WELLS FARGO
Investment Institute

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2025 Outlook

Charting the economy's next chapter

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Charting the economy's next chapter

Darrell L. Cronk, CFA

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

"In investing, what is comfortable is rarely profitable."

— Robert Arnott

The centerpiece of our 2025 global economic outlook is a U.S. growth acceleration that leads the world economy, which we believe will grow more slowly. The Wall Street term is a "soft landing," in which the U.S. economy regains momentum after a growth slowdown. To earn its name, the soft landing must feature catch-up spending so that lagging manufacturing and other segments catch up to services, which have been much stronger. But in that catch-up, and in likely new tariffs and tighter immigration, we expect a modest inflation uptick by year-end.

Our outlook for investment returns looks solid. Equity markets seem to have embraced the soft-landing scenario since mid-2023, and the S&P 500 Index posted a 33% total return in the 12 months through December 2, 2024, but the Bloomberg Aggregate U.S. Bond Index appears set for another year of loss and still has not recovered from its 17% drop between July 2020 and October 2022. Investors seeking income have gravitated toward money market funds and short-term instruments, but we favor shifting those holdings into broadening equity-market opportunities and longer-term fixed income in 2025.

Beyond the economy, the incoming administration and congressional leaders want a fast start. The likeliest policy priorities include extending tax benefits, expiring next year, and deregulation, plus new tariffs and tighter border control. These tax-cut extensions passed the House of Representatives in 2024 but stalled in the Senate. A 2025 extension seems likely but, as with deregulation, may take time to develop. We believe these policies match up well with the economic trends we foresee, and the following pages describe how that alignment fits in our investment guidance.

We also see long-term themes that we believe are investable today. For example, U.S. industrialization combines infrastructure rebuilding and manufacturing reshoring from China with strong spending on new technology in areas like robotics and artificial intelligence (AI). Corporate equipment spending in 2024 has been multiple times software spending, but one company's capital spending is another's revenue — and possibly an investment prospect. We find value among these equipment and materials suppliers, not just among a few names in technology hardware.

Likewise, reindustrialization propels a wide range of economic activity and complements a power generation renaissance. Cybersecurity, cryptocurrencies, AI, and global defense spending are also helping drive the first material acceleration in U.S. power generation in decades. We are pleased to outline how to invest in tomorrow's opportunities today.

The pages that follow offer our highest-conviction investment ideas for 2025 and beyond. Throughout the year, we will keep our focus on an economic soft landing and the path of interest rates and inflation while we watch for policy-related opportunities from Washington and prospects beyond 2025. On behalf of my Wells Fargo Investment Institute colleagues and all our advisors, thank you for the trust our clients extend to us.

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1. 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.

Top five portfolio ideas

1 | Prepare for abundant liquidity to broaden opportunities

We expect abundant cash available for spending and investment as fiscal spending and monetary policy both support economic growth. Bank reserves have declined from their peak but remain plentiful, supporting credit growth in 2025 (see chart below). Additionally, ample cash on the sidelines and continued elevated levels of federal government spending and Fed interest-rate cuts bolster the case for a full allocation to equities, in our view. Over a tactical horizon through 2025, we anticipate a modest economic recovery with lower short-term interest rates, an environment that typically favors sectors that are closely tied to the pickup in economic activity, including Industrials and Energy. Also, Financials should see improving net interest margins with lower federal funds rates on tap.

While Communication Services is part of the tech-plus[2] equation, we also believe valuations of companies in this sector are relatively attractive. Within our favored sectors, we prefer to focus on specific sub-sectors, including Multi-Industrials,[3] Specialty Retail, and Specialty Chemicals, all of which are poised to capitalize on increasing consumer spending and industrial production.

And while our favored sectors seek to take advantage of growth opportunities, we think it is equally important to avoid areas of the market that are defensive in nature and may detract from tactical performance, like Consumer Staples and Utilities.

Cash available for banks to lend is near a 15-year high

Sources: Wells Fargo Investment Institute and Bloomberg. U.S. reserve balances with Federal Reserve Banks. Weekly data, January 7, 2009 – November 6, 2024.

2. Tech plus includes stocks that fall across the Information Technology, Communication Services, and Consumer Discretionary sectors.
3. Multi-Industrials includes the Industrial Conglomerates, Electrical Components & Equipment, Industrial Machinery & Supplies & Components, and Trading Companies & Distributors sub-industries.

2 | Position for a cyclical recovery but remain tilted toward U.S. assets

Even beyond ample liquidity to support the economy and capital markets, we anticipate stronger and more sustained economic growth to take hold. To take advantage of this next chapter in the economy, we favor establishing positions in economically sensitive asset classes now. Doing so should provide investors the option to build more sizable positions as economic conditions likely improve in 2025. Smaller companies tend to depend more on credit, so lower borrowing costs should bolster their earnings growth.

We think the global economic recovery will be strongest in the U.S. as developed markets and emerging markets grow more slowly amid relatively weaker fiscal and monetary support initiatives. China's struggling real estate sector and overreliance on exports for growth, coupled with Europe's trade restrictions against China, undermine the positive symbiosis that developed between the two in previous decades. This is another reason why U.S. assets have traded at a premium and why we continue to favor U.S. markets over international and developed markets over emerging markets. We prefer to reposition portfolios to favor the following asset classes: U.S. Large Cap Equities, U.S. Intermediate Term Taxable Fixed Income, and Commodities.

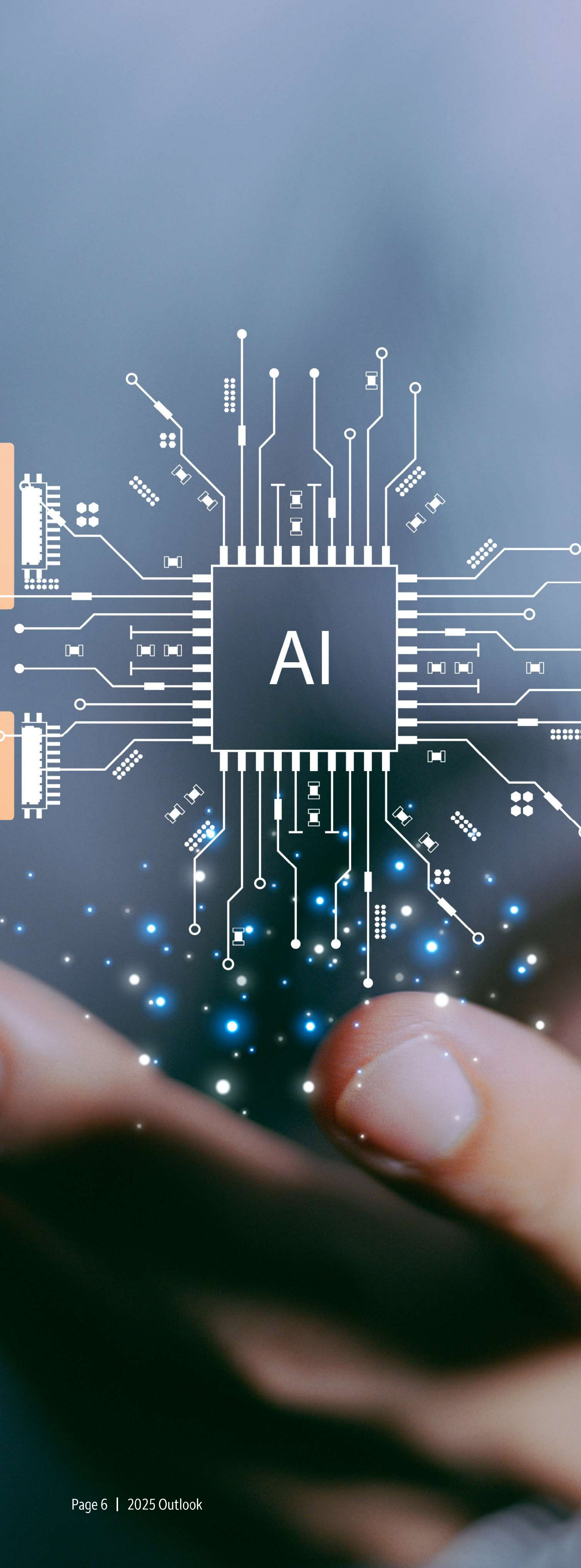
3 | Rethink investment income

The Fed has begun cutting interest rates, and we expect additional cuts between December 2024 and year-end 2025. That combination implies that money market funds and other short-term fixed-income instruments may be less likely to stay ahead of inflation. We favor extending maturities through a laddered strategy, investing first in intermediate maturities (3 – 7 years), next in longer-dated maturities, and finally shorter maturities. Investors could consider this sequence when purchasing new fixed-income securities, redeploying maturing securities or reallocating among selected managers to achieve this laddering.

Besides fixed income, investors may earn dividend income from equities. U.S. large-cap companies have accumulated over $2.4 trillion in cash on their balance sheets and could choose to initiate or increase dividend payouts.[4] When selecting companies for dividend income potential, we favor those that offer a sustainable stream of income and high-quality balance sheets. For qualified investors, Private Debt offers opportunities to increase income through exposure to often fast-growing, high-yield companies.

U.S. large-cap companies have accumulated over $2.4 trillion in cash on their balance sheets and could choose to initiate or increase dividend payouts.[4]

4. Bloomberg, as of October 15, 2024. Dividends are not guaranteed and subject to change or elimination.



4 | Consider expanding opportunities in AI

While the direct investment in semiconductors and cloud services needed to build AI capabilities has been the driving force behind much of the investor excitement over the past couple of years, we think this direct investment growth rate will slow. We expect increased investor scrutiny and potential divergence among the mega-cap technology companies in 2025 as investors start to question the large sums of money being dedicated to AI and how they will ultimately be monetized. Even so, this trend likely will moderate, not end, the recent torrid pace of price gains.

We expect the AI theme to broaden, benefiting companies across many sectors and industries typically more removed from the technology-related sectors. Over the long term, Utilities and industrial equipment (electrical, HVAC, generators, water utility infrastructure, midstream energy, nuclear power, and construction materials) are needed to build the infrastructure of a world driven by this emerging technology. We favor a full allocation to the Information Technology sector, which means a hefty 30%-plus equity-portfolio position, but we prefer to wait for a better entry point to overweight this sector. Meanwhile, we continue to favor the Energy and Communication Services sectors where we are beginning to see AI-fueled efficiencies, especially in the Interactive Media & Services sub-sector. These core inputs to the growth trend in AI look more attractively priced than the big names in the Information Technology sector.

The next chapter for AI will be the true test of its ability to enhance real productivity. If the technology lives up to the hype, it could fuel the next leg of earnings growth, capex spending, and economic growth.

AI has largely been a U.S. story and supports our overweight preference to U.S. Large Cap Equities. It also supports our view of domestic over international assets and our favorable views on the Energy, Industrials, and Communication Services sectors.

