Trinity CAPITAL MANAGEMENT

TCM 2023 Investment Outlook & Strategy

January, 2023

Stephen M. Mills, CIMA® *Partner*
Chief Investment Strategist

Brad Bays, CIMA® *Partner*
PIM Portfolio Manager

Executive Summary

Introduction (*Page 2*)

- *For the first time in over 50 years, both the stock and the bond market major averages experienced double-digit declines and officially entering a bear market.*
- *We believe the carnage in the financial markets in 2022 was primarily caused by two underlying factors: high inflation and rising interest rates that were fueled by the U.S. Federal Reserve monetary tightening.*

Global & U.S Economies – *(Page 3)*

- *The biggest fear facing investors currently is the prospect of a global recession developing during 2023.*
- *We expect that the U.S. economy will experience a mild-to-moderate recession in 2023 lasting two or three quarters.*
- *Economic conditions in Europe and Asia have continued to deteriorate. Recession looks likely for most European and Asian economies, in our view.*

Equities/Commodities – *(Pages 3-5)*

- *Rising interest rates and inflation were the main drivers of the bear market in stocks in 2022, in our view.*
- *We see the primary influence on stocks prices in 2023 will be corporate earnings.*
- *We believe corporate earnings will weaken in the first half of 2023 but begin to recover in the second half of the year.*
- *One of the few bright spots for investors in 2022 was the commodity market.*

Fixed Income – *(Page 5)*

- *Interest rates on fixed-income instruments of all maturities increased significantly in 2022. This rise in rates caused major losses in most intermediate and longer-term securities and funds.*
- *We believe 2023 will be a much better year for fixed-income investors. With interest rates exceeding 4% across much of the yield curve, investors can potentially enjoy meaningful cash flow from newly purchased high-quality fixed-income instruments.*

Strategy – *(Pages 5-6)*

- *We are guardedly optimistic on equities and favor high-quality dividend paying stocks and certain growth stocks.*
- *Small-cap stocks look attractive to us on a valuation basis but we feel this sector will continue to underperform large and mid-cap stocks in the first half of the year.*
- *We remain bearish in foreign stocks based on our negative economic outlook for most international economies and the potential of continued U.S. dollar strength in 2023.*
- *We remain very bullish on commodities in general, but in particular crude oil. We favor high-quality energy stocks in both the production and pipeline sectors that have attractive dividend yields.*
- *We favor precious metals like gold and silver based on a positive fundamental and technical picture.*
- *We continue to favor high-quality fixed-income instruments like U.S. Treasuries, bank CD's, prime money market funds and high-grade corporate and municipal bonds.*

The Bottom Line - *(Page 7)*

- *Looking out to the second half of 2023, we believe the Fed will have stopped its rate-hike strategy, inflation statistics will be moving closer to the Fed's 2% target, and the economy will be in the later stages of a recession and perhaps beginning to recover by year-end.*
- *In the meantime, we are encouraging our clients to stay the course, ride out the near-term market volatility and look for brighter skies to hopefully develop in the second have of 2023.*

Introduction

2022 is perhaps a year most investors would like to forget. For the first time in over 50 years, both the stock and the bond market major averages experienced double-digit declines with stocks officially entering a bear market on June 17 when the broad-based S&P 500 Index (S&P 500) hit a level that was 24% lower than its January 4 all-time high.[1] A bear market is typically defined as a 20% decline from the previous high. The more value-oriented Dow Jones Industrial Average (DJIA) fared better but still recorded a loss of 8.8% for the year.[1] The NASDAQ Composite Index, which is dominated by growth stocks, suffered a decline of 33.1% for 2022.[1]

High-grade fixed-income instruments, which typically insulate investors during stock bear markets, didn't fare much better in 2022. Most major bond market indices ended the year with negative returns. The closely watched 10-year U.S. Treasury Note yield rose from 1.5% to 3.9% by year-end. This rise in yield translated into a 16.7% loss for those who held the 10-year T-Note for the year.[1] Intermediate to long-term municipal and corporate bonds experienced similar losses.

