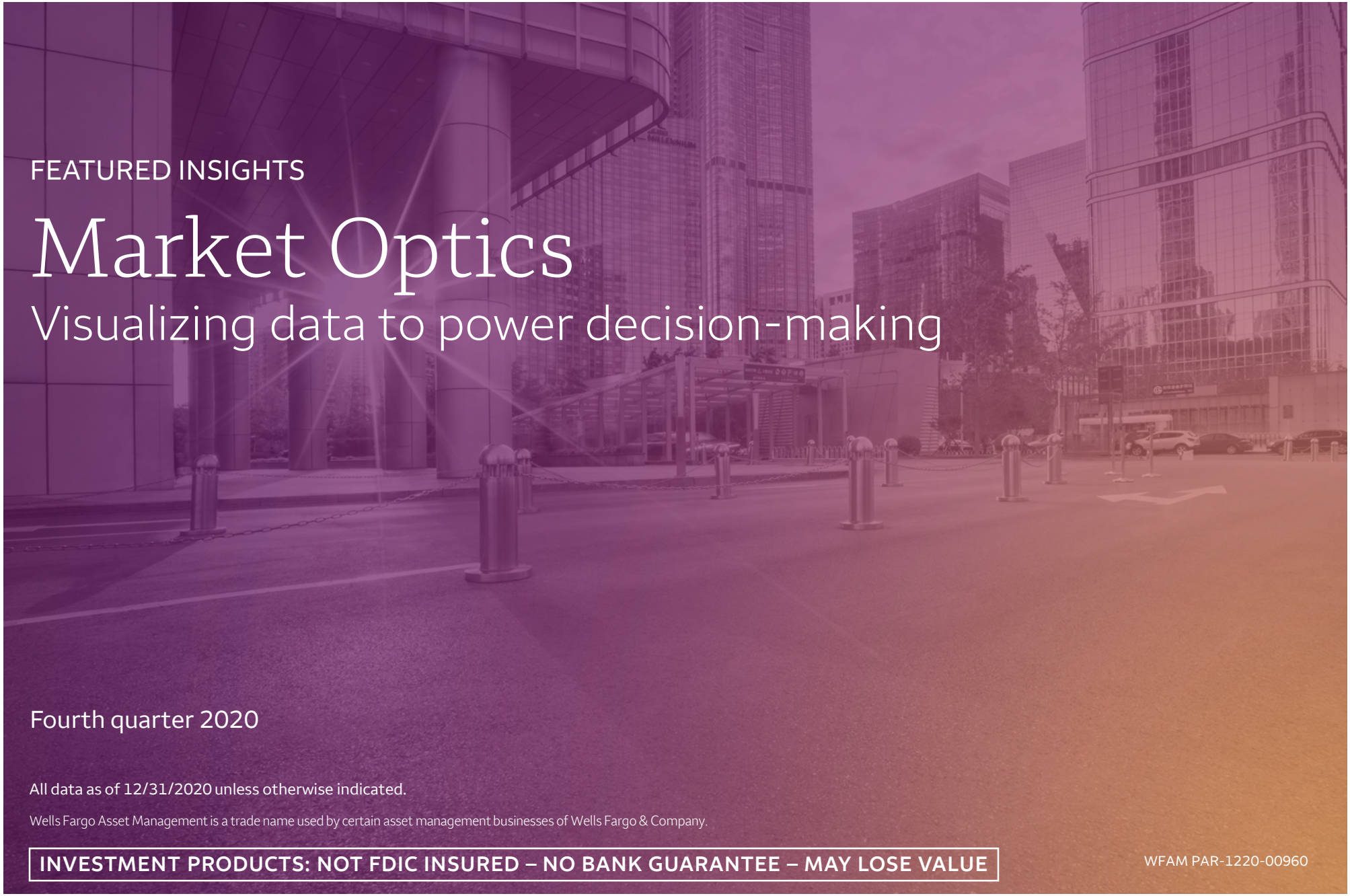
WELLS FARGO Asset Management



FEATURED INSIGHTS

Market Optics

Visualizing data to power decision-making

Fourth quarter 2020

All data as of 12/31/2020 unless otherwise indicated.

Wells Fargo Asset Management is a trade name used by certain asset management businesses of Wells Fargo & Company.

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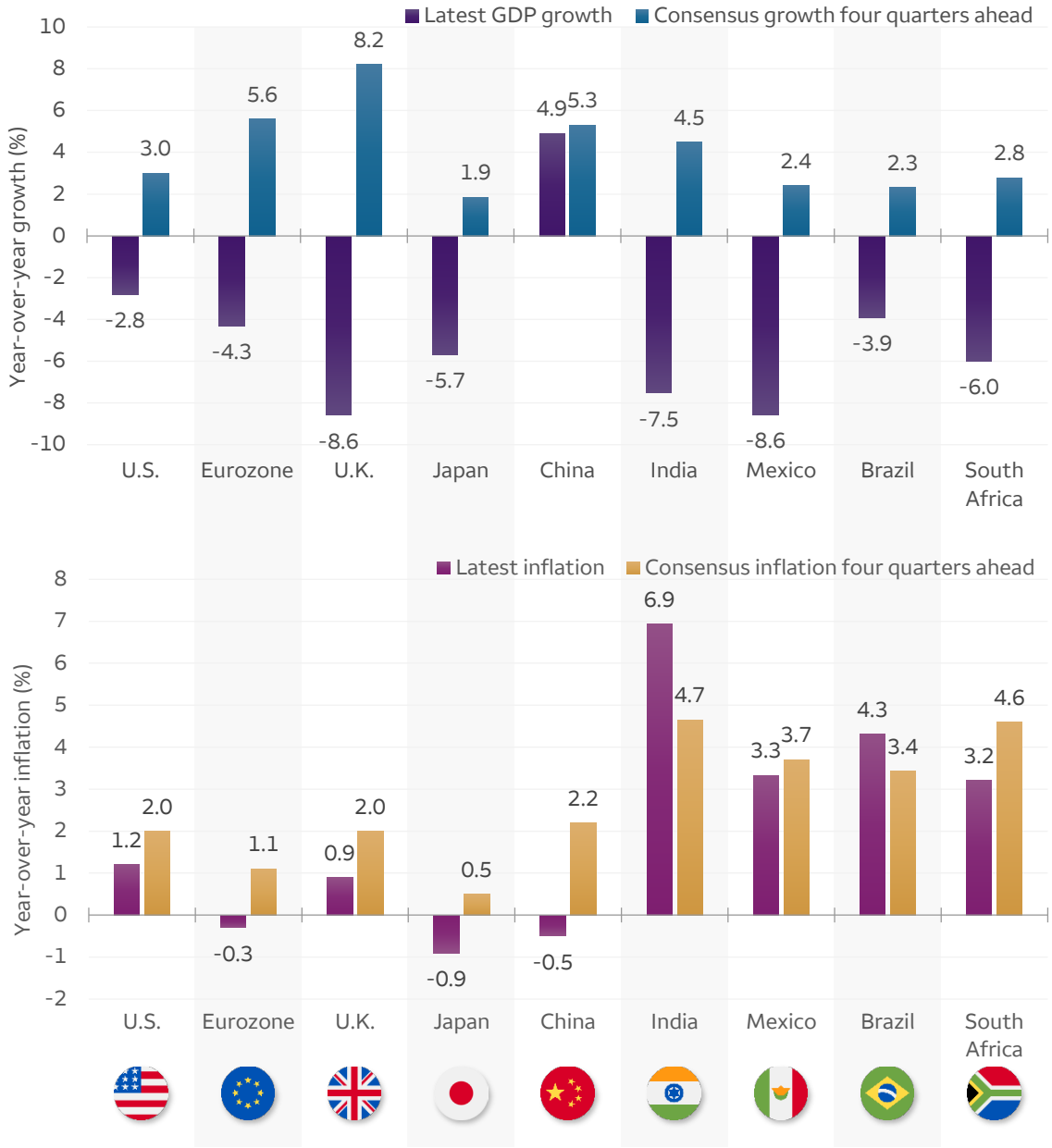
WFAM PAR-1220-00960

