

# 2015 Midyear Outlook

Opportunities in an Improving Global Economy



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## 2015 Midyear Outlook prepared by:

### Darrell Cronk, CFA®

President, Wells Fargo Investment Institute  
Chief Investment Officer, Wealth, Brokerage, and Retirement,  
Wells Fargo & Company

### Paul Christopher, CFA®

Head of International Strategy  
Co-Head of Real Asset Strategy

### Stuart Freeman, CFA®

Co-Head of Global Equity Strategy

### Chris Haverland, CFA®

Global Asset Allocation Strategist

### Justin Lenarcic

Global Alternative Investment Strategist

### Mark Litzerman, CFA®

Co-Head of Real Asset Strategy

### Sean Lynch, CFA®

Co-Head of Global Equity Strategy

### Tracie McMillion, CFA®

Head of Global Asset Allocation Strategy

### Brian Rehling, CFA®

Co-Head of Global Fixed Income Strategy

### George Rusnak

Co-Head of Global Fixed Income Strategy

### Sameer Samana, CFA®

Senior Global Strategist

### Jim Sweetman

Senior Global Alternative Investment Strategist

### Adam Taback

Head of Global Alternative Investments

### Gary Thayer

Head of Global Macro Strategy

### Elizabeth Weindruch

Global Alternative Investment Strategist

### Peter Wilson

Global Fixed Income Strategist

### Scott Wren

Senior Global Equity Strategist

## Economic and Market Forecast

ECONOMY	2015 E	2014	2013
Domestic U.S. GDP growth	2.8%	2.4%	2.2%
Domestic U.S. inflation	0.8%	1.6%	1.5%
Domestic U.S. unemployment rate	5.0%	5.6%	6.7%
Global GDP growth	3.5%	3.4%	3.0%
Developed-market GDP growth	2.2%	1.8%E	1.4%
Developed-market inflation	0.75-1.25%	1.0-1.25%E	1.2%
Emerging-market GDP growth	4.4%	5.25-5.5%E	5.5%
Emerging-market inflation	4.5-5.0%	0.8%	-0.4%
Eurozone GDP growth	1.5%	5.6%	6.7%
Eurozone inflation	0.6%	-0.2%	0.8%

EQUITIES			
S&P 500 Index	2150-2250	2059	1848
S&P 500 operating earnings per share	\$128	\$119	\$111
Russell Mid Cap Index	1685-1785	1663	1492
Russell Small Cap Index	1160-1240	1205	1164
MSCI Developed Market Index	1950-2050	1775	1916
MSCI Emerging Market Index	1010-1090	956	1003

FIXED INCOME			
10-year U.S. Treasury yield	2.25-2.50%	2.17%	3.04%
30-year U.S. Treasury yield	2.75-3.00%	2.75%	3.97%
Fed funds rate	0.75%	0.25%	0.25%

REAL ASSETS			
West Texas Intermediate Crude price	\$50-60	\$53	\$98
Brent Crude price	\$55-65	\$57.33	\$110.80
Gold price	\$1,050-1,150	\$1,184	\$1,202
Dollar/euro exchange rate	\$1.06-1.10	\$1.21	\$1.37

GDP = gross domestic product

E = estimate

Estimates do not guarantee performance.

Past performance is no guarantee of future results.

Sources: FactSet, Bloomberg, and Wells Fargo Investment Institute



# 2015 Midyear Outlook

## Key Takeaways

### ECONOMY

We continue to believe the global economy will improve in 2015, but mainly in the year's second half, which may bring broader global economic improvement within the U.S. and internationally.

Overseas, monetary stimulus in Europe, Japan, and China should support global confidence.

We believe investors should stay fully invested and buy on market pullbacks while the economic recovery continues. Investors should also stay diversified; diversification offers the opportunity to mitigate a portfolio's long-term up-and-down swings while retaining the potential to gain from positive returns.

### EQUITIES

Our expectations for many leading indicators support our outlook for continuing broad economic expansion for 2015.

Relative to inflation and interest rates, domestic large-cap valuations do not appear stretched.

We believe earnings momentum is building in the European and Japanese equity markets.

The economic outlook for emerging markets remains mixed for the remainder of 2015 with a growth rate favoring many Asian economies.

### FIXED INCOME

After a long wait, global monetary policies should finally begin to diverge during this year's second half, but we expect the divergence to occur in slow motion.

It is not necessarily the timing, but rather the path of rate increases that investors should focus on.

We expect the market impact of an initial rate increase to be relatively modest when it occurs. We expect continued aggressive monetary policies from foreign central banks will keep foreign yields depressed in many countries.

We continue to see value in the municipal bond market for investors to take advantage of these securities' tax-exempt nature.

### REAL ASSETS

With the exception of gold and silver, demand for commodities seems steady while various markets are in the process of adjusting production levels.

We believe the likelihood of additional global excess oil inventory seems likely to cap oil price's upside in the balance of the year.

We see some encouraging signs for real estate investment trusts (REITs) heading into the year's second half.

The master limited partnership (MLP) market's performance likely will continue to be more closely tied to crude oil prices in the near term than what has been the historic norm.

### ALTERNATIVE INVESTMENTS

We expect diverging monetary policies across global markets will have a significant impact on the prospects for active management in the near term. We believe this trend will provide a myriad of opportunities in the second half of the year for implementing alternative strategies that offer the potential for increased diversification and risk-adjusted returns.

Equity Hedge remains one of our highest conviction strategies, and we continue to support an overweight outlook for this strategy.

We also expect a growing illiquidity premium found in Private Capital strategies will benefit patient investors with a longer investment horizon.

## We Believe the Year Should Be a Good One, Despite a Slow Start

### We expect better days ahead

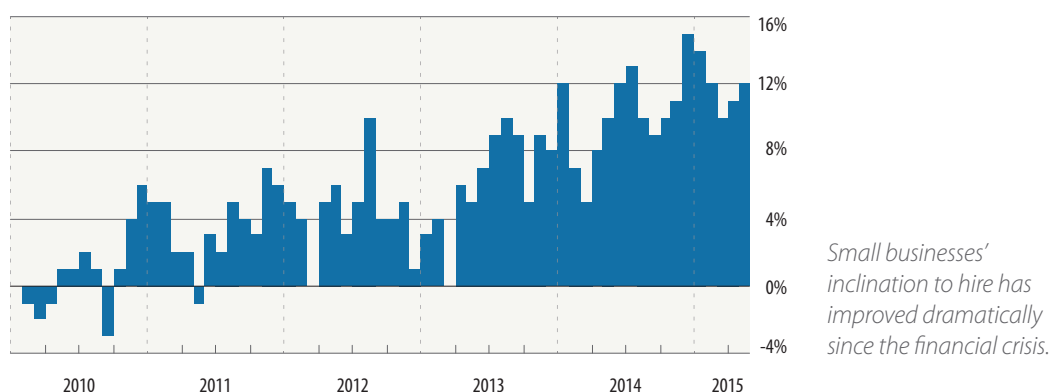
2015 YEAR-END FORECASTS	
<b>Domestic U.S. GDP growth</b> <i>Rolling four quarters</i>	2.8%
<b>U.S. unemployment</b> <i>End of period</i>	5.0%
<b>Domestic U.S. inflation</b> <i>12-month average</i>	0.8%
<b>Global GDP growth</b>	3.5%

We continue to expect the global economy to improve in 2015, but mainly in the year's second half. This scenario has progressed since the beginning of the year as we had anticipated.\* In the U.S., frigid weather gripped many parts of the Midwest and Northeast, and a labor stoppage halted shipping at California ports. The slow momentum then spilled over into the spring. Meanwhile, the impact of China's slowing economy and falling commodity export prices spread to many emerging economies. Nevertheless, the European and Japanese economies quickened their pace earlier than we anticipated, thanks in large part to improved business and consumer confidence and more expansive monetary policies.

