is 0.75%–1.25%, while our 30-year yield target is 1.50%–2.00%—only slight increases from today’s historically low levels. In 2021, we expect rates to edge up slightly, with both our 10-year and 30-year Treasury yield target just 25 basis points higher than our year-end 2020 target levels.¹

¹One hundred basis points equal 1.00%.

The Fed’s balance sheet reflects its market support

We expect a substantial increase in issuance for Treasury securities and across many fixed-income classes and sectors. We anticipate that this new issuance will be absorbed by market participants and by Fed balance-sheet purchases.



Sources: Bloomberg and Wells Fargo Investment Institute. Weekly data, December 18, 2002–June 1, 2020.

Yield is king

As the economy begins to grow again and Fed liquidity continues to support asset prices, we believe that credit-focused investments (such as corporate bonds) will continue to recover from the virus-induced sell-off that we experienced in the first half of 2020. While quality remains important, we believe that investors can begin to add higher-risk holdings to their fixed-income portfolios.

We remain favorable on investment-grade credit (and corporate bonds), along with preferred securities. Investors should remain well-diversified as certain industries—such as energy, retail, and leisure—could see concentrations of defaults. We generally believe that credit-oriented sectors are poised to outperform lower-yielding, higher-quality, fixed-income sectors during the upcoming, expected economic recovery.

Municipal bonds retain their appeal

States and municipalities face economic headwinds as revenue declines force difficult budget decisions. We expect that these challenges will remain throughout the recovery, but we believe that state issuers will continue to make bond payments. We are therefore favorable on municipal bonds. For investors in higher effective tax brackets, municipal securities remain attractive. We would take care to diversify positions, and we favor general obligation and essential service revenue issues with credit ratings of A2/A or higher.²

A mixed view of international debt

Outside of the U.S., we expect a low, or even negative, interest rate environment to remain pronounced and prolonged for developed market debt. We believe that the eventual economic recovery in Europe and Japan will not be sufficiently robust to allow policymakers to normalize interest rates over the next several years. With yields still below U.S. yields and negative for many issues, and significant political risk from sources such as Italy and Brexit, we remain unfavorable on developed market (ex-U.S.) fixed income.

We remain neutral on emerging market sovereign debt denominated in dollars. U.S.-dollar-denominated sovereign debt has remained relatively insulated from market pressures due to the lack of currency conversion risk and the inherently higher yields these securities offer investors. We believe that valuations will become more attractive once volatility subsides.

² Moody's, Standard & Poor's.

Key takeaways

- The Fed should be slow to reverse easy monetary policies, which should help support many fixed-income asset classes.
- While quality remains important, we believe that investors can begin to add higher-risk holdings to their fixed-income portfolios.

What it means for investors

- As the economy recovers, fixed-income investors are more likely to be rewarded for taking risk.
- We expect the Fed to remain on hold through year-end 2021. With short-term rates near zero, investors should be cautious with excessive cash balances.

Favored asset classes

- U.S. Taxable Investment Grade Fixed Income
 - U.S. Intermediate Term Taxable

Favored fixed-income sectors

- Municipal Bonds
- U.S. Investment Grade Credit
 - Corporate Bonds
 - Preferred Securities

Commodities may be ready to bounce



John LaForge
Head of Real Asset Strategy



Austin Pickle, CFA
Investment Strategy Analyst

An ugly start to 2020 offers opportunities for the second half of 2020 and 2021

The economic shock waves from the coronavirus arguably hit the real asset space harder than any other major asset class. Opportunities exist in the aftermath, yet selectivity is key.

Commodities look primed to rebound if the economy recovers as we expect, and we upgraded them to favorable on March 12. Violent demand shocks, like those witnessed in the first half of 2020, have often led to significant supply reductions in the commodity space. As demand recovered, supply was often slow to react, which was often price-positive. We believe crude oil and gold, in particular, appear to have upside. Quality midstream energy companies have the potential to bounce with oil, but we remain cautious because investors' appetites for the energy space remain sour. Global real estate investment trusts (REITs) held up better than midstream in the first half of 2020, but we are not convinced that this will last over the next year.

Global REITs—the future is uncertain post-pandemic

We recently downgraded Global REITs—which include both U.S. and International REITs—to unfavorable. Commercial real estate appears to be caught in the crosshairs of the global shock, with few clear answers on its future. From retailers struggling to pay rent to office space likely set to shrink, the REIT space could be facing significant secular headwinds. Valuations look fairly attractive, but history suggests that buying REITs solely because they look cheap has not been a good investment strategy. Although we believe that an unfavorable rating is most appropriate for Global REITs, we do prefer U.S. REITs over International REITs.

Commodities—low prices cure low prices

Amid low price levels in March, we upgraded commodities to favorable; in our view, many key commodities were priced too cheaply. Their prices were so low, in fact, that we believe global supplies are likely to shrink significantly, especially in the energy markets. We anticipate commodity demand should manage a modest recovery along with the global economy as we move past 2020 and into 2021. Additionally, the supply response may be slow to react, which should be price-supportive.

A closer look at oil and gold

Our views on oil and gold support our favorable commodity outlook. Oil's supply/demand balance, while uneven now, should be better aligned by year-end 2020. We are already seeing signs that global supplies have shrunk significantly. By year-end 2021, we forecast that WTI and Brent crude oil will trade at \$40 to \$50 and \$45 to \$55 per barrel, respectively.

