

Market Comment *Economic Highlights for the week ended April 9, 2010*

Economic Week in Review: Signs of Spring in Services Sector

Vanguard 4/9 - A light economic news calendar and unseasonably warm weather in the mid-Atlantic region made this week feel like late summertime. More in keeping with spring, however, were the hopeful signs of growth in the service sector of the U.S. economy. Meanwhile, minutes from the March meeting of the Federal Open Market Committee shed little light on the possible timing of an increase in the Fed's target for short-term interest rates. For the week ended April 9, the S&P 500 Index rose 1.4% to 1,194 (for a year-to-date total return of about 7.7%). The yield of the 10-year U.S. Treasury fell 6 basis points to 3.90% (for a year-to-date increase of 5 basis points).

ISM Non-Manufacturing Index (Services Index) – March

Vanguard 4/9 - Following on the heels of last week's announcement that momentum is building in the manufacturing sector, the services sector delivered its own good news. The Non-Manufacturing Index published by the Institute for Supply Management (ISM) posted its fourth consecutive monthly gain, rising to 55.4—the highest reading since September 2007. The better-than-expected improvement (2.4 points) was especially welcome because the services sector—which represents roughly two-thirds of the U.S. economy and the lion's share of jobs—has been lagging its manufacturing-index counterpart. The ISM's survey of purchasing and supply executives revealed several encouraging trends: New orders rose more than 7 points to 62.3, export orders rose more than 10 points to 57.5, and business activity rose more than 5 points to 60.0. All but two industries (real estate and educational services) reported growth.

Press Release 4/5 (excerpts) - *March 2010 ISM Non-Manufacturing Index (NMI) at 55.4%*

Economic activity in the non-manufacturing sector grew in March for the third consecutive month, say the nation's purchasing and supply executives in the latest Non-Manufacturing ISM Report On Business®. Fourteen non-manufacturing industries, including agriculture, reported growth in March. Respondents' comments are mostly positive about business conditions and the direction of the economy:

- *"Business conditions have returned to normal (pre-recession). Our business is up significantly since 2009. We are very positive about the upcoming year." (Information)*
- *"Demand for loans, credit cards, mortgages and equity lending is expected to continue to increase." (Finance & Insurance)*
- *"Brisk business activity continues as more projects get 'green light.'" (Utilities)*
- *"Observing some relaxation on several fronts regarding spending and hiring. Still very cautious, but making investments where they make sense." (Retail Trade)*
- *"Limited funding available for development [and] expansions." (Accommodation & Food Services)*
- *"The economy appears to be holding its own; however, state and local funding is projected to decrease next fiscal year." (Educational Services)*

Fed Minutes Shed Little Light on Key Questions

Vanguard 4/9 - The newly released minutes of the March 16 meeting of the Federal Open Market Committee provided little additional insight into some of the key questions on the minds of many. When might the Federal Reserve begin raising its target for short-term interest rates? How and when might the Fed drain some of the extraordinary amounts of liquidity it has injected into the U.S. economy and financial markets? Fed watchers may have to wait awhile longer for more clues. The minutes indicate that the Fed was more confident about the U.S. economic recovery. As for the timing of a potential interest rate increase, the minutes reported that "nearly all members judged that it was appropriate to reiterate the expectation that economic conditions—including low levels of resource utilization, subdued inflation trends, and stable inflation expectations—were likely to warrant exceptionally low levels of the federal funds rate for an extended period."

April 6 (excerpts) - The information reviewed at the March 16 meeting suggested that economic activity expanded at a moderate pace in early 2010. Business investment in equipment and software seemed to have picked up, consumer spending increased further in January, and private employment would likely have turned up in February in the absence of the snowstorms that affected the East Coast. Output in the manufacturing sector continued to trend higher as firms increased production to meet strengthening final demand and to slow the pace of inventory liquidation.

On the downside, housing activity remained flat and the nonresidential construction sector weakened further.

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Meanwhile, a sizable increase in energy prices pushed up headline consumer price inflation in recent months; in contrast, core consumer price inflation was quite low. Available indicators suggested that the labor market might be stabilizing. Declines in private payrolls slowed markedly in recent months, and, in the absence of the snowstorms, private employment probably would have risen in February.

Overall, net debt financing by nonfinancial firms was about zero over the first two months of 2010, consistent with firms' weak demand for credit and banks' tight credit policies. Gross public equity issuance by nonfinancial firms was robust in the fourth quarter of 2009.

In their discussion of the economic situation and outlook, participants agreed that economic activity continued to strengthen and that the labor market appeared to be stabilizing.

Spreads in short-term funding markets were near pre-crisis levels, and risk spreads on corporate bonds and measures of implied volatility in equity markets were broadly consistent with historical norms given the outlook for the economy.

Participants were also reassured by the absence of any signs of renewed strains in financial market functioning as a consequence of the Federal Reserve's winding down of its special liquidity facilities. In contrast, bank lending was still contracting and interest rates on many bank loans had risen further in recent months.

While recent data pointed to a noticeable pickup in the pace of consumer spending during the first quarter, participants agreed that household spending going forward was likely to remain constrained by weak labor market conditions, lower housing wealth, tight credit, and modest income growth. For example, real disposable personal income in January was virtually unchanged from a year earlier and would have been even lower in the absence of a substantial rise in federal transfer payments to households.

While all participants anticipated that inflation would be subdued over the near term, a few noted that the risks to inflation expectations and the medium-term inflation outlook might be tilted to the upside in light of the large fiscal deficits and the extraordinarily accommodative stance of monetary policy.