The year's second half is likely to bring broader global economic improvement within the U.S. and beyond. Household spending in the U.S. constitutes roughly 70 percent of the economy and should benefit from several factors. The unemployment rate has fallen in each of the past five years, and the pace of job creation—notably for small businesses—is improving faster than we originally forecasted, as the chart shows. Also, the combination of low mortgage rates and cheaper gasoline prices over last year should help reinforce this increase in consumer confidence.

### Small Businesses May Be Increasing Headcount

*Net percentage of small businesses reporting now is a good time to hire*



Percentage of small businesses saying now is a good time to hire, less those saying now is not a good time to hire. Survey respondents are members of the National Federation of Small Business.

**Sources:** Bloomberg and Wells Fargo Investment Institute. Data through May 2015 is the latest available (as of June 9, 2015).

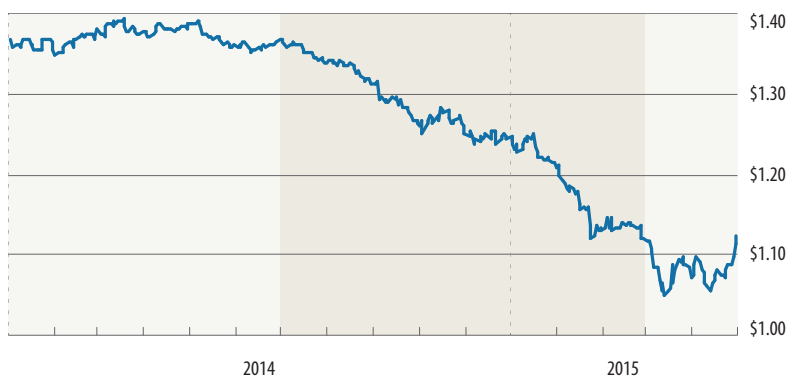
Even with these prospective improvements, low oil and other commodity prices should help keep U.S. and global inflation in check and below average levels. The sluggish economy and contained inflation outlook have delayed expectations for the first Federal Reserve interest rate hike—probably until later this year.

Overseas, monetary stimulus in Europe, Japan, and China should support global confidence. Also, stable commodity prices should help consumers and businesses benefit from cheaper raw materials while exporters appreciate the competitive edge of these countries' cheaper currencies. These benefits are helping to boost European confidence and should filter into corporate earnings. The benefits of monetary expansion and low commodity prices typically develop over months, but the early signs are apparent across Europe, Japan, and China and should support these economies going forward.

*\*Forecasts do not guarantee performance.*

## Euro's Eight-Month Decline Against the U.S. Dollar Has Paused

U.S. dollar per euro



*Cheaper foreign currencies reduced international returns in dollars in the last year but also made European exporters more competitive and helped many international developed equity markets outperform the S&P 500 in the first five months of 2015. The cheaper euro should boost the European economy and equity markets, and we believe long-term investors should keep their international allocations.*

Past performance is not indicative of future results.

Sources: Bloomberg and Wells Fargo Investment Institute (as of May 29, 2015)

### U.S. economy's advantage has slimmed

The economic growth improvement in Europe and Japan this year has narrowed but not eliminated the U.S. economy's advantage. The U.S. economy also should extend its lead in growth over the emerging economies. Significant appreciation in the past year makes the dollar already strong against the euro and yen, but the narrowing U.S. growth advantage implies that the dollar may not strengthen much more against these currencies this year. The chart above indicates the dollar has stabilized after an eight-month rally against the euro. By contrast, if the U.S. economy widens its lead against the emerging economies, the dollar should appreciate further against those currencies.

The main risk to our outlook for the global economy remains shocks to the gradual and still incomplete recovery from the 2008 financial crisis. Globally, we are still observing a surplus of factory capacity, which has led to chronically low interest rates and generally slow growth in sales, employment, and wages, especially outside the U.S. Excess capacity typically causes consumer prices to rise more slowly or even fall (as in some European economies), and last year's precipitous drop in commodity prices aggravated the problem. There has been some improvement in price levels due to a number of factors, including industry consolidation, economic reform measures, and monetary stimulus, and we think global inflation will continue to stabilize gradually.

Still, the recovery is slow and remains vulnerable to another dip in commodity prices and geopolitical uncertainty. Investors should not expect quick or easy resolutions to current disputes (Greece) or conflicts (Ukraine, the Middle East); however, we think the economic recovery is more resilient than even a few years ago to these types of disruptions. In our view, the breadth of economic growth has reached a point where investors should seek to be fully invested with an appropriate asset allocation and focus concerns about risk on whether a particular event can stop the world's emerging growth momentum.

### We recommend being fully invested and diversified

Broadening global growth and a strong U.S. dollar lead us to several recommendations. First, we believe investors should look to stay fully invested and buy on market pullbacks while the economic recovery continues. Second, stay diversified: Cross-country differences offer the opportunity to mitigate a portfolio's long-term up-and-down swings while retaining the potential to gain from positive international returns. Finally, currency hedging tends to work best for fixed-income positions. Hedging equities often can be an effective strategy, particularly when the dollar is in a strong uptrend and an investor's time horizon is less than a year. If the dollar stabilizes as we expect, then now might not be the best time for a long-term investor to hedge equity positions.



## We Like Domestic and International Developed Markets

### Global equity strategy

2015 YEAR-END FORECASTS	
S&P 500 Index	2150-2250
S&P 500 operating earnings per share	\$128
Russell Mid Cap Index	1685-1785
Russell Small Cap Index	1160-1240
MSCI Developed Market Index	1950-2050
MSCI Emerging Market Index	1010-1090

As of the May reading for GDP, the U.S. economy contracted during the first quarter. However, S&P 500 Index operating earnings increased by 5.9 percent in the quarter. Since March, a material swath of data points toward the start of a domestic economic rebound. Favorable indicators have included the initial jobless claims, the University of Michigan's Sentiment Index, the April Institute for Supply Management (ISM) non-manufacturing composite, and the Conference Board's Leading Economic Indicator (LEI), which are all signaling better growth ahead.

We have plotted the LEI's long-term progress back to 2000 in the chart below. In general, the composite of these forward-looking indicators has tended to move higher ahead of the economy. The index's continuing expansion through April (in blue) and our own projections through late-2015 (in brown) suggest to us that domestic growth should rebound through the remainder of this year and well into 2016. We also believe the current 2015 consensus earnings estimate for the S&P 500 Index will continue to rise through year-end.

Although domestic stock indices moved to all-time highs during the first half of 2015, we do not see aggressive investor chasing. In other words, it does not appear that investors, worried they might miss out on the next upside run, are piling into the market and chasing stocks higher.

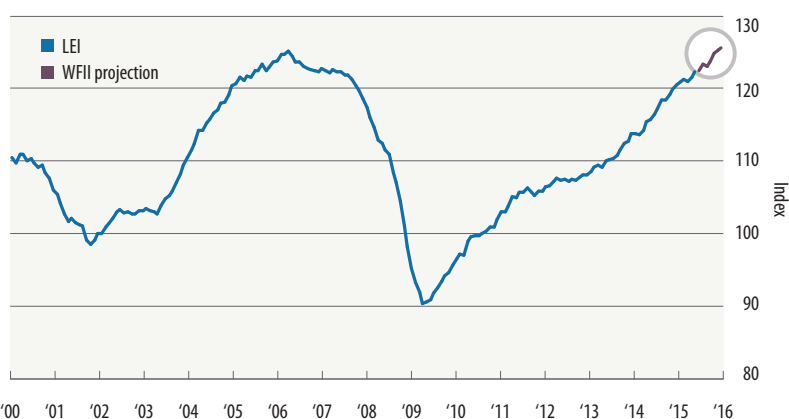
Historically (looking back to 1984), when trailing 12-month internal breadth of the S&P 500 Index has been at current levels, the index moved higher over the next six months 94 percent of the time with a median increase of 7.8 percent. Over the following 12 months, the market moved higher 94 percent of the time with an 11.4 percent median increase. Our view of market breadth, therefore, also adds favorable color to the equity outlook.

