WELLS FARGO ADVISORS

Why Long-Term Investors Should Consider Buying Stocks Today

When times are uncertain, we often look to what others are doing and then do the same. Unfortunately, when it comes to stock investing, going along with the crowd can lead to costly mistakes, like buying when the market is up and selling when it's down. For long-term investors, a better strategy during times like today, when many are turning their backs on stocks, may be to use this as an opportunity to look for values and accumulate shares of quality stocks.

Together we'll go far

See page 8 for important disclaimers.

When investors become uncomfortable with common stocks' volatility, they often seek refuge in fixed income investments' relatively conservative nature. However, it's a good idea to take a step back to remember why you invested in stocks in the first place before you make any changes to your portfolio.

Equities: Beneficiaries of long-term earnings growth

Common stocks, or equities, are vehicles through which investors can purchase partial ownership in businesses that have the potential to grow over time. Because fixed income investments are "lending" rather than "owning" instruments, earnings growth does not benefit them.

Common stocks' long-term return and potential to outperform fixed income vehicles over time is largely due to the possibility that stocks may potentially benefit from economic, earnings and dividend growth. Earnings growth has been persistent over the long-term, particularly in free-market economies, due to business operators' incentives to grow their businesses profitably. Earnings can also benefit from modest inflation. Thus, common stocks tend to offer a measure of defense against inflation that fixed income vehicles do not. Furthermore, growth potential is generally on stockholders' side due to the ongoing expansion of the world's population and persistent human innovation, resulting in the development of new and improved products as well as productivity increases.

Although past performance is no guarantee of future results, it's worthwhile to view the historical perspective to see how earnings growth has benefited common stocks' performance versus fixed income investments'. For example, if one assumes a dollar was invested at the end of 1925 in large-company stocks and all returns and dividends were reinvested through 2010, that dollar's value would have appreciated to approximately $2,976 versus only $133 for long-term corporate bonds, $93 for long-term government bonds and $21 for Treasury bills (see chart at right).

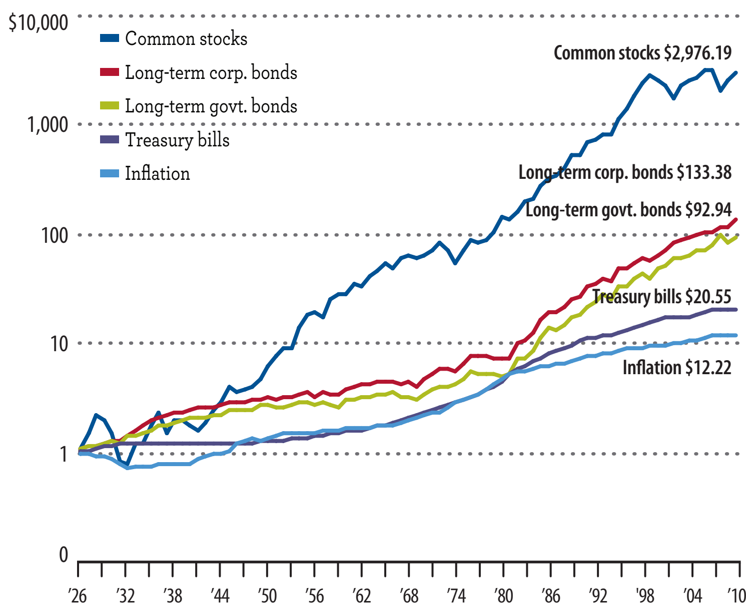
Although the average annual standard deviation (a commonly used barometer of volatility risk) for large-company stocks is 20.4%, which is more than twice that of long-term corporate bonds and Treasury bonds, stocks' return potential is materially greater for long-term investors capable of weathering shorter-term price swings.

Earnings for the S&P 500 index, an often-used proxy for large-company domestic growth stocks, have long benefited from component companies' ability to grow their market shares and earnings both here and abroad. Partly for this reason, S&P 500 revenues have tended to grow at a more rapid pace than nominal gross domestic product (GDP).

Over the long term, international and emerging-country growth opportunities should remain important to investors seeking wealth-building opportunities for retirement (although emerging-country stocks also tend to carry more near- and intermediate-term volatility). Common stocks are important vehicles for long-term investors seeking to increase their retirement net worth over multiple business cycles and decades.

