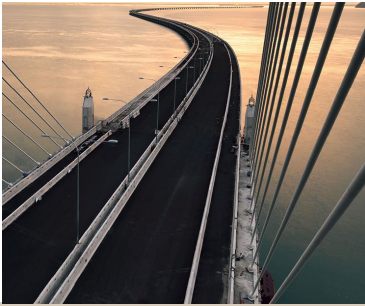


Investment Strategy



Weekly guidance from our Investment Strategy Committee May 26, 2026

Equities Spotlight: Weak fundamentals limit upside for U.S. small-caps 2

- Despite U.S. small-cap equities outperforming U.S. large-cap equities year-to-date, underlying fundamentals for U.S. small-cap equities are weakening.
- U.S. large-cap equities maintain significantly stronger profitability, balance sheets, and earnings momentum, supported by scale, pricing power, technology adoption, and global diversification.

Fixed Income: Long-term rates likely to rise 4

- We believe long-term U.S. Treasury rates should remain elevated due to modest economic growth, rising inflation expectations, and upward pressure to the term premium.
- In our view, the income component of fixed income should remain a key driver of total return for investors in 2026.

Real Assets: Surging exports squeeze inventories 5

- U.S. petroleum exports have surged in recent weeks, putting pressure on already low inventories.
- While we expect elevated prices to persist, we do not recommend chasing energy returns at current prices and would rather rotate exposure into Precious or Industrial Metals.

Alternatives: Crosscurrents persist in distressed credit markets 6

- Despite a recent decline in defaults, rising levels of distressed debt suggest underlying weaknesses persist, supporting what we believe is an opportunity set for distressed credit sub-strategies to help reposition overleveraged companies.
- We continue to favor distressed credit sub-strategies, as ongoing energy supply constraints may further pressure business fundamentals and limit the Federal Reserve’s (Fed)’s ability to lower short-term interest rates.

Current tactical guidance 7

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

Equities Spotlight

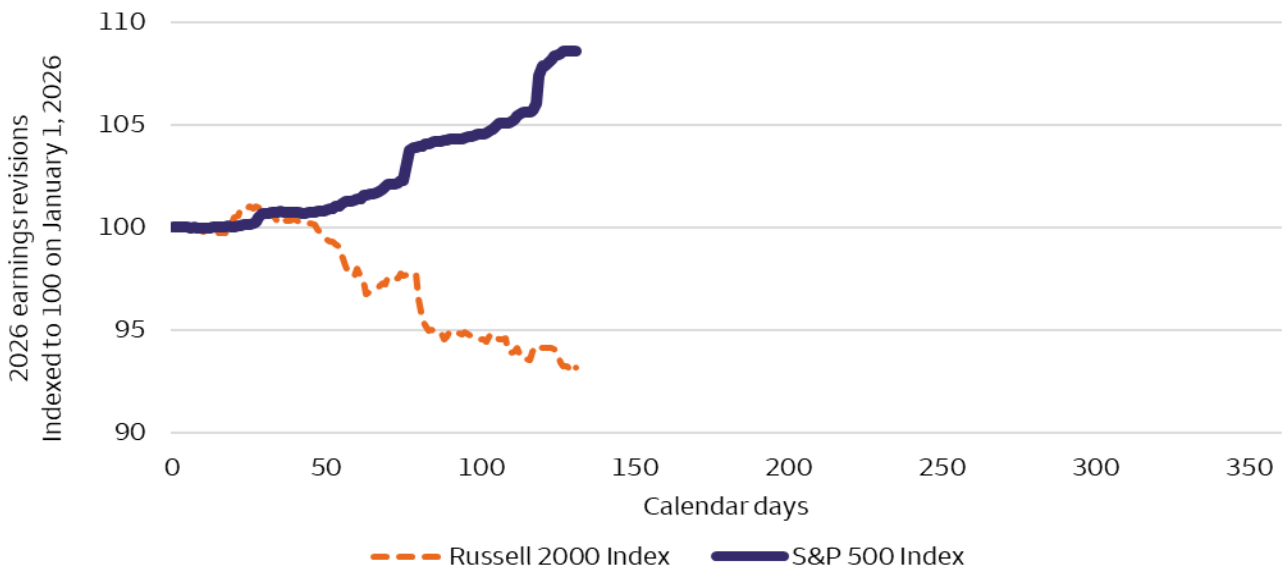
Alex Sagal
Investment Strategy Analyst

Weak fundamentals limit upside for U.S. small-cap equities

The Russell 2000 Index, our benchmark for U.S. small-cap equities, has performed well in recent months, outperforming the S&P 500 Index, our benchmark for U.S. large-cap equities, year-to-date as of May20, 2026. While this may suggest a turning point in relative performance, we believe this recent momentum is masking weakness in underlying small-cap equity fundamentals. In our view, the divergence between price performance and fundamental trends creates an increasingly fragile backdrop for U.S. small-cap equities and reinforces our preference for U.S. large- and mid-cap equities.

