Market Comment *Economic Highlights for the week ended March 4, 2011*

Economic Week In Review: A Self-Sustaining Recovery?

Vanguard 3/4 – March came in like a lamb, at least as far as U.S. economists were concerned. Although turmoil in the Middle East and northern Africa have forced Americans to pay more for gas at the pump, at least temporarily, this week's data seemed to reflect an economy on the mend. For the week ended March 4, the S&P 500 Index rose 0.1% to 1,321 (for a year-to-date total return of about 5.5%). The yield of the 10-year U.S. Treasury note rose 7 basis points to 3.49% (for a year-to-date increase of 19 basis points).

Fed's Beige Book – March: A Modest Recovery

Vanguard 3/4 – The recovery continued at a slow pace in January and early February, according to the Federal Reserve's latest Beige Book survey of nationwide conditions. With the exception of the Chicago region, activity picked up modestly in each of the Fed's 12 districts. The labor market, auto sales, and the manufacturing sector showed small upticks, but real estate, not surprisingly, remained soft in most areas. Analysts detected subtle warning signs of inflation in the Fed's data—among them, rising prices for commodities and raw materials for manufacturers. Some observers also cautioned that the next edition of the Beige Book is likely to reflect the impact of the wave of political unrest in the oil-producing world.

Econoday 3/2 – All twelve Fed Districts reported overall activity as improving though in varying degrees. The biggest positive was in manufacturing as "all Districts, except St. Louis, experienced solid growth in manufacturing production."

The next strongest sector is retail with the Beige book stating "retail sales increased in all Districts, except Richmond and Atlanta." This is in the context of Boston, New York, Philadelphia, Atlanta, and Kansas City noting that severe snowstorms had a negative impact on retail sales.

Changes in loan demand were mixed across Districts, with Richmond, Dallas, and San Francisco experiencing increased loan demand and Kansas City noting a decrease. As already noted by Fed Chairman Ben Bernanke in Congressional testimony, lending standards remained tight across most Districts.

Labor markets are showing modest improvement.

An increasingly important story is the increasing cost pressures.

Real estate and construction remain at low levels of activity but are showing signs of improvement.

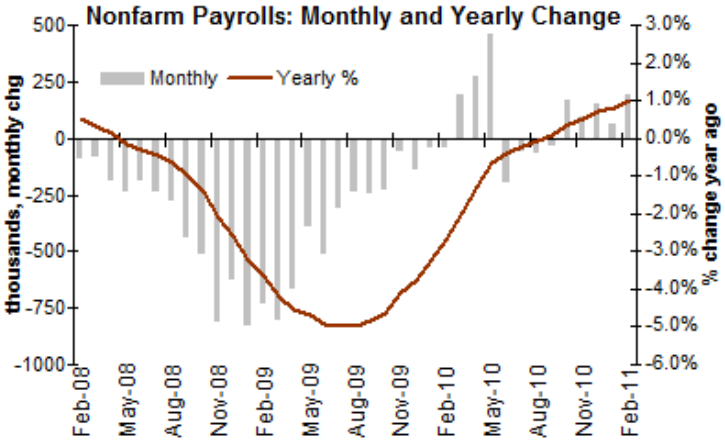
Overall, the Beige Book is consistent with most economists' view that the recovery is slowly gaining momentum with sector strength in manufacturing, followed by the consumer. Building inflation pressures bear watching.

Non-Farm Payrolls: US Employment Rebounds In February, More Americans Head Back To Work

Vanguard 3/4 – Confounding expectations of another increase, the unemployment rate dropped 0.1% in February to 8.9%, its lowest level since April 2009. Private-sector payrolls grew by 222,000 (public-sector payrolls fell slightly), and figures for December and January were revised upward as well, for a three-month average of 136,000 new jobs. Gains were posted in most job sectors, including professional services and the construction industry, though retailers shed about 8,000 jobs. Although the data were encouraging, analysts noted that the jobless rate remains dispiritingly high and anything resembling "full employment" is still a few years away, at best.

"The latest data bear out our expectations that the economy will continue to gain traction toward a self-sustaining recovery," said Vanguard's chief economist, Joe Davis, Ph.D. "The recent spike in crude oil prices is an area of concern, however, as it could negatively impact consumer spending and force businesses to cut back on investment and hiring. Oil benchmarks will bear careful scrutiny over the next several months, but we remain cautiously optimistic about the outlook for 2011 and 2012."

Barclays 3/4 - Altogether we characterize this report as moderately better than expected given the clean drop in the unemployment rate to 8.9% against our (9.0%) and the consensus (9.1%) forecast. This is a report that suggests that labor market conditions continue to improve at a moderate pace and signals that the weakness in the January report was mainly a weather-related effect as opposed to a loss of momentum. We do not see this report as causing the Fed to alter the stance of its asset purchase program as most FOMC members have said that they need to see much stronger job creation before characterizing the recovery as having taken hold. We continue to see little to change our view that the Fed will complete its intended $600bn in purchases of Treasury securities by the end of the second quarter.



