

Investment Strategy

Weekly guidance from our Investment Strategy Committee July 7, 2025

Global Economy Spotlight: U.S. dollar down, but not out 2

- The U.S. dollar has been undergoing a challenging repricing period this year as markets adjust to rapid policy change, but we still believe reports of the dollar’s demise are greatly exaggerated.¹
- Taking a statistical approach to analyzing the U.S. dollar’s role, it is clear to us that the greenback remains the linchpin of global trade and finance and is far from becoming irrelevant.

Equities: Tariff headwinds test strength of cautious consumers 4

- Consumer spending remains resilient, albeit quite cautious and value oriented.
- The impact of tariffs has yet to hit store shelves, with back-to-school shopping likely being the first real test of consumer acceptance to price hikes.

Fixed Income: Banks pass annual stress test..... 5

- All 22 banks passed the 2025 Federal Reserve (Fed) stress test, with only two banks seeing modestly higher loan loss rates than the prior year.
- Strong regulatory capital and quality loan underwriting remain key factors for investors to assess bank credit quality.

Real Assets: REIT earnings growth slows as internal gains normalize 6

- While real estate investment trusts (REITs) generated reasonable growth in same-store net operating income (NOI), funds from operations (FFO) per share increased slightly from the year-ago quarter.
- We recommend investors considering REITs to focus on Data Center, Telecommunications, and Industrial REITs given positive long-term demand drivers.

Alternatives: Private equity exits recovery stalls, but for how long? 7

- While the recovery in private equity exit activity may have stalled, we expect the upturn to resume as tariff and geopolitical uncertainties fade and corporate leaders become more confident in the economic outlook.
- As exit activity increases, we expect that additional distributions should allow investors to reinvest in new opportunities, thereby increasing the supply of capital and leading to improved valuations overall.

Current tactical guidance 8

Investment and Insurance Products: ➤ NOT FDIC Insured ➤ NO Bank Guarantee ➤ MAY Lose Value

1. For more a detailed, client-approved publication on our view of the U.S. dollar, see our Special Report: “The dollar’s future as an international currency,” Wells Fargo Investment Institute, May 29, 2025.

Global Economy Spotlight

Jennifer Timmerman

Investment Strategy Analyst

U.S. dollar down, but not out

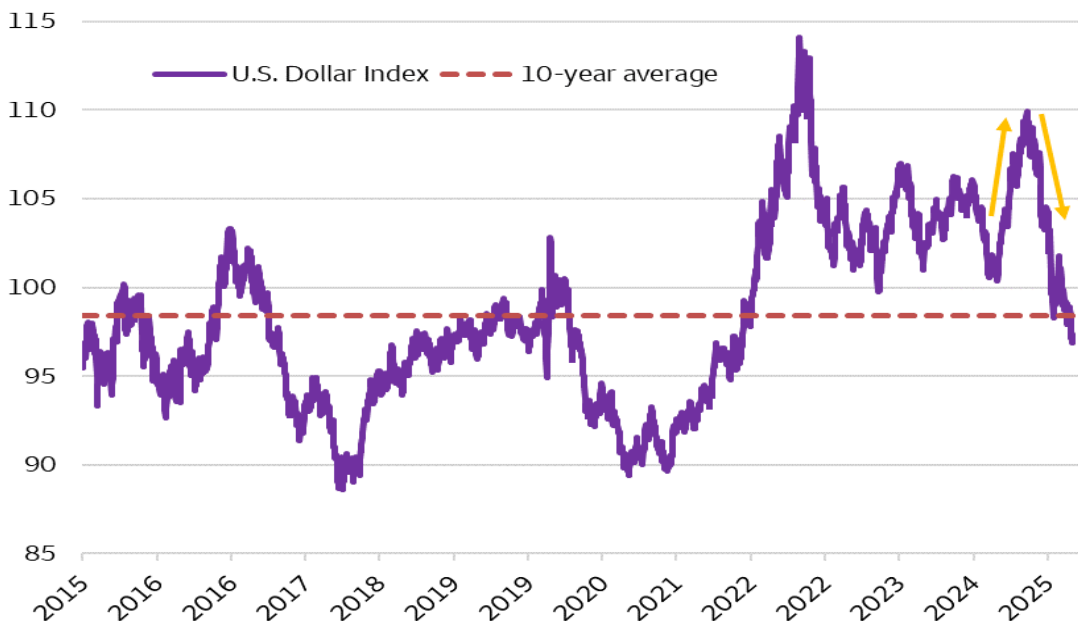
As we detailed in our 2025 Midyear Outlook — “Opportunities amid uneven terrain,” — rapid policy change has been the defining feature of the past six months and likely will continue to drive capital markets in the near term. U.S. tariff and budget uncertainty have whipsawed both equity and fixed-income markets, but perhaps the most worrisome asset move for many investors has been the U.S. dollar’s noticeable selloff. Despite the barrage of negative headlines, we believe reports of the dollar’s demise remain greatly exaggerated.

