

December 2023

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# 2024 Outlook

A pivotal year for the economy and markets

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The U.S. economy proved resilient throughout 2023 with key support from consumer spending, a strong labor market, and business capital spending. The journey, however, was more difficult for investors, as the Federal Reserve (Fed) raised interest rates, tightened monetary conditions to battle inflation, and will now be faced with the lagging impacts on the real economy as 2023 ends and the calendar turns over into 2024.

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*“Uncertainty is actually the friend of the buyer of long-term values.”*

— Warren Buffett

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We believe that 2024 will mark an important pivot point for the global economy and capital markets. The price trends across the past two years ranged from disappointing to vexing for investors. For the two years ended November 14, 2023, the S&P 500 Index was down roughly 4%. Fixed-income performance was worse. The Bloomberg U.S. Aggregate Bond Index fell 12.5% over the same period. Our outlook over most of this period was cautious and focused on selectivity and quality, but with an eye toward a better 2024. We continue to expect that pivot to more positive returns by the end of 2024.

In our view, the hinge for investment returns remains the global economic slowdown and particularly the gradual but steady cascade of U.S. economic sectors losing momentum. What began as contraction in housing (December 2021), and then spread to manufacturing (mid-2022) and credit (2023), leaves standing only consumer spending and services, which appear to be wavering and rapidly reaching a tipping point. The consumer usually follows the much-vaunted strong labor market. And the weakening U.S. economy is increasingly unlikely to skate by some mix of other stressors: the growing federal deficit, labor strikes, student-loan repayments, plus war and faltering international economies. The slow march toward the end of the economic cycle reminds us of the 1990–1991 contraction. While slow to evolve, that downturn was moderate — unlike that of 2008 — and we expect a similarly moderate (if comparatively shorter) slowdown during the first half of 2024.

Our investment guidance has been cautious and selective throughout this slow-motion slowdown. Investors who have followed this advice have accumulated shorter-term fixed-income assets that could become the dry powder to invest later in 2024. We expect opportunities to put money back to work across more markets and regions as 2024 develops. Turbulence is still likely, but we expect improving long-term opportunities as the pivot emerges. Patience remains an investor’s best tool.

Looking at current data is simply reporting, not forecasting. Forecasting the direction and trajectory of the economy and markets can be challenging, but not as challenging as precisely predicting the timing and the bottom of an economic slowdown and the subsequent pivot to recovery. Inside this 2024 Outlook, you’ll find our highest-conviction ideas for the new year. We believe that the time to pivot will come in due course, and we commit to you that we will identify those opportunities as they reveal themselves. On behalf of my Wells Fargo Investment Institute colleagues and all our advisors, I want to thank you for the trust you extend to us as our clients.

A handwritten signature in black ink, appearing to read 'Darrell Cronk'. The signature is fluid and cursive.

**Darrell L. Cronk, CFA**

President, Wells Fargo Investment Institute  
Chief Investment Officer, Wealth & Investment Management

# What's inside

## 2024 economic and market forecasts .....page 4

### Global economy .....page 6

- We anticipate a moderate global economic slowdown (including in the U.S.) in the first part of 2024, followed by a gradual, U.S.-led global recovery in the latter months of the year.
- We expect the U.S. dollar's peak to correspond with this economic cycle's bottom, though a global recovery later in the year should spark risk appetite and prompt a moderate pullback in the greenback.

### Global equities .....page 8

- We favor quality and a more defensive posture within equities as earnings per share (EPS) decelerate and the economy slows. As a result, we prefer U.S. large caps over U.S. mid caps and small caps, as well as developed-market over emerging-market equities.
- Health Care, Industrials, and Materials are our favored sectors while we hold unfavorable ratings on Consumer Discretionary and Real Estate.

### Global fixed income ..... page 13

- We expect U.S. Treasury yields to remain volatile in 2024, declining early on as the economic slowdown gathers momentum but rising as the recovery evolves in the latter months of the year.
- High-quality credit, in both corporate and municipal bonds, remains paramount to our guidance.

### Global real assets ..... page 16

- The bull super-cycle<sup>1</sup> that began in 2020 pushed many commodity prices to decade highs. However, even the best of bull markets consolidate. We remain favorable on commodities but expect performance will continue to moderate as the global economy slows further.
- For 2024, we are unfavorable on real estate investment trusts (REITs) as headwinds for the asset class remain strong and fundamentals continue to weaken.

### Global alternative investments\* ..... page 19

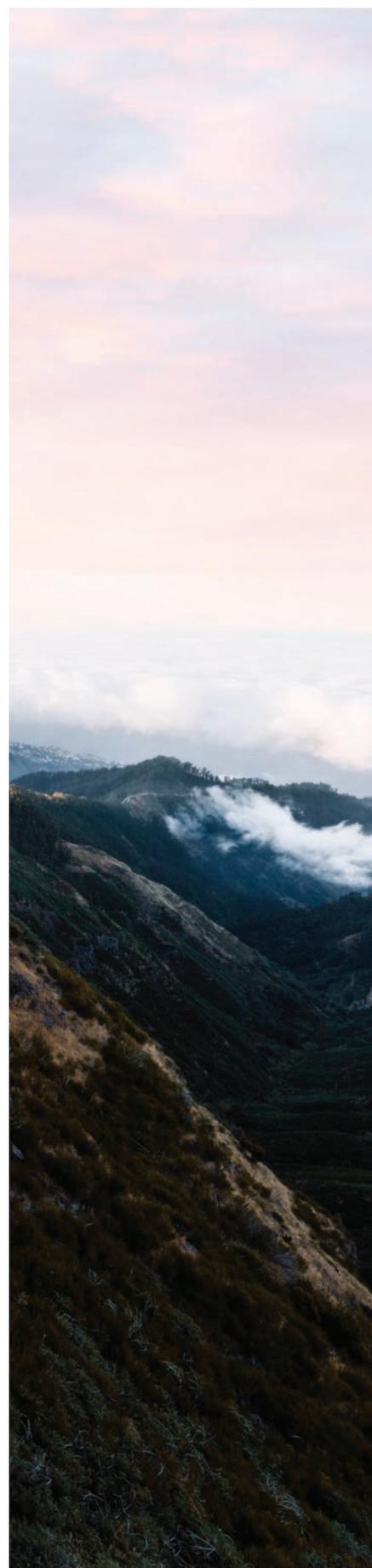
- Although financial distress levels have remained moderate thus far, we believe the uptrend will resume in the coming quarters and present a robust opportunity set for Distressed Credit strategies (both hedge funds and private-capital funds).
- Global Macro and Relative Value strategies typically exhibit low correlation to traditional equity and fixed-income markets and may provide an opportunity to diversify portfolios if traditional markets turn volatile.

### Our top five portfolio ideas for 2024 ..... page 21

\*Alternative investments are not appropriate for all investors and are open only to "accredited investors" or "qualified investors" within the meaning of the U.S. securities laws. They are speculative, highly illiquid, and designed for long-term investment and not as trading vehicles.

1. Bull super-cycles are extended periods of time, historically 15-20 years, where commodity prices move upward together.

Please see pages 26-27 for important definitions and risk considerations.



# 2024 economic and market forecasts

## 0.7%

U.S. GDP (gross domestic product) growth

We expect a moderate economic recovery in the back half of 2024 to snap back from a slowing economy early in the year.

Average % change in the latest four quarters from the same year-ago period, unless otherwise noted

Global economy	2023 latest*	2024 target
U.S. GDP growth	1.9% (Q3)	0.7%
U.S. inflation <sup>2</sup>	3.2% (Oct.)	2.5% (Dec.)
U.S. unemployment rate <sup>3</sup>	3.8% (Oct.)	5.6% (Dec.)
Global GDP growth <sup>4</sup>	3.1% (Q3)	2.3%
Global inflation <sup>4</sup>	4.0% (Q3)	3.3%
Developed-market GDP growth	2.0% (Q3)	0.8%
Developed-market inflation	6.6% (Q3)	2.4%
Eurozone GDP growth	0.9% (Q3)	0.6%
Eurozone inflation <sup>2</sup>	2.4% (Nov.)	2.0% (Dec.)
Emerging-market GDP growth	3.9% (Q3)	3.3%
Emerging-market inflation	4.7% (Q3)	4.0%

Sources: Wells Fargo Investment Institute and Bloomberg. \*Latest economic data as of November 30, 2023. Targets for 2024 are based on forecasts by Wells Fargo Investment Institute as of December 5, 2023. Q3 = third quarter. GDP = gross domestic product. 2. Latest month percent change from a year ago. 3. Three-month average as of the date indicated, percent of labor force. 4. Global GDP and global inflation are calculated using GDP weights for developed market and emerging market economies. **Forecasts, targets, and estimates are based on certain assumptions and on our current 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.**

Foreign currency exchange rates	2023 latest*	2024 year-end target
Dollar/euro exchange rate	\$1.09	\$1.08–\$1.12
Yen/dollar exchange rate	¥147	¥136–¥140
ICE U.S. Dollar Index**	103	99–103

## 4.75%–5.25%

10-year U.S. Treasury yield

This forecast anticipates that yields will fall with a slowing economy and then rebound collectively by year-end.

