WELLS FARGO
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U.S. slowing down

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Our analysis suggests that after economic contraction in the first and second quarters of 2022, the U.S. economy's deterioration is likely to continue into early 2023. Housing and business capital spending plans are two examples of key domestic economic segments whose outlooks have dimmed as the Federal Reserve aggressively hikes interest rates and inflation wreaks havoc on consumer's wage gains. We now expect a moderate recession to begin soon and last until the middle of next year.

But we are already in what some would consider to be a technical recession, defined as two consecutive quarters of economic contraction. Historically, over the past 75 years, a technical recession has been a reliable indicator of an eventual "official" recession — as declared, usually in hindsight, by the National Bureau of Economic Research. At the very least, it is safe to say growth in the first half of this year shows the U.S. economy has little forward momentum.

Higher-for-longer inflation and the synchronized tightening response from many of the major (and minor) global central banks have taken a toll on equity valuations as well as consumer and business confidence. The economy is slowing quickly based on our analysis of the data. Earnings headwinds have been more pronounced in the second quarter and overall guidance has been adjusted to the downside. Based on these expectations, we recently lowered our 2022 earnings estimate for the S&P 500 to $200, down from $220.

With lower valuations and earnings estimates, we now expect the S&P 500 Index to finish the year in the 3800-4000 range. We do expect to see economic improvement as we move through 2023 as the worst of the recession will likely occur late this year. By mid-2023, we expect brighter skies to be on the horizon, as the Federal Reserve will likely have halted its tightening process and interest rates fall back in response to more modest economic growth and lower inflation.

While many investors may be nervous, we do not favor selling into the current weakness. The U.S. and global economies may go through a rough patch in coming quarters, but history has shown that the bottoming process in financial markets can often take time. Those investors who have funds on the sidelines can patiently and incrementally take advantage of downside volatility to put money to work and potentially benefit from the rebound that we believe may occur next year.

We recommend incrementally putting sidelined funds to work in the equity market. We favor U.S. over International, larger cap over smaller cap, and have taken a more defensive posture in terms of sectors by favoring Health Care, Technology, and Energy. We are also playing defense in fixed income and favor exposure to short-term fixed income. Alternative strategies we favor include macro and relative value. For now, we are more focused on capital preservation over capital appreciation.

Risk considerations

Forecasts are not guaranteed and based on certain assumptions and on views of market and economic conditions which are subject to change.

Equity securities are subject to market risk which means their value may fluctuate in response to general economic and market conditions and the perception of individual issuers. Investments in equity securities are generally more volatile than other types of securities. 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.

Investing in foreign securities presents certain risks not associated with domestic investments, such as currency fluctuation, political and economic instability, and different accounting standards. This may result in greater share price volatility.

Investments in fixed-income securities are subject to interest rate, credit/default, liquidity, inflation and other risks. Bond prices fluctuate inversely to changes in interest rates.

Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility. Some of the risks associated with investment in the **Health Care** sector include competition on branded products, sales erosion due to cheaper alternatives, research and development risk, government regulations and government approval of products anticipated to enter the market. Risks associated with the **Technology** sector include increased competition from domestic and international companies, unexpected changes in demand, regulatory actions, technical problems with key products, and the departure of key members of management. Technology and Internet-related stocks, especially smaller, less-seasoned companies, tend to be more volatile than the overall market.

Products that employ alternative strategies are more complex investment vehicles. They tend to be more volatile than other types of investments and present an increased risk of investment loss. Some of these strategies may expose investors to risks, such as short selling, leverage risk, counterparty risk, liquidity risk, commodity price volatility risk, and/or managed futures roll yield risk. In addition, alternative strategies engage in derivative transactions. The use of derivatives will expose an investment to further risks that it would not be subject to if it invested directly in the securities underlying those derivatives.

Definitions

An index is unmanaged and not available for direct investment.

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the US stock market.

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