WELLS FARGO Advisors

December 2021

2022 Equity Sector Outlook:

Back to Basics

Wells Fargo Advisors
Global Securities Research

2021 performance review

The equity markets have thus far turned in a solid total return performance (26% as of 11/15/21) in 2021, following up on above-average returns the two prior years (18.4% in 2020 and 31.5% in 2019). The environment has been conducive for risk assets, aided by liquidity from fiscal and monetary authorities, which have boosted consumer and business liquidity. Leadership changed hands within the market several times during 2021 with the only constant being that defensive areas generally lagged. Value stocks sporadically continued the revival that began in the second half of 2020, culminating with Energy and Financials as the two best performing sectors in the S&P 500 in 2021. Breadth also improved to some extent, but fears of additional waves of the pandemic, slowing growth in China, expectations for moderating liquidity, uncertainty in Washington, and supply chain issues impacted performance for portions of cyclicals (Industrials, Materials, Consumer Discretionary) in the second half. Mega-cap tech stocks did not dominate the market but did in aggregate generate returns commensurate with their now even more substantial weighting within the S&P 500 Index. Bottom line — both value and growth stocks had good years.

What to expect in 2022

We believe the key factors in 2022 are earnings growth and the rate of change in both interest rates and inflation. These are generally the building blocks for equity valuation, hence our "Back to Basics" title. We believe earnings per share should be solid in 2022 with the Wells Fargo Investment Institute projecting nearly 10% year-over-year growth for the S&P 500. Higher inflation has already been observed in areas such as labor, procurement, and freight, and there is a relatively high degree of uncertainty as to when these headwinds may normalize. We believe companies with strong pricing power will largely be able to pass these higher costs along to customers in an effort to preserve margins. Meanwhile, the potential for modestly higher rates could act as a tailwind for certain sectors while also impacting valuation models for certain types of companies.

As the economy and market exit the earliest innings of the recovery, we believe that high-quality sub-industries and companies could resume their outperformance. Quite simply, the recent run of explosive economic growth created a rising tide that lifted most, if not quite all, boats. If this normalizes as we expect, we believe investors could increasingly embrace companies with strong quality metrics — high margins, clean balance sheets, consistent cash flow generation, and the ability to grow into secular trends. We would note that growth stocks now compose an increasingly high percentage of companies that would fit this bill. Somewhat higher interest rates could be a modest headwind for valuations, and while we acknowledge this cross-current, we think the persistent earnings power within many high quality sub-industries likely wins out. Our sub-industry recommendations are largely consistent with this view, and we recommend investors consult each sector-level text for more expanded thoughts.

Table of contents

Communication Services

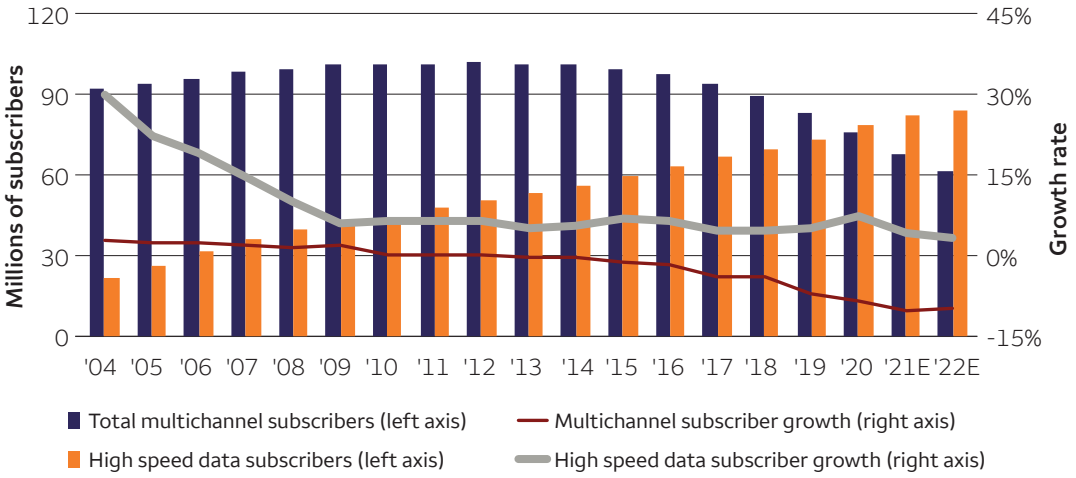
Sector drivers/themes

Multiple secular themes continued throughout the past year, including cord-cutting, antitrust, regulatory threats, an evolving gaming industry, and the continued buildout of the 5G wireless network. It appears many companies benefited from stay-at-home activities related to the pandemic as entertainment options were generally limited while people sheltered in place. However, consumers increased their use of social media, the gaming ecosystem continued to evolve and demand for streaming media continued to rise.

Thomas Christopher
Equity Sector Analyst

The pandemic also brought to light the importance of a reliable broadband connection, which is essential for daily activities. Many U.S. households upgraded to faster broadband connectivity due to increased data usage throughout the pandemic. The current administration has proposed an infrastructure plan[1] to revitalize the digital infrastructure. Consequently, we believe the home broadband connection should gain importance as many activities are dependent on a stable, fast, and generally reliable connection.

U.S. cable subscribers continue to decline while broadband subscribers rise



Sources: Historical and estimated data from S&P Global Market Intelligence LLC, Wells Fargo Advisors. Estimated years are denoted with "E." Estimates provided by S&P Global Market Intelligence, LLC.

While traditional U.S. multichannel video subscriber losses have accelerated over the past few years, broadband penetration continued to rise. Nearly one-third of U.S. households do not have a traditional pay-TV subscription. We look for the number of "broadband only" households to continue to grow, necessitated by the need for increased bandwidth on home networks.

Where to invest in 2022

Broadly speaking, we believe growth investors should focus on the interactive media & services and entertainment industries. These companies appear well-positioned to take advantage of ongoing shifts in consumer behavior and structural changes occurring within the industry. For income investors, we continue to favor the telecommunication services industry group as these firms generally offer attractive dividends and may potentially benefit from 5G enhancements.

1. Bipartisan Infrastructure Framework Plan, The White House. June 24, 2021.

The advertising sub-industry has stabilized following a difficult 2020, highlighted by a resilient digital advertising market. This ongoing recovery highlights the structural shift within advertising as we anticipate more ad spend moves toward digital platforms and potentially away from traditional channels. We believe the leading interactive media & services companies enjoy competitive advantages within their respective industries, notably search, advertising, and social media. Still, challenges may emerge due to rising antitrust and regulatory oversight, changes to privacy and ad-blocking, and rising competition. However, these companies appear well positioned due to their size, scale, superior technology, and enhanced targeting capabilities.

Many streaming platforms have launched over the past few years, and the space has become crowded. While consumer fatigue was expected as the pandemic endured, industry data shows that U.S. households are subscribing to more video services versus pre-COVID levels. Streaming options tend to be cheaper and offer greater viewing flexibility with no long-term contracts. Although engagement may be choppy over the short term, current secular tailwinds should remain intact over the longer term. We believe companies offering competitive pricing, cutting-edge content, and widespread distribution are among the best-positioned going forward.

The rollout of 5G remains a high priority as network expansion could result in further growth and new revenue streams. The telecom industry is highly capital intensive, and carriers continue allocating billions annually to maintain the infrastructure. The government's infrastructure bill could help ease this capital expenditure (capex) burden as it allocates more than $65 billion to broadband improvements over the next five years to provide reliable high-speed internet, reduce prices, and shrink the digital divide. Further, supply chain constraints should ease as we progress through the year, improving the availability of 5G-capable devices.

Favorable

- Integrated telecom services
- Interactive home entertainment
- Interactive media and services
- Movies and entertainment

Neutral

- Advertising
- Broadcasting
- Cable and satellite
- Wireless telecom services

Unfavorable

- Alternative carriers
- Publishing

Valuation

The Communication Services sector currently trades at 21.6x the next 12 months (NTM) consensus earnings-per-share (EPS) estimate of $12.87, a premium to the sector's average five-year historical valuation of 17.1x. Relative to the S&P 500, the Communication Services sector is trading at 1.0x relative to its historical level of 0.9x. Historical valuations are skewed and not directly comparable due to the fact that only the Telecommunications industry is accounted for prior to September 21, 2018.

Risks

The way people communicate and consume data is continuously evolving, which could lead to disruption among incumbent business models. Within the telecom, interactive media, and cable industries, cord cutting is weighing on traditional TV services and affecting how media firms approach customers. Telecom companies are subject to extensive regulation, and an adverse regulatory environment could hinder innovation while adding heightened levels of uncertainty and risk.