Fixed-income targets	2023 latest*	2024 year-end target
10-year U.S. Treasury yield	4.33%	4.75%–5.25%
30-year U.S. Treasury yield	4.50%	5.00%–5.50%
Federal funds rate	5.25%–5.50%	4.75%–5.00%

Sources: Wells Fargo Investment Institute and Bloomberg. \*Latest market data as of November 30, 2023. Targets for 2024 are based on forecasts by Wells Fargo Investment Institute as of December 5, 2023. \*\*The ICE U.S. Dollar Index is a weighted average of the value of the U.S. dollar relative to a basket of U.S. trade partner currencies, composed of the euro, Japanese yen, pound sterling, Canadian dollar, Swedish krona, and Swiss franc. A higher index value indicates dollar appreciation. **Forecasts, targets, and estimates are based on certain assumptions and on our current 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.**

Real assets targets	2023 latest*	2024 year-end target
West Texas Intermediate crude (barrel)	\$75	\$85–\$95
Brent crude (barrel)	\$82	\$90–\$100
Gold (troy ounce)	\$2,036	\$2,100–\$2,200
Bloomberg Commodity Index	232	235–255

Global equities	2023 latest*	2024 year-end target
S&P 500 Index	4,567	4,600–4,800
Earnings per share	\$221	\$220
Russell Midcap Index	2,894	2,900–3,100
Earnings per share	\$156	\$155
Russell 2000 Index	1,809	1,800–2,000
Earnings per share	\$63	\$65
MSCI EAFE Index	2,123	2,000–2,200
Earnings per share	\$153	\$150
MSCI Emerging Markets Index	983	900–1,100
Earnings per share	\$72	\$70

Sources: Wells Fargo Investment Institute and Bloomberg. \*Latest market data as of November 30, 2023 and latest 2023 EPS figures reflect Bloomberg consensus estimates. Targets for 2024 are based on forecasts by Wells Fargo Investment Institute as of December 5, 2023. **Forecasts, targets, and estimates are based on certain assumptions and on our current 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.**

## \$85–\$95

West Texas Intermediate crude

Energy prices likely will grind moderately higher by year-end.

## 4,600–4,800

S&P 500 Index

Once investors begin to anticipate an economic and earnings recovery, we expect the S&P 500 Index to gain into year-end.

# Preparing for the economic turning point

## Key takeaways

- We anticipate a continued global economic slowdown, followed by a gradual U.S.-led recovery in the latter part of 2024.
- We believe the U.S. dollar will likely find support from risk aversion during the remainder of the global slowdown, followed by a moderate depreciation toward year-end as a global economic recovery reignites risk appetite.

## What it may mean for investors

- The sharp increase in real (inflation-adjusted) interest rates will continue to slow economic growth, in our view, and to center our portfolio guidance around a quality theme until a recovery becomes visible, likely in the second half of 2024.

## Navigating financial normalization ...

Economic crosswinds will precipitate a moderate U.S. economic slowdown by the early part of 2024, in our view, reducing the annual growth rate to 0.7% in 2024 from our 2.2% forecast for 2023. Cascading weaknesses already are apparent from sequential slowing of manufacturing, housing, and overseas growth. Economic headwinds have been aggravated by an increase in strike activity, elevated fuel costs, resumption of student-loan repayments, and outsized budget deficits.

Financial normalization — that is, rising interest rates (see chart on next page) and tightening credit conditions — poses an added threat to the economy by early 2024 as it collides with increasing consumer and business leveraging and the lagged effect of monetary tightening.<sup>5</sup> Budget worries, political gridlock, and a less sanguine inflation outlook, have supported the biggest increase in key inflation-adjusted interest rates in decades. In turn, tightening financial conditions and eroding credit quality are slowing economic growth.

Our view is that the economic slowdown will cool consumer spending and inflation. Once inflation falls below wage growth, households should recapture purchasing power. Also, as inflation falls closer to the Fed's 2% target, we expect that policymakers will cut short-term interest rates, reducing borrowing costs for households and businesses. Lower interest rates and households with new spending power should prompt spending, inventory rebuilding, and an economic recovery, at least into year-end 2024, and probably beyond.

We expect lower interest rates near the nadir of the economy's slowdown to support a moderate turnaround in housing by easing the pressure on affordability. Moreover, we anticipate that business and government investment will provide more than its usual lift early in the next recovery from government and private sector reshoring incentives and increased public and private infrastructure spending.

## ... with falling inflation as the guiding light

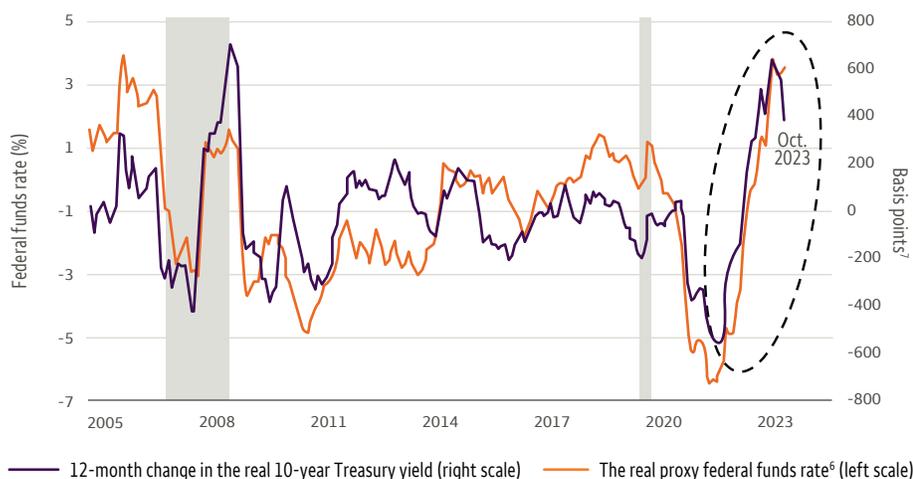
Inflation ultimately will guide the pivot to rate cuts and broader financial normalization. We expect 12-month increases in the Consumer Price Index (CPI) to be cut to 2.5% in December 2024 from 3.6% at the end of 2023 by the economy's slowdown, U.S. dollar strength much of next year, and further unwinding of price distortions created by the pandemic. However, structural changes will make it difficult to drive inflation back to its pre-pandemic average, which was below 2%. These structural factors include an aging population and potential productivity gains from new technologies. Slowing growth of labor supply from an aging workforce is boosting workers' bargaining power. Reglobalization is becoming a less potent source of disinflation by moving the

5. The lagged effect of monetary tightening refers to the fact that the Federal Reserve can raise its benchmark interest rate in a day, but leases, wage contracts, and agreements to buy or sell assets at predetermined prices and future dates can take a year or longer to account for the central bank's rate decision.

needle from supply-chain efficiency to national security. A commodity super-cycle created by years of under-investment should keep materials prices elevated. And manufacturing reshoring means more capital-intensive growth pressuring goods demand.

### Sharp increases on the road to interest-rate normalization

Rapid rate increases stress the economy.



6. Federal funds rate adjusted for CPI inflation and for policy changes affecting financial conditions, including quantitative tightening (QT). 7. 100 basis points equal 1.00%.

Sources: Wells Fargo Investment Institute, Federal Reserve Board, U.S. Labor Department. Monthly data, December 2005–October 2023. Shaded areas of chart denotes recessions.

### The U.S. dollar is poised to swing lower as 2024 progresses

Our bias remains for modest dollar upside in the first half of 2024, supported by a flight to quality during a global economic slowdown. We also expect the dollar to find support while U.S. interest rates exceed those in the eurozone and Japan. A global economic pivot to recovery later in 2024 should rekindle risk appetite and bring a slightly weaker dollar as capital flows diversify away from the U.S.

A moderating interest-rate environment in emerging markets may provide a broad negative driver to emerging-market currencies in 2024. Still, we believe a global economic recovery in the second half of 2024 may benefit emerging markets and help offset the interest-rate environment to drive emerging-market currency gains.

# Prioritize quality until the economy turns

## Key takeaways

- We expect global earnings to be challenged in early 2024 before rebounding later in the year as the economy reaccelerates. Valuations likely will increase in 2024 as markets anticipate an earnings recovery into 2025.
- We remain defensively positioned, preferring high-quality assets. However, as investors begin to look past the economic slowdown to a recovery, we expect our guidance to lean more cyclically.

## What it may mean for investors

- We believe investors should continue to favor high-quality U.S. large-cap equities. We will look for opportunities during the downturn to add to economically sensitive areas of the market.

