

Preparing for Better Days

2012 Economic and Market

# OUTLOOK

A special publication from our Investment Strategy Committee

## Economy

### Will the economic recovery continue?

See what our Chief Macro Strategist forecasts for GDP, unemployment and inflation.

## U.S. Equities

### What's ahead for stocks?

Our Chief Equity Strategist looks at what may be down the road for earnings and stock prices.

## Fixed income

### How should you respond to today's low interest rates?

Get useful ideas from our Chief Fixed Income Strategist.

## International

### What about investments outside the United States?

Our Chief International Investment Strategist also checks up on commodities and currencies.

Please see page 15 for important disclaimers and analyst certification.

# Economic and market forecast

As of December 12, 2011, unless otherwise noted

Our forecasts and recommendations in this report are produced by analysts and strategists on Wells Fargo Advisors' Investment Strategy Committee.

Economy		2010 year end	2011 latest	2012 year-end forecast
Inflation-adjusted GDP	rolling four quarters	3.1%	1.5% <sup>1</sup>	2.2%
Inflation-adjusted GDP	latest quarter percent change annual rate		2.0% <sup>1</sup>	
Unemployment	end of period/latest	9.4%	8.6% <sup>2</sup>	8.0%
CPI inflation	12-month average	1.6%	2.8% <sup>2</sup>	2.5%
Federal deficit	rolling 12-months	\$1.3 tril.	\$1.3 tril. <sup>2</sup>	\$1.2 tril.
Existing home sales (SAAR*)	end of period/latest	5.2 mil.	4.9 mil. <sup>2</sup>	5.5 mil.
Total vehicle sales (SAAR*)	end of period/latest	12.5 mil.	13.6 mil. <sup>2</sup>	15.0 mil.

U.S. equity		2010 year end	2011 latest	2012 year-end forecast
S&P 500 index	latest (as of 12/12/11)	1,257.64	1,236.47	1,325-1,375
S&P operating earnings	trailing 4 quarters	\$83.77/shr.	\$94.66/shr. <sup>1</sup>	\$103.00/shr.
S&P 500 price/earnings	trailing 4 quarters oper. earnings	15.01	13.06 <sup>1</sup>	13.11

Fixed income		2010 year end	2011 latest	2012 year-end forecast
Target federal funds rate	latest (as of 12/12/11)	0.12%	0.12%	0.12%
10-year Treasury	latest (as of 12/12/11)	3.30%	2.05%	3.00%
30-year Treasury	latest (as of 12/12/11)	4.34%	3.09%	4.00%

International, commodities and currency		2010 year end	2011 latest	2012 year-end forecast
MSCI EAFE index	latest (as of 12/12/11)	1,658.30	1,404.67	1,500.00
MSCI Emerging Markets index	latest (as of 12/12/11)	1,151.38	924.51	1,100.00
Oil	latest (as of 12/12/11)	\$91.38	\$97.77	\$107.00
Gold	latest (as of 12/12/11)	\$1,420.78	\$1,666.57	\$1,900.00
U.S. dollars per euro	latest (as of 12/12/11)	\$1.34	\$1.32	\$1.23

\*SAAR = Seasonally adjusted annual rate

<sup>1</sup> = Data as of third-quarter 2011

<sup>2</sup> = Data as of November 2011

Source: Bloomberg, Wells Fargo Advisors

## Recommended portfolio weightings

As of December 12, 2011

### Equity sectors

Overweight	% of S&P 500	Guidance	Evenweight	% of S&P 500	Guidance	Underweight	% of S&P 500	Guidance
Industrials	10.7%	12.0%	Consumer Discret.	10.8%	11.0%	Consumer Staples	11.4%	9.5%
Materials	3.5%	4.0%	Energy	12.3%	12.0%	Financial	13.4%	11.0%
Telecom.	3.1%	5.5%				Health Care	11.5%	10.8%
Utilities	3.7%	7.0%				Info. Tech.	19.6%	17.2%

Note: Weightings may not add to 100% due to rounding.

Source: Bloomberg, Wells Fargo Advisors

### Asset classes

Overweight	Evenweight	Underweight
Growth stocks	Dollar	Commodities
Short-term IG <sup>1</sup> bonds	Emerging-market stocks	Long-term IG <sup>1</sup> bonds
	High-yield securities	Value stocks
	Intermediate-term IG <sup>1</sup> bonds	
	International developed stocks	
	International fixed income	
	REITs	
	U.S. large-cap stocks	
	U.S. mid-cap stocks	
	U.S. small-cap stocks	

Note: Weightings are relative to current firm asset allocation models.

