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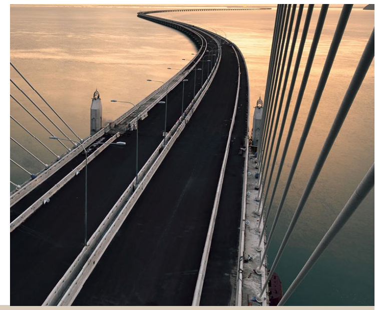
Investment Strategy



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

Fixed Income Spotlight

Tony Miano, CFA, CAIA
Investment Strategy Analyst

2025 halftime report for fixed income

2025 has been an interesting year for fixed-income markets, with the installation of a Republican-controlled government in January, subsequent budget negotiations, and the volatility that ensued after President Donald Trump's April tariff announcements. While the Federal Reserve (Fed) has kept rates on hold after briefly cutting in 2024, volatility in credit and rate markets has been apparent. Nonetheless, most major fixed-income indexes have displayed positive single-digit returns with income generation being a key component of total return.

Waiting for the Fed

Market expectations around Fed actions and interest rates (using the fed funds Futures) have been changed over the year, even with the Fed remaining on hold following its December rate cut. Chart 1 illustrates these movements. It shows that earlier this year, markets expected just one rate cut for 2025 on the belief that President Trump's planned deregulation and tax cuts would accelerate economic growth. The number of rate cuts expected jumped to four in April on economic concerns driven by tariffs before moderating in May and June on the Fed's inflationary concerns. Expectations have drifted higher in recent weeks on speculation of subdued inflation. We have been consistent for the last several months in our view the Fed will likely cut once in 2025.

Chart 1. Evolution of market pricing of Fed rate cuts in 2025

Sources: Wells Fargo Investment Institute and Bloomberg as of July 2, 2025. Market pricing of 2025 rate cuts as determined by fed funds Futures. Starting value: 1.738, ending value 2.598.

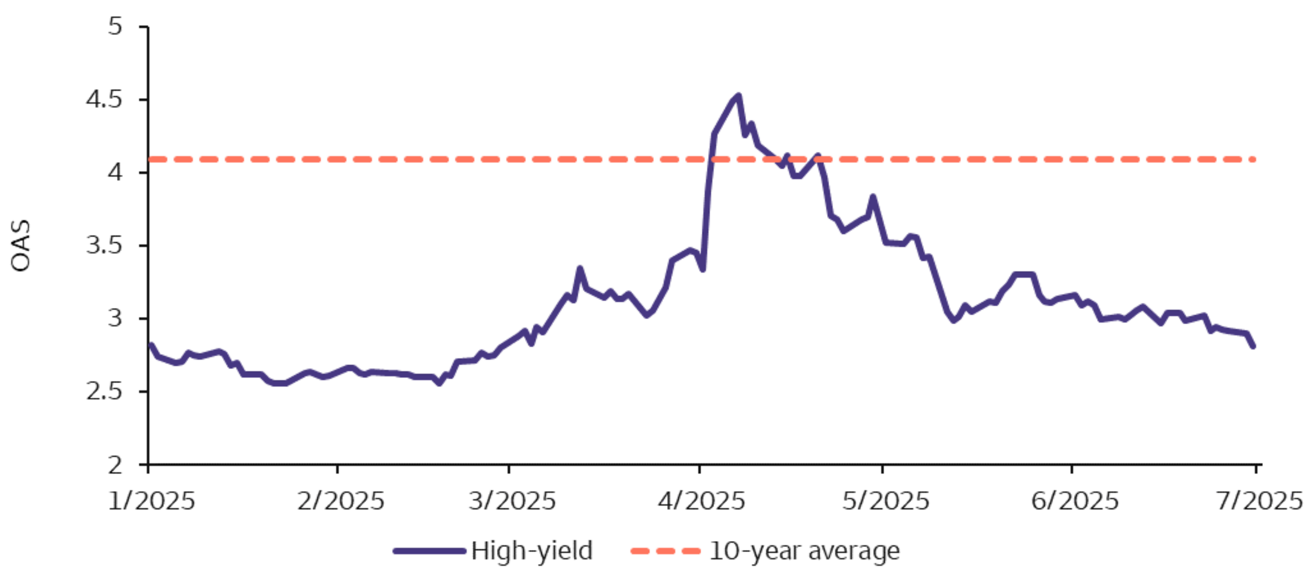
We see the same potential for tariff-driven inflation that has kept the Fed on the sidelines this year, but we also anticipate better growth potential in 2026. This may lead to higher rates than the market expects.

