

Economics Group

Weekly Economic & Financial Commentary

U.S. Review

Change Yes, But Not Very Comfortable

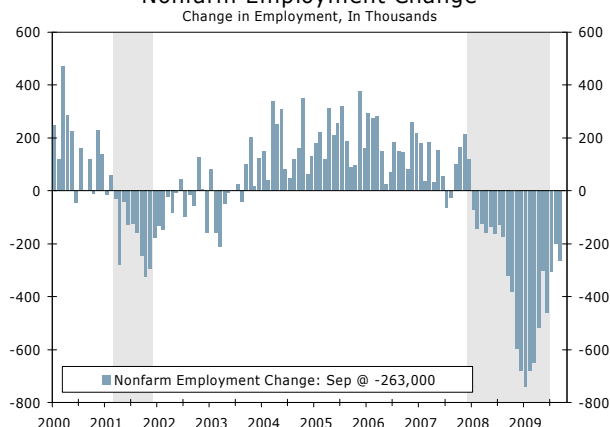
- This will not be your typical economic recovery. September's employment report brought home the harsh realities of the forces of cyclical weakness with soft consumer incomes and spending for the second half of this year.
- Secular change will be most evident in a slower pace of consumer spending and residential construction in this recovery.
- Globalization of production will continue as emerging markets grow faster than the U.S.

Global Review

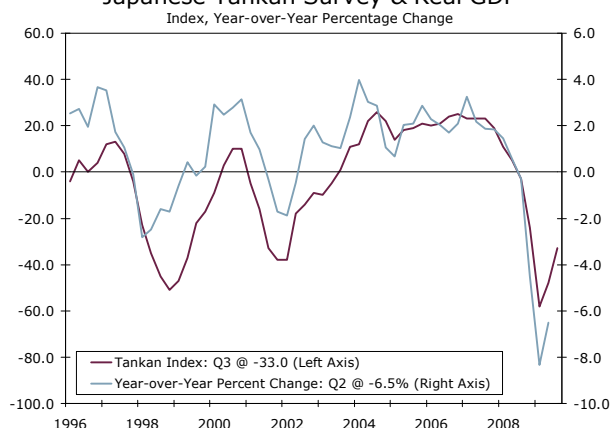
Tankan Survey Signals Further Expansion in Japan

- The Tankan index of Japanese business sentiment, which is highly correlated with real GDP growth, suggests that the Japanese economy expanded further in the third quarter. Indeed, recent "hard" data are consistent with another increase in real GDP in the recently completed quarter.
- Yen appreciation represents a risk factor to the nascent Japanese economic recovery. The yen has strengthened nearly 10 percent against the dollar since early August, and export growth could slow if the Japanese currency were to rise significantly further.

Nonfarm Employment Change



Japanese Tankan Survey & Real GDP



Wells Fargo U.S. Economic Forecast														
	Actual				Forecast				Actual			Forecast		
	2008				2009				2006	2007	2008	2009	2010	2011
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q						
Real Gross Domestic Product ¹	-0.7	1.5	-2.7	-5.4	-6.4	-1.0	3.7	2.5	2.7	2.1	0.4	-2.5	2.1	2.5
Personal Consumption	-0.6	0.1	-3.5	-3.1	0.6	-1.0	1.7	0.0	2.9	2.7	-0.2	-0.9	0.7	1.5
Inflation Indicators ²														
"Core" PCE Deflator	2.4	2.5	2.6	2.0	1.7	1.6	1.4	1.5	2.3	2.4	2.4	1.6	1.3	1.6
Consumer Price Index	4.2	4.3	5.2	1.5	-0.2	-0.9	-1.8	0.5	3.2	2.9	3.8	-0.6	1.3	2.0
Industrial Production ¹	0.2	-4.6	-9.0	-13.0	-19.1	-11.4	1.2	1.9	2.3	1.5	-2.2	-10.8	1.3	3.9
Corporate Profits Before Taxes ²	-4.9	-12.0	-5.4	-25.1	-19.0	-10.9	-11.0	3.5	10.5	-4.1	-11.8	-10.1	7.8	9.8
Trade Weighted Dollar Index ³	70.3	71.0	76.1	79.4	83.2	77.7	75.8	77.9	81.5	73.3	79.4	77.9	82.4	83.4
Unemployment Rate	4.9	5.4	6.1	6.9	8.1	9.3	9.6	10.0	4.6	4.6	5.8	9.2	10.1	9.3
Housing Starts ⁴	1.06	1.02	0.87	0.66	0.53	0.54	0.59	0.64	1.81	1.34	0.90	0.58	0.79	0.95
Quarter-End Interest Rates														
Federal Funds Target Rate	2.25	2.00	2.00	0.25	0.25	0.25	0.25	0.25	5.25	4.25	0.25	0.25	1.50	3.50
Conventional Mortgage Rate	5.97	6.32	6.04	5.33	5.00	5.42	5.20	5.20	6.14	6.10	5.33	5.20	5.60	6.60
10 Year Note	3.45	3.99	3.85	2.25	2.71	3.53	3.50	3.60	4.71	4.04	2.25	3.60	4.00	5.00

Forecast as of: September 9, 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

Harsh Job Realities Greet Simplistic Recovery Hopes

This will not be your typical economic recovery. The September employment report brought home the harsh realities of the forces of cyclical weakness, structural change and the globalization of the production cycle.

Cyclical weakness is evident from the employment report for both income and production. Household income will be weaker than usual in this economic recovery as job losses are accompanied by diminishing gains in average hourly earnings. In addition, the average work week has declined over the past three months. Fewer workers working fewer hours for more modest wage increases is a prescription for subpar consumer spending in the second half of this year and likely a disappointing start for early next year.