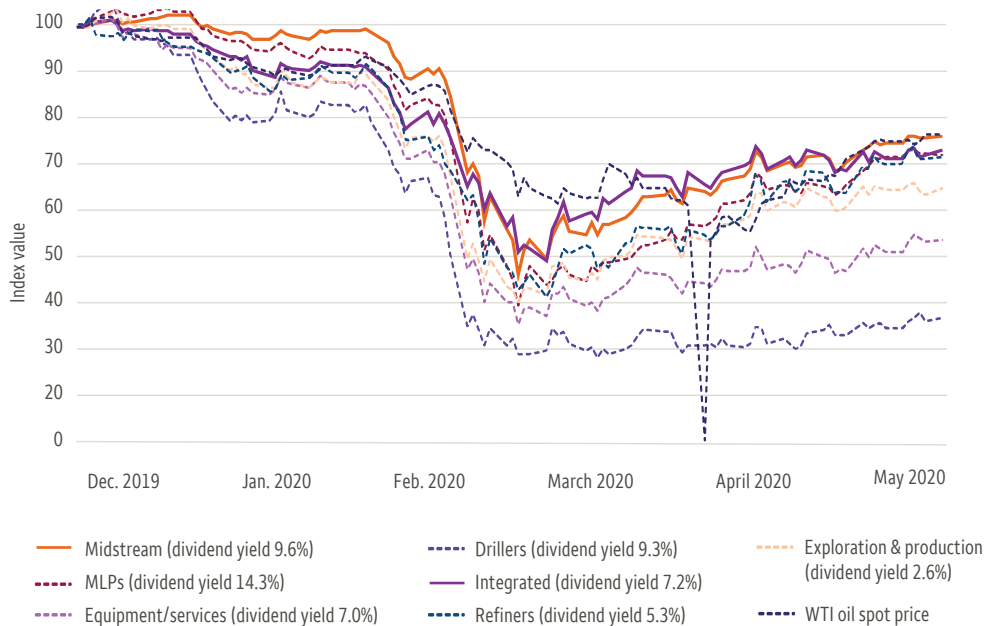
While the rally in gold prices could take a pause over the next few months, we view gold's economic backdrop as solid, with two major tailwinds potentially pushing its price higher: 1) low long-term interest rates and 2) growing global money supply (quantitative easing). Our gold target midpoints for year-end 2020 and year-end 2021 are \$1,850 and \$2,250, respectively.

Midstream—stay high quality

Midstream assets, including master limited partnerships (MLPs) and C-corporation companies, were hit hard in the first half of 2020 but performed better than most other energy subsectors (see the chart below). We believe the valuations of quality midstream assets remain compelling—some with two-to-three times the dividend yield of quality REITs. Selectivity is key, however. Weaker energy and midstream companies should continue to struggle with the fallout from low oil prices. We caution investors to retain a high-quality focus in the midstream space.

Midstream has been one of the best houses in a bad neighborhood

Midstream prices held up relatively well amid the Energy sector sell-off. We favor high-quality assets in the midstream space.



Please see pages 22 to 23 for important notes, definitions, and risk considerations.

Key takeaways

- Commodity prices look set to rebound; we turned favorable on March 12.
- Stay high quality in the midstream space, even if energy prices bounce as we expect.
- Global REITs' future looks uncertain in a post-pandemic world; we turned unfavorable on April 30.

What it means for investors

- Global REITs likely will underperform other real assets.
- Crude oil and gold should outperform most other real assets.

Favored real assets

- High-quality midstream MLPs and C-corporation companies
- Commodities
 - Gold
 - Oil

Sources: Bloomberg and Wells Fargo Investment Institute. Daily data, December 31, 2019–May 22, 2020. Indexed to 100 as of start date.

Midstream is represented by the Alerian Midstream Energy Index, MLPs by the Alerian MLP Index, Equipment/services by the S&P 1500 Oil & Gas Equipment & Services Index, Drillers by the S&P 1500 Oil & Gas Drilling Index, Integrated by the S&P 1500 Integrated Oil & Gas Index, Refiners by the S&P 1500 Oil & Gas Refining & Marketing Index, and E&P by the S&P 1500 Exploration & Production Index, WTI=West Texas Intermediate.

Performance is measured as the total return of each index. 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 deductions 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.** Please see the end of this report for definitions of indices and descriptions of asset-class risks.

Opportunities should come in phases



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How we expect events to unfold in 2020 and 2021

We believe that the dual oil and coronavirus crash will present a multiphase opportunity set for alternative investments in 2020 and 2021. In the early phases of a dislocation or recession, we believe capital preservation should remain the priority over capital growth, which is why we maintain our favorable view of Long/Short Equity and Long/Short Credit. As the extent of the economic recession becomes clearer, investors may consider moving down the capital structure, where returns skew higher. With that as our base case, below are the four phases that we are preparing for:



Source: Wells Fargo Investment Institute, May 12, 2020

Phase 1—Lending and liquidity opportunities: We believe that alternative investment funds focused on direct lending, opportunistic credit, and rescue financing may have the potential to both fill the capital shortfall and more easily protect their investment by customizing loan covenants. Furthermore, in times of stress or recession, many investors tend to place a high premium on liquidity and may be willing to sell their illiquid positions at a discount. We believe that secondary funds willing to purchase these discounted opportunities are particularly interesting after major dislocations.

Phase 2—Dislocation opportunities: Prior to the COVID-19 crisis, consumer mortgage fundamentals were quite strong. Although we believe they will most certainly deteriorate as a result of the recession, we believe that our expectation for eventual economic recovery will likely cause spreads to tighten in certain areas of structured and corporate credit—such as nonagency residential mortgage-backed securities and collateralized loan obligations.

Alternative investments are not suitable 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.

Phase 3—Distress and restructuring opportunities: This phase focuses on purchasing and restructuring the debt of companies that are bankrupt or that defaulted. 2020 likely will be the first year in a multiyear default cycle. We expect to see more forced asset sales, lasting for two to three years in developed markets and up to five to seven years in less developed markets. This opportunity set is generally much less liquid and can include nonperforming loans, new money, and special situations lending.

