Market Comment *Economic Highlights for the week ended January 29, 2010*

Economic Week In Review: Recovery Gathers Momentum

Vanguard 1/29 - While the economy has wobbled and sputtered during its long recovery, progress was noticeable if not notable this week. Although the Federal Open Market Committee (FOMC) kept the federal funds rate at historically low levels, its message was a bit more optimistic than in past months. GDP (gross domestic product), durable-goods orders, consumer confidence, and employer costs all were up. Existing-home and new-home sales were down, after the original deadline to receive the first-time homebuyer tax credit passed. For the week, the S&P 500 fell 1.6% to 1,074 (for a year-to-date total return of about –3.6%). The yield of the 10-year U.S. Treasury note rose 1 basis point to 3.63% (for a year-to-date loss of 22 basis points).

FOMC Repeats Message––With A Twist

Vanguard 1/29 - The FOMC said on Wednesday that it would keep the target range for the federal funds rate at 0% to 0.25% for "an extended period." The fed funds rate—the interest rate banks charge one another for lending and the benchmark for the market's short-term rates—has remained unchanged since mid-December 2008. However, one committee member dissented from the Fed's decision to use the "extended period" language once again, noting that conditions have improved since the phrase was first used in June. Additionally, in an effort to wean the financial markets from its support, the Fed said it plans to grind to a halt its purchase of agency mortgage-backed securities and debt by first quarter's end. The Fed also stated that "the pace of economic recovery is likely to be moderate for a time," and that inflation should remain "subdued for some time." Separately, on Thursday, Fed Chairman Ben Bernanke was confirmed by the Senate for a second four-year term.

FOMC Statement 1/27 (excerpts) –

- Information received since the Federal Open Market Committee met in December suggests that economic activity has continued to strengthen and that the deterioration in the labor market is abating. Household spending is expanding at a moderate rate but remains constrained by a weak labor market, modest income growth, lower housing wealth, and tight credit.
- Business spending on equipment and software appears to be picking up, but investment in structures is still contracting and employers remain reluctant to add to payrolls.
- The Committee will maintain the target range for the federal funds rate at 0 to 1/4% and continues to anticipate 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.
- To provide support to mortgage lending and housing markets and to improve overall conditions in private credit markets, the Federal Reserve is in the process of purchasing $1.25 ***trillion*** of agency mortgage-backed securities and about $175 billion of agency debt. In order to promote a smooth transition in markets, the Committee is gradually slowing the pace of these purchases, and it anticipates that these transactions will be executed by the end of the first quarter. The Committee will continue to evaluate its purchases of securities in light of the evolving economic outlook and conditions in financial markets.
- Voting against the policy action was Thomas M. Hoenig, who believed that economic and financial conditions had changed sufficiently that the expectation of exceptionally low levels of the federal funds rate for an extended period was no longer warranted.

GDP Makes Impressive Jump – 4Q2009 Advance Estimate

Vanguard 1/29 - GDP—the broadest measure of the country's economic activity—climbed at a 5.7% annual rate in the fourth quarter, the largest gain since 2003. Additionally, GDP eked out a 0.1% gain compared with the fourth quarter of 2008, the first year-over-year rise since the third quarter of 2008. Positive change in inventories accounted for nearly 60% of the growth; inventories made their biggest contribution to GDP in 25 years. "The strong rebound in GDP was expected from the anticipated swing in business inventories and the residual impact of the fiscal stimulus," Vanguard economist Roger Aliaga-Diaz explained. "Unfortunately, those two alone are not enough for a self-sustaining recovery. At the end of this inventory cycle, fading fiscal support in combination with a weak consumer outlook make it likely that we're looking at a slow and subdued GDP growth rate for 2010."

Press Release 1/29 - GROSS DOMESTIC PRODUCT: FOURTH QUARTER 2009 (ADVANCE ESTIMATE)

Real gross domestic product -- the output of goods and services produced by labor and property located in the United States -- increased at an annual rate of 5.7% in the fourth quarter of 2009, (that is, from the third quarter to the fourth quarter), according to the "advance" estimate released by the Bureau of Economic Analysis. In the third quarter, real GDP increased 2.2%.

The acceleration in real GDP in the fourth quarter primarily reflected an acceleration in private inventory investment, a deceleration in imports, and an upturn in nonresidential fixed investment that were partly offset by decelerations in federal government spending and in PCE.

The price index for gross domestic purchases, which measures prices paid by U.S. residents, increased 2.1% in the fourth quarter, compared with an increase of 1.3% in the third. Excluding food and energy prices, the price index for gross domestic purchases increased 1.2% in the fourth quarter, compared with an increase of 0.3% in the third. Real GDP decreased 2.4% in 2009, in contrast to an increase of 0.4% in 2008.

