WELLS FARGO ASSET MANAGEMENT

Portfolio Manager Commentary

Overview, strategy, and outlook: As of January 31, 2019

Contributing authors

Jeffrey L. Weaver, *Head of Money Funds and Short Duration Strategies*
415-396-4758 | jeff.weaver@wellsfargo.com

Laurie R. White, *Managing Director and Senior Fund Manager, Taxable Money Funds*
612-667-4275 | laurie.r.white@wellsfargo.com

Michael C. Bird, *Senior Fund Manager, Taxable Money Funds*
612-667-6529 | michael.c.bird@wellsfargo.com

James C. Randazzo, *Senior Fund Manager, Municipal Money Markets*
704-374-3086 | jrandazzo@wellsfargo.com

Madeleine M. Gish, *Senior Fund Manager, Taxable Money Funds*
415-396-2668 | madeleine.gish@wellsfargo.com

John R. Kelly, *Senior Fund Manager, Taxable Money Funds*
612-667-2045 | kellyjr@wellsfargo.com

Daniel J. Tronstad, *Senior Fund Manager, Taxable Money Funds*
612-667-7647 | daniel.j.tronstad@wellsfargo.com

Money market overview

The January news cycle was dominated by the federal government shutdown. As the shutdown dragged on, the talking heads nattered about the amount of gross domestic product growth being destroyed each week, the economic hardships affecting furloughed workers and their families, knock-on effects throughout the world, and the negative volleys between the executive and legislative branches of government stalling progress on resolving their impasse. When a temporary funding bill seemingly abruptly ended the "longest shutdown in history"—history being relative, as we're talking about 15 instances since 1980—it was cause for not only a wee bit of optimism about the ability for compromise to be found going forward but also a huge sigh of relief that the incessant discussion might cease for a while, or at least until February 15.

Against this backdrop, market observers began to notice that there seemed to be signs of a global slowdown. Taking the shutdown in context with ongoing trade wars with China, an increasing chorus of voices began to opine that the current economic expansion had aged out. There was a real possibility of the U.S. following the rest of the world into a slowdown, if not an outright recession. Market participants revised their expectations of any further tightening in 2019 from a small possibility at the end of December to a zero probability by the end of January, even going so far as to add in a fairly high likelihood of a *cut* to federal funds. And so all eyes were naturally on the Federal Reserve (Fed) when it met during the polar vortex. And it did not disappoint. In a relatively dovish statement, the Fed pivoted slightly from its data dependence stance in the previous statement to one requiring "patience," citing increasing downside risk from abroad, weaker domestic data, and tighter financial conditions. The Fed also acknowledges being in the range of neutral policy estimates. While maintaining that this pause in further tightening was therefore appropriate, it further noted that its duration would be entirely dependent on incoming data. Market participants largely interpreted this as meaning that the Fed was done tightening for this cycle.

Sector views

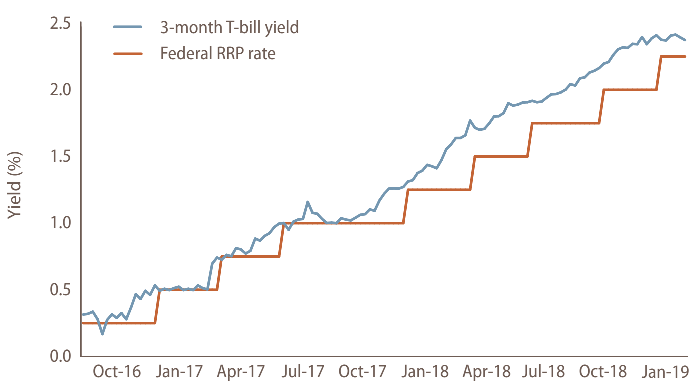
U.S. government sector

With the dysfunctional year-end markets behind them, the money markets quickly returned to normalcy early in January, embracing the Fed's rediscovered "patience" by robustly flattening the curve. Like skinny ties, an on-hold Fed, data dependent and patient, was bound to come back in style eventually. Also like skinny ties, the patient Fed may have returned a bit soon for investors' tastes.

With the steadily hiking Fed stepping aside as it seeks clarity amid the confusing jumble of equity markets, slowing Chinese growth, trade wars, government shutdowns, and Brexit, the sole remaining pillar supporting government money market yields is the U.S. government's borrowing appetite. That doesn't appear to be in any danger of being sated. The expanding deficits, while not good if you're on the hook for them as most of us are, will need to be funded, ensuring an adequate supply of Treasury securities for the foreseeable future.