Econoday 3/4 - Transportation and warehousing employment increased by 22,000 in February, with half of that gain in truck transportation. On the downside, employment in retail trade slipped 8,000-possibly due to adverse winter weather. Government jobs fell 30,000, following a 5,000 dip in January.

ISM Manufacturing Index – February: Factories Pick Up The Pace

Vanguard 3/4 –The manufacturing sector remained a bright spot in February, with the Institute for Supply Management (ISM) reporting an increase in factory activity for the nineteenth consecutive month. The ISM's manufacturing index rose to 61.4 from 60.8, beating expectations and reflecting the overall improvement in economic conditions nationwide. New and backlogged orders expanded and inventories shrank, while manufacturers added jobs to meet growing demand: The ISM factory employment index rose 4.5% to 64.5, its highest level in a generation.

Econoday 3/1 – Month-to-month acceleration in both the employment and production components lead the ISM manufacturing report which shows exceptionally robust strength in February. The composite headline index rose more than a 1/2 point to a 61.4 level that matches the best strength of the last expansion.

The manufacturing sector has re-emerged as a center of the nation's strength and its economic recovery. But the one factor that clouds this report is the ongoing spike in oil prices, threatening to increase already very high input prices.

Barclays 3/1 - This is quite a strong report, which corroborates the improvement seen in regional manufacturing indices throughout the month. The continued surge in the employment index is especially encouraging, as it suggests a growing consensus among manufacturers that the recovery is indeed sustainable and warrants expansion of payrolls.

Factory Orders – January

Econoday 3/4 – Factory orders are very strong led by a surge in January and including a large upward revision to December. New orders jumped 3.1% in January on top of a strong December base where orders were revised to plus 1.4% from plus 0.2%. The January gain is centered in aircraft -- a key component of the manufacturing sector -- and includes gains for primary metals, fabricated metals, mining equipment as well as a 3.1% gain for non-durable goods. Note that gains for non-durables, specifically petroleum and coal, along with gains for metals reflect price effects.

ISM Services – February: An Early Spring For The Service Sector

Vanguard 3/4 –The ISM also had good news for the service sector. Its non-manufacturing index inched up a few fractions of a point in February to 59.7, the highest level in nearly six years. Buried in the data were signs that many businesses are poised to expand in coming months, portending further strengthening in the job market.

Econoday 3/3 – The reading is above 50 to show month-to-month growth and is above January to show month-to-month acceleration, but here again only mild acceleration. February's strength is centered in output readings including acceleration for business activity and in employment which came in at 55.6 for a more than one point gain and the best reading of the recovery. Today's report is yet another positive for the economic outlook. Note

that readings here are not skewed by price effects as respondents are asked to judge month-to-month change in volume terms, not price terms.

Construction Spending Down Slightly

Vanguard 3/4 –Spending on construction projects slipped slightly in January, dropping 0.7% to $791.8 billion. Private residential construction was up considerably, however, posting a 5.3% gain from December, for a total of $245.6 billion. Among the sectors reporting declines were power and utility (–11.8%), health care facilities (–9.7%), and factories (–2.7%). Overall, construction spending was down 5.9% from January 2010. Analysts found little reason to expect a major rebound in the near future, with federal stimulus funds drying up and few signs of a turnaround in the beleaguered housing market.

Barclays 3/1 - The disappointment in the headline was entirely due to the non-residential component, which fell 3.3%. Today's report reflects further softness in non-residential spending and suggests a weak start for the fixed structures component of Q1 GDP.

Personal Income and Outlays– January: Higher Earnings, But No Spending Spree

Vanguard 3/4 –Americans earned more in January, but they saved more, too. Thanks in large part to a reduction in Social Security taxes, personal income jumped 1.0%, but consumers seemed inclined to hold on to the extra money, with the savings rate rising almost half a percentage point, to 5.8%, and consumer spending virtually flat. Inflation remained largely under control in January, as consumer prices rose just 0.1% when ever-volatile food and energy costs are factored out.

Econoday 2/28 – Year on year, personal income for January was up 4.6%, compared to 3.8% in December. PCEs growth improved to 4.0% from 3.9% in December.

On the inflation front, the PCE price index posted a 0.3% rise, matching the gain in December. The core rate was not as strong but still warmed up a bit with a 0.1% rise, compared to no change in December. On a year-ago basis, headline PCE prices are up 1.2% in January-the same rate as in December. Core inflation held steady at 0.8% year-on-year versus in December.

Income is up, which is good, but spending has slowed. Moving forward, healthier gains in wages & salaries are going to be needed to keep spending ahead of what appears to be building headline inflation.

Barclays 2/28 - All in all, a soft report. While unemployment insurance relief provides a timely boost to household incomes facing a drag from higher gasoline prices, and while we expect consumer spending growth to rebound later in the quarter, growth in Q1 as a whole is likely to be noticeably softer than the 4.1% registered in Q4.

Chicago PMI –February

Econoday 2/28 – Business growth has accelerated strongly this month in the Chicago area where the purchasing managers' composite index rose to 71.2 from January's already robust 68.8. Production is a stand-out component, jumping 4-1/2 points to 78.2 to indicate, like the composite, accelerating month-to-month grow from an already very high month-ago base.

