Quick Market Update

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In this Quick Market Update:

» Fourth quarter economic and earnings growth may be lower than expected given the fiscal debate; however, losses may be recovered in coming quarters.

» Fundamentals should improve as we enter 2014, with a modest pickup in the pace of global growth, relatively tame inflation, and still accommodative central banks.

» Investors should consider maintaining target allocations, including appropriate short-term liquidity. We see opportunities in equities and challenges in fixed income, so diversification across asset classes, countries, and sectors will be critical.

With the fiscal fiasco in Washington D.C. coming to an end (for now), it’s time for investors to focus on fundamentals again. Heading into the U.S. government shutdown and debt ceiling debate, there were positive economic signs coming from the U.S., Europe, and even some emerging markets. Global manufacturing surveys showed expansion, earnings were growing, inflation was relatively tame, and major central banks around the world remained extremely accommodative.

The debacle in D.C. likely caused some damage to that momentum in October and could have a modest negative impact on fourth quarter economic and earnings growth. Indeed, we’ve already seen some third quarter earnings disappointments and several companies have lowered their outlooks for the remainder of the year. The good news is we believe the events of the past few weeks are likely to have only resulted in a temporary setback and much of the lost output likely will be recovered in the coming quarters. In fact, as the political distractions abate, we see global economic growth improving in 2014 and equity markets reaching new recovery highs.

<table>
<thead>
<tr>
<th>Economic Forecasts</th>
<th>2014E</th>
<th>2013E</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global GDP Growth</td>
<td>3.6%</td>
<td>3.3%</td>
</tr>
<tr>
<td>U.S GDP Growth</td>
<td>2.4%</td>
<td>2.0%</td>
</tr>
<tr>
<td>Inflation</td>
<td>2.0%</td>
<td>2.0%</td>
</tr>
<tr>
<td>Unemployment Rate</td>
<td>6.7%</td>
<td>7.2%</td>
</tr>
<tr>
<td>Fed Funds Rate</td>
<td>0.25%</td>
<td>0.25%</td>
</tr>
<tr>
<td>10-Year U.S. Treasury Yield</td>
<td>3.50%</td>
<td>2.75%</td>
</tr>
<tr>
<td>30-Year U.S. Treasury Yield</td>
<td>4.50%</td>
<td>4.00%</td>
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</tbody>
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<table>
<thead>
<tr>
<th>Market Forecasts</th>
<th>2014E</th>
<th>2013A/E</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P 500 EPS</td>
<td>$113.50</td>
<td>$108.00 E</td>
</tr>
<tr>
<td>S&amp;P 500 Index Level</td>
<td>1,850-1,900</td>
<td>1,733 A</td>
</tr>
<tr>
<td>Russell Midcap Index Level</td>
<td>1,510-1,560</td>
<td>1,421 A</td>
</tr>
<tr>
<td>Russell 2000 Index Level</td>
<td>1,150-1,200</td>
<td>1,102 A</td>
</tr>
<tr>
<td>MSCI EAFE Index Level</td>
<td>1,900-1,950</td>
<td>1,864 A</td>
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<tr>
<td>MSCI EM Index Level</td>
<td>1,050-1,100</td>
<td>1,044 A</td>
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<tr>
<td>Euro</td>
<td>$1.27-1.32</td>
<td>$1.37 A</td>
</tr>
</tbody>
</table>

A: actual / E: estimate; actuals as of 10/17/13; Source: Wells Fargo Wealth Management, 10/15/13
Quick Market Update

Our outlook

The global economic picture should show modest improvement in 2014, with overall GDP growth coming in at around 3.6 percent. Surprisingly the expected pickup in growth next year will come from developed countries, where growth should average 2.0 percent. Emerging economies are anticipated to experience a mild deceleration in growth (average 5.0 percent) as they struggle with inflation and tighter monetary policies implemented in the U.S. and within their own countries. Although developing country growth may continue to outpace developed country growth in 2014, the gap is likely to continue to narrow.

We expect U.S. growth to improve from 2.0 percent this year to 2.4 percent in 2014. This acceleration will be driven by continued improvement in consumer spending, a resurgent housing sector, greater business spending, and less fiscal drag. Europe is expected to stabilize and show modest growth during the year, while Japan’s expansion may be fueled by ongoing accommodative monetary policies.