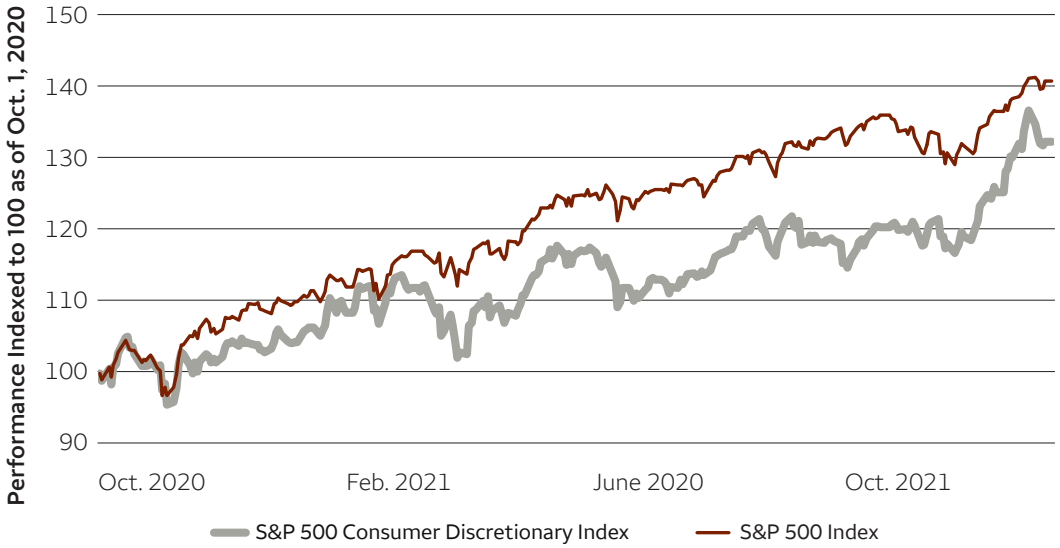
Consumer Discretionary

Sector drivers/themes

Pent-up demand and excess stimulus and savings have fueled consumers into going out and spending amidst a nationwide reopening — that is the good news. The bad news is unprecedented supply chain disruption impacts the supply of product availability, which is contributing to heightened inflationary pressures. Over the course of 2020 and 2021, consumers enjoyed unprecedented levels of government stimulus. Encouragingly, most consumers understood this fiscal stimulus received would not be permanent, and they saved a higher percentage of their stimulus. Heightened savings should have a positive impact over time on spending. Besides savings, consumers also paid down credit card debt, which can be viewed as a form of deferred savings. Less debt can translate into more consumer spending confidence. Therefore, we believe demand factors remain solid entering 2022 and consumer spending will be heavily dependent on when the current supply chain disruptions finally unravel and lead to improved product availability.

Brian Postol
Equity Sector Analyst

Consumer Discretionary sector performance vs. S&P 500



Since the beginning of the COVID-19 pandemic, the Consumer Discretionary sector has underperformed as discretionary spending on services and leisure took a backseat to savings. Heading into 2022, we believe these sub-industries should fare better given pent-up demand and healthy household balance sheets.

Sources: FactSet, Wells Fargo Advisors. Data ranges from 10/1/2020 through 11/15/2021. Performance data indexed to 100 starting on 10/1/2020. **Past performance is no guarantee of future results.** An index is unmanaged and not available for direct investment. The S&P 500 Sector Indices measure the performance of the widely used Global Industry Classification Standard (GICS®) sectors and sub-industries. Each index comprises those companies included in the S&P 500 that are classified as members of their respective GICS® sectors. The S&P 500 is a market capitalization-weighted index generally considered representative of the U.S. stock market.

Where to invest in 2022

The majority of fiscal COVID-19 stimulus benefited low- and middle-class consumers — each of which received outsized benefits occurring primarily from January 2021-May 2021 with diminishing benefits as each month passed.[1] Absent additional governmental stimulus, consumer spending will be more a function of employment, wage growth, and savings drawdown. Under this scenario, we believe the upper- and middle-income consumers have the wherewithal to maintain a healthy level of spending whereas low-income consumer spending will likely suffer relative to the prior year and upper-income cohorts. As health concerns ease and vaccination rates increase, we believe consumers will be increasingly more eager to spend on food services, travel, and leisure activities — things that they delayed during 2020 and 2021. Hence, we believe personal consumption expenditures on durable goods — a hallmark of the pandemic — will give way to services spending over the next few years. Any future spike in COVID cases and/or introduction of a new variant, would likely further delay this eventual shift toward services.

Unlike in recent years, we now see casinos & gaming, hotels, restaurants and leisure facilities, and textiles, apparel and luxury goods as the preferred sub-industries within Consumer Discretionary for 2022 as a potential shift away from goods spending and one toward service spending as well as a shift toward the mid- and upper-tier consumer. While comparisons within internet retail remain challenging during the first half of 2022, we continue to believe it offers the potential for outperformance in long-term secular growth within all of Consumer Discretionary to gain market share as consumers preferred choice of retail commerce.

Favorable

- Casinos and gaming
- Hotels, resorts and cruise lines
- Leisure facilities
- Internet retail
- Restaurants
- Textiles, apparel, accessories and luxury goods

Neutral

- Apparel retail
- Footwear
- Home improvement retail

Unfavorable

- Automobile manufacturers
- Department stores
- Motorcycle manufacturers

Valuation

The Consumer Discretionary sector currently trades at 32.8x the NTM consensus estimate of $49.52. The current price-to-earnings (P/E) ratio is above the five-year historical valuation of 25.2x. Relative to the S&P 500, the Consumer Discretionary sector is trading at 1.5x, above historical levels of 1.3x. Historical valuations are skewed by the fact that the media and digital streaming and internet services industries left the Consumer Discretionary sector and moved into the Communication Services sector as of September 21, 2018.

Risks

A strong job market generally provides consumers more financial comfort and increased disposable income. However, rising wages are a Catch-22 for the Consumer Discretionary sector. On one hand, higher wages are positive tailwinds for consumer spending. However, sectors and industries with a high labor component (restaurants, hotels/resorts/cruises, and retail) will likely receive less incremental benefit given the increased operating expense impact on profits. Additionally, rising logistics, gas prices, and interest rates coupled with potentially lower federal transfer payments are headwinds to consumer spending trends.

1. "How Long Might the Savings Glut Boost Consumption?" Empirical Research Partners. April 27, 2021.

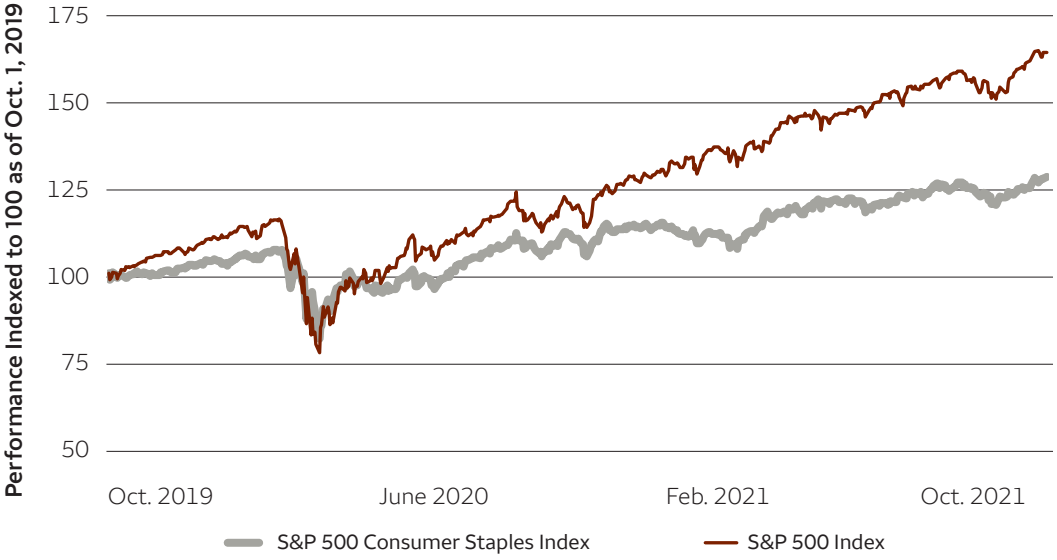
Consumer Staples

Sector drivers/themes

Consumer Staples stocks along with many defensive sectors trailed the broader market's gains for most of the last two years. Progress on combatting COVID-19 combined with unprecedented amounts of monetary and fiscal stimulus led to risk-on assets outperforming at the expense of risk-off. However, the setup going into 2022 may be aligning in Consumer Staples' favor. Concerns that the Federal Reserve (Fed) might pull back on easy monetary policy sooner than expected, global supply chain issues, persistently high inflation, and the dwindling effect from fiscal stimulus all could weigh on future growth. Potentially slowing economic growth could weigh on cyclicals and growth companies, boosting the relative attractiveness of defensive groups like Consumer Staples. There are always concerns with staple products, and now these include rising rates and input/commodity costs, which are presently hurting margins at many staple product companies. However, we have been pleasantly surprised by how well staple product demand has held up overall likely due to healthy consumer balance sheets and folks just spending more time at home. We also believe the group could be better poised in 2022 given its pricing power, relative earnings stability, geographically diversified profit streams, and, finally, the healthy dividends the group provides as investors desperately search for income.

