WELLS FARGO Asset Management

Contributing authors

Jeff 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

PORTFOLIO MANAGER COMMENTARY

Overview, strategy, and outlook

As of April 30, 2019

Money market overview

The current environment of above-trend growth, low unemployment, and lack of concern about the Federal Reserve (Fed) tightening monetary policy has propelled risk assets to perform unevenly. While the S&P 500[1] and Nasdaq[2] indices are up roughly 17% and 22%, respectively, year to date through April 30, the Bloomberg Barclays U.S. Aggregate Bond Index[3] has posted a relatively cash-like return of roughly 2.70% this year. At the same time, yields in the short end of the taxable money markets, in contrast, barely budged in April.

In spite of stubbornly flat yields, money market fund assets behaved atypically. With tax day falling on April 15, the month is usually one for heavy outflows across all money market fund assets, and industry-wide assets under management typically bottom out at this time of year. True to form, tax-related outflows of about $24 billion hit retail prime and government funds and tax-exempt money funds. On the other hand, institutional prime and government funds experienced inflows of about $20 billion in April, with roughly 75% going into prime funds. So far this year, industry assets are at a near year-to-date high of $3.2 trillion, driven largely by $80 billion in renewed interest in prime money market funds.

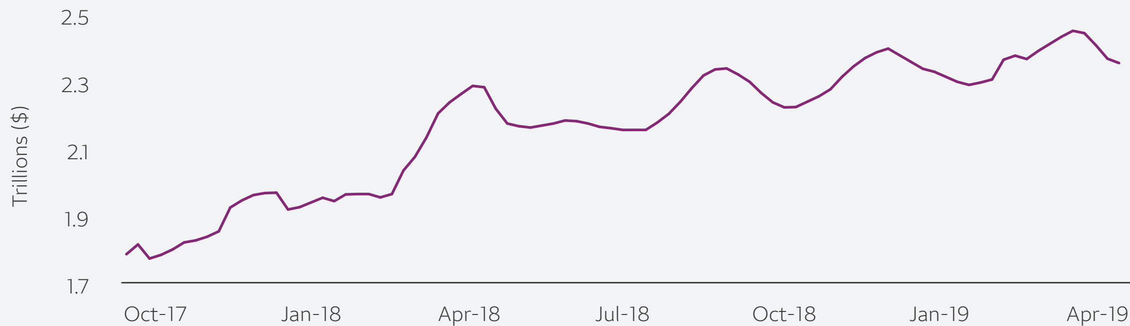
Sector views

U.S. government sector

Market participants were treading water in April, waiting for some kind of clarity on the economy and the Fed's reaction to it. The Fed has been wildly successful in meeting its employment mandate, with initial jobless claims, continuing claims, and the unemployment rate all recently at 45- to 50-year lows. That has been crystal clear. The hazy part is that despite all those people with regular paychecks to spend, core inflation just refuses to rise above 2% and stay there for any length of time. The Fed's preferred inflation gauge, the core personal consumption expenditure (PCE)[4] deflator, snuck above 2% briefly in 2012 and again in July 2018, but since that July peak at 2.04% it has fallen to 1.55% last month. The disconnect between employment and inflation, which has bedeviled the Fed all through the recovery from the financial crisis, continues to puzzle it, with the appropriate next step uncertain. An observer from the past would be stunned to see a Fed considering rate cuts with exceptionally low unemployment and no imminent economic shock on the horizon, but then someone from the past would be surprised by a lot in today's world. With the Fed thinking aloud about lowering rates, the peanut gallery is egging them on, with Treasury yields reflecting expected rate cuts this year and next.

In the money market space, the yield curve is flat for maturities out to six months, where it begins to bend down to reflect potential rate cuts. Inside six months, any Treasury bill (T-bill) can be bought or sold in the 2.35% to 2.40% range. Following the usual tax-driven seasonality, T-bill supply rose in March and then fell in April, as shown in the chart on the next page of several years of T-bill issuance.

