

Portfolio Manager Commentary

Overview, Strategy, and Outlook, as of January 31, 2010

There was plenty of new information for money market investors to chew on this past month. The U.S. Securities and Exchange Commission (SEC), the Obama administration, and Congress all weighed in on topics that affected the money markets. In addition, international bodies, such as the United Kingdom's Financial Services Administration (FSA) and the Basel Committee on Banking Supervision, have proposed new regulations that both complement and conflict with proposals here in the United States. Although somewhat overshadowed by all the regulatory activity, the Federal Open Market Committee (FOMC) met in January, taking a somewhat more conservative stance in its statement following the meeting.

Surveying the Landscape

The main focus for U.S. money market funds was the meeting of the SEC on January 27. At this meeting, the SEC approved amendments to Rule 2a-7, the section of the Investment Company Act that governs money market funds. The SEC had proposed certain amendments last June, asking for public comment. After receiving over 150 comments from the public, the final amendments largely mirrored the initial proposals, with a few significant exceptions.

The SEC states that the rule changes are intended to "increase the resilience of these funds to economic stresses and reduce the risks of runs on the funds" and would "improve liquidity, increase credit quality, and shorten maturity limits. They would also enhance disclosures..."

See Exhibit A on page 5 for a table that summarizes the changes to Rule 2a-7 that were adopted.

Since changes to money market fund regulation were first discussed early last year, we'd like to focus our comments here on the proposals that relate to liquidity in these funds. We think it's a good idea for funds to focus on their liquidity, and these changes will help to sharpen that focus.

We have long been advocates of managing money market funds in a highly liquid manner in an effort to provide adequate liquidity for shareholder redemptions, stabilize the net asset value (NAV), and to make a fund's yield more responsive to changes in the general level of interest rates. For this reason, the amendments largely codify our current investment practices.

So what's the rub?

For one thing, not all funds are currently managed in this way. The imposition of minimum liquidity targets on money market funds means that more funds will be buying the types of investments that we regularly buy. Increased demand for short-maturity and highly liquid investments means that the yields in this sector are likely to experience even more downward pressure. While banks are paid interest at a rate of 25 basis points (bps) on their excess reserves held at the Fed, money market funds and other investors who are not eligible to be paid interest by the Fed are forced into the marketplace, where the unsubsidized rate on overnight investments has been considerably lower. For example, the rate on overnight U.S. Treasury-backed repo has averaged ten bps since December 2008, when the Fed cut its target for Fed funds to a range of 0% to 0.25% and began paying interest on excess reserves. With more investors being forced into the overnight market, rates here are likely to drop even more.

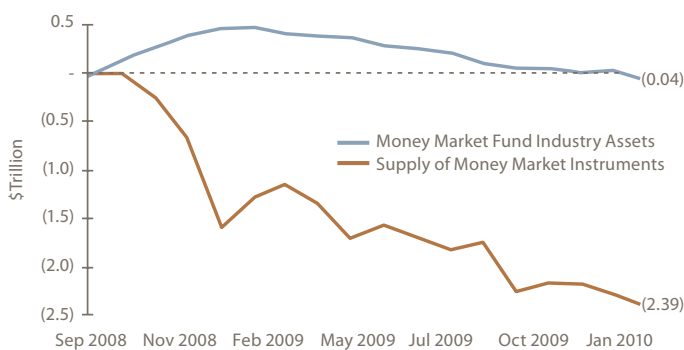
At the same time, changes on other regulatory fronts will have the effect of cutting the supply of short repurchase agreements and bank deposits even more. In our opinion, an over-reliance on short-term funding by financial organizations is seen as one of the root causes of the liquidity crisis of 2008. Regulators across the globe are attempting to curtail what are seen as potentially dangerous funding mismatches by banks by encouraging these borrowers to rely on more long- and medium-term financing. The FSA and Basel Committee propose to limit reliance on short-term funding by requiring these financial institutions to offset short-term borrowings with liquid assets. In a similar fashion, large U.S. financial institutions may be subject to the proposed Financial Crisis Responsibility Fee, or "bank tax," and will likely have little incentive to borrow on a short-term basis from large investors, since those borrowings would be subject to the tax.