Follow the bouncing buck

Although much ink has been spilled in 2025 around the U.S. Dollar Index’s more than 10% year-to-date drop (through June 30, 2025), the greenback is down less than 4% from the end of last September — the point at which market participants started pricing in President Donald Trump’s 2024 election victory. In fact, going long the U.S. dollar was one of the most crowded trades coming into 2025 as the S&P 500 Index Information Technology sector outperformed the composite index throughout the final quarter of 2024 and into January 2025, before reversing sharply into early April.

By April, the tariff uncertainty and tech sector weakness combined to accompany a falling dollar and, in turn, forced foreign investors to sell the dollar forward at even cheaper exchange rates to hedge potential currency losses. Despite the whiplash, as of June 30, the greenback was still trading near its 10-year average (see Chart 1).

Chart 1. U.S. policy uncertainty, hedging dynamics behind recent dollar whiplash



Sources: Wells Fargo Investment Institute and Bloomberg. Data as of June 30, 2025. **Past performance is no guarantee of future results.**

U.S. dollar should find its footing over tactical horizon, in our view

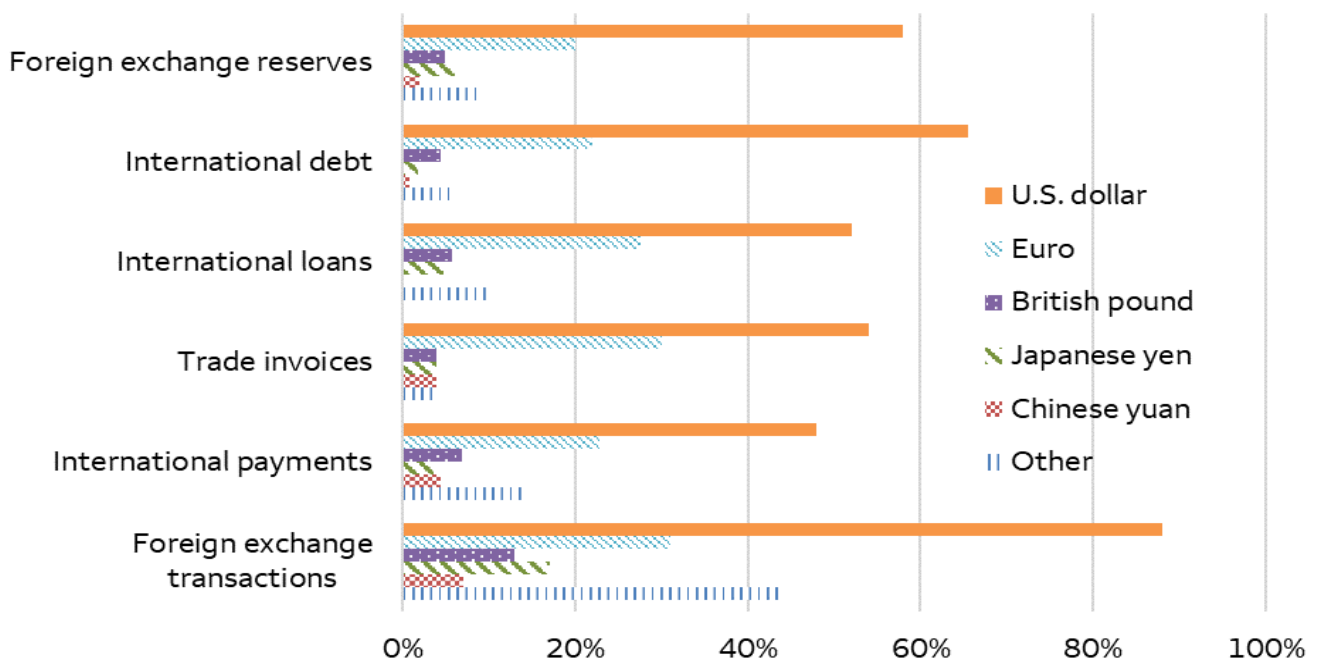
We expect the dollar to stabilize at a modestly higher level later this year and through 2026 as fundamental drivers begin to reassert themselves. Over the next 12 to 18 months, we anticipate relatively strong U.S. economic growth as tax cuts and the cumulative effect of deregulation spur a moderate growth recovery overriding the negative economic impact from tariffs and tighter immigration controls.