Industrial production, a coincident economic indicator, has also not fared well. A decline in the manufacturing workweek and a drop of 51,000 jobs suggests a decline for industrial production to be reported later this month. This view is reinforced by the flattening out of the gain reported in the ISM manufacturing index. The ISM data for September suggest that both production and new orders decreased in September. Moreover, prices paid rose suggesting rising input cost pressures—especially on metals—for manufacturers. Our outlook remains for only modest gains in industrial production of one to two percent for the rest of this year. This outlook received further reinforcement from the decline in light vehicle sales in the aftermath of the cash for clunkers program. The weakness in vehicle sales, both cars and trucks, is consistent with weak consumer income and low levels of consumer confidence. Our outlook remains for subpar consumer spending of just below one percent compared to two percent prior to the financial correction.

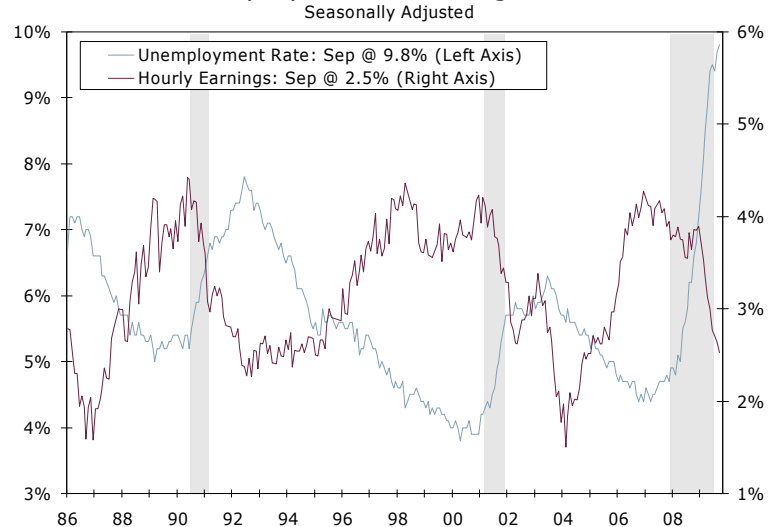
One positive to the outlook is the stabilization that appears to be happening in private residential construction spending. Here too the test will be the response in the market once the first-time home buyer credit lapses—if it lapses at all. Unfortunately, nonresidential construction does not appear to have found a bottom and we expect that this sector of the economy will continue to be a drag on growth going forward.

Secular Change and Global Production

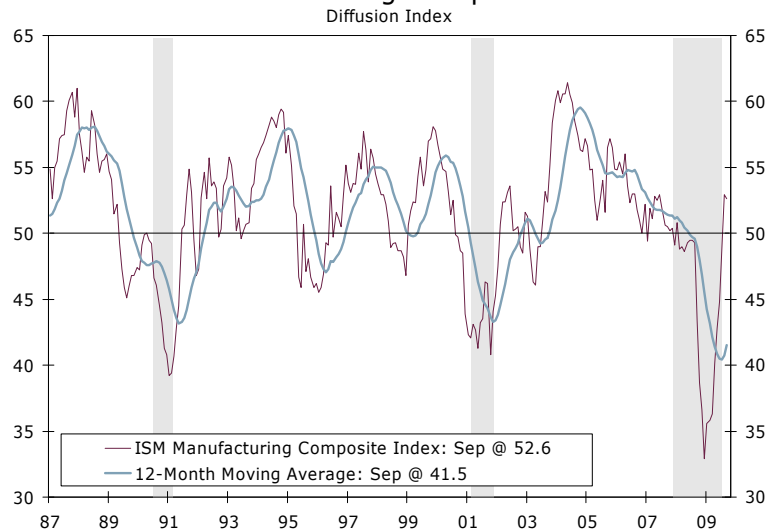
Beyond the business cycle, the strength of the expansion will be tested by secular forces that will dampen, in our view, the pace of growth in consumer spending and housing starts for the year ahead. A more cautious, higher saving consumer will limit spending. The financial incentives to invest in housing are more limited. Moreover, job opportunities will increasingly favor college-educated workers and this will flavor life-time income expectations for many households in our society.

Production will continue its global outreach as U.S. growth will remain moderate compared to growth in Asia and other emerging markets. Production will follow sales. Moreover, production will continue to move up the value chain as lower value-added production, and its associated employment, will move offshore.