U.S. Durable Goods: Orders Rise Below Expectations - December

Vanguard 1/29 - Orders for manufactured durable goods in December increased a less-than-expected 0.3%, mostly because of a 2% drop in transportation orders. However, it was the first rise since September, and excluding the transportation sector, orders advanced a somewhat brisker 0.9%. The gains were attributed mostly to orders for machinery and metals.

In addition, shipments of durable goods rose 2.9%, unfilled orders dropped for the 15th straight month, and inventories fell for the 12th month in a row.

Reuters 1/28 - New orders for long-lasting U.S. manufactured goods increased less than expected in December, restrained by an unexpected drop in civilian aircraft bookings.

Analysts polled by Reuters forecast orders rising 2% last month on the basis of 59 aircraft orders received by Boeing (BA.N), up from only nine in November. The report showed non-defense aircraft and parts orders tumbled 38.2% last month after a 40.0% drop the month before. Defense aircraft orders rose 14.7% after a 10.4% fall in November. Orders for the whole of 2009 fell a record 20.2%, the department said.

Durable goods orders are a leading indicator of manufacturing activity, which in turn provides a good measure for overall business health.

Employer Costs Slowly Rise Again

Vanguard 1/29 - The employer cost index—which measures employer costs for wages, salaries, and benefits—increased 0.5% in the fourth quarter. The figure exceeded economists' expectations, but was still low by historical standards. Compensation and benefits both increased 0.5%. While there has been improvement, compensation isn't expected to grow more until the labor market improves. Companies continue to focus on labor costs as they struggle to balance their budgets.

Existing-Home, New-Home Sales Decline

Vanguard 1/29 - The approaching end of the first-time homebuyer tax credit led to December declines of 16.7% in existing-home sales and 7.6% in new-home sales; the original November 30 deadline to receive the tax credit had resulted in an influx of sales in the fall, but the pace weakened as the deadline drew closer. Although Congress expanded the tax credit and extended it until April, demand in December was weak in both categories. It was a larger retreat than economists predicted. New-home sales were also lower than expected. Months of inventory for existing- and new-home sales increased because of the sales decline.

December Existing-Home Sales Down but Prices Rise; 2009 Sales Up

Press Release 1/25 (excerpts) - After a rising surge from September through November, existing-home sales fell as expected in December after first-time buyers rushed to complete sales before the original November deadline for the tax credit. However, prices rose from December 2008 and annual sales improved in 2009, according to the National Association of Realtors®.

Existing-home sales – including single-family, townhomes, condominiums and co-ops – fell 16.7% to a seasonally adjusted annual rate of 5.45 million units in December from 6.54 million in November, but remain 15.0% above the 4.74 million-unit level in December 2008.

For all of 2009 there were 5,156,000 existing-home sales, which was 4.9% higher than the 4,913,000 transactions recorded in 2008; it was the first annual sales gain since 2005.

The national median existing-home price for all housing types was $178,300 in December, which is 1.5% higher than December 2008. "The median price rose because of an increased number of mid- to upper-priced homes in the sales mix," Yun said. It was the first year-over-year gain in median price since August 2007.

Total housing inventory at the end of December fell 6.6% to 3.29 million existing homes available for sale, which represents a 7.2-month supply at the current sales pace, up from a 6.5-month supply in November. Raw unsold inventory is 11.1% below a year ago, is at the lowest level since March 2006, and is 28.2% below the record of 4.58 million in July 2008.

Distressed homes, which accounted for 32% of sales last month, continue to downwardly distort the median price. For all of 2009, the median price was $173,500, down 12.4% from $198,100 in 2008; distressed homes accounted for 36% of total sales last year.

According to Freddie Mac, the national average commitment rate for a 30-year, conventional, fixed-rate mortgage rose to 4.93% in December from 4.88% in November; the rate was 5.29% in December 2008.

New Home Sales – December 2009

Press Release 1/27 (excerpts) - Sales of new one-family houses in December 2009 were at a seasonally adjusted annual rate of 342,000, according to estimates released jointly today by the U.S. Census Bureau and the Department of Housing and Urban Development.

This is 7.6% (±14.6%) below the revised November rate of 370,000 and is 8.6% (±15.2%) below the December 2008 estimate of 374,000.

The median sales price of new houses sold in December 2009 was $221,300; the average sales price was $290,600. The seasonally adjusted estimate of new houses for sale at the end of December was 231,000. This represents a supply of 8.1 months at the current sales rate.

An estimated 374,000 new homes were sold in 2009, the lowest level since records began in 1963 (Bloomberg). This is 22.9% (±2.9%) below the 2008 figure of 485,000.