A more fragmented, less efficient foreign-trade environment should create a greater growth headwind for more trade-dependent, overseas economies. In our view, stronger economic growth also increases the likelihood that interest-rate differentials will move in favor of the U.S. dollar over the next year. The Fed remains hesitant to cut its policy rate. Meanwhile, the European Central Bank has been aggressively reducing its benchmark rate over the past year to boost its more fragile economy, outmatched by the Swiss National Bank, which slashed its policy rate to zero last month.

The big picture

Taking a statistical approach to analyzing the U.S. dollar’s role, it is clear to us that the greenback remains the linchpin of global trade and finance and is far from becoming irrelevant (see Chart 2).

Chart 2. U.S. dollar dominance in perspective, as of June 30, 2025



Sources: Wells Fargo Investment Institute, Brookings Institute, Atlantic Council (Dollar Dominance Monitor), Bank for International Settlements (Triennial Central Bank Survey), European Central Bank (The International Role of the Euro Report), International Monetary Fund (Currency Composition of Official Foreign Exchange Reserves), Society for Worldwide Interbank Financial Telecommunication (RMB [renminbi] Tracker). Note: China is included in “Other” for the international loans category. Trade invoice and international payments data excludes Eurozone trade. Sum of shares of foreign exchange transactions totals 200% since each transaction involves two currencies. Data as of June 30, 2025, latest available for each metric.

We prefer to avoid making portfolio adjustments based on speculation that the dollar may be in danger of losing its global status anytime soon. Over the longer term, the slow erosion observed in recent years may persist as global central banks diversify holdings and new methods of payment evolve — and this erosion risks being accelerated by poor policy decisions like lax monetary policies, or oversized deficits and an excessive buildup of government debt.

For now, however, we believe the U.S. dollar benefits from deep-seated advantages (such as the rule of law, transparency, and a highly liquid financial market) that make a global shift away from the dollar an extremely difficult and slow-moving process — especially because of underlying weaknesses of the most visible dollar alternatives. We detail this analysis in our May 29, 2025, Special Report — “The dollar’s future as an international currency.”