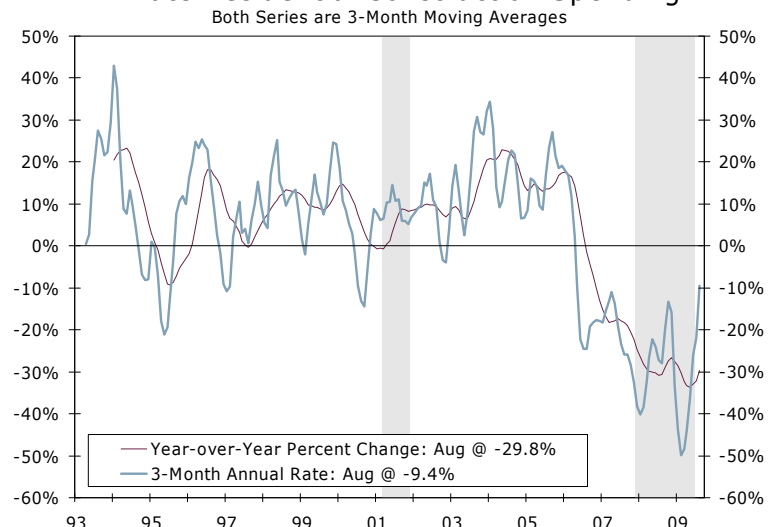
Unemployment and Wage Rates



ISM Manufacturing Composite Index



Private Residential Construction Spending



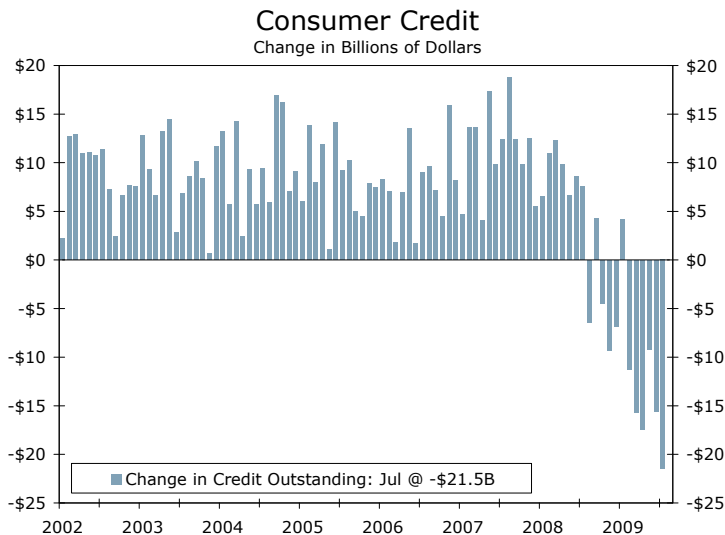
ISM Non-Manufacturing • Monday

The “headline” ISM non-manufacturing index continued to edge closer to the expansion demarcation line in August rising two points to 48.4. Business activity rose 5.2 points into expansion territory for the first time since September 2008. Prices paid rose around 22 points likely reflecting higher commodity prices. We expect the headline index to rise further in September to 49.8, which is consistent with a slower pace of decline in the service sector. While the ISM non-manufacturing time series only dates back to 1997, including just one recession, we can garner some useful insight. The headline index in the last recession finally crossed into expansion territory three months after the recession ended with business activity reaching the demarcation line the month after the recession ended. These data also support the notion an economic recovery likely began in the third quarter.

Previous: 48.4

Wells Fargo: 49.8

Consensus: 50.0



Trade Balance • Friday

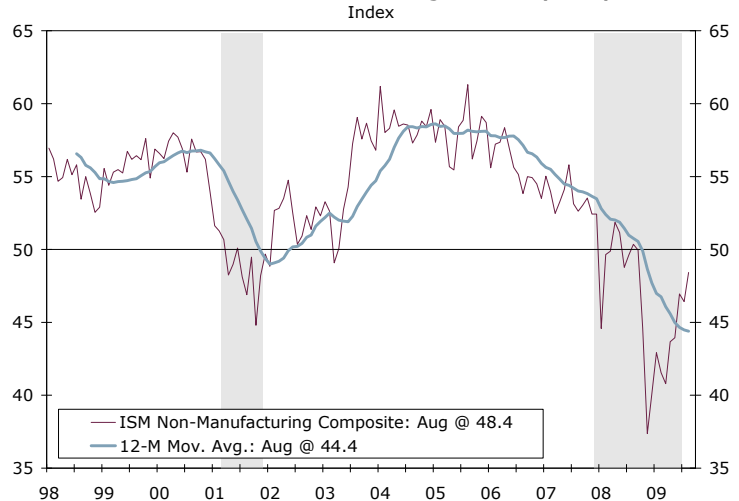
The trade deficit widened in July to \$32 billion with imports excluding oil surging \$6.2 billion, the largest gain on record. The rise in imports excluding petroleum was broad based likely reflecting an increase in U.S. consumer demand. Autos, pharmaceuticals and aircraft had the largest monthly gains. Exports in July rose for the third consecutive month, which is consistent with an economic recovery in the rest of the world. The \$2.7 billion rise in exports was positive with autos accounting for most of the gain. We expect the trade deficit to widen for the third consecutive month to \$33.7 billion in August due mostly to a spike in petroleum and autos, but these gains will likely not be sustainable. In real terms, however, the coming months should begin to show a narrowing of the trade deficit as oil prices stabilize and import volume edges higher.

Previous: -\$32.0B

Wells Fargo: -\$33.7B

Consensus: -\$33.0B

ISM Non-Manufacturing Index (NMI)