Source: Bloomberg, Wells Fargo Advisors

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



# Preparing for better days

When laying siege to a fortress back in the day, you might have encountered layered walls. If you were able to overcome the outermost wall, you would hit a second and then, possibly, a third. It seems the economy and the markets could be facing just such a “fortress” when it comes to the recovery from the 2008-2009 recession. Every time one obstacle has been overcome, another has raised its head.

The good news is that in spite of this, there has been ongoing – although slow – improvement in a number of areas. Output is rising, and profits are increasing.

Although it would be nice if the last “wall” had been overcome, we still see plenty of others down the road, including the European debt situation, less-than-robust housing market, U.S.-government-debt challenges, ongoing high unemployment, etc. However, we also expect to see better days in 2012

as a result of continuing slow improvement in the economy and the markets.

What this outlook means for your investments depends on a number of factors, including your situation and objectives. That’s why we invite you to read the analyses on the following pages and talk with your Financial Advisor about what adjustments, if any, you want to make. If you don’t have a Financial Advisor, visit [wellsfargo.com/advisors](http://wellsfargo.com/advisors) to locate a Wells Fargo Advisors branch near you.

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## Economy 4

The slow recovery should continue. Expectations are low; look for any upside surprises to have significant effects.

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## U.S. equities 6

Anticipate slow earnings growth and continued volatility. Large-cap and growth stocks are likely to perform best.

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## Fixed income 8

Expect no relief from low interest rates. Diversification, not “reaching for yield,” should be the name of the game.

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## International 10

Everyone’s talking about Europe, but divergence between developed countries and most everyone else is a trend to watch.

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## Conclusion 12

Investors should maintain a balanced strategy to ride out the storm and prepare for better days.

# Waiting for the storm clouds to clear

Things should continue to slowly improve rather than get worse



**Gary Thayer**  
Chief Macro Strategist

## Slow recovery continues

The U.S. economy has been recovering from the 2008-2009 recession for 2½ years. Normally, the economy rebounds rapidly after a steep contraction. This time is different. The current recovery has been relatively slow because of lingering problems from the recession. In particular, housing remains depressed despite record low mortgage interest rates. In addition, companies traditionally hire more workers after the economy and corporate profits rebound. In this recovery, profits have increased, but companies have been slow to add workers. As a result, unemployment remains stubbornly high, which limits income growth and consumer spending. Finally, state- and local-government spending usually recovers as the economy improves and tax revenues increase. Unfortunately, state and local governments are still cutting spending because of budget constraints. All these problems limit economic expansion, and as a result, the U.S. economy is growing at only a modest rate.

We look for inflation-adjusted gross domestic product (GDP) to increase at a 2.2% annual rate in 2012. This would be below the 30-year 2.7% average GDP growth rate. We expect consumer spending and business investment to remain the two biggest contributors to GDP growth. On the negative side, a slowdown in the global economy will probably reduce net exports. In addition, state- and local-government spending will probably subtract from growth; however, the impact should be less in 2012 than in 2011.

## Slow growth likely to reduce inflationary pressures

We look for a couple of factors to help reduce inflationary pressure in the year ahead. First, the global economic slowdown will probably decrease inflation because the demand for resources has declined. At the same time, the high unemployment rate has dampened wage increases. As a result, labor costs have moderated, keeping inflation in check. Monetary officials have pumped a lot of liquidity



### Forecasts

2.2%

Inflation-adjusted GDP  
Rolling four quarters

8.0%

Unemployment  
End of period/latest

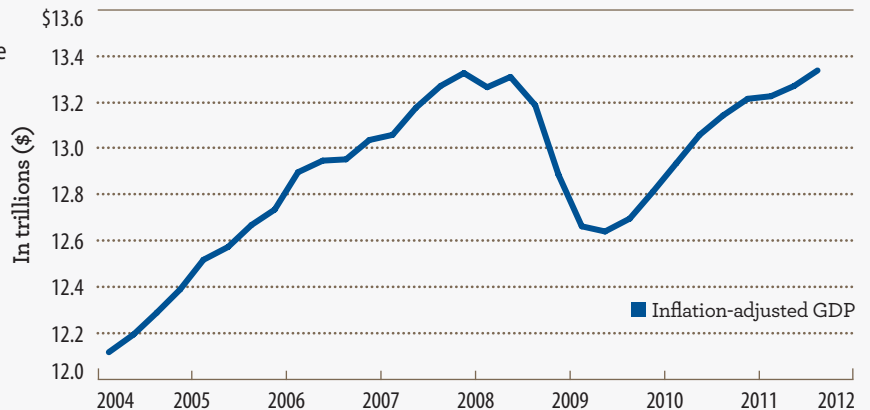
2.5%

CPI inflation  
12-month average

Source: Wells Fargo Advisors

## U.S. economy continues to rebound

U.S. gross domestic product (GDP) – a measure of all products and services the country produces – continues to grow as it has since mid-2009. However, the recovery has been disappointingly slow.