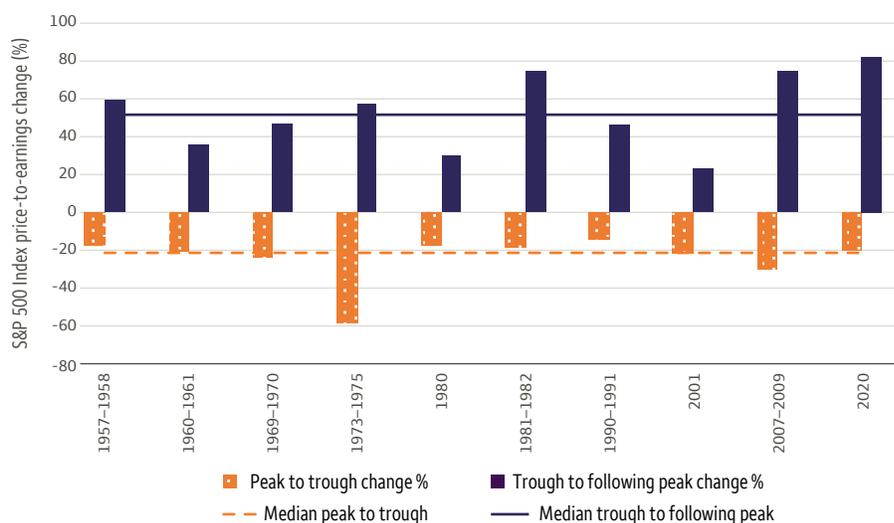
## Prices are likely to recover before earnings in 2024

In our view, the earnings decline experienced in 2023 will continue in 2024. Sticky first-half production input and wage costs, along with rising interest expenses, likely will weigh on net profit margins. But profits should rebound with an economic recovery in the back half of 2024 even as earnings may not recapture their 2022 peak until early 2025. Even before earnings mount a sustained recovery, investors typically anticipate the coming recovery and begin buying, pushing up price-to-earnings (P/E) valuations. We expect that pattern of rising prices and valuations as the economic slowdown approaches its bottom. However, as earnings begin to rise, late in 2024, we anticipate that P/E valuations will finally begin to decline.

The chart below illustrates how valuations for the S&P 500 Index historically moved around the economy's pivots from weakness to recovery. While the economy weakened, prices tended to fall faster than earnings, as investors anticipated weaker profits to come. In the cycles between 1957–1958 and 2020, the median P/E contraction was 22%. But as the slowdown neared its end, investors typically looked toward recovery, and prices generally rose to anticipate earnings growth. Over those same cycles, the median P/E expansion was 54% during the first 12 months of economic expansion.

## Past recessions pressured P/Es early before recoveries sparked a spike

Stock valuations typically anticipate an earnings recovery.



Sources: Wells Fargo Investment Institute and Bloomberg. Monthly data, July 1957 to March 2021. P/E represented by the S&P 500 Index trailing 12-month P/E ratio. Horizontal axis shows the recession years. Peak measured from within the 12 months prior to recession start date. Trough measured from 6 months of recession end date. Following peak measured from 12 months after trough.

## Stay defensive until the market pivots toward recovery

Early in a recovery, we expect to see broad-based equity-market gains, but this was not the case in 2023. The lack of market breadth (along with our expectation for an economic slowdown) suggests late-cycle dynamics are at play, leading us to maintain our defensive positioning entering 2024. Before the pivot to recovery, we suggest a patient and diligent focus on quality in equity markets. Specifically, we are favorable on U.S. large-cap equities, neutral on U.S. mid-cap equities, and most unfavorable on U.S. small-cap equities.

Our work suggests U.S. large-cap equities (represented by the S&P 500 Index) generally lead all other equity classes in quality characteristics such as profitability, earnings stability, liquidity, and healthy balance sheets. U.S. small-cap equities (represented by the Russell 2000 Index) score poorly on several quality metrics, including profitability, with nonearning companies composing more than 40% of the index.

Once the economic slowdown appears to be fully priced in to market valuations, we will look for an opportunity to position for an emerging early-cycle recovery later in 2024. Historically, that time tends to come while the economy is still weakening. Equities (specifically cyclically oriented equities) should benefit the most when the Fed begins cutting interest rates, the economy begins to recover, and corporate earnings begin to grow again. Of course past performance is not a guarantee of future results.

## International exposure should lean toward quality

Our quality bias extends to international equities, where we prefer developed-market ex-U.S. equities (neutral) over emerging-market equities (unfavorable). In our view, this defensive positioning has worked well late in the cycle and may have the potential to benefit investors during the slowdown.

Our view toward developed-market equities improved considerably after Europe avoided an energy crisis during the winter of 2022–2023 while sentiment reached a pessimistic extreme and valuations bottomed out. As a result, we upgraded the asset class earlier in 2023 from a most-unfavorable to a neutral rating. We believe that after over 15 years of underperformance, the MSCI EAFE index reached an inflection point where further significant relative return deterioration may prove difficult.

Yet, the neutral rating reflects our view that sustained developed-market equity gains may not emerge quickly. A recession in Europe is likely to be a headwind, and the region remains susceptible to further energy shocks. A continued slowdown in China could also weigh on these export-oriented markets. Even the boost to U.S. dollar-based returns from a potentially weaker dollar in 2024 is likely not enough to upset this balance between positive and negative factors, leaving us satisfied with our neutral rating.

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### Favored asset class

- U.S. Large Cap Equities

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### Favored equity sectors

- Health Care
- Industrials
- Materials

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## Favored equity sectors and sub-sectors

- **Health Care:** Life Sciences Tools & Services, Managed Health Care, Health Care Equipment & Supplies
- **Industrials:** Aerospace & Defense, Commercial & Professional Services, Multi-Industrials<sup>8</sup>, Rail Transportation
- **Materials:** Construction Materials, Industrial Gases, Specialty Chemicals

Emerging-market equities, on the other hand, face formidable headwinds that keep us unfavorable. Nearly 80% of the MSCI Emerging Markets Index is weighted toward Asia, where several China-related issues pressure the region. These include ongoing political risks from Chinese regulatory reform, U.S.-China diplomatic and economic strains, and China's slower growth potential. The positive takeaways for the proliferation of artificial intelligence and the related boost to the semiconductor industry in Taiwan and South Korea are unlikely to provide an equal counterbalance, in our view. Oil prices, which we expect will soften during the global economic slowdown, should be a drag on emerging-market oil-producing countries, while geopolitics remain a key risk for other emerging-market countries. The momentum around near-shoring that supports certain Latin American countries is likely to pause as well, given the sharp run-up to date. In our view, there is little to convince us that emerging-market equities will sidestep the underperformance that typically occurs during a global economic slowdown.

## Favorable sectors tilt toward quality and defense

At the sector level, we prefer investors remain tilted toward quality and defense as well. We hold favorable ratings on Health Care, Industrials, and Materials and unfavorable ratings on the highly cyclical Consumer Discretionary sector and the beleaguered Real Estate sector.

The Health Care sector is often termed a defensive sector for good reason. We believe the combination of sound earnings stability, solid underlying secular demand trends from the combination of an aging population and technological advances, and generally attractive valuations provide a favorable backdrop.

Our other two favorable-rated sectors, Materials and Industrials, are typically considered more cyclical. Yet, we believe each currently enjoys the potential for durable tailwinds — including large fiscal programs discussed in detail below — that will insulate them from the economic downturn while also allowing participation in any cyclical rallies.

Our unfavorable-rated sectors are areas of the market likely to bear the brunt of the economic slowdown. We expect Consumer Discretionary to suffer as consumers dial back spending as their confidence in the economy and labor market fades at the same time that their excess post-pandemic savings have been exhausted. Higher-for-longer interest rates, robust supply, and the propensity for companies to cut or postpone real-estate investments during economic downturns are all factors likely to weigh on the Real Estate sector.

8. Multi-Industrials includes conglomerates, electrical equipment, industrial machinery, and trading companies and distributors.

## Fiscal tailwinds support Materials and Industrials

In 2021 and 2022, Congress passed legislation containing \$972 billion in incremental funding for infrastructure investment (broadly defined) that is slated for disbursement over the next decade. These wide-ranging programs aim to improve America's physical infrastructure, incentivize companies to locate production of certain items in the U.S., and provide support for the energy transition. In turn, we have seen a significant expansion of stated investment intentions in areas including semiconductor production, utility-scale renewable-power generation, electric-vehicle battery plants, and several second-order impact industries (notably steel and electrical equipment).

The most visible impact we have observed to this point is in nonresidential construction. Private manufacturing construction spending is currently near all-time highs. For some perspective, the August 2023 reading was at a seasonally adjusted annual run rate 66% higher than the month prior to the passage of the Inflation Reduction Act and Creating Helpful Incentives to Produce Semiconductors and Science Act and 244% higher than the comparable 2019 period. Meanwhile, supported by provisions of the Infrastructure Investment and Jobs Act, August 2023 total public construction spending was roughly 20% higher compared with levels from two years prior. Categories with significant growth include highway and street, power, water, and sewage and waste disposal. These higher levels of activity in heavy construction have, in turn, supported certain industries, such as steel, aggregates, and construction equipment.

In our view, the Industrials and Materials sectors are the most likely to experience a positive impact from these trends in both the short and medium term. We acknowledge that business investment and industrial activity are unpredictable, and our current expectation for an economic slowdown in the near term could create fluctuations in these sectors. That said, we believe targeting the higher-quality areas within these sectors is a prudent strategy, and we prefer investors be opportunistic. Within Industrials and Materials, certain beneficiaries stand out in sub-sectors, such as Multi-Industrials (favorable rating), Construction Machinery and Heavy Truck Equipment (neutral rating), Construction Materials (favorable rating), and Industrial Gases (favorable rating).