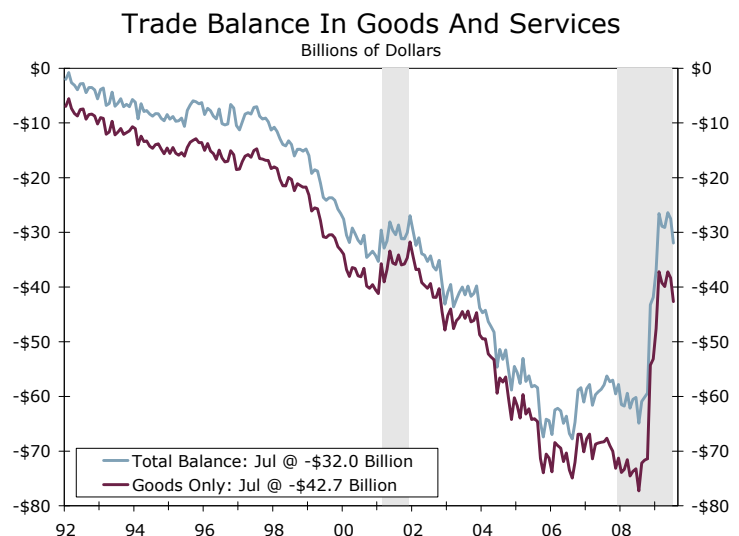


Consumer Credit • Wednesday

Consumer credit dropped a much larger than expected \$21.6 billion in July and declines from previous months are now reported to be much larger than first estimated. Consumers are clearly cutting back on discretionary purchases and using debit cards and cash more frequently. Credit card issuers are also reducing credit lines and charging-off doubtful accounts. The high level of charge-offs means credit underwriting will likely remain tight for some time, which will make it tough for consumer spending to post big gains. Continued job losses, declining wage and salary growth and reduced consumer credit will combine to strain consumers through 2010. We expect consumer spending will be muted in 2010, likely rising only 0.7 percent at an annualized rate, which will cause a sluggish economic recovery.

Previous: -\$21.6B

Consensus: -\$10.0B



Global Review

Tankan Survey Signals Further Expansion in Japan

Although the Bank of Japan's Tankan survey is only conducted on a quarterly basis, it is widely followed by investors because it contains a treasure trove of information about the Japanese economy. For starters, the "headline" index, which measures business conditions among large manufacturers, has a high degree of correlation with real GDP growth (see chart on front page). Therefore, the rise in the index from -48 in June to -33 in September suggests that the economy expanded further on a sequential basis in the third quarter. Indeed, "hard" data show that industrial production (IP) through the first two months of the third quarter rose more than 6 percent relative to the second quarter. Although IP remains 18 percent below its level of a year ago, it has risen 20 percent since its nadir in February (top chart).

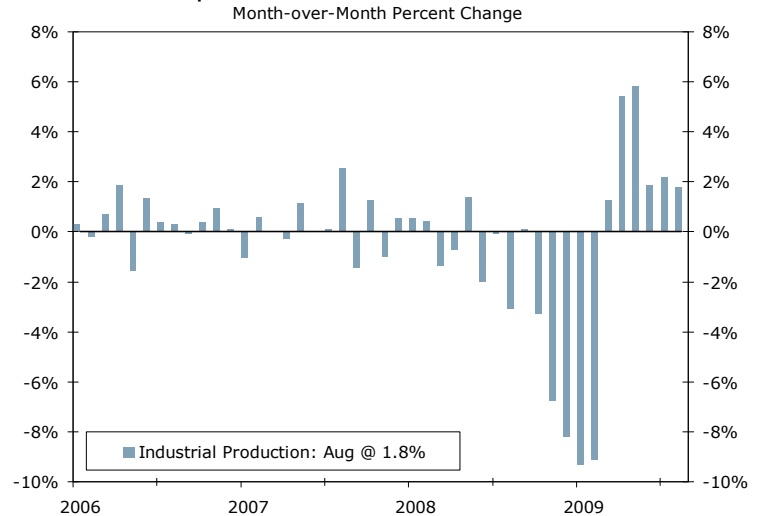
Japanese businesses reported in the Tankan survey that overseas demand improved considerably in the third quarter, and "hard" data, which show a 9 percent rise in export volumes through August, corroborate the anecdotal evidence. But domestic demand is also starting to do its part. Data on machinery orders suggest that capital expenditure may be in the process of stabilizing, and growth in consumer spending has turned positive. The value of retail sales is up more than 2 percent relative to the low set in March. (That said, retail spending is still down on a year-over-year basis—see middle chart.)

Speaking of retail sales, consumer spending may strengthen further over the next few quarters. The new government that took power a few weeks ago promised in its campaign platform to significantly increase tax deductions for families with dependent children. If this policy proposal is passed into law later this year, as seems likely, the boost to household real disposable income could lead to stronger consumption expenditures, at least over the next few quarters.

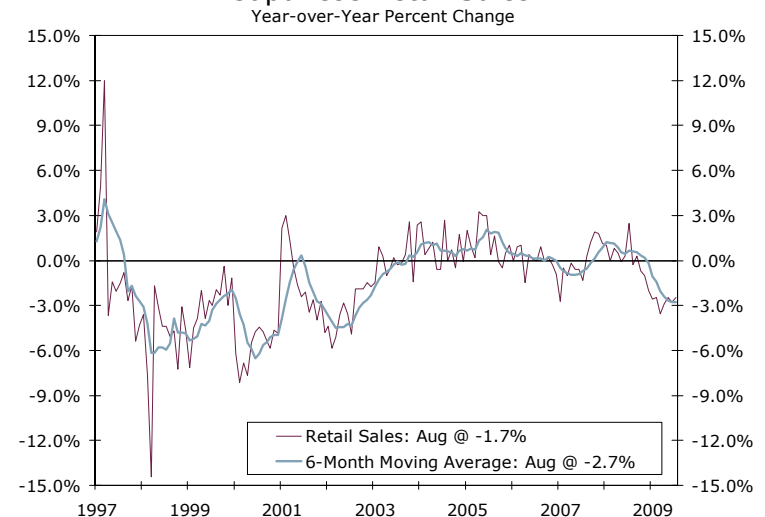
In sum, the Japanese economy fell off a cliff in the wake of last autumn's worldwide financial crisis, and most indicators suggest that economic activity remains below the levels of a year ago. However, an incipient recovery appears to be taking hold. Is there anything that could cause the recovery to stall? Clearly, there are a number of shocks that could cause the economy to lurch lower again, but a notable risk to the recovery is significant yen appreciation. The Japanese currency has strengthened nearly 10 percent versus the dollar since early August (bottom chart). Moreover, the yen has appreciated against most major currencies as well recently.

