WELLS FARGO ADVANTAGE MULTI-SECTOR INCOME FUND
Form N-CSR
January 02, 2015
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED

MANAGEMENT INVESTMENT COMPANIES

Investment Company Act file number: 811-21331

Wells Fargo Advantage Multi-Sector Income Fund

(Exact name of registrant as specified in charter)

525 Market St., San Francisco, CA 94105

(Address of principal executive offices) (Zip code)

C. David Messman

Wells Fargo Funds Management, LLC

525 Market St., San Francisco, CA 94105

(Name and address of agent for service)

Registrant s telephone number, including area code: 800-222-8222

Date of fiscal year end: October 31

Date of reporting period: October 31, 2014

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ITEM 1. REPORT TO STOCKHOLDERS

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Wells Fargo Advantage

Multi-Sector Income Fund

Annual Report

October 31, 2014

This closed-end fund is no longer offered as an initial public offering and is only offered through broker/dealers on the secondary market. A closed-end fund is not required to buy its shares back from investors upon request.

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The views expressed and any forward-looking statements are as of October 31, 2014, unless otherwise noted, and are those of the Fund managers and/or Wells Fargo Funds Management, LLC. Discussions of individual securities, or the markets generally, or any Wells Fargo Advantage Fund are not intended as individual recommendations. Future events or results may vary significantly from those expressed in any forward-looking statements; the views expressed are subject to change at any time in response to changing circumstances in the market. Wells Fargo Funds Management, LLC and the Fund disclaim any obligation to publicly update or revise any views expressed or forward-looking statements.

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Karla M. Rabusch

President

Wells Fargo Advantage Funds

The U.S. investment-grade corporate bond, mortgage-backed securities (MBS), and high-yield bond markets delivered positive performance overall for this 12-month period.

Dear Valued Shareholder:

We are pleased to offer you this annual report for the *Wells Fargo Advantage Multi-Sector Income Fund* for the 12-month period that ended October 31, 2014. The U.S. investment-grade corporate bond, mortgage-backed securities (MBS), and high-yield bond markets delivered positive performance overall for this 12-month period.

In the fourth quarter of 2013, bond markets rallied following the tapering announcement.

As the reporting period began, investors were waiting to hear when the U.S. Federal Reserve (Fed) would begin tapering its bond purchases. This question finally was answered in December 2013 when the Fed announced that it would start reducing its bond purchases by $10 billion per month in January 2014. The news was well received by the markets, which ended 2013 on a positive note; equities performed strongly, credit spreads continued to tighten, and the dollar rallied.

Despite heightened volatility, bond markets generally delivered positive results in the first quarter of 2014.

Bond markets rallied further during the first quarter of 2014, as low growth and low inflation expectations appeared to drive yields lower and longer-term bond prices higher. Global high-yield and emerging markets debt sectors performed best. After a volatile January that saw yields and risk move higher in smaller economic regions, markets recovered in February and March, which drove some smaller bond markets to outperform the major bond markets over the entire quarter. Brazil, Italy, and Spain outperformed other countries, while Russia declined in value and South Africa and South Korea lagged the broader global markets. Currency markets were mixed; the Brazilian real appreciated, while the Russian ruble and Polish zloty depreciated. The Japanese yen appreciated during the quarter, halting its decline from previous quarters. The U.S. high-yield market rallied midquarter as investor confidence in lower-rated bonds improved following a brief period of spread-widening and U.S. Treasury rallies in mid-January

2014. High-yield bonds ultimately led U.S. fixed-income quarterly performance; investment-grade corporate bonds also delivered positive results.

Bond markets displayed strength in the second quarter of 2014 although global events caused concern.

Global high-yield and emerging markets debt sectors performed strongly during the second quarter of 2014; smaller bond markets generally outperformed the major markets. From a foreign-exchange perspective, the second quarter of 2014 was relatively quiet, with minimal movement among the world s largest currencies and volatility running close to record lows. In the U.S., Fed officials continued winding down their bond-buying program during the quarter, leaving it on pace to end in October 2014. They also revisited the question of when to begin raising short-term interest rates from near zero and released new projections showing rates rising more than previously expected in 2015 and 2016, but on a positive note they slightly reduced their projection for rates over the longer term. Bond markets took this news in stride, continuing their rally. But as the quarter progressed, concern over geopolitical events and a perceived weaker global market overall seemed to overpower investor optimism. Consequently, U.S. Treasuries rallied as investors sought safety, pulling investment-grade bond valuations higher, which resulted in a lower-rate

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environment than previously anticipated for mid-2014. Across the sectors within the Barclays U.S. Aggregate Bond Index[1], corporate bonds outperformed the securitized sectors within the index, although MBS performed well while commercial mortgage-backed securities and asset-backed securities delivered positive returns. The U.S. high-yield bond market delivered strong quarterly results. Longer-duration high-yield bonds performed best. BB-rated bonds performed well because a number of higher-quality names in the BB-rated tier tend to have longer durations. However, BBB-rated bonds outperformed all other high-yield tiers.