Jack Russo, CFA®
Equity Sector Analyst

Consumer Staples sector performance vs. S&P 500



Consumer Staples underperformed the S&P 500 for most of the last two years, but an investment thesis for a more defensive approach may be aligning into 2022.

Sources: FactSet, Wells Fargo Advisors. Data series ranges from 10/1/2019 through 11/15/2021. Performance data indexed to 100 starting on 10/1/2019. **Past performance is no guarantee of future results.** An index is unmanaged and not available for direct investment. The S&P 500 Sector Indices measure the performance of the widely used Global Industry Classification Standard (GICS®) sectors and sub-industries. Each index comprises those companies included in the S&P 500 that are classified as members of their respective GICS® sectors. The S&P 500 is a market capitalization-weighted index generally considered representative of the U.S. stock market.

Where to invest in 2022

Our sub-industry views are unchanged from 2021, and we favor household products and beverages of the four sub-industries. We realize household products companies face commodity cost pressure currently, but their pricing and brand power could help them preserve margins somewhat. Furthermore, household product companies could potentially benefit from ongoing strong demand for cleaning supplies. Beverage sub-industry growth could benefit given its strong brands, vast international footprints, and emphasis in growing noncarbonated beverages (water, teas, sports drinks, and juices) that represent perceived "healthier" choices. Tobacco stocks (in which we remain unfavorable) could benefit from a robust global reopening but continue to lose favor among investors due to the ever increasing popularity of environmental, social, and governance (ESG) investing and heightened Food and Drug Administration (FDA) focus on nicotine reduction. The packaged food sub-industry (neutral) has the potential to alter its lukewarm outlook as it focuses more on consumers' desire for healthier foods, but this investment theme will take time to play out.

Favorable

- Beverages
- Household products

Neutral

- Packaged food

Unfavorable

- Tobacco products

Valuation

The Consumer Staples sector currently trades at 20.9x the NTM consensus estimate of $36.43. The current P/E ratio is above the five-year historical valuation of 19.4x. Relative to the S&P 500, the Consumer Staples sector is trading at 1.0x, slightly below historical levels of 1.1x.

Risks

Risks to companies within the Consumer Staples sector include intense competitive conditions, geopolitical risk, and rising interest rates causing additional dollar strength hurting multinationals reported sales and earnings. Other risks could include fluctuating commodity costs, labor cost pressures, and potential pricing compression from private label competition. Higher interest rates could make staples less valuable as bond proxies with their above-average dividend yields.

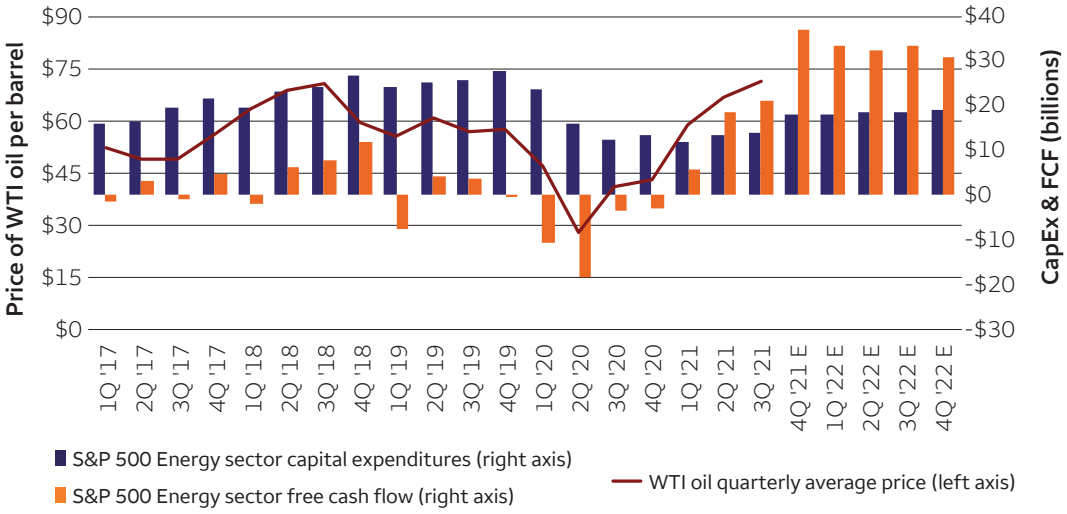
Energy

Sector drivers/themes

"It is different this time" is a notoriously dangerous phrase when it comes to investing (particularly in highly cyclical, commodity-driven sectors), but as 2021 comes to a close, we believe that there have been notable differences within the current cycle for oil and gas companies. Unlike previous cycles, both domestic and global producers have remained disciplined by not responding to higher energy commodity prices with increased production, and we see this supply discipline continuing into 2022 as Energy companies continue to refocus capital toward deleveraging and shareholder returns. After strong Energy sector performance in 2021, we note that valuations remain below historical averages and we believe that the structural developments that have taken shape in 2021 provide an improved fundamental backdrop for investors in the Energy sector.

Ian Mikkelsen, CFA®
Equity Sector Analyst

Higher commodity prices combined with lower spending enables improved cash generation for the Energy sector



The chart compares quarterly aggregate capital expenditures to free cash flow generation for the S&P 500 Energy sector, with an overlay of the average West Texas Intermediate (WTI) crude oil price for each quarter. For capital expenditures and free cash flows, we show actual quarterly results from first-quarter 2017 through third-quarter 2021 and consensus estimates for fourth-quarter 2021 through fourth-quarter 2022.

Sources: U.S. Energy Information Administration, FactSet, Wells Fargo Advisors. Estimated years are denoted with "E" and provided by Factset Consensus Estimates.

Where to invest in 2022

We continue to favor the major integrated oil companies as a core Energy holding due to their scale, financial flexibility, and diversified exposure across the Energy value chain. For income-oriented investors, we also maintain a favorable view on high-quality midstream c-corps where we favor larger companies with competitively advantaged assets and healthy balance sheets.

We recently updated our views on upstream exploration and production companies (E&Ps) to neutral. The structural changes that have developed throughout the energy complex this year have alleviated some of the risks to independent oil and gas producers, and we believe that high quality E&Ps stand to benefit from our favorable view on energy commodities. Oil and gas producers are likely to face higher labor and materials costs in 2022, but we expect that well positioned producers can absorb these costs and still generate strong cash flows within our commodity outlook (Wells Fargo Investment Institute currently has a price forecast of $85–$95 per barrel of WTI crude oil through year end 2022). However, we remain unfavorable on the oil field services industry, which is seeing improved demand off of trough levels but may be challenged to expand margins after passing through labor and materials cost inflation in this environment.

We are neutral on downstream refiners as we believe the refining industry continues to face an uncertain outlook. We believe refiners stand to benefit from resilient fuels demand and leaner global product inventories, and exposure to areas such as petrochemicals, renewable fuels, and marketing has also provided solid contributions to earnings. However, higher power costs, relatively narrow pricing differentials, uncertainty around the pace of global industry capacity additions, and uncertainty related to future renewable blending obligations (also known as costs associated with Renewable Identification Numbers, or RINs) temper our enthusiasm for the downstream refining industry.

Favorable

- Integrated oil companies
- Midstream C-corps

Neutral

- Exploration and production (E&Ps)
- Master Limited Partnerships (MLPs)
- Refiners

Unfavorable

- Oilfield services

Valuation

The Energy sector is currently trading at an enterprise value to earnings before interest, taxes, depreciation, and amortization (EV/EBITDA) value of 6.1x. The current EV/EBITDA ratio is below the five-year average for the group of 7.8x. Relative to the S&P 500, the Energy sector has been trading at 0.6x P/E, in line with the five-year historical average of 0.6x.

Risks

Risks include commodity price exposure, the potential for additional COVID-19 variants to impact demand for oil and related products, a slowing pace of economic recovery, international competition from foreign government-owned entities, regulatory risks at both the state and federal government levels, and environmental concerns. Additionally, master limited partnerships (MLPs) may face volumetric risks, customer concentration risk, and economically stranded assets.

Financials

Sector drivers/themes

The Fed's actions in the past year and a half kept credit flowing, hastened spread tightening, and generally supported debt and equity markets. With central banks now pledging to pull back and fiscal assistance programs winding down, investors might reasonably expect the range of possible outcomes for the Financial sector in 2022 to be broader than it has been in the past several years. Given that setting, we think a "back to basics" approach makes a great deal of sense with investors revisiting the classic drivers of the sector: liquidity, capital, the demand for credit, interest rates, and loss cycles. We've heard the recent market environment described as the "golden age" of credit. Discerning investors might therefore want to contemplate the potential return of a credit cycle. After all, as lenders will note, some of the worst loans are made during the best market conditions.

Michael Ruesy, CFA®
Equity Sector Analyst

Financials sector relative performance vs. yield curve

Roughly midway through the quarter, the yield curve began to steepen, which helped put a bid back into the Financials.

