July 10, 2009

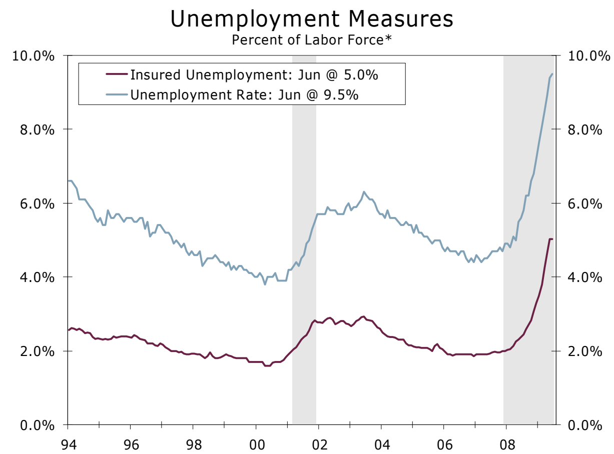
Economics Group

Weekly Economic & Financial Commentary

U.S. Review

Expectations of Recovery Continue to be Scaled Back

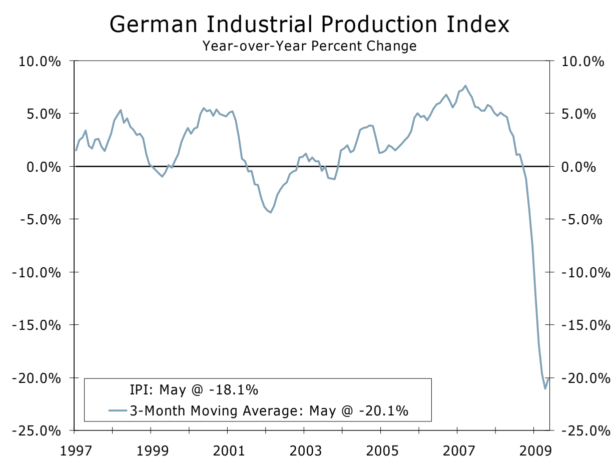
- A slight rise in the ISM non-manufacturing survey and another weak ICSC Chain Store sales report highlighted this week's economic calendar.
- Unemployment claims fell sharply in early July but the drop was distorted by unusually large swings in motor vehicle production schedules and the Fourth of July holiday.
- Some members of the Obama Administration have expressed surprise about how high the unemployment has risen, hinting at the possibility of a second stimulus package.



Global Review

Signs of a Bounce in the Euro-zone?

- Industrial production in France, Germany and Italy was stronger than expected in May. In Germany, it appears that the "cash for clunkers" program is helping to lift IP.
- Don't pop the champagne corks just yet. May's stronger-than-expected rise in production notwithstanding, IP in most European economies probably contracted in the second quarter relative to the previous quarter. Moreover, the level of production currently stands at levels that were achieved more than a decade ago. Although the worst may be over, the Euro-zone economy faces a long, slow climb out of its current hole.



Wells Fargo U.S. Economic Forecast

	Actual				Forecast				Actual				Forecast	
	2008				2009				2005	2006	2007	2008	2009	2010
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q						
Real Gross Domestic Product [1]	0.9	2.8	-0.5	-6.3	-5.5	-1.6	2.2	1.6	2.9	2.8	2.0	1.1	-2.4	1.7
Personal Consumption	0.9	1.2	-3.8	-4.3	1.4	-0.6	1.7	1.0	3.0	3.0	2.8	0.2	-0.7	1.3
Inflation Indicators [2]														
"Core" PCE Deflator	2.2	2.3	2.3	1.9	1.8	1.8	1.3	1.2	2.1	2.3	2.2	2.2	1.5	1.0
Consumer Price Index	4.2	4.3	5.2	1.5	-0.2	-1.2	-2.6	-0.2	3.4	3.2	2.9	3.8	-1.0	1.0
Industrial Production [1]	0.2	-4.6	-9.0	-13.0	-19.0	-14.3	3.1	2.9	3.3	2.3	1.5	-2.2	-11.1	1.3
Corporate Profits Before Taxes [2]	-1.5	-8.3	-9.2	-21.5	-17.6	-16.0	-12.0	-8.0	17.6	15.2	-1.6	-10.1	-13.7	5.8
Trade Weighted Dollar Index [3]	70.3	71.0	76.1	79.4	83.2	77.2	82.6	85.0	86.0	81.5	73.3	79.4	85.0	85.0
Unemployment Rate	4.9	5.4	6.1	6.9	8.1	9.3	9.8	10.2	5.1	4.6	4.6	5.8	9.3	10.3
Housing Starts [4]	1.06	1.02	0.87	0.66	0.53	0.49	0.52	0.55	2.07	1.81	1.34	0.90	0.52	0.70
Quarter-End Interest Rates														
Federal Funds Target Rate	2.25	2.00	2.00	0.25	0.25	0.25	0.25	0.25	4.25	5.25	4.25	0.25	0.25	0.50
Conventional Mortgage Rate	5.97	6.32	6.04	5.33	5.00	5.42	5.10	5.20	6.27	6.14	6.10	5.33	5.20	5.60
10 Year Note	3.45	3.99	3.85	2.25	2.71	3.53	3.50	3.60	4.39	4.71	4.04	2.25	3.60	4.00

Forecast as of: July 8, 2009
[1] Compound Annual Growth Rate Quarter-over-Quarter
[2] Year-over-Year Percentage Change
[3] Federal Reserve Major Currency Index, 1973=100 - Quarter End
[4] Millions of Units