## Equity sector and sub-sector preferences

		Sub-sector guidance		
Sector guidance	Sector	Favorable	Unfavorable	
Sector guidance	Favorable	Health Care	Life Sciences Tools & Services; Managed Health Care; Health Care Equipment & Supplies	Health Care Services
		Industrials	Aerospace & Defense; Commercial & Professional Services; Multi-Industrials**; Rail Transportation	Passenger Airlines
		Materials	Construction Materials; Industrial Gases; Specialty Chemicals	Containers & Packaging
	Neutral	Communication Services	Interactive Home Entertainment; Interactive Media & Services	Alternative Carriers; Publishing
		Consumer Staples	Beverages; Consumable Staples Merchandise Retail; Household Products	Tobacco
		Energy	Integrated Oil & Gas; Oil & Gas Storage & Transportation (Midstream Energy)	Oil & Gas Refining & Marketing
		Financials	Asset Management & Custody Banks; Diversified Banks; Insurance Brokers; Property & Casualty Insurance; Transaction & Payment Processing Services	Business Development Companies*; Consumer Finance; Life & Health Insurance; Mortgage REITs*
		Information Technology	IT Services; Communications Equipment; Semiconductors Materials & Equipment; Software	Electronic Equipment & Instruments
		Utilities	Electric Utilities; Multi-Utilities; Renewable Electricity*	Independent Power Producers & Energy Traders
Unfavorable	Consumer Discretionary	Broadline Retail; Hotels, Restaurants & Leisure ; Specialty Retail	Leisure Products	
	Real Estate	Data Center REITs; Industrial REITs; Infrastructure REITs; Self-Storage REITs	Diversified REITs; Lodging/Resort REITs; Office REITs; Specialty REITs; Timber REITs	

Source: Wells Fargo Investment Institute; sub-sector preferences are by Global Securities Research and sector preferences are by Global Investment Strategy. As of December 5, 2023.

\*These sub-sectors do not contain constituents in the S&P 500 Index or represent clarifications of Global Securities Research's opinion.

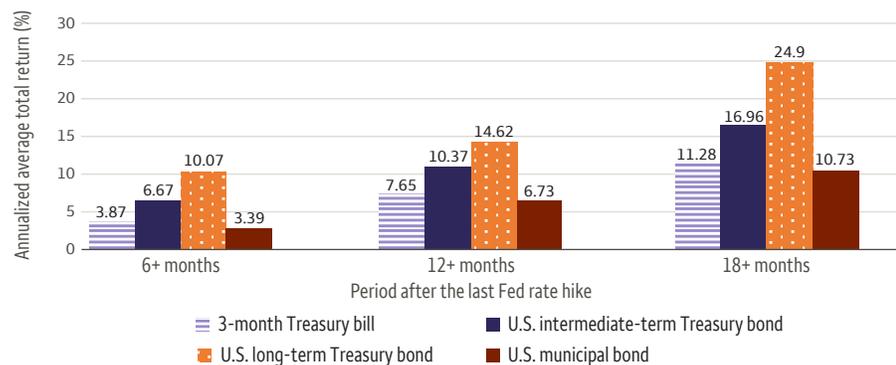
\*\* Multi-Industrials includes conglomerates, electrical equipment, industrial machinery, and trading companies and distributors.

# A tale of two halves

We believe the Fed will pivot away from tightening monetary policy in 2024 and will most likely remain on a pause in the early months since the hurdle to cut rates remains high due to still-elevated inflation. We then look for the Fed to proceed cautiously through the remainder of the year and expect modest policy rate cuts as the U.S. economic slowdown deepens. We believe the Fed will also continue with its balance-sheet reduction but most likely will halt its program in the second half of the year, especially if financial liquidity and credit conditions tighten.

## Performance after the last Fed rate hike of a tightening cycle

Longer-term bond yields tend to peak near the end of a Fed tightening cycle and are likely to outperform once the Fed pivots to rate cuts.



Sources: Wells Fargo Investment Institute and Bloomberg. Data represents the annualized average performance of the ICE BofA 3-Month Treasury Bill Total Return (TR) Index, the Bloomberg U.S. Intermediate-Term Treasury TR Index, the Bloomberg U.S. Long-Term Treasury TR Index, and the Bloomberg U.S. Municipal Bond TR Index over the 6-month, 12-month, and 18-month periods following the last hike in the federal funds rate in the previous seven tightening cycles by the U.S. Federal Reserve. (Last hike dates were: February 15, 1980; May 5, 1981; February 24, 1989; February 1, 1995; May 16, 2000; June 29, 2006; and December 19, 2018.) **Past performance is not a guarantee of future results. Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment.**

We expect U.S. Treasury yields to remain volatile in 2024. In our view, the year will be the tale of two halves: a decline in yields during the first half of 2024 as the economic slowdown deepens, followed by a climb in yields in the second half as the recovery begins to take shape. Ultimately, we see an opportunity for our favored fixed-income asset classes to produce positive returns in the first half of 2024, recovering from the losses experienced in 2022 and 2023 due to rising interest rates. We believe that maintaining exposure in short- and long-term high-quality fixed income may provide an advantage before potentially moving into lower credit exposure in the second half of the year.

## Key takeaways

- We believe the Fed will pivot away from tightening monetary policy in 2024 and will most likely remain on pause in the early months of the year, but we expect modest policy rate cuts as the U.S. economy slows further.
- Investment-grade corporate issuers enter 2024 with strong credit metrics and largely supportive outlooks from the major rating agencies. An eventual economic recovery in the latter half of the year should begin to support credit-oriented asset classes and sectors.

## What it may mean for investors

- In our view, 2024 will be a tale of two halves for fixed income: a decline in yields during the early part of the year as the economic slowdown deepens, followed by a climb in yields in the latter months as a recovery evolves. We see an opportunity for many defensive fixed-income asset classes to produce positive returns in the first half of 2024, and as the economy recovers, we look to add to higher-risk bond-market sectors such as high-yield bonds.

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### Favored asset classes

- U.S. Short Term Taxable Fixed Income
- U.S. Long Term Taxable Fixed Income

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### Favored fixed-income sectors

- U.S. Municipal Bonds
- U.S. Government Securities

Investors' focus on inflation, the U.S. fiscal deficit, Treasury issuance, and supply/demand imbalances in the Treasury market should support a "higher for longer" bias in interest rates. Our base scenario implies two quarter-point Fed rate cuts in 2024, causing the federal funds rate target to decline toward 4.75%–5.00%. We also expect a U.S. economic recovery to move longer-term rates modestly higher after a decline during the first half. Our year-end 2024 target for 10-year U.S. Treasury yields is 4.75%–5.25% and for 30-year yields is 5.00%–5.50%, slight increases from levels at the end of November 2023. Effectively un-inverting the curve, which has been a historical bond market signal of an economic recovery.

## Unattractive backdrop for global bonds

Inflation, coupled with relatively weaker economies, and still-elevated policy interest rates from developed-market central banks should continue to pressure developed-market ex-U.S. fixed-income performance in 2024. We believe the eurozone will struggle with a recession and persistent fiscal policy challenges, while Japanese yields remain artificially low, influenced by the Bank of Japan. Furthermore, the U.S. dollar should remain strong, at least in the first half of 2024. With yields generally below those available in the U.S., and currency returns seen as negative until the strong dollar trend turns, we continue to have no strategic or tactical allocation to developed-market ex-U.S. bonds.

The global environment also remains challenging for emerging-market debt as weak developed economies, sluggish Chinese growth, and a stronger U.S. dollar weigh on these markets. Higher-for-longer U.S. yields and potential sovereign emerging-market credit-spread widening may also dent performance. Should rates move lower in the first half of 2024, as we expect, the longer maturities inherent in the emerging-market debt sector may help lift the sector's performance. These crosscurrents leave our outlook neutral on emerging-market sovereign debt denominated in dollars, but we believe the outlook may brighten in the second half of 2024 as the global economy begins to recover.

## Opportunities in corporate bonds

Investment-grade corporate issuers enter 2024 with strong credit metrics and largely supportive outlooks from the major rating agencies. The proportion of BBB-rated issuers at risk of downgrades in an economic slowdown is low, and among highly levered credits, we have already seen management take steps to curtail shareholder rewards in favor of maintaining investment-grade credit metrics. We prefer investors prioritize issuers with strong business profiles that are less reliant on debt-funded acquisitions to maintain their competitive position.

In our view, a quality-centric approach to high-yield credit should benefit investors in 2024 as most BB-rated companies have the credit quality and business strength to manage a downturn without substantial credit risk. However, few issuers rated B and below may be able to manage rising funding costs, significant refinancing needs, and pressured business models without a substantial risk of credit loss more than offsetting misleadingly attractive yields. While selling high-yield bonds typically accompanies a weakening economy, we prefer companies that are likely to remain solvent through more than just the current default cycle.

## Municipal bonds remain resilient

We remain favorable on municipals, and for investors in higher effective tax brackets, municipal securities remain relevant and an important part of fixed-income positioning. We prefer A-rated or higher general obligation (GO) bonds, particularly local GO bonds. Compared with the broader municipal market, we believe GO bonds have the potential to offer an attractive opportunity for outperformance in 2024.

Now is also a good time for municipal bond investors to focus on portfolio maintenance by moving up in credit quality given the relative underperformance of high-quality bonds and outperformance of lower-quality bonds, which would be more susceptible to credit risk and underperformance during an economic slowdown. During the past five recessions, municipal bonds have, on average, outperformed corporate bonds and recovered their value more quickly. Municipal credits continue to carry an average rating that is significantly higher than corporates and have had a lower default rate.

