Market Comment *Economic Highlights for the week ended May 7, 2010*

Economic Week In Review: Markets Take A Fall; Economy On Better Footing

Vanguard 5/7 - The U.S. stock market's historic plunge toward the end of the week, which wiped out gains for the year, overshadowed positive news about the economy. Job growth surged in April as businesses gained more confidence and hired more people in a variety of sectors. Firms invested more in their businesses, ramped up production, and restocked depleted inventories. The manufacturing sector has played a key role in this recovery; it's added more than 100,000 jobs since December. Economists said continued improvement in employment in all sectors will be critical for a sustained recovery. For the week ended May 7, the S&P 500 Index fell 6.4% to about 1,111, for a year-to-date total return of about 0.3%. (Total return reflects price change plus dividends.) The yield of the 10-year U.S. Treasury note fell 24 basis points to 3.45%, for a year-to-date decrease of 40 basis points.

Barclays 5/7 - *Strong Data, But Markets Are Focused Elsewhere*

The incoming economic data point to strong growth in Q2 10, as employment growth picked up in April and the ISM manufacturing index hit another 5-year high. However, markets were dominated by **fears about European sovereign debt** and the potential economic impact. The potential direct trade effect of the debt crisis is real but does not threaten the recovery; the bigger risks are fiscal worries and prolonged stock market weakness.

If one were somehow able to avoid looking at market moves this week, the US economic data were reassuring and consistent with our forecast that GDP growth will pick up in Q2 10. The April employment report showed job growth of 290k, with a 224k rise outside of the Census that continues the trend of improvement in recent months; there was also an upward revision of 121k to prior months. Looking across sectors, the 3-month change in private services, manufacturing, and government employment all are now in positive territory, with only the construction sector still slightly negative on this basis. The unemployment rate rose 0.2pp, to 9.9%, but this was more than accounted for by a 0.3pp rise in the labor force participation rate; job growth of 550k in the household survey continues to be strong.

Also, the Fed's Senior Loan Officer Survey was encouraging. Banks eased commercial and industrial (C&I) loan standards for large firms and did not tighten them for small firms for the first time since 2006.

How Will Europe's Problems Affect The U.S.?

Barclays 5/7 - While economists were focused on the incoming data, at times it felt like nobody else was, as investors focused on the risks from sovereign debt problems in Europe. If these continue to worsen, how will they affect the US economy? One straightforward way is through trade. The euro area accounts for about 15% of US exports, so any further domestic weakness in that region could serve as a notable drag on US growth. However, it is worth noting that our growth forecast for the euro area is fairly weak at 1.0% in 2010, and exports to the euro area are actually down on a y/y basis, while overall exports are up 16.7% and those to the Pacific Rim up 33.8%

Thus, the euro area has not served as the engine of growth for US export industries, and the growth effect of any downward surprise would likely be limited. However, the appreciation of the dollar against the euro will also weigh over time on US exports to other economies where US exporters compete with their European counterparts.

Another channel in which these issues could affect the US would be if they transformed into worries about the fiscal situation at the federal or state and local level. Worries about the federal deficit appear not to be in the front of investors' minds, as US Treasuries were a main recipient of flight-to-liquidity flows. Also, there does not appear to be any panicked reaction away from state and local debt in the US. Thus, this channel does not appear to be a major issue right now, but is worth monitoring. Another way the crisis could affect US growth is if risk aversion and diminished expectations of global growth were to drive down the stock market persistently. As we have discussed previously, we view the stock market wealth effect as an important reason for the improvement in consumer spending this year, and a persistent downward move would imply a weaker spending trajectory. However, changes in wealth affect spending with a significant lag, so the key to any effect in this direction would be persistence. It is also worth noting that if a decline in the stock market were to be accompanied by falling energy prices and lower interest rates, as occurred in the risk aversion trading this week, those moves give some partially offsetting benefits to growth.

Non-Farm Payrolls: Job Growth Surprisingly High - April

Vanguard 5/7 - The U.S. labor market gained an unexpectedly high 290,000 jobs in April, while the unemployment rate rose to 9.9%. This was the fourth consecutive monthly gain in job growth. The rise in employment was fueled by increased hiring in manufacturing, professional and business services, health care, and leisure and hospitality. The federal government also hired more workers to help collect data for the census.

