WELLS FARGO
Investment Institute

EXECUTIVE SUMMARY

2020 Midyear Outlook

2020 and 2021 targets as of June 15, 2020

Recession, Recovery, and Resilience

Economy and exchange rates

The 2020 economic recession is historic in depth and the sharpness of the contraction. More than 40 million jobs have been lost—more than were created in the economic expansion of the past decade.

But we are seeing recovery now. We're looking for a strong second-half bounce. In 2021, the recovery should moderate as bankruptcies and rising unemployment remain obstacles. Considering the gradualness of the recovery, inflation pressures should remain muted through 2021.

Advanced economies outside of the U.S. are expected to have a deeper recession and likely will have a weaker recovery because of greater exposure to slumping world trade, demographic and structural restraints on growth, and more limited policy support. Emerging markets should benefit from China's 2020 rebound, but our expectations for China's slower 2021 pace, reduced global trade, and poor health care systems likely will slow emerging markets in 2021.

The dollar likely has peaked, as Federal Reserve (Fed) liquidity blunted the dollar's interest rate advantage. However, the U.S. economy's comparatively faster pace should moderate the dollar's decline.

	2020 year-end target	2021 year-end target
U.S. GDP growth	-4.5%	3.0%
U.S. inflation	0.7%	1.7%
U.S. unemployment rate	9.5%	6.5%
Global GDP growth	-3.3%	3.0%
Dollar/euro exchange rate	$1.14	$1.17

Sources: Wells Fargo Securities Economics Group, Bloomberg, and Wells Fargo Investment Institute, June 15, 2020. 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

We expect the Fed to remain on hold through year-end 2021, which should help support fixed-income markets. While quality remains important, we favor adding higher-risk holdings.

With short-term rates near zero, we believe investors should stay fully invested. We favor U.S. investment-grade fixed income, particularly intermediate-term (duration of four to five years).[1] We also favor investment-grade municipals and preferred securities.

	2020 year-end target	2021 year-end target
Federal funds rate	0.00%–0.25%	0.00%–0.25%
10-year U.S. Treasury yield	0.75%–1.25%	1.00%–1.50%
30-year U.S. Treasury yield	1.50%–2.00%	1.75%–2.25%

Sources: Wells Fargo Investment Institute, June 15, 2020. Forecast and targets are based on certain assumptions and on our current views of market and economic conditions, which are subject to change.

[1]Duration is a measure of a bond's interest-rate sensitivity.

Equities

We estimate that S&P 500 Index 2020 earnings per share will decline by 30% to $115 but rebound to $145 as the economic recovery develops through 2021. Our 2020 year-end median price target for that index is 3,250, implying a price/earnings (P/E) ratio of 28x. Improving economic data and bullish investor sentiment should support further gains, and broadening market participation, a steepening yield curve, and a softening U.S. dollar should add support.

Our 2021 price target range of 3,400 to 3,600 implies a trailing P/E ratio of 24x, which is consistent with previous market and earnings recoveries. Even so, the ongoing uncertainty surrounding the pandemic and the November elections may lead equity global markets at times to trade in ranges around our targets.

Our targets also indicate upside for international markets, but not as much as in the S&P 500 Index. Limited fiscal and monetary support is available internationally, and the struggles in these economies that predate the pandemic should make significant headwinds to international earnings prospects in developed ex-U.S. and emerging markets.

For well over a year, we have guided investors to move up in quality within their equity exposure. This includes a focus on U.S. equities over international equities and large-cap and mid-cap stocks over small-cap equities. Within sectors, we favor Information Technology, Communication Services, Consumer Discretionary, Financials, and Health Care.

	2020 year-end target	2021 year-end target
S&P 500 Index	3,150–3,350	3,400–3,600
Earnings per share	$115	$145
Russell Midcap Index	2,230–2,430	2,400–2,600
Russell 2000 Index (small cap)	1,450–1,650	1,550–1,750
MSCI EAFE Index	1,800–2,000	1,850–2,050
MSCI Emerging Markets Index	930–1,130	950–1,150

Sources: Wells Fargo Investment Institute, June 15, 2020. 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

Commodity prices look set to rebound, and we particularly expect per barrel U.S. West Texas Intermediate crude-oil prices to stabilize between $40 and $50 by year-end 2021. Higher gold prices also are likely ($2,200 to $2,300 per ounce) by year-end 2021. We favor staying high in quality in the midstream energy space.

Commercial real estate appears to be caught in the crosshairs of the pandemic, and commercial real estate faces significant long-term headwinds. History tells us that buying real estate investment trusts solely because they look cheap has not been a good investment strategy.

	2020 year-end target	2021 year-end target
West Texas Intermediate crude (barrel)	$35–$45	$40–$50
Brent crude (barrel)	$40–$50	$45–$55
Gold (troy ounce)	$1,800–$1,900	$2,200–$2,300
Bloomberg Commodity Index (total return)	145–155	150–160

Sources: Wells Fargo Investment Institute, June 15, 2020. 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

We believe the pandemic and oil-price collapse present opportunities for alternative investments through 2021. We favor positioning for both rising defaults and a gradual spending recovery. Rising bankruptcies, even as the recession ends, favor distressed debt and structured credit strategies. Investors willing to tie up funds in illiquid private capital may consider opportunistic strategies to buy attractively priced debt and real estate.

Risks to our outlook

The main risks to these investment preferences revolve around the speed and timing of the recovery—and, of course, the track of COVID-19 infections. If these turn out to give a slower and later economic rebound, then we could see riskier assets like equities and commodities perform poorly and could push interest rates even closer to zero than we anticipate.

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. **Preferred securities** are subject to interest rate and credit risks. Interest rate risk is the risk that preferred securities will decline in value because of changes in interest rates. Credit risk is the risk that an issuer will default on payments of interest and principal. Preferred securities are generally subordinated to bonds or other debt instruments in an issuer's capital structure, subjecting them to a greater risk of non-payment than more senior securities. In addition, the issue may be callable which may negatively impact the return of the security. Preferred dividends are not guaranteed and are subject to deferral or elimination. 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. **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. Investing in **Financials** companies will subject an 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. Risks associated with the **Information 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 of smaller, less-seasoned companies tend to be more volatile than the overall market. 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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