Equities

Brian Postol

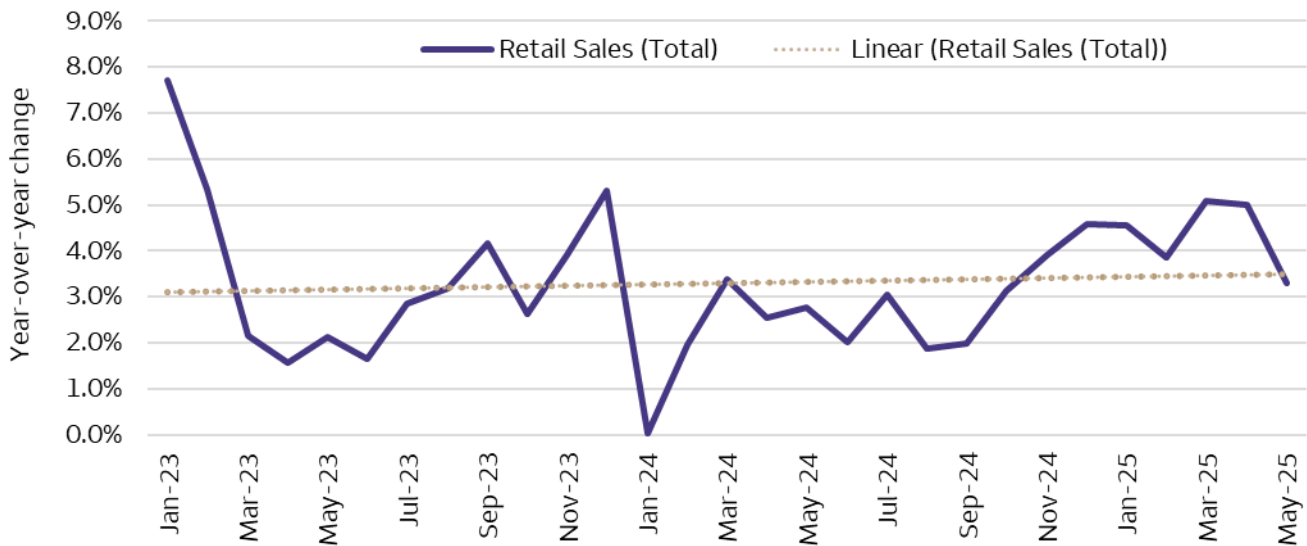
Equity Sector Analyst

Tariff headwinds test strength of cautious consumers

In the current economic environment, consumers remain resilient, yet cautious and value focused. Since Memorial Day, trends appear to have hit an air pocket, at best. Weather has been anything but helpful, with May ranking as one of the rainiest months on record (at least for 75% of the country). Convenience continues to play an important part, with several large mass merchants pushing the envelope with same day — and increasingly, three-hour-or-less — deliveries. Forward-deployed inventory, coupled with a broad and deep assortment of stock-keeping units, helps make it easy for time- and cash-strapped consumers return for more value and merchandising strength.

Tariffs remain a key source of uncertainty. Depending on the category, some pass-through is inevitable. Generally, the larger, more scaled, companies are becoming optimistic that tariffs should create market share opportunities, as smaller operators feel a greater impact. Many companies have started selectively raising prices, but concerns persist that tariffs could broadly weigh upon discretionary spending. Back-to-school shopping will be the first real test of price elasticity, as there may be some pockets of discretionary products that need promotion to sell through. More nimble retailers are reducing inventories while maintaining the flexibility to chase demand. On the contrary, the One, Big, Beautiful Bill could provide stimulus into 2026 — but until it passes, businesses and households are unsure of the direction to ultimately take. The more uncertain a consumer feels, the less they spend, particularly on items of want (discretionary products).

May retail sales slowdown, a tariff issue or just a pause?



Sources: Wells Fargo Investment Institute and U.S. Census Bureau. Monthly data from January 1, 2023, through May 31, 2025. Data series = Advance Monthly Sales, Retail Sales (Total), seasonally adjusted.

