WELLS FARGO Asset Management

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PORTFOLIO MANAGER COMMENTARY

Overview, strategy, and outlook

As of March 31, 2020

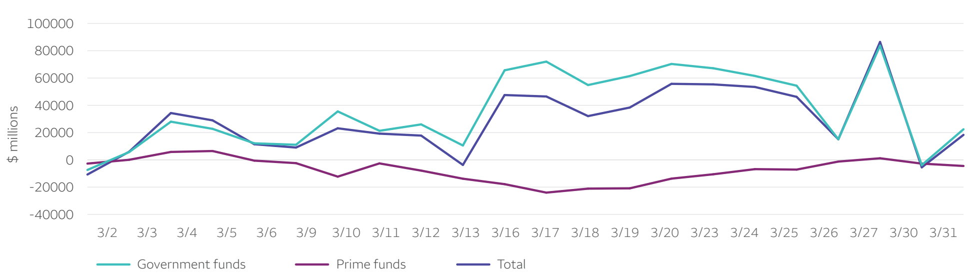
Money market overview

In our February commentary, we noted that the coronavirus could pose a threat to economic growth in the coming months. We apparently were not alone in this thought. As February turned to March, it became clear that the virus had jumped borders and became more widespread in a shorter period than seemed possible only a few weeks prior. Concerns over economic growth and corporate profits soon heightened as the prospect of a pandemic grew. Coupled with an oil shock in the first week of March as Russia and Saudi Arabia battled over production, investors accelerated a search for a safe haven and liquidity that had quietly begun in the last week of February. As a result, in the four weeks ending March 25, Lipper[1] reported over $66 billion flowed out of equity funds and over $138 billion flowed out of bond funds.

It is not unusual for money market funds to be the beneficiaries of risk-off trades, and so it probably comes as no surprise that the big news in money markets this month was money markets.

The magnitude of the story, however, was breathtaking: As Lipper reported in the midst of the fray, industry flows into money market mutual funds were the biggest seen in records dating back to January *1992*. From March 2 to March 31, over $625 billion of new money flowed into money market funds, an increase of 16%. Virtually all of that money flowed into government and Treasury funds, which also attracted an additional $160 billion from prime funds as investors shunned risk assets and gravitated toward the traditionally perceived safe harbor of government funds. All told at the end of the month, government and Treasury funds had increased by over 29.9%, attracting $790 billion, while prime funds had contracted by 15%. And the municipal sector was not immune either: Although they occurred on a slightly smaller scale than that experienced in the taxable sector, municipal money market funds experienced net redemptions of $5.8 billion, or a reduction of 4.2%.

Money market industry flows—March 2020



Source: Crane Data

In response to volatility in the short-term markets, the Federal Reserve (Fed) unleashed a veritable alphabet soup of facilities designed to backstop money market funds, free up dealer balance sheets, and help smooth the functioning of fixed-income markets. We will discuss those programs below, but first we will examine the direct actions of the Fed to improve system liquidity and functioning.

Sector views

U.S. government sector

Demonstrating that one of the lessons the Fed learned from the Global Financial Crisis was to be aggressive, the Fed acted early and large to begin to temper the effects of the coronavirus and to keep the financial markets functioning properly as they assessed the economic impact.

The Fed kicked things off by lowering interest rates on March 3, moving the lower end of its target range from 1.50% to 1.00%. As conditions in the markets worsened, on Sunday night, March 15, three days ahead of its regularly scheduled meeting, it took away the remainder of the cost of money, lowering the target range to 0.00% to 0.25%. For those keeping score at home (which is nearly everyone at this point), the reverse repurchase agreement (RRP) and interest on excess reserves (IOER) rates were set at 0% and 0.10%, respectively.

With the Sunday night 1% cut in interest rates, the Fed also began quantitative easing (QE) again in earnest, pledging to buy at least $500 billion in Treasuries and $200 billion in mortgage-backed securities over the coming months. The Fed began at a seemingly rapid pace, buying about $180 billion in the first four days, when it realized that market stresses required it to move even faster. By the end of March, the Fed had declared that it would buy as much as it needed to, without limits, and in just over half a month, the Fed bought about $820 billion in Treasuries and $290 billion in mortgages. The speed and scale of this operation is unprecedented, and it provided sufficient liquidity to restore market functioning.