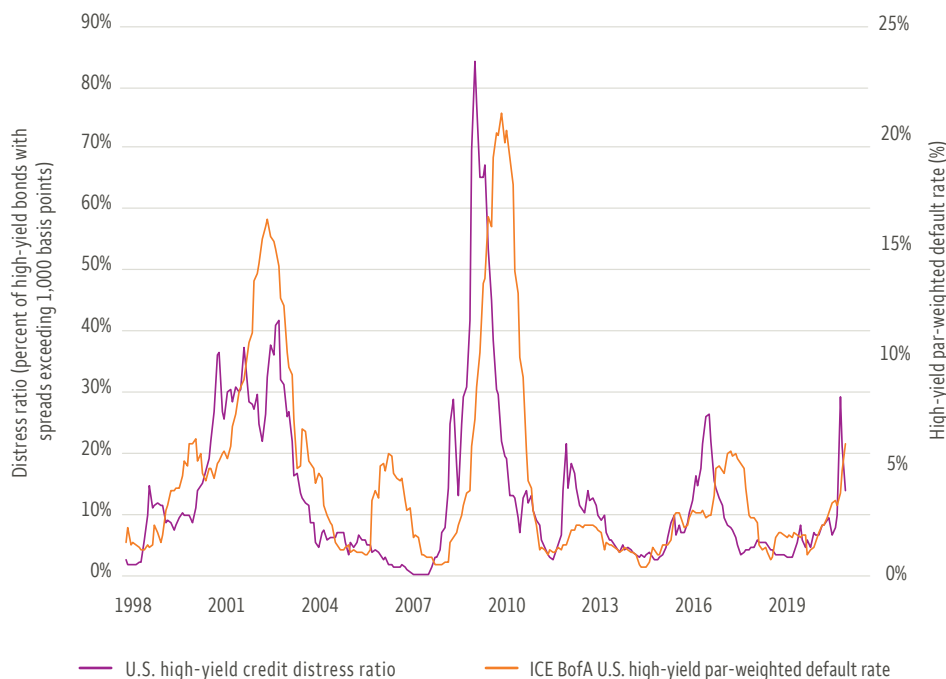
Phase 4—Recovery and high-beta opportunities: Risk appetite should return with clearer evidence of an economic recovery and an unprecedented flood of liquidity. Higher-beta (market sensitivity) hedge funds and more opportunistic private capital strategies could potentially provide qualified investors with favorable returns.

Timeline for recovery

We believe both Phase 1 and Phase 2 opportunities exist currently. While it appears risk appetite has recovered significantly from the March dislocation, we look for the debt restructuring opportunities of Phase 3 should begin if the default cycle accelerates and eventually peaks as we expect. Phase 4 opportunities are likely not available until later in the economic recovery.

Distress rates historically have tended to lead default rates, pointing to future opportunity potential

March 2020 was the most recent epitome of fear and dislocation. Based on history, we would expect actual defaults and accompanying restructurings to soon follow.



Key takeaways

- Forward returns are compelling in Structured Credit but risks remain.
- We are early in a default cycle that could be larger than the 2008 global financial crisis.
- Investors should seek to ensure they are positioned for rising defaults as well as the eventual economic recovery.

Favored hedge fund strategies

- Event Driven: Distressed
- Relative Value: Structured Credit

Favored private capital strategies

- Private Debt: Opportunistic Credit
- Private Equity: Secondary Funds
- Private Real Estate: Opportunistic Real Estate

Sources: Bank of America and Bloomberg, monthly data, January 1998–May 2020.

The distress ratio is calculated by dividing the total face value of bonds priced below \$75 in the ICE BofAML Developed Markets High Yield Index by the total face value of bonds within the index. Default rates are the percentage of borrowers in an index who failed to make a scheduled principle or interest payment over the past 12 months.

Past performance is no guarantee of future results.

2020 & 2021 economic and market forecasts

U.S. GDP (gross domestic product) growth

After what we anticipate to be a deep but short 2020 recession, we expect modest expansion through 2021.

Economic forecasts	2019 (actual)	2020 year-end target	2021 year-end target
U.S. GDP growth	2.3%	-4.5%	3.0%
U.S. inflation	1.8%	0.7%	1.7%
U.S. unemployment rate	3.5%	9.5%	6.5%
Global GDP growth	3.0%	-3.3%	3.0%
Developed market GDP growth	1.9%	-5.7%	1.3%
Developed market inflation	1.6%	0.6%	1.5%
Emerging market GDP growth	3.8%	-1.7%	4.2%
Emerging market inflation	4.8%	4.0%	4.0%
Eurozone GDP growth	1.2%	-8.0%	0.4%
Eurozone inflation	1.2%	-0.1%	1.2%
Dollar/euro exchange rate	\$1.12	\$1.14	\$1.17
Yen/dollar exchange rate	¥109	¥106	¥105

Federal funds rate

We expect modest yield increases for longer maturities through 2021.

Fixed Income targets	2019 (actual)	2020 year-end target	2021 year-end target
Federal funds rate	1.75%	0.00%–0.25%	0.00%–0.25%
10-year U.S. Treasury yield	1.92%	0.75%–1.25%	1.00%–1.50%
30-year U.S. Treasury yield	2.39%	1.50%–2.00%	1.75%–2.25%

West Texas Intermediate crude

Deep supply cuts but our outlook for a modest demand rebound should spur prices higher.

Sources: Wells Fargo Securities Economics Group, Bloomberg, and Wells Fargo Investment Institute, June 15, 2020. GDP = gross domestic product. 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.

