

Economics Group

MONTHLY OUTLOOK

U.S. Overview

After Years of Hard Work, a Better U.S. Outlook

As we transition into 2012, our growth outlook reflects more of the same for the year ahead. We expect the economy to expand at around 2.1 percent for the year ahead driven by many of its components as opposed to a major contribution from one segment.

Consumer spending should continue to add to economic growth as real income gains benefit from slower inflation and steady gains in employment. Business fixed investment most likely will also continue to support growth with gains in both capital equipment and non-residential construction. Residential construction, particularly remodeling, will also add to growth. Government spending remains the primary negative for 2012 while net exports will also subtract a bit from growth.

Inflation will slow down in the year ahead as commodity and producer prices moderate and unit labor costs stay tame. With moderate growth and lower inflation, we expect short-term interest rates to remain low for most of the year while longer-term borrowing rates rise as the search for yield continues; risk trade moderates and investors seek opportunity.

Europe and political developments in this election year are the two main sources of surprise with the outcomes in either direction. We expect a European recession is in swing right now and that it will persist through June, which should lower export growth and earnings for many U.S. companies. Politics always brings out the event risk associated with new proposed policies.

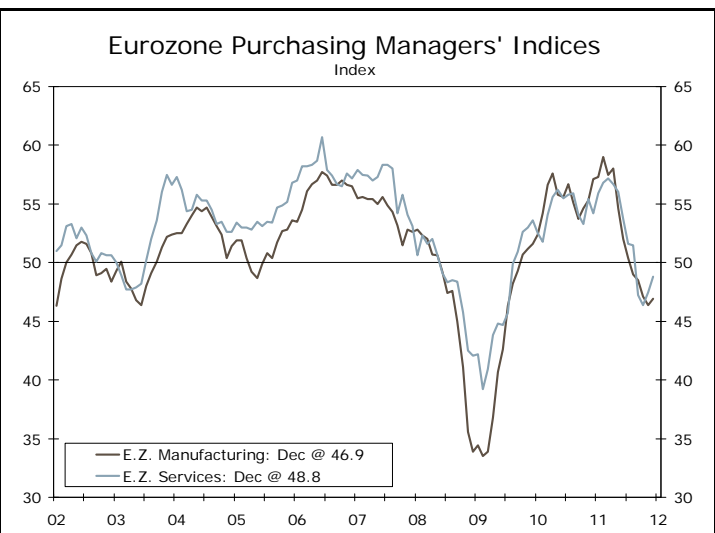
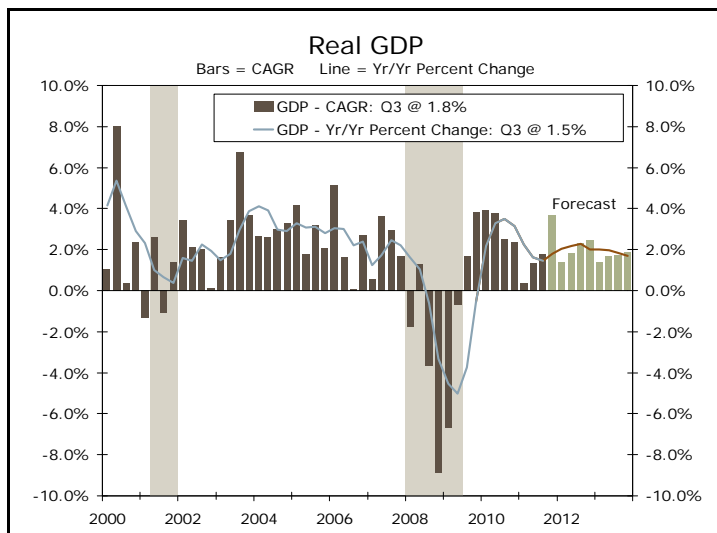
International Overview

Global Economy: No Recession, but Slow Growth

Excluding the United States, most major economies appear to have experienced slower growth in the fourth quarter than in the third period. Recent monthly data suggest that the Eurozone is sliding back into a modest recession due, at least in part, to the erosion in consumer and business confidence stemming from the ongoing sovereign debt crisis. In our view, the European Central Bank will likely cut rates further, and it may also eventually need to provide unlimited support to the Spanish and Italian government bond market.