A key challenge for U.S. small-cap equities is the structural decline in the Russell 2000 Index quality over time. The composition of the small-cap equities universe has shifted meaningfully over the past two decades, with a growing share of companies lacking consistent profitability. According to Bloomberg data, the percentage of non-earning companies within the Russell 2000 Index has risen dramatically from roughly 17% twenty years ago to 40% today, highlighting a broad deterioration in profitability.. We believe this trend reflects multiple forces, including the rise of private capital markets, which have allowed high-quality firms to remain private, as well as increased merger and acquisition activity, which has removed profitable companies from the public small-cap universe. As a result, U.S. small-cap indices have been populated by early-stage, less profitable, and more speculative businesses, which we believe inherently limits the ability of the asset class to generate sustained earnings growth and margin expansion.

Chart 1. 2026 earnings revisions: U.S. small- and large-cap earnings forecast revisions have diverged



Sources: Bloomberg and Wells Fargo Investment Institute. Consensus forecast data as of May 18, 2026. An index is unmanaged and not available for direct investment. **Past performance does not guarantee future results.** Earnings revisions are based off Bloomberg data from analysts covering the S&P 500 Index and Russell 2000 Index.

This erosion in profitability is further reinforced by a persistent pattern of earnings disappointment. U.S. small-cap companies have historically struggled to meet initial calendar-year earnings expectations, with consensus forecasts declining by 20% from the start of the year through year-end, on average since 1995, per Bloomberg. In fact, over these 30 years (1995 – 2025), the Russell 2000 Index has met or exceeded the consensus earnings forecast at the beginning of the year only three times. We are seeing a similar dynamic unfold currently, as earnings expectations for 2026 have been revised 7% lower as the year has progressed, as of May 18. (see Chart 1) this stands in contrast to U.S. large-cap equities, where earnings forecasts have jumped 8% higher (see Chart 1). Importantly, as earnings expectations for U.S. small-cap companies are revised downward, valuation multiples rise because the “E” in the price-to-earnings ratio is deteriorating.

The gap in profitability and financial strength between U.S. small- and large-cap equities is particularly striking today. U.S. small-cap equities currently generate returns on equity of less than 1% over a trailing 12 month period through Q1 2026, compared to approximately 20% for U.S. large-cap equities. Profit margins have exhibited an equally stark divergence, with U.S. small-cap net margins around 4.4% versus roughly 14.5.8% for U.S. large-cap companies over the same period. Balance sheet quality has further compounded these challenges. U.S. small-cap companies tend to carry high leverage, with net debt-to-EBITDA¹ ratios near 4.5x compared to roughly 1.5x for U.S. large-cap firms, based on a trailing 12 month period through Q1 2026. This elevated leverage not only may increase financial risk but also may reduce flexibility in a higher interest rate environment.

In contrast, U.S. large-cap equities continued to benefit from a set of structural advantages that have driven sustained margin expansion over time. Profit margins for the S&P 500 Index are at historical highs and have trended upward over several decades. This expansion has been supported by a combination of favorable sector composition, technological innovation, and operational efficiency gains. The increasing weight of high-margin sectors (particularly Information Technology and Communication Services) has played a significant role, as these businesses tend to operate with asset-light models, high gross margins, and strong operating leverage.

Beyond sector mix, U.S. large-cap companies have been leaders in adopting productivity-enhancing technologies, including artificial intelligence (AI), automation, and advanced data analytics. These investments have improved efficiency, reduced labor intensity, and enhanced scalability. At the same time, economies of scale enable large companies to spread fixed costs over broader revenue bases, negotiate more favorable supplier terms, and invest more heavily in research and development. These scale advantages can create a reinforcing cycle of competitive strength and margin durability.

Taken together, these structural advantages have allowed U.S. large-cap (S&P 500 Index) profit margins to expand steadily over time, while U.S. small-cap margins have remained stagnant. Importantly, we believe the elevated margins observed in U.S. large-cap equities are not solely a function of cyclical strength but reflect enduring competitive advantages that provide insulation against macroeconomic softness. We view this resilience as important in the current environment, where growth uncertainties persist and cost pressures remain unevenly distributed across the economy.

