Wells Fargo Money Market Funds

WELLS FARGO Asset Management

Contributing authors

Jeff 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

PORTFOLIO MANAGER COMMENTARY

Overview, strategy, and outlook

As of January 31, 2020

Sector views

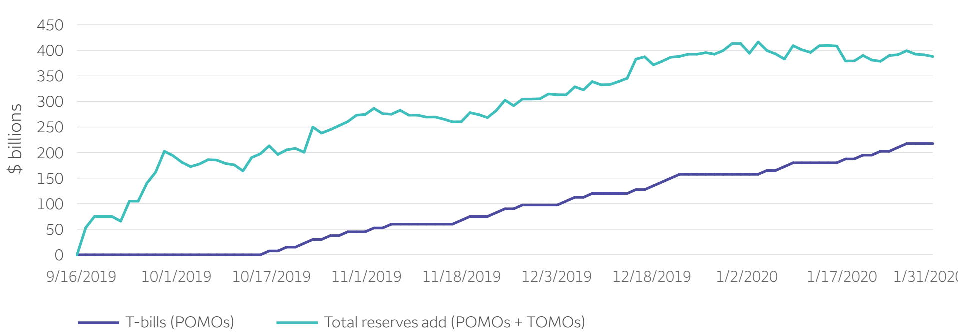
U.S. government sector

New Year's Eve, marking the close of one decade and the debut of another, was a celebration worthy of fireworks, but they were conspicuously absent in the money markets. Just as year-end came and went without a hint of dislocation, January also passed with barely a whisper of volatility, demonstrating the effectiveness of a Federal Reserve (Fed) committed to reining in the repo market.

The Fed had three pieces of news for the money markets as it concluded its meeting on January 29. First, there was no change in its interest rate target range, and it is comfortable with its rate stance.

Second, its repo market interventions in the form of Treasury bill (T-bill) purchases (labeled permanent open market operations, or POMOs) and direct repo injections (called temporary open market operations, or TOMOs) will continue through at least April, with the effectiveness of the former eventually and gradually making the latter unnecessary. The degree to which the transition is already under way is displayed in the chart below, with POMOs making up an ever-greater share of the total Fed interventions.

Reserves management operations



Source: Bloomberg L.P.

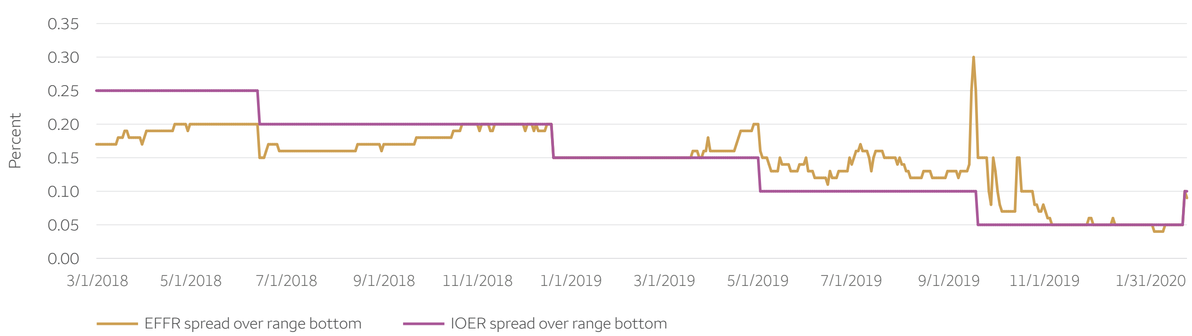
The Fed's impact on the repo market has been overwhelming, with rates driven down nearly to the bottom of the Fed's target range, as shown below.

Tri-party repo spread over Fed range bottom, 4-week moving average

Sources: Federal Reserve Bank and Bloomberg L.P.

Third, because the POMOs and TOMOs have been too successful in suppressing rates, the Fed made a technical adjustment to its two administered rates, reverse repurchase agreements (RRP) and interest on excess reserves (IOER), bumping each up by 5 basis points (bps).[1] The interest rate measure that the Fed targets to implement monetary policy is the effective federal funds rate (EFFR), the recent history of which is shown in the chart below. Each of the four times the EFFR has gotten to within 5 bps of the top of the target range in the past two years, the Fed has made a 5-bp technical adjustment lower in the IOER rate. Turnabout is apparently fair play, as in this case the EFFR had moved to within 5 bps of the bottom of the range, necessitating the Fed's tweak. Look for the Fed to continue to fine-tune its monetary policy implementation to strike a balance between POMOs, TOMOs, and its administered rates to keep the EFFR near the middle of the target range.