Real Assets targets	2019 (actual)	2020 year-end target	2021 year-end target
West Texas Intermediate crude (barrel)	\$61	\$35–\$45	\$40–\$50
Brent crude (barrel)	\$66	\$40–\$50	\$45–\$55
Gold (troy ounce)	\$1,517	\$1,800–\$1,900	\$2,200–\$2,300
Bloomberg Commodity Index (total return)	172	145–155	150–160

Equity targets	2019 (actual)	2020 year-end target	2021 year-end target
S&P 500 Index	3,231	3,150–3,350	3,400–3,600
Earnings per share	\$163	\$115	\$145
Russell Midcap Index	2,382	2,230–2,430	2,400–2,600
Earnings per share	\$105	\$70	\$88
Russell 2000 Index (small cap)	1,668	1,450–1,650	1,550–1,750
Earnings per share	\$44	\$20	\$28
MSCI EAFE Index	2,037	1,800–2,000	1,850–2,050
Earnings per share	\$130	\$85	\$100
MSCI Emerging Markets Index	1,115	930–1130	950–1150
Earnings per share	\$71	\$45	\$55

S&P 500 Index

We expect a significant rebound in earnings and relatively modest price appreciation in 2021.

Sources: Wells Fargo Securities Economics Group, Bloomberg, and Wells Fargo Investment Institute, June 15, 2020. GDP = gross domestic product. 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.

Risks to our forecasts

Economy

- Our expected gradual economic recovery is at risk if COVID-19 infections surge and truncate the reopening, or if consumer activity fails to resume.
- The main risk is for a deeper dollar depreciation, especially if eurozone stimulus gains traction.

Fixed income

- If bond markets cannot absorb issuance, interest rates may rise by more and credit spreads may improve by less than we expect.
- If fiscal and monetary policy fail to stimulate the economy and deflation sets in lower interest rates than we expect could result.

Real assets

- If COVID-19 infections surge again, new lockdowns could force a downgrade of our 2021 commodity outlook.

Equities

- A new surge in COVID-19 infections could restrain the recovery and create new uncertainties about EPS growth.
- Lingering bankruptcies and unemployment could prolong a full earnings recovery by years instead of quarters.

Alternative investments

- An abrupt recovery (although not our base case) could truncate the default cycle and lead to a new bull market more quickly than we are expecting.
- If deflation arrives, it could erode debt and equity value, especially in private capital strategies.

Investment themes for the next 3 to 5 years



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Chief Investment Officer, Wealth and
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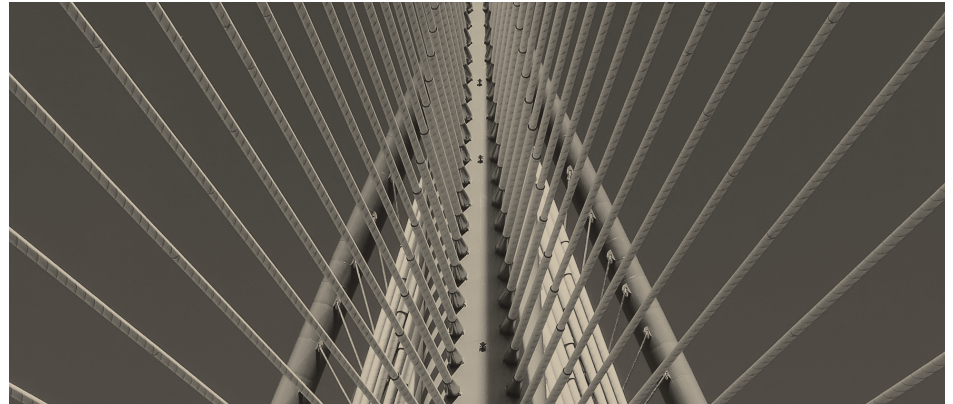
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The pandemic likely will affect the path and speed of the recovery in the coming 12 to 18 months, but we believe that five main themes are already changing how investable markets interact with the economy. The previous sections of this Outlook report addressed the immediate investment implications of these trends, but this section outlines the longer-term themes at a high level.

How things may be different

- 1 Consumption patterns are likely to change.
- 2 Businesses will reassess how to add flexibility while maintaining efficiency.
- 3 The pandemic is likely to intensify existing stresses globally.
- 4 Government influence in the economy will increase—for better or worse.
- 5 Health care will play an increasingly prominent role in the future.

The trajectories of these themes will depend heavily on how events and the risks to our outlook evolve in the years ahead, but we strongly suspect that resilience will figure prominently in the temperament of successful investors through 2021 and beyond.

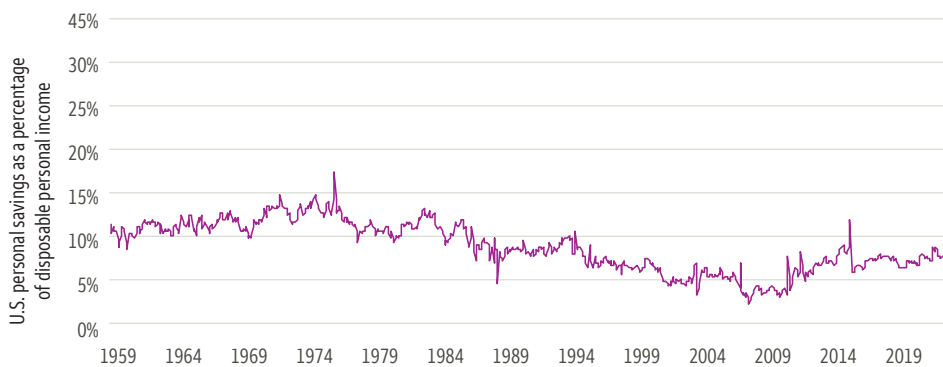
1 Consumption patterns are likely to change

Precautionary savings fell in the decades since 1980 (see the chart below), perhaps because investors who came to working age beginning in the 1970s did not live through economic depression or a world war. Yet, the global financial crisis of 2008–2009 taught households greater caution with the use of debt—and higher savings rates followed. Today, wide-scale unemployment may reinforce that lesson across all types of debt and lead households to increase savings further—to the extent that their incomes allow it—which may also impair future consumption.

