

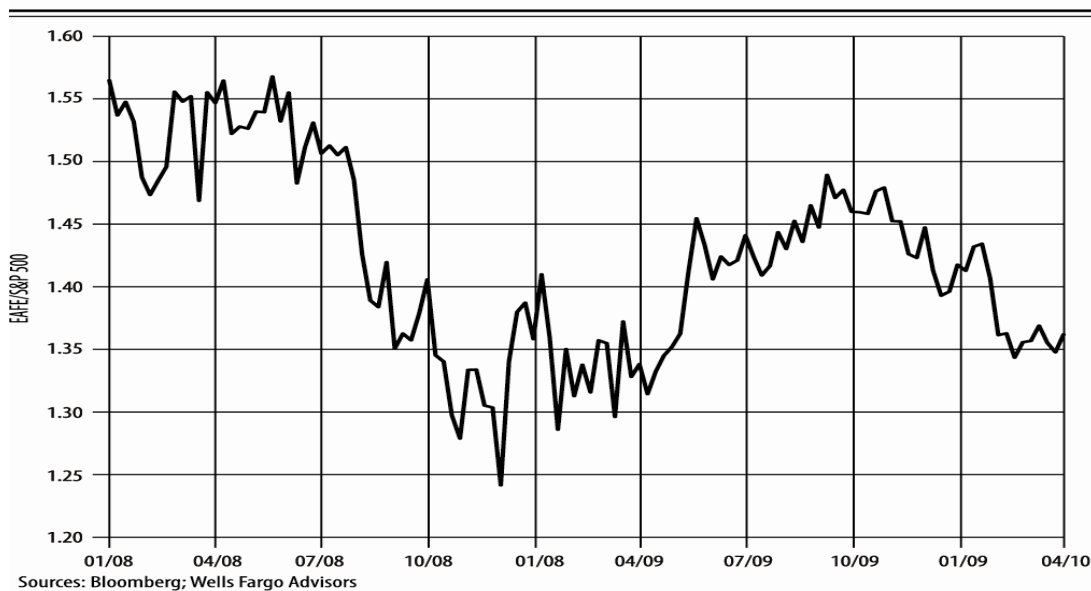
The Week

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Worth noting

- During the first quarter of 2010, the U.S. economy continued to crawl out of the deep hole that it fell into during the recession. However, the recovery is uneven and likely to be modest compared to previous rebounds from recession.
- The U.S. equity market was volatile early in the first quarter, but ended the period at a new recovery high. At the same time, continued sovereign debt problems in Europe hurt many foreign equity markets. Consequently, foreign developed equity markets, as measured by the EAFE index (European, Australasia and Far East) underperformed the U.S. equity market as measured by the S&P 500.
- Late in the first quarter, investors showed an increased appetite for risk, with defensive sectors of the U.S. equity market underperforming the overall equity market while credit spreads narrowed slightly, further indicating investors were less concerned about credit problems of borrowers.

Ratio: EAFE Index / S&P 500 Index



Past performance is not an indication of future results. An index is not managed and is unavailable for direct investment.

First quarter review

The first quarter of 2010 started with increased equity market volatility, but ended with the markets advancing further along the trend started in March 2009. The equity markets moved higher because the economic news was more positive than negative, and the Federal Reserve continued to put excess liquidity into the financial system. Our work indicates this is now one of the longest equity market rallies in the past 10 years.

By the end of the first quarter, the Fed recognized that the economy was strengthening. Therefore, policymakers decided to end several of their emergency liquidity programs started during the financial crisis, including the purchases of mortgage-backed securities. However, policymakers decided that current conditions still warranted exceptionally low short-term interest rates for an extended period of time.

One reason the Fed may be keeping short-term interest rates low is the U.S. economic recovery is not uniform. Most of the strength has been in manufacturing. It would be better if other sectors were doing as well. Unfortunately, housing is not leading the economic recovery as it has in past cycles. In fact, single-family new home sales dropped in February to the lowest level on record, going back to 1963. This means that the economic recovery is lacking in some areas, and growth is likely to be modest rather than robust.

On the positive side, the index of leading economic indicators continues to advance, although the February reading was the smallest increase in the past 11 months. This suggests that the economy may be poised to cool off this spring and summer, after a healthy start to the recovery during the past three quarters.

Concerns about inflation also remain relatively modest during the first quarter, despite the Federal Reserve pumping a lot of liquidity into the financial system. That's because many parts of the economy are still deleveraging. This has been happening for more than a year. During the four quarters ended in December, net lending was negative. In other words, the amount of debt paid off by consumers and businesses, plus the amount of debt written off by lenders, exceeded the amount of new loans created, including all the Fed lending. This is still a deflationary condition not an inflationary environment.

The U.S. equity markets, as measured by the S&P 500, continued to advance during the first quarter, outperforming developed equity markets, while keeping pace with emerging equity markets. At the same time, the dollar rallied against the euro as sovereign debt problems in Greece raised concerns about the viability of the common currency.

Within the equity markets, small-cap and mid-cap stocks outperformed large-cap equities while value stocks outperformed growth stocks for both small- and large-cap stocks. This is a sign that investors were more optimistic about economic prospects, helping to boost small- and mid-cap stocks as well as value stocks. Also within the equity markets, the defensive sectors underperformed the overall market as positive sentiment helped lift the cyclically sensitive sectors over the weak defensive sectors.

In the credit markets, the Fed continues to say that low interest rates are warranted for an extended period of time. However, policymakers will probably change this language before the Fed reverses policy and begins to drain reserves. In the meantime, interest rates remain low and credit spreads have narrowed as investors reached for yield. The credit spreads did not narrow as much in the first quarter as they did in the previous three quarters. This suggests that fixed-income investors may also be expecting more modest economic growth in coming quarters, as the index of leading economic indicators is suggesting.

Activity in the commodity markets was mixed with the average price of commodities moving sideways to lower during the first quarter. Weak grain markets and weak soft commodities, including sugar and cocoa offset strength in metals, meats and energy, pulling the Commodity Research Bureau (CRB) index down modestly during the first quarter.

Looking ahead, the second quarter of 2010 will be an important time of testing for the financial markets. The gains in the equity markets since the lows in March 2009 may continue, if the economic recovery does not falter. However, the equity markets are extended and well above those March 2009 lows. Consequently, the equity markets are vulnerable to unexpected negative news or signs that the pace of economic recovery is slowing.

Important Information, Risk Factors and Disclaimers:

Past performance is not a guarantee of future results.

Dividends are not guaranteed and are subject to change or elimination.

An index is not managed and is unavailable for direct investment.

The prices of small cap and mid cap company stocks are generally more volatile than large company stocks. They often involve higher risks because smaller companies may lack the management expertise, financial resources, product diversification and competitive strengths to endure adverse economic conditions.

Investing in foreign securities presents certain risks not associated with domestic investments, such as currency fluctuation, political and economic instability, and different accounting standards. This may result in greater share price volatility.

Buying commodities allows for a source of diversification for those sophisticated persons who wish to add commodities to their portfolios and who are prepared to assume the risks inherent in the commodities market. Any purchase represents a transaction in a non-income-producing commodity and is highly speculative. Therefore, commodities should not represent a significant portion of an individual's portfolio.

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