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# Four steps of successful investing

Global Asset Allocation



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# Key takeaways

- Uncertainty is an inherent part of investing. An investor's key to success largely depends on how they respond to it.
- We recommend four steps for investors to prepare for what could be ahead.
  - *Start with a plan, which involves defining goals and determining a strategic asset allocation to help achieve them.*
  - *Construct a portfolio based on the chosen allocation strategy.*
  - *Globalize the portfolio with appropriate levels of international investments in addition to U.S. investments.*
  - *Maintain alignment to the plan to help ensure that the portfolio adheres to the target allocation despite market movements and the passage of time.*

# Dealing with the certainty of uncertainty

Investors have myriad questions weighing on their minds these days, ranging from the lingering economic and financial impacts of COVID-19 to political uncertainties at home and abroad. While these are important questions, and the answers could have great bearing on the direction of financial markets, what many investors may really want to know is how each of these concerns will impact their individual financial circumstances today and tomorrow.

For some investors, it may seem today's markets are more complex and daunting than those of the past, and in some ways that may be true. However, investors invariably have to deal with an element of uncertainty. Although the questions and concerns may change over time, the inherent nature of uncertainty in investing is why we encourage investors to focus on the basics. We believe the greatest risk is not a market downturn but the risk of not meeting their financial goals.

**We have identified four steps we believe will help investors meet their financial goals. In this report, we describe each of these steps.**

*We believe the greatest risk investors face is not a market downturn but the risk of not meeting their financial goals.*

1

Start with a plan

2

Construct a portfolio

3

Globalize the portfolio

4

Maintain alignment to the plan



# 1. Start with a plan

Each investor is unique. Just as one chooses their lifestyle according to personal preferences and circumstances, an investor should work with an advisor to develop an investment plan that is compatible with their individual financial needs. The plan should be durable enough for the long term, yet stable enough to dissuade investors from abandoning it out of fear when times get tough. And while the plan should be flexible enough to accommodate major life changes, it should stay focused on the investor's goals.

## Determine financial goals

In developing a plan, an investor begins by identifying their financial goals. Each of these goals should be matched to a time when they will need the funds to accomplish the goal. Some will be near-term goals, like establishing a "rainy day fund" to help cover day-to-day bills should they experience an interruption in income. Others may be intermediate-term goals, such as paying for a child's college tuition or buying a new or vacation home. Still others may be longer-term goals, like helping finance retirement or perhaps making a bequest for future generations or charitable organizations.

## Build a rainy day fund for unexpected expenses

Starting with shorter-term goals means identifying how much liquidity, or readily accessible funds, an investor may need to cover day-to-day expenses should they experience an interruption in regular income or a significant unexpected expense. Carving out a cash fund to meet household expenditures can help investors prepare for rainy days by providing a cushion to pay these expenses for a period of time. Building sufficient cash reserves should allow investors to avoid selling investments that have fallen in value before they have a chance to recover.

We believe investors should set aside an amount of cash necessary to remain committed to their long-term investment plan. Some investors might consider one or two years' worth of living expenses as a reasonable amount. For others, six to nine months' worth of living expenses may be sufficient. Like the investment plan, the appropriate level of reserves is unique for each investor.



## Select investments appropriate for the goal

With cash reserves set aside for emergencies, an investor can focus on intermediate- and longer-term goals. Keeping in mind the goals their investment plan is targeted to accomplish can help them decide which types of assets are appropriate for funding each of their goals. For example, if one is saving for college tuition for a newborn child, then stocks may be an appropriate choice. If stock prices should plunge in value, as they did in early 2020, many years remain for the market to potentially recover before the child will need the funds. And by investing in stocks regularly over time, an investor could be purchasing more shares at lower prices. On the other hand, savings for a home down payment in two years may be better left in cash or short-term fixed income.

## Prepare for changing circumstances

An important consideration when choosing an appropriate mix of assets is risk tolerance. Understanding tolerance for risk is essential to sticking to an investment plan. Asking how easily an investor panics when market volatility surges and the value of their portfolio fluctuates significantly is one way to determine risk tolerance. Determining how comfortable they are to look beyond short-term market dips and ride out the bad times without abandoning their long-term strategy can also assist in determining risk tolerance.

*We believe investors should set aside an amount of cash necessary to remain committed to their longer-term investment plan.*



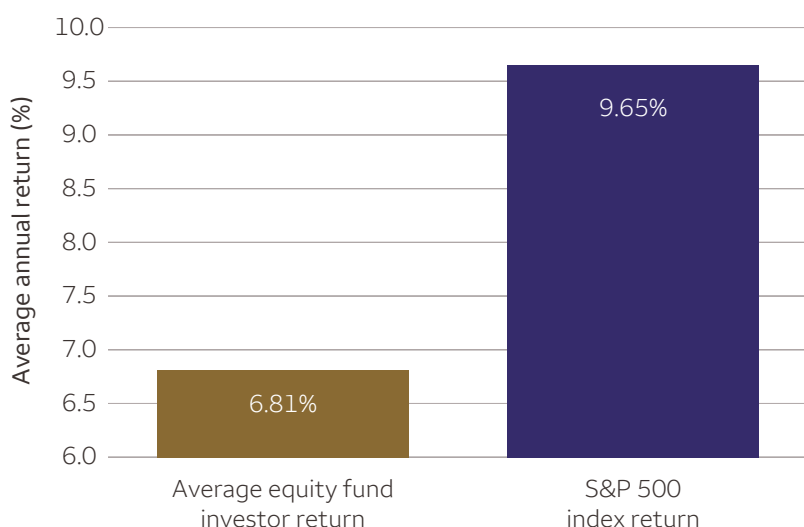
## Keep emotions in check

Human emotions, especially fear and greed, play an important role in investor behavior. Unfortunately, these emotions often do not lead to prudent investment decision-making. Consider Dalbar's well-respected annual study that calculates the returns for average investors and compares them with the mutual fund universe and equity market returns. Interestingly, it turns out the average retail investor fares much worse than the S&P 500 Index (see chart below). Dalbar attributes this result mainly to performance-chasing behavior, in which investors allocate more funding to assets that have done well recently and ignore those that have done poorly. They call this tendency the "investor behavior penalty."

