Market Comment *Economic Highlights for the week ended February 3, 2012*

Economic Week In Review: Surprisingly Good News On Employment

Vanguard 2/3 - The first major employment report for the year suggested that businesses may be willing to hire at greater levels than expected. While the unemployment rate remains historically high and risks abound, there are more signs that the economic recovery is strengthening. Manufacturing activity continues to grow, construction spending is improving, and consumers' expectations for the near term are somewhat positive. For the week ended February 3, the S&P 500 Index rose 2.2% to 1,345 (for a year-to-date total return of about +7.1%). The yield on the 10-year U.S. Treasury note rose 4 basis points to 1.97% (for a year-to-date increase of 8 basis points).

Employment Situation – January (Non-Farm Payrolls): Job Growth Better Than Expected

Vanguard 2/3 - The U.S. economy added 243,000 jobs in January, the most since April 2010, thanks largely to an increase in hiring by the private sector. The U.S. jobless rate, which is based on a separate household survey, fell to 8.3%, its lowest level since February 2009. The job gains were widespread, coming from a variety of sectors including professional and business services (+70,000), manufacturing (+50,000), and leisure and hospitality (+44,000). Government employment remained an area of weakness; public payrolls shrank by 14,000 in January.

Econoday 2/3 – The January jobs report posted stronger than expected with payroll gains and unemployment dip. Payroll jobs in January advanced 243,000 after jumping 203,000 in December (originally 200,000) and rising 157,000 in November (prior estimate up 100,000). The net revisions for November and December were up 60,000. Today's report includes annual revisions to payroll series, including benchmark revisions to payroll levels and new seasonal factors. Household data received annual revisions last month but reflect updated population estimates in January data.

As for some time, private payrolls outstripped the total, increasing 257,000 in January, following a gain of 220,000 in December. Expectations were for a 150,000 rise in private payrolls. Private-sector employment was led by gains in professional and business services (+70,000), leisure and hospitality (+44,000), and manufacturing. The public sector continued to shrink as government employment slipped 14,000, following a 7,000 decline in December.

Average hourly earnings rose 0.2% in January, following a 0.1% increase the prior month. The average workweek for all workers in January held steady at 34.5 hours.

From the household survey, the unemployment rate dropped to 8.3% from 8.5% in December. The market median forecast was for an 8.5% unemployment rate. Despite worries about adverse seasonal adjustment issues, the January employment report indicates that the recovery is gaining momentum.

Barclays 2/3 - …construction (+21,000) … was likely boosted by warm weather.

The household survey also took a strong tone, as the unemployment rate fell 0.2pp, to 8.3%, driven by an estimated 847k increase in employment. This substantial rise in employment is slightly distorted, however, because of the annual update to the population estimates; however, controlling for the population effect, household survey employment still increased 631k. The adjustments were not behind the fall in the unemployment rate, which was driven by employment gains. The population adjustments resulted in a decline in the labor force participation of 0.3pp, as the number of persons over 55 years of age and, to a lesser degree, those 16-24 years of age - individuals that typically participate less in the labor force than prime-aged workers (ie, those 25-54) - was increased. Without the population adjustments, the labor force participation rate would have remained unchanged. We expect, however, that demographic forces will continue to exert a downward trend on the labor force participation rate, although this is likely to be offset in the near term by some cyclical increase in re-entrants.

Overall, we view this as a strong report and indicative of a labor market that continues to gain momentum, although we note that January is a notoriously volatile month that is subject to relatively large seasonal adjustments. Still, the three-month average gain in payrolls is now 201k, and we view that as an accurate reflection of labor market conditions.

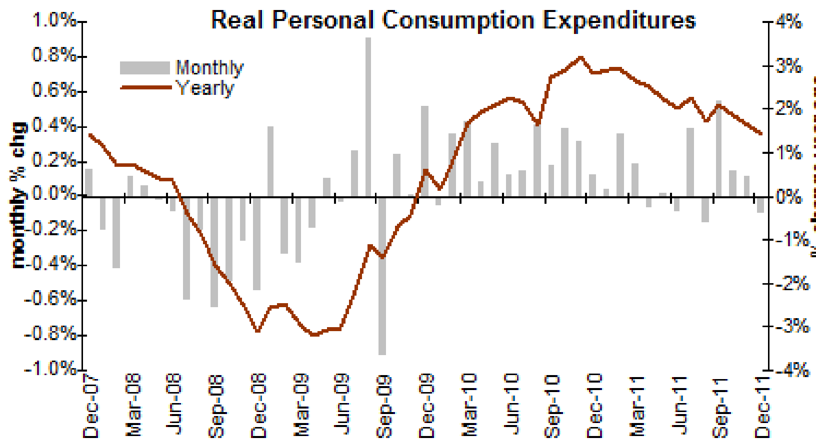
We also view the report as slightly lowering the likelihood of additional Fed easing, although the population adjustments did lower the employment-to-population ratio by 0.3pp, an indicator that Chairman Bernanke and NY Fed President Dudley have recently mentioned as reflective of a weak labor market. Still, the decline in the unemployment rate pushes it below the lower end of the Fed's projected range of 8.5-8.7% by the end of this year. Thus, the Fed may begin gradually adjusting its view regarding the pace of labor market improvement and progress in meeting its full employment mandate.