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### Fixed-income sector and sub-sector preferences

Sectors	Sub-sectors	
	Favorable	Unfavorable
U.S. Government Securities (favorable)	U.S. Treasuries	
U.S. Municipal Bonds (favorable)	General Obligation	Dedicated sales tax, small private higher-education institutions, smaller health care providers, and high-yield municipals
Securitized (neutral)		Commercial Mortgage-Backed Securities
Investment-Grade Corporate Bonds (neutral)	Financials, Health Care, Utilities	Consumer Discretionary, Real Estate

Source: Wells Fargo Investment Institute; sub-sector preferences are by Global Securities Research and sector preferences are by Global Investment Strategy. As of December 5, 2023.

# Commodity bull intact, but gains slow

## Key takeaways

- Commodity price gains have slowed recently, but we remain favorable as the commodity bull super-cycle is intact, in our view. With an economic slowdown imminent, commodity prices are likely to stagnate in early 2024, but we expect a resumption in the rally by year-end.
- REIT headwinds remain strong as we enter 2024, which keeps us unfavorable relative to other S&P 500 sectors.

## What it may mean for investors

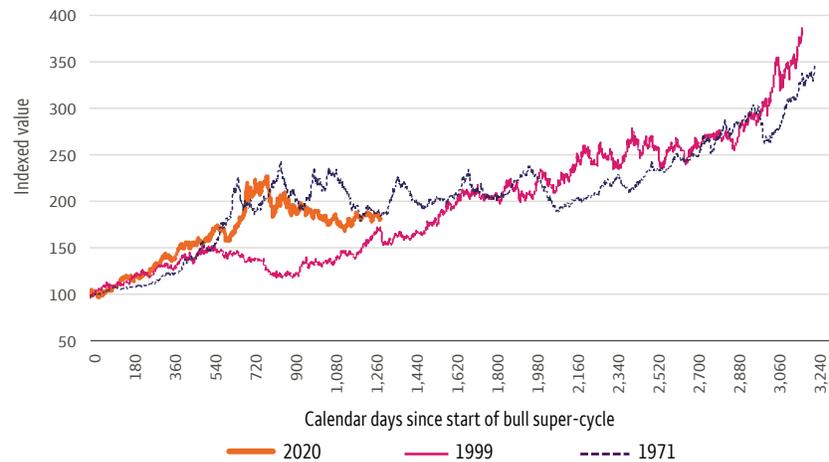
- We favor commodities but are unfavorable on REITs.

## Favorable on commodities and unfavorable on REITs

The commodity bull super-cycle that began in 2020 has pushed many commodity prices to decade highs. Commodity bull super-cycles are multiyear periods, often lasting a decade or longer, of persistently rising commodity prices. However, these long cycles typically consolidate as persistently rising prices can bring added supply or slow demand. Following the adjustment, the bull super-cycle often reasserts itself (see chart below). We remain favorable on commodities, but we expect gains will slow in 2024 as the economic slowdown deepens. We believe REITs on the other hand, will continue to struggle with higher interest rates, and so we remain unfavorable. Large, well-capitalized, broadly diverse midstream energy companies — both master limited partnerships (MLPs) and C-corporations — may fare better than some of their energy peers.

## Current commodity bull super-cycle behaving similar to past periods

The commodity bull super-cycle since March 2020 appears to be following the same track as recent super-cycles, which also experienced consolidation periods.



Sources: Wells Fargo Investment Institute and Bloomberg. Daily data, October 4, 1971–November 13, 2023. Indexed to 100 as of the start of the bull super-cycle (March 18, 2020). Performance measured from October 4, 1971–November 20, 1980, July 13, 1999–July 2, 2008, and March 18, 2020–November 13, 2023. Commodity performance measured by the Refinitiv Equal Weight Commodity Index from October 4, 1971–November 20, 1980. The Bloomberg Commodity Total Return Index is used to measure performance from July 13, 1999–November 13, 2023. **Past performance is not a guarantee of future results. Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment.**

## Conditions support modestly higher commodity prices

As high global interest rates continue to undercut economic growth, we see commodity demand slowing. On the supply side, global growth remains underwhelming, however. Commodity supplies are mainly restrained by capital discipline among producers after a decade, prior to 2020, of low commodity prices. There are other supply-related issues too, such as government policies to favor green energy and lingering pandemic-related issues that localize supply chains. All told, even with slowing demand, tepid supply growth will likely keep commodity prices grinding higher by the end of 2024.

## Gold positioned to rally in 2024

Gold prices have stalled for the better part of the three-year commodity bull super-cycle, frustrating investors. In 2023, especially, the yellow metal faced sizable headwinds in a stronger U.S. dollar, higher global interest rates, and surging cryptocurrency prices. Considering the magnitude of the headwinds, gold prices, impressively, managed to hold key support levels and even rallied some. We believe gold could add to its positive price momentum in 2024 as its recent headwinds appear poised to reverse and become tailwinds in 2024.

## Oil's paradigm shift

Supply restraint from Saudi Arabia, Russia, and the rest of OPEC+ (Organization of the Petroleum Exporting Countries and their allies) has tightened energy markets considerably. We expect OPEC+ will continue to take a disciplined approach in bringing spare capacity back online, especially until the pivot to stronger global economic activity occurs. U.S. oil production did increase near the end of 2023, but we anticipate that a weak economy will keep production growth capped as producers continue to pledge capital discipline. This has been a paradigm shift in U.S. producer strategy from the “pump at will” mentality of recent years. In our view, this muted global supply growth will likely offset weaker global demand and support current prices.

## REITs likely to keep struggling

Stubbornly high interest rates, a slowing economy, and tighter lending conditions continue to hamper most REIT segments. Even if interest rates retreat in early 2024 as the economic slowdown deepens, the mini banking crisis of 2023 remains fresh in the minds of lenders, which should limit credit to the industry.

We enter 2024 with an unfavorable rating on REITs overall. Within the REITs sector, however, we favor Data Centers, Industrial, Infrastructure, and Self-Storage, and we are unfavorable on Diversified, Lodging/Resort, Office, Specialty, and Timber.

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### Favored asset class

- Commodities

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### Favored real assets sectors and sub-sectors

- Energy, Precious Metals
- Data Center REITs, Industrial REITs, Infrastructure REITs, and Self-Storage REITs

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## Public real estate sector and sub-sector preferences

Sectors	Sub-sectors	
	Favorable	Unfavorable
Public Real Estate (unfavorable)	Self-Storage, Data Centers, Industrials, Infrastructure	Diversified, Lodging/Resort, Office, Specialty, Timber

Source: Wells Fargo Investment Institute; sub-sector preferences are by Global Securities Research and sector preferences are by Global Investment Strategy. As of December 5, 2023.

## Midstream energy (MLPs and C-corporations)

We view an environment of higher and stable oil prices as attractive for midstream energy companies. The group offers sizable dividend yields, even more so than REITs, and after years of cuts and balance-sheet repair, now appears sustainable in our view. The ongoing commodity bull super-cycle provides an added benefit.

We expect large, well-capitalized, and broadly diversified midstream companies to continue holding up well relative to some of their energy company peers. We prefer midstream C-corporations slightly over MLPs as the C-corporation structure is more likely to attract capital.

# Tread with caution before a visible recovery

## Maintain a cautious playbook heading into 2024

The 2024 alternative investment playbook remains defensively oriented as we maintain favorable ratings on strategies that we believe offer greater diversification benefits or may have the potential to generate positive returns regardless of market direction. These include Relative Value – Arbitrage strategies that attempt to capture mispricings across related securities and seek to profit as the relationship normalizes. Global Macro strategies also offer very low correlations — that is, they tend to not move in lockstep — with traditional markets and have proven to add significant value in some of the most difficult market environments in recent years. Environments with persistent trends, such as rising (or falling) commodity prices, currencies, equity indexes, or interest rates historically bode well for the category. Lastly, Relative Value – Long/Short Credit strategies also offer more defensive attributes and can benefit from periods of heightened volatility in fixed-income markets, as witnessed in recent periods. The flexible mandates allow skilled managers to benefit from identifying improving or deteriorating credit fundamentals.

## The evolving opportunity in distressed assets

The lingering effects of the historic rise in interest rates may have longer-term implications as well. As companies incurred additional debt during the prior era of low borrowing costs, many were unable to maintain positive cash flow as the cost of that debt has risen sharply recently. Distressed Credit strategies (hedge funds and private-capital funds) may benefit from this new normal where interest rates remain higher than in recent decades. While interest rates may be near their peaks, the liquidity buffer for many lower-quality companies continues to erode with each passing month. As shown in the chart on the next page, the distress ratio and default rate rose from the very low levels witnessed in mid-to-late 2021, yet the rise was truncated in 2023 as forecasts for a “soft landing” began to emerge. However, we believe the modest pullback in distress/default rates will be short-lived as the combination of higher debt service costs and slowing consumer spending provides a one-two punch that many small and midsize businesses are ill-equipped to manage.

## Opportunities in private markets

Within the private-capital strategies, we maintain our neutral view of the broad categories of Private Equity, Private Debt, and Private Real Estate. However, within Private Equity, we maintain our favorable rating on Growth Equity strategies as investors continue to seek out higher-quality opportunities that include businesses with proven business models, significant revenue generation, and earnings growth, yet may be available at lower valuations. Additionally, we still see opportunities within Small-/Mid-Cap Buyout strategies as deal financing remains readily available via the private-credit markets.