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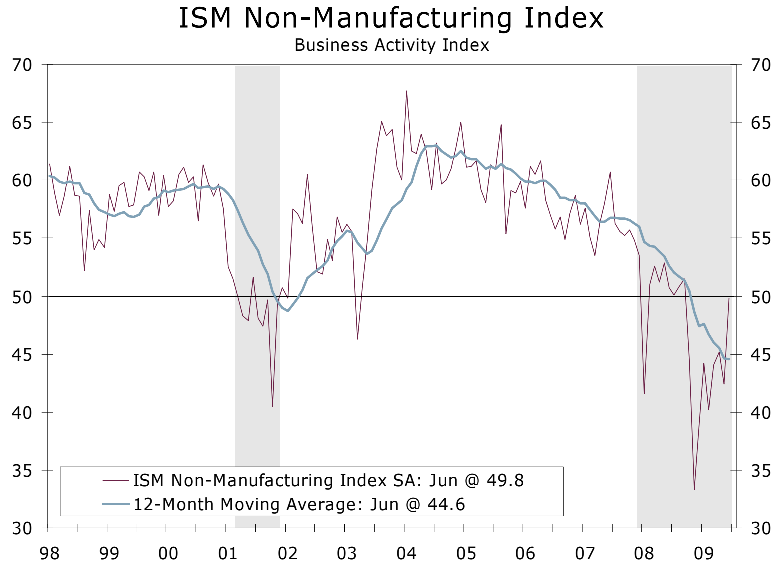
Together we'll go far

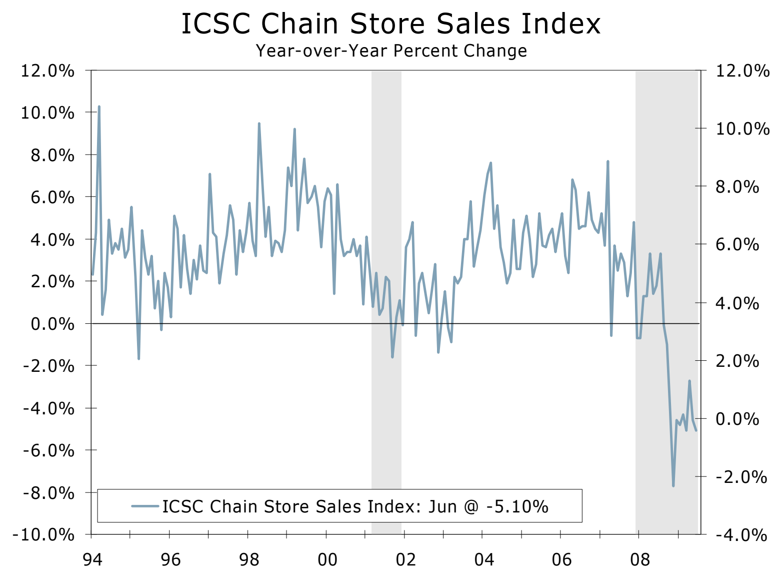
U.S. Review

Reality Sets in for the Summer

The economic data continue to show an economy gradually moving toward recovery. The ISM non-manufacturing survey increased slightly more than expected in June and has now risen convincingly above its 12-month moving average. Such moves have tended to coincide with turning points in the business cycle. The business activity series rose 7.4 points during the month. New orders also improved and export orders jumped 7.5 points to 54.5. The overall index remains slightly below the level it rose to when the economy emerged from the 2001 recession. Inventory liquidations remain a drag on the economy. The inventory sentiment index remains unusually high at 67.0, suggesting many firms still believe their inventories are too high.

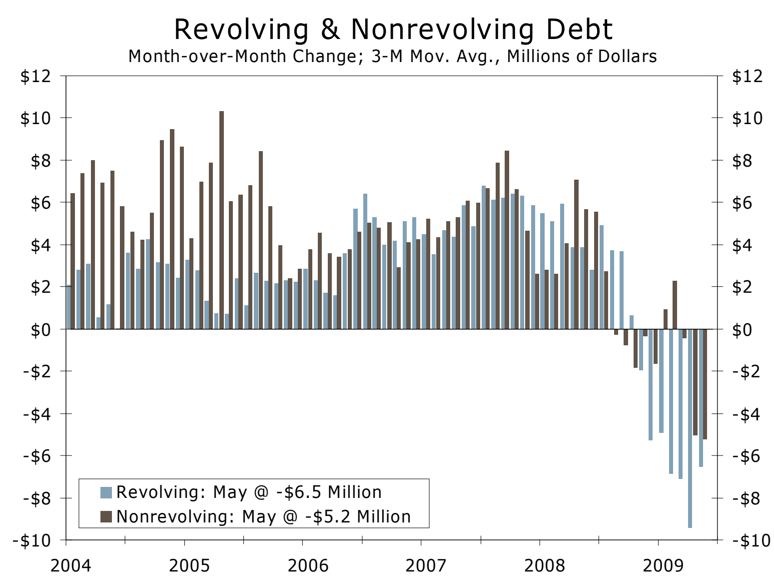


While the ISM non-manufacturing survey reported a much less contraction in business activity during June, one notable exception was retail trade, which continued to report declining activity during the month. The ICSC chain store sales report for the month of June appears to confirm this notion. Chain store sales fell 5.1 percent over the past year, with sales at apparel shops and department stores tumbling 9.3 percent and 9.1 percent, respectively. Consumers continue to shy away from making major purchases but are showing an increased tendency to purchase discounted and lower cost products. An increase in food stamp allocations also appears to be bolstering spending at grocery stores and discount stores that sell groceries.



June's chain store sales were widely viewed as disappointing but there were a few extenuating circumstances. Chain store sales are reported on a year-to-year basis and sales last June were bolstered by the rebate checks sent out under President Bush. Last June saw the strongest year-to-year gain in chain store sales for all of 2008, meaning that this past month's sales faced its most difficult comparison of the year. The chain store sales figures also exclude Wal-Mart, which continues to gain market share and is the nation's largest retailer. Finally, June was unusually cool, which likely dampened demand for summer merchandise. The tough year-to-year comparisons and absence of Wal-Mart's sales mean next week's retail sales report will likely be stronger than this past week's chain store sales figures.

