WELLS FARGO

INVESTMENT INSTITUTE

2018 Outlook

Moving Ahead in an Aging Recovery

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

Forecast update
March 2018

2018 forecast year-end numbers

Targets as of March 1, 2018

ECONOMY

Year-end forecasts

U.S. GDP growth Rolling four quarters	2.9%
U.S. unemployment rate End of period	3.9%
U.S. inflation 12-month average	2.4%
Global GDP growth	3.7%
Dollar/euro exchange rate	$1.24–$1.32

Overview

- We believe the U.S. economy is in the last third of its recovery, but we do not expect a recession in 2018.
- Another year of potentially slow growth and low inflation may deliver mixed results for the U.S. dollar—ranging versus the yen, but weaker against the euro and emerging-market currencies.

Investor watch

- The U.S. economic expansion is maturing, but international economies are gaining momentum.
- The slow-but-steady economic recovery may be encouraging some complacency that the economic expansion could run indefinitely. When markets become complacent, investors should weigh risk and reward even more carefully.

EQUITIES

Year-end forecasts

S&P 500 Index	2,800–2,900
S&P 500 operating earnings per share	$152
Russell Midcap Index	2,200–2,300
Russell Small Cap Index	1,650–1,750
MSCI EAFE Index	2,050–2,150
MSCI Emerging Markets Index	1,160–1,240

Overview

- We believe the U.S. bull market is maturing but still has room to run.
- We favor U.S. stocks over international stocks for 2018 because we believe tax reform will meaningfully boost domestic profits.

Investor watch

- We believe that S&P 500 Index revenue and earnings growth will continue. Cyclically dependent (versus defensive) companies should continue to benefit from global growth.
- International equities are earlier in their cycle and should continue to show solid gains.
- We believe international small-cap equities look attractive. Investors might want to consider allocating to this asset class by using a portion of their international developed-market equity allocation.

FIXED INCOME

Year-end forecasts

10-year U.S. Treasury yield	2.75%–3.25%
30-year U.S. Treasury yield	3.25%–3.75%
Federal funds rate	2.00%–2.25%

Overview

- We expect the Federal Reserve (Fed) to continue tightening monetary policy slowly and deliberately; we expect three rate hikes in 2018 and slightly higher long-term rates as measured by the 30-year U.S. Treasury bond yield.
- Our outlook for international developed-market fixed income remains unfavorable.

Investor watch

- We recommend that investors upgrade their fixed-income credit profiles, favoring investment-grade-rated debt.
- Given the current low-yield environment, fixed-income investors are likely to experience lower returns in the future than they have experienced over the past decade.
- We favor domestic over international fixed-income positions. The yield pickup in moving out the curve has diminished; investors should look to position evenly across the curve.

REAL ASSETS

Year-end forecasts

West Texas Intermediate Crude-oil price per barrel	$50–$60
Brent Crude-oil price per barrel	$55–$65
Gold Price per troy ounce	$1,250–$1,350

Overview

- We continue to have a slightly bearish outlook for commodities, which are in the seventh year of a bear market that could last 12 to 15 years.
- We believe that real estate investment trusts (REITs) offer opportunities because many of them currently sell at a discount to their underlying assets.

Investor watch

- We expect downside action in oil and gold to begin in 2018 and sideways price action for most commodities.
- We expect mid- to high-single-digit returns for REITs for the remainder of 2018, although rising interest rates could cause volatility.
- Master limited partnerships (MLPs) generally should track oil prices, which we expect to be flat to down. However, we believe MLP performance should be respectable because of the potential for growth, and relatively high dividend yields.

ALTERNATIVES

Overview

- As the era of quantitative monetary stimulus slowly winds down, we continue to forecast an improved environment for active management.
- Dispersion strategies such as long/short equity and credit should perform best, followed by event driven strategies focused on special situations and stressed/distressed credit.

Investor watch

- We anticipate another strong year for hedge fund returns in 2018, with credit and equity selection driven by a maturing economic cycle and the gradual removal of monetary stimulus.
- The illiquidity premium offered by private capital strategies, especially private credit, is likely to increase in 2018 as lending conditions tighten and credit markets weaken.

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

Five portfolio moves that could make a difference

Evaluate hypothetical model portfolios against historical events

Find out how various hypothetical portfolio allocations might have performed in past crisis events.

Seek alpha through active strategies

Incorporate active management into your portfolio to potentially enhance return.

Stay flexible when assets are mispriced

Be cautious with high-yield corporate and municipal bonds, which look overpriced to us.

Hold appropriate levels of cash alternatives

Aim for having only 6 to 18 months of living expenses in these investments.

Keep your eyes on the goal

Determine whether your portfolio contains assets that have reacted differently to various situations.

Risk considerations

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. **Mid- and small-cap stocks** are generally more volatile, subject to greater risks, and are less liquid than large-cap stocks. **Bonds, including municipal bonds,** are subject to market, interest rate, price, credit/default, call, liquidity, inflation, and other risks. Prices tend to be inversely affected by changes in interest rates. Municipal securities also are 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. **High-yield** (junk) bonds have lower credit ratings and are subject to greater risk of default and greater principal risk. **Cash alternatives** typically offer lower rates of return than longer-term equity or fixed-income securities and may not keep pace with inflation over extended periods of time. 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 in the portfolio to fluctuate more than other fixed-income securities. 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. **MLPs** may be sensitive to price changes in oil, natural gas, etc., other risks, including the volatility associated with the use of leverage, volatility of the commodities markets, market risks, supply and demand, natural and man-made catastrophes, competition, liquidity, market price discount from net asset value, and other material risks. An MLP is not required to make distributions and distributions may represent a return of capital as detailed in the K-1 delivered to the unitholder. Unlike regular dividends, a return of capital is typically tax-deferred for the unitholder of an MLP and each distribution may reduce the unitholder's cost basis. **Real estate** has special risks, including the possible illiquidity of underlying properties, credit risk, interest-rate fluctuations, and the impact of varied economic conditions. The use of **alternative investment strategies**, such as long/short equity and credit and event driven strategies, such as special situations and stressed/distressed credit, are speculative and involve a high degree of risk. These strategies may expose investors to risks such as short selling, derivatives, leverage, liquidity, volatility and other significant risks. Investing in event driven situations such as reorganizations, spin-offs, mergers, and bankruptcies involves the risks that the proposed opportunities in which a fund may invest may not materialized as planned or may be renegotiated or terminated which can result in losses to the fund. Short selling involves leverage and theoretically unlimited loss potential since the market price of securities sold short may continuously increase. The use of leverage can magnify any price movements resulting in high volatility and potentially significant loss of principal. Derivatives generally have implied leverage and may entail other risks such as market, interest rate, credit, counterparty, and management risks.

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