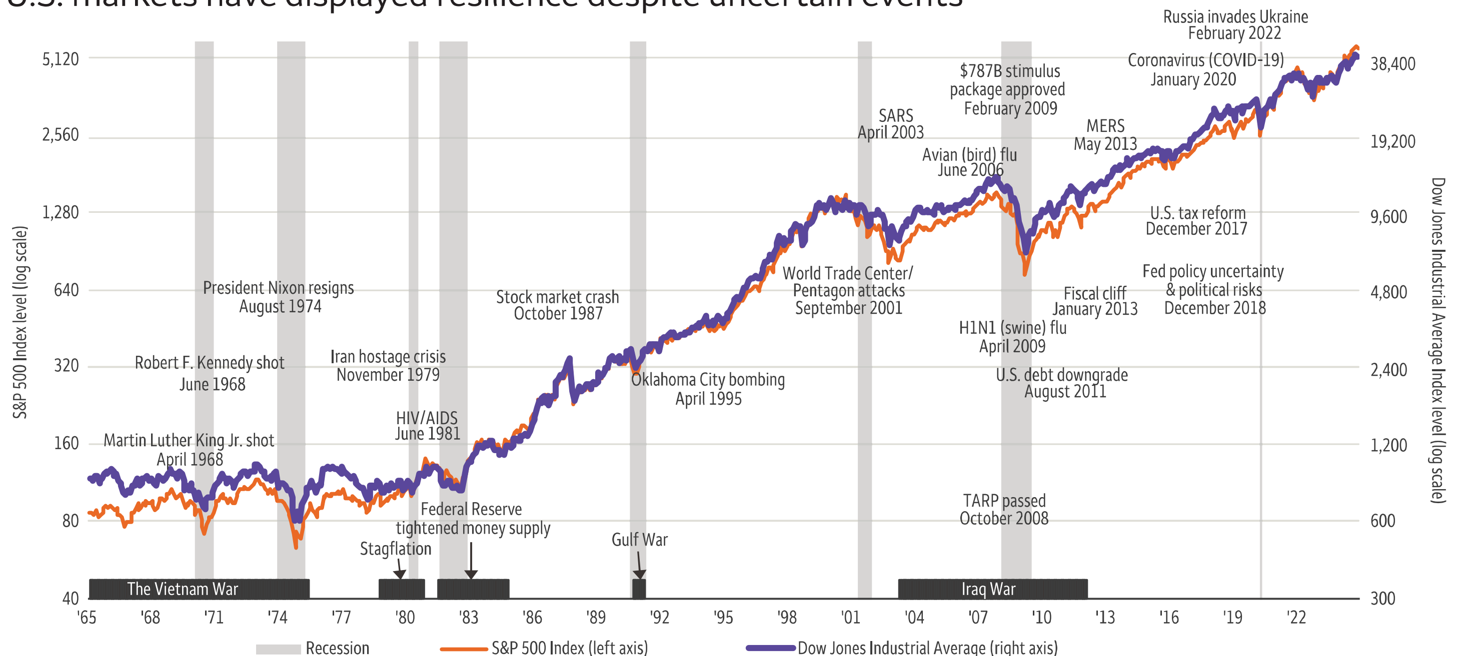
5 | Keep extreme risks in perspective

We remain cautious of the risks that adverse geopolitical events pose to global market conditions. Historically, markets have overcome short-lived disruptions and over time displayed remarkable resilience (see chart below). It is important to note that conflicts in the Middle East and Eastern Europe did escalate in 2024 but remained contained as regional combatants observed constraints against all-out regional war and outside powers largely refrained from joining in offensive moves. In our view, restraint remains in the interest of all parties, but the risk of abrupt escalation is very likely to continue.

We believe the temptation to allocate heavily to cash or cash equivalents because of geopolitical fears neglects that such events typically are inherently unpredictable; that other, unanticipated negative events hit without warning anyway; and, not least, that markets ultimately adjust. The cash-heavy portfolio may help during a surprise event but could miss other return opportunities as markets recover. To illustrate, the chart below shows that the period from January 2001 – October 2024, brought the 9/11 attacks, war, financial crisis, and a pandemic, but in each case the U.S. economy resumed growing. Of course, past performance is not a guarantee of future results. Nonetheless, over this period, the S&P 500 Index total return was 8.4% annualized, compared with only 1.7% for cash.[5] Relying too much on cash can compromise long-term goals.

By seeking what we believe are the best opportunities across varied markets, we believe our guidance accommodates hedges against low-probability, high-impact risks. For example, investors may consider that overweight allocations to a broad basket of commodities may hedge against events that limit global commodity supplies. Our constructive economic outlook favors the Industrials equity sector, but that sector potentially offsets geopolitical risks that induce a U.S. military buildup. Our fixed-income preferences seek to lock in income but also could buffer the portfolio return under unexpected or abrupt events. Qualified investors may want to consider directional hedge fund strategies, such as Long/Short Credit and Macro, which can generate returns under persistent trends, whether up or down.

U.S. markets have displayed resilience despite uncertain events



Sources: Wells Fargo Investment Institute and Bloomberg, as of October 31, 2024. Monthly data, January 1965 – October 2024. Representative indexes include the S&P 500 Index and the Dow Jones Industrial Average. An index is not managed and not available for direct investment. **Past performance is not a guarantee of future results.**

5. Source: Bloomberg, as of October 31, 2024. Cash is represented by Bloomberg U.S. Treasury Bills (1 – 3 month) Index. U.S. Large Cap Equities is represented by the S&P 500 Index.

Please see pages 33-35 for important definitions and risk considerations

U.S. economy to lead

KEY TAKEAWAYS

- We expect more balanced growth across the U.S. economy's sectors, and that greater balance and some acceleration should modestly lift inflation by year-end 2025.
- We think the U.S. economy is well-positioned as a world growth leader in 2025, which should reinforce the U.S. dollar's relative strength against other global currencies.

WHAT IT MAY MEAN FOR INVESTORS

- Our expectation for U.S. economic leadership and a relatively stronger U.S. dollar underscores our preference for domestic assets.

The economy's service sector accounted for more than 55% of overall real gross domestic product (GDP) growth since the recovery from the midyear trough of the 2020 recession. By contrast, interest-rate sensitive sectors (such as small businesses, manufacturing, and homebuilding) have suffered under a long period of high interest rates, creating a divergence across the economy's sectors.

We view postelection clarity, economic policy, and early-year disinflation as catalysts for stronger growth and a narrowing divergence in 2025. Business and consumer confidence are reviving while election-related uncertainties fade. Business inventories are likely to build ahead of expected new tariffs, and that should bolster manufacturing. For households, the extended rally in equity prices has helped upper-income households drive consumer spending. Looking ahead, inflation-adjusted wage gains are strengthening and should support improved spending growth among lower-income households.

Higher inflation later in 2025

We anticipate Consumer Price Index (CPI) inflation will rise to a 3.3% annual pace by year-end. Several trends are worth watching in this regard. First, it is important to remember that the economy's modest 2024 slowdown — instead of a recession — reduced factory operation to only 2% below capacity by year-end. The implication is that any pickup in household or business activity that demands additional factory capacity should quickly lift production costs and, ultimately, consumer prices. Second, fuel and other commodity prices could recover quickly under sustained, moderate economic growth. Third, sticky inflation in medical, insurance, and especially shelter rental costs — nearly a third of the CPI — should add to inflation pressure through 2025. We also anticipate an added postelection wrinkle in the form of upward inflation pressure from wage prices tied to higher tariffs and tighter immigration restrictions.

Global economies trail the U.S.

In our view, the U.S. economy is once again positioned as the global growth leader. Not only do we anticipate a U.S. recovery next year, but structural advantages — such as comparatively stronger fiscal stimulus, a vibrant technology sector, and less dependence on exports — should continue to benefit the U.S.

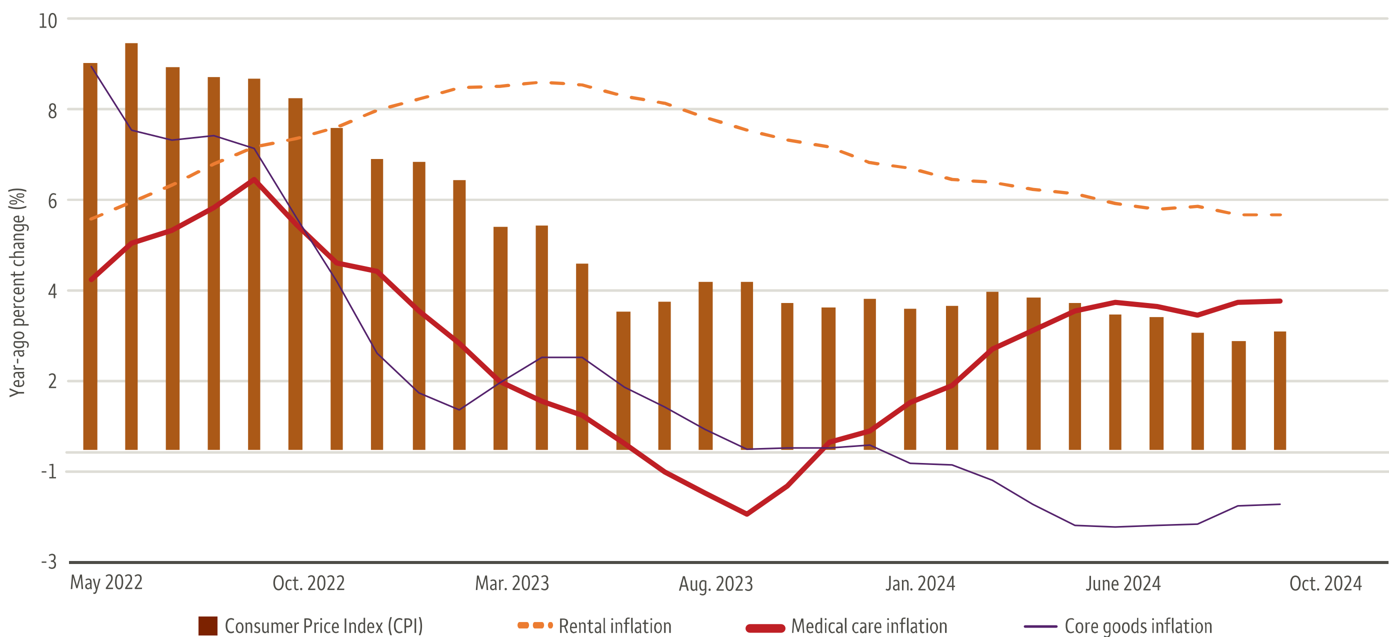
Nevertheless, we also expect some modest international economic improvement. Late-2024 fiscal stimulus should stabilize the Chinese economy and support global trade growth through improved credit flows and greater confidence among Chinese consumers. However, while structural factors are largely positive for the U.S., they are negative for China, Europe, and Japan. All suffer from much more regulation than the U.S., and declining populations along with insufficient regional economic integration and fiscal restraint in Europe. We believe these comparative structural weaknesses will maintain the U.S. economy's lead position in 2025.