### Key takeaways

- We prefer allocations to defensive hedge-fund and private-capital strategies as the U.S. economy slows further.
- As we anticipate an eventual return to economic growth, we may look to more directional strategies, such as Equity Hedge and the Structured Credit/Asset-Backed strategy within Relative Value.

### What it may mean for investors

- Our current favored strategies and sub-strategies are more defensive and historically have not moved in tandem with traditional stock and bond markets. We will look to add risk as the downturn evolves and investors anticipate an economic recovery.

### Favored hedge fund strategies and sub-strategies

- **Event Driven:** Distressed Credit
- **Relative Value:** Arbitrage
- **Relative Value:** Long/Short Credit
- **Macro:** Systematic
- **Macro:** Discretionary

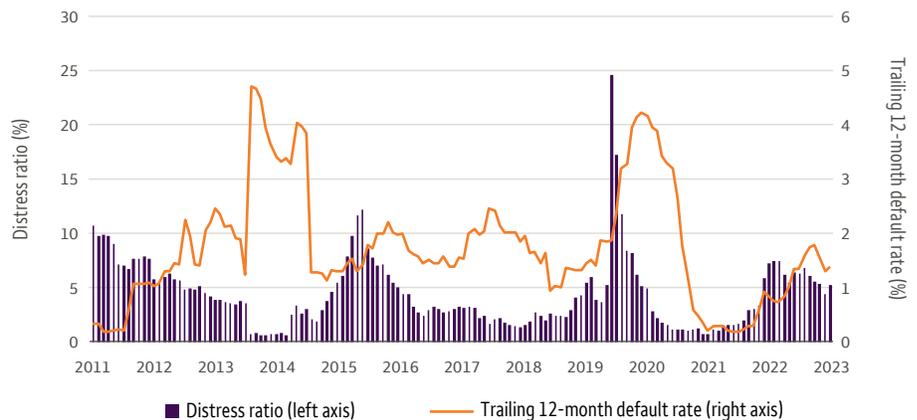
### Favored private capital strategies and sub-strategies

- **Private Debt:** Distressed/Special Situations
- **Private Equity:** Small- and Mid-Cap Buyout
- **Private Equity:** Growth Equity

Secondary investments are interests in existing private equity funds that are acquired in privately negotiated transactions after the end of the private equity fund's fundraising period. Typically these funds have portfolios of existing investments as well as capital available for new investments. 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.

### U.S. bank loan index distress ratio and default rate (past 12 months)

The recent pullback in distressed levels may not last.



Sources: Wells Fargo Investment Institute and Pitchbook/LCD. Monthly data from October 2007 to October 2023. Representative index includes Morningstar LSTA US Leveraged Loan Index. "Distress ratio" is defined as percent of loans priced below 80 (of 100 par value). **Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment.**

We also believe secondary investments in Private Equity funds may have the potential to offer an attractive opportunity for qualified investors today. Secondary fund investments sell at significant discounts to net asset value, offering attractive entry points for skilled secondary managers.

In Private Debt, we maintain our neutral guidance on Direct Lending strategies. While direct lenders have entered new markets exited by struggling regional banks, we remain cautious as higher interest rates result in higher debt service costs for small and midsize businesses. We expect lower-quality borrowers, those that suffer from higher input costs, rising wages, and an inability to raise prices, to remain under stress. However, lenders with disciplined underwriting standards and a focus on higher-quality credits should be able to better navigate the environment as stresses build. As the credit cycle unfolds and default rates begin to trend downward, we expect to become more constructive on Direct Lending strategies.

We also maintain our neutral guidance within Private Real Estate. Valuations remain under significant pressure across most property types, including lower-quality Office and Retail, which are especially vulnerable. The stalled "return to work" trend, higher financing costs, and continued shift to online retail foster uncertainty around the timing of any future inflection point.

### Pivot to a recovery

As the economic slowdown evolves in early 2024, we expect to shift toward strategy types with greater sensitivity to the general equity and fixed-income markets. Our defensive positioning is expected to transition to a more aggressive stance that favors more "return enhancing" attributes during the economic bottom.

# Our top five portfolio ideas for 2024

## 1 Stay defensive but prepare for early-cycle recovery

As we move into 2024, we still favor more defensive positioning among and within asset groups. Overall, our portfolio guidance favors fixed income over equities, especially as yields have risen to multiyear highs. In addition, we have been overweight real assets, an asset group that tends to perform well in inflationary environments, since early 2020. Our current allocations have reduced volatility versus our strategic benchmarks. We believe rebalancing portfolios back to weightings that incorporate our tactical adjustments is an opportune way to position portfolios for an early-cycle recovery.

We favor rebalancing because it provides a tool to help manage portfolio risk and seek higher returns over time. The first step is to reduce holdings that have become expensive and where there is risk of losing value. After harvesting profits from these assets, our tactical favorites provide potential targets to reinvest the proceeds for long-term value. Industrials, Materials, and Health Care are sectors we believe appear reasonably priced today and should help drive the economy moving forward.

## 2 Anticipate a pivot to riskier equity classes

Looking ahead, we anticipate that the economic slowdown will weigh on equity markets, allowing for a potential pivot toward investments that we believe are most likely to benefit from the subsequent recovery. These tend to be assets that are more leveraged to the economic cycle, such as small-cap and emerging-market equities, as well as high-yield debt. Equity sector positioning would likely follow suit with its own risk-on tilt toward more cyclical and growth sectors like Financials, Consumer Discretionary, and Energy.

The narrowness of the S&P 500 Index in 2023 was stunning, driven by seven mega-cap technology names related to artificial intelligence, whose price returns roughly doubled from January 1, 2023 to November 14, 2023. By comparison, the average stock in the S&P 500 Index was roughly flat (up only 2.1%) during that same period.

The economic cycle itself can reinforce the performance of growth stocks. During an economic slowdown, investors generally favor large growth companies with strong fundamentals and balance sheets, as they are generally better equipped to withstand a slowing economy. In contrast, as the economy ends its slowdown and begins to recover, smaller companies tend to outperform in anticipation of a broad earnings recovery. Likewise, early in the global economic recovery, international currencies tend to appreciate against the dollar, and this trend supplements returns to dollar-based investors.

### 3 Lock in attractive long-term bond yields

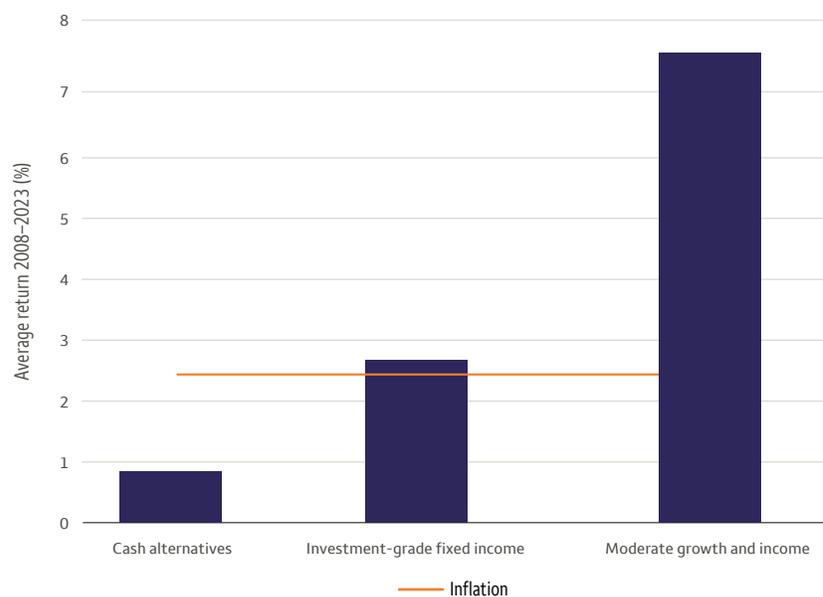
A fundamental reason for holding fixed-income assets in a diversified portfolio is their historical ability to moderate risks in equity markets while contributing income. In addition, the recent rise in yields opens other potential advantages. The 10-year U.S. Treasury yield excluding core inflation (as measured by CPI excluding food and energy) turned positive in September 2023, and we believe investors currently have an opportunity to lock in the highest yields in decades. As long as the bond is from a high-quality issuer, an investor can lock in a known yield out to the maturity date with limited default risk.

Many long-term investors concerned about the short-term volatility in equity prices related to the economic slowdown-to-recovery pivot have noticed that cash alternatives and certificate-of-deposit (CD) rates are the most attractive in decades. But if inflation and short-term rates fall next year, as we expect, it likely will be difficult to renew that CD at today's high rates. Building a laddered bond position as part of a diversified portfolio that adds multiple maturities is one way to take advantage of high rates while hedging against the possibility of variable rates in the future. A laddered bond position can also provide an income stream and liquidity for expected or unexpected distributions and market opportunities.

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#### Comparative returns can guide portfolio selection

A diversified allocation has historically outperformed cash and fixed income.