So regulators are in agreement about the nature of liquidity—it's good to have but not so good to give—with the outcome being that investors are being required to have it, while borrowers are being discouraged from providing it. Clearly this clash will lead to a disconnect between supply and demand.

The decline of supply of eligible and acceptable money market instruments has been a growing problem for money market funds. The total assets of money funds are slightly below the levels of September 2008, before the liquidity crisis, but the supply of all money market instruments has declined markedly. The current regulatory trend of requiring more liquidity in investors' portfolios while, at the same time, requiring longer-term funding by borrowers will only exacerbate this problem, especially in the very short end of the money market spectrum.

SUPPLY HAS FALLEN MUCH FASTER THAN DEMAND.

Taxable money market fund assets under management versus total money market supply



Data Source: iMoneyNet, JP Morgan Securities, Inc.

The lack of available liquidity, especially the decline in the size of the repo market, may have other unforeseen negative consequences. For example, the Fed has targeted reverse repo as one means of unwinding its bloated balance sheet. While money funds would welcome the supply, the Fed would like to execute longer-term reverses to secure stable funding of its assets, but longer-term repos don't meet the liquidity needs of the funds. Because of the proposed "bank tax" and other regulatory constraints, the ability of the primary dealers and banks to mediate this maturity mismatch would likely be severely constrained.

Another negative effect relates to market liquidity. Because a healthy and robust repo market is necessary for a properly functioning secondary market, that area may also be negatively affected by the decline of the repo market. This could have the effect of impairing liquidity in all sorts of fixed-income instruments, including U.S. Treasury securities.

Treasury officials have expressed concern about this and have pledged to protect the repo market, at least for U.S. Treasury securities. How they plan to do so is not clear, but any relief, however limited, would be welcomed.

Funds do have the alternative under these rule changes to invest in certain government securities maturing inside of 60 days and count those toward their Daily and Weekly Liquidity requirements. This is one alternative to using short-term maturities, but not only are the yields close to zero, supply is contracting in this sector as well. Total U.S. Treasury bills outstanding have fallen 16% to \$1.7 trillion from their peak of \$2.033 trillion in March 2009. The supply of agency discount notes has declined even more dramatically, having fallen 44% to \$620 billion from its peak of \$1.1 trillion in January 2009. Indeed, the long-term viability of the discount note market must be called into question when one sees public comments made by Rep. Barney Frank, chairman of the House Financial Services Committee discussing a recommendation to "abolish" mortgage giants Fannie Mae and Freddie Mac in their current form and create a new system of housing finance.

In a recent PBS interview, Treasury Secretary Timothy Geithner also commented on the financial system overhaul. "It's just a complicated thing to get right," he said. "But we are completely supportive and agree completely with the need to make sure that we take a cold, hard look at what the future of those institutions should be in our country."

So while the new Rule 2a-7's inclusion of agency discount notes in the Weekly Liquidity category is helpful, it may not prove to be a long-term solution.

For a clue to that, we turn to the municipal money market funds, where supply has long been an issue for money funds. In this sector, the newly approved Rule 2a-7 requirements for Weekly Liquidity are largely a non-event, due to their use of variable-rate demand notes and tender option bonds with daily and weekly put features. These instruments were created years ago to meet the liquidity needs of municipal money market funds. Although other types of money market participants do invest in the sector, it is dominated by the municipal money market funds. If the demand for short-term paper by taxable money funds is high enough and supply is lacking, one way to close that gap would be through the creation of alternative products that meet the needs of both the borrowers and the money market participants. That said, currently rates are so low, and the bank liquidity necessary to back such products and make them acceptable to money funds are in tight supply, so this solution may not be close at hand. But if the gap between the supply and demand of liquid

investments persists, and if rates move higher, we are hopeful that the marketplace may eventually evolve to a point where new products surface that meet the needs of both money market participants and borrowers.