While many equity investors remain nervous with respect to potential Federal Reserve (Fed) rate increases, looking at the history of the prior two tightening cycles shows fundamental growth resulted in persistent 12-month forward expansion for the S&P 500 Index for multiple years past the start of rate increases. We believe the international recovery is still likely to enhance the domestic recovery in coming quarters and this cyclical expansion abroad should favor the more cyclically sensitive U.S. sectors. Increasingly tighter domestic capacity utilization and rising consumer confidence should also benefit cyclically sensitive versus defensive domestic sectors.

The current trailing 12-month S&P 500 Index price/earnings (P/E) valuation is slightly above the 30-year median. However, when one compares the P/E valuation against the 10-year Treasury yield, we believe stocks appear meaningfully more attractive than Treasuries. We perceive that the equity

### Domestic Growth Should Continue Rebound

*The Conference Board Leading Economic Index (LEI) and Wells Fargo Investment Institute (WFII) projection*



*The LEI's continuing expansion and our projection suggest domestic growth should rebound in the year's second half and into 2016.*

Sources: Factset, The Conference Board, and Wells Fargo Investment Institute (as of June 2, 2015)

## 2015 Opportunities in Domestic U.S. Equities

OVERWEIGHT	% of S&P 500	Guidance	NEUTRAL	% of S&P 500	Guidance	UNDERWEIGHT	% of S&P 500	Guidance
Consumer Discret.	12.5%	13.4%	Energy	8.0%	8.0%	Consumer Staples	9.5%	8.5%
Industrials	10.3%	11.6%	Financials	16.3%	16.5%	Utilities	3.0%	0.0%
Info. Tech.	20.0%	21.8%	Health Care	15.0%	14.8%			
			Materials	3.2%	3.0%			
			Telecom.	2.3%	2.4%			

See "sector weightings" definition on page 18.

**Note:** S&P 500 weightings as of May 31, 2015. May not add to 100% due to rounding.

**Sources:** Bloomberg and Wells Fargo Investment Institute

market is already meaningfully anticipating early Fed tightening. Our current year-end S&P 500 Index target range remains between 2150 and 2250, although we anticipate new highs during 2016. We recommend investors continue to overweight the cyclically sensitive Consumer Discretionary, Industrials, and Information Technology sectors of the market as the U.S. economy rebounds from early-year weakness and international monetary stimulus helps promote international and domestic growth.

### International developed equities show continued promise

We believe earnings momentum is building in the European and Japanese equity markets, and this trend may be the catalyst for higher equity returns for the remainder of the year. Developed markets should benefit from gradual economic improvement in these regions. Corporate earnings revisions in these markets have turned positive for the first time since 2011. In addition to supporting business and consumer sentiment, another round of quantitative easing (QE) measures launched by the European Central Bank (ECB) and Bank of Japan (BoJ) should provide a nice cushion for equity prices. Equity valuations have increased ahead of improvements in fundamentals and earnings, and stocks are no longer priced as cheaply as they have been in prior years. The MSCI Europe, Australasia and Far East (EAFE) Index, a primary measure of equity market performance of developed markets outside of the U.S. and Canada, trades at 16.08 times our 2015 estimate. We estimate that price multiples may stay somewhat elevated as investors await the profit cycle to accelerate.

We are maintaining our overweight to developed-market equities. Key risks to this view that bear watching include another rapid slide in the euro against the U.S. dollar, a relapse of economic weakness, particularly in Europe and Japan, and a dip in corporate earnings. Inflated equity-market valuations could become a relevant headwind if we do not see earnings growth start to rebound.

### Emerging markets remain questionable

The economic outlook for emerging markets remains mixed for the remainder of 2015 with growth rates favoring many Asian economies. Corporate earnings will be an important determinant for emerging-market performance in the year's second half. The long-overdue rebound in corporate profits could finally take shape as margins begin to improve, thanks primarily to lower commodity prices. Arguably, the predominant risk facing emerging markets today is uncertainty about capital outflows once the Fed starts to raise interest rates. That said, we believe that collectively these markets are in a better economic position to withstand higher interest rates than they were just a few years ago. However, we think it is still too early for investors to overweight emerging-market positions and reiterate our neutral stance for this asset class.

## Still Waiting for the Fed to Act

### We expect monetary policy to diverge

After a long wait, global monetary policies should finally begin to diverge during this year's second half, but we expect the divergence to occur in slow motion. The European Central Bank (ECB) is expected to continue QE bond purchases over the next year, while in the U.S., the Fed is very slowly moving toward interest rate hikes for the first time in over eight years. The BoJ continues its \$670 billion annual asset purchase program as inflation remains below target, while China continues to cut rates in hopes of alleviating the debt burden of companies and governments, allowing for a pickup in economic activity.

We expect the Fed to take an overly cautious approach to rate increases during the second half of 2015. Given weak economic data to date in 2015 coupled with sluggish inflation, we see little reason in the data for the Fed to hike rates this year. However, a strong desire by many Federal Open Market Committee (FOMC) members to "get the process started" makes a rate increase likely to occur later this year, most likely in September.

As we have stated numerous times, it is not necessarily the timing, but rather the path of rate increases upon which investors should focus. It should be clear that the Fed will move forward at a very slow and gradual pace once it begins to raise rates—much more gradual than the last Fed tightening cycle (2004-2006) when rates were increased by 25 basis points at each subsequent FOMC meeting.\* As a result, we expect the market impact of an initial rate increase to be relatively modest.

Further out the interest-rate curve, the uncertain economic recovery, low global yields, benign inflation, and rates close to or below zero in many countries and across a wide range of maturities, should help keep rates in the U.S. relatively low. As a result, we are refining our year-end expectation of the 10-year U.S. Treasury yield to between 2.25 percent and 2.50 percent and our 30-year U.S. Treasury yield to between 2.75 percent and 3.00 percent.

*\*Basis point = 1/100 of one percent.*

### 2015 Fixed Income Tactical Recommendations

Sectors			
	OVERWEIGHT	NEUTRAL	UNDERWEIGHT
		High-yield bonds	U.S. Treasuries
		Preferred stock	
		U.S. agency	
		U.S. investment-grade corporate	
		U.S. MBS	
		U.S. TIPS	
Asset class			
	OVERWEIGHT	NEUTRAL	UNDERWEIGHT
	Intermediate-term investment-grade bonds	Emerging-market bonds	Developed-market bonds
		Short-term investment-grade bonds	Long-term investment-grade bonds
		U.S. investment-grade bonds*	
Duration			
	OVERWEIGHT	NEUTRAL	UNDERWEIGHT
			Taxable
			Tax-exempt

\*Combined recommendation for short-term, long-term, and intermediate-term investment-grade U.S. bonds.

Source: Wells Fargo Investment Institute (as of May 29, 2015)



We expect continued aggressive monetary policies from foreign central banks will keep foreign yields depressed in many countries. While rates may remain low, the extremely low current yields provide little in the way of potential upside. A strengthening U.S. dollar further hampers international developed fixed income, an already challenged asset class. Ongoing negotiations between Greece and Eurozone creditors may continue to be a source of volatility for developed-market bonds through year end. We recommend investors continue to underweight developed international fixed income. We expect better medium-term performance from emerging-market debt, although investors should be prepared for a bumpy ride with this asset class, too.

### Credit is still king

Investments with credit exposure continue to be among the best performing fixed-income investments; the first half of 2015 was no exception. A precipitous drop in oil prices negatively impacted the credits of energy producers early in the year, but much of the market damage recovered as oil prices rebounded. Given our positive economic outlook, we have little reason to expect the trend of credit outperforming to reverse in the next six months. Nevertheless, investors should be prepared for periods of increased volatility as the market transitions to a change in the Fed's rate policy. Our outlook remains positive, but the risk-return proposition is much less favorable for fixed-income investors than it has been in the past, especially in lower-rated credits. We urge investors to proceed with caution.

Illiquidity in the fixed-income market is a growing concern as fewer counterparties and tighter regulation limit the desire and ability of many firms to commit significant capital to trading operations. As investors move lower in credit quality, markets tend to become more illiquid, especially during times of stress. We urge investors to balance credit exposure with the need for account stability and liquidity; we recommend a neutral weight to credit in the current environment.