Sources: Wells Fargo Investment Institute and Morningstar Direct. Averages calculated over the period November 1, 2008–October 31, 2023. Inflation is measured by the Consumer Price Index. Cash alternatives is measured by the Bloomberg U.S. Treasury Bills (1-3 Month) Index. Investment-grade fixed income is measured by the Bloomberg U.S. Aggregate Bond Index. See Index Definitions page for moderate growth and income definition. An index is not managed and not available for direct investment. **Past performance is not a guarantee of future results.**

## 4 Position for potential correlation spikes by using alternative investments

Spikes in correlations among asset classes can occur when the same factors are impacting multiple asset classes. This has occurred several times over the past few years as inflation and the higher rates imposed by the Fed to combat inflation have weighed on both equity and fixed-income prices simultaneously. This is a tricky environment for investors in these two traditional asset classes as history suggests that their portfolios may temporarily offer limited downside price protection until the longer-term diversification benefits reassert themselves. One way to gain additional diversification is for qualified investors to add exposure to alternative strategies that not only offer the potential to enhance returns but also can help diversify a variety of risks, including market and inflation risk. We believe that the Macro strategy may provide a low correlation to global risk assets, including stocks and bonds in 2024. For their part, we expect that Relative Value strategies potentially can provide defensive characteristics and may offer positive performance independent of market direction. We also favor Distressed and Special Situations Private Debt in anticipation of additional high-yielding opportunities in this space in the coming months.



## 5 Use pullbacks to add to commodities

Supply constraints and demand growth traditionally have been the principal drivers of super-cycles. We anticipate both dynamics to continue for the foreseeable future, supporting commodity prices as demand picks up and many are structurally undersupplied. Commodities' potential diversification benefits make them appealing for both tactical and strategic investment time frames. Although performance may moderate as a weakening economy softens demand in cyclically sensitive sectors, at three years into the current bull super-cycle, we see more upside potential ahead. Any pullback in commodities' prices at this point in the cycle may offer opportunities for investors to add exposure to the asset class at a reasonable cost. A favorable outlook on performance not only makes the asset class attractive but also links well with our view on equity sectors. Looking through to an economic reacceleration, we expect strong performance in our favored Materials and Industrials sectors given the infrastructure building that we envision in the U.S. and China over the next decade. Within commodities, we remind investors to remain diversified and not concentrate in one class or subclass, including gold.

### Commodities may diversify portfolios

Commodities outperformed equities and hedged inflation risk during past commodity bull super-cycles.

	Commodity bull super cycles			Commodity bear super cycles	
	1971–1980	1999–2008	2020–present	1980–1999	2008–2020
<b>Bloomberg Commodity Index</b>	25.7%	12.1%	15.4%	-3.2%	-10.6%
<b>Consumer Price Index</b>	8.3%	3.1%	4.9%	3.6%	1.4%
<b>S&amp;P 500 Index</b>	3.9%	-0.8%	14.1%	13.0%	6.1%

Sources: Wells Fargo Investment Institute and Bloomberg. Monthly data, October 1971–October 2023. Commodity bull super-cycles measured from October 4, 1971–November 20, 1980, July 13, 1999–July 2, 2008, and March 18, 2020–present. Commodity bear super-cycles measured from November 20, 1980–July 13, 1999 and July 2, 2008–March 18, 2020.

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# Definitions

**Moderate Growth & Income (Liquid)** is composed of: 2% Bloomberg U.S. Treasury Bills (1–3 Month) Index, 30% Bloomberg U.S. Aggregate Bond Index, 6% Bloomberg U.S. Corporate High Yield Bond Index, 5% JPM EMBI Global Index, 24% S&P 500 Index, 10% Russell Midcap Index, 6% Russell 2000 Index, 8% MSCI EAFE Index, 5% MSCI Emerging Markets Index, 4% Bloomberg Commodity Index.

Performance results for Moderate Growth & Income are for illustrative purposes only. Dynamic allocations change as needed with adjustments to the strategic allocations. Results do not represent actual trading and the results achieved do not represent the experience of any individual investor. In addition, results do not reflect the impact of any fees, expenses or taxes applicable to an actual investment. The indexes reflect the historical performance of the represented assets and assume the reinvestment of dividends and other distributions. An index is unmanaged and not available for direct investment. **Past performance does not guarantee future results.** *Different investments offer different levels of potential return and market risk.*

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

**Bloomberg U.S. Corporate High Yield Bond Index** covers the U.S. dollar-denominated, non-investment grade, fixed-rate, taxable 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. Included issues must have at least one year until final maturity.

**Bloomberg U.S. Treasury Bills (1–3 Month)** Index is representative of money markets.

**Bloomberg United States Financial Conditions Index** tracks the overall level of financial stress in the U.S. money, bond, and equity markets to help assess the availability and cost of credit.

**Bloomberg Municipal Bond Index** is an unmanaged index composed of long-term tax-exempt bonds with a minimum credit rating of Baa.

**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.

**Commodity Composite Price Index** measures a basket of commodity prices as well as inflation. It blends the historical commodity index introduced by George F. Warren & Frank A. Pearson, former academics at Cornell, collected and published commodity price data in their book, *Prices*, and the producer price index for commodities (PPI-Commodities), and the National Bureau of Economic Research (NBER) Index of Spot Market Prices of 22 Commodities and the Reuters Continuous Commodity Index. The index components and weightings, from Warren and Pearson's *Prices*, change over time but the 11 commodity groups used from 1786-1932 are: Farm Products, Foods, Hides and Leather products, Textile Products, Fuel and Lighting, Metals and Metal Products, Building Materials, Chemicals and drugs, Spirits (stopped tracking 1890), House furnishing Goods, and Miscellaneous. The PPI-Commodities is compiled by the Bureau of Labor Statistics and shows the average price change from the previous month for commodities such as energy, coal, crude oil and the steel scrap. The NBER Index of Spot Market Prices of 22 Commodities is a measure of price movements of 22 sensitive basic commodities whose markets are presumed to be among the first to be influenced by changes in economic conditions. The Reuters Continuous Commodity Index comprises 17 commodity futures that are continuously rebalanced: cocoa, coffee, copper, corn, cotton, crude oil, gold, heating oil, live cattle, Live hogs, natural gas, orange juice, platinum, silver, soybeans, sugar no. 11, and wheat.

**Consumer Price Index (CPI)** produces monthly data on changes in the prices paid by urban consumers for a representative basket of goods and services.

**Bloomberg Commodity Index** is comprised of 23 exchange-traded futures on physical commodities weighted to account for economic significance and market liquidity.

**JPMorgan EMBI Global Index** is a U.S. dollar-denominated, investible, market cap-weighted index representing a broad universe of emerging market sovereign and quasi-sovereign debt. While products in the asset class have become more diverse, focusing on both local currency and corporate issuance, there is currently no widely accepted aggregate index reflecting the broader opportunity set available, although the asset class is evolving. By using the same index provider as the one used in the developed-market bonds asset class, there is consistent categorization of countries among developed international bonds (ex. U.S.) and emerging market bonds.

**Morningstar LSTA US Leveraged Loan Index** is designed to deliver comprehensive, precise coverage of the U.S. leveraged loan market.

**MSCI EAFE Index (Europe, Australasia, Far East) Index** is a free float-adjusted market capitalization index designed to measure the equity market performance of developed markets, excluding the U.S. and Canada.

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

MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, reviewed, or produced by MSCI.

**Refinitiv Equal Weight Commodity Index** (formerly known as the Continuous Commodity Index) is a major US barometer of commodity prices.

**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, which measures the performance of the 3,000 largest U.S. companies based on total market capitalization.

**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, which represent approximately 25% of the total market capitalization of the Russell 1000® Index, which measures the performance of the 1,000 largest U.S. companies based on total market capitalization.

**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.

# Risk considerations

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

*All investing involves risks, including the possible loss of principal. There can be no assurance that any investment strategy will be successful and meet its investment objectives. Investments fluctuate with changes in market and economic conditions and in different environments due to numerous factors, some of which may be unpredictable. Asset allocation and diversification do not guarantee investment returns or eliminate risk of loss. Each asset class has its own risk and return characteristics, which should be evaluated carefully before making any investment decision. 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. Some of the risks associated with the representative asset classes include:*

## General market risks

Stock markets, especially foreign markets, are volatile. A **stock's** value may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors.

**International investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. This may result in greater share price volatility. These risks are heightened in emerging and frontier markets. Investing in **small- and mid-cap companies** involves additional risks, such as limited liquidity and greater volatility.

Investments in **fixed-income securities, including municipal securities**, are subject to market, interest rate, credit, liquidity, inflation, prepayment, extension, and other risks. Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can result in a decline in the bond's price. **High-yield fixed-income** securities are considered speculative, involve greater risk of default, and tend to be more volatile than investment-grade fixed-income securities. **Municipal securities** may also be subject to the alternative minimum tax and 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.

**Sovereign debt** is generally a riskier investment when it comes from a developing country and tends to be a less risky investment when it comes from a developed country. The stability of the issuing government is an important factor to consider, when assessing the risk of investing in sovereign debt, and sovereign credit ratings help investors weigh this risk.

**U.S. government securities** are backed by the full faith and credit of the federal government as to payment of principal and interest if held to maturity. Although free from credit risk, they are subject to interest rate 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.

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.

**Treasury Inflation-Protected Securities (TIPS)** are subject to interest rate risk, especially when real interest rates rise. This may cause the underlying value of the bond to fluctuate more than other fixed income securities. TIPS have special tax consequences, generating phantom income on the "inflation compensation" component of the principal. A holder of TIPS may be required to report this income annually although no income related to "inflation compensation" is received until maturity.

