

Finding balance in today's economy

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Prepared by the Advisory Services Group

2011 forecasts

All market comments are as of June 21, 2011

Year-end S&P 500	1250-1300*
S&P 500 EPS	\$95.50
Real GDP	2.8%†
10-year U.S. Treasury	3.5%*

Source: Wells Fargo Advisors

*2011 base-case year-end target

†Gross domestic product growth (fourth quarter 2010 to fourth quarter 2011)

Past performance is not an indication of future results. An index is not managed and is unavailable for direct investment. There can be no assurance that any of the target objectives will be met.

Executive summary

- ▶ The U.S. economy is continuing to recover from the 2008-2009 recession. However, the economy has slowed as it enters the midcycle phase of the expansion where the Federal Reserve (the Fed) stops adding liquidity. We expect economic growth to average 2.8% this year, leaving the unemployment rate around 9.0% at the end of 2011.
- ▶ We expect consumer price inflation to be 2.5% in the 12 months ending in December 2011. Inflation was above this rate this spring when the civil war in Libya cut off oil shipments from that country. However, core consumer price inflation remains subdued and energy prices have retreated as the global economy cooled and Saudi Arabia said it would supply more oil.
- ▶ The Fed has pumped a lot of liquidity into the U.S. economy in order to boost economic growth. However, this second round of quantitative easing (QE2) ends in June 2011. After QE2, the Fed will no longer be pumping as much liquidity into the markets but will not begin to drain liquidity yet.
- ▶ Looking back over the past several quarters, the QE2 program helped boost equity markets and commodities but hurt the dollar. More recently, investors turned cautious, and inflation expectations decreased slightly. As a result, in May and June, the bond market rallied, the equity markets softened, commodity markets pulled back and the dollar stabilized.
- ▶ We continue to believe long-term interest rates are likely to rise as the economic expansion continues. Therefore, we recommend that long-term investors use the recent rally in bonds as an opportunity to reduce exposure to long-term bonds. Our year-end target for the 10-year Treasury yield remains 3.5%. We continue to favor high-quality corporate debt over government debt.
- ▶ U.S. equity markets are likely to consolidate as investors wait to see if the economy can continue to grow without extra Fed stimulus. Our base-case, year-end 2011 target for the S&P 500 index remains 1250-1300. A higher level remains possible if revenues reaccelerate meaningfully in coming quarters.
- ▶ As the stock market consolidates in this midcycle slowdown, we believe investors should follow a balanced equity strategy. We continue to favor the cyclically sensitive Industrial and Material sectors. In addition, we favor the defensive Telecom and Utilities sectors for their yield.
- ▶ On the international front, we continue to believe that diverging economic performance, rebalancing trade patterns and moderating global economic growth will create important investment opportunities. The Arab uprisings this spring highlight why we remain concerned about the risk from unexpected global developments.
- ▶ Sentiment toward the dollar is very negative. Therefore, over the near-term, good news could help the greenback more than bad news hurts. Nevertheless, we believe the dollar will continue to decline over the long run.

Overview

Our midyear outlook examines investment strategies that are likely to perform better during this expansion's midcycle phase, especially since the Fed is ending its QE2 program. We recommend a balanced investment strategy during this period. In the early phase of expansion, we favored the cyclical sectors of the stock market over the defensive. During this midcycle phase, we favor a balance of some cyclical and some defensive sectors. In the fixed income arena, we favor intermediate-term securities over longer-term securities due to the likely increase in interest rates as the economy strengthens over the next few years. On the international and commodity front, we believe the dollar has already discounted a lot of bad news about U.S. debt and deficits as well as risks of excess liquidity from the Fed's easy money policies. At this point, good news for the dollar may help the greenback more than bad news hurts it. In addition, as the Fed ends QE2, some of the excess liquidity that has fueled the commodity rally and weighed on the dollar could dissipate. This could dampen commodity prices and support the dollar in the months ahead.

At this point, it does not look like the Fed will initiate another round of quantitative easing as long as the dollar remains weak and job growth is good. Of course, if some unexpected major negative shock significantly hurts consumer and business confidence, the Fed still has the option to restart large-scale asset purchases to sustain U.S. economic growth.

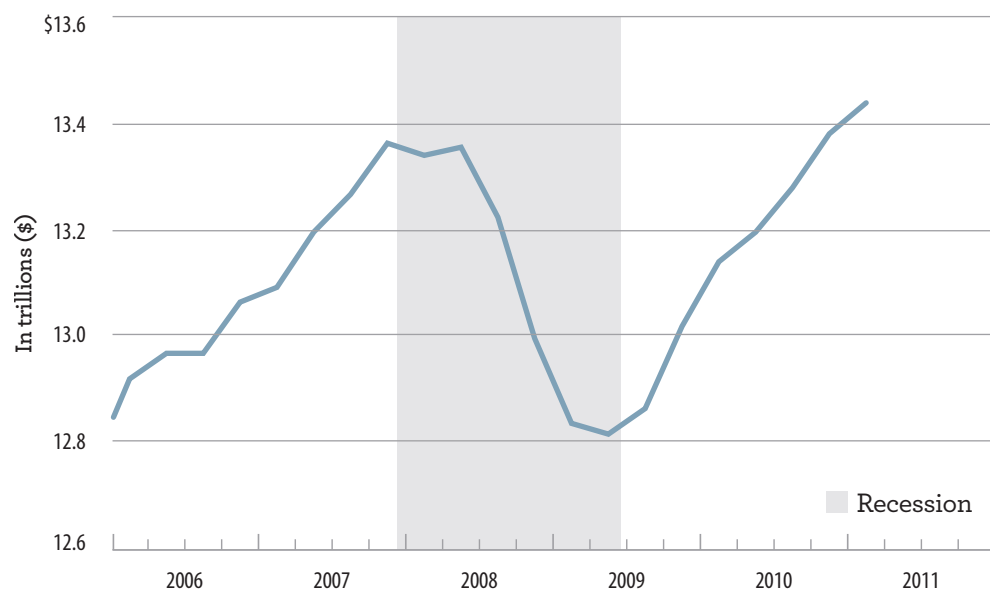
The 2008-2009 recession is still fresh in many investors' minds. Fortunately, the deep wounds suffered during the financial crisis are healing as the economic recovery hits its second anniversary. The economy is not yet strong, but it is healthier than it was during the crisis. Businesses are expanding, profits are rising and companies are starting to hire more workers. Unfortunately, the housing market remains depressed, and unemployment is still very high. As a result, the economy is growing at only a modest rate. At this point, our work suggests the current economic expansion that began in July 2009 could continue until 2014 or beyond. However, the economy will not grow smoothly through these various phases. There will be periods of strength and weakness along the way.

Businesses are expanding, profits are rising and companies are starting to hire more workers. Unfortunately, the housing market remains depressed, and unemployment is still very high. As a result, the economy is growing at only a modest rate.

Figure 1

The U.S. economic recovery continues

Inflation-adjusted gross domestic product (GDP)



Source: Haver Analytics, Wells Fargo Advisors

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Economy

What is ahead for the economy?

Looking ahead, the economy still faces many headwinds. High energy prices are squeezing profit margins and reducing consumer purchasing power. In addition, many homeowners are still underwater on their mortgages, limiting their ability to buy a different house. Consequently, housing activity is low despite very affordable home prices. Overseas, rising inflation has prompted central banks in several countries to raise interest rates to dampen inflationary pressures. Equally important, the European sovereign debt crisis continues to hinder the European economic recovery. Finally, we expect the unemployment rate to end the year at 9.0%. We believe the next six to 12 months could be challenging for the U.S. economy.

After two years of a very easy monetary policy, the Federal Reserve (Fed) will stop adding extra liquidity when its second round of quantitative easing (QE2) ends in June 2011. At this point, the U.S. economy will transition from the early-cycle period of very easy money to the midcycle period where policymakers take steps to withhold liquidity and eventually drain the excess liquidity. The final late-cycle period of an economic expansion is usually when the economy is operating near full employment and the Fed is following a tight monetary policy to combat inflation. The economic expansion's early-cycle period lasted two years, from mid-2009 to mid-2011. The midcycle period that the economy appears to be entering now is likely to last another year or two. The final late-cycle period could then last a few more years. Right now, the pace of economic activity appears to be cooling off as the economy transitions into the expansion's midcycle phase.