Very low interest rates in the United States relative to Japan—the 3-month dollar LIBOR rate is currently 6 basis points below the comparable yen rate—has contributed to the yen's rise vis-à-vis the greenback. In addition, the new government has hinted that it will essentially take a hands-off approach to the exchange rate because yen appreciation helps consumers by reducing import costs. However, export growth could slow in the quarters ahead if the yen were to strengthen significantly more, which could put a damper on overall economic growth in Japan.

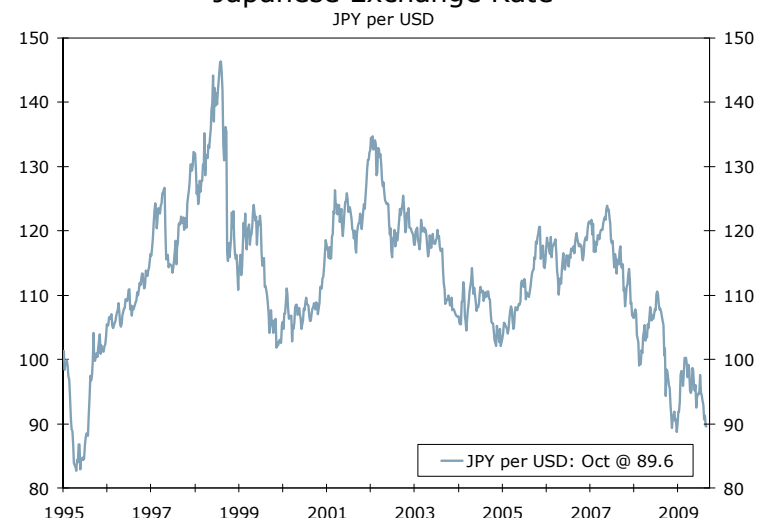
Japanese Industrial Production



Japanese Retail Sales



Japanese Exchange Rate



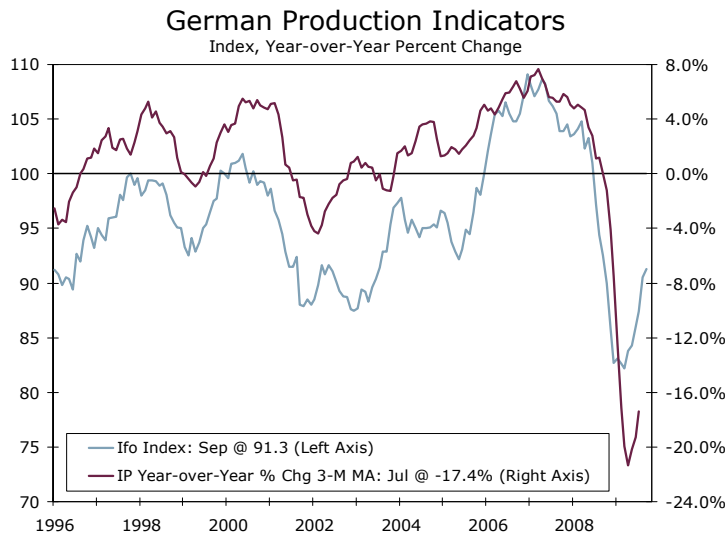
U.K. Industrial Production • Tuesday

As in most other countries, industrial production (IP) in the United Kingdom tanked in the months following last autumn's financial meltdown. However, British IP has increased for two consecutive months, and the rise in the manufacturing PMI points in the direction of further modest increases in the months ahead. On the service side of the economy, the service sector PMI has stood above the demarcation line that separates expansion from contraction for four consecutive months, and most investors expect it to remain there in September. (The service sector PMI will print on Monday.)

The Bank of England holds its monthly policy meeting on Thursday, and few market participants look for a change in rates. Of more interest will be its decision regarding its asset purchase program. We expect that the Bank will keep the size of its program unchanged at £175 billion.

Previous: 0.5% (month-on-month change)

Consensus: 0.1%



Canadian Employment • Friday

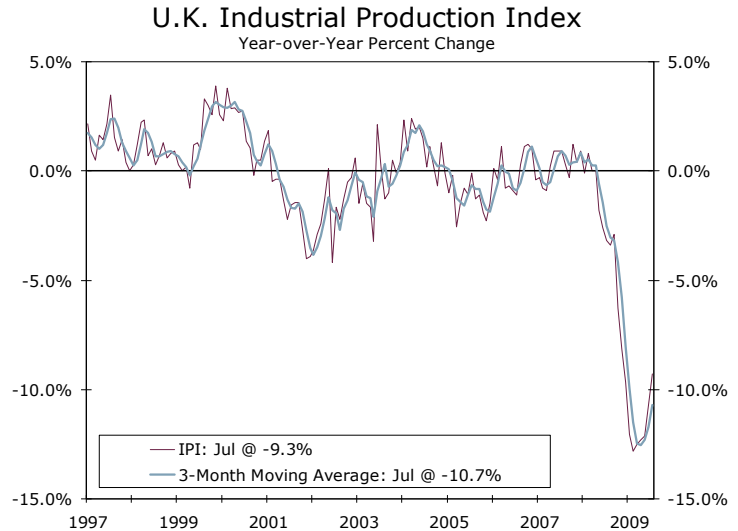
Market-watchers in Canada were taken by surprise when they learned that payrolls increased in August. On Friday of this week we will find out whether or not the momentum continued when the Canadian jobs report for September will be released. The consensus is expecting a decrease in jobs, but not enough to erase last month's gains.

