

Economics Group

MONTHLY OUTLOOK

U.S. Overview

The Recovery Looks More Durable But Not Stronger

Recent economic reports have cast doubts about the strength and durability of the recovery. Many concerns center on disappointing reports from the nation's beleaguered housing sector, which has seen home sales tumble following a spurt fueled by the tax incentives. Sales of new and existing homes have fallen sharply in recent months, and pending home sales data suggest sales weakened further in February.

While data on the housing sector have been an early disappointment this year, reports from the factory sector have been a pleasant surprise. The ISM manufacturing index has rebounded sharply in recent months and is considerably stronger at this point of the recovery than it was in either of the past two business cycles. The rebound in the ISM index is supported by the regional manufacturing surveys, which show activity picking up on a broad front. Industrial production has risen 5.3 percent since bottoming in June, and manufacturing employment increased in both January and February.

Consumer spending also appears to be stronger than had been expected, with the rebound in the stock market and apparent stabilization of home prices deflating some of the fears about the drag from the wealth effect. Retail sales rose solidly in January and early reports for chain stores show sales rising solidly in February as well. We now expect real GDP to grow at a 3.4 percent pace in the first quarter but still look for growth to moderate around the middle of the year as the impact from various economic stimulus programs begins to fade.

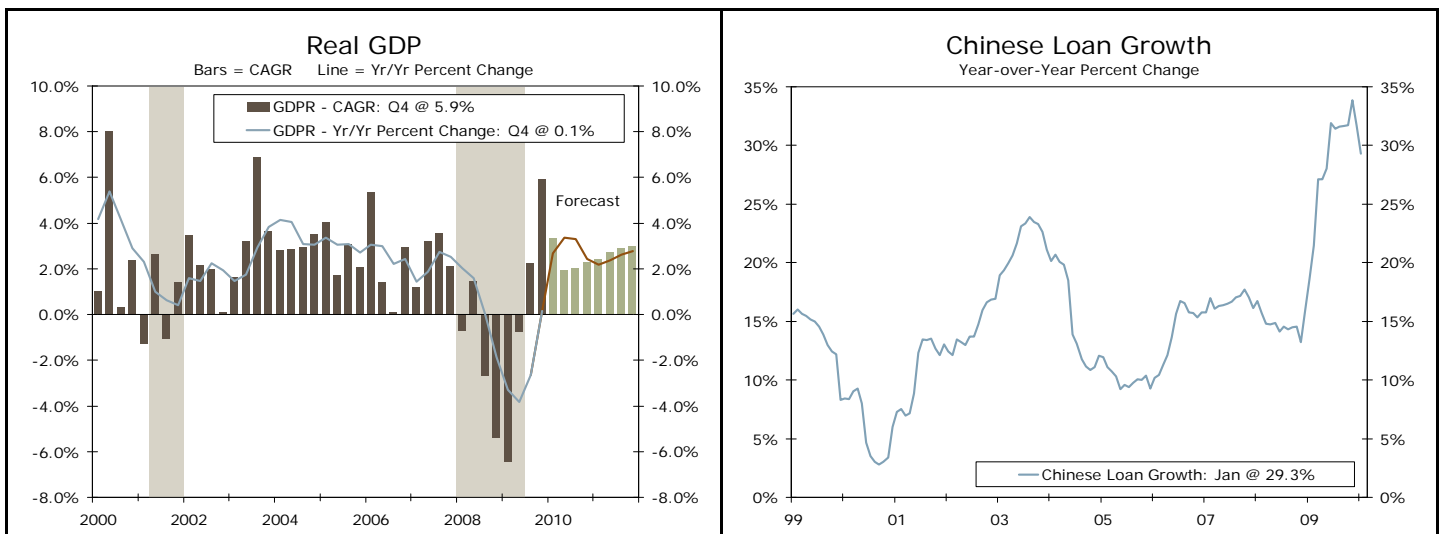
International Overview

Policies in Asia Becoming Less Accommodative

With the Greek debt drama occupying center stage at present, policy tightening in Asia has moved into the background. However, the issue hasn't gone away. Chinese authorities have directed banks to slow down the rapid pace of credit growth, and the Malaysian central bank recently hiked rates for the first time in four years. Will policymakers in Asia tighten too much this year? Is the nascent global recovery in peril?

