

# Wells Fargo Advantage Ultra Short-Term Income Fund (WUSDx)

**Portfolio Managers:** Jay N. Mueller, CFA; D. James Newton II, CFA, CPA; Thomas M. Price, CFA

**Subadvisor:** Wells Capital Management

**Category:** Ultra Short-Term 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 excess performance through an overweight of spread product and by actively managing the four key elements of total return: duration, yield-curve positioning, sector allocation, and security selection.
- Use a risk-managed, relative-value approach that seeks to add value through tactical positioning opportunities and bottom-up fundamental securities analysis.

## KEY DRIVERS OF PERFORMANCE

- For the fourth consecutive quarter, short-term credit and short-term structured products outperformed U.S. Treasuries. The Fund's overweight of credit and structured products, and its underweight of U.S. Treasuries and agency debt, added to relative performance. The Fund outperformed its benchmark during the fourth quarter and over the past 12 months.
- Lower-quality securities continued to outperform higher-quality securities for the fourth consecutive quarter. The Fund's bias for holding medium-quality credits and structured products added relative return during the quarter.
- The Fund's overweight of corporate debt, particularly in the banking and noncyclical sectors, added to 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 (11-25-88)
Ultra Short-Term Income Fund—Admin	1.66%	8.72%	8.72%	1.63%	2.65%	3.04%	5.12%
Lipper Ultra Short Obligations Funds Average	0.79%	5.28%	5.28%	1.20%	2.05%	2.88%	—
Barclays Capital Short-Term U.S. Government/Credit Bond Index	0.19%	1.47%	1.47%	3.53%	3.66%	—	—

\*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 September 30, 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 0.89%.*

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## PORTFOLIO CHARACTERISTICS

	Wells Fargo Advantage Ultra Short-Term Income Fund	Barclays Capital Short-Term U.S. Government/Credit Bond Index
Duration	0.49	0.53
30-Day SEC Yield	2.07%	—
Avg. Credit Quality <sup>1</sup>	A+	AAA/AA+
Avg. Maturity	0.68	0.54
<b>Sector Weights</b>		
U.S. Treasuries	0.1%	61.6%
Agency Debt	4.6%	25.6%
Credit	54.7%	12.8%
ABS/CMBS	11.2%	0.0%
MBS	3.1%	0.0%
CMO	10.8%	0.0%
Other/Municipals	4.2%	0.0%
Cash	11.3%	0.0%
<b>Credit Quality Allocation</b>		
U.S. Treasuries	0.1%	61.6%
Agency Quality	10.3%	25.6%
AAA	9.6%	0.0%
AA	8.9%	2.8%
A	18.5%	6.5%
BBB	39.1%	3.6%
BB/B	2.3%	0.0%
Cash Equivalents	11.3%	0.0%

1. The ratings indicated are from Standard & Poor's and/or Moody's Investors Service.

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

(See pages 6–7 for important information.)

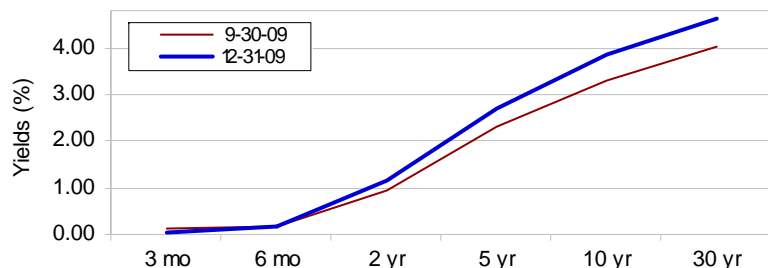
STRATEGY AND PERFORMANCE ATTRIBUTION (GROSS OF EXPENSES<sup>2</sup>)