The midcycle phase is often a time when economic activity becomes self-sustaining even though growth may not be robust. During the midcycle phase, job growth boosts income. This, in turn, leads to more spending, which encourages businesses to hire more workers, producing more spending and reinforcing the expansion. Once the economy hits this point, the Fed no longer needs to pump as much liquidity into the financial system. Therefore, this is the phase in which monetary policy shifts from adding liquidity toward eventually draining excess liquidity.

We believe that the economy is likely to expand at a 2.8% average annual rate in 2011. However, the economy was growing below that rate early this year. On the inflation front, we believe that consumer prices could increase 2.5% in the 12 months ending in December 2011. However, inflation was running above this level early this year. At this point, core consumer price inflation (CPI) is still well below 2.0%, and if commodity prices pull back in the months ahead as the economy cools off, overall inflation, including food and energy, could slow toward that 2.5% rate by year-end.

Looking ahead, the economy still faces many headwinds such as high energy prices, weak housing activity, rising inflation overseas and the European debt crisis. In addition, we expect the unemployment rate to end the year at 9.0%

On the inflation front, we continue to believe that consumer prices could increase 2.5% in the 12 months ending in December 2011.

Right now, the pace of economic activity appears to be cooling off as the economy transitions into the expansion's midcycle phase.

We believe that the economy is likely to expand at a 2.8% average annual rate in 2011.

The Fed will stop new purchases of Treasury securities in June 2011, giving policymakers time to see how the economy acts on its own before considering further steps.

If the economy continues to improve slowly, the Fed may pursue actions to begin removing liquidity during the fall months.

We expect the Fed will keep the benchmark federal funds target rate unchanged at 0% to 0.25% throughout 2011 and into the first half of 2012.

For the remainder of 2011, we look for the 10-year U.S. Treasury to generally trade in a range between 3.00%-4.00%. We project the 10-year to end the year with a 3.50% yield. In 2012 and beyond, we see the possibility of higher rates as the economy slowly improves and inflation risks and government-debt levels increase.

What will the Fed do after QE2?

Since early December 2010, the Fed has been executing QE2 through the purchase of \$600 billion of longer-term Treasury securities. However, the Fed has made it clear that it is prepared to adjust the size of its holdings as needed to foster its dual mandate of both maximum employment and price stability. The Fed will stop new purchases once QE2 is completed in June 2011, giving policymakers time to see how the economy acts on its own before considering further steps.

If the economy continues to improve slowly, the Fed may pursue actions to begin removing liquidity during the fall months. While it seems clear that raising the widely quoted federal funds rate (the interest rate at which banks lend to other member banks) is still some time away, the Fed may employ other strategies to begin tightening monetary policy well before an increase in the federal funds rate. Some of the tools the Fed has at its disposal include:

- Reducing the reinvestment of maturing bonds – This puts less funds back into the system than drains out when Fed holdings of Treasury securities mature.
- Reverse repurchase agreements – This drains excess reserves.
- Making term deposits to depository institutions – These new deposits would turn excess reserves into short-term bank investments, reducing the potential for other loans to bank customers.
- Increasing the federal funds rate – This raises the cost to banks of making new loans with excess reserves.
- Increasing the interest paid on excess reserves – This discourages banks from making loans with excess reserves.

What is our current interest rate outlook? Has it changed?

We have remained consistent in our rate outlook throughout the first half of 2011 and currently see little reason to change. Given our expectation that unemployment will remain elevated and inflation will remain contained, we expect the Fed will keep the benchmark federal funds target rate unchanged at 0% to 0.25% throughout 2011 and into the first half of 2012.

For the remainder of 2011, we look for the 10-year U.S. Treasury to generally trade in a range between 3.00%-4.00%. We project the 10-year to end the year with a 3.50% yield. In 2012 and beyond, we see the possibility of higher rates as the economy slowly improves and inflation risks and government-debt levels increase.

The yield that investors will potentially demand to buy and hold increasing U.S. government debt is a particular concern, especially with almost 50% of Treasury securities being held by foreign investors. So far, the demand for Treasuries remains strong while Fed policy is on hold. But demand could lessen as we move closer to potential Fed tightening in 2012. Consequently, fixed income investors may be faced with greater volatility.

Short term: It is important for investors not to become complacent after the decline in long-term yields this spring. Interest rates do not move in a straight line. This is probably just a countercyclical swing in yields along a long-term trend toward higher interest rates in the years ahead. While we see rate movements as somewhat benign over the next three to six months, we recommend that investors not reach for yield or take risks outside of their comfort zone during this lull in the secular move higher in rates. Investors should take this opportunity to re-examine portfolios, shorten durations and remain vigilant.

Fixed income

Long term: Over the next several years, we see rates trending higher – a change in the long-term trend. During the past 30 years, rates have generally moved lower and bond prices higher. While there have been cyclical moves higher in rates in the past three decades, investors have become conditioned that buying and holding bonds produces solid gains. We believe that the long-term downward trend in yields bottomed in late 2008 as the 10-year Treasury yield hit 2.05%. Looking ahead, as rates increase, investors will need to readjust their expectations of fixed income performance. While fixed income remains an important and stabilizing asset class within a broader asset allocation (investment mix), investors should take care not to extend beyond their comfort levels. Over the next few years, yields could move several percentage points higher and still be well within historical context.

Figure 2
10-year Treasury yields



Source: Bloomberg, Wells Fargo Advisors

Past performance is not an indication of future results.

What does QE2's end mean for bonds?

As QE2 ends, the Fed will pull back from its monthly Treasury purchases. Currently, the Fed purchases \$90 to \$100 billion of Treasury securities each month. While we still expect the Fed will continue reinvesting maturing debt on the order of about \$17 billion per month, the end of QE2 may significantly change the market's supply/demand dynamic. While conventional wisdom suggests that fewer buyers will push yields higher and prices lower, we think it will take some time for the scenario to play out. Investors have seen the end of QE2 coming for some time, and many large investors have already significantly reduced Treasury positions in anticipation of QE2's end. Consequently, fixed income investors should not fear QE2's end. While we are likely to see more volatility, an immediate increase in yields is unlikely. Nevertheless, long-term rates are likely to move higher over time as the economy improves, inflation increases and debt concerns mount.

Fixed income investors should not fear QE2's end. While we are likely to see more volatility, an immediate increase in yields is unlikely. Nevertheless, long-term rates are likely to move higher over time as the economy improves, inflation increases and debt concerns mount.

How should fixed income investors be positioned?

Short-term, high-quality fixed income securities can preserve capital and liquidity, but this comes at a cost: little-to-no yield or return. To achieve incremental yield or return, fixed income investors face the decision of extending their time horizon (longer maturities), reducing their quality parameters (lower quality bonds) or pursuing some combination of the two. Below are our current fixed income sector allocation recommendations.

Opportunities in fixed income

Fixed income sector allocation recommendations

Overweight	Slight overweight	Neutral	Slight underweight	Underweight	Duration
	Corporate bonds	Emerging-market debt	U.S. Treasuries	Agency securities	Slightly short*
	Municipal bonds	High-yield securities	Mortgage-backed securities		
		Treasury Inflation-Protected Securities			
		Preferred Securities			
		International developed-market debt			

*We recommend a duration slightly short of an investor's target duration. If an investor does not have a target duration, we recommend a duration of four years in taxable portfolios. Duration, stated in years, can be used to estimate the percentage change in a bond's value that results from a 1% change in interest rates. The longer (higher) the duration, the more prices will fluctuate as interest rates rise and fall.

Investment-grade corporate bonds and high-yield securities

As we entered 2011, we believed that the credit-sensitive sectors offered the best relative value, and through the first half of 2011, these sectors did see the best returns. Since then, we have seen significant spread compression in the high-yield and corporate space and thus have reduced our recommended allocations to the both the high-yield and corporate sectors. We still maintain a neutral recommended weighting to high-yield bonds and a slight overweight recommendation for investment-grade corporate bonds; however, we recommend that investors review their credit-sensitive exposures. We advise that clients refrain from "reaching for yield" by moving lower in credit quality than is appropriate for their risk tolerance. We advocate that investors search out high-credit-quality instruments because lower-credit-quality investments have generally been bid up and do not offer the same level of value that they have in the past.