U.S. dollar poised to maintain strength

Our bias remains for moderate U.S. dollar upside, particularly in the back half of 2025, supported by interest-rate and economic growth differentials that favor the dollar. The market expects euro and U.S. dollar interest differentials to end 2025 at around the same level as today. We also expect the dollar to find support from potential further U.S. tariffs against China and possibly other countries. A global economic recovery in the second half of the year with clear-cut U.S. growth leadership and a disappointing European rebound should hamper the move of capital away from the U.S.

A moderating interest-rate environment in emerging markets has yet to provide a clear-cut negative in their currencies as global rates may fall as well. A global economic recovery in the second half of 2025, but with disappointing growth in emerging markets, may be a negative for their currencies and tip the balance to moderate depreciation against the dollar.

Certain CPI inflation components remain stubbornly high



Sources: Wells Fargo Investment Institute and Bureau of Labor Statistics. Monthly data, May 2022 – October 2024.

Stock rally to widen

KEY TAKEAWAYS

- We believe accelerating economic growth will drive company sales while deregulation, continued cost control, and loosening credit conditions should support expanding profit margins in 2025.
- We expect stock prices to continue to march higher, driven primarily by earnings growth that should broaden to more cyclically oriented areas of the market.

WHAT IT MAY MEAN FOR INVESTORS

- We prefer U.S. Large Cap Equities (favorable) over U.S. Mid Cap Equities (neutral) and U.S. Small Cap Equities (neutral) as well as Developed Market ex-U.S. Equities (neutral) over Emerging Market Equities (unfavorable).

FAVORED ASSET CLASS

- U.S. Large Cap Equities

Earnings should be the primary driver of 2025 prices across equity asset classes. We expect that a broadening and acceleration of economic growth, spurred on by a Fed easing cycle and resilient consumer, should fuel healthy top-line sales growth while the past two years' focus on cost control should help turn revenue growth into profit growth. Our year-end 2025 earnings per share (EPS) target for the S&P 500 Index is $275.

Valuations also should support earnings growth. Notably, the S&P 500 Index price-to-earnings (P/E) multiple was higher 12 months after the Fed began interest-rate cuts in all but one case since 1980 (past performance is no guarantee of future results). Anticipated deregulation and tax-cut extensions should help. Possible tariffs and immigration controls are negatives, but their impacts may take most of 2025 to develop. Taking all these anticipated policies together, we assess that the net effect likely will be positive for the economy and equity markets.

Collectively, we expect these factors to support our year-end 2025 S&P 500 Index midpoint of 6,600.

As we have suggested, this story likely will not end with the large-cap S&P 500 Index. Mid-cap and small-cap companies, which struggled through one of the most difficult operating environments in recent history, should finally earn a reprieve. The historically long Fed interest-rate-hiking cycle weighed heavily on these companies that rely much more on credit than their large-cap peers. For example, the S&P 500 Index debt-to-EBITDA[6] ratio sits around 1.5 times (as of October 31, 2024), whereas the Russell Midcap and Russell 2000 Indexes are roughly double and triple that, respectively. In summary, we anticipate that many headwinds from 2024 will ease in 2025, including easing credit conditions, moderating wage gains, normalizing supply-chain issues, and improving sentiment. As these obstacles fade, we expect earnings and returns to respond positively across all U.S. equity asset classes.

6. EBITDA = earnings before interest, taxes, depreciation, and amortization.

Rate-cut returns following historical script

The prevailing wisdom is that a Fed interest-rate-cutting cycle precedes or coincides with poor stock returns, but historically, this has been true only when a recession develops. In fact, of the four easing-cycle cases absent a recession since 1980, the average S&P 500 Index return 12 months following the first cut was over 22%, with the single worst return still an impressive 16% (see chart below).

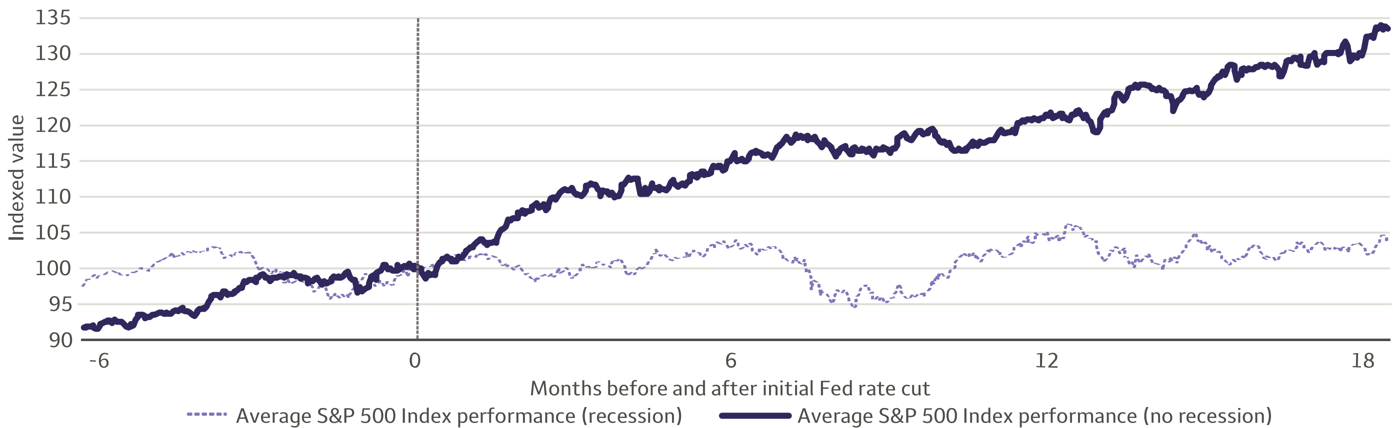
Slight quality lean until the economy reaccelerates

While the operating environment is likely to improve generally, we are not yet signaling the all-clear for the riskiest areas of the market. Small caps, as an example, will likely face continued headwinds until the economy accelerates. Additionally, the Russell 2000 Index's high percentage of companies that have no earnings — which, nearing 45%, is well above its Russell Midcap Index (17%) and S&P 500 Index (6%) peers — and relative dependence on credit mean the group is particularly sensitive to economic or monetary-policy disappointments. Yet, we expect this group to respond vigorously when the economic acceleration becomes clear and as monetary and political uncertainties ease in 2025.

The time will come to lean away from quality to position more forcefully for the typical economic-recovery bounce in riskier assets. As of this report, we remain tilted toward quality as we prefer U.S. Large Cap Equities (favorable) over U.S. Mid Cap Equities (neutral) and U.S. Small Cap Equities (neutral).

We prefer a similar lean toward quality in international equities as well where we hold a neutral rating on Developed Market ex-U.S. Equities versus an unfavorable rating on Emerging Market Equities.

Favorable stock return track record when Fed cuts rates while avoiding a recession



Sources: Wells Fargo Investment Institute and Bloomberg. Daily data. Indexed to 100 as of the initial Fed interest-rate cut in a cycle. Recession cases include the interest-rate-cutting cycles that began on 5/30/1980, 11/2/1981, 1/3/2001, 9/18/2007, and 7/31/2019. No recession cases include the interest-rate-cutting cycles that began on 11/21/1984, 6/6/1989, 7/6/1995, and 9/29/1998. An index is not managed and available for direct investment. **Past performance is not a guarantee of future results.**

Developed Market ex-U.S. Equities offer investors access to quality companies outside the U.S. at relatively inexpensive valuations. As of October 31, 2024, the MSCI EAFE Index leverage ratios, such as debt-to-EBITDA, are almost identical to those of the S&P 500 Index, but its P/E ratio is at a roughly 40% discount. For now, we are comfortable at a full allocation as attractive valuations and poor market sentiment reduce downside risk. However, a resilient U.S. dollar could mute Developed Market ex-U.S. Equities' return potential.

Emerging Market Equities, on the other hand, face headwinds that ultimately 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 as it shifts to emphasize domestic consumption.

Sector positioning for an economic recovery

A mix of secular earnings drivers and attractive P/E multiples have brought the Communication Services, Energy, Financials, and Industrials sectors of the S&P 500 Index to the top of our sector ranking. As markets evolve through the year, we expect opportunities to upgrade these and other sectors whose business models perform best under long-term growth and the improving economic cycle. By contrast, we rate the defensive Consumer Staples and Utilities sectors as unfavorable, and these ratings are more likely to toggle between unfavorable and neutral through the year.

Historically, this dichotomy between growth/cyclicals versus defensives has worked well when economic growth accelerates and during Fed-easing cycles without an ensuing recession as the chart on the previous page indicates. For example, 12 months after the 1995 Fed interest-rate cut, the more cyclical Energy, Financials, and Industrials sectors of the S&P 500 Index outperformed the more defensive Utilities and Real Estate sectors by 11% on average.

After the Fed's 1998 interest-rate cut, the Consumer Discretionary, Industrials, and Information Technology sectors outperformed the more defensive Utilities, Real Estate, Consumer Staples, and Health Care sectors by 40% on average. Each Fed easing cycle is different, but we believe they rhyme, where a mix of cyclical and growth sectors tend to outperform select defensives.

Sector positioning for an economic recovery, long-term interest rates that remain elevated, a resilient consumer, improving sentiment, and long-term secular growth themes can be summed up and oversimplified with the theme "anything but defensives." In other words, we generally prefer more cyclical and growth-oriented sectors over the typically defensive ones.

Our conviction is in cyclical sectors

Within the S&P 500 Index sectors, our highest conviction guidance into 2025 is to focus on quality cyclicals. Our notion of quality is more about consistent strength of business model, profitability and returns metrics, low debt and debt service, earnings stability, and organic growth potential.[7] We believe these characteristics give a company some ability to resist the ups and downs of the economic cycle. We stress the classification of quality cyclicals because our overall economic outlook calls for lower short-term interest rates alongside modestly improving growth conditions. This kind of recovery is unlikely to be the more classical "early cycle" spending rebound that occurs once households and businesses exit a recession with pent-up demand. We believe a wide range of areas within the S&P 500 fits this bill and highlight a few areas.

Within Financials we point to Diversified Banks, Capital Markets, and Transaction & Payment Processing Services. These industries are typically highly consolidated, and pricing power is typically strong. Each also offers its niches for organic growth opportunities. Importantly, each also offers a tether to a brighter economic backdrop in the form of higher demand for credit, increased transaction activity, rising asset prices, and higher volumes of consumer spending.

7. By profitability and return metrics, we refer to some combination of earnings margins before interest, taxes, depreciation, and amortization (EBITDA), free cash flow margin, return on equity, and return on invested capital.

On the Energy front, Integrated Oil & Gas companies historically have benefited from high economies of scale and robust balance sheets while Midstream Energy companies have typically showcased strong earnings stability and reasonably consistent growth. We expect these groups to benefit from higher demand from hydrocarbons due to both a modest turn upward in the cycle as well as underappreciated secular demand drivers for energy consumption, including liquefied natural gas (LNG) and data centers.