Stocks have outperformed fixed income investments over time

Wealth indexes of investment in the U.S. capital markets



Source: Factset, Baseline, Wells Fargo Advisors

As of Dec. 31, 2010. Past performance is no guarantee of future results. You cannot invest directly in an index.

See page 8 for important disclaimers.

Volatility: A potential advantage for bargain hunters

Fixed income vehicles typically offer a predetermined yield and the repayment of principle at a set date; equities do not. As a result, near- and intermediate-term swings in real or perceived economic and individual-company fundamentals result in greater stock volatility. Volatility can also result from geopolitical events, catastrophic weather events, cyclical economic swings, changes in investor and/or consumer confidence levels (sometimes unwarranted) or unexpected events that investors feel may not dissipate for extended time periods.

At this point, we believe extremely negative investor sentiment appears to be out of sync with stocks' actual intermediate-term fundamentals. Most leading indicators continue to point toward slow growth over the next six to 18 months. And investor sentiment is overly negative, in our opinion, if one takes into consideration the potential for longer-term earnings growth.

History tends to show that many of the most attractive periods for investors to acquire stocks occur during recessionary periods when fear, volatility, and uncertainty are at their highest levels and after shares have shown a high degree of downside variability. Of course, those are also the periods during which the headlines are more negative. Already well-documented negative news is often the reason why shares have moved to lower levels.

Better opportunities to accumulate common stocks for the long term often occur in times when:

- Stock indexes have drifted from cyclical highs
- Consumer and investor confidence levels are negative
- Stock valuations appear attractive

In other words, **when fear is running through the streets, it makes sense for long-term investors to be opportunistic by accumulating equities on volatility and weakness.**

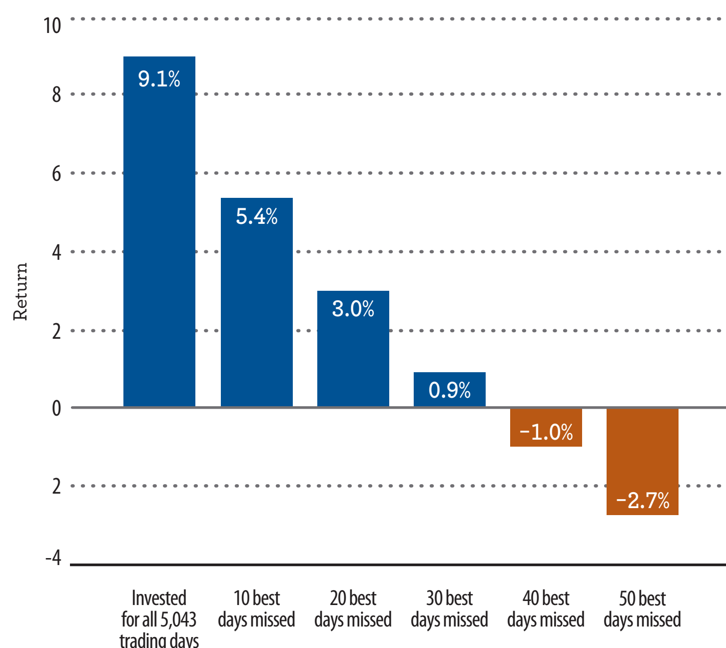
Conversely, during periods in which stock indexes are approaching or are at new highs, consumer and investor confidence levels are high, and stock valuations appear rich, it is often a reasonable time for longer-term investors to consider partially reducing their equity exposure. Often such frothy periods offer clues that investors are inordinately comfortable owning speculative positions in a variety of assets. In other words, **when investors are clamoring for more stocks, it is often best to sell them some of yours.**

In addition, history shows that equity performance is not linear but generated in clumps. Frequently, investors who try to time shorter-term stock market swings (as opposed to taking multi-year or multidecade approaches) can materially underperform the general market by missing just a handful of the strongest performance days over time (see chart below).

As noted financier and investor Bernard Baruch is purported to have told reporters, investors should "buy your straw hats in the wintertime." (Back in Mr. Baruch's day, straw hats were a summer fashion.) Of course, every investor must understand his or her tolerance for volatility, and long-term investors should not expect to always acquire stocks at their lows. In the short term, shares can always move lower.

The cost of market timing

The risk of missing the best days in the market (1991–2010)



Source: ©2010 Morningstar,® Inc. All rights reserved. This hypothetical illustration is based on the S&P 500 with dividends reinvested over the 20-year period between 1991–2010. This example does not include fees or commissions. Past performance is no guarantee of future results. This chart is for illustrative purposes only and is not indicative of the performance of any specific investment. An investor cannot invest directly in an index.