	Fund Positioning	Market Activity	Result
<b>Duration</b>	Duration positioning was shortened throughout the fourth quarter to a level that was shorter than the benchmark. Most of the Fund's duration exposure is in corporate securities and mortgage-backed securities (MBS). The Fund's duration exposure from Treasuries was minimal.	The U.S. Treasury curve modestly rallied at the very front end of the curve but shifted higher across the broader range of the curve. Short-term credit spreads tightened further during the quarter. The Fund's shorter spread-duration exposure restrained relative performance, but shorter Treasury duration helped.	Neutral
<b>Yield Curve</b>	The Fund had a structurally neutral yield-curve positioning during the fourth quarter but employed some tactical positioning for steepening.	The U.S. Treasury curve steepened during the fourth quarter as yields on all maturities longer than three months shifted higher. The tactical positioning added to performance.	Slight Positive
<b>Sector</b>	The Fund was significantly overweight in credit, asset-backed securities (ABS) and MBS, which is typical of the Fund's strategy. We continued to increase our corporate allocation as we started to do in the third quarter, bringing our corporate positions to around 55% of the Fund. Our allocations of ABS and MBS continued to decline due to some pay-downs that we invested in other sectors to around 24% from 30% in the third quarter. We maintained our approximate 5% allocation in municipal bonds.	For the fourth consecutive quarter, short-term corporate bonds, ABS, and MBS outperformed U.S. Treasuries and agencies. The Fund's significant overweight of credit generated positive relative value for the Fund. The Fund's overweight of financial sector bonds continued to add positive value for the Fund, as bank and insurance company paper continued to perform well. Overweights in utilities, energy, and noncyclicals also added to performance. The Term Asset-Backed Securities Loan Facility (TALF) continued to have a positive supporting effect on the short-term structured products market in the fourth quarter, as it has done throughout much of 2009.	Positive
<b>Quality</b>	The Fund had a lower average credit quality than the benchmark in the fourth quarter, as it did throughout 2008 and 2009. This is typical for the Fund because of its strategic overweights in nongovernment securities.	Lower-quality securities continued to outperform higher-quality securities for the fourth consecutive quarter. The Fund's preference for lower-quality credit tiers added relative value.	Positive
<b>Issue Selection</b>	We continued to focus on holding securities with higher levels of income generation, as we did throughout 2008 and 2009. Notable positions in the fourth quarter were similar to positions that have performed well throughout 2009: home equity lines of credit (HELOCs), financials sector credits, food and beverage sector credits, older-vintage nonagency MBS and ABS, and real estate investment trusts (REITs).	Our preference for higher-income-producing securities continued to generate positive relative value for the Fund in the fourth quarter, as it did throughout 2009. The Fund's yield carry from these types of securities was around 225 basis points, down from 350 in the previous quarter but still a good contributor of excess return. Several HELOC deals that we held performed well in the fourth quarter, continuing to benefit from TALF. Specific bank and insurance securities also added value, as did credits from the food and beverage sector. Certain nonagency MBS and older-vintage MBS and ABS also performed well.	Positive

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

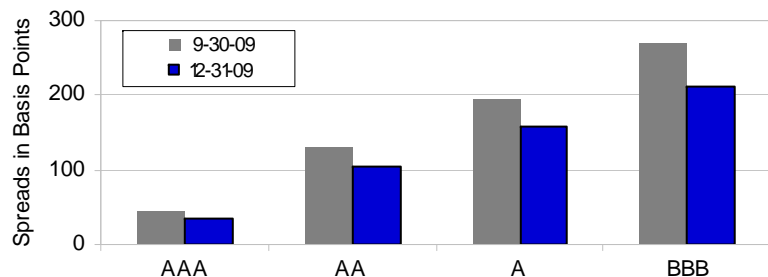
**FIXED-INCOME MARKET REVIEW**

**The U.S. Treasury Yield Curve Steepened in the Fourth Quarter**



- The U.S. Treasury curve steepened and shifted higher during the fourth quarter, which was a reversal of the rally in Treasury yields during the third quarter. The 30-year bond increased the most, shifting 59 basis points higher.
- The shift higher in U.S. Treasury yields was consistent with the general trend over 2009. The third quarter was the only quarter in which U.S. Treasury yields declined during 2009.
- The yield on the 1-year note increased by only five basis points, while the 5-year note increased by 37 basis points, and the 10-year note by 53 basis points. The 3-month bill was the only Treasury that rallied, dropping by six basis points to a yield of only five basis points.

**Credit Spreads Tightened Further in the Fourth Quarter**



- Credit spreads continued to tighten further in the fourth quarter, extending the spread-tightening trends that persisted throughout 2009.
- Although the spread-tightening trends continued in the fourth quarter, the pace of tightening has slowed from previous quarters. In the fourth quarter, BBB-rated spreads tightened by 59 basis points, after tightening by 105 basis points in the third quarter, and 274 basis points in the second quarter.
- AA-rated, A-rated, and BBB-rated spreads finished 2009 at levels similar to where they were at the end of 2007. AAA-rated spreads finished at levels not seen since the fourth quarter of 2006.