The unemployment rate rose despite the high level of job creation because so many individuals entered or reentered the workforce during the month. "As previously expected, improving conditions in the economy are attracting a backlog of new graduates as well as previously discouraged job seekers. Thus the unemployment rate may stay at these high levels for some time, in spite of jobs growth," said Vanguard economist Roger Aliaga-Díaz.

"However, the private sector job numbers are encouraging, since they are currently above the break-even level needed to absorb the new entrants; if sustained, they will eventually push the jobless rate down."

Econoday 5/7 (excerpts) - Today's jobs report was unexpectedly strong-including after discounting Census jobs. And a rise in the unemployment rate actually points to optimism on the part of workers.

Payroll gains were widespread, including increases in goods-producing and service-providing sectors.

Goods-producing jobs increased 65,000 after a 55,000 rebound in March. Manufacturing employment surged 44,000, following a 19,000 advance in March. Construction jobs even continued a comeback with a 14,000 rise, after rebounding 26,000 in March. Mining jobs rose 7,000 in April.

Private service-providing employment gained 166,000 in April, following a 119,000 boost the month before. Latest strength was in professional & business services, up 80,000; leisure & hospitality, up 45,000; and education & health services, up 35,000.

On a year-ago basis, payroll jobs improved to minus 1.0% in April from minus 1.7% the month before.

Wage inflation is nonexistent currently but it is hard to tell initially if weakness is related to shifts in the composition of hiring or not but that likely partially explains the weakness. Average hourly earnings were flat in April, following a 0.1% dip in March. Analysts had expected a 0.2% boost.

Not only is hiring improving but the workweek. The average workweek for all workers firmed to 34.1 hours from 34.0 hours in March. The consensus had projected 34.0 hours. The traditional series for production and nonsupervisory workers improved to 33.4 hours in April from 33.3 the prior month.

From the household survey, the unemployment rate rose to 9.9% from 9.7% in February, coming in above the consensus estimate for 9.6%. But the jump was due to an 805,000 surge in the labor force. April household employment actually jumped 550,000. Basically, discouraged workers see hope of employment and have jumped back into the labor force.

The bottom line is that the U.S. labor market is showing notable improvement. This could help the consumer sector regain optimism and strengthen the overall recovery.

U.S. Added 290,000 Jobs in April

WSJ 5/7 (excerpts) - The U.S. economy in April added jobs at the fastest pace in four years, but the unemployment rate unexpectedly rose.

The Labor Department said nonfarm payrolls rose by a higher than expected 290,000 jobs last month -- the largest gain since March 2006. That followed an upwardly revised 230,000 increase in March. The March figure was originally reported as a 162,000 increase.

Taking into account revisions to prior months, the U.S. economy added an average of 143,000 jobs a month in the first four months of the year, which may fuel optimism about the job market's recovery.

The U.S. economy has lost nearly 8.5 million jobs over the past two years, more than half of today's total unemployed. Although the downturn probably ended 10 months ago, companies have been reluctant to ramp up hiring as they await for more evidence of a stronger economy. In the meantime, they're focusing on producing more with fewer workers.

Total government employment, which include state and local jobs, rose by 59,000, helped by the influx of the Census workers. The decennial Census accounted for 66,000 of the employment boost last month. As those jobs will be lost in the second half of the year, some economists cautioned not to read too much into the headline figure. Census hires in March were 48,000.

Beyond government jobs, the report showed that the private sector created 231,000 jobs. Manufacturing continued to trend up, rising by 44,000. The industry, which is leading the economy's recovery, has added 101,000 jobs since December. Construction, a sector that has been suffering, added 14,000 jobs in April.

However, investors should be cautious about concluding from the April data that the jobs market is now out of the woods.

Economists expect the unemployment rate to fall very slowly as discouraged job seekers who had stopped looking for work return to the labor force and are counted as unemployed. The size of the labor force rose by 805,000 in April, the Labor Department said.