We believe the best approach for investors within the Communication Services sector is to consistently allocate to the industry leaders in search, social media, streaming media, and wireless. These companies typically boast superior balance-sheet and cash-flow characteristics compared with other players in the sector. In addition, the various categories within the sector may benefit from stronger advertising spending and consumers' improved ability and willingness to pay for higher volumes of content.

Turning to Industrials, we continue to see Multi-Industrials[8] as best positioned for the evolving environment as these companies may offer strong margin profiles and high-quality asset portfolios. They also stand to benefit from potential rebounds in consumer spending on durable goods and broader investment trends. Meanwhile, several companies in this area have meaningful exposure to secular growth areas such as data-center capital spending and aerospace and defense production.

For complete details on our preferences across all 11 S&P 500 Index sectors, please see the table on the following page.

8. Multi-Industrials includes the Industrial Conglomerates, Electrical Components & Equipment, Industrial Machinery & Supplies & Components, and Trading Companies & Distributors sub-industries.

Please see pages 33-35 for important definitions and risk considerations

Equity sector and sub-sector preferences

SECTOR GUIDANCE	SECTOR	SUB-SECTOR GUIDANCE: FAVORABLE	SUB-SECTOR GUIDANCE: UNFAVORABLE
FAVORABLE	Energy	Integrated Oil; Midstream Energy	Refining
	Communication Services	Interactive Home Entertainment; Interactive Media & Services	Alternative Carriers; Publishing
	Financials	Capital Markets; Diversified Banks; Insurance Brokers; Multi-Sector Holdings; Property & Casualty Insurance; Transaction & Payment Processing Services	Business Development Companies; Life & Health Insurance; Mortgage Real Estate Investment Trusts (REITs); Regional Banks
	Industrials	Aerospace & Defense; Commercial & Professional Services; Multi-Industrials[1]	Cargo Ground Transportation; Passenger Airlines
NEUTRAL	Consumer Discretionary	Broadline Retail; Hotels, Restaurants & Leisure; Specialty Retail	Leisure Products
	Health Care	Life Sciences Tools & Services; Managed Health Care; Health Care Equipment & Supplies	Health Care Services
	Information Technology	Semiconductors; Semiconductor Materials & Equipment; Software	Communications Equipment
	Materials	Construction Materials; Industrial Gases; Specialty Chemicals	Containers & Packaging
	Real Estate	Data Center REITs; Industrial REITs; Self-Storage REITs; Telecommunications REITs	Diversified REITs; Lodging/Resort REITs; Office REITs; Specialty REITs; Timberland REITs
UNFAVORABLE	Consumer Staples	Beverages; Consumable Staples Merchandise Retail; Household Products	Tobacco
	Utilities	Electric Utilities; Independent Power & Renewable Electricity Producers; Multi-Utilities	Water Utilities

Sources: Wells Fargo Investment Institute Global Investment Strategy and Global Securities Research as of December 10, 2024. 1. Multi-Industrials includes the Industrial Conglomerates, Electrical Components & Equipment, Industrial Machinery & Supplies & Components, and Trading Companies & Distributors sub-industries.

Long-term yields to rise

KEY TAKEAWAYS

- We believe the Fed has flexibility to cut interest rates further, but we think policymakers will proceed cautiously based on how quickly the economy and inflation rebound.
- Investment-grade corporate issuers enter 2025 with strong credit metrics and largely supportive outlooks from the major rating agencies. A resilient economy should continue to support credit-oriented asset classes and sectors.

WHAT IT MAY MEAN FOR INVESTORS

- Ultimately, we see an opportunity for fixed-income investors to remain active and implement defensive and growth-oriented strategies concurrently. We believe that maintaining overweight exposure in U.S. Intermediate Term Taxable Fixed Income will provide investors with the best relative yield while considering potential interest-rate risk.

FAVORED ASSET CLASS

- U.S. Intermediate Term Taxable Fixed Income

In our view, the Fed has leeway to cut interest rates further in the early months of 2025 while inflation permits. However, we look for the Fed to proceed cautiously through the remainder of the year, calibrating as needed but with a bias to keep the policy rate on hold after delivering additional cuts between now and the end of 2025. Also, we believe the Fed most likely will halt its balance-sheet reduction program, known as quantitative tightening, in the first half of the year as appropriate levels of reserves likely are reached.[9]

We expect the bond market to remain sensitive to policy announcements and economic developments, especially around the trajectory of inflation and how the Fed adjusts policy. 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 yield, as shown in the chart on the following page. Hence our belief that investors need to remain agile: If yields move above our stated year-end 2025 targets, we prefer to extend maturities to lock in attractive yields; if yields decline below our targets, we favor shortening the duration profile of a portfolio.

9. The end of the quantitative tightening program is important because it leaves cash reserves in the banking system (see the chart on page 4) at a level that allows banks to offer loans at terms that are more favorable for borrowers than might be the case, were the program to continue to drain reserves. Put simply, we view the end of quantitative tightening as a positive for economic growth.

We favor extending maturities by reallocating capital away from ultra-short money market funds and U.S. Treasury bills into longer maturities. We believe this shift will improve the expected yield. Also, we favor exposure to investment-grade credit risk, particularly in high-quality investment-grade corporate bonds and mortgage-backed and asset-backed securities, which we expect will provide attractive yields, especially while the Fed cuts rates, economic growth improves, and inflation remains subdued.

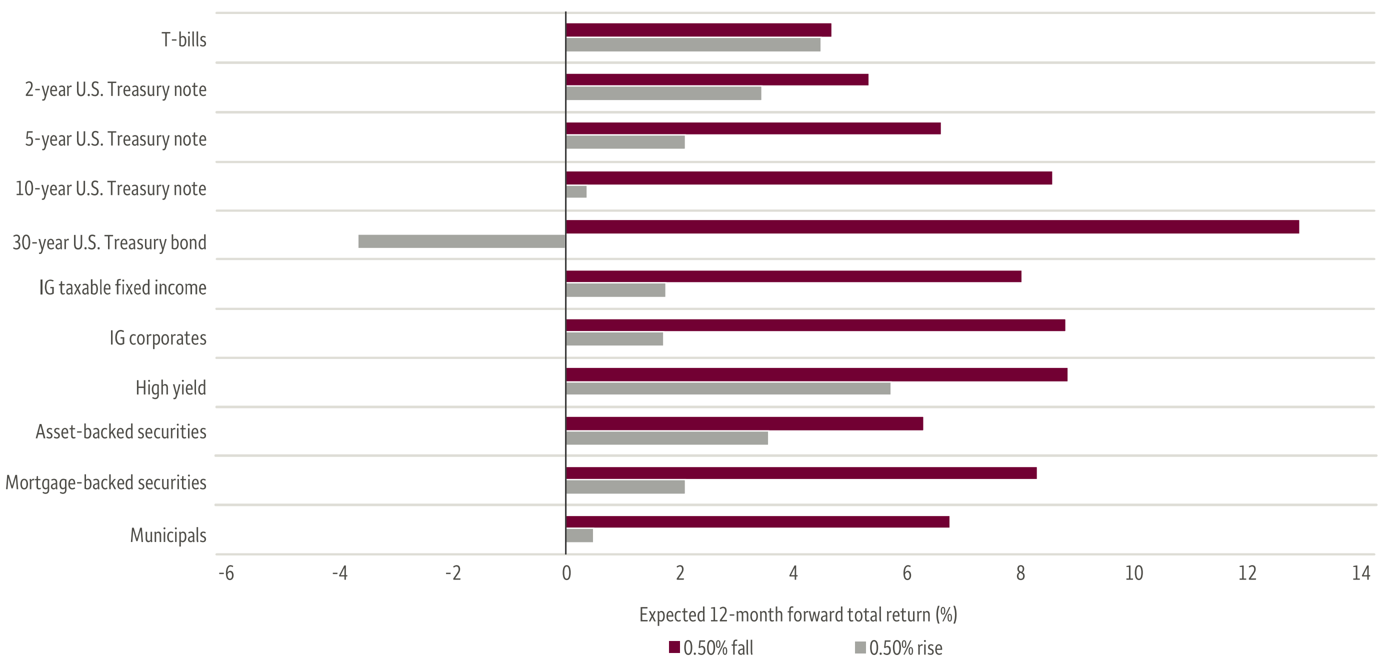
Mixed crosscurrents for global bonds

We expect European fixed-income yields to decline gradually, mostly from further European Central Bank (ECB) policy interest rate cuts that are more aggressive than those we expect from the Fed and other major central banks. Japanese yields will also likely remain near current low levels as not much intervention is expected from the Bank of Japan. Declining yields are positive for returns.

However, as discussed earlier, we expect a strong U.S. dollar, which would then undermine expected currency returns on international developed-market ex-U.S. fixed income. Taking the balance of these two factors together, we retain our neutral rating on Developed Market Ex-U.S. Fixed Income.

The global environment also remains mixed for emerging-market debt with headwinds including slow Chinese growth and a stronger U.S. dollar relative to emerging-market currencies. Higher U.S. yields for most of 2025 could also dent performance. However, stronger economic activity coupled with declining inflation in emerging-market countries and a better outlook for commodities diminish credit risk potential in our view. These crosscurrents leave our outlook neutral on Emerging Market Fixed Income denominated in dollars.

Long-maturity bonds are most sensitive to a half-point move in interest rates



Sources: Wells Fargo Investment Institute and Bloomberg, as of November 12, 2024. 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. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.** See index definitions on back of the report.

Opportunities in corporate bonds

While credit metrics have fallen from all-time highs in some cyclical sectors like Energy and Industrials, broad measures remain in line with long-term averages. We suspect most risk in 2025 will come from management decisions to pursue debt-funded mergers and acquisitions, capital spending, and generous shareholder return programs rather than underlying business fundamentals. Despite a few high-profile exceptions, strong fundamentals among triple-B's may continue to drive convergence in credit quality with single-A's, which justifies the narrowing spread valuations between the two rating tiers.[10]

Also, we expect corporate high-yield credit quality to hold up well despite the volatility in interest rates and slightly lower interest-coverage ratios. Credit strength can be seen in declining debt leverage, and recent Moody's data indicating the number of issuers with potential to be upgraded to investment grade (rising stars) is the highest in over a decade. We see the growing demand for private credit benefiting lower-rated issuers (single-B and below) as they seek to refinance debt; however, this could also lead to reduced recoveries for bondholders if refinancing occurs through a distressed exchange.

10. 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".

Please see pages 33-35 for important definitions and risk considerations

Consider municipal bonds

Overall municipal-credit fundamentals remain favorable; however, credit pressure may emerge among lower-quality credits in certain sectors following the drawdown of stimulus funds. We expect overall municipal supply to continue to trend above the annual 10-year average of $390 billion. In early 2025, downward pressure on interest rates could bring more issuance, which could serve as a headwind to municipal performance, especially if relative-value metrics remain below historical averages. On the other hand, we expect demand to keep up with supply because of the tax advantages and superior credit quality that municipal bonds offer, making the municipal market more balanced, in our view.