The past two recessions provided examples of this phenomenon at its most extreme — following the 2007 – 2008 Global Financial Crisis (GFC) and the COVID-19 pandemic. This type of risk-averse behavior persisted well beyond the GFC but was relatively short-lived during the pandemic as capital markets anticipated an economic and earnings rebound following the announcement of a new vaccine. In both cases, we cautioned investors against making decisions based on risk aversion during the volatile periods. Actions like these can keep investors from achieving their financial objectives and most likely are indications that their fears are thwarting their strategic investment plan.

## Attempting to time the market has proven costly

Investor returns have substantially lagged the markets, 1993 – 2022.

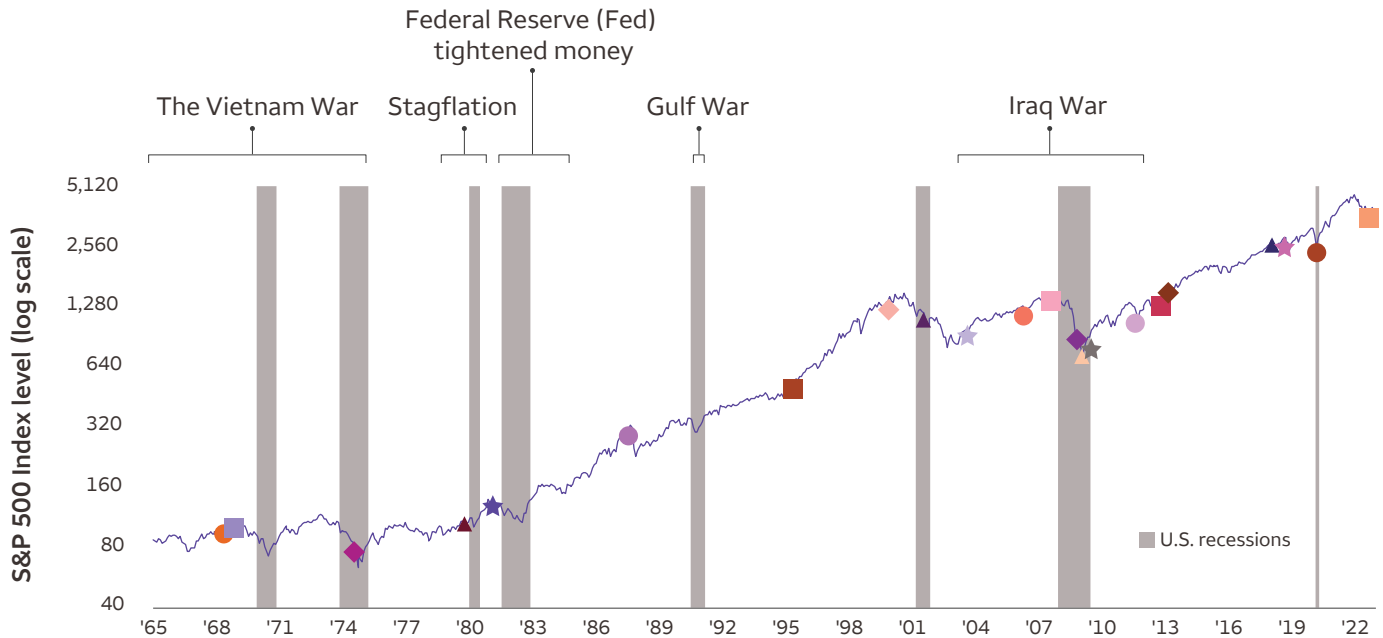


**Source:** Dalbar, 30 years from 1993 – 2022. "Quantitative Analysis of Investor Behavior," 2023, DALBAR, Inc., [www.dalbar.com](http://www.dalbar.com). For illustrative purposes only. Dalbar computed the average stock fund investor return by using industry cash flow reports from the Investment Company Institute. The average stock fund return figure represents the average return for all funds listed in Lipper's U.S. Diversified Equity fund classification model. All Dalbar returns were computed using the S&P 500 Index. The S&P 500 Index is a market-capitalization-weighted index composed of 500 stocks generally considered representative of the U.S. stock market. The fact that buy and hold has been a successful strategy in the past does not guarantee that it will continue to be successful in the future. The performance shown is not indicative of any particular investment. An index is unmanaged and not available for direct investment. Total returns assume reinvestment of dividends and capital gain distributions. **Past performance is not a guarantee of future results.**

# The times when it's hardest to invest may be the best

Historically, difficult periods have been good times to invest in stocks.

## Performance of the S&P 500 Index, January 1965 – March 2023



● Robert F. Kennedy shot  
June 1968

■ Martin Luther King Jr. shot  
April 1968

◆ President Nixon resigns  
August 1974

▲ Iran hostage crisis  
November 1979

★ HIV/AIDS  
June 1981

● Stock market crash  
October 1987

■ Oklahoma City bombing  
April 1995

◆ Dot-com bubble burst  
March 2000

▲ World Trade Center/  
Pentagon attacks  
September 2001

★ SARS  
April 2003

● Avian (Bird) Flu  
June 2006

■ Global Financial Crisis  
2007–2008

◆ TARP passed  
October 2008

▲ \$787B stimulus  
package approved  
February 2009

★ H1N1 (Swine) Flu  
April 2009

● U.S. debt downgrade  
August 2011

■ Fiscal cliff  
January 2013

◆ MERS  
May 2013

▲ U.S. tax reform  
December 2017

★ Fed policy uncertainty  
and political risks  
December 2018

● Coronavirus (COVID-19)  
January 2020

■ Russia invades Ukraine  
February 2022

**Sources:** Wells Fargo Investment Institute and Bloomberg, as of March 31, 2023. For illustrative purposes only. A price index is not a total return index and does not include the reinvestment of dividends. The S&P 500 Index is a market-capitalization-weighted index considered representative of the U.S. stock market. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.** There is no guarantee equity markets will perform similarly during other periods of uncertainty. All investing involves risks, including the possible loss of principal. Note that shaded areas reflect recessions.



