

Portfolio Manager Commentary

Overview, Strategy, and Outlook, as of February 28, 2010

We have seen the first steps toward a normalization of monetary policy as a number of the emergency liquidity programs expired and the Fed set the stage for the next phase as it raised the discount rate. The reintroduction of the Supplementary Financing Program by the U.S. Treasury begins the process of reducing the Fed's balance sheet. Regulatory changes across the globe set up a clash of the titans as market participants sought more liquid short-term investments and borrowers, especially banks, attempted to lengthen the term of their borrowings. Changes to regulations governing money market funds were finalized with the release of the new Rule 2a-7 late in the month.

Surveying the Landscape

Typically, an interest rate forecast attempts to answer three questions: which way will rates go, when will they change, and by how much? In the current money market environment, the first question is a gimme. With rates at zero for all practical purposes, the only direction they can go is up. So the remaining questions are when will they rise and by how much. We think the answer to the first question is sooner than most market participants think, though like everyone, including policy makers, we are completely in the dark as to where they will end up when all is said and done.

We believe that the Fed is getting ready to enter the next phase of monetary policy by continuing to withdraw some of the extraordinary measures of liquidity support from the money markets. Already a good part of the alphabet soup of Fed support is gone with the expiration of the AMLF, CPFF, PDCF, and TSLF¹ on February 1, 2010. The Term Auction Facility (TAF), which effectively replaced the Fed discount window during the financial crisis, is set to expire in March. In February, the Fed hiked the discount rate, the rate at which banks may borrow from the Fed, to 0.75%, widening the spread over the upper end of the federal funds target of 0.25%. The Fed also normalized the term of loans from the discount window from 30 days to overnight.

None of this should have come as any surprise to the markets. After all, in his testimony before Congress on February 10 (which was submitted in writing while Congress went sledding), Chairman Bernanke noted that

“...before long, we expect to consider a modest increase in the spread between the discount rate and the target

federal funds rate. These changes, like the closure of a number of lending facilities earlier this month, should be viewed as further normalization of the Federal Reserve's lending facilities, in light of the improving conditions in financial markets; they are not expected to lead to tighter financial conditions for households and businesses and should not be interpreted as signaling any change in the outlook for monetary policy, which remains about as it was at the time of the January meeting of the FOMC.”

This affirmed the observation made in the minutes of the January FOMC meeting that “it would soon be appropriate” to widen the spread between the discount rate and the federal funds target. And the Fed took great pains to emphasize that the discount rate increase did not signal a turning point in policy, noting in its announcement that

“Like the closure of a number of extraordinary credit programs earlier this month, these changes are intended as a further normalization of the Federal Reserve's lending facilities. The modifications are not expected to lead to tighter financial conditions for households and businesses and do not signal any change in the outlook for the economy or for monetary policy, which remains about as it was at the January meeting of the Federal Open Market Committee (FOMC). At that meeting, the Committee left its target range for the federal funds rate at 0 to 1/4 percent and said it anticipates that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period.”

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).

Prior to the financial crisis, the spread between the discount rate and the federal funds rate was 100 basis points (bps). During the financial crisis, the spread between the primary credit rate and the federal funds rate was cut in order to encourage banks to use the discount window for liquidity on two different occasions, from 100 bps to 50 bps at the onset of the crisis in August 2007, and from 50 bps to 25 bps after the near collapse of Bear Stearns in March 2008. As financial conditions have improved, this recent increase in the discount rate can appropriately be viewed as a move towards the normalization of the markets.

So why did the market seem to be caught off guard? Perhaps it's the shock of seeing the words "rate" and "hike" paired together in a flashing red headline on the bottom of the TV screen across the financial news channels. Perhaps it's because, despite all the Fed's efforts to be transparent, the investing public does not comb through the details of Fed testimony and FOMC minutes. Or perhaps it's because investors know that an increase in rates is inevitable and for a moment thought the question of "when" had been answered. Both stock and bond markets reacted negatively to the announcement, with prices in the futures markets declining in after hours trading. By the next day however, the markets had caught their breath, and the markets recovered as most participants accepted that no immediate change was in store. We would suggest that investors should view this as a first step toward the tightening of what has been for the past several years an extremely accommodative monetary policy. Call it normalization if you like, but where we're going is tighter than where we are now.