### Municipal bonds remain attractive

We continue to see value in the municipal bond market for investors who want to consider taking advantage of these securities' tax-exempt nature. Select issuers are likely to remain in the news over the next six months as pockets of credit uncertainty continue to make headlines. We could see some market spillover effect in the broader municipal market but would view any weakness as an opportunity to add to better quality positions. As the global economy continues its recovery, the vast majority of municipal credits continue to be supported by strong fundamentals. We recommend investors purchase the single-A rated or better debt of general obligation (GO) and essential service revenue issuers.

### U.S. and German Government Bond Yields Have Diverged

*10-Year U.S. Treasury yield vs. 10-Year German Bund yield*



*The current level of divergence between the yields of the 10-year U.S. Treasury bond and the 10-year German Bund is near the widest level we have ever seen. But looking ahead, we believe further divergence is unlikely.*

*Although the Eurozone shares a common currency, each country issues its own government bonds. As a result, there is no common issuer to compare U.S. Treasury yields against. To fill that role, the German Bund serves as a good proxy because it is the zone's highest quality issuer with decent liquidity.*

Past performance is no guarantee of future results.

Sources: Bloomberg and Wells Fargo Investment Institute (as of May 29, 2015)

## Commodities Regroup While REITs Build Momentum

### Slow commodity rebound likely to continue

#### 2015 YEAR-END FORECASTS

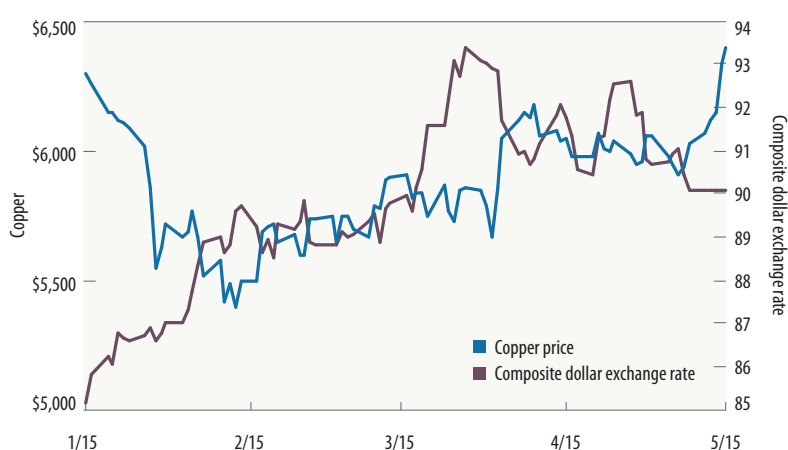
West Texas Intermediate crude price	\$50-60
Brent Crude price	\$55-65
Gold price	\$1,050-1,150
Dollar/euro exchange rate	\$1.06-1.10

At the beginning of the year, our outlook on commodities for 2015 projected weak performance in the first half, but gradually improving conditions after mid-year. Looking back on the year's first half, commodity prices, overall, did weaken in the first quarter as pervasive negative sentiment spilled over from late 2014. Yet, many commodity prices, particularly in the energy, agricultural, and industrial or base metals (e.g., copper and aluminum) sectors, slowed their decline and began to move sideways by mid-year. We believe this pivot in prices points to an improving outlook for commodities through year-end.

A number of factors can explain the dissipating pessimism and point to a neutral second half of 2015. News of production interruptions (e.g., in copper) and new policies to limit exports (e.g., Russian wheat) helped to limit price downside. Likewise, worries that U.S. oil oversupply will exhaust storage tanks dominated the first quarter but faded by springtime. In addition, expectations for postponed Fed interest rate hikes weighed on the dollar but supported commodity prices by easing storage costs. As long as the timing of the Fed's rate hikes remains uncertain, investors may expect short-term commodity prices to move opposite the dollar's exchange value (see chart below).

### Copper Prices Rise as the Dollar's Value Falls

*Copper price vs. composite dollar exchange rate*



*Copper is a key barometer for all the industrial metals. Its broad applications in electronics and, especially, construction tie the red metal even more closely than its siblings—aluminum, nickel, and zinc—to the world's economic cycle. The price of copper has shown strength as the dollar's value has weakened.*

The dollar exchange rate is a combination of exchange rates, weighted by shares in trade with the United States. The copper price is the three-month forward contract price on the London Metals Exchange.

Sources: Bloomberg and Wells Fargo Investment Institute (as of May 29, 2015)

Precious metals still look unappealing to us. Falling prices and geopolitical tensions have fueled physical demand for gold and silver. Investment demand, nevertheless, is the key determinant for gold and silver prices but is fading under a combination of tame inflation readings and the expectations that U.S. interest rates eventually will rise. Due to these factors, we recommend investors consider reallocating from precious metals into a broadly diversified commodity position.

With the exceptions of gold and silver, commodity demand seems steady as various markets adjust production. We caution that supply adjustments may proceed slowly, especially in oil, so a fast return to \$100 per barrel seems unlikely. Still, the prospects for modest upside in industrial metals, most energy products, and some agricultural markets, create an opportunity for investors to gradually increase their exposures to commodities toward their long-term target allocations.

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### **We see encouraging signs for REITs**

Heading into 2015, our expectations for U.S. real estate investment trusts (REITs) were somewhat tempered, despite a solid fundamental footing. The eight-month rally that saw REITs appreciate over 20 percent in value by mid-January was likely to pause as valuations became stretched and concerns about the timing of interest-rate increases were more prevalent. In fact, it has been a disappointing start to the year. Interest rates in particular have been the primary headwind as REITs have become very sensitive to rate changes in the short term.

However, we see some encouraging signs heading into the year's second half. First, fundamentals in the U.S. real estate sector, in general, remain strong with demand continuing to increase, pushing rental income higher. Ample capital is available to fuel investment, including significant inflows from overseas investors, which have helped to drive prices higher. Meanwhile, new supply coming into the market continues to be well below levels we have seen in past cycles. Second, we expect interest-rate headwinds to be temporary as we anticipate that rate increases will be very modest and likely have little impact on REIT valuations. Finally, the silver lining in the asset class's recent underperformance is that valuations appear more attractive than at the start of the year. REIT returns struggled early in the year, but the second-half outlook should improve.

### **MLP investors may get more clarity**

After a volatile start this year, master limited partnerships (MLPs) began to see a gradual but steady improvement in returns starting in mid-March. It was no coincidence that this occurred in conjunction with the rally in crude oil prices.

For better or worse, the MLP market's performance likely will continue to be more closely tied to crude oil prices in the near term than what has been the historic norm. Although the vast majority of MLP income is derived from volume-based fees, the collapse in energy prices last year has injected a degree of uncertainty for MLP investors. However, assuming energy markets continue to recover, we anticipate a bit more clarity in the year's second half regarding the longer-term outlook for MLP operating results. Given the uncertainties in the energy markets at this time, we continue to encourage investors to focus on well-capitalized, midstream partnerships invested in fee-based pipeline assets.