Source: Commerce Department, Haver Analytics

## Unemployment has improved but remains relatively high

Unemployment has declined from 10.1% in October 2009 to 8.6% in November 2011. At this pace, it could take several years to get back to pre-recession levels.



Source: Labor Department, Haver Analytics

into the global economy during the past few years. But this money is not turning over rapidly. In fact, net lending is still low. Financial institutions are making new loans, but businesses and consumers are deleveraging by paying off old loans to get their finances in better shape. The added liquidity from the Federal Reserve would be inflationary only if the velocity or turnover of that money increases. That is not happening now.

We look for the consumer price index (CPI) to increase 2.5% in 2012. This would be slightly above the growth in underlying core prices, or CPI excluding the volatile food and energy components. Inflation was a concern in early 2011, but the global economic slowdown is likely to prevent any shortages that would drive prices substantially higher in the year ahead. However, looking out over the longer term, we expect inflation to average 3.0% over the next 10-15 years.

### Unemployment likely to remain high

The good news is that more industries are adding jobs than are cutting jobs. Unfortunately, not enough jobs are being created to substantially reduce the unemployment rate. After all, businesses need to create jobs faster than the labor force expands to bring the unemployment rate down.

We expect the unemployment rate to remain high through most of 2012, ending the year only slightly lower than in 2011. Specifically, we believe the unemployment rate is likely to be around 8.0% at the end of 2012. This is well above the 4.6% average prevailing rate in the two years ahead of the 2008-2009 recession.

### Good news would probably surprise more than negative news

After several years of disappointing economic performance, expectations for growth are currently very low. Therefore, investors are more likely to be surprised in 2012 by better economic performance than continued weak economic activity.

Investors are still worried that the U.S. economy could fall into recession. We currently put the double-dip recession probability at 35%. Obviously, anything could happen. However, the economy may be more resilient than many people think. Moreover, during the past few years, home sales have been running below the trend of individuals forming households (household formation). This condition is unlikely to last forever. We believe we are getting closer to the point where housing will begin to turn up. When housing activity starts to increase, the economy is likely to surprise on the upside.

# Geopolitical events should continue to drive the markets

## Large-cap and growth stocks may offer the best opportunities



**Stuart Freeman, CFA®**  
Chief Equity Strategist

### Forecasts

\$103

S&P 500 earnings

1,325-1,375

S&P 500 index

Source: Wells Fargo Advisors

### Slow earnings growth expected

In the equity arena, we continue to look for slow earnings growth. We expect S&P 500 operating earnings to increase approximately 5.1% in 2012. We see this growth being driven half by unit (sales) growth and half by price (inflation) growth but are anticipating little increase in margins.

In 2011, the overall broad market was roughly flat. The best performance took place through early May, but the markets settled to lower levels as the year wore on. A number of factors led to volatility, including the mid-year end of the Fed's second bond purchase program to boost liquidity, known as quantitative easing (QEII), the Japanese tsunami, concerns over European sovereign debt troubles, the U.S. government's financial condition, rating company downgrades and concerns that the U.S. government may not generate material deficit reduction ahead of next year's presidential election.

### Larger-cap equities should outperform

Overall, given slowing international growth and high visibility concerns regarding European recession, we generally expect that large-capitalization and mid-capitalization domestic equities will be best positioned for performance during 2012, at least until the uncertainties of European financial difficulties and slowing growth in China become clearer. In general, larger-cap companies tend to have greater access to capital and more potential to make acquisitions and/or to buy back shares. These companies usually represent lower risk than small-cap companies when global growth is slow. In addition, large- and mid-cap equities provide more liquidity than small-cap equities, which can help to moderate volatility.

### Growth versus value equities

While a strong rebound in financial stocks would materially benefit the value category, generally slow economic and loan growth as well as regulatory action within the sector are likely to limit the rate of margin growth within the Financial sector in the intermediate term. However, we foresee better performance potential in next year's slower-growth environment to be generated by companies capable of expanding their market shares and growing their revenues here and abroad at a faster pace than the general economy.