Global economy: Growth and inflation comparison

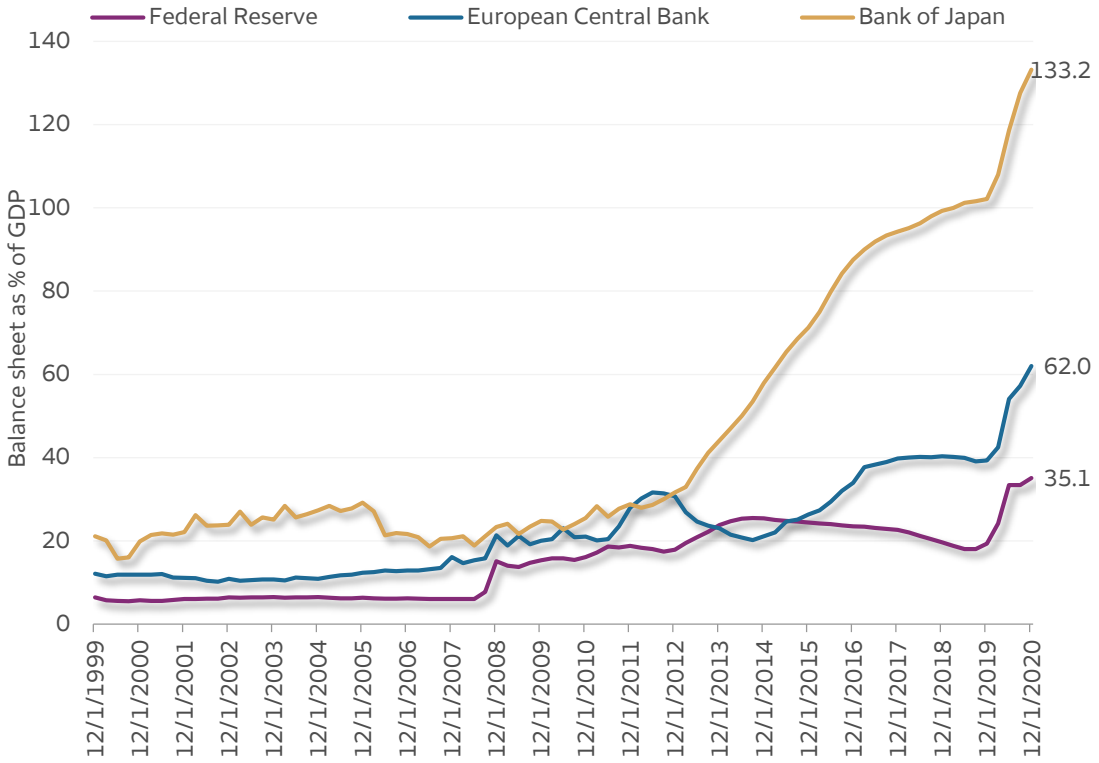
- Maybe 2021 is the year of the do-over. Coming into 2020, it was supposed to be the year of synchronized growth as manufacturing and trade recovered from the U.S.-China trade war of 2019. Instead, COVID-19 struck, and there was a synchronized shutdown. Going into 2021, there's a vaccine that could induce synchronized global growth.
- The difference between now and the end of 2019 is stark: Then, the economic cycle was getting old. Now, it's a brand new cycle. There's also the long-tail of fiscal and monetary stimulus that should help growth.
- The consensus seems to be calling for a brighter 2021, but still against a backdrop of low inflation. While a brighter outlook, it's not overly optimistic.

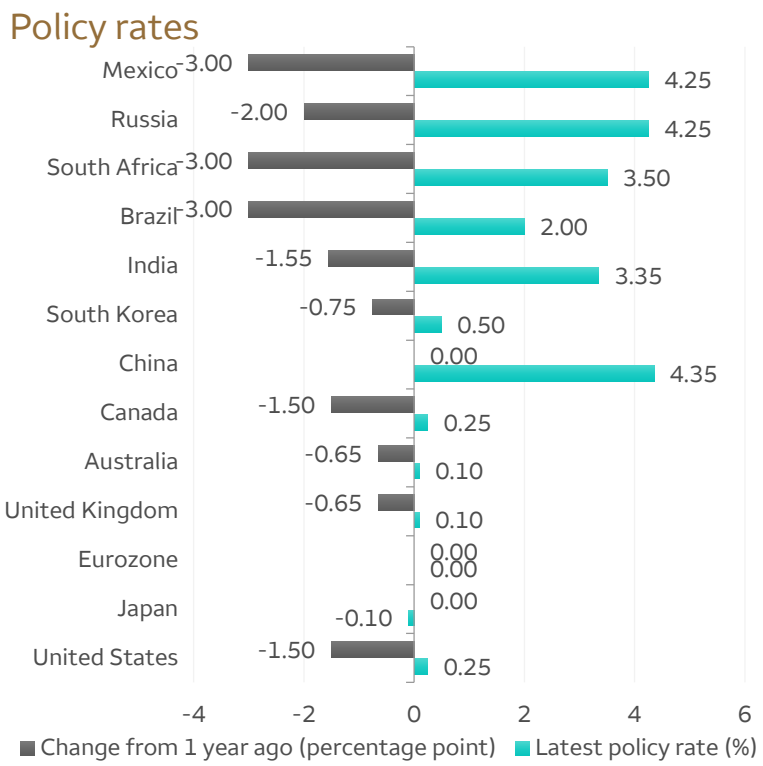


Sources: WFAM and Bloomberg. Consensus is from the Bloomberg survey. Data as of 12/31/2020.

Global economy: Monetary policy

- In response to the manufacturing recession of 2019 induced by the U.S.-China trade war and Brexit uncertainty, central banks pivoted from tightening to loosening policy.
- In the wake of the coronavirus crisis, central banks had to do even more to provide economic relief. For central banks that had already pushed rates to their lowest comfort level, this meant more asset purchases. A lot of these asset-purchase programs were designed to keep credit flowing and served as a type of "bridge loan" until the coronavirus lockdowns were lifted.
- Now, central banks seem prepared to be very patient with removing accommodation. If anything, their bias appears to be quick to provide more support rather than to be quick to get too optimistic.
- Extraordinary monetary support does not need to be inflationary. In this case, it was offsetting a possible collapse in credit. Central banks can sop up excess liquidity, if necessary, by paying interest on reserves and slowly letting the acquired assets mature.

