Wells Fargo Money Market Funds

WELLS FARGO Asset Management

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PORTFOLIO MANAGER COMMENTARY

Overview, strategy, and outlook

As of October 31, 2019

Money market overview: A good place

On October 30, the Federal Reserve (Fed) delivered the third of its mid-cycle adjustment easings, thus completing its validation of the rally in the fixed-income markets over the preceding quarters. As Fed Chair Jerome Powell noted in the opening remarks to his press conference, *"We took this step to help keep the U.S. economy strong in the face of global developments and to provide some insurance against ongoing risks."* Signaling that this insurance cut likely brought the Fed's easing policies to a pause, Powell noted its current stance would be appropriate as long as economic conditions continued to evolve according to the Fed's expectations. While the Fed's actions and words have soothed bond markets somewhat, markets were still factoring in the possibility of another cut to the federal funds target range in December, and at 26% it was unchanged from expectations prior to the October meeting!

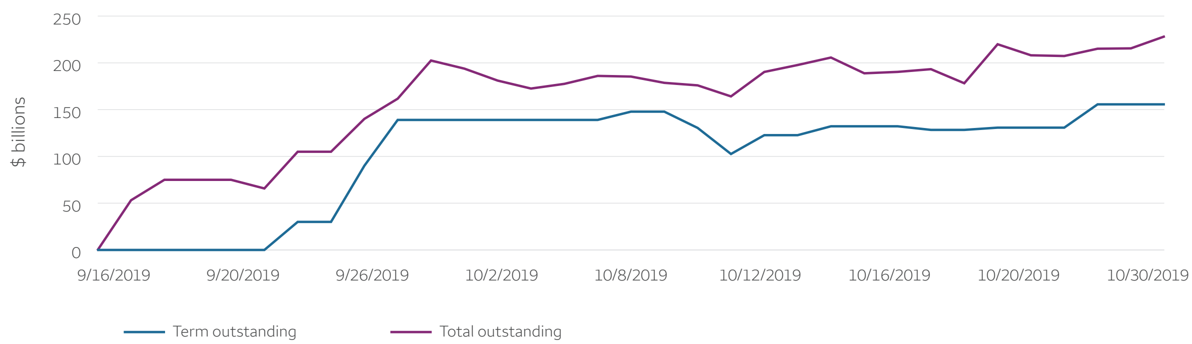
In addition to adjusting its target range for interest rates, the Fed has been busily taking steps since mid-September to ensure market interest rates stay within that range, as we discuss in detail in this commentary. With each step the Fed's taken, it's been sure to remind us that these actions don't represent changes in monetary policy and, during the post-meeting press conference, Chair Powell went on to further differentiate these reserves-management operations from monetary policy. To ensure market participants would not mistakenly interpret them as a change in monetary policy, he stated, *"These actions are purely technical measures to support the effective implementation of monetary policy as we continue to learn about the appropriate level of reserves."* In the following sections, we discuss more of the specifics related to these two operations.

Sector views

U.S. government sector

The Fed's initial response to mid-September's repurchase agreement (repo) market volatility was to immediately begin providing cash to the market in the form of overnight and term open market operations (OMOs). We suspected last month that this wouldn't be the full extent of the Fed's efforts, and the Fed didn't disappoint as it began buying Treasury bills (T-bills) in October to build banking system reserves back up to a point where they are functionally ample. As an overview of the current state of these affairs, the Fed's commitment to the cause of repo rate containment is to engage in OMOs at least into next January and to buy T-bills at least into the second quarter of 2020 at an initial pace of $60 billion per month. On the OMO front, as shown in the chart below, the Fed provided over $200 billion of cash to the repo market at the end of October.

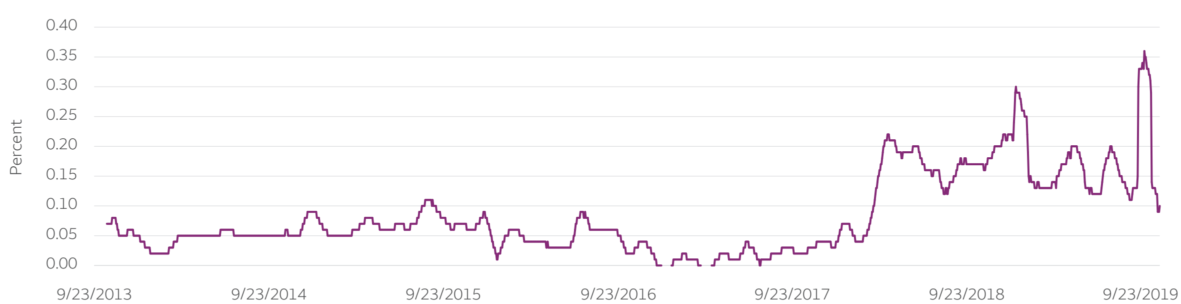
Fed repo interventions



Sources: Federal Reserve Bank and Bloomberg L.P.

