

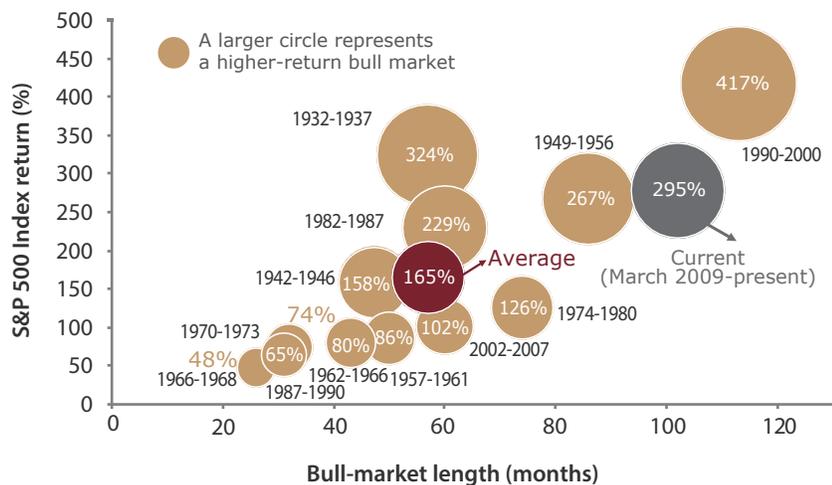
WELLS FARGO
INVESTMENT INSTITUTE

Advice Into Action

It has been more than 290 trading days (or about 14 months) since the S&P 500 Index experienced a decline of at least 3% and more than 2 years since there was a 10% correction in this index. Since 1988, the market has averaged a 3% pullback every 14 trading days. Given such an extended rally, investors' equity allocations may have grown disproportionately large. If that is the case, then a correction may erase more of an investment portfolio's value than investors may be expecting. We recommend investors be prepared for a potential pullback by holding a diversified portfolio and making sure that current allocations correspond with their original investment plan. It may be time to rebalance.

Strong performance in equity markets could have increased risk in your portfolio

The current equity-market recovery has surpassed the return and duration of the average bull market.



The bull market by the numbers

- Began March 9, 2009, and has run for 105 months
- Is the second-longest bull market since 1900
- Has provided a price return of 295% and a total return of 371%

Sources: Bloomberg, Factset and Wells Fargo Investment Institute, as of December 31, 2017. For illustrative purposes only.

The market is represented by the S&P 500 Index. Index returns reflect general market results, do not reflect actual portfolio returns or the experience of any investor, nor do they reflect the impact of any fees, expenses or taxes applicable to an actual investment. The S&P 500 Index is a market-capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the U.S. stock market. **Past performance is no guarantee of future results.** An index is unmanaged and not available for direct investment.

Our outlook for the rest of 2018

What we expect

- ▶ Stock prices should continue to rise through 2018, although higher interest rates could be a near-term headwind.
- ▶ Modest inflation should gradually lift bond yields but weigh on bond prices.
- ▶ Notwithstanding the expected benefit to U.S. markets in 2018 from the new tax legislation, global diversification will likely be increasingly important as the U.S. moves further along in its economic recovery than international markets.