Also on January 27, the FOMC concluded its two-day meeting. Overshadowed perhaps by the developments at the SEC, the statement released by the FOMC is worth a closer look, for it took a decidedly more hawkish tone. The first indication that the Fed may be beginning to lean toward a tighter rate environment was the dissenting vote by Kansas City Fed President Hoenig. In the first dissenting vote in a year, Hoenig objected to the “extended period” language, indicating that the time frame for maintaining an easing posture is at least up for discussion on the Board. The second indication is that the Fed has now removed most of the liquidity programs that it has had in place. The alphabet soup of AMLF, CPFF, PDCF, and TSLF¹ were all allowed to expire on February 1, 2010, as scheduled. The temporary swap facilities between the Fed and other central banks expired on that same day, and they are in the process of winding down the Term Auction Facility (TAF), leaving Term Asset-Backed Securities Loan Facility (TALF) loans and discount window credit as the only means of expanding its balance sheet. This now allows the Fed to swing into a mode of reducing its balance sheet and draining the emergency liquidity that it has provided to the markets. While there is no indication as to when this might begin, indeed the Fed retained the statement that conditions “are likely to warrant exceptionally low levels of the federal funds rate for an extended period.” It is reasonable to us, however, to infer that the Fed is beginning to seriously plan its exit strategy.

Strategies for the Prime Markets

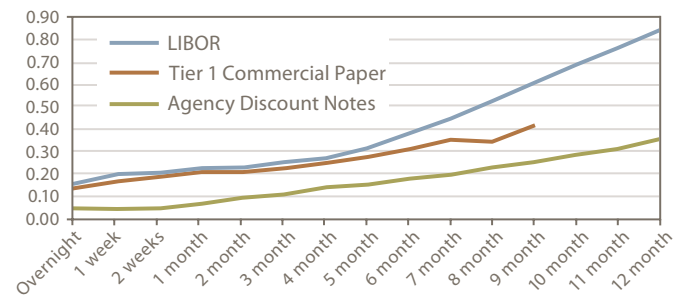
Rates on overnight investments, such as bank time deposits and repurchase agreements, continued to track the effective federal funds rate, which has traded below the federal funds target every day since October 2008. Demand has remained strong for overnight investments, even at these low rates, because the supply of alternatives, like discount notes and commercial paper, has shrunk so materially. For most of January, overnight rates were in the low to mid teens (bps).

The one-year London Interbank Offered Rate (LIBOR) dropped by 13 bps to end the month at 0.85%, while one- and three-month LIBOR levels stayed anchored in the low 0.20s%. The steepness in the long end of the LIBOR curve reflects market expectations of higher yields. One- to six-month high-quality

commercial paper yields are available in the market at LIBOR -3 to -8 bps or yields of 0.17% to 0.30%. With expectations of stagnant interest rates, last year money market participants seemed to be willing to invest in six-month assets picking up about ten bps to three-month levels. But with the “weighted average life” limits introduced by the changes to Rule 2a-7 announced at month-end, investors will likely demand a larger premium to invest in longer maturities. We expect the curve to steepen further as funds implement the necessary changes to their portfolios.

