

Investment Strategy

Weekly guidance from our Investment Strategy Committee **January 22, 2024**

Spotlight: What’s the deal with all that cash on the sidelines?2

- Since July 2022, roughly \$1.3 trillion has flowed into money market funds likely to seize attractive yields.
- With elevated yields and cooling inflation, markets are trying to reconcile if the large cash inflow may become fuel to extend the current equity rally or reflective of cautious investor sentiment.

Equities: Round trip4

- After two long years, the S&P 500 Index is close to its all-time highs. Unfortunately, much of the recent move higher has been driven by unreasonable expectations.
- Going forward, we believe a slowing economy and tighter financial and credit conditions will pose greater headwinds. Investors should stay disciplined and maintain a defensive posture.

Fixed Income: Positioning for a neutral fixed income duration stance.....5

- We believe that investors should maintain a neutral duration position relative to their individually selected benchmarks. For reference, the Bloomberg U.S. Aggregate Bond Index currently has a duration of 6.27 years.
- Our current guidance is favorable on U.S. short-term fixed income and neutral on intermediate- and long-term fixed income.

Real Assets: Our take on Copper and Industrial Metals6

- China accounts for 57% of global copper demand, making the country’s economic health important for global copper prices.
- We suspect that China’s struggling property sector will ultimately weigh on copper prices.

Alternatives: Interesting time in venture capital.....7

- Venture capital fundraising has slowed down while managers’ uninvested capital has grown.
- Along with compelling secular investment themes like artificial intelligence, this may lead to an interesting time to invest in venture capital.

Current tactical guidance8

Asset Allocation Spotlight

Michael Taylor CFA

Investment Strategy Analyst

Doug Beath

Global Investment Strategist

What's the deal with all that cash on the sidelines?

Over the past 18 months, roughly \$1.3 trillion has flowed into money market funds, likely to take advantage of the highest rates these vehicles have seen in several years. A sizable portion of the inflows has come from owners of U.S. bank saving accounts that are currently paying an average percentage yield (APY) of 0.58% as of January 10, 2024.¹ The influx of funds was exacerbated by a few regional bank failures in March 2023 that spooked savers. Today, the balance is nearly \$6 trillion.²

As money market yields remain elevated and inflation cools, investors may question whether they should maintain cash holdings or consider potential opportunities in riskier assets. More broadly, as the U.S. equity market (using the S&P 500 Index as proxy) returned 26% last year, market observers are trying to reconcile whether the sizable cash balances are fuel to extend the equity rally or if persistent growth in money market balances reflects guarded sentiment toward riskier assets.

What are money market funds and who invests in them?

Money market funds typically comprise short-term fixed-income assets, whose yields have risen over the past 18 months as the Federal Reserve (Fed) embarked on an aggressive rate-hike campaign to combat inflation. The principal purchasers of money markets are institutional investors — including insurance companies and pension funds — and retail investors. Today, money market holdings are split between institutional and retail accounts, 61% and 39%, respectively.³

Investors have traditionally increased their liquid holdings during periods of uncertainty as a perceived flight-to-safety strategy. Spikes in money market assets occurred during the Great Financial Crisis and the onset of the pandemic. Since the pandemic, money market balances have remained above pre-pandemic levels, yet the recent uptrend in inflows appears to be driven by attractive yields that come with minimal volatility risk.

Tracking recent money market inflows

From July 2022 through December 2023, money market fund balances grew from \$4.6 trillion to \$5.9 trillion (see chart).⁴ Over \$1 trillion flowed into U.S. money markets in 2023 alone, reflecting 24% year-over-year growth.⁵ This raises the question: Are these flows transfers from conventional savings accounts in search of higher yields? To tackle this question, we consider M1 versus M2⁶ balances adjusted for inflation during the pre- and post-pandemic periods for insight into the cash origins to ascertain whether it is potentially available for deployment into equity markets.

¹ Bankrate.com

² Investment Company Institute (ICI), January 4, 2024.

