

Recession, recovery, and rebound

Economy and exchange rates

We expect U.S. and global economies to face a moderate recession through the summer in 2023 followed by a second-half recovery capable of extending into 2024.

More trade-sensitive, manufacturing-oriented economies abroad are bracing for a steeper economic slowdown from interest-rate increases and market liquidity pressure potentially more serious than in the U.S.

We will be watching two main risks. First is the risk of tightening financial conditions tied to, among other things, higher interest rates, the Federal Reserve's (Fed's) quantitative tightening, a strong U.S. dollar, and reduced money-supply growth. Second, any new commodity shortages could raise raw-materials prices, prolong high inflation and monetary policy restrictions, and thereby extend the recession.

Our conviction is that inflation will decline, leaving its December 2022 to December 2023 rate below 3%. Inflation is susceptible to declines now that a series of shocks contributing to its "spike" are unwinding.

We expect the dollar to recover from its reversal in late 2022 and remain firm into early 2023. Over the course of 2023, we expect a potential slowing of the dollar's ascent, a flattening, and a partial reversal of its upward trajectory.

Average percent change from the same period a year ago, unless otherwise noted.

	Latest	2023 target
U.S. GDP growth	3.3% (Period ending Q3)	-1.3%
U.S. CPI inflation ¹	7.7% (Oct.)	2.2% (Dec.)
U.S. unemployment rate ²	3.6% (Oct.)	5.2% (Dec.)
Global GDP growth ³	3.4% (Period ending Q3)	0.9%
Dollar/euro exchange rate	\$1.04	\$1.01–\$1.09

Sources: Wells Fargo Investment Institute and Bloomberg, December 6, 2022. Latest economic and market data as of November 30, 2022. GDP = gross domestic product. CPI = Consumer Price Inflation. 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. An index is unmanaged and not available for direct investment. Past performance is no guarantee of future results.**

1. 12-month change as of date indicated.

2. 3-month average as of date indicated.

3. Global GDP is GDP-weighted average for developed and emerging economies.

Fixed income

We believe the Fed will pivot away from monetary policy tightening in 2023 after signs of waning inflation pressures begin to emerge and the recession takes hold.

We believe the recession may result in even stronger demand for municipal bonds.

We favor remaining nimble in bond portfolio allocations with a barbell strategy that lengthens maturities but also takes advantage of ultra-short-term yields. An eventual economic recovery in the year's second half should begin to support credit-oriented asset classes and sectors.

	Latest	2023 year-end target
Federal funds rate	3.75%–4.00%	3.50%–3.75%
10-year U.S. Treasury yield	3.64%	3.50%–4.00%
30-year U.S. Treasury yield	3.76%	3.50%–4.00%

Sources: Wells Fargo Investment Institute, December 6, 2022. Latest economic and market data as of November 30, 2022. **Forecast and targets are based on certain assumptions and on our current views of market and economic conditions, which are subject to change. Past performance is no guarantee of future results.**

Equities

In the U.S., we expect corporate revenue to decline as the economy falls into recession. We also see operating margins slipping from record levels as sales growth stalls and interest, labor, and input expenses remain elevated. Earnings are likely to contract early in the year due to the projected economic weakness in the coming quarters. We see earnings rebounding toward the end of 2023 as the U.S. economy begins to grow again.

Our forecasts for the recession to end in mid-2023, inflation to cool, and the Fed to begin easing policy should lead to improving investor sentiment and higher price/earnings (P/E) multiples. Investors should anticipate the late-2023 to 2024 economic and earnings recovery to send equity prices higher. Similar to prior early cycles, equity prices likely will increase much more rapidly than earnings can recover, leading to above-average P/E multiples. However, once earnings catch up to prices, the multiples should normalize at a lower level.

We continue to favor higher-quality U.S. large-cap and mid-cap equities over small-cap and international equities.

We continue to prefer balance, patience, and a tilt toward quality, both across equity sectors and at the sub-industry level. Our favored sectors remain Information Technology (IT), Health Care, and Energy, while we remain unfavorable on the highly cyclical Consumer Discretionary sector and the interest-rate-sensitive Real Estate sector.

	Latest	2023 year-end target
S&P 500 Index	\$4,080	4,300–4,500
Earnings per share	\$220	\$205
Russell Midcap Index	2,860	2,900–3,100
Russell 2000 Index (small cap)	1,886	1,800–2,000
MSCI EAFE Index	1,945	1,700–1,900
MSCI Emerging Markets Index	952	800–1,000

Sources: Wells Fargo Investment Institute and Bloomberg, December 6, 2022. Latest economic and market data as of November 30, 2022; latest 2022 earnings per share figures reflect consensus estimates. **Forecast and targets are based on certain assumptions and on our current views of market and economic conditions, which are subject to change. An index is unmanaged and not available for direct investment. Past performance is no guarantee of future results.**

Real assets

Commodities have had a strong two-year run, and we expect more gains in 2023. We like the Energy sector the best. We also favor large, well-capitalized, broadly diversified midstream energy companies — both master limited partnerships (MLPs) and C-corporations. We remain unfavorable on real estate investment trusts (REITs) due to rising interest rates and an impending recession.

Oil prices are likely on track for another positive year driven by production challenges and strategic opportunities in large oil-producing countries. Limited global production growth will likely keep prices moving higher over the next few years.

We are neutral on the Precious Metals sector, which includes gold. Gold has positives, but its negatives have been directing prices for some time now.

	Latest	2023 year-end target
West Texas Intermediate crude (barrel)	\$80	\$100–\$120
Brent crude (barrel)	\$85	\$105–\$125
Gold (troy ounce)	\$1,769	\$1,900–\$2,000
Bloomberg Commodity Index (total return)	252	270–290

Sources: Wells Fargo Investment Institute, December 6, 2022. Latest economic and market data as of November 30, 2022. **Forecast and targets are based on certain assumptions and on our current views of market and economic conditions, which are subject to change. An index is unmanaged and not available for direct investment. Past performance is no guarantee of future results.**

Alternative investments

While equity and bond market volatility remain elevated, we favor strategies that offer low correlation to these traditional markets. Credit markets have begun to show signs of weakness despite relatively low default and distress ratios. As conditions continue to deteriorate, we will look to shift our guidance on distressed investing within both Event Driven and Private Debt strategies.

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

Risk considerations

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

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

Index definitions

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

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

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

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

Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index.

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

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