Municipal bonds

We continue to recommend that investors take advantage of weakness in the municipal bond market to accumulate high-quality positions. State and local municipal issuers continue to face significant budgetary challenges from prolonged declines in their municipal tax revenue sources. Nevertheless, we continue to believe that the primary risk will be ratings downgrades rather than actual default risk, particularly in our favored municipal sectors. We recommend that investors focus on accumulating positions of single A-rated or better (by one of the major rating agencies) general-obligation and essential-service revenue bonds.

We advise that clients refrain from "reaching for yield" by moving lower in credit quality than is appropriate for their risk tolerance. We advocate that investors search out high-credit-quality instruments.

We continue to recommend that investors take advantage of weakness in the municipal bond market to accumulate high-quality positions.

We recommend accumulating positions of single A-rated or better general-obligation and essential-service revenue bonds.

Fixed income

Duration

We are not concerned about significantly higher yields in the short-term. However, long-term investors purchasing longer-term fixed income investments could face a period of significantly higher yields over the long run that could negatively impact bond prices. For investors who are concerned about their fixed income portfolio's price volatility, we look to purchase shorter-dated securities even if there are relatively few income opportunities. Investors should also ensure their portfolios are properly diversified. We currently recommend investors remain slightly short of their duration target.

How can I take advantage of low interest rates?

While a low-interest-rate environment can make earning income from your assets difficult, it potentially lets you lower interest costs on new or outstanding debt. Just as most bonds are sensitive to changes in interest rates, so are mortgage rates. Figure 3 below shows both historical 10-year Treasury yields and 30-year mortgage rates. You can see that the two levels often move in the same direction. Thirty-year fixed mortgage rates are currently near the lowest levels in decades; only the second half of 2010 saw rates lower than today's. If you did not refinance outstanding debt during the second half of 2010, the recent bond market rally may offer you another chance to make low interest rates work for you. For investors who want to take advantage of low rates while potentially decreasing the time to pay off a mortgage, 15-year rates are also near historically low levels. We recommend investors take the time to review the interest costs of outstanding debts and refinance loans that carry higher interest rates.

Thirty-year fixed mortgage rates are currently near the lowest levels in decades. If you did not refinance outstanding debt during the second half of 2010, the recent bond market rally may offer you another chance to make low interest rates work for you.

Figure 3
Mortgage rates move with Treasury yields



Source: Bloomberg, Wells Fargo Advisors

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U.S. equities

S&P 500 forecasts

	2011 year-end
Earnings	\$95.50
S&P 500 target	1,250-1,300*

Source: Wells Fargo Advisors

*2011 base-case year-end target

An index is not managed and is not available for direct investment.

Does recent market volatility suggest this cyclical bull market is now mature?

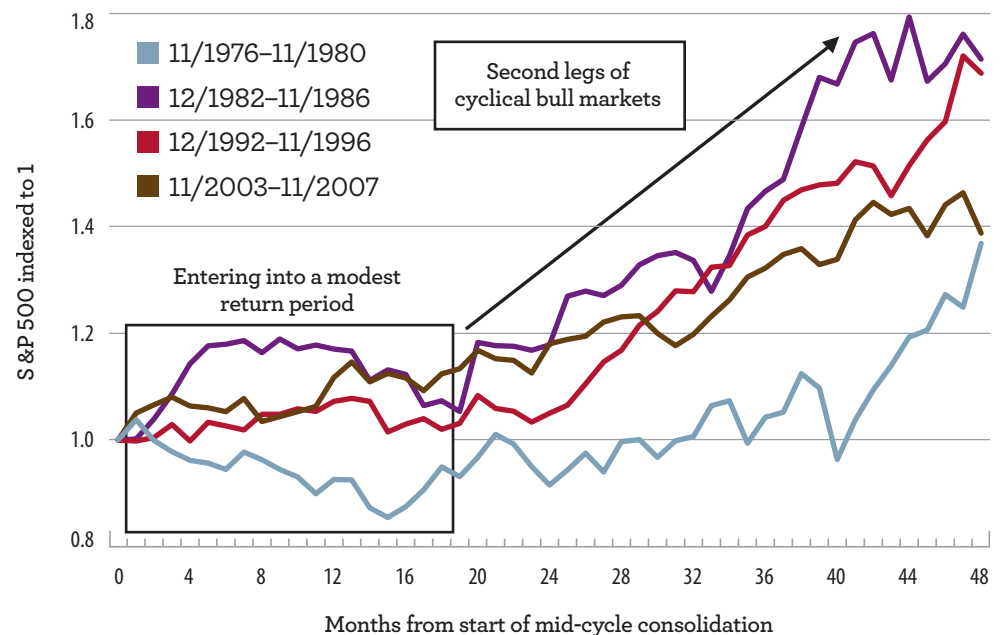
In recent months, we have seen more equity market swings than was typical between August 2010 and March 2011. The economy has begun to grow at a slower pace, in part due to the upward move in oil and gas prices. However, occasional pockets of slower growth are not unusual once the initial cyclical economic upswing has taken place. High oil and gas prices and the combination of concerns over European sovereign debt, inflation in Asia and impacts from the Japanese earthquake have all led to an increase in investor uncertainty and market volatility. Very recent dollar strength has also represented somewhat of a headwind for stocks.

At this stage of a market cycle, it is not unusual for stocks to go through a period of personality change and/or even modest correction. Investor uncertainty often increases a number of months before stimulus programs are expected to be adjusted. In Figure 4, we have plotted the S&P 500 Index performance following the first up-leg of the prior four cyclical market recoveries as the Fed started to increase the fed funds rate. As shown for those prior four cycles, a midcycle adjustment tends to result in a period of more modest stock returns before economic growth continues to push stocks into their second up-leg of the cycle.

Figure 4

Historical S&P 500 Index cyclical performance

Moderates just before Fed tightening



Source: Baseline, Wells Fargo Advisors

Past performance is not an indication of future results.

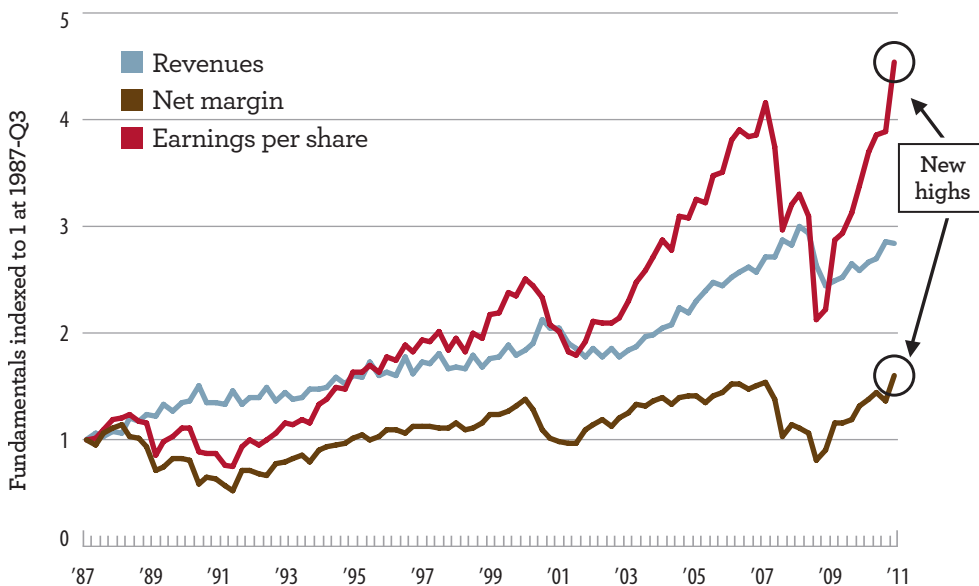
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U.S. equities

What sectors have generated the strongest fundamental rebounds thus far in this cycle?

While the stock market increased roughly 98% since the recession lows, S&P 500 Index operating earnings have increased by 114% on a 15.8% increase in revenues. The operating earnings recovery has been strongest for the Materials (+331.3%), Energy (+131.5%), Technology (+126.4%), Industrial (+50.3%), Financial (\$7.31 vs. -\$2.96 in EPS) and Consumer Discretionary (\$4.56 vs. -\$0.02 in EPS) sectors of the S&P 500 Index to this point in the cycle. Moreover, the Materials, Technology and Consumer Discretionary sectors' operating margins have hit historically high levels in recent quarters. In Figure 5, we have plotted the expansion of S&P 500 index revenues, operating earnings and operating margins back to the late 1980s. As shown, operating earnings have now surpassed all-time highs (encircled). The figure also shows that S&P net operating margins (net operating earnings divided by revenues) hit a new high in 2011's first quarter even though S&P 500 revenues remain below their old highs.