Looking at the chart on page 7, it is clear that some of the best years for stock market performance were fraught with concern. The past decade is a testament to this principle as investors who have avoided stocks due to fear of another crisis may have missed out on one of the most lucrative bull markets in the history of the U.S. stock market.

## The risks of fear or overconfidence

Other poignant reminders of how stocks can outperform during periods of crisis include 1991, amidst the Iraq War and a U.S. economic recession, the years following the September 2001 terrorist attack, and the performance following the Brexit vote. Clearly, investors may doubt their investment decisions in a downturn, when their portfolio value is declining, and become too conservative out of fear. Conversely, in a rising market, investors may become overconfident and invest too aggressively. Both of these are examples of failing to adhere to an investment plan to the detriment of future financial goals.

The bottoming process for equity markets during the most recent bear market required investor patience and fortitude. We recommend investors work with their financial professionals to make sure their investment plans are up to date and their portfolios are broadly diversified, and not overextended in riskier assets, such as U.S. small-cap equities, developed market ex-U.S. equities, and emerging market equities.





## 2. Construct a portfolio

Each of an investor's financial goals has different attributes: priority; time horizon; and the need for liquidity, income, or growth. As a result, each goal has a unique investment objective — and a distinct combination of assets that is most likely to help achieve the goal. Establishing this combination (or strategic allocation) is one of the most important investment decisions. As shown on the following page, the strategic allocation has historically been the biggest determinant of portfolio return variability (the year-to-year variation in returns).

### Asset allocation can be the most important investment decision

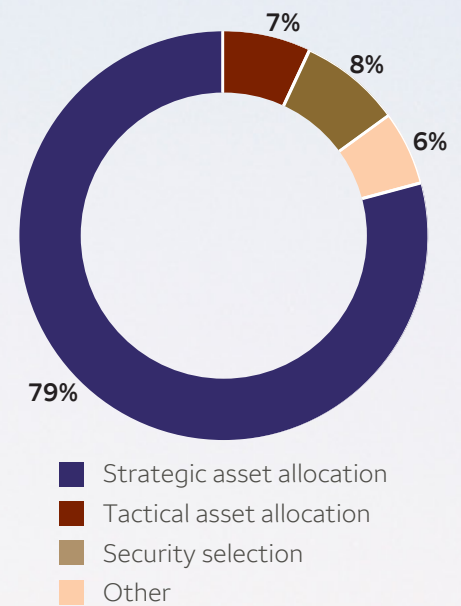
Studies have shown asset allocation is often a crucial determinant of portfolio performance. The other factors shown in the chart on page 10 have proven to have much less impact on the variability of returns over time. While tactical asset allocation has a six- to 18-month time horizon, strategic asset allocation has a much longer horizon covering multiple market cycles. Strategic allocation, therefore, deserves considerable focus and effort.

*While tactical asset allocation has a six- to 18-month time horizon, strategic asset allocation has a much longer horizon covering multiple market cycles.*

The capital markets offer a variety of investments that perform different functions. In general, growth = stocks, income = bonds, stability = short-term Treasury bonds, and inflation protection = gold. But this oversimplified view ignores the potential benefits of broader diversification. For example, income can come from a variety of sources beyond bonds, such as high-dividend stocks and real estate investment trusts (REITs), while commodities beyond gold can provide a hedge against inflation. For this reason, we recommend a wide range of asset types for a portfolio.

Even so, investors may be tempted to look for a singular investment strategy, such as investing entirely in U.S. stocks because they outperformed during most of the previous bull market. Such a strategy would likely be counterproductive, however, in our opinion, because markets rarely maintain a trend for an extended period of time. The “quilt chart” on the next page shows that just as a performance trend for an asset class becomes established, we frequently observe a sharp reversal of that trend.

Notice the moderate growth and income allocation (in white) has been neither the best nor the worst performer in any given year. It comprises a variety of asset classes that collectively have created a smoother return path even though, individually, the components may be quite volatile from year to year. Combining different assets in a diversified portfolio can help investors benefit from the overall upward trend in markets but with lower levels of volatility.



**Sources:** “Determinants of Portfolio Returns,” Wells Fargo Wealth Management, November 2011; Morningstar Direct; Roger G. Ibbotson and Rex A. Sinquefeld, “Stocks, Bonds, Bills, and Inflation: Year-by-Year Historical Returns,” University of Chicago Press Journal of Business (January 1976); Standard & Poor’s; and Wells Fargo Wealth Management.

**Tactical asset allocation:** Making of short-term adjustments to asset-class weights based on shorter-term expected relative performance.

**Strategic asset allocation:** An investor’s return objectives, risk tolerances, and investment constraints are integrated with long-term return assumptions to establish exposure to permissible asset classes.

Asset allocation, including strategic and tactical asset allocation, does not guarantee investment returns or eliminate the risk of loss.





# The value of asset allocation

Being diversified has helped stabilize portfolio performance.

