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Investment Institute

TIMELY GUIDANCE
Institute Alert

Timely guidance that may affect your investment strategy **June 14, 2021**

Global Investment Strategy Team

☑ **Guidance change**

☑ **Forecast change**

☐ **Allocation change**

Announcing 2022 economic forecasts and market targets

Guidance changes

- To align with changing trends in real estate, we are upgrading our guidance on Private Real Estate from unfavorable to neutral.[1]

Forecast changes

- Global economy: We believe the U.S. economy should see economic growth and inflation decelerate in 2022 but remain above their pre-pandemic paces.
- Global equities: We foresee 2022 earnings gains, albeit at a slower pace than in 2021. Rising U.S. taxes as well as higher global inflation and interest rates may restrain 2022 equity price gains somewhat. On balance, however, we believe earnings growth should still support higher global equity market benchmark levels.
- Global fixed income: Although we believe short-term rates will remain anchored, the increases in economic growth and inflation we expect should push longer-term rates meaningfully higher than today's levels.
- Global real assets: Our 2022 commodity targets anticipate higher prices overall, notably for oil and gold.
- Global foreign exchange targets: We expect a clearer U.S. dollar depreciation trend to emerge as global economic growth broadens in 2022.

Allocation changes

- No allocation changes.

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

[1] Alternative investments, such as hedge funds, private equity and private real estate funds are not appropriate for all investors and are only open to "accredited" or "qualified" investors within the meaning of U.S. securities laws.

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Table 1. 2021 and 2022 economic and market forecasts

Global economy	Year-end 2021 target	Year-end 2022 target
U.S. GDP growth	7.0%	5.3%
U.S. CPI Inflation	3.8%	2.8%
U.S. unemployment rate	4.7%	4.1%
Global GDP growth	6.3%	5.1%
Developed market GDP growth	4.9%	4.6%
Developed market inflation	2.2%	2.0%
Eurozone GDP growth	3.7%	3.9%
Eurozone inflation	1.3%	1.5%
Emerging market GDP growth	6.2%	5.5%
Emerging market inflation	4.2%	4.4%
Global equity	**Year-end 2021 target**	**Year-end 2022 target**
S&P 500 Index	4,400-4,600	4,800-5,000
S&P 500 earnings per share	$200	$220
Russell Midcap Index	3,200-3,400	3,500-3,700
Russell Midcap earnings per share	$130	$155
Russell 2000 Index	2,450-2,650	2,650-2,850
Russell 2000 earnings per share	$72	$95
MSCI EAFE Index	2,300-2,500	2,400-2,600
MSCI EAFE Index earnings per share	$130	$145
MSCI EM Index	1,400-1,600	1,500-1,700
MSCI EM Index earnings per share	$88	$105
Global fixed income	**Year-end 2021 target**	**Year-end 2022 target**
10-year U.S. Treasury yield	2.00%-2.50%	2.25%-2.75%
30-year U.S. Treasury yield	2.75%-3.25%	2.75%-3.25%
Fed funds rate	0.00%-0.25%	0.00%-0.25%
Global real assets	**Year-end 2021 target**	**Year-end 2022 target**
WTI crude oil	$70-$80	$75-$85
Brent crude oil	$75-$85	$80-$90
Gold	$2,000-$2,100	$2,100-$2,200
Bloomberg Commodity Index (total return)	210-220	225-235
Exchange rate	**Year-end 2021 target**	**Year-end 2022 target**
Dollars per euro	$1.17-$1.25	$1.25-$1.33
Yen per dollar	¥105-¥115	¥102-¥112

Sources: Wells Fargo Securities Economic Group and Wells Fargo Investment Institute, June 14, 2021. GDP = gross domestic product. CPI = consumer price index. EM = emerging markets. WTI = West Texas Intermediate. Wells Fargo Investment Institute forecast and targets. Forecast and targets are based on certain assumptions and on our current views of market and economic conditions, which are subject to change.

Table 1 illustrates our previously published 2021 forecast and target revisions, and it introduces the specifics of our 2022 outlook.[2] We believe that the next 18 months will sustain a powerful, ongoing macroeconomic and investment mosaic featuring a steadily weakening U.S. dollar, rising commodity prices, strong global equity returns,

[2] For complete details on our previously published 2021 targets, please see “Rotating sectors and raising targets on surge in growth”, May 20, 2021.

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falling equity and bond volatility, low interest rates, and a robust fiscal stimulus push. Even with some moderation from 2021 to 2022, we believe economic growth and inflation should stay significantly above their pre-pandemic paces.