To understand what is happening now, we must return to the autumn of 2008 when the global economy was melting down. Because the outlook for most Asian economies was so grim at the time, governments in the region took emergency steps—directing banks to lend aggressively and cutting interest rates to extraordinary levels—to support growth. A year later, the global economy is starting to recover and economic growth in Asia has rebounded strongly. Asian governments are now removing some of the emergency measures that are no longer needed.

Will they tighten too much, thereby leading to renewed downturns in the region? Although credit growth will slow and rates will rise slowly, there are few reasons for monetary policy in most Asian economies to move into "restrictive" territory anytime soon. Core rates of inflation are benign at present and, as we argued in a recent special report, there is little evidence to support the popular notion that massive asset price bubbles are inflating in Asia at present.



Source: CEIC, U.S. Department of Commerce and Wells Fargo Securities, LLC



Modest Economic Growth Looks Set To Continue

We have updated our forecast with all of the most recent economic reports and our forecast remains remarkably similar to where it was one month ago. Real GDP is expected to rise at a 3.4 percent pace during the first quarter and grow 2.9 percent for all of 2010. The pace of economic activity is expected to moderate this spring, however, as some of the stimulus put in place to fight the financial crisis and recession begins to be wound down. We expect real GDP to expand at a 2.0 percent pace in both the second and third quarters of this year before gradually ramping back up toward the end of the year. Growth is expected to return to a 3 percent pace by the second half of 2011.

While economic growth is expected to continue, the relatively slow pace of the recovery means that job growth will likely remain subdued and unemployment will likely remain relatively high. We expect nonfarm employment to move back into positive territory this spring. The monthly numbers will be buffeted by the hiring of hundreds of thousands of temporary workers for the decennial census. Excluding census hiring, we expect job growth to gradually pick up over the course of the year. We expect the unemployment rate to rise slightly from its current level, as economic growth will not likely be strong enough to generate enough jobs to keep pace with growth in the labor force.

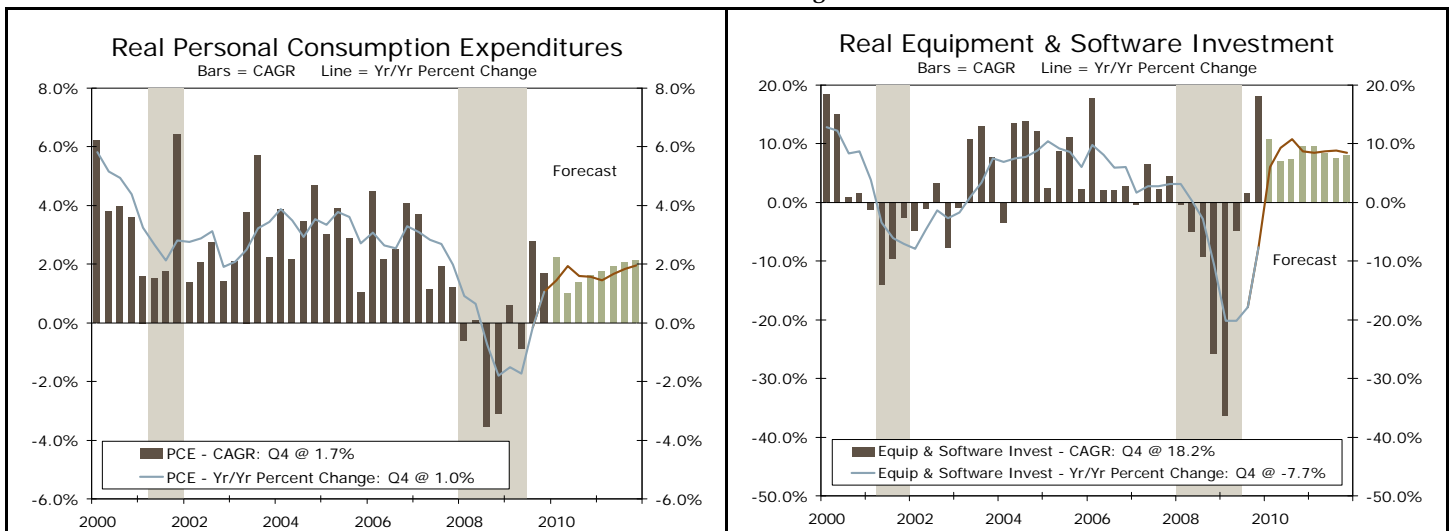
High unemployment will likely hold back consumer confidence and keep consumers in a generally cautious state of mind for much of the next two years. Spending will grow in this environment, however, and is now expected to be slightly stronger than we projected in earlier forecasts. The rebound in the stock market and apparent stabilization of home prices has allowed some of the worst fears about the wealth effect to dissipate. We still expect the saving rate to rise further, however, and look for it to stabilize around 5.5 percent.