Ultimately, while the recent performance of U.S. small-cap equities (Russell 2000 Index) may appear encouraging, we believe it is not supported by fundamentals. The combination of declining earnings quality, persistent downward consensus earnings revisions, weak profitability, and elevated leverage presents a challenging backdrop for sustained outperformance. In contrast, U.S. large-cap equities (S&P 500 Index), especially since 2024, have demonstrated strong earnings, robust margins, and structural advantages that support long-term growth and resilience. As such, we view the recent rally in U.S. small-cap equities as an opportunity to rebalance portfolios. We believe investors should consider trimming overweight exposures and reallocating toward U.S. large and mid-cap equities, where the fundamental outlook remains significantly more compelling.

1. EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization) measures a company's core operational performance by excluding financing costs, tax effects, and non-cash accounting items like depreciation and amortization.

Fixed Income

Luis Alvarado
Co-Head of Global Fixed Income Strategy

Long-term rates to likely rise

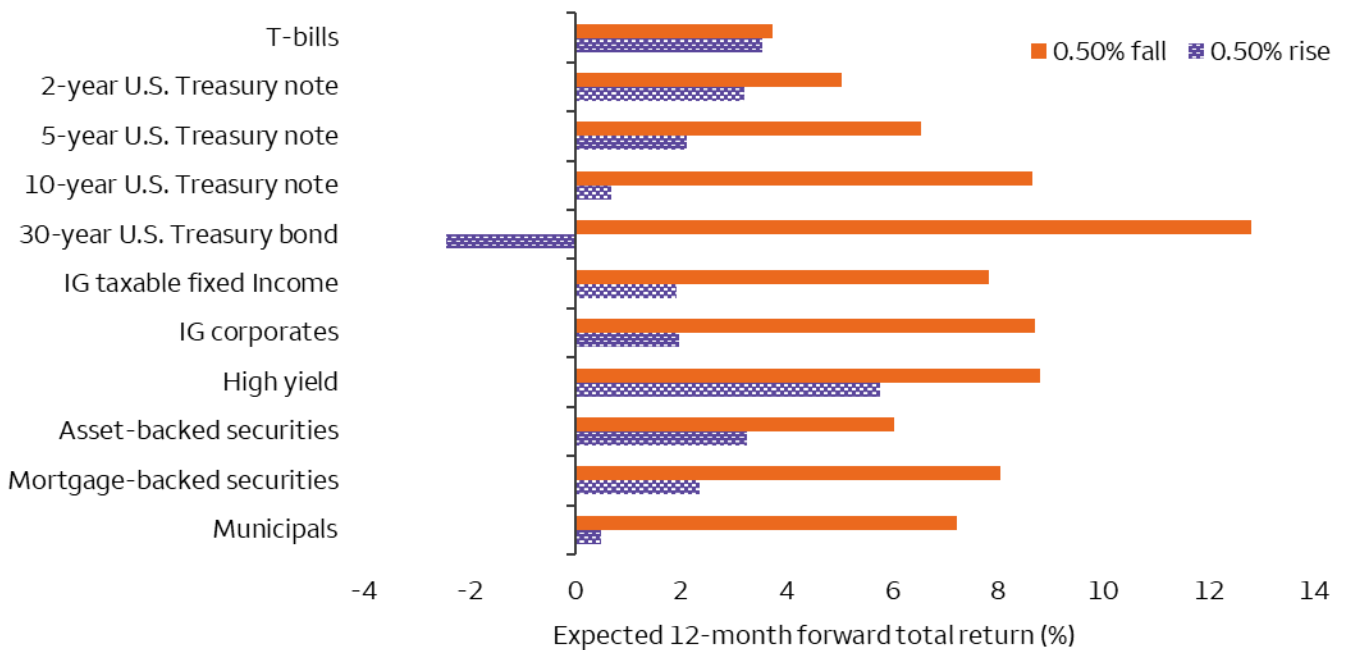
We look for the Fed to proceed cautiously, calibrating as needed but with a bias to keep the federal funds target rate on hold. We are expecting no cuts or hikes between now and the end of 2026. However, federal funds futures markets are now implying potential for hikes in 2027, especially if the Iran conflict extends for longer.