As the Fed begins to line up the tools it needs to lower the size of its balance sheet, three strategies have emerged as the most likely to be successful on a large scale:

- The first, reverse repos, have been discussed here at length in previous months. Additional collateral in the repo markets would be welcome by money market funds and other short-term market participants who are looking for high-quality liquid investments. Reverse repos have been tested by the Fed, but the date when the Fed will begin is uncertain. It will probably be fairly soon, as they are nearing the completion of their purchases of Federal agency and mortgage-backed securities.
- The second tool was taken back out of the toolbox on Tuesday, February 23, as the U.S. Treasury announced the reintroduction of the Supplementary Financing Program (SFP) bills. Eight auctions of \$25 billion began on February 24, 2010, and will result in a total of \$200 billion in outstandings, up from the current \$5 billion. Each SPF bill matures in eight weeks. Since the Treasury deposits

the proceeds from the SPF auctions in its account at the Fed, excess reserves will be reduced by \$195 billion, a good reduction of the current excess net reserve balance of \$1.1 trillion. To give you an idea of just how large the Fed's balance sheet has gotten, prior to the financial crisis, excess reserves generally totaled around \$1 or \$2 billion! The SPF had wound down as the U.S. Government approached the overall debt ceiling, but with the cap lifted by a substantial amount, that should not present a near-term issue. This should take the amount of SFP bills outstanding back to where they were in early 2009.

- The third tool is the concept of the Fed taking term deposits from member banks. Currently, banks are paid interest on their excess reserves at the upper end of the Federal funds target range, 0.25%. If the Fed is going to entice banks to commit these deposits for a longer term, it would essentially reclassify them into non-lendable accounts in order to reduce the net size of its balance sheet. If the banks expect rates to rise then they would want a higher rate on term deposits than the overnight rate they are collecting on excess reserves. Since the rate on the term deposits will be capped at the discount rate to prevent the potential for arbitrage, the spread between the discount rate and the federal funds rate must increase. We would therefore view the discount rate hike as a necessary first step to the implementation of term deposits.

As the Fed begins to implement its programs to remove the quantitative easing from the markets, rates will naturally begin to rise. If additional collateral is brought into the markets in the form of reverse repo and the SFP bills, the repo rate, now trading well below the Federal funds target, should begin to move up. The effective federal funds rate, now depressed by sales of cash into that market by the government-sponsored enterprises (GSE), should also begin to inch upward as Fannie Mae and Freddie Mac begin to spend some of their excess funds on the recently announced delinquent loan buyouts. As market rates begin to move higher, the Fed will be hard pressed to leave the federal funds target untouched. Just as the Fed's presence as the largest lender has exerted downward pressure on rates below the expressed targets, so its role as a major borrower/seller will exert upward pressure on rates.

The strength of the economy may also force the Fed's hand. With the Gross Domestic Product (GDP) having grown at 5.9% in 4Q09, following a +2.2% 3Q09, we think the Fed would be hard-pressed to leave the federal funds rate at zero should we see another quarter of healthy economic growth. While inflation has remained fairly subdued, fears of an inflationary bubble could increase were that to happen, leading to higher long-term interest rates and all sorts of nasty problems for

the Fed. The Fed's dilemma will be what to do if the economy seems strong but unemployment remains high. With many in Congress calling for increased control of the Fed in an election year, the Fed is not likely to be overly aggressive with any rate increases. It seems comfortable with measured incremental changes at this point and will likely follow that course unless its hand is forced by market conditions.