We currently target two rate cuts before year-end 2026, while the Fed sees four and market participants see five or more. However, we believe the path of rates will depend on how quickly the economic bounces back in 2026 and the timing and magnitude of tariffs to bump up price inflation. This, coupled with risks associated with tariff policy and a rising federal deficit, have led to volatility in U.S. Taxable Long Term Fixed Income this year. We have been unfavorable on that asset class since early March. Ten-year U.S. Treasury yields have seen an almost 80-basis-point move (100 basis points = 1%) between 2025 highs and lows, one of the largest periods of movement over the last five years. Simply put, we do not feel that current yields properly compensate investors for the risks we see in longer-term bonds.

Credit risks take center stage, then fade into the background

Credit risks have also had a mercurial year. Option-adjusted spread (OAS), a measure of credit risk, for both high-yield and investment-grade bonds entered the year near 10-year lows — a product of both a resilient economic environment and one that was poised to become even stronger with deregulation and fiscal stimulus. The volatility brought by April's tariff announcements impacted credit risks, as well, and the high-yield OAS nearly doubled. Chart 2 illustrates that this move was short-lived and that OAS has returned to well below long-term averages.

Chart 2. Credit risks fall after early-April spike



Sources: Wells Fargo Investment Institute and Bloomberg, as of July 2, 2025. 10-year average of high-yield OAS is 4.09. Option-adjusted spread (OAS) is the spread relative to a risk-free interest rate.

As the economy slows into year-end 2025, driven by tariffs, we expect the potential for credit spreads to widen from current levels. Still, in our view, any risks to High Yield Taxable Fixed Income in this event are likely to be cushioned by the level of yields available and as such, our guidance remains neutral. We believe investors who are significantly underweight should consider using any potential economic softness or price pullbacks as a buying opportunity. In higher quality areas of fixed income, like Corporate Securities and Securitized, we are favorable and view their mix of quality and yields as attractive.

Our focus across asset classes has been to prioritize quality and position portfolios for the second half of a year that is likely to remain volatile. Deficit concerns, driven by bond issuance to fund the new budget, and tariffs are likely to be catalysts for this volatility. We believe the income generation available in fixed income can help cushion some of the interest-rate and credit risks that are likely to reemerge, but we believe investors should be careful that the yields available justify the risks.

In our view, a focus on high-quality, income-generating fixed income may allow investors exposure to potential underlying strength while making sure that they're being properly compensated for the risks they take.

Equities

Chris Haverland, CFA
Global Equity Strategist

Bar is low for second-quarter earnings

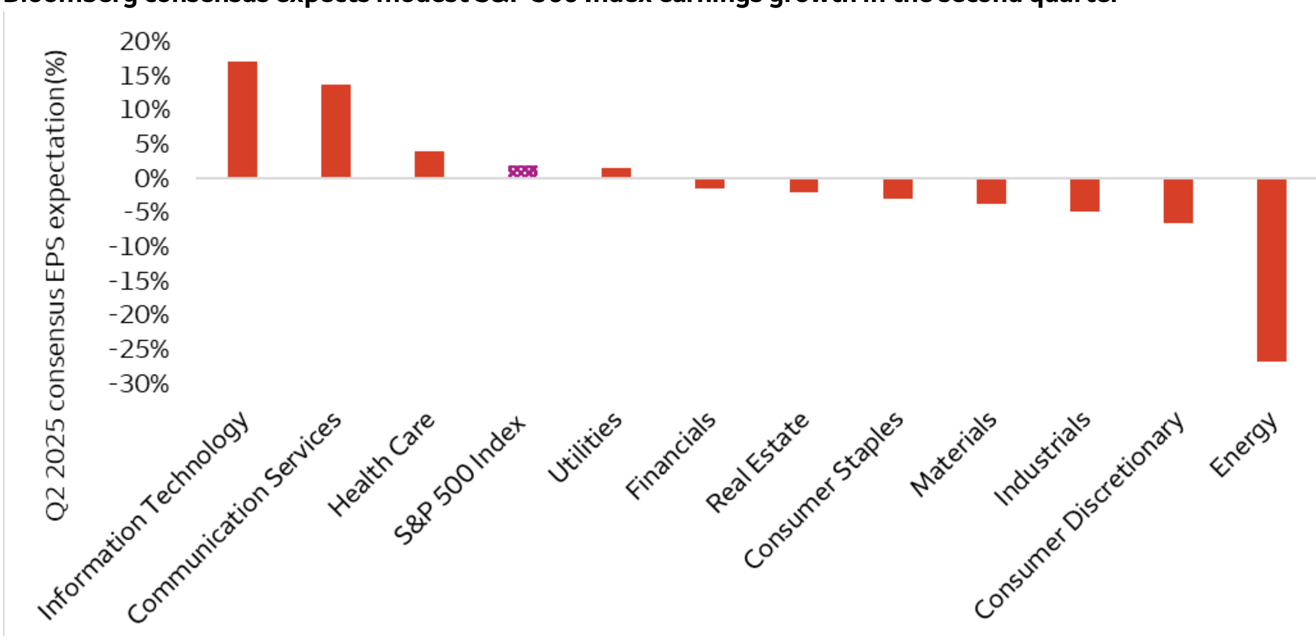
Second-quarter earnings season kicks off this week with the S&P 500 Index likely showing modest growth. Unlike the first quarter, second-quarter earnings should reflect the impact of tariffs as they were implemented as they have accumulated since February. Bloomberg consensus estimates call for approximately 4% in revenue growth and 2% – 3% in earnings growth for the S&P 500 Index.