We believe the carnage in the financial markets in 2022 was primarily caused by two underlying factors. First, high and rising inflation and second, rising interest rates which were fueled by U.S. Federal Reserve monetary tightening implemented to combat the high inflation. Inflationary pressures in the economy began building in early 2021 as post pandemic spending began to heat up and supply chain problems reduced the availability of many goods. Entering 2022, the Consumer Price Index (CPI) was rising at an annual rate of 7%, according to the December 2021 CPI report issued by the U.S. Bureau of Labor Statistics.[2] The CPI continued to rise in January and February of 2022 prompting the Federal Reserve to begin raising the Fed funds interest rate in March by .25%.[2] As inflation continued to increase, reaching a peak level of 9.1% for the CPI in June, the Federal Reserve accelerated their rate-hike strategy with a .75% increase at the June FOMC (Federal Open Market Committee) meeting. This was followed by three more .75% rates-hikes over the next three FOMC meetings.[3] It has been one of the fastest, most aggressive rate-high cycles in the Federal Reserve's history.[8] A final rate-hike of .50% in December brought the Fed funds rate to 4.5%, up from just .25% at the beginning of the year.[3]

In addition, the Federal Reserve ended its quantitative easing program that it had begun in early 2020 to provide liquidity for the financial system that had been stressed by the coronavirus pandemic. This so-called "quantitative tightening," removes liquidity from the financial system and tends to dampen economic growth. Both the stock and bond markets reacted negatively to the Federal Reserve's monetary tightening strategy. Further deterioration in both markets followed the mid-December FOMC meeting when Chairman Jerome Powell indicated that the Federal Reserve will continue to increase the Fed funds rate.

Global & U.S. Economies

The biggest fear facing investors currently is the prospect of a global recession developing as result of the aggressive monetary tightening by most central banks around the world, in our view. Higher interest rates tend to depress economic activity as the cost of borrowing rises making it more expensive to purchase things like real estate and other goods with financing. As an example, mortgage loan rates in the U.S. have risen from a 3% average 30-year fixed mortgage rate in December 2021 to a 6.5% average rate as of the end of 2022.[4] This over doubling of the mortgage loan rate has hurt housing market. The number of contracts to purchase a home fell for the sixth consecutive month as of November home sales data.[5] Also, retail sales fell .6% during the traditionally strong month of November, another sign that higher interest rates may be impacting spending.[6]

Despite the tightening monetary conditions, the U.S. economy has remained resilient. Although certain pockets of the economy are experiencing weakness like housing, retail sales, and durable goods, there are other areas showing strength like automobiles, healthcare, and energy. The job market remains strong indicating that businesses are still hiring workers. According to the December jobs report issued by the U.S. Bureau of Labor Statistics, employers added 223,000 jobs and the unemployment rate was 3.5%.[7] We feel the unemployment rate will rise as higher interest rates work their way through the economy. However, because of the persistent under-supply of workers, we don't see the jobless rate going above 4.5% in 2023. Fed officials forecast the unemployment rate to rise to 4.6% by the fourth quarter of 2023, in economic projections released in December.

We expect that the U.S. economy will experience a mild-to-moderate recession in 2023 lasting two or three quarters. Wells Fargo Investment Institute (WFII) is projecting a moderate recession this year. They expect U.S. GDP (Gross Domestic Product) to decline by 1.3% in 2023.[8] WFII is also projecting an unemployment rate of 5.2% and the CPI moving all the way down to an annualized rate of 2.2% by the end of 2023. We agree with their inflation forecast but do not believe the unemployment rate will reach that level in 2023. We feel that once the Federal Reserve is convinced inflation is moving persistently toward its target annual inflation rate of 2%, they will pause further rate-hikes. We see this happening sometime during the first half of 2023 after perhaps two or three more .25% rate-hikes. That would bring the Fed funds rate to 5-5.25% which we believe will be sufficiently restrictive to slow economic activity and bring inflation down significantly.