That said, we are mindful that the FOMC expresses its view on the trend in short-term rates in the statements following its meetings, where for a number of months it has repeated that it "... anticipates that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the federal funds rate for an extended period."

While current economic factors argue for a continuation of the zero interest rate policy, technical factors and the possibility of an economic resurgence weigh toward an increase in rates. These factors may not be as much in conflict as it first seems, as the Fed could raise rates in response to market conditions and still argue that rates are exceptionally low from a historical perspective.

Other regulatory initiatives regarding liquidity are also expected to have an effect on the money markets. All the regulators seem to have the same view of liquidity. For better or worse, in the same view that a three-year-old has of Christmas: it's better to receive than to give. At the same time that money funds are being pushed to accumulate more liquidity by the SEC through its amendments to Rule 2a-7, banks are being pressured to rely less on short-term funding. Regulatory changes at the Financial Service Authority in the United Kingdom (FSA), along with the Basel III recommendations that will govern global banks, require banks to conform to new measures of their funding.

The net result is that banks will be less willing to take short-term deposits and other forms of institutional funding that money funds will want to provide in order to comply with the new 2a-7 requirements. At the same time, banks can be expected to compete more aggressively for funding longer than three months to satisfy their new requirements. One would expect that this will have the effect of widening the spread of the London Inter-Bank Offered Rate (LIBOR) over other rates, especially in the longer end of the money market spectrum, and steepening the money market yield curve.

While there has been no indication of the standards that the Fed intends to impose on U.S. banks, the expectation is that they will generally fall along the same lines as the FSA and Basel. While the new guidelines are not expected to take effect for some time, banks are already moving their funding

in line with those requirements. As the term funding that has been provided to banks by the Fed and the European Central Bank (ECB) rolls off, it will be interesting to see if there is enough demand by investors for longer term bank paper to meet their needs.

On February 23, the SEC released the final text of the amended Rule 2a-7 governing money market funds. [See page 6](#) for a table that summarizes the changes to Rule 2a-7 that were adopted. The implementation of the Rule with respect to Portfolio Quality, Liquidity, and Maturity is set for May 28, 2010, while the new guidelines on weighted average maturity (WAM) and weighted average life (WAL) (which uses the final maturity of portfolio investments) is set for the end of June. Neither date should present a problem for the industry. Other requirements, which are primarily operational in nature, are set for implementation later this year and into 2011.

Strategies for the Prime Markets Section

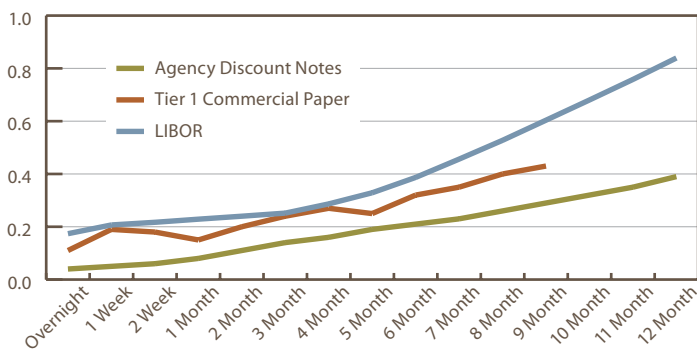
Early in the month, nervousness about levels of sovereign debt spread from Greece to Spain, Portugal, and Italy. Pledged support for Greece from the European Union leaders calmed markets somewhat. But the question remains, if the EU steps in to support Greece, do they also have to help the other countries with large amounts of debt? So far the main impact of the sovereign debt crisis is a weakening of the euro. There was no direct impact on U.S. money market instruments and it would not appear that money market funds have direct exposure to Greece.