One of the secondary impacts of moving a large slice of outstanding government securities from private hands to the Fed's balance sheet was to remove the need for private holders to fund the assets in the repo market. This took a chunk of supply out of the repo market, but it was just one of three large forces acting on that market. The second was the flood of money—$790 billion—that poured into government and Treasury money market funds in March, boosting demand. The third was the Fed throwing incredible firepower at the repo market, ensuring that anyone who needed funding could find it. Beginning around that fateful March 15 weekend, the Fed began offering $1 trillion in overnight repo each day, as well as offering two-week, one-month, and three-month term repos every week in amounts up to $90 billion, $500 billion, and $500 billion, respectively. Because of the decreased supply and heavy demand as discussed above, borrowers have not needed anywhere near the notional amounts offered by the Fed. As of March 31, the total term repo outstanding was $262 billion, and the overnight repo that day totaled just $0.3 billion.

The extent to which the demand expansion and supply contraction have combined to materially affect the repo market can be seen in two indicators. First, the Secured Overnight Financing Rate (SOFR)[2] registered an all-time low of 0.01 for the quarter's last week. Second, the Fed's recently nearly dormant RRP program, where excess money in the repo market goes when it has no other home, suddenly began taking in large amounts, including $285 billion on March 31. If you are wondering if you're reading the overall picture correctly: Yes, the Fed is on both sides of the repo market, lending hundreds of billions at 0.10% and borrowing hundreds of billions at 0%. It's a good gig if you can get it.

For investors, it obviously has been a trying month. Repo began the month earning around 1.60% and ended it at 0.01%. With the uncertainty surrounding the duration of the social shutdown, the degree of economic contraction, and the pace of recovery, it's difficult to project how long rates will be at zero, although last time the answer was seven years. One question we'll be answering soon is whether "zero" means actually zero or somewhere else within the Fed's range for instruments like repo and Treasury bills (T-bills). In the short term, the Treasury will need to fund the government's historic $2 trillion rescue plan, and it has typically met short-term cash needs largely with T-bills. Those extra T-bills should balance out the robust demand at least to some extent. Our first look at a potential market impact came on March 30, when 3- and 6-month T-bills were auctioned at 0.085% and 0.100%, respectively, compared with the prior week, which had yet to see a fiscal rescue package become law, when the auctions stopped at 0.00% and 0.08%, respectively. While these auctions were encouraging, there are likely to be many twists and turns ahead.

For the Wells Fargo Funds, the challenge has been, and will continue to be, finding investments for all of the new cash flowing into the space. The flexibility offered by funds that can invest in repo has been particularly welcome as interim supply and demand dynamics have forced some Treasury securities temporarily into negative territory. We continue to diligently search for investment alternatives with a positive yield while maintaining a high degree of liquidity for investors.

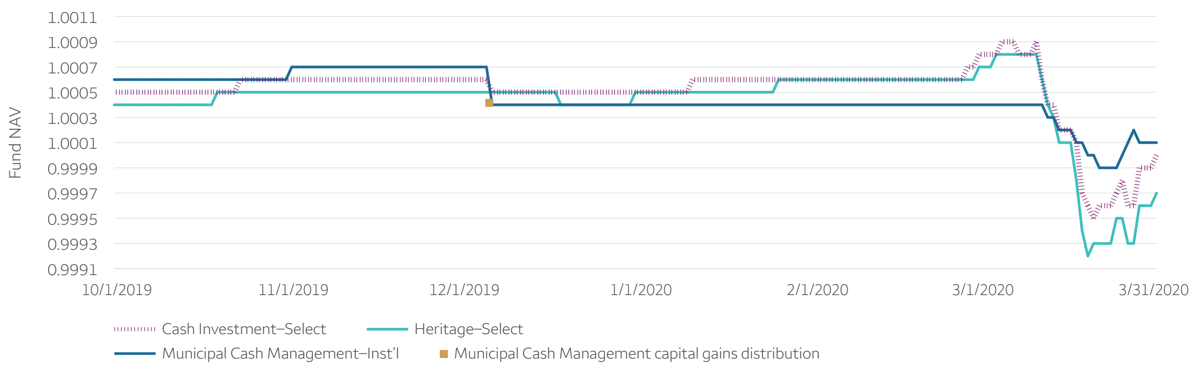
Prime sector

In times of market stress, the demand for liquidity increases across all asset classes as investors adjust to a rapidly evolving risk event—in this case, the coronavirus. As bank balance sheets have benefited from recent regulation focusing on capital requirements and leverage ratios, these same regulations have hampered their ability to provide intermediation in markets—specifically to make markets in securities that they sell—and so have proven to be somewhat limiting. The Fed recognized this quickly and swiftly took the lead with implementing a slew of programs to deal with the liquidity crisis by dusting off its playbook from the Global Financial Crisis. The collective goal for each of these programs is to support the credit needs of American households and businesses and to restart the flow of capital through improved functionality of all capital markets. Below is a brief description of these programs:

- Primary Market Corporate Credit Facility (PMCCF): The PMCCF will allow companies access to credit so that they are better able to maintain business operations and capacity during the period of dislocations related to the pandemic. This facility is open to investment-grade companies and will provide bridge financing for up to four years.
- Secondary Market Corporate Credit Facility (SMCCF): The SMCCF will purchase in the secondary market corporate bonds issued by investment-grade U.S. companies and U.S.-listed exchange-traded funds whose investment objective is to provide broad exposure to the market for U.S. investment-grade corporate bonds.
- Term Asset-Backed Securities Loan Facility (TALF): The TALF will enable the issuance of asset-backed securities (ABS) backed by student loans, auto loans, credit card loans, loans guaranteed by the Small Business Administration (SBA), and certain other assets.
- Money Market Mutual Fund Liquidity Facility (MMLF): The MMLF was established to support the flow of credit to households and businesses. The Federal Reserve Bank of Boston will make loans available to eligible financial institutions secured by high-quality assets purchased by the financial institution from money market mutual funds. Money market funds are common investment tools for families, businesses, and a range of companies. The MMLF will assist money market funds in meeting demands for redemptions by households and other investors, enhancing overall market functioning and credit provision to the broader economy.
- Commercial Paper Funding Facility (CPFF): The CPFF was established to support the flow of credit to households and businesses. Commercial paper markets directly finance a wide range of economic activity, supplying credit and funding for auto loans and mortgages as well as liquidity to meet the operational needs of a range of companies. By ensuring the smooth functioning of this market, particularly in times of strain, the Fed is providing credit that will support families, businesses, and jobs across the economy.

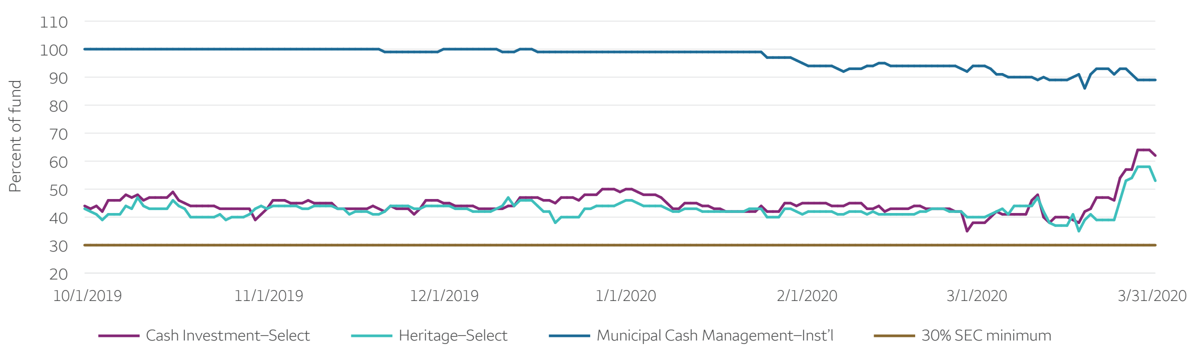
The MMLF has proven particularly effective in providing liquidity support for money market funds, as the banks participating in this facility are exempt from risk-based capital and leverage requirements. This exemption allows banks to intermediate the flow of credit and support market prices and liquidity. As a result, prices in money market securities stabilized and have rebounded and market liquidity has improved. With the introduction of the MMLF, much of the pressure from shareholder redemptions—as well as the pace of those redemptions—has subsided. Nonetheless, we recognize that while we are three weeks into this volatile period, we are still only three weeks into this coronavirus-induced crisis. Our focus is on maintaining and growing liquidity in the funds, as can be seen below, in order to meet our shareholder expectations. We anticipate maintaining higher-than-normal liquidity levels in the near future until we can determine that conditions in the markets have begun to normalize.

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

As pandemic concerns roiled the global markets, the short end of the municipal market was not immune to the liquidity pressures experienced in other markets. During the second week of the month, a sudden and dramatic burst of redemptions from municipal bond funds resulted in heavy selling of variable-rate demand notes (VRDNs)[3] and tender option bonds (TOBs)[4] as well as short-term notes as managers sought to raise liquidity to meet outflows. By mid-month, redemptions began to spread to municipal money market funds as well, adding further pressure on supply. The rapid rise in VRDN inventories reflected the need for managers to raise liquidity quickly rather than concerns about the creditworthiness of the municipal issuers and third-party letter-of-credit providers on the securities.

The Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Index[5] rapidly spiked to 5.20%, a level last seen in 2008, up from 1.15% at the end of February. Further out on the curve, levels on one-year high-grade paper, which had fallen to a low yield of 0.68% at mid-month, quickly gapped to as high as 2.50% as selling pressure moved from variable-rate paper to the fixed-rate space.

Shortly after it introduced the MMLF to backstop prime money market funds, the Fed expanded the list of securities eligible for the MMLF to include municipal money market funds and their holdings of certain municipal securities, which provided additional support to the municipal markets and led to a surge in demand for VRDNs. Rates on overnight paper, which had spiked to as high as 7.50% on average during the middle of the month, rapidly fell to as low as 0.75% at month-end. The SIFMA Index, which resets weekly, fell to 4.71% on March 25, just two days after the MMLF program was implemented. With weekly inventories rapidly falling over the last few days of the month, we expect the SIFMA Index will fall back into the 1.00%–1.50% range in early April. The short-term notes market recovered as well, with one-year paper falling to 1.34% after reaching a mid-month high of 2.14%

During the month, we continued to focus our purchases primarily in VRDNs and TOBs with daily and weekly puts. By structuring our funds with an overweight in the short end of the municipal curve, we were well positioned to withstand market volatility and actually benefited from the rapid spike in the SIFMA Index. Looking ahead, we expect the municipal money market space to continue to normalize as we enter a new phase of the zero interest rate policy. In this environment, we expect to maintain our steadfast commitment to maintaining high degrees of liquidity while focusing on principal preservation.

On the horizon

The magnitude of March's flight to quality and liquidity has inevitably drawn comparisons to the Global Financial Crisis in 2008. For money market funds, the similarities depend on which sector you're examining. As the table below indicates, both government and prime funds experienced relatively similar rates of inflows and outflows in 2008 and 2020. However, due to the post-reform changes in the relative sizes of the funds, the actual dollar amounts involved differed—in the case of government funds, quite dramatically. The 2008 period also affected institutional prime money market funds to a greater degree than the present period, though again the rate of change on the government sector was quite similar.

	September 2008		March 2020	
	$ change (billions)	% change	$ change (billions)	% change
All funds	(175)	(4.9)	624	15.8
All government[6] funds	261	28.2	790	29.9
All prime funds	(341)	(15.1)	(160)	(14.6)
Institutional government[6] funds	217	31.1	663	33.3
Institutional prime funds	(313)	(23.4)	(116)	(10.6)

Sources: ICI, Bloomberg, and Crane Data

In spite of those similarities, the key difference between the two is the credit environment—specifically the health of the financials sector. In 2008, there were real questions about which financial institutions would survive, and at times it seemed some parts of the system were on the verge of collapse. This time around, we do not view current market volatility as a credit event, primarily due to the fact that the conditions of financial institutions' balance sheets are much more sound than they were 12 years ago, thanks to some of the postcrisis regulations. In our view, current volatility in pricing is due to market participants' uncertainty over current events and that this is not a "new normal" but rather a temporary situation. We believe this will be resolved through the efforts of the Fed and global central banks to support smooth market functioning as well as evolving clarity over the coronavirus and its effects on the economy. Due to the programs put in place to support the markets, we have seen a moderation in industry flows as well as a stabilization and slight improvement in pricing. We anticipate these improvements will continue as capital markets stabilize and as more clarity around the effects of the current pandemic becomes known. Similar to 2008, though, we are not able to put a time frame around the normalization of current conditions, but we will keep a vigilant eye out for evidence that the risk environment is stabilizing.

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

Sector	1 day	1 week	1 month	2 month	3 month	6 month	12 month
U.S. Treasury repos	0.01	0.02	–	–	–	–	–
Fed reverse repo rate	0.00	–	–	–	–	–	–
U.S. Treasury bills	–	–	0.00	0.04	0.07	0.13	0.15
Agency discount notes	0.41	0.01	0.08	0.04	0.05	0.07	0.25
LIBOR	0.11	0.43	1.02	1.24	1.44	1.20	1.00
Asset-backed commercial paper	0.11	0.25	1.26	1.43	1.32	1.47	–
Dealer commercial paper	1.40	1.46	2.03	2.22	2.09	1.58	–
Municipals	0.92	4.71	1.50	1.30	1.20	1.23	1.34

Sources: Bloomberg L.P. and Wells Capital Management

Wells Fargo Fund	7-day current yield
Cash Investment MMF*–Select	1.14%
Heritage MMF*–Select	1.28%
Municipal Cash Management MMF*–Inst'l	3.70%
Government MMF**–Select	0.35%
Treasury Plus MMF**–Select	0.28%
100% Treasury MMF**–Inst'l	0.47%

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 an investment in 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 1.02%, 1.17%, 3.59%, 0.28%, 0.19%, and 0.45%, 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. Source: Refinitiv Lipper U.S. Fund Flows: lipperusfundflows.com
2. The Secured Overnight Financing Rate (SOFR) is a broad measure of the cost of borrowing cash overnight collateralized by Treasury securities.
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.
6. Includes government and Treasury funds.

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

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