**Lower-Quality and Financial Credits Continued to Perform Best**

Short Gov/Credit	Short Credit Quality	Maturities
U.S. Treasuries 0.07%	AAA 0.09%	1–3 Month 0.09%
Agencies 0.13%	AA 0.44%	3–6 Month 0.12%
Industrials 0.78%	A 0.65%	6–9 Month 0.20%
Financials 0.97%	BBB 1.75%	9–12 Month 0.29%
Utilities 0.66%		

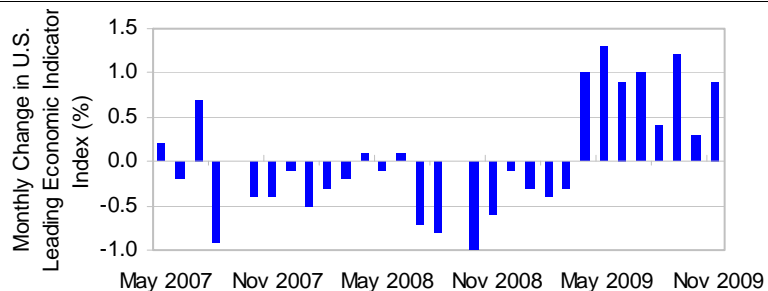
- In the short-term credit market, lower-quality securities continued to outperform higher-quality securities for the fourth consecutive quarter. BBB-rated debt returned 1.75%, A-rated debt returned 0.65%, but AAA-rated debt underperformed again, returning only 0.09%.
- Credit and structured products continued to outperform U.S. Treasuries and agencies. Financials led performance in the short-term credit sectors for the third consecutive quarter, returning 0.97%. By contrast, U.S. Treasuries returned only 0.07%.
- Longer-maturities generally lost value across the broader range of the yield curve, however short-term securities provided positive returns for the fourth consecutive quarter. Thus, short-term securities performed better than the rest of the yield curve during the fourth quarter.

Source: Barclays Capital

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

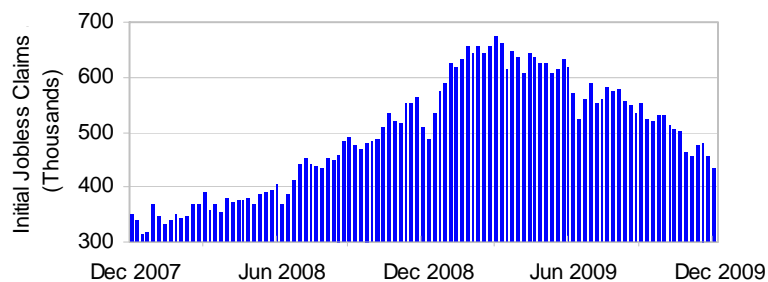
**THE ECONOMY AND MONETARY POLICY**

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



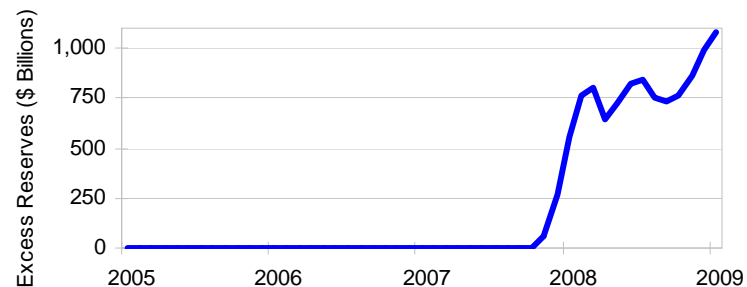
- Positive trends in economic conditions continued in several key economic measures during the fourth quarter. The Conference Board's index of ten leading economic indicators continued to improve throughout the fourth quarter, building on the economic expansion from the third quarter. Gross Domestic 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, 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."

**Initial Jobless Claims Declined but Unemployment Remained High**



- 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 at 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."

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



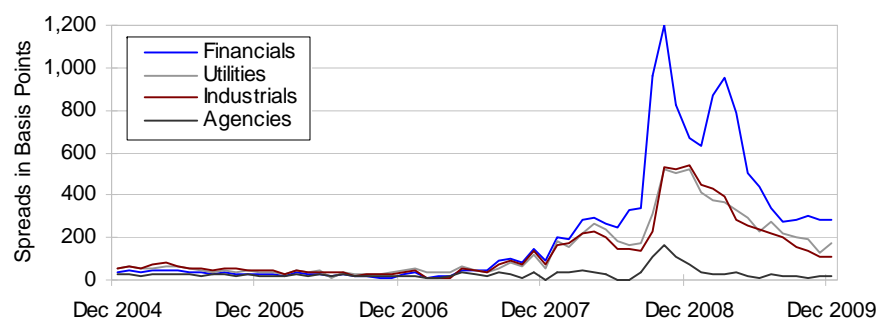
- The monetary base surged in unprecedented fashion over the last five quarters. The continued use of quantitative easing programs by the Fed resulted in more than \$1 trillion held in excess reserves in the fourth quarter of 2009. Prior to 1991, excess reserves never exceeded \$2 billion. With the exception of September 2001, when they temporarily reached \$19 billion, they 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.