Sources: FactSet, Wells Fargo Advisors.Data ranges from 1/1/2021 through 11/15/2021. Yield Curve defined by the U.S. 10-Year Treasury Yield minus the U.S. 2-Year Treasury Yield. Performance data indexed to 100 starting on 1/1/2021. **Past performance is no guarantee of future results.** An index is unmanaged and not available for direct investment. The S&P 500 Sector Indices measure the performance of the widely used Global Industry Classification Standard (GICS®) sectors and sub-industries. Each index comprises those companies included in the S&P 500 that are classified as members of their respective GICS® sectors. The S&P 500 is a market capitalization-weighted index generally considered representative of the U.S. stock market.

Where to invest in 2022

With elevated valuations in public markets, and perhaps private capital too, low rates, and tight spreads, we think investors should continue to upgrade the quality of the underwriters among their holdings in the sector. While fiscal and monetary support may have helped recapitalize some consumers, and aided some commercial businesses, we do not believe the notion of a credit cycle has been rescinded. Rather, we see it as likely drawn out, and believe that when loss cycles arrive, the worth of the underwriting is revealed. Over the long haul, we think stronger underwriters can produce competitive returns. Presuming economic and geopolitical conditions are stable to improving, the universal banks look well positioned to capitalize on the potential for improving loan demand as excess liquidity is reduced. They are likely more asset-sensitive and should benefit as interest rates rise. Their revenues would also be boosted should capital market activities (underwriting, trading, mergers and acquisitions [M&A], etc.) continue apace and indeed if this is a multiyear upcycle for M&A. All of this presumes credit remains benign.

We also favor select property and casualty (P&C) insurers that look to underwrite for a profit. For some commercial lines, market conditions are hardening. Given these conditions, sharper underwriters are eager to grow their businesses in sensible, risk-adjusted ways. We would be quite selective in bargain-hunting among regional banks, preferring those with very strong records on credit, even though there is an active merger and acquisition (M&A) trend among regional and community banks. We would look to avoid business development companies (BDCs) and mortgage real estate investment trusts (mREITs). Both groups, generally speaking, may now have dividends sized at levels they can cover, but companies in these two industries still remain vulnerable to a loss of market access, one of our key concerns, which often goes under-appreciated by investors captivated by their dividends in a market challenged for yield.

Favorable

- Insurance brokers
- Property and casualty insurance
- Universal banks

Neutral

- Asset management and custody banks
- Credit card issuers
- Financial exchanges and data
- Investment banking and brokerage
- Regional banks

Unfavorable

- Business development companies
- Mortgage real estate investment trusts

Valuation

The Financials sector currently trades at 15.0x the NTM consensus EPS estimate of $44.41. The P/E ratio is at a modest premium to the five-year historical valuation of 13.3x. Relative to the S&P 500, the Financials sector is trading at 0.7x, which is in line with historical levels of 0.7x.

Risks

Key risks to the Financial sector include the withdrawal of liquidity from the markets, an end to the accommodating period for credit, deterioration in underwriting conditions, higher credit losses, tight lending spreads, financial leverage, changes in regulation, and weak asset or capital markets. Some firms, which are dependent on external financing, may not be able to access the capital markets on favorable terms or at all. As well, the market is extremely competitive with financial technology (fintech) challengers aggressively pursuing perceived market opportunities. These fintechs may even enjoy a near-term advantage since they may not yet experience the same level of regulatory scrutiny as incumbents.

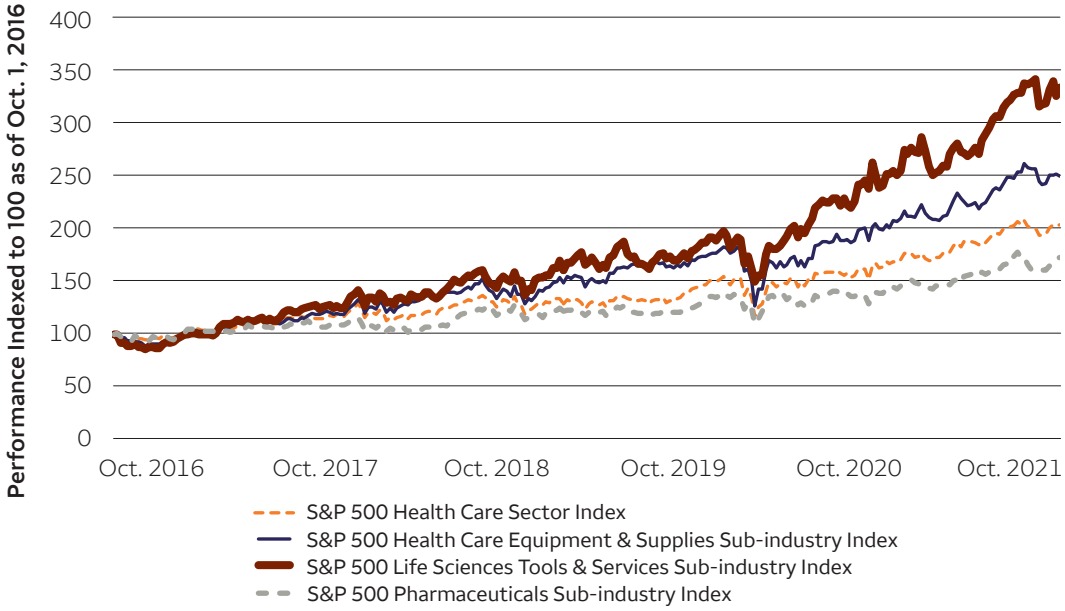
Health Care

Sector drivers/themes

The overall Health Care sector has modestly underperformed the general market during the first nine months of 2021 as measured by the S&P 500 Index. Specifically, the overall Health Care sector increased +13.5% through the end of September as compared to the +15.9% gain for the S&P 500 Index. Our preferred sub-industries — medical devices and life sciences performed especially well, following modest underperformance early in the year. As with many sectors, COVID remains a disrupting factor for many Health Care companies, though a return to a more normal environment in 2022 would be a clear positive for the sector. Longer-term, we believe the sector remains very well positioned, as the overall sector continues to embrace the concept of value-based health care. Barring any unforeseen and unfavorable policies coming out of Washington, D.C., we believe Health Care should remain an attractive sector for investors over the next several years.

Greg Simpson, CFA®
Equity Sector Analyst

Health Care equipment & supplies, pharmaceuticals, and life sciences tools & services vs. S&P 500 Health Care Index



Sources: FactSet, Wells Fargo Advisors. Data 10/1/2016 through 11/15/2021. Performance data indexed to 100 starting on 10/1/2016.
Past performance is no guarantee of future results. An index is unmanaged and not available for direct investment. The S&P 500 Sector Indices measure the performance of the widely used Global Industry Classification Standard (GICS®) sectors and sub-industries. Each index comprises those companies included in the S&P 500 that are classified as members of their respective GICS® sectors. The S&P 500 is a market capitalization-weighted index generally considered representative of the U.S. stock market.

We note that the medical device (health care equipment and supplies) and life sciences sub-industries have consistently outperformed the broader Health Care sector over the past several years while the pharmaceutical sub-industry has underperformed fairly significantly. As we look forward to 2022, we see little reason, at this point, for this to change. As such, we continue to prefer medical device and life sciences companies within the Health Care sector.

Where to invest in 2022

We had expected a "return to normalcy" in 2021 for the Health Care sector, only to be disrupted once again by rebounding COVID-19 cases during the summer. Looking forward to 2022, we believe the sector is well-positioned, regardless of how the COVID dynamic plays out, barring, of course, the emergence of a vaccine-resistant variant. As of this writing, it remains too early to determine whether the latest variant will require revised vaccines, but our overall outlook is reflective of our belief that the rising trends in Covid cases in late 2021 give way to improving trends in early 2022. Companies across most Health Care sub-industries have adapted well to the challenges associated with COVID. Supply chain issues, should they continue into 2022, could pose challenges for some companies, though the impact to this point has been minimal. As we look at our preferred sector positioning for 2022, we continue to favor the medical device and life sciences sub-industries. We anticipate both areas should continue to offer strong fundamentals, consistently improving technology, and attractive insulation to most macro risks. We continue to suggest a neutral stance on pharmaceutical stocks, which have consistently underperformed the overall Health Care sector and the general market over the last several years. While valuations are generally very attractive for pharmaceutical stocks, the stocks have continued to languish, and we fail to see a meaningful catalyst, other than valuation, for the group at this point. With respect to managed care, while we remain neutral, we have viewed this sub-industry more favorably following the election. The narrow majorities in both houses of Congress left little opportunity for disruptive health care reform, and we continue to believe the current political dynamic will likely result in gridlock during 2022. We believe gridlock is generally favorable for the group, and a more benign COVID environment could provide a favorable catalyst for managed care equities.

