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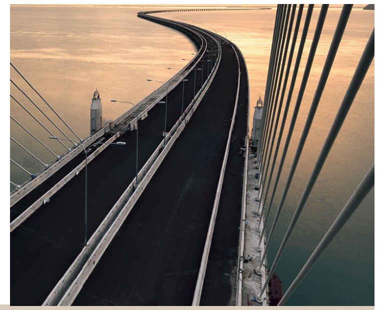
Investment Strategy



Weekly guidance from our Investment Strategy Committee June 23, 2025

Equities Spotlight

Chris Haverland, CFA
Global Equity Strategist

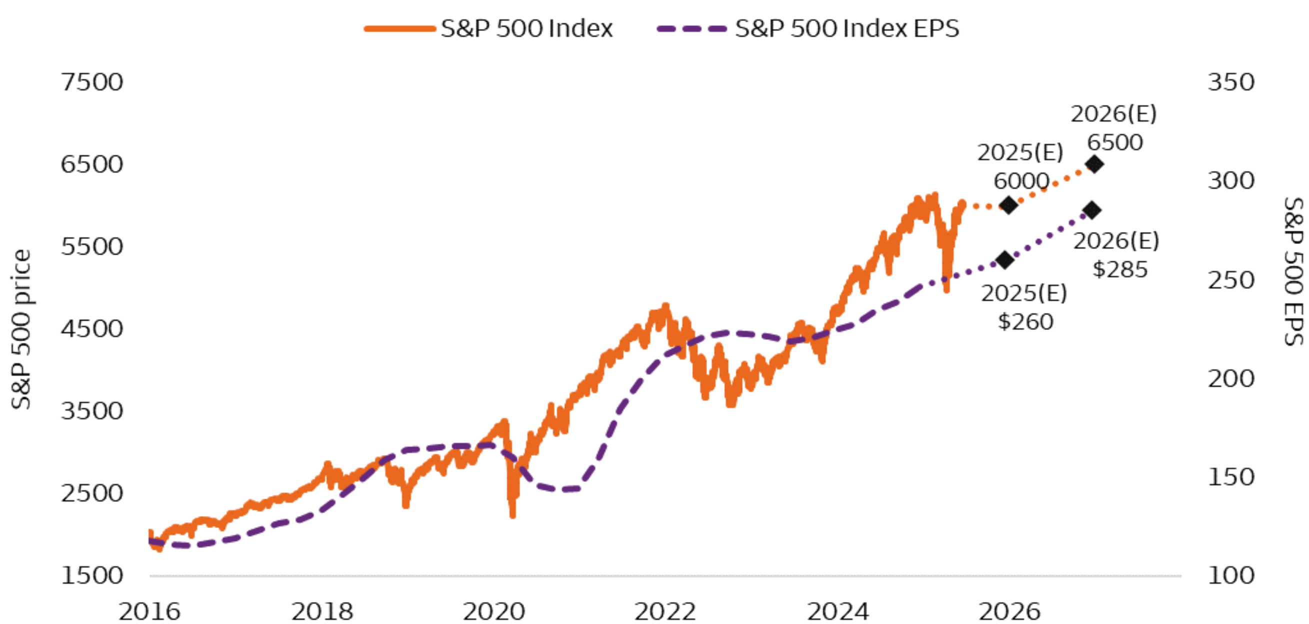
Take advantage of near-term volatility

Equity markets have been fixated on trade policy for much of 2025, and more recently, geopolitical tensions have added to the list of uncertainties. While the Israel-Iran conflict may restrain investor sentiment, tariffs have the potential to hit corporate sales as consumers purchase fewer goods and services. In addition, tariffs can squeeze profit margins as companies attempt to absorb some of that burden. But the drag from tariffs does not end there. With trade-policy negotiations ongoing, companies' ability to allocate capital toward growth projects can be impaired. C-suites (the highest-ranking executive positions in a company) are less likely to approve a project if the return after costs is unknowable.

In addition to geopolitical and tariff uncertainty (especially around the July expiration of the 90-day reciprocal tariff pause), we believe the next few months will be full of potential market-moving events. These include continued negotiation and the anticipated passage in Congress of the One Big Beautiful Bill Act, second-quarter earnings season that likely will reflect the impact of tariffs, and the debt-ceiling debate. In the near term, when we expect trade-policy and geopolitical uncertainty to be highest, volatility is likely to be elevated and returns muted.