Global economy	2023 year-end forecasts	Latest[4]	Year-end 2021
Global GDP growth[1]	0.9%	3.5% (period ending Q3 2022)	6.0%
Global inflation[1]	4.5%	7.7% (Q3 2022)	4.7%
U.S. GDP growth[1]	-1.3%	3.3% (period ending Q3 2022)	5.7%
U.S. CPI[2]	2.2%	7.1% (Nov. 2022)	7.0%
U.S. unemployment rate[3]	5.2%	3.6% (Nov. 2022)	4.2%

Sources: Bloomberg, Bureau of Labor Statistics, and Wells Fargo Investment Institute. 2023 year-end forecasts by Wells Fargo Investment Institute are as of December 15, 2022. All 2021 data is as of December 31, 2021.

[1] Average year-over-year % change.

[2] 12-month change as of month indicated.

[3] Three-month average as of month indicated.

[4] Latest economic data is as of date specified in table.

GDP = Gross Domestic Product. CPI = Consumer Price Index. The CPI measures the price of a fixed basket of goods and services purchased by an average consumer. Global inflation is calculated using a weighted average of developed market inflation and emerging market inflation. An index is unmanaged and not available for direct investment.

Yields represent past performance and fluctuate with market conditions. **Past performance is no guarantee of future results.**

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

Economic conditions in Europe and Asia have continued to deteriorate. Recession looks likely for most European and Asian economies, in our view. The one bright spot may be China which is in the process of lifting its' Covid restrictions that have been largely in place since the pandemic started in early 2020. If China can successfully reopen their economy in the first half of 2023, it could give a boost to other Asian economies as well as other major trading partners like the U.S and Europe.

Equities

As we closed books on 2022, the so-called "Santa Clause rally" for equities in December never materialized. In fact, over the last two weeks of December, when the stock market typically rallies, stocks fell 4% as measured by the S&P 500 Index.[1] For the entire month of December, the S&P 500 declined by 5.8%.[1] We believe that worries of a recession in 2023 as well as the likely continuation of Federal Reserve rates-hikes in the first quarter fueled the decline in stocks. This weakness in the stock market was in spite of positive news on inflation that was reported by the Bureau of Labor Statistics (BLS) on December 13.[9] The BLS reported that CPI rose by only .01% in November and the 12-month inflation rate fell to 7.1.[9] Although that rate of inflation is still high by historical standards, it is a significant improvement from the June 12-month CPI level of 9.1%.[9] Perhaps more importantly, it was the fifth consecutive month of declining CPI.

If this trend of declining inflation continues in the first quarter of 2023, we believe the Federal Reserve may pause their rate-hike strategy sometime in the first half of the year. We believe this would be a potential positive catalyst for both stocks and bonds. In the meantime, we expect the stock market to remain volatile. In 2022, the S&P 500 experienced a 2% daily move in either direction 46 times, the most since the 2008 financial crisis.[10] While we don't expect 2023 to experience this level of volatility, we feel the stock market will continue to be volatile for first quarter of the year.

While high inflation and rising interest rates have been the primary driver of financial market volatility in 2022 in our observation, we believe investors will shift their focus away from these two factors and toward corporate earnings in 2023. We have long believed that the two primary factors that determine stock prices are interest rates and company earnings. The level of interest rates influences investor preferences for various investments. The higher the level of interest rates, the more attractive are fixed-income type of investments. Currently, interest rates for short maturity U.S. Treasuries, bank CDs and prime money market funds are in the 4% to 4.5% range.[8] These short-term fixed-income instruments now offer significant competition for stocks which currently have an average yield of 1.8% using the S&P 500.[1] We believe one of the primary reasons for the weakness in stocks in 2022 was a shift by investors from stocks to fixed income as interest rates rose. With the Federal Reserve possibly ending its current rate-hike program sometime in the first half of the year, we believe the downward pressure on stocks from rising rates will subside.