Figure 5
S&P 500 Index fundamentals
Revenues, margin and earnings



Source: Baseline, Wells Fargo Advisors

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It is typical for margin expansion to offer an outsized contribution to cyclical earnings recovery during the earliest phases of a cyclical economic recovery. However, at some point near midcycle (similar to where we are today), increasing demand and revenues finally make it necessary for companies to purchase more land and/or equipment and to increase hiring. At that point of a recovery, costs begin to rise, productivity growth slows and the earnings growth rate starts to slow. We are currently targeting annual S&P 500 operating earnings per share of \$95.50 for 2011 and a preliminary \$102.00 for 2012, representing a 7% increase next year. Should the revenue growth rate show acceleration in coming quarters, despite a lower level of stimulus, our earnings number for this year could be conservative.

We are currently targeting S&P 500 operating earnings of \$95.50 for 2011 and a preliminary \$102.00 for 2012, representing a 7% increase next year.

The market's rebound has been highly cyclical in nature — until just recently

As one would expect, the market's performance has been skewed materially toward the cyclically sensitive sectors whose earnings and stocks were hit the hardest during the last recession. These stocks tend to look attractive for an extended period as their revenues and earnings recover. In the latest 12-month period, overall performance has leaned heavily toward cyclical issues as the S&P 500 index increased in value by 16.2%. In the table below, we have ranked the sectors by their performances over the last 12 months.

Performance has leaned heavily toward cyclically-sensitive stocks

Sector performance — trailing 12 months (as of 6/22/11)

Sector performance — trailing 12 months	Cyclical performance	Cyclical	Performance vs. S&P 500
S&P 500 index	16.2%		
Energy	31.6	Typically later cycle	Outperformed
Materials	24.9	Mid and later cycle	Outperformed
Consumer Discretionary	22.3	Early cycle	Outperformed
Telecom Services	22.0	Defensive	Outperformed
Industrials	21.2	Mid and later cycle	Outperformed
Health Care	19.1	Defensive	Outperformed
Consumer Staples	16.7	Defensive	Outperformed
Utilities	13.1	Defensive	Underperformed
Information Technology	10.0	Strong at various points	Underperformed
Financials	1.7	Early cycle	Underperformed

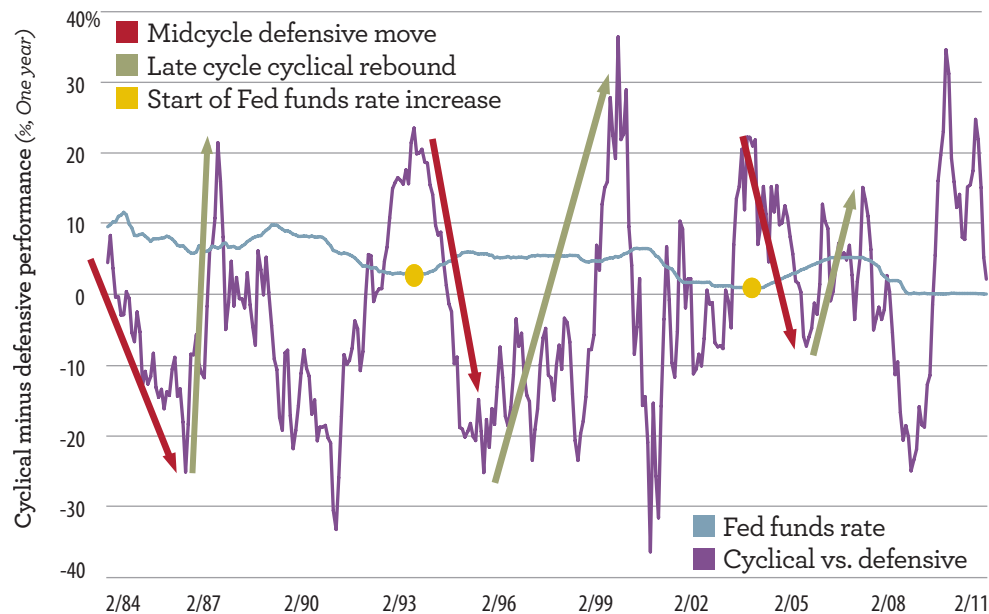
When a shift toward less accommodative Fed policy is anticipated, defensive stocks tend to perform better for a period. However, as investors become more confident in the economy, outperformance goes back toward the cyclically sensitive stocks during an economic cycle's later stages.

Roughly three months ago, as oil and gas prices moved higher and economic growth was impacted by the earthquake in Japan, the flavor of the domestic equity market moved toward a more balanced tone. The more defensive Telecom Services, Utilities, Health Care, and Consumer Staples sectors started to show stronger relative performances – a type of personality shift that is not uncommon once a recovery moves toward midcycle. In addition, small- and mid-cap stocks have underperformed since early April as investors have moved toward lower-risk larger-cap stocks. We also find that as the Fed becomes less accommodative, the number of declining stocks often increases for a period of time.

However, once investors become more comfortable that the economic cycle will carry beyond the reduced stimulus programs, the more cyclical sectors and smaller-cap equities typically regain leadership. In Figure 6 on page 11, we have plotted our index of cyclical versus defensive performance. When the index is moving in an upward direction, the flavor of the market is becoming more cyclical. When the index is in decline, the market is moving in a more defensive direction. We have also included yellow dots at points where the Fed started to become less accommodative (tightened monetary policy). The chart suggests that when a shift toward less accommodative Fed policy is anticipated, defensive stocks tend to perform better for a period (red arrows). However, as investors become more confident in the economy during and/or after a tightening phase, outperformance goes back toward the cyclically sensitive stocks during an economic cycle's later stages (green arrows).

U.S. equities

Figure 6
Market flavor versus Fed Funds rate



Source: Baseline, Wells Fargo Advisors
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Two years ago, our guidance was skewed heavily toward cyclical issues and away from defensives. We now carry a more balanced stance in which we are underweight some defensive sectors but overweight others. In addition, we overweight some cyclical sectors but underweight others. We believe this balanced approach should help reduce portfolio volatility as we are likely to see investors swing back and forth from more bullish to less bullish stances in typical midcycle fashion. By remaining somewhat balanced on a sector basis, we believe it will be easier to roll back toward the cyclically sensitive side when the time is right. In the meantime, we don't want to lean heavily toward the defensive side given that we believe the longer-term trend is likely to favor cyclically sensitive issues.

By remaining somewhat balanced on a sector basis, we believe it will be easier to roll back toward the cyclically sensitive side when the time is right. In the meantime, we don't want to lean heavily toward the defensive side given that we believe the longer-term trend is likely to favor cyclically sensitive issues.

Opportunities in equities

Equity sector allocation recommendations

Overweight	Evenweight	Underweight
Industrials	Consumer Discretionary	Consumer Staples
Materials	Energy	Information Technology
Telecom Services		Financials
Utilities		Health Care

Source: Wells Fargo Advisors

U.S. equities

The combination of roughly a double in the stock market from its cyclical low, less stimulus from the federal government and the Fed, slower earnings growth in coming quarters, continued sovereign debt problems in Europe, as well as oil price volatility are all likely to result in more volatility for stocks as liquidity is slowly removed.

We continue to carry a year-end 2011 target for the S&P 500 Index of 1,250-1,300. If the economy re-accelerates in coming months and no significant negative surprises arise, the market may surpass our year-end target range.

As the breadth of the economic recovery widens, earnings for smaller companies may grow faster than for large companies as their fundamentals catch up. Equally important, as investors become more confident in those earnings, multiples should expand.

How might QE2's end impact the equity market?

We believe that QE2 has had a favorable impact on stocks' performances since the program was first discussed in late August 2010. The Fed, too, appears to believe that QE2 has favorably impacted the equity markets and anticipated that stronger asset prices would likely help increase investors' confidence levels and, perhaps, their propensity to spend. New spending can result in stronger corporate revenues and the creation of new jobs in the private sector. We would not be surprised if a reduction in liquidity after QE2 has a neutral or negative impact upon stock performance for a period. The combination of roughly a double in the stock market from its cyclical low, less stimulus from the federal government and the Fed, slower earnings growth in coming quarters, continued sovereign debt problems in Europe, as well as oil price volatility are all likely to result in more volatility for stocks as liquidity is slowly removed.

