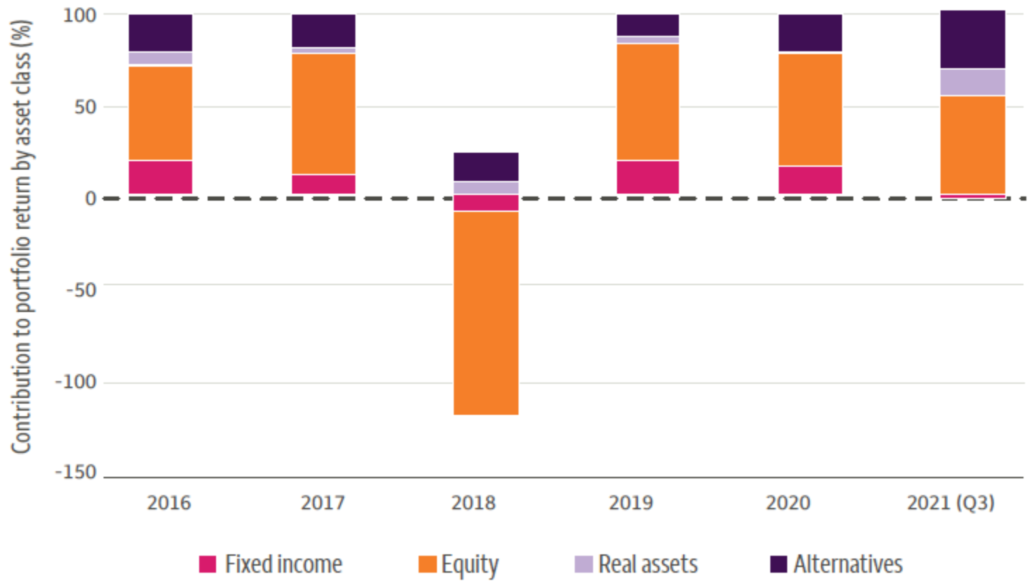
WELLS FARGO
Investment Institute

Chart of the Week

Weekly market analysis on key market indexes **December 7, 2021**

How can diversified portfolios help mitigate risks?



Sources: Morningstar[1] and Wells Fargo Investment Institute. Data as of September 30, 2021. Performance results of the moderate growth and income four-asset group are hypothetical and do not reflect and actual investment. An index is unmanaged and not available for direct investment. **Hypothetical and past performance do not guarantee future results.** Moderate Growth and Income is composed of 2% Bloomberg U.S. Treasury Bill (1–3 Month) Index, 21% Bloomberg U.S. Aggregate Bond Index, 4% Bloomberg U.S. Corporate High Yield Bond Index, 4% JPM EMBI Global Index, 18% S&P 500 Index, 8% Russell Midcap Index, 3% Russell 2000 Index, 6% MSCI EAFE Index, 6% MSCI Emerging Markets Index, 6% NCREIF Property Index, 2% Bloomberg Commodity Index, 10% HFRI Fund Weighted Composite Index, 7% Cambridge Associates U.S. Private Equity Index, and 3% ILPA Private Credit Fund Index. U.S. Investment Grade Fixed Income encompasses the allocations to short term, intermediate term, and long term.

The diversification benefit for a four-asset-group portfolio was especially evident in 2018, when equity prices declined

We expect positive equity returns in 2022, so higher tactical equity allocations should lead to higher portfolio returns. But to help with risk mitigation, a bond allocation is generally appropriate for most investors. In a rising-rate environment, long-term fixed income may lose money as interest rates rise, but we favor allocations to intermediate-term fixed income. We also favor preferred and municipal securities.

For qualified investors preferring a non-bond alternative to help hedge equity risk, we favor non-directional strategies, including Merger Arbitrage and Convertible Arbitrage, and trend-following Discretionary and Systematic Macro strategies. As of the third quarter of 2021, alternatives' and real assets' collective contribution significantly outpaced the past five years. In 2022, we expect this trend to continue.

What it may mean for investors

Investors with a disciplined diversification approach may benefit from multiple return sources while reducing risks within the portfolio.

Global Investment Strategy Team

This chart was excerpted from the *2022 Outlook*: "Which way to the recovery?" (December 8, 2021)

Risk Considerations

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. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Foreign investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. These risks are heightened in emerging markets. **Small- and mid-cap stocks** are generally more volatile, subject to greater risks and are less liquid than large company stocks. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates. **High yield (junk) bonds** have lower credit ratings and are subject to greater risk of default and greater principal risk. **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. **Preferred securities** have special risks associated with investing. Preferred securities are subject to interest rate and credit risks. 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. The **commodities** markets 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, private equity/private debt and private real estate funds, are speculative and involve a high degree of risk that is suitable only for those investors who have the financial sophistication and expertise to evaluate the merits and risks of an investment in a fund and for which the fund does not represent a complete investment program. They entail significant risks that can include losses due to leveraging or other speculative investment practices, lack of liquidity, volatility of returns, restrictions on transferring interests in a fund, potential lack of diversification, absence and/or delay of information regarding valuations and pricing, complex tax structures and delays in tax reporting, less regulation and higher fees than mutual funds. Hedge fund, private equity, private debt and private real estate fund investing involves other material risks including capital loss and the loss of the entire amount invested. A fund's offering documents should be carefully reviewed prior to investing.

