Market Comment *Economic Highlights for the week ended February 19, 2010*

Economic Week In Review: Data, Fed Move Signal Strengthening Recovery

Vanguard 2/19 - This week's economic reports were mostly positive. Consumer confidence continued to rebound, industrial production remained strong, new home construction rose, and inflation increased modestly. The good news, coupled with the Federal Reserve's decision on Thursday to raise the interest rate it charges on banks for emergency loans, suggests that the current economic recovery is strengthening.

For the week, the S&P 500 rose 3.1% to 1,109 (for a year-to-date total return of about –0.3%). The yield of the 10-year U.S. Treasury note increased 9 basis points to 3.78% (for a year-to-date decrease of 7 basis points).

FOMC Minutes: Fed Follows Through On Pledge to Tighten

Vanguard 2/19 - A general consensus appears to be forming among members of the Federal Reserve Board's Open Markets Committee (FOMC) that the U.S. economy is in the middle of a moderate expansion, according to minutes released this week from the FOMC's most recent meeting.

The Fed also signaled at last month's session that it was seriously considering hiking the interest rate it charges on emergency loans to banks. This week it followed through by raising the bank discount rate from 0.50% to 0.75%.

According to Vanguard economist Roger Aliaga-Diaz, the increase in the discount rate is largely symbolic and simply reflects the fact that banks' demand for emergency funding through the discount window has waned." It just confirms that financial conditions in the interbank markets have remained normal for a considerably long period since they improved early last year, so banks aren't using that funding anymore," said Mr. Aliaga-Diaz. "Having said that, this symbolic move by the Fed sends a positive signal to the markets and helps ease investors' concerns about the inflationary impact of the Fed policies."

At last month's meeting, the Fed also discussed its expectations for key economic indicators over the next three years, including the following.

- A relatively low inflation environment despite recent increases in energy prices and stronger growth.
- Inflation-adjusted economic growth of between 2.8% and 3.5% in 2010 and 4% in 2011 and 2012.
- An unemployment rate close to its current level of 9.7% for the remainder of 2010, dropping to about 8.5% at the end of 2011 before settling between 6.6% and 7.5% in 2012.

Econoday 2/17 (excerpts) - The biggest concern for the FOMC was weakness in labor markets. Prospects for job growth were seen as an important source of uncertainty in the economic outlook, particularly in the outlook for consumer spending. Participants noted that while the average pace of layoffs diminished substantially in recent months, few firms were hiring.

We finally got more detail on the one dissenting vote by the Kansas City Fed on the wording of the FOMC statement.

"Mr. Hoenig dissented because he believed it was no longer advisable to indicate that economic and financial conditions were likely to "warrant exceptionally low levels of the federal funds rate for an extended period." In recent months, economic and financial conditions improved steadily, and Mr. Hoenig was concerned that, under these improving conditions, maintaining short-term interest rates near zero for an extended period of time would lay the groundwork for future financial imbalances and risk an increase in inflation expectations. Accordingly, Mr. Hoenig believed that it would be more appropriate for the Committee to express an expectation that the federal funds rate would be low for some time--rather than exceptionally low for an extended period. Such a change in communication would provide the Committee flexibility to begin raising rates modestly. He further believed that moving to a modestly higher federal funds rate soon would lower the risks of longer-run imbalances and an increase in long-run inflation expectations, while continuing to provide needed support to the economic recovery."

Overall, the Fed is moving closer to starting to unwind its balance sheet expansion. The Fed clearly sees the need to blatantly telegraph its intentions so as to not unsettle the financial markets when these moves begin.

Producer Prices Surge

Vanguard 2/19 - Wholesale prices jumped 1.4% in January, double the consensus forecast. Led by rising prices for gasoline, home heating oil, and jet fuels, prices for energy goods increased 5.1% and were the biggest driver of the increase. Other increases included prices for food products, which rose 0.4%, the fourth consecutive monthly rise. Excluding food and energy, core prices for finished goods were up 0.3%.

Increases in core prices for crude goods have affected core prices for intermediate goods, which rose significantly during the past 12 months. While economists admit this is an encouraging sign, they expect producer price inflation to remain modest in 2010 as the acceleration in core finished goods prices will be limited by high levels of slack in the economy, caused by high unemployment and low capacity utilization.

Econoday 2/18 (excerpts) - Today's report indicates that there are pockets of inflation despite the sluggish recovery. But if economic growth remains soft and if the Fed does unwind its balance sheet expansion in a timely manner, the pockets of inflation likely will not spread. But those are big ifs.

Improvement In Leading Indicators Continues

Vanguard 2/19 - The Conference Board's index of leading indicators rose for a tenth consecutive month, increasing 0.3% in January. The index was also up 8.9% compared with January 2009, the fastest yearly growth rate since 2004. The interest rate spread and the index of supplier deliveries were the biggest contributors to last month's increase.