The market recovery since 2009 has been stronger than all of the last six cyclical market recoveries. As we study market performance during quantitative easing part one (QE1) and QE2 versus the period prior to the recession, we see market performances have been materially boosted by Fed liquidity inflows. While the average trailing three-month return between late 2005 and the 2007 market peak was only 2.9%, the average trailing three-month return was 4.7% from QE1 and more than 6.0% during QE2. And as the equity market showed some weakness post-QE1, that weakness appeared to dissipate with the institution of QE2.

We continue to carry a base-case year-end 2011 target range for the S&P 500 Index of 1,250-1,300. Our expectation has been that the greatest catalysts for equities in 2011 would be during the year's first half. If the economy re-accelerates in coming months and no significant negative surprises arise, the market may surpass our year-end target range. However, we believe volatility is likely to remain high over the next several months.

Will confidence in mid- and small-caps grow?

Earnings continue to improve for mid- and small-cap stocks despite headwinds. Why should we expect this to continue? What should we expect from these stocks? Up to this point in the cycle, underlying fundamentals of smaller companies have improved but have lagged larger companies'. As the breadth of the economic recovery widens, earnings for smaller companies may grow faster than for large companies as their fundamentals catch up. Equally important, as investors become more confident in those earnings, multiples should expand.

Breadth and confidence explain why the stocks do not need eye-popping gross domestic product (GDP) growth to perform well. Smaller companies still face a constrained credit environment. Nevertheless, stable and positive growth could reduce the cost of capital and increase the returns on investments that lead to profitable growth. A challenge is that stocks can appear expensive as they come to be priced on better future earnings. This gap between the present and future can make small- and mid-cap stocks more vulnerable to sentiment.

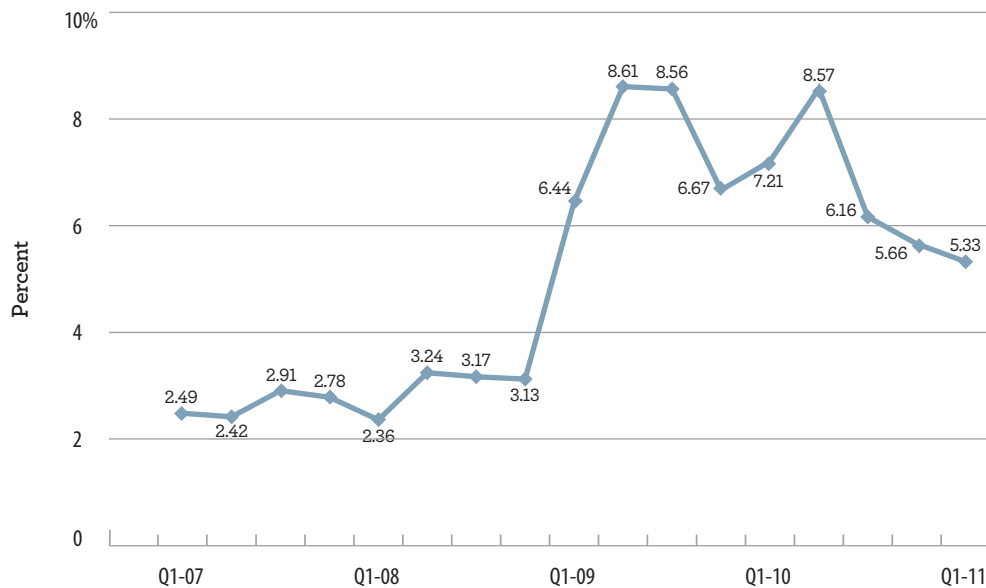
An indicator of improving confidence is the fact that investors are getting better at estimating earnings. To show this, we looked at the median earnings surprise for the Russell 2500 going back to early 2007 (see Figure 7 on page 13). This number shows how accurate analysts were at forecasting earnings. When this number went up, the surprises got bigger, meaning that the market had a harder time estimating earnings. Declining numbers reflect the market coming to terms with the business environment. This series has shown the market has been more accurate predicting earnings since early 2010. We still have ground to cover if we are going to get back to precrisis levels. It makes sense that investors are more likely to buy assets they feel better about.

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U.S. equities

Our conversations with many company management teams support our expectation of the potential for sustainable growth, even if at a slower pace. We have spoken to management teams in a variety of sectors and industries that are anticipating better business conditions. In our opinion, the breadth speaks to a stronger outlook for smaller companies, and management views, on balance, are realistic. They are not investing too far ahead of demand as happened in the previous cycles. A glass-is-half-empty investor could take this to mean that business is deteriorating. We take it as a sign of an improving risk/reward ratio.

Figure 7
Stronger fundamentals implied by declining EPS surprises
Median quarterly EPS surprise for Russell 2500



Source: Bloomberg, Wells Fargo Advisors
Past performance is not an indication of future results.

What is the technical view of the stock market?

The stock market increased in an up-trending channel from the March 2009 lows. However, the market has recently entered a more sluggish phase. Figure 8 on page 14, is a three-year chart of the S&P 500. Sharp rises are characteristic of the bull market's initial dynamic phase as investors begin to look beyond the economic recession to better times ahead. The current cycle has certainly fit the typical historical pattern with the S&P 500 increasing in price from the March 2009 low to the April 2011 high. It also experienced only one pullback of significance during the two-year period: 16% in the spring to summer 2010 period as the Fed's QE1 program came to a conclusion.

In addition, the average stock has outperformed the market-cap weighted indexes. The Value Line Arithmetic Composite (an index that equally weights each of its 1,700 component stocks) rose more than 200% between March 2009 and April 2011. In recent months, however, progress has become more sluggish, and we expect this to continue during the mid-phase of the cycle. For perspective, the Dow Jones Industrial Average (DJIA) has swung in a range as wide as 1,300 points from mid-February to mid-June, yet the index has made no net progress. This is indicative of a fatigued market that's facing more uncertainties, including the Japanese disaster, Chinese growth concerns, inflation, U.S. budget and debt worries, rising commodity prices, renewed European debt concerns, high U.S. unemployment, the housing debacle, and, of course, QE2's end.

The stock market increased in an up-trending channel from the March 2009 lows. However, the market has entered a more sluggish phase.

Please see pages 22-24 for analyst certifications, definitions, disclosures and disclaimers.

Figure 8
Stocks advanced in an uptrending channel
S&P 500 index (June 2008 – June 2011)



Source: Bloomberg, Wells Fargo Advisors
Past performance is not an indication of future results.
An index is not managed and is not available for investment.

Regarding investor sentiment, surveys are showing a more mixed picture. Mutual fund flows suggest that investors are still acting more cautiously.

Figure 9 on page 15, shows the New York Stock Exchange cumulative advance/decline (A/D) line (a measure of whether most stocks are going up or down). This measure's recent action has shown a few divergences from the popular stock market averages' actions. Although the A/D line did make a new high along with the popular averages' actions in February, it failed to confirm the averages' new highs in late April. Instead, the peak was made in early April, and a series of lower highs have been made in the A/D line since that period. While this signifies a negative divergence and deteriorating momentum, it may only represent just one signal of a short-to-intermediate-term top rather than a major top.

Regarding investor sentiment, surveys are showing a more mixed picture. These surveys are contrary indicators, and thus a high degree of bullishness has historically been associated with stock market pullbacks. Measured by the Investors' Intelligence (II) Survey, investor sentiment increased to a high level in April, indicating increased complacency. Specifically, the weekly percentage of bulls rose to an extreme of 57% in early April whereas bears fell to just 16%. Alternatively, the American Association of Individual Investors (AAII) survey has shown a slightly different picture. The bullish percentage peaked and bearish percentage troughed at extremes last December. Mutual fund flows suggest that investors are still acting more cautiously. According to the Investment Company Institute (ICI), stock mutual funds experienced \$39 billion of outflows in 2009 and \$96 billion of outflows in 2010. However, ICI's estimates through mid-May 2011 indicate there has been only a net \$13 billion inflow. This is still historically low, which indicates a lingering hesitancy by individuals to return to equities in big numbers.