Consumer spending is still expected to proceed at a fairly conservative pace. This past year's unusually harsh winter weather led to surge in utility usage and much high power bills during the first quarter, which will boost outlays during that period but drain some purchasing power from the spring. Uncertainty surrounding the many recalls of popular automobiles will also likely restrain motor vehicle sales, which are already struggling to attract buyers amid high unemployment and tighter credit conditions.

Business fixed investment rebounded solidly during the fourth quarter and is expected to continue to grow at a solid pace throughout the forecast period. Capital spending is being led by the technology sector, particularly equipment used to drive the mobile Internet. Capital spending outside the tech sector is recovering much more slowly.

Inflation is expected to remain in check throughout the forecast period. Measures of core inflation will likely track at or below the lower boundary of the Fed's comfort zone in 2010. Housing costs account for a disproportionate share of the core CPI and core PCE deflator. The oversupply of housing is putting downward pressure on rents and helping restrain core inflation. While housing will still likely be in oversupply a year from now it will not likely exert as much of a moderating force on inflation as it does today. That said, core inflation should still track well within the Fed's comfort zone, although we expect to core PCE deflator to be closer to 2 percent by the end of 2011.

The Federal Reserve has started to reverse many of the extraordinary measures it put in place to combat the financial crisis. One of the first moves was to end many of the temporary liquidity facilities put in place. More recently, the Fed has begun to raise the discount rate and return it to its pre-crisis spread over the federal funds rate. We do not expect an overt rate increase until much later this year and have the first hike in the federal funds rate occurring after the midterm congressional elections.