The market's adjustment to the Fed can be seen in the pricing of 3-month Treasury bills (T-bills), yields on which have flattened out after more than a year of steady increases since Congress passed its tax cut in December 2017. In addition to spurring further issuance to fund the larger deficit, the tax cut provided a fiscal boost to the economy, nudging the Fed to continue its gradual quarterly interest rate hikes. As shown in the chart below, T-bill yields, which had regularly reflected the expectation of future hikes throughout 2018, no longer appear to do so.

3-month T-bill yield vs. reverse repurchase agreement



Sources: Bloomberg L.P. and Wells Capital Management Inc.

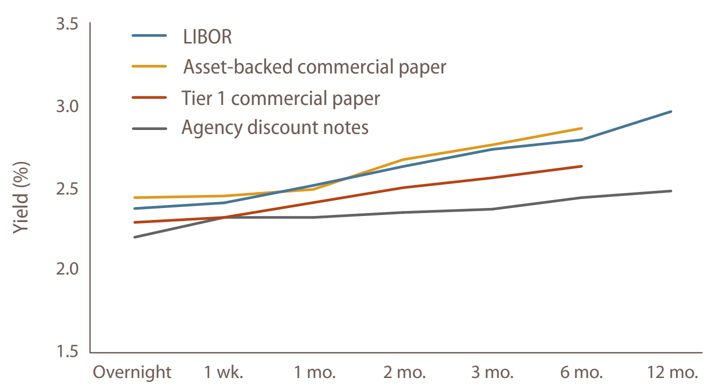
Also likely to become a topic, but not a real issue, in February is the debt ceiling. The debt ceiling, the bane of many an existence, is currently suspended and will be reestablished on March 2, 2019, at the amount of debt then outstanding. What it means for markets in February is that the Treasury needs to get its cash balance down from the current balance of about $400 billion to the statutorily required balance of about $200 billion on March 1. Fortunately, it's the right time of the year for rapidly running the cash balance down, as the Treasury should be paying tax refunds all month long, thus avoiding the need to drastically cut T-bill issuance to accomplish the same thing. It would be like someone directed you to run your cash balance down while on a European vacation. It's something that takes care of itself. In the absence of some action to re-suspend it, the debt ceiling will become a real issue later in the summer, as the Treasury begins to run out of both extraordinary measures and cash at the same time.

Prime sector

Only one month has passed but there has been a marked shift in market expectations and mindset as we flipped the calendar to the new year. Yes, there were some rumblings before the Fed meeting in December that the pace of tightening would slow. And, yes, the statement afterward reflected we would no longer expect quarterly hikes. Instead, *patience* was the key word, with an emphasis on data, but the Fed indicated that gradual rate increases could still be warranted. The current mindset and the rate compression that we've seen since December reflect a dramatic shift in outlook from market participants in response to the gradual changes coming from the Federal Open Market Committee (FOMC).

By the end of January, London Interbank Offered Rates (LIBOR) had fallen in the belly of the curve with three and six months down 7 and 10 basis points (bps)[1] to 2.74% and 2.78%, respectively. One-month and one-year LIBOR are almost unchanged from year-end. The change in LIBOR, however, doesn't reflect the dramatic change in yields available in the market. In mid-December, commercial paper or CD issuers that were paying a yield 5 bps to 10 bps **above** the corresponding LIBOR to get short, fixed funding were able to get that same term and pay 10 bps to 15 bps **less** than LIBOR by the end of January.

Money market yield curves, as of 1/31/2019

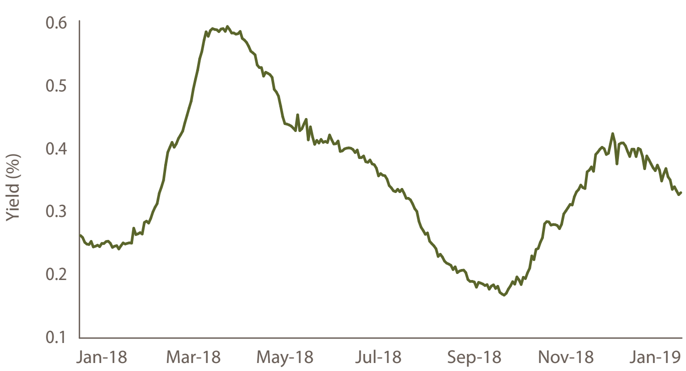


Sources: Bloomberg L.P. and Wells Capital Management Inc.