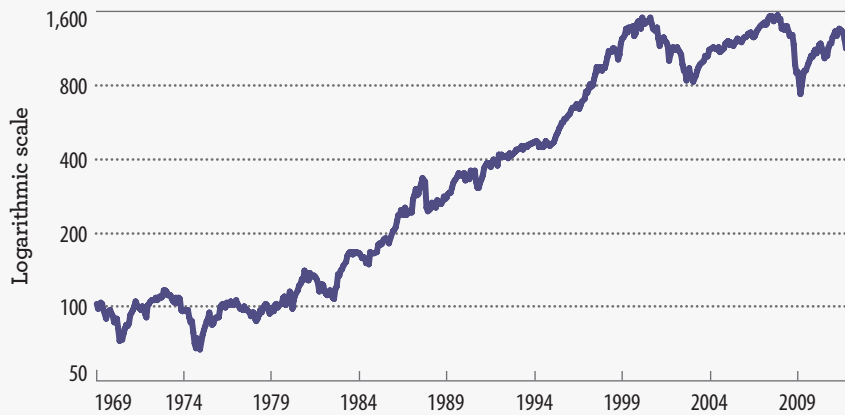
### Sector exposure should remain balanced

In the current below-average-growth economic recovery, we continue to recommend that investors keep their sector exposure relatively balanced. We currently recommend investors carry overweight positions in the more defensive Utility and Telecom Services sectors, which offer the potential for less volatile total returns in addition to above-average dividend yields. Our overweight recommendations for the Industrial and Materials sectors offer upside potential for a 2012 environment in which we expect inflation-adjusted GDP to grow at a 2.2% average annual rate. While both sectors' market prices have picked up steam since early October, these two cyclical segments lost some ground versus the market in the second half of 2011 as investors moved to a more cautious stance on the economy and stocks from a more optimistic one earlier in the year.

For now, we continue to recommend investors maintain underweighted positions in the Technology (which now represents the largest market capitalization sector in the S&P 500) and Financial sectors. Should investor concerns surrounding Europe's financial issues moderate and domestic growth outperform our current expectations, our stance on these two more cyclically driven segments could potentially lift over the course of 2012's first half.

## A bumpy ride for the S&P 500

Although down from its all-time highs, the S&P 500 index has recovered significantly from its 2009 recession lows.



Past performance is not an indication of future results. An index is not managed and is unavailable for direct investment.

Source: Factset, Wells Fargo Advisors

## Higher stock prices and continued volatility

Given the economy's modest growth rate and signs of a slow decline in initial unemployment claims, we foresee stronger consumer and investor confidence by late next year. On that basis, we believe a 5.1% increase in operating earnings growth has the potential to push the S&P 500 toward the 1,325-1,375 range by year-end 2012. These target range boundaries represent price/earnings (P/E) valuations of approximately 12.9x to 13.3x on our 2012 operating earnings estimate.

Given our 2012 projections of below-average 2.2% inflation-adjusted GDP growth and 5.1% operating earnings per share growth for the S&P 500, we believe unexpected events and bumps in the road will continue to have material impacts on volatility and the market's trend. We anticipate that a number of factors will play a part in keeping volatility alive within the domestic equity markets, including European Union (EU) sovereign debt issues that appear to currently be spreading in Europe, concerns over U.S. government debt and deficit issues, the noise of a presidential election year, ongoing anxieties regarding Iran's nuclear programs, the direction of the price of oil, and other potential unexpected geopolitical events.

## Stocks appear to be undervalued long term

The S&P 500 index is lower today than it was over a decade ago in the middle of the 2000 calendar year. On the other hand, S&P 500 operating earnings are now 70% higher than they were at that time. As a result, stocks are attractively priced for the long term compared to earnings and alternative asset classes. Attractive valuations could help support equities as the global economy moves through these challenging times.

# Continued low interest rates will present challenges

Fixed-income investors should focus on diversification



**Brian Rehling, CFA®**  
Chief Fixed Income Strategist

## Fixed income investment challenges will continue

Next year is setting up to be another difficult year for investors seeking interest income. Short-term, high-quality fixed income securities can help preserve capital and liquidity, but these investments offer very little in the way of yield. We currently see little reason to be optimistic that the challenging investment environment will change in 2012 given the Federal Reserve's commitment to keep short-term rates unchanged at 0% to 0.25% through mid-2013. Fixed income investors who are looking to achieve incremental yield or return will be forced to take on additional risks by extending their time horizon (buying longer maturities), lowering their quality parameters (purchasing lower quality bonds) or some combination of the two.