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U.S. equities

Figure 9

Many stocks have been diverging from major indices

NYSE cumulative advance/decline line



Source: Bloomberg, Wells Fargo Advisors

Past performance is not an indication of future results.

An index is not managed and is not available for investment.

The VIX indicator or “fear gauge” – the label given to the Chicago Board Options Exchange (CBOE) Volatility Index – measures how much investors are willing to pay for options to protect against stock market declines. This gauge has recently been hovering at low levels similar to those it experienced in April 2010 and February 2011 before a corrective phase in stocks prices occurred. Its current level has historically accompanied periods of sideways to declining prices that removed some of the excesses from the marketplace.

Finally, seasonality is working against stocks as the market is in the midst of its historically weak six-month period of the year between May and October. So far, the poor seasonal period has been living up to its reputation.

Psychologically, the greatest impact that QE2's conclusion will have for the stock market depends on how the Fed adjusts monetary policy through the year's second half. We believe stock market expectations are for a slow and deliberate process, which is consistent with public statements from the majority of monetary policymakers, including Chairman Bernanke, who have indicated that they believe it will be quite some time before the Fed backs away from its easy monetary policy. A negative scenario would be if the Fed abruptly indicates that asset sales and tightening were imminent. We believe the probability of this scenario is low. If it did happen, it would be upsetting to equity markets. Regardless, later in 2011, we expect investors will start to anticipate the beginning of interest rate hikes, and historically stocks have behaved sluggishly as investors start to discount a new cycle of higher interest rates.

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We saw trends at the beginning of the year — where do they stand now?

At the beginning of 2011, we expected three main trends to dominate pricing in international markets:

- Divergent growth rates between developed- and emerging-market economies
- Rebalancing in emerging-market economies away from exports and toward domestic consumption
- Inflation pressures building in the emerging markets leading to a moderation in global growth

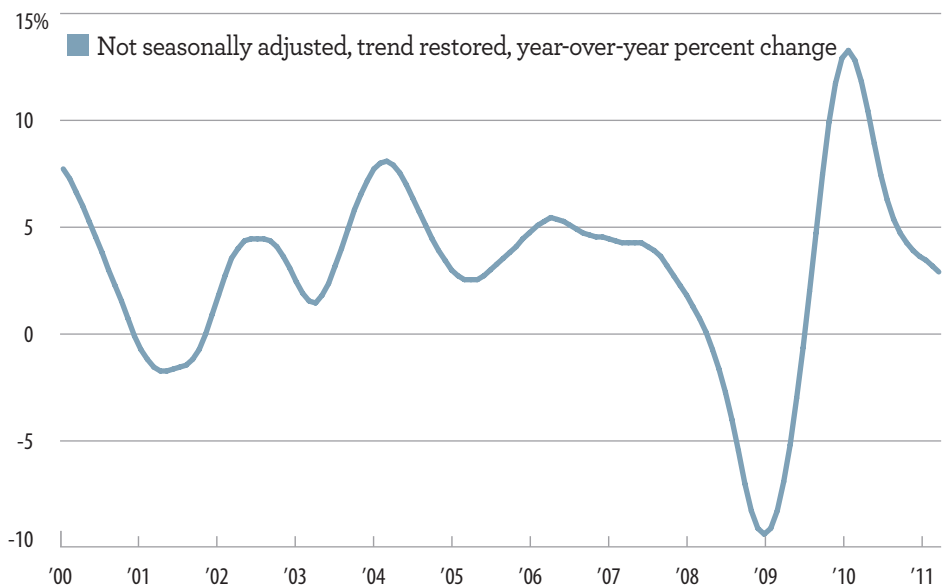
We see multiple signs that the global economic expansion is moderating, not heading toward a new recession. Figure 10 below shows that global leading economic indicators declined sharply in the recession years of 2001 and 2008. By contrast, the global economy slowed but kept growing in 2003 and 2005. The indicators' latest pace appears closer to that of 2005. Second, earnings globally continue to grow. Third, recessions tend to come after factories run at capacity and skilled labor is hard to find, not when significant slack remains in U.S. and European factory capacity and labor markets. Finally, global interest rates are slowly rising but remain below the recent historical average and below where they were in 2008 when high rates curtailed economic growth.

Looking ahead, the divergence and rebalancing trends continue to support our long-term preference for low-debt and trade-oriented economies into 2012 and beyond. In addition, the midcycle economic growth consolidation, easing commodity prices and interest rate hikes in faster growing countries overseas should help correct emerging-market inflation. However, the economic consolidation may extend into 2011's latter half and create short-term risks or headwinds for international markets.

We see multiple signs that global economic expansion is moderating, not heading toward a new recession.

Figure 10

Economic recoveries sometimes slow before quickening again OECD* Member and major six nonmember leading indicators



Source: Bloomberg, Wells Fargo Advisors

*The Organization for the Economic Co-operation and Development (OECD)

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What is the outlook for the European debt crisis?

Disappointing news about the European debt crisis emerged in several episodes in the first half of the year. The pattern since last year has been that European leaders meet new liquidity crises with bailouts, new accounting rules and promises to make foreign investors accept some losses. In March, European leaders announced changes they hoped would prevent further crises, but even these seemed to focus on rules and more bailouts. Market sentiment seems to have adapted to the pattern as evidenced by the shortening time between initial worry and market rebounds.

Brussels, Paris and Berlin have emphasized bailouts and rules, but these do not address the underlying economic problem that European exporters let inflation rise with the euro's strength in the past 10 years, greatly reducing their competitiveness in international trade. Now, slowing economic growth hurts government revenues, and austerity measures weaken the economy even further. In Greece, the budget-cutting measures appear to be intensifying the recession and undercutting government efforts to shrink the deficit. Meanwhile, trade competitiveness is difficult to regain while the euro continues so strong.

Greece's collapsing economy and growing need for financial assistance make a government default possible at some time in the future. This prospect remains a risk of unknown magnitude to European financial markets, mainly because the European banks' exposure to Greek debt is not clear. However, some factors mitigate the potential stress on European financial markets if a default does ultimately occur. European leaders are working to raise additional bailout funds that could avoid a default in the near-term and buy time for European banks to strengthen their balance sheets. Also, it is important to remember that the Irish and Portuguese economies are not as weak as Greece's and are recovering.

The European debt crisis appears far from over, but investors should approach the risks in a balanced way. A serious European banking crisis that causes a new recession does not seem imminent. However, we advise investors to avoid speculating in the debt of Ireland, Portugal, Spain and Greece and to use equity rallies to divest of undiversified equity exposure to euro zone countries except for France and Germany.

Will the U.S. dollar continue to depreciate or is a new rally likely?

The U.S. trade deficit remains a negative for the dollar. Also, low U.S. interest rates, relative to those in other developed countries, should continue to lead demand for other currencies. We expect these disadvantages to push the dollar lower against most emerging-market currencies. However, the dollar could do better against developed-country currencies.

The dollar's slide against developed-market currencies in early 2011 exceeded our expectations. But, the dollar should find new strength against its developed-market competitors, whose current advantages in economic growth rates and interest-rate differentials could quickly reverse, if, as we expect, U.S. economic growth improves next year and interest rates rise. Moreover, any U.S. deficit-cutting progress at the federal level could be a positive surprise for the dollar. Overall, sentiment on the dollar has been so negative that good news may matter more than bad news in the coming months.

U.S. dollar forecasts

	2011 year-end
Dollars per euro	\$1.35
Yen per dollar	¥85
Dollars per Australian dollar	\$1.06
Dollars per Canadian dollar	\$1.03

Source: Wells Fargo Advisors

International

Maintain a diversified, core position in the following asset classes and supplement with favorite satellites.

Developed equity markets

Favorite country satellites:

- France
- Germany
- Switzerland
- United Kingdom

Source: Wells Fargo Advisors

Emerging equity markets

Favorite country satellites:

- Mexico
- South Korea
- Taiwan

Source: Wells Fargo Advisors

International fixed income

Favorite country satellites:

- Australia
- Germany
- Switzerland
- New Zealand

Source: Wells Fargo Advisors

Emerging markets fixed income

Favorite country satellites:

None at this time

Source: Wells Fargo Advisors

How do we adjust our investment strategy for the next six months?