Non-Treasury bonds were challenged in the third quarter of 2014 as Treasuries rallied.

The Fed maintained its tapering schedule throughout the third quarter. Although the Fed retained its view that interest rates will remain low for a considerable time, Fed Chair Janet Yellen made it clear that monetary policy is data dependent. The U.S. stock market experienced bouts of volatility during the quarter as investors reacted to interest-rate concerns at home and increased tensions abroad. Ultimately, U.S. stocks ended the third quarter up slightly, buoyed by positive economic data. In contrast to the U.S., many international economies continued to struggle. Globally, low interest rates largely due to accommodative monetary policies around the world and investors desire for less-risky investments led longer-duration bonds to continue their outperformance. The summer months brought a limited supply of new issues across most fixed-income asset classes, and geopolitical events kept concerned investors steadily focusing on fixed-income markets. U.S. Treasuries rallied as investors sought safety.

In the high-yield market, a months-long rally began weakening toward the end of June, likely driven by concern expressed by Fed Chair Janet Yellen that the leveraged financial markets might be overheating. Shortly after her comments, high-yield bond mutual funds experienced outflows for the first time in more than nine months; by the end of the third quarter, they had suffered nearly $20 billion in net outflows. The high-yield market as measured by the Barclays U.S. Corporate High Yield Index[2], had its worst quarterly performance (-1.87%) in three years and second-worst performance since the height of the financial crisis in the fourth quarter of 2008.

Bond markets showed renewed strength as October 2014 progressed.

The volatility in non-Treasury bond markets carried into October. A sharp shift away from riskier assets was driven, in our view, by a variety of investor concerns, such as slowing global growth particularly in Europe, disinflationary pressures resulting from falling oil prices, the end of the Fed s bond-purchase program in October 2014, and the spread of the Ebola virus. However, on the last day of October, the Bank of Japan unexpectedly announced an extension of its qualitative and quantitative easing programs. Investors responded positively to the news, which pushed bond markets into positive territory for the month.

1. The Barclays U.S. Aggregate Bond Index is a broad-based benchmark that measures the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM passthroughs), ABS, and CMBS. You cannot invest directly in an index.

2. The Barclays U.S. Corporate High Yield Index is an unmanaged, U.S. dollar-denominated, nonconvertible, non-investment-grade debt index. The index consists of domestic and corporate bonds rated Ba and below with a minimum outstanding amount of $150 million. You cannot invest directly in an index.

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Periods of uncertainty can present challenges, but experience has taught us that maintaining long-term investment goals can be an effective way to plan for the future.

Don t let short-term uncertainty derail long-term investment goals.

Periods of uncertainty can present challenges, but experience has taught us that maintaining long-term investment goals can be an effective way to plan for the future. Although diversification cannot guarantee an investment profit or prevent losses, we believe it can be an effective way to manage investment risk and potentially smooth out overall portfolio performance. We encourage investors to know their investments and to understand that appropriate levels of risk-taking may unlock opportunities.

Thank you for choosing to invest with *Wells Fargo Advantage Funds*. We appreciate your confidence in us and remain committed to helping you meet your financial needs. For current information about your fund investments, contact your investment professional, visit our website at **wellsfargoadvantagefunds.com**, or call us directly at **1-800-222-8222**. We are available 24 hours a day, 7 days a week.

Sincerely,

Karla M. Rabusch

President

Wells Fargo Advantage Funds

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Investment objective

The Fund seeks a high level of current income consistent with limiting its overall exposure to domestic interest-rate risk.

