

# Wells Fargo Advantage California Tax-Free Fund (SGCAX)

**Portfolio Managers:** Stephen Galiani, Adrian Van Poppel  
**Subadvisor:** Wells Capital Management  
**Category:** California Municipal Bond

All information is as of 12-31-09 unless otherwise indicated.

## FUND STRATEGY

- Use both bottom-up credit research and top-down macroeconomic analysis.
- Seek to generate equivalent amounts of excess performance through actively managing the four key elements of total return: security selection, sector rotation, duration management, and yield-curve positioning.
- Use a relative-value approach based on extensive credit analysis that seeks opportunities from changing market trends and pricing inefficiencies to generate excess returns.
- Manage the portfolio to seek current income exempt from federal income tax and California state income tax.

## KEY DRIVERS OF PERFORMANCE

- After several consecutive quarters of positive performance in California municipal bonds, longer-term California debt declined in value in the fourth quarter. The Fund's shorter duration and underweight of the long end of the municipal yield curve helped performance relative to peers; however, the Fund underperformed its national benchmark during the fourth quarter, in part because California debt underperformed the national market. The Fund outperformed its benchmark over the last 12 months.
- The Fund's overweight of A-rated debt and underweight of AAA-rated debt detracted from performance, as lower-quality underperformed in the fourth quarter. An underweight of prerefunded bonds also detracted from performance.

## AVERAGE ANNUAL TOTAL RETURNS\* (AS OF 12-31-09)

	3 Month	Year to Date	1 Year	3 Year	5 Year	10 Year	Since Inception (10-6-88)
<b>California Tax-Free Fund—Admin</b>	-1.20%	15.80%	15.80%	2.95%	3.76%	5.42%	6.30%
<b>Lipper California Municipal Debt Funds Average</b>	-2.26%	17.67%	17.67%	1.58%	2.75%	4.62%	—
<b>Barclays Capital Municipal Bond Index</b>	-0.96%	12.91%	12.91%	4.41%	4.32%	5.75%	—

\*Returns for periods of less than one year are not annualized.

**Figures quoted represent past performance, which is no guarantee of future results.** Investment return, principal value, and yields of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Current month-end performance is available at the Fund's Web site, [www.wellsfargo.com/advantagefunds](http://www.wellsfargo.com/advantagefunds). Administrator Class shares are sold without a front-end sales charge or contingent deferred sales charge.

The adviser has committed, through October 31, 2010, to waive fees and/or reimburse expenses to maintain the Fund's net expense ratio at 0.55%. Without these reductions, the Fund's returns would have been lower. The Fund's gross expense ratio is 0.81%.

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## PORTFOLIO CHARACTERISTICS

	Wells Fargo Advantage California Tax-Free Fund	Barclays Capital Municipal Bond Index
Duration	7.70	8.29
30-Day SEC Yield	3.83%	—
Avg. Credit Quality <sup>1</sup>	AA-	AA/AA-
Avg. Maturity	13.57	13.53
AMT <sup>2</sup>	15.21%	—
<b>Credit Quality Allocation</b>		
AAA	19.4%	30.4%
AA	17.5%	36.4%
A	39.2%	20.9%
BBB	10.3%	12.3%
BB	0.9%	0.0%
B	0.0%	0.0%
CCC	0.0%	0.0%
Nonrated	5.3%	0.0%
SP-1/MIG1	4.9%	0.0%
SP-2/MIG2	0.0%	0.0%
Cash Equivalents	2.5%	0.0%
<b>Sector Allocation</b>		
GO Bonds	12.0%	24.4%
Insured Bonds	14.1%	11.5%
Prerefunded Bonds	6.9%	10.6%
Revenue Bonds	64.5%	53.6%

1. The ratings indicated are from Standard & Poor's and/or Moody's Investors Service. 2. % of net assets in AMT bonds.

Portfolio characteristics and allocations are subject to change and may have changed since the date specified.

(See pages 6–7 for important information.)

