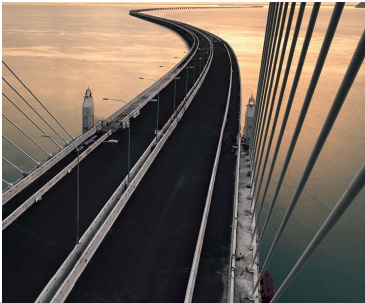


# Investment Strategy



Weekly guidance from our Investment Strategy Committee

June 2, 2025

## Real Assets Spotlight: Natural gas demand on the rise ..... 2

- We believe that the convergence of several secular factors will contribute to increased natural gas demand in the coming years.
- We view infrastructure as the missing link to bridge expected growth in both supply and demand for natural gas, which underscores our favorable view on the Midstream Energy sub-sector.

## Equities: AI market transitioning from training to inference..... 4

- We believe recent releases of complex chain-of-thought artificial intelligence (AI) reasoning models will require even higher levels of computing resources, particularly for inference workloads.
- We expect China’s AI technical breakthroughs will lead to lower inference costs and a broader lift in overall AI demand, with a shift in AI spending tilted more toward inferencing versus training.

## Fixed Income: Muni tax exemption untouched in tax bill, for now..... 5

- The recently passed House tax and spending bill leaves tax exemption for municipal bonds in place.
- Although changes could be made in the Senate, we consider this initial version to be good news for municipal-bond investors.

## Alternatives: How to develop a diversified alternative allocation..... 6

- We believe it is prudent for qualified investors to consider a diversified alternative allocation to complement their public investments given the variety of private-capital and hedge-fund strategies available.
- In doing so, we believe investors should consider their investment objectives and diversify across and within alternative asset classes.

## Current tactical guidance ..... 7

**Investment and Insurance Products: ➤ NOT FDIC Insured ➤ NO Bank Guarantee ➤ MAY Lose Value**

## Real Asset Spotlight

**Ian Mikkelsen, CFA**  
Equity Sector Analyst

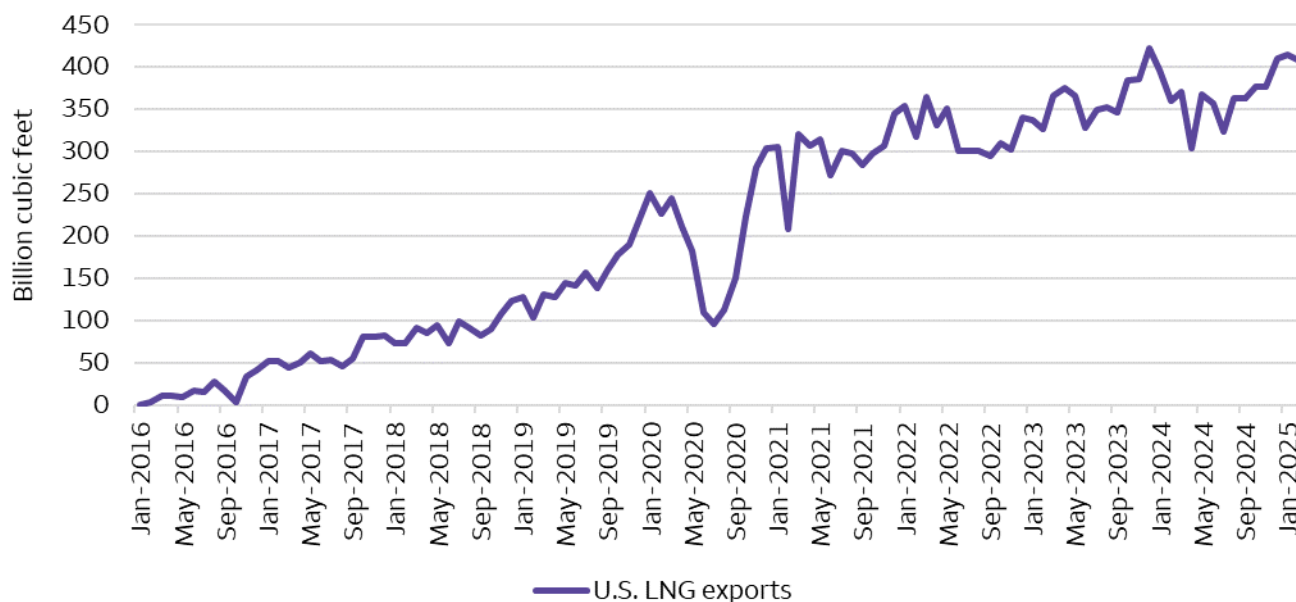
### Natural gas demand on the rise

We believe that the outlook for U.S. natural gas demand growth has shifted structurally higher, driven by the convergence of multiple secular factors. Among the drivers of growing natural gas demand, we view increasing exports of liquefied natural gas (LNG) and growing domestic power needs as particularly significant.