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."

Cautious Consumers Reduce Borrowing

Vanguard 4/9 - After increasing in January for the first time in a year, consumer credit balances fell \$11.5 billion in February. The larger-than-expected decline came mostly from lower revolving credit (primarily credit-card borrowing) as consumers have been trying to pay more bills on time. Non-revolving credit (primarily auto loans) also declined, but modestly.

Vanguard economist Roger Aliaga-Diaz noted, "We should continue seeing more consumer credit declines in the near future. Still, there is a large overhang of U.S. household financial leverage, with household debt currently more than 120% of personal disposable income. Acceptable levels for this ratio would be in the 70%–80% range, so there's still a long way to go."

Pending Home Sales Show Healthy Gain, Hint at Spring Surge

Press Release 4/5 (excerpts) - Pending home sales rose in February, potentially signaling a second surge of home sales in response to the home buyer tax credit, according to the National Association of Realtors®.

The Pending Home Sales Index, a forward-looking indicator based on contracts signed in February, rose 8.2% to 97.6 from a downwardly revised 90.2 in January, and remains 17.3% above February 2009 when it was 83.2. The data reflects contracts and not closings, which usually occur with a lag time of one or two months.

Lawrence Yun, NAR chief economist, said "We need a second (buying) surge to meaningfully draw down inventory and definitively stabilize home values." "Anecdotally, we're hearing about a rise of activity in recent weeks with ongoing reports of multiple offers in more markets, so the March data could demonstrate additional improvement from buyers responding to the tax credit."

Unemployment Insurance Weekly Claims Report (Initial Jobless Claims) – week of April 3

Press Release 4/8 (excerpts) - In the week ending April 3, the advance figure for seasonally adjusted initial claims was 460,000, an increase of 18,000 from the previous week's revised figure of 442,000. The 4-week moving average was 450,250, an increase of 2,250 from the previous week's revised average of 448,000.

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The advance seasonally adjusted insured unemployment rate was 3.5% for the week ending March 27, a decrease of 0.1 percentage point from the prior week's unrevised rate of 3.6%.

The advance number for seasonally adjusted insured unemployment during the week ending March 27 was 4,550,000, a decrease of 131,000 from the preceding week's revised level of 4,681,000. The 4-week moving average was 4,648,250, a decrease of 36,000 from the preceding week's revised average of 4,684,250.

WEEK ENDING	April 3	March 27	Change	March 20	Prior Year
Initial Claims (SA)	460,000	442,000	+18,000	445,000	643,000
4-Wk Moving Average (SA)	450,250	448,000	+2,250	454,000	643,000

Econoday 4/8 - The Labor Department is citing special calendar factors for an unexpected jump in initial jobless claims to 460,000 in the April 3 week vs. the prior week's 442,000 (revised 3,000 higher). The Labor Department is not only citing Easter as a distortion but also the Cesar Chavez holiday in California, and it is further warning that seasonal volatility will shake up the numbers through the next several weeks.

Wholesale Inventories - February

Econoday 4/9 - In a good sign for the economy, inventories at the wholesale level jumped 0.6% in February and were revised slightly higher in January to now show a monthly gain of 0.1%. February's gain is headlined by a 0.5% rise for durables in a solid indication that wholesalers are now beginning to build stocks. Non-durable inventories, a smaller component that's subject to price effects, jumped 0.8%. Details show a build for metals and computers and a second straight build for lumber, one that may reflect weather-dislocations for construction.

April 9 (Bloomberg) -- "Firms are seeing more reason for optimism in the outlook and are looking to build inventories to fill future sales growth," said Zach Pandl, an economist at Nomura Securities International Inc. in New York who correctly forecast the inventory increase. Inventories at wholesalers were forecast to rise 0.4% after a previously estimated drop of 0.1% for January, according to the median estimate of 35 economists surveyed by Bloomberg News. Estimates ranged from a decline of 0.2% to a gain of 0.6%.

The bigger-than-projected gain in February and the January revision indicate efforts to stabilize stockpiles again added to economic growth last quarter. Inventories contributed 3.8 percentage points to gross domestic product from October through December, the most in 22 years.

The Economic Week Ahead: April 12 - 16

Vanguard 4/9 - A full slate of economic reports is scheduled for next week, starting with international trade on Tuesday, April 13. Due out on Wednesday are the consumer price index, retail sales, business inventories, and the Fed's Beige Book report on economic conditions across the United States. Industrial production follows on Thursday, and new residential construction comes out on Friday.

U.S. Economic Calendar

Source: Briefing.com

Date	ET	Release	For	Briefing.com	Consensus	Prior
Apr 13	08:30	Import and Export Prices	March	NA	NA	
Apr 13	08:30	Trade Balance	February	-\$38.3B	-\$39.0B	-\$37.3B
Apr 14	08:30	Consumer Price Index (CPI)	March	0.2%	0.1%	0.0%
Apr 14	08:30	Retail Sales	March	1.4%	1.1%	0.3%
Apr 14	10:00	Business Inventories	February	0.6%	0.3%	0.0%
Apr 14	14:00	Fed's Beige Book	April	NA	NA	NA
Apr 15	08:30	Initial Claims	04/10	425K	440K	460K
Apr 15	09:15	Industrial Prod. & Capacity Utilization	March			
Apr 16	08:30	Building Permits	March	630K	626K	637K
Apr 16	08:30	Housing Starts	March	590K	610K	575K
Apr 16	09:55	U of Michigan Sentiment	April	75.3	75.0	73.6