Yields on taxable money market instruments remain low and compressed. The yield pick-up from one-month to three-month commercial paper averaged about 3 bps this month. (0.17% versus 0.20%). Overnight rates have been below the target funds rate since Fall 2008. We had hoped that after the Fed made signs of normalizing rates (the discount rate increase and ramping up SFP, see comments in the "Surveying the Landscape" section) overnight rates would rise a bit in response. Unfortunately, higher overnight rates did not materialize in February. The federal funds effective rate for the month averaged 0.13%, still well below the 0.25% target set by the Fed in December 2008.

One positive result of the discount rate hike was to firm commercial paper rates at current levels. Market participants always wrestle with issuers over levels. As LIBOR rates fell and overnight rates are about half of the 0.25% target, issuers have had the upper hand. Buyers dug in their heels after the discount rate increase, anticipating that the shift to higher rates is now on the horizon. So while we haven't seen an increase in rates, they do seem to have stopped falling.

YIELD COMPARISON IN THE MONEY MARKETS

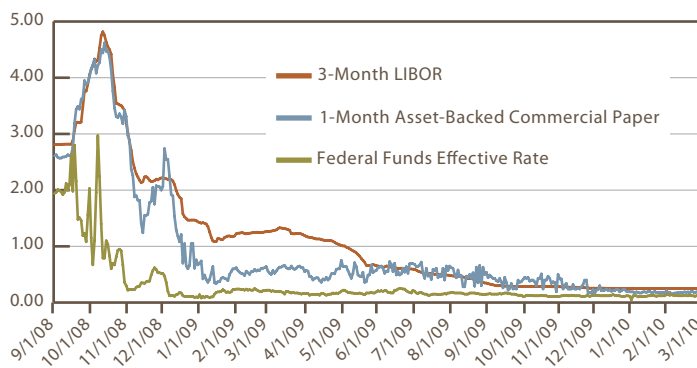
as of 2-28-10



Source: Bloomberg LP

HISTORICAL INTEREST RATES

September 2008 through February 2010

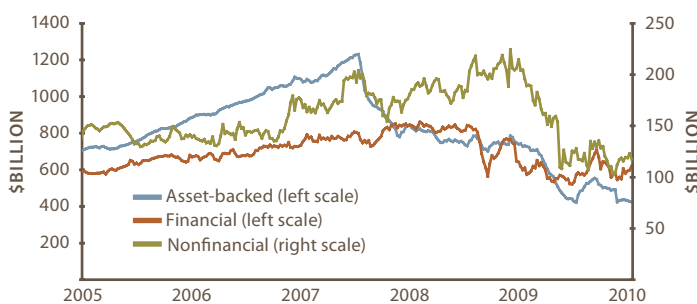


Source: Bloomberg LP

The commercial paper market resumed its contraction after a positive blip in January. Non-seasonally adjusted outstandings fell \$30.9 billion in February. Corporate paper was the only category that experienced an increase in outstandings.

COMMERCIAL PAPER OUTSTANDINGS

Weekly (Wednesdays), Seasonally Adjusted



Source: Federal Reserve Board

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 Net Asset Value (NAV). In our prime category money market funds, we have avoided investing in securities longer than three to four months in maturity. In general, rates are too low and the yield curve too flat. When rates do rise, we will have the liquidity to take advantage of some of those offerings. Of course we will do so judiciously. Once the trend in rates shifts to increasing levels, it could continue for some time before yields get to a normalized level.

In this unusual rate environment, rates have compressed such that the yields on tax-exempt Variable Rate Demand Notes are on par with taxable yields. These securities are puttable with daily or weekly notice and thus add to liquidity requirements. The weighted average maturity of our portfolios remains well below the industry average of 47 days in institutional prime funds and 56 days in retail prime funds.