Favorable

- Life sciences tools and services
- Medical devices and equipment

Neutral

- Biotechnology
- Health care distributors
- Health care facilities
- Health care services
- Managed care
- Pharmaceuticals

Unfavorable

- Generic pharmaceuticals

Valuation

The Health Care sector is currently trading at 16.9x the NTM consensus EPS estimate of $91.44. The current P/E ratio is moderately above the five-year average for the group of 15.9x. Relative to the S&P 500, the Health Care sector has been trading at 0.8x, slightly below the 0.9x five-year historical average level.

Risks

Risks to companies within the Health Care sector include competition on branded products, sales erosion due to cheaper alternatives (such as generic pharmaceuticals and/or biosimilar products), research and development risk, and dependence on regulators such as the FDA to approve products anticipated to enter the market. Additionally, companies can be exposed to cuts in Medicare reimbursements (either based on yearly review or due to sequestration) as well as uncertainty surrounding health care reform efforts in the U.S.

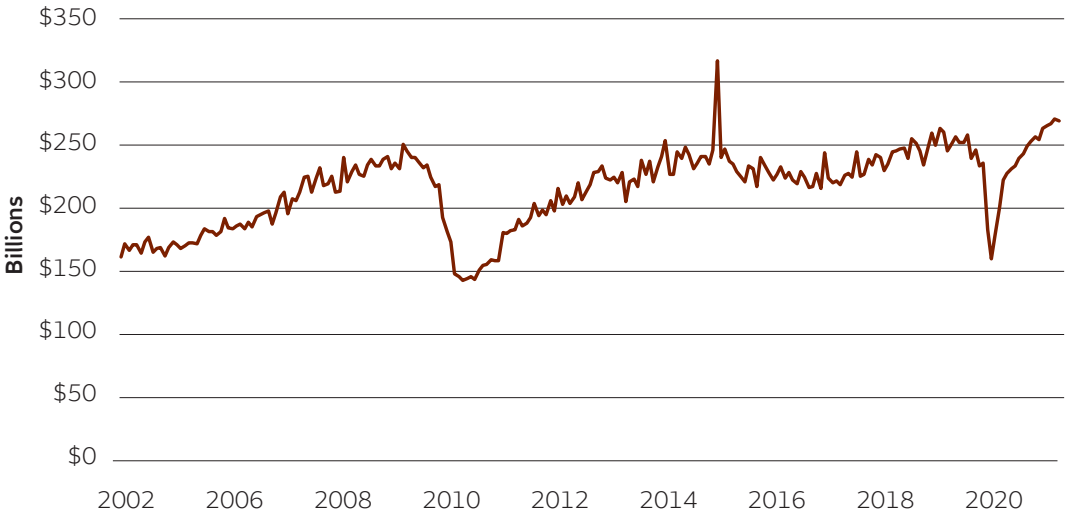
Industrials

Sector drivers/themes

Change is a constant in the Industrials sector, but 2022 will likely experience a high amount, even by this sector's standards. We see a positive outlook for demand as we anticipate companies look to replenish inventories and expand capacity. However, margin forecasts are unsettled as input costs (commodities, freight, and labor) have continued to escalate and product shortages and logistics delays have prevented many companies from producing to meet demand. We would expect a moderation in these issues in the second half of 2022, but we admittedly make that forecast with a degree of humility. In short, our expectation for the top line should be there, but there are more than a few pitfalls in translating it to the bottom line. As it regards longer-term factors, we'll highlight a few we anticipate most companies will increasingly grapple with: strategic supply chain decisions, navigating the energy transition, and the continued shift toward software and services.

Lawrence Pfeffer, CFA®
Equity Sector Analyst

Manufacturers' new orders: durable goods



Durable goods orders have rebounded since the peak of the COVID-19 pandemic and have gained momentum heading into 2022.

Sources: U.S. Census Bureau, FactSet, Wells Fargo Advisors. Data as of 11/15/2021 and consists of all available data 1/31/2002 through 9/30/2021.

Where to invest in 2022

We expect relatively strong growth from certain areas: alternative energy, automation (particularly in warehouses), housing, and, potentially, physical infrastructure. That said, we believe the current backdrop of widespread capacity constraints and persistently strong underlying demand augurs well for solid capital spending trends across the industrial landscape in the medium term. Meanwhile, standing valuations remain high relative to medium-term averages, although there has been some normalization on certain metrics in deeply cyclical portions of the sector.

Bottom line, we believe it's a positive picture but a complex one, and we would expect a variety of fundamental crosscurrents to impact the next several years. So, we would spread our exposure. In this vein, we are favorable on more than half of the market capitalization of the sector (multi-industrials, railroads, building products, air freight, and logistics), although we are neutral to less favorable on most sub-industries with single-market exposure or that are typically more cyclical than the sector average in nature. This posture means we have a preference for quality at this point in the cycle — i.e., high margins, strong cash flow generation, and balance sheet capacity.

Multi-industrials (this definition covers electrical equipment, conglomerates, and portions of industrial machinery) and railroads are favorable in our our outlook. They are in essence the "core" of the Industrials sector. Companies in these areas touch industrial, consumer, and commodity markets. They also operate in highly consolidated industries and have an intense focus on operational efficiency and capital allocation. There is often little sizzle here but potentially plenty of substance for longer-term investors.

Elsewhere we like specific drivers for air freight logistics — sustained e-commerce growth and improving pricing power — as well as building products — emissions reduction and air quality. We remain less favorable on airlines and commercial aerospace due to increased leverage, execution risk, and lingering pandemic effects.

Favorable

- Air freight and logistics
- Building products
- Multi-industrials
- Railroads

Neutral

- Agricultural machinery
- Commercial services and supplies
- Construction and engineering
- Construction machinery
- Defense contractors
- Industrial distributors
- Professional services
- Truck machinery
- Trucking

Unfavorable

- Airlines
- Commercial aerospace

Valuation

The Industrials sector currently trades at 21.8x the NTM consensus estimate of $41.88. The current P/E ratio is above the five-year historical valuation of 19.2x. Relative to the S&P 500, the Industrials sector is trading at 1.0x, in line with historical levels of 1.0x.

Risks

The Industrials sector is heavily influenced by underlying conditions in the global economic environment. Many companies in the sector are also heavily tied to government policy in multiple jurisdictions, covering topics such as trade, taxes, interest rates, and fiscal spending. The pace of technological change also appears to be accelerating, which could make incumbent business models more challenging in the future.

Information Technology

Sector drivers/themes

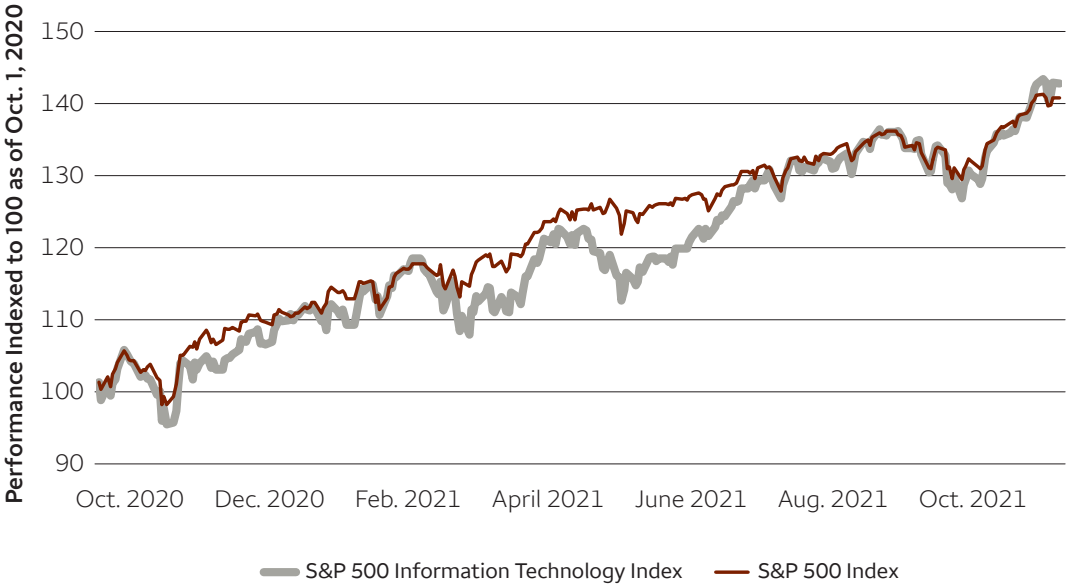
Despite investor excitement over a smooth reopening of the economy waning due to the recent resurgence of the delta variant, we remain bullish on multiple secular themes within the Information Technology sector. Several themes, including cloud computing, the Internet of Things, artificial intelligence (AI), digital payments, autonomous driving, and shift to 5G remain well positioned to lead the next decade in high tech innovation. Although we witnessed an accelerated adoption of some of these technologies during the onset of the pandemic, we expect individual and company dependency on technology more broadly to increase going forward.

Amit Chanda
Equity Sector Analyst

Massive increases in computing power and storage have helped the early adoption of AI. We expect AI to enable enterprises to capture value by becoming more productive and efficient.

We expect ongoing U.S. and China trade tensions will push the U.S. toward building a more resilient supply chain with less dependence on China.