³ Ibid

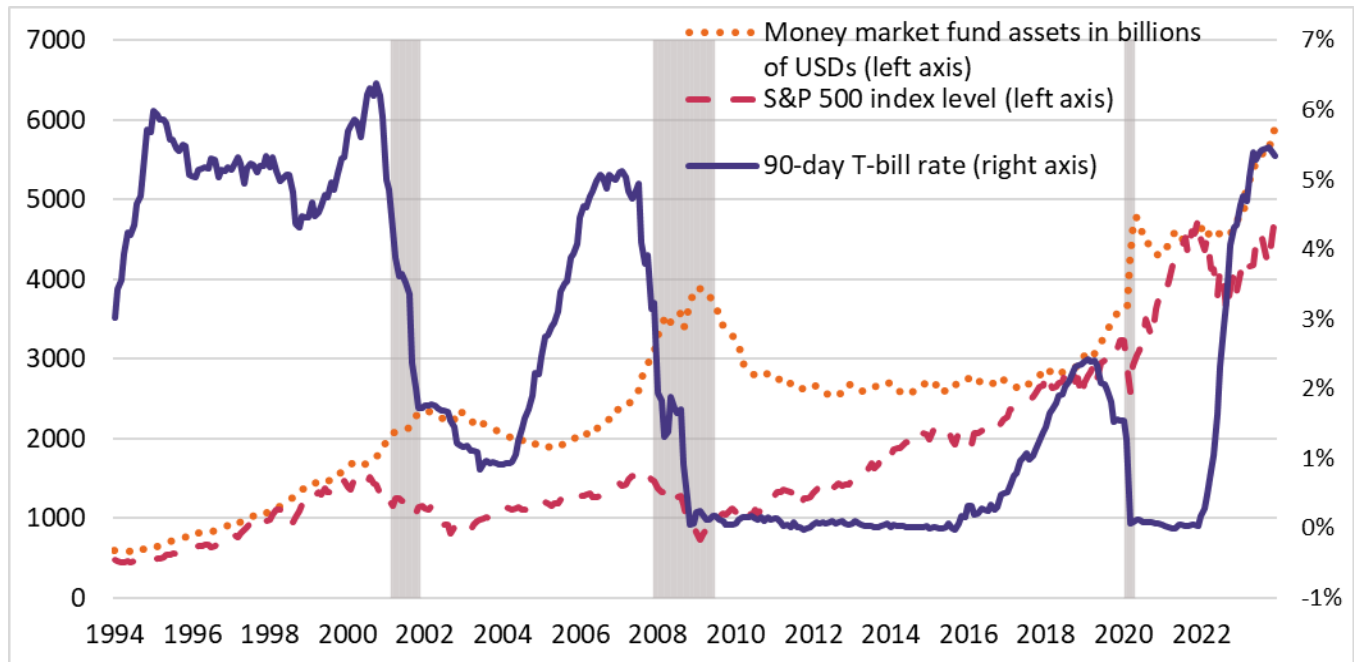
⁴ Ibid

⁵ Strategas. January 4, 2024.

⁶ M1 includes currency and bank demand deposits. M2 comprises M1 components plus money market mutual fund balances. For comprehensive definitions see disclosures section on page 9.

M1 (proxy for bank deposits) declined from \$20.5 trillion in July 2022 to about \$18 trillion in November of 2023. Meanwhile, money market funds (proxy for M2) increased from \$1.3 trillion over the same period. The data would suggest that a portion of flows into money market funds over the past 18 months presumably came from low-interest bank deposits and does not automatically reflect “dry powder” opportunities for equity investments. A similar trend in bank deposits shifting from demand deposits into time deposits (such as certificates of deposit or CDs) has also been observed.⁷

Money market balances have grown alongside higher yields



Sources: Bloomberg, Investment Company Institute, and Wells Fargo Investment Institute. Data as of January 16, 2024. T-bill = U.S. Treasury bill. **Past performance is no guarantee of future results.** An index is unmanaged and not available for direct investment.

Implications for markets and investors

Last year’s significant inflow to money market funds may reflect a cautious attitude among investors toward riskier assets and the economy and markets more broadly. Given today’s macroeconomic environment, investors may be hesitant about redeploying cash, and understandably so. Yet, we caution investors that overexposure to cash comes with certain risk — the opportunity cost of foregoing assets with greater growth potential. So, while potentially attractive in the near term, holding large cash positions is not likely the most effective long-term investment strategy.