WSJ 5/7- Economists React: Jobs Report Confirms 'No Double Dip'

Jobs grew by 290,000 in April with important improvements in a broad swath of sectors. Both the average workweek and aggregate hours rose. A recovery is in place and there is no double dip. *–John Silvia, Wells Fargo*

The recovery has finally reached the labor market. … Most of these job gains occurred in professional business services, education & health, leisure & hospitality and in manufacturing. In April, there was no sector that continued to cut back on employment on a large scale *–Harm Bandholz, Unicredit*

Census hiring continues to be fairly muted, making the headline employment readings even stronger than they otherwise would be. This raises the prospect that May census hiring may be even stronger than we anticipated. However we must note that the return rate on mail in forms has been higher than expected which may reduce the number of employees the bureau will need to hide. *–Dan Greenhaus, Miller Tabak*

Private job creation was the missing link of the recovery and it now appears to be coming on stream. *–RDQ Economics*

The April employment report was blow-out strong. In a different environment, this would be a game-changer for the Fed, but it remains to be seen whether this will even move the needle for policymakers given their concerns about excessive disinflation as well as renewed market turmoil emanating from Europe. *–Stephen Stanley, Pierpoint Securities*

Press Release 5/7 (excerpts) - THE EMPLOYMENT SITUATION -- APRIL 2010

Nonfarm payroll employment rose by 290,000 in April, the unemployment rate edged up to 9.9%, and the labor force increased sharply, the U.S. Bureau of Labor Statistics reported today. Job gains occurred in manufacturing, professional and business services, health care, and leisure and hospitality. Federal government employment also rose, reflecting continued hiring of temporary workers for Census 2010.

Household Survey Data

In April, the number of unemployed persons was 15.3 million, and the unemployment rate edged up to 9.9%. The rate had been 9.7% for the first 3 months of this year.

Chart 1. Unemployment rate, seasonally adjusted, April 2008 – April 2010

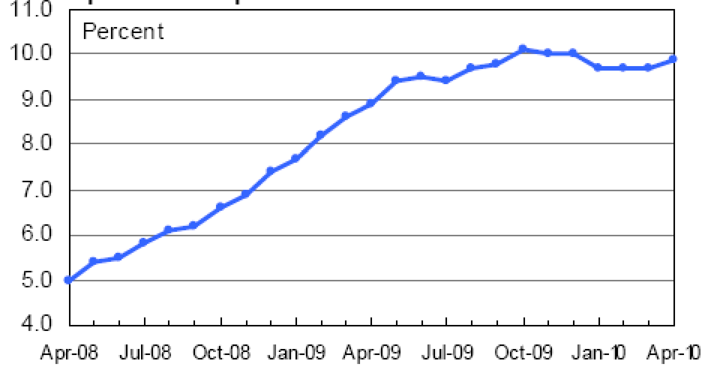
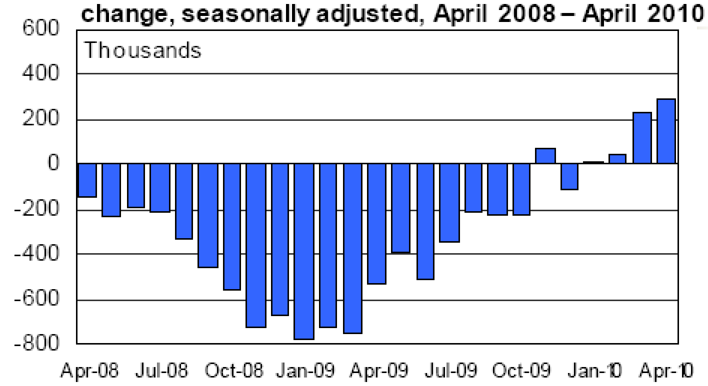


Chart 2. Nonfarm payroll employment over-the-month change, seasonally adjusted, April 2008 – April 2010



Personal Income and Outlays: Strong End To Q1 For Consumer Spending

Vanguard 5/7 - Consumers increased spending at a faster pace in March than they increased income, according to the Commerce Department. Personal income rose 0.3% for the month, while consumption grew 0.6%. As a result, the savings rate dropped to 2.7%—the lowest since September 2008. Most consumers spent their money on durable goods such as automobiles.

Barclays 5/3 - The March personal income and outlays report revealed a 0.6% rise in consumer spending and a 0.3% rise in personal income, both in line with the consensus forecasts. This represents a strong end to Q1 for consumption and points to further healthy growth in Q2 (our current forecast is 3.5%). A small upward revision to February was partly offset by a downward revision to January to leave our Q1 tracking estimate broadly unchanged.