#### Liquefied natural gas exports expanding

We view the growth in U.S. LNG exports as the most pertinent near-term driver of natural gas demand growth based on the amount of export capacity currently under construction. U.S. LNG exports have increased steadily over the past several years, and the data suggests growth is just getting started. Domestic LNG export capacity is expected to increase by 73% through the end of this decade based on projects that are already under construction. Accounting for additional proposed LNG projects that are in development, LNG capacity could potentially increase by as much as 150% over the next seven years.<sup>1</sup>

**Chart 1. U.S. exports of LNG have risen steadily over the past several years**



Source: EIA. Data from January 2016 – February 2025.

#### Data centers and power generation

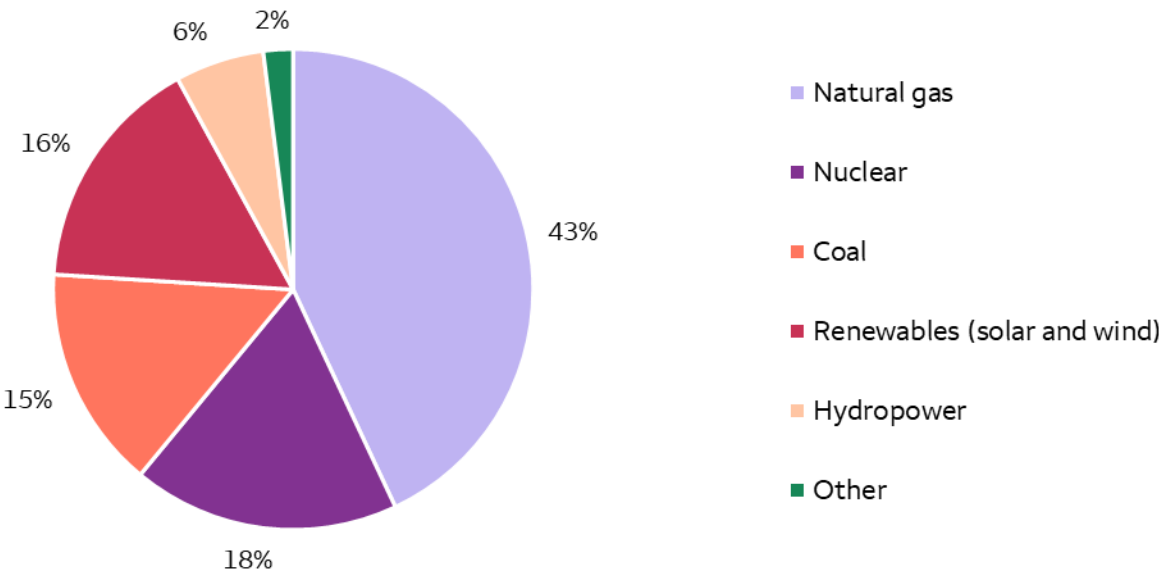
The buildout of data-center capacity in the U.S. is emerging as an important demand driver of power demand. Ultimately, the impact that data centers will have on natural gas demand will depend on the cadence of development as well as a number of other variables, and current forecasts vary widely based on differing assumptions. Recent developments, such as the DeepSeek artificial intelligence breakthrough and some

1. According to the U.S. Energy Information Administration (EIA) and Wells Fargo Securities.  
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uncertainty around the future capital spending outlooks of hyperscalers<sup>2</sup>, have cast a shadow of doubt over the relative pace of development. However, we see no signs that the data-center boom is slowing, and we expect this trend to remain an important driver of robust electricity demand growth over the coming years.