Fixed income | Sector and sub-sector preferences

	SUB-SECTORS	
SECTORS	**FAVORABLE**	**UNFAVORABLE**
Investment-Grade (IG) Credit (favorable)	IG corporate bonds in Energy, Financials, Utilities	IG corporate bonds in Industrials and Information Technology
Securitized (favorable)	Residential Mortgage-Backed Securities, Asset-Backed Securities	
U.S. Municipal Bonds (neutral)	State and Local General Obligation, Essential Service Revenue	Niche private higher-education institutions, smaller health-care providers

Sources: Wells Fargo Investment Institute Global Investment Strategy and Global Securities Research as of December 10, 2024.

Bull super-cycle to resume

KEY TAKEAWAYS

- In our view, the commodity bull super-cycle remains intact as global demand seems set to recover and tight supply conditions across many key commodities persist.
- We remain neutral on the S&P 500 Index Real Estate sector but see opportunities in certain Real Estate Investment Trust (REIT) sub-sectors.

WHAT IT MAY MEAN FOR INVESTORS

- We favor holding a basket of commodities to gain exposure to the re-acceleration of the commodity bull super-cycle but prefer to await clarity around the economic turning point before increasing allocations to REITs.

FAVORED ASSET CLASS:

- Commodities

Throughout history, commodity prices have moved together through long-term bull and bear cycles known as super-cycles. We believe commodities have been in a bull super-cycle since March 2020. Historically, bull super-cycles have been driven by a lack of supply growth, which pushes most commodity prices significantly higher for periods that typically last 10 to 15 years. Prices during bulls are not a straight shot higher, however. They are prone to short-term corrections brought about by economic weakness. We believe such a correction began in July 2022 amid lingering concerns of a global economic slowdown.

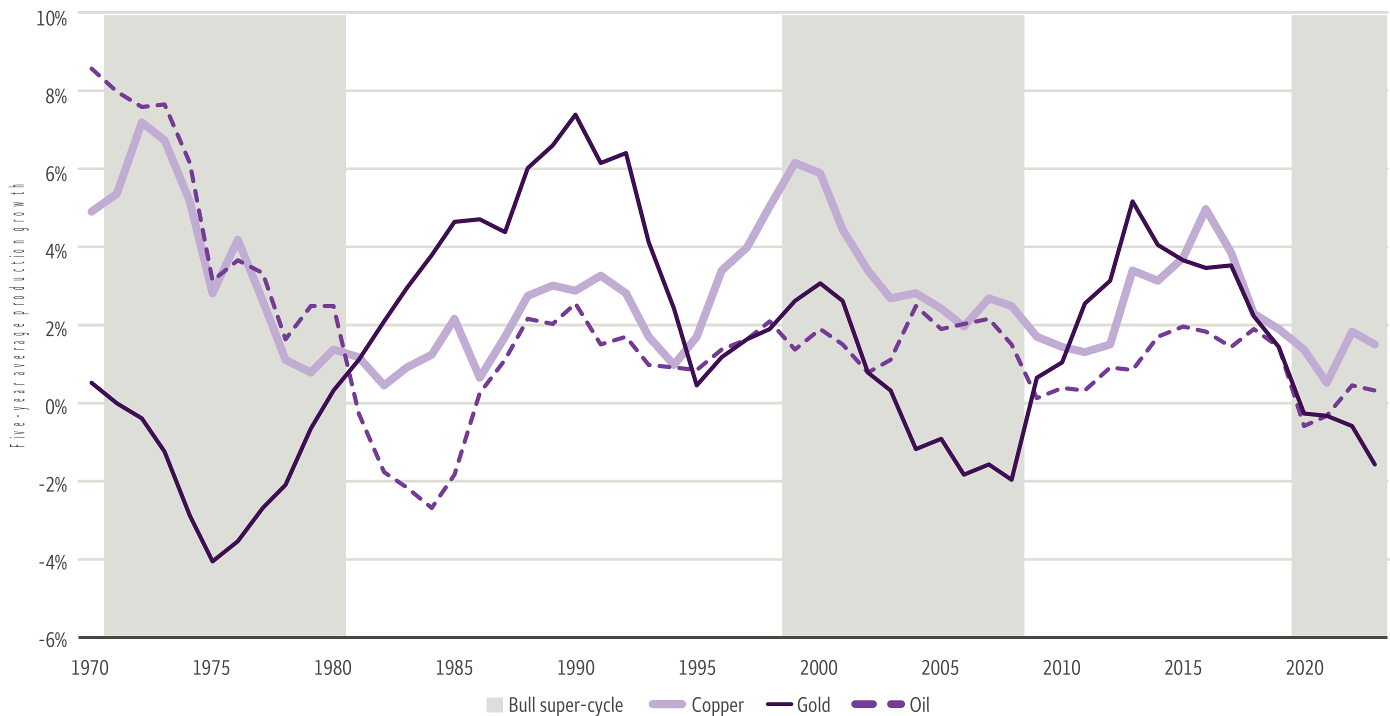
What has been missing since July 2022 is global commodity demand, particularly from China, but we believe that story is about to turn more constructive for commodity prices. The modest international economic recovery we anticipate should provide some spending support for businesses and households overseas. Chinese government spending to invigorate that economy should help considerably to improve commodity demand. Even outside China, commodity demand in emerging markets continues to show structural growth in areas such as energy as their populations and economies expand. Lower global interest rates in many of these countries should reinforce the near-term demand pickup and the long-term demand trends.

Please see pages 33-35 for important definitions and risk considerations

Weak global commodity supply growth

Equally important, bull super-cycles are driven largely by a lack of commodity supply growth. As seen in the chart below, global supply growth rates often decline during bull super-cycles, and we are seeing the same dynamic again during our current cycle. As of year-end 2023, the five-year growth rates for gold, crude oil, and copper were -1.6%, 0.4%, and 1.5%, respectively. We suspect that supply growth rates will remain under pressure. The past two years of weak pricing have done little to entice producers to produce more. It should also be noted that supply growth cannot be "turned on" overnight. A prime example of this would be a new copper mine, which takes roughly 18 years to become operational.[11] From the perspective of supply and demand, we view current commodity prices as an attractive entry point for investment portfolios looking to gain commodity exposure.

Low supply growth of copper, oil, and gold should help support prices



Sources: Wells Fargo Investment Institute, Bloomberg, USGS, and Energy Institute. Annual data is from 1970 – 2023. Bull super-cycles are represented the grey shaded areas spanned from 1971–1980, 1999–2008, and 2020–current.

11. S&P Global "Average lead time almost 18 years for mines started in 2020 – 2023", as of April 10, 2024.

Fed may help some real-estate sub-sectors

Although we remain neutral on REITs as an equity sector, some components of the broader REIT sector continue to improve following the Fed's pivot to interest-rate cuts in late 2024. The Fed could be a friend to Real Estate with further rate cuts in 2025. Company press releases and Securities and Exchange Commission filings show that several equity REITs have taken advantage of an improved cost of equity capital to issue new common shares to fund acquisitions and development activities. On this basis, we expect most REIT sub-sectors will see moderate rental demand beginning in 2025. That said, it may take some time for equity REITs to benefit from a turning economy as real estate does not typically turn on a dime.

We remain neutral on the sector but see value in certain sub-sectors. The bottom line is that equity REITs within the subset of our favorably rated REIT sub-sectors are well-positioned to capitalize on several long-term trends; these trends include increased demand for data-center usage driven by AI, the continued rollout of fifth-generation (5G) wireless network technology, and continued growth in e-commerce sales volume. Additionally, we believe self-storage REITs are positioned to benefit from possible increases in home-sale and home-improvement activity.

Public Real Estate sub-sectors

	SUB-SECTORS	
SECTORS	**FAVORABLE**	**UNFAVORABLE**
Public Real Estate (neutral)	Data Centers, Industrials, Self-Storage, Telecommunications	Diversified, Lodging/Resort, Office, Specialty, Timberland

Sources: Wells Fargo Investment Institute Global Investment Strategy and Global Securities Research as of December 10, 2024.

Please see pages 33-35 for important definitions and risk considerations

Alts to shift gears

KEY TAKEAWAYS

- In alternative investments, we favor transitioning to strategies poised to potentially benefit from accelerating economic growth.
- In Private Capital, we maintain our favorable guidance on Growth Equity and Small-Mid Buyout strategies as deal activity continues to highlight preferences for quality growth and less debt.

WHAT IT MAY MEAN FOR INVESTORS

- If economic growth accelerates in 2025 as we expect, we favor allocating to strategies with the flexibility to adjust to changing market conditions, such as Equity Hedge – Directional, Relative Value – Long/Short Credit, and Macro – Discretionary.

FAVORED HEDGE FUND STRATEGIES AND SUB-STRATEGIES

- Event Driven: Distressed Credit
- Relative Value: Long/Short Credit
- Equity Hedge: Directional
- 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

The start of a transition

Our alternative investment guidance is making a multistep shift toward exposure to strategies that might benefit from our expectations for lower short-term interest rates, a rise in equity prices, and a gradual recovery in the economy. However, as we begin this transition, we maintain our favorable guidance on select counter-cyclical opportunities as well. Inflation and high interest rates since 2022 have created a divergence for companies. As the fittest survive and potentially thrive, the lowest-quality segment burdened with too much debt may continue to look to restructure or reduce their debt loads with the hope of re-emerging in better financial health.

To achieve those goals, we favor increasing exposure to Equity Hedge – Directional (favorable) and Event Driven – Activist (neutral) strategies as these equity-oriented strategies should benefit from a broadening of the large-cap equity rally. As shown in the chart on the following page, during historical periods characterized by gradual economic growth (U.S. GDP growth between 1.8% and 2.8%) and S&P 500 Index price returns in line with average levels (7% to 15%), those economically sensitive, or cyclical, strategies recorded above-average returns relative to the broad hedge-fund universe. Of course, past performance is not a guarantee of results. The returns shown in the chart are only averages across multiple historical periods.