The Fed has exhausted its ability to lower short-term rates and has been relying on unconventional measures to further ease monetary policy. Over the past two years, the Fed has implemented two rounds of quantitative easing (bond purchase programs designed to boost liquidity in the economy) and is currently executing "operation twist," which involves buying longer-term bonds and selling shorter-term securities. This is intended to lower long-term rates. Additional monetary-easing measures in 2012 are not a foregone conclusion; however, an unexpected slowdown in the U.S. economy would likely lead the Federal Open Market Committee (FOMC) to announce a third round of quantitative easing.

### Forecasts

0.00% - 0.25%

Target federal funds rate

3.0%

10-year Treasury yield

4.0%

30-year Treasury yield

Source: Wells Fargo Advisors

## 10-year Treasury yields remain historically low

Investors may want to think carefully before locking in today's historically low rates for significant periods of time.



Past performance is not an indication of future results.

Source: Bloomberg

We expect that the economy and employment picture will gradually improve in 2012, which could, in our view, lead to longer-term rates moving higher throughout the year. We expect this trend to be gradual and do not see a scenario in which the Fed would be willing to let rates move substantially higher. For 2012, we look for the 10-year U.S. Treasury yield to trade in a range between 1.75% and 3.25%, ending the year at 3.00%.

While we do not expect a rapid rise in long-term rates over the next 12 months, investors purchasing longer-dated bonds face an investment horizon that may include significantly higher yields, which would negatively impact bond prices. It is important that investors not become complacent. Much like equity prices, interest rates do not move in a straight line. While we see rate movements somewhat benign over the next 12 months, the timing of significant moves often takes the market by surprise.

### Consider adding allocations to credit-sensitive sectors

We encourage investors looking to increase yield within their fixed income portfolios to consider adding allocations to credit-sensitive sectors, such as corporate bonds and preferred securities. Many corporations have improved their balance sheets in recent years, and we think these securities currently offer better value than Treasury securities. We recommend that investors with short investment horizons use caution in adding to the more credit-sensitive sectors given these sectors' potentially volatile nature. We advise that investors refrain from "reaching for yield" by moving lower in credit quality than is appropriate for their risk tolerance.

Tax-exempt fixed income investors should take advantage of any weakness in the municipal bond market to accumulate high-quality positions. While municipal issuers will continue to face significant budgetary challenges in 2012, we believe the primary risk will be rating downgrades rather than actual default risk. We recommend that investors focus on accumulating positions of single "A"-rated or better (by Standard and Poor's) general-obligation and essential-service revenue bonds.

### Investors should remain diversified

The risk of European debt contagion next year remains heightened. The U.S. Treasury is still perceived as a safe-haven instrument and would likely see further gains if European debt concerns increase. Looking past 2012, the debt issue currently wreaking havoc in Europe has the potential to impact the United States if investors act on concerns over the growing U.S. government debt load. Political differences in the United States pose ongoing risks to the fixed income market, and we believe we are unlikely to see a substantial long-term U.S. debt solution before the 2012 presidential and congressional elections. Investors should take care to diversify their holdings in fixed income allocations, holding positions both outside of the United States and in currencies other than the dollar to be better prepared for any future market issues.

### Manage both sides of your balance sheet

While investors are faced with difficult decisions, borrowers can use the low-rate environment to their advantage. With mortgage rates near historically low levels, investors should take the time to review their current interest costs and refinance outstanding loans that may carry higher interest rates.

## 2012 opportunities in fixed income

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

Source: Wells Fargo Advisors

\*We recommend a duration slightly short of an investor's target duration. If an investor does not have a target duration, then we recommend a duration of approximately 4 years in taxable portfolios, and 6.75 years for tax-exempt 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.

# Austerity, especially in Europe, may hinder growth

Investors should allocate across countries and commodities



**Paul Christopher, CFA®**  
Chief International  
Investment Strategist

## Divergence remains a strong trend

The strongest trend in the global economy has been, and remains, the divergent growth rates between the heavily indebted developed economies and most of the rest of the world. The heavily indebted group includes the U.S., euro-zone and Japanese economies. The rest of the world is led by China but includes many emerging economies and the developed economies of Canada, Australia and Scandinavia. As those in the former group struggle with large debts, their outlook is for austerity and slow economic growth in the coming years. By contrast, economic growth in the latter group has stronger prospects and is well positioned to benefit from domestic economic stimulus and lower commodity prices in 2012.