The latest reading for the Ivey PMI will print on Tuesday. This will provide some insight on business sentiment during the month of September.

Homebuilders in Canada have been under pressure during this recession. However judging by housing starts data, new construction activity may have bottomed in the spring. Since April, starts have been rising on trend, the latest starts data will be reported on Thursday of this coming week.

Previous: 27.1K

Consensus: -7.5K



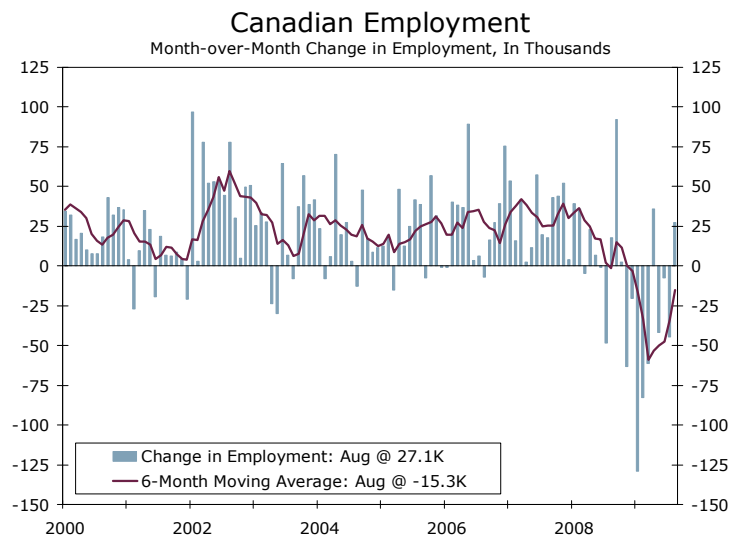
German Industrial Production • Thursday

Data on the German factory sector in August will print next week. Orders have risen 16 percent from their nadir in February, and the consensus forecast anticipates another increase in August. The rise in orders has translated into a trend increase in industrial production over the past few months, and data on IP that are slated for release on Thursday will show whether the trend remained intact in August. Data on French and Italian industrial production, which have also trended higher over the past few months, are on the docket for Friday.

The European Central Bank holds its monthly policy meeting on Thursday. Although there is very little prospect that the ECB will change its main policy rate, investors will scrutinize comments that President Trichet will make in his post-meeting press conference for clues about the stance of policy going forward.

Previous: -0.9% (month-on-month change)

Consensus: 1.8%



Interest Rate Watch

Economic Recovery Accompanies Credit Improvements

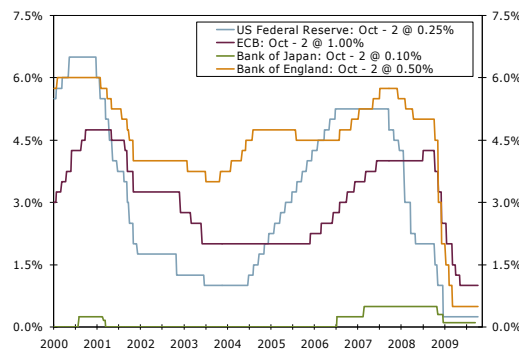
As we enter the second quarter of the economic expansion, the recovery will be accompanied by continued increases in issuance and decreases in credit spreads as they both reflect the improvement in corporate profits. Investment grade corporate spreads have now returned to pre-crisis levels. Since May, interest spreads on both high grade and high yield bonds have declined while issuance has improved. Historically, a decline in interest rate spreads has been a leading indicator of an economic recovery and this pattern has reasserted itself. Even AAA CMBS spreads have declined in recent months as the Fed's TALF program has taken hold for high-quality, asset-backed securities.

Smaller spreads and rising profits should form the basis for what we expect will be an improvement in corporate financial ratios. This improvement will support economic growth going forward. In this way the economic and financial systems will reinforce each other giving us a sustained expansion. We see no reason to expect a "W" economic pattern similar to the 1980-82 experience.

There are the three risks we have outlined before—the dollar, the fiscal policy exit strategy and the interplay of domestic policy and global investors—yet we do not sense that these risks, right now, are such as to suggest a second-leg down.

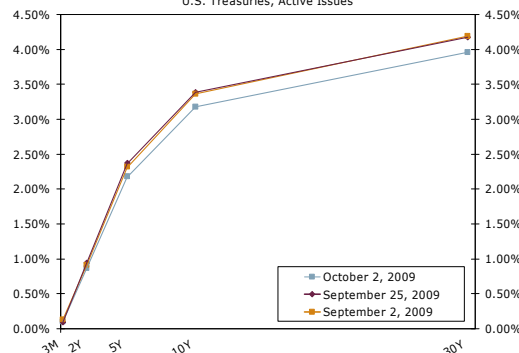
As for the private credit markets, the improvements in liquidity, reinforced by continued low inflation, will support growth and therefore we expect a virtuous cycle going forward. For example, in recent months we have seen an upturn in orders and shipments for selected capital goods and software which suggests that both the financing and expected returns for investment spending have improved. While the directions of impacts from credit to the economy are on the upside, the magnitude of the support for growth will remain modest. The process of deleveraging will take time and will dampen growth but the outlook remains positive.