We also expect e-commerce to continue to accelerate as new public health protocols raise the cost of providing goods and services. The savings uptick during the past decade was a significant headwind for retail brick-and-mortar companies, which had the capacity to support a higher level of consumption that never materialized. Another shift higher in personal savings should be a further headwind for the retail space, as long as consumers are unwilling to assume high debt.

U.S. personal savings as a percent of disposable personal income

After a multi-decade decline, the U.S. personal savings rate has shown a significant increase in recent years as consumers respond to economic shocks.



Sources: Bloomberg and Wells Fargo Investment Institute. Monthly data, January 1959–April 2020. Disposable income is personal income after income taxes.

Key takeaways

- Consumer behavior may turn much more conservative—with reduced debt levels, increased saving, and slower consumption growth.
- To counter the risk of another economic lockdown, the U.S. government will broaden its reach into the economy—especially into health care—while consumers and businesses will build flexibility into how they shop, produce, and distribute.

What it means for investors

- The higher profile for technological change in production, distribution, and day-to-day shopping should benefit sectors that support or facilitate trends.

Aligning with our midyear forecast

- We favor the technology-oriented themes in the Consumer Discretionary and Communication Services sectors.
- We are most favorable on the Information Technology sector.

See our equities forecast, pages 6–7.

Key takeaways

- We believe businesses will take steps to be more flexible about how they produce products, but global competition will maintain pressure to do so in a cost-efficient way.
- Some overseas supply chains are likely to reshore to the U.S.—but selectively, not broadly.

Aligning with our midyear forecast

- The analytics to drive business flexibility are predominately expected to come through Information Technology and Communication Services—again, these are our most favored and favored sectors, respectively.

See our equities forecast, pages 6–7.

2 Businesses will reassess how to add flexibility while maintaining efficiency

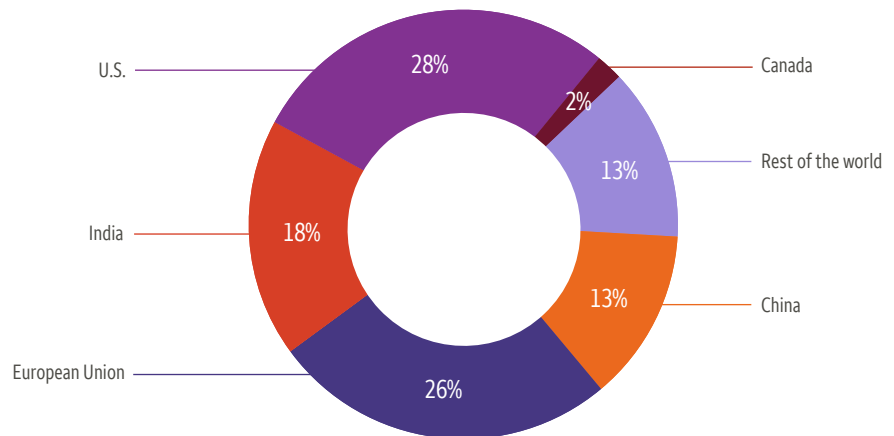
Businesses can increase flexibility by adding technology that uses less office space, reduces travel, and automates customer service, marketing, and supply chain processes. More workers likely will work from home, and some jobs may disappear. We expect more—not fewer—jobs, but employers will demand new skills and flexibility. Restaurant waitstaff may manage pickup windows. Instead of production-line jobs, there may be more demand for programmers.

Companies would like more flexible and shorter supply chains but will weigh the cost of maintaining dispersed operations. Some may seek more vertical operations (for example, e-commerce firms that take orders and then deliver packages themselves). U.S. dependence on China for essential public health supplies also will attract new scrutiny.

Nevertheless, increasing supply chain flexibility does not imply reshoring all or even most supply chains. Companies may improve their efficiency by using technology to better understand their inventory levels, to predict what components will be where and when, and if weather or local labor and economic conditions may interrupt supplies. Still other supply chains do not make sense to relocate because their supplies are located in the markets that they serve. We believe that the pandemic and the preceding trade dispute will focus management on balancing flexibility, efficiency, and risks across their businesses.

Percentage of active pharmaceutical ingredients manufacturing for all drugs by country or region, August 2019

Notably, 13% of active pharmaceutical ingredients in U.S. prescription drugs come from China.³ There is growing political rhetoric to return production of strategically important goods to the U.S.



Source: U.S. Food and Drug Administration, “Safeguarding Pharmaceutical Supply Chains in a Global Economy,” October 30, 2019

³Food and Drug Administration, “Safeguarding Pharmaceutical Supply Chains in a Global Economy,” testimony of Janet Woodcock, M.D., Director of the Center for Drug Evaluation and Research, October 30, 2019, before the House Committee on Energy and Commerce Subcommittee on Health

