Wells Fargo Stable Value Fund W

Portfolio Commentary – Third Quarter 2020

The Wells Fargo Stable Value Fund W (the Fund) is 100% invested in the Wells Fargo Stable Return Fund G.

INVESTMENT PERFORMANCE

During the third quarter, Wells Fargo Stable Value Fund W continued its positive performance with a quarterly return of 0.59% (before investment management fees), which was in line with the second quarter's return of 0.60% (before investment management fees). The current blended yield for the Fund decreased during the quarter to 2.34% (before investment management fees). In the coming quarter, we expect the Fund's blended yield to remain pressured as portfolio cash flows are reinvested at lower prevailing rates and the Fund's contracts amortize the market value premium.

PORTFOLIO COMMENTARY

The Fund had net outflows of $142.6 million during the quarter, which represented a decrease of 0.5% in total Fund assets. The overall duration of the Fund was 2.60 years at the end of the quarter, marginally higher than the duration at the end of the previous quarter. We have not changed our approach to duration management, as the underlying portfolios continue to remain generally in line with their corresponding benchmark durations. The average credit quality at the contract level remains strong at Aa3/AA-.

The Fund's market-to-book-value ratio increased during the quarter to 104.4%, due to market value returns more than offsetting the continued amortization of the Fund's market value premium. We feel our diversification and bias to high quality securities positions us well to weather the ongoing market volatility. The credit quality of the underlying bond portfolios remains strong with 68.9% of the portfolio's securities rated AAA on average, as rated by S&P, Moody's, and Fitch.

ECONOMIC COMMENTARY

The economy staged a comeback during the third quarter, by many measures recovering approximately half the initial pandemic damage. Current forecasts are calling for 30% q/q annualized GDP growth in 3Q followed by relatively normal growth of 4%-5% in 4Q. The economic outlook continues to closely track the evolution of the virus and considerable uncertainty remains regarding the public's willingness to accept a vaccine and to resume pre-COVID-19 activity. The Fed continues to provide an unprecedented level of monetary support while Congress has been unable to pass an additional round of stimulus to pick up where the $2+ trillion CARES Act left off. There is growing concern that the lack of additional stimulus is beginning to weigh on the economy and markets have taken notice.

Interest rates were broadly unchanged during the quarter. Headline and core CPI have rebounded nicely over the past few months; however, inflation is not yet back to pre-pandemic levels y/y. Despite the Fed's new FAIT framework, the market continues to price in subdued inflation expectations for the foreseeable future. Since hitting a pandemic low point in April, the labor market has consistently outperformed expectations across a variety of measures. However, there are signs that this recovery is starting to slow. Retail sales data indicates consumer demand is back to pre-COVID levels and recent housing measures show demand has accelerated past pre-pandemic trends. While some measures of business activity have improved meaningfully, others have only partially recovered.

COVID-19 will continue to evolve, with ebbing and flowing infection rates being combated with regional and local restrictions, and vaccine approval will continue to grab headlines. We expect economic measures will continue to expand at a more normal rate after accelerating considerably in 3Q; however, we are cognizant that an event of this magnitude could have a long tail with unintended consequences. Asset valuations continue to fully reflect easy financing conditions and government stimulus, perhaps limiting the upside for now. Volatility could become elevated due to a highly uncertain path forward regarding virus treatment, the election, fiscal stimulus, and the economy. As a result, heightened focus on downside risk is paramount.

GUIDELINE COMPLIANCE

We have not become aware of any investment guideline compliance issues occurring in the portfolio during the quarter.

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