WELLS FARGO
Investment Institute

EXECUTIVE SUMMARY

2021 Midyear Outlook

2021 and 2022 targets as of June 14, 2021

Fuel for Growth

Economy and exchange rates

We expect the global economy to chalk up 2021 growth above 6.0%. The pace in 2022 may moderate somewhat but should remain robust.

Our view is that global economic momentum will broaden later this year. Advanced economies should propel further gains in world trade. Exposure to international trade will likely drive the emerging market recovery.

We believe the U.S. economy already is enjoying a boom that will carry this year's growth to 7%. The 2022 pace also should remain strong. Fiscal stimulus should diminish.

We project the U.S. Consumer Price Index (CPI) will average 3.8% this year. We believe inflation will decelerate in 2022, but the degree depends on how quickly supply shortages ease and how well household and business spending persist.

We expect the dollar's depreciation trend to become more apparent later in the year or early in 2022. We expect emerging market currencies to benefit from a recovery in global growth and world trade as well as a robust Chinese economy and Asian technology exports.

	2021 year-end target	2022 year-end target
U.S. GDP growth	7.0%	5.3%
U.S. inflation	3.8%	2.8%
U.S. unemployment rate	4.7%	4.1%
Global GDP growth	6.3%	5.1%
Dollar/euro exchange rate	\$1.17–\$1.25	\$1.25–\$1.33

Sources: Wells Fargo Securities Economics Group, Bloomberg, and Wells Fargo Investment Institute, June 14, 2021. GDP = gross domestic product. 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.

Fixed income

Rising U.S. Treasury yields along with continued government spending, Federal Reserve bond purchases, and low short-term interest rates are likely to persist through at least the first half of 2022. The combined impact should reverberate in fixed-income markets through 2022.

The strong economic recovery should support credit-oriented asset classes and sectors. We expect strong corporate bond issuance to continue along with positive inflows into credit-oriented investments.

We remain favorable on municipal securities.

	2021 year-end target	2022 year-end target
Federal funds rate	0.00%–0.25%	0.00%–0.25%
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%

Sources: Wells Fargo Investment Institute, June 14, 2021. Forecast and targets are based on certain assumptions and on our current views of market and economic conditions, which are subject to change.

Equities

Over the next 18 months, we project U.S. economic growth will remain robust as the country reopens. This is likely to boost corporate sales, sending S&P 500 Index profits to record levels.

We increased our year-end 2021 earnings and price targets for the S&P 500 Index, the Russell Midcap Index, and the MSCI EAFE Index due to first-quarter earnings that were much better than expected. For 2022, we see the pace of earnings growth slowing for all equity classes.

We believe the robust U.S. economic rebound will support continued Russell 2000 Index outperformance. Earnings recovery will be key for small caps. To counter small-cap volatility, we continue to favor large caps.

In the first year of this new equity bull market, our sector guidance shifted to include favorable ratings on economically sensitive sectors, such as Financials, Industrials, and Materials, and we have upgraded Energy to favorable and Real Estate to neutral. We maintain our unfavorable view on defensive sectors, such as Consumer Staples and Utilities.

We believe developed market ex.-U.S. equities will be restrained by a moderate recovery in Japan and ongoing struggles with vaccine distribution and reopenings in Europe. The global economic boom expected over the next 12 months should drive strong emerging country earnings growth. We recommend taking advantage of recent weakness in Emerging Market Equities to add exposure.

	2021 year-end target	2022 year-end target
S&P 500 Index	4,400–4,600	4,800–5,000
Earnings per share	$200	$220
Russell Midcap Index	3,200–3,400	3,500–3,700
Russell 2000 Index (small cap)	2,450–2,650	2,650–2,850
MSCI EAFE Index	2,300–2,500	2,400–2,600
MSCI Emerging Markets Index	1,400–1,600	1,500–1,700

Sources: Wells Fargo Investment Institute, June 14, 2021. Forecast and targets are based on certain assumptions and on our current views of market and economic conditions, which are subject to change.