Source: U.S. Department of Commerce and Wells Fargo Securities, LLC

Wells Fargo U.S. Economic Forecast

	Actual								Forecast								Actual			Forecast	
	2008				2009				2010				2011				2007	2008	2009	2010	2011
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q					
Real Gross Domestic Product (a)	-0.7	1.5	-2.7	-5.4	-6.4	-0.7	2.2	5.9	3.4	2.0	2.0	2.3	2.4	2.8	2.9	3.0	2.1	0.4	-2.4	2.9	2.5
Personal Consumption	-0.6	0.1	-3.5	-3.1	0.6	-0.9	2.8	1.7	2.2	1.0	1.4	1.6	1.8	1.9	2.1	2.1	2.6	-0.2	-0.6	1.6	1.7
Business Fixed Investment	1.9	1.4	-6.1	-19.4	-39.2	-9.6	-5.9	6.5	5.5	2.0	3.6	6.1	7.5	7.1	6.9	7.2	6.2	1.6	-17.7	2.3	6.2
Equipment and Software	-0.5	-5.0	-9.4	-25.9	-36.4	-4.9	1.5	18.2	10.8	7.2	7.4	9.5	9.7	8.4	7.6	8.0	2.6	-2.6	-16.7	8.7	8.6
Structures	6.8	14.5	-0.1	-7.2	-43.6	-17.3	-18.4	-13.9	-13.0	-11.0	-6.5	-3.5	1.0	3.0	4.5	5.0	14.9	10.3	-19.6	-12.5	-0.6
Residential Construction	-28.2	-15.8	-15.9	-23.2	-38.2	-23.2	18.9	5.0	-2.0	5.8	8.5	9.0	9.0	8.5	10.0	10.0	-18.5	-22.9	-20.4	3.6	8.8
Government Purchases	2.6	3.6	4.8	1.2	-2.6	6.7	2.7	-1.2	2.9	1.6	2.4	1.4	1.1	1.1	1.5	1.1	1.7	3.1	1.9	1.9	1.4
Net Exports	-550.9	-476.0	-479.2	-470.9	-386.5	-330.4	-357.4	-347.1	-353.1	-348.8	-356.5	-363.0	-366.7	-365.7	-360.6	-351.6	-647.7	-494.3	-355.4	-355.3	-361.1
Pct. Point Contribution to GDP	0.4	2.4	-0.1	0.5	2.6	1.7	-0.8	0.3	-0.2	0.1	-0.2	-0.2	-0.1	0.0	0.1	0.3	0.6	1.2	1.0	0.0	0.0
Inventory Change	0.6	-37.1	-29.7	-37.4	-113.9	-160.2	-139.2	-16.9	6.0	20.5	28.5	37.0	40.5	47.5	50.0	50.0	19.5	-25.9	-107.6	23.0	47.0
Pct. Point Contribution to GDP	-0.2	-1.3	0.3	-0.6	-2.4	-1.4	0.7	3.9	0.7	0.4	0.2	0.3	0.1	0.2	0.1	0.0	-0.3	-0.3	-0.6	1.0	0.2
Nominal GDP	1.0	3.5	1.4	-5.4	-4.6	-0.8	2.6	6.3	4.8	3.1	3.3	3.7	4.1	4.5	4.8	4.9	5.1	2.6	-1.3	3.9	4.1
Real Final Sales	-0.5	2.7	-2.9	-4.7	-4.1	0.7	1.5	1.9	2.3	1.5	1.8	2.1	2.3	2.6	2.9	3.0	2.5	0.8	-1.7	1.8	2.3
Retail Sales (b)	2.6	2.4	0.3	-8.4	-9.1	-9.5	-6.7	2.0	4.5	5.1	4.6	4.2	4.4	5.0	5.0	5.1	3.3	-0.8	-6.0	4.6	4.9
Inflation Indicators (b)																					
"Core" PCE Deflator	2.4	2.5	2.6	2.0	1.7	1.6	1.3	1.5	1.4	1.2	1.2	1.2	1.5	1.6	1.7	1.8	2.4	2.4	1.5	1.3	1.7
Consumer Price Index	4.2	4.3	5.3	1.6	-0.2	-1.0	-1.6	1.5	2.5	2.4	1.9	1.6	1.7	2.0	2.2	2.4	2.9	3.8	-0.3	2.1	2.1
"Core" Consumer Price Index	2.4	2.3	2.5	2.0	1.7	1.8	1.5	1.7	1.4	1.1	1.0	0.9	1.2	1.2	1.4	1.6	2.3	2.3	1.7	1.1	1.3
Producer Price Index	7.2	7.7	9.4	1.4	-2.2	-4.1	-5.2	1.7	5.5	5.4	5.1	3.9	2.2	2.2	2.4	2.4	3.9	6.4	-2.5	5.0	2.3
Employment Cost Index	3.3	3.1	2.9	2.6	2.1	1.8	1.5	1.5	1.9	1.6	1.6	1.7	1.8	1.7	1.7	1.8	3.4	3.0	1.7	1.2	1.7
Real Disposable Income (a)	-2.4	9.8	-8.5	3.4	0.2	6.2	-3.6	1.9	0.3	2.4	2.0	2.0	2.2	2.3	2.5	2.8	2.2	0.5	0.9	1.2	2.2
Nominal Personal Income (b)	3.7	4.0	2.9	1.1	-1.6	-2.0	-2.3	-1.0	2.1	2.1	3.5	3.6	4.0	4.1	4.1	4.3	5.6	2.9	-1.7	2.8	4.1