Personal Income And Outlays – December: Consumers Earn More But Spend Less

Vanguard 2/3 - Personal income rose 0.5% in December—its biggest increase since March—as consumers benefited from increased wages, dividend income, and rental income. Yet consumer spending remained unchanged. An increase in personal taxes limited disposable income to a 0.4% gain. The savings rate increased to 4.0% in December, up from 3.5% in November.

Econoday 1/30 – *Personal income picked up strength in December but spending softened*. The important wages & salaries component grew a healthy 0.4% after no change in November. In the earlier employment report, aggregate private earnings had been strong.

Consumer spending in December was sluggish, coming in at flat after edging up 0.1% in November. Weakness was in both durables and nondurables, reflecting in part a decline in auto sales and gasoline prices.



Inflation at the headline and core levels was soft. The headline PCE price index firmed a bit to a 0.1% rise after no change in November. The core pace was a touch warmer at 0.2% in December, compared to 0.1% in November.

Year-on-year, headline prices were up 2.4%, compared to 2.6% in November. The core was up 1.8% versus 1.7% the month before.

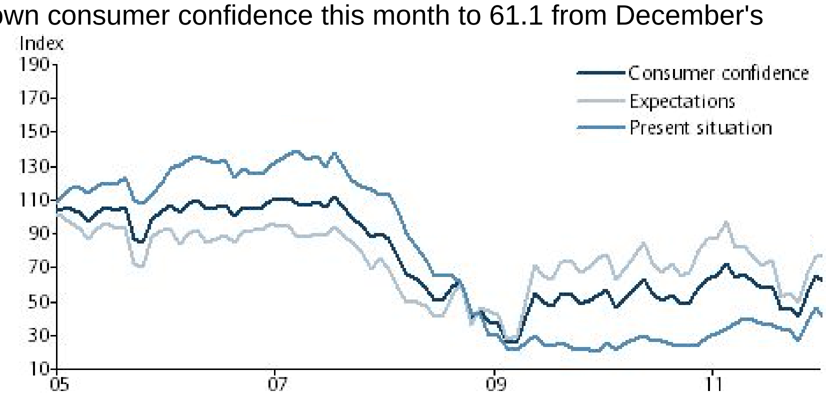
While recent spending has slowed to catch up with income, the income gain in December is favorable to future gains in consumer spending. Also, durables spending is likely to be supported by the Fed's pledge to keep rates low until late 2014. Favorable auto financing is likely to encourage an increase in auto demand.

Consumer Confidence - January: US Consumer Confidence Surprises To The Downside

Vanguard 2/3 - The Conference Board's Consumer Confidence Index slid to 61.1 in January, much lower than analysts expected. The decline was largely driven by consumers' lackluster assessment of their present situation. Many found business conditions less favorable and jobs harder to find. Their expectations for the near term were more mixed.

"Regarding the short-term outlook, consumers are more upbeat about employment, but less optimistic about business conditions and their income prospects," said Lynn Franco, director of The Conference Board Consumer Research Center.

Econoday 1/31 – Weakness in the assessment of current conditions -- likely reflecting rising gas prices and perhaps a more difficult jobs market -- pulled down consumer confidence this month to 61.1 from December's revised 64.8. The report's present situation component fell more than 8 points to 38.4 in what nearly erases December's strong showing. Weakness here is centered unfortunately in the jobs market where 43.5% say jobs are hard to get. This is not a good indication for Friday's employment report and compares with the recovery low of 41.6% in December.



Consumers see their income power falling in the months ahead which is a negative for the consumer spending outlook. Gas prices …certainly affect inflation expectations which are up 2 tenths this month to plus 5.5% for the one-year outlook. This report hints at trouble for January suggesting the month may prove to be a weak one in what is otherwise a rising trend for the economy.