U.S. Treasury bills outstanding



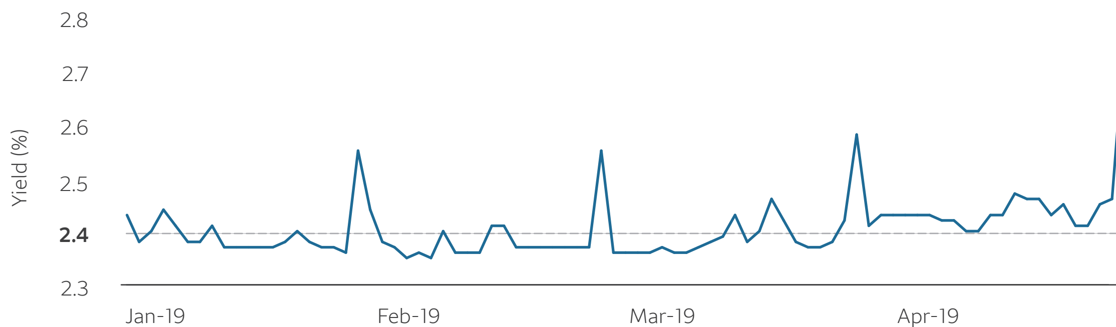
Source: Bloomberg L.P.

Although T-bill yields barely budged from the supply fluctuations, the repo market reacted to the supply by doing what the repo market often does, which is the exact opposite of what you might expect. In this case, repo rates in April were consistently higher than they were for most of the first quarter despite the contraction in T-bill supply. The chart of repo yields below reminds us that the repo market is noisy, with periodic spikes on reporting dates, Treasury settlement dates, and sometimes just because. Looking through the noise, though, the chart shows that repo yields, which often traded below 2.40% throughout the first quarter, never traded below that level in April. It's quite possible that the flip side of the tax-seasonality coin, the April tax payments of cash into the Treasury, cash that had formerly been parked in money market instruments such as repo, was behind the higher rates in April.

Prime sector

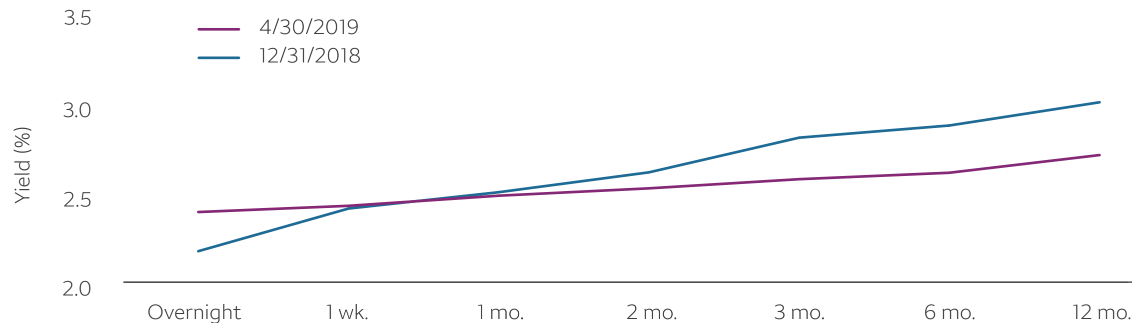
At the conclusion of the March Federal Open Market Committee (FOMC) meeting, the message was abundantly clear the Fed was going to be patient in assessing economic developments before any future adjustment to its target rate occurred. The Fed was uncomfortable with inflation running stubbornly below its stated 2% target even as the U.S. was experiencing above-trend growth and low unemployment. The market took this focus on stubbornly

Tri-party repo yield



Sources: Federal Reserve Bank, Bloomberg L.P., and the Bank of New York

LIBOR yield curves



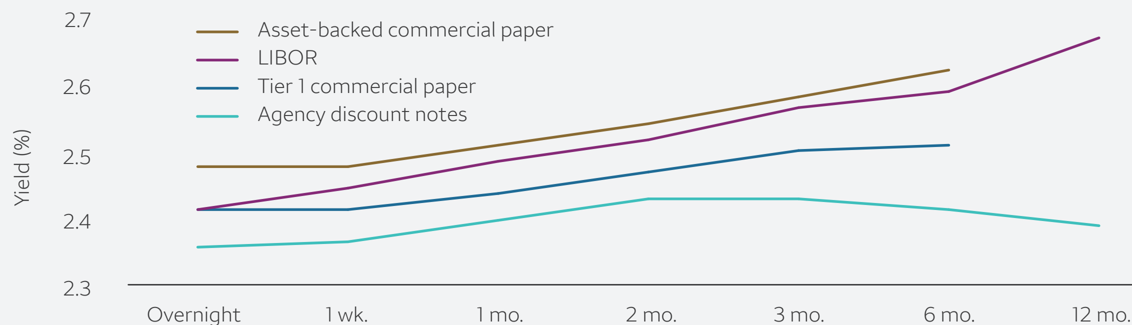
Source: Bloomberg L.P.