Even so, we expect more trade deals to provide some additional clarity and eventually reduce corporate, consumer, and investor anxiety. Deregulation, tax cuts, and lower short-term borrowing rates should further bolster earnings. In sum, the new tariffs are significant, and uncertainty may persist for some months to come. However, they could be more than offset by market-friendly tax and regulatory policies, potentially allowing earnings to drive equity returns through 2026 (see chart 1).

Chart 1. 2026: Reaching new highs

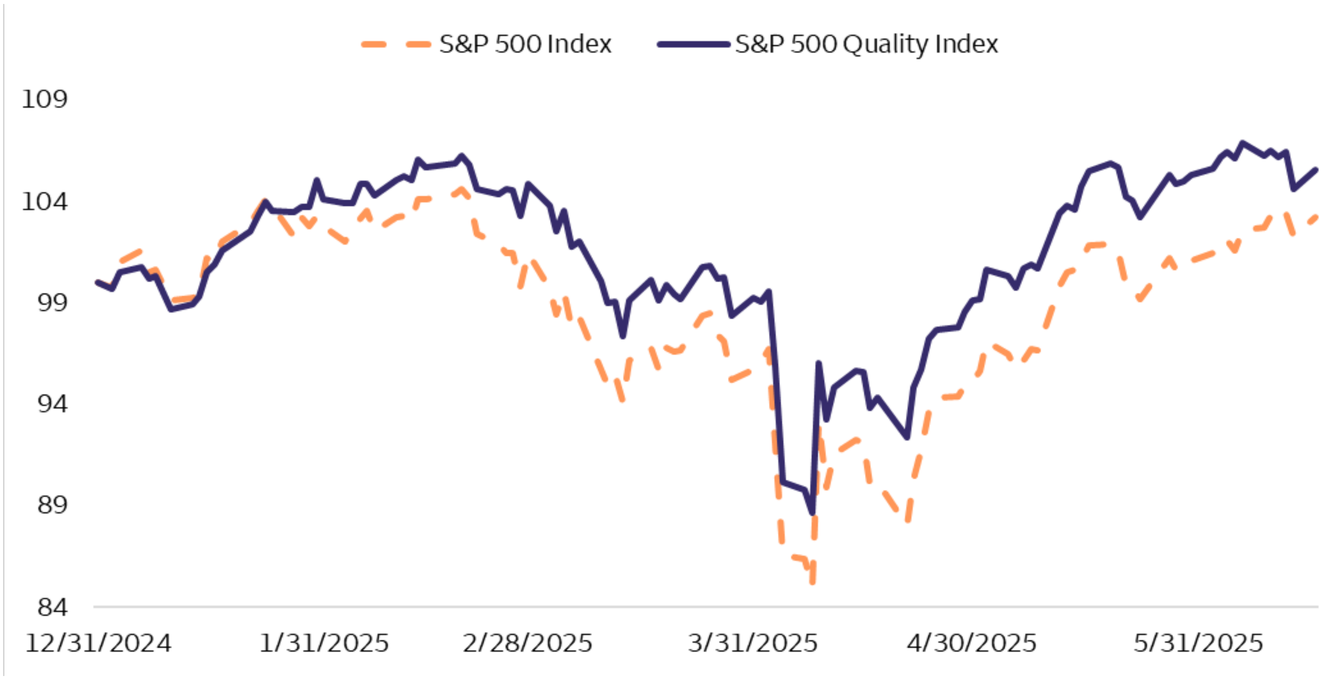


Sources: Bloomberg and Wells Fargo Investment Institute as of June 16, 2025. EPS = earnings per share. 2025(E) and 2026(E) represent Wells Fargo Investment Institute estimates. Estimates are based on certain assumptions and on views of market and economic conditions which are subject to change. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

Lean into quality

Absent a recession or a widening of the Iran-Israel war to other countries, we believe the risk of downside below 2025 lows is likely limited while the upside reward potential over the next 18 months is significant. Our preference remains to allocate based on quality, which has worked well year-to-date through June 16 (see chart 2). We define quality as companies with strong profit margins, limited balance-sheet leverage, and high earnings stability. These companies also have the size and earnings potential to navigate choppier economic periods that put smaller peers under earnings pressure. We favor U.S. Large Cap and Mid Cap Equities over U.S. Small Cap Equities. We also favor Developed Market (DM) ex-U.S. Equities over Emerging Market (EM) Equities.