Barclays 1/31 - Future expectations of the labor market continued to improve, however, with 16.2% of respondents saying that they expected more jobs in the next six months. This was up from 14.0% in December and the highest reading since July. Despite the decline in the headline index in January, it remains above its November level and suggests to us that the sharp rise in December likely overstated the actual improvement in confidence.

Construction Spending - December: Spending Rises Across Both Public And Private Sectors

Vanguard 2/3 - Construction spending grew 1.5% in December, more than double the rate expected by analysts, thanks to large gains in private non-residential construction (+3.3%). Increased spending on power and utility structures and manufacturing projects helped lift the category. Although the construction industry remains weak overall, there are signs that spending is picking up across the board. Spending on both private residential and public sector projects rose slightly in December. Construction spending for the month was 4.3% above its level in December 2010; however, for the full year, construction spending in 2011 was 2.0% below its 2010 level.

Econoday 2/1 – Construction spending rose more than expected in December but November was not as strong as earlier estimated. Construction spending in December jumped another 1.5% after a 0.4% increase the month before (originally up 1.2%).

The boost in December was led by a 3.3% surge in private non-residential outlays after a 0.5% dip the month before. Residential spending rebounded 0.8% after a 0.3% decline. Public outlays rose 0.5%, following a 1.7% boost in November.

Within the private residential component, new one-family construction advanced 1.5% while the new multifamily subcomponent eased 0.3% after a 6.1% surge in November. Overall, the construction sector is showing signs of improvement though still at low levels of activity.

Barclays 2/1 - Private non-residential construction continued its upward trend by rising 3.3%, driven by increases in manufacturing (13.6%), communication (6.5%), and power (3.2%). In terms of public construction, federal spending increased 0.3%, following the sharp 12. 2% increase in the month prior, and now stands 2.3% above its level one year ago - the first positive y/y reading in eight months. State and local spending increased by 0.5%, but still stands 3% below its level one year ago. However, spending has increased in four of the past five months, suggesting some of the financial strains for state and local governments are ebbing.

ISM Manufacturing Index – January: Business Activity Stronger

Vanguard 2/3 - The ISM Manufacturing Index, which measures U.S. manufacturing activity, climbed to 54.1 in January, its third consecutive increase. (An index measure above 50 indicates expansion.) There were gains in new factory orders and exports. Employment levels remained fairly steady, while growth in production slowed. And backlogged orders rose for the first time in eight months, suggesting the potential need to increase production and possibly employment to meet future demand.

Econoday 2/1 – Moderate and steady growth is the indication from the ISM manufacturing report where readings pretty much match those of December. A key highlight of the report is the new orders index which rose nearly 3 points to 57.6 to indicate a little bit more than just a moderate rate of monthly expansion. In another positive, backlog orders increased 4.5 points to show a build at 52.5.

Price pressures for raw materials picked up slightly in the month to end three months of contraction. The manufacturing sector is a bulwark of the economy and, despite troubles in Europe and slowing in Asia, continues to expand

Barclays 2/1 - Elsewhere, the employment index was down slightly (to 54.3 from 54.8) and the prices paid index jumped to 55.5 from 47.5, suggesting that some pipeline price pressures continue to persist despite the recent easing of energy price inflation.

All in all, a positive report - the increase in new orders suggests solid output growth in coming months and the dip in the production level is likely indicative of the recent mini-inventory cycle, rather than a notable drop in demand.

ISM Non-Manufacturing Index (Services) – January

Vanguard 2/3 - The ISM non-manufacturing index had even stronger results for January. The index rose to 56.8, its highest level since February 2011. Overall, analysts view the results of the ISM reports as positive and supportive of gains seen in other economic reports released this week.

Econoday 2/3 – A gigantic surge in employment and almost an equally dramatic surge in new orders headline a very strong ISM non-manufacturing report where the headline composite index jumped to 56.8, a strong 3.6 points above December's upwardly revised 53.0.

New orders jumped nearly 5 points to a 59.4 level that indicates strong monthly growth and points to acceleration in general activity in the months ahead. But the employment index is the eye catcher, up 8 points to 57.4 for by far the strongest reading of the recovery. This index has been lagging improvement in employment data from the government -- but not anymore.

Other readings include acceleration for business activity (production) and a slowing in the backlog draw. This report is echoing the message of this morning's jobs report -- that the economy is pivoting higher.

Chicago PMI - January: Chicago PMI Declines In January

Econoday 1/31 – Slowing at a still high rate of expansion is the call on overall business conditions in the Chicago area. The Chicago composite index eased 2 points this month to 60.2 (prior revised), well over 50 to indicate strong growth in year-on-year business activity though slightly below December to indicate a slightly slower rate of growth. This report has been uniformly and strongly positive this recovery, but not this month.