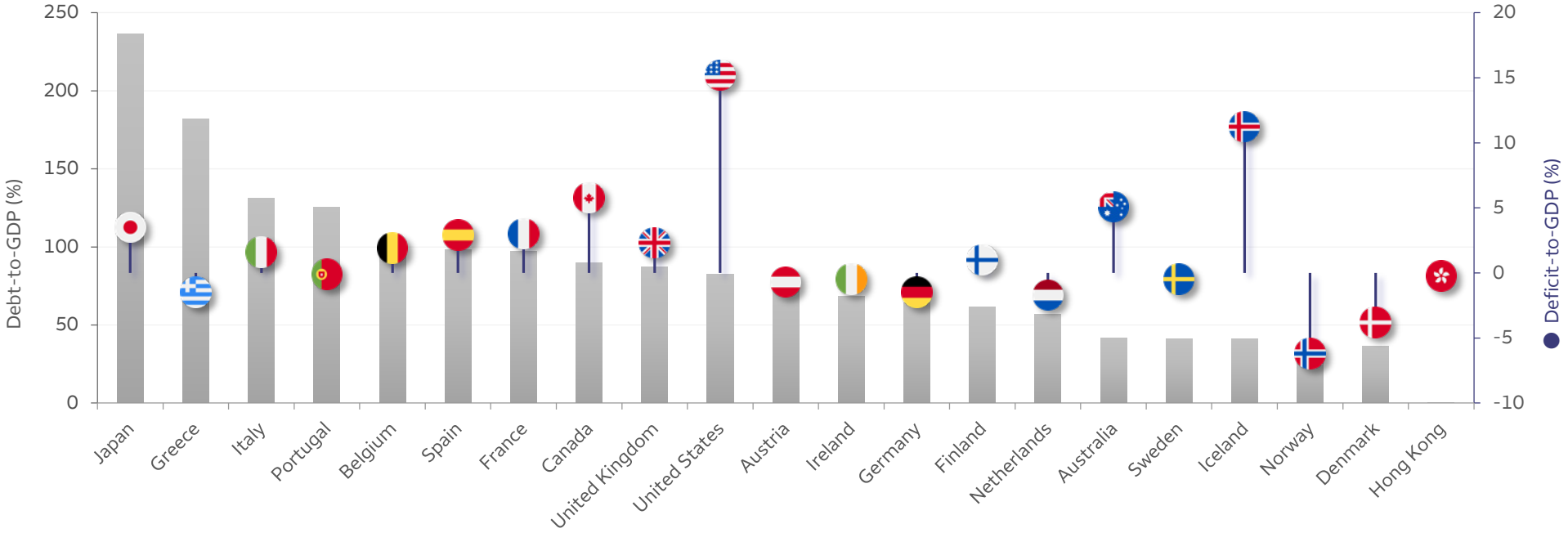




Sources: WFAM and Bloomberg. Based on monthly data from December 1999. Data as of 12/31/2020.

Global economy: Fiscal policy

- Entering the coronavirus crisis, investors were worried about elevated deficits in countries like the U.S. Deficits as a percentage of gross domestic product (GDP) were never that high during peacetime. Other countries, like Germany, were reluctant to engage in deficit spending. The concern was that if a shock happened, those who needed to spend wouldn't have the "fiscal space" to do so while those who could spend wouldn't be willing to.
- When the pandemic hit, the fiscal policy response was uniformly big and bold. The U.S. showed that despite high budget deficits, there was plenty of appetite for more government debt. Even Germany announced spending programs in the low double digits of GDP.
- The policy response seemed proportionate to the coronavirus problem, provided economic activity was put on hiatus for only a couple of months. Now that economic restrictions are lifting, investors are beginning to wonder how the bills will be paid. If post-wartime fiscal policies are any historical guide, it'll likely be from a combination of central banks keeping government financing costs abnormally low, a slight bending of the government spending curve, a little faster economic growth, and perhaps eventually higher taxes. The bills will come due, but not all at once.

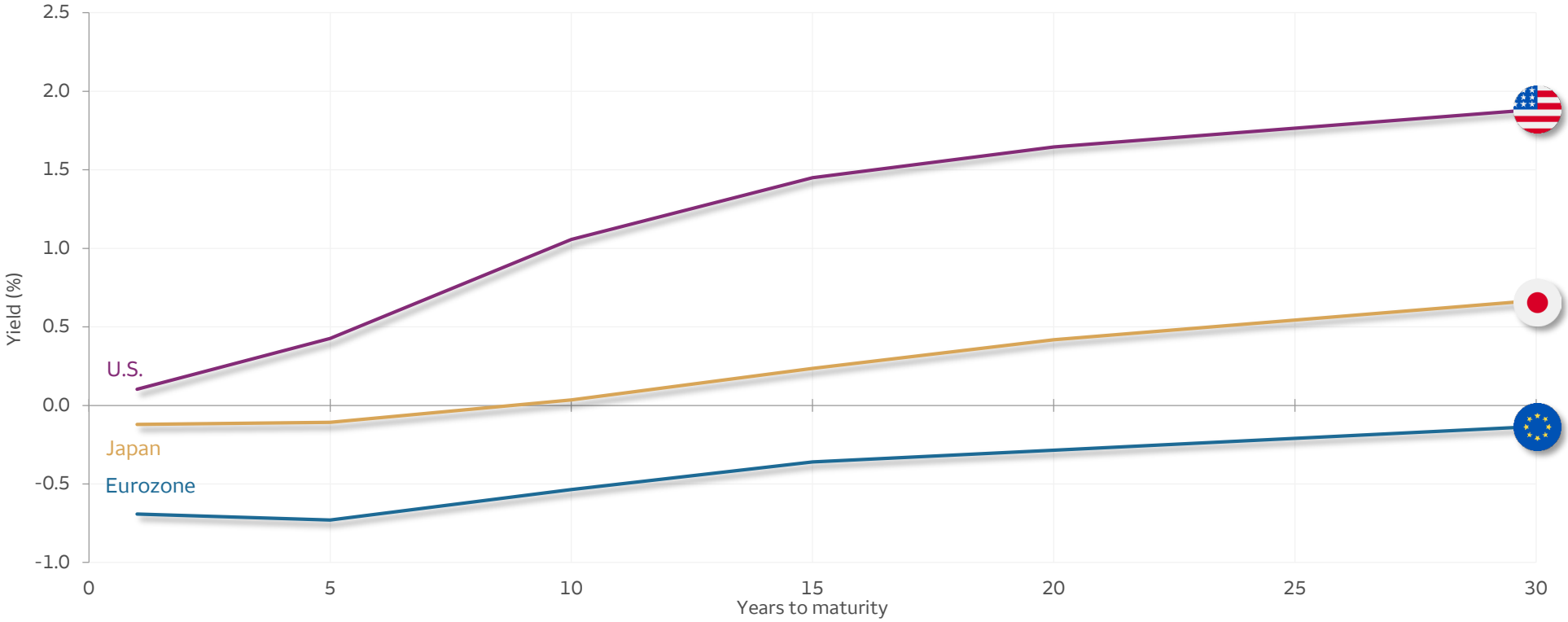


Sources: WFAM and Bloomberg. Data as of 12/31/2020.

Fixed income: Global yield curves

The level of yields is historically low and so is the slope of yield curves

- Aggressive action by central banks around the world have pinned the front end of most yield curves at very low points.
- Yield curves flattened in 2020 as investors bid up intermediate- and longer-term debt in “safe-haven” trades and to try to capture higher levels of yield.
- Front-end rates are likely to stay low while there is the potential for curves to steepen in 2021.



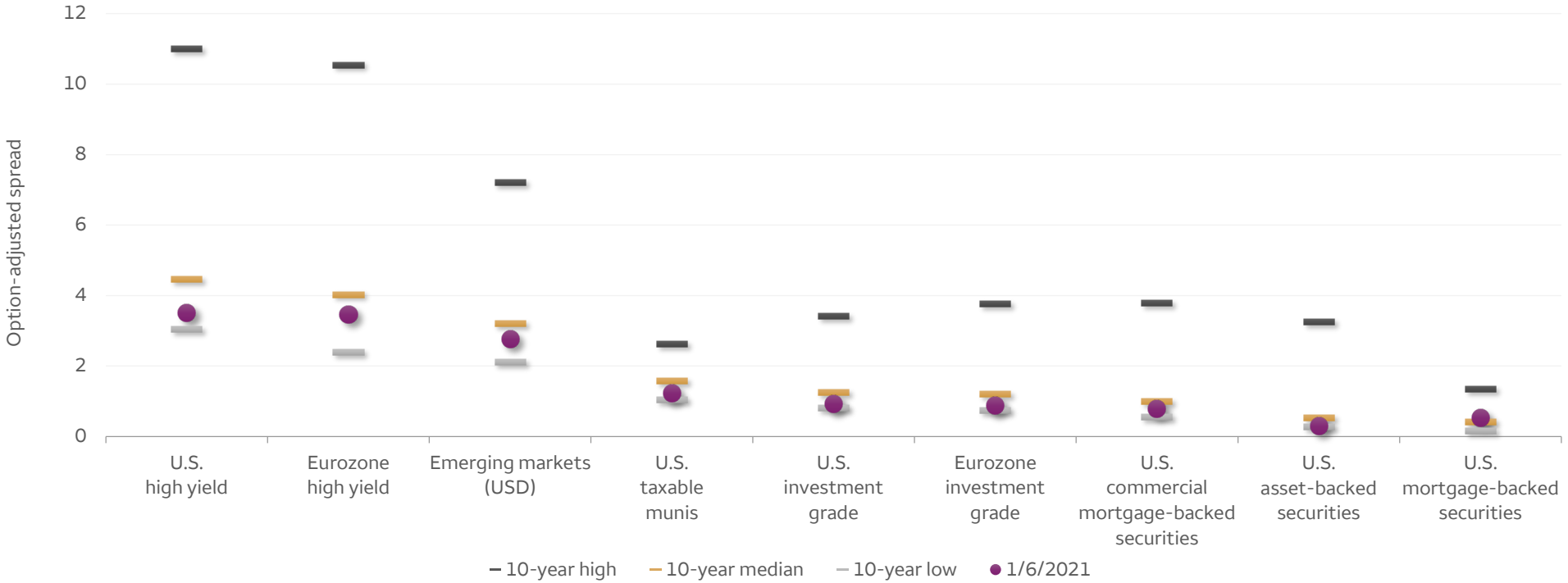
Source: Bloomberg. Data as of 12/31/2020.