Chart 2. Quality has outperformed in 2025 (through June 16)



Sources: Bloomberg and Wells Fargo Investment Institute as of June 16, 2025. S&P 500 Quality Index is an index that comprises the highest quality names in the S&P 500 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 U.S. stock market. Indexed to 100 as of December 31, 2024. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

We ultimately see upside potential in U.S. equities through 2026 but are focusing on valuations while near-term market action is volatile. If risk appetite weakens and prices fall, we favor reallocating from our unfavorably rated defensive sector (Consumer Staples) and from some neutral-rated sectors (Health Care and Real Estate) to our favorable cyclical sectors (Energy, Financials, Communication Services, and Information Technology). By contrast, during risk-on rallies, we prefer to reallocate from sectors we see as overvalued, such as the cyclically oriented Consumer Discretionary sector to a more defensive sector, Utilities, which we see as more favorably valued.

For investors, we believe this may be a good time to dollar-cost-average systematically and continue to participate in the equity markets. In our view, the potential upside through 2026 remains stronger for equities than for commodities and fixed income. Given our 2025 year-end targets, the payoff might not be as compelling for the second half of this year, but we expect policy clarity in 2026 to provide solid returns on committed capital.

Fixed Income

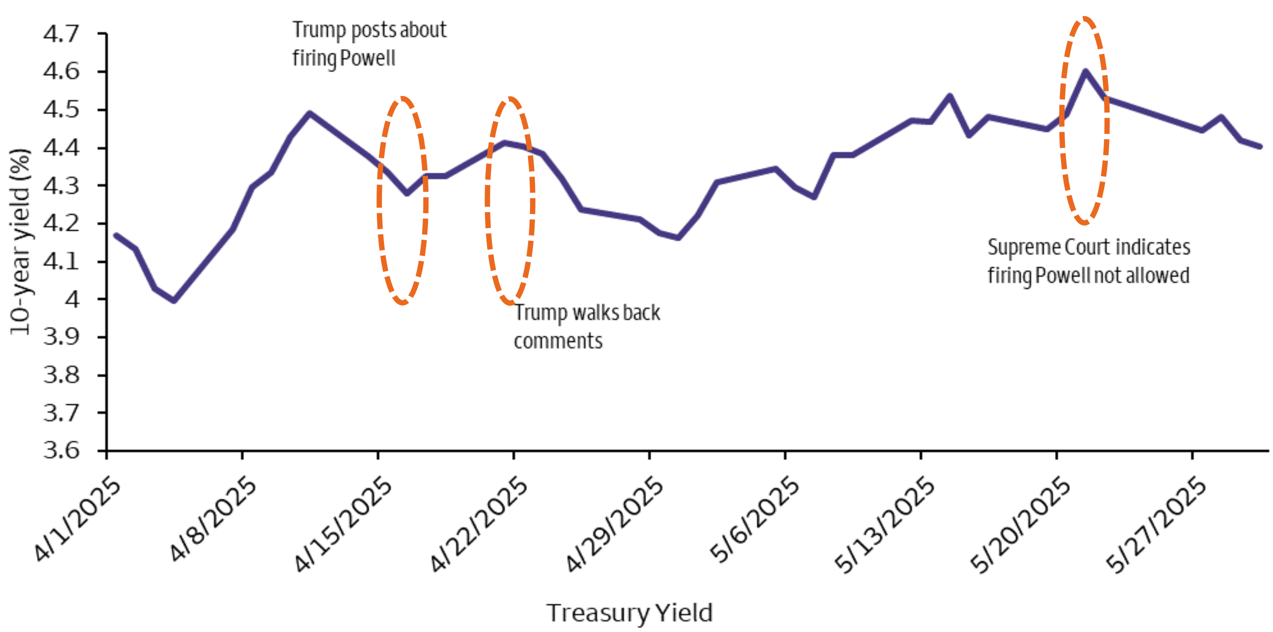
Tony Miano, CFA, CAIA
Investment Strategy Analyst

Early Fed chair nomination may cloud monetary policy

President Trump has announced his intention to nominate a Federal Reserve (Fed) chairman to succeed Jerome Powell, whose term expires in May 2026. Historically, presidents have named successors to the Fed chair only a few months in advance. If the president follows through and gives Mr. Powell's successor a much longer in-waiting period, the shadow voice on monetary policy could create uncertainty for financial markets. Although we note that rate decisions are a collaborative process among Fed governors and not the sole discretion of the chair.

