

Market Comment *Economic Highlights for the week ended May 27, 2011*

Economic Week in Review: The Pause That Refreshes?

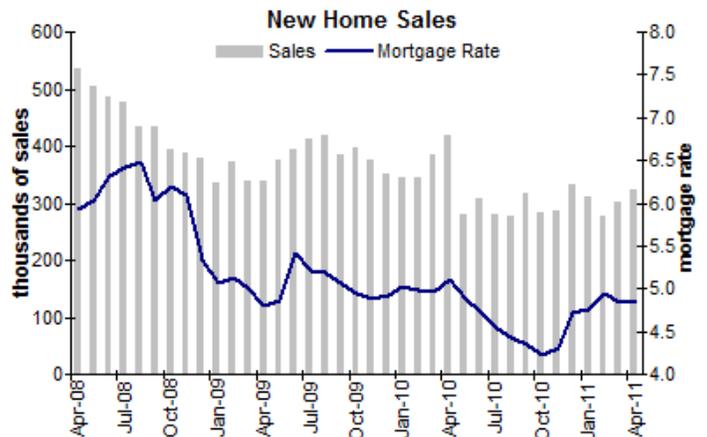
Vanguard 5/27 - Heading into Memorial Day and the unofficial start of summer, the U.S. economy has continued to expand, but at a more gradual pace. Growth in real gross domestic product (GDP) slowed in the first quarter, while April's durable-goods orders fell. Economists expect both measures to rebound. Personal spending growth also dropped slightly, while growth in income remained steady. However, there was some shine to the week's news as new-home sales rose for the second straight month. For the week ended May 27, the S&P 500 Index fell 0.2% to 1,331 (for a year-to-date total return—including price change plus dividends—of about 6.7%). The yield of the 10-year U.S. Treasury note decreased 8 basis points to 3.07% (for a year-to-date decrease of 23 basis points).

New-Home Sales – April: New Home Sales Fully Reverse Weather-Related Softness

Vanguard 5/27 - Sales of new homes rose for the second straight month as the market bounced back from February's dismal lows. New-home sales increased 7.3% in April to an annual rate of 323,000, better than analysts forecast. Paced by a 15.1% surge in the West, all four of the nation's regions showed gains. Inventory dropped to 6.5 months from 7.2. Even so, new-home sales were 23.1% below April 2010, when the federal homebuyer tax credit was still in effect. However, the median sales price increased 4.6% during the past year, to \$217,900.

Econoday 5/24 –Strong sales drew down supply to 6.5 months from 7.2 in March and 7.9 in February. In a useful signpost for how deeply the residential sector has contracted, only 175,000 new homes are up for sale for the lowest total in data that goes back to 1963!

Barclays 5/24 - We expect trends in housing activity to improve gradually as the economic backdrop firms and new home inventory levels remain lean. New homes for sale at 175k is the lowest recorded inventory level in the history of the series dating back to January 1963 and suggests that homebuilders will ultimately need to increase start activity even at this low pace of sales.



GDP – 2nd Estimate: Q1 - GDP Slowly Advances

Vanguard 5/27 - GDP—which represents the total value of the nation's goods and services—rose at an annual rate of 1.8% in the first quarter, according to the Commerce Department's second estimate. The rate was unchanged from last month's previous first-quarter estimate, shattering expectations of an increase. It was also below the fourth quarter's 3.1% pace. A deceleration in personal spending growth and increase in imports led to the slowdown along with a reduction in spending from the federal government. A rise in inventories, which had dropped in the fourth quarter, boosted growth. Despite the slower growth, GDP has been positive for seven straight quarters. Economists expect the pace of growth to rise again this year. Next month's revised estimate will be the last for the quarter.

Econoday 5/26 – The economy did not get the hoped for upgrade for the start of the year. The Commerce Department's second estimate for quarter GDP growth was unrevised at up 1.8% annualized and came in lower than the consensus forecast for 2.1%. The first quarter remains notably softer than the 3.1% pace in the fourth quarter.

Economy-wide inflation was unrevised, with the GDP price index posting at 1.9%.