Adviser

Wells Fargo Funds Management, LLC

Subadvisers

First International Advisors, LLC

Wells Capital Management Incorporated

Portfolio managers

Michael Bray, CFA

Christopher Y. Kauffman, CFA

Michael Lee

Niklas Nordenfelt, CFA

Anthony Norris

Alex Perrin

Janet S. Rilling, CFA, CPA

Phillip Susser

Christopher Wightman

Peter Wilson

Average annual total returns[1] (%) as of October 31, 2014

	1 Year	5 Year	10 Year
Based on market value	6.55	9.15	7.05
Based on net asset value (NAV) per share	6.67	9.09	7.46

Figures quoted represent past performance, which is no guarantee of future results, and do not reflect taxes that a shareholder may pay on fund distributions or the sales of fund shares. *Investment return and principal value of an investment will fluctuate so that an investor s shares, when sold, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted, which assumes the reinvestment of dividends and capital gains. Performance figures of the Fund do not reflect brokerage commissions that a shareholder would pay on the purchase and sale of shares. If taxes and such brokerage commissions had been reflected, performance would have been lower. To obtain performance information current to the most recent month-end, please call 1-800-222-8222.*

The Fund s expense ratio for the year ended October 31, 2014 was 1.21%, which includes 0.07% of interest expense.

Comparison of NAV vs. market value[2]

The Fund is leveraged through a secured debt borrowing facility and also may incur leverage by issuing preferred shares in the future. The use of leverage results in certain risks including, among others, the likelihood of greater volatility of net asset value and the market value of common shares. Foreign investments are especially volatile and can rise or fall dramatically due to differences in the political and economic conditions of the host country. These risks are generally intensified in emerging markets. Derivatives involve additional risks including interest rate risk, credit risk, the risk of improper valuation, and the risk of non-correlation to the relevant instruments that they are designed to hedge or to closely track. Bond values fluctuate in response to the financial condition of individual issuers, general market and economic conditions, and changes in interest rates. Changes in market conditions and government policies may lead to periods of heightened volatility in the bond market and reduced liquidity for certain bonds held by the Fund. In general, when interest rates rise, bond values fall and investors may lose principal value. Interest rate changes and their impact on the Fund and its share price can be sudden and unpredictable. High-yield securities have a greater risk of default and tend to be more volatile than higher-rated debt securities. This Fund is exposed to mortgage- and asset-backed securities risk.

1. Total returns based on market value are calculated assuming a purchase of common stock on the first day and sale on the last day of the period reported. Total returns based on NAV are calculated based on the NAV at the beginning of the period and end of the period. Dividends and distributions, if any, are assumed for the purposes of these calculations to be reinvested at prices obtained under the Fund s Automatic Dividend Reinvestment Plan.

2. This chart does not reflect any brokerage commissions charged on the purchase and sale of the Fund s common stock. Dividends and distributions paid by the Fund have the effect of reducing the Fund s NAV.

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MANAGERS DISCUSSION

The Fund s return based on market value was 6.55% during the 12 months that ended October 31, 2014. During the same period, the Fund s return based on net asset value was 6.67%.

Overview

The Fund contains the following sleeves: mortgage/corporate bonds, high-yield bonds, and international/emerging markets bonds.

U.S. investment-grade corporate bonds and structured products outperformed U.S. Treasuries during the one-year period that ended October 31, 2014. The mortgage/corporate sleeve of the Fund continued to invest in commercial mortgage-backed securities (CMBS), non-agency residential mortgage-backed securities (RMBS), and corporate bonds. The lower-rated segments of these sectors tended to aid performance the most during the period.

High-yield bond performance was aided by rising stock prices, increasing prices for long-term U.S. Treasuries, and relatively low volatility during the reporting period. However, these positive effects were partially offset by a decline in commodity prices and higher yields for intermediate-term Treasuries. The rise in Treasuries interest rates that began in the summer of 2013 has subsided, and since the end of 2013, interest rates for long-term Treasuries have consistently declined with a few small pullbacks. We believe the resulting environment provided a strong backdrop for long-duration high-yield bonds in particular.

Within the international/emerging markets sleeve, emerging markets bonds and currency markets diverged from one another in terms of their respective performance over the reporting period; gains in emerging markets bonds contrasted with losses in currency markets versus the U.S. dollar. We found it striking that such a large portion of overall emerging markets currency losses during the period was due to results in just two months: January 2014 and September 2014. Emerging markets bonds were well supported by below-trend growth; moderating inflation aided by lower commodity prices and continued investor interest also played roles. In Russia, we reduced the Fund s allocation to both bonds and currency in March 2014 due to the escalating tension between Russia and Ukraine. We increased the Fund s exposure to the U.S. dollar at the expense of Eastern European currencies and maintained significant exposure to Asian currencies.