Strategies for the U.S. Government Markets

Yields on U.S. Treasury Bills (T-Bills) rose significantly during the month, mainly driven by supply factors. The most notable development, and one discussed in the "Surveying the Landscape" section, was the announcement, late in the month, by the U.S. Treasury (Treasury) that the Supplementary Financing Program (SFP) would be increased to \$200 billion over the course of two months. Remember, the SFP was created in September 2008 as a way for the Federal Reserve to manage the balance sheet impact of initiatives created to address heightened liquidity pressures in the financial markets. The Treasury raises cash by issuing bills, apart from their current borrowing programs, and then deposits that cash at their account at the Fed, effectively draining reserves from the system. At one point there was \$600 billion in outstanding SFP bills in the market, but that amount dropped to just \$5 billion as the Government approached the debt ceiling limit. With the debt ceiling limit increased, the program is now able to ramp back up. In addition to the SFP program increase, the Treasury also increased the amount of regularly scheduled weekly T-Bill auctions due to seasonal factors.

The significant increase in supply was not the only factor driving yields higher in the T-Bill market during the month. Broker/Dealers have held relatively large net long positions in T-Bills during the past year and a half for a variety of reasons (failed trade charges, market crisis, etc). However, just this month, dealer positions in T-Bills have entered a net short position. That has not been seen since the fourth quarter of 2008. Improving market conditions and the increase in overall supply have made dealers a bit more bearish on T-Bill yields.

At month-end, the yield on the one-month T-bill was 0.07%, up seven bps from the prior month. Meanwhile, T-bills maturing in three months yielded 0.11% at month-end, five bps higher from one month ago, and six-month T-bills ended the month yielding 0.17%, up four bps.

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 offer price stability and daily liquidity at a higher yield than T-bills.

Riding on the yield coattails, if you will, of the T-Bill market, yields on GSE discount notes also rose during the month. Without this rise, yields on discount notes would have been below that of T-Bills and demand would have all but dried up. Outstanding supply actually increased this month for the first time in over a year. However, the increase was a relatively small \$11B, or just shy of 2%, month over month. Even so, the increase in outstandings was certainly a welcome sight and helped a bit with the increase in yields.

With regard to overall supply, one development that occurred this month was the announcement that both Fannie Mae and Freddie Mac will begin buying delinquent mortgages from their securitization pools over the next few months. New accounting rules that took effect at the beginning of this year will allow the two agencies to recognize cost savings by bringing these loans back onto their balance sheets. It is thought that one way the agencies will fund the purchases of these delinquent loans will be to issue discount notes. While this increase in supply has yet to materialize, the perception that it could occur shortly has helped to cheapen yields.

The yield on one-month discount notes rose one bp to 0.08% while the yield on three-month discount notes rose three bps, from 0.11% to 0.14%. 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.

Strategies for the Tax-Exempt Markets

Both institutional and retail municipal money market funds continued to experience outflows. Total tax exempt money market assets under management now total \$386.6 billion, back to levels last observed in May 2007. The main contributor to the outflows continues to be historically low absolute rates. Market participants seem to continue their quest for higher return, moving into short-term municipal bond funds.

For the month, the Securities Industry and Financial Markets Association Municipal Swap Index (SIFMA) continued its range bound ways resetting between 0.17% and 0.23% for the month. On a positive note, a new floating rate product with multiple liquidity modes was just approved for purchase by our money market committee. The new product known as "Windows Variable Rate Demand Bonds" allows the highest quality municipal issuers to provide their own liquidity if necessary. The product is attractive for numerous reasons: adding much needed supply to the municipal market place, its high-quality credits help diversify away from bank credits, and an attractive spread off of the SIFMA index makes it an attractive option.

Our strategy across the municipal money market funds emphasizes a WAM that is shorter than the peer group and a concentration on puttable variable rate securities. We believe that rates are too low and the yield curve is too flat from a historical perspective to warrant a significant extension of maturity.

The Inside Track

Because statements released after the last several FOMC meetings indicate that money market rates 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 NAV and liquidity for shareholders.