In order to meet growing power demand, we believe that an all-of-the-above supply approach is required. This includes increasing electrification from natural gas, renewables, and nuclear facilities, and we expect significant growth across all three of these power verticals over the coming years. However, we note that renewable and nuclear power generation face various logistical and economic limitations, while natural gas power generation is relatively flexible and easier to deploy. We expect natural gas to account for an increasing share of domestic power generation over the coming years, up from around 43% today, which is further supported by our expectation for continued coal-to-gas switching in the power-generation mix over the coming years.

**Chart 2. U.S. power-generation mix led by natural gas**



Source: EIA. Data as of 2024.

Investment implications

The U.S. has ample supply of natural gas to meet this growing demand as it is the world’s largest producer of natural gas, accounting for over 25% of global production with approximately 80 years of recoverable reserves at current production levels.<sup>3</sup> The acceleration of demand growth represents a structural shift, and we believe that natural gas producers are generally in a good position to meet this demand growth with increased supply. However, the timing of supply growth will be a key variable, which may result in periods of imbalances between supply and demand. As a result, we see the potential for increased volatility and modestly higher natural gas prices on average over the coming years.

We view infrastructure as the missing link to bridge supply and demand growth in this environment, which is critical to our favorable view of the Midstream Energy sub-sector. We expect midstream energy companies focused on natural gas to benefit from a fairly steady runway of incremental growth opportunities as well as higher utilization and an extended useful life for existing assets. In this environment, a number of midstream energy companies have reported improved fundamental growth outlooks and expanding project backlogs with attractive returns.<sup>4</sup>

2. Hyperscalers refers to hyperscale cloud providers, a small group of companies who operate large networks of large data centers to facilitate cloud computing.

3. According to the EIA.

4. According to various Midstream Energy financial statements, earnings guidance, and Wells Fargo Securities.

# Equities

**Amit Chanda**  
Equity Sector Analyst, Information Technology

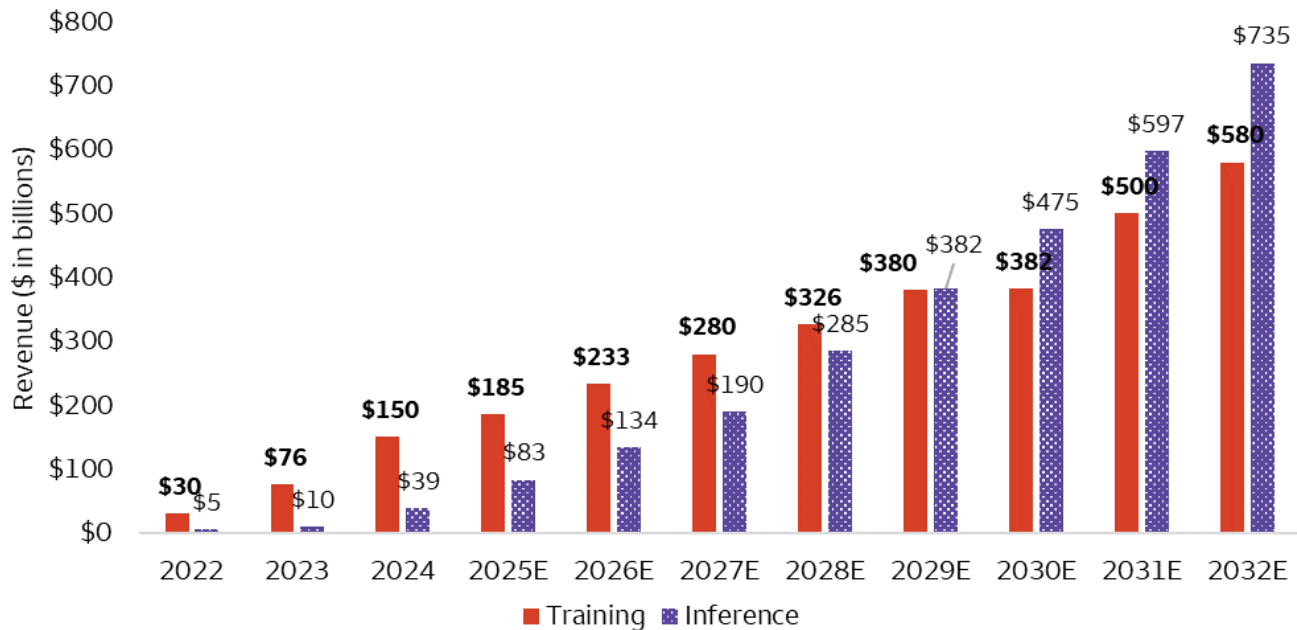
## AI market transitioning from training to inference