The British economy is also very weak at present. Although the United Kingdom may narrowly skirt a recession, most Britons would consider the 1 percent real GDP growth rate that we forecast for 2012 to be decidedly subpar. Even the once high-flying Chinese economy has gotten into slowdown mode. In our view, it will not be long before Chinese real GDP is growing less than 8 percent on a year-over-year basis, which is quite slow by Chinese standards. Japan will be hard pressed to repeat the strong growth performance it registered in the third quarter, which was influenced by the bounce back from the natural disasters it suffered in March.

Looking into the new year, we project that global GDP will grow about 3 percent in 2012. Although not a global recession, it would be the slowest year for global growth since the sharp downturn in 2009. In addition, there are a number of downside risks to keep in mind including a "bad" outcome to the festering European sovereign debt crisis and a spike in oil prices caused by a potential conflict with Iran. Stay tuned.



Source: U.S. Department of Commerce, IHS Global Insight and Wells Fargo Securities, LLC



After Years of Hard Work, a Better U.S. Outlook

In sports, very few titles are won without hard work. For the economy, the hard work of restructuring household and government balance sheets and coming to grips with a global marketplace is beginning to pay off.

Moderate growth at 2.1 percent is the outlook for 2012 with a slower pace at the start of this year in response to the 3.7 percent gain we expect to be reported for the fourth quarter of 2011. Consumer spending will likely slow in the first quarter of this year to 1.4 percent after a strong gain of 2.8 percent in the fourth quarter. Consumer spending gains follow the improvement in real income as inflation slows and employment continues to show improvement. Business fixed investment is expected to rise 6 percent plus in the first half of this year as equipment and software, as well as structures, continues to improve. Slower gains in orders and a reduction in the accelerated depreciation schedules suggest more moderate equipment investment spending next year. Nonetheless, investment should reflect the imperatives of global competition and continued economic growth. Energy and power spending as well as industrial structures likely will continue to lead the contribution of non-residential construction to growth. However, spending on offices likely will remain subdued as vacancy rates have just started to turn down. Retail space is still a work in progress. Residential construction, particularly remodeling, should also add to growth although the real recovery in housing is still a ways off as new home prices remain uncompetitive with existing home prices. Construction of multi-family units should continue to strengthen.

On the downside, government spending remains the primary negative for 2012 as many state and local revenue gains lag the business cycle and, therefore, spending restraint remains imperative. State and local governments continue to align their spending with slower growth in their tax bases. Net exports will

also subtract a bit from growth as a Eurozone recession, and weakness in Eastern Europe likely will slow U.S. export growth.

Inflation, Interest Rates and Profits

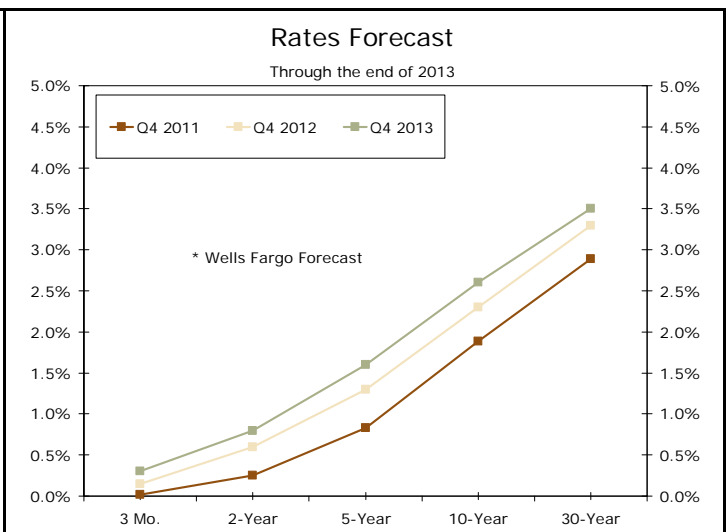
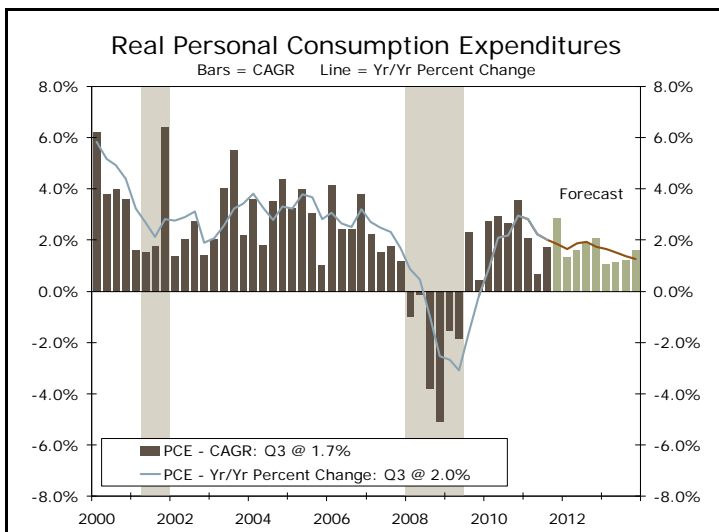
Inflation should moderate in the year ahead as commodity and producer price inflation slows and unit labor costs remain very tame. The employment cost index likely will remain at 2.1 percent for the second consecutive year. Producer prices are expected to moderate to 2.5 percent in 2012 after a gain of 6.0 percent last year. With moderate growth and lower inflation, we expect short-term interest rates to remain low for most of the year while longer-term borrowing rates begin to rise as the search for yield continues; risk trade moderates and investors seek opportunity. Our outlook is for the 10-year Treasury note to gradually rise to end the year at 2.3 percent. For now, we estimate that any Federal Reserve action toward more quantitative easing would take place through a purchase of mortgage-backed securities and therefore work primarily to provide liquidity while lowering the mortgage rate.