Industrial Production (a)	0.2	-4.6	-9.0	-13.0	-19.0	-10.4	6.4	6.6	8.3	3.9	3.4	6.5	6.4	6.1	6.0	5.0	1.5	-2.2	-9.7	4.9	5.7
Capacity Utilization	80.1	78.9	76.9	74.2	70.4	68.7	70.0	71.4	72.2	72.5	73.0	74.3	75.3	76.2	76.9	77.4	80.6	77.6	70.1	73.0	76.4
Corporate Profits Before Taxes (b)	-4.9	-12.0	-5.4	-25.1	-19.0	-12.6	-6.6	24.0	22.0	16.0	10.0	8.5	8.0	7.5	8.0	8.5	-4.1	-11.8	-5.1	13.8	8.0
Corporate Profits After Taxes	6.6	-3.7	4.8	-15.8	-19.7	-15.3	-9.7	34.0	32.0	20.0	15.0	9.0	7.5	8.0	8.5	9.5	-4.0	-2.0	-4.6	18.2	8.4
Federal Budget Balance (c)	-205.9	26.9	-168.9	-332.5	-448.9	-304.9	-329.4	-388.1	-590.3	-196.2	-255.4	-316.5	-502.5	-193.5	-252.5	-300.0	-161.5	-454.8	-1415.7	-1430.0	-1265.0
Current Account Balance (d)	-179.3	-187.7	-184.2	-154.9	-104.5	-98.0	-108.0	-120.0	-130.0	-135.0	-140.0	-140.0	-145.0	-145.0	-150.0	-150.0	-726.6	-706.1	-430.5	-545.0	-590.0
Trade Weighted Dollar Index (e)	70.3	71.0	76.1	79.4	83.2	77.7	74.3	74.7	75.4	76.8	78.5	80.1	81.5	82.4	83.0	83.6	73.3	79.4	74.7	80.1	83.6
Nonfarm Payroll Change (f)	-31	-191	-334	-652	-753	-478	-260	-90	5	80	-30	110	130	135	150	165	90	-302	-395	41	145
Unemployment Rate	5.0	5.3	6.0	7.0	8.2	9.3	9.6	10.0	9.7	9.8	10.1	10.0	9.9	9.7	9.5	9.3	4.6	5.8	9.3	9.9	9.6
Housing Starts (g)	1.06	1.02	0.87	0.66	0.53	0.54	0.59	0.56	0.59	0.64	0.67	0.70	0.71	0.73	0.76	0.82	1.34	0.90	0.55	0.65	0.76
Light Vehicle Sales (h)	15.2	14.1	12.9	10.5	9.5	9.6	11.5	10.8	10.7	11.0	11.0	11.3	11.6	11.9	12.2	12.5	16.1	13.2	10.3	11.0	12.1
Crude Oil - WTI - Front Contract (i)	97.90	123.98	117.98	58.74	43.08	59.62	68.30	76.19	78.00	82.00	80.00	80.00	82.00	84.00	87.00	90.00	72.31	99.65	61.80	80.00	85.75
Quarter-End Interest Rates																					
Federal Funds Target Rate	2.25	2.00	2.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	1.25	2.00	2.75	3.25	4.25	0.25	0.25	0.50	3.25
3 Month LIBOR	2.69	2.78	4.05	1.43	1.19	0.60	0.29	0.25	0.30	0.35	0.55	0.80	1.50	2.35	3.10	3.60	4.70	1.43	0.25	0.80	3.60
Prime Rate	5.25	5.00	5.00	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.50	4.25	5.00	5.75	6.25	7.25	3.25	3.25	3.50	6.25
Conventional Mortgage Rate	5.97	6.32	6.04	5.33	5.00	5.42	5.06	4.88	5.40	5.70	5.80	5.80	5.80	5.90	6.00	6.10	6.10	5.33	4.88	5.80	6.10
3 Month Bill	1.38	1.90	0.92	0.11	0.21	0.19	0.14	0.06	0.10	0.10	0.30	0.55	1.25	2.10	2.85	3.35	3.36	0.11	0.06	0.55	3.35
2 Year Note	1.62	2.63	2.00	0.76	0.81	1.11	0.95	1.14	1.00	1.20	1.50	1.70	1.90	2.50	3.10	3.60	3.05	0.76	1.14	1.70	3.60
5 Year Note	2.46	3.34	2.98	1.55	1.67	2.54	2.31	2.69	2.40	2.60	2.80	2.90	3.00	3.30	3.60	3.90	3.45	1.55	2.69	2.90	3.90
10 Year Note	3.45	3.99	3.85	2.25	2.71	3.53	3.31	3.85	3.70	3.80	4.00	4.10	4.20	4.30	4.40	4.50	4.04	2.25	3.85	4.10	4.50
30 Year Bond	4.30	4.53	4.31	2.69	3.56	4.32	4.03	4.63	4.60	4.70	4.80	4.90	5.00	5.10	5.20	5.30	4.45	2.69	4.63	4.90	5.30