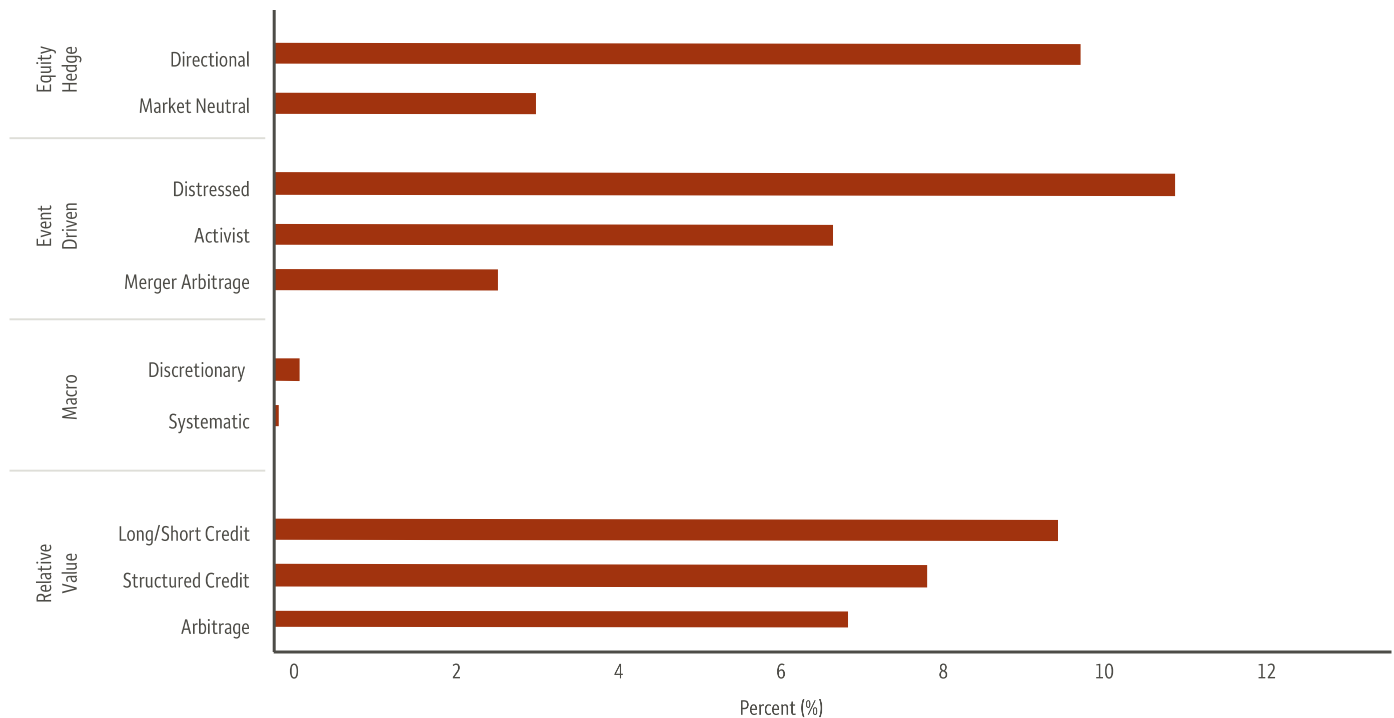
Our takeaway from the chart is mainly that cyclical strategies could outperform under the economic and S&P 500 Index outlook that we describe in the preceding pages.

We also recently upgraded Event Driven – Merger Arbitrage to neutral. The strategy should benefit as lower interest rates may drive greater levels of merger and acquisition activity. During the Fed's previous rate-cutting cycle that began in July 2019, deal volumes increased approximately 32% from July 2019 to December 2021.[12] In addition, an improving regulatory environment and less economic uncertainty should help ensure deals are completed without major roadblocks.

We remain favorable on Relative Value – Long/Short Credit strategies that should offer the ability to participate in up markets while providing the potential for risk protection during market pullbacks. The flexible strategy has historically offered diversification benefits when combined with equity and fixed-income markets and performed well during recoveries. Additionally, we continue to favor Macro – Discretionary strategies that should be well-suited to navigate the challenging geopolitical risks and markets driven by central-bank interactions.

Lastly, despite our improving outlook, we maintain our favorable guidance on Event Driven – Distressed Credit while overleveraged companies look for ways to reduce their debt-service costs and position themselves for growth.[13]

Historical performance of hedge fund strategies during periods of gradual growth and average equity returns



Sources: Wells Fargo Investment Institute and Hedge Fund Research. Quarterly data, March 2008 – October 2024. The chart shows average annualized return of HFRI indexes (see definitions at the end of this report) during historical periods when the the S&P 500 Index generated 7% to 15% annualized returns and real GDP growth was between 1.8% and 2.8%. Those periods are January 2013 – March 2013, January 2016 – September 2016, January 2017 – March 2017, and January 2018 – March 2018. **Past performance is no guarantee of future results.** An index is unmanaged and not available for direct investment. See index definitions at the end of this report.

12. Bloomberg, as of October 23, 2024.
13. For more detail, see "Institute Alert: Revising Guidance to Lengthen Fixed-Income Maturities," Wells Fargo Investment Institute, October 21, 2024.

Private Capital playbook

We remain neutral on the broad categories of Private Equity, Private Debt, and Private Real Estate. In looking at the sub-categories under each, however, we maintain our favorable guidance on Growth Equity strategies. We prefer higher-quality opportunities with proven business models that have generated significant revenue and earnings. Growth Equity deal volumes in U.S. dollars were strong in 2024, accounting for nearly 23% of all U.S. Private Equity transactions, and we expect this category to maintain (and possibly increase) its share in 2025 because Private Equity firms are opting for more established firms that are growing rapidly and are less reliant on debt financing.[14] Our neutral stance on Venture Capital reflects the wait for improving fundamentals in the exit environment. Buyers have been cautious as prices remain modestly expensive relative to historical standards.[15]

In Buyouts, we continue to favor Small-Mid Buyout over Large Buyout (neutral) strategies. Greater clarity on the extent of interest-rate cuts and their effect on activity over the next few quarters may lead to an improved outlook in this category.

In Private Debt, we continue to believe the opportunity set for Distressed Credit/Special Situations strategies will remain robust into the early stages of the expected recovery in late 2025. While our expectations for lower rates may ease the burden for many firms, we expect that rates may not fall fast enough for those unable to pay their current debt service costs.

We see positive trends developing in Private Real Estate, but they are still nascent so we are maintaining our neutral rating. Among the emerging positive signs, we see:

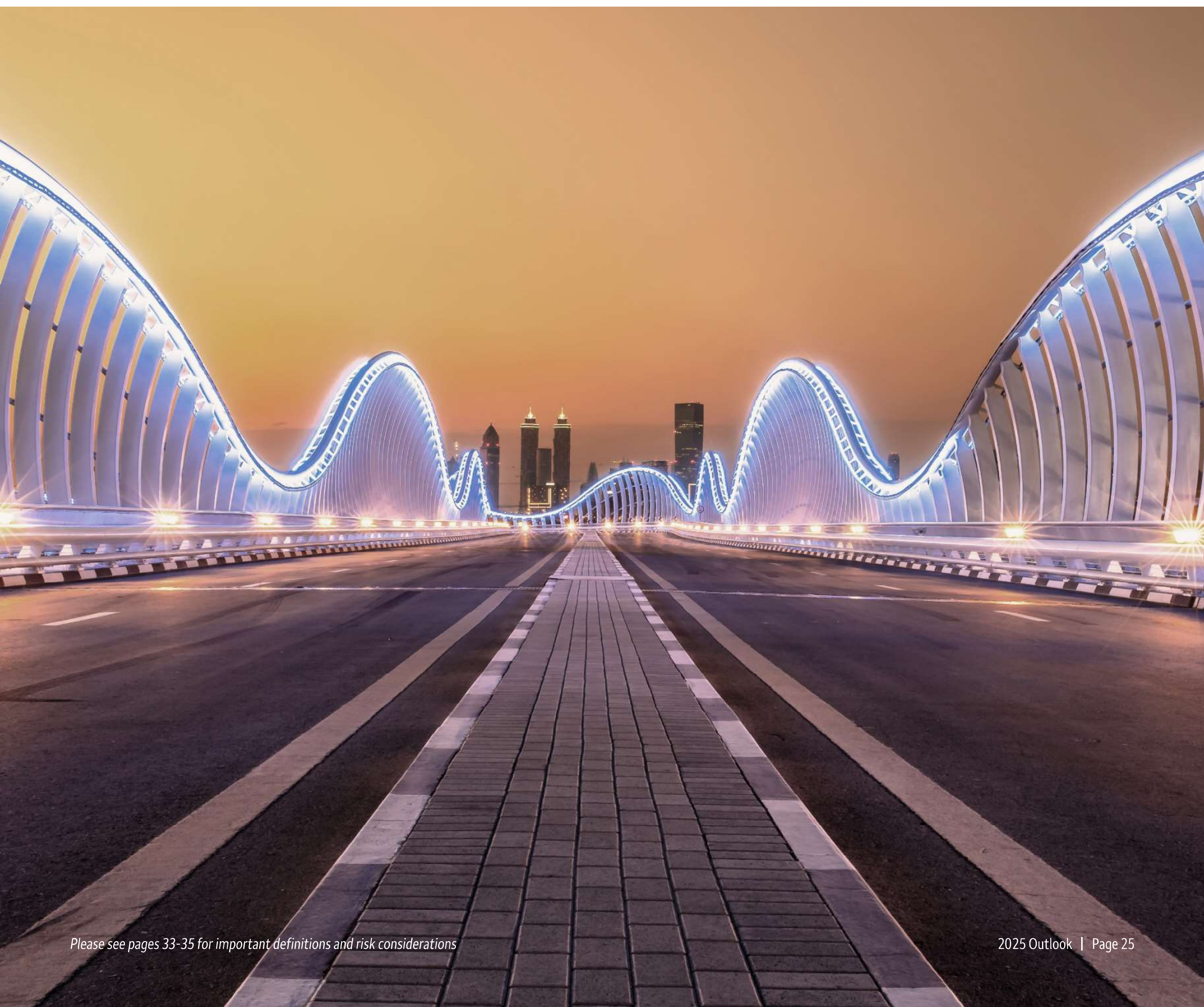
- Easing bank lending standards
- Falling short-term interest rates
- Improving operating incomes
- Favorable tailwinds in select sectors, including Industrial and Data Centers

As witnessed following the Great Financial Crisis in 2008, the easing of bank lending standards coincided with a significant move higher in real estate values. More recently, the net share of banks tightening standards on real estate loans decreased by 20% to 30% as of September 2024, down from approximately 60% to 70% a year earlier.[16] In addition to easing lending standards, lower short-term interest rates may act as a catalyst to spur a broad economic recovery during the second half of 2025, which should contribute to greater demand for real estate in general. Yet, employment-market weakness and/or stickier-than-expected inflation remain as significant risks.

14. “The Q3 2024 Quantitative Perspectives: US Market Insights,” PitchBook, as of October 23, 2024.
15. Ibid
16. Federal Reserve, Senior Loan Officer Survey, as of September 30, 2024

Looking beyond 2025 ...

Generative AI and industrial power are two opportunities investors may want to consider for the long term.