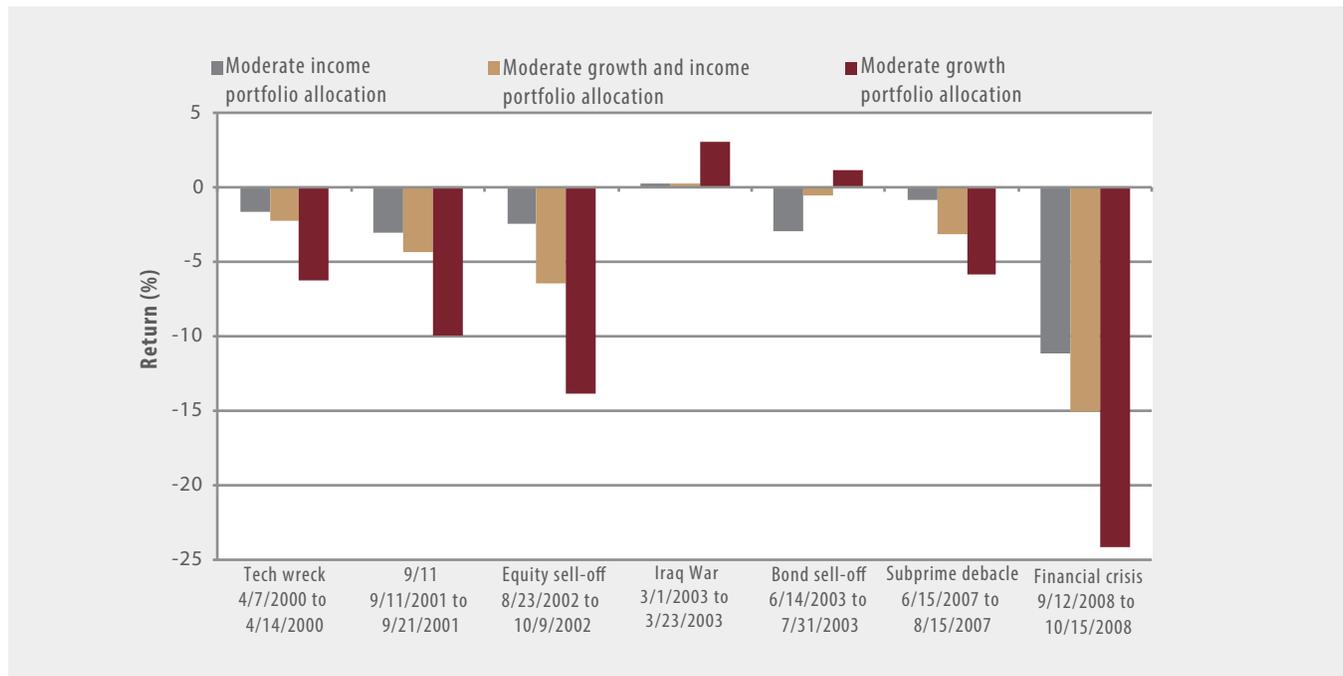
Actions to take now

- ▶ Evaluate how hypothetical portfolio allocations might have performed during past crisis events.
- ▶ Make sure your plan and current asset allocation are aligned with your risk and return expectations.
- ▶ Consider using excess cash to bring your current portfolio allocations into alignment with your plan's targets.

Make sure your portfolio is aligned with your investment goals

2017 was a great year for global stocks. Bonds, public real estate, and many hedge funds also posted positive returns. Following an unusually broad-based market rally, the way a portfolio is allocated can shift dramatically, sometimes without the investor's knowledge. As a result, we recommend investors regularly identify the risks in their portfolios in case of a market downturn. An evaluation of hypothetical historical investment performance is a good way to see how a portfolio allocation may have performed in past crisis events. A portfolio that has more risky assets like equities tends to rise more in positive markets and suffer greater losses in negative markets. The chart below shows that during certain historical crisis events, growth portfolios declined the most, income portfolios tended to decline the least, and growth and income portfolios experienced moderate declines.

Performance of model portfolios against historical events



Sources: Wells Fargo Investment Institute and Morningstar Direct. Cumulative returns for the time periods noted as of September 30, 2017.

Performance results for the model portfolios are hypothetical and for illustrative purposes only. The indices reflect the historical performance of the represented assets and assume the reinvestment of dividends and other distributions. An index is unmanaged and not available for direct investment. Index returns reflect general market results and do not reflect actual portfolio returns; the experience of any investor; or the impact of any fees, expenses, or taxes applicable to an actual investment. **Hypothetical and past performance does not guarantee future results.**