The Fed's various interventions have been a big success, as both repo rates and the Fed's target rate, the effective federal funds rate (EFFR), have traded to relative lows not seen in over a year. Basically, those rates had spent most of the year in the upper half of the Fed's target range, and now they've been pushed by the big bully down into the lower half of the range. Given the ammunition available to the Fed, the new lower rate range may well endure. As shown below, following the mid-September spike, the spread of the average tri-party repo rate over the bottom of the Fed's target range has moved to levels not seen since the spring of 2018, when the U.S. deficit and Treasury issuance began to surge. If early indications are correct and the Fed does in fact succeed in consistently suppressing rates, the higher rates of the past 18 months may turn out to have been a happy aberration (not an apparition, although it was recently Halloween).

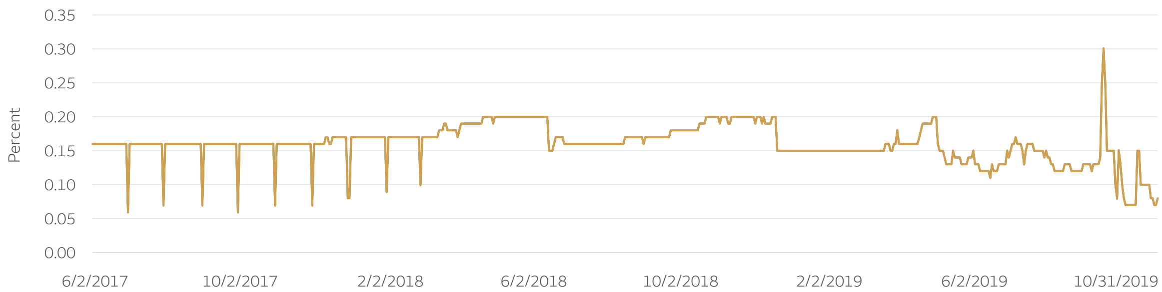
Tri-party repo spread over Fed's target range bottom



Sources: Federal Reserve Bank and Bloomberg L.P.

As for the EFFR, the chart below indicates that it, too, has been marked down about 10 basis points (bps),[1] leaving the Fed feeling satisfied. For borrowers, it's like they're part of the Peanuts gang on Halloween: "I got five pieces of candy! I got a chocolate bar!" Investors, on the other hand, now know how Charlie Brown felt when he looked in his Halloween bag and said, "I got a rock." This disappointed feeling perhaps stems from the fact that the Fed's actions may not only suppress repo rates but also weigh on the T-bill market, setting the stage for an unpleasant few quarters where investors will be regularly competing with the Fed when making investments.

Excess of EFFR over bottom of Fed's target range



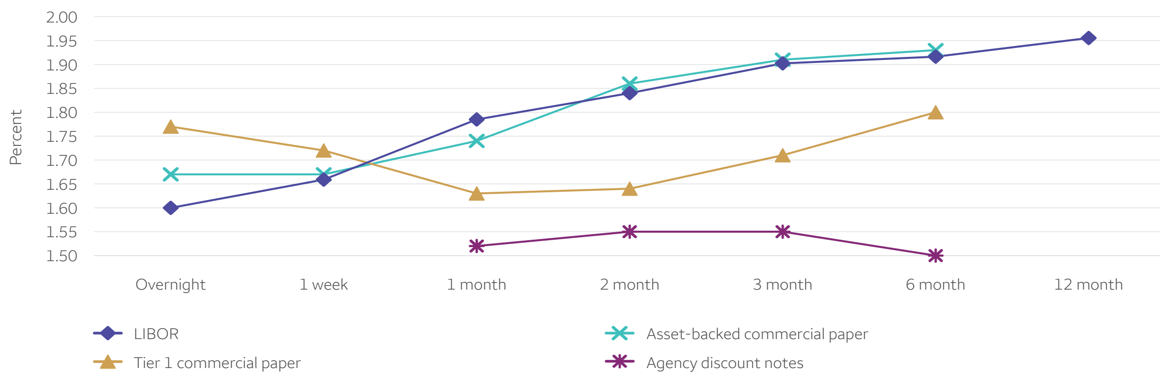
Sources: Federal Reserve Bank and Bloomberg L.P.