See page 8 for important disclaimers.

Recent volatility has resulted in attractive valuations

The combination of gridlock in Washington and the debt ceiling crisis, political wrangling in Europe over sovereign debt, and banking troubles (and how to handle them), as well as the end of the Federal Reserve's quantitative easing part two (QE2) program have all likely had their respective impacts upon the 20% pullback in stocks since early July 2011.

However, we are forecasting S&P 500 index operating earnings of $101.50 for 2011 and $106 for 2012 (+4%). Both of these estimates represent new earnings highs for the index. Although the economy is growing at a slower pace than the average of the last 10 cycles, the Composite of Ten Leading Indicators (LEI, the Conference Board) increased in August for the fourth month in a row, which points toward continuing growth over the next six to nine months. Our own forward-looking work on leading economic indicators suggests modest growth for next year. We do not see the typical signs of an overheating economy (i.e., tightness of capacity, labor capacity and inflation) that often precede recessionary periods.

Importantly, the price-to-earnings (P/E) valuation of the S&P 500, as of October 5, 2011, is only 11.7x trailing earnings and 10.8x our 2012 operating earnings estimate. (The higher the P/E ratio, the more expensive stocks are considered to be.) We have plotted the trailing 12-month P/E ratio for the S&P 500 back to 1986 in the chart below to the left. We believe the index's current low absolute valuation (alongside our forward-looking economic work) suggests that recent persistent uncertainties here and abroad are offering an opportunity for long-term investors to average into stocks; we currently foresee only a 35% chance the domestic economy will slip into a recession next year.

Stocks also appear to be attractively priced versus the 10-year Treasury note. In this analysis, below to the right, we compare the earnings yield (or the earnings-to-price ratio) of the S&P 500 to the 10-year Treasury note yield. When the blue line is at a high positive level, stocks appear expensive versus bonds (as they did in early 1999 when the 10-year Treasury yielded more than 5% and the S&P 500 was trading at 30x earnings). When the blue line is at a high negative level (like today, at the right side of the graph), stocks appear attractively priced versus the 10-year Treasury. In fact, stocks currently appear more undervalued versus the 10-year Treasury than they appeared overvalued in 1999 and 2000. Although this relative valuation indicator is not a trustworthy predictor of short-term equity performance, it is a worthwhile indication of the potential for investors to benefit from long-term earnings expansion as investor confidence lifts over time.

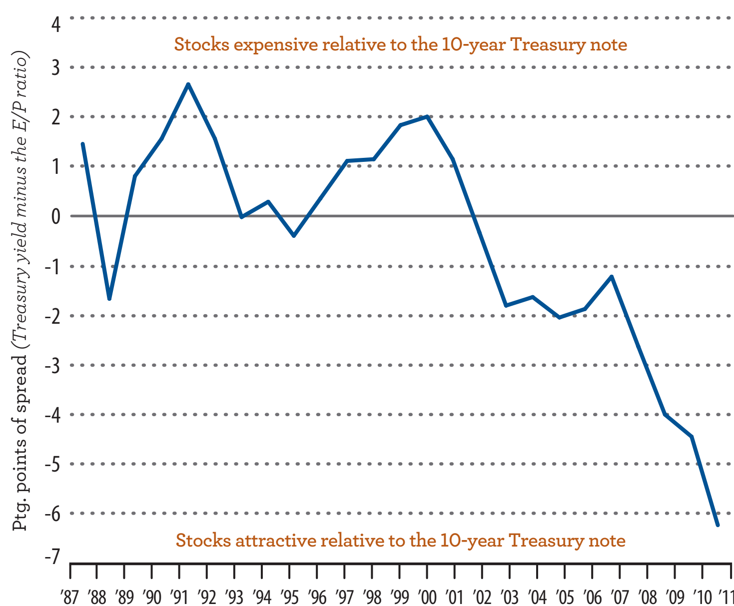
Stocks are attractively priced based on earnings and versus 10-year Treasuries

S&P 500 trailing 12-month price/earnings valuation

Source: Factset, Baseline, Wells Fargo Advisors

As of September 27, 2011. Past performance is no guarantee of future results. You cannot invest directly in an index.

Relative valuation of the S&P 500



Source: Factset, Baseline, Wells Fargo Advisors

As of September 27, 2011. Past performance is no guarantee of future results. You cannot invest directly in an index.