## Calendar-year asset class and Moderate Growth & Income allocation returns

2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Emg Mkt Fixed Inc 8.5%	Emg Mkt Equity 18.6%	US Small Cap Equity 38.8%	US Large Cap Equity 13.7%	US Large Cap Equity 1.4%	US Small Cap Equity 21.3%	Emg Mkt Equity 37.8%	Cash Alternative 1.8%	US Large Cap Equity 31.5%	US Small Cap Equity 20.0%	US Large Cap Equity 28.7%	Commod 16.1%
Inv Grade Fixed Inc 7.8%	Emg Mkt Fixed Inc 18.5%	US Mid Cap Equity 34.8%	US Mid Cap Equity 13.2%	Emg Mkt Fixed Inc 1.2%	High Yield Fixed Inc 17.1%	Dev ex-US Equity 25.6%	Inv Grade Fixed Inc 0.0%	US Mid Cap Equity 30.5%	Emg Mkt Equity 18.7%	Commod 27.1%	Cash Alternative 1.5%
Dev ex-US Fixed Inc 5.9%	Dev ex-US Equity 17.9%	US Large Cap Equity 32.4%	Mod Grwth Inc 6.2%	Inv Grade Fixed Inc 0.5%	US Mid Cap Equity 13.8%	US Large Cap Equity 21.8%	Dev ex-US Fixed Inc -1.7%	US Small Cap Equity 25.5%	US Large Cap Equity 18.4%	US Mid Cap Equity 22.6%	Hedge Funds -4.1%
High Yield Fixed Inc 5.0%	US Mid Cap Equity 17.3%	Dev ex-US Equity 23.3%	Inv Grade Fixed Inc 6.0%	Cash Alternative 0.0%	US Large Cap Equity 12.0%	US Mid Cap Equity 18.5%	High Yield Fixed Inc -2.1%	Dev ex-US Equity 22.7%	US Mid Cap Equity 17.1%	US Small Cap Equity 14.8%	High Yield Fixed Inc -11.2%
US Large Cap Equity 2.1%	US Small Cap Equity 16.3%	Mod Grwth Inc 13.7%	Emg Mkt Fixed Inc 5.5%	Dev ex-US Equity -0.4%	Commod 11.8%	US Small Cap Equity 14.6%	US Large Cap Equity -4.4%	Mod Grwth Inc 19.5%	Mod Grwth Inc 13.9%	Dev ex-US Equity 11.8%	Inv Grade Fixed Inc -13.0%
Mod Grwth Inc 1.1%	US Large Cap Equity 16.0%	Hedge Funds 9.1%*	US Small Cap Equity 4.9%	Hedge Funds -1.1%	Emg Mkt Equity 11.6%	Mod Grwth Inc 14.4%	Emg Mkt Fixed Inc -4.6%	Emg Mkt Equity 18.9%	Hedge Funds 11.8%	Mod Grwth Inc 10.2%	Dev ex-US Equity -14.0%
Cash Alternative 0.1%	High Yield Fixed Inc 15.8%	High Yield Fixed Inc 7.4%	Hedge Funds 3.0%	Mod Grwth Inc -1.7%	Emg Mkt Fixed Inc 10.2%	Dev ex-US Fixed Inc 9.9%	Hedge Funds -4.7%	Emg Mkt Fixed Inc 14.4%	Dev ex-US Fixed Inc 10.5%	Hedge Funds 10.2%	Mod Grwth Inc -14.7%
US Mid Cap Equity -1.5%	Mod Grwth Inc 12.5%	Cash Alternative 0.0%	High Yield Fixed Inc 2.5%	US Mid Cap Equity -2.4%	Mod Grwth Inc 9.0%	Emg Mkt Fixed Inc 9.3%	Mod Grwth Inc -4.9%	High Yield Fixed Inc 14.3%	Dev ex-US Equity 8.3%*	High Yield Fixed Inc 5.3%	Emg Mkt Fixed Inc -16.5%
US Small Cap Equity -4.2%	Hedge Funds 6.4%	Inv Grade Fixed Inc -2.0%	Cash Alternative 0.0%	US Small Cap Equity -4.4%	Hedge Funds 5.4%	Hedge Funds 8.6%	US Mid Cap Equity -9.1%	Hedge Funds 10.4%	Inv Grade Fixed Inc 7.5%	Cash Alternative 0.0%	US Mid Cap Equity -17.3%
Hedge Funds -5.3%	Inv Grade Fixed Inc 4.2%	Emg Mkt Equity -2.3%	Emg Mkt Equity -1.8%	High Yield Fixed Inc -4.5%	Inv Grade Fixed Inc 2.6%	High Yield Fixed Inc 7.5%	US Small Cap Equity -11.0%	Inv Grade Fixed Inc 8.7%	High Yield Fixed Inc 7.1%	Emg Mkt Fixed Inc -1.5%	US Large Cap Equity -18.1%
Dev ex-US Equity -11.7%	Dev ex-US Fixed Inc 0.8%	Dev ex-US Fixed Inc -5.1%	Dev ex-US Fixed Inc -2.5%	Dev ex-US Fixed Inc -4.8%	Dev ex-US Fixed Inc 1.9%	Inv Grade Fixed Inc 3.5%	Commod -11.2%	Commod 7.7%	Emg Mkt Fixed Inc 5.9%	Inv Grade Fixed Inc -1.5%	Emg Mkt Equity -19.7%
Commod -13.3%	Cash Alternative 0.1%	Emg Mkt Fixed Inc -6.6%	Dev ex-US Equity -4.5%	Emg Mkt Equity -14.6%	Dev ex-US Equity 1.5%	Commod 1.7%	Dev ex-US Equity -13.4%	Dev ex-US Fixed Inc 5.2%	Cash Alternative 0.5%	Emg Mkt Equity -2.2%	US Small Cap Equity -20.4%
Emg Mkt Equity -18.2%	Commod -1.1%	Commod -9.5%	Commod -17.0%	Commod -24.7%	Cash Alternative 0.3%	Cash Alternative 0.8%	Emg Mkt Equity -14.2%	Cash Alternative 2.2%	Commod -3.1%	Dev ex-US Fixed Inc -9.5%	Dev ex-US Fixed Inc -21.9%

Best  
↑  
Performance  
↓  
Worst

- Moderate Growth & Income Liquid
- Cash Alternatives: Bloomberg U.S. Treasury Bill (1-3 Month) Index
- Commodities: Bloomberg Commodity Index
- Developed Markets ex-U.S. Equity: MSCI EAFE (Europe, Australasia, Far East) Index
- Emerging Market Equity: MSCI Emerging Markets Index
- Investment Grade Fixed Income: Bloomberg U.S. Aggregate Bond Index
- Hedge Funds: HFRI Fund Weighted Composite Index
- High Yield Fixed Income: Bloomberg U.S. Corporate High Yield Bond Index
- Developed Market ex-U.S. Fixed Income: JP Morgan GBI Global ex-U.S. Index
- Emerging Market Fixed Income: JP Morgan EMBI Global Index
- U.S. Large Cap Equity: S&P 500 Index
- U.S. Mid Cap Equity: Russell Midcap Index
- U.S. Small Cap Equity: Russell 2000 Index