Fixed income: Spreads

Treasury yields are low, as are most credit spreads, yet opportunities remain

- Several credit sector spreads are inside of their longer-term averages offering less incremental compensation for bearing risk.
- Some sectors continue to offer spread above longer-term averages where careful security selection may offer investors opportunities to realize more attractive total returns.
- Sectors more directly affected by the pandemic and recession may offer more spread compensation.

Bloomberg Barclays Indexes*

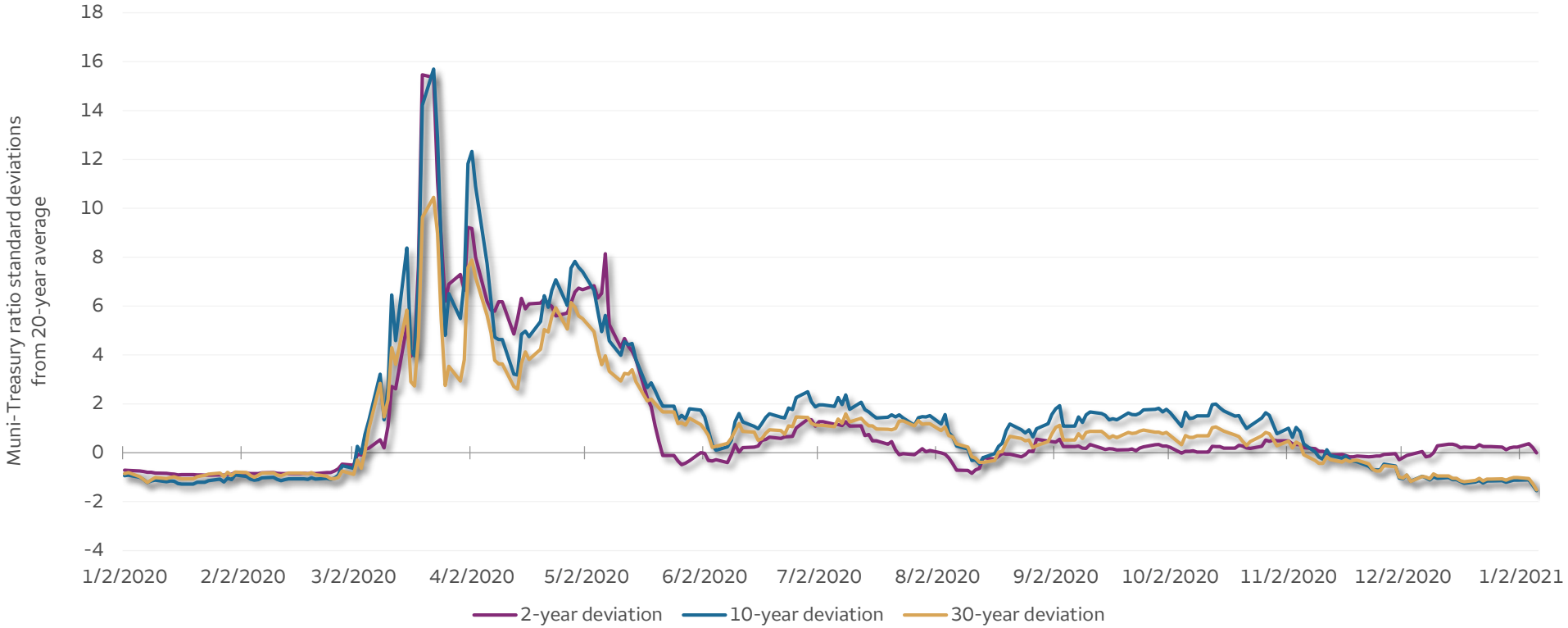


Sources: Bloomberg and WFAM. Data as of 1/6/2021. Calculations are based on daily data over the trailing 10 years.
* Indexes are for the Bloomberg Barclays Indexes as follows: U.S. high yield: *U.S. Corporate High Yield Bond Index;* Eurozone high yield: *Pan-European Aggregate Index;* Emerging Markets (USD): *Emerging Markets Hard Currency Aggregate Index;* U.S. taxable munis: *Municipal Bond Index;* U.S. investment grade: *U.S. Aggregate Credit;* Eurozone investment grade: *Euro-Aggregate Corporates Index;* U.S. commercial mortgage-backed securities (CMBS): *U.S. Aggregate CMBS Index;* U.S. asset-backed securities (ABS): *U.S. Aggregate ABS Index;* U.S. mortgage-backed securities (MBS): *MBS Conventional 30-Year Average.*

Fixed income: Municipal bonds

Municipal bonds remain extremely well supported by market technicals and yields are near all-time lows

- Municipal yields look generous relative to Treasury yields on a ratio-basis on the shorter-end of the curve, though absolute yields remain low for both municipals and Treasuries. Intermediate and longer municipals are priced very expensive relative to Treasuries with ratios hitting multi-year lows at spots along the yield curve.
- Highly rated municipal bonds continue to trade near all-time low yields while lower investment-grade municipal bonds (those rated A and BBB) are trading wide of their historical averages.
- Given the weak fundamental backdrop, thoughtful credit research and careful security selection will be key to realizing total returns in 2021.