## Spillover risks

Still, globalization has made it hard for any part of the world to avoid the serious problems that spill over from other parts. China, the Middle East and Europe are the three areas we consider most important for markets right now. China has been trying to engineer an economic slowdown to ease inflationary pressures and appears to be succeeding. Managing an economy of China's size is not easy, and a sharp slowdown could adversely affect China's Asian and Latin American trade partners. And even after a year of political upheaval in the Middle East, conditions remain unstable, and world oil prices remain vulnerable to tensions – especially between Iran and Saudi Arabia.

## European debt crisis remains primary concern

The most prominent issue remains Europe's debt crisis and the concern that it will trigger a financial collapse that will lead to a new global economic recession. Europe's leaders have made progress, and the worst case (government default or a series of large bank failures) seems low. The leaders' dual challenge is to implement long-term reforms while assuring investors that the crisis can be contained in the present. Despite progress, more questions remain. Our highest probability scenario is more partial measures and volatility, until Europe can convince investors it has contained the problem.

Even if Europe succeeds, global economic growth differences may widen in 2012. Austerity measures in Europe should continue to weigh on growth. Near-zero interest rates may not fuel much additional growth, but the emerging markets have room to cut interest rates to stimulate their economies as inflation fears dissipate.

## Diversification is key

The ongoing divergence in economic growth rates implies that correlations between markets should decline over time. In other words, just because one market does well will not mean that others will necessarily follow suit. These lower correlations should lead to higher benefits from portfolio diversification. This is why we recommend holding core, diversified positions in international equities, sovereign debt and commodities. It is important to remember that diversification does not eliminate losses but can help reduce the risk from any one market, especially when correlations are low.

### Forecasts

1,500  
MSCI EAFE equity index

1,100  
MSCI Emerging-market equity index

\$107 Crude oil  
Per barrel

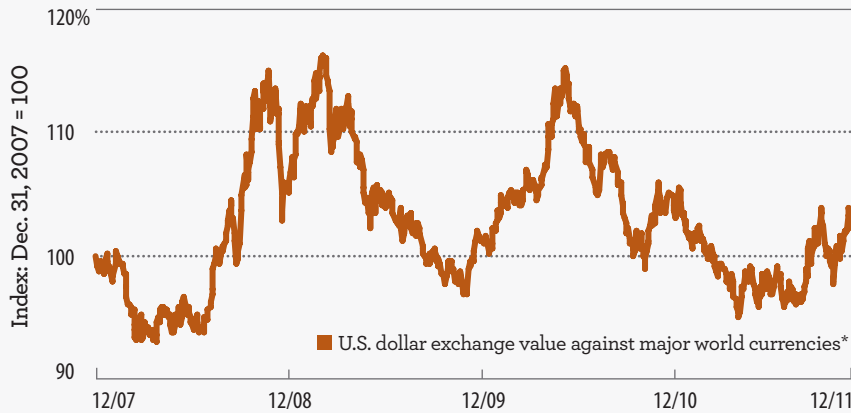
\$1,900 Gold  
Per troy ounce

\$1.23 Euro/dollar  
Exchange rate

Source: Wells Fargo Advisors

## Expect more strength in the dollar

The dollar's current relative strength should continue, especially in the year's first half of 2012.



\*Note: The index is a composite of exchange rates of the U.S. dollar against the euro, Japanese yen, British pound, Canadian dollar, Swedish krona and Swiss franc, weighted by their respective shares in total trade with the United States.

## Focus on economic growth

International markets enter 2012 on a weak note. Sluggish growth, a low level of confidence around the North Atlantic and open questions about Europe and China will weigh on markets during the first half. Choppy commodity and equity markets that have trouble gaining traction are likely in the first quarter or two. The dollar should stay strong, especially against the euro and other developed-market currencies (except the yen). However, international developed bond markets may benefit from the continued caution and slow economic momentum. Long-term investors should expect range-bound markets that react sharply to headlines in the first quarter or two. Continued caution is in order, and investors are advised to use selloffs to gradually rebalance core, diversified positions in international financial and commodity markets.

## Strong global currency performance against the dollar

If the questions about Europe and China begin to resolve favorably in the first half of the year, as we expect, then investment conditions could start to recover by mid-year. The possibility of accelerating growth could recharge international equities, commodities and emerging-market debt. Any new stability in Europe and signs of re-acceleration in the Chinese economy may also boost confidence and reverse the demand for perceived safe havens, such as developed-market sovereign debt, the dollar, and the yen. In this scenario, we expect stronger performances, especially among emerging-market currencies, against the dollar in the year's second half.