Information Technology sector performance vs. S&P 500



Sources: FactSet, Wells Fargo Advisors. Data 10/01/2021 through 11/15/2021. Performance data indexed to 100 starting on 10/1/2020. **Past performance is no guarantee of future results.** An index is unmanaged and not available for direct investment. The S&P 500 Sector Indices measure the performance of the widely used Global Industry Classification Standard (GICS®) sectors and sub-industries. Each index comprises those companies included in the S&P 500 that are classified as members of their respective GICS® sectors. The S&P 500 is a market capitalization-weighted index generally considered representative of the U.S. stock market.

The Information Technology sector slightly underperformed the S&P 500 through September 30, 2021, on a last-12-month basis due to more cyclically oriented sectors being favored as a way to play the eventual reopening of the economy. We continue to prefer semiconductor and semiconductor capital equipment, networking equipment, payment processors, and software in 2022.

Where to invest in 2022

2021 was characterized by rotations between growth- and value-oriented equities. The initial shift from growth to value started with the approval of the first coronavirus vaccines toward the end of 2020. As interest rates inched higher on higher inflation expectations driven by massive fiscal stimulus, investor focus shifted toward the more cyclically oriented sectors that would benefit as the economy reopened. However, growth stocks started to show strength following the Federal Reserve's Federal Open Market Committee (FOMC) meeting in mid-June. At this meeting, the Federal Reserve brought forward its rate hike projections signaling it may raise interest rates in 2023 instead of 2024 (Fed officials now expect a rate hike in 2022). All of this contributed to uncertainty regarding the duration of the economic recovery once the economy is fully reopened. Also, additional variants beyond the delta variant are possible and a large percentage of the U.S. population remains unvaccinated, all of which could impact the worldwide economic reopening. This led to a rotation back into more of the growth-oriented technology equities.

The semiconductor industry continues to experience material supply constraints. Most semiconductor companies expect supply constraints to last through at least midyear 2022 as manufacturing supply catches up with higher levels of demand.[1]

As the domestic economy works its way closer to a successful reopening, we expect worldwide IT spending to improve this year in the low-to-mid single digit percentage range. As more and more corporate offices reopen this year, this should lead to higher on-premise enterprise IT spending patterns, particularly for networking equipment providers. Worldwide geographic divergences in the economy reopening have suppressed cross-border travel and e-commerce. We expect digital payment processors will capitalize on the pending recovery in cross-border travel and cross-border e-commerce during the next stage of the economy reopening.

Favorable

- IT services
- Networking equipment
- Payment processors
- PC hardware
- Semiconductors and semiconductor equipment
- Software

Neutral

- Electronic equipment instruments and components

Unfavorable

- Storage and peripherals

Valuation

The Information Technology sector currently trades at 27.5x the NTM consensus EPS estimate of $106.75. The P/E ratio is above the five-year historical valuation of 20.9x. Relative to the S&P 500, the Information Technology sector is trading at 1.3x, which is at a slight premium to historical levels of 1.1x. Historical comparisons are skewed as a result of the Internet Services and Home Entertainment and Software industries, which left the Information Technology sector and moved into the Communication Services sector as of September 21, 2018.

Risks

Risks for the Information 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.

1. Sourced from five publicly traded semiconductor company's 2021 third-quarter earnings calls.

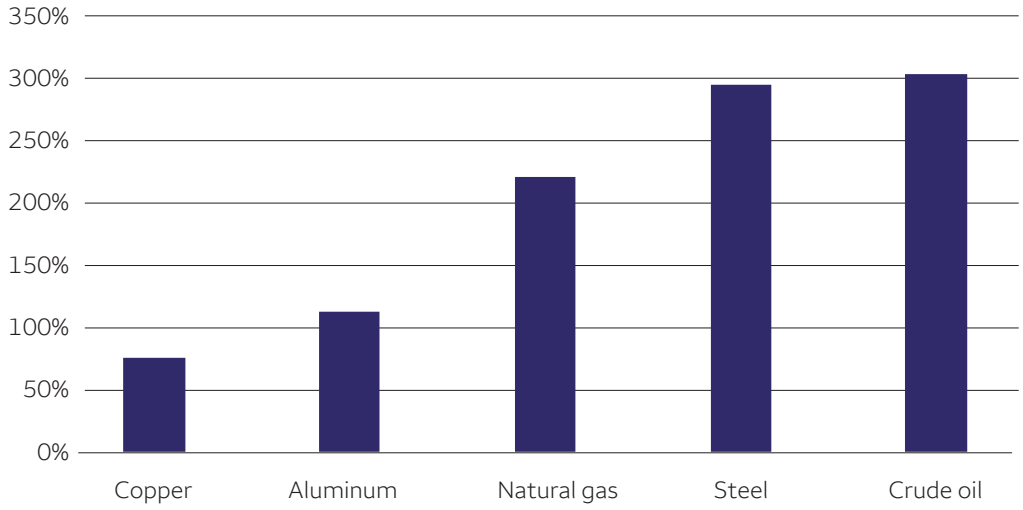
Materials

Sector drivers/themes

2021 may well have been the peak earnings year in this cycle for many of the more cyclically oriented sub-industries within Materials. However, unlike the past several cycles, we see an increased probability that the current tightness in most basic materials markets persisting for longer than normal, and it is thus more challenging than usual to forecast when earnings may normalize. On the other hand, even the "steadier" areas within the sector are dealing with increased input costs (particularly power and energy), weather-related outages, and a generally challenging operating environment. We would expect earnings trends to remain solid for the sector as a whole, but company-level variability will likely increase in 2022. In terms of longer-term themes, we expect the energy transition to present both opportunities and threats at an increasing pace across the sector.

Lawrence Pfeffer, CFA®
Equity Sector Analyst

Percentage price increase from April 30, 2020 – September 30, 2021



The Materials sector has seen historically strong inflation in both inputs (crude oil, natural gas) as well as outputs (copper, aluminum, steel), which has created an environment of uncertainty around the future path of profitability for the sector.

Sources: FactSet, Wells Fargo Advisors. Data through September 30, 2021. Each commodity listed is representative of an index based on that commodity and condensed on the above chart for readability. The indices and the commodity it represents, along with their respective units, are as follows: steel: U.S. Midwest Domestic Hot-Rolled Coil Steel Index (New York Mercantile Exchange [NYMEX] U.S. dollars per short ton); copper: High Grade Copper Continuous Futures (NYMEX U.S. dollars per pound); oil: Crude Oil West Texas Intermediate Continuous Futures (NYMEX U.S. dollars per barrel); aluminum: Aluminum Cash Futures Official London Metals Exchange (U.S. dollars per metric ton); natural gas: Natural Gas Henry Hub Spot NYMEX (U.S. dollars per million British thermal units).

Where to invest in 2022

Readers of our work in this sector are likely to think we sound like a broken record, but here we go again. We still like industrial gases and coatings. Quite simply, we like the fact that these areas are consolidated and/or specialized, have the ability to consistently price for the value of the products and services they provide, and have leverage to broad swathes of the economy rather than a heightened focus on an individual commodity or end market.

On the coatings side, we expect product shortage and input cost headwinds to gradually ease in 2022 while home improvement remains robust and a wider array of industrial markets participate in the recovery. For industrial gases, we see benefits from expanding industrial production and capital spending benefiting the top line and anticipate consistently high operating margins to be sustained via execution and pricing actions.

We have no sub-industries classified as less favorable. Basic materials remain in high demand and even for the areas where we may see less long-term opportunity, we do not believe that we can convincingly argue for a less favorable viewpoint in the short term. We remain neutral on the majority of sub-industries within the sector as we believe it is currently difficult to add exposure in areas where spot market prices and, hence, current earnings are well above medium-term averages.

Favorable

- Coatings
- Industrial gases

Neutral

- Commodity chemicals
- Construction materials
- Containers and packaging
- Diversified chemicals
- Fertilizers
- Metals and mining
- Paper and forest products
- Specialty chemicals (excluding coatings)

Valuation

The Materials sector currently trades at 17.2x the NTM consensus EPS estimate of $32.68. This P/E ratio is slightly below the average five-year historical valuation of 17.8x. Relative to the S&P 500, the sector is trading at 0.8x, moderately below historical levels of 1.0x.

Risks

The sector is sensitive to fluctuations in and relationships among commodity prices, particularly crude oil, natural gas, metals, and agricultural products. China has been a major factor in driving demand for commodities in the Materials sector, and trends in its economy are a key variable to watch here. A global economic slowdown would likely weigh on the Materials sector's performance. Additionally, strength in the U.S. dollar could negatively impact reported results within the sector.

