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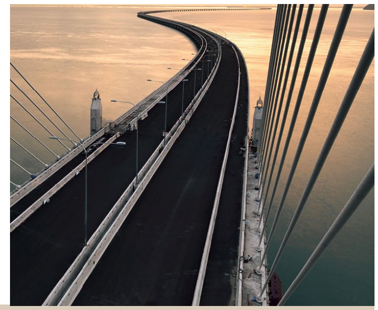
Investment Institute

# Investment Strategy



**Weekly guidance from our Investment Strategy Committee** **April 14, 2025**

# Fixed Income Spotlight

**Tony Miano, CFA**
Investment Strategy Analyst

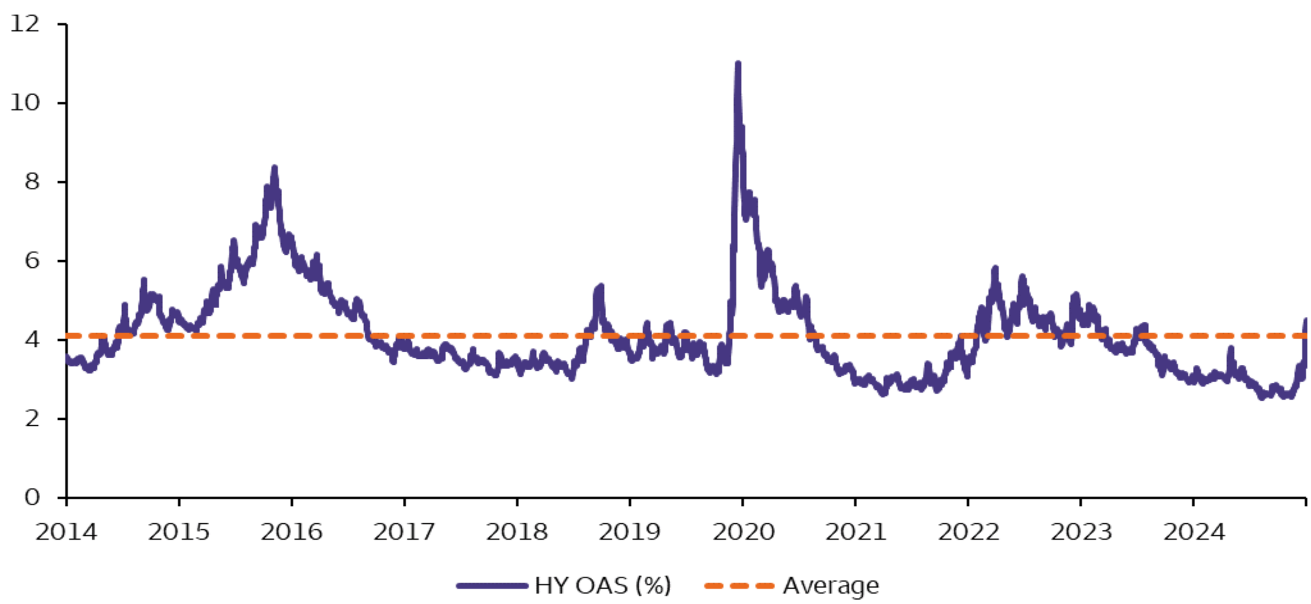
## Waiting for more opportunities in high yield

This year has, so far, been a volatile one for credit risks, with the option-adjusted spread (OAS, a measure of the credit risk associated with bonds) moving higher from February lows on recent economic concerns. A notable move has been in the High Yield (HY) Taxable Fixed Income asset class. As a result, yields available in high-yield securities are significantly higher than those available in investment-grade corporates or U.S. Treasuries. While some investors have begun to move into high yield bonds as yields have increased, with net inflows to high-yield investment products year-to-date,[1] we continue to have a mixed view and remain neutral on High Yield Taxable Fixed Income.

### Just the beginning for credit risks?

Credit risks have increased notably in high yield bonds, with the OAS rising from a low of 2.6% in mid-February to above 4.2% on April 4, 2025.[2] As concerns about the U.S. economic backdrop have mounted, so too have credit risks. Despite this widening spread, we believe the economic environment has room to soften further, and we remain cautious. As Chart 1 demonstrates, even after this recent move higher in credit spreads, they still remain considerably below what would be considered normal for periods of economic turmoil. Even after the economic turmoil and are only near their average for the past 10 years.