We expect the bond market to remain sensitive to geopolitical events, Fed policy announcements, and economic developments, especially around the trajectory of inflation and how the Fed adjusts policy. Also, the term premium (the extra yield investors demand for holding long-term debt in lieu of short-term debt) has also been rising. We anticipate upward pressure to remain in term premium given increasing deficits, further Treasury issuance and the potential for Fed balance sheet trimming.

These policy and economic uncertainties present return risks that are asymmetrically larger for longer-term bonds, which mathematically have the largest price impact from a change in rates (see Chart 2). Hence, we believe that investors need to remain agile — if rates rise well above our year-end 2026 stated targets, we prefer to extend maturities; if rates decline below our targets, we favor shortening duration (a measure of interest rate sensitivity) by taking shorter maturities.

We still think the income component of fixed income should remain a key driver of total return for investors in 2026, while active management is crucial, in our view, to capture relative value within fixed-income sectors and subsectors.

Chart 2. Long-maturity bonds are most sensitive to a move in interest rates



Sources: Bloomberg and Wells Fargo Investment Institute, as of May 19, 2026. T-bills (Treasury bills): Bloomberg U.S. Treasury Bills (1–3M) Index, Investment-grade (IG) taxable fixed income: Bloomberg U.S. Aggregate Bond Index. IG corporates: Bloomberg U.S. Corporate Bond Index, High yield: Bloomberg U.S. Corporate High Yield Bond Index, Asset-backed securities: Bloomberg U.S. Asset Backed Securities Index, Mortgage-backed securities: Bloomberg U.S. Mortgage-Backed Securities Index, Municipals: Bloomberg Municipal Index. For illustrative purposes only. Expected return is calculated by the income return (interest) plus the price change from the 0.50% interest rate move. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

Real Assets

Mason Mendez

Investment Strategy Analyst

Surging exports squeeze inventories

As the Iran war extends into May, pressures on U.S. petroleum inventories are beginning to emerge. Although the U.S. position as a net energy exporter provided some insulation from the immediate global supply shocks, oil markets are interconnected, meaning the U.S. is not immune to the lasting effects of higher global prices and supply disruptions.

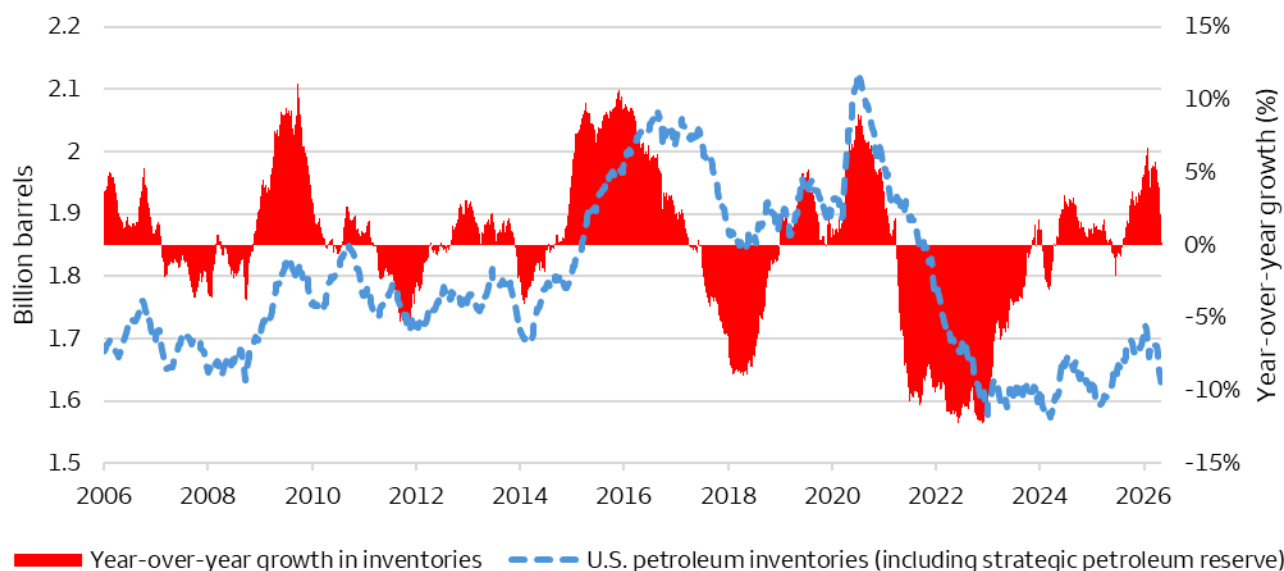
This dynamic can be seen in how trade flows have shifted and are starting to pull on U.S. inventories. The loss of Middle East energy exports left many countries seeking alternative suppliers, and the strong growth in U.S. production along with lower transportation risks make U.S. exports an attractive alternative.

