



Equity Strategy Weekly

(Formerly *Equity Strategy Comments* and *Out of the Blocks*)

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Worth Noting

- Based upon a breadth of models and studies of past bull market behaviors, we continue to carry our 1135-1175 target for the S&P Composite Index for later next year. However, we still believe that a combination of stronger than expected earnings and lower than expected inflation may likely bring us to set our S&P Composite Index sights for year-end 2010 above the 1135-1175 level.
- The current rally is being led by the cyclical sectors of the market while the defensives have lagged. Continue to average into this market in coming months. We believe the S&P 500 will be higher than current levels one year out. While some consolidation and pullback is probably overdue, our advice is to stay invested.

Market Breadth Dramatically Improved – What Does Breadth Say about the Next 12 Months?

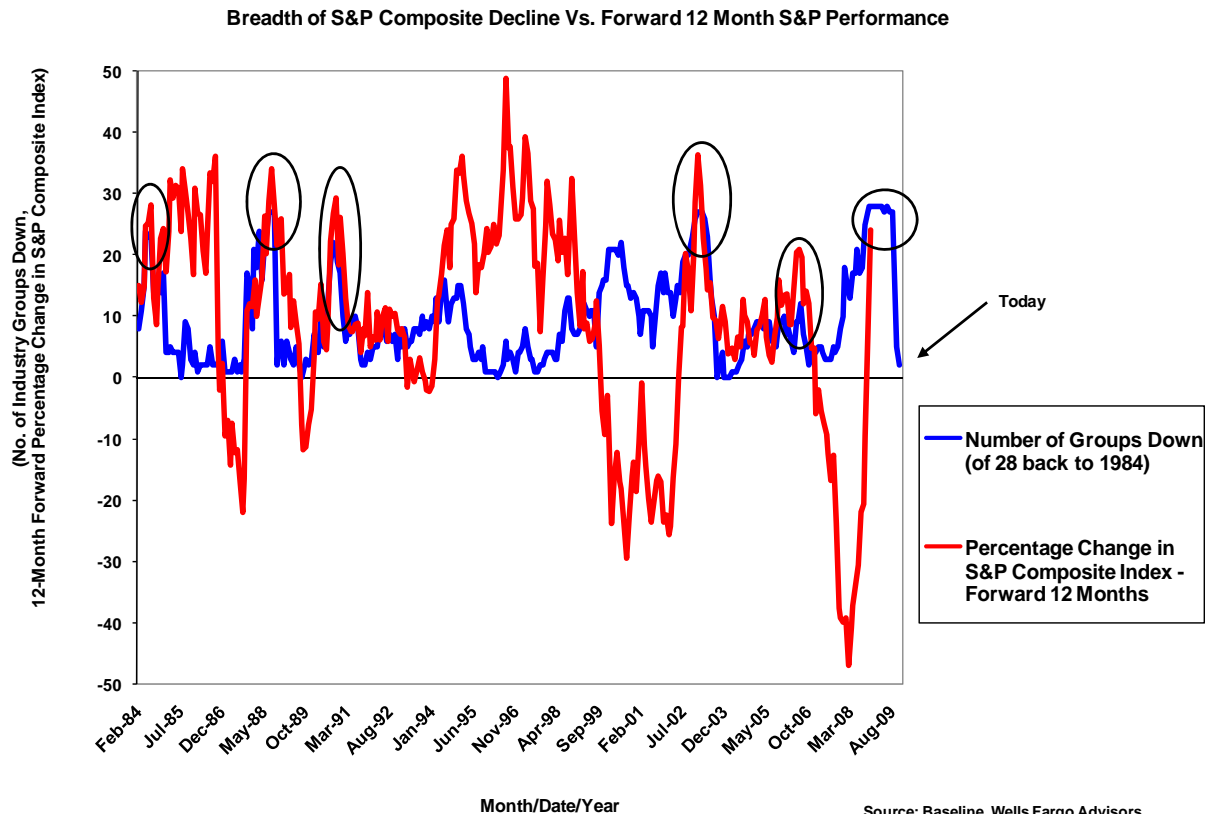
From time to time during the recent bear market, we brought out our negative breadth graph. This is a graph that depicts the number of major sub-industry groups (of a diversified set of 28 groups) whose index prices are still down (year-over-year). When the majority of key groups are down, this would signify a market in which negative sentiment has already taken over. Between October 2008 and August 2009, between 27 and 28 of those subgroups were lower than they were a year earlier. Our message through most of that period was that there was more room for positive surprises and a return to more favorable investor sentiment from such extremely negative levels of breadth and sentiment.