Consumers' reluctance to make big ticket purchases was also apparent in May's consumer credit numbers. Overall consumer credit fell 1.5 percent in May, with practically all the drop occurring in revolving credit. Spending for big ticket items was notably weak in both May and June. The best performing sectors tended to be stores where a larger proportion of sales tend to be paid with cash. Nonrevolving credit was little changed during the month, reflecting the recent leveling off in motor vehicle sales.



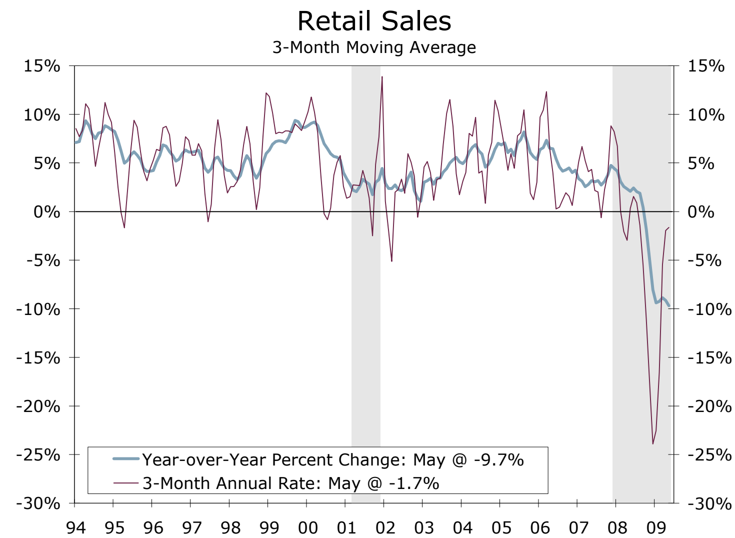
Unemployment claims fell 52,000 to 565,000 in early July. The decline was readily dismissed, however, since it has more to do with the timing of motor vehicle assembly plant shutdowns than any fundamental improvement in the labor market. Continuing unemployment claims increased by 159,000 in the latest week and the insured unemployment rate rose 0.1 percentage point to 5.1 percent. The increase suggests the unemployment rate will rise further in July. Some members of the Administration have expressed dismay at how much the unemployment rate has increased, even though many forecasts made earlier in the year, including our own, had the jobless rate rising to around nine percent this summer.

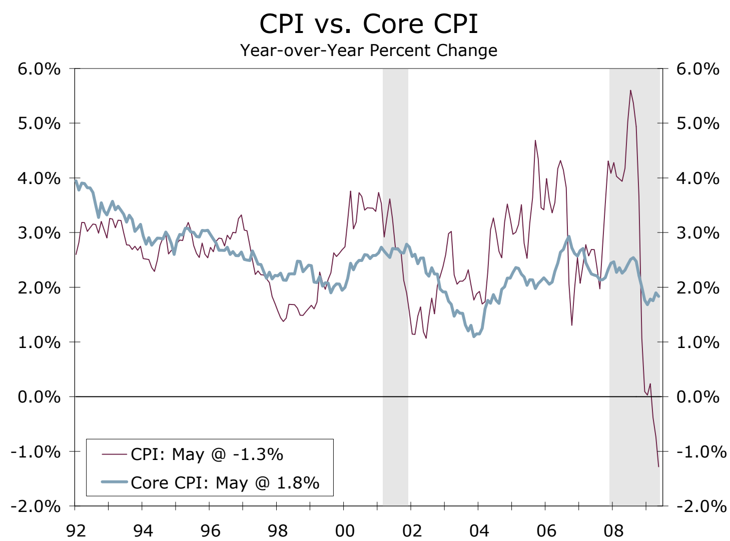
Retail Sales • Tuesday

Overall retail sales in June likely fell 0.4 percent, following a 0.5 percent gain in the prior month. A key indicator of retail sales is same store sales, which fell 5.1 percent in June as consumers continued to pull back on discretionary purchases. Department and luxury stores continue to be hardest hit as consumers stick to necessities. We expect consumers will continue to prioritize spending towards essential items until the labor market begins to improve. The gain in prices at the pump and impact from the stimulus package which increased food stamp allocations and encouraged energy efficient home improvements through tax credits should help to cushion some of the downside. Retail sales excluding autos likely rose 0.9 percent.

Previous: 0.5% **Wells Fargo: -0.4%**

Consensus: 0.4%





Consumer Price Index • Wednesday

The Consumer Price Index (CPI) likely rose 0.6 percent in June, following a 1.0 percent gain in May. The third consecutive increase in headline CPI is sure to fuel the inflation debate, but the gain in consumer prices will likely be driven by the spike in prices at the pump. Consumers should catch a bit of a break in coming months with energy prices now falling and food prices finally moderating. Lower prices for groceries and gasoline should put a few more dollars in consumers' pockets. Excluding food and energy items, the CPI likely increased 0.2 percent in June following a 0.1 percent gain in May. Looking back further in the production pipeline, wholesale prices excluding food and energy were likely flat in June giving even less reason to be concerned about inflation in the near term.