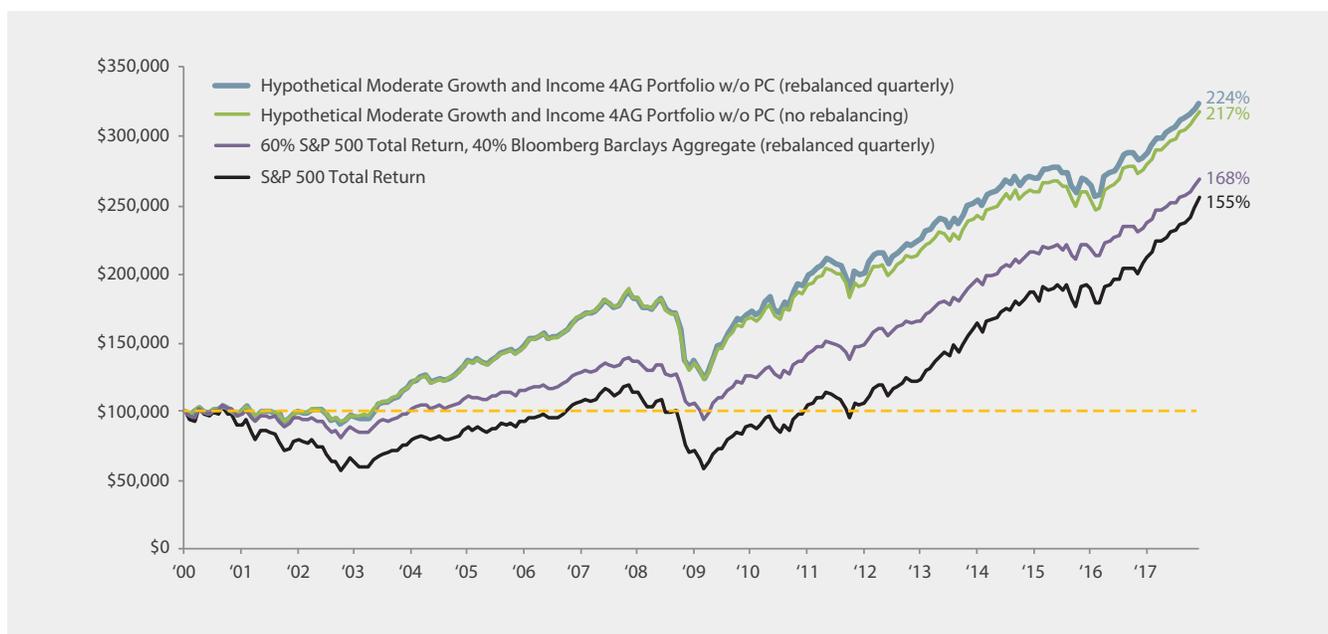
Keep in mind, there are difficulties in assessing hypothetical asset-class performance during certain crisis periods, in part, because these results do not represent actual trading and cannot completely account for the impact financial risk has on actual trading. In addition, any actual portfolio or account will invest in different economic conditions during periods with different volatility and in different securities than those incorporated in the hypothetical performance shown above. It is possible there are other scenarios or crisis events that could have resulted in heavier losses for a portfolio than those that occurred during the time periods shown. There is no guarantee any asset class will perform in a similar manner in the future. Please see the end of this report for the model portfolio compositions, definitions of the indices, and risks associated with the representative asset classes.

Consider rebalancing now to help manage risk

If you find your portfolio has shifted away from your desired asset allocation, we recommend you consider rebalancing. This means selling investments from allocations that have outgrown their targeted portion of your portfolio and using the proceeds to purchase investments that are underallocated in comparison with your target. For example, if a targeted 60% stock/40% bond portfolio is now at 75% stocks/25% bonds, you may want to sell stocks and buy bonds. While rebalancing might reduce your portfolio's upside potential in the near term, it also can lessen the possible downside when a market correction occurs, potentially enhancing your longer-term returns (see chart below).

Rebalancing is advisable when there has been market activity like we've seen during the past few years. We recommend rebalancing at least annually as a standard practice to help manage risk and return on an ongoing basis.

Hypothetical benefits of diversification and rebalancing



Sources: Morningstar Direct and Wells Fargo Investment Institute; as of November 30, 2017. Performance results for the Moderate Growth and Income Four Asset Group portfolio without private capital (PC); and 60% S&P 500 Total Return Index, 40% Bloomberg Barclays Aggregate Index portfolios are hypothetical and are presented for illustrative purposes only.