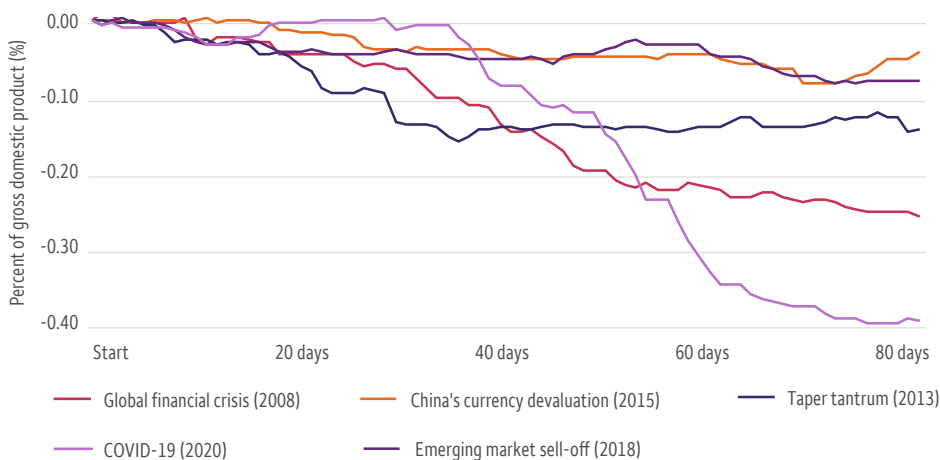
3 The pandemic is likely to intensify existing stresses globally

More selective international investment opportunities

The costs of virus containment will strain national budgets, which already have less room for support than the U.S. (think Brazil, Mexico, and India). Moreover, China's move toward technological self-sufficiency reduces trade revenue to its neighbors around the Pacific. Emerging market portfolio allocations may become less about broad, regional exposure than about opportunities in specific countries.

Foreign investment tends to exit emerging markets during crises

Foreign investment has historically left emerging markets during economic disruptions—which can accentuate the effect of the crisis on those economies.



Sources: International Monetary Fund and Wells Fargo Investment Institute, March 31, 2020.

Countries in the sample include China, Brazil, Hungary, India, Indonesia, Korea, Mexico, Pakistan, the Philippines, Qatar, Sri Lanka, South Africa, Taiwan, Thailand, Ukraine, and Vietnam. Lines show daily outflows for the first 80 calendar days of each crisis (beginning January 13, 2020, for COVID-19). The Taper tantrum was the May 2013 collective reactionary panic that triggered a spike in U.S. Treasury yields, after investors learned that the Fed was slowly putting the brakes on its quantitative easing (QE) program.

In Europe, political disagreements about government finance are likely to intensify, straining European relations between northern and southern countries and blocking policies to enhance productivity and earnings growth. Beyond Europe, slowing global economic growth will likely aggravate deflation, income inequalities, and populism among the developed economies.

Continued U.S. dollar dominance

If the pandemic strains emerging market public budgets and aggravates deflation in Europe and Japan, the U.S. dollar eventually could break above the cap that we foresee for the next 18 months. The U.S. dollar's relative strength should add another disincentive to international exposure and, instead, favor relative U.S. equity and fixed-income market outperformance.

Key takeaways

- International economies are less well-equipped than the U.S. to deal with the pandemic and its aftermath.
- The largest economies (China and the U.S.) are likely to grow larger and more influential, which should support the U.S. dollar in the years ahead.
- International opportunities may lie less in global or regional trends than in idiosyncratic national trends.

Aligning with our midyear forecast

- We favor the U.S. over international markets.
- Irrespective of its midyear 2020 depreciation, the U.S. dollar should find support at or above current levels due to the structural economic problems in Europe, Asia, and Latin America.

See our equities forecast, pages 6–7.

Key takeaways

- We expect that the federal government will take a more active role in managing the economy, especially to encourage the recovery and to prevent future lockdowns because of pandemics and other global events.
- Wider government economic involvement poses certain risks for businesses and for investors.

Aligning with our midyear forecast

- We anticipate low interest rates for longer.

See our *fixed-income forecast*, pages 8–9.

- Mandatory federal spending in 2019 was approximately 14% of U.S. total economic output, but the Congressional Budget Office projects the share to be 17% by 2049.⁴ The pandemic is likely to increase even further the already large share that mandatory federal spending takes out of the U.S. economy.

4 Government influence in the economy will increase—for better or worse

We expect governments to take a more active role in shaping economic activity. The 2008–2009 and 2020 crises have evoked larger and larger government support programs. Slow economic growth and worker-skill deficits may widen income inequalities and trigger additional government income support. Congress could decide to use deficits to encourage U.S. manufacturing to move home from overseas (reshoring). Such initiatives could produce federal budget deficits that are significantly wider than those of the past. Once viewed as an extreme form of government spending and borrowing, Modern Monetary Theory may even be positioned for mainstream thinking following the COVID-19 crisis.

Greater government involvement in the economy poses several risks to financial markets:

1. Increasingly large bailouts in response to economic crises may cause private firms to always expect a bailout and thereby underappreciate the risk of taking on more debt.
2. Businesses may have to adjust their return of capital policies to reflect society's desire to avoid large future bailouts. Companies will rethink stock buybacks and other decisions about retained earnings.
3. Government taking of equity or warrants in private companies as a form of compensation for government bailouts increases government ownership/control of some industries.
4. Fiscal and monetary policy may become so linked that money supply expands when governments issue more debt. Inflation is not a near-term risk in a weak economy, but a rapidly rising money supply poses a long-run risk for inflation and dollar devaluation.

⁴Mandatory federal spending is established under laws that require Congress to maintain a program. Congress can only reduce funding by changing the law that authorized the program. For example, the Social Security Act created that program, and Congress later amended the law to create Medicare. The largest mandatory programs are Social Security, Medicare, and Medicaid. U.S. economic output is measured by gross domestic product. Figures on spending are from "The 2019 Long-Term Budget Outlook" by the Congressional Budget Office, June 2019, page 3.