S&P/Case-Shiller Price Index

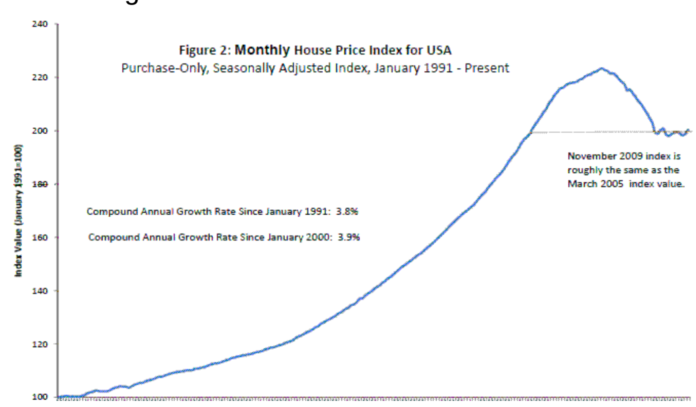
NAR 1/26 - The S&P Case-Shiller home price index for 20 metropolitan areas declined a non-seasonally adjusted 5.3% compared to a year ago, to 146.28, and up 0.2% from the previous month. This was in line with economists' expectations. On a seasonally adjusted basis, the index continued an upward trend of 0.2% from the prior month, after a 0.3% rise in October.

Also, the home price index for 10 metropolitan areas declined a non-seasonally adjusted 4.5% since a year ago, and similarly 0.2% from the previous month. On an adjusted basis, 10-city index was unchanged from the previous month.

It is important to keep in mind that the S&P/Case-Shiller Price Index is a 3-month rolling average of prices between September and November and published with a two month lag.

FHFA House Price Index – November 2009

NAR 1/26 - In today's release of the Federal Housing Finance Agency's monthly House Price Index, U.S. house prices rose 0.7% on a seasonally adjusted basis from October to November. On a year over year basis, November's figure shows U.S. house prices rose 0.5%. The U.S. index is currently 10.3% below its April 2007 peak. (graph at right is FHFA index)



The FHFA monthly index is calculated using purchase prices of houses backing mortgages that have been sold to or guaranteed by Fannie Mae or Freddie Mac.

Consumer Confidence Improves Slightly - January

Vanguard 1/29 - Consumer confidence rose for the third straight month, though the Conference Board index reading of 55.9 remains low by historical standards. The index is at its highest level since September 2008, a key inflection point in the financial crisis. Most of the gain came from the present situation measure, which increased 4.8 points in January. The expectations measure increased 0.6 points. Consumers' view of the labor market and their purchasing plans both continued to recover a bit.

Press Release 1/29 (excerpts) - Consumer confidence rose in January to its highest level in two years due to a more favorable outlook for the national economy. Despite the expected gains in the economy, consumers still anticipate no improvement in their overall personal financial situation. In past economic cycles, consumers typically expected gains in their own finances to be as rapid as gains in the overall economy.

Consumers are overwhelmingly convinced that the worst is over but nonetheless expect stagnating income and job prospects rather than solid growth during the year ahead. Moreover, consumers feel quite vulnerable given the still fragile condition of their investments and reserve funds, the burden of their debts, especially those underwater on their mortgages, the negative impact of foreclosures and bankruptcies on their communities, and the impact of continued credit constraints that limit their flexibility. Although recent gains have extended to buying plans, it is still true that job and income uncertainty dominates purchase plans to a significant extent.

Unemployment Insurance Weekly Claims Report (Initial Jobless Claims) – week of Jan. 23

Press Release 1/28 – In the week ending Jan. 23, the advance figure for seasonally adjusted initial claims was 470,000, a decrease of 8,000 from the previous week's revised figure of 478,000. The 4-week moving average was 456,250, an increase of 9,500 from the previous week's revised average of 446,750.

The advance seasonally adjusted insured unemployment rate was 3.5% for the week ending Jan. 16, a decrease of 0.1 percentage point from the prior week's revised rate of 3.6%.

WEEK ENDING	Advance Jan. 23	Jan. 16	Change	Jan. 9	Prior Year
Initial Claims (SA)	470,000	478,000 rev.	-8,000	444,000	590,000
4-Wk Moving Average (SA)	456,250	446,750	+9,500	440,750	547,000

The advance number for seasonally adjusted insured unemployment during the week ending Jan. 16 was 4,602,000, a decrease of 57,000 from the preceding week's revised level of 4,659,000. The 4-week moving average was 4,669,250, a decrease of 94,250 from the preceding week's revised average of 4,763,500.

The fiscal year-to-date average for seasonally adjusted insured unemployment for all programs is 5.404 million.