Hedge fund 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. Arbitrage strategies expose a fund to the risk that the anticipated arbitrage opportunities will not develop as anticipated, resulting in potentially reduced returns or losses to the fund.

Definitions

Bloomberg Commodity Index is a broadly diversified index of commodity futures on 20 physical commodities, subdivided into energy, U.S. agriculture, livestock, precious metals, and industrial metals sectors. Commodity weights are derived in a manner that attempts to fairly represent the importance of a diversified group of commodities to the world economy.

Bloomberg U.S. Treasury Bill (1–3 Month) Index is representative of money markets.

Bloomberg U.S. Aggregate Bond Index is a broad-based measure of the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market.

Bloomberg U.S. Corporate High Yield Bond Index covers the universe of fixed-rate, noninvestment-grade debt.

Cambridge Associates U.S. Private Equity Index uses a horizon calculation based on data compiled from more than 1,400 institutional-quality buyout, growth equity, private equity energy, and subordinated capital funds formed between 1986 and 2020. The funds included in the index report their performance voluntarily and therefore the index may reflect a bias towards funds with records of success. Funds report unaudited quarterly data to Cambridge Associates when calculating the index. The index is not transparent and cannot be independently verified because Cambridge Associates does not identify the funds included in the index. Because Cambridge Associates recalculates the index each time a new fund is added, the historical performance of the index is not fixed, can't be replicated and will differ over time from the day presented. The returns shown are net of fees, expenses and carried interest. Index returns do not represent fund performance.

HFRI Fund Weighted Composite Index is a global, equal-weighted index of over 2,000 single-manager funds that report to HFR Database. Constituent funds report monthly netof-all-fees performance in U.S. Dollars and have a minimum of $50M under management or a 12-month track record of active performance. The HFRI Fund Weighted Composite Index does not include Funds of Hedge Funds.

Note: HFRI Indices have limitations (some of which are typical of other widely used indices). These limitations include survivorship bias (the returns of the indices may not be representative of all the hedge funds in the universe because of the tendency of lower performing funds to leave the index); heterogeneity (not all hedge funds are alike or comparable to one another, and the index may not accurately reflect the performance of a described style); and limited data (many hedge funds do not report to indices, and, therefore, the index may omit funds, the inclusion of which might significantly affect the performance shown. The HFRI Indices are based on information self-reported by hedge fund managers that decide on their own, at any time, whether or not they want to provide, or continue to provide, information to HFR Asset Management, L.L.C. Results for funds that go out of business are included in the index until the date that they cease operations. Therefore, these indices may not be complete or accurate representations of the hedge fund universe, and may be biased in several ways. Returns of the underlying hedge funds are net of fees and are denominated in USD.

ILPA Private Credit Fund Index is a horizon calculation based on data compiled from 323 private credit funds (credit opportunities and subordinated capital funds), including fully liquidated partnerships, formed between 1986 and 2020. The pooled horizon return is net of fees, expenses, and carried interest. The funds in the index are exclusively those that ILPA members have invested in; the goal of the ILPA private markets benchmark effort is to create a private markets benchmark that represents the investible universe and fund performance for global, institutional investors. The benchmark is issued on a quarterly basis, approximately 140 calendar days after quarter end. All data included in the ILPA Benchmark is derived from the quarterly and annual audited financial statements that general partners produce for their limited partners. Performance statistics include rates of return (net IRR & public market equivalents) and investment multiples (DPI, RVPI and TVPI). These statistics are expressed in terms of time period (since-inception, year-to-date, etc.), quartile ranking, vintage year, geography and strategy. As the benchmark same size expands, the number of statistics, composites and types of analysis is expected to increase. Index returns do not represent fund performance.

JPM EMBI Global Index covers 27 emerging market countries. Included in the EMBI Global are U.S.-dollar-denominated Brady bonds, Eurobonds, traded loans, and local market debt instruments issued by sovereign and quasi-sovereign entities.

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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NCREIF Property Index is a quarterly time series composite total rate of return measure of investment performance of a very large pool of individual commercial real estate properties acquired in the private market for investment purposes only.

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

An index is unmanaged and not available for direct investment.

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