Motor Vehicle Sales - January: Sharp Increase In US Auto Sales In January

Econoday 2/1 – Vehicle sales jumped to a 14.2 million annual rate in January for a 5% gain from December. But sales, no doubt due to rising gas prices, were concentrated on cars which jumped 13% to a 7.4 million rate. Truck sales actually fell in January, down 4% to a 6.8 million rate. This is the first time in nine months that the car sales rate exceeded the truck sales rate.

Case-Shiller Index - November: Home Prices Soft, Declines Persist In High-Foreclosure States

Econoday 1/31 – Home prices are continuing to erode with no meaningful signs of a turnaround in the offing. This is the conclusion of the Case-Shiller report where in November, for the third straight month, the composite-20 index fell a sizable 0.7% (October revised). All but 3 of the 20 cities show monthly contraction. The year-on-year rate of contraction for the composite-20 deepened slightly to minus 3.7% from minus 3.4%.

Falling prices are a major factor that's helping to lift housing sales from depressed levels. But at the same time, lower prices are a major negative for existing home owners, trapping many with negative equity and limiting resale options.

Barclays 1/31 - The largest declines were in Chicago (-2.06%), Detroit (-1.28%), Atlanta (-1.22%), and Portland (-1.12%), as well as states that continue to struggle with high foreclosures, as prices fell in San Francisco (-1.30%), Los Angeles (-0.86%), Las Vegas (-0.86%), Miami (-0.82%) and Tampa (-0.74%). More broadly, regional price trends indicate that prices in high foreclosure states are starting to slip at a slightly faster rate than earlier in 2011. Thus, given the number of properties that remain distressed, working through elevated inventories in areas with high foreclosures will likely continue to weigh on headline home price indices.

Employment Cost Index – Q4: US Employment Cost Index Points To Stable Wage Growth

Vanguard 2/3 - The Employment Cost Index, a broad measure of employers' labor costs including wages and benefits, ticked up 0.4% in the fourth quarter of 2011. The wages-and-salaries component of the index rose 0.4%, while the cost of benefits grew 0.6%. Year-over-year growth in total compensation held steady at about 2%.

Econoday 1/31 – Wages are showing some pressure, nothing severe but pressure that contrasts a bit with the high rate of unemployment. The unemployment rate, at 8.6%, has been coming down which does give those who are employed a greater advantage when negotiating pay. But the wage power is likely centered in high skill employees, which means the average worker may not be enjoying increasing leverage

Barclays 1/31 - Government sector growth was slightly softer - with total compensation rising 0.3% for the quarter.

Productivity And Costs – 4Q2011 : Productivity Gains Slower Than Expected

Vanguard 2/3 - Nonfarm productivity increased an annualized 0.7% in the fourth quarter of 2011, below expectations and the 1.9% gain in the previous quarter. Still, nonfarm output jumped 3.6% in the fourth quarter and hours worked rose 2.9%. Compensation per hour also rose 1.9%. Unit labor costs rose 1.2%. Analysts attribute the slowing in productivity growth to a rise in manufacturing hours worked, which is a good sign for a recovering economy.

Econoday 2/2 –The headline numbers appear to have worsened but the key driver was a boost in hours worked and this is good for the economy. Long-term trends for productivity and unit labor costs remain on track and are favorable.

Unemployment Insurance Weekly Claims Report (Initial Jobless Claims) – week of Jan 28

Press Release 2/2 (excerpts) - In the week ending January 28, the advance figure for seasonally adjusted initial claims was 367,000, a decrease of 12,000 from the previous week. The 4-week moving average was 375,750, a decrease of 2,000.

WEEK ENDING	Jan 28	Jan 21	Change	Jan 14	Prior Year
Initial Claims (SA)	367,000	379,000	-12,000	356,000	424,000
4-Wk Moving Average (SA)	375,750	377,750	-2,000	380,000	429,750

Econoday 2/2 –Initial claims fell 12,000 in the January 28 week to a slightly lower-than-expected total of 367,000. In a partial offset, the prior week is revised 2,000 higher to 379,000. The results in this weekly series are always clouded during the shortened weeks of January and December which puts the focus on the 4-week average -- and it continues to improve with a 2,000 decline to 375,750. The average has held below the 400,000 mark for a very convincing 12 weeks in a row.

US Factory Orders - December: Slightly Stronger Shipments, But Less Stock Building

Vanguard 2/3 - New orders for manufactured goods increased in December for the second consecutive month, by $5.3 billion or 1.1%. Shipments of durable goods—items expected to last at least three years, such as automobiles—rose 2.2%. Nondurable goods orders and shipments, which are often affected by shifts in energy prices, declined in December. Orders for core capital goods, a measure of business investment plans, rose 3.1%.