Fixed Income

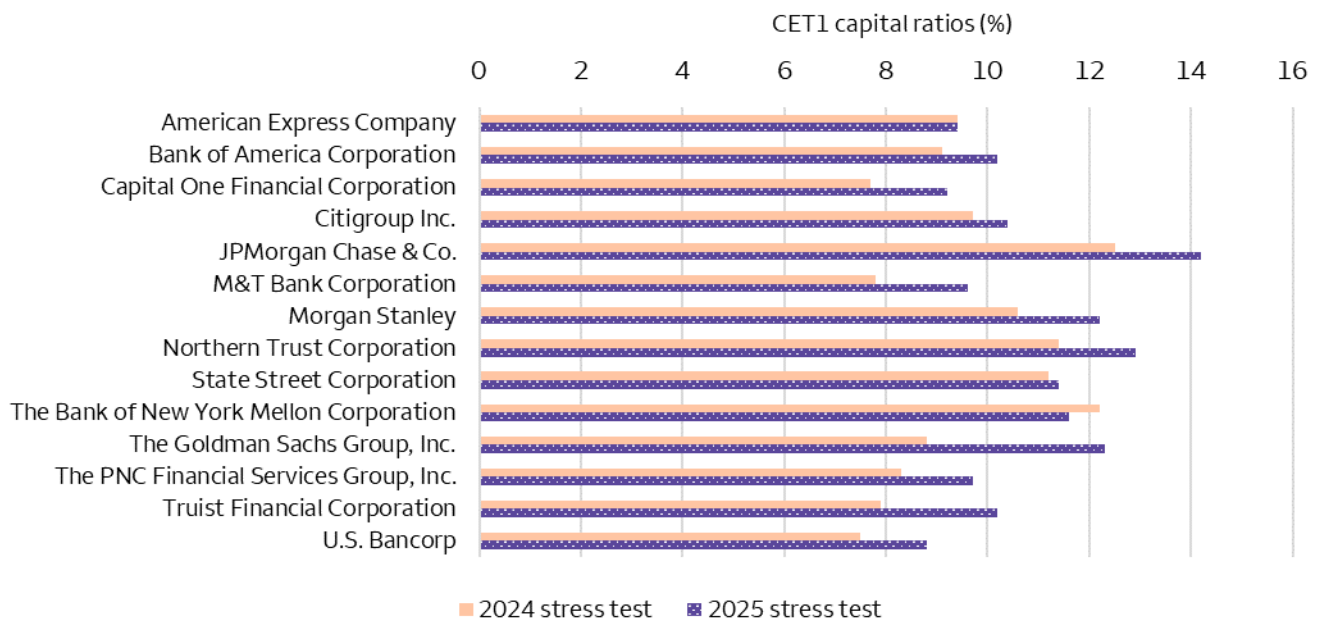
David Brandmire, CFA

Taxable Analyst

Banks pass annual stress test

All 22 banks passed the 2025 Fed stress test, with only six of the banks having common equity tier 1 (CET1) capital ratios touching under 10% (minimum is 4.5%, excluding stress capital buffer and global systemically important bank buffer). Only JPMorgan Chase & Co. (JPMorgan) and Northern Trust would see a higher rate of loan losses when comparing the 2025 results with the prior year. However, JPMorgan’s and Northern Trust’s minimum tier 1 capital ratios are expected to remain above the 2024 stress scenario minimum tier 1 capital ratios.

Minimum common equity tier 1 capital ratios (Top 14 U.S. banks)



Source: Federal Reserve Bank. Data as of June 30, 2025. CET1 = common equity tier 1 capital ratios.

The aggregate CET1 capital ratio of the 22 banks in this year’s stress test fell from an actual 13.4% in the fourth quarter of 2024 to a projected minimum of 11.6% under the severely adverse scenario. At the end of the projection horizon, first quarter 2027, the CET1 ratio is projected to recover to 12.7%. The 2025 stress results benefited from lower peak unemployment rates, a less severe decline in gross domestic product, and improved bank profitability.

The large banks would absorb projected losses of \$553 billion in the severely adverse scenario, including \$472 billion of loan losses with \$157 billion, \$124 billion, and \$52 billion from credit cards, commercial and industrial loans, and commercial real estate loans, respectively. The 10 banks with substantial trading, processing, or custodial operations would also incur \$44 billion in losses. Strong bank capital levels are expected to allow businesses and consumers access to loans and capital over the near term.