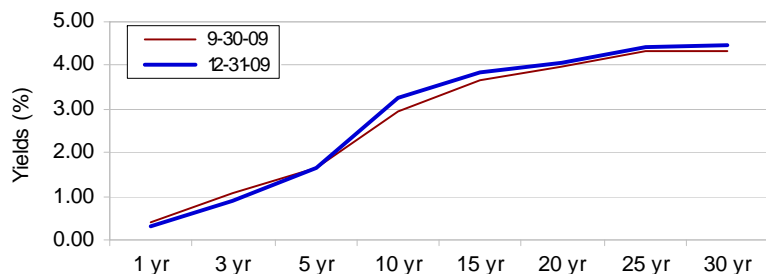
STRATEGY AND PERFORMANCE ATTRIBUTION (GROSS OF EXPENSES<sup>3</sup>)

	Fund Positioning	Market Activity	Result
<b>Duration</b>	Duration positioning of the Fund was shorter than the benchmark in the fourth quarter, after being longer than the benchmark for much of the previous quarter.	Municipal bond yields shifted higher across most of the yield curve. Maturities longer than five years declined in value, while shorter-term maturities appreciated. The Fund's shorter duration positioning provided protection from the rising-yield environment.	Positive
<b>Yield Curve</b>	The Fund's yield-curve positioning was underweight the long end of the curve, as it had been for the previous four quarters. We were underweight long-term maturities and short-term maturities, with an overweight to the intermediate part of the curve, particularly the ten- to 18-year range.	Longer-maturity municipal bonds declined the most in the fourth quarter, which was a reversal of their positive performance from the first three quarters of 2009. The Fund's underweight of the long end added relative value during the quarter.	Positive
<b>Sector</b>	The Fund was overweight in revenue bonds and insured bonds during the fourth quarter. We were underweight prerefunded bonds and general obligation (GO) bonds, particularly underweight in state GOs.	California municipal bonds underperformed the national municipal market in the fourth quarter, reversing their positive performance from the third quarter. The prerefunded bond sector was the only positive-performing broad sector in California during the quarter, as California revenue bonds, insured bonds, and GOs all declined. The Fund's underweight of prerefunded bonds and overweight of revenue bonds detracted from performance. The large underweight of California state GOs helped performance, as GOs were the worst performers during the fourth quarter.	Negative
<b>Quality</b>	The Fund's overall credit quality was similar to slightly lower than the benchmark's. The Fund was overweight in A-rated bonds and underweight the AA-rated and AAA-rated credit tiers.	Lower-quality municipal bonds underperformed in the fourth quarter, after rallying throughout much of the first three quarters of 2009. The Fund's overweight of A-rated bonds and underweight of AAA-rated bonds detracted from performance.	Negative
<b>Issue Selection</b>	We continued to be significantly underweight California state GOs in the fourth quarter in preference for essential-service revenue bonds, such as water, sewer, and power. Security selection has proven to be a primary driver of relative performance because of the increasingly diverse distribution of relative credit profiles in California municipal bonds. We held several state appropriation bonds, such as California Public Works, which are issued by a state-level agency to raise funding for prisons, state office buildings, community colleges, etc. Other notable positions were Adelanto auction-rate securities (ARS), Cal. Statewide Community Development Authority, Santa Ana Unified School District, and several other school district appropriation bonds.	Individual credit analysis has proven to be one of the most important factors in assessing California municipal bond values in the changing environment. Our significant underweight of state GOs contributed to performance; however, some of the Fund's specific GOs performed well, such as the Cal Statewide Community Development Authority, which rallied by around 100 basis points during the quarter. These bonds are issued by the state to pay specific cash flow obligations to local municipalities and have performed better than other state GOs. The Adelanto ARS yielded its maximum variable rate during the quarter before being refinanced, which helped performance. Santa Ana school district zero-coupon bonds rallied strongly during the quarter. However, some Cal Public Works issues detracted from returns.	Positive

3. The gross of expenses performance attribution does not reflect the deduction of the Fund's expenses as shown in the prospectus.

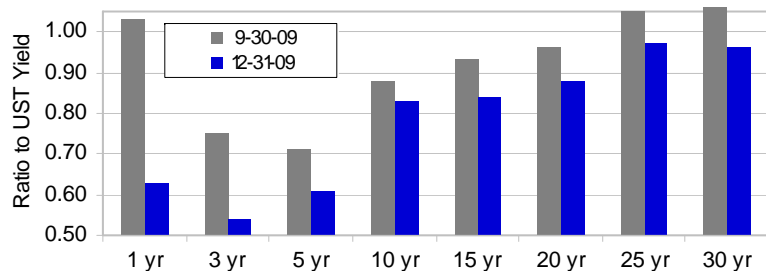
**FIXED-INCOME MARKET REVIEW**

**The Municipal Yield Curve Steepened Further During the Quarter**



- The municipal bond yield curve steepened further during the fourth quarter as yields on maturities shorter than five years declined, while those longer than five years shifted higher. This ended three consecutive quarters of rallies in longer-maturity municipal bonds.
- The ten-year segment of the municipal bond curve moved the most during the quarter, shifting higher in yield by 33 basis points.
- The U.S. Treasury curve also steepened during the quarter due to a strong upward shift in longer-maturity yields. The 5-year Treasury note shifted higher by 36 basis points, the 10-year note by 53 basis points, and the 30-year bond by 59 basis points.