Profits benefit from the continued gains in economic growth, modest increases in the employment cost index and stable interest rates. We estimate that pretax corporate profits will rise 6 percent plus during the first half of this year after a slightly stronger gain in the second half of last year.

Risks: Europe, Politics and Oil

Our three risks to the outlook begin with our concern of a greater downside risk to the expected recession in Europe. We expect a European recession is in swing now and that it will persist through mid-year, which will lower export growth and earnings for many U.S. companies. Second, politics always bring out the event risk associated with new proposed policies as well as the confusion that policy change may bring to central industries such as finance, energy and resource development.

Finally, oil and the tensions with Iran represent another source of risk and would bias our growth expectations downward and our inflation expectations upward.



Source: U.S. Department of Commerce and Wells Fargo Securities, LLC

Wells Fargo U.S. Economic Forecast

	Actual								Forecast								Actual		Forecast		
	2010				2011				2012				2013				2009	2010	2011	2012	2013
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q					
Real Gross Domestic Product (a)	3.9	3.8	2.5	2.3	0.4	1.3	1.8	3.7	1.4	1.8	2.3	2.4	1.4	1.7	1.7	1.9	-3.6	3.0	1.8	2.1	1.9
Personal Consumption	2.7	2.9	2.6	3.6	2.1	0.7	1.7	2.8	1.3	1.6	1.9	2.1	1.0	1.1	1.2	1.6	-2.0	2.0	2.2	1.8	1.4
Business Fixed Investment	6.0	18.6	11.3	8.7	2.1	10.3	15.7	11.9	6.3	6.8	7.8	8.1	3.9	5.0	5.9	6.9	-18.0	4.4	9.3	9.1	6.0
Equipment and Software	21.7	23.2	14.1	8.1	8.7	6.2	16.2	4.3	6.3	6.7	8.0	8.4	3.6	4.6	5.6	6.6	-16.3	14.6	10.2	7.5	5.8
Structures	-24.7	7.5	4.2	10.5	-14.3	22.6	14.4	4.0	6.5	7.0	7.0	7.0	5.0	6.5	7.0	8.0	-21.2	-15.8	4.9	8.1	6.5
Residential Construction	-15.3	22.8	-27.7	2.5	-2.5	4.2	1.2	6.5	5.5	5.0	5.0	5.5	5.0	5.5	6.0	6.5	-22.3	-4.3	-1.6	4.9	5.4
Government Purchases	-1.2	3.7	1.0	-2.8	-5.9	-0.9	-0.1	-0.8	-1.7	-1.5	-1.1	-1.0	-1.1	-1.0	-0.7	-0.7	1.7	0.7	-1.9	-1.1	-1.0