Our main concerns are the rates issues — inflation rates, tax rates, and interest rates. Over the next 18 months, we expect all three to far exceed their pre-pandemic pace. Demand is outstripping supply in many industries, and the friction is leading inflation and interest rates to recover back to pre-pandemic rates, or higher. These forces collectively should exert some dampening effect. Still, they appear to us very unlikely to douse the economic recovery or to alter our investment preferences for equities over fixed income and for cyclical equity sectors over defensive and growth-oriented sectors.

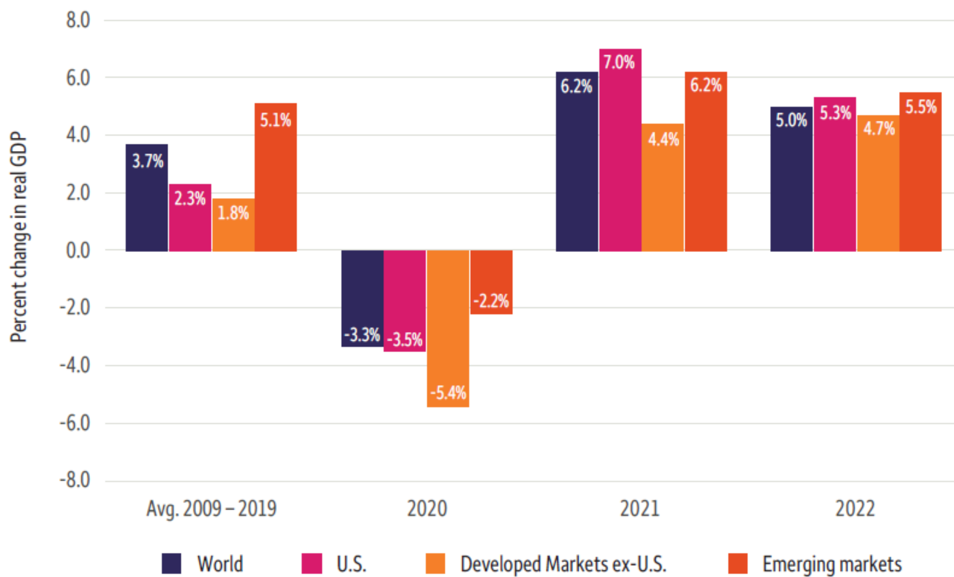
Global economy to remain strong in 2022

We believe that the early-cycle U.S. economic boom will spill over into 2022, although several factors should moderate the pace slightly. Fiscal stimulus and pent-up private demand should diminish as fiscal stimulus and excess savings used to finance the spending expire. That said, we think the housing recovery as well as gains in employment and wages will provide more fuel for growth.

Moreover, we anticipate that global economic momentum will broaden later in 2021 following delayed reopenings in Europe and Japan (please see Chart 1). Advanced economies should propel further gains in world trade, especially in the exports of technology and manufacturers that drive the Asian economies. Exposure to international trade likely will drive the emerging-market recovery in turn.

Chart 1. From a U.S.-led boom this year to more moderate, uniform growth in 2022

We expect fairly uneven, U.S.-led global growth in 2021 to converge at a still-healthy, but more moderate, rate in 2022.



Sources: International Monetary Fund and Wells Fargo Investment Institute, annual data, 2009-2020. GDP=gross domestic product. WFII forecasts for 2021-2022. Forecasts are not guaranteed and based on certain assumptions and on views of market and economic conditions which are subject to change.

Inflation: Higher than during the previous decade

We believe inflation will decelerate in 2022, but the degree depends on how quickly supply shortages dissipate and how well household and business spending persist in 2022. Especially if the pace of spending remains robust,

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upward pressure on prices could linger. Inflation in the U.S. and around the world may sustain a rate hotter than its pre-pandemic pace as global economic activity recovers, but a repeat of the 1970s seems very unlikely.

Clearer dollar downtrend to come

We expect a more apparent U.S. dollar depreciation trend later in 2021 or early in 2022 as eurozone growth converges with the U.S. rate and a more synchronized post-pandemic recovery emerges. An environment of more balanced global growth and recovering trade, with U.S. twin deficits large and growing, has historically accompanied dollar depreciation. U.S. policymakers favor a market-determined exchange rate and are unlikely to interfere.

Eventual global recovery to support emerging-market currencies

We remain constructive on emerging-market currencies. We believe the strong global trade recovery in manufactured goods should more than compensate for a slower return in local spending due to vaccine rollout delays and prolonged COVID-19 disruptions. We expect emerging-market currencies to benefit from a recovery in global growth and world trade as well as a robust recovery in Chinese consumer spending.