Since the start of the year, a few topics have sparked a heated investor debate about AI data-center investments peaking at some point. These have included news that China developed a competitive reasoning model more efficiently at a fraction of the cost of the best reasoning models released by the U.S., along with broader macro uncertainty related to tariffs imposed by the Trump administration. While investors’ worries over AI data-center capital expenditure (capex) growth will take time to figure out, we expect ongoing domestic hyperscale capex spending, incremental sovereign AI demand, and enterprise adoption of AI will help bolster AI demand in 2025.

Over the past few years, a considerable portion of generative AI’s initial infrastructure buildout phase has been driven by the need to train cutting-edge large language models and now by complex reasoning models released by U.S. hyperscale companies. The costs associated with developing, training, and managing chain-of-thought reasoning models are prohibitive as these models are very compute, semiconductor, and networking intensive.

We believe China’s technical breakthrough in overall model training and inference efficiency will result in lower inference costs and help accelerate the transition from capex spending on training to inference. While absolute U.S. hyperscale capex investments remain high this year at \$312 billion, we believe lower inference costs will eventually lead to new use cases, a broader lift in overall AI demand, higher computing requirements, and a shift in hyperscale capex spending tilted more toward inferencing versus training earlier than we expected.

### Forecasts for training versus inference revenues



Sources: Wells Fargo Investment Institute, Bloomberg, and International Data Corporation (IDC). Data as of March 24, 2025. E = estimated. Estimates based on Bloomberg Intelligence forecasts using IDC data. **Forecasts are not guaranteed and based on certain assumptions and on views of market and economic conditions which are subject to change.**

## Fixed Income

**Sara Kisner**

Municipal Analyst

### **Muni tax exemption untouched in tax bill, for now**

On May 22, the U.S. House of Representatives passed a wide-sweeping tax and spending bill in part as a response to the expected extension of the 2017 Tax Cuts and Jobs Act, originally set to expire in 2025. The vote in the House successfully passed the legislation by the narrowest of margins, 215 votes to 214 votes. The legislation, also referred to as “The One, Big, Beautiful Bill,” makes no mention of any changes to the current tax-exempt nature of municipal bonds, either those issued for traditional municipal borrowers or those issued for qualified private-activity bonds.

Municipal market stakeholders were anxiously awaiting the bill since January, when it was determined that municipal tax exemption was one of numerous items on the table for cost-cutting consideration. We attribute the lack of action with respect to the revocation of the municipal tax exemption to the significant amount of lobbying and education on the importance of the municipal-bond tax exemption for both investors as well as public infrastructure funding over the past three to four months.

We consider the absence of discussion on municipal-bond tax exemption in the bill to be good news for municipal investors. However, the process is not yet complete, and there is certainly potential for change as it moves to the Senate for consideration. Although the chance of revocation of the municipal tax exemption is not zero, we continue to maintain our belief that the status quo will ultimately be maintained for state and local government borrowers. However, we continue to acknowledge there is more risk to the exemption for private-activity bonds should any changes be made in the finalization of the legislation. Wells Fargo Investment Institute (WFII) currently has a favorable view on the U.S. Municipal Bond sector.