**Chart 1. High-yield OAS**




Sources: Bloomberg and Wells Fargo Investment Institute as of April 7, 2025. Measured by the Bloomberg U.S. Corporate High Yield Bond OAS Index. **Past performance is no guarantee of future results.** An index is unmanaged and not available for direct investment.

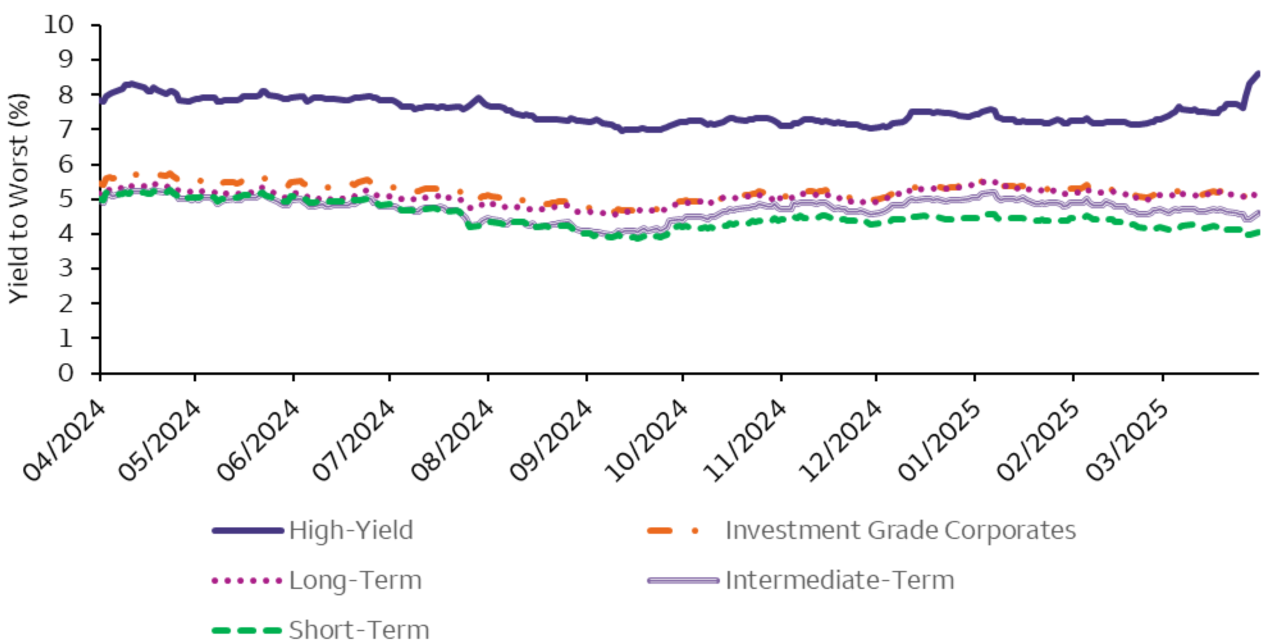
1. Morningstar, as of February 28, 2025, for fund flows. Bloomberg, as of March 31, 2025, for exchange-traded funds (ETFs).
2. Bloomberg as of April 4, 2025, measured by Bloomberg U.S. Corporate High Yield Bond OAS Index.

While our base case is not for recession in 2025, we do see the potential for economic concerns to increase further and for credit risks to increase with them. With the backdrop of higher-than-expected tariffs, we would expect the current economic softening to last later into the year before eventually reaccelerating into year-end 2025. Default rates have not shown significant cause for concern, but an increase could significantly impact High Yield Taxable Fixed Income, with the possibility that even the shallowest of recessions could see credit spreads moving up meaningfully from current levels.[3]

## Investor implications

While questions remain on credit risks, we do still see some potential positives in High Yield Taxable Fixed Income. Issuance of higher-rated BB and B bonds has increased, potentially decreasing the prevalence of lower-rated credit risks in high-yield indexes compared to historical averages. Additionally, as the name suggests, yields in this space are high. Chart 2 demonstrates the yields of a variety of U.S. fixed-income categories. Yields in both U.S. Treasuries and investment-grade corporates have fallen as investors gravitate towards higher quality.