**Municipal Bond Ratios Declined Further During the Quarter**



- The ratios of municipal bond yields to equivalent U.S. Treasuries continued to decline further during the fourth quarter, particularly in the short-maturity range of the curve. Most of the ratios are now at, or even below, their historic averages after starting the year at extraordinarily high levels.
- Ratios of the 1-year, 3-year, and 5-year notes marked new historic lows, primarily due to the exceptionally low short-term U.S. Treasury yields.
- Ratios of intermediate and longer-maturity municipal bond yields generally hovered around historic averages, despite the sharp shift higher in longer-maturity U.S. Treasury yields.

**Lower-Quality and Longer-Maturity Bonds Declined the Most**

CA Municipal Sector	CA Municipal Quality	CA Municipal Maturities
CA Muni Bond	AAA	1 Year 0.59%
GO Bond	AA	3 Year 0.72%
Insured Bond	A	5 Year 0.13%
Prerefunded	BBB	10 Year -2.14%
Revenue Bond		20 Year -3.30%
		Long Bond -4.79%

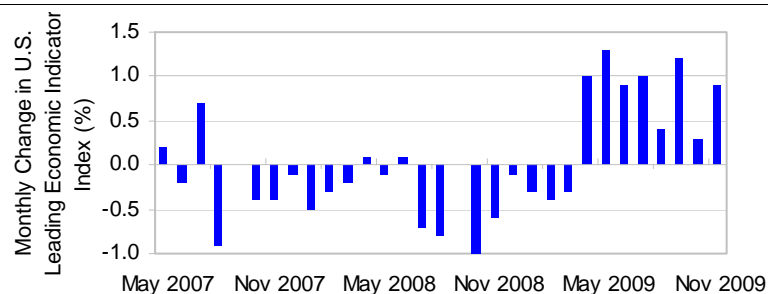
- In a reversal of the trends from the first three quarters of 2009, lower-quality and longer-maturity California bonds declined in value during the fourth quarter. Previously, the riskier areas of the California municipal bond market had been the best performers, but that year-long rally finally came to an end in the fourth quarter.
- Lower-quality was not in favor in the fourth quarter, as each respectively lower credit-quality tier underperformed each respectively higher credit tier. AAA-rated bonds returned -0.92%, while BBB-rated bonds shed -3.68%.
- Prerefunded bonds were the best-performing sector during the quarter, after being out of favor for much of 2009. By contrast, the California GO sector declined after being the strongest-performing California sector in the third quarter. Revenue bonds also declined after performing well for most of 2009.

Source: Barclays Capital

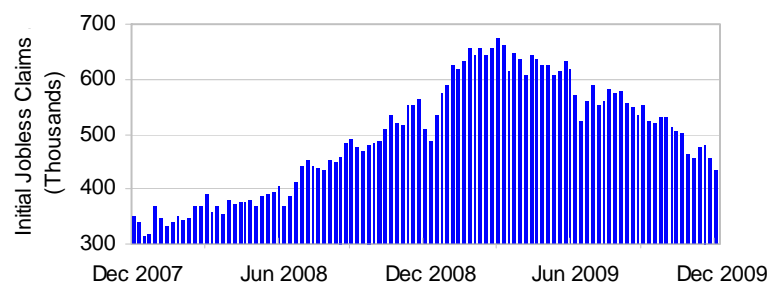
**Past performance is no guarantee of future results.**

## THE ECONOMY AND MONETARY POLICY

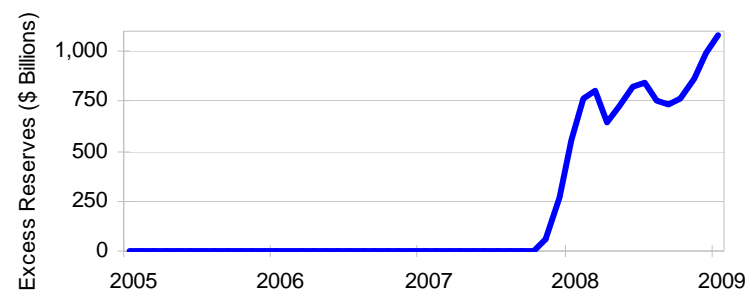
### The Index of Leading U.S. Economic Indicators Expanded