Ten largest holdings[3] (%) as of October 31, 2014	
Brazil,10.00%,1-1-2017	2.60
Poland, 3.25%,7-25-2025	2.33
Texas Competitive Electric Holdings LLC, 4.65%, 10-10-2015	2.15
Sprint Capital Corporation, 6.88%, 11-15-2028	1.96
Republic of South Africa, 8.00%, 12-21-2018	1.40
Columbia, 7.00%, 5-4-2022	1.38
Thailand, 3.25%, 6-16-2017	1.28
Dell Incorporated, 4.50%, 4-29-2020	1.24
Turkey, 8.20%, 7-13-2016	1.19
Greektown Holdings LLC, 8.88%, 3-15-2019	1.10

Positive contributors to performance

The mortgage/corporate credit sleeve s focus on A-rated and BBB-rated credits added value because lower-rated credits outperformed higher-rated credits during the period. The Fund s holdings in corporate bonds, CMBS, and RMBS broadly added value, as credit spreads tightened over the first three quarters of the period in addition to providing a yield advantage over similarly maturing Treasuries.

The performance of the high-yield market during the reporting period generally was positive, with the

exception of five sectors in which the Fund overall had relatively low exposure. Three of these sectors were commodity-related, one was gaming-related, and one was consumer products-related. An emphasis on longer-duration bonds which outperformed shorter-duration bonds also contributed to performance. In addition, exposure to pipeline companies helped relative performance.

Within the international/emerging markets sleeve, the Fund benefited most from country allocation. Exposures to the bond markets of Brazil, Poland, and South Africa were especially beneficial, as were minimal exposures to the bond markets of Malaysia and Thailand. In currency, reduced exposure to the Russian ruble and Turkish lira were key contributors to Fund performance. In addition, positions in U.S. dollar-denominated high-yield emerging markets bonds added modestly to overall results.

Detractors from performance

Certain RMBS and CMBS holdings within the Fund s mortgage/corporate bond sleeve detracted from performance during the period due to security-specific prepayment and ratings changes. The Fund also was negatively affected by its exposure to the energy sector.

Please see footnotes on page 9.

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Within the Fund s high-yield bond sleeve, performance was negatively affected by exposure to electric utilities in particular, to Energy Future Intermediate Holding Company LLC. (The position in this company was held for part of the period and then no longer held.)

In terms of the international/emerging markets sleeve, the Fund s positioning in Russian bonds hindered performance, partly due to the negative effect of the ongoing Ukraine conflict and the imposition of sanctions and partly due to minimal exposure to Russia during a temporary rally in the second quarter of 2014. In currency, exposure to the Chilean peso held back results, as did underexposure to the Indonesian rupee in the first quarter of 2014.

Credit quality[4] as of October 31, 2014

Management outlook

In terms of the Fund s U.S. mortgages and investment-grade corporate bond sleeve, we believe that stable interest rate policy for the rest of 2014 and for 2015 should continue to preserve a comfortable environment for yield carry. The effect of the Federal Reserve s tapering and end of its bond-purchase program appears to be fully priced into the market and has not negatively affected spreads in either of these sectors. We continue to focus on the medium-quality credit tiers of A-rated and BBB-rated securities as compelling sources of yield. As of

October 31, 2014, approximately 55% of the mortgage/corporate sleeve was invested in corporate bonds, and roughly 44% was invested in fixed-rate and floating-rate mortgage securities. Credit exposure remained centered on industrials and financials, particularly banks.

We feel that accommodative central bank monetary policies will be a key to high-yield bond performance over the coming year. High-yield bonds and most other asset classes have been underpinned by low rates and quantitative easing, which have pushed investors into higher-yielding assets. Should interest rates rise meaningfully over the coming year, we would not be surprised to see a sell-off in the high-yield market. However, if an increase in interest rates coincides with a strong economy, we believe high-yield bonds could continue to outperform other fixed-income assets. Alternatively, should rising interest rates trigger a slowdown in the economy, we are unsure which (if any) assets would perform well, and we would not be surprised by a sharper drop in the high-yield bond market. In the near term, our default outlook remains benign and supportive of high yield. Over a full cycle, we believe the best way to protect the Fund s high-yield sleeve from periodic bouts of systemic fears and volatility will be our continued focus on a bottom-up approach that attempts to minimize downside risk while capturing the return potential of high-yield issuers.