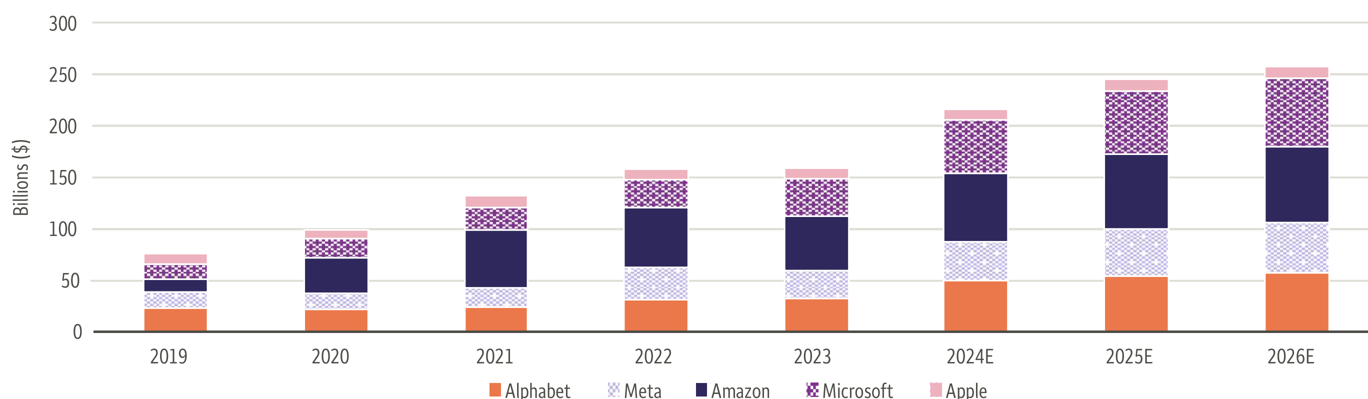
Please see pages 33-35 for important definitions and risk considerations

… for potentially transformative technologies

We acknowledge that the technology mega-caps (we would apply this term to any stocks with a market capitalization over $1 trillion) typically have strong market positioning, above-average margins, robust balance sheets, and above-average medium-term earnings growth prospects (this last part as measured by FactSet consensus estimates). We believe the market has rewarded these characteristics in recent years for two reasons. First, uncertainty about the economy's near-term trajectory has encouraged investment in longer-term themes. Second, we believe that these companies have the data, financial resources, and networks to gain an early advantage in the pursuit of gains from generative AI (gen AI).

However, the scale of capital-spending plans in pursuit of gen AI has created two corollaries in our view. First, high levels of upfront investment have begun to erode the extent to which these companies' fundamental underpinnings are superior to that of the market in the short term (see chart below). Second, material outlays on data centers, network infrastructure, the grid, and power generation are also becoming increasingly relevant potential earnings growth opportunities for a wider array of companies. As such, we anticipate increased investor scrutiny and potential divergence among the mega-cap technology stocks in 2025. For these reasons we expect investors to focus increasing amounts of attention on a wider group of AI beneficiaries.

AI-related capital expenditures by mega-cap companies have grown rapidly in recent years



Sources: Wells Fargo Investment Institute and cited company earnings reports for 2019 – 2023. FactSet for 2024 – 2026 estimates. Chart includes companies with market capitalizations over $1 trillion and capital expenditure in excess of $4 billion whose primary business is technology related. Data as of October 14, 2024.

We currently view the Communication Services, Industrials, and Energy sectors as providing some of the most interesting investment opportunities related to this theme. Specific sub-sectors that provide the building blocks for potential spending include Electrical Equipment and Industrial Machinery (Industrials) and Midstream Energy (Energy). Meanwhile, in Communication Services, we believe heavy levels of investment have given way to improved operating efficiency as well as the potential for revenue generation within the Interactive Media & Services sub-sector.

We believe the near and medium term will remain focused on the brick-and-mortar phase, in which we are somewhat reminded today of the initial stages of the shale boom in North America that gathered particular intensity in the early 2010s. The rapid scale-up of the infrastructure required to support materially higher levels of hydrocarbon production, transportation, and storage was a significant call on the country's industrial capacity. What we would call outdoor factories were stood up quickly, driving significant construction spending and the corresponding need for mobile and stationary equipment — think cement and aggregates, excavators, severe-service electrical equipment, off-grid power generation, and large-scale natural-gas generators. If this all sounds familiar with stories you may be reading surrounding this current wave of investment, that's because it should.

There are important differences today. The first would be that electrical and HVAC equipment do have a higher level of importance in data centers than they do in the oil fields or traditional industrial facilities. The second would be that data centers are likely to have decades-long lives and operate with a much higher level of power-generation demand. In turn, we view this as likely to drive higher levels of investment in all levels of the power market. Given our expectations for the scale of demand and rapid development of the market, we believe this should be a benefit to those companies that provide equipment for fossil-fuel power generation and renewables.

As the infrastructure grows to support gen AI, we believe incremental opportunities will present themselves in the application layer. We are currently most constructive on those that have shown tangible proof of business-model improvement due to investments in gen AI, which we believe includes Communication Services as noted above.

Venture capital AI investment boom

Looking beyond this area, we would note that both corporate investors and venture capital are playing an important role in funding the development of the next generation of AI technology. According to Pitchbook, the growth in AI dealmaking and fundraising has outstripped many other venture-capital areas in recent years, and the continued financial support for leading start-ups across code development, hardware, and downstream applications has kept driving valuations higher.[17] As technology has become an increasingly important driver to economic growth, we believe the secular trend in venture-capital AI investments will continue in coming years.

At the macroeconomic level, a recent McKinsey & Company study estimated that gen AI could add 0.1% to 0.6% to the global economy's average annual productivity growth between now and 2040, depending on the speed with which the technology is absorbed and workers' time savings are realized.[18] Increases of that magnitude in the U.S. would imply a material lift to U.S. labor productivity growth, which is measured and reported each quarter by the U.S. Department of Labor. By this measure, productivity growth fell to 1.5% in the decade ended September 2024, from its 2.8% average over the decade ended December 2007, just before the global financial crisis. This in turn could provide opportunities across a wider range of sectors and asset classes over time.

Material outlays on data centers, network infrastructure, the grid, and power generation are also becoming increasingly relevant earnings growth opportunities for a wider array of companies.

We believe the Communication Services, Industrials, and Energy equity sectors provide some of the most interesting investment opportunities related to the AI-investment theme.

17. "AI eats up 41% of US VC deal value, with help from Big Tech bucks," PitchBook, August 13, 2024.
18. "The economic potential of generative AI: The next productivity frontier," McKinsey & Company, June 14, 2023.

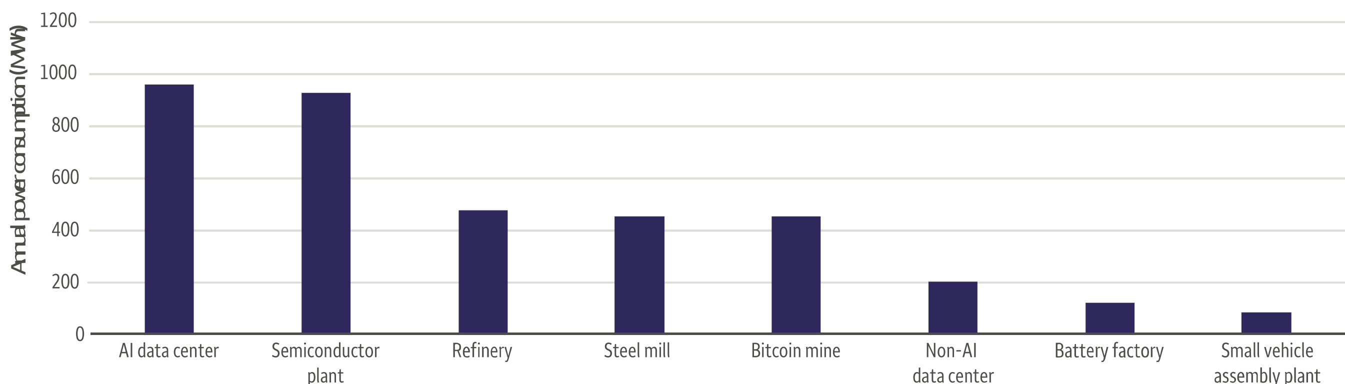
… for the industrial power renaissance

We see longer-term tailwinds for infrastructure investing as the world looks to modernize its infrastructure to meet the needs of tomorrow. Whether it is investment to meet the staggering growth in data consumption (not just for AI but also additional workloads in areas such as cybersecurity and crypto mining), the shift away from traditional fossil fuels, or the acceleration toward e-commerce, these and other long-term trends require a tremendous amount of investment in upgrading infrastructure.

Case in point, after a decade-plus of little-to-no growth, Wells Fargo Securities expects power demand to step up to 2.6% between 2024 and 2030.[19] This step-function increase in demand is driven by multiple factors, some of which — electric-vehicle penetration, reshoring of manufacturing and supply chains, broad electrification of the economy, and increasing defense spending — have been percolating for multiple years. The largest driver, gen AI data-center construction, has entered the scene more recently and generated heightened investor interest in this topic.

Why has data-center demand proven to be the tipping point? First, today's data centers require a very large amount of power. In fact, the data center with the highest current nameplate facility in the U.S. is quite possibly the largest single facility power consumer in the country (see chart below). Data centers have been around for a while now, so what's changing here? Most importantly, the server-rack power density required to train a gen-AI-based large language model can require up to five to seven times more power than server racks used for traditional information technology workloads in a data center. Not only is the overall power consumption high, it is worth noting that data centers typically have a relatively consistent demand pattern and are highly price inelastic. In other words, most of these facilities operate on a near continuous basis due to both issues that can arise from interrupted service (for example, internet outages) and the business need for high levels of asset utilization on what is increasingly expensive equipment.

AI data centers require large amounts of continuous power



Sources: Wells Fargo Investment Institute, individual company reports, Energy Star, and Assembly Magazine. Data as of October 14, 2024.

19. Wells Fargo Securities, "AI Power Surge: Generation Outlook 2050; Demand Strikes Back!" May 30, 2024.

The other facilities listed in the chart either operate on a noncontinuous production cadence in which power consumption is ratable during working hours or are much more sensitive to price signals on energy costs. Electric Power Research Institute current projections estimate that by 2030, data centers broadly will account for up to 9% of total U.S. electricity consumption, up from about 4% today.[20] To meet this increase in demand for generation, we foresee an all-of-the-above approach by utilities with renewable power continuing to grow rapidly, additional natural gas-fired facilities coming online, and nuclear largely holding share while coal-fired generation continues to shrink, albeit at a slower pace. Deployment of energy storage (batteries) is also expected to continue.

Global energy demand rising

In addition to rising domestic demand for power generation in the U.S., global demand for energy also continues to rise. In fact, we view the growth in U.S. liquefied natural gas (LNG) exports as the most pertinent near-term driver of natural-gas demand growth based on the amount of export capacity currently under construction. According to the Energy Information Administration (EIA), domestic LNG export capacity is currently 13.8 billion cubic feet per day (bcf/d) with an additional 10.8 bcf/d currently under construction through 2027, an increase of 78%, plus another 18.3 bcf/d of potential projects beyond 2027 that have received regulatory approvals but have not been sanctioned yet. The EIA notes that natural-gas demand increased 43% between 2012 and 2022 with LNG exports accounting for approximately 46% of the demand growth during this period and the balance being attributed to coal-to-gas switching.