### Initial Jobless Claims Declined but Unemployment Remained High



### Excess Reserves Continued to Build to an Extraordinary Level



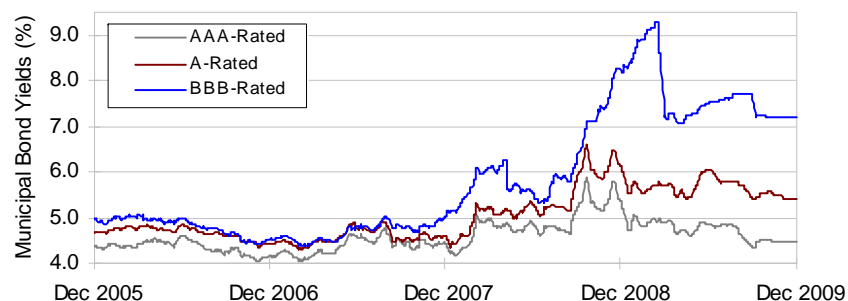
Source: Bloomberg

- Positive trends in economic conditions continued in several key economic measures during the fourth quarter. The Conference Board's index of ten leading economic indicators continued to improve throughout the fourth quarter, building on the economic expansion from the third quarter. The Gross Domestic Product (GDP) expanded by 2.2% in the third quarter after four consecutive quarters of contraction.
  - The Institute for Supply Management (ISM) Manufacturing Index continued to improve strongly, finishing the fourth quarter above 55, which is the highest level since the first half of 2006. Figures above 50 indicate economic expansion in manufacturing.
  - The Federal Open Market Committee (FOMC) introduced new language regarding economic conditions in its December 16 policy statement, acknowledging that "financial market conditions have become more supportive of economic growth."
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- Initial jobless claims continued to decline during the fourth quarter, finishing the year at a weekly average of around 450,000 compared with a weekly average of around 650,000 during the first quarter of 2009. Despite the trend toward improving employment conditions, continuing jobless claims remained elevated at recessionary levels, and the unemployment rate finished the year around 10%.
  - At its December 16 meeting, the FOMC observed that "economic activity has continued to pick up and that deterioration in the labor market is abating... [however], businesses are still cutting back on fixed investment... and remain reluctant to add payrolls."
  - Consequently, the FOMC stated that it intends to keep the target range for the federal funds rate at 0% to 0.25% percent, citing that "economic conditions, including low rates of resource utilization... are likely to warrant exceptionally low levels of the federal funds rate for an extended period."
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- Excess reserves grew to extraordinary levels throughout the credit crisis of 2008 and its aftermath in 2009. The continued use of quantitative easing programs by the Fed resulted in more than \$1 trillion held in excess reserves in the fourth quarter of 2009. Prior to 1991, excess reserves never exceeded \$2 billion. With the exception of September 2001, when they temporarily reached \$19 billion, excess reserves never exceeded \$5 billion until the recent credit crisis.
  - In the fourth quarter, the Fed began to focus its attention on reducing excess reserves and unwinding several quantitative easing programs. Potential methods for reducing excess reserves included a massive reverse repurchase program and the eventual closing of the Fed's temporary liquidity swap arrangements with central bank counterparties.
  - In the December 16 FOMC statement, the Federal Reserve confirmed that most of its special liquidity facilities would expire on February 1, 2010.