The continued improvement in the leading index and January's 0.2% jump in the coincident indicator, which includes nonfarm payrolls, industrial production, personal income less transfer payments, and manufacturing and trade sales, suggest that the recovery will continue through the first half of 2010. <u>Economists caution, however, that the pace of the recovery will be modest as the benefits from the recent inventory swing abate while poor housing and labor market conditions continue</u>.

Econoday 2/18 (excerpts) - The Conference Board's index of leading economic indicators is pointing ahead to a deceleration in growth, up 0.3% in January vs. gains of just over 1% in the prior two months. <u>The biggest plus as it has been this whole cycle is the yield spread, reflecting the stimulative effects of the Fed's zero interest rate policy</u>. Delivery times, that is a slow down in deliveries, have jumped to the second most important plus, pointing to <u>the emergence of constraints in the supply chain</u>. Such constraints are the result of increased output, confirmed by an increase in the factory workweek which is the report's third biggest positive. <u>Two big negatives</u> in the report, negatives that had been positives and that are behind the month's slower rate of headline increase, are <u>a fall in building permits and an increase in jobless claims</u>. Money supply is also a major negative in the report.

New Home Construction Up 2.8%

Vanguard 2/19 - New housing starts rose from 575,000 in December to a seasonally adjusted annual rate of 591,000 in January. While the monthly gain was a modest 2.8%, January's number represents an impressive 21% increase on a year-over-year basis. Construction of multifamily homes led the way, increasing 9.2% for the month, while new construction of single family homes rose at a much more modest pace of 1.5%.

Regionally, housing starts saw impressive gains in the Northeast and West and more modest increases in the South. The Midwest was the only section of the country to experience a drop in new construction.

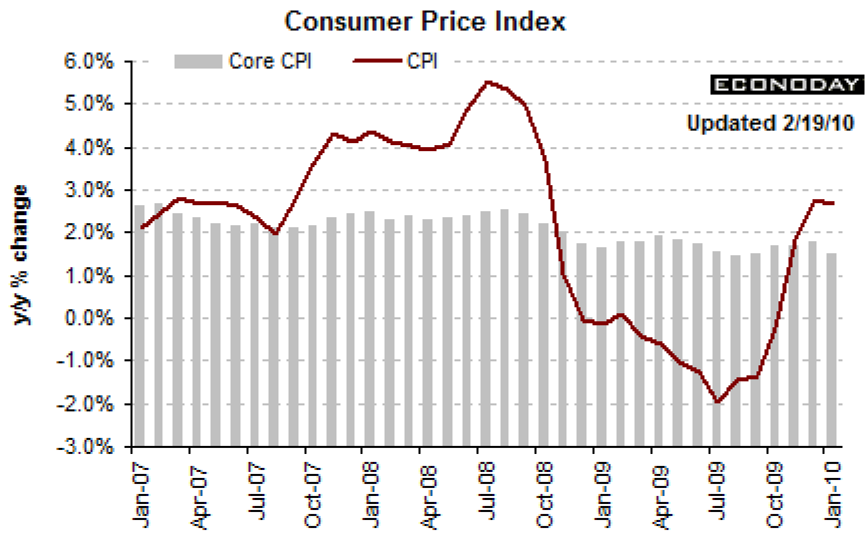
Economists attribute the recent surge in housing demand to several factors, including the homebuyer tax credit, low mortgage interest rates, and declining job losses. Despite the recent good news, the housing market has a long way to go before reaching full recovery with total starts still 74% below peak levels.

Industrial Production Takes Off

Vanguard 2/19 - Industrial production rose 0.9% in January, providing further evidence that the manufacturing sector is improving. The recovery in industrial production was broad-based last month across a number of industries. Auto output rose the most, but other areas showed signs of strength, including consumer goods and business equipment, both of which rose for the second consecutive month. Manufacturing output rose more than 1% for the first time in five months. Though still well off its prerecession high, capacity utilization rose to its highest level in more than a year.

Consumer Prices Are Slowly On The Rise

Vanguard 2/19 - The Consumer Price Index (CPI)—the government's key inflation indicator—was up 0.2% in January and is up 2.7% since January 2009. Much of the increase was attributable to prices for nonfood nondurable commodities, which rose 1.6% for the month, caused mostly by higher gasoline prices, which increased 4.4%, the largest increase since August. The CPI for food increased by 0.2% for the month but is still down since January of last year. Offsetting some of these gains was a 0.2% decline in the CPI for services, which is now only 0.5% above its January 2009 level.