We anticipate interest rates to remain steady in the immediate near term. Although real yields on money market funds have risen thanks to easing inflation rates, that trend may be changing if the economy continues to slow and the Fed starts to lean toward relaxing monetary policy as we expect. As the Fed begins to cut rates, money market yields should also begin to fall, and may prompt investors with sizable cash holdings to consider higher-yielding and potentially higher-growth assets. We suggest that investors who are over-allocated to cash to consider using market pullbacks as opportunities to invest in a diversified allocation — to reestablish or maintain strategic and tactical allocation targets.

⁷ Ned Davis, “Bullish Propaganda,” January 11, 2024.

Equities

Sameer Samana, CFA

Senior Global Market Strategist

Round trip

Given the strength of equity markets in 2023 (the S&P 500 Index was up +26%), investors can be forgiven for forgetting that all we have done is get back to levels where we previously peaked in late 2021. In fact, the S&P 500 Index’s total return for all of 2022 and 2023 cumulatively was 3.37%, a return most investors could have earned in the shorter part of the Treasury market as the Fed raised interest rates. This meager performance reinforces our messaging of the past two years that equities will have real difficulty making headway during the period when the Fed is hiking interest rates and fighting inflation.

The question now is what comes next. Unfortunately, much of the recent move to round trip to the all-time highs has come as a result of the markets expecting a combination of aggressive rate cuts, a still-strong economy, low inflation, and easy financial and credit conditions; those factors do not coincide all that often. We believe the market’s disappointment upon realizing that its investment case is built on hope rather than reality will lead markets to test important support levels.

Currently, we believe the S&P 500 Index sits close to resistance at 4800 (all-time high) and has pulled forward typically favorable spring seasonality. From here, a pullback toward key support levels at the 50- (4611) and 200-day moving average (4393) seems likely. In the meantime, investors should stay disciplined and defensively positioned.

S&P 500 Index back at all-time highs



Sources: Bloomberg and Wells Fargo Investment Institute. Daily data from January 16, 2021 to January 16, 2024. **Past performance is no guarantee of future results.** An index is unmanaged and not available for direct investment.