See page 8 for important disclaimers.

Looking beyond near-term uncertainties

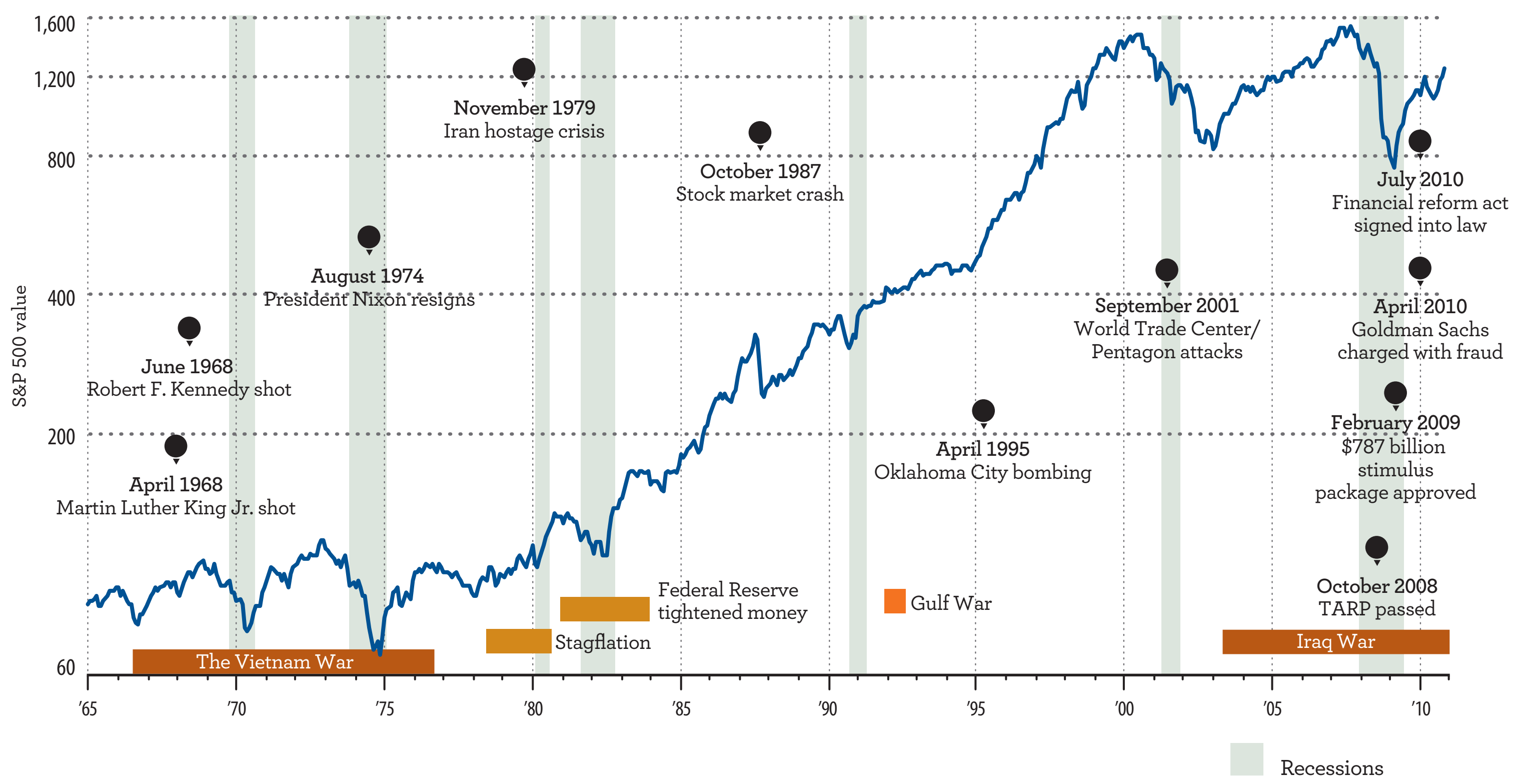
We have included a chart of S&P 500 performance from 1965 to 2010 below, which shows periods of recession (grey bands) as well as other significant news items and catalysts of uncertainty through the years. (Note the broad index's long-term persistent rise with time. Also, keep in mind that while stock performance has been relatively flat from the top of the cyclical bull market that ended in early 2000 to today, earnings growth has persisted.) As a result of a 74% increase in operating earnings between the peak cyclical earnings in the second quarter of 2000 through the second quarter of 2011, the index's P/E multiple has declined from 30x in 2000 to the current trailing multiple, as of October 5, 2011, of only 11.7x. Investors are currently paying roughly 60% less for a dollar of S&P 500 operating earnings than 12 years ago. As we suggested earlier, this lower P/E multiple increases the potential for upside in share prices over time as well-managed companies continue to generate growth.