Previous: 0.1% **Wells Fargo: 0.6%**

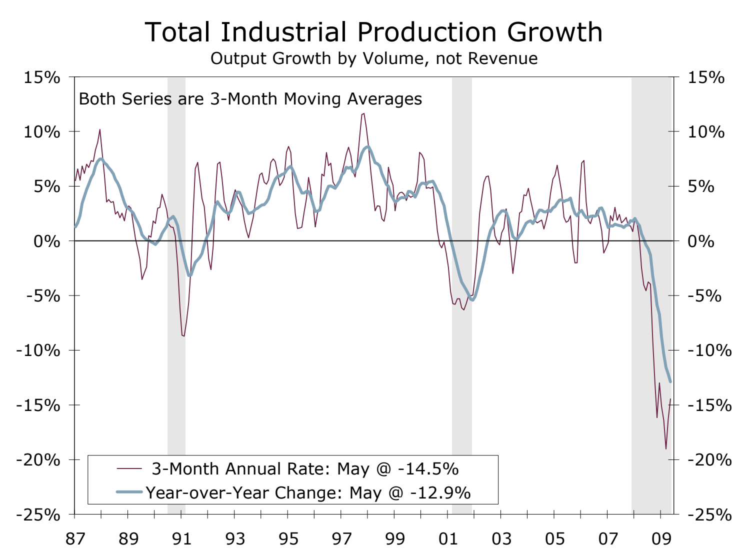
Consensus: 0.6%

Industrial Production • Wednesday

Industrial production likely fell for the eighth consecutive month in June, but the pace of decline is slowing. The Chicago Business Barometer and the ISM manufacturing index saw substantial increases in June, but still remain below the expansion/contraction threshold of 50. Headline ISM manufacturing index rose to 44.8 with improvements in production and employment. Assembly plant shutdowns led to a 7.9 percent plunge in motor vehicles and parts output in May with the headline falling 1.1 percent, but we expect a reversal as many auto plants reopen. Business investment, however, should remain weak. Capacity utilization levels will likely remain at historic lows. Lower utilization will hurt corporate profits in coming quarters as manufacturers' pricing power will be all but eliminated.

Previous: -1.1% **Wells Fargo: -0.4%**

Consensus: -0.6%



Global Review

Signs of a Bounce in the Euro-zone?

After months of disappointing economic news, there were some positive developments in the Euro-zone this week. First, factory orders in Germany shot up 4.4 percent in May relative to the previous month, which was much stronger than most investors had expected. The upturn in orders over the past few months translated into a 3.7 percent rise in industrial production (IP) in May, the largest monthly increase since Germany climbed out of the 1992-93 recession.

What's behind the rise in German IP? The country's "cash for clunkers" legislation that went into effect earlier this year undoubtedly is helping. Indeed, new car registrations in June were up 40 percent on a year-over-year basis. In that regard, production of consumer durable goods, which includes autos, shot up 6.4 percent in May relative to the previous month.

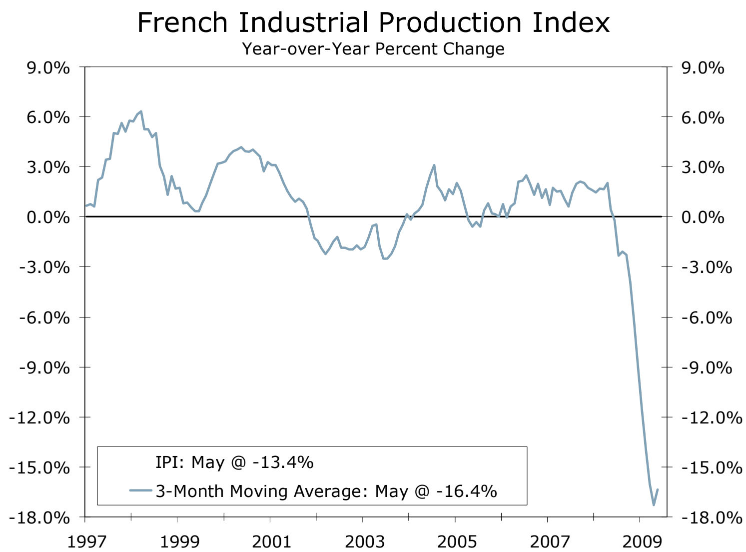
The better-than-expected news in Western Europe was not confined to just Germany. French IP climbed 2.6 percent in May, and a measure of business sentiment in France rose in June to its highest level since last September. Italian IP bested expectations of a sizeable decline in May by remaining unchanged during the month. Moreover, the 1.1 percent increase in Italian IP that was registered in April was revised up a bit.

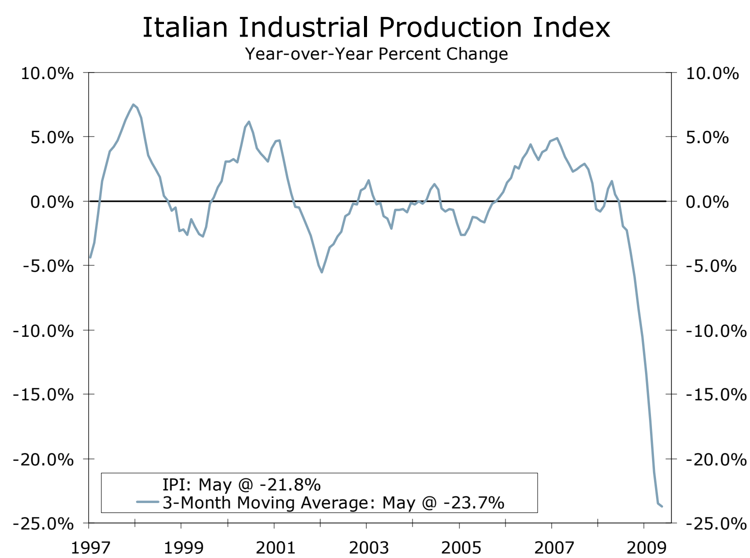
Is it time to pop the champagne corks and toast the strong economic recovery that is taking hold in the Euro-zone? In our view, that celebration would be very premature. Although industrial production in the three largest Euro-zone economies has bounced recently, IP in those countries is down sharply on a year-over-year basis (see charts). If German IP holds steady in June, the second quarter average will still be down almost five percent (annualized rate) relative to the first quarter. France is looking at a similar rate of decline in the second quarter. Major European economies continue to contract, albeit less rapidly than in the first quarter.