Prime sector

As expected, the Federal Open Market Committee (FOMC) lowered its target rate range 25 bps to 1.50% to 1.75% at the conclusion of its October meeting. This rate adjustment makes it three consecutive meetings that the FOMC has lowered its target rate by 25 bps and was implemented universally across all rates that the Fed controls. As you'll recall, the 25-bp ease in the federal funds target range at the September meeting was accompanied by the FOMC adjusting the reverse repo program and interest on excess reserves down by 30 bps in an effort to keep the effective fed funds rate within the target range. The Fed modified its approach to control effective rates by using overnight and term repo as well as open market T-bill purchases to ensure ample supply of banking reserves are in the system.

The accompanying statement and press conference delivered the message that the October rate cut was the final step of the mid-cycle adjustment. The FOMC removed the assurance to *"act as appropriate to sustain the expansion"* from the meeting statement and replaced it with a more neutral stance, promising to *"monitor the implications of incoming information for economic outlook as it assesses the appropriate path of the target range for the federal funds rate."* And during the ensuing press conference, Chair Powell set a high bar for further rate cuts in noting that the cumulative easing to date will continue to provide support for the economy as monetary policy stimulus traditionally operates with a lag. He also mentioned uncertainty surrounding trade conflicts and Brexit seems to have subsided. Finally, he offered a constructive economic assessment by mentioning the consumer continues to drive the economy and hasn't been affected by weakness in other areas. Market pricing after the announcement adjusted to reflect a Fed truly data dependent and mostly on hold with a slight chance of further rate cuts if global growth slows further or the economy takes an unexpected downturn.

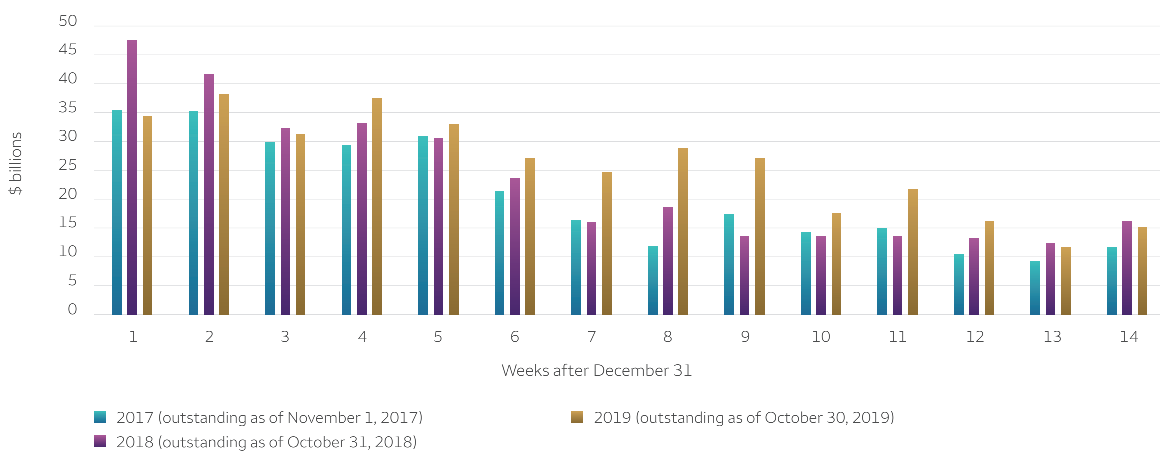
Money market yield curves as of 10/31/2019



Sources: Federal Reserve Bank and Bloomberg L.P.

The annual year-end funding rite is upon the money markets. As of October 30, 2019, the percent of commercial paper outstanding that matures after the end of the year is 39.5%, an amount that is higher compared with the past several years at about the same time. While the pressure on issuers to extend over year-end for regulatory requirements remains the same, this year we are in a decreasing (or perhaps static) yield environment as opposed to the past several year-ends where rates were expected to rise. In years past, investors waited to extend over year-end as rates were expected to rise, thus favoring shorter maturities that reset more frequently. As the Fed informed us, even though the mid-cycle adjustment is over, the risk is for lower, not higher, rates. Consequently, investors have tended to buy longer-dated securities to lock in higher yields, a pattern that is evident in the Fed maturity chart that tracks weekly statistics on commercial paper maturing after year-end.