Many investors are saving for planned retirements 30 years or longer into the future. Over such long periods, near-term volatility should take a back seat in investors' minds. Even over 10-year periods, near- and intermediate- term volatility should not dissuade investors from making longer-term commitments to their retirement plans through diversified stock portfolios.

Continued on next page

Stocks' long-term trend has been upward

Performance of the S&P 500 (1965-2010)



Source: *Wall Street Journal*, Haver Analytics

As of September 27, 2011. Past performance is not an indication of future results. An index is not managed and is unavailable for direct investment.

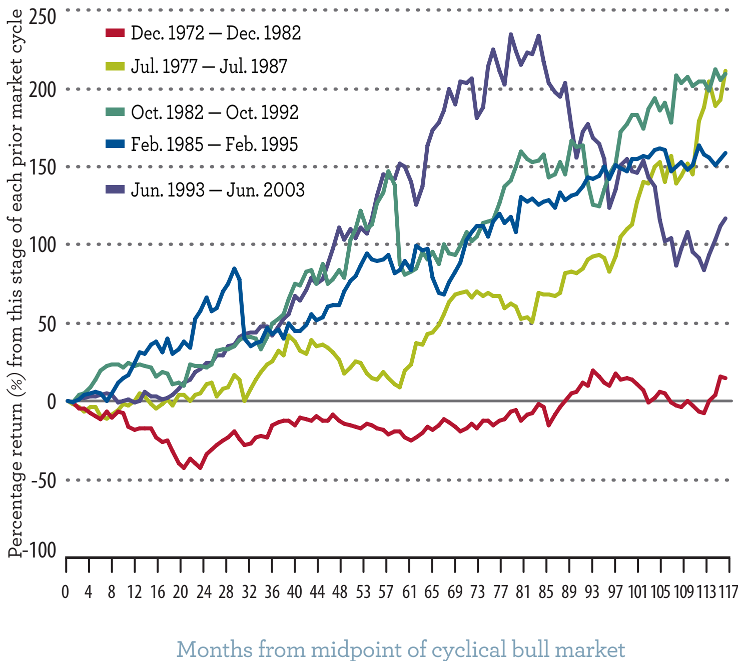
See page 8 for important disclaimers.

To demonstrate the outlook we believe longer-term investors should maintain, we have plotted the S&P 500 index's 10-year performance trajectory for the last five available market cycles. For each cycle, we started the performance plot from the midpoint in the cycle (similar to where we are in the current market recovery). As shown in the chart below to the left, four of the five cycles generated between 100% and more than 200% index increases over the following 10 years. One of the five 10-year periods generated only a 21% increase in value. However, keep in mind that this period included two significant recessions (the 1973-74 and the 1980-82 double-dip recession) as well as periods of dramatic inflation. The deep 1973-74 recession was very early in the 10-year period and had a particularly significant impact upon performance.

We have also plotted the average performance of the five cycles for the same 10-year time frames. As shown below to the right, the average performance of the S&P 500 for those periods was more than 145% (the range was between 21% and 220%). Of course, the future never exactly mimics the past. However, long-term investors should note that the returns from these 10-year periods were even generated starting from midcycle points and not from recessionary lows.