Fixed Income

Luis Alvarado

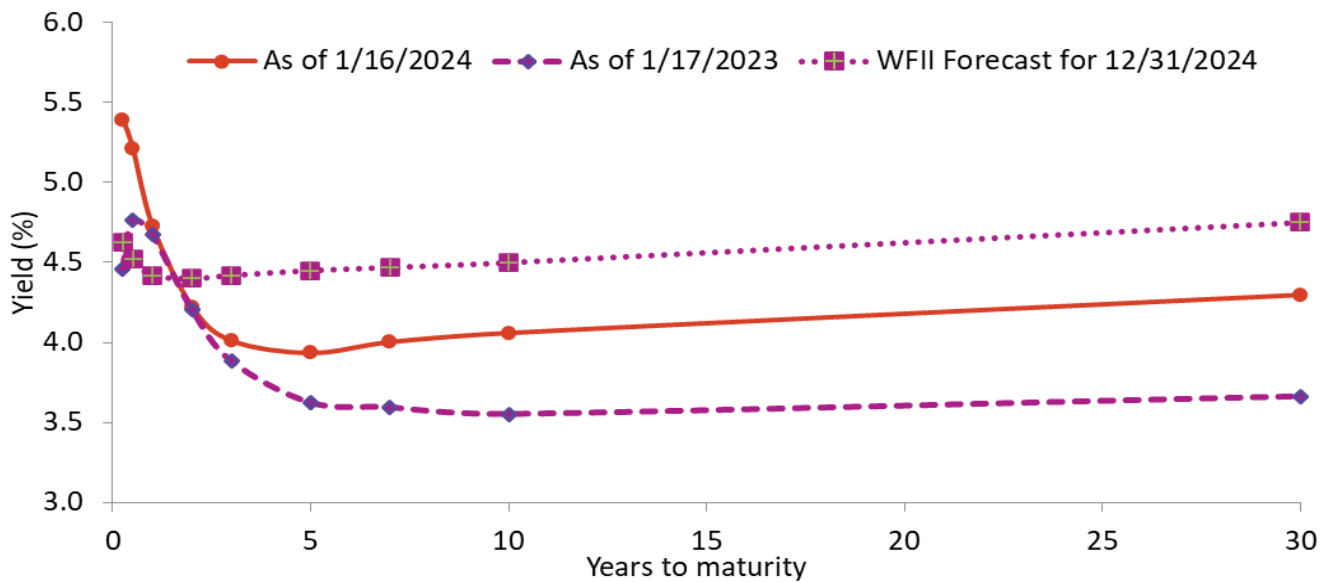
Global Fixed Income Strategist

Positioning for a neutral fixed income duration stance

In early January, we changed our bond duration exposure to neutral (relative to an investor’s individual benchmark).⁸ This does not mean that we want to avoid duration, it just means that at current interest rate levels we are more cautious of adding beyond our strategic allocation weights. For now, we believe that a neutral duration position should allow fixed income investors to remain flexible in case interest rates move lower or higher while still enjoying relative attractive yields. Keep in mind that we still believe the story of interest rates in 2024 will be a tale of two halves — moving lower during the first half of the year, but then moving higher toward the midpoint of our year-end 10-year U.S. Treasury yield target of 4.25% – 4.75%.

Index and portfolio durations change over time; therefore, for most investors it is impractical to be overly precise with duration matching when constructing portfolios. There are also costs that may be incurred when adjusting fixed-income portfolios, and these factors should be considered as well. Investors who own managed or index products (for example, mutual funds or exchange-traded funds) with a shorter-term or longer-term duration profile than desired could target a manager or exchange-traded product with a duration profile that better meets the neutral recommendation.

U.S. Treasury yield curve flattening expected by year-end



Sources: Bloomberg and Wells Fargo Investment Institute. Data as of January 16, 2024. Shape of the U.S. Treasury yield curve at given dates. **Forecasts are based on certain assumptions and subject to change.**

⁸ Duration is a measure of interest rate risk. Bloomberg U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, U.S.-dollar-denominated, fixed-rate taxable bond market including Treasuries, government-related and corporate securities, MBS ABS, and CMBS. An index is unmanaged and not available for direct investment.

Real Assets

Mason Mendez

Investment Strategy Analyst

John LaForge

Head of Real Asset Strategy

Our take on Copper and Industrial Metals

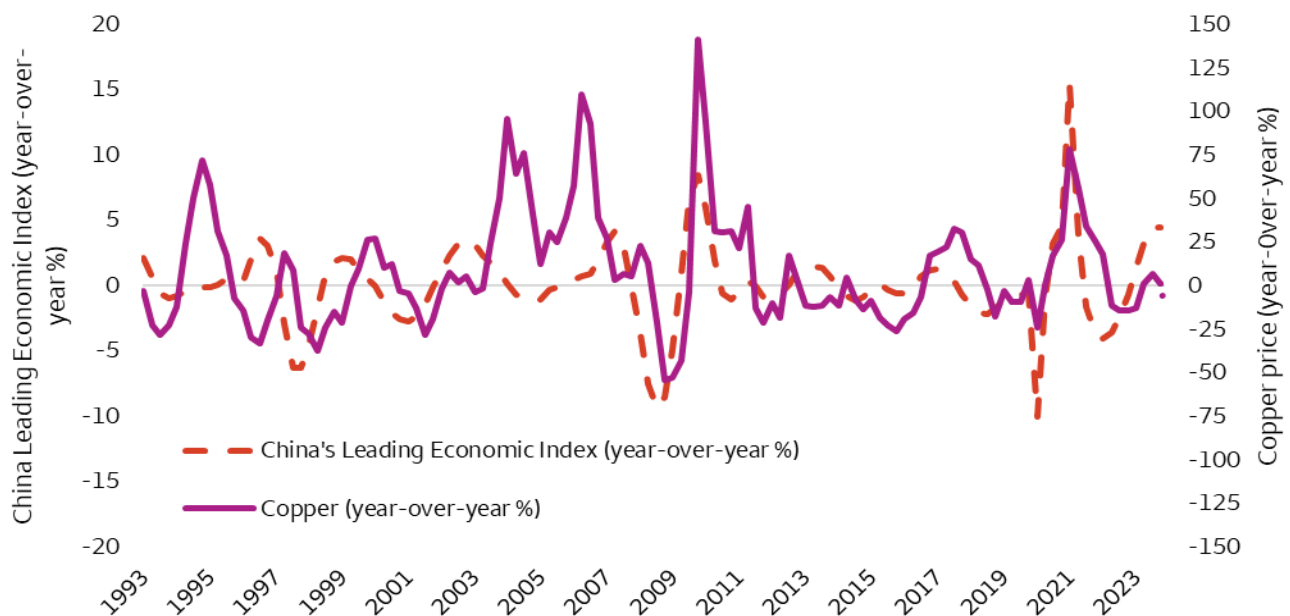
Recently, we read that some expect higher copper prices in 2024, due to an improving U.S. economic outlook by year-end. While we do believe that the U.S. economy matters to global copper prices, the direction of China’s economy typically matters more.

