

The Week

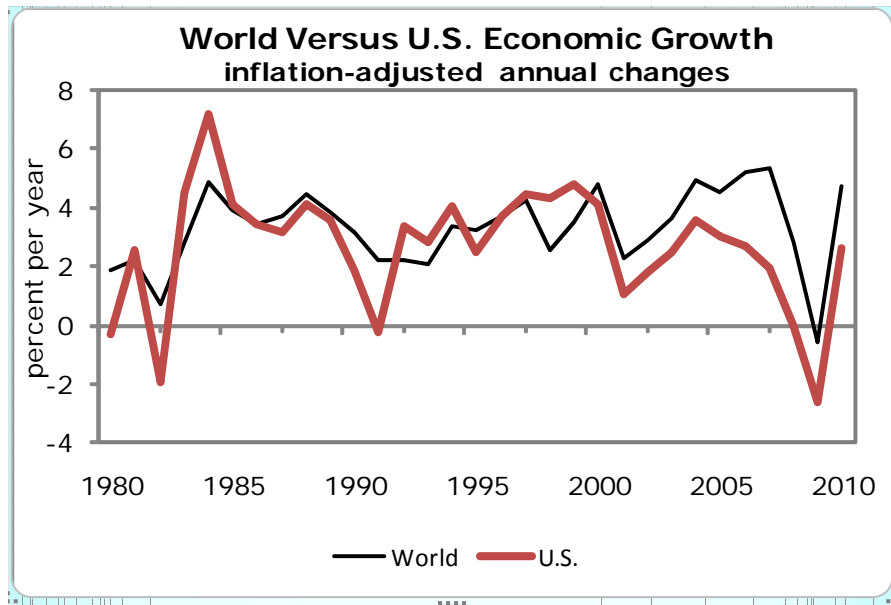
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Why international events matter increasingly for our U.S. outlook

The U.S. economy has historically led global economic expansions, but today other regions of the world are in front. While we expect further U.S. economic growth and long-term equity market gains, occasional bouts of global risk aversion may interrupt the trend. Our long-term strategy looks to exploit investment opportunities at home and abroad, while our short-term view seeks to preserve capital and make the most out of possibly wide swings in global sentiment.

Historically, the U.S. economy usually leads the global economic recovery but this time around, the U.S. is following the lead of stronger growth in other countries, particularly in Asia. Consequently, the economic and market outlook may depend more on foreign developments than in the previous cycles. The chart illustrates the historical pattern. In the early 1980s and 1990s, the U.S. and world economies stalled at approximately the same time, but the U.S. economy's sharp and more sustained rebounds led the world out of both recessions.

The U.S. began to relinquish its leadership with the 2001 recession, but lost even more ground in the recent financial crisis. The chart reveals that world growth outstripped the U.S. 2002-2007 recovery, and the difference has been just as stark since 2009. In fact, the chart shows a severe U.S. contraction in 2008-9, exceeding even the 1982 recession, while the overall world recession was much milder and the rebound much stronger. In other words, for the first time since at least 1980, U.S. economic momentum is not leading the world.



Sources: International Monetary Fund and Wells Fargo Advisors
Past performance does not guarantee future results

The current economic recovery is broad based and appears to be gaining momentum, not least in the United States. We look for further gains in U.S. and international markets in the coming year. Still, the global recovery also poses unique challenges, which the world is only slowly mastering. For example, U.S. households and businesses are learning to be more productive while cutting debt – in essence, to do more with less. Policy makers in Washington and in European capitals meanwhile are struggling to spend and borrow less, while preventing austerity from undercutting their economic recoveries. Even China, which in important respects leads the global recovery, is trying to prevent an inflationary bubble but not derail its economic expansion.

While so many countries advance along their learning curves, some mistakes and stresses are likely. Ireland's late-November government bailout deal with the rest of Europe reminds investors that the European debt crisis may still produce further disappointments. Nor has China yet secured a sustainable economic growth path. Consequently, we expect the positive U.S. market trends to continue but be punctuated by episodes of market volatility, and with the triggers coming more from overseas than historically was the case.

Key risks and our strategy approach

Our overall investment strategy targets U.S. and overseas opportunities and addresses the possibility of more frequent periods of global risk aversion. The U.S. economic recovery appears set to continue into 2011 with strong profit growth. We look for further U.S. market gains but also acknowledge that other countries are leading this global expansion. Thus, we have added international exposure to our strategic recommendations, to exploit the expanded opportunities we expect in the coming years.

From a shorter-term perspective, our tactical recommendations are sensitive to the possibility of additional U.S. market volatility, coming from overseas sources. In one tactical approach to this risk, we recommend a short-term overweight to the utility and telecom services sectors, while the potential exists for near-term corrective behavior in the market. These defensive recommendations nevertheless offer attractive yields versus the yields on other equities and fixed-income vehicles.

A second approach is that we adapt our short-term or tactical recommendations to exploit sentiment swings. We expect the S&P 500 index to finish 2011 in the range of 1250-1300, but we expect to recommend taking profits, when the market approaches our year-end target. The second part of this tactical approach calls for putting assets back into the market, as equity prices pull back. We envision continuing this tactical approach during 2011.

Conclusion

The U.S. economy has proven very resilient over the decades – able to shake off shocks like the 9/11 attacks, the 1991 Iraq war, and domestic economic crises like the savings and loan crisis and stock market decline of 1987. But during those earlier decades, the U.S. economy was leading the expansion. Today, other economies are leading the way forward. U.S. economic vulnerability to overseas shocks may remain elevated, just as a patient recovering from a serious illness is susceptible to a new setback. Our long-term strategy looks to exploit investment opportunities at home and abroad, while our short-term view seeks to preserve capital and make the most out of possibly wide swings in global sentiment.

Important Information, Risk Factors and Disclaimers:

- Past performance is not a guarantee of future results.
- An index is not managed and is unavailable for direct investment.
- Diversification does not guarantee a profit or protect against loss.
- Investing in fixed income securities involves certain risks such as market risk if sold prior to maturity and credit risk, especially if investing in high yield bonds, which have lower ratings and are subject to greater volatility. All fixed income investments may be worth less than the original cost upon redemption or maturity. Bond prices fluctuate inversely to changes in interest-rates. Therefore, a general rise in interest rates can result in the decline of the value of your investment.
- Investing in foreign securities presents certain unique risks not associated with domestic investments, such as currency fluctuation and political and economic changes. This may result in greater price volatility.

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