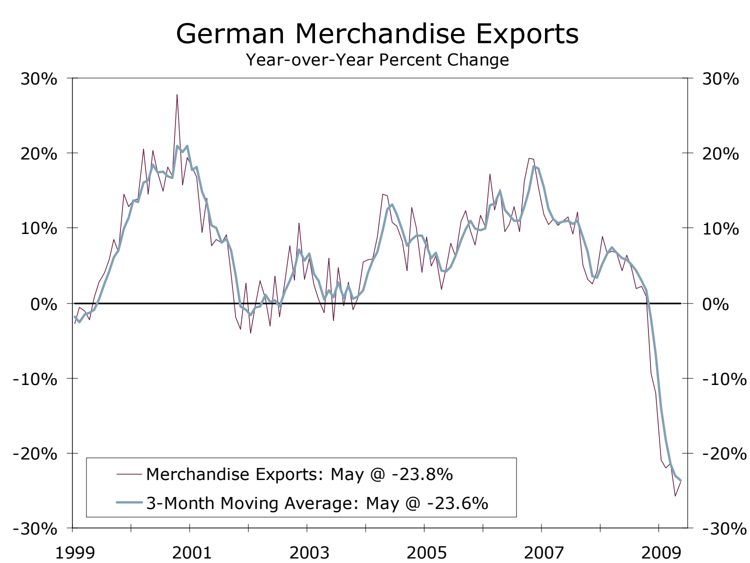
In short, the Euro-zone fell into a deep hole late last year and early this year, and it is just now starting to claw its way back. May's strong rise notwithstanding, IP in both France and Germany currently stand at their levels in the mid to late 1990s. In other words, the rise in production that took a decade to achieve was wiped out in a few months.

Moreover, the Euro-zone faces a number of strong headwinds. Both Ireland and Spain experienced sharp increases in house prices over the past decade or so, and the bursting of the respective housing bubbles has imparted significant shocks to those economies. Unemployment rates in both Ireland and Spain have more than doubled over the past year, and both economies probably face years of sluggish growth.

Speaking of burst bubbles, many economies in Eastern Europe became over-leveraged earlier this decade, and most countries in the region are experiencing their own deep recessions. The shockwaves from Eastern Europe have affected Germany via capital goods exports. Indeed, the value of German exports is down more than 20 percent at present (bottom chart). Therefore, sluggish growth in German exports, especially to Eastern Europe, will likely constrain growth in IP in Germany, and in the broader Euro-zone, for some time. Although we expect Western Europe to emerge from recession later this year, the pace of the upturn should be very slow, at least initially.







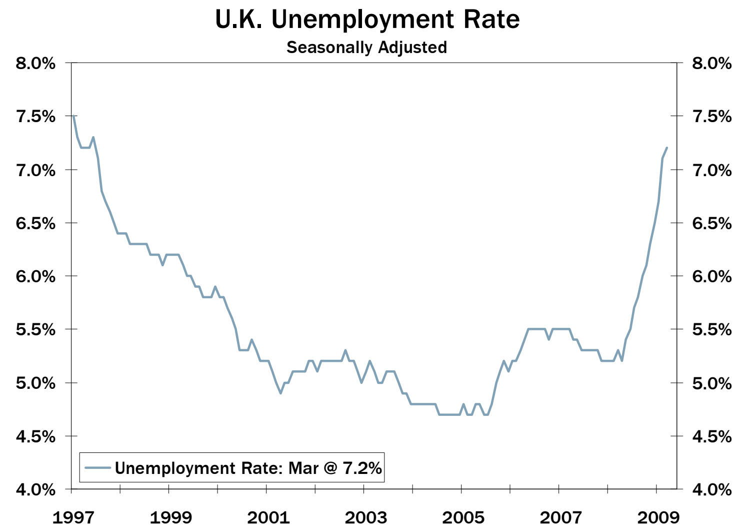
U.K. Unemployment Rate • Wednesday

The unemployment rate in Great Britain has risen sharply over the past year as the economy has slumped. Although there are indications that the rate of decline in real GDP slowed sharply in the second quarter, it is probably too early to expect a meaningful improvement in the labor market. Indeed, the consensus forecast anticipates that the unemployment rate rose from 7.2 percent in April to 7.4 percent in May.

The rise in the ranks of the unemployed has caused wage inflation to slow significantly, and the labor market report will also provide the most recent wage data. Speaking of inflation, data on CPI inflation in June will print on Tuesday, and most market participants look for further moderation in the overall CPI inflation rate.

Previous: 7.2%

Consensus: 7.4%



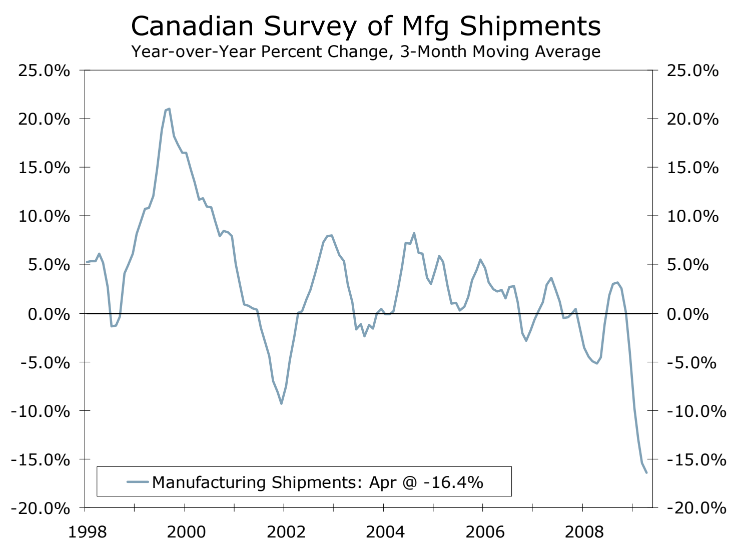
Canadian Manufacturing Shipments • Wed

Markets in Canada will be watching for the May data on factory sales which are reported in the survey of manufacturing shipments on Wednesday. The 0.1 percent decline for this series last month was less than the market expected, but a troubling 5.5 percent decline in unfilled orders raised concern that the pipeline for production could be drying up. That concern was ameliorated somewhat by the better-than-expected reading of business sentiment reported in the Ivey index earlier this week. Still, the consensus estimate is for a decline on the order of 0.8 percent, reflecting the ongoing challenges in Canadian manufacturing.