Performance results for the Four Asset Group without private capital and the 60/40 portfolios are hypothetical and for illustrative purposes only. Hypothetical results do not represent actual trading. The indices reflect the historical performance of the represented assets and assume the reinvestment of dividends and other distributions. Index returns reflect general market results and do not reflect actual portfolio returns, the experience of any investor, or the impact of any fees, expenses or taxes applicable to an actual investment. Because the HFR indices are calculated based on information that is voluntarily provided their actual returns may be higher or lower than those reported. Unlike most asset class indices, HFR Index returns reflect deduction for fees and expenses. An index is unmanaged and not available for direct investment. **Hypothetical and past performance does not guarantee future results.** Please see the end of the report for the risks associated with the representative asset classes and the definitions of the indices.

Don't let low cash returns interfere with your goals

Holding enough cash in cash alternatives, such as money market funds, to cover living expenses in the event of an emergency is critically important for money management. This practice may allow your longer-term investments to grow over time and reduce the likelihood that you'll be forced to sell during unfavorable market conditions. However, we suggest holding only 6 to 18 months of living expenses in cash alternatives because of their low returns. Once you have determined the right amount of cash for your circumstances, consider investing any excess. One approach is using dollar cost averaging—investing a set amount over time at a specific interval, such as monthly or quarterly.* We recommend investing the cash in underallocated asset classes first and then spreading it across your full portfolio.

	CHECK THESE ASSET CLASSES FOR OVERALLOCATION	CONSIDER ADDING TO THESE ASSET CLASSES IF YOUR HOLDINGS ARE BELOW YOUR INVESTMENT PLAN'S TARGET ALLOCATIONS
Equities	U.S. Equities	Developed Market ex-U.S. Equities Emerging Market Equities
Fixed Income	High Yield Fixed Income	U.S. Investment Grade Fixed Income
Real Assets	Commodities	Public Real Estate

Source: Wells Fargo Investment Institute, as of December 29, 2017

*A periodic investment plan such as dollar cost averaging does not assure a profit or protect against a loss in declining markets. Since such a strategy involves continuous investment, the investor should consider their ability to continue purchases through periods of low price levels.

Diversifying can help you avoid the fear of investing at the wrong time

Although we expect 2018 to be another positive year for stocks, no one knows for certain how much further stocks will climb before they experience a significant decline. Holding a variety of assets in an investment portfolio provides the opportunity to participate in market advances while potentially mitigating a market decline's impact on your portfolio. A diversified portfolio can also be a good place to invest excess cash, knowing that if markets continue to advance, you can reallocate some of your gains to assets that are expected to be less volatile, like high-quality bonds. If markets decline, those less-volatile asset classes should help reduce the potential for portfolio losses.

ASSET CLASSES THAT MAY PARTICIPATE IN A RISING EQUITY MARKET	ASSET CLASSES THAT MAY MITIGATE EQUITY MARKET LOSSES
U.S. Equities Developed Market Equities Emerging Market Equities High Yield Fixed Income REITs (Real Estate Investment Trusts) Hedge Funds*	Cash U.S. Investment Grade Fixed Income Developed Market Investment Grade Fixed Income Emerging Market Fixed Income Commodities Hedge Funds*

Source: Wells Fargo Investment Institute, as of December 29, 2017

*Hedge Funds are not suitable for all investors and are available only to persons who are "accredited investors" or "qualified purchasers" within the meaning of U.S. securities laws. Hedge funds trade in diverse complex strategies that are affected in different ways and at different times by changing market conditions. Strategies may, at times, be out of market favor for considerable periods with adverse consequences for the investor.

Whether you have been investing for a long time or are new to managing your investments, we firmly believe that taking steps now to be more nimble can help you recognize potential investment opportunities. We recommend reviewing your portfolio as a regular, routine step, and believe now is a good occasion to contact your investment professional to discuss new opportunities we expect will materialize in the year ahead.