## Prospects for the Year's Second Half Look Favorable

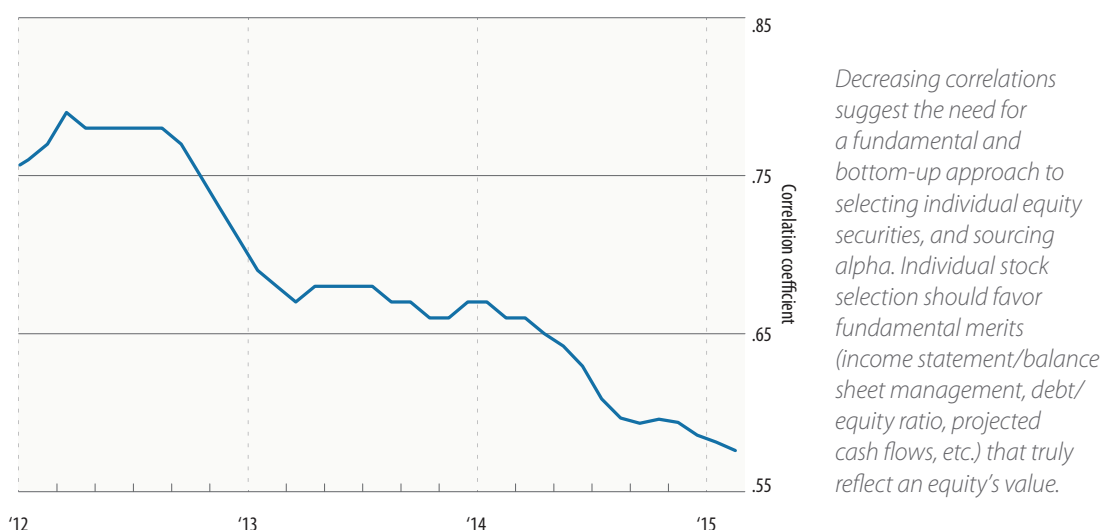
### Many strategies have done well thus far

So far in 2015 we have experienced positive performance across the alternative investment landscape, providing much-needed additional diversification benefits and reinforcing the advantages often seen with active management. We expect diverging monetary policies across global markets will have a significant effect on the prospects for active management in the near term. We believe this trend will provide a myriad of opportunities in the year's second half for implementing alternative strategies that offer the potential for additional diversification and risk-adjusted returns.

We continue to recommend an overweight to the Equity Hedge strategy. In our view, the equity markets' tone will be fundamentally driven, which should further reduce the correlations among equities, fixed income, and commodities. In addition, once interest rates eventually rise, larger return variations among companies and within sectors should allow investors to benefit from active long and short stock selections. A meaningful decrease in correlations across asset classes and an increase in the dispersions across equity returns bode well for the Equity Hedge strategy outlook.

### Correlations Among Equity Sectors Have Been Steadily Decreasing

*12-month rolling correlation for the S&P 500 sectors*



See "correlation" definition on page 18.

Past performance is no guarantee of future results.

Source: Bloomberg (data as of March 24, 2015)

We maintain our neutral-weight outlook on Relative Value, although it is becoming an increasingly exciting strategy that may warrant an upgrade in the future. The prospect for U.S. interest rate normalization has led to increased volatility across most global assets, notably fixed income and currencies, that we anticipate should produce a more fertile backdrop for this strategy. Presently, Structured Credit remains our highest conviction sub-strategy based on a stronger U.S. economy and its impact on Residential Mortgage-Backed Securities (RMBS) and Commercial Mortgage-Backed Securities (CMBS). Investors who aim to maintain credit exposure but are concerned about the potential impact of higher interest rates or are seeking to take advantage of spikes in volatility, might want to consider an allocation to Relative Value.

Expectations are that the major macroeconomic factors currently influencing asset prices will continue to generate profitable trends across global markets, supporting our neutral-weight recommendation for Macro. However, the correlation between the U.S. dollar and Macro performance seen earlier this year posed a concern, especially given the rapid appreciation of the U.S. dollar against most major currencies. (Recent weakness in the greenback posed a challenge for Macro Strategies and validated our decision to maintain a neutral weight recommendation.) Nevertheless, the last 12 months have reminded investors of the benefits of a Macro allocation. Aside from providing additional diversification benefits, Macro strategies potentially can provide incrementally higher risk-adjusted returns by capitalizing on strong trends across global assets.

Looking at the Event Driven strategy, the current environment of high corporate cash balances, a large supply of uninvested private equity capital, muted growth, an increasingly friendly climate for activism, and uncertainty surrounding the energy markets, may also provide attractive opportunities for investors. However, while acquisition activity remains at a high level, we are tempering our outlook given the expectation that the large amount of capital chasing concentrated positions will result in heightened volatility. For that reason, we remain at a neutral weight for Event Driven. We are watching closely the effects of the collapse of crude oil prices triggering broader economic consequences, resulting in a surge of defaults that could lead to growing opportunities for Distressed Credit investors in the second half of 2015.

We remain concerned with inflated asset prices and high leverage multiples and maintain our neutral weight to Private Equity. Investors in more mature private equity offerings, either via older vintages or secondary fund investing, have seen ample liquidity in portfolio realizations. Indeed, it's been a great time for sellers, but the buy side has been challenged.

Private Debt remains a high conviction strategy, and we maintain our current recommendation of an overweight allocation. Due to the precipitous decline in oil prices, many energy-related businesses are looking to the capital markets for shorter-term liquidity needs. In addition, the dislocation has created the opportunity to invest in distressed assets from a control-oriented or secondary standpoint. We believe Private Debt can provide an authentic illiquidity premium when compared to traditional fixed-income strategies and should be treated judiciously as part of an investor's alternative income allocation.

We maintain our neutral-weight outlook for Private Real Estate as there has been significant recovery in core real estate pricing, continued capital flows into this asset class, and mitigated return expectations going forward. We believe attractive opportunities exist outside the core markets for investors willing to take additional risk. Value-add and opportunistic real estate strategies that are not constrained by leasing metrics, property types, or geographies may offer investors the potential for greater rewards by taking on additional risk.

**Equity Hedge strategies** maintain both long and short positions in primarily equity and equity derivative securities.

**Event Driven strategies** maintain positions in companies currently or prospectively involved in a wide variety of corporate transactions, including mergers, restructurings, financial distress, tender offers, shareholder buybacks, debt exchanges, security issuance, or other capital structure adjustments.

**Macro strategies** base their holdings on primarily on overall economic and political views of various countries.

**Private Debt strategies** allow investors to act as lenders, typically to companies that lack the size to issue stocks or bonds to raise needed capital.

**Relative Value strategies** are predicated on realization of a valuation discrepancy in the relationship between multiple securities.

## 2015 Outlook for Best Environments for Long/Short Trading

	Volatility High	Volatility Low
Dispersion High	Good (alpha) security picking	Ideal long/short
Dispersion Low	Poor	Good (beta) risk taking

There are no assurances that this will occur.

Source: Wells Fargo Investment Institute, based on proprietary data and research.

## Three Ways to Help Position Your Investments

### Plan for volatility

Near-term challenges, including geopolitical concerns and stimulative monetary policy in the U.S., could increase investor concerns and financial market volatility through the remainder of the year. Although most assets have posted positive returns year-to-date, it is important to recognize that risks exist even in a market in which most assets are rising in value. The price gains so far this year have masked the day-to-day choppiness financial markets have experienced and are likely to continue to experience as we approach a probable Fed interest rate increase. We believe now is the time to develop an investment plan you can stick with through volatile markets.

If you already have a plan, congratulations, you are among the investors who are more likely to achieve your longer-term financial goals and realize the benefits of investing. These potential benefits include having ready access to cash when you need it, generating sufficient income, and experiencing longer-term growth of your assets for goals like retirement. Developing a plan allows you to match your financial goals with the assets you believe are most likely to help you meet these goals. Many times that means investing in equities for growth, bonds for stability and income, real assets for inflation hedging and income, and alternative investments for stability and additional diversification. Diversified investors are typically rewarded with more consistent risk-adjusted returns. Over time a diversified portfolio historically has provided more consistent returns than many of its individual components. Diversification does not mean your portfolio will always go up in value, but it does help smooth returns during market downturns so you're less likely to feel compelled to act in a way that may jeopardize your longer-term objectives.

A plan that includes holding target allocations to a variety of assets and incorporates a regular rebalancing strategy to keep it in line with target allocations can provide the framework for successful investing. Because markets often move higher than the underlying fundamentals would suggest or lower than changing market conditions would warrant, this strategy can take the emotion out of the equation.

### Identify unexpected sources of risk

Investors should manage risks that come from unexpected sources like adding to yesterday's outperformers and reaching for yield.