As one can see in the graph, (we have encircled some of the extreme cases of the past), when negative breadth levels were extreme (graphed in blue), S&P Composite Index performance had a very strong opportunity to become very favorable over the next 12 months. The chart displays our negative breadth indicator (in blue) versus the forward 12-month performance of the S&P Composite Index back to early 1984.

Please see Page 6 of this report for Important Disclosures.

Analyst Certification: *The Equity Strategists who prepared the report hereby certify that the views expressed in this report accurately reflect their personal views about the subject companies and their securities. The Strategists also certify that they have not been, are not, and will not be receiving direct or indirect compensation for expressing the specific recommendation(s) or view(s) in this report.*

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

When the negative breadth indicator was sitting up at 27 or 28, of course, the market was looking for a bottom. Historically, when the negative breadth indicator was at 22 or higher, the average forward 12-month return for the S&P Composite Index was an average 23% and a median 26%. The S&P Composite Index is currently up 24% from one year ago. Since the last very negative reading on the breadth indicator was in August of 2009, there still exists upside between now and August 2010, on that basis.

However, at this stage of the market rebound, we must also point out that the breadth indicator that was showing us 27 or 28 of 28 industry groups lower (out of 28) between October 2008 and August 2009 is now reading a 2. Of the 28 diversified groups, only 2 of those groups are still lower than a year ago. The two are the electric utility group (in a sector we are underweighting) and the international integrated oils group (a group for which we carry an even-weighting or neutral rating). In the past, the median forward performance of the S&P Composite Index was roughly 12.5% when only two of the 28 groups were still down (and 26 groups had already moved to year-over-year gains). On the basis of this single model, then, it would appear the S&P Composite Index has potential (based upon the median behavior back to 1984) to move toward the 1245 area by November of 2010. Of course, a 12-13% move from here is not as exciting as the 24% move we have experienced during the last twelve months. However, it is quite normal for capital returns to moderate after the initial upsurge in a new bull market.

Based upon a breadth of models and studies of past bull market behaviors, we continue to carry our 1135-1175 target for the S&P Composite Index for later next year. However, we still

believe that a combination of stronger than expected earnings and lower than expected inflation (versus "Street" consensus) may likely bring us to set our S&P Composite Index sights for year-end 2010 above the 1135-1175 level we set earlier this year. Although back in March 2009, we were targeting a 52% increase in the S&P Composite Index by year end, the S&P is currently 66% higher since March (so we ended up being a bit conservative despite the bold stance we took). We continue to believe it more likely that we will adjust our target upwards versus downwards for year-end 2010; we continue to believe that the S&P Composite's move will be driven by earnings growth from cyclically sensitive segments of the economy. We continue to underweight the less cyclically sensitive Health Care, Consumer Staples, and Utilities sectors of the market.

Specific Recommendations:

The Consumer Discretionary sector makes up roughly 9.4% of the total market capitalization of the S&P 500. This sector's index has risen 44.5% over the last 12 months versus a 20% increase for the S&P 500. Looking at sector performance over a longer period of time, many investors will be surprised to discover that this very cyclical sector has steadily outperformed the S&P 500 since January of 2008 (nearly 23 months). Companies in this sector tend to experience trough earnings in the middle portion of a recession. Their common shares frequently bottom prior to the earnings trough. Over a shorter time span, the Consumer Discretionary sector index has outperformed the S&P 500 by approximately 15% since the early March (2009) lows. The economic news has been improving of late but investors have been anticipating better future fundamental performance out of this sector for some time. Currently, for clients with average risk tolerance, we recommend carrying an evenweight (11%) equity allocation to this sector. "Buy" rated Consumer Discretionary stocks among our correspondent research providers total 185 companies. The companies listed below are currently "Buy" rated by at least one of our correspondent research providers:

- Dick's Sporting Goods Inc. (DKS-NYSE-\$25.25)
- Staples Inc. (SPLS-NASDAQ-\$22.90)
- Target Corp. (TGT-NYSE-\$49.70)

Weekly wrap and look ahead:

All three major indices posted gains in last week's trading. The S&P 500 rose 2.3% (Year-to-date up 21.1%), the Dow Industrials gained 2.5% (YTD up 17.0%) and the NASDAQ Composite rose 2.6% (YTD up 37.5%). Five of 10 S&P sectors outperformed the Index and all 10 finished higher for the second consecutive week. The best performing sectors were Materials (up 4.2%), Consumer Discretionary (up 3.3%) and Information Technology (up 3.2%). The worst performers were Energy (up 0.2%), Utilities (up 1.2%) and Telecom Services (up 1.7%).