Compositions and definitions for model portfolios

Compositions for model portfolios, page 2:

Moderate income model portfolio: 3% Bloomberg Barclays 1–3 Month Treasury Bill Index, 19% Bloomberg Barclays U.S. Aggregate Bond Index (1–3Y), 30% Bloomberg Barclays U.S. Aggregate Bond Index (5–7Y), 7% Bloomberg Barclays U.S. Aggregate Bond Index (10+Y), 6% Bloomberg Barclays U.S. Corporate High Yield Bond Index, 5% JPM GBI Global ex.-U.S. Index, 5% JPM EMBI Global, 12% S&P 500 Index, 2% Russell Midcap® Index, 2% Russell 2000® Index, 4% MSCI EAFE Index (USD), 5% FTSE EPRA/NAREIT Developed Index.

Moderate growth & income model portfolio: 3% Bloomberg Barclays 1–3 Month Treasury Bill Index, 4% Bloomberg Barclays U.S. Aggregate Bond Index (1–3Y), 16% Bloomberg Barclays U.S. Aggregate Bond Index (5–7Y), 7% Bloomberg Barclays U.S. Aggregate Bond Index (10+Y), 6% Bloomberg Barclays U.S. Corporate High Yield Bond Index, 3% JPM GBI Global ex.-U.S., 5% JPM EMBI Global, 21% S&P 500 Index, 9% Russell Midcap® Index, 8% Russell 2000® Index, 6% MSCI EAFE Index (USD), 5% MSCI EM Index (USD), 5% FTSE EPRA/NAREIT Developed Index, 2% Bloomberg Commodity Index.

Moderate growth model portfolio: 2% Bloomberg Barclays 1–3 Month Treasury Bill Index, 2% Bloomberg Barclays U.S. Aggregate Bond Index (1–3Y), 3% Bloomberg Barclays U.S. Aggregate Bond Index (5–7Y), 3% Bloomberg Barclays U.S. Aggregate Bond Index (10+Y), 3% Bloomberg Barclays U.S. Corporate High Yield Bond Index, 2% JPM GBI Global ex.-U.S., 3% JPM EMBI Global, 29% S&P 500 Index, 13% Russell Midcap® Index, 13% Russell 2000® Index, 10% MSCI EAFE Index (USD), 10% MSCI EM Index (USD), 5% FTSE EPRA/NAREIT Developed Index, 2% Bloomberg Commodity Index.

Composition for model portfolio, page 3:

Moderate Growth and Income Four Asset Group model portfolio without private capital: 3% Bloomberg Barclays 1–3 Month Treasury Bill Index, 11% Bloomberg Barclays U.S. Aggregate Bond Index (5–7Y), 6% Bloomberg Barclays U.S. Aggregate Bond Index (10+Y), 6% Bloomberg Barclays U.S. Corporate High Yield Bond Index, 3% JPM GBI Global ex.-U.S., 5% JPM EMBI Global, 20% S&P 500 Index, 8% Russell Midcap® Index, 6% Russell 2000® Index, 5% MSCI EAFE Index (USD), 5% MSCI EM Index (USD), 5% FTSE EPRA/NAREIT Developed Index, 2% Bloomberg Commodity Index, 3% HFRI Relative Value Index, 6% HFRI Macro Index, 4% HFRI Event-Driven Index, 2% HFRI Equity Hedge Index.

Index definitions

The **Bloomberg Barclays 1–3 Month Treasury Bill Index** includes all publicly issued zero-coupon U.S. Treasury bills that have a remaining maturity of less than three months and more than one month, are rated investment grade, and have \$250 million or more of outstanding face value. In addition, the securities must be denominated in U.S. dollars and must be fixed rate and nonconvertible.

The **Bloomberg Barclays U.S. Aggregate Bond Index** is composed of the Bloomberg Barclays U.S. Government/Credit Index and the Bloomberg Barclays U.S. Mortgage-Backed Securities Index and includes Treasury issues, agency issues, corporate bond issues, and mortgage-backed securities.