**Chart 2. Fixed-income yields**




Sources: Bloomberg and Wells Fargo Investment Institute as of April 7, 2025. Measured by yield to worst. High yield represented by the Bloomberg U.S. Corporate High Yield Index. Investment-grade corporates represented by the Bloomberg U.S. Corporate Index. Short-term represented by the Bloomberg U.S. Aggregate 1 – 3 Year Index. Intermediate term represented by the Bloomberg U.S. Aggregate 5 – 7 Year Index. Long-Term represented by the Bloomberg U.S. Aggregate 10+ Year Index. **Past performance is no guarantee of future results.** An index is unmanaged and not available for direct investment.

For income-focused investors, high-yield bonds may help boost portfolio yields, and income could be a key portion of returns, in our view. We maintain a neutral allocation to High Yield Taxable Fixed Income and believe that any further widening in credit spreads will create better entry points. Other areas of interest for income-oriented investors who may be willing to trade yield for higher credit quality would be Investment Grade Credit and Securitized sectors, both of which we have a favorable guidance rating on.

3. Bloomberg, as of March 31, 2025. Measured by Bloomberg U.S. Corporate High Yield Average OAS.

# Equities

**Chris Haverland, CFA**
Global Equity Strategist

## Adjusting 2025 equity targets

Uncertainties over tariffs, worries of consumer exhaustion, increased costs, and a lowered economic growth outlook will likely drag on sales, margins, profits, and valuations more than we had anticipated this year. As a result, we reduced our 2025 year-end earnings and price targets nearly across the board. Each of our new earnings target is lower than Bloomberg consensus estimates, which tend to be slow to react to changing environments. We expect the analyst community to adjust to the worsening outlook over time and begin to cut estimates in the coming months as companies report updated forecasts to account for tariff impacts.

We suspect that lower-quality companies with less-flexible supply chains and balance sheets will have the toughest time navigating this environment. As such, we lowered our earnings-per-share (EPS) targets for U.S. Small Cap Equities and Emerging Markets (EM) Equities by the greatest percentage. Despite the worsened earnings outlook, the new EPS forecasts still show either flat EM or modest earnings growth (all other asset classes) relative to 2024 numbers.

We are not changing our price target for Developed Market ex-U.S. (DM) Equities. Coming into the year, investor sentiment was excessively pessimistic, and we prescribed a lower price multiple with our original target as result. A string of better-than-expected European economic data and news of increased fiscal spending should support improved sentiment and suggests our prescribed price multiple should be raised. The drop in our earnings expectations and increase in price-to-earnings multiple cancel each other out and result in an unchanged price target.

Later this year, we expect investor attention to refocus on the expected market-friendly policies of deregulation and tax-cut extensions. If this focus shifts and the economy skirts a recession and stages a modest second-half recovery as we expect, equity indexes should move higher. However, meaningfully surpassing recent highs by year-end 2025 may prove difficult. We continue to favor quality, including U.S. over international equities, U.S. Large and Mid Cap Equities over U.S. Small Cap Equities, and DM over EM Equities.

### 2025 equity earnings and price targets

| Global equities | New year-end 2025 targets | Previous year-end 2025 targets |
|---|---|---|
| S&P 500 Index | **5,900-6,100** | 6,500-6,700 |
| S&P 500 Index EPS | **$260** | $275 |
| Russell Midcap Index | **3,600-3,800** | 4,100-4,300 |
| Russell Midcap Index EPS | **$190** | $195 |
| Russell 2000 Index | **2,000-2,200** | 2,700-2,900 |
| Russell 2000 Index EPS | **$70** | $80 |
| MSCI EAFE Index | 2,400-2,600 | 2,400-2,600 |
| MSCI EAFE Index EPS | **$160** | $170 |
| MSCI EM Index | **1,000-1,200** | 1,100-1,300 |
| MSCI EM Index EPS | **$75** | $85 |