On the income side, the wage and salary component was up 0.2% in March. Gains in rental income (0.7%) and current transfers (1.1%) offset a 1.6% decline in dividend income. After-tax disposable income rose 0.3%. On the consumption side, the PCE price index rose 0.1% (as did the core, both as expected), which meant real consumer spending was up 0.5%. The increase was driven by a strong gain in durable goods (3.4%). Non-durable goods rose 0.4% and service consumption was flat. The strength in spending relative to income pushed the saving rate down to 2.7% from 3.0%.

The 0.1% prints on the headline and core PCE price indexes pushed the y/y rate on the former up to 2.0% from 1.8%. The latter was unchanged at 1.3%

Econoday 5/3 - It's not gangbusters but according to the latest personal income report, the consumer sector is making gains. Economists have been saying for many months that the recovery would be anemic until the consumer sector became healthier-and it is beginning to look like that is the case. However, improvement is still modest compared to past recoveries.

AFP 5/10 - The overall gain in personal income was boosted by continued government transfer payments while wage income increased by only 0.2%. Spending growth outpaced that of incomes for the 2nd consecutive month, increasing 0.6% in March.

Construction Spending

Econoday 5/3 - Construction outlays made a partial comeback in March but February's decline was worse than earlier believed. Construction spending in March rebounded 0.2%, following a 2.1% drop the month before. March topped analysts' forecast for a 0.3% decrease for the latest month. However, the February figure originally had been at a 1.3% dip.

The March gain was led by a jump in public outlays which increased 2.3% after a 1.6% decline in February. The private sector was weak. Residential spending fell 1.1%, following a 3.4% decrease in February. Meanwhile, private nonresidential outlays slipped 0.7%, following a 1.5% fall the month before.

On a year-ago basis, overall construction outlays improved to minus 12.3% in March from minus 12.9% in February.

Vanguard 5/7 - The biggest drag on private residential construction remains weak demand for multifamily homes; high inventory levels also remain a challenge. Commercial real estate was in even worse shape in March, as there were few planned retail space expansions. There are large numbers of vacancies in office space across the country and economists don't expect a dramatic change anytime soon.

ISM Manufacturing Index: Manufacturing Sector Is Expanding - April

Vanguard 5/7 - The Institute for Supply Management's manufacturing index climbed to 60.4 in April, well above the expansionary threshold of 50. The strength in the manufacturing sector was evident in increased factory production, new orders, and employment. Analysts expect the widening gap between new orders and inventories to translate to higher production in the next couple of quarters.

Econoday 5/3 - The manufacturing expansion is accelerating quickly. The ISM's composite index, at 60.4, posted its strongest reading in six years. The pace of new orders is very strong, at 65.7 to extend a run of 10 straight months of strength. Production is following new orders, at 66.9 for a nearly 7 point gain from March for its strongest reading in six years.

Manufacturers are adding workers to meet the ramped up production schedule as the employment index rose nearly 3-1/2 points to 58.5 for its strongest reading, again, in six years.

Inventories, which jumped in March, showed no significant change in April, that is they held steady with an April index of 49.4. At 78.0, input prices continue to rise at a significant rate. Deliveries continue to slow and backlogs continue to build. Both exports and imports are strong.

Factory Orders

Vanguard 5/7 - New orders for manufactured goods were up 1.3% in March, the same as last month, but better than expected. This was the 11th increase in new orders over the past 12 months. Nondurable-goods orders climbed 2.9%, while durable-goods orders fell 0.6%. The largest decline in durable-goods orders was in transportation, where orders for commercial aircraft slid nearly 67%.

ISM Nonmanufacturing Index: Modest Growth In Service Sector - April

Vanguard 5/7 - The Institute for Supply Management's nonmanufacturing index remained flat at 55.4 in April. While the results of both this index and the manufacturing index (see above) suggest overall economic growth, activity in the service sector remains relatively muted. While demand is on the rise and production is growing, companies are hesitant to hire additional workers.

Econoday 5/5 - Prices showed steady acceleration reflecting rising fuel costs. This report, though showing little change, is positive for the economic outlook, indicating steady growth for the bulk of the nation's economy.