At the end of next week, market-watchers will turn their attention to inflation data which prints on Friday. Headline inflation may dip into negative territory on a year-over-year basis. If it does, it will be the first negative year-to-year reading since November 1994. This gives the Bank of Canada the cover it needs to keep rates low.

Previous: -0.1%

Consensus: -0.8%



Chinese GDP Growth • Thursday

Real GDP growth in China has slowed significantly from the heady days of 2007. Indeed, the 6.1 percent growth rate registered in the first quarter was the slowest year-over-year growth rate in nearly 10 years. That said, most monthly indicators suggest that economic growth picked up noticeably in the second quarter, and real GDP data that will be released on Thursday should confirm that perception.

Industrial production has clearly accelerated over the past few months, and monthly data released next week should show that growth in IP strengthened further in June. Data on the trade balance, retail sales, CPI inflation and fixed asset investment, which all are slated for release next week, should give investors an up-to-date assessment on the current state of the Chinese economy.

Previous: 6.1% (year-over-year rate) **Wells Fargo: 7.1%**

Consensus: 7.8%

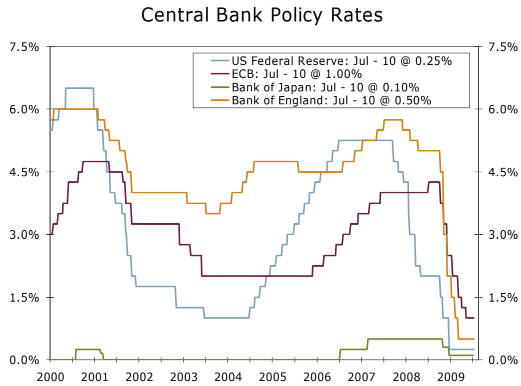
Interest Rate Watch

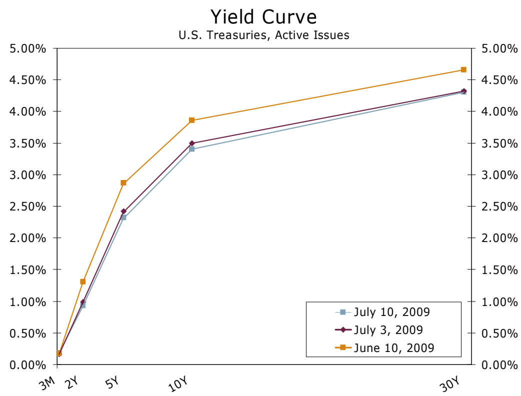
Outlook: Fundamentals Drive Interest Rates

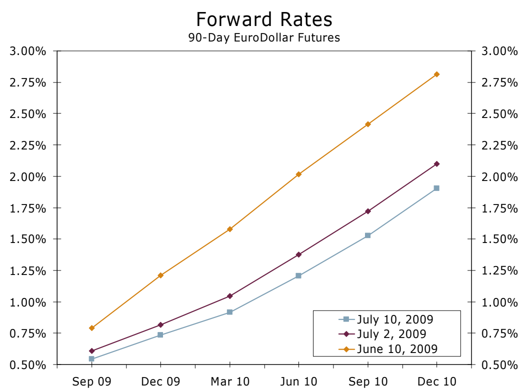
Our July monthly outlook supports the case for an unchanged federal funds rate target for the Federal Reserve and a gradual rise in the benchmark 10-year Treasury rate. Growth and inflation expectations provide the framework for our expectations of Fed policy. We expect sluggish growth of one to two percent for the second half of this year driven on the upside by a sub-par recovery of the consumer and federal government spending. Inflation, meanwhile, will remain subdued in the short-run given the lack of pricing power for firms and the lack of wage pressures for labor. While the Federal Reserve is not likely to alter the formal federal funds target range, we do expect three-month and two year Treasury rates to rise in anticipation of a change in Fed security purchases next year.

At the long-end of the yield curve we expect a modest rise in rates for two primary reasons. First is the continued decline of the flight to safety trade. Second, there remains the conflict of a very limited supply of savings in the face of increased U.S. Treasury debt issuance. Foreign concerns continue to be expressed about the value of the dollar as a global standard given the decline in foreign confidence in U.S. economic policy and concerns about future debt issuance.

As for credit markets, spreads will reflect direct Federal Reserve involvement, the pace of consumer de-leveraging and corporate profitability. We anticipate continued Fed intervention until next February, which will help to keep credit spreads narrower than they would be otherwise. This is particularly true for asset-backed and mortgage-backed securities. In recent weeks we have seen spreads widen with the announcement of Fed intentions for purchases of these securities. Meanwhile, the de-leveraging of the consumer will continue with household saving expected to rise over the next six months. On the corporate side, corporate profits will improve over the rest of this year. We believe this will help narrow spreads in the corporate bond market.







Consumer Credit Insights

Valued Clients –

This column picks up from the legacy Wells Fargo "Mortgage Monitor." This column will broaden its focus to include the breadth of consumer credit trends to include developments in installment credit, home equity loans and mortgage credit as well as any new developments that may impact the interaction of our customers and their access to credit. Commentary on the fundamental trends in interest rates will continue to be included in the "Interest Rate Watch" column at left.