Four of eleven sectors are expected to post earnings growth, with the Information Technology and Communication Services sectors leading the way (see the chart below). The Energy sector will likely be the biggest laggard, as oil prices remain lower than year-ago levels. Company outlooks regarding capital spending and consumer trends for the remainder of the year will be key for potential growth.

The banks will be first to report, coming off solid beat rates in the first quarter with most companies reaffirming guidance. Technology-related companies will report later in the month, and we believe investors will look for guidance on artificial intelligence (AI) capital expenditures. In addition, we want to know how they are going to navigate the different tariffs and if they are making wholesale changes or taking a wait-and-see approach.

In a positive sign, Bloomberg consensus earnings revisions appear to have bottomed in recent weeks. We still believe tariff uncertainty and weaker economic growth will weigh on profitability this year. However, our S&P 500 Index earnings per share (EPS) target of $260 implies about a 5% growth rate. In this environment, our guidance prioritizes quality and profitability. We favor U.S. equities over international, and among the U.S. markets, we favor U.S. Large and Mid Cap Equities over low-quality U.S. Small Cap Equities.

Bloomberg consensus expects modest S&P 500 Index earnings growth in the second quarter



Sources: Wells Fargo Investment Institute and Bloomberg. EPS growth measures the earnings growth of the S&P 500 and each of its sectors, as of July 7, 2025, versus second-quarter 2024 EPS. Q2 = quarter two. Forecasts and targets are based on certain assumptions and on views of market and economic conditions which are subject to change.