low inflation and skewed lower the expected future path of its target rate. As a result, federal funds futures show a roughly 60% chance of a 25-basis-point (bp)[5] rate cut priced in by the end of 2019.

In this wait-and-see environment, money market rates were mainly range-bound with longer-dated yields trending lower and pricing in the possibility of a rate cut by year-end. This is illustrated by the yield spread between the one-month London Interbank Offered Rate (LIBOR) and the six-month LIBOR, which stands at roughly 14 bps. The last time this occurred was during the Fed's 2008–2009 interest rate cutting episode. Although we are arguably miles away from those economic conditions, it is worth noting how quickly markets jump to certain conclusions and stand in contrast to the 2013–2014 period, when the Fed was firmly on hold and the spread trended around 20 bps. The very front end of the LIBOR curve remains pegged close to the upper end of the federal funds target rate range as this rate is more of an indication of current policy and not quite pricing in future moves.

Credit spreads in the money market space have remained range-bound as well. The LIBOR-OIS (LOIS)[6] spread has moved tighter by roughly 2 bps in April to a spread of 17 bps. As you may recall, LOIS is the difference between three-month LIBOR and the Overnight Indexed Swap (OIS) rate. It represents the difference between an interest rate with

Money market yield curves, as of 4/30/2019



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

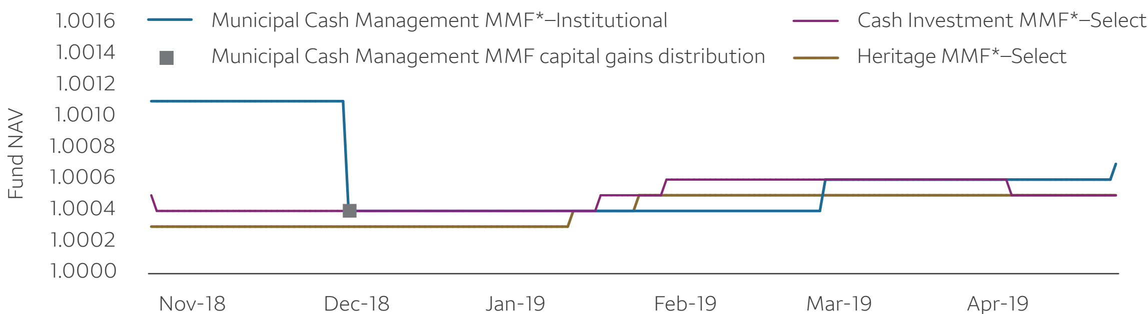
some credit risk built in (LIBOR) and one that is relatively risk free (OIS) over a certain time period, thus incorporating not only credit risk but also term premia. Typically, the LIBOR-OIS spread widens as a result of credit stresses in the banking sector or from a decline in demand from investors. In the current environment, though, demand for floating-rate product continues to be quite strong even though the Fed is being patient and the market is pricing in the potential for an ease later this year. This may seem a little counterintuitive that in the face of a possible rate-cutting environment floating-rate product has maintained sufficient demand to tighten spreads. However, as the money market fixed-rate curve continues to flatten as rate cuts are being priced into the market, fixed yields are pricing at levels below LIBOR, whereas floating-rate products are still pricing at relatively attractive levels of LIBOR plus a spread.

In the current environment, we continue to favor our investment strategy of emphasizing highly liquid portfolios, relatively short weighted average maturities, and a position in securities that reset frequently. This allows us to capture higher yields on the shorter end of the curve, with minimal NAV pricing pressures, while giving us the flexibility to add longer-dated product as opportunities arise.

