

## Approaching the economy's pivot point

### Economy and exchange rates

The U.S. economy is slowing from its 2023 pace, but we anticipate growth will still clock in at a 2.5% rate for 2024. Job creation and wage growth have slowed closer to their pre-pandemic trends. Some households are facing growing financial stress from credit-card debt. However, interest rates have not moved high enough to increase financial stress pervasively as the economy slows.

This economic "soft patch" should produce lower inflation that allows the Federal Reserve (Fed) to pivot to modest interest-rate cuts. We expect a mild recovery.

Inflation began 2024 uncomfortably high, which should keep the overall Consumer Price Index (CPI) inflation rate close to 3%. But in the coming months, we expect softer consumer demand to weaken inflation until the economy regains enough momentum to rekindle some pricing pressures and another 3% CPI inflation pace later in 2025.

Our bias remains for a strong U.S. dollar through year-end 2024 and into 2025. We believe the global interest-rate environment will also remain favorable for the dollar.

Compared with global economies, we expect relatively stronger U.S. economic growth and more attractive yields. These factors should bolster the U.S. dollar and support our preference for domestic U.S. assets.

	2024 targets	2025 targets
U.S. GDP growth <sup>1</sup>	2.5%	2.1%
U.S. CPI inflation <sup>2</sup>	3.0%	3.0%
U.S. unemployment rate <sup>3</sup>	4.1%	4.0%
Global GDP growth <sup>4</sup>	2.5%	2.6%
Dollar/euro exchange rate	\$1.06–\$1.10	\$1.03–\$1.07

**Source:** Targets for 2024 and 2025 are based on forecasts by Wells Fargo Investment Institute as of June 11, 2024, and provide a forecast direction over a tactical horizon through 2025.

GDP = gross domestic product.

CPI = Consumer Price Index.

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

1. Average annual percent change
2. December-to-December change
3. Three-month average as of the fourth quarter, percent of labor force
4. Weighted average of developed country and emerging market forecasts

### Fixed income

We believe the U.S. central bank is aiming to make a pivot toward lower interest rates but wants to wait for more clarity from key economic indicators to gain greater confidence around disinflationary trends.

We envision positive fixed-income returns for both taxable and municipal bonds for the rest of the year, supported largely by the income component and eventual Fed interest-rate cuts.

We still envision that short-term rates will exceed long-term rates over the next 6 to 18 months. Our guidance is for investors to focus on credit quality.

	Year-end 2024 targets	Year-end 2025 targets
Federal funds rate	4.75%–5.00%	4.50%–4.75%
10-year U.S. Treasury yield	4.25%–4.75%	4.00%–4.50%
30-year U.S. Treasury yield	4.50%–5.00%	4.25%–4.75%

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## Equities

After navigating one of the more difficult and uncertain operating environments in recent memory, we believe large-cap companies are likely to remain hyper-focused on efficiencies. Add in the potential for artificial intelligence (AI) adoption to broadly boost productivity, and the company profit-margin picture going forward should improve.

Our outlook for positive economic growth and gradually easing inflation should allow large companies to maintain both pricing power and unit sales growth. The improved macro environment we expect should support earnings growth as sales advance and corporations remain committed to cost cutting and improved efficiencies. Many small-cap companies will have a relatively more difficult time repairing margins, in our view.

We believe the accelerating earnings recovery will allow the stock rally to be primarily driven by earnings growth rather than by price/earnings (P/E) multiple expansion.

We suspect that markets could struggle to advance past recent highs in the near term while uncertainties persist. Still, we would view periods of equity-market weakness as opportunities.

We reiterate our preference for quality. We view U.S. Large Cap Equities as the highest-quality major equity class with strong company balance sheets compared with other equity classes, durable pricing power, and resilient growth potential. We continue to prefer U.S. Large Cap Equities (favorable) over U.S. Mid Cap Equities (neutral) and U.S. Small Cap Equities (most unfavorable).

	Year-end 2024 targets	Year-end 2025 targets
S&P 500 Index	5,100–5,300	5,600–5,800
Earnings per share	\$240	\$260
Russell Midcap Index	3,300–3,500	3,700–3,900
Russell 2000 Index (small cap)	2,100–2,300	2,500–2,700
MSCI EAFE Index	2,200–2,400	2,400–2,600
MSCI Emerging Markets Index	950–1,150	1,100–1,300

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## Real assets

It appears the commodity bull super-cycle (a multiyear period, often lasting over a decade, in which prices trend higher) has reasserted itself after a lackluster 2023. We suspect prices will continue to rise over the next 6 to 18 months. As a result, we prefer holding a basket of commodities.

Gold has shown strong performance. Cooler inflation that brings down fixed-income yields will help boost gold prices, in our view, as should recent increases in foreign gold purchases. Gold prices are also likely to be helped later in 2024 by Fed interest-rate cuts.

We believe higher oil prices are here to stay. Global supply growth remains tight as OPEC+<sup>5</sup> continues to implement its restrictive production policy and U.S. producers recommit to capital discipline. We believe there is a low risk that OPEC+ unwinds its production cuts late in 2024.

	Year-end 2024 targets	Year-end 2025 targets
West Texas Intermediate crude (barrel)	\$80–\$90	\$85–\$95
Brent crude (barrel)	\$85–\$95	\$90–\$100
Gold (troy ounce)	\$2,300–\$2,400	\$2,400–\$2,500
Bloomberg Commodity Index (total return)	235–255	250–270

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## Alternative investments

Given the ongoing economic slowdown, we continue to prefer defensive hedge funds and private capital strategies that can offer diversification benefits, generate counter-cyclical returns, or offer a quality bias. Our current favored strategies and sub-strategies are more defensive and historically do not correlate to traditional stock and bond markets.

Once the economy pivots to recovery as we expect, we will look to strategies that historically have outperformed when an accelerating economy drives more sustained market trends. Such strategies may include Long/Short Equity and Activist Equity categories.

Alternative investments are not appropriate 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.

# 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. **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 appropriate 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.

## Index definitions

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

**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.

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

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

**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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