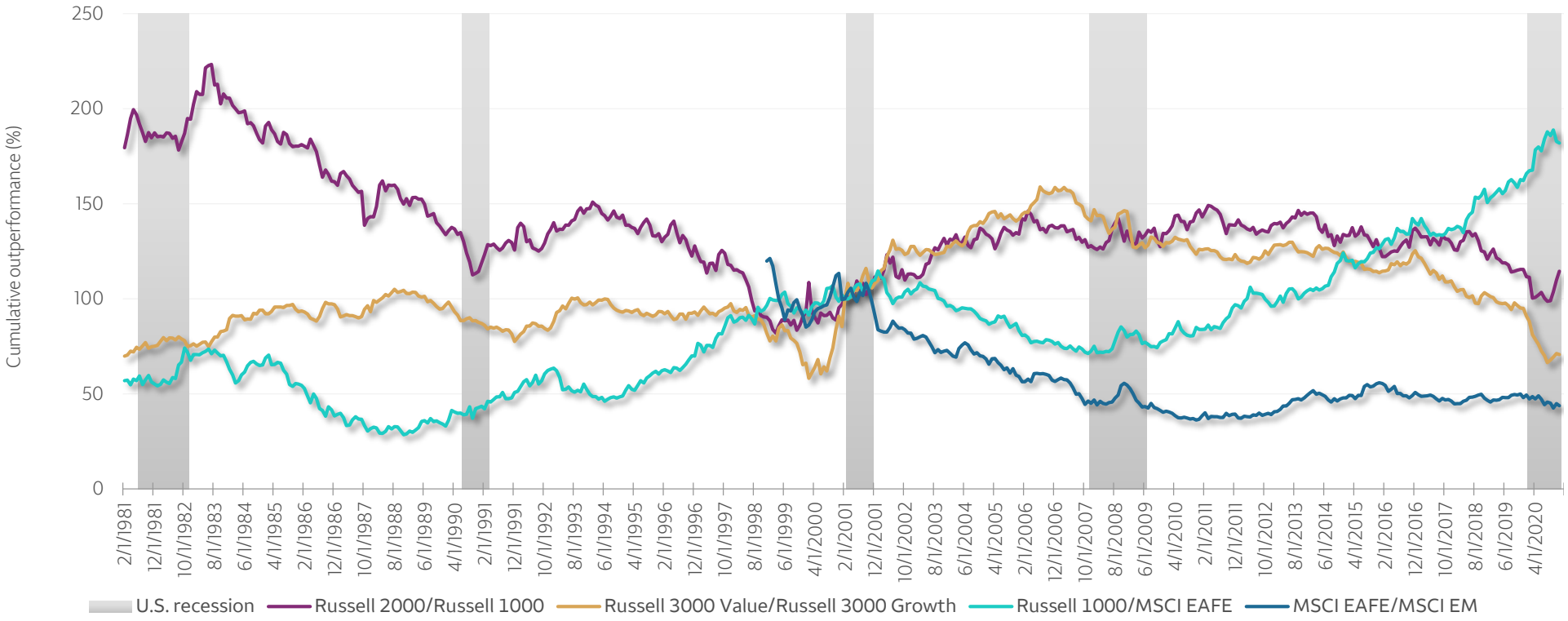
Source: Bloomberg, daily data over the past 20 years from the generic U.S. Treasury yields and the Bloomberg Benchmark for tax-exempt AAA rated municipal bonds. Data as of 12/31/2020.

Equities: Relative returns

Cyclical areas ready to shine?

- Although U.S. small-cap equities have underperformed U.S. large-cap equities post the Chinese tariffs instituted by the Trump administration in 2018, some of the best periods to own U.S. small-cap equities have been during recovery periods after recessions.
- U.S. value equities have underperformed U.S. growth equities in 2020 and in most of the period since 2006.
- U.S. equities have outperformed developed non-U.S. equities since 2010.
- Emerging markets outperformed developed non-U.S. equities, except from 2012 – 2016 period when there were concerns about China navigating its growth slowdown.

Performance summary	4Q20	YE2020
Russell 1000	13.69	20.95
Russell 2000	31.36	19.93
Russell 3000 Value	17.21	2.86
Russell 3000 Growth	12.41	38.26
MSCI EAFE (USD)	16.09	8.39
MSCI EM (USD)	19.61	18.50

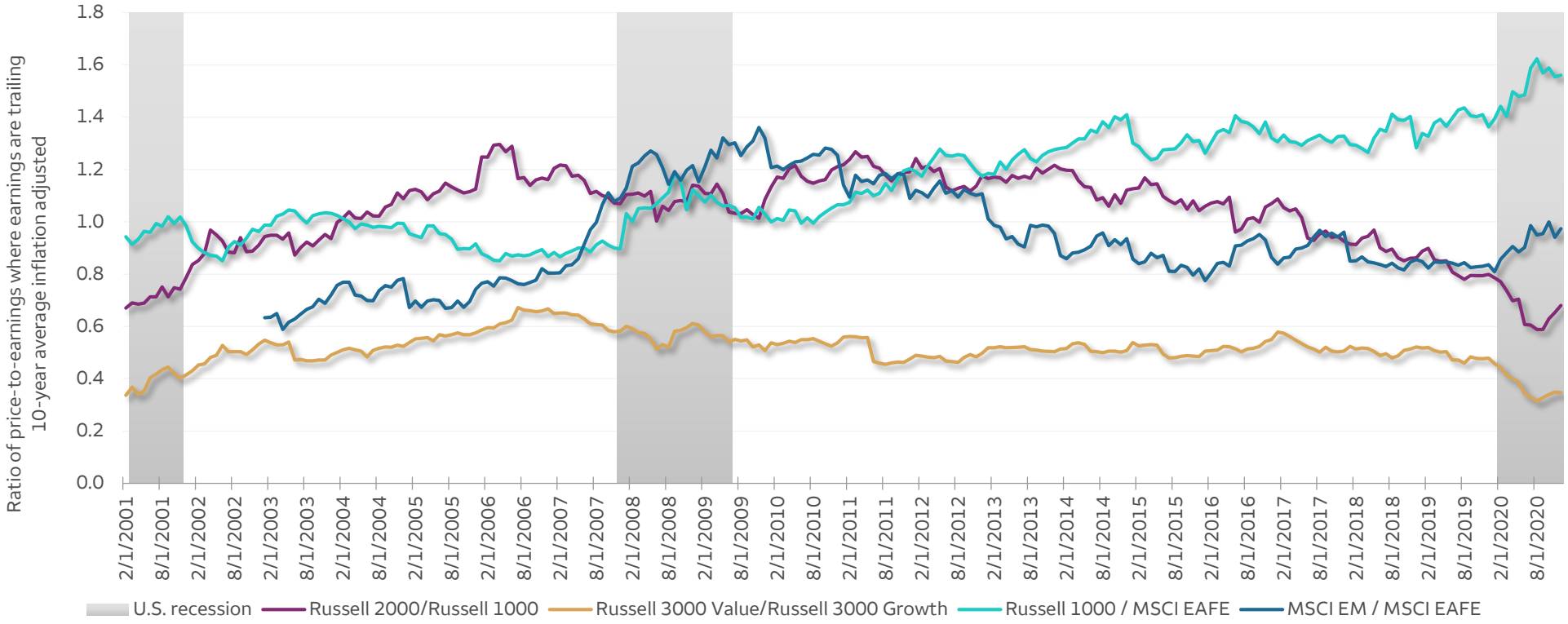


Source: Bloomberg. Data as of 12/31/2020. Chart (lower): Monthly data from February 1981. Summary table reflects the 2020 performance of each index for both the 4th quarter and year end.

Equities: Relative multiples

Market-multiple dislocations present opportunities

- Based on cyclically adjusted earnings, U.S. small cap equities have rarely been this cheap relative to U.S. large cap equities.
- Only during the tech bubble was value at such a discount from growth.
- U.S. equities are pricey compared to developed non-U.S. equities.
- Emerging markets offer value relative to developed market equities.