YIELD COMPARISON IN THE MONEY MARKETS

as of 1-29-10

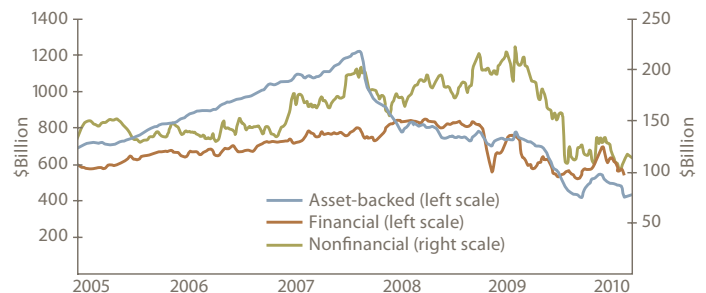


Source: Bloomberg LP

The commercial paper market grew \$15.2 billion in January, or just over 1%. It was the first expansion in total outstandings since early 2008. The increase was due entirely to financial and industrial paper, as asset-backed commercial paper outstandings continued to shrink. From the peak in August 2007, outstanding asset-backed commercial paper is down by 64%.

COMMERCIAL PAPER OUTSTANDINGS

Weekly (Wednesdays), Seasonally Adjusted



Source: Federal Reserve Board

1. Liquidity programs that expired 2-1-2010 are as follows: Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF), Commercial Paper Funding Facility (CPFF), Primary Dealer Credit Facility (PDCF), Term Securities Lending Facility (TSLF).

Even though issuers continue to show rates out the maturity spectrum, investors are focused on maturities three months and earlier. In looking at Volume Statistics for Commercial Paper Issuance from the Federal Reserve, in January, 91% of all commercial paper placed in the market had a term of less than 81 days. We believe this trend should only be exacerbated with the Rule 2a-7 changes on portfolio liquidity.

With one- and three-month LIBOR levels essentially flat, we have maintained our 20% to 25% exposure to the floating-rate note sector by investing in securities that reset off one-month LIBOR as our quarterly resets mature. The monthly resets will more quickly reflect any increase in the levels of interest rates.

Our focus remains on liquidity and maintaining a stable \$1.00 NAV. In our prime category money market funds, we have been able to use our highly liquid position to selectively purchase longer-dated investments. Most of our short-term investments have been made in the one- to three-month maturity sector, with some selected purchases in longer-dated paper, where those investments are consistent with the primary objectives of the funds. Rates in the one- to three-month taxable sector are compressed at or below 0.20%. Rates on municipal variable-rate demand notes are also compressed around 0.20%. As supply comes into the secondary market we have been able to add to our holdings in that sector. The current weighted average maturity of our portfolios remains well below the industry average of 47 days in institutional prime funds and 55 days in retail prime funds.

Strategies for the U.S. Government Markets

Typical for the month of January, the supply of U.S. Treasury bills (T-bills) fell significantly. Treasury cash needs are usually light the first month of the year so it is not unusual to see outstandings fall. However, the decline this month was more pronounced, as recent Troubled Asset Relief Program (TARP) repayments by a couple of large banks filled the Treasury's coffers even more. Supply for the month dropped by \$100 billion.

The reduction of T-bill supply caused the yield curve to flatten as the month progressed. Yields on T-bills maturing one month and earlier were already trading on either side of 0% as we entered the new year. Demand by a wide swath of investors for these short maturities continued during the month, keeping the yields very low and, for a time, trading at negative yields. Those wanting incremental pickup in yield began to look further out on the curve. As such, demand for T-bills maturing in one year picked up again after almost completely drying up as 2009 came to a close. At month-end, the yield on one-year T-bills fell 16 bps over the month to

0.28%, while the yield on the one-month T-bill was 0.005%, down three bps from the prior month. As a result, the spread between one-month and one-year T-bills narrowed 11 bps from 40 bps to 29 bps.

Meanwhile, T-bills maturing in three months yielded 0.07% at month-end, two bps higher than one month ago, and six-month T-bills ended the month yielding 0.15%. As mentioned previously, the one-year T-bill experienced the largest month-over-month decline in yield, to 0.28% from 0.43%.