In our view, the addition of a potentially competing voice to Powell over the next 11 months could be a potential source of uncertainty for financial markets. Given the magnitude of disagreement between Trump and Powell, with Powell content to leave rates where they are and Trump calling for a 1% rate cut, it seems likely that the new nominee may echo the president's sentiment. This brings the potential for added confusion on the Fed's messaging regarding monetary policy implementation as well as concerns about the Fed's independence. Both of these would likely contribute to volatility in Treasury yields, as they have in previous instances where Powell and the president found themselves at odds. The chart below shows the volatility in 10-year Treasury yields before and after the president's last spat with Powell, around April 17.

10-year Treasury yield and commentary on Fed independence



Sources: Bloomberg and Wells Fargo Investment Institute. Data as of June 16, 2025. Yields represent past performance and fluctuate with market conditions. Current yields may be higher or lower than those quoted above. **Past performance is no guarantee of future results.**

We view this newest development as being another escalation in the tensions between Trump and the Fed. These tensions are on a list of political risks that have the potential to drive long-term yields higher over the coming months. At current levels, we do not believe long-term yields compensate for these risks, and we remain unfavorable on U.S. Long Term Taxable Fixed Income. We are neutral on U.S. Intermediate Term Taxable Fixed Income and see it as a better mix of yield and risk.

Real Assets

Ian Mikkelsen, CFA
Equity Sector Analyst, Energy

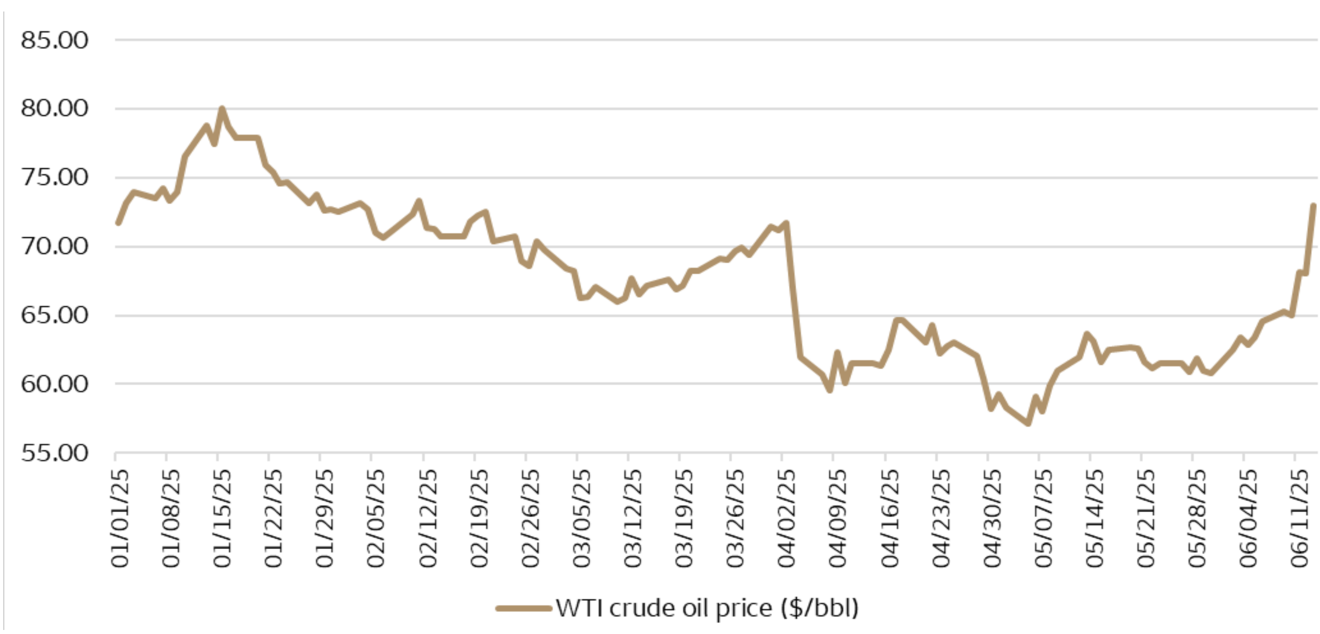
The geopolitical risk premium is back in oil

