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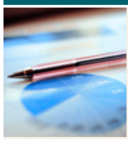
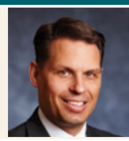
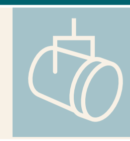
Investor Advantage







Market commentary

By Brian Jacobsen, Ph.D., CFA, CFP®
Chief Portfolio Strategist

Changes in presidential administrations often spur investors to reassess their forecast for the economy and for the equity and bond markets. As 2017 brings uncertainty about policy changes and their implications, diversification and patience are key investor virtues.

Investors should focus on the long-term economic fundamentals that drive market trends over time while staying alert to policy-driven opportunities. Fundamentals include earnings growth, policy changes from central banks, and inflation trends and interest rates.

Look for better growth but prepare for higher inflation this year. Investment performance over the next 12 to 18 months likely will be driven by economic performance and the possibility of higher inflation.

We expect economic growth to accelerate, which could be positive for stocks and corporate bonds. We think the inflation trend will remain moderate, but any uptick could put upward pressure on Treasury bond yields.

Earnings growth could provide opportunities, but watch valuations.

As of early 2016, we saw signs that earnings growth would regain momentum later in the year via positive adjustments in earnings expectations. If improved expectations translate into actual earnings growth, it should support the stock market. And when earnings are increasing across the board, smaller companies may have a better chance to outperform. But if expectations rise faster than actual earnings, keep an eye on valuations.

Bonds are reacting to prospects of fiscal initiatives and faster economic growth—contributors to short-term volatility.

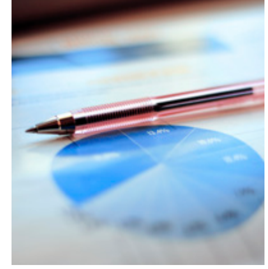
Expect volatility as bond markets adjust to a change in fundamentals.

The Federal Reserve (Fed) seems set to continue raising short-term interest rates at a gradual pace. If corporate earnings growth remains acceptable in this environment, credit-sensitive high-yield bonds could outperform interest-rate-sensitive Treasury bonds.

What could investors consider?

- **Look globally:** Consider favoring U.S. investments, but also consider adding non-U.S. holdings.
- **Watch valuations:** If earnings expectations rise faster than earnings do, the market may become overvalued.
- **Consider small and mid caps:** Earnings momentum could help small- and mid-cap stocks outperform.
- **Focus on credit and duration:** Longer-duration bonds are sensitive to rising interest rates, while corporate and high-yield bonds may hold up better.

*To read or listen to the latest insights from our market strategists, visit **wellsfargofunds.com**.*



Expecting volatility in 2017? A case for diversifying.

Even as their optimism reaches record highs, nearly 75% of investors expect increased market volatility in 2017. Learn how to prepare mentally and financially for potential bumps in the road.

Consumer confidence recently reached levels not seen since 2001. Investor sentiment is up, too, according to the 2016 fourth-quarter Wells Fargo/Gallup Investor and Retirement Optimism Index, which reached a nine-year high.

Optimistic investors still expect volatility

Many market strategists say that when individuals get bullish, it's time to get bearish. I disagree. There's often a difference between how people feel and how they act. For example, rising consumer confidence does not regularly result in future retail sales growth. Confidence does a better job of reflecting what consumers have done rather than predicting what they will do.

So what might investors do in 2017, given their uptick in optimism? Consider their market outlook: Nearly 75% of investors surveyed in the Investor and Retirement Optimism Index say the stock market will be volatile in 2017. How volatile should investors expect stocks to be?

Volatility has been average in recent years

Three common measures of market volatility can offer some historical context.

Intraday range: The intraday range (the high minus the low divided by the previous day's close) of the S&P 500 Index averaged 0.96% for 2016. Going back to 1931, the average was 1.61%. Even a slight pickup in this type of volatility would get us back to only average.

Standard deviation of daily returns: This gauges the bumpiness of the market's daily ride. For 2016, the average monthly standard deviation of daily returns was 0.79%. The average going back to 1930 is 0.93%. Markets have been relatively smooth compared with the past.

Average drawdown over a month: This measure looks forward one month and asks what the largest market drop was during that moving window. In 2016, the average monthly drawdown was 1.8%. That's a lot less than the average going back to 1930, which is 3.4%.

Some people point to central bank policy as a reason for low volatility, but volatility also was low in the mid-1990s and from 2004 to 2006 when the Fed was removing monetary policy accommodation. The fact is, markets that moved higher typically did so with below-average volatility.

Fortify your diversification strategy

It may be time to prepare for higher volatility, but don't lose sight of potential opportunities. Yes, it's sometimes good to be a contrarian when everyone seems optimistic, but it's better to determine if the optimism is well founded.

Historically, the proven method for dealing with volatility has been to stay diversified. That doesn't just mean keeping your equity/bond allocation in line with your goals and appetite for risk; it also means keeping equity and bond allocations diversified. Not all parts of the bond market move in tandem, as evidenced by how high-yield bonds dramatically outperformed Treasuries in 2016.

Similarly, not all parts of the equity market move together. While 2015 was about momentum and growth, 2016 saw a rotation toward more cyclical parts of the market. That rotation can change, so it may be prudent to keep a globally diversified portfolio across all sectors.