We believe that greatest influence on stock prices in 2023 will be corporate earnings. Currently, the consensus estimate for S&P 500 earnings is $230. Using the December 31, 2022 closing level of 3840 for the S&P 500 Index, that price gives us a Price-to-Earnings Ratio (P/E Ratio) of 16.6. This is compared to a P/E Ratio of 24.8 at the beginning of the bear market on January 4, 2022 as you can see in the accompanying chart. The average P/E Ratio at the S&P 500 lows for the last five bear markets was 15.6 as indicated in the chart. The S&P 500, at its year-end 2022 closing level of 3840, is only 6% away from that average bear market P/E Ratio low. That is not to say that the P/E Ratio for the S&P will not drop below that level. However, it does demonstrate that the S&P 500 is at a reasonable valuation level based in the consensus earnings forecast, in our view.

Sources: Bloomberg and Wells Fargo Investment Institute. Data as of December 14, 2022. Past bear market periods: July 16, 1990 – October 11, 1990; July 17, 1998 – August 31, 1998; March 24, 2000 – October 9, 2002; October 9, 2007 – March 9, 2009; February 19, 2020 – March 23, 2020. An index is unmanaged and not available for direct investment. See end of report for index definitions. **Past performance does not guarantee future results.**

We feel the current level of the S&P 500 Index, after having fallen nearly 20% in 2022, mostly reflects the higher market interest rates and the possibility of a mild-to-moderate recession for the U.S. economy in 2023. We expect 2023 corporate earnings will decline from 2022 levels as the economy weakens and possibly falls into recession. Weaker earnings would most likely be negative for stock prices. We could even see a testing of the 2022 market lows in the first half of the year. The S&P 500 Index hit its lows for the year on October at 3491 as discussed earlier. We believe there is a possibility that the October low for the S&P 500 could be tested in the first half of 2023. That's about 10% below the level where the S&P 500 started the year.

While we expect the October low to hold, if corporate earnings worsen more than expected in the first half of 2023, we could see the S&P 500 break below that level. If that happens, we believe the next level of support for the S&P 500 is the 3200-3300 range. While we don't believe the S&P 500 will go down that much from here, it is a risk that should be considered by investors looking to put cash to work in equites. To be clear, we believe the October low for the S&P 500 will hold if tested. At that 3500 level for the S&P 500, we feel stocks would be very attractive on a valuation basis.

We see a more positive environment for stocks in the second half of 2023. We believe there are three potential catalysts for a recovery in stocks. First, the possibility that the Federal Reserve not only pauses its rate-hike strategy, but also begins to ease monetary policy in the second half of the year. Second, the continued decline in the inflation data as the impact of higher interest rates begins to dampen both consumer and business demand for product and services. Third, potential recovery in corporate earnings in the latter half of the year. We also expect investor sentiment toward stocks to become more positive by mid-year. Sentiment is also an important driver of stock prices, in our view.

Commodities:

One of the few bright spots for investors in 2022 was the commodity market. Most commodities have been on a tear since May of 2020 as demand exploded for various commodities like copper, steel, aluminum, energy and agricultural products. We believe that strong demand, supply constraints and inflationary pressures have pushed prices higher. Using the Invesco DB Commodity Tracking Index as a basis for performance, commodities have increased in value by about 130% since May 1, 2020.[1] Energy prices are a major component of most commodity tracking funds, typically making up over 50% of the benchmark weighting. Since May of 2020, crude oil prices, as measured by West Texas Intermediate (WTI) prices, have increased by almost 200%.[1] While there are various reasons for the rise in crude oil prices, we believe it all comes down to an insufficient supply of crude oil in order to cover ongoing demand. A similar story applies to many other commodities. Economics 101 teaches that when demand exceeds supply, prices must rise. We remain optimistic on most commodities sectors although we could see some weakness in the first half of the year due to slowing economic growth.

Fixed Income

At the beginning of 2022, interest rates across the maturity spectrum on most fixed-income instruments were at historically low levels. Short-term instruments like U.S. Treasuries, bank CD's and prime money market funds offered yields below .5%.[8] Intermediate and long-term yields weren't much better on highly-rated fixed-income securities. The 10-Year U.S. Treasury Note yield started 2022 at a yield of 1.6%.[1] That all changed when the first quarter inflation data came in higher than expected and the Federal Reserve responded by raising interest rates in March. The increase in interest rates in 2022 hit bonds with maturities more than 10 years very hard as we previously discussed. 2022 was one of the few years in U.S. financial market history where many investors experienced losses on both stocks and fixed-income investments.