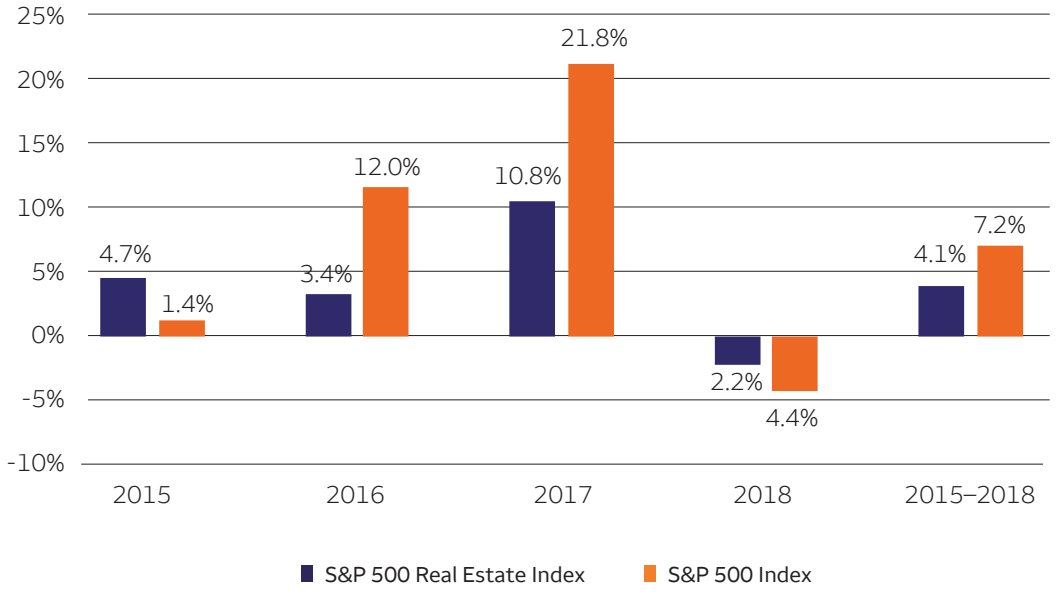
Real Estate

Sector drivers/themes

Given the significant impacts on real estate investment trusts (REITs) resulting from the COVID-19 pandemic, we believe a meaningful influence on 2022 REIT total returns will be the continued pace of a post-COVID-19 economic recovery given a number of REIT sub-industries are viewed as economically sensitive. We also believe the meaningful progress toward a medical solution to the COVID-19 pandemic has had, and could continue to have, a positive impact on a number of REIT sub-industries, particularly industries related to retail and hospitality. While the interest rate environment is usually a factor in REIT total returns, we believe the increase in the 10-year U.S. Treasury Bond yield and expectations for the Federal Reserve to increase the federal funds rate will make the interest rate environment especially meaningful for REIT total returns in 2022. Another major influence will likely be the ability of REITs to access attractively priced capital. Finally, should the Real Estate sector return to more consistent common dividend growth during 2022, we believe REIT valuations would likely improve.

John Sheehan, CFA®
Equity Sector Analyst

Real Estate sector performance vs. S&P 500 2015–2018



During the last period when the Federal Reserve was increasing the federal funds rate (2015-2018), Real Estate sector total returns lagged the S&P 500 Index. While Real Estate sector total returns exceeded the S&P 500 in 2015, Real Estate sector returns were lower than the S&P 500 by a relatively wide margin during 2016 and 2017. Although Real Estate sector total returns also trailed the S&P 500 in 2018, the magnitude was not as large as 2016 and 2017 results.

Sources: FactSet, Wells Fargo Advisors. Data through December 31, 2018. **Past performance is no guarantee of future results.** An index is unmanaged and not available for direct investment. The S&P 500 Sector Indices measure the performance of the widely used Global Industry Classification Standard (GICS®) sectors and sub-industries. Each index comprises those companies included in the S&P 500 that are classified as members of their respective GICS® sectors. The S&P 500 is a market capitalization-weighted index generally considered representative of the U.S. stock market.

Where to invest in 2022

On the earnings growth front, we expect specialty REITs (particularly technology-related REITs such as cell-tower REITs) and industrial REITs to produce growth due to solid underlying demand from their tenants. Cell-tower REITs are benefiting from continued growth in mobile data usage and the rollout of new 5G wireless communication technology while tenant demand for industrial buildings is being positively impacted by higher e-commerce sales driven by COVID-19 along with companies seeking to improve their supply chains. Additionally, earnings growth from the manufactured-housing REITs is also anticipated to remain stable given consistent tenant demand combined with very low levels of new property construction. We believe REIT property sectors that may outperform during a period of rising interest rates and stronger economic growth would include REITs with shorter lease durations (such as self-storage and residential sectors including manufactured housing, apartments, and single-family home rentals). We view REITs with shorter lease terms as generally better positioned to potentially benefit from an inflationary environment as their shorter lease terms allow these REITs to increase rental rates faster than REITs with longer lease terms. Conversely, industries with longer lease terms (such as free-standing retail and health care) or sectors that could be negatively impacted by trends resulting from the pandemic (office) may lag the broader Real Estate sector returns. Should the post-COVID-19 economic recovery weaken, REITs in these more economically sensitive sub-industries such shopping center, regional mall, and lodging/resorts could underperform.

Favorable

- Apartment REITs
- Industrial REITs
- Infrastructure (tower) REITs
- Self-storage REITs
- Single family home REITs

Neutral

- Multi-tenant retail REITs
- Net lease REITs

Unfavorable

- Health care REITs
- Hotel & lodging REITs
- Office REITs

Valuation

The Real Estate sector is currently trading at a price-to-funds from operations ratio (P/FFO)[1] of 23.3x NTM FFO based on consensus estimates of $13.00.The current P/FFO[1] ratio is modestly above the five-year average of 19.1x. Relative to the S&P 500, the Real Estate sector has been trading at 1.1x, above its five-year average of 1.0x. The current common dividend yield for the Real Estate sector is 2.4% compared to the S&P 500 Index yield of approximately 1.3%.

Risks

Risks to companies within the Real Estate sector include changes in economic growth in key markets, competition from new property developments, larger tenants encountering financial difficulties lessening their ability to pay rental obligations, a rapid rise in interest rates that makes other income-oriented investments more attractive, potential unexpected common dividend reductions, and changes in the cost or availability of attractively priced capital that is necessary for REITs to complete acquisitions and new property developments.

1. Price-to-funds from operations is calculated by dividing the market capitalization by funds from operations. Funds from operations equals net income + depreciation expense + amortization expense + losses on sale of assets – gains on sale of assets. The P/FFO for the Real Estate sector is calculated as the aggregate market capitalization of all companies in the Real Estate sector divided by their total estimated funds from operations.

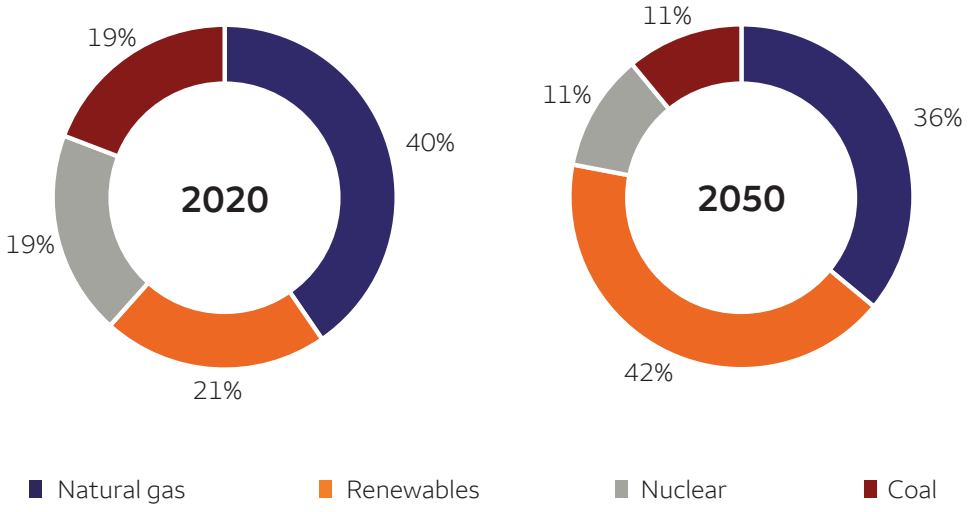
Utilities

Sector drivers/themes

At the sector level, Utilities is driven by the undercurrents of the overall market and macroeconomic narrative. Swings between risk-on and risk-off are often reflected in this defensive sector's performance. Within the sector, we see several specific drivers, mostly tied to clean energy. In our view, utilities play a vital role in the ongoing transition to a lower-carbon world. Electric utilities generate electricity, primarily by burning fossil fuels, and distribute it to customers. Gas utilities source and deliver natural gas to customers. Both of these industries have ample opportunities to dial back emissions and help move the country to net-zero status. Opportunities include adding renewables to the generation mix, facilitating electrification of buildings and vehicles, advancing relatively new technologies like renewable natural gas and hydrogen, and simply limiting gas leaks in systems. Potential governors on the sector include rising interest rates and inflation as well as bill affordability.

Joseph Buffa
Equity Sector Analyst

Share of U.S. electricity generation — 2020 compared to projected 2050



Generation from renewable sources is expected to double in share relative to other fuel types by 2050. Note, however, natural gas is expected to remain a major contributor.