Central Bank Policy Rates



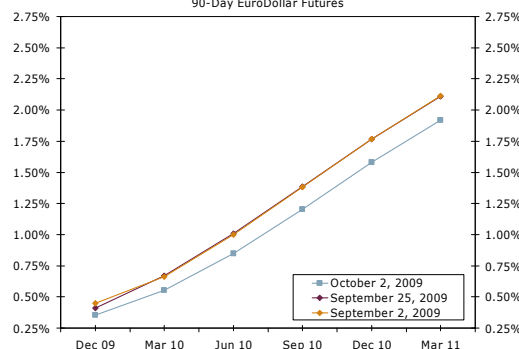
Yield Curve

U.S. Treasuries, Active Issues



Forward Rates

90-Day EuroDollar Futures



Consumer Credit Insights

Recovery but No Boom: Limits on Consumer Credit Demand

Three factors will limit the recovery of consumer credit demand over the next twelve months; slow income gains, excess asset inventories and wealth rebuilding. Even while the economy begins to show signs of recovery, household income gains will be limited by weak job gains and subpar wages and salaries growth in the year ahead. In addition, consumer confidence remains modest at best.

Second, households purchased and are still retaining a significant holding of physical assets (autos, appliances, computers, big-screen TVs) relative to their planned consumption of these goods. This is the legacy of credit-financed spending over the recent expansion. Physical assets, relative to their expected depreciation, are excessive compared to the planned purchases of household based upon their expected, now lower, future income.

In contrast, household wealth is below planned retirement levels and, therefore, in our view, we expect that household savings rates will remain higher and credit usage lower than that of the prior expansion.

Our outlook remains for subpar consumer spending, especially on durable goods, as the real interest rate on credit is still extremely high while inflation remains very low, and consumer desires for credit are limited by modest income gains, excess real goods and a shortage of retirement savings.

Mortgage Data

	Current	Week Ago	4 Weeks Ago	Year Ago
Mortgage Rates				
30-Yr Fixed	4.94%	5.04%	5.08%	6.10%
15-Yr Fixed	4.36%	4.46%	4.54%	5.78%
5/1 ARM	4.42%	4.51%	4.59%	6.00%
1-Yr ARM	4.49%	4.52%	4.62%	5.12%
MBA Applications				
Composite	649.6	668.5	554.1	455.4
Purchase	270.4	288.3	277.6	304.8
Refinance	2,857.3	2,881.5	2,164.1	1,333.9

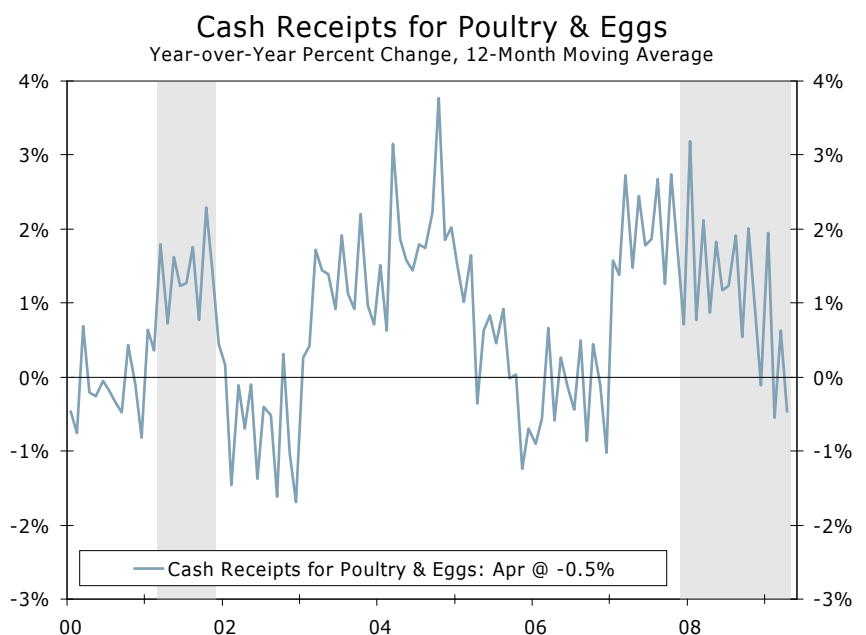
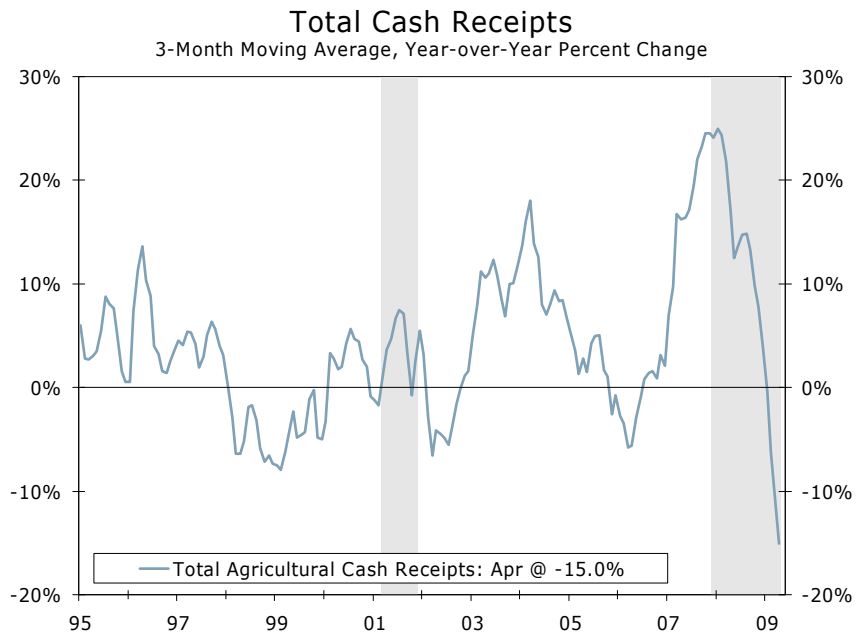
Source: Freddie Mac, Mortgage Bankers Association and Wells Fargo Securities, LLC