Real Assets

Sameer Samana, CFA
Head of Global Equities and Real Assets

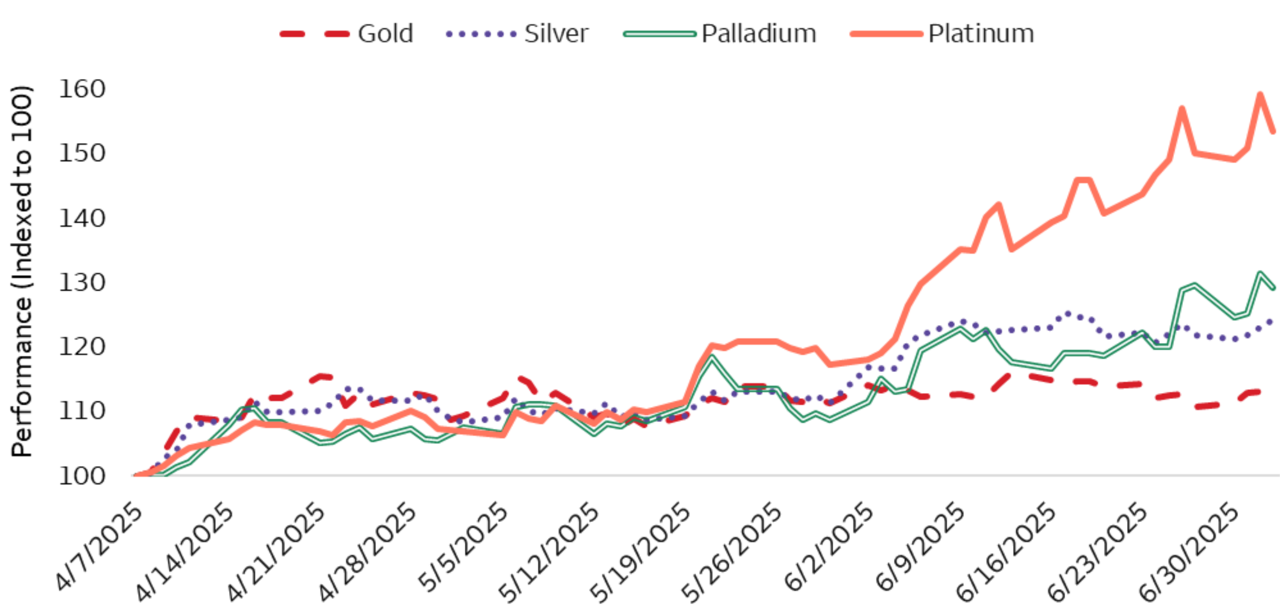
Precious-metals rally broadens out

Precious metals have had a strong 2025, as the Bloomberg Precious Metals Total Return (TR) Index was up 25.83% year to date (YTD; from December 31 to July 3). That is good enough to put precious metals ahead of commodities (the Bloomberg Commodity TR Index is up 6.98% YTD); equities (the S&P 500 Index is up 7.50% YTD); and fixed income (the Bloomberg US Aggregate Bond Index is up 3.56% YTD). The main drivers of performance have been a sharp fall in the U.S. dollar, tariff-related uncertainty, and expectations for additional rate cuts and higher inflation, all of which tend to boost precious-metals demand.

While gold was the first to break out in 2025, silver, palladium, and platinum have outperformed during the equity market recovery that started on April 7. Platinum has been the clear standout, but palladium and silver are also besting gold (see chart). Much of this change in leadership is due to the shifting investment environment over the past six months.

First, markets went from contending with sharp increases in reciprocal tariffs and the possibility of a global economic slowdown to delays in tariff implementation and the possibility of a flurry of trade frameworks being announced. Second, gold's initial burst led businesses, such as jewelry makers, to cheaper substitutes such as platinum and silver. Lastly, many of the non-gold precious metals have industrial uses, such as silver in electronics and platinum and palladium in catalytic converters, which allowed them to benefit from improving economic sentiment. This broadening rally reinforces our favorable guidance on Precious Metals, and we think investors should consider using pullbacks to add exposure.

Gold goes from leader to laggard in 2025



Sources: Wells Fargo Investment Institute and Bloomberg. Data as of July 3, 2025. Gold is represented by the Bloomberg Gold Subindex TR, silver is represented by the Bloomberg Silver Subindex TR, platinum is represented by the Bloomberg Platinum Subindex TR, and palladium is represented by the Bloomberg Palladium Subindex TR. **Past performance is no guarantee of future results.**

Alternatives

Chao Ma, PhD, CFA, FRM
Global Portfolio and Investment Strategist

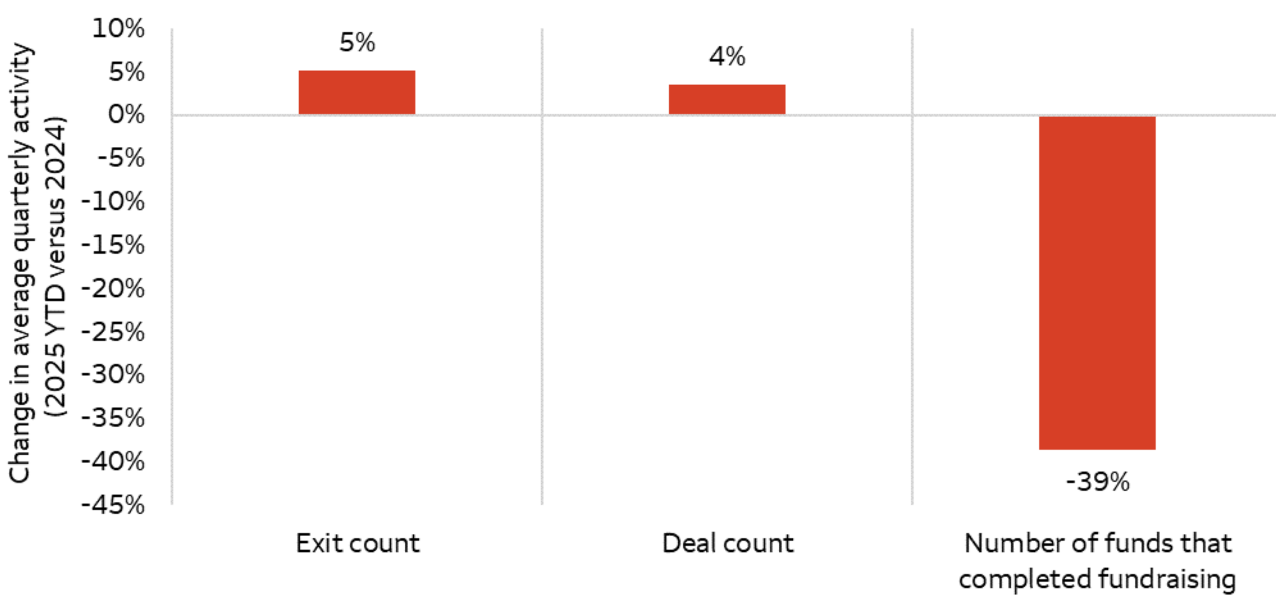
Slow environment continued to weigh on private equity