Net Exports	-376.8	-437.4	-458.7	-414.2	-424.4	-416.4	-402.8	-409.8	-420.0	-426.9	-427.7	-430.4	-424.6	-412.6	-407.2	-412.0	-358.8	-421.8	-413.3	-426.3	-414.1
Pct. Point Contribution to GDP	-1.0	-1.9	-0.7	1.4	-0.3	0.2	0.4	-0.2	-0.3	-0.2	0.0	-0.1	0.2	0.4	0.2	-0.1	1.0	-0.5	0.1	-0.1	0.1
Inventory Change	39.9	64.6	92.3	38.3	49.1	39.1	-2.0	13.0	21.0	31.0	38.0	44.5	49.5	49.5	49.5	50.0	-145.0	58.8	24.8	33.6	49.6
Pct. Point Contribution to GDP	3.1	0.8	0.9	-1.8	0.3	-0.3	-1.4	0.5	0.2	0.3	0.2	0.2	0.1	0.0	0.0	0.0	-0.8	1.6	-0.3	0.1	0.1
Nominal GDP	5.5	5.4	3.9	4.2	3.1	4.0	4.4	5.8	3.5	4.0	4.4	4.5	3.5	3.8	4.0	4.1	-2.6	4.2	4.0	4.3	4.0
Real Final Sales	0.8	3.0	1.7	4.2	0.0	1.6	3.2	3.0	1.2	1.5	2.1	2.3	1.3	1.7	1.8	1.9	-2.8	1.4	2.1	2.0	1.8
Retail Sales (b)	5.3	6.9	5.6	7.6	8.2	7.8	8.0	6.8	4.7	4.4	4.3	3.7	3.8	3.9	4.1	4.3	-7.0	6.4	7.7	4.3	4.0
Inflation Indicators (b)																					
"Core" PCE Deflator	1.7	1.5	1.3	1.0	1.1	1.3	1.6	1.7	1.7	1.5	1.4	1.5	1.5	1.6	1.6	1.7	1.5	1.4	1.4	1.5	1.6
Consumer Price Index	2.4	1.8	1.2	1.2	2.2	3.3	3.8	3.3	2.4	1.9	1.5	1.7	1.9	1.9	2.0	2.2	-0.3	1.6	3.2	1.9	2.0
"Core" Consumer Price Index	1.3	1.0	0.9	0.6	1.1	1.5	1.9	2.2	2.1	1.9	1.6	1.5	1.5	1.6	1.7	1.7	1.7	1.0	1.7	1.8	1.6
Producer Price Index	5.1	4.3	3.7	3.8	5.0	6.7	6.9	5.7	3.1	2.0	2.2	2.5	2.8	2.9	2.9	2.9	-2.6	4.2	6.0	2.5	2.8
Employment Cost Index	1.7	1.9	1.9	2.0	2.0	2.2	2.0	2.0	2.2	2.0	2.0	2.1	2.3	2.1	2.2	2.2	1.7	1.3	2.1	2.1	2.2
Real Disposable Income (a)	4.9	5.6	2.3	1.5	1.2	-0.5	-1.9	1.2	1.5	1.6	1.8	2.0	-0.6	1.3	1.8	2.1	-2.1	1.8	0.9	1.0	1.1
Nominal Personal Income (b)	1.4	3.2	4.9	5.4	5.8	5.1	4.2	3.8	2.1	2.0	2.7	3.0	2.1	2.1	2.1	2.3	-4.0	3.7	4.7	2.4	2.2
Industrial Production (a)	8.1	7.1	6.7	3.1	4.8	0.7	6.1	2.7	2.8	3.6	3.0	2.2	-0.3	3.3	4.0	4.2	-11.1	5.3	4.1	3.2	2.3
Capacity Utilization	72.3	74.0	75.5	76.1	76.8	76.7	77.6	77.6	77.0	77.2	77.2	77.3	77.4	77.6	77.8	78.1	69.2	74.5	77.2	77.2	77.7
Corporate Profits Before Taxes (b)	46.7	41.5	27.4	18.2	8.8	8.5	7.5	6.4	6.2	6.0	6.4	6.6	6.7	6.9	7.1	7.2	9.1	32.2	7.8	6.3	7.0
Corporate Profits After Taxes	36.0	36.2	23.3	17.4	10.6	9.4	11.1	7.0	7.4	7.2	7.4	7.4	7.6	7.8	8.0	8.2	16.0	27.5	9.5	7.4	7.9