Israel's direct attacks on Iran have been more aggressive than market participants had previously discounted, leading to a geopolitical premium being priced into oil. As of this writing, this impact on oil prices has been speculative as oil infrastructure has not been disrupted. However, given the importance of production and exports in the region, there is concern that further escalation could cause disruption to global supplies of crude oil and refined products. Notably, about 20% of global petroleum supply is transported through the Strait of Hormuz,[1] which is partially controlled by Iran. While a full shutdown of the Strait of Hormuz is highly unlikely in our view, there is the potential for significant bottlenecks.

Historically, geopolitical disruptions of this nature have been relatively short lived. We do see several dynamics that could buffer the impact of potential disruptions to oil supply arising from this conflict, including spare production capacity from OPEC+ (Organization of the Petroleum Exporting Countries plus allies) and the International Energy Agency's commitment to release oil from its emergency stockpiles to keep the market in balance. Yet, given the existential nature of this war, we believe that the tail risks should not be ignored. We expect oil prices to remain volatile potentially with an upside bias in the near term due to the presence of a geopolitical risk premium.

In the current environment, we believe that investors should consider Energy sector exposure within a diversified portfolio as a potential hedge against the inflationary impact that higher commodity prices may have. Our guidance is neutral on the Exploration & Production sub-sector, which has the most direct exposure to commodity prices, and we favor the Integrated Oil sub-sector, with a preference for the largest companies given their broad diversification and strong financial flexibility.

Geopolitical risk has offset the recent decline in oil prices



Sources: FactSet and Wells Fargo Investment Institute. WTI = West Texas Intermediate. bbl = barrel. Data as of January 1, 2025 – June 13, 2025.

[1] U.S. Energy Information Administration, June 16, 2025.

Alternatives

Mark Steffen, CFA, CAIA
Global Alternative Investment Strategist

The importance of manager selection in private markets

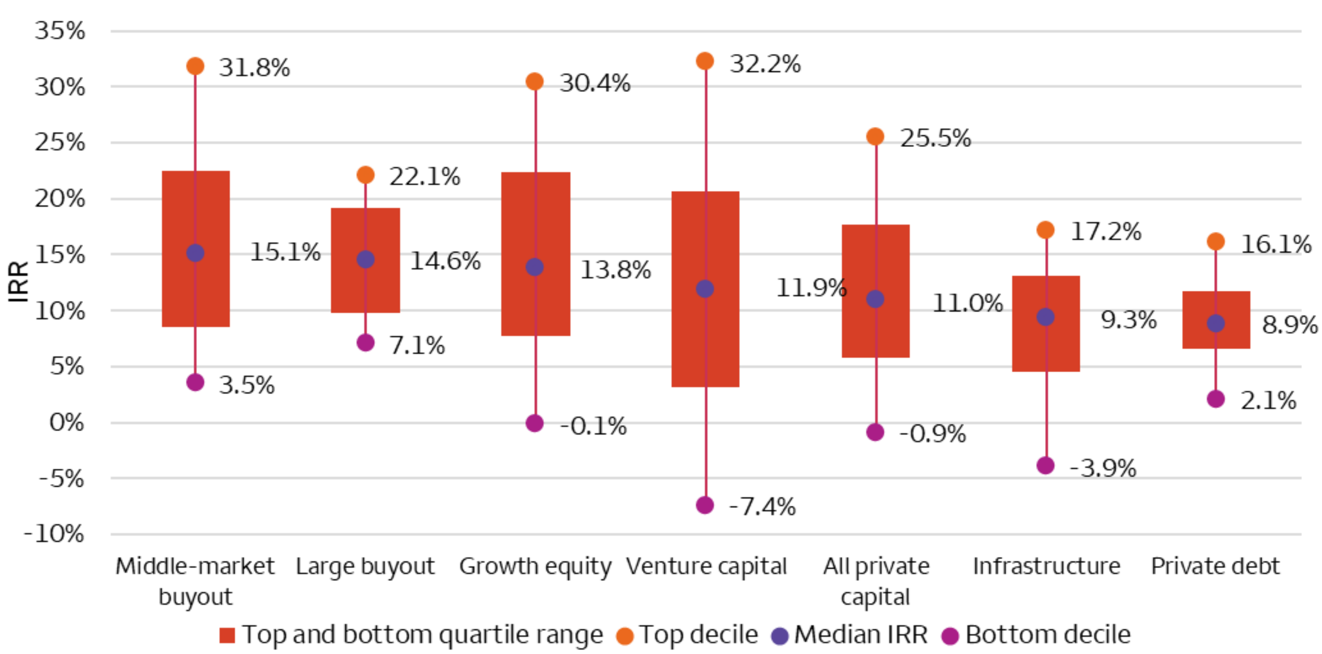
Unlike public markets, private-market strategies have often exhibited above-average return dispersion, meaning the performance can vary widely from fund to fund. We believe identifying managers with unique sourcing capabilities and extensive experience in evaluating (and investing in) attractive investment opportunities is a key facet in pursuing above-average performance results over time.