# Alternatives

Chao Ma, PhD, CFA, FRM

Global Portfolio and Investment Strategist

## How to develop a diversified alternative allocation

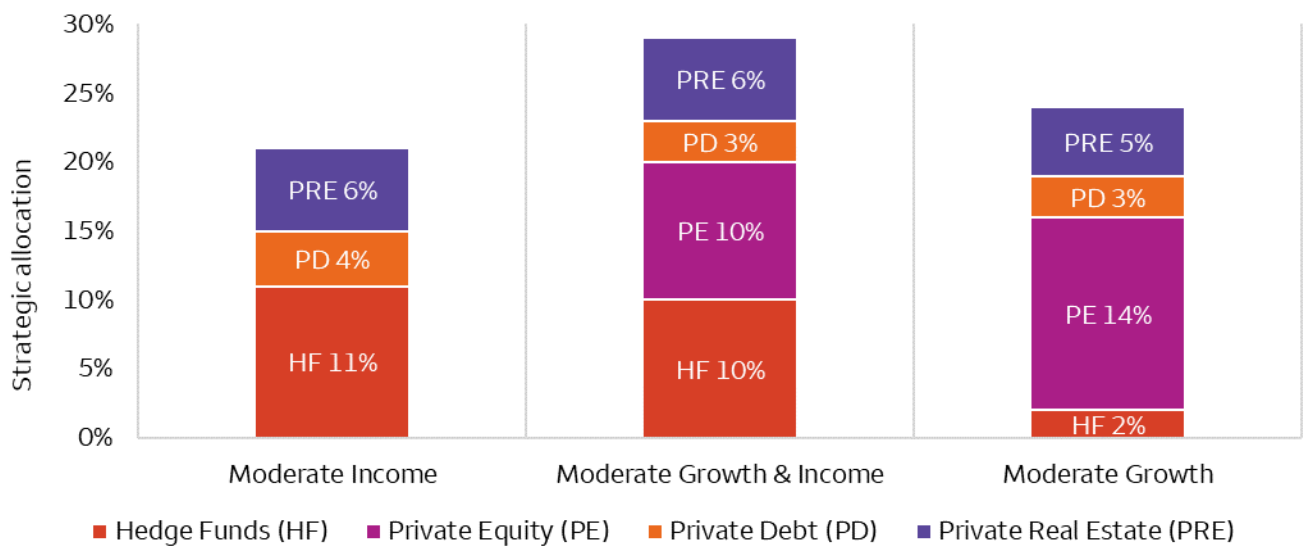
Among the variety of alternative investments available across private-capital and hedge-fund strategies, many offer a differentiated return-and-risk profile or focus on specialized investment opportunities. Therefore, we believe it is prudent for qualified investors to consider a diversified alternative allocation to complement their traditional equity and fixed-income investments.

We believe qualified investors should first consider their investment objectives, such as their preference for long-term capital appreciation or desire for regular investment income. WFII's illiquid strategic asset allocation, which allocates between 20% and 30% to alternative investments, provides a useful reference (chart below). For income objectives, the strategic allocation emphasizes yield-oriented asset classes, including both Private Debt and Private Real Estate. Additionally, hedge-fund strategies may have the potential to benefit income portfolios with their low correlation to public markets. In both Growth & Income and Growth objectives, Private Equity is introduced in strategic allocations given its potential to offer long-term returns.

We believe it is also often prudent to further diversify among alternative investment strategies given the market backdrop. For example, in the current environment we prefer to diversify income sources across multiple Private Real Estate property sectors and Private Infrastructure to leverage long-term demographic and digitization trends, while also reducing a portfolio's sensitivity to inflation. Within Private Equity, investors may consider allocating across Large Cap Buyout, Small/Mid Cap Buyout, Growth Equity, and Venture Capital sub-strategies to invest in the landscape of private companies in various life stages that balance appreciation potential with different levels of risk.

We believe a diversified alternative allocation can complement a portfolio of traditional equities and fixed-income investments and potentially enhance a portfolio's long-term return while reducing volatility over time.

### WFII's illiquid strategic asset allocation allocates 20% – 30% to alternative investments



Source: Wells Fargo Investment Institute. Strategic asset allocation as of May 31, 2025.

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

# Tactical guidance\*

## Cash Alternatives and Fixed Income

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

## Equities

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

Source: Wells Fargo Investment Institute, June 2, 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

Asset allocation and diversification are investment methods used to help manage risk. They do not guarantee investment returns or eliminate risk of loss including in a declining market.

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. **Municipal bonds** offer interest payments exempt from federal taxes, and potentially state and local income taxes. Municipal bonds are subject to credit risk and potentially the Alternative Minimum Tax (AMT). Quality varies widely depending on the specific issuer. Municipal securities are also subject to legislative and regulatory risk which is the risk that a change in the tax code could affect the value of taxable or tax-exempt interest income. 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. Investments in the **energy sector** are subject to the adverse economic events within that industry. A downturn in the energy sector of the economy, adverse political, legislative or regulatory developments or other events could have a large impact on a portfolio's investments. **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.

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