Inflation, which has been subdued for the past year, is projected to increase gradually as the U.S. economy picks up steam. We are forecasting an average 2.0 percent inflation rate for 2014, which is in line with the Fed’s long-term target. Wage inflation could begin to materialize in 2014 as the labor market recovers and the unemployment rate is likely to end the year in the 6.5-7.0 percent range.

From a capital markets perspective, bonds (especially sovereign debt) likely will be challenged next year as rates climb. In our estimation, the Fed will likely unwind its bond-buying program throughout the year putting upward pressure on longer-term rates. In addition, discussions on when to begin raising short-term rates could begin later in the year; however, we believe the Fed will not increase rates before 2015.

The bull market should continue for stocks in 2014 and we believe the S&P 500 Index could reach new all-time highs during the year. Our forecast is for the S&P 500 Index to end the year in the 1,850-1,900 range, based on approximately 5.0 percent in earnings growth and modest price to earnings (P/E) multiple expansion. Mid- and small-cap stocks likely will also be supported by strong earnings growth, but valuations are less compelling.

International stocks may offer investors attractive opportunities in 2014 given their relative underperformance since the recovery began. Developed market equities likely will be supported by European earnings moving into recovery mode and Japanese companies gaining momentum on improvements in fundamentals. Emerging stocks, which have struggled this year, may continue to be hampered by sluggish demand, falling commodity prices, and a rising U.S. dollar. We continue to believe in the long-run emerging market story, albeit realizing that volatility may be an overriding theme in the near term.

Overall, we expect the global economy to continue to expand at a moderate pace with inflation remaining contained in most of the developed world. Evolving central bank policy likely will have the greatest impact on bond yields next year, but fundamentals should support continued advancement in stocks.

How to position your portfolio for 2014

Despite the temptation to concentrate on short-term headlines, long-term investors know fundamentals drive asset prices over time. Economic growth has been subpar since the recovery began and that may be the case in 2014 as well. Nonetheless, our economy is expected to continue to grow, with U.S. gross
domestic product (GDP) likely reaching new all-time highs next year. Earnings are likely to grow at a slightly slower pace than in 2013; however, we anticipate that earnings per share will hit record highs next year. Meanwhile, the Fed likely will keep rates at extraordinarily low levels throughout the year to help support the economic recovery.

In our view, these conditions will continue to favor risky assets, in which case we suggest investors maintain strategic allocations in equities as a part of a diversified portfolio heading into 2014. Volatility is expected to remain elevated, but we recommend buying on the dips and focusing on cyclical sectors, such as Consumer Discretionary, Industrials, and Technology. Internationally, we see pockets of strength and recommend globalizing equity holdings, especially in areas that have underperformed during the recovery.

Fixed income markets may struggle next year due to rising long-term rates; however, a properly diversified portfolio may help provide downside protection. We continue to recommend underweighting developed sovereign bonds (both U.S. and international) as they are most sensitive to interest rate risk. Staying short of benchmark durations and favoring credit will also be themes for 2014. Additionally, we think municipal bonds offer value here, especially relative to U.S. Treasuries. If you are concerned that your fixed income portfolio is not properly diversified, please contact your investment professional for a fixed-income diagnostic review.

Even with moderate inflation, real assets still have a place in investment portfolios. Real estate investment trusts (REITs) continue to show favorable fundamentals and may offer attractive income opportunities. Although we recommend an underweight on commodities, the asset class continues to provide diversification and protection against unforeseen inflation.

Complementary strategies will play a critical role in investment portfolios in 2014. This may help investors to take advantage of uneven global economic growth and evolving central bank policies. Complementary strategies may be used to mitigate some of the downside risk in portfolios, particularly in fixed income portfolios.

All data for this Quick Market Update was sourced from Bloomberg Finance, LLP, unless otherwise noted.

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The Russell Midcap Index measures the performance of the 800 smallest companies in the Russell 1000 Index, which represent approximately 25% of the total market capitalization of the Russell 1000 Index.

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