Mortgage rates have declined in line with the drop in the 10-year yield as the spread between yields on 10-year Treasuries and MBS was little changed. Thirty year MBS current coupon spreads over Treasury swaps peaked in the fourth quarter of last year at over 160 basis points and declined to 50 basis points before rising modestly in recent weeks. This pattern reflects the influence of investor expectations on market intervention by the Federal Reserve. Spreads narrowed with the initial announcement and subsequent purchases of both Treasuries and Mortgages for this year. The recent backup in spreads reflects the Fed's comments recently that such purchases would be limited going forward.

Our outlook is for a gradual rise in mortgage rates for the next year as credit markets reprice risk. Yet, we also expect that housing starts will improve as the broader economic recovery supports a slow return to the underlying demographic trend.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	5.20%	5.32%	5.59%	6.37%
15-Yr Fixed	4.69%	4.77%	5.06%	5.91%
5/1 ARM	4.82%	4.88%	5.17%	5.82%
1-Yr ARM	4.82%	4.94%	5.04%	5.17%
MBA Applications				
Composite	493.1	444.8	611.0	513.4
Purchase	285.6	267.7	270.7	365.8
Refinance	1,707.7	1,482.2	2,605.7	1,379.3

Source: Freddie Mac, Mortgage Bankers Association and Wells Fargo Securities, LLC

Topic of the Week

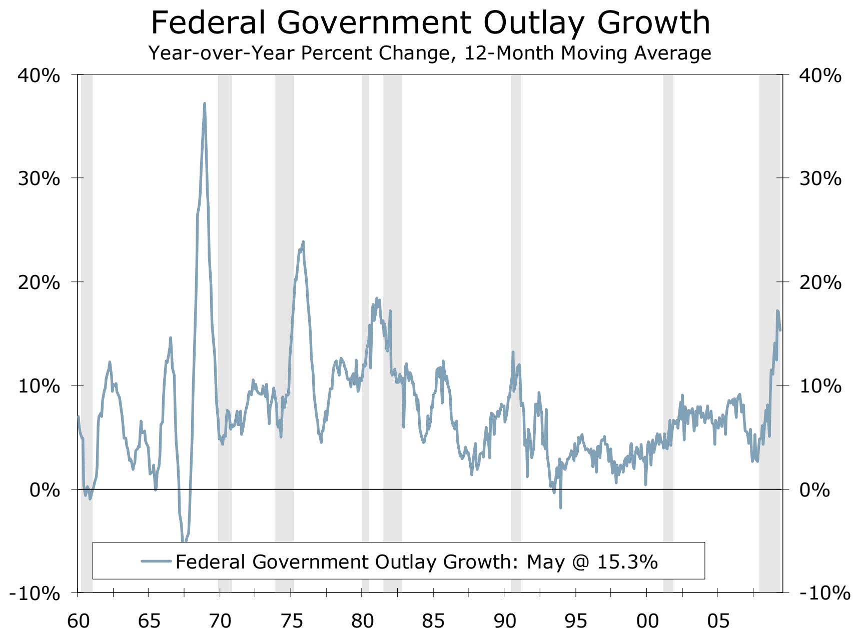
Macro Clouds, Micro Foundations

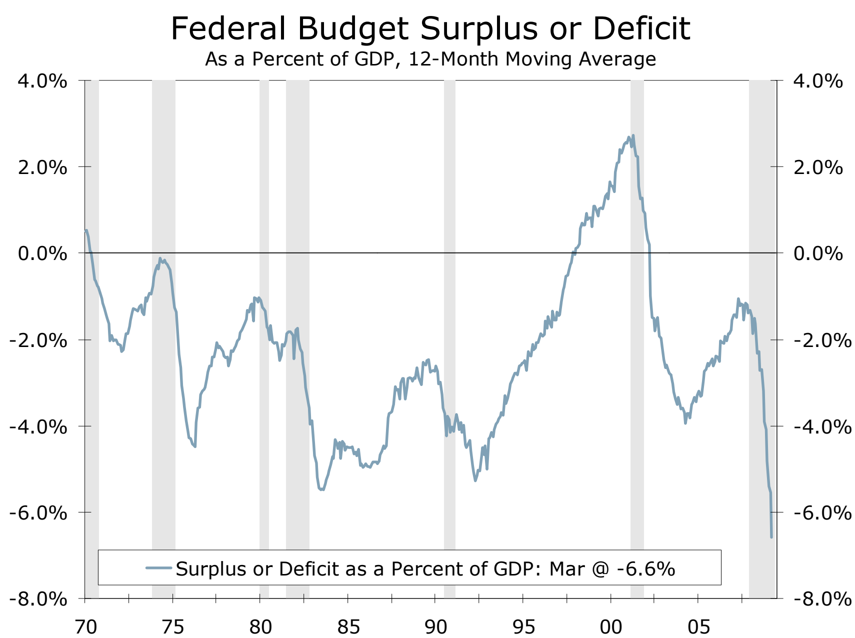
In the rush to solve the current economic problems policymakers base their projections of success on high-level multipliers and big-picture estimates. Often missed, however, are the on the ground microeconomic implications of policy proposals, a failure which has led to disappointment in the past.

What can decision-makers expect for policy initiatives and how will these initiatives affect basic hiring and investment decisions? The easy path to analysis is to rely on the broad sophism that government spending and tax cuts, along with a healthy dose of monetary easing, will stimulate sustainable economic growth. However, macro policy experiments in prior administrations, including the most recent Bush administration, were fixed on broad macro initiatives and failed to provide sustained growth due to the disregard for micro foundations. Policy actions based solely on conclusions drawn from large macroeconomic experiments and simplistic multipliers - those that ignore how households and firms will react on the micro level - will not be effective. Stated differently, incentives always matter.

