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2009 Mid-Year Outlook

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Together we'll go far



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Agenda

Welcome and Introduction

- The Economy
- Inflation
- Equity Markets
- Fixed Income Markets

The Economy

Q. Is the recession likely to end soon, and what type of recovery are we likely to see?

Arguments for a robust recovery:

- The Federal Reserve and the Federal Government are following the most aggressive stimulus policies since WWII.
- Global interest rates have been reduced along with U.S. interest rates
- Housing affordability at record highs looking back to 1971
- Companies are getting access to credit once again
- Inventories are lean due to decreased production

The Economy

Arguments for a Modest recovery:

- Housing still facing increasing foreclosures and declining home prices
- Weak commercial real estate depresses rents and property prices
- Consumers have very little purchasing power after big losses in wealth
- Unemployment is high and likely to go higher

The Economy

A. At this point the most likely scenario, in our opinion, is for a modest recovery.

The Economy

Q. Is the dollar overvalued and vulnerable to a dramatic decline, or is it fairly valued with modest downside risk?

The Economy

- Over the last few years the dollar has weakened when the US economy expanded and strengthened when the US economy contracted

There are frequently other issues affecting the dollar besides inflation and economic growth. According to Wells Fargo Advisors Advisory Services Group, when including all these other factors, the dollar has tended to decline about .6% against the value of the euro for every 1% increase in U.S. prices.

- The Dollar is not currently overvalued

Work done by our Advisory Services Group suggests the rally in the dollar last year pushed the dollar from undervalued to fairly valued.

- Could the dollar Drop in value as it did in the 70's?

70's were a high inflation environment caused by many developments, especially going off the gold standard when the dollar was overvalued.

The Economy

A. The Dollar is not currently overvalued. If US inflation remains low during the next year or two the value of the dollar is likely to weaken modestly against other major currencies.

Inflation

Q. Will the massive expansion of liquidity by the Federal Reserve and deficit spending by the federal government necessarily lead to rapid inflation?

Inflation

Arguments for High inflation:

- High inflation is caused by too much money chasing too few goods.
- The federal government's economic stimulus program is producing record high federal budget deficits
- Global demand may boost commodity prices, pushing inflation upward
- If foreign investors lose confidence in U.S. policies the dollar could drop

Inflation

Arguments for Low Inflation:

- Money Supply increase is being offset by a slowdown in the velocity of money
- History shows Inflation is influenced more by credit growth than money supply growth
- High unemployment means there is no shortage of labor, and wage inflation should remain low
- The dollar is not overvalued

Inflation

A. We believe the argument against a surge in inflation in the near term are more compelling than the arguments for high inflation.

Equity Markets

Q. From a technical perspective, has the stock market bottomed and is it too late to participate in the stock market's rebound?

Equity Markets

We believe the bottom was reached on March 9, 2009

- The Dow Jones Industrial Average (DJIA) declined 54% from its peak on October 9, 2007 – second largest decline since 1900
- S&P 500 declined 56% from the October 2007 peak
- The percentage of New York Stock Exchange (NYSE) stocks trading above their 200-day moving average bottomed near 1%
- The percentage of money market mutual funds (institutional plus individual) as a percentage of market capitalization of all NYSE and NASDAQ stocks reached 48%.

prior 5 ½ year average = 18%

Equity Markets

Positive Divergences: Selling pressure was more intense last October and November than it was in March

- The Chicago Board Option Exchange (CBOE) put/call ratio reached an 11-year high last November
- NYSE stock reaching new 52-week lows reached 1,860 in October, 1,197 in November, and just 667 in March
- The CBOE Volatility Index (VIX) rose to a multiple year high near 81 in November '08 and made a lower peak in March. This ratio is commonly perceived that the higher the ratio, the more bearish investors are.

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&P500 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".

Equity Markets

A. We believe the bear-market bottom was reached at the March 9, 2009, closing lows. It is not too late for investors to buy stocks.

Equity Markets

Q. From a fundamental perspective, what is our outlook for the equity market over the next twelve months?

Equity Markets

Price to Earnings (P/E ratio)

- Currently at levels similar to the last quarter of '08

We still believe the S&P 500 can reach our target of 1015 by the end of 2009

Graph on pg. 7

Equity Markets

A. Based on what we feel is an appropriate 13.5 to 14 times P/E ratio using our 2011 estimate of \$84, we believe the S&P 500 can reach the 1135-to-1175 range by 2010

Equity Markets

Q. Where are the current opportunities in the equity markets?

A Shift in Economic Sectors

- Since the March Lows the momentum in the market has shifted to the cyclical sectors:

Industrials, Consumer Discretionary and Materials

Financials have outperformed by 60%

- Historically these cyclical performances are inline with what investors experience once markets begin to look toward recovery

Table on pg. 10

Fixed Income Markets

Q. How should fixed-income investors be positioned over the next twelve months given our outlook for inflation and interest rates ?

Fixed Income Markets

Yields:

- The Fed should leave the Federal Funds Target rate at or near 0% for an “extended period”
- Our opinion that the fed will leave it unchanged through 2009 and into 2010
- For the remainder of 2009 we are looking for the 10 year treasuries to trade around 3.75% and 4% to 4.5% in 2010
- Increasing yield are primarily influence by the amount of debt needed to current programs
- In our opinion there are three factors that create the increase in treasury yields:
 1. removal of the fear/liquidity premium
 2. growing sign the economy is stabilizing
 3. the gross amount of debt sold on a continual basis and what price market participants will demand to buy and hold this debt.

Fixed Income Markets

Spreads:

- High Yield market saw spreads peak at 2000 basis points (bps) above the 10 year Treasury
 Currently the spread is around 1100 bps
- Similar patterns can be found in investment grade corporate and municipal sectors
 chart pg 12

Fixed Income Markets

A. We currently recommend overweight positions in investment grade corporate and municipal bonds, and neutral positions in agency, high yield and emerging market sectors. We are underweight Treasuries and mortgage backed securities (MBS)

Questions?



Investment and Insurance Products:

NOT FDIC-INSURED	NO BANK GUARANTEE	MAY LOSE VALUE
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