5 Health care will play an increasingly prominent role in the future

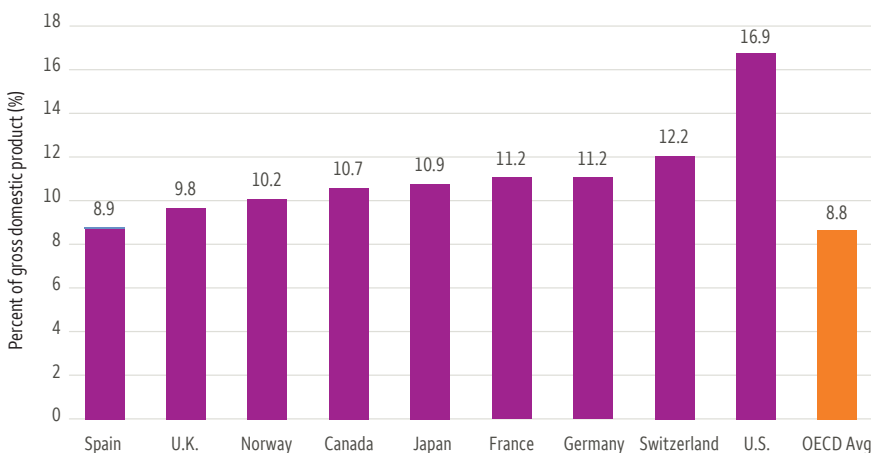
Aging populations and the fear of new pandemics underscore the political debate about how deeply and broadly public health spending will mount. Additional pressure may come from the increasing frequency of new coronaviruses: SARS (2003), bird flu (2005), swine flu (2009), MERS (2012), and now COVID-19 (2020). The possibility of animal-to-human viral transmission becomes more likely as human settlements continue to spread into uninhabited areas and contact wildlife more frequently. Our interconnected world accelerates the transmission of new viruses. In the future, we believe the health care system will expand even faster to build flexibility for aging populations and possible future epidemics.

U.S. health care spending already is a significantly larger share of national output than in other developed economies (see the chart below). We expect health care to become a much larger investment focus. Important growth drivers we look for will include building stockpiles of supplies, increasing hospital capacity, and adding staffing and funding for governmental agencies that ensure health care preparedness.

The governments in Singapore, Taiwan, and South Korea took these steps after suffering through coronavirus outbreaks between 2003 and 2012. They also created systems to facilitate information sharing across government agencies—notably between immigration and public health offices.

U.S. health care expenditures are significantly greater than those of other developed countries

The U.S. health care system was about 17% of the U.S. economy in 2018, which was nearly double the 9% average share among the world's most developed economies.



Sources: Organisation for Economic Co-operation and Development (OECD) Health Statistics 2019 and Wells Fargo Investment Institute, July 2019 (latest available data)

Key takeaways

- The pandemic is likely to accelerate trends already in place that increase the future importance of the Health Care sector in the economy.
- We believe that important potential investment opportunities will develop as health care systems expand even faster and build more flexibility to cope with aging populations and possible future epidemics.

Aligning with our midyear forecast

- We favor the Health Care sector.

See our equities forecast, pages 6–7.

Definitions

The **Alerian Midstream Energy Index** is a broad-based composite of North American energy infrastructure companies. It is a capped, float-adjusted, capitalization-weighted index whose constituents earn the majority of their cash flow from midstream activities involving energy commodities.

The **Alerian MLP Index** is a composite of the 50 most prominent energy master limited partnerships (MLPs) that provides investors with an unbiased, comprehensive benchmark for this emerging asset class. The index, which is calculated using a float-adjusted, capitalization-weighted methodology, is disseminated real-time on a price-return basis and on a total-return basis.

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

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

The **ICE BofAML Developed Markets High Yield Index** is a market-capitalization-weighted index that tracks the performance of below-investment-grade corporate debt publicly issued in the major domestic or eurobond markets. Qualifying securities must have a below-investment-grade rating (based on an average of Moody's, S&P, and Fitch), at least 18 months to final maturity at the time of issuance, at least one year remaining term to final maturity as of the rebalancing date, a fixed coupon schedule, and a minimum amount outstanding of USD 250 million, EUR 250 million, GBP 100 million, or CAD 100 million.

The **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.

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

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

The **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.

The **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.

The **S&P 1500 Exploration & Production Index** comprises stocks in the S&P 1500 Index that are classified in the GICS oil & gas exploration & production sub-industry and is a capitalization-weighted index.

The **S&P 1500 Integrated Oil & Gas** comprises stocks in the S&P 1500 Index that are classified in the GICS oil & gas integrated sub-industry and is a capitalization-weighted index.

The **S&P 1500 Oil & Gas Equipment & Services Index** comprises stocks in the S&P 1500 Index that are classified in the GICS oil & gas equipment & services sub-industry and is a capitalization-weighted index.

The **S&P 1500 Oil & Gas Drilling Index** comprises stocks in the S&P 1500 Index that are classified in the GICS oil & gas drillers sub-industry and is a capitalization-weighted index.

The **S&P 1500 Oil & Gas Refining & Marketing Index** comprises stocks in the S&P 1500 Index that are classified in the GICS oil & gas refining & marketing sub-industry and is a capitalization-weighted index.

A/A2 rating (S&P/Moody's): Upper-medium grade and subject to low credit risk.

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 involves risks, including the possible loss of principal. There can be no assurance that any investment strategy will be successful and meet its investment objectives. Investments fluctuate with changes in market and economic conditions and in different environments due to numerous factors, some of which may be unpredictable. Asset allocation and diversification do not guarantee investment returns or eliminate risk of loss. Each asset class has its own risk and return characteristics, which should be evaluated carefully before making any investment decision. 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. Some of the risks associated with the representative asset classes include:

General market risks

Stock markets, especially foreign markets, are volatile. A stock's value may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **International investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. This may result in greater share price volatility. These risks are heightened in emerging markets. Investing in **small- and mid-cap companies** involves additional risks, such as limited liquidity and greater volatility.