Real Assets

John Sheehan, CFA
Equity Sector Analyst,

REIT earnings growth slows as internal gains normalize

In the first quarter of 2025, the REIT industry reported a 0.9% increase in FFO per share relative to the first quarter of 2024 — these results followed stronger fourth-quarter 2024 FFO-per-share growth of 6.7%.² Additionally, REITs reported 3.2% growth in NOI from their same-store portfolios relative to the first quarter of 2024. Most REIT investors view same-store performance as a good indicator of internal growth.

We view the same-store NOI growth generated during the first quarter of 2025 as reasonable and in line with same-store NOI growth reported over the previous five quarters. We believe REITs did not have an overly challenging internal growth comparison with first-quarter 2024, when they also generated a 3.2% increase in same-store NOI. Although we do not believe REITs faced a challenging comparison period for FFO-per-share growth (which declined 3.0% in first-quarter 2024), it is worth noting that following the pandemic, REITs began reporting strong FFO-per-share growth from second-quarter 2021 through year-end 2022, with average quarterly FFO-per-share growth of nearly 21% over that period. Over this seven-quarter period, REITs also generated stronger same-store NOI growth, averaging 7.2% per quarter. We believe higher interest costs (resulting from the federal funds target rate, which saw increases in 2022 and 2023) and slowing rent growth contributed to the modest FFO-per-share increase reported in first-quarter 2025.

In conjunction with their first-quarter 2025 earnings, the majority of REITs we closely monitor updated their 2025 earnings guidance — while most REITs reiterated their initial 2025 outlooks, a few lowered guidance (primarily Lodging/Resort REITs) and several boosted their 2025 expectations. We recommend investors considering REITs to focus on Data Center, Telecommunications, and Industrial REITs given positive long-term demand drivers.

2. All data provided by the National Association of Real Estate Investment Trusts (Nareit) as of May 20, 2025.
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Alternatives

Mark Steffen, CFA, CAIA

Global Alternative Investment Strategist

Private equity exits recovery stalls, but for how long?

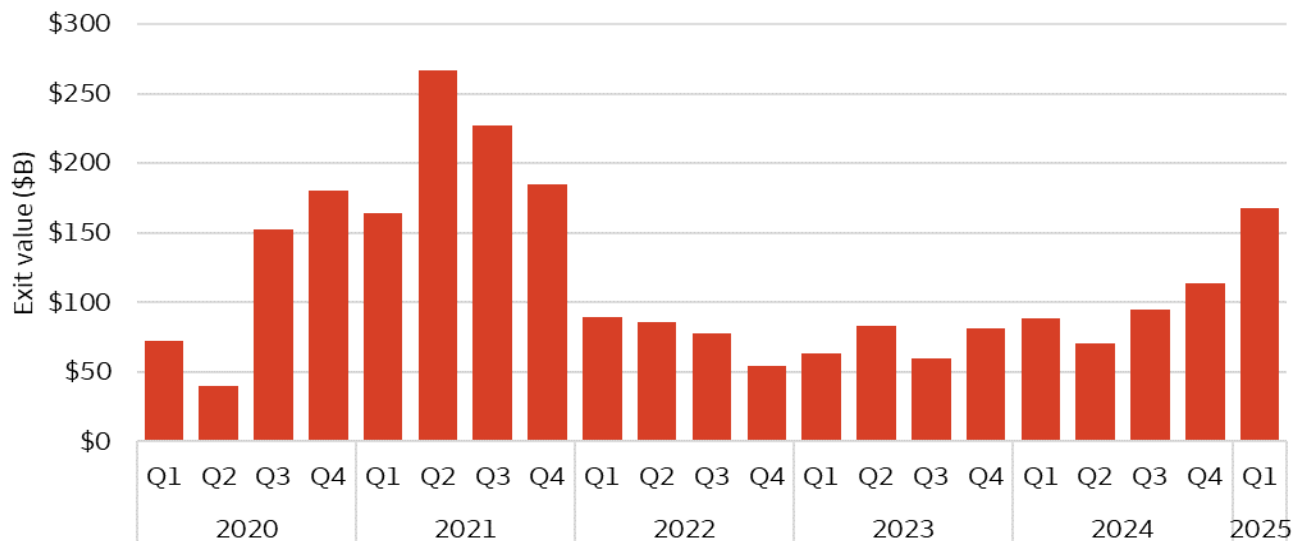
The private equity exit environment witnessed a notable increase in volume during the second half of 2024 that has continued through the first quarter of 2025 (see chart). While the increase in exit investment values provided hope that a recovery may be gaining momentum, the recent tariff-induced market volatility and geopolitical uncertainty has likely stalled or potentially reversed the upturn. As the Fed remains on hold awaiting the potential inflationary impacts of the tariffs, the elevated interest-rate environment also remains as a significant headwind that may restrict potential buyers from becoming more active.