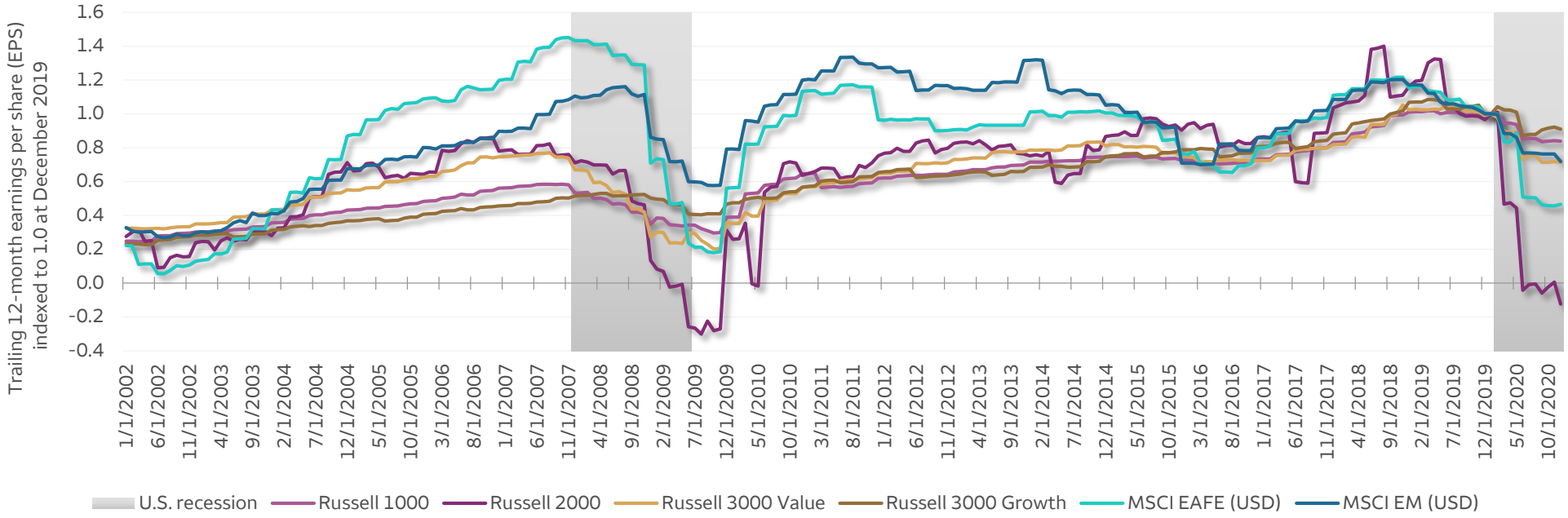
Source: Bloomberg. Data as of 12/31/2020. Monthly data from February 2001.

Equities: Earnings growth

Earnings trends help explain past returns

- With a significant earnings decline in 2020, market multiples based on trailing earnings are at or near the highest levels of the past 25 years.
- Scarcity of growth and the coronavirus-driven acceleration of digital trends have muted the earnings decline of Russell 3000 Growth companies. However, stock valuations remain extended even if earnings levels fully recover.
- If U.S. small cap, U.S. value, and international companies earnings climb back to 2019 levels after the reopening of the economy, forward multiples look attractive.

	Russell 1000	Russell 2000	Russell 3000 Value	Russell 3000 Growth	MSCI EAFE (USD)	MSCI EM (USD)
Trailing 12-month earnings per share (EPS) as of 12/31/2020	67.39	(4.14)	68.20	41.74	49.10	50.69
Price as of 12/31/2020	2,120.87	1,974.86	1,774.76	1,952.61	2,147.53	1,291.26
Price-to-earnings based on trailing 12-month EPS	31.47	(477.02)	26.02	46.78	43.74	25.47
Percent rank since 1995	**100%**	N/A	**98%**	**96%**	**92%**	**95%**
Maximum EPS since 1995	81.73	46.87	100.65	49.83	152.79	94.13
Price-to-earnings based on trailing maximum EPS	25.95	42.13	17.63	39.19	14.06	13.72
Hypothetical* percent rank since 1995	**88%**	**71%**	**48%**	**91%**	**8%**	**53%**

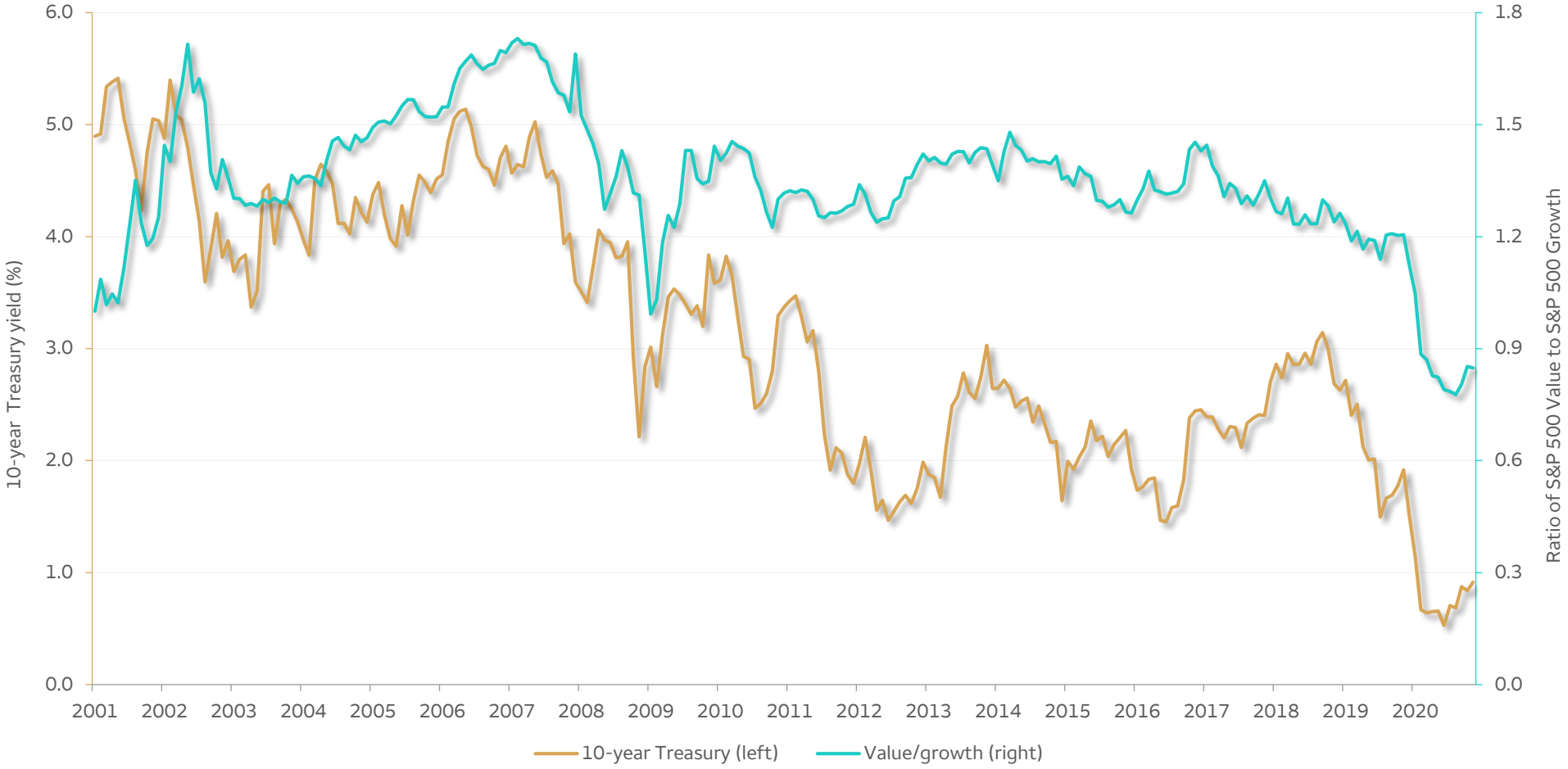


Source: Bloomberg. Data as of 12/31/2020. Top: Table shows monthly data from January 1995. Bottom: Chart shows data from January 2002.
*This measure is hypothetical as it represents the current price divided by the maximum trailing earnings to show what that would look like within the distribution of historical price-to-earnings.

Equities: Value, growth, and yields

Lower Treasury yields have probably contributed to growth's outperformance over value

- Lower yields have coincided with the growth style outperforming the value style. Growth equities typically have longer-dated cash flows as the basis for their valuations, so lower yields make those cash flows more valuable.