**Sources:** © 2022 – Morningstar Direct, All Rights Reserved<sup>1</sup>, and Wells Fargo Investment Institute, as of December 31, 2022. The historical returns for Moderate Growth & Income are rebalanced quarterly to target allocations at the beginning of each period. Index return information is provided for illustrative purposes only. Performance results for Moderate Growth & Income are calculated using blended index returns. Index returns do not represent investment returns or the results of actual trading nor are they forecasts of expected gains or losses a fund might experience. Index returns reflect general market results; assume the reinvestment of dividends and other distributions; and do not reflect deduction for fees, expenses, or taxes applicable to an actual investment nor do they constitute a recommendation to invest in any particular fund or strategy. An index is unmanaged and not available for direct investment. Unlike most asset-class indexes, HFR Index returns reflect deduction for fees. Because the HFR indexes are calculated based on information that is voluntarily provided, actual returns may be higher or lower than those reported. **Past performance does not guarantee future results.** Please see the end of the report for the risks associated with the representative asset classes and the definitions of the indexes.

**Moderate Growth & Income Liquid** is composed of 2% Bloomberg U.S. Treasury Bills (1 -3 Month) Index, 30% Bloomberg U.S. Aggregate Bond Index, 6% Bloomberg U.S. Corporate High Yield Bond Index, 5% JPM EMBI Global Index, 24% S&P 500 Index, 10% Russell Midcap Index, 6% Russell 2000 Index, 8% MSCI EAFE Index, 5% MSCI Emerging Markets Index, 4% Bloomberg Commodity Index.



## 3. Globalize the portfolio

Although many investors gravitate toward easily recognizable U.S. companies, building a globally diversified portfolio means adding appropriate levels of international assets. Many large, internationally based companies have become household names in the U.S. And historically, international stocks have benefited from a strengthening U.S. and global economy. We encourage investors to focus on the long-term positive outlook for global economic growth.

### Emerging markets offer growth potential

Some exposure to faster-growing emerging markets can add another layer of diversification to a portfolio. As illustrated in the chart on page 13, emerging markets contribute more to global economic growth than developed markets. Countries like China, India, and Brazil are among the emerging economies that are helping drive this major shift in the composition of global economic growth. Rapid population growth combined with a younger population's desire for a higher standard of living should contribute to global consumption and production in the coming decades.

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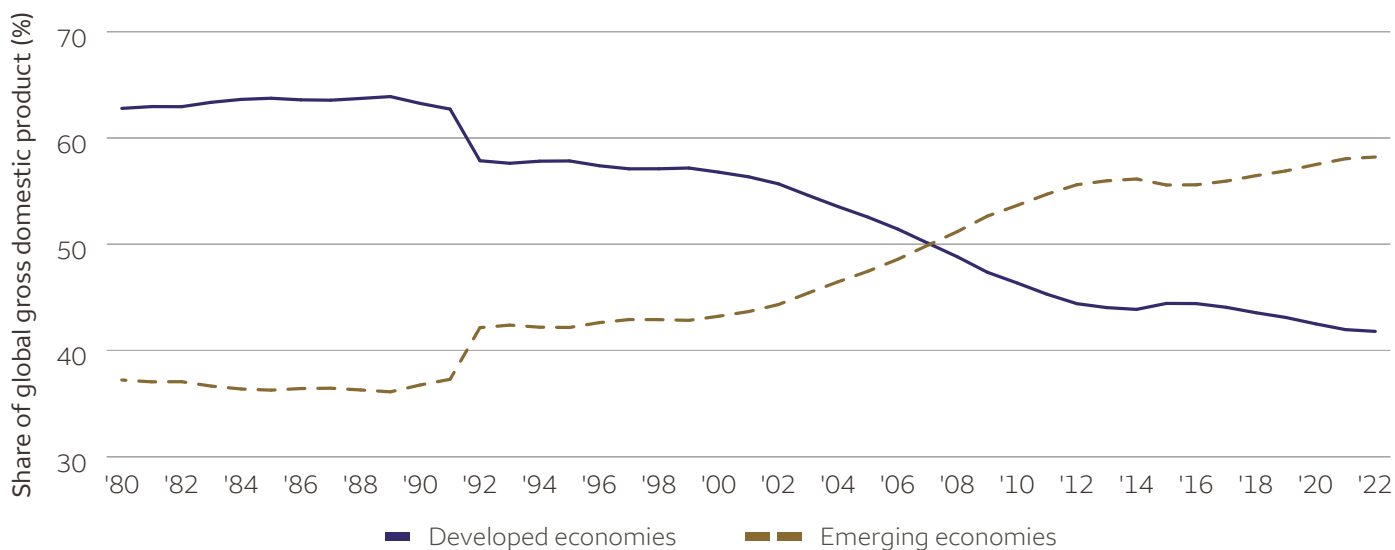


Because many emerging markets are underdeveloped and their governments tend to be protective of local companies, it may be challenging to gain exposure to individual holdings. One approach for investors to participate in the emerging world's growth potential is through emerging market equity and bond funds that span geographies, sectors, and currencies.

The more informed an investor is about the spectrum of investments available to them, the more confident they should become about embracing a variety of asset classes for a diversified portfolio. Becoming knowledgeable about different types of investments and their roles in a portfolio can also help investors establish reasonable expectations and plan accordingly. Longer-term risk and return assumptions can be estimated based on the historical and current performance of different types of investments. When assembled into a portfolio (the strategic allocation), reasonable expectations about future portfolio returns can be established. While expected returns are just that — expected — they can help an investor plan for an uncertain future.