Barclays 5/26 - The underperformance relative to our expectation came from softer growth in real consumption than first recorded. Real consumption growth was revised down from 2.7% to 2.2%, mainly reflecting softer goods consumption. Goods consumption was revised down from 4.8% to 3.5% as both durable and nondurable goods consumption was softer than originally reported.

Altogether, the second release confirms the soft start to the year for GDP growth. We continue to believe some of the main sources of weakness, the declines in structures investment and defense spending in particular, are generally supportive of our view that temporary factors played a significant role in the slowdown, and we look for

Market Comment *Economic Highlights for the week ended May 27, 2011*

GDP growth to rebound in Q2. However, the slowdown in consumption was sharper than reported in the first release, suggesting that the surge in headline inflation from higher food and energy prices in the first quarter cut into real spending more than originally estimated.

Durable Goods Orders – April: Orders Tumble

Vanguard 5/27 - New orders for U.S. durable goods—goods expected to last at least 3 years—dropped 3.6% in April, worse than forecast. Economists cited Japan's March earthquake as a major reason for the decline, as interference with supplies slowed automobile and parts production. Not including the transportation sector's 9.5% fall, new orders decreased 1.5%. New orders for core capital goods—which exclude aircraft and defense orders—fell 2.6%.

Econoday 5/25 –Weakness in the latest month was broad-based but also followed a broad-based jump in March. This series is living up to its reputation as one of the most volatile monthly data series.

Weakness in the latest month was led by transportation equipment which dropped a monthly 9.5% in April after a 10.3% boost the month before. By subcomponents for April, nondefense aircraft plunged 30.0% (essentially a fall in Boeing orders); defense aircraft & parts decreased 8.9%; and motor vehicles declined 4.5%.

Outside of transportation, weakness was widespread. Declines were seen in primary metals, down 1.6%; fabricated metals, down 1.1%; machinery, down 3.4%; electrical equipment, down 4.9%; and "other" durables, down 1.0%. Computers & electronics orders rose 0.7%.

Barclays 5/25 - Durable goods orders declined 3.6% in April after an upwardly revised 4.4% in March (previous: 4.1%). As expected, the decline was broad-based across volatile and non-volatile components.

Furthermore, we believe the softness in April core capital goods orders reflects the general pattern of decreases in core capital goods orders during the first month of the quarter as manufacturers wait to gauge demand, rather than signaling a shift in trend. Today's report is a small negative for our Q2 GDP tracking estimate, which stands at 3-3.5%.

Personal Income and Outlays – April: Personal Spending Growth Backs Off

Vanguard 5/27 - Consumer spending increased 0.4% in April, in line with economists' expectations but retreating slightly from March's 0.5% increase. Rising energy and food prices triggered the gains, as consumers paid more at the pump and in the produce aisles. Analysts report that higher gas and grocery bills are forcing consumers to cut their savings or trim less-essential items from their budgets. Income growth, also at a 0.4% rate, remained the same; March's figure was revised downward from 0.5%. The savings rate remained steady at 4.9% after March's number was revised down from 5.5%.

Econoday 5/27 – Income growth continued to support the consumer sector in April. Spending was moderately strong but largely due to higher prices. Notably, inflation is still on the warm side. As the report's biggest positive, personal income in April posted a 0.4% gain equaling the pace in March and matching analysts' forecast. Importantly, the key wages & salaries component increased 0.4%, following a boost of 0.3% in March.

Spending looks healthy at face value but inflation was the underlying factor for the most part. Energy is keeping overall inflation on the high side. The headline PCE price index posted a 0.3% gain, down marginally from 0.4% in March but still strong. However, the core rate firmed to 0.2% from 0.1% in March.

On a year-ago basis, headline PCE inflation worsened to 2.2% from 1.8% in March. Core PCE price inflation edged up to 1.0% on a year-ago basis from 0.9% in March. Core inflation has been on an uptrend since the recent year-ago low of 0.7% in December 2010.

The good news is that income growth remains moderately strong. The bad news is that inflation has eaten into those earnings and has restrained real spending.

Michigan Consumer Sentiment – May

Econoday 5/27 –Consumers aren't as glum as many suspect, at least not based on the consumer sentiment