Record earnings this year as the country reopens

Over the next 18 months, our projection for fast economic growth should boost corporate sales and send S&P 500 Index profits to record levels. Companies made significant progress cutting expenses during the 2020 recession, creating large operating leverage despite rising input costs. We also expect operating margins to climb as labor productivity and corporate pricing power strengthen. Even as corporate taxes rise in 2022, we expect the combination of supportive monetary policy and public and private spending to push equity markets higher through the year.

Although we expect to see record levels for most U.S. equity asset classes in 2022, the earnings growth pace should slow modestly under prospective increases in corporate tax rates. Increases in interest rates also could add some downward pressure on price/earnings ratios. These factors may restrain 2022 gains but, overall, we still expect higher equity markets.

Emerging Market Equities favored over Developed Market ex-U.S. Equities

Europe and Japan are starting to recover, but we believe their struggles with vaccine distribution should restrain earnings growth to below the pace of the U.S. benchmark indices into 2022. Meanwhile, some emerging countries also have had their share of virus challenges, but most Asian countries (which we favor from a regional perspective) have been well on their way to recovery since 2020. The global trade economic boom that we expect over the next 12 months should drive strong emerging-country earnings growth and promote earnings outperformance relative to Developed Market ex.-U.S. Equities in the early innings of the recovery.

Yield curve steepening likely to continue

The Federal Reserve (the Fed) likely will keep financial conditions easy until it achieves its goals, or at least until significant progress is more evident. To this point, we do not expect the Fed to hike its target federal funds rate through 2022. Although we believe short-term rates will remain anchored, we do expect higher economic growth and inflation (compared to pre-pandemic rates) to push longer-term rates meaningfully higher versus today.

Eventually, we believe strong economic growth is likely to give policymakers enough assurance to begin reducing policy stimulus. As long as inflation does not trend higher, we expect the Fed to follow a sequence: first, a change in language (or a signal of tapering), likely later this year, and then the implementation of tapering sometime in 2022 followed by a potential 2023 hike.

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Commodities — a continued bounce

We expect the commodity price bounce to continue through 2022, supported by increasingly synchronized global economic growth. Potentially large and multiyear infrastructure spending and the accelerating green energy transition are commodity-intensive and likely to reinforce the price uptrends. Additionally, our forecast for the recent U.S. dollar strength to fade later this year or in early 2022 should benefit commodities.

All major commodity sectors are likely to participate in the rally. The Energy and Industrial Metals sectors are cyclical and typically benefit directly from a surging world economy. A weaker U.S. dollar and globally accommodative fiscal and monetary policies should support the Precious Metals sector. Agriculture should benefit from falling inventories and rising demand.

Gold grinding higher

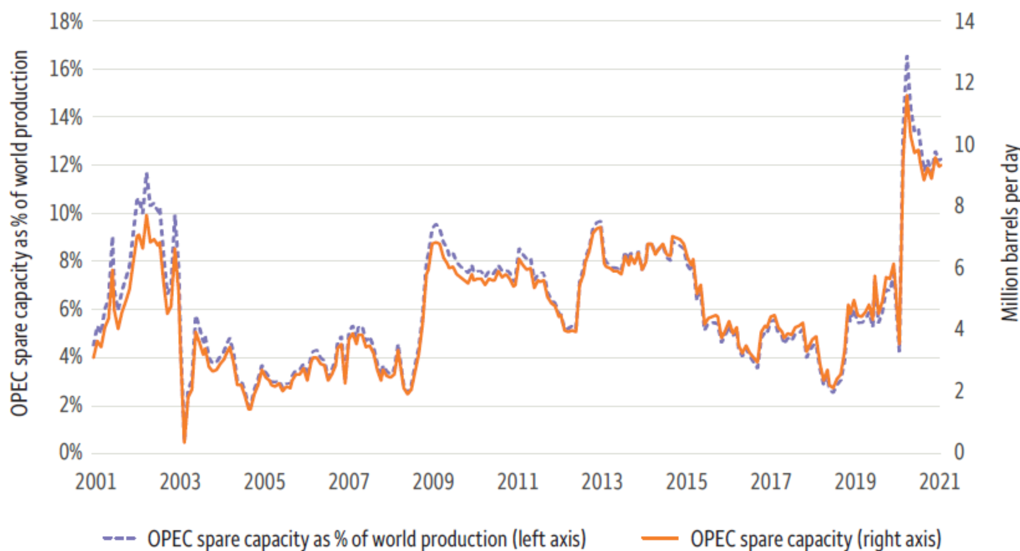
We believe sizable amounts of monetary and fiscal stimulus as well as investor concerns over possible inflation should weaken the dollar and shift funds into gold. Some moderation in the pace of economic growth also should help drive the yellow metal to all-time highs in 2022. Modestly higher inflation-adjusted interest rates may be a headwind, but we think they are unlikely to prevent the price of gold from reaching a range between $2,100 and $2,200 by year-end 2022.

