



## Economics Group

John E. Silvia, Chief Economist

[john.silvia@wellsfargo.com](mailto:john.silvia@wellsfargo.com) • (704) 410-3275

Zachary Griffiths, Economic Analyst

[zachary.griffiths@wellsfargo.com](mailto:zachary.griffiths@wellsfargo.com) • (704) 410-3284

## Mutual Funds: Volatility Leads to Demand for Safer Assets

*While the massive drop in oil prices seems to have come to an end with prices flattening more recently, there has continued to be volatility—which has trickled into other markets, increasing demand for safer assets.*

### High Interest in High Grade

One of the most prominent themes in financial markets in recent months has been the precipitous drop in oil prices. More recently we have seen prices stabilize and begin to trend modestly upward, however, with large day-to-day and week-to-week price fluctuations. As a result, we saw more volatility in financial markets corresponding with the steep decline in oil prices, and this had increased investors' appetite for investment grade bonds in Q4-2014 (top chart). As a result, the yield on Aaa rated corporate bonds has trended steeply lower, approaching all-time lows that we experienced towards the end of 2012. With the U.S. economy leading the world in economic growth, we would expect to see further inflows into a wide array of "safe" U.S. assets, keeping downward pressure on yields in the near-term. In the longer-run, we see interest rates increasing, as we currently expect the Fed to raise short-term rates in June, which should put upward pressure on rates across the spectrum.

As we have seen demand for "safer" assets rise, we have seen a corresponding fall in net flows into emerging market funds. This is likely a response to recent volatility, and the drop in oil prices, which has had adverse effects on certain emerging market economies that rely on crude oil or other commodities for export growth. Indeed, the 3-month moving average of net new cash flow into emerging markets funds fell into negative territory in December, and may remain that way in the coming few months at the start of the year.

### Equity Funds: Upward

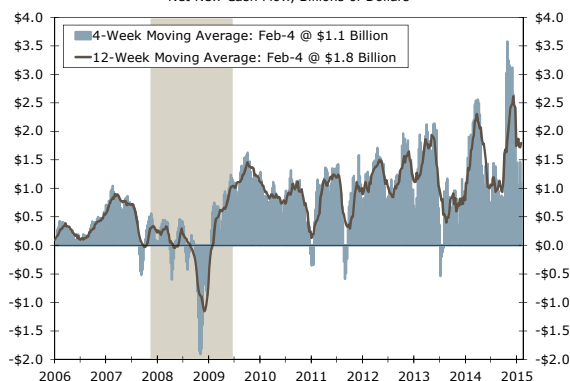
Growth in equity fund holdings has continued to trend upward, although is showing some recent signs of flattening (middle chart). This comes even through some recent volatility, as stocks have continued to edge higher with the S&P 500 closing at an all-time high on Feb. 13. U.S. equity prices have climbed higher as the economy has outperformed other large global economies. Consumer confidence has climbed to levels last seen prior to the recession; as the labor market continues to firm and gasoline prices have fallen 40 percent since this past summer.

### Tax-Free Funds Stabilizing

The decreasing trend in total net tax-free money market funds has moderated, following the sharp run-up leading into the recession, then the equally steep decline following the recession (bottom chart). The level of tax-free assets held are now at the lower end of the spectrum of what we experienced during the previous economic expansion. Instead, investors seem to have taken to corporate bonds more recently, likely in a search for yield. Investment grade corporate bond funds may yield quite a bit more than a comparable duration government bond, but would also offer relative safety compared to, say, emerging market bond funds.