Targets are based on forecasts by Wells Fargo Investment Institute as of April 14, 2025, and provide a forecast direction over a tactical horizon through 2025. **Values in bold indicate changes from previously published values.** *Forecasts, targets, and estimates are not guaranteed and are based on certain assumptions and on our current views of market and economic conditions, which are subject to change..*

# Real Assets

**Sameer Samana, CFA**
Head of Global Equities and Real Assets

## Oil: the hits just keep on coming

West Texas Intermediate (WTI) oil has now fallen 25.35% from its recent high on January 15, 2025, through April 8, 2025. The most recent news headlines to hit oil markets were President Donald Trump's announcement of a combination of reciprocal and universal tariffs; the Organization of Petroleum Exporting Countries (OPEC) plus restoration of some previously cut production; and Saudi Arabia's deeper cuts to pricing for Asian buyers to retain market share.

These developments should lead to further oversupply and negative sentiment, and our expectations for a rally this year have been meaningfully curtailed, as seen in our recently lowered WTI oil target of $65 – $75, down from $85 – $95. Still, we believe that once businesses, consumers, and investors adjust to the recently announced tariffs, the global economic recovery will resume with greater breadth as both China and Europe are trying to foster domestic consumption and investment. Investors would do well to maintain exposure to Commodities, including oil, as the asset class can help smooth portfolio returns during periods when both equities and fixed income struggle.

The chart shows that WTI crude oil is in a downtrend, with the 50-day moving average (69.27) now trading below the 200-day moving average (72.37). It should find support at April 2021 lows (59.32) and resistance at the 50-day moving average (69.27).

**Oil trading at early 2021 levels**


Sources: Bloomberg and Wells Fargo Investment Institute. Daily data from April 8, 2021, through April 8, 2025. CL1 = Generic 1st WTI futures contract. SMAVG (50) = 50-day simple moving average. SMAVG (200) = 200-day simple moving average. RSI = relative strength index. **Past performance is no guarantee of future results.** An index is unmanaged and not available for direct investment.

# Alternatives

**Mark Steffen, CFA, CAIA**
Global Alternative Investment Strategist

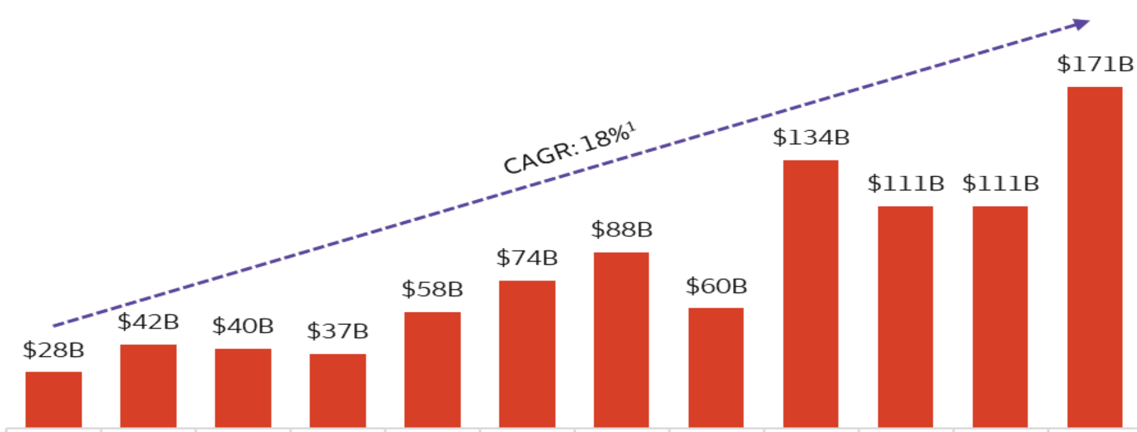
## No sign of slowdown in secondary Private Equity markets

Investors in Private Equity funds commit their capital for the duration of the fund's life, with a typical horizon of six to twelve years. While these investments have limited liquidity options, investors may have an opportunity to sell their fund interests on the secondary market. The secondary market is typically only available for larger-fund stakes and is a common solution for institutional investors looking to rebalance their portfolios. Investors who purchase these secondary interests, while responsible for any future funding obligations, are often able to buy at a discount to the fund's current net asset value (NAV). In addition to purchasing at a significant discount, other advantages may accrue to secondary investors — these potentially include improved visibility in the underlying portfolio holdings, , and a shortened fund life span.  While these features can be beneficial, investors should remember that a fund's NAV is challenging to determine and inaccuracies could negatively affect the value of fund interests.  Additionally, there may be no further secondary market for the interests and transferability may be limited or even prohibited.