Briefing.com 1/28 - The consensus projected a much more substantial drop of 28,000 claims. Last week, the Department of Labor (DOL) announced that the increase in claims from 444,000 to 478,000 was not due to economic conditions, but from administrative backlogs in the processing of applications. The DOL has not announced if the backlogs continued into this week's data.

INFLATION: Overblown Fears?

BofA 1/27 - On page C1 of today's Wall Street Journal ("For Inflation Tips Look to 5yr5yr Breakeven") it is noted that 5-year 5-year inflation rates are moving higher of late and notes that implied inflation rates are similar to levels seen in 2003. Oddly, despite the concern, it is interesting to note that the levels cited – around 3% –are, in fact, the long run average (1985 to 2009) of total inflation. In short, they are expecting the average inflationary environment that has existed since Volcker and the Fed broke the back of inflation following the stagflation of the 1970s. Why is this cause for concern?

Format For Future Fed Interest Rate Increases

BofA 1/26 - Previously, we had anticipated that the first Fed rate hike would result in the current 0.00-0.25% Fed funds target range being eliminated in favor of a traditional point target of 0.25%. However, we now anticipate that the Fed's communications will shift from a focus on the Fed funds target to the interest rate paid on reserves (IOR). As a result, we would look for the Fed to announce rate increases in the Fed funds target rate as a range rather than a point estimate, while maintaining the IOR rate at the upper end of the Fed funds target range. As an example, although we continue to look for the first Fed rate hike in March of 2011, we look for the increase to be to 0.25-0.50%, rather than simply 0.25% (the IOR rate would be 0.50%).

Bank of America Merrill Lynch 26 January 2010 **Interest rate outlook summary**

Interest Rate Committee Forecast

Table 2: Still on hold until 2011

(% EOP)	Q409	Q110	Q210	Q310	Q410	Q111	Q211	Q311	Q411	2009	2010	2011
Fed Funds	0.125	0.00-0.25	0.00-0.25	0.00-0.25	0.00-0.25	0.25-0.50	0.50-0.75	0.50-0.75	0.75-1.00	0.125	0.00-0.25	0.75-1.00
3-Month T-Bill	0.05	0.20	0.20	0.20	0.50	0.75	1.05	1.30	1.45	0.050	0.50	1.45
3-Month LIBOR	0.25	0.35	0.35	0.35	0.65	0.90	1.20	1.45	1.60	0.250	0.65	1.60
2-Year T-Note	1.14	1.00	1.20	1.30	1.50	1.65	1.75	1.90	2.00	1.140	1.50	2.00
5-Year T-Note	2.68	2.60	2.90	3.00	3.10	3.20	3.30	3.35	3.40	2.680	3.10	3.40
10-Year T-Note	3.84	3.60	4.00	4.10	4.25	4.30	4.40	4.45	4.45	3.840	4.25	4.45
30-Year T-Bond	4.64	4.45	4.75	4.90	4.95	4.95	5.00	5.00	5.00	4.640	4.95	5.00

Source: Bloomberg, BofA Merrill Lynch Global Research

The Economic Week Ahead: February 1 – February 5

Vanguard 1/29 - Monday's reports on personal income, construction spending, and manufacturing activity usher in an eventful week on the economic calendar. The ISM nonmanufacturing report is set for Wednesday, productivity and costs and factory orders on Thursday, and the employment situation and consumer credit on Friday.

U.S. Economic Calendar

Date	ET	Release	For	Actual	Consensus	Prior
Feb 01	08:30	Personal Income	Dec	0.4%	0.3%	0.5%
Feb 01	08:30	Personal Spending	Dec	0.2%	0.3%	0.7%
Feb 01	10:00	Construction Spending	Dec	-1.2%	-0.5%	-1.2%
Feb 01	10:00	ISM Index	Jan	58.4	55.5	54.9
Feb 02	10:00	Pending Home Sales	Dec		1.1%	-16.0%
Feb 03	08:15	ADP Employment Change	Jan		-40K	-84K
Feb 03	10:00	ISM Services	Jan		50.9	50.1
Feb 04	08:30	Initial Claims	01/30		454K	470K
Feb 04	08:30	Continuing Claims	01/30		4600K	4602K
Feb 04	08:30	Productivity-Preliminary	Q4		6.0%	8.1%
Feb 04	08:30	Unit Labor Costs - Preliminary	Q4		-2.5%	-2.5%
Feb 04	10:00	Factory Orders	Dec		0.6%	1.1%
Feb 05	08:30	Nonfarm Payrolls	Jan		13K	-85K
Feb 05	08:30	Unemployment Rate	Jan		10.0%	10.0%
Feb 05	15:00	Consumer Credit	Dec		-$9.5B	-$17.5B

Source: Briefing.com