These factors supported a surge in U.S. export demand from a 52 week average of 4 million barrels per day (mbpd) prior to the Iran war, to 6.4 mbpd during the week of April 24. This pressured already declining inventories, driven by heightened refining activity and an emergency 172 million-barrel release from the Strategic Petroleum Reserve earlier this year (see Chart 3). In effect, these drawdowns have reduced some of the U.S. supply buffer heading into the summer.

Upcoming seasonal demand could intensify these pressures, as inventories typically decline during the summer from increased consumption. For consumers, this will likely translate into further gasoline prices over the coming months.

As such, elevated energy prices will likely persist as inventories continue to draw down, which could lead to higher inflation and slower economic growth. For investors, however, we do not recommend chasing returns in energy with oil prices already elevated near \$100 per barrel. In our view, the risk-to-return is unattractive, and we expect supply constraints to ease over the next 12–18 months. We recommend taking profits in energy and rotating exposure to our favorably rated areas that show greater upside over the tactical horizon — such as Precious or Industrial Metals.

Chart 3. U.S. petroleum inventories pressured lower



Sources: Bloomberg and Wells Fargo Investment Institute. Weekly data is from January 5, 2006 through May 8, 2026. Petroleum inventories represent total crude oil and petroleum product inventories.

Alternatives

Mark Steffen, CFA, CAIA

Global Alternative Investment Strategist

Crosscurrents persist in distressed credit markets

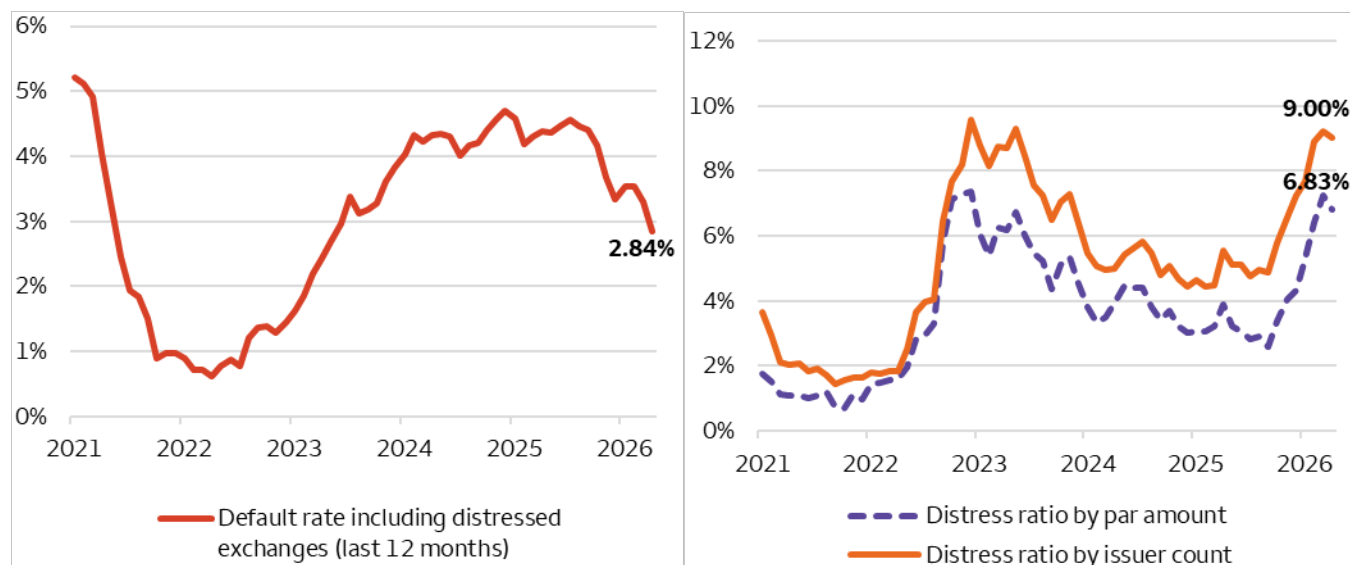
As we assess opportunities in distressed credit, signals remain mixed, raising questions about whether business conditions have truly stabilized or if the recent decline in defaults may reverse. On one hand, default rates², including distressed exchanges, have been trending lower, suggesting some easing of financial stress (see Chart 4 - left). Distressed exchanges include out-of-court restructurings that reduce debt, extend maturities, or lower interest costs, designed to help companies stabilize their balance sheets.