Copper plays a crucial role in the global economy, due to its wide array of industrial uses. Because of its broad use, it makes sense that the world’s two largest economies, the U.S. and China, matter to copper prices. Of the two economies, though, China often matters more because of its sheer size. At the end of 2023, as an example, China accounted for 57% of global refined copper demand, while the U.S. was close to only 6.5%.

We bring this up because China’s economy is showing signs of slowing as we enter 2024. One of those indicators, the year-to-year change in China’s Leading Economic Index, is the dashed orange line in the chart below. Notice that growth in the index has started to roll over and stall, along with copper prices (solid purple line). It is also important to note that help does not appear imminent for interest rate sensitive sectors, like real estate, with China’s central bank recently deciding not to cut key interest rates.

Overall, we remain neutral on copper and industrial metals as we enter 2024. We are watching China’s economy closely, though. Additional signs of economic weakness could lead us to downgrade Industrial Metals to unfavorable, relative to other commodity sectors.

Copper vs. China’s Leading Economic Index



Sources: Organization for Economic Co-Operation and Development Bloomberg, and Wells Fargo Investment Institute. Quarterly data is from March 1993 – December 2023. Price performance through January 12, 2024, is shown by the dotted purple line. Data as of January 12, 2024. **Past performance is no guarantee of future results.** An index is unmanaged and not available for direct investment.