Our balanced strategy across asset classes is really about adjusting to the headwinds of slowing global growth, emerging-market inflation pressures and the gradual removal of extraordinary U.S. monetary stimulus. In early 2011, anticipating a dollar rebound and volatility overseas, we moved to a slight underweight in developed-market equities relative to our strategic allocations and to a slight overweight to U.S. small- and mid-capitalization equities. That tactical move turned out to be a bit early but ultimately paid off. But looking into the balance of 2011, the softening U.S. economic data led us to remove the slight overweight to U.S. equities in June. Investors are advised to return to their long-term allocations on U.S. equities, international bonds, equities and commodities. We have shifted to this neutral or balanced stance entering the second half of the year, anticipating new opportunities, once the current headwinds subside.

A second principle of a balanced strategy pertains to allocating within international asset classes. We recommend that investors allocate the majority (depending upon the investor's risk tolerance) of the capital available for each asset class into a broadly diversified or "core" position. Clients should regard the core holding as an allocation in a broad, well-diversified, benchmark position in a given international asset class (including equities, fixed income and currencies).

We also recommend that clients supplement the core position with satellite positions based on our recommendations of individual countries. The relative sizes of the core and satellite positions depend on each investor's individual circumstances. For the most conservative investors, the entire allocation for a given asset class may be allocated to the core position. If the investor is willing to accept some volatility risk, we recommend putting a majority of international allocation into the core position with the remaining allocation in the satellite countries. The core allocation has a better chance of preserving the benefit of diversification while the minority satellite allocation potentially enables the investors to benefit from the best individual country opportunities. The recommendation tables identify recommended core and satellite positions for each international asset class.

How should investors adjust their international equity allocations?

Among the developed markets, our recommended satellites are those that should best resist the global economic moderation, including Germany, Switzerland, France, and the United Kingdom. Germany, the United Kingdom and Switzerland appear favorable based on their export strength. Also, France has improved the competitiveness of its exports and historically has been one of the more resilient markets to interest rate hikes. We believe any pullback in their equity prices and their currency values against the dollar in the coming months would represent a long-term buying opportunity.

Several emerging markets stand out for their relatively low inflation and economic prospects. Taiwan, South Korea and Mexico all have avoided the recent emerging-market inflation trend and have special economic advantages. Taiwan and South Korea should benefit from their ties to China and should also gain opportunities while Japan works to restore its supply chain from its earthquake damage. Mexico's economy is still in the early stages of improving employment and private spending before inflation becomes an issue.

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What about international fixed income?

Our international sovereign debt recommendations for the coming 12 months emphasize a core, diversified exposure, supplemented with positions chosen from those countries with strong ties to international trade. The satellite recommendations avoid those sovereigns with heavy debt obligations. Our recommendations among the developed markets continue to rely most heavily on low government debt levels, export strength and a benign inflation outlook. The best performers in 2011 are likely to be Australia, Germany, New Zealand and Switzerland.

For the long-term, we continue to recommend emerging-market sovereign debt, though only in a broadly diversified exposure at this time. This asset class has gained attention recently among investors for the favorable long-term growth trend, low debt burdens (compared with some developed economies) and much-improved liquidity. However, emerging-market sovereign bond prices drifted lower for much of the year's first half because of inflation issues, especially among the largest emerging markets. Investors are advised to take only a core, diversified position, to average into positions and not to overweight this category. In addition, a core position in emerging-market debt emphasizes a dollar-denominated exposure for consistency with our long-term strategic allocations.

Does our outlook continue to support commodity investment?

We expect solid global demand and increasing supply constraints for raw materials over the long-term. In the near-term, investors who can tolerate the risks and volatility of commodities are advised to consider a diversified position in these various commodity sectors as an appropriate way to take a core commodity exposure.

The recent corrections in commodity prices and the likelihood of softer near-term demand as the world economy moderates leave few markets as favored candidates for satellites positions. In particular, our current favorites include only corn and silver. Corn takes fundamental support from demand both as a food and as an energy additive. Silver corrected sharply in early May but remains a hedge against long-term dollar weakness.

Many investors have bought gold as a hedge against inflation and the falling U.S. dollar, and gold prices may rise further in the second half of 2011. But the risk from holding gold is also rising. In the coming months, gold prices could move sideways if the dollar rebounds, or once U.S. interest rates look set to rise. Moreover, evidence suggests that a broadly diversified commodity position is superior to gold alone to counter inflation and dollar depreciation. Considering the risks to gold's price and the historical superiority of a broad commodity exposure, we advise investors to consider whether their gold holdings are too large. Investors need not sell all their gold holdings at once but should consider using further gold price gains to gradually rebalance their portfolios toward a more diversified commodity approach.

Maintain a diversified, core position in commodities and supplement with favorite satellites.

Commodities

Favorite commodity satellites:

- Corn
- Silver

Source: Wells Fargo Advisors

Energy forecasts

	2011 year-end
Crude oil	\$95 per barrel
Natural gas	\$5.00 per million BTU

Source: Wells Fargo Advisors

Gold forecast

	2011 Range	2011 year-end
Baseline range	\$1,350-\$1,600	\$1,450
Upper range	\$1,400-\$2,200	\$2,000
Lower range	\$900-\$1,400	\$1,000

Source: Wells Fargo Advisors

Gold prices increase (upper range)

- U.S. economy stalls but inflation rises (stagflation)
- Large new European government bailouts or defaults
- New U.S. war or war in Afghanistan engulfs Pakistan
- U.S. Congress significantly expands budget deficit

Gold prices decline (lower range)

- U.S. economic growth rises faster than inflation
- No new European government bailouts or defaults
- Prospects for U.S. victory in Afghanistan improve
- U.S. Congress credibly commits to long-term debt control

Conclusion

The economic recovery that began two years ago is now in a midcycle slowdown. During this period, rising profits will likely lead to further job creation and more consumer spending, allowing the economic expansion to become sustainable without additional Fed stimulus.

After the strong advance during the past two years, the stock market is likely to consolidate during the second half of this year, and is likely to be supported by the growth in corporate profits, not the Fed's easy-money policy.

Slower economic growth and the ending of monetary stimulus are weighing on commodity prices and supporting the dollar. As a result, short-term inflation expectations have diminished slightly, giving the bond market a boost. Nevertheless, we believe that interest rates are likely to rise again as the economic expansion continues.

On the international front, low-debt emerging market economies continue to do better than high-debt developed economies, creating opportunities for investors looking for long-term growth. However, foreign markets could be volatile in the short run because central banks in several emerging economies are raising interest rates in order to fight inflation.

Looking ahead, uncertain events, such as the Greek debt problems, turmoil in the Middle East, natural disasters and lingering problems with U.S. debt and the deficit remain the biggest risks to the economic outlook. However, the longer the economic recovery continues, the more it may resist unexpected shocks. The key for investors in today's economy is to find proper balance in their portfolios as we weather these uncertainties.

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Economic and market and forecast

As of June 21, 2011 unless otherwise noted

		2010 year end	2011 latest	2011 year-end forecast
Real GDP	<i>rolling four quarters</i>	2.8%	2.3% ¹	2.8%
Real GDP	<i>latest quarter % chg. annual rate</i>		1.8% ¹	
Unemployment	<i>end of period/latest</i>	9.4%	9.1% ²	9.0%
CPI Inflation	<i>rolling 12-months</i>	1.5%	3.6% ²	2.5%
Federal Deficit	<i>rolling 12-months</i>	\$1.3 tril.	\$1.3 tril. ²	\$1.4 tril.
Existing Home Sales (SAAR*)	<i>end of period/latest</i>	5.2 mil.	4.8 mil. ²	5.3 mil.
Oil Prices	<i>latest (as of 6/21/11)</i>	\$91.38	\$93.40	\$95.00
Gold	<i>latest (as of 6/21/11)</i>	\$1,420.78	\$1,546.00	\$1,450.00
U.S. Dollars per Euro	<i>latest (as of 6/21/11)</i>	\$1.34	\$1.44	\$1.35
Target Federal Funds Rate	<i>latest (as of 6/21/11)</i>	0.12%	0.12%	0.12%
10-year Treasury	<i>latest (as of 6/21/11)</i>	3.30%	2.98%	3.50%
30-year Treasury	<i>latest (as of 6/21/11)</i>	4.34%	4.22%	4.50%
MSCI EAFE Index	<i>latest (as of 6/21/11)</i>	1658.30	1666.70	1720
MSCI Emerging Markets Index	<i>latest (as of 6/21/11)</i>	1151.38	1113.00	1225
S&P 500	<i>latest (as of 6/21/11)</i>	1257.64	1295.50	1250-1300
S&P Operating Earnings	<i>trailing 4 quarters</i>	\$86.70/shr	\$93.60/shr ¹	\$95.50/shr
S&P 500 Price/Earnings	<i>trailing 4 quarters oper. earnings</i>	14.51	13.84 ¹	13.35