Exits, or the selling of private-equity holdings, have been a primary way for fund managers to realize potential gains and return capital to investors. During the first half of the year, the average quarterly number of exit transactions only saw a 5% increase over last year, below the growth rate seen in 2024 (chart below). The path this year has also been uneven, as the first quarter contributed the entire increase. To contrast, exit counts dropped below the 2024 level in the second quarter, likely owing to the growing policy uncertainties, economic concerns, and market volatility that began in April. Private-equity dealmaking activity has also followed a similar pattern so far this year (see chart).

According to Pitchbook, both total exit and deal values this year were concentrated in a few outsized transactions, which continued to reflect a low participation beyond the larger and higher-quality private companies favored by buyers. Additionally, the number of funds that completed fundraising in 2025 has declined by 39% since last year (see chart). New funds have spent an average of 12 months raising capital, the longest since 2022 (US Private Equity funds covered by the Pitchbook database).

With over 38,000 U.S. private equity-backed companies that have been held for over five years awaiting exits, according to Pitchbook, we believe pressure is likely building for many fund managers, and Secondaries sub-strategies may be positioned to provide much-needed liquidity. The recent passage of the budget bill and developments on trade agreements are, in our view, further encouraging signs that policy clarity may be reemerging and macro conditions are stabilizing. If these developments continue, we believe they have the potential to catalyze a broad recovery in private equity, as indicated by sustained increases across exits and dealmaking.

Recovery in private-equity exits and dealmaking largely stalled in the second quarter



Sources: Wells Fargo Investment Institute and Pitchbook. Data as of June 30, 2025. YTD = year to date.

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, July 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. Investing in **physical commodities**, such as gold, silver, platinum or palladium exposes a portfolio to other risk considerations such as potentially severe price fluctuations over short periods of time and storage costs that exceed the custodial and/or brokerage costs associated with a portfolio's other holdings. **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. **Communication Services** companies are vulnerable to their products and services becoming outdated because of technological advancement and the innovation of competitors. Companies in the Communication Services sector may also be affected by rapid technology changes, pricing competition, large equipment upgrades, substantial capital requirements and government regulation and approval of products and services. In addition, companies within the industry may invest heavily in research and development which is not guaranteed to lead to successful implementation of the proposed product. The **Energy** sector may be adversely affected by changes in worldwide energy prices, exploration, production spending, government regulation, and changes in exchange rates, depletion of natural resources, and risks that arise from extreme weather conditions. Risks associated with the **Technology** sector include increased competition from domestic and international companies, unexpected changes in demand, regulatory actions, technical problems with key products, and the departure of key members of management. Technology and Internet-related stocks, especially smaller, less-seasoned companies, tend to be more volatile than the overall market.

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

An index is unmanaged and not available for direct investment.

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

Bloomberg Commodity Total Return Index reflects the returns that are potentially available through an unleveraged investment in the futures contracts on 19 physical commodities comprising the Index plus the rate of interest that could be earned on cash collateral invested in specified Treasury Bills. The Index is a rolling index rebalancing annually.

Bloomberg Sub Precious Metals Index is a commodity group subindex of the Bloomberg CITR. The index is composed of futures contracts on gold and silver. It reflects the return on fully collateralized futures positions and is quoted in USD.
Gold: Bloomberg Gold Subindex Total Return Index reflects the return of fully collateralized future positions.

Silver: Bloomberg Silver Subindex Total Return Index is a single commodity index comprised of futures contracts on silver. The index is part of the BCOMTR family. It reflects the return on fully collateralized futures positions and is quoted in USD.

Palladium: Bloomberg Palladium Total Return Subindex is a single commodity subindex of BCOM composed of futures contracts on Palladium. It reflects return of underlying commodity futures price movements along with returns on cash collateral invested in 13 week (3 Month) U.S. T-Bills. The index is quoted in USD.

Platinum: Bloomberg Platinum Subindex Total Return Index is a single commodity subindex of the BCOM composed of futures contracts on Platinum. It reflects the return of underlying commodity futures price movements only and is quoted in USD.

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.

General disclosures

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