SUMMARY OF MAJOR CHANGES TO SEC RULE 2A-7

SECTION	REVISED RULES	PRIOR RULES
PORTFOLIO LIQUIDITY	Daily Liquidity: For all taxable money market funds, at least 10% of assets must be in cash, U.S. Treasury securities, or securities that convert into cash the next business day.	No daily liquidity provision.
	Weekly Liquidity: For all money market funds, at least 30% of assets must be in cash, U.S. Treasury securities, certain government securities maturing within 60 days, or securities that convert into cash the next five business days.	No weekly liquidity provision.
	Illiquid Securities: (i.e. a security that cannot be sold at carrying value within seven days) Illiquid securities cannot exceed 5% of portfolio at time of purchase.	Illiquid securities cannot exceed 10% of fund assets.
PORTFOLIO MATURITY	Weighted Average Maturity (WAM)¹ : Maximum WAM of 60 days.	Maximum WAM of 90 days.
	Weighted Average Life (WAL)² : Maximum WAL of 120 days.	No comparable requirement.
CREDIT QUALITY	Second Tier Securities³: Second tier 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 Nationally Recognized Statistical Rating Organizations (NRSRO) to be used to determine minimum ratings criteria.	No comparable requirement.
	Repurchase Agreements: To “look through,” collateral must be cash items or government securities with creditworthy counterparties. Advisor must evaluate the creditworthiness of the repurchase counterparty.	Collateral must be “highly rated.” No requirement with respect to the creditworthiness of repo counterparties.
KNOW YOUR INVESTOR	All Funds: Hold sufficient liquid securities to meet “foreseeable” redemptions. Funds are required to develop procedures to identify investors whose redemption requests may pose risks for the funds.	No comparable requirement.
PERIODIC STRESS TESTING	Monthly testing of a fund’s ability to maintain a stable \$1.00 net asset value (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 at least monthly and maintained for a period of at least six months.	No portfolio holdings Web site disclosure requirement.
	Monthly SEC Filing (Form N-MFP): Information about a fund’s risk characteristics, yield, portfolio holdings, and mark-to-market (“shadow”) NAV (this will be made public with a 60-day lag).	No disclosure requirement.
MONEY FUND OPERATIONS	Funds may suspend redemptions if the NAV falls below \$1 and, as a result, the fund will be liquidated; advisor systems must be able to process shareholder transactions at a price other than \$1.	No comparable requirement.
	Affiliates may purchase securities from funds before a downgrade or default without prior approval by the SEC; SEC must still be notified if this occurs.	SEC approval was required prior to allowing affiliate purchases.
FUTURE CONSIDERATIONS	<ul style="list-style-type: none"> ▪ A floating NAV, rather than the stable \$1.00 NAV prevalent today; ▪ Mandatory redemptions-in-kind for large redemptions (such as by institutional investors); ▪ “Real time” disclosure of shadow NAV; ▪ A private liquidity facility to provide liquidity to money market funds in times of stress; ▪ A possible “two-tiered” system of money market funds, with a stable NAV only for money market funds subject to greater risk-limiting conditions and possible liquidity facility requirements; and ▪ Several other options being discussed with the President’s Working Group. 	All new concepts.

Source: Securities and Exchange Commission

1. Weighted Average Maturity (WAM): WAM calculates an average time to maturity of all of the securities held in the portfolio, weighted by each security’s percentage of net assets. The calculation takes into account the final maturity of a fixed income security and the interest rate reset date for floating rate securities held in the portfolio. This is a way to measure a fund’s sensitivity to potential interest rate changes.
2. Weighted Average Life (WAL): WAL calculates a fund’s average time to maturity for all of the securities held in the portfolio, weighted to their percentage of assets in the fund. In contrast to WAM, the WAL calculation takes into account the final maturity date for each security held in the portfolio. This is a way to measure a fund’s potential sensitivity to credit spread changes.
3. Second Tier Securities: Are eligible money market securities that, if rated, have received other than the highest short-term debt rating from the requisite NRSROs or, if unrated, have been determined by the fund’s board of directors to be of comparable quality.

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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 February 28, 2010, 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.

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