Fed Chair Bernanke: Commodity Price Effect On Inflation "Temporary And Relatively Modest"

Barclays 3/1 - In his prepared remarks before the Senate Committee on Banking, Housing, and Urban Affairs, Chairman Bernanke struck a similar note to his recent testimonies. He said a moderate recovery was continuing, suggested the Fed's asset purchases are working as planned, and indicated that he was not worried that rising commodity prices would lead to a sustained increase in US inflation. He reiterated the FOMC forecast that the unemployment rate will likely be around "7-1/2 to 8% at the end of 2012."

In terms of inflation, he emphasized that "high levels of resource slack" have contributed to the decline in inflation since the onset of the crisis. He indicated longer-term inflation expectations have remained stable, but that "private-sector forecasters generally also anticipate subdued inflation over the next few years." Perhaps of greatest interest were his comments on the recent rise in commodity prices, in which he expressed the view that the "increase in commodity prices in recent months have largely reflected rising global demand for raw materials." In a subtle attempt to deflect any criticism that may attribute the rise in commodity prices to the Fed's large-scale asset purchase program, he stated that "commodity prices have risen significantly in terms of all major currencies," which suggests that dollar weakness is unlikely to "have been an important driver of the [commodity price] increases." He also indicated that "the rate of pass-through from commodity price increases to

broad indexes of U.S. consumer prices has been quite low in recent decades" and that the rise in commodity prices would lead to "at most, a temporary and relatively modest increase in U.S. consumer price inflation." His comments reinforce the view that higher commodity prices are not an immediate concern of most FOMC members. Instead, the threat to growth would come from "sustained rises in the prices of oil or other commodities" and to inflation if "inflation expectations were to become less well anchored."

Overall, Bernanke's comments contained few surprises in terms of the economic outlook and monetary policy. His comments also gave no indication that the Fed will change course in terms of its large-scale asset purchase program, reinforcing our expectations that it will purchase the full $600bn of Treasury securities.

US Vehicle Sales Jump Higher In February

Barclays 3/1 - Vehicle sales, as reported by Autodata, increased to 13.4mn seasonally-adjusted annual rate (saar) in February from 12.6mn saar in January. Apart from the months boosted by the Cash for Clunkers stimulus, this is the fastest pace of sales since August 2008. Overall, this is a strong report.

Unemployment Insurance Weekly Claims Report – Week Ended Feb. 26

Press Release 3/3 (excerpt) – In the week ending Feb. 26, the advance figure for seasonally adjusted initial claims was 368,000, a decrease of 20,000 from the previous week's revised figure of 388,000. The 4-week moving average was 388,500, a decrease of 12,750 from the previous week's revised average of 401,250.

The advance seasonally adjusted insured unemployment rate was 3.0% for the week ending Feb. 19, a decrease of 0.1 percentage point from the prior week's revised rate of 3.1%.

The advance number for seasonally adjusted insured unemployment during the week ending Feb.19 was 3,774,000, a decrease of 59,000 from the preceding week's revised level of 3,833,000. The 4-week moving average was 3,863,750, a decrease of 40,500 from the preceding week's revised average of 3,904,250.

WEEK ENDING	Feb. 26	Feb. 19	Change	Feb. 12	Prior Year
Initial Claims (Seasonally Adj)	368,000	388,000	-20,000	413,000	466,000
4-Wk Moving Average (SA)	388,500	401,250	-12,750	418,500	467,500

Econoday 3/3 - In clear data pointing strongly to month-to-month acceleration for payroll gains, initial jobless fell a substantial 20,000 in the February 26 week on top of a 25,000 decline in the prior week. The number of claims, at 368,000, is the third sub 400,000 reading in the last four weeks (note the February 19 week was revised 3,000 lower to 388,000). The four-week average, down 12,750 to 388,500, is the first sub 400,000 reading of the recovery. Importantly, the Labor Department reports no special factors clouding the data.

The Economic Week Ahead: March 7 – March 11, 2011

Vanguard 3/4 - Economists will spend the coming week sorting through fresh data on consumer credit (due Monday), international trade (Thursday), and retail sales and business inventories (both on Friday).

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

Date	ET	Release	For	Briefing.com	Consensus	Prior
Mar 07	15:00	Consumer Credit	Jan	$3.5B	$3.3B	$6.1B
Mar 09	10:00	Wholesale Inventories	Jan	0.5%	1.0%	1.0%
Mar 10	08:30	Initial Claims for Unemployment	03/05	370K	382K	368K
Mar 10	08:30	Continuing Claims	02/26	3750K	3750K	3774K
Mar 10	08:30	Trade Balance	Jan	$41.5B	-$41.5B	-$40.6B
Mar 10	14:00	Treasury Budget	Feb	NA	-$196B	-$220.9B
Mar 11	08:30	**Retail Sales**	Feb	1.4%	1.0%	0.3%
Mar 11	09:55	Michigan Consumer Sentiment	Mar	78.0	76.5	77.5

Date	ET	Release	For	Briefing.com	Consensus	Prior
Mar 11	10:00	Business Inventories	Jan	0.8%	0.8%	0.8%