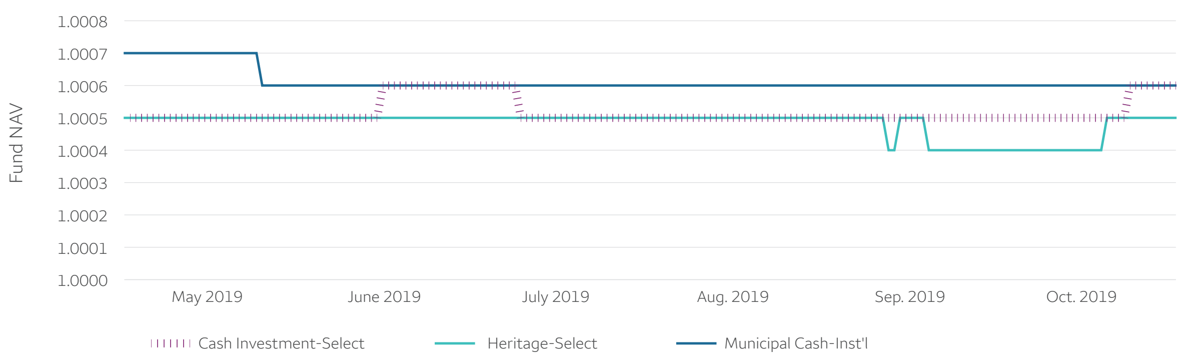
Weekly pattern of commercial paper maturing after December 31



On the international front, the British Parliament avoided the usual political brinkmanship as Boris Johnson got to a "second reading" of his Brexit Withdrawal Agreement Bill, meaning the principles proposed could be debated. But the timetable for the exit package negotiated with the European Union (EU) couldn't get an "expeditious" (read: no time to study the details) vote by the October 31 exit deadline. So, another extension to January 31 has been granted by the EU—dubbed a "flextension" for its provision allowing early termination in case a deal is ratified by Members of the European Parliament—and a general election has been called in the United Kingdom (U.K.) to take place December 12. The victorious party will determine if and when the U.K. exits Europe. If Johnson's Conservative party wins, expect his withdrawal terms to prevail. If the Liberal Democrats win, expect a new public vote. More to come.

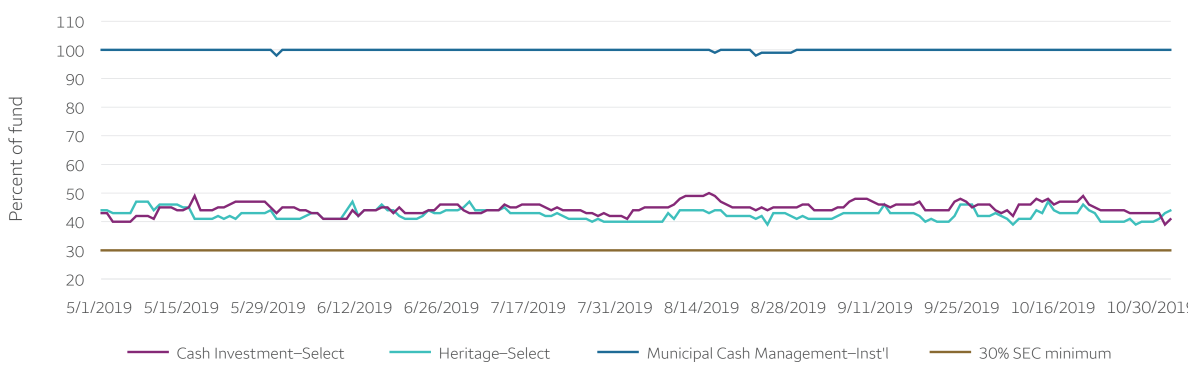
In anticipation of the FOMC ending the mid-cycle adjustment, we increased our weighted average maturities (WAMs)[2] and weighted average life (WAL)[3] on our portfolios to capture higher yields and wider spreads. As always, we continue to construct portfolios in a conservative manner to maintain a high degree of liquidity and minimal net asset value (NAV) adjustments.