### ***A recency bias may prove costly***

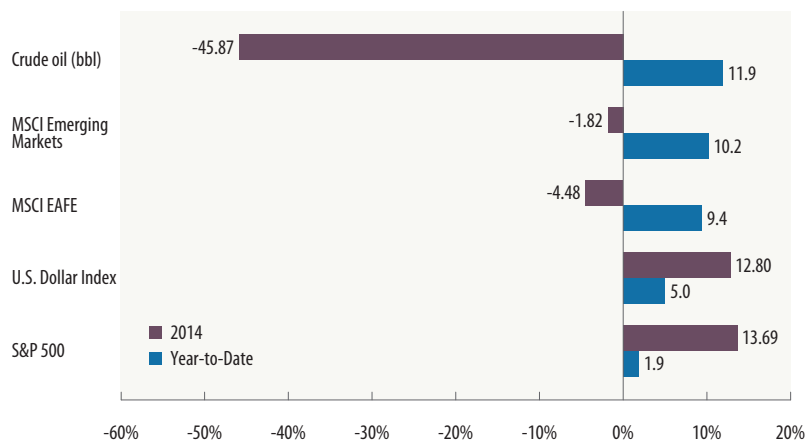
Investing too heavily in yesterday's outperformers (or avoiding yesterday's laggards) may hinder your portfolio's performance. For example, going into this year, international stocks and oil appeared to be headed for even greater losses but have, instead, reversed course. Meanwhile, U.S. stocks and the dollar appeared poised to continue their upward trends, but so far, neither has moved significantly higher. Placing too much faith in short-term market trends can cause investors to underperform. A 20-year study by Dalbar, a research firm, shows over longer time periods individual investors have significantly underperformed market indices due to their failed efforts at short-term market timing.\*

*\*"Quantitative Analysis of Investor Behavior, 2015" by Dalbar, Inc. and Lipper.*



## The Problem With Investing Based on Recent Performance

2014 vs. year-to-date 2015 performance of selected investments



*Some of last year's disappointments (oil, emerging markets, developed international) have done well in 2015 while U.S. large-cap stocks and the dollar, which did well in 2014, have been unimpressive so far this year.*

Past performance is no guarantee of future results. An index is unmanaged and not available for direct investment.

Source: Wells Fargo Investment Institute (year-to-date as of April 30, 2015)

### Being too cautious may be risky

Under-confidence can also be a risk. To many investors, holding cash or short-term bonds is a way to reduce risk in their portfolios, yet investing too conservatively can be detrimental to achieving longer-term financial goals. For example, investors who have held cash since the 2009 market trough have earned a mere one-half of a percent (cumulative) over those six years.\* Investors in U.S. high-quality bonds have seen their assets grow a cumulative 35 percent (based on the Barclays U.S. Aggregate Bond Index) since March 2009, while most stock markets and even some segments of the bond markets are up triple digits. Although we are expecting more episodes of periodic market volatility as we proceed through the latter stages of the cyclical recovery, we are not suggesting you invest more heavily in cash or even bonds. Instead, we recommend using periods of market volatility as opportunities to invest in lower-cost assets.

### Consider a total return approach

It is important to develop and maintain a mix of assets that aligns with your investment goals, time horizon, and risk tolerance. However, there are times when expected asset returns may not match your investment goals. For example, investors who use income from their portfolio to fund their day-to-day expenses are faced with the dilemma of low yields. They have several options, such as investing:

- » A greater percentage of their portfolio in high-quality bonds
- » A larger proportion of their bond allocation in higher-yielding bonds or other historically high-yielding assets, such as REITs, MLPs, or high-dividend stocks
- » For total return

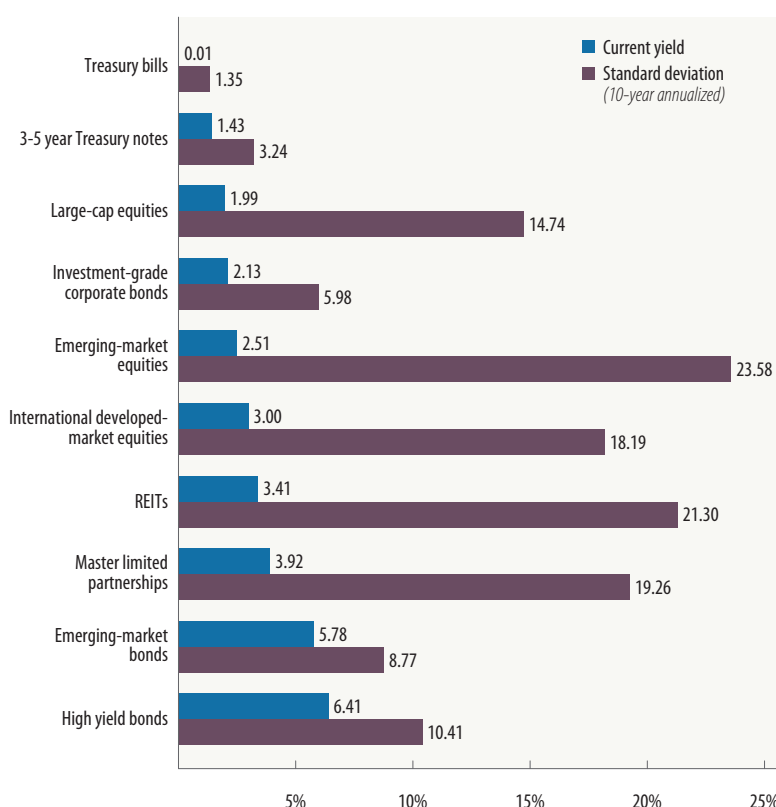
\*Source: FactSet (as of May 1, 2015)

Any one of these options may be appropriate for an individual investor, but choosing either of the first two may significantly change your portfolio's risk profile. When you invest more of your overall portfolio in high-quality bonds, you may produce more income today; however, you may also forgo the potential to grow your assets for greater income-generating potential in the future. When you allocate a greater share of your portfolio to higher-yielding assets (reaching for yield), you may be assuming additional default, maturity, and/or market risk.

Investing for total return is a bit different in that you may not need to change your allocation significantly to satisfy your income needs. Instead, you may be able to realize some gains from your equity holdings to supplement the portfolio's income yield. The approach that is right for you will depend on your individual situation. That is why we suggest developing a plan and reviewing it regularly as market conditions and expectations shift and as your own personal circumstances change.

### Consider the Risks When "Reaching for Yield"

*Standard deviation (risk) vs. current yield for selected investments*



*Higher-yielding fixed-income investments come with significant risk (as measured by standard deviation). While stocks carry more risk, they also bring greater potential for market price appreciation.*

**Treasury bills:** Barclays U.S. Treasury Bills (1-3 month) Index. **3-5 year Treasury notes:** Barclays 3-5 year U.S. Treasury Index. **Large-cap stocks:** S&P 500 Index. **Investment-grade corporate bonds:** Barclays U.S. Aggregate Bond Index. **Emerging market stocks:** MSCI Emerging-Market Index. **International stocks:** MSCI EAFE Index. **REITs:** FTSE EPRA/NAREIT Equity Index. **Master limited partnerships:** Wells Fargo Securities Master Limited Partnership Index. **Emerging-market bonds:** BofA Merrill Lynch Global High Yield & Emerging Market Index. **High-yield bonds:** Barclays U.S. Corporate High Yield Bond Index.

Past performance is no guarantee of future results.