## PORTFOLIO POSITIONING

- In the fourth quarter, defensive duration positioning helped performance. In our view, many of the risk concerns that we had in the fourth quarter are still relevant going into the first quarter of 2010; thus, duration is shorter than the index. We intend to maintain a defensive duration positioning in the first quarter, in view of both the budget uncertainties in the state of California and the historic steepness of the yield curve.
- Over the past couple of quarters, we have been reducing our weighting in the long end of the curve in preference for the ten- to 18-year range of the curve. Additionally, because the yields are so low in the front end, we have underweighted the front end in preference for a bulleted structure in the ten- to 18-year range.
- Going into the first quarter of 2010, we continue to have a significant overweight of the A-rated credit tier, with an underweight of the AAA-rated tier. In our opinion, the lower-quality credit tiers have offered several attractive valuations on a case-by-case basis, despite the underperformance in the lower-quality credit tiers in the fourth quarter. We generally continue to prefer the yield opportunities in the mid-quality credit tiers of the revenue bond sectors.
- We intend to continue overweighting California revenue bonds while underweighting California state GOs. Going into the first quarter of 2010, most of our GO allocation is in local GOs, not state GOs, though we did modestly increase our state GO position to around 4.6% from 3.5%. We have generally preferred state appropriation bonds to GOs. We are also underweight prerefunded bonds going into the next quarter.
- We have increased our insured bond position and may continue to selectively add to this sector in the first quarter. We currently like the relative price-appreciation potential in specific issues within the sector. We have also been adding local GOs on a case-by-case basis, depending on their individual credit profiles.

## YIELD DISPERSION ACROSS CREDIT TIERS STILL HISTORICALLY WIDE



Source: Barclays Capital. Past performance is no guarantee of future results.

## OUTLOOK

As 2009 came to a close, it was impossible not to look back with astonishment at some of the impressive levels of return from broad areas of the fixed-income markets. According to the Barclays Capital sector indices, municipal bonds returned 12%, corporate bonds 18%, asset-backed securities 24%, commercial mortgage-backed securities 28%, and high yield 58%. With the exception of municipal bonds, each of these sectors appreciated further in the fourth quarter, building on strong 2009 rallies. However, it's important to note that "normal" yielding years from here on out will likely look languid in comparison with 2009. We started to see the first indications that some sectors of the fixed-income markets were throttling back a touch in the fourth quarter, particularly in longer-maturity municipal bonds. As the fourth quarter came to a close, it appeared that fixed-income markets were beginning to prepare for a return to modesty in 2010.

At the outset of 2010, we see the potential for improving economic growth, albeit with continued strong headwinds from high levels of unemployment. In our view, it is unlikely that the Fed will raise rates until a considerable improvement in employment conditions takes form. In our assessment, the Fed is more vigilant toward economic risks than to inflation risk at this time, meaning a tightening response is not likely until economic fundamentals and financial market conditions are reasonably secure. This implies extraordinarily low interest rates for an extended period, which would likely preserve the current historically steep yield curve through the first quarter of 2010, or until the Fed indicates that it will begin considering a tightening response.

Certainly there are events to monitor in the upcoming quarter, most notably the retirement of several stimulus and liquidity-support programs from the Federal Reserve, particularly the end of the mortgage-backed securities buying program. This will likely influence the market for mortgage-related debt but may also create opportunities and valuation shifts across various other asset classes. We intend to remain vigilant with those shifting opportunities. In our opinion, diligent and earnest assessment of the fundamental risks in individual fixed-income securities will be a key differentiating factor between which investment strategies perform well and which do not.

After a strong third quarter from California GO and revenue bonds, the broad California market both lost value and underperformed the national market in the fourth quarter. State GOs were once again one of the more vulnerable areas of the market as state budget concerns persisted. Clearly, California still has budgetary challenges to work through; however, we continue to find opportunities for value in municipal issuances that are tied to essential-service revenue streams and project revenues, as opposed to just tax revenues.

Despite state budget concerns, we believe that the California municipal bond market offers California residents a unique opportunity to invest in the debt issuance of a diverse state that is one of the largest economies in the world, while also potentially benefiting from state tax incentives. There is a wide range of economic regions throughout California that make the state a competitive alternative to investing in a national municipal bond fund. In our view, the *Wells Fargo Advantage California Tax-Free Fund* is positioned well to capture long-term value from the California municipal bond market.

**FUND FACTS**

Inception Date	10-6-88
Net Expense Ratio—Admin	0.55%
Assets—All Share Classes	\$526.4M

Sources: FactSet, Zephyr Analytics

**RANKINGS AND RATINGS**

Morningstar Total Return Rankings—Administrator Class (as of 12-31-09)

Morningstar Category	Municipal California Long
1 Year	74 out of 166 funds
3 Year	31 out of 155 funds
5 Year	7 out of 143 funds
10 Year	8 out of 113 funds

Overall Morningstar Rating™ ★★★★★

The Overall Morningstar Rating, a weighted average of the three-, five-, and ten-year ratings, is out of 155 funds in the Municipal California Long category, based on risk-adjusted return as of 12-31-09.