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

Yields in the municipal money market sector began to normalize following a mini spike in short-term rates during the volatile month of September. After reaching a multi-month high of 1.58% on September 25, the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Index[4] fell for five straight weeks to close out the month at 1.12%, or 67% of 1-week LIBOR. Demand for overnight and weekly variable-rate demand notes (VRDNs)[5] and tender option bonds (TOBs)[6] strengthened throughout the month as municipal money market funds were the recipients of approximately $1.5 billion of inflows during the month, according to Crane Data. The drop in short-term municipal rates effectively priced in the Fed's rate cut from September 18, just on a one-month lag. The potential impacts from the FOMC's October 30 rate cut should become apparent next month.

The municipal money market yield curve steepened as rates in the short end of the market fell precipitously throughout the month. Overnight rates dropped as much as 60 bps from September highs, while yields on high-grade notes and bonds in the one-month to three-month space drifted lower by roughly 15 bps to the 1.10%–1.15% area. Further out on the curve, yields on high-grade one-year paper stabilized after September's backup, with rates settling in the 1.22% area. The municipal yield curve closed out the month with a positive sloping yield curve for the first time since early June.

During the month, we continued to emphasize principal preservation and liquidity by targeting our purchases on VRDNs and TOBs with daily and weekly puts. The persistence of a flat to inverted municipal money market yield curve offers little incentive to aggressively extend our portfolio's maturity profile. We continue to feel that the short end of the municipal yield curve offers value in terms of attractive nominal and after-tax returns for municipal investors.

On the horizon

We are quickly progressing toward the end of the year. And for the first time in what seems like a long time, we're not really anticipating any year-end Fed action. Since the Fed will be out of the news, we will look to Washington to fill the void. The House is scheduled to be in session for only four weeks until it breaks for Christmas on December 12. This brings to mind two scenarios. First, the impeachment investigation heats up and increases speed to come to a resolution by mid-December. Second, the investigation carries on at its current pace and does not come to a speedy conclusion, dragging on into the new year. Either outcome has the potential for affecting volatility in risk assets, though the second would likely cause the timing to be less accelerated than the first. While not necessarily good news for their holders, it's not unusual to see a knock-on effect from such volatility in the form of increased flows into the money markets as a sort of perceived refuge from market gyrations. Time will tell how this all plays out, but based on these as well as seasonal factors, money markets seem poised to hit new highs in total assets under management. Stay tuned!

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

Sector	1 day	1 week	1 month	2 month	3 month	6 month	12 month
U.S. Treasury repos	1.73	1.63	–	–	–	–	–
Fed reverse repo rate	1.45	–	–	–	–	–	–
U.S. Treasury bills	–	–	1.48	1.51	1.50	1.51	1.46
Agency discount notes	1.43	1.45	1.52	1.55	1.55	1.50	1.42
LIBOR	1.60	1.66	1.78	1.84	1.90	1.92	1.96
Asset-backed commercial paper	1.67	1.67	1.74	1.86	1.91	1.93	–
Dealer commercial paper	1.77	1.72	1.63	1.64	1.71	1.80	–
Municipals	1.31	1.12	1.13	1.13	1.13	1.15	1.22

Sources: Bloomberg L.P. and Wells Capital Management
Past performance is no guarantee of future results.

Wells Fargo Fund	7-day current yield
Cash Investment MMF*–Select	1.94%
Heritage MMF*–Select	1.95%
Municipal Cash Management MMF*–Inst'l	1.10%
Government MMF**–Select	1.75%
Treasury Plus MMF**–Select	1.71%
100% Treasury MMF**–Inst'l	1.63%

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 reimbursement through May 31, 2020. Brokerage commissions, stamp duty fees, interest, taxes, acquired fund fees and expenses (if any), and extraordinary expenses are excluded from the expense 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 1.83%, 1.86%, 0.99%, 1.67%, 1.62%, and 1.60%, respectively, and the total returns would have been lower. Prior to or after the commitment expiration date, 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

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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. Weighted average life (WAL): An average of the final maturities of all securities held in the portfolio, weighted by their 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. The calculation of WAL allows for the maturities of certain securities with demand features to be shortened but, unlike the calculation of WAM, does not allow shortening of the maturities of certain securities with periodic interest rate resets. WAL is a way to measure a fund's potential sensitivity to credit spread changes. WAL is subject to change and may have changed since the date specified

4. The Securities Industry and Financial Markets Association (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.

5. 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.

6. 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 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

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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 October 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 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 Asset Management disclaims any obligation to publicly update or revise any views expressed or forward-looking statements.

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