We believe 2023 will be a better year for fixed-income investors. With interest rates exceeding 4% across much of the yield curve, investors can potentially enjoy meaningful cash flow from newly purchased high-quality fixed-income instruments. With the potential of a pause in the Fed's rate-hike strategy in the first half of the year, we see interest rates stabilizing near current levels. If a recession hits the U.S. economy in 2023 and inflation pressures continue to subside, the Fed may even begin cutting rates in the second half of the year. This would potentially lead to falling bond yields and rising bond prices which would give fixed-income investors an opportunity to recover some of their losses from 2022

Strategy

Equities/Commodities:

- We continue to favor high-quality, U.S. mid and large company stocks over smaller company stocks. We especially like stocks that pay dividends and sell at reasonable valuation levels. There are many high-quality dividend paying stocks that now offer yields in excess of 3%. We also favor companies that have a history of raising their dividends each year. However, dividends are not guaranteed and are subject to change or elimination. While we are unable to mention specific securities in our letter, we would be happy to discuss our recommendations with you.

- We believe there is also a potential opportunity in certain high-quality growth stocks now that prices of many of these stocks have come down significantly in 2022. The Russell 1000 Growth Index, which is made up of higher growth and higher P/E Ratio stocks, declined by 33% in 2022 after several years of double-digit positive returns.[1] Several high-quality growth stocks, in particular those in the technology sector, dropped in value by 50-70%. We believe many of these stocks are now very attractive for the long-term investor.

- Small-cap stocks look attractive to us on a valuation basis but we feel this sector will continue to underperform large and mid-cap stocks in the first half of the year. Higher interest rates and recession could negatively impact small companies since they tend to borrow more to finance their businesses and typically don't have the cash reserves to weather a recession. We have been bearish on this area for a couple of years and will remain bearish until we can get a clearer picture on the direction of interest rates and the economy. While waiting for this clearer picture may cause us to be a little late in participating in the recovery of this asset class, we want to maintain a more conservative outlook for the first half of the year for the reasons stated above.

- We remain bearish on foreign stocks based on our negative economic outlook for most international economies and the potential of continued U.S. dollar strength in 2023. At some point, we feel both developed country and emerging market country stocks will be attractive for investment however, we believe that now is not the time to add exposure to these asset classes. A small exposure to international stocks may be appropriate for those investors seeking more portfolio diversification. However, we would wait to add to this area until we get closer to the middle of 2023.
- We remain very bullish on commodities in general, but in particular crude oil. We believe the supply of crude oil will continue to be constrained for at least the next 12 to 18 months. Although we may see some drop-off in demand due to economic weakness in the first half of the year, we believe the supply/demand imbalance will remain and support crude oil prices near current prices. WTI is currently trading at about $76 per barrel. If demand softens as we expect in the first half of the year, we could see the price of WTI fall below $70 to the mid-60s. However, we feel the upside potential for WTI is significantly greater once the global economy begins to recover. We see prices possibly nearing the $110-120 level sometime in 2023.
- We continue to favor equities in the commodity sector, in particular, energy stocks. Even if crude oil prices weaken this year, we believe energy companies involved in the oil and gas production area will continue to show strong positive cash flows as long as crude prices stay above $60 per barrel for WTI. Dividends for this sector are well above the dividend rate for the S&P 500 which currently stands at 1.8%.[1] In addition, several high-quality oil and gas pipelines stocks are paying dividend yields over 5%. Again, dividends are not guaranteed and are subject to change or elimination. We see upside potential for energy stock prices in 2023 if energy prices move higher as we expect.
- At this time, we are cautious in the near-term on the basic metals sector of the commodity market based on our belief the global economy will be in recession this sometime this year and demand for many commodities like copper, steel, and aluminum may temporarily decline. We would wait until the middle part of year to add to this sector.
- We favor precious metals like gold and silver which have been strengthening in price recently. We believe the fundamental and technical picture for gold and silver is very positive. These precious metals tend to perform well in recessionary environments, from our observation.

