WELLS FARGO
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Capital Market Assumptions

Presenter: Veronica Willis, Investment Strategy Analyst, Wells Fargo Investment Institute

Capital market assumptions, or CMAs, provide our expectations for asset-class performance and risk. CMAs reflect what we believe investors may experience through at least one full market cycle, including periods when financial markets rise and fall.

Our CMAs incorporate trends we expect over at least the next 10 to 15 years, which we consider our strategic time frame. We utilize a building-block approach starting with our long-term expectations for inflation and cash returns.

Using the building-block approach, we assume that investors demand compensation for taking additional risks, including term risk, credit risk, equity risk, and illiquidity.

Based on our expectation for inflation to remain elevated over the next few years, we've increased our inflation expectation to 2.25%. In the later years of the strategic time frame, we do expect inflation to trend back toward the Federal Reserve's (Fed's) 2% target. We still anticipate a cash discount to inflation, but at a smaller level than we've observed over the past 10 years.

Overall, our CMA return assumptions for cash and fixed income are higher this year, reflecting that, as the Fed raises rates, the higher expected total return to cash will flow through to fixed income returns and yields. We also expect higher commodity returns as the bull super cycle for commodities advances.

We continue to expect a positive environment for risk assets with returns for most asset classes that are similar to last year's expectations. One major exception is that we reduced return expectations for emerging market equities, as we expect slowing economic and earnings growth to impede performance for this asset class.

We use CMAs to develop strategic asset allocation recommendations that reflect an investor's goals and risk tolerance.

This year, changes to our strategic allocations include reductions in Emerging Market Equities and High Yield Fixed Income in favor of Commodities, which we expect to perform well over the strategic time frame. In our view, including a diversifier like Commodities in a portfolio can be beneficial as this class of assets has historically not moved exactly in tandem with stocks or bonds.

We believe a well-diversified portfolio will help manage volatility and smooth out performance over the strategic time horizon. Comparing the risk-and-return characteristics of various asset allocations may also help investors choose the portfolio mix that best suits their needs.