**Benchmark Descriptions:**

**The Barclays Capital Municipal Bond Index** is an unmanaged index composed of long-term tax-exempt bonds with a minimum credit rating of Baa. You cannot invest directly in an index.

**The Lipper Averages** are compiled by Lipper, Inc., an independent mutual fund research and rating service. Each Lipper Average represents a universe of funds that are similar in investment objective. You cannot invest directly in a Lipper Average.

**Definition of Terms:**

**30-Day SEC Yield:** The 30-Day SEC yield is calculated with a standardized formula mandated by the SEC. The formula is based on an estimated yield to maturity (assuming all portfolio securities are held to maturity) and is intended to reflect a fund's hypothetical annualized income, as a percentage of its assets. A fund's actual distribution rate will differ from the SEC yield and any income distributions from the fund may be higher or lower than implied by the SEC yield.

**Credit Quality Ratings:** Credit quality ratings apply to underlying holdings of the Fund and not the Fund itself. Standard & Poor's rates the creditworthiness of bonds, ranging from AAA (highest) to D (lowest). Standard & Poor's rates the creditworthiness of short-term notes from SP-1 (highest) to SP-3 (lowest). Ratings from A to CCC may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the rating categories. Moody's rates the creditworthiness of bonds, ranging from Aaa (highest) to CC (lowest). Ratings Aa to B may be modified by the addition of a number 1 (highest) to 3 (lowest) to show relative standing within the ratings categories. Moody's rates the creditworthiness of short-term U.S. tax-exempt municipal securities from MIG-1/VMIG-1 (highest) to SG (lowest).

**Duration:** The weighted average of the timing of cash flow payments from fixed-income securities. Duration is used as a measurement of sensitivity to interest rates.

**Yield Curve:** A graphical representation of fixed-income security yields (usually U.S. Treasuries) at their respective maturities, starting with the shortest time to maturity and sequentially plotting in a line chart to the longest maturity.

**Risks:** Bond fund values fluctuate in response to the financial condition of individual issuers, general market and economic conditions, and changes in interest rates. In general, when interest rates rise, bond fund values fall and investors may lose principal value. The use of derivatives may reduce returns and/or increase volatility. Certain investment strategies tend to increase the total risk of an investment (relative to the broader market). This Fund is exposed to California municipal securities risk, high-yield securities risk, and nondiversification risk. Consult the Fund's prospectus for additional information on these and other risks. 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 views expressed in this document are as of December 31, 2009, and are those of the portfolio manager(s) 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. Any specific securities discussed may or may not be current or future holdings of the Fund. The securities discussed should not be considered recommendations to purchase or sell a particular security.

Administrator Class shares inception on December 15, 1997. Performance shown prior to the inception of the Administrator Class reflects the performance of the Class A shares.

Please note, some of the Morningstar<sup>®</sup> proprietary calculations, including the Morningstar Rating<sup>™</sup> and rankings, are not customarily calculated based on adjusted historical returns; however, in some cases, the investment's independent rating and ranking metric is compared against the retail mutual fund universe break points to determine its hypothetical rating and ranking. The evaluation of this investment does not affect the retail mutual fund data published by Morningstar.

For each fund with at least a three-year history, Morningstar calculates a Morningstar Rating based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a fund's monthly performance (including the effects of sales charges, loads, and redemption fees, unless otherwise indicated), placing more emphasis on downward variations and rewarding consistent performance.

The top 10% of funds in each category receive five stars, the next 22.5% receive four stars, the next 35% receive three stars, the next 22.5% receive two stars, and the bottom 10% receive one star. (Each share class is counted as a fraction of one fund within this scale and is rated separately, which may cause slight variations in the distribution percentages.) Across U.S.-domiciled Municipal California Long funds, the California Tax-Free Fund received four stars among 155 funds, five stars among 143 funds, and five stars among 113 funds for the three-, five-, and ten-year periods, respectively. Morningstar Ratings are for the Administrator share class only; other classes may have different performance characteristics. Past performance is no guarantee of future results.

*Carefully consider a fund's investment objectives, risks, charges, and expenses before investing. For a current prospectus, containing this and other information, visit [www.wellsfargo.com/advantagefunds](http://www.wellsfargo.com/advantagefunds). Read it carefully before investing.*

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**NOT FDIC INSURED • NO BANK GUARANTEE • MAY LOSE VALUE**

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