EFFR and IOER adjustments



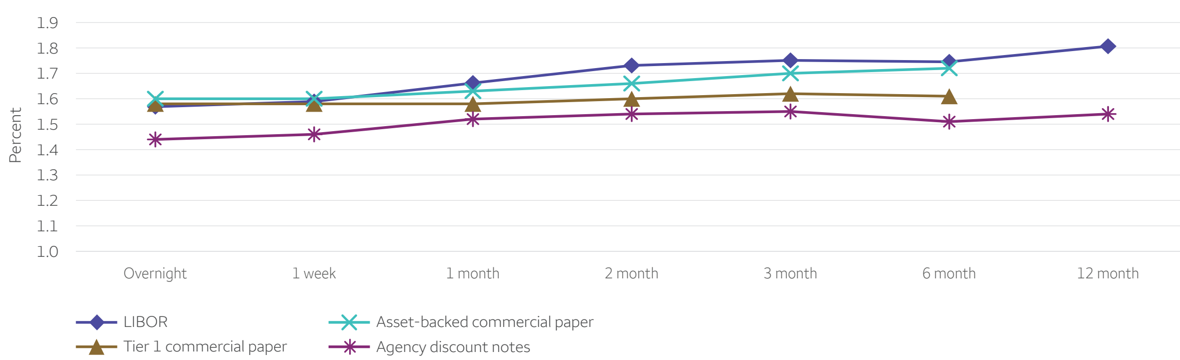
Sources: Federal Reserve Bank and Bloomberg L.P.

Prime sector

As expected, the Fed left its target rate range unchanged at 1.50% to 1.75% at the conclusion of the January Federal Open Market Committee (FOMC) meeting. The corresponding policy statement was little changed from the December statement and indicated a willingness by the FOMC to act as appropriate to continue to support economic expansion and achieve inflation and inflation expectations symmetrically around 2%. As previously noted, the committee did make one change by increasing the rate paid on IOER and RRP by 5 bps to 1.60% and 1.50%, respectively. This technical adjustment was designed to lift the EFFR closer to the middle of the 1.50%–1.75% target range instead of closer to the lower bound where it has been averaging prior to the meeting.

With the FOMC on hold and the market pricing in a greater risk of potential rate cuts later this year, the money market yield curve has flattened. Since year-end, the one-month London Interbank Offered Rate (LIBOR) has fallen by 10 bps to 1.66% and one-year LIBOR is lower by 19 bps to 1.80%. The three- and six-month "belly" of the curve is down roughly 15 bps to yield 1.75% each. The change in LIBOR, however, doesn't reflect the dramatic change in yields available in the market. During the fourth quarter of 2019, commercial paper or certificate of deposit issuers were paying a yield 5 bps to 10 bps **above** the corresponding LIBOR to obtain fixed funding, whereas by the end of January, that same term issuance was 5 bps to 10 bps **less** than corresponding LIBOR.

Money market yield curves as of 1/31/2020



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

A situation exacerbating the yield shift is lackluster supply due to calendar timing. January is a notoriously slow issuance month. Many issuers that raised money to ensure funding over year-end did so with maturities extending to early- to mid-February, at the earliest, in order to meet regulatory requirements. Funds, on the other hand, generally held extra liquidity at year-end to cover unexpected cash flows, planning to invest any extra liquidity back into the market after the calendar turn. As a result, January turned into a bit of a food fight with investors pouncing on the reduced issuance and driving rates lower.

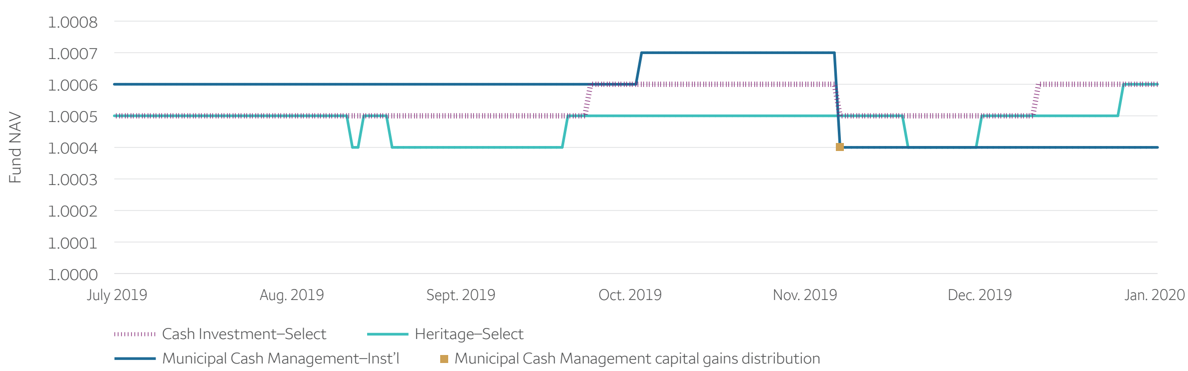
As the yield on fixed-rate paper declined, attention shifted to floating-rate notes. But in a similar vein, a lack of maturities in January caused issuers to look for opportunistic funding, which was met with great demand, in turn causing floating-rate spreads to narrow. The LIBOR-OIS chart on the next page illustrates the direction of credit spreads in the money market space. As you may recall, the LIBOR-OIS spread is the difference between the London Interbank Offered Rate (LIBOR) and the Overnight Index Swap (OIS) 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

Source: Bloomberg L.P.