Real assets

Above-trend U.S. and global economic growth should support robust commodity demand and a sustained rally in prices. After having trailed the improvement in the economy, real estate investments trusts (REITs) now look poised to keep pace with the upturn. We remain favorable toward Commodities and have upgraded REITs to neutral. Increased oil production volumes and prices should benefit midstream and integrated energy companies.

Modestly higher real interest rates may be a headwind, but we think they're unlikely to prevent the price of gold from reaching a range between $2,000 and $2,100 by year-end 2021 and between $2,100 and $2,200 by year-end 2022.

	2021 year-end target	2022 year-end target
West Texas Intermediate crude (barrel)	$70–$80	$75–$85
Brent crude (barrel)	$75–$85	$80–$90
Gold (troy ounce)	$2,000–$2,100	$2,100–$2,200
Bloomberg Commodity Index (total return)	210–220	225–235

Sources: Wells Fargo Investment Institute, June 14, 2021. Forecast and targets are based on certain assumptions and on our current views of market and economic conditions, which are subject to change.

Alternative investments

Over the upcoming quarters, we expect to see a supportive environment for equity and credit selection strategies. Moreover, as interest rates rise, we may eventually see an accelerated credit cycle leading to higher defaults and wider spreads. Over the next 12 to 36 months, we favor the Equity Hedge strategy and maintain a neutral view for the Relative Value, Macro, and Event Driven strategies.

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

Risks to our outlook

Our conviction remains that economic growth and inflation will remain elevated, even if they decelerate modestly from their 2021 levels. Yet, we see a symmetry between downside and upside risks. On the downside, the economic environment could return to the regime of 2010-19, which featured low inflation, slow economic growth, historically low interest rates, and dollar appreciation. Alternatively, inflation and economic growth could rise further with commensurately higher interest rates and a weaker dollar; this scenario could cause us to raise targets.

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 involve risks, including the possible loss of principal. 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. Their values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Foreign markets** have additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. These risks are heightened in emerging markets. **Mid- and small-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large-company stocks. **Bonds** are subject to interest rate, credit/default, liquidity, call, inflation and other risks. Prices tend to be inversely affected by changes in interest rates. Investors should consider the stability of the issuing entity when investing in sovereign debt. **Municipal bonds** offer interest payments exempt from federal taxes, and potentially state and local income taxes. Municipal bonds are subject to credit risk and potentially the Alternative Minimum Tax (AMT). Quality varies widely depending on the specific issuer. Municipal securities are also subject to legislative and regulatory risk which is the risk that a change in the tax code could affect the value of taxable or tax-exempt interest income. The **commodities** markets, including investments in physical commodities such as gold, are considered speculative, carry substantial risks, and have experienced periods of extreme volatility. Investing in a volatile and uncertain commodities market may cause a portfolio to rapidly increase or decrease in value which may result in greater share price volatility. **Real estate** has special risks including the possible illiquidity of underlying properties, credit risk, interest rate fluctuations, and the impact of varied economic conditions. **Alternative investments**, such as hedge funds and private capital/private debt and private real estate strategies, are speculative and not suitable for all investors. These investments are only available to persons who are "accredited investors" or "qualified purchasers" within the meaning of U.S. securities laws. Investors could lose all or a substantial amount investing in these products. Alternative investment strategies, such as Equity Hedge, Event Driven, Macro and Relative Value, may expose investors to the risks associated with the use of short selling, leverage, derivatives and arbitrage methodologies. Short sales involve leverage and theoretically unlimited loss potential since the market price of securities sold short may continuously increase. The use of leverage in a portfolio varies by strategy. Leverage can significantly increase return potential but create greater risk of loss. Derivatives generally have implied leverage which can magnify volatility and may entail other risks such as market, interest rate, credit, counterparty and management risks.

Sector risks

Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility.

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 an investment to adverse economic or regulatory occurrences affecting the sector.

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.

Utilities are sensitive to changes in interest rates, and the securities within the sector can be volatile and may underperform in a slow economy.

Index definitions

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

The **MSCI EAFE Index** is a free-float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of developed markets, excluding the U.S. and Canada.

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

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

The **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.

The **S&P 500 Index** is a capitalization-weighted index calculated on a total return basis with dividends reinvested. The index includes 500 widely held U.S. market industrial, utility, transportation, and financial companies.

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