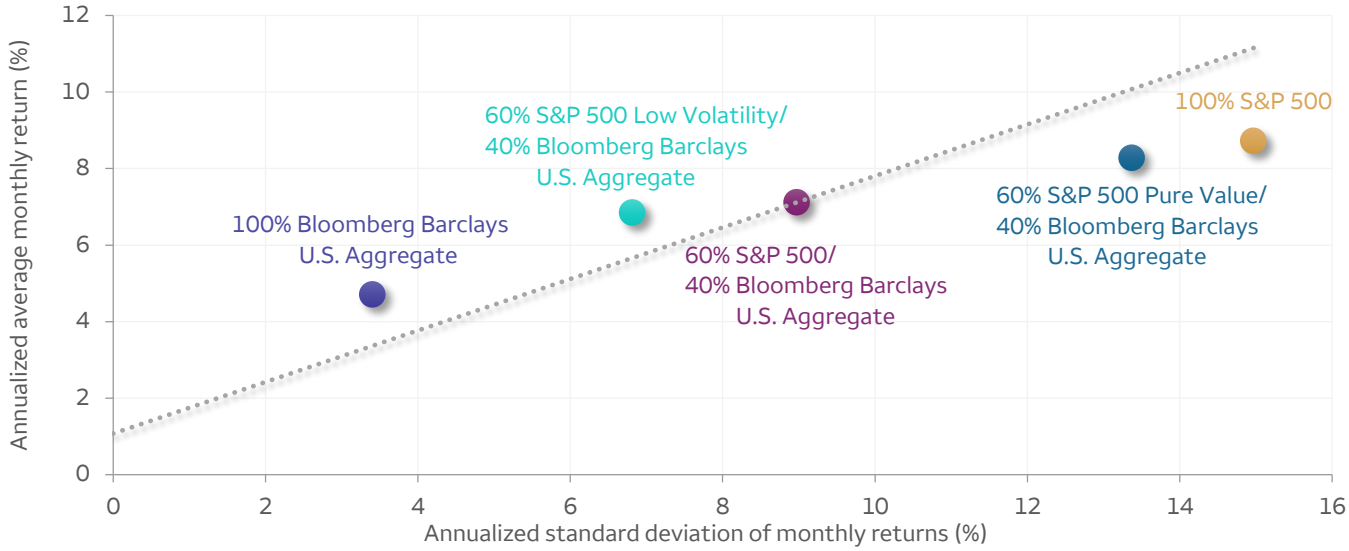


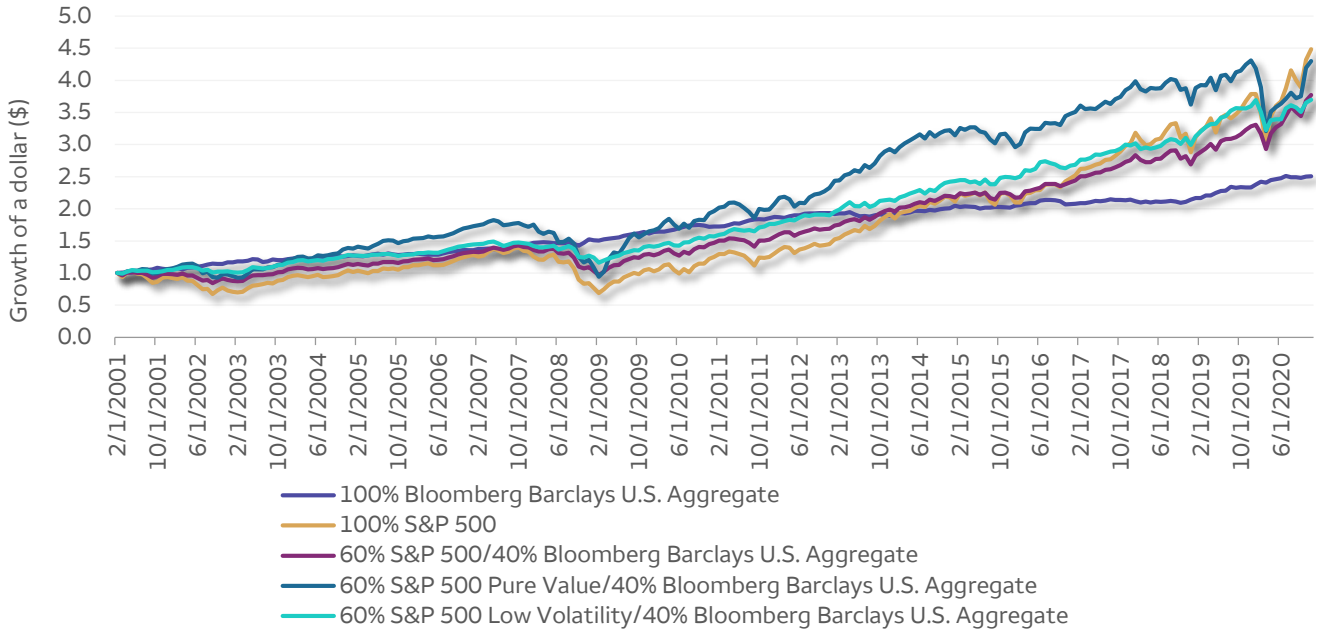
Source: Bloomberg. Data as of 12/31/2020. Monthly data from February 2001.

Diversification and factors

Working over time, not necessarily all the time

- Some factors have struggled, like value and low volatility. However, investing in factors is about trying to improve the ride over long periods of time. They come in and out of favor and have lately been coming back into favor.
- Diversification is about trying to improve risk-adjusted returns, not trying to shoot the lights out with the highest returns all the time. The longer perspective shows that diversification and a bias toward some factors have improved risk-adjusted returns.





Source: Bloomberg. Data as of 12/31/2020. Monthly data from February 2001. Factors, in this context, are features of companies.

Index definitions

Bloomberg Barclays U.S. Aggregate ABS Index
The Bloomberg Barclays Asset-Backed Securities (ABS) Index Is the ABS component of the Bloomberg Barclays U.S. Aggregate Index. The index includes pass-through, bullet, and controlled amortization structures. The ABS Index includes only the senior class of each ABS issue and the ERISA-eligible B and C tranche. You cannot invest directly in an index.

Bloomberg Barclays Emerging Markets Hard Currency (USD) Aggregate Index
The Bloomberg Barclays Emerging Markets Hard Currency Aggregate Index is a flagship hard currency emerging markets (EM) debt benchmark that includes U.S.-dollar-denominated debt from sovereign, quasi-sovereign, and corporate EM issuers. You cannot invest directly in an index.

Bloomberg Barclays Euro-Aggregate: Corporates Index
The Bloomberg Barclays Euro-Aggregate: Corporates Index measures the corporate component of the Euro Aggregate Index. It includes investment grade, euro-denominated, fixed-rate securities. The Bloomberg Barclays Euro-Aggregate index is a benchmark that measures the investment grade, euro-denominated, fixed-rate bond market, including treasuries, government-related, corporate, and securitized issues. Inclusion is based on currency denomination of a bond and not country of risk of the issuer. It is a market-cap weighted index. You cannot invest directly in an index.

Bloomberg Barclays Euro High Yield Index
The Bloomberg Barclays Euro High Yield Index measures the market of non-investment-grade, fixed-rate corporate bonds denominated in euros. Inclusion is based on the currency of issue, not the domicile of the issuer. The index excludes emerging market debt. You cannot invest directly in an index.

Bloomberg Barclays MBS Conventional 30-Year Average Index
The Bloomberg Barclays MBS Conventional 30-Year Is an unmanaged index that tracks agency mortgage backed pass-through securities (both fixed-rate and hybrid ARM) guaranteed by GNMA, FNMA, and FHLM for mortgages with 30 years to maturity. You cannot invest directly in an index.

Bloomberg Barclays Municipal Bond Index
The Bloomberg Barclays Municipal Bond Index is an unmanaged index composed of long-term taxable municipal bonds with a minimum credit rating of Baa. You cannot invest directly in an index.

Bloomberg Barclays Pan-European Aggregate Index
The Bloomberg Barclays Pan-European Aggregate Index tracks fixed-rate, investment-grade securities issued in the following European currencies: euro, British pound, Norwegian krone, Danish krone, Swedish krona, Czech koruna, Hungarian forint, Polish zloty, and Slovakian koruna. You cannot invest directly in an index.