## Sizing up gold

Gold should remain supported by safe-haven demand from European investors looking for protection from the debt crisis and low interest rates across the G7 countries, particularly in the United States. But gold could continue to be volatile in 2012's first two quarters or for as long as it takes to contain the risks from the European debt crisis. We currently recommend limiting gold exposure to what can be obtained through a diversified commodity position so that volatility doesn't have too big an effect on portfolios.

## 2012 opportunities in international investments

Equities	Sovereign debt	Currencies
Japan	Australia	Australia
Malaysia	New Zealand	Sweden
Indonesia		
Mexico		

Source: Wells Fargo Advisors

# More storms and, eventually, clearer skies are likely

Storms buffeted the U.S. economy this year. The economy is growing, but problems here and overseas are hindering expansion. As a result, the financial markets have been volatile, and investors have been worn down by a seemingly unending stream of bad news. At this point, investors would probably like a little relief. Unfortunately, the storm clouds are yet to clear. As a result, investors should maintain a balanced investment strategy to ride out the storm and be ready to take advantage of better times when the storms pass.

We believe the most likely scenario is that the global economy will work through its current problems during the next year. Of course, anything can happen. The efforts to contain the financial crisis in Europe could fail, pushing the global economy into a deep contraction. However, policymakers are making progress and could eventually get ahead of the problems. In the meantime, investors should probably not take on too much risk. The storm is not over yet.

In the United States, the economy is still struggling with a weak housing market and cautious consumer and business spending. In addition, the government will need to reduce its deficit trajectory, or within a few years, it could find itself in a situation like some European countries today. Reduced government spending and/or higher taxes would be good for government finances over the long run but would dampen economic growth in the short run, much like consumer and business deleveraging has hindered the economic recovery during the past few years.

In this environment, investors should keep a well-diversified portfolio that has a balanced risk profile. Equity exposure is still appropriate with corporate profits rising and valuations attractive. However, sector weightings should not be too defensive nor too cyclical. In the fixed income area, investors may need to take some risk to find yield but should probably take modest credit risk rather than a lot of long-term maturity risk.

On the international front, the growth opportunities still look best in emerging markets. More important, if the dollar's value increases against other developed-country currencies in the year ahead, investors may benefit from more U.S. exposure compared to developed international markets.

Many investors are probably worried that the increase in liquidity used to fight the European financial crisis could lead to inflation. However, this may not be a problem as long as the global economy is soft. In fact, the extra liquidity could help financial assets at the same time that the weak global economy restrains resource inflation. If so, U.S. stocks could outperform commodities as investors prepare for clearer skies.