Source: Bloomberg, Wells Fargo Advisors

1 = data as of first quarter 2011

*SAAR - Seasonally adjusted annual rate

2 = Data as of May 2011

Investment Strategy Committee tactical weightings *as of June 21, 2011*

Major markets	Recommended weighting	Sectors	Recommended weighting	Percent of S&P	Guidance
U.S. large-cap stocks	Neutral	Cons. Discret.	Even	10.5%	11.0%
U.S. mid-cap stocks	Neutral	Cons. Staples	Under	11.1	10.0
U.S. small-cap stocks	Neutral	Energy	Even	12.6	11.0
Growth stocks	Neutral	Financial	Under	15.2	13.0
Value stocks	Neutral	Health Care	Under	11.9	10.0
International developed stocks	Neutral	Industrials	Over	11.1	13.0
Emerging-market stocks	Neutral	Info. Tech.	Under	17.5	15.0
Dollar	Neutral	Materials	Over	3.5	4.0
Commodities	Neutral	Telecom.	Over	3.1	6.0
Short-term IG ⁺ bonds	Neutral	Utilities	Over	3.5	7.0
Intermediate-term IG ⁺ bonds	Over				
Long-term IG ⁺ bonds	Under				
International fixed income	Neutral				
High Yield Securities	Neutral				
REITs	Neutral				

Source: Bloomberg, Wells Fargo Advisors

Note: Weightings may not add due to rounding

¹IG - Investment grade - Treasuries, agency securities, mortgage-backed securities, corporate bonds and municipal bonds.

Note: Weightings are relative to current firm asset allocation models

Definitions

The CBOE (Chicago Board Options Exchange) Volatility Index (VIX) shows the market's expectation of 30-day volatility. It is constructed using the implied volatilities of a wide range of S&P 500 index options. This volatility is meant to be forward-looking and is calculated from both calls and puts. The VIX is a widely used measure of market risk and is often referred to as the "investor fear gauge."

The Dow Jones Industrial Average is based on 30 major companies weighted by price.

The S&P 500 Index consists of 500 industrial, financial, utility and transportation companies with market capitalizations of \$3 billion or more.

New York Stock Exchange Composite Index measures all common stocks listed on the New York Stock Exchange and four subgroup indexes: industrial, transportation, utility and finance. The index tracks the change in the market value of NYSE common stocks and is adjusted to eliminate the effects of new listings and delistings.

MSCI EAFE (Europe, Australasia and Far East) Index is compiled by Morgan Stanley Capital International (MSCI) is a value-weighted index of the equity performance of major foreign markets. In effect, it is a non-American world index of more than 1,000 stocks.

MSCI Emerging Market Index was created by MSCI and designed to measure equity market performance in global emerging markets.

The Russell 2500 Index measures the performance of the 2,500 smallest companies in the Russell 3000 Index. It is calculated by Frank Russell Company and reflects reinvestment of all dividends and capital gains.

Russell 3000 Index measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market.

Consumer Price Index (CPI) is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. The CPI is calculated by taking price changes for each item in the predetermined basket of goods and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living.

Short-term fixed income is instruments that mature in one to six years.

Intermediate-term fixed income is instruments that mature in six to 12 years.

Long-term fixed income is instruments whose maturities are greater than 12 years.

International investing involves putting money into financial markets in developed economies outside of the United States.

Emerging markets are financial markets in countries with developing economies. These markets are typically immature compared to those of the world's major financial centers but are becoming increasingly sophisticated and integrated into international markets; they provide potentially higher returns but are intensely volatile.

High yield is noninvestment-grade fixed income securities (rated Ba1 or lower by Moody's and/or BB+ or lower by S&P). These investments are considered to be speculative and are subject to a higher degree of risk.

Real estate investment trusts (REITs) trade on the major exchanges and invest in real estate directly, either through properties or mortgages.

Large-cap growth stocks have a market cap greater than \$6 billion and a price-to-book ratio greater than 2.15.

Large-cap value stocks have a market cap greater than \$6 billion and a price-to-book ratio less than or equal to 2.15.

Mid-cap growth stocks have a market cap between \$1.2 - \$6 billion and a price-to-book ratio greater than 2.15.

Mid-cap value stocks have a market cap between \$1.2 - \$6 billion and a price-to-book ratio less than or equal to 2.15.

Small-cap growth stocks have a market cap less than \$1.2 billion and a price-to-book ratio greater than 2.15.

Commodities are basic goods used in commerce that are generally interchangeable with other commodities of the same type. Commodities are most often used as inputs in the production of other goods or services.

Credit rating — Single "A"-rated Moody's: Possess many favorable investment attributes and are to be considered as upper-medium grade obligations.

Standard & Poor's: Are somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher rated categories. The issuer's responsibility to meet its financial commitment on the obligation is still strong.

Important disclosures

Past performance is not an indication of future results.

An index is not managed and is unavailable for direct investment.

Investing in foreign securities presents certain risks not associated with domestic investments, such as currency fluctuations, political and economic instability, and different accounting standards. This may result in greater share price volatility.

Dividends can be increased, decreased or totally eliminated at any point without notice.

Technology and Internet-related stocks, especially of smaller, less-seasoned companies, tend to be more volatile than the overall market.

The prices of small- and mid-cap company stocks are generally more volatile than large-company stocks. They often involve higher risks because smaller companies may lack the management expertise, financial resources, product diversification and competitive strengths to endure adverse economic conditions.

Investing in fixed income securities involves certain risks such as market risk if sold prior to maturity and credit risk especially if investing in high yield bonds, which have lower ratings and are subject to greater volatility. All fixed income investments may be worth less than original cost upon redemption or maturity. Income from municipal securities is generally free from federal taxes and state taxes for residents of the issuing state. While the interest income is tax-free, capital gains, if any, will be subject to taxes. Income for some investors may be subject to the federal Alternative Minimum Tax (AMT).

Bond prices fluctuate inversely to changes in interest-rates. Therefore, a general rise in interest rates can result in the decline of the value of your investment.

The interest rate for Treasury Inflation-Protected Securities (TIPS), which is set at auction, remains fixed throughout the term of the security. The principal amount of the security is adjusted for inflation, but the inflation-adjusted principal will not be paid until maturity although the adjustment will be subject to income tax in the year it was earned. Wells Fargo Advisors is not a tax advisor. TIPS have special tax consequences, generating phantom income on the "inflation compensation" component of the principal. A holder of TIPS may be required to report this income annually although no income related to "inflation compensation" is received until maturity.

There are special risks associated with an investment in real estate, including credit risk, interest rate fluctuations and the impact of varied economic conditions. Distributions from REIT investments are taxed at the owner's tax bracket.

While stocks generally have a greater potential return than government bonds and Treasury securities, they involve a higher degree of risk. Government bonds and Treasury bills, unlike stocks, are guaranteed as to payment of principal and interest by the U.S. government if held to maturity. Although Treasuries are considered free from credit risk, they are subject to other types of risks. These risks include interest rate risk, which may cause the underlying value of the bond to fluctuate inversely to a change in interest rates.

Buying commodities allows for a source of diversification for those sophisticated persons who wish to add commodities to their portfolios and who are prepared to assume the risks inherent in the commodities market. Any purchase represents a transaction in a non-income-producing commodity and is highly speculative. Therefore, commodities should not represent a significant portion of an individual's portfolio.

Buying gold, silver, platinum or palladium allows for a source of diversification for those sophisticated persons who wish to add precious metals to their portfolios and who are prepared to assume the risks inherent in the bullion market. Any bullion or coin purchase represents a transaction in a non-income-producing commodity and is highly speculative. Therefore, precious metals should not represent a significant portion of an individual's portfolio.

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High-yield bonds, also known as junk bonds, are subject to greater risk of loss of principal and interest, including default risk, than higher-rated bonds. The prices of these bonds may be volatile, and they are generally only suitable for aggressive investors.

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Disclosure Information

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