Downturns have historically offered opportunities for stock investors

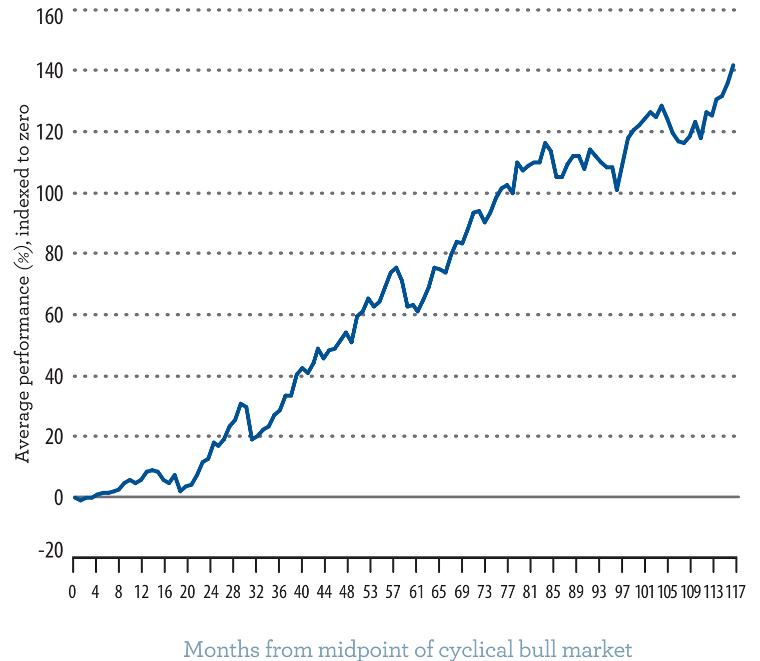
Forward 10-Year S&P 500 performance in the last five market cycles



Source: Factset and Wells Fargo Advisors

Past performance is no guarantee of future results. You cannot invest directly in an index.

Average of forward 10-Year S&P 500 performance in the last five market cycles



Source: Factset and Wells Fargo Advisors

Past performance is no guarantee of future results. You cannot invest directly in an index.

See page 8 for important disclaimers.

Look to stocks for long-term wealth-building potential

Again, we believe long-term investors should be cautious not to put excessive focus on short- and intermediate-term volatility. Concentration on short-term volatility will likely take long-term investors away from their goals and may result in making emotional decisions to buy or sell at exactly the wrong time. In summary, the comparisons of longer-term performances in other cycles, the record of uncertainty-provoking events and their impacts over time, and market valuations suggest that long-term investors should use pullbacks, such as the one we are currently experiencing, as opportunities to accumulate equities.

We see valuation opportunities for long-term investors in a variety of equities today, particularly in those stocks offering solid historical dividend yields. In addition to some defense to fight against volatility, quality yield-bearing stocks can offer attractive total-return (price appreciation combined with dividend yield) potential over time.

While other asset classes may offer greater defenses against near-term downside risk, the potential benefits of buying stocks with growing long-term earnings streams (particularly when valuations are attractive) increase the likelihood that they can help you meet your longer-term savings goals. Investors should still maintain diversified multi-asset class portfolios including stocks, fixed income investments and cash alternatives for diversification and volatility reduction. Keep in mind that diversification does not guarantee a profit or protect against losses. As investors' time frames lengthen, near-term market volatility will likely be increasingly dwarfed by longer-term returns. Long-term investors must look beyond near-term volatility and negative sentiment toward the potential for longer-term wealth building.

See page 8 for important disclaimers.

Important disclaimers

Past performance is not an indication of future results.

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

Dividends can be increased, decreased or totally eliminated at any point without notice.

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.

Income from municipal securities is generally free from federal taxes and state taxes for residents of the issuing state. While the interest income is tax-free, capital gains, if any, will be subject to taxes. Income for some investors may be subject to the federal alternative minimum tax (AMT).

While stocks generally have a greater potential return than government bonds and Treasury bills, they involve a higher degree of risk. Government bonds and Treasury bills, unlike stocks, are guaranteed as to payment of principal and interest by the U.S. government if held to maturity. Although Treasuries are considered free from credit risk, they are subject to other types of risks. These risks include interest rate risk, which may cause the underlying value of the bond to fluctuate inversely to a change in interest rates.

Wells Fargo Advisors is a trade name for certain broker/dealer affiliates of Wells Fargo & Company; other broker/dealer affiliate of Wells Fargo & Company may have differing opinions than those expressed in this report.

Advisory Services Group contributor

Stuart T. Freeman, CFA®
Chief Equity Strategist
Vice-Chairman,
Investment Strategy Committee

Investment and Insurance Products: ▶ NOT FDIC Insured ▶ NO Bank Guarantee ▶ MAY Lose Value

Wells Fargo Advisors is the trade name used by two separate registered broker-dealers: Wells Fargo Advisors, LLC and Wells Fargo Advisors Financial Network, LLC, Members SIPC, non-bank affiliates of Wells Fargo & Company. First Clearing, LLC, Member SIPC, is a registered broker-dealer and non-bank affiliate of Wells Fargo & Company. © 2011 Wells Fargo Advisors, LLC. All rights reserved.

87491-v1

1011-1146

0000589715 (Rev 00, 1 ea)