Part of the recent compression in yields is related to supply/demand factors and calendar timing. A situation exacerbating the yield shift is lackluster supply combined with increasing demand. According to Crane Data, prime assets have grown by $8.5 billion so far this year, with more than $15 billion flowing into retail funds while $6.4

billion left institutional funds. On the supply side, January is a notoriously slow issuance month. Many issuers place paper in December to ensure funding over year-end, with maturities typically extending to early to mid-February at the earliest in order to meet regulatory requirements. Seasonally adjusted commercial paper outstandings published by the New York Fed show a decrease in paper supply of about $34 billion in January. As the supply of fixed-rate paper declined, attention shifted to floating-rate notes. But in a similar vein, a lack of maturities in January prompted issuers to look for opportunistic funding, which was met with great demand, in turn causing floating-rate spreads to narrow. The LIBOR-OIS chart below illustrates the direction of spreads in the money market space. However, actual spreads have moved considerably more. As you may recall, The LIBOR-OIS spread is the difference between the LIBOR and the Overnight Index Swap rate. It represents the difference between an interest rate with some credit risk built in (LIBOR) and one that is relatively risk-free (OIS) over a certain period and reflects not only credit risk but also term premia.

LIBOR-OIS spread

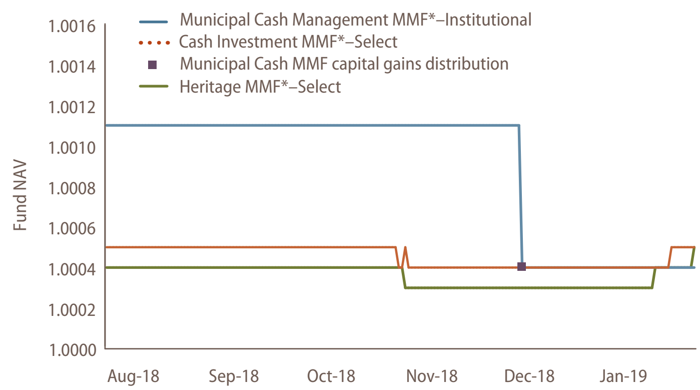


Sources: Bloomberg L.P. and Wells Capital Management Inc.

But of course the greatest influence on our rate environment comes from the FOMC. The Fed provides current thinking after each committee meeting via a statement and later releases minutes that contain the Summary of Economic Projections, or dot plot. And, beginning in January 2019, Fed Chair Powell will also hold a press conference after each meeting, instead of every two meetings as was initiated by his predecessor. The dot plot released after the December meeting showed that three more rate hikes might be possible this cycle. However, six weeks later and the January statement had the words "some further gradual increases" removed and replaced with wording the market took to say "we might be here for quite a while."

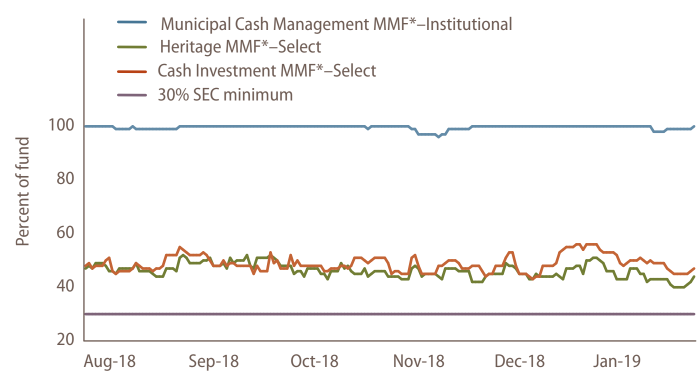
As mentioned above, the return of an on-hold Fed came back in style a bit too soon. Going forward, money market rates should continue to look toward the FOMC and other market indicators for future rate guidance. As we get more clarity to the end of the tightening cycle, money market participants may look to extend weighted average maturities (WAMs)[2] to capture higher yields. Our strategy of emphasizing highly liquid portfolios, relatively short WAMs, and a position in securities that reset frequently allows us to capture elevated LIBOR levels with minimal net asset value (NAV) pricing pressures and to afford the flexibility to add longer-dated securities as opportunities arise.