Source: Bloomberg

## PORTFOLIO POSITIONING

- We intend to continue overweighting credit and structured products in the first quarter of 2010, as we did throughout 2009. This structural preference for spread product is part of the Fund's primary strategy.
- Our duration positioning is shorter than the benchmark's going into the first quarter, in view of the extraordinarily low rate environment. In lieu of adding yield from duration risk, we have preferred to add income from credit quality. We expect to keep our yield-curve positioning structurally neutral; however, we anticipate opportunities for tactical trading to capture value from occasional misalignments yields across the curve.
- Our preference for medium-quality credit will likely continue in the first quarter of 2010, because, in our opinion, these areas continue to offer several compelling opportunities to add good levels of income to the Fund. We continued to harvest value in some lower-quality assets, as we did in the third quarter, while rotating into some more defensive corporate securities, such as those in the noncyclical, energy, insurance, and utilities sectors. We will likely continue to focus on slightly more defensive names in the first quarter of 2010.
- We continued to take our corporate allocation higher in the fourth quarter to around 55% of the Fund and will likely look to continue adding corporate names that offer good levels of income at attractive valuations in the first quarter. Our structured product allocation continued to decline with pay-downs during the quarter, and we have preferred to deploy those cash flows into other opportunities, most notably into corporate notes. The Fund continues to hold around 5% in municipal bonds.

## SHORT-TERM CREDIT SPREADS TIGHTENED BUT REMAIN DISPERSED



Source: Bloomberg

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%, ABS 24%, commercial MBS 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" return 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 MBS 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.

Short-term credit markets extended their year-long rally through the fourth quarter of 2009. Spreads in the short-term markets have now virtually fully recovered from the credit crisis of 2008 and are back to levels not seen since late 2007. Yet even with the rally, short-term credit sectors still offer compelling yields when measured against overnight interest rates and U.S. Treasury bills. Additionally, despite the ongoing rally, there still remains a wide dispersion in yields across the various short-term credit sectors, offering investors varying opportunities to add higher levels of relative income.

The rally and stabilization of the short-term credit markets in 2009 provided opportunities to once again garner generous levels of income from varying short-term credit sectors. We believe that the yield of the *Wells Fargo Advantage Ultra Short-Term Income Fund* can continue to provide attractive income for investors should similar stable conditions continue. We seek to continue using our discipline of rigorous credit analysis to identify the most appropriate, income-producing investments at the right fundamental valuations.

**FUND FACTS**

Inception Date	11-25-88
Net Expense Ratio—Admin	0.55%
Assets—All Share Classes	\$763.1M

Sources: FactSet, Zephyr Analytics

**RANKINGS AND RATINGS****Morningstar Total Return Rankings—Administrator Class (as of 12-31-09)**

Morningstar Category	Ultra Short Bond
1 Year	31 out of 95 funds
3 Year	62 out of 89 funds
5 Year	51 out of 80 funds
10 Year	30 out of 47 funds

Overall Morningstar Rating™ ★★

The Overall Morningstar Rating, a weighted average of the three-, five-, and ten-year ratings, is out of 89 funds in the Ultra Short Bond category, based on risk-adjusted return as of 12-31-09.

**Benchmark Descriptions:**

**The Barclays Capital Short-Term U.S. Government/Credit Bond Index** contains securities that have fallen out of the U.S. Government/Credit Index because of the standard minimum one-year-to-maturity constraint. Securities in the Short-Term U.S. Government/Credit Bond Index must have a maturity from one up to (but not including) 12 months. 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.

**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 foreign investment risk, high-yield securities risk, and mortgage- and asset-backed securities risk. Consult the Fund's prospectus for additional information on these and other risks.

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.

Administrator Class shares inceptioned on April 11, 2005. Performance shown prior to the inception of the Administrator Class reflects the performance of the Institutional Class shares, adjusted to reflect Administrator Class expenses. Performance shown prior to August 31, 1999, for the Administrator Class shares reflects the performance of the Investor Class shares, and includes expenses that are not applicable to and are higher than those of the Administrator Class 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 Ultra Short Bond funds, the Ultra Short-Term Income Fund received two stars among 89 funds, three stars among 80 funds, and three stars among 47 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/advantagereports](http://www.wellsfargo.com/advantagereports). Read it carefully before investing.*

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

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