Bloomberg Barclays U.S. Aggregate Bond Index
The Bloomberg Barclays U.S. Aggregate Bond Index measures the performance of the U.S. investment-grade, fixed-rate bond markets. You cannot invest directly in an index.

Bloomberg Barclays U.S. Aggregate CMBS Index
The Bloomberg Barclays U.S. Aggregate CMBS Index tracks commercial mortgage-backed securities issued both by agencies of the federal government and those issued by non-agencies. The index is market cap weighted. You cannot invest directly in an index.

Bloomberg Barclays U.S. Aggregate Credit
The Bloomberg Barclays U.S. Aggregate Credit Index is an unmanaged market-value-weighted index of investment-grade corporate fixed-rate debt issues with maturities of one year or more. You cannot invest directly in an index.

Bloomberg Barclays U.S. Corporate High Yield Bond Index
The Bloomberg Barclays U.S. Corporate High Yield Bond Index is an unmanaged, U.S.-dollar-denominated, nonconvertible, non-investment-grade debt index. The index consists of domestic corporate bonds rated Ba and below with a minimum outstanding amount of $150 million. You cannot invest directly in an index.

Bloomberg Barclays U.S. Securitized Index (ABS/MBS/CMBS)
The Bloomberg Barclays U.S. Securitized Index is an unmanaged composite of asset-backed securities, collateralized mortgage-backed securities (ERISA-eligible), and fixed-rate mortgage-backed securities. You cannot invest directly in an index.

Bloomberg Benchmark for tax-exempt AAA rated municipal bonds
A market-cap weighted measure of the yield from high quality U.S. municipal bonds with an average rating of AAA from Moody's and S&P.

MSCI EAFE Index (USD)
The Morgan Stanley Capital International (MSCI) Europe, Australasia, Far East (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, when translated into U.S. dollars. You cannot invest directly in an index.

MSCI Emerging Markets Index (USD)
The Morgan Stanley Capital International (MSCI) Emerging Markets Index is a free-float-adjusted market-capitalization-weighted index that is designed to measure equity market performance of emerging markets when translated into U.S. dollars. You cannot invest directly in an index.

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Price/earnings (P/E)
P/E is the price of a share of a stock divided by earnings per share, usually calculated using the latest year's earnings.

Index definitions (continued)

Russell 1000® Index
The Russell 1000® Index measures the performance of the 1,000 largest companies in the Russell 3000® Index, which represents approximately 92% of the total market capitalization of the Russell 3000 Index. You cannot invest directly in an index.

Russell 2000® Index
The 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. You cannot invest directly in an index.

Russell 3000® Growth Index
The Russell 3000® Growth Index measures the performance of those Russell 3000® Index companies with higher price/book ratios and higher forecasted growth values. You cannot invest directly in an index.

Russell 3000® Value Index
The Russell 3000® Value Index measures the performance of those Russell 3000® Index companies with lower price/book ratios and lower forecasted growth values. You cannot invest directly in an index.

Standard & Poor's 500 Index (S&P 500 Index)
The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market-value-weighted index with each stock's weight in the index proportionate to its market value. You cannot invest directly in an index.

Standard & Poor's 500 Low Volatility Index (S&P 500 Low Volatility Index)
The S&P 500 Low Volatility Index consists of 100 stocks chosen from the S&P 500 Index that have the lowest trailing 252-day return volatility. It is a market-value-weighted index with each stock's weight in the index proportionate to its market value. You cannot invest directly in an index.

Standard & Poor's 500 Pure Growth Index (S&P 500 Pure Growth Index)
The S&P 500 Pure Growth Index consists of stocks in the S&P 500 Index chosen for their growth characteristics as defined by the index committee. It is a market-value-weighted index with each stock's weight in the index proportionate to its market value. You cannot invest directly in an index.

Standard & Poor's 500 Pure Value Index (S&P 500 Pure Value Index)
The S&P 500 Pure Value Index consists of stocks in the S&P 500 Index chosen for their value characteristics as defined by the index committee. It is a market-value-weighted index with each stock's weight in the index proportionate to its market value. You cannot invest directly in an index.

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Diversification does not ensure or guarantee better performance and cannot eliminate the risk of investment losses.

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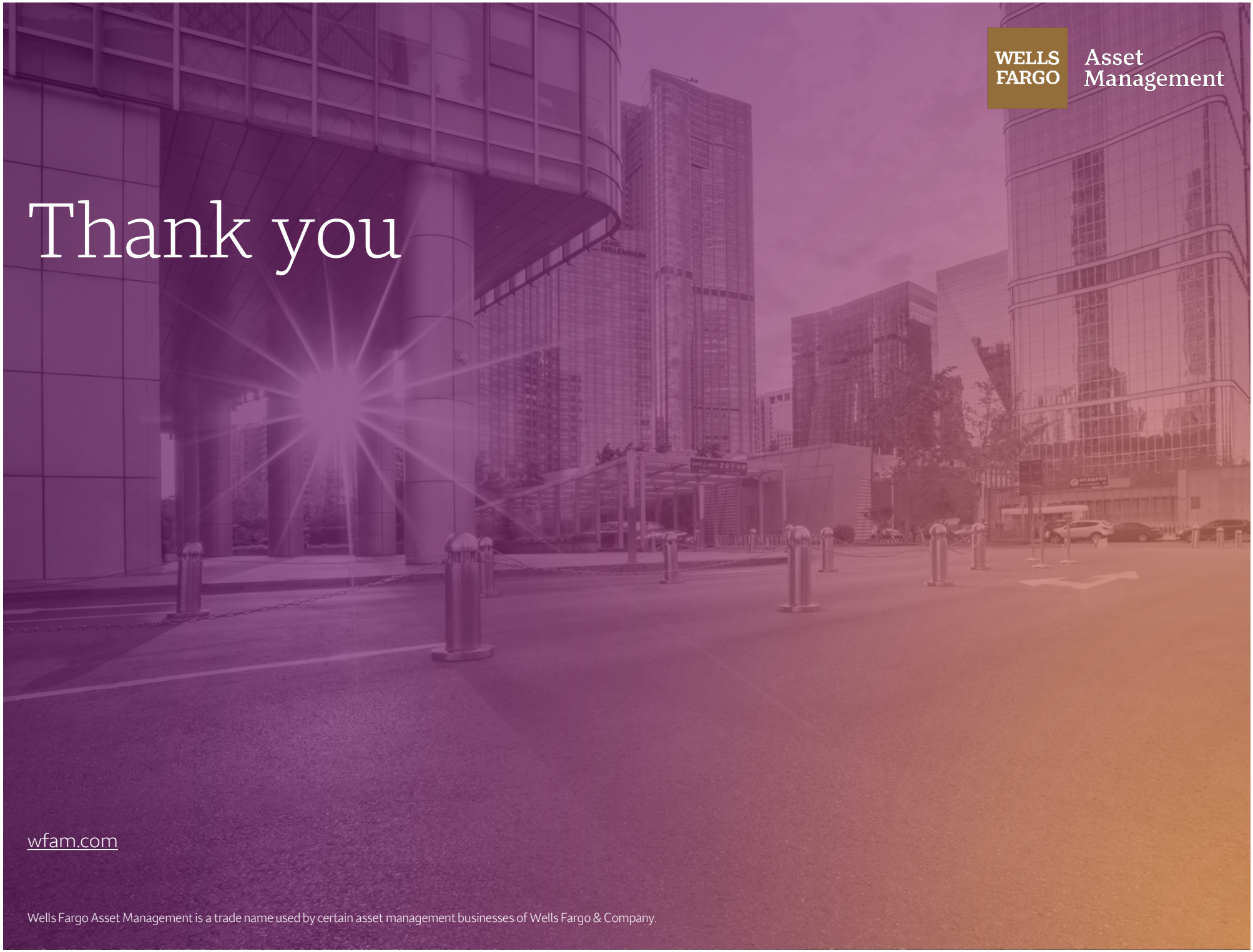
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