Wells Fargo floating net asset value (FNAV) money market fund NAVs



Source: Wells Fargo Funds

Wells Fargo FNAV money market fund weekly liquid assets



Source: Wells Fargo Funds

Municipal sector

Municipal money markets got off to a volatile start this year as strong initial asset inflows gave way to exceptionally large redemptions during the latter half of the month. Yields on variable-rate demand notes (VRDNs)[3] and tender option bonds (TOBs)[4] in the overnight and weekly space responded in dramatic fashion to the sudden swings in demand.
The Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Index,[5] which had closed out 2018 at 1.71% (71% of 1-week LIBOR), quickly fell to 1.28% (53% of

1-week LIBOR) as strong seasonal demand overwhelmed available supply during the first two weeks of the month (as of January 14, 2019). Yields on overnight high-grade paper fell even more dramatically, falling from roughly 1.70% to as low as 0.85% (as of January 14, 2019). However, after the initial surge in seasonal demand was satisfied, the municipal money market was left vulnerable due to the richness of tax-exempt issues relative to taxable paper.

Municipal money market funds would eventually experience roughly $5 billion in redemptions over the last two weeks of January, causing a sharp reversal in the direction of rates in the short end of the curve. As a result, the SIFMA Municipal Swap Index closed out the month at 1.43% (59% of 1-week LIBOR), while overnight rates spiked to as high as 1.65%, nearly double levels seen earlier in the month. In contrast, the long end of the curve was relatively stable. With strong demand for high-grade one-year paper carrying over into the new year, exerting steady downward pressure on rates, the municipal money market yield curve flattened further as rates on one-year paper fell to roughly 1.74% from 1.90% at year-end.

During the month, we continued to emphasize principal preservation and liquidity by targeting our purchases in VRDNs and TOBs with daily and weekly puts. Despite the rapid but expected drop in rates in the short end during the first part of the month, our strategy enabled us to quickly capture the rise in yields on floating-rate securities during the second half of the month. Additionally, we continue to feel that a conservative posture with respect to WAM given the relative flatness of the municipal money market yield curve is warranted.

On the horizon

Next month, we'll be taking a deep dive into the credit environment. We'll also return at the end of March just in time to discuss the debt ceiling and its resolution!

Rates for sample investment instruments — current month-end % (January 2019)

Sector	1 day	1 week	1 month	2 month	3 month	6 month	12 month
U.S. Treasury repos	2.56	2.42	–	–	–	–	–
Fed reverse repo rate	2.25	–	–	–	–	–	–
U.S. Treasury bills	–	–	2.35	2.37	2.35	3.39	2.46
Agency discount notes	2.20	2.32	2.32	2.35	2.37	2.44	2.48
LIBOR	2.37	2.41	2.51	2.63	2.73	2.79	2.96
Asset-backed commercial paper	2.44	2.45	2.49	2.67	2.76	2.86	–
Dealer commercial paper	2.29	2.32	2.41	2.50	2.56	2.63	–
Municipals	1.64	1.43	1.46	1.49	1.52	1.63	1.74

Sources: Bloomberg L.P. and Wells Capital Management

Wells Fargo Fund	7-day current yield
Cash Investment MMF*–Select	2.58
Heritage MMF*–Select	2.56
Municipal Cash Management MMF*–Inst	1.30
Government MMF**–Select	2.33
Treasury Plus MMF**–Inst	2.25
100% Treasury MMF**–Inst	2.23

Source: Wells Fargo Funds

Figures quoted represent past performance, which is no guarantee of future results, and do not reflect taxes that a shareholder may pay on a fund. *Yields will fluctuate. Current performance may be lower or higher than the performance data quoted and assumes the reinvestment of dividends and capital gains. Current month-end performance is available at the funds' website, wellsfargofunds.com.*

Money market funds are sold without a front-end sales charge or contingent deferred sales charge. Other fees and expenses apply to an investment in the fund and are described in the fund's current prospectus.

The manager has contractually committed to certain fee waivers and/or expense reimbursements. Brokerage commissions, stamp duty fees, interest, taxes, acquired fund fees and expenses, and extraordinary expenses are excluded from the cap. Without these reductions, the seven-day current yield for the Institutional Class of the Cash Investment Money Market Fund, Heritage Money Market Fund, Municipal Cash Management Money Market Fund, Government Money Market Fund, Treasury Plus Money Market Fund, and 100% Treasury Money Market Fund would have been 2.43%, 2.46%, 1.15%, 2.25%, 2.23%, and 2.15%, respectively, and the total returns would have been lower. The cap may be increased or the commitment to maintain the cap may be terminated only with the approval of the Board of Trustees. The expense ratio paid by an investor is the net expense ratio (the total annual fund operating expenses after fee waivers) as stated in the prospectus.