Often, top-tier managers may possess unique competitive advantages that allow them to gain access to the most sought-after deals. These advantages can take many forms, which may include the development of a wide network of industry relationships, in-house expertise in a particular segment of the market, and the ability to apply a disciplined approach to underwriting and pricing deals across market cycles.

As shown in the chart below, the performance of the best and worst funds within each category can vary quite dramatically. For example, in venture capital, the performance of the top decile of funds registered an internal rate of return (IRR) of 32.2%, while the bottom decile recorded an IRR of -7.4%. The nearly 40% gap between the top and bottom decile is an extreme example of the critical role that manager selection can play in private-market investing.

We conduct thorough research and due diligence on investment managers, aiming to increase the probability of selecting managers that perform at or near the top of their peer universe. This experienced group of analysts works to ensure that investors have access to many top-tier managers across the private-capital spectrum.

Private fund net IRR dispersion by strategy (vintages 2002 to 2018)



Sources: PitchBook and Wells Fargo Investment Institute. First quarter (Q1) 2025 Quantitative Perspectives report. Data as of June 30, 2024. A fund's vintage year is generally the year the fund was formed or began investing capital. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.** Please see the end of the report for the definitions of the indexes for each strategy and risk considerations.

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 23, 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

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

A periodic investment plan such as dollar cost averaging does not assure a profit or protect against a loss in declining markets. Since such a strategy involves continuous investment, the investor should consider his or her ability to continue purchases through periods of low price levels.

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. Although **Treasuries** are considered free from credit risk, they are subject to other types of risks. These risks include interest rate risk, which may cause the underlying value of the bond to fluctuate. 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. **Sector investing** can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility.

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

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

S&P 500 Quality Index is an index that comprises the highest quality names in the S&P 500 Index.

Fund category definitions from page 6: Internal Rate of Return (IRR) data sourced from Pitchbook database and include categories grouped according to the funds' strategy and investment approach, as defined below:

Middle-market buyout funds are defined as investment vehicles with between 10 million and 5 billion USD or EUR in capital commitments.

Large buyout funds are defined as investment vehicles with over 5 billion USD or EUR in capital commitments.

Growth Equity funds are private equity funds that make minority (non-control) equity investments.

Venture Capital funds are defined as pools of capital raised for the purpose of investing in the equity of startup companies. In addition to funds raised by traditional VC firms, PitchBook also includes funds raised by any institution with the primary intent above. Funds identifying as growth-stage vehicles are classified as PE funds and are not included.

Infrastructure funds are defined as funds that invest specifically in infrastructure, including roads, canals, airports, power lines, etc.

Private Debt funds are defined as pools of capital raised for the purpose of lending to private companies, including those held by Private Equity funds, Venture Capital funds, real estate funds and infrastructure funds.

All Private Capital funds include all the aforementioned fund categories, as well as several other private capital fund types that report performance information to Pitchbook.

An index is unmanaged and not available for direct investment.

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