Productivity & Unit Labor Costs: Productivity Up, But At A Slower Pace

Vanguard 5/7 - Nonfarm business productivity grew at an annual rate of 3.6% in the first quarter, down from 6.3% in the fourth quarter, but well ahead of analysts' expectation of 2.5%. Companies continued to increase output without significantly increasing the hours worked by employees. During the past year, business productivity has risen 6.3%—the largest annual gain since the 1960s. Firms have increased profitability as they have gained productivity; however, productivity gains have thus far restrained employment and income growth. As the economy improves and demand increases, firms are expected to increase the hours of their existing workers and hire additional workers.

Econoday 5/6 - The easing in productivity growth was largely due to less robust output growth and was largely expected, given the slowing in GDP growth. Output in the nonfarm business sector advanced 4.4%, following a 7.0% spike the prior quarter. The good news in the report is that hours worked has risen modestly for two quarters, indicating some improvement in demand for labor. While modest, these gains are in sharp contrast to large declines in prior quarters.

Both productivity and costs were a little better than expected. This is good news for the Fed, which needs to see a continuation of subdued inflation pressures.

Unemployment Insurance Weekly Claims Report (Initial Jobless Claims)

Press Release 5/6 (excerpts) – In the <u>week ending May 1</u>, the advance figure for seasonally adjusted initial claims was 444,000, a decrease of 7,000 from the previous week's revised figure of 451,000. The 4-week moving average was 458,500, a decrease of 4,750 from the previous week's revised average of 463,250.

The advance seasonally adjusted insured unemployment rate was 3.6% for the week ending April 24, unchanged from the prior week's unrevised rate of 3.6%.

The advance number for seasonally adjusted insured unemployment during the week ending April 24 was 4,594,000, a decrease of 59,000 from the preceding week's revised level of 4,653,000. The 4-week moving average was 4,649,000, an increase of 8,000 from the preceding week's revised average of 4,641,000.

WEEK ENDING	May 1	April 24	Change	April 17	Prior Year
Initial Claims (SA)	444,000	451,000 rev	-7,000	459,000	604,000
4-Wk Moving Average (SA)	458,500	463,250	-4,750	461,000	617,250

Econoday 5/6 (excerpts) - Unemployment claims improved for a third straight week but far from dramatically. <u>Initial claims for the May 1 week fell 7,000 to 444,000</u>, pulling the four-week average down 4,750 to 458,500. The <u>prior week was revised 3,000 higher to 451,000</u>. Continuing claims for the April 24 week fell 59,000 to 4.594

million, though the four-week average for this reading rose slightly to 4.649 million. The unemployment rate for insured workers is unchanged at 3.6%.

The Economic Week Ahead: May 10 – May 14

Vanguard 5/7 - Lots of economic news is expected late next week. The week begins with a report on international trade on Wednesday. On Friday, reports are expected on the following topics: durable-goods orders, retail sales, industrial production, and business inventories.

U.S. Economic Calendar

Source: Briefing.com

Date	ET	Release	For	Briefing.com	Consensus	Prior
May 11	10:00	Wholesale Inventories	March	0.5%	0.5%	0.6%
May 12	08:30	**Trade Balance**	March	-$39.5B	-$40.0B	-$39.7B
May 13	08:30	Continuing Claims	05/08	4600K	4590K	4594K
May 13	08:30	Initial Claims for Unem. Benefits	05/08	440K	440K	444K
May 13	08:30	Import & Export Prices	April	NA	NA	NA
May 14	08:30	**Retail Sales**	April	0.6%	0.2%	1.9%
May 14	09:15	Capacity Utilization	April	73.7%	73.8%	73.2%
May 14	09:15	**Industrial Production**	April	0.6%	0.6%	0.1%
May 14	09:55	Michigan Sentiment	May	73.7	73.5	72.2
May 14	10:00	**Business Inventories**	March	0.4%	0.4%	0.5%

FFCB Weekly Debt Issuance Activity

Week Ended Date	Discount Notes $million	New Bonds $millions	Issue Count	Called Bonds Par $millions	Issue Count
9-Apr	$ 4,435	$ 927	13	$ 720	5
16-Apr	5,785	2,511	26	546	6
23-Apr	8,295	2,570	19	2,037	13
30-Apr	7,210	1,063	12	337	6
7-May	9,999	1,341	12	259	3