**Mortgage-related securities** are subject to prepayment and call risks in addition to the risks of investing in debt securities. Call risk is the risk that the issuer will redeem the issue prior to maturity. This may result in reinvestment risk, which means the proceeds will generally be reinvested in a less favorable environment. Changes in prepayments may significantly affect yield, average life, and expected maturity.

**Currency** risk is the risk that foreign currencies will decline in value relative to that of the U.S. dollar. Exchange rate movement between the U.S. dollar and foreign currencies may cause the value of a portfolio's investments to decline.

There are special risks associated with an investment in **real estate**, including the possible illiquidity of the underlying properties, credit risk, interest rate fluctuations, and the impact of varied economic conditions. Other risks associated with investing in listed **REITs** include the use of leverage, unexpected reductions in common dividends, increases in property taxes, and the impact to listed REITs from new property development.

Investment in Master Limited Partnerships (MLPs) involves certain risks which differ from an investment in the securities of a corporation. MLPs may be sensitive to price changes in oil, natural gas, etc., regulatory risk, and rising interest rates. A change in the current tax law regarding MLPs could result in the MLP being treated as a corporation for federal income tax purposes which would reduce the amount of cash flows distributed by the MLP. Other risks include the volatility associated with the use of leverage; volatility of the commodities markets; market risks; supply and demand; natural and man-made catastrophes; competition; liquidity; market price discount from Net Asset Value and other material risks.

A barbell strategy allows investors to take advantage of current interest rates by investing in short-term bonds, while also benefitting from the higher yields of holding long-term bonds.

Bond rating firms, such as Moody's, Standard & Poor's and Fitch, use different designations consisting of upper- and lower-case letters 'A' and 'B' to identify a bond's credit quality rating. 'AAA' and 'AA' (high credit quality) and 'A' and 'BBB' (medium credit quality) are considered investment grade. Credit ratings for bonds below these designations ('BB', 'B', 'CCC', etc.) are considered low credit quality, and are commonly referred to as "junk bonds".

## Sector investing

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. **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. Risks associated with the **Consumer Discretionary** sector include, among others, apparel price deflation due to low-cost entries, high inventory levels and pressure from e-commerce players; reduction in traditional advertising dollars, increasing household debt levels that could limit consumer appetite for discretionary purchases, declining consumer acceptance of new product introductions, and geopolitical uncertainty that could affect consumer sentiment. **Consumer Staples** industries can be significantly affected by competitive pricing particularly with respect to the growth of low-cost emerging market production, government regulation, the performance of the overall economy, interest rates, and consumer confidence. 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. Investing in the **Financial** services companies will subject a investment to adverse economic or regulatory occurrences affecting the sector. Some of the risks associated with investment in the **Health Care** sector include competition on branded products, sales erosion due to cheaper alternatives, research and development risk, government regulations and government approval of products anticipated to enter the market. There is increased risk investing in the **Industrials** sector. The industries within the sector can be significantly affected by general market and economic conditions, competition, technological innovation, legislation and government regulations, among other things, all of which can significantly affect a portfolio's performance. **Materials** industries can be significantly affected by the volatility of commodity prices, the exchange rate between foreign currency and the dollar, export/import concerns, worldwide competition, procurement and manufacturing and cost containment issues. **Real estate** investments have special risks, including possible illiquidity of the underlying properties, credit risk, interest rate fluctuations, and the impact of varied economic 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 smaller, less-seasoned companies, tend to be more volatile than the overall market.

## Alternative investments

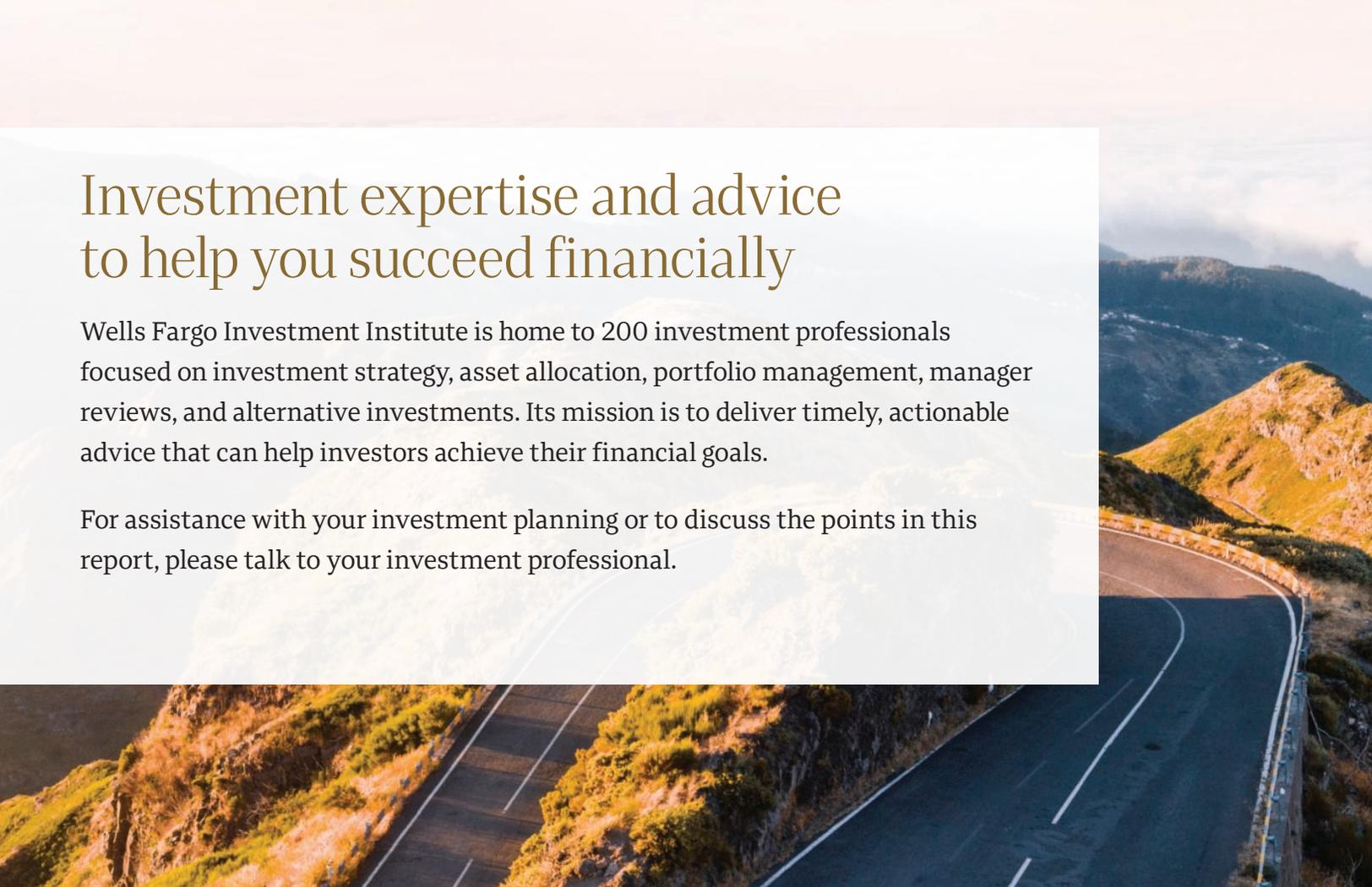
Alternative investments, such as **hedge funds, private equity/private debt, and private real estate funds** are speculative and involve a high degree of risk that is appropriate only for those investors who have the financial sophistication and expertise to evaluate the merits and risks of an investment 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, and less regulation and higher fees than mutual funds. Hedge fund, private equity, private debt, and private real estate fund investing involve 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.

**Private debt strategies** seek to actively improve the capital structure of a company, often through debt restructuring and deleveraging measures. Such investments are subject to potential default, limited liquidity, the creditworthiness of the private company, and the infrequent availability of independent credit ratings for private companies. Investing in distressed companies is speculative and involves a high degree of risk. Because of their distressed situation, these securities may be illiquid, have low trading volumes, and be subject to substantial interest rate and credit risks. **Private capital investments** are complex, speculative investment vehicles not appropriate for all investors. They are not subject to the same regulatory requirements as registered investment products and engage in leverage and other aggressive investment practices. There is often limited (or even nonexistent) liquidity and a lack of transparency regarding the underlying assets.

Hedge fund strategies, such as **Event Driven, Equity Hedge, Global Macro, Relative Value, Structured Credit, and Long/Short Credit**, 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 because 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. Private capital investments are complex, speculative investment vehicles not appropriate for all investors. They are not subject to the same regulatory requirements as registered investment products and engage in leverage and other aggressive investment practices. There is often limited (or even nonexistent) liquidity and a lack of transparency regarding the underlying assets.

## Real assets

Real assets are subject to the risks associated with **real estate, commodities**, and other investments and may not be appropriate for all investors. The **commodities markets**, including investments in **gold and other precious metals**, 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 commodities may be affected by changes in overall market movements, commodity index volatility, changes in interest rates, or factors affecting a particular industry or commodity. Products that invest in commodities may employ more complex strategies, which may expose investors to additional risks. Investment in **real estate securities** includes risks, such as the possible illiquidity of the underlying properties, credit risk, interest rate fluctuations, and the impact of varied economic conditions.



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