Federal Budget Balance (c)	-328.9	-287.0	-290.2	-369.0	-460.5	-141.1	-326.3	-310.8	-348.0	-174.0	-200.2	-220.0	-215.0	-210.0	-210.0	-185.0	-1415.7	-1294.2	-1296.8	-1033.0	-855.0
Current Account Balance (d)	-118.3	-120.3	-120.1	-112.2	-119.6	-124.7	-110.3	-125.0	-145.0	-160.0	-165.0	-165.0	-160.0	-150.0	-145.0	-150.0	-376.6	-470.9	-479.6	-635.0	-605.0
Trade Weighted Dollar Index (e)	76.1	78.8	73.6	73.2	70.6	69.4	72.8	73.3	74.0	74.5	75.0	76.0	77.0	78.0	79.0	80.0	77.7	75.6	70.9	74.9	78.5
Nonfarm Payroll Change (f)	39.3	181.0	-45.7	138.7	165.7	96.7	147.0	137.3	110.0	125.0	140.0	150.0	110.0	130.0	130.0	130.0	-421.9	78.3	136.7	131.3	125.0
Unemployment Rate	9.8	9.6	9.5	9.6	9.0	9.0	9.1	8.7	8.4	8.5	8.6	8.5	8.4	8.3	8.2	8.1	9.3	9.6	9.0	8.5	8.3
Housing Starts (g)	0.61	0.60	0.58	0.54	0.58	0.57	0.62	0.66	0.66	0.70	0.69	0.70	0.74	0.78	0.83	0.84	0.55	0.58	0.61	0.69	0.80
Light Vehicle Sales (h)	11.0	11.4	11.6	12.3	13.0	12.1	12.4	13.4	13.5	13.6	13.8	14.0	13.6	13.8	14.2	14.5	10.4	11.6	12.7	13.7	14.0
Crude Oil - WTI - Front Contract (i)	78.72	78.03	76.20	85.17	94.10	102.56	89.76	94.06	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	61.80	79.53	95.12	100.00	100.0
Quarter-End Interest Rates (j)																					
Federal Funds Target Rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
3 Month LIBOR	0.29	0.53	0.29	0.30	0.30	0.25	0.37	0.58	0.60	0.60	0.55	0.50	0.45	0.40	0.35	0.35	0.69	0.34	0.34	0.56	0.39
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25
Conventional Mortgage Rate	4.97	4.74	4.35	4.71	4.84	4.51	4.11	3.96	4.00	4.10	4.10	4.20	4.20	4.30	4.30	4.40	5.04	4.69	4.46	4.10	4.30
3 Month Bill	0.16	0.18	0.16	0.12	0.09	0.03	0.02	0.02	0.05	0.05	0.10	0.15	0.20	0.20	0.25	0.30	0.15	0.14	0.05	0.09	0.24
2 Year Note	1.02	0.61	0.42	0.61	0.80	0.45	0.25	0.25	0.30	0.40	0.50	0.60	0.60	0.70	0.70	0.80	0.96	0.70	0.45	0.45	0.70
5 Year Note	2.55	1.79	1.27	2.01	2.24	1.76	0.96	0.83	0.90	1.00	1.10	1.30	1.30	1.40	1.50	1.60	2.20	1.10	1.52	1.08	1.45
10 Year Note	3.84	2.97	2.53	3.30	3.47	3.18	1.92	1.89	2.00	2.10	2.20	2.30	2.30	2.40	2.50	2.60	3.26	3.22	2.78	2.15	2.45
30 Year Bond	4.72	3.91	3.69	4.34	4.51	4.38	2.90	2.89	3.00	3.10	3.20	3.30	3.30	3.30	3.40	3.50	4.08	4.25	3.91	3.15	3.38