In 2008, former President George W. Bush's fiscal rebate program aimed to stimulate the economy. Such stimulus did lead to a brief pick-up in retail spending but did not generate ongoing economic recovery. Certainly, there were other factors involved, but the basic lesson is that such "rebates" were simply handouts that did not alter individual incentives to work, save or invest. Estimates of job creation and sustainable growth owing to these macro policies were wildly optimistic. Policy endeavors that appear effective only when viewed at the 40,000-foot level, without changing individual incentives, generate no permanent stimulus to the economy. This year, President Obama's stimulus has come in terms of transfer payments, and not sustained job growth. In the latest personal income report we saw that personal income rose primarily due to these transfer payments, and as a result, household saving rates rose, but very little of the additional income was spent. There was little, if any, multiplier for the economy.

Please see our full report on our website, below.





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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 7/10/2009	1 Week Ago	1 Year Ago
3-Month T-Bill	0.17	0.15	1.66
3-Month LIBOR	0.51	0.56	2.79
1-Year Treasury	0.14	0.15	1.94
2-Year Treasury	0.90	0.98	2.40
5-Year Treasury	2.25	2.42	3.07
10-Year Treasury	3.33	3.50	3.80
30-Year Treasury	4.24	4.32	4.41
Bond Buyer Index	4.71	4.81	4.56

Foreign Exchange Rates

	Friday 7/10/2009	1 Week Ago	1 Year Ago
Euro ($/€)	1.392	1.398	1.579
British Pound ($/₤)	1.618	1.633	1.978
British Pound (₤/€)	0.860	0.856	0.798
Japanese Yen (¥/$)	92.350	96.040	107.070
Canadian Dollar (C$/$)	1.164	1.161	1.009
Swiss Franc (CHF/$)	1.088	1.087	1.028
Australian Dollar (US$/A$)	0.777	0.797	0.962
Mexican Peso (MXN/$)	13.688	13.231	10.302
Chinese Yuan (CNY/$)	6.833	6.832	6.843
Indian Rupee (INR/$)	49.005	47.890	42.996
Brazilian Real (BRL/$)	2.015	1.953	1.605
U.S. Dollar Index	80.295	80.151	72.493

Foreign Interest Rates

	Friday 7/10/2009	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.98	1.04	4.96
3-Month Sterling LIBOR	1.05	1.14	5.84
3-Month Canadian LIBOR	0.60	0.60	3.43
3-Month Yen LIBOR	0.44	0.45	0.93
2-Year German	1.20	1.24	4.40
2-Year U.K.	1.10	1.25	4.87
2-Year Canadian	1.16	1.17	3.16
2-Year Japanese	0.25	0.27	0.78
10-Year German	3.28	3.34	4.40
10-Year U.K.	3.74	3.73	4.87
10-Year Canadian	3.30	3.36	3.75
10-Year Japanese	1.31	1.33	1.58

Commodity Prices

	Friday 7/10/2009	1 Week Ago	1 Year Ago
WTI Crude ($/Barrel)	59.23	66.73	141.65
Gold ($/Ounce)	911.14	932.25	947.66
Hot-Rolled Steel ($/S.Ton)	335.00	335.00	1125.00
Copper (¢/Pound)	218.50	229.00	373.35
Soybeans ($/Bushel)	11.07	12.63	15.76
Natural Gas ($/MMBTU)	3.37	3.62	12.30
Nickel ($/Metric Ton)	14,814	16,374	21,299
CRB Spot Inds.	357.18	407.79	495.05

Source: Bloomberg LP and Wells Fargo Securities, LLC

Next Week's Economic Calendar

	Monday 13	Tuesday 14	Wednesday 15	Thursday 16	Friday 17
U.S. Data		**Retail Sales** May 0.5% June -0.4% (W) **PPI** May 0.2% June 0.6% (W) **Business Inventories** April -1.1% May -0.8% (W)	**CPI** May 0.1% June 0.6% (W) **Industrial Production** May -1.1% June -0.4% (W) **Capacity Utilization** May 68.3% June 68.3% (W)		**Housing Starts** May 532K June 540K (W)
Global Data		**UK** **CPI (YoY)** Previous (May) 2.2%	**UK** **Unemployment Rate** Previous (Apr) 7.2% **Canada** **Manufacturing** Previous (Apr) -0.1%	**China** **Real GDP (YoY)** Previous (1Q) 6.1% **China** **Indus. Production (YoY)** Previous (May) 8.9%	**Canada** **CPI (YoY)** Previous (May) 0.1%

Note: (W) = Wachovia Estimate (c) = Consensus Estimate

Wells Fargo Securities, LLC Economics Group

Diane Schumaker-Krieg	Global Head of Research & Economics	(704) 715-8437 (212) 214-5070	diane.schumaker@wachovia.com
John E. Silvia, Ph.D.	Chief Economist	(704) 374-7034	john.silvia@wachovia.com
Mark Vitner	Senior Economist	(704) 383-56355	mark.vitner@wachovia.com
Jay Bryson, Ph.D.	Global Economist	(704) 383-3518	jay.bryson@wachovia.com
Sam Bullard	Economist	(704) 383-7372	sam.bullard@wachovia.com
Anika Khan	Economist	(704) 715-0575	anika.khan@wachovia.com
Azhar Iqbal	Econometrician	(704) 383-6805	azhar.iqbal@wachovia.com
Adam G. York	Economist	(704) 715-9660	adam.york@wachovia.com
Tim Quinlan	Economic Analyst	(704) 374-4407	tim.quinlan@wachovia.com
Kim Whelan	Economic Analyst	(704) 715-8457	kim.whelan@wachovia.com
Yasmine Kamaruddin	Economic Analyst	(704) 374-2992	yasmine.kamaruddin@wachovia.com

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