Sources: U.S. Energy Information Administration, FactSet, Wells Fargo Advisors. Data as of February 2021.

Where to invest in 2022

Generally speaking, we do not favor investing in themes or trends when it comes to Utilities. However, we currently see an intersection between our core utility investing thesis and what we view as the long-term trend toward clean energy.

We believe the main attraction of utility investing is the stability often displayed by the companies and subsequently the reliable income they can provide. For this reason, we generally suggest the core utility exposure of a portfolio should be concentrated in high-quality, well-run, regulated utilities in supportive regulatory jurisdictions. We recently introduced an added qualifier of "primarily" in front of regulated to open up to growth prospects of certain unregulated operations (i.e., renewables). Additionally, we've noticed many of the same utilities that fall into our core thesis overlap with those taking leading roles in advancing clean energy.

Among the sector's industries, we believe electric and multi utilities offer the most exposure to the quality/clean energy intersection. Utilities in these industries can potentially benefit from the transition toward clean energy driven by state (and potentially federal) requirements, customer demand, and electrification, among other items. The water utility industry doesn't have the same level of exposure to clean energy but does have a long runway of growth opportunities and ESG appeal. With regard to independent power and renewable energy producers, we generally view independent power as more volatile than we prefer, but renewable electricity producers are attractive. Our neutral view on gas utilities is driven by the accelerating shift away from fossil fuels, gas included, in different regions of the country. This shift goes hand-in-hand with the move toward clean energy. We're doubtful, however, that natural gas's role disappears in short order, but sentiment could restrain the stocks' performance.

Favorable

- Electric utilities
- Independent power and renewable electricity producers
- Multi-utilities
- Water utilities

Neutral

- Gas utilities

Valuation

The Utilities sector trades at approximately 19.6x the NTM consensus EPS estimate of $17.43, which is above its five-year historical average of about 18.1x. Relative to the S&P 500, the Utilities sector is trading at 0.9x, slightly below historical levels of 1.0x. The Utilities sector pays an annual dividend of about 3.1%, compared to the yield of 1.3% within the S&P 500 Index.

Risks

Regulatory risk remains a key uncertainty for the Utilities sector, both at the federal and state levels. Additionally, utility companies typically carry high debt levels, and rising rates could impact their overall borrowing costs. High debt levels could also put a strain on credit ratings, which would also limit the ability to finance capital expenditures. As mergers and acquisitions (M&A) activity increases, companies may face challenges when integrating those acquired businesses.

Other risk considerations

Forecasts are based on certain assumptions and on views of market and economic conditions which are subject to change. All investing involves risks, including the possible loss of principal. There can be no assurance that any investment strategy will be successful. Investments fluctuate with changes in market and economic conditions and in different environments due to numerous factors, some of which may be unpredictable. Each asset class has its own risk and return characteristics, which should be evaluated carefully before making any investment decision. Some of the risks associated with the representative asset classes discussed in this report include:

Equity Securities
Equity securities are subject to market risk, which means their value may fluctuate in response to general economic and market conditions and the perception of individual issuers. Investments in equity securities are generally more volatile than other types of securities. There are no guarantees that growth or value stocks will increase in value or that their intrinsic values will eventually be recognized by the overall market. The return and principal value of stocks fluctuate with changes in market conditions. The growth and value types of investing tend to shift in and out of favor.

There is no guarantee that dividend-paying stocks will return more than the overall stock market. Dividends are not guaranteed and are subject to change or elimination.

The prices of small-cap company stocks are generally more volatile than large-company stocks. They often involve higher risks because smaller companies may lack the management expertise, financial resources, product diversification, and competitive strengths to endure adverse economic conditions.

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. **Communication Services** companies are vulnerable to their products and services becoming outdated because of technological advancement and the innovation of competitors. Companies in the Communication Services sector may also be affected by rapid technology changes, pricing competition, large equipment upgrades, substantial capital requirements and government regulation, and approval of products and services. In addition, companies within the industry may invest heavily in research and development, which is not guaranteed to lead to successful implementation of the proposed product. Risks associated with the **Consumer Discretionary** sector include, among others, apparel price deflation due to low-cost entries, high inventory levels, pressure from e-commerce players, reduction in traditional advertising dollars, increasing household debt levels that could limit consumer appetite for discretionary purchases, declining consumer acceptance of new product introductions, and geopolitical uncertainty that could affect consumer sentiment. **Consumer Staples** industries can be significantly affected by competitive pricing, particularly with respect to the growth of low-cost emerging market production, government regulation, the performance of the overall economy, interest rates, and consumer confidence. The **Energy** sector may be adversely affected by changes in worldwide energy prices, exploration, production spending, government regulation, changes in exchange rates, depletion of natural resources, and risks that arise from extreme weather conditions. Investing in **Financial** services companies will subject an investment to adverse economic or regulatory occurrences affecting the sector. Some of the risks associated with investment in the **Health Care** sector include competition on branded products, sales erosion due to cheaper alternatives, research and development risk, government regulations, and government approval of products anticipated to enter the market. There is increased risk investing in the **Industrials** sector. The industries within the sector can be significantly affected by general market and economic conditions, competition, technological innovation, legislation, and government regulations, among other things, all of which can significantly affect a portfolio's performance. **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. **Real Estate** investments have special risks, including possible illiquidity of the underlying properties, credit risk, interest rate fluctuations, and the impact of varied economic 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, especially smaller, less-seasoned companies, tend to be more volatile than the overall market. **Utilities** are sensitive to changes in interest rates, and the securities within the sector can be volatile and may underperform in a slow economy.

Sustainable investing focuses on companies that demonstrate adherence to environmental, social, and corporate governance principles, among other values. There is no assurance that social impact investing can be an effective strategy under all market conditions. Different investment styles tend to shift in and out of favor. In addition, a firm's social policy could cause it to forgo opportunities to gain exposure to certain industries, companies, sectors, or regions of the economy, which could cause it to underperform similar portfolios that do not have a social policy.

Master Limited Partnerships
Investments in Master Limited Partnerships (MLPs) involve certain risks that differ from an investment in the securities of a corporation. MLPs may be sensitive to price changes in oil, natural gas, etc., regulatory risk, and rising interest rates. A change in the current tax law regarding MLPs could result in the MLP being treated as a corporation for federal income tax purposes, which would reduce the amount of cash flows distributed by the MLP. Investment in real estate securities include risks such as the possible illiquidity of the underlying properties, credit risk, interest rate fluctuations, and the impact of varied economic conditions.

Definitions

An index is unmanaged and not available for direct investment.

Purchasing Managers Index (PMI) is an indicator of the economic health of the manufacturing sector. The PMI Index is based on five major indicators: new orders, inventory levels, production, supplier deliveries, and the employment environment.

S&P 100 Index measures large-cap company performance and consists of up of 100 major, blue chip companies across diverse industry groups. The primary criterion for index inclusion is the availability of individual stock options for each constituent.

S&P 500 Communication Services Index comprises those companies included in the S&P 500 that are classified as members of the GICS® communication services sector.

S&P 500 Consumer Discretionary Index comprises those companies included in the S&P 500 that are classified as members of the GICS® consumer discretionary sector.

S&P 500 Consumer Staples Index comprises those companies included in the S&P 500 that are classified as members of the GICS® consumer staples sector.

S&P 500 Energy Index comprises those companies included in the S&P 500 that are classified as members of the GICS® energy sector.

S&P 500 Health Care Index comprises those companies included in the S&P 500 that are classified as members of the GICS® health care sector.

S&P Pharmaceuticals Select Industry Index represents the pharmaceuticals sub-industry portion of the S&P Total Markets Index.

S&P 500 Industrials Index comprises those companies included in the S&P 500 that are classified as members of the GICS® industrials sector.

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.

S&P 500 Materials Index comprises those companies included in the S&P 500 that are classified as members of the GICS® materials sector.

S&P 500 Utilities Index comprises those companies included in the S&P 500 that are classified as members of the GICS utilities sector.

S&P 1500 Index is a market capitalization-weighted index that is based on the S&P 500, S&P MidCap 400, and the S&P SmallCap 600 Indices and represents approximately 90% of the entire U.S. equity market. **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. **S&P MidCap 400** Index is a capitalization-weighted index measuring the performance of the mid-range sector of the U.S. stock market and represents approximately 7% of the total market value of U.S. equities. **S&P SmallCap 600** Index consists of 600 domestic stocks chosen for market size, liquidity (bid-asked spread, ownership, share turnover, and number of no-trade days), and industry group representation. It is a market value-weighted index (stock price times the number of shares outstanding) with each stock's weight in the index proportionate to its market value.

Wells Fargo Advisors Equity Research Team

Michael A. Colón
Director of Equity Research

Alexander D. Sagal
Associate Investment Analyst

Corey Johnson
Associate Investment Analyst

How can we help?

Start the conversation with your Wells Fargo Advisors Financial Advisor today.

0000595949 (1 ea)