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WELLS FARGO ADVISORS

The Week

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A bumpy road to recovery – the 2010 outlook

The following is a summary of the Wells Fargo Advisors 2010 outlook released last week, with analysis and forecasts by strategists in the Advisory Services Group.

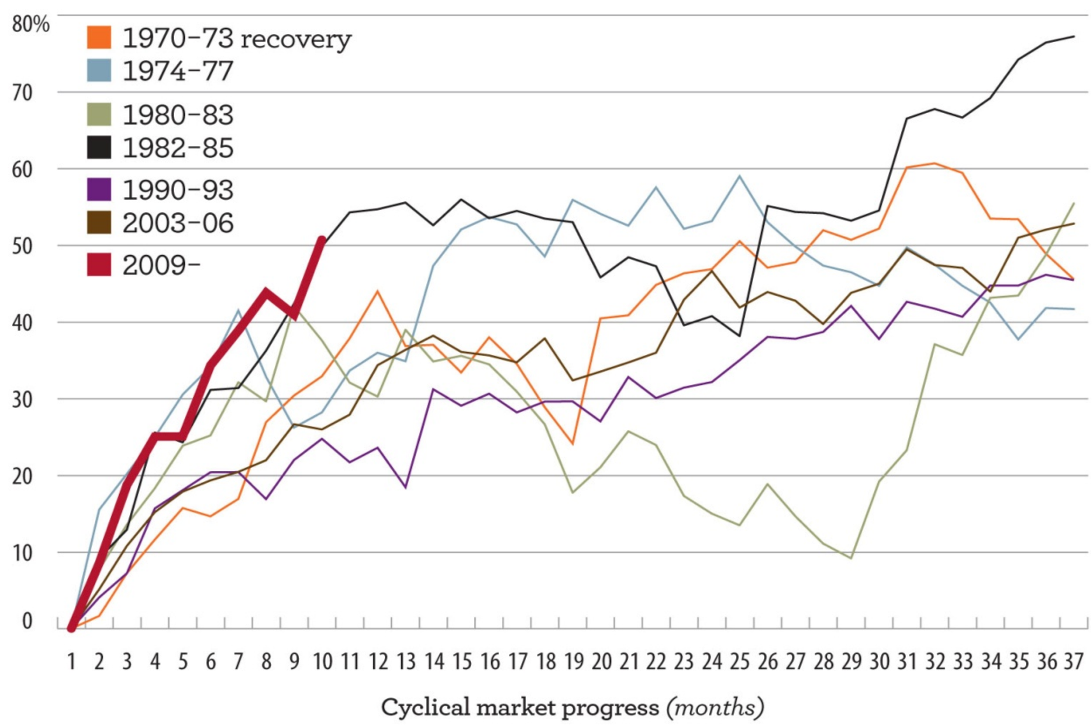
- The U.S. economy started a modest economic recovery in the third quarter of 2009. Looking ahead, the economy faces many headwinds, but if it can avoid any unexpected shocks, we look for a U-shaped recovery with the economy growing by 2.5% in 2010.
- We expect U.S. Consumer Price Index (CPI) inflation to be 2.0% in the 12 months ending December 2010. Inflation is likely to remain low in the near term, despite the Federal Reserve's easy money policy and big federal deficits. This is because lending is still depressed, capacity utilization is low and wage inflation is moderating.
- On a shorter-term basis, we recommend a neutral weighting in equities and fixed income securities. Typically, gains in the equity markets in the second year of recovery are often not as strong as during the first year, and volatility can be higher. From a longer-term asset allocation perspective, we suggest investors use periods of market weakness to adopt a bias toward equities, which have more upside potential when the economy expands.
- After bottoming in March 2009, the stock market has recovered half of its losses. Our year-end 2010 S&P 500 Composite Index target range is 1175-1200, which implies a more modest return of 6-8%.
- We continue to favor more cyclically sensitive sectors such as industrials and materials during the first half of this economic cycle. However, the degree of cyclical outperformance could be more muted than in 2009.
- In taxable fixed income markets, we recommend focusing on the senior debt of corporate issuers. We see corporate credit spreads tightening slightly throughout 2010, offering investors an attractive return.
- Municipal bonds offer compelling valuations, in our opinion, and we suggest investors overweight the sector. We recommend investors focus on general obligation and essential purpose revenue debt.
- The U.S. dollar declined at an orderly rate during the past six months as investors sought foreign investment opportunities. We recommend a neutral weighting to non-U.S. equities in the short-term, reflecting our belief that the dollar could strengthen modestly in the near-term as investors temper their appetite for risk in foreign markets after the strong gains in 2009.

This week's chart of the week also comes from the 2010 outlook. It compares the recovery in the S&P 500 index in 2009 with other market recoveries following the previous six U.S. recessions. So far, the current rally is in line with the strongest rally in this comparison.

The analysis shows that the first year of a cyclical bull market is often the strongest. That's because sentiment is so negative before the rally starts that good news is a positive surprise, turning investors from bearish to bullish. The chart also shows that the second year of a cyclical bull market is often characterized by increased market volatility and more modest gains. That's because investors are generally positive after a strong first-year advance, and good news is no longer that surprising.

In addition, the markets are often more volatile in the second year because policymakers frequently begin to remove some of the stimulus that fueled the rally during the first year. In 2010 we look for the Fed and other central banks to end many programs that added extra liquidity to the financial system. However, we expect the Fed to keep short-term interest rates low most of 2010.

Market performance of the S&P 500 is in line with that of the strongest initial cyclical rebound of the past six cycles.



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