Source: Wells Fargo Investment Institute (as of April 30, 2015)

## We See Opportunities in an Improving Global Economy

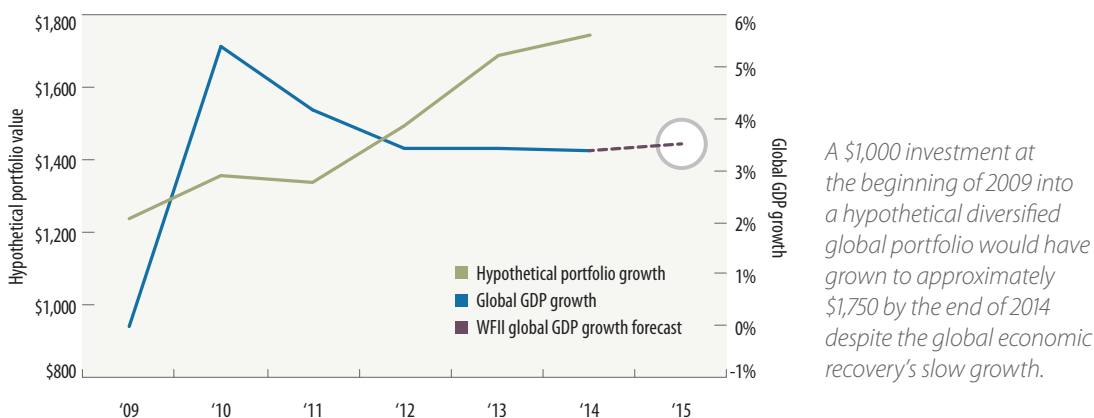
The global economic recovery has had some tumultuous episodes in its six-year history. Yet, recent events—whether the slow U.S. recovery, the European debt crisis, or the historic social upheavals in Eastern Europe and the Middle East—have not curtailed the global economic expansion. Moreover, our forecast remains for slightly stronger global economic momentum for the remainder of 2015. We think it's notable that a hypothetical, globally diversified and fully invested portfolio could have earned a positive return in each of the past six years except 2011 (the peak of the European crisis). Of course, hypothetical and past performance does not guarantee future results, but an acceleration of the global recovery in 2015 and beyond, as we expect, should maintain a favorable investment environment.

This report laid out our detailed reasons why we believe a globally allocated portfolio should continue to benefit from current and expected economic improvement. We broadly favor equities over bonds, while regional differences rank the U.S. and developed equity markets ahead of emerging markets. But these regional differences are also the source of additional diversification benefits. Diversification is important between stocks and bonds as well. Yields are low compared to history, but there are still values in credit and municipal bonds. Alternative strategies, REITs, and MLPs also continue to offer chances for return and diversification, in our view.

Markets may still be vulnerable to events that create uncertainty, but we think the economic expansion is gaining both breadth across countries and momentum at home. In light of this, we think investors should make an overall investment plan and stick to it. Having a plan can help greatly when it comes to looking past swings in the daily news and can help you align your long-term goals with our views for what we believe is the best long-term combination of risk and return.

### Portfolio Growth Has Been Possible in Recent Environment

*Hypothetical portfolio growth vs. global GDP growth*



Return assumes \$1,000 invested at the beginning of 2009 in 60% MSCI All Country World Index (ACWI) total return and 40% JP Morgan Global Aggregate Bond Index (GABI) total return. For illustrative purposes only. Does not represent any specific investment. Past performance is not indicative of future results. Indices are unmanaged and not available for direct investment.

Sources: Bloomberg, International Monetary Fund, and Wells Fargo Investment Institute, annual data, 2007-2014

## DEFINITIONS

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### Indexes

An index is unmanaged and not available for direct investment.

**Barclays 3-5 Year U.S. Treasury Index** measures the performance of intermediate-term government notes issued by the U.S. Treasury.

**Barclays U.S. Aggregate Bond Index** covers the U.S. dollar-denominated, investment-grade (rated Baa3 or above by Moody's), fixed-rate, and taxable areas of the bond market. This is the broadest measure of the taxable U.S. bond market, including most Treasury, agency, corporate, mortgage-backed, asset-backed, and international dollar-denominated issues, all with maturities of one year or more.

**Barclays U.S. Corporate High-Yield Bond Index** covers the U.S. dollar-denominated, non-investment grade, fixed-rate, taxable corporate bond market. Securities are classified as high-yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB= or below. Included issues must have at least one year until final maturity.

**Barclays U.S. Treasury Bills (1-3M)** Index is representative of money markets.

**BofA Merrill Lynch Global High Yield & Emerging Markets Index** tracks the performance of the below-investment-grade global debt markets denominated in the major developed market currencies.

**FTSE EPRA/NAREIT Developed Index** is designed to track the performance of listed real-estate companies and REITs in developed countries worldwide.

**JP Morgan Global Aggregate Bond Index (GABI) total return** is constructed from over 5,500 instruments issued from over 60 countries and denominated in over 25 currencies. GABI represents nine distinct asset classes: developed-market treasuries, emerging-market local treasuries, emerging-markets external debt, emerging-markets credit, U.S. credit, euro credit, U.S. agencies, U.S. MBS, and Pfandbriefe.

**MSCI All Country World Index (ACWI) total return** captures large- and mid-cap representation across 23 developed-market and 23 emerging-market countries. With 2,466 constituents, the index covers approximately 85% of the global investable equity opportunity set. The developed-market countries include Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, United Kingdom, and United States. The emerging-market countries include Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Poland, Russia, Qatar, South Africa, Taiwan, Thailand, Turkey, and United Arab Emirates.

**MSCI EAFE (Europe, Australasia and Far East) index (developed market)** compiled by Morgan Stanley Capital International (MSCI) is a value-weighted index of the equity performance of major foreign markets. In effect, it is a non-American world index of more than 1,000 stocks.

**MSCI Emerging Market Index** was created by MSCI and designed to measure equity market performance in global emerging markets.

**Russell 2000® Index (small cap)** 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 Midcap® Index** measures the performance of the 800 smallest companies in the Russell 1000® Index, which represent approximately 25% of the total market capitalization of the Russell 1000® Index.

**S&P 500® Index** consists of 500 industrial, financial, utility and transportation companies with market capitalizations of \$4 billion or more.

**U.S. Dollar Index (USDx)** measures the value of the U.S. dollar relative to majority of its most significant trading partners. This index is similar to other trade-weighted indexes, which also use the exchange rates from the same major currencies.

**Wells Fargo Securities Master Limited Partnership Index** is a float-adjusted, capitalization-weighted index of energy master limited partnerships (MLPs) with a market capitalization of at least \$200 million at the time of inclusion.

### Terms

**Active management** refers to a strategy where the manager makes specific investments with the goal of outperforming an investment benchmark index.

**Alpha** is a coefficient measuring the risk-adjusted performance, considering the risk due to the specific security, rather than the overall market. A large alpha indicates that the stock or mutual fund has performed better than would be predicted given its beta (volatility).

**Alternative income** can include income from international fixed income, high yield, emerging-market debt and real estate investment trusts.

**Alternative investments** are investments outside of the traditional asset classes (stocks, bonds, cash alternatives) and can include investments in private equity, hedge funds, and managed futures.

**Beta** measure a stock's price volatility based solely on general market movements. The higher the beta, the more volatile the stock is relative to the market.

**Commodities** are basic goods used in commerce that are generally interchangeable with other commodities of the same type. Commodities are most often used as inputs in the production of other goods or services.

**Consumer Price Index (CPI)** is a measure of the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. The CPI is calculated by taking price changes for each item in the predetermined basket of goods and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living.

**Correlation** is the tendency for the returns of two assets, such as a portfolio and an index, to move together relative to their average. The measurement of this statistic (the correlation coefficient) can range from -1 (perfect negative correlation, one goes up the other down) to 1 (perfect positive correlation, both moving in the same direction). A correlation of 0 means no relationship can be found between the movement in the index and the movement in the portfolio's performance.

**Current yield** (frequently referred to as yield) is the annual income an investment provides divided by its current market price. For example, a bond selling at par (\$1,000) paying \$100 annually in interest would have a 10% yield. However, if the bond's market price fell to \$900, its yield would increase to approximately 11%.

**Cyclical stocks** are typically those of companies that sell discretionary items that consumers can afford to buy more of in a booming economy and will cut back on during a recession. In other words, when the economy is doing well, cyclical investments tend to perform well. The opposite, of course, is true when the economy is doing poorly. Defensive investments, on the other hand, tend to be less affected by economic cycle changes.

**Dispersion** describes a lack of correlation between the performance of two or more different investments.

**Duration** can be used to estimate the percentage change in a bond's value that will result from a 1% change in interest rates. For example, a duration of four means that a 1% change in prevailing rates in a one-year period should shift the bond's price in the opposite direction by 4%. The longer (higher) the duration, the more the bond's price will fluctuate as interest rates rise and fall.

**Emerging markets** are financial markets in countries with developing economies. These markets are typically immature compared to those of the world's major financial centers but are becoming increasingly sophisticated and integrated into international markets; they provide potentially higher returns but are intensely volatile.