Investments in **fixed-income securities**, including **municipal securities**, are subject to market, interest rate, credit, liquidity, inflation, prepayment, extension, and other risks. Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can result in a decline in the bond's price. **High-yield fixed-income securities** are considered speculative, involve greater risk of default, and tend to be more volatile than investment-grade fixed-income securities. **Municipal securities** may also be subject to the alternative minimum tax and 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. If sold prior to maturity, fixed-income securities are subject to market risk. All fixed-income investments may be worth less than their original cost upon redemption or maturity.

Similar to bonds, **preferred securities** are interest rate sensitive. Their dividends are not guaranteed and are subject to change. Some preferred securities include a call provision, which may negatively affect the return of the security. A **prerefunded bond** is a callable bond collateralized by high-quality securities, typically Treasury issues. **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 free from credit risk, they are subject to interest rate risk. **Mortgage-related and asset-backed securities** are subject to prepayment and call risks in addition to the risks of investing in debt securities. Call risk is the risk that the issuer will redeem the issue prior to maturity. This may result in reinvestment risk, which means the proceeds will generally be reinvested in a less favorable environment. Changes in prepayments may significantly affect yield, average life, and expected maturity.

Sector investing

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. **Communication Services** companies are vulnerable to their products and services becoming outdated because of technological advancement and the innovation of competitors. Companies in the Communication Services sector may also be affected by rapid technology changes, pricing competition, large equipment upgrades, substantial capital requirements, and government regulation and approval of products and services. In addition, companies within the industry may invest heavily in research and development, which is not guaranteed to lead to successful implementation of the proposed product. 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. The **Energy** sector may be adversely affected by changes in worldwide energy prices, exploration, production spending, government regulation, changes in exchange rates, depletion of natural resources, and risks that arise from extreme weather conditions. Investing in **Financials** companies will subject an investment to adverse economic or regulatory occurrences affecting the sector. Some of the risks associated with investment in the **Health Care** sector include competition on branded products, sales erosion due to cheaper alternatives, research and development risk, government regulations, and government approval of products anticipated to enter the market. There is increased risk investing in the **Industrials** sector. The industries within the sector can be significantly affected by general market and economic conditions, competition, technological innovation, legislation, and government regulations, among other things, all of which can significantly affect a portfolio's performance. **Materials** industries can be significantly affected by the volatility of commodity prices, the exchange rate between foreign currency and the dollar, export/import concerns, worldwide competition, procurement, and manufacturing and cost containment issues. **Real Estate** investments have special risks, including possible illiquidity of the underlying properties, credit risk, interest rate fluctuations, and the impact of varied economic conditions. Risks associated with the **Information Technology** sector include increased competition from domestic and international companies, unexpected changes in demand, regulatory actions, technical problems with key products, and the departure of key members of management. Technology and internet-related stocks of smaller, less-seasoned companies tend to be more volatile than the overall market. **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

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 suitable 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, and less regulation and higher fees than mutual funds. Hedge fund, private equity, private debt, and private real estate fund investing involve 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.

Private debt strategies seek to actively improve the capital structure of a company, often through debt restructuring and deleveraging measures. Such investments are subject to potential default, limited liquidity, the creditworthiness of the private company, and the infrequent availability of independent credit ratings for private companies. Investing in distressed companies is speculative and involves a high degree of risk. Because of their distressed situation, these securities may be illiquid, have low trading volumes, and be subject to substantial interest rate and credit risks. Private capital investments are complex, speculative investment vehicles not suitable for all investors. They are not subject to the same regulatory requirements as registered investment products and engage in leverage and other aggressive investment practices. There is often limited (or even nonexistent) liquidity and a lack of transparency regarding the underlying assets.

Hedge fund strategies, such as **Arbitrage Event Driven**, **Equity Hedge**, **Relative Value**, **Structured Credit**, **Long/Short Credit**, and **Discretionary Macro**, 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 because 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. Private capital investments are complex, speculative investment vehicles not suitable for all investors. They are not subject to the same regulatory requirements as registered investment products and engage in leverage and other aggressive investment practices. There is often limited (or even nonexistent) liquidity and a lack of transparency regarding the underlying assets.

Real assets

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

The commodities markets, including investments in gold and other precious metals, 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. Investments in commodities may be affected by changes in overall market movements, commodity index volatility, changes in interest rates, or factors affecting a particular industry or commodity. Products that invest in commodities may employ more complex strategies, which may expose investors to additional risks. Investment in securities of MLPs involves certain risks that differ from an investment in the securities of a corporation. MLPs may be sensitive to price changes in oil, natural gas, etc.; regulatory risk; and rising interest rates. A change in the current tax law regarding MLPs could result in the MLP being treated as a corporation for federal income tax purposes, which would reduce the amount of cash flows distributed by the MLP. In addition, there are certain tax risks associated with an investment in MLP units, and conflicts of interest may exist between common unitholders and the general partner, including those arising from incentive distribution payments. Other risks include the volatility associated with the use of leverage, volatility of the commodities markets, market risks, supply and demand, natural and man-made catastrophes, competition, liquidity, market price discount from net asset value, and other material risks. Investment in real estate securities includes risks, such as the possible illiquidity of the underlying properties, credit risk, interest rate fluctuations, and the impact of varied economic conditions.

Investment expertise and advice to help you succeed financially

Wells Fargo Investment Institute is home to more than 145 investment professionals focused on investment strategy, asset allocation, portfolio management, manager reviews, and alternative investments. Its mission is to deliver timely, actionable advice that can help investors achieve their financial goals.

For assistance with your investment planning or to discuss the points in this report, please talk to your investment professional.



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