# Have an overall strategy before you act

Our models can help you and your Financial Advisor get started

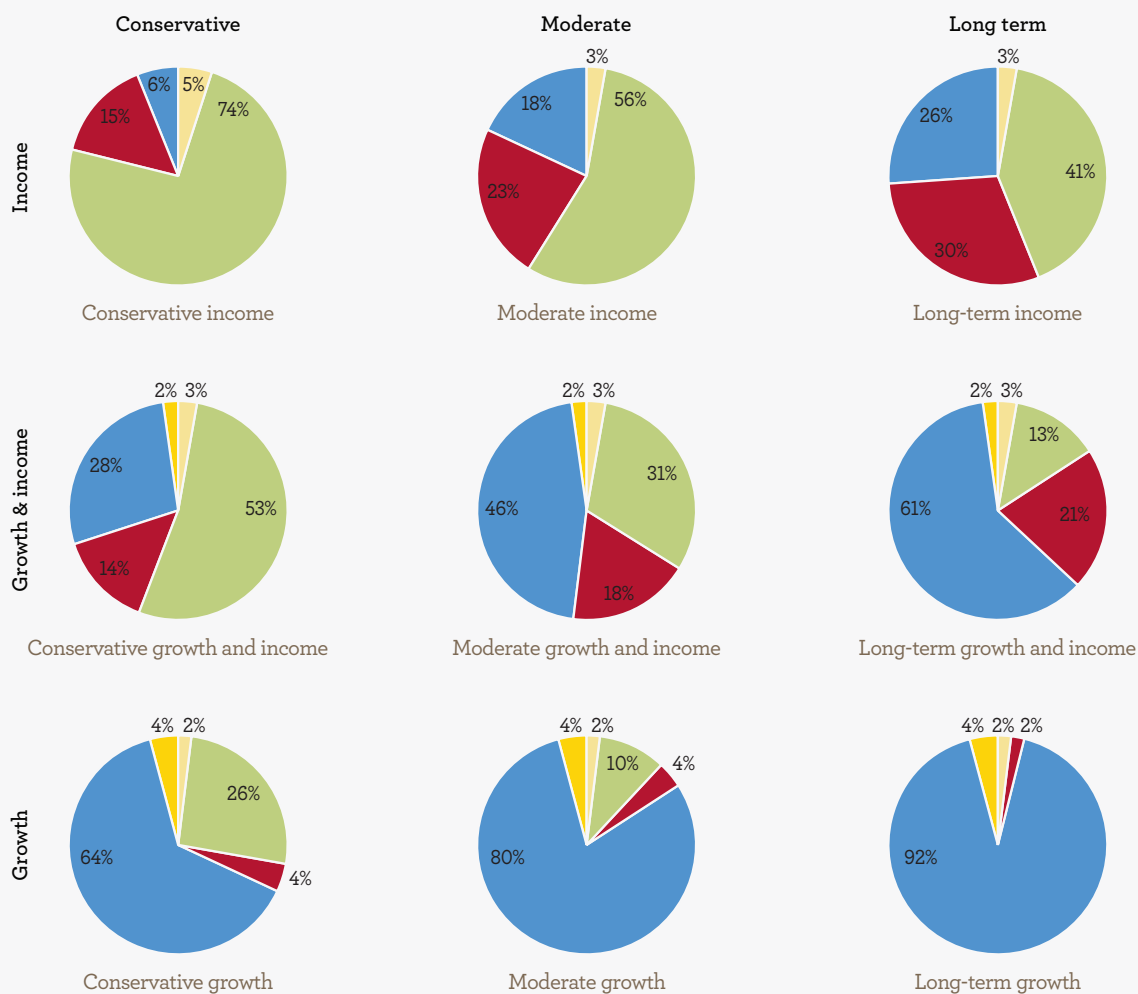
Assessing and, possibly, making adjustments to your investments based on expectations for the near future can be an effective approach. However, we believe that this should be done within the context of an overall investment strategy designed to help you work toward your goals.

To make the process of developing your overall strategy easier, Wells Fargo Advisors has crafted nine models (shown below) that cover a wide range of objectives from conservative income to long-term growth. Using the appropriate model as a starting

point, your Financial Advisor can work with you to create a custom asset allocation (investment mix) specifically addressing your situation and goals.

For more information and to start or update your strategy, contact your Financial Advisor with Wells Fargo Advisors or go to [wellsfargoadvisors.com](http://wellsfargoadvisors.com) to locate a branch near you.

## Strategic asset-allocation models



### Investment objectives

**Growth.** Emphasis is on potential capital appreciation.

**Growth and income.** Balance in emphasis between potential capital appreciation and income.

**Income.** Emphasis on achieving current income.

### Risk tolerance

**Conservative.** The least risk for a given investment objective.

**Moderate.** A higher degree of risk for the potential to receive higher returns.

**Long-term.** The highest risk within a given investment objective.

- Cash alternatives
- Fixed income
- Alternative income
- Equities
- Commodities

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# Definitions

**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.

**Consumer Price Index (CPI)** is a measure of 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.

**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.

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

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

**Large-cap growth stocks** have a market cap greater than \$10 billion and a price-to-book ratio greater than 2.3.

**Large-cap value stocks** have a market cap greater than \$10 billion and a price-to-book ratio less than or equal to 2.3.

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

**MSCI EAFE (Europe, Australasia and Far East) index** 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.

**Mid-cap growth stocks** have a market cap between \$2 billion – \$10 billion and a price-to-book ratio greater than 2.3.

**Mid-cap value stocks** have a market cap between \$2 billion – \$10 billion and a price-to-book ratio less than or equal to 2.3.

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

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

**Small-cap growth stocks** have a market cap less than \$2 billion and a price-to-book ratio greater than 2.3.

**S&P 500 index** consists of 500 industrial, financial, utility and transportation companies with market capitalizations of \$4 billion or more.

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*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).*

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*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.*

*There are special risks associated with investing in preferred securities. Preferred securities generally offer no voting rights with respect to the issuer. Preferred securities are generally subordinated to bonds or other debt instruments in an issuer's capital structure, subjecting them to a greater risk of non-payment than more senior securities. In addition, the issue may be callable, which may negatively impact the return of the security. Preferred dividends are not guaranteed and are subject to deferral or elimination.*

*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.*

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