**Gross domestic product (GDP)** is the total value of the goods and services the economy produces during a year. Increasing GDP indicates growing economic activity. Decreasing GDP suggests the opposite.

**High yield** is noninvestment-grade fixed-income securities (rated Ba1 or lower by Moody's and/or BB+ or lower by S&P). These investments are considered to be speculative and are subject to a higher degree of risk.

**Illiquidity premium** is additional return an investor receives for putting money into an investment that may be difficult to convert into cash.

**Institute of Supply Management (ISM) Purchasing Manager's Index** gauges internal demand for raw materials/goods that go into end-production. An index value over 50 indicates expansion; below 50 indicates contraction. The values for the index can be between 0 and 100.

**Intermediate-term fixed income** includes instruments that mature in six to 12 years.

**International investing** involves putting money into financial markets in developed economies outside of the United States.

**Large-cap stocks** have a market cap greater than \$10 billion.

**Liquidity**, in regard to the economy, is a reference to the money supply. The greater the liquidity, the larger the money supply.

**Long-term fixed income** includes instruments whose maturities are greater than 12 years.

**Mortgage-backed security (MBS)** is an asset-backed security secured by a mortgage or, more commonly, a collection of mortgages. The mortgages are sold to a group of individuals that packages the loans into a security sold to investors.

**Mid-cap stocks** have a market cap between \$2 billion – \$10 billion.

**Quantitative easing** is a central bank strategy for increasing the money supply (adding liquidity) to help keep interest rates low and stimulate economic activity. In general, it involves central bank purchases of bonds from banks, providing them with money to lend to businesses and consumers.

**Real estate investment trusts (REITs)** trade on the major exchanges and invest in real estate directly, either through properties or mortgages.

**Sector weightings** are guidance stock market strategists use to indicate how they believe investors should allocate their stock portfolios. When a strategist's guidance is to overweight a sector, he or she believes it will perform well in the future and investors should allocate a larger percentage of their stock portfolios to that sector than its relative representation in the S&P 500 index. For example, if the Energy sector represents 11% of the S&P 500 index and a strategist's guidance is to overweight that sector, he or she is recommending that investors allocate more than 11% of their stock portfolios to the sector. If a strategist's guidance is to evenweight a sector, he or she believes investors' allocation to that sector should be in line with its representation in the S&P 500. If a strategist's guidance is to underweight a sector, he or she believes investors' allocation to that sector should be less than its representation in the S&P 500.

**Short-term fixed income** includes instruments that mature in one to six years.

**Small-cap stocks** have a market cap less than \$2 billion.

**Standard deviation:** Standard deviation of return measures the average deviations of a return series from its mean, and is often used as a measure of risk. A large standard deviation implies that there have been large swings in the return series of the manager.

**Treasury Inflation Protected Securities (TIPS)** are Treasury securities indexed to inflation to help protect investors from the negative effects of inflation.

## RISK CONSIDERATIONS

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There is no assurance that any of the target prices or other forward-looking statements mentioned will be attained. Any market prices are only indications of market values and are subject to change.

Asset allocation and diversification do not guarantee a profit or protect against loss.

### Alternative investment risk considerations

**Alternative investments, such as hedge funds, private capital/private debt and private real estate strategies, are speculative and not suitable for all investors. Any offer to purchase or sell a specific alternative investment product will be made by the product's official offering documents. 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.**

**Hedge strategies are speculative and involve a high degree of risk. Event Driven** strategies involve investing in opportunities created by significant transactional events, such as spinoffs, mergers and acquisitions, bankruptcy reorganization, recapitalization, and share buybacks. Managers who use such strategies may invest in, and might sell short, the securities of companies where the security's price has been, or is expected to be, affected by a distressed situation. **Macro** managers trade a broad range of strategies in which the investment process is predicated on movements in underlying economic variables and the impact these have on equity, fixed income, hard currency, and commodity markets. **Equity Hedge** strategies maintain positions both long and short in primarily equity and equity derivative securities. Successful **hedging strategies** may require the anticipation of future movements in securities prices, interest rates, and other economic factors. No assurance can be given that such judgments will be correct.

**Private companies are subject to substantial risks.** Such companies are not subject to SEC reporting requirements and are not required to maintain effective internal controls over financial reporting. They may have limited financial resources, shorter operating histories, more asset concentration risk, narrower product lines, and smaller market shares than larger companies. In addition, securities issued by private companies are typically illiquid, and there may be no readily available trading market for such securities. **Privately offered real estate funds** include the risks inherent in an investment in securities, as well as specific risks associated with investments in real estate, limited liquidity, the use of leverage, arbitrage, short sales, options, futures, derivative instruments, investment in non-U.S. securities, "junk" bonds, and illiquid investments. **Private debt** has speculative characteristics that include potential default, limited liquidity, and the infrequent availability of independent credit ratings for private companies.

### Other risk considerations

**Commodities:** Investing in commodities is not suitable for all investors. Exposure to the commodities markets may subject an investment to greater share price volatility than an investment in traditional equity or debt securities. The prices of various commodities may fluctuate based on numerous factors. Products that invest in commodities may employ more complex strategies which may expose investors to additional risks. Investing in gold, silver, or other precious metals involves special risk considerations, such as severe price fluctuations and adverse economic and regulatory developments affecting the sector or industry.

**Fixed-income securities:** Investing in fixed-income securities involves certain risks, such as market risk if sold prior to maturity and credit risk, especially if investing in high-yield bonds, which have lower ratings and are subject to greater volatility. All fixed-income investments may be worth less than original cost upon redemption or maturity. Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can result in the decline of the value of your investment.

**Foreign securities:** Investing in foreign securities presents certain risks not associated with domestic investments, such as currency fluctuations, political and economic instability, and different accounting standards. This may result in greater share price volatility. These risks are heightened in emerging markets.

**Master limited partnerships (MLPs):** MLPs involve certain risks which differ from an investment in the securities of a corporation. MLPs may be sensitive to price changes in oil, natural gas, etc., regulatory risk, and rising interest rates. A change in the current tax law regarding MLPs could result in the MLP being treated as a corporation for federal income tax purposes, which would reduce the amount of cash flows distributed by the MLP. Other risks include 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.

**Mortgage-backed securities (MBS):** The yield, average life and the expected maturity of MBS are based on prepayment assumptions that may or may not be met. Changes in prepayments may significantly affect yield, average life and expected maturity.

**Municipal securities:** Income from municipal securities is generally free from federal taxes and state taxes for residents of the issuing state. While the interest income is tax-free, capital gains, if any, will be subject to taxes. Income for some investors may be subject to the federal alternative minimum tax (AMT).

**Preferred securities:** There are special risks associated with investing in preferred securities. Preferred securities generally offer no voting rights with respect to the issuer. 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.

**Real estate:** There are special risks associated with an investment in real estate, including illiquidity of underlying properties, credit risk, interest rate fluctuations and the impact of varied economic conditions.

**Small- and mid-capitalization stocks:** The prices of small- and mid-cap company stocks are generally more volatile than large-company stocks. They often involve higher risks because smaller companies may lack the management expertise, financial resources, product diversification and competitive strengths to endure adverse economic conditions.

**Stocks:** Stocks offer long-term growth potential, but may fluctuate more and provide less current income than other investments. An investment in the stock market should be made with an understanding of the risks associated with common stocks, including market fluctuations.

**Technology and Internet-related stocks:** Technology and Internet-related stocks, especially of smaller, less-seasoned companies, tend to be more volatile than the overall market.

**Treasury Inflation-Protected Securities (TIPS):** The interest rate for TIPS, which is set at auction, remains fixed throughout the term of the security. The principal amount of the security is adjusted for inflation, but the inflation-adjusted principal will not be paid until maturity although the adjustment will be subject to income tax in the year it was earned. Wells Fargo Advisors is not a tax advisor. TIPS have special tax consequences, generating phantom income on the "inflation compensation" component of the principal. A holder of TIPS may be required to report this income annually although no income related to "inflation compensation" is received until maturity.



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*To help with your investment planning or to discuss the points in this report, please talk to your investment professional.*

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