Alternatives

Karin Geldfeld

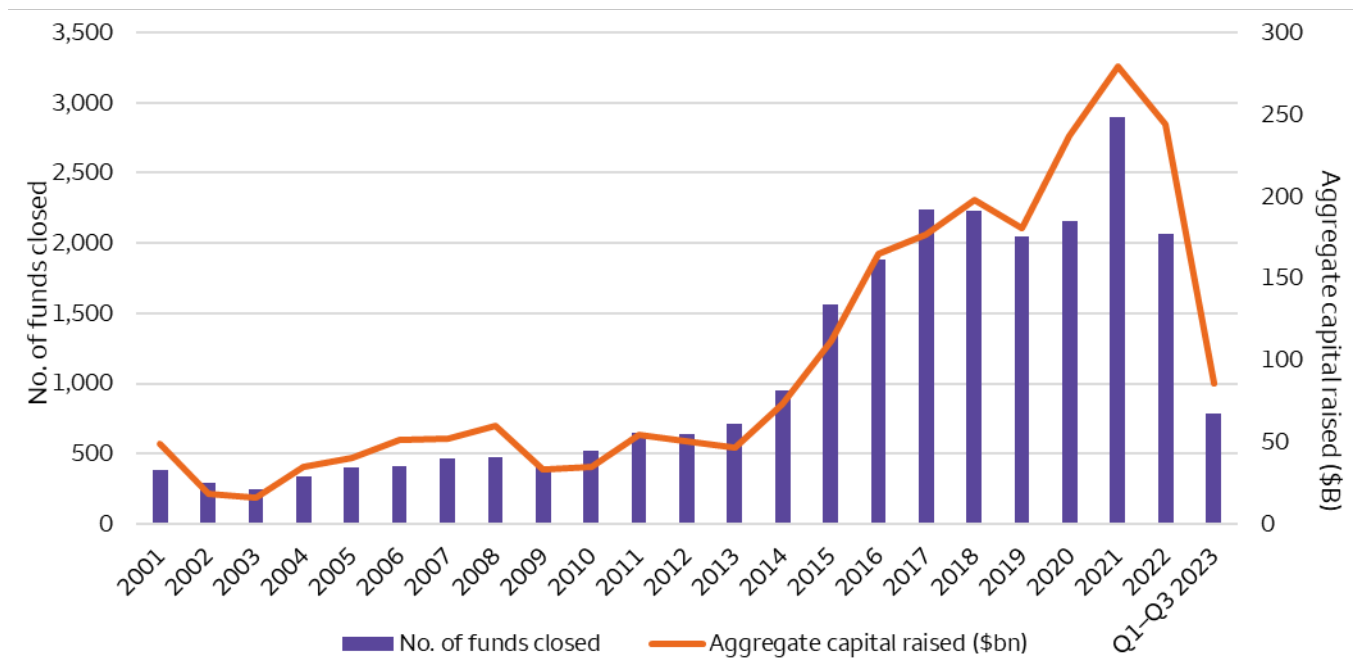
Senior Retail Investment Analyst

Interesting time in venture capital

Only 783 funds managed to close in the first three quarters of 2023, raising a total of \$85.7 billion, representing a 49% and 54% drop, respectively, from the prior year (full year 2022) according to Preqin. This significant investor resistance to investing in new funds we believe signals lower investment sentiment in the venture capital (VC) asset class. This is likely leading to only the best managers with a proven track records being able to raise capital, making the fundraising arena extremely competitive and likely spilling into discerning investment activity as VCs compete for compelling deals to lure in investors.

In parallel, dry powder (uninvested capital) reached a significant \$600 billion as of October of 2023 according to Preqin. These two trends are likely brewing more competitive pressure, more thoughtful investment rigor, and valuation discipline, a combination that was largely absent during the past decade. During that time, venture capital investors were often clamoring to get into VC deals at any price. We believe those dynamics are largely over, ushering in a more conservative era of investment. In the background, a growing secular trend of investment in artificial intelligence (AI) is most applicable in the venture capital investment stage across nearly every industry. New investment trends like AI, a pullback in valuations, and greater investment discipline from venture capitalists, are likely to make for a compelling investment opportunity for limited partners seeking investment in the venture capital asset class.

Decreased number of funds and capital raised in venture capital through October 2023



Source: Preqin Pro. Data as of 10/31/2023.

Alternative investments, such as hedge funds, private equity, private debt and private real estate funds are not appropriate for all investors and are only open to “accredited” or “qualified” investors within the meaning of U.S. securities laws.

Current guidance over tactical horizon (6-18 months)

Cash Alternatives and Fixed Income

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

Equities

Most Unfavorable	Unfavorable	Neutral	Favorable	Most Favorable
U.S. Small Cap Equities	Emerging Market Equities	U.S. Mid Cap Equities Developed Market Ex-U.S. Equities	U.S. Large Cap Equities	

Real Assets

Most Unfavorable	Unfavorable	Neutral	Favorable	Most Favorable
		Private Real Estate	Commodities	

Alternative Investments*

Most Unfavorable	Unfavorable	Neutral	Favorable	Most Favorable
		Hedge Funds—Event Driven Hedge Funds—Equity Hedge Private Equity Private Debt	Hedge Funds—Relative Value Hedge Funds—Macro	

Source: Wells Fargo Investment Institute, January 22, 2024.

*Alternative investments are not appropriate for all investors. They are speculative and involve a high degree of risk that is appropriate only for those investors who have the financial sophistication and expertise to evaluate the merits and risks of an investment in a fund and for which the fund does not represent a complete investment program. Please see end of report for important definitions and disclosures.

Risk considerations

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Foreign investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. These risks are heightened in emerging markets. **Small- and mid-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large company stocks. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates. **High yield (junk) bonds** have lower credit ratings and are subject to greater risk of default and greater principal risk. The **commodities** markets are considered speculative, carry substantial risks, and have experienced periods of extreme volatility. Investing in a volatile and uncertain commodities market may cause a portfolio to rapidly increase or decrease in value which may result in greater share price volatility. **Real estate** has special risks including the possible illiquidity of underlying properties, credit risk, interest rate fluctuations and the impact of varied economic conditions.

Cash alternatives typically offer lower rates of return than longer-term equity or fixed-income securities and provide a level of liquidity and price stability generally not available to these investments. Some examples of cash alternatives include: Bank certificates of deposit; bank money market accounts; bankers' acceptances, federal agency short-term securities, money market mutual funds, Treasury bills, ultra-short bond mutual funds or exchange-traded funds and variable rate demand notes. Each type of cash alternatives has advantages and disadvantages which should be discussed with your financial advisor before investing.