Our focus in the *Wells Fargo Advantage 100% Treasury Money Market Fund* has been to ladder maturities across the yield curve in an effort to provide liquidity and maintain a stable \$1.00 NAV. In the *Wells Fargo Advantage Treasury Plus Money Market Fund*, we have emphasized U.S. Treasury-backed repurchase agreements, which currently offer more price stability and daily liquidity at a higher yield than T-bills.

Yields on government-sponsored enterprise (GSE) discount notes followed a pattern very similar to that discussed above in the T-bill market. Once year-end had passed, investors' appetite for longer-dated maturities began to pick up steam, causing the yield curve to flatten. On top of this, investors in December bought a significant amount of discount notes to mature in January in an effort to have cash invested over year-end. As January progressed, the reinvestment of these maturities continued to grow, making the demand for discount notes go even higher.

As mentioned in the "Surveying the Landscape" section at the beginning of this month's commentary, supply of discount notes fell precipitously in the past 12 months. While the pace of decline might be slowing, down a mere 3% this month, the fact that contraction in this sector is still occurring continues to drive yields lower. Part of the reason the supply of discount notes continues to fall is that the GSEs still find that longer-term funding—beyond the maximum maturity permitted for money market funds—is advantageous to them.

The yield on one-month discount notes rose four bps to 0.07% while the yield on three-month discount notes rose two bps to 0.11%. It was the longer end of the yield curve that experienced the most demand as six-month discount note yields fell three bps to 0.18% and one-year note yields were down nine bps to 0.36%. Our focus in the *Wells Fargo Advantage Government Money Market Fund* has been on liquidity and a stable \$1.00 NAV. Most of our investments have been in GSE floating-rate notes and three- to six-month GSE debt, which is consistent with the primary objectives of the funds.

SUMMARY OF MAJOR CHANGES TO SEC RULE 2A-7

SECTION		REVISED RULES	PRIOR RULES
PORTFOLIO LIQUIDITY	Daily Liquidity	At least 10% of fund assets maturing or puttable the next business day, plus U.S. Treasury securities maturing within 60 days	No comparable rule
	Weekly Liquidity	At least 30% of fund assets and daily liquid assets, plus maturing or puttable the next five business days, plus certain Government agency securities maturing within 60 days	No comparable rule
	Illiquid Securities	Non-marketable securities limited to 5% of fund assets	Illiquid securities limited to 10%
PORTFOLIO MATURITY	Weighted Average Maturity (WAM)	Maximum WAM of 60 days	Maximum WAM of 90 days
	Weighted Average Life	Maximum weighted average final maturity of 120 days	No comparable rule
CREDIT QUALITY	Tier 2 Securities	Second tier ("A2/P2/F2") exposure limited to 0.5% per issuer and 3% in total, maturing in 45 days or less	1% per issuer, 5% total Maximum maturity of 397 days
	Ratings Agencies	Fund board will annually designate four NRSROs to be used to determine minimum ratings criteria	No comparable rule
	Repurchase Agreements	To "look through," collateral must be cash items or government securities with creditworthy counterparties	Collateral must be "highly rated"
PERIODIC STRESS TESTING		Monthly testing of a fund's ability to maintain a stable \$1 NAV in the event of interest-rate or spread changes, shareholder redemptions, and credit changes	No comparable requirement
DISCLOSURE	Portfolio Holdings	Portfolio holdings to be posted to fund's Web site and submitted to SEC monthly	No requirement
	Net Asset Value (NAV)	Fund's mark-to-market ("shadow") NAV to be available to the public on a 60-day lag	No requirement
MONEY FUND OPERATIONS		Funds may suspend redemptions if the NAV falls below \$1, must be able to process shareholder transactions at a price other than \$1, and must develop procedures to identify shareholders who pose potential risk of large redemptions	No comparable requirement
		Affiliates may purchase securities from funds before a downgrade or default without prior approval by the SEC	Prior approval required
FUTURE CONSIDERATIONS		Floating NAV	All new concepts
		Mandatory redemption in kind for large redemptions over a threshold	
		Real-time disclosure of shadow NAV	
		A two-tiered system of stable and floating NAV money funds	
		A private liquidity facility for money funds	
	Other ideas to be discussed with the President's Working Group		