Forecast as of: March 10, 2010

Notes: (a) Compound Annual Growth Rate Quarter-over-Quarter

(b) Year-over-Year Percentage Change

(c) Quarterly Sum - Billions USD; Annual Data Represents Fiscal Yr.

(d) Quarterly Sum - Billions USD

(e) Federal Reserve Major Currency Index, 1973=100 - Quarter End

(f) Average Monthly Change

(g) Millions of Units

(h) Quarterly Data - Average Monthly SAAR; Annual Data - Actual Total Vehicles Sold

(i) Quarterly Average of Daily Close

What Are Central Bankers in Asia Thinking?

Policy tightening in Asia was the worry du jour in financial markets earlier this year before the Greek debt crisis burst on the scene. Although Greece continues to dominate the headlines, the issue of policy tightening in Asia has not disappeared. Indeed, the Malaysian central bank recently increased its main policy rate by 25 bps, the first rate hike in that country in nearly four years. Why are Asian central banks tightening policy at a time when the global economic outlook remains uncertain? Will rate hikes in Asia derail the budding global recovery?

To understand why Asian central banks are starting to tighten monetary policy now, we must consider why they eased policy in the first place. Flash back to the autumn of 2008 when global trade was collapsing in the wake of the failure of Lehman Brothers. Because exports are very important for many Asian countries, the outlook for these economies was rather grim at the time. In response, Asian governments moved to support growth via expansionary economic policies.

Start with China. Not only did the Chinese government accelerate infrastructure spending, but it also directed banks to start lending aggressively. And lend aggressively they did. By late last year, lending was up by more than 30 percent on a year-ago basis (see graph on front page). Due in part to strong credit growth and expansionary fiscal policy, real GDP in China bounced back sharply over the course of the year (chart below). Strong economic growth over the past few quarters has not been limited to China. For example, real GDP in Taiwan was up more than 9 percent in the fourth quarter on a year-ago basis. The Indian, Korean and Thai economies posted 6 percent growth rates in the fourth quarter.

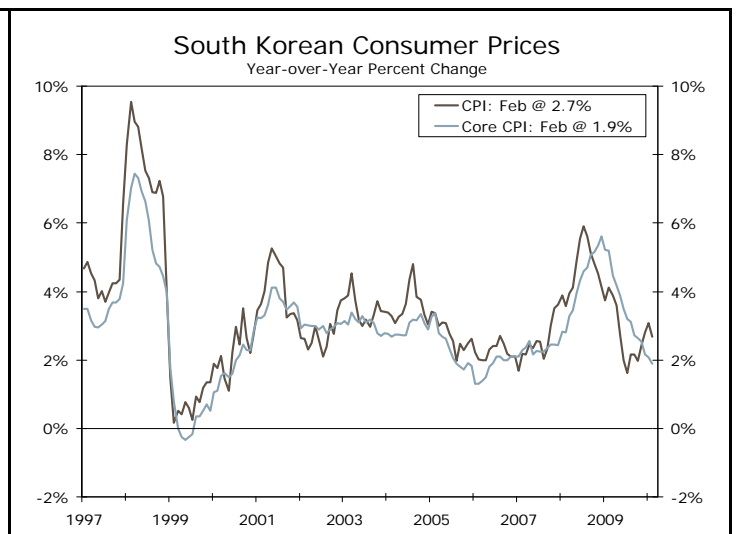
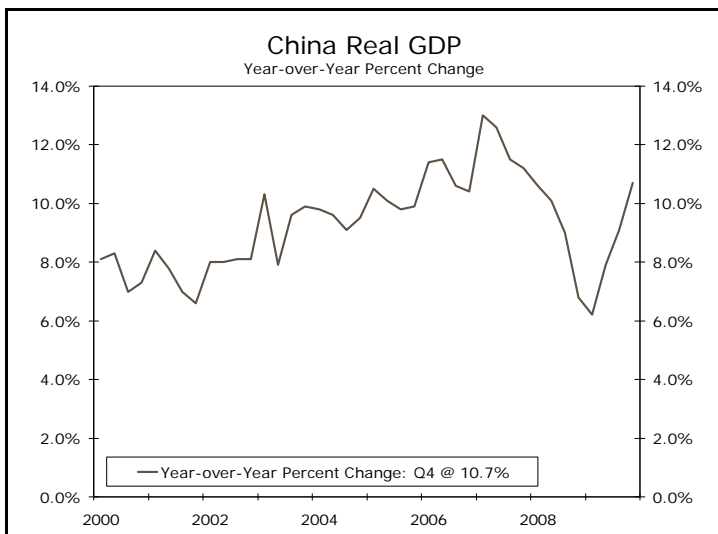
In other words, the emergency policy measures that were put in place in late 2008/early 2009 are no longer appropriate now that the emergency has apparently passed. A year ago, when it

appeared that the global economy was melting down, Chinese authorities directed banks to open the lending taps in order to support economic activity. Now that global economic activity is starting to recover, and the Chinese economy is humming along again, 30 percent loan growth is not needed anymore. Indeed, inflation—in both goods and asset prices—could become an issue if monetary policy remains extremely accommodative. Extraordinarily low interest rates in most other Asian economies are no longer needed either.