Fixed Income:

- We continue to favor high-quality fixed-income instruments like U.S. Treasuries, bank CD's, prime money market funds as well as high-grade corporate and municipal bonds. We view tax-free municipal bonds, with current yields ranging from 3% to 4.5% for intermediate and longer-term maturities, as very attractive for investors in higher tax brackets. Those tax-free yields calculate to a taxable equivalent yield for investors in a 35% tax bracket of 5.4% to 6.9%. In 2022, this sector experienced significant outflows as investors sought to protect principal from rising interest rates. We see cash flowing back into this sector in the first half of the year as investors seek lock in these yields.
- Over the past two years, we have favored keeping average bond maturities under 10 years in order to help reduce downside risk if rates were to rise.[11] We are now favoring lengthening the average maturity for the fixed-income component of a portfolio in order to take advantage of the higher interest rates. In particular, we favor a barbell strategy for the fixed-income component. This strategy involves investing a portion of the fixed-income allocation in short-term instruments, with maturities of less than 2 years, while investing the remainder of the allocation in longer-term bonds with maturities ranging from 10-20 years.
- We would avoid most international and emerging market fixed-income holdings for now as a potentially stronger U.S. dollar and weaker overseas economic conditions could negatively impact prices, in our view.
- We would also avoid so called "high-yield" bonds. These bonds, which have lower credit ratings than high-grade bonds, tend to underperform in a recession as default rates typically rise.

The Bottom Line

We realize that our forecast for the first half of the year for the U.S. economy and stock market is cautious if not somewhat pessimistic. We have maintained this cautious position since June of last year when the Fed surprised investors with a .75% rate-hike and indicated further rate-hikes to follow. We believe these moves by the Federal Reserve changed the short-term outlook for stocks and increased the probability of a recession for the U.S. economy. This cloud of Fed monetary tightening still hangs over the stock market. We believe that until the Fed is finished increasing the Fed funds rate, it will be difficult for stocks to sustain an upward tread.

However, we see the proverbial light at the end of the tunnel. Looking out to the second half of 2023, we believe the Fed will have stopped its rate-hike strategy, inflation statistics will be moving closer to the Fed's 2% target, and the economy will be in the later stages of a recession. On the basis of these forecasts, we believe the bear market in stocks will end by no later than early summer and the stock market will be in the early stages of a more durable recovery.

For this reason, we are encouraging our clients to stay the course and ride out the near-term market volatility. Since it is very difficult to time stock market movements in our experience, we believe investors should continue to hold equity allocations according to their long-term investment objectives. We believe any further downside in stocks would be a good time to selectively add to high-quality equities, where appropriate.

In addition, we believe the beginning of the year is a good time to evaluate your current asset allocation strategy to help ensure your portfolio is in line with your long-term goals and objectives. This could also be a good time to rebalance portfolios back to long-term asset allocation targets.

As we begin the new year, we are very grateful for your confidence and trust in us. We are honored to serve you and your families and look forward to our continued relationship.

May you and your families have a very Happy and Prosperous New Year!

Your Trinity Capital Management Team

Tyler, TX Location
821 ESE Loop 323, Suite 100
Tyler, Texas 75701
903-747-3960

TCM Dallas, TX Galleria Location
13355 Noel Rd., Suite 1100
Dallas, Texas 75244
214-746-3575

TCM Nacogdoches, TX Location
1323 N. University Dr.
Nacogdoches, Texas 75961
936-560-3930

Webite:*www.tcmtx.com*

Investment products and services are offered through Wells Fargo Advisors Financial Network, LLC (WFAFN), Member SIPC, a registered broker-dealer and separate non-bank affiliate of Wells Fargo and Company. Trinity Capital Management, LLC is separate entity from WFAFN.