Secondary market volumes have grown rapidly over time, achieving a compounded annual growth rate (CAGR) of 18% since 2013 (see chart). As a recent driver of this growth trend, a disconnect between the price sellers are willing to accept and buyers are willing to pay has been leading many mature Private Equity funds to extend their investment hold times instead of choosing to wait for a more seller-friendly environment to exit positions. Given this propensity of fund managers to hold investments longer, many investors have turned to the secondary markets as a source of liquidity.

Although the positive public-market returns in recent years had many fund managers optimistic the exit environment would improve in 2025, the recent equity-market drawdown may instead fuel further growth in the secondary market. We remain constructive on secondary markets as the recent market volatility may result in opportunities for investors amid greater transaction volumes and larger discounts in secondary markets.

**Secondary market transaction volumes (in billions)**




| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Average age of funds (years) | 7 | 8 | 8 | 9 | 8 | 8 | 6 | 8 | 9 | 6 | 6 | 9 |

Sources: Greenhill Advisory and Wells Fargo Investment Institute. Data as of December 31, 2024. [1] Simple average of all funds in Greenhill sample set of closed transactions.

# Tactical guidance*

### Cash Alternatives and Fixed Income

| Most Unfavorable | Unfavorable | Neutral | Favorable | Most Favorable |
|---|---|---|---|---|
| | U.S. Long Term Taxable Fixed Income<br>U.S. Short Term Taxable Fixed Income | Cash Alternatives<br>Developed Market Ex-U.S. Fixed Income<br>Emerging Market Fixed Income<br>High Yield Taxable Fixed Income<br>U.S. Intermediate Term Taxable Fixed Income | | |

### Equities

| Most Unfavorable | Unfavorable | Neutral | Favorable | Most Favorable |
|---|---|---|---|---|
| | Emerging Market Equities | Developed Market Ex-U.S. Equities<br>U.S. Small Cap Equities | U.S. Large Cap Equities<br>U.S. Mid 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—Equity Hedge<br>Hedge Funds—Relative Value<br>Private Equity<br>Private Debt | Hedge Funds—Event Driven<br>Hedge Funds—Macro | |

Source: Wells Fargo Investment Institute, April 14, 2025.

*Tactical horizon is 6-18 months

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

### Risk considerations

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

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 1-3 Year Bond Index is composed of the Bloomberg U.S. Government/Credit Index and the Bloomberg U.S. Mortgage-Backed Securities Index, and includes Treasury issues, agency issues, corporate bond issues, and mortgage-backed securities with maturities of 1-3 years.

Bloomberg U.S. Aggregate 5-7 Year Bond Index is composed of the Bloomberg U.S. Government/Credit Index and the Bloomberg U.S. Mortgage-Backed Securities Index, and includes Treasury issues, agency issues, corporate bond issues, and mortgage-backed securities with maturities of 5-7 years.

Bloomberg U.S. Aggregate 10+ Year Bond Index is composed of the Bloomberg U.S. Government/Credit Index and the Bloomberg U.S. Mortgage-Backed Securities Index, and includes Treasury issues, agency issues, corporate bond issues, and mortgage-backed securities with maturities of 10 years or more.

Bloomberg U.S. Corporate Bond Index includes publicly issued U.S. corporate and Yankee debentures and secured notes that meet specified maturity, liquidity, and quality requirements.

Bloomberg U.S. Corporate High Yield Index covers the universe of fixed-rate, noninvestment-grade debt.

Bloomberg U.S. Corporate High Yield Bond OAS Index measures the Option adjusted spreads of USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below.

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

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

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.

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.

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