Within the international/emerging markets sleeve, we continue to favor economies displaying sustainable growth, lower deficits, and central banks that have the ability to maneuver freely rather than developed, lower-yielding economies that have structural problems. We believe the low yields and poor debt dynamics of the older industrial economies make those markets a poor value. We anticipate maintaining this bias for the remainder of 2014 and into 2015. Specific bond markets we favor include Australia, Brazil, Italy, Korea, Malaysia, Mexico, Norway, Poland, Spain, Sweden, South Africa, and Thailand.

Please see footnotes on page 9.

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Effective maturity distribution[5] as of October 31, 2014

Country allocation[5] as of October 31, 2014

3. The ten largest holdings are calculated based on the value of the securities divided by total net assets of the Fund. Holdings are subject to change and may have changed since the date specified.

4. The credit quality of portfolio holdings reflected in the chart is based on ratings from Standard & Poor s, Moody s Investors Service, and/or Fitch Ratings Ltd. Credit quality ratings apply to the underlying holdings of the Fund and not to the Fund itself. The percentages of the Fund s portfolio with the ratings depicted in the chart are calculated based on the total market value of fixed income securities held by the Fund. If a security was rated by all three rating agencies, the middle rating was utilized. If rated by two of three rating agencies, the lower rating was utilized, and if rated by one of the rating agencies, that rating was utilized. Standard & Poor s rates the creditworthiness of bonds on a scale of AAA (highest) to D (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. Standard & Poor s rates the creditworthiness of short-term notes on a scale SP-1 (highest) to SP-3 (lowest). Moody s rates the creditworthiness of bond on a scale of Aaa (highest) to C (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). Fitch rates the creditworthiness of bonds, ranging from AAA (highest) to D (lowest). Credit quality, and credit quality ratings, are subject to change.

5. Percentages are subject to change and are calculated based on the total long-term investments of the Fund.

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The Summary Portfolio of Investments shows the 50 largest portfolio holdings in unaffiliated issuers and any holdings exceeding 1% of the total net assets as of the report date. The remaining securities held are grouped as Other securities in each category. You can request a complete schedule of portfolio holdings as of the report date, free of charge, by accessing the following website:

http://a584.g.akamai.net/f/584/1326/1d/www.wellsfargoadvantagefunds.com/pdf/ann/holdings/multisectorincome.pdf or by calling *Wells Fargo Advantage Funds* at **1-800-222-8222**. This complete schedule, filed on the Form N-CSR, is also available on the SEC s website at sec.gov.

Security name	Interest rate	Maturity date	Principal	Value	Percent of net assets
Agency Securities: 2.33%					
FHLMC	0.55-8.50%	4-25-2020 to 7-25-2048	$ 20,817,355	$ 13,808,784	2.04%
Other securities				1,996,398	0.29
Total Agency Securities (Cost $14,785,998)				15,805,182	2.33
Asset-Backed Securities: 0.10%					
Other securities				680,814	0.10
Total Asset-Backed Securities (Cost $654,811)				680,814	0.10
Common Stocks: 0.17%					
Materials: 0.00%					
Chemicals: 0.00%					

Other securities				825	0.00
Telecommunication Services: 0.17%					
Diversified Telecommunication Services: 0.17%					
Other securities				1,169,337	0.17
Total Common Stocks (Cost $1,618,617)				1,170,162	0.17
Corporate Bonds and Notes: 67.03%					
Consumer Discretionary: 10.75%					
Auto Components: 1.07%					
Allison Transmission Incorporated 144A	7.13	5-15-2019	3,790,000	3,984,238	0.59
Other securities				3,257,385	0.48
				7,241,623	1.07
Distributors: 0.12%					
Other securities				773,120	0.12
Diversified Consumer Services: 0.98%					
Other securities				6,654,763	0.98
Hotels, Restaurants & Leisure: 2.75%					
CCM Merger Incorporated 144A	9.13	5-1-2019	6,270,000	6,740,250	1.00
Greektown Holdings LLC 144A	8.88	3-15-2019	7,425,000	7,462,125	1.10
Other securities				4,445,081	0.65
				18,647,456	2.75
Household Durables: 0.22%					
Other securities				1,509,613	0.22

Internet & Catalog Retail: 0.18%		
Other securities	1,221,667	0.18

The accompanying notes are an integral part of these financial statements.

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Security name	Interest rate	Maturity date	Principal	Value	Percent of net assets
Media: 4.29%					
Gray Television Incorporated	7.50%	10-1-2020	$ 6,040,000	$ 6,319,350	0.93%
Other securities				22,720,866	3.36
				29,040,216	4.29
Multiline Retail: 0.09%					
Other securities					