For more information, please contact:

Institutional Sales Desk: **1-888-253-6584**

Website: **wellsfargofunds.com** (*Click "Institutional Cash Management"*)

1. 100 bps = 1.00%

2. Weighted average maturity (WAM): An average of the effective maturities of all securities held in the portfolio, weighted by each security's percentage of total investments. The maturity of a portfolio security is the period remaining until the date on which the principal amount is unconditionally required to be paid, or in the case of a security called for redemption, the date on which the redemption payment is unconditionally required to be made. WAM calculations allow for the maturities of certain securities with demand features or periodic interest rate resets to be shortened. WAM is a way to measure a fund's sensitivity to potential interest rate changes. WAM is subject to change and may have changed since the date specified.

3. VRDNs are debt securities commonly held within the Wells Fargo Money Market Funds. Like all bonds, VRDN 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. In general, when interest rates rise, bond values fall and investors may lose principal value. Interest rate changes can be sudden and unpredictable. In addition to credit and interest rate risk, VRDNs are subject to municipal securities risk.

4. A TOB is a type of VRDN where a long-term bond is placed into a trust. Floating-rate securities are created from the trust.

5. The SIFMA Municipal Swap Index is a seven-day high-grade market index composed of tax-exempt variable-rate demand obligations with certain characteristics. The index is calculated and published by Bloomberg. The index is overseen by SIFMA's Municipal Swap Index Committee. You cannot invest directly in an index.

**For floating NAV money market funds: You could lose money by investing in the fund. Because the share price of the fund will fluctuate, when you sell your shares they may be worth more or less than what you originally paid for them. The fund may impose a fee upon sale of your shares or may temporarily suspend your ability to sell shares if the fund's liquidity falls below required minimums because of market conditions or other factors. An investment in the fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The fund's sponsor has no legal obligation to provide financial support to the fund, and you should not expect that the sponsor will provide financial support to the fund at any time.*

For retail money market funds: You could lose money by investing in the fund. Although the fund seeks to preserve the value of your investment at $1.00 per share, it cannot guarantee it will do so. The fund may impose a fee upon sale of your shares or may temporarily suspend your ability to sell shares if the fund's liquidity falls below required minimums because of market conditions or other factors. An investment in the fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The fund's sponsor has no legal obligation to provide financial support to the fund, and you should not expect that the sponsor will provide financial support to the fund at any time.

***For government money market funds: You could lose money by investing in the fund. Although the fund seeks to preserve the value of your investment at $1.00 per share, it cannot guarantee it will do so. An investment in the fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The fund's sponsor has no legal obligation to provide financial support to the fund, and you should not expect that the sponsor will provide financial support to the fund at any time.*

For the municipal money market funds, a portion of the fund's income may be subject to federal, state, and/or local income taxes or the alternative minimum tax. Any capital gains distributions may be taxable. For the government money market funds, the U.S. government guarantee applies to certain underlying securities and not to shares of the fund.

The views expressed and any forward-looking statements are as of January 31, 2019, and are those of the fund managers and the Money Market team at Wells Capital Management, subadvisor to the Wells Fargo Money Market Funds, and Wells Fargo Funds Management, LLC. Discussions of individual securities, the markets generally, or any Wells Fargo Funds are not intended as individual recommendations. Future events or results may vary significantly from those expressed in any forward-looking statements; the views expressed are subject to change at any time in response to changing circumstances in the market. Wells Fargo Funds Management, LLC, disclaims any obligation to publicly update or revise any views expressed or forward-looking statements.

Carefully consider a fund's investment objectives, risks, charges, and expenses before investing. For a current prospectus and, if available, a summary prospectus, containing this and other information, visit wellsfargofunds.com. Read it carefully before investing.

Wells Fargo Asset Management (WFAM) is the trade name for certain investment advisory/management firms owned by Wells Fargo & Company. These firms include but are not limited to Wells Capital Management Incorporated and Wells Fargo Funds Management, LLC. Certain products managed by WFAM entities are distributed by Wells Fargo Funds Distributor, LLC (a broker/dealer and Member FINRA).

INVESTMENT PRODUCTS: NOT FDIC INSURED ▪ NO BANK GUARANTEE ▪ MAY LOSE VALUE