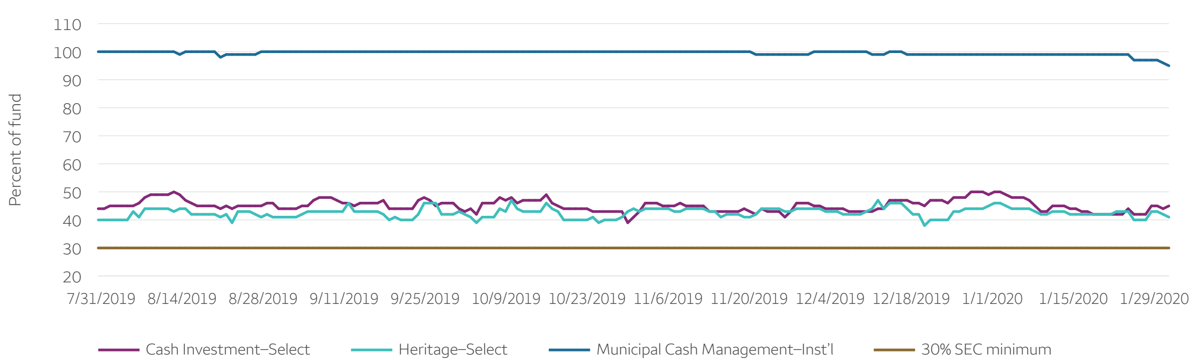
Going forward, money market rates will continue to look toward the FOMC and other market indicators for future rate guidance. In addition to the FOMC being on hold, the supply of and demand for money market products will contribute to portfolio positioning, with increased supply possibly pausing the yield-curve flattening. Our strategy of emphasizing highly liquid portfolios, opportunistically extending weighted average maturities (WAMs),[2] and maintaining positions in securities that reset frequently should allow us to capture elevated LIBOR levels with minimal net asset value (NAV) pricing pressures.

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

The short end of the municipal money market space continued to exhibit a high level of volatility as seasonal flows resulted in a roller-coaster ride for rates on variable-rate demand notes (VRDNs)[3] and tender option bonds (TOBs).[4] The Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Index,[5] which had spiked to 1.61% (99% of 1-week LIBOR) to close out 2019, quickly fell to 0.80% (51% of 1-week LIBOR) as strong seasonal demand overwhelmed available supply during the first two weeks of the new year. Yields on overnight high-grade paper fell even more dramatically, falling from roughly 1.65% to as low as 0.45%.

Municipal money market funds were the recipients of approximately $4 billion in inflows during the first week of the month, according to Crane Data. However, as the month progressed, municipal money market funds eventually experienced consistent outflows that erased the early-month gains. Accordingly, rates began to normalize, with the SIFMA Index gradually rising before closing out the month at 0.94% (60% of 1-week LIBOR). Overnight rates spiked to as high as 1.15% at month-end, more than double levels seen earlier in the month. Further out on the curve, strong demand for high-grade one-year paper carried over into the new year, exerting consistent downward pressure on rates. Yields in the one-year space closed out the month at roughly 0.95%, down from roughly 1.15% at the end of December. Continued strong inflows into municipal bond funds are still contributing to downward pressure on rates across the curve.

During the month, we continued to focus our purchases primarily in VRDNs and TOBs with daily and weekly puts in order to emphasize principal preservation and fund liquidity. The municipal money market yield curve remains relatively flat, and we have remained highly selective in deploying cash for investments further out on the curve. 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

It's time for our annual roundup of the year in credit, which will be our focus piece for next month. We will examine credit trends for the past year and focus on timely, sector-specific topics in the money markets. Barring any unforeseen market developments, we will be back at the end of March with more market commentary, just in time for tax day.

Rates for sample investment instruments—current month-end % (January 2020)

Sector	1 day	1 week	1 month	2 month	3 month	6 month	12 month
U.S. Treasury repos	1.57	1.57	–	–	–	–	–
Fed reverse repo rate	1.50	–	–	–	–	–	–
U.S. Treasury bills	–	–	1.45	1.53	1.51	1.49	1.39
Agency discount notes	1.44	1.46	1.52	1.54	1.55	1.51	1.54
LIBOR	1.57	1.59	1.66	1.73	1.75	1.75	1.81
Asset-backed commercial paper	1.60	1.60	1.63	1.66	1.70	1.72	–
Dealer commercial paper	1.58	1.58	1.58	1.60	1.62	1.61	–
Municipals	1.19	0.94	0.87	0.88	0.89	0.91	0.95

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	1.70%
Heritage MMF*–Select	1.72%
Municipal Cash Management MMF*–Inst'l	0.80%
Government MMF**–Select	1.52%
Treasury Plus MMF**–Select	1.51%
100% Treasury MMF**–Inst'l	1.42%

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, to cap the funds' total annual fund operating expenses after fee waivers. 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 1.58%, 1.61%, 0.69%, 1.43%, 1.41%, and 1.38%, 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.

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")

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. 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.

4. 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.

5. 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.

**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 January 31, 2020, 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.

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.

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