Oil targets increased

OPEC+ has shown surprising resolve this past year by withholding a historical amount of production (see Chart 2).[3] Even now, with oil prices significantly higher than year-ago levels, OPEC+ has stayed disciplined in its supply response. U.S. producers also have avoided boosting production as quickly as in past cycles. As long as this restraint holds firm, booming global trade and ramping consumer demand should maintain the oil price rally, which is what we expect to see.

Chart 2. OPEC spare capacity supports oil price ceiling

OPEC's spare capacity reached unprecedented extremes in 2020. We expect the group to continue to take a disciplined approach to bringing those barrels back online.



Sources: Bloomberg, Department of Energy, and Wells Fargo Investment Institute, as of April 30, 2021. Monthly data: January 31, 2001, to April 30, 2021. OPEC = Organization of the Petroleum Exporting Countries.

[3] OPEC+ is the 14 members of the Organization of Oil Exporting Countries, plus 10 non-OPEC countries, including Russia.

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Upgrading our guidance on Private Real Estate

Private Real Estate (unfavorable to neutral): As the economic recovery has proceeded, most of our concerns have abated, which led us to upgrade the Private Real Estate sector. The upgrade also aligns with our neutral rating on Public Real Estate.

- **Core and core plus (unfavorable to neutral):** Core and core plus are by far the largest strategies in Private Real Estate. Between March and May last year, U.S. commercial real estate (CRE) prices fell 11% according to CRE analytics firm Green Street, but they have recovered 7% since then. That turnaround stands in sharp contrast to the 2008 financial crisis, when U.S. CRE prices fell 37% and took years to recover. Moreover, the federal government's aggressive efforts to support the economy kept landlords from suffering steep losses, and financial institutions have offered delinquent property owners additional support. CRE assets also should continue to provide a more attractive income stream than many fixed-income investments. The CRE sector remains variable. We expect positive returns in the Industrial sector but believe the Retail space will need to adapt further.
- **Value-add and opportunistic (neutral to favorable):** Over a horizon of three to five years, our view is that the most attractive opportunities are in the value-add and opportunistic strategies (particularly in industrial and multifamily assets). After a pause in activity last year, market conditions are stabilizing and funds have resumed making transactions. We believe funds employing the value-add and opportunistic strategies could outperform over the next three to five years.

  Private investment funds focused on real estate are already feeling flush. They had $356 billion in cash reserves in April according to Preqin, which was approximately double what these funds held at the end of 2009. In a recent survey by Hodes Weill & Associates and Cornell University, 29% of large institutions said they want to put a bigger share of their wealth into real estate, while only 5% said they want to reduce exposure.

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Risk Considerations

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

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Foreign investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. These risks are heightened in emerging markets. **Small- and mid-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large company stocks. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates. The **commodities** markets are considered speculative, carry substantial risks, and have experienced periods of extreme volatility. Investing in a volatile and uncertain commodities market may cause a portfolio to rapidly increase or decrease in value which may result in greater share price volatility. Investing in **gold** or other precious metals involves special risk considerations such as severe price fluctuations and adverse economic and regulatory developments affecting the sector or industry. **Real estate** has special risks including the possible illiquidity of underlying properties, credit risk, interest rate fluctuations and the impact of varied economic conditions.

Alternative investments, such as hedge funds, private equity/private debt, and private real estate funds, are speculative and involve a high degree of risk that is appropriate only for those investors who have the financial sophistication and expertise to evaluate the merits and risks of an investment in a fund and for which the fund does not represent a complete investment program. They entail significant risks that can include losses due to leveraging or other speculative investment practices, lack of liquidity, volatility of returns, restrictions on transferring interests in a fund, potential lack of diversification, absence and/or delay of information regarding valuations and pricing, complex tax structures and delays in tax reporting, 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.

Definitions

An index is unmanaged and not available for direct investment.

Bloomberg Commodity Index is comprised of 22 exchange-traded futures on physical commodities and represents 20 commodities weighted to account for economic significance and market liquidity.

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

MSCI EAFE Index is designed to represent the performance of large and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the U.S. and Canada.

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Russell Midcap Index measures the performance of the 800 smallest companies in the Russell 1000 Index.

Russell 1000 Index measures the performance of the 1,000 largest companies in the Russell 3000 Index, which represents approximately 90% of the total market capitalization of the Russell 3000 Index.

Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index.

Russell 3000 Index measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market.

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

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