With the third quarter earnings season virtually over, let's take one last look at the results. Through last Friday, with 93% of companies in the S&P 500 reporting, earnings were down approximately 5% on a market capitalization "float adjusted" basis. Remember that Standard & Poor's makes a float adjustment when reporting earnings results. S&P only counts those shares they consider "available" for trading. Note that this adjustment often causes the reported results to differ greatly from the traditional market cap weighted results. In fact, on a purely market cap weighted basis, third quarter earnings were actually up 14% according to Bloomberg. Of those companies reporting, more than 80% beat the average Street estimate while less than 13% fell short of the consensus projection. The overall results were much better than we (and the Street) anticipated coming into the reporting season. On a market cap weighted basis, the sector results from best year-over-year growth rate to worst are as follows: Financials +209.9%, Information Technology +17%, Health Care +9%, Consumer Staples +4.1%, Utilities -1.6%, Consumer Discretionary -6.9%, Telecom Services -15.6%, Industrials -36.1%, Materials -38.9% and Energy -60.2%. Clearly, based on sector performance since the

March lows, investors are anticipating significant earnings improvement in the more cyclical sectors next year. We believe the Street is underestimating the earnings power of the S&P 500 in 2010 and 2011 and expect to see full-year projections increased in coming months.

Last week's economic calendar was sparsely populated but a couple of reports are worth mentioning. The University of Michigan released its early November consumer sentiment survey and, not surprisingly, the results were lower than the market anticipated. Sentiment fell across the board. The current situations index dropped as did the 12-month economic outlook portion of the survey. The outlook index fell to 67, the lowest reading since last April. In our opinion, it will be tough for confidence/sentiment readings to post sustainable gains until the job environment improves. However, remember these indicators are coincident indicators at best and often times what U.S. consumers say in these surveys and what they actually do (in terms of discretionary spending) are two different things. We do believe that consumer spending will be slower to come back after the recent recession than in past downturns and have built that into our earnings estimates and economic outlook. In other news, investors seem to be quite happy with the comments out of the recent G20 meeting stating that the largest economies in the World intend to leave interest rates low and will continue to take measures to stimulate their economies for the foreseeable future. While the worst of this downturn is likely past (we are certainly playing it that way based on our sector recommendations), the global economy is not totally out of the woods yet. As far as other G20 topics such as climate change, terrorism and cap and trade we would expect far less agreement between the major players (the "old" G8 countries). Also note the \$8,000 first time home buyers tax credit, as expected, was extended until June of next year.

This week's economic calendar is packed with potential market-moving reports. Monday brings reports on October retail sales and the latest reading on New York area manufacturing (Empire State Index). Retail sales tumbled in September but will likely rebound a bit in this report. Still, consumers will be reluctant to do much spending until jobs are easier to find. The regional manufacturing indexes have been climbing strongly in recent months. Expect a modest pullback in the October readings for both the Empire State and Philly Fed (due Thursday) reports. Tuesday and Wednesday bring reports on PPI (Producer Price Index) and CPI (Consumer Price Index) respectively. There will not be any surprises here in our opinion. Inflation readings are likely to be quite tame for the foreseeable future. Excess capacity in the economy, another reason why we believe inflation is not right around the corner, will be reported along with industrial production on Tuesday. Finally, on Thursday, initial jobless claims and the October leading economic indicators (LEI) will be released. We do not see initial claims dropping below the 500,000 market yet but our analysis suggests that will happen in the next month or two.

The current rally is being led by the cyclical sectors of the market while the defensives have lagged. Continue to average into this market in coming months. We believe the S&P 500 will be higher than current levels one year out. While some consolidation and pullback is probably overdue, our advice is to stay invested.

Wells Fargo Advisors Sector Weighting Recommendations:

<u>Sector</u>	<u>S&P Weighting*</u>	<u>Wells Fargo Advisors Guidance</u>	
Industrials	10.4%	Overweight	15.0%
Materials	3.5%	Overweight	7.0%
Telecom Services	3.0%	Overweight	5.0%
Consumer Discretionary	9.4%	Evenweight	11.0%
Energy	12.2%	Evenweight	11.0%
Financials	14.5%	Evenweight	16.0%
Information Technology	19.1%	Evenweight	17.0%
Consumer Staples	11.6%	Underweight	8.0%
Health Care	12.5%	Underweight	10.0%
Utilities	3.6%	Underweight	0.0%

Source: Bloomberg, Wells Fargo Advisors

*Weightings May Not Add To 100% Due To Rounding

Pricing: based on November 13, 2009 close

Important Disclosures

Dick's Sporting Goods Inc, (DKS-NYSE-\$25.25)

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Wells Fargo Advisors or an affiliate owns 1% or more of the equity or equity equivalents.

Target Corp. (T-NYSE-\$49.70)

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Wells Fargo Advisors or an affiliate owns 1% or more of the equity or equity equivalents.

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