Alternative investments, such as hedge funds, private equity/private debt and private real estate funds, are speculative and involve a high degree of risk that is appropriate only for those investors who have the financial sophistication and expertise to evaluate the merits and risks of an investment in a fund and for which the fund does not represent a complete investment program. They entail significant risks that can include losses due to leveraging or other speculative investment practices, lack of liquidity, volatility of returns, restrictions on transferring interests in a fund, potential lack of diversification, absence and/or delay of information regarding valuations and pricing, complex tax structures and delays in tax reporting, less regulation and higher fees than mutual funds. Hedge fund, private equity, private debt and private real estate fund investing involves other material risks including capital loss and the loss of the entire amount invested. A fund's offering documents should be carefully reviewed prior to investing.

Hedge fund strategies, such as Equity Hedge, Event Driven, Macro and Relative Value, may expose investors to the risks associated with the use of short selling, leverage, derivatives and arbitrage methodologies. Short sales involve leverage and theoretically unlimited loss potential since the market price of securities sold short may continuously increase. The use of leverage in a portfolio varies by strategy. Leverage can significantly increase return potential but create greater risk of loss. Derivatives generally have implied leverage which can magnify volatility and may entail other risks such as market, interest rate, credit, counterparty and management risks. Arbitrage strategies expose a fund to the risk that the anticipated arbitrage opportunities will not develop as anticipated, resulting in potentially reduced returns or losses to the fund.

Definitions

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

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the US stock market.

An index is unmanaged and not available for direct investment.

M1 consists of (1) currency outside the U.S. Treasury, Federal Reserve Banks, and the vaults of depository institutions; (2) demand deposits at commercial banks (excluding those amounts held by depository institutions, the U.S. government, and foreign banks and official institutions) less cash items in the process of collection and Federal Reserve float; and (3) other liquid deposits, consisting of other checkable deposits (or OCDs, which comprise negotiable order of withdrawal, or NOW, and automatic transfer service, or ATS, accounts at depository institutions, share draft accounts at credit unions, and demand deposits at thrift institutions) and savings deposits (including money market deposit accounts). Seasonally adjusted M1 is constructed by summing currency, demand deposits, and other liquid deposits, each seasonally adjusted separately.

M2 consists of M1 plus (1) small-denomination time deposits (time deposits in amounts of less than \$100,000) less individual retirement account (IRA) and Keogh balances at depository institutions; and (2) balances in retail money market funds (MMFs) less IRA and Keogh balances at MMFs. Seasonally adjusted M2 is constructed by summing small-denomination time deposits and retail MMFs, each seasonally adjusted separately, and adding the result to seasonally adjusted M1.

General disclosures

Global Investment Strategy (GIS) is a division of Wells Fargo Investment Institute, Inc. (WFII). WFII is a registered investment adviser and wholly owned subsidiary of Wells Fargo Bank, N.A., a bank affiliate of Wells Fargo & Company.

The information in this report was prepared by Global Investment Strategy. Opinions represent GIS' opinion as of the date of this report and are for general information purposes only and are not intended to predict or guarantee the future performance of any individual security, market sector or the markets generally.

GIS does not undertake to advise you of any change in its opinions or the information contained in this report. Wells Fargo & Company affiliates may issue reports or have opinions that are inconsistent with, and reach different conclusions from, this report.

The information contained herein constitutes general information and is not directed to, designed for, or individually tailored to, any particular investor or potential investor. This report is not intended to be a client-specific suitability or best interest analysis or recommendation, an offer to participate in any investment, or a recommendation to buy, hold or sell securities. Do not use this report as the sole basis for investment decisions. Do not select an asset class or investment product based on performance alone. Consider all relevant information, including your existing portfolio, investment objectives, risk tolerance, liquidity needs and investment time horizon. The material contained herein has been prepared from sources and data we believe to be reliable but we make no guarantee to its accuracy or completeness.

Wells Fargo Advisors is registered with the U.S. Securities and Exchange Commission and the Financial Industry Regulatory Authority, but is not licensed or registered with any financial services regulatory authority outside of the U.S. Non-U.S. residents who maintain U.S.-based financial services account(s) with Wells Fargo Advisors may not be afforded certain protections conferred by legislation and regulations in their country of residence in respect of any investments, investment transactions or communications made with Wells Fargo Advisors.

Wells Fargo Advisors is a trade name used by Wells Fargo Clearing Services, LLC and Wells Fargo Advisors Financial Network, LLC, Members SIPC, separate registered broker-dealers and non-bank affiliates of Wells Fargo & Company. PM-07182025-6255696.1.1