## Emerging economies have overtaken developed economies

The percentage of global GDP contributed by emerging economies eclipsed that from developed economies several years ago.



**Sources:** International Monetary Fund (IMF) and Wells Fargo Investment Institute, as of December 31, 2022. GDP=gross domestic product. The percentage of GDP data is based on PPP (purchasing power parity) numbers.





## 4. Maintain alignment to the plan

A change in economic conditions or large market moves, upward or downward, can significantly alter a portfolio's risk/reward profile. Failing to rebalance during a bull market can lead to overexposure to equities, drastically changing the risk profile of the intended allocation and leaving the portfolio vulnerable when a bear market starts. Allowing the portfolio to drift during a bear market can result in a higher allocation to fixed income than intended as portfolio allocations drift from strategic targets and an investor's desired risk level. This could impact the time it takes for a portfolio to recover once the bear market is over. As an example, a moderate growth and income investor who did not rebalance their portfolio during the last bull market would likely have too much of their portfolio allocated to stocks, especially U.S. stocks, and too little allocated to international and fixed-income investments. When the stock market entered a bear market in March 2020, a portfolio that had drifted far above its strategic equity allocations exhibited more volatility than one that adhered to its recommended allocation.

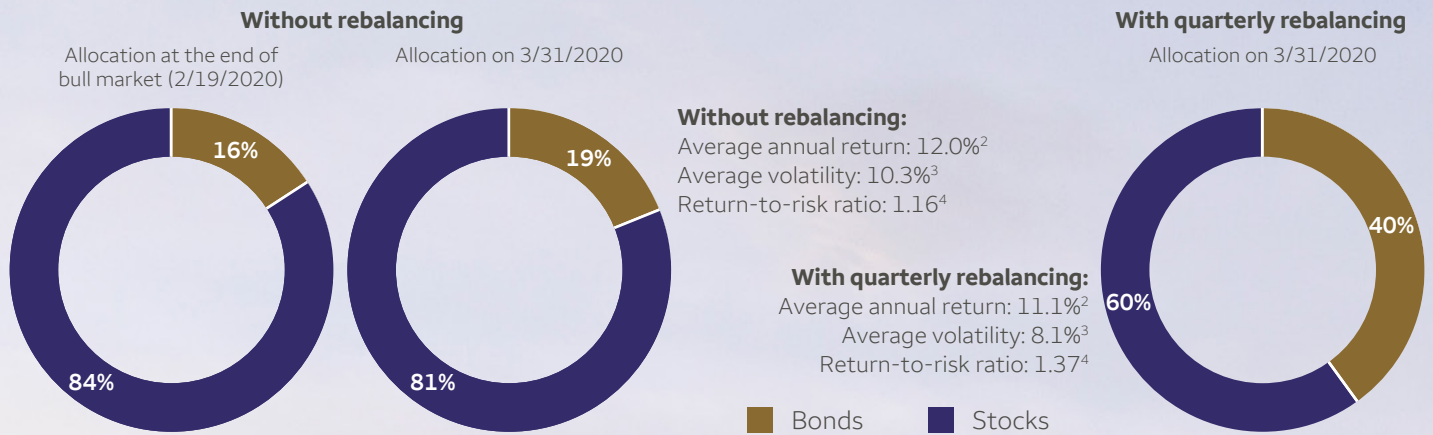
### Rebalancing can help manage risk

As shown in the following example, a portfolio that drifted away from its intended 60% stocks/40% bonds allocation achieved a higher return than the rebalanced portfolio, but its volatility was greater than the portfolio that did not drift (right portfolio). The return-to-risk ratio was higher for the rebalanced portfolio.

A constructive way to realign a portfolio is to periodically trim those asset classes that have grown beyond target levels and invest in those that have dropped below target levels to bring the allocation back to its original targets. This is an effective version of the "buy low, sell high" principle. But it is important to recognize that rebalancing a portfolio may trigger capital gains taxes, so tax-sensitive investors need to take this factor into consideration. A more subtle way of rebalancing is to direct any new funds into asset classes that are underweighted and to fund any cash needs by selling asset classes that are overweighted.



# Portfolio drift during the last full market cycle (March 2009 – March 2020)



**Sources:** © 2021 – Morningstar Direct, All Rights Reserved<sup>1</sup>, and Wells Fargo Investment Institute, as of August 31, 2021. In this example, stocks are represented by the S&P 500 Index and bonds are represented by the Bloomberg U.S. Aggregate Bond Index. The indexes are unmanaged and not available for direct investment. Illustrations are for the period March 9, 2009, to March 31, 2020, with starting allocation of 60% stocks and 40% bonds on March 9, 2009.