Does this mean that Asian central banks will tighten policy too much in the months ahead, thereby threatening to choke off the recovery in economic activity? Probably not, at least not in the foreseeable future. Although overall rates of CPI inflation have risen in recent months, core rates of inflation generally remain benign. For example, the overall rate of CPI inflation in Korea has moved up from less than 2 percent last summer to nearly 3 percent at present (chart below). However, the increase largely reflects the wild swing in energy prices over the past year or so. The core inflation rate, which excludes energy prices, continues to trend lower and is less than 2 percent at present. Similar stories about inflation can be told in most other Asian economies as well.

In addition, there is not much evidence, at least not in our view, to support the notion that massive bubbles are forming in Asian asset markets. (For further reading see “2010: Year of the Tiger or Asian Bubble?”, which is posted on our website.)

Will loan growth slow in China and interest rates rise in other Asian countries over the course of 2010? Yes. However, monetary policy settings will move from extremely accommodative back toward “neutral.” Most Asian governments have historically shown a preference for policies that support economic growth. With few inflationary pressures at present, policies in most Asian countries likely won’t become “tight” for a few more years.



Source: Bloomberg LP, IHS Global Insight and Wells Fargo Securities, LLC

Wells Fargo International Economic Forecast

(Year-over-Year Percent Change)

	GDP			CPI		
	2009	2010	2011	2009	2010	2011
Global (PPP weights)	-0.8%	4.1%	4.1%	2.8%	4.2%	4.2%
Global (Market Exchange Rates)	-2.0%	2.9%	2.9%	n/a	n/a	n/a
Advanced Economies ¹	-3.3%	2.4%	2.5%	-0.3%	1.5%	1.7%
United States	-2.4%	2.9%	2.5%	-0.3%	2.1%	2.1%
Eurozone	-4.0%	1.3%	2.2%	0.3%	1.1%	1.3%
United Kingdom	-5.0%	1.5%	2.2%	2.2%	2.8%	1.9%
Japan	-5.1%	2.6%	1.7%	-1.3%	-0.8%	0.4%
Korea	0.1%	5.0%	3.5%	2.8%	2.6%	2.7%
Canada	-2.5%	2.3%	2.8%	0.3%	1.9%	1.9%
Developing Economies ¹	2.3%	6.1%	5.9%	6.5%	7.3%	7.3%
China	8.5%	9.4%	9.0%	-0.7%	2.4%	3.3%
India	6.8%	8.0%	7.8%	11.4%	12.2%	8.0%
Mexico	-6.5%	3.4%	3.5%	5.3%	5.1%	5.3%
Brazil	-0.9%	3.5%	3.9%	4.9%	5.2%	5.6%
Russia	-7.9%	3.6%	4.1%	11.8%	6.8%	8.8%

Forecast as of: March 10, 2010

¹Aggregated Using PPP Weights

Wells Fargo International Interest Rate Forecast

(End of Quarter Rates)

	3-Month LIBOR						10-Year Bond					
	2010			2011			2010			2011		
	Q2	Q3	Q4	Q1	Q2	Q3	Q2	Q3	Q4	Q1	Q2	Q3
U.S.	0.35%	0.55%	0.80%	1.50%	2.35%	3.10%	3.80%	4.00%	4.10%	4.20%	4.30%	4.30%
Japan	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	1.35%	1.35%	1.45%	1.50%	1.60%	1.80%
Euroland	0.60%	0.80%	1.00%	1.40%	2.25%	3.00%	3.25%	3.30%	3.70%	4.00%	4.25%	4.40%
U.K.	0.65%	0.75%	1.00%	1.75%	2.75%	3.40%	4.10%	4.40%	4.70%	4.80%	4.90%	5.00%
Canada	0.40%	0.50%	1.00%	2.00%	3.00%	3.50%	3.60%	3.90%	4.10%	4.30%	4.40%	4.45%

Forecast as of: March 10, 2010

Source: Wells Fargo Securities, LLC

Wells Fargo Securities, LLC Economics Group

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