Forecast as of: January 11, 2012

Notes: (a) Compound Annual Growth Rate Quarter-over-Quarter
 (b) Year-over-Year Percentage Change
 (c) Quarterly Sum - Billions USD; Annual Data Represents Fiscal Yr.
 (d) Quarterly Sum - Billions USD
 (e) Federal Reserve Major Currency Index, 1973=100 - Quarter End

(f) Average Monthly Change
 (g) Millions of Units
 (h) Quarterly Data - Average Monthly SAAR; Annual Data - Actual Total Vehicles Sold
 (i) Quarterly Average of Daily Close
 (j) Annual Numbers Represent Averages

Global Economy: No Recession, But Slow Growth

As we enter 2012, the global economy continues to expand, but at a slower rate than it was a quarter or two ago. Yes, it appears that the sequential rate of U.S. real GDP growth in the fourth quarter was stronger than the 1.8 percent annualized rate that registered in the previous quarter. However, outside of the United States it appears that most other major economies grew slower and in some cases, significantly slower, than in the previous quarter.

Let's start with the Eurozone. Real GDP in the Eurozone rose only 0.6 percent (annualized) in the third quarter, and it appears that output likely contracted in the fourth quarter. The level of industrial production (IP) in October was 0.9 percent below the third quarter's average, and the low readings on manufacturing and service sector purchasing managers' indices (PMI) in November and December suggest that the quarter ended on a weak note (see graph on front page). Indices of business and consumer confidence have sagged in recent months, no doubt reflecting the uncertainty surrounding the ongoing sovereign debt crisis in the Eurozone. If there is any "good news" out of the area it is that the "soft" data (e.g., the PMIs and the confidence measures) are suggesting that the rate of contraction did not increase further in December. However, there are few signs yet that economic activity is stabilizing.

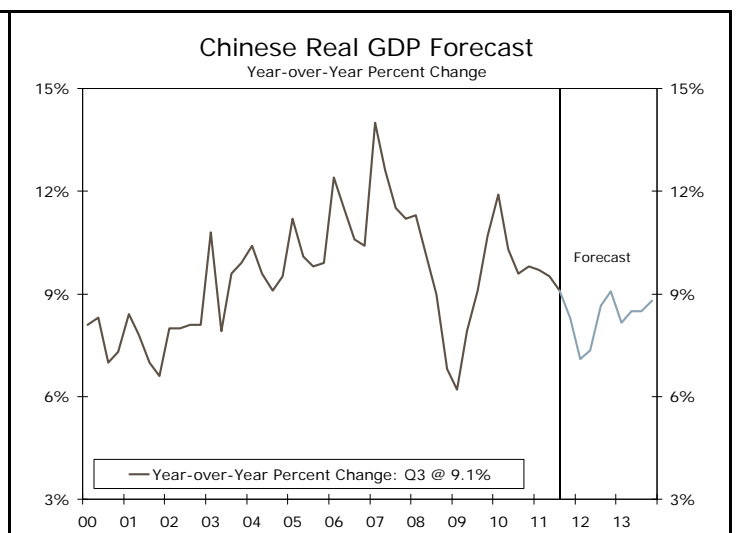
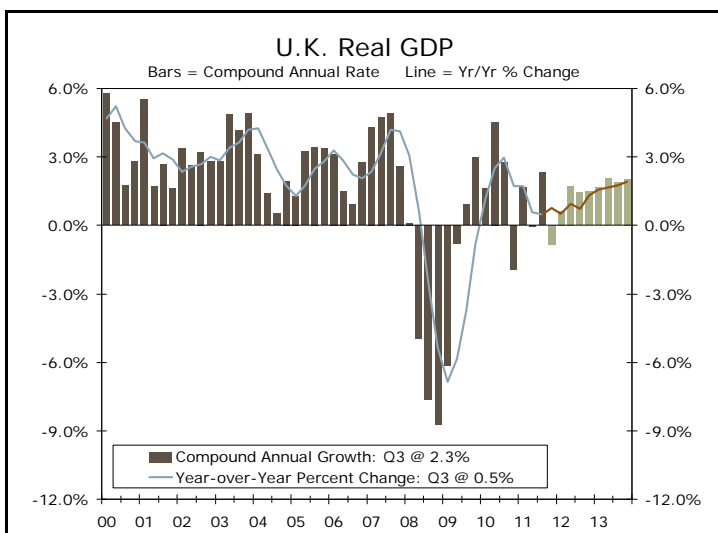
As noted previously, indices of business and consumer confidence have sagged in recent months. In our view, consumers and businesses will remain very cautious in the months ahead as the crisis continues to fester, and we look for real GDP to sink further over the next quarter or two. The European Central Bank (ECB) has already cut its main policy rate by 50 bps, and we look for it to ease further in coming months. The ECB may eventually need to provide unlimited support to the Spanish and Italian government bond markets (For further reading see "Europe in 2012: Renaissance or More

Dark Ages" (December 19, 2011), which is posted on our website).