As private-equity funds look to exit (or sell) their mature investments, a brief review of the primary routes used to monetize their investments underscores the potential impediments to a more sustained recovery:

1. Sale to a corporation: Potential tariff implications led to a growing wave of uncertainty among corporate leadership in the economic outlook, which typically results in fewer strategic acquisitions.
2. Initial public offerings (IPOs): The less-than-robust investor appetite for new IPOs continues to limit companies' willingness to attempt a migration to the public markets.
3. Sale to another private-equity firm: Despite an ample supply of dry powder in the hands of private-equity funds, the reality that other exit routes remain limited affords buyers the patience to be more selective in deal quality and pricing.

While the exit environment may remain challenged in the near term, we believe the private equity exit recovery will resume as tariff and geopolitical uncertainties subside. In our view, the return of a robust exit environment will likely be instrumental in unlocking capital currently stuck in mature private-equity investments, allowing investors to reinvest that cash into new investment opportunities.

Private equity exit activity by quarter



Source: PitchBook. Data as of March 31, 2025. Q1 = first quarter, Q2 = second quarter, Q3 = third quarter, Q4 = fourth quarter. **Past performance is no guarantee of future results.**

Alternative investments, such as hedge funds, private equity, private debt and private real estate funds are not appropriate for all investors and are only open to “accredited” or “qualified” investors within the meaning of U.S. securities laws.

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Tactical guidance*

Cash Alternatives and Fixed Income

Most Unfavorable	Unfavorable	Neutral	Favorable	Most Favorable
	U.S. Long Term Taxable Fixed Income U.S. Short Term Taxable Fixed Income	Cash Alternatives Developed Market Ex-U.S. Fixed Income Emerging Market Fixed Income High Yield Taxable Fixed Income U.S. Intermediate Term Taxable Fixed Income		

Equities

Most Unfavorable	Unfavorable	Neutral	Favorable	Most Favorable
	Emerging Market Equities	Developed Market Ex-U.S. Equities U.S. Small Cap Equities	U.S. Large Cap Equities U.S. Mid Cap Equities	

Real Assets

Most Unfavorable	Unfavorable	Neutral	Favorable	Most Favorable
		Private Real Estate	Commodities	

Alternative Investments**

Most Unfavorable	Unfavorable	Neutral	Favorable	Most Favorable
		Hedge Funds—Equity Hedge Hedge Funds—Relative Value Private Equity Private Debt	Hedge Funds—Event Driven Hedge Funds—Macro	

Source: Wells Fargo Investment Institute, July 7, 2025.

*Tactical horizon is 6-18 months

**Alternative investments are not appropriate for all investors. They are speculative and involve a high degree of risk that is appropriate 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. Please see end of report for important definitions and disclosures.

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. 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. Other risks associated with investing in listed **REITs** include the use of leverage, unexpected reductions in common dividends, increases in property taxes, and the impact to listed REITs from new property development.

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 appropriate 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

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.

S&P 500 Information Technology Index comprises those companies included in the S&P 500 that are classified as members of the GICS® information technology sector.

U.S. Dollar Index measures the value of the U.S. dollar relative to majority of its most significant trading partners. This index is similar to other trade-weighted indexes, which also use the exchange rates from the same major currencies.

An index is unmanaged and not available for direct investment.

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