The **Bloomberg Barclays U.S. Aggregate 1–3 Year Bond Index** is unmanaged and is composed of the Bloomberg Barclays U.S. Government/Credit Index and the Bloomberg Barclays U.S. Mortgage-Backed Securities Index and includes Treasury issues, agency issues, corporate bond issues, and mortgage-backed securities with maturities of one to three years.

The **Bloomberg Barclays U.S. Aggregate 5–7 Year Bond Index** is unmanaged and is composed of the Bloomberg Barclays U.S. Government/Credit Index and the Bloomberg Barclays U.S. Mortgage-Backed Securities Index and includes Treasury issues, agency issues, corporate bond issues, and mortgage-backed securities with maturities of five to seven years.

The **Bloomberg Barclays U.S. Aggregate 10+ Year Bond Index** is unmanaged and is composed of the Bloomberg Barclays U.S. Government/Credit Index and the Bloomberg Barclays U.S. Mortgage-Backed Securities Index and includes Treasury issues, agency issues, corporate bond issues, and mortgage-backed securities with maturities of 10 years or more.

The **Bloomberg Barclays U.S. Corporate High Yield Bond Index** covers the universe of fixed-rate, non-investment-grade debt.

The **Bloomberg Commodity Index** is a broadly diversified index composed of 22 exchange-traded futures on physical commodities and represents 20 commodities weighted to account for economic significance and market liquidity.

The **FTSE EPRA/NAREIT Developed Index** is designed to track the performance of listed real estate companies and REITs in developed countries worldwide.

The **HFRI Relative Value (Total) Index** is managed by maintaining positions in which the investment thesis is predicated on realization of a valuation discrepancy in the relationship between multiple securities. Managers employ a variety of fundamental and quantitative techniques to establish investment theses, and security types range broadly across equity, fixed-income, derivative, or other security types.

The **HFRI Macro (Total) Index** is managed by trading a broad range of strategies in which the investment process is predicated on movements in underlying economic variables and the impact these have on equity, fixed-income, hard currency, and commodity markets. Managers employ a variety of techniques: both discretionary and systematic analyses, combinations of top-down and bottom-up theses, quantitative and fundamental approaches, and long- and short-term holding periods.

The **HFRI Event-Driven (Total) Index** is managed by maintaining positions in companies currently or prospectively involved in corporate transactions of a wide variety, including but not limited to mergers, restructurings, financial distress, tender offers, shareholder buybacks, debt exchanges, security issuance, or other capital structure adjustments.

The **HFRI Equity Hedge (Total) Index** is managed by maintaining positions both long and short in primarily equity and equity derivative securities.

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, LLC (HFR). 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.

The **J.P. Morgan Global Ex United States Index (JPM GBI Global Ex-US)** is a total return, market-capitalization-weighted index that is rebalanced monthly and consists of the following countries: Australia, Germany, Spain, Belgium, Italy, Sweden, Canada, Japan, United Kingdom, Denmark, Netherlands, and France.

The **J.P. Morgan Emerging Market Bond Index Global (EMBI Global)** currently 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.

The **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.

The **MSCI Emerging Markets Index** is a free-float-adjusted market-capitalization-weighted index that is designed to measure equity-market performance of emerging markets.

The **Russell Midcap® Index** measures the performance of the 800 smallest companies in the Russell 1000® 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.

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

Risk considerations

Asset allocation is an investment method used to help manage risk. It does not ensure a profit or protect against a loss. 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. **Stocks** 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**. **Cash alternatives**, such as money market funds, typically offer lower rates of return than longer-term equity or fixed-income securities and may not keep pace with inflation over extended periods of time. **Bonds** are subject to market, interest-rate, price, credit/default, call, 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.

About the author



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Ms. McMillion leads the development of global investment strategy. She oversees the creation of asset allocation recommendations and writes economic and market commentary and analysis. Prior to her current role, she served as an asset allocation strategist and a senior investment research analyst for Wells Fargo and predecessor firms.

Investment expertise and advice that can help you succeed financially

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For assistance with your investment planning or to discuss the points in this report, please talk to your investment professional.

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