Municipal sector

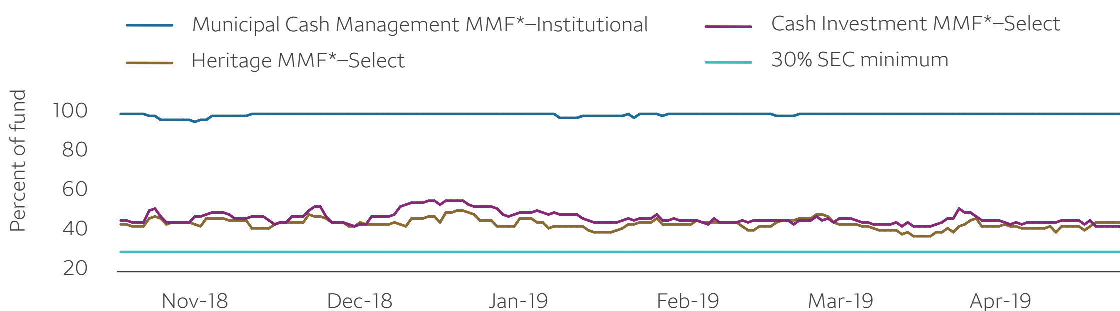
Yields in the short end of the municipal money market space spiked during April as tax season ushered in approximately $4.5 billion in outflows from municipal money market funds. The Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Index[7] rose rapidly from 1.50% (62% of 1-week LIBOR) to 2.30% (95% of 1-week LIBOR), a level not seen since the beginning of the financial crisis in 2008. While the tax-time spike in rates is not unusual for the municipal money market, the abruptness and magnitude of the move caught many participants off guard. The SIFMA Index had remained compressed throughout the first quarter of the year as demand from municipal bond funds remained exceptionally high based on record inflows into those funds. This incremental demand had easily made up for lagging demand from municipal money market funds and had led many to believe that this year's tax season bounce would be muted.

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



Source: Wells Fargo Funds

Wells Fargo FNAV money market fund weekly liquid assets



Source: Wells Fargo Funds

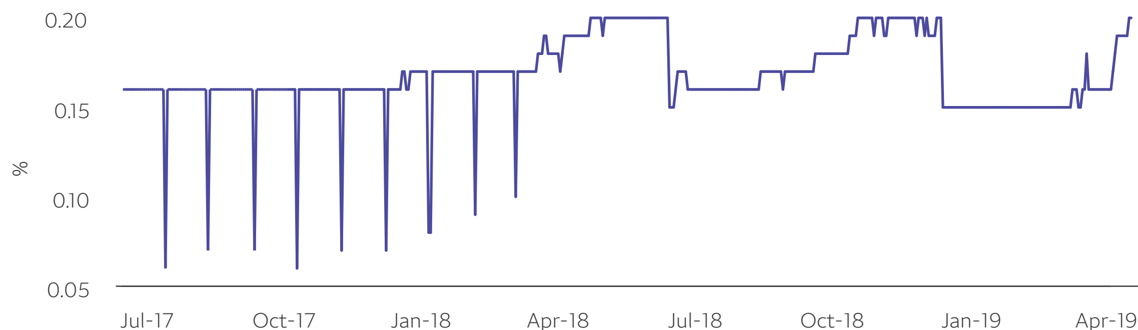
Instead, rates on overnight and weekly variable-rate demand notes (VRDNs)[8] and tender option bonds (TOBs)[9] skyrocketed as dealers were forced to quickly recalibrate offering levels to entice new buyers as demand evaporated in the second half of the month. The municipal yield curve rapidly inverted as rates on overnight and weekly paper exceeded the levels on 15-year high-grade paper. Further out on the short-term curve, yields on high-grade commercial paper and notes in the one-month to three-month space rose in sympathy with VRDNs and TOBs. However, levels in this area of the curve rose much less dramatically than SIFMA, increasing roughly 15 bps to 25 bps. Meanwhile, yields on one-year high grades bucked the trend and finished out the month at 1.68%, down from 1.70%. Bids on long-dated tax-exempt paper remained strong given the temporary nature of the tax-season spike and a dovish outlook for monetary policy heading into 2020.