The U.K. economy, which grew at an annualized rate of 2.3 percent in the third quarter, appears to have stagnated in the fourth quarter. In October, IP was 0.6 percent below the third-quarter average, and growth in real retail spending remained very weak, at least through November. Although the U.K. economy may narrowly skirt a recession, most Britons would consider the 1 percent real GDP growth rate that we forecast for 2012 to be decidedly subpar. The combination of weak growth and receding inflation should preclude any rate hikes by the Bank of England this year (bottom graph).

Even the once high-flying Chinese economy has gotten into slowdown mode. At 12.4 percent, the year-over-year growth rate in Chinese IP in November was the weakest since August 2009. Real GDP was up 9.1 percent in the third quarter, but we forecast that it will not be long until the economy is growing less than 8 percent, which is slow by Chinese standards. Japanese GDP shot up at an annualized rate of 5.6 percent in the third quarter as the economy rebounded from the natural disasters in March. However, it appears that the Japanese economy contracted modestly again in the fourth quarter.

We project that global GDP will grow about 3 percent in 2012. Although not a global recession, it would be the slowest year for global growth since the sharp downturn in 2009. There are also a number of downside risks to keep in mind. First, the European sovereign debt crisis has not been solved. Although a breakup of the Eurozone is not likely in 2012, the risk that a "bad" outcome occurs is not just an insignificant tail risk either (For more reading on the subject see the reports that are posted on our website). In addition, a conflict with Iran could cause oil prices to spike. Oil at \$150/barrel or higher would present a threat to global GDP growth. Stay tuned.



Source: Bloomberg LP, IHS Global Insight and Wells Fargo Securities, LLC

Wells Fargo International Economic Forecast

(Year-over-Year Percent Change)

	GDP			CPI		
	2011	2012	2013	2011	2012	2013
Global (PPP weights)	3.5%	3.1%	3.6%	5.4%	4.1%	4.1%
Global (Market Exchange Rates)	2.3%	1.9%	2.4%	n/a	n/a	n/a
Advanced Economies ¹	1.5%	1.3%	1.9%	2.9%	1.7%	1.6%
United States	1.8%	2.1%	1.9%	3.2%	1.9%	2.0%
Eurozone	1.5%	-0.1%	1.6%	2.7%	1.9%	1.5%
United Kingdom	0.9%	0.9%	1.7%	4.5%	2.3%	1.8%
Japan	-0.9%	1.0%	1.4%	-0.3%	-0.3%	-0.1%
Korea	3.5%	2.4%	3.3%	4.0%	3.1%	3.0%
Canada	2.4%	2.0%	2.8%	2.9%	2.2%	2.1%
Developing Economies ¹	5.8%	5.2%	5.6%	8.2%	6.9%	7.1%
China	9.2%	8.0%	8.5%	5.4%	3.3%	3.8%
India	7.2%	7.0%	7.6%	9.0%	7.8%	7.9%
Mexico	4.1%	4.3%	4.5%	3.4%	5.0%	5.3%
Brazil	2.8%	3.1%	4.0%	6.5%	5.3%	5.0%
Russia	4.1%	3.0%	3.0%	8.5%	6.5%	6.6%

Forecast as of: January 11, 2012

¹Aggregated Using PPP Weights

Wells Fargo International Interest Rate Forecast

(End of Quarter Rates)

	3-Month LIBOR						10-Year Bond					
	2012				2013		2012				2013	
	Q1	Q2	Q3	Q4	Q1	Q2	Q1	Q2	Q3	Q4	Q1	Q2
U.S.	0.60%	0.60%	0.55%	0.50%	0.45%	0.40%	2.00%	2.10%	2.20%	2.30%	2.30%	2.40%
Japan	0.20%	0.20%	0.20%	0.20%	0.20%	0.20%	1.03%	1.06%	1.09%	1.11%	1.12%	1.14%
Euroland*	0.90%	0.65%	0.65%	0.65%	0.65%	0.70%	2.00%	2.10%	2.25%	2.40%	2.60%	3.10%
U.K.	0.90%	0.65%	0.65%	0.65%	0.65%	0.70%	2.15%	2.25%	2.35%	2.50%	2.70%	3.10%
Canada	1.30%	1.25%	1.15%	1.20%	1.50%	1.75%	2.10%	2.30%	2.50%	2.90%	3.20%	3.40%

Forecast as of: January 11, 2012

*10-year German Government Bond Yield

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