Econoday 2/3 – Factory orders rose a very healthy 1.1% in December on top of November's even stronger and upwardly revised 2.2% jump. Other data are positive including a solid 0.7% rise for factory shipments, a 1.4% jump in backlog orders, and a thin 0.1% rise inventories that point to very lean and healthy conditions in the supply chain. The manufacturing sector is once again providing leadership in the economy's recovery.

Federal Reserve Chairman Bernanke: The Frustratingly Slow Recovery, …

Barclays 2/12 - In prepared remarks to the Committee on the Budget in the U.S. House of Representatives, Chairman Bernanke commented on the outlook, the recent changes to FOMC communication strategies and fiscal policy. In terms of the outlook, he described the pace of the recovery as "frustratingly slow" and that the "sluggish expansion has left the economy vulnerable to shocks" - although, he said "indicators of spending, production, and job market activity have shown some signs of improvement." He noted that "households continue to face significant headwinds," reflecting real household incomes and wealth that "stagnated" in 2011 and that "access to credit "remained tight for many borrowers." He said household spending will "depend heavily on developments in the labor market" and commented that "the jobs situation does appear to have improved modestly over the past year." In terms of indicators he cited regarding the strength of the labor market, he noted that the unemployment rate has fallen by 1pp in 2011, but also that the employment-to-population ratio still has a "long way to go before the labor market can be said to be operating normally." Regarding the housing sector, he cited "uncertain job prospects" and "tight mortgage conditions" as weighing on housing. In contrast to household spending and housing, he said "the business sector has been a relative bright spot in the current recovery." Although the rate of new business investment has slowed, he said it was likely due to "concerns about both the domestic outlook and developments in Europe." However, he noted there are "signs that these concerns are abating somewhat," and consequently, "U.S. firms should be well positioned to increase both capital spending and hiring." In terms of inflation, he noted that "consumer price inflation moderated considerably over the course of 2011" and expects "inflation to remain subdued."

In terms of monetary policy, he reiterated that the FOMC "anticipates that economic conditions are likely to warrant exceptionally low levels of the federal funds rate through late 2014." He also commented on the statement the FOMC released to "provide greater clarity about the Committee's longer-term goals and policy strategy," simply restating that the FOMC collectively views that inflation of two percent in the PCE price index is "most consistent over the longer run with the Federal Reserve's statutory mandate."

The Chairman also commented on the fiscal outlook, observing that "even after economic conditions have returned to normal, the nation will face a sizable budget gap if current budget policies continue." His comments were tailored to address longer-term risks associated with fiscal policy, rather than focus on the array of expiring tax provisions at the end of this year and pending spending cuts. In particular, he noted that large structural budget deficits and high debt levels may "crowd out private capital formation and thus reduce productivity growth," "impair the ability of policymakers to respond effectively to future economic shocks" and raise the "possibility of a sudden fiscal crisis."

Overall, the Chairman's comments did not break any major new ground and mostly reinforced that he views the current highly accommodative stance of monetary policy as appropriate and continues to see the housing and labor markets as key factors shaping the outlook. We do note, however, that there is continued mention of the employment-to-population ratio among some FOMC participants as a measure of the overall health of the labor market. Thus, even further declines in the unemployment rate, which we expect due primarily to demographic forces, may not completely alter the view of the FOMC regarding its progress on fulfilling its full employment mandate unless there is also a rise in the employment-to-population ratio.

The Economic Week Ahead: Feb 6– Feb 10, 2012

Vanguard 2/3 - Next week will be a light one for economic reports. Two reports are expected: consumer credit (Tuesday) and international trade (Friday).

This Week's U.S. Economic Calendar *Source: MarketWatch*

	TIME (ET)	REPORT	PERIOD	FORECAST	PREVIOUS
MONDAY, FEB 6		None Scheduled			
TUESDAY, FEB 7	10 am	Job Openings	November	--	3.2 million
	3 pm	**Consumer Credit**	December	--	$20.4 billion
WEDNESDAY, FEB. 8		None Scheduled			
THURSDAY, FEB. 9	8:30 a.m.	Jobless Claims	2/4/2012	N/A	N/A
	10 am	Wholesale Inventories	December	--	0.1%
FRIDAY, FEB. 10	8:30 am	**Trade Deficit**	December	-$48.7 billion	-$47.8 billion
	9:55 am	Consumer Sentiment	February	--	75.0
	2 pm	Federal Deficit	January	--	-$50 billion