During the month, we continued to emphasize principal preservation and liquidity by targeting our purchases in VRDNs and TOBs with daily and weekly puts. Accordingly, we were able to fully capture the dramatic backup in rates on the short end of the curve. Although we anticipate that short-term rates will normalize in the near term, we continue to feel that this sector of the curve offers attractive nominal and after-tax returns for municipal investors. Additionally, we continue to feel that a focus on liquidity and principal preservation is prudent, particularly given the shape of the municipal money market yield curve.

On the horizon

In addition to making big-picture decisions about the appropriate level of interest rates, the Fed must also deal with more mundane tasks such as keeping the federal funds rate within its target range. Twice in the past year, in June and December 2018 as shown below, the federal funds rate moved up to within 5 bps of the top of its range. Although the reasons are not entirely clear, the upward pressure on federal funds likely stemmed in part from the Fed shrinking its balance sheet over this period, which also reduced reserves in the banking system. In the two previous cases, after the federal funds rate consistently stayed at that level for more than a month, the Fed acted to push it back down by lowering its Interest on Excess Reserves (IOER) rate by 5 bps. Over the past month, the federal funds rate again worked its way back up to within 5 bps of the range top, reaching that level in the last two days of April. As this was the trigger for the two previous IOER cuts, it's possible the Fed may again cut the IOER rate modestly by another 5 bps to keep the federal funds rate comfortably in its target range. The main question is whether the Fed chooses to wait another month or more as it did in the last two instances or addresses it immediately.

Excess of federal funds effective rate over bottom of Fed's target range



Source: Bloomberg L.P.

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

Sector	1 day	1 week	1 month	2 month	3 month	6 month	12 month
U.S. Treasury repos	2.75	2.51	–	–	–	–	–
Fed reverse repo rate	2.25	–	–	–	–	–	–
U.S. Treasury bills	–	–	2.38	2.38	2.37	2.37	2.30
Agency discount notes	2.32	2.33	2.37	2.41	2.41	2.39	2.36
LIBOR	2.39	2.43	2.48	2.52	2.58	2.61	2.71
Asset-backed commercial paper	2.47	2.47	2.51	2.55	2.60	2.65	–
Dealer commercial paper	2.39	2.39	2.42	2.46	2.50	2.51	–
Municipals	2.30	2.30	1.80	1.75	1.73	1.65	1.68

Sources: Bloomberg L.P. and Wells Capital Management

Wells Fargo Fund	7-day current yield
Cash Investment MMF*–Select	2.53
Heritage MMF*–Select	2.53
Municipal Cash Management MMF*–Inst	2.17
Government MMF**–Select	2.36
Treasury Plus MMF**–Inst	2.37
100% Treasury MMF**–Inst	2.26

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, wfam.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 2.41%, 2.43%, 2.06%, 2.29%, 2.29%, and 2.18%, 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.

1. 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. You cannot invest directly in an index.
2. The Nasdaq Composite Index measures the market value of all domestic and foreign common stocks, representing a wide array of more than 5,000 companies, listed on the Nasdaq Stock Market. You cannot invest directly in an index.
3. The Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based benchmark that measures the investment-grade, U.S.-dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, mortgage-backed securities (agency fixed-rate and hybrid adjustable-rate mortgage pass-throughs), asset-backed securities, and commercial mortgage-backed securities. You cannot invest directly in an index.
4. The Personal Consumption Expenditures (PCE) Index is the primary measure of consumer spending on goods and services in the U.S. economy. It accounts for about two-thirds of domestic final spending and is part of the personal income report issued by the Bureau of Economic Analysis of the Department of Commerce. You cannot invest directly in an index.
5. 100 bps = 1.00%
6. LOIS is the spread between the 3-month LIBOR (the London Interbank Offered Rate) and the Overnight Indexed Swap (OIS). The LIBOR-OIS spread represents the difference between an interest rate with some credit risk built in and one that is virtually risk free.
7. 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.
8. Variable-rate demand notes (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.
9. A tender option bond (TOB) is a type of VRDN where a long-term bond is placed into a trust. Floating-rate securities are created from the trust.

For more information, please contact:

Institutional Sales Desk:
1-888-253-6584

Website: **wfam.com**

(Click "Select Your Role" in the top navigation and select "Institutional Cash Investor")

**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 April 30, 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 Fund 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 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 wfam.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

© 2019 Wells Fargo Funds Management, LLC. All rights reserved. FN-401987 IHA-6509010

FASS301 05-19