On the other hand, a key countersignal is the rising share of bank loans trading at distressed levels (below 80% of face value), which typically indicates borrower stress (see Chart 4 - right). This trend suggests that underlying pressures may still be building and that the recent improvement in default activity could prove temporary.

Distressed credit sub-strategies primarily invest in fundamentally strong companies that are experiencing financial strain, often due to excessive debt. Through restructuring or reducing that debt burden, these companies can emerge with stronger balance sheets and improved financial flexibility, positioning them for future growth.

While mixed signals in the credit markets suggest a transitional environment, we remain constructive on distressed credit sub-strategies. These strategies have historically performed strongest during the recovery phase following periods of significant credit dislocation, when valuations have reset and underlying fundamentals begin to stabilize.

Chart 4. Default rates (including distressed exchanges) show recent decline while distress ratios rise



Sources: Pitchbook (Leveraged Commentary and Data) and Morningstar. Data shown is from the Morningstar Loan Syndications and Trading Association (LSTA) U.S. Leveraged Loan Index. Data as of April 30, 2026.

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.

2. Default is defined as a failure to meet contractual obligations, primarily caused by missed interest or principal payments or bankruptcy filing. The default rate referenced is for the Morningstar Loan Syndications and Trading Association (LSTA) U.S. Leveraged Loan Index, inclusive of distressed exchanges. Distressed exchanges include all liability management transactions, which are typically out-of-court restructurings designed to improve the financial position of a company by reducing debt, extending maturities, or lowering debt-service obligations. S&P Global Ratings determines situations that are considered a distressed exchange or default.

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
	U.S. Small Cap Equities	Developed Market Ex-U.S. Equities Emerging Market Equities	U.S. Large Cap Equities U.S. Mid Cap Equities	

Real Assets

Most Unfavorable	Unfavorable	Neutral	Favorable	Most Favorable
		Commodities Private Real Estate	Private Infrastructure	

Alternative Investments**

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

Source: Wells Fargo Investment Institute, May 26, 2026. Please see Wells Fargo Investment Institute's Asset Allocation Strategy Report for more detailed, investable ideas in each asset group.

*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. **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. 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.

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 Municipal Bond Index represents municipal bonds with a minimum credit rating of at least Baa, an outstanding par value of at least \$3 million and a remaining maturity of at least one year. The index excludes taxable municipal bonds, bonds with floating rates, derivatives and certificates of participation.

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

Bloomberg U.S. Asset Backed Securities Index is a flagship, rules-based benchmark that measures the performance of investment-grade, U.S. dollar-denominated, fixed-rate taxable bonds. It tracks the securitized debt market and is the dedicated ABS component of the broader Bloomberg U.S. Aggregate Bond Index.

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. MBS Index measures the performance of investment grade fixed-rate mortgage-backed pass-through securities of GNMA, FNMA and FHLMC.

Bloomberg 1-3 Month U.S. Treasury Bill Index includes all publicly issued zero-coupon U.S. Treasury Bills that have a remaining maturity of less than 3 months and more than 1 month, are rated investment grade, and have \$250 million or more of outstanding face value. In addition, the securities must be denominated in U.S. dollars and must be fixed rate and non-convertible.

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.

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.

S&P 600 Index consists of 600 domestic stocks chosen for market size, liquidity (bid-asked spread, ownership, share turnover and number of no trade days) and industry group representation. It is a market value-weighted index (stock price times the number of shares outstanding), with each stock's weight in the index proportionate to its market value.

The Morningstar Loan Syndications and Trading Association (LSTA) U.S. Leveraged Loan Index is a market value weighted index designed to measure the performance of the U.S. leveraged loan market. The legacy payment default rate includes Morningstar LSTA U.S. Leveraged Loan Index constituents where the company files for bankruptcy, the facility gets downgraded to D by S&P (excluding distressed exchanges and sub-par buybacks), or the interest payment is missed without a forbearance. Distressed exchanges include all liability management transactions considered a distressed exchange or default by S&P Global Ratings, a U.S. credit rating agency that publishes financial research and analysis on stocks, bonds, and commodities. Distress ratios represent the percentage of performing loans priced below 80% of par, a level typically associated with borrower stress.

An index is unmanaged and not available for direct investment.

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