Footnotes

[1] Thompson charts
[2] https://www.bls.gov/regions/mid-atlantic/data/consumerpriceindexhistorical_us_table.htm
[3] https://www.forbes.com/advisor/investing/fed-funds-rate-history
[4] https://fred.stlouisfed.org/series/MORTGAGE30US
[5] https://www.usnews.com/news/economy/articles/2022-12-28/home-sales-fall-4-in-november-way-below-forecasts-and-the-sixth-monthly-decline-in-a-row
[6] https://www.cnn.com/2022/12/15/economy/us-retail-sales-november/index.html
[7] Wall Street Journal article, "Hiring, Wage Gains Eased in December, Pointing to a Cooling Labor Market in 2023," January 9, 2023
[8] Wells Fargo Investment Institute, 2023 Outlook, December 2022.
[9] Wall Street Journal, "Inflation Isn't Vanquished Yet" December 13, 2022.
[10] Barron's, "What a Crazy Year: A Bear Market, Oil's Pop, and Those Bond Yields" December 30, 2022
[11] TCM 2021 Investment Outlook & Strategy dated 1/11/21 and TCM 2022 Investment Outlook & Strategy dated 1/10/22.

See page 8 for notes and disclaimers

The indices presented in this material are to provide you with an understanding of their historic performance and are not presented to illustrate the performance of any security. Investors cannot directly purchase any index.

Stocks offer long-term growth potential, but may fluctuate more and provide less current income than other investments. An investment in the stock market should be made with an understanding of the risks associated with common stocks, including market fluctuations. 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.

The opinions expressed in this report are those of the author(s) and are not necessarily those of Wells Fargo Advisors Financial Network or its affiliates. The material has been prepared or is distributed solely for information purposes and is not a solicitation or an offer to buy any security or instrument or to participate in any trading strategy.

Wells Fargo Advisors Financial Network is not a legal or tax advisor. Consult your tax advisor or accountant for more details regarding your specific circumstance.

Investing in fixed income securities involves certain risks such as market risk if sold prior to maturity and credit risk especially if investing in high yield bonds, which have lower ratings and are subject to greater volatility. All fixed income securities may be worth less than the original cost upon redemption or maturity. Yields and market value will fluctuate so that your investment, if sold prior to maturity, may be worth more or less than its original cost. Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can result in the decline of the value of your investment.

Asset allocation cannot eliminate the risk of fluctuating prices and uncertain returns nor can diversification guarantee profits in a declining market.

Diversification does not guarantee profit or protect against loss in declining markets.

Wells Fargo Investment Institute, Inc. is a registered investment adviser and wholly-owned subsidiary of Wells Fargo & Company and provides investment advice to Wells Fargo Bank, N.A., Wells Fargo Advisors and other Wells Fargo affiliates. Wells Fargo Bank, N.A. is a bank affiliate of Wells Fargo & Company.

P/E Ratio is a valuation of a company or an index's current value compared to its earnings per share. It is calculated by dividing the market value per share by earnings per share.

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.

Dow Jones Industrial Average: The Dow Jones Industrial Average is an unweighted index of 30 "blue-chip" industrial U.S. stocks.

The Russell 1000® Growth Index measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.

Index return information is provided for illustrative purposes only. Index returns do not represent investment performance or the results of actual trading. Index returns reflect general market results, assume the reinvestment of dividends and other distributions and do not reflect deduction for fees, expenses or taxes applicable to an actual investment. An index is unmanaged and not available for direct investment.

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.

- The Energy sector may be adversely affected by changes in worldwide energy prices, exploration, production spending, government regulation, and changes in exchange rates, depletion of natural resources, and risks that arise from extreme weather conditions.
- 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 smaller, less-seasoned companies, tend to be more volatile than the overall market.
- Materials industries can be significantly affected by the volatility of commodity prices, the exchange rate between foreign currency and the dollar, export/import concerns, worldwide competition, procurement and manufacturing and cost containment issues.

Past performance is no guarantee of future results and there is no guarantee that any forward-looking statements made in this communication will be attained.

PND-0123-00998