The core CPI—which excludes food and energy prices, both of which can be very volatile—also fell 0.1% for the month, but remains up 1.5% from January 2009 levels.

Econoday 2/19 (excerpts) - Higher gasoline prices slammed consumer wallets in January but a drop in shelter costs kept both the headline and core rate softer than expected. The gain in the headline CPI was due largely to higher gasoline prices. The core was pulled down by a 2.1% drop in lodging while away from home and by a 0.1% dip in owners' equivalent rent. Basically, hotels and resorts are still trying to lure customers with discounts. And rents are soft for housing in markets, caused by high unemployment.

Unemployment Insurance Weekly Claims Report (Initial Jobless Claims) – week of Feb. 13

Econoday 2/18 (excerpts) - Stocks and commodities dropped in immediate reaction to a much larger-than-expected level of jobless claims, at 473,000 in the Feb. 13 week vs. expectations for 440,000. There are important special factors possibly affecting the data but their effects are unknown and the Labor Department isn't offering any explanations. There was extremely heavy weather through most of the nation in the reporting week, and results from four states had to be estimated including the key states of Texas and California with holiday backlog in the latter having skewed prior reports.

Turning to the four-week average points to steady conditions in the labor market. The average fell 1,500 to 467,500, a level roughly in line with the last four weeks and in line with readings in late December. Other data in the report include no change for continuing claims, at 4.563 million, and no change in the unemployment rate for insured workers, at 3.5%.

Wait and see is the best approach to judge jobless claims. The weather effect may yet appear, having produced perhaps another backlog due to the closure of claims offices. The outlook for the jobs report in February is open.

Press Release 2/18 – In the week ending Feb. 13, the advance figure for seasonally adjusted initial claims was 473,000, an increase of 31,000 from the previous week's revised figure of 442,000. The 4-week moving average was 467,500, a decrease of 1,500 from the previous week's revised average of 469,000.

The advance seasonally adjusted insured unemployment rate was 3.5% for the week ending Feb. 6, unchanged from the prior week's unrevised rate of 3.5%.

The advance number for seasonally adjusted insured unemployment during the week ending Feb. 6 was 4,563,000, unchanged from the preceding week's revised level of 4,563,000. The 4-week moving average was 4,585,750, a decrease of 24,000 from the preceding week's revised average of 4,609,750.

The fiscal year-to-date average for seasonally adjusted insured unemployment for all programs is 5.240 million.

WEEK ENDING	Advance Feb. 13	Feb. 6	Change	Jan. 30	Prior Year
Initial Claims (SA)	473,000	442,000	+31,000	483,000	631,000

4-Wk Moving Average (SA)	467,500	469,000	-1,500	469,500	615,500

The Economic Week Ahead: Feb. 22 – Feb. 26

Vanguard 2/19 - The Commerce Department's Friday announcement on GDP growth for the fourth quarter of 2009 highlights next week's economic news. Other reports scheduled for release next week include consumer confidence (Tuesday), new-home sales (Wednesday), durable goods (Thursday), manufacturing (Friday), and existing-home sales (Friday).

U.S. Economic Calendar

Date	ET	Release	For	Briefing.com	Consensus	Prior
Feb 23	09:00	Case-Shiller 20-city Index	Dec	-4.5%	-3.0%	-5.3%
Feb 23	10:00	Consumer Confidence	Feb	56.5	55.0	55.9
Feb 24	10:00	New Home Sales	Jan	325K	355K	342K
Feb 25	08:30	Initial Claims for Unemployment	02/20	425K	458K	473K
Feb 25	08:30	Continuing Claims	02/13	4570K	4570K	4563K
Feb 25	08:30	Durable Goods Orders	Jan	NA	1.5%	0.3%
Feb 25	10:00	FHFA Housing Price Index	Dec	0.4%	NA	0.7%
Feb 26	08:30	GDP - Second Estimate	Q4	5.3%	5.7%	5.7%
Feb 26	08:30	GDP Deflator - Second Estimate	Q4	0.6%	0.6%	0.6%
Feb 26	09:45	Chicago PMI	Feb	57.5	59.0	61.5
Feb 26	09:55	U Mich Consumer Sentiment - Final	Feb	74.6	74.0	73.7
Feb 26	10:00	Existing Home Sales	Jan	5.20M	5.50M	5.45M

Source: Briefing.com

FFCB Weekly Debt Issuance Activity

Week Ended Date	Discount Notes $million	New Bonds $millions	Issue Count	Called Bonds Par $millions	Issue Count
22-Jan	$ 4,970	$ 2,928	18	$ 1,972	10
29-Jan	3,685	2,784	15	1,733	9
5-Feb	515	2,797	27	1,954	12
12-Feb	2,046	1,520	24	1,041	12
19-Feb	835	1,721	14	802	4