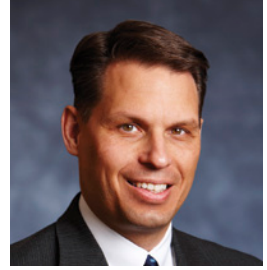
Diversification is about having a wide mix of ideas as well as a wide mix of assets in your portfolio.

*For help with your investment goals, use the tools at **wellsfargofunds.com** or call **1-800-233-6370**.*

This is the final issue of *Investor Advantage*.

Thank you for being a Wells Fargo Asset Management client. For future insights, performance updates, and more, please visit **wellsfargofunds.com/ind** or call us at **1-800-233-6370** for support.

Asset allocation and diversification do not ensure or guarantee better performance and cannot eliminate the risk of investment losses.



Munis in the new administration: An interview with Lyle Fitterer

Lyle Fitterer, CFA®, portfolio manager of the Wells Fargo Strategic Municipal Bond Fund, discusses the sectors he's watching as the Trump administration begins.

How might the new administration affect the municipal bond market?

Anticipated economic growth this year likely will drive increased tax revenues, which is good overall for municipalities. But the tobacco and health care credit sectors may be rattled as certain policies are in flux.

Higher cigarette taxes may strain tobacco bonds

New cigarette taxes being passed across the U.S. (for example, California has more than doubled its cigarette taxes) likely will curb cigarette consumption in many areas. We expect most cigarette- or tobacco-backed bonds, which make up 25% of the municipal bond index, to be affected. Many high-yield funds hold these bonds, which may contribute to volatility there.

Obamacare uncertainty hits health care sector

Potential changes to the Affordable Care Act may affect the profitability and balance sheets of health care providers, especially not-for-profit providers. Could this create an opportunity to find good credits at cheaper valuations? For-profit providers' stocks were down 25% to 50% last year and have struggled since the election.

What's next?

Uncertainty around potential policy change will continue to affect these and other credit sectors. To learn more about related risks and opportunities, listen to Lyle's full *On the Trading Desk* interview at the AdvantageVoice blog: **wellsfargofunds.com/blog.**

Wells Fargo Funds in the spotlight

Special Mid Cap Value Fund: WFPAX

Seek the equity sweet spot with mid caps

- Focuses on mid caps for diversification and higher return potential
- Finds high-quality companies with long-term potential but trading at a discount
- Is run by managers with both accounting and investment expertise

How to use

Diversify your small- and large-cap holdings

Strategic Municipal Bond Fund: VMPAX

Tap into a nimble income strategy that seeks return from four sources

- Seeks opportunities in changing market trends and pricing inefficiencies
- Uses munis of various maturities and credit quality and aims to distribute monthly income
- Is run by a seasoned team of nine portfolio managers and analysts, led by Lyle Fitterer, CFA

How to use

Complement traditional muni investments with a flexible strategy

Municipal Bond Fund: WMFAX

Build a tax-smart income strategy

- Seeks growth and an above-benchmark dividend yield from stocks in emerging markets
- Invests in a low-volatility portfolio diversified across countries and market sectors
- Aims to distribute monthly income to shareholders

How to use

Add another slice of international, topped with potential income

*To learn more about the funds in the spotlight, call **1-800-233-6370** or do your own research at **wellsfargofunds.com**.*

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Standard deviation of return measures the average deviations of a return series from its mean and is often used as a measure of risk. Standard deviation is based on historical performance and does not represent future results.

The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market-value-weighted index with each stock's weight in the index proportionate to its market value.

For Class A, the maximum front-end sales charge is 4.50%.

Mutual fund investing involves risks, including the possible loss of principal, and may not be appropriate for all investors. Stock values fluctuate in response to the activities of individual companies and general market and economic conditions. Bond values fluctuate in response to the financial condition of individual issuers, general market and economic conditions, and changes in interest rates. Changes in market conditions and government policies may lead to periods of heightened volatility in the bond market and reduced liquidity for certain bonds held by the fund. In general, when interest rates rise, bond values fall and investors may lose principal value. Interest-rate changes and their impact on the fund and its share price can be sudden and unpredictable.

Funds that concentrate their investments in a single industry may face increased risk of price fluctuation over more diversified funds due to adverse developments within that industry. Foreign investments are especially volatile and can rise or fall dramatically due to differences in the political and economic conditions of the host country. These risks are generally intensified in emerging markets. Smaller- and mid-cap stocks tend to be more volatile and less liquid than those of larger companies. High-yield securities have a greater risk of default and tend to be more volatile than higher-rated debt securities. Consult a fund's prospectus for additional information on these and other risks. A portion of the fund's income may be subject to federal, state, and/or local income taxes or the Alternative Minimum Tax (AMT). Any capital gains distributions may be taxable. Consult the fund's prospectus for additional information on these and other risks.

Performance for certain Wells Fargo Funds reflects a predecessor fund's performance and may be adjusted to reflect the Wells Fargo Fund's sales charges and/or expenses. Predecessor fund information can be found in each fund's prospectus.

Carefully consider the investment objectives, risks, charges, and expenses before investing. For a current prospectus and, if available, a summary prospectus for Wells Fargo Funds, containing this and other information, visit wellsfargofunds.com. Read it carefully before investing.

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