Wells Fargo Securities believes that the combination of factors outlined above will result in natural-gas demand growing at a 2.9% compound annual growth rate through 2030 and will likely continue growing beyond then. The U.S. has an ample supply of natural gas to meet this growing demand as the world's largest producer of natural gas (accounting for over 25% of global production) with approximately 80 years of recoverable reserves at current production levels, and this acceleration of demand growth represents a significant structural shift for the domestic natural-gas industry landscape.

Connecting the dots

On this theme, we would reiterate that this favors our current asset-class stances — namely, U.S. over international and large-cap equities within that. We see specific investment opportunities in the Energy and Industrials sectors. It also reinforces our favorable stance on Commodities more generally and favorable view on Energy more specifically.

In addition to equities and real assets, we would also highlight alternative investments as an area likely to provide opportunities here. In our view, one of the key reasons is that even as the demand for investment in these secular themes has risen, government debt levels have continued to rise through the years, and it will be a challenge for the public sector to fund the growing demand completely. The Global Infrastructure Outlook, a G20 initiative, estimates that gap to be $15 trillion short of the $94 trillion in global infrastructure investment needed by 2040. This has created an opportunity for Private Capital to step in and fill the gap.

As a result, infrastructure fundraising has continued to stay strong in recent years, reflecting growing interest from long-term investors.[21] Several global private asset managers also stated their optimism around the future of infrastructure through acquiring specialized infrastructure fund companies. We expect the rise of infrastructure investing to continue, owing to growing needs as well as support from recent legislation.

Current projections estimate that by 2030, data centers are broadly expected to account for up to 9% of total U.S. electricity consumption, up from about 4% today.[22]

Our preference for U.S. Large Cap Equities lends itself to the industrial power renaissance theme. We see specific investment opportunities in the Energy and Industrials sectors while this theme also reinforces our favorable view of Commodities.

20. Electric Power Research Institute (EPRI), "EPRI Study: Data Centers Could Consume up to 9% of U.S. Electricity Generation by 2030," May 29, 2024.
21. Jacob Robbins, "AI eats up 41% of US VC deal value, with help from Big Tech bucks," PitchBook, August 13, 2024.
22. EPRI, "EPRI Study: Data Centers Could Consume up to 9% of U.S. Electricity Generation by 2030," May 29, 2024.

2025 targets

GLOBAL ECONOMY	LATEST	2025 TARGETS
U.S. GDP growth	2.9% (Q3)	2.5%
U.S. inflation[1]	2.6% (Oct.)	3.3% (Dec.)
U.S. unemployment rate[2]	4.1% (Oct.)	4.8% (Dec.)
Global GDP growth[3]	3.4% (Q3)	2.6%
Global inflation[3]	5.9% (Q3)	3.3%
Developed-market GDP growth[4]	1.7% (Q3)	1.7%
Developed-market inflation[4]	4.1% (Q3)	2.4%
Eurozone GDP growth	0.6% (Q3)	1.1%
Eurozone inflation[1]	2.3% (Nov.)	2.0% (Dec.)
Emerging-market GDP growth	4.7% (Q3)	3.3%
Emerging-market inflation	7.2% (Q3)	3.8%

Sources: Wells Fargo Investment Institute and Bloomberg. All latest numbers from Bloomberg as of November 29, 2024. Targets for 2025 are based on forecasts by Wells Fargo Investment Institute as of December 10, 2024, and provide a forecast direction over a tactical horizon through 2025. **Average percent change from the same period a year ago, unless otherwise noted.** GDP = gross domestic product. CPI = Consumer Price Index. Q1 = first quarter, Q2 = second quarter, Q3 = third quarter, Q4 = fourth quarter.
1. December-to-December change. 2. Three-month average as of the date indicated, percent of labor force. 3. Weighted average of developed country and emerging-market forecasts. 4. Weighted average of U.S. and other developed-country forecasts. **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.**

GLOBAL EQUITIES	LATEST	YEAR-END 2025 TARGETS
S&P 500 Index	6,032	6,500 – 6,700
S&P 500 EPS	$243	$275
Russell Midcap Index	3,807	4,100 – 4,300
Russell Midcap EPS	$170	$195
Russell 2000 Index	2,435	2,700 – 2,900
Russell 2000 EPS	$54	$80
MSCI EAFE Index	2,316	2,400 – 2,600
MSCI EAFE EPS	$156	$170
MSCI Emerging Markets (EM) Index	1,079	1,100 – 1,300
MSCI EM EPS	$81	$85

Sources: Wells Fargo Investment Institute and Bloomberg. Latest EPS (earnings per share) figures are Bloomberg consensus estimates for full-year 2024 EPS as of November 29, 2024. All other latest numbers from Bloomberg as of November 29, 2024. Targets for 2025 are based on forecasts by Wells Fargo Investment Institute as of December 10, 2024, and provide a forecast direction over a tactical horizon through 2025. **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.

GLOBAL FIXED INCOME	LATEST	YEAR-END 2025 TARGETS
10-year U.S. Treasury yield	4.17%	4.50% – 5.00%
30-year U.S. Treasury yield	4.36%	4.75% – 5.25%
Federal funds rate	4.50% – 4.75%	4.00% – 4.25%

GLOBAL REAL ASSETS	LATEST	YEAR-END 2025 TARGETS
WTI crude oil price ($ per barrel)	$68	$85 – $95
Brent crude oil price ($ per barrel)	$73	$90 – $100
Gold price ($ per troy ounce)	$2,643	$2,800 – $2,900
Bloomberg Commodity Index	236	250 – 270

CURRENCIES	LATEST	YEAR-END 2025 TARGETS
Dollars per euro exchange rate	$1.06	$0.98 – $1.02
Yen per dollar exchange rate	¥150	¥158 – ¥162
Dollar composite exchange rate[5]	106	108 – 112

Sources: Wells Fargo Investment Institute and Bloomberg, as of November 29, 2024. Targets for 2025 are based on forecasts by Wells Fargo Investment Institute as of December 10, 2024, and provide a forecast direction over a tactical horizon through 2025. 5. 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.**

Contributors

Darrell L. Cronk, CFA©

President

Wells Fargo Investment Institute

Chief Investment Officer, Wealth & Investment Management

Global Investment Strategy

Paul Christopher, CFA©
Head of Global Investment Strategy

Luis Alvarado
Global Fixed Income Strategist

Chris Haverland, CFA©
Global Equity Strategist

John LaForge
Head of Real Asset Strategy

Edward Lee
Program Analyst

Sam Lombardo
Investment Strategy Analyst

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

Mason Mendez
Investment Strategy Analyst

Tony Miano, CFA©
Investment Strategy Analyst

Austin Pickle, CFA©
Investment Strategy Analyst

Brian Rehling, CFA©
Head of Global Fixed Income Strategy

Sameer Samana, CFA©
Senior Global Market Strategist

Gary Schlossberg
Global Strategist

Mark Steffen, CFA©, CAIA
Global Alternative Investment Strategist

Jennifer Timmerman
Investment Strategy Analyst

Scott Wren
Senior Global Market Strategist

Global Asset Allocation Strategy

Tracie McMillion, CFA©
Head of Global Asset Allocation Strategy

Douglas Beath
Global Investment Strategist

Jeremy Folsom
Investment Strategy Analyst

Michael Taylor, CFA©
Investment Strategy Analyst

Michelle Wan, CFA©
Global Investment Strategist

Veronica Willis
Global Investment Strategist

Global Securities Research

Dorian Jamison
Municipal Fixed Income Analyst

Eric M. Jasso, CFA©
Corporate Fixed Income Analyst

Joe Buffa
Equity Sector Analyst

Ian Mikkelsen, CFA©
Equity Sector Analyst

Lawrence Pfeffer, CFA©
Equity Sector Analyst

John Sheehan, CFA©
Equity Sector Analyst

Definitions

Bloomberg Commodity Index (BCOMTR) reflects the total return on U.S. Treasuries, and 23 commodity futures weighted to account for economic significance and market liquidity.

Bloomberg Municipal Bond Index is a U.S. dollar denominated long-term tax-exempt bond index. It is unhedged and current has 57,947 members.

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. Asset Backed Securities Index measures the investment-grade market of U.S. Credit Card, Auto and Student Loan asset backed securities deals.

Bloomberg U.S. Corporate Bond Index measures the performance of the investment-grade corporate 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.

Bloomberg U.S. Mortgage-Backed Securities Index includes agency mortgage-backed pass-through securities (both fixed-rate and hybrid ARM) guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

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

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

The **Dow Jones Industrial Average** is a price-weighted average of 30 blue-chip stocks that are generally the leaders in their industry.

HFRI Event Driven Index maintains positions in companies currently or prospectively involved in corporate transactions of a wide variety including but not limited to mergers, restructurings, financial distress, tender offers, shareholder buybacks, debt exchanges, security issuance or other capital structure adjustments. Security types can range from most senior in the capital structure to most junior or subordinated, and frequently involve additional derivative securities. Event Driven exposure includes a combination of sensitivities to equity markets, credit markets and idiosyncratic, company-specific developments. Investment theses are typically predicated on fundamental characteristics (as opposed to quantitative), with the realization of the thesis predicated on a specific development exogenous to the existing capital structure.

HFRI Macro Index: Investment Managers which trade a broad range of strategies in which the investment process is predicated on movements in underlying economic variables and the impact these have on equity, fixed-income, hard currency and commodity markets. Managers employ a variety of techniques, both discretionary and systematic analysis, combinations of top-down and bottom-up theses, quantitative and fundamental approaches and long and short term holding periods. Although some strategies employ RV techniques, Macro strategies are distinct from RV strategies in that the primary investment thesis is predicated on predicted or future movements in the underlying instruments, rather than realization of a valuation discrepancy between securities. In a similar way, while both Macro and equity hedge managers may hold equity securities, the overriding investment thesis is predicated on the impact movements in underlying macroeconomic variables may have on security prices, as opposes to EH, in which the fundamental characteristics on the company are the most significant are integral to investment thesis.

HFRI Equity Hedge Index consists of Investment Managers who maintain positions both long and short in primarily equity and equity derivative securities. A wide variety of investment processes can be employed to arrive at an investment decision, including both quantitative and fundamental techniques; strategies can be broadly diversified or narrowly focused on specific sectors and can range broadly in terms of levels of net exposure, leverage employed, holding period, concentrations of market capitalizations and valuation ranges of typical portfolios. EH managers would typically maintain at least 50%, and may in some cases be substantially entirely invested in equities, both long and short.

HFRI Relative Value Index maintains positions in which the investment thesis is predicated on realization of a valuation discrepancy in the relationship between multiple securities. Managers employ a variety of fundamental and quantitative techniques to establish investment theses, and security types range broadly across equity, fixed-income, derivative, or other security types.

The HFRI indexes are based on information self-reported by hedge fund managers that decide, on their own, at any time, whether or not they want to provide, or continue to provide, information to HFR Asset Management, L.L.C. Results for funds that go out of business are included in the index until the date that they cease operations. Therefore, these indexes may not be complete or accurate representations of the hedge fund universe, and may be biased in several ways.

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.

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.

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 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.

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".

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. I****nternational 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.*

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

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.*

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.

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.'

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