Source: Securities and Exchange Commission

Strategies for the Tax-Exempt Markets

Both institutional and retail municipal money market funds experienced outflows for the month of January. The Securities Industry and Financial Markets Association Municipal Swap Index dropped to a record low of 0.15% the first week of January from an already absolute-low level. The index as a percentage of three-month LIBOR fell from 99.75% in December 2009 to 80.30% as of January 29. One pocket of value in the municipal market versus LIBOR is 90-day general market commercial paper. Currently, 90-day general market tax-exempt commercial paper is trading at 132.50% of 90-day LIBOR. This seems attractive on a relative basis when compared with taxable investments.

With tax-exempt money market fund net yields so low, the tax advantage is almost nonexistent. As a result, tax-exempt money market funds continue to lose assets as retail investors are reallocating cash into bank deposit accounts or extending maturity into the municipal bond market.

The general strategy across all tax-exempt money market funds continues to remain relatively short to our peer group, with a focus on floating-rate securities. With absolute rates at historical lows and a flat yield curve, extension trades have not made a lot of sense. We will add, and have added, smaller municipal note issues on a selective basis when we find those that are high in credit quality and offer attractive yield.

The Inside Track

Because statements released after the last several FOMC meetings indicate that the federal funds rate will remain low for "an extended period," we have expected this rate environment to persist into 2010. The question has been how long into 2010? The most recent Fed statement would indicate that the FOMC is at least beginning the thought process of a monetary strategy that takes some of the easing off the table. This strategy would be likely to include higher short-term rates.

With rates at or near zero now, it is clear that they are more likely to rise than fall further. Since the timing of changes in the direction of interest rates is always quite unpredictable, we continue to believe that the prudent course is to plan for that event now. As a result, we continue to maintain comparatively liquid and short portfolio structures designed to achieve our primary objectives of a stable \$1.00 NAV and liquidity for shareholders.

For more information, please contact:

Institutional Sales Desk

Web Site

1-888-253-6584

www.wellsfargo.com/advantagefunds

Click Institutional Cash Management.

[Click here](#) for current money market fund performance.

[Click here](#) to view a list of complete holdings.

An investment in a money market fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the Wells Fargo Advantage Money Market Funds seek to preserve the value of your investment at \$1.00 per share, it is possible to lose money by investing in a money market fund.

A portion of the Fund's income may be subject to federal, state, and/or local income taxes or the alternative minimum tax (AMT). Any capital gains distributions may be taxable. The U.S. government guarantee applies to certain underlying securities and not to shares of the Fund.

The views expressed are as of January 31, 2009, and are those of David D. Sylvester, head of Money Markets at Wells Capital Management, subadvisor to the Wells Fargo Advantage Money Market Funds and Wells Fargo Funds Management, LLC. The views are subject to change at any time in response to changing circumstances in the market and are not intended to predict or guarantee the future performance of any individual security, market sector or the markets generally, or any Wells Fargo Advantage Fund.

*Carefully consider the investment objectives, risks, charges, and expenses before investing. For a current prospectus for **Wells Fargo Advantage Funds**[®], containing this and other information, visit www.wellsfargo.com/advantagefunds. Read it carefully before investing.*

Wells Fargo Funds Management, LLC, a wholly owned subsidiary of Wells Fargo & Company, provides investment advisory and administrative services for *Wells Fargo Advantage Funds*. Other affiliates of Wells Fargo & Company provide subadvisory and other services for the Funds. The Funds are distributed by **Wells Fargo Funds Distributor, LLC**, Member FINRA/SIPC, an affiliate of Wells Fargo & Company. 120535 02-10

NOT FDIC INSURED • NO BANK GUARANTEE • MAY LOSE VALUE