Topic of the Week

Headwinds in the Agriculture Industry

The agriculture sector has been facing significant headwinds this year due to unfavorable weather, higher input costs and lower prices. Total cash receipts were down 14.1 percent year-over-year in April, and the U.S. Department of Agriculture (USDA) forecasted net farm income in 2009 will be down 38 percent from the previous year. While the USDA forecasted the production of corn and soybean will increase, their prices remain 11 and 24 percent below last year's average, respectively. Many states with heavy concentrations in agriculture have been suffering. For example, in Georgia, cash receipts are down 7.5 percent. The production of peanuts, one of the state's leading crops, is projected to be down 35.5 percent this year. Heavy rains and freezing temperatures in the Southeast this past Spring damaged many crops and made field work difficult. However, milder weather in the summer created favorable planting conditions for certain crops. Summer in California and the Southwest was much dryer. Rainfall was below normal levels and the dryness led to an increase in wildfire activity in California.

The poultry industry has also faced several challenges such as high feed costs, weakening demand worldwide and the bankruptcy of Pilgrim's Pride Corporation. The Pilgrim's Pride bankruptcy is severely impacting parts of South Georgia, particularly the Douglas/Coffee County area, where the company was the largest employer. Pilgrim's Pride also announced a plant closing in Athens, Georgia. Falling exports are responsible for much of the drop in demand. Exports fell sharply in the second half of 2008, but have picked up slightly this year, with the volume of shipments through July rising 1 percent above the comparable period from one year ago. The value of exports, however, is still down 2 percent, reflecting lower prices. In addition, the Chinese government has announced they will investigate chicken imports from the U.S., which may further dampen broiler exports to China, Georgia's top chicken export market.



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Market Data ♦ Mid-Day Friday

U.S. Interest Rates

	Friday 10/2/2009	1 Week Ago	1 Year Ago
3-Month T-Bill	0.10	0.10	0.60
3-Month LIBOR	0.28	0.28	4.21
1-Year Treasury	0.36	0.44	1.43
2-Year Treasury	0.85	0.98	1.62
5-Year Treasury	2.16	2.37	2.66
10-Year Treasury	3.15	3.32	3.63
30-Year Treasury	3.93	4.09	4.15
Bond Buyer Index	3.94	4.04	5.36

Foreign Exchange Rates

	Friday 10/2/2009	1 Week Ago	1 Year Ago
Euro (\$/€)	1.457	1.469	1.382
British Pound (\$/£)	1.589	1.595	1.764
British Pound (£/€)	0.917	0.921	0.783
Japanese Yen (¥/\$)	88.949	89.636	105.335
Canadian Dollar (C\$/ \$)	1.087	1.091	1.079
Swiss Franc (CHF/\$)	1.037	1.028	1.136
Australian Dollar (US\$/A\$)	0.864	0.868	0.773
Mexican Peso (MXN/\$)	13.741	13.563	11.196
Chinese Yuan (CNY/\$)	6.826	6.829	6.845
Indian Rupee (INR/\$)	47.755	47.973	46.610
Brazilian Real (BRL/\$)	1.795	1.790	2.021
U.S. Dollar Index	77.089	76.812	80.439

Foreign Interest Rates

	Friday 10/2/2009	1 Week Ago	1 Year Ago
3-Month Euro LIBOR	0.70	0.70	5.32
3-Month Sterling LIBOR	0.54	0.55	6.28
3-Month Canadian LIBOR	0.50	0.50	4.20
3-Month Yen LIBOR	0.35	0.35	1.03
2-Year German	1.19	1.22	3.30
2-Year U.K.	0.75	0.74	3.96
2-Year Canadian	1.17	1.28	2.59
2-Year Japanese	0.24	0.22	0.78
10-Year German	3.11	3.26	3.93
10-Year U.K.	3.42	3.61	4.37
10-Year Canadian	3.24	3.37	3.65
10-Year Japanese	1.26	1.32	1.52

Commodity Prices

	Friday 10/2/2009	1 Week Ago	1 Year Ago
WTI Crude (\$/Barrel)	68.99	66.02	93.97
Gold (\$/Ounce)	999.22	991.00	836.40
Hot-Rolled Steel (\$/S.Ton)	555.00	555.00	940.00
Copper (¢/Pound)	265.20	273.10	265.25
Soybeans (\$/Bushel)	9.11	9.12	9.88
Natural Gas (\$/MMBTU)	4.54	3.99	7.48
Nickel (\$/Metric Ton)	17,348	17,011	15,710
CRB Spot Inds.	426.12	432.85	440.10

Next Week's Economic Calendar

	Monday	Tuesday	Wednesday	Thursday	Friday
	5	6	7	8	9
U.S. Data	ISM Non-Manuf. August 48.4 September 49.8 (W)		Consumer Credit July -\$21.6B August -\$10.0B (C)	Wholesale Inventories July -1.4% August -1.0% (C)	Trade Balance July -\$32.0B August -\$33.7B (W)
Global Data	UK PMI Services Previous (Aug) 54.1	UK Industrial Prod. (MoM) Previous (Jul) 0.5%	Germany Factory Orders (MoM) Previous (Jul) 3.5%	Germany Industrial Prod. (MoM) Previous (Jul) -0.9%	France Industrial Prod. (MoM) Previous (Jul) 0.1% Canada Net Chg. in Employ. Previous (Aug) 27.1K
Note: (W) = Wells Fargo Estimate (c) = Consensus Estimate					

Wells Fargo Securities, LLC Economics Group

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