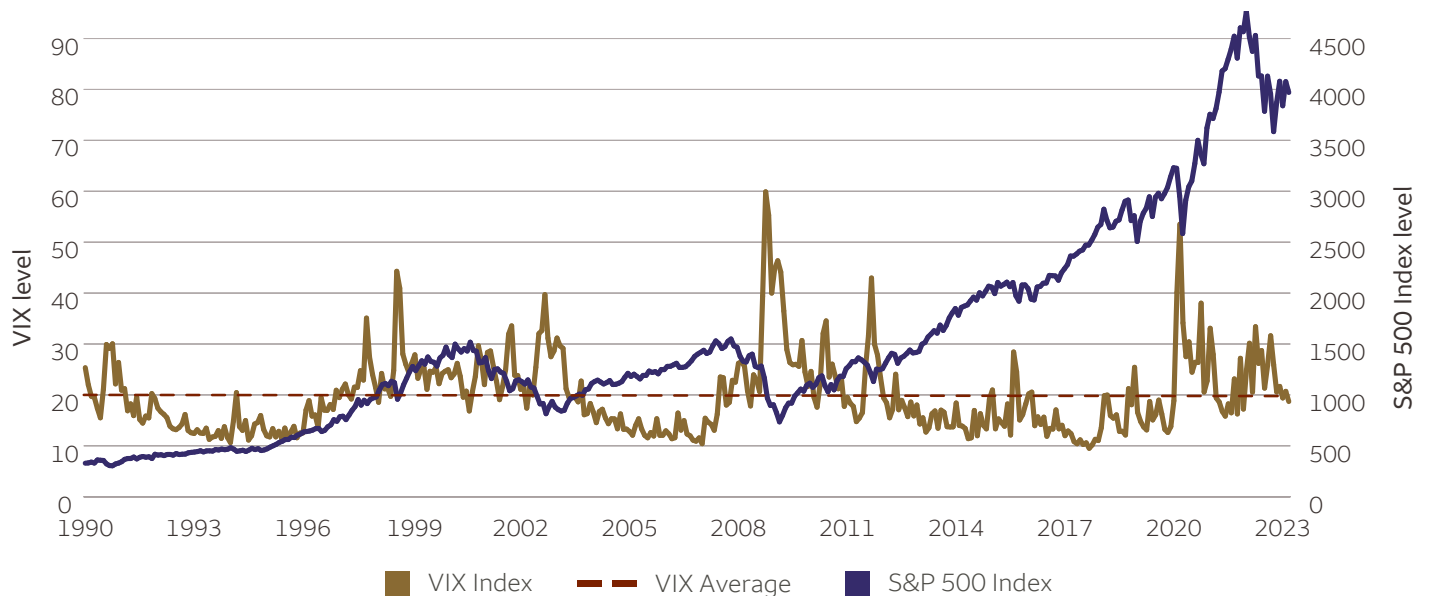
Index return information is provided for illustrative purposes only. Performance results are hypothetical. Index returns do not represent investment returns or the results of actual trading nor are they forecasts of expected gains or losses a fund might experience. Index returns reflect general market results; assume the reinvestment of dividends and other distributions; and do not reflect deduction for fees, expenses, or taxes applicable to an actual investment nor do they constitute a recommendation to invest in any particular fund or strategy. An index is unmanaged and not available for direct investment. **Past performance does not guarantee future results.** Please see the end of the report for the risks associated with the representative asset classes and the definitions of the indexes.

## Stay the course

While it is important to design a solid plan and then implement it using the right mix of assets and proper diversification, these efforts may be all for naught if an investor is unable to adhere to the plan. The developments surrounding COVID-19 initially propelled equities into a bear market, followed by a vigorous rebound that resulted in a doubling of the S&P 500 Index. Investors who sold their equity positions during the downturn and held the proceeds in cash, missed out on the recovery. Looking ahead, we expect volatility to remain elevated in the near term as markets prepare for an economic slowdown and contraction in corporate earnings. Assessing and updating plans, if necessary, should allow investors to reposition portfolios in an effort to take better advantage of opportunities that periods of elevated volatility may create.

## We expect choppier waters

Volatility, as measured by the CBOE Market Volatility Index (VIX), could increase as the U.S. economy faces challenges from slowing growth and a possible recession.



Sources: Bloomberg and Wells Fargo Investment Institute, as March 31, 2023.

For illustrative purposes only. The CBOE Volatility Index® (VIX®) shows the market's expectation of 30-day volatility. It is constructed using the implied volatilities of a wide range of S&P 500 Index options. This volatility is meant to be forward looking and is calculated from both calls and puts. The VIX is a widely used measure of market risk and is often referred to as the "investor fear gauge." The S&P 500 Index is a market-capitalization-weighted index generally considered representative of the U.S. stock market. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

## Periodically reevaluate your investment strategy

There are legitimate reasons to change an investment plan. Milestones such as getting married, buying a home, starting a family, supporting a child through college, and retirement are just a few examples of significant life changes. As major life events approach, this offers an opportune time to reevaluate investment goals and determine whether any changes to the overall investment strategy are warranted.

Material changes in net worth also provide grounds to reevaluate the investment asset mix. A market downturn and subsequent rebound may put some investors' portfolios out of sync due to selling assets too early and/or waiting to rebalance. These "opportunity" losses could increase the need for portfolio growth and may even require more risk-taking in the portfolio.



# Turning points that can affect an investment plan for individuals in their:



- 20s**
- Pursuing an advanced degree
  - Landing your first job
  - Getting married

- 30s**
- Buying a home
  - Starting a family
  - Establishing an investment plan
  - Starting a business



- 40s**
- Changing jobs
  - Saving for retirement
  - Saving for children's education
  - Getting a divorce

- 50s**
- Losing a loved one
  - Receiving an inheritance
  - Caring for a family member
  - Shopping for long-term care



- 60s**
- Starting retirement
  - Shopping for health care insurance
  - Dealing with illness
  - Planning your legacy

- 70+**
- Planning for charitable giving
  - Changing residences
  - Entering an assisted living facility



Examples are for illustrative purposes only and may not reflect an individual's own experience.

Source: Wells Fargo Investment Institute

# Develop an investment plan

The questions on investors' minds we mentioned at the beginning of this report reflect today's economic and geopolitical uncertainty. Wars, disease, and changes in policy are examples of issues that markets and individuals struggle to comprehend. A well-constructed investment plan based on an investor's unique circumstances that is rebalanced regularly can help alleviate anxiety over market uncertainty. This can be especially helpful during periods of heightened volatility that we expect from time to time in normally functioning markets.

## Volatility can present opportunity

We believe market volatility should be viewed as a potential opportunity rather than an obstacle for investors. During the last bull market leading up to COVID-19, the steady gains and low equity market volatility overshadowed the benefits of discipline and patience. While volatility skyrocketed during the 2020 bear market, it has since returned to more normal levels, yet remains above the low volatility experienced during the last bull market. Expectations for more normal volatility levels, with periodic spikes given today's economic and geopolitical uncertainties, may offer greater rewards to patient and disciplined investors. In an effort to take full advantage of these changes, investors should make sure their portfolios are aligned with their plan.

Some investors hesitate to invest after a significant increase in stock prices or wait until the markets are "normal." Yet, as mentioned above, attempts at market timing have often been costly. Instead, we recommend periodic rebalancing as it can enhance investment performance even when the market is up by maintaining the portfolio's desired risk profile.

We recommend investors update their investment plans to ensure they are not overextended in riskier assets, such as small-cap equities or international equities. Bond yields can offer sources of income and help provide stability to a diversified portfolio. However, longer-duration fixed-income instruments and less creditworthy investments, while usually boasting higher yields, come with greater risks. (Duration is a measure of a bond's interest rate sensitivity.) We recommend investors properly diversify within their fixed-income allocation to both traditional and higher-yielding areas while targeting duration to match the portfolio's time horizon.

*We believe market volatility should be viewed as a potential opportunity rather than an obstacle for investors.*

# Keep plan aligned with investment goals

We recommend working together with an investment professional to develop an investment plan. If a plan is already in place, we suggest checking with an investment advisor to ensure the plan reflects current financial circumstances and goals. Once goals are identified and reviewed for reasonableness, they should serve as the basis for a well-constructed, long-term strategy.

But having a proper investment plan is not enough; an investor also needs to invest in line with the recommended allocations and maintain alignment with the plan over time. Comprehensive monitoring and maintenance of the plan should involve rebalancing regularly to help preserve gains, incorporating an element of robustness through diversification, and limiting the amount of risk in the portfolio based on an investor's ability and willingness tolerate wide swings in asset prices.

Our outlook calls for volatility to remain elevated in the near term. Periods of volatility may offer opportunities for investors with cash to add to their designated allocations. A diversified portfolio can help investors manage near-term uncertainty by enhancing risk-adjusted returns and smoothing performance over time. We believe now is an opportune time for investors to make sure a plan is in place and their allocation strategies are appropriately aligned with their investment goals.



# Asset-class risk disclosures

Asset allocation cannot eliminate the risk of fluctuating prices and uncertain returns. Diversification cannot eliminate the risk of fluctuating prices and uncertain returns.

**Commodities:** Exposure to the commodities markets may subject an investment to greater share price volatility than an investment in traditional equity or debt securities. 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.

**Equity investments:** Stocks offer long-term growth potential but may fluctuate more and provide less current income than other investments. An investment in the stock market should be made with an understanding of the risks associated with common stocks, including market fluctuations.

**Fixed income:** Investments in fixed-income securities are subject to interest rate, credit/default, 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. Credit risk is the risk that an issuer will default on payments of interest and/or principal. High-yield fixed-income securities (junk bonds) are considered speculative, involve greater risk of default, and tend to be more volatile than investment-grade fixed-income securities. 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.

**Foreign investments:** Investing in foreign securities presents certain risks not associated with domestic investments, such as 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.

**Hedge funds:** Alternative investments, such as hedge funds, are speculative and 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 investing involves other material risks including capital loss and the loss of the entire amount invested. They are intended for qualified, financially sophisticated investors who can bear the risks associated with these investments. Hedge fund strategies, such as Equity Hedge, Event Driven, Macro, and Relative Value may expose investors to risks such as short selling, leverage, counterparty, liquidity, volatility, the use of derivative instruments, and other significant risks.

**Real estate:** There are special risks associated with an investment in real estate, including the possible illiquidity of underlying properties, credit risk, interest rate fluctuations, and the impact of varied economic conditions.

**Small- and mid-cap companies:** The prices of small- and mid-company stocks are generally more volatile than large-company stocks. They often involve higher risks because smaller companies may lack the management expertise, financial resources, product diversification, and competitive strengths to endure adverse economic conditions.

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2. Geometric average return considers the effects of compounding and is the standard metric for conveying return performance for investments.
3. Volatility is measured using standard deviation of monthly returns, which is a statistic that reflects the degree of risk surrounding the outcome of an investment decision. The higher the standard deviation, the more the risk.
4. The return-to-risk ratio is the geometric average annual return divided by the volatility of yearly returns. As the ratio increases, the amount of return for the level of risk goes up.



# Index definitions

An index is unmanaged and unavailable for direct investment.

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

**Bloomberg U.S. Corporate High-Yield Bond Index** covers the universe of fixed-rate, non-investment-grade debt.

**Bloomberg U.S. Treasury Bill (1–3 Month) Index** is representative of money markets.

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

**HFRI Fund Weighted Composite Index** is a global, equal-weighted index of over 2,000 single-manager funds that report to HFR Database. Constituent funds report monthly net-of-all-fees performance in U.S. dollars and have a minimum of \$50 million under management or a 12-month track record of active performance. The HFRI Fund Weighted Composite Index does not include funds of hedge funds.

**HFRI indexes** have limitations (some of which are typical of other widely used indexes). These limitations include survivorship bias (the returns of the indexes may not be representative of all the hedge funds in the universe because of the tendency of lower-performing funds to leave the index); heterogeneity (not all hedge funds are alike or comparable to one another, and the index may not accurately reflect the performance of a described style); and limited data (many hedge funds do not report to indexes, and, therefore, the index may omit funds, the inclusion of which might significantly affect the performance shown). The HFRI indexes are based on information self-reported by hedge fund managers that decide on their own, at any time, whether or not they want to provide, or continue to provide, information to HFR Asset Management, LLC. Results for funds that go out of business are included in the index until the date that they cease operations. Therefore, these indexes may not be complete or accurate representations of the hedge fund universe and may be biased in several ways. Returns of the underlying hedge funds are net of fees and are denominated in USD.

**JP Morgan GBI Global Ex United States Index (JPM GBI Global ex-U.S.)** is a total return, market-capitalization-weighted, rebalanced monthly, consisting of the following countries: Australia, Germany, Spain, Belgium, Italy, Sweden, Canada, Japan, the United Kingdom, Denmark, the Netherlands, and France.

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

**MSCI EAFE Index** 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-weighted index designed to measure equity market performance of 24 emerging market countries.

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**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.

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

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

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