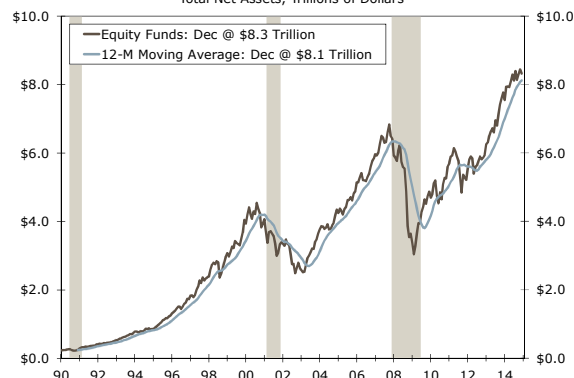
Investment Grade Bond Funds

Net New Cash Flow, Billions of Dollars



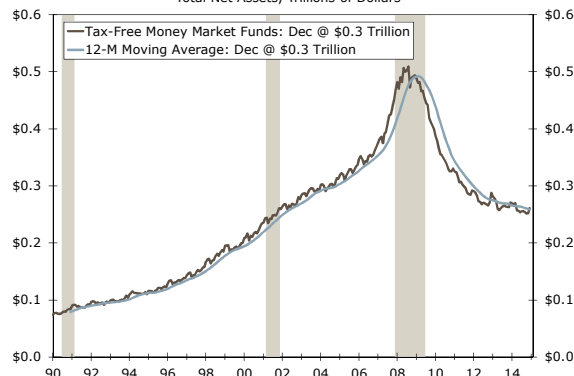
Equity Funds

Total Net Assets, Trillions of Dollars



Tax-Free Money Market Funds

Total Net Assets, Trillions of Dollars



## Wells Fargo Securities, LLC Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 410-1801 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 410-3275	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Currency Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Eugenio J. Alemán, Ph.D.	Senior Economist	(704) 410-3273	eugenio.j.aleman@wellsfargo.com
Anika R. Khan	Senior Economist	(704) 410-3271	anika.khan@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Eric Viloría, CFA	Currency Strategist	(212) 214-5637	eric.viloria@wellsfargo.com
Sarah Watt House	Economist	(704) 410-3282	sarah.house@wellsfargo.com
Michael A. Brown	Economist	(704) 410-3278	michael.a.brown@wellsfargo.com
Michael T. Wolf	Economist	(704) 410-3286	michael.t.wolf@wellsfargo.com
Zachary Griffiths	Economic Analyst	(704) 410-3284	zachary.griffiths@wellsfargo.com
Mackenzie Miller	Economic Analyst	(704) 410-3358	mackenzie.miller@wellsfargo.com
Erik Nelson	Economic Analyst	(704) 410-3267	erik.f.nelson@wellsfargo.com
Alex Moehring	Economic Analyst	(704) 410-3247	alex.v.moehring@wellsfargo.com
Donna LaFleur	Executive Assistant	(704) 410-3279	donna.lafleur@wellsfargo.com
Cyndi Burris	Senior Admin. Assistant	(704) 410-3272	cyndi.burris@wellsfargo.com

Wells Fargo Securities Economics Group publications are produced by Wells Fargo Securities, LLC, a U.S. broker-dealer registered with the U.S. Securities and Exchange Commission, the Financial Industry Regulatory Authority, and the Securities Investor Protection Corp. Wells Fargo Securities, LLC, distributes these publications directly and through subsidiaries including, but not limited to, Wells Fargo & Company, Wells Fargo Bank N.A., Wells Fargo Advisors, LLC, Wells Fargo Securities International Limited, Wells Fargo Securities Asia Limited and Wells Fargo Securities (Japan) Co. Limited. Wells Fargo Securities, LLC ("WFS") is registered with the Commodities Futures Trading Commission as a futures commission merchant and is a member in good standing of the National Futures Association. Wells Fargo Bank, N.A. ("WFBNA") is registered with the Commodities Futures Trading Commission as a swap dealer and is a member in good standing of the National Futures Association. WFS and WFBNA are generally engaged in the trading of futures and derivative products, any of which may be discussed within this publication. Wells Fargo Securities, LLC does not compensate its research analysts based on specific investment banking transactions. Wells Fargo Securities, LLC's research analysts receive compensation that is based upon and impacted by the overall profitability and revenue of the firm which includes, but is not limited to investment banking revenue. The information and opinions herein are for general information use only. Wells Fargo Securities, LLC does not guarantee their accuracy or completeness, nor does Wells Fargo Securities, LLC assume any liability for any loss that may result from the reliance by any person upon any such information or opinions. Such information and opinions are subject to change without notice, are for general information only and are not intended as an offer or solicitation with respect to the purchase or sales of any security or as personalized investment advice. Wells Fargo Securities, LLC is a separate legal entity and distinct from affiliated banks and is a wholly owned subsidiary of Wells Fargo & Company © 2015 Wells Fargo Securities, LLC.

### Important Information for Non-U.S. Recipients

For recipients in the EEA, this report is distributed by Wells Fargo Securities International Limited ("WFSIL"). WFSIL is a U.K. incorporated investment firm authorized and regulated by the Financial Conduct Authority. The content of this report has been approved by WFSIL a regulated person under the Act. For purposes of the U.K. Financial Conduct Authority's rules, this report constitutes impartial investment research. WFSIL does not deal with retail clients as defined in the Markets in Financial Instruments Directive 2007. The FCA rules made under the Financial Services and Markets Act 2000 for the protection of retail clients will therefore not apply, nor will the Financial Services Compensation Scheme be available. This report is not intended for, and should not be relied upon by, retail clients. This document and any other materials accompanying this document (collectively, the "Materials") are provided for general informational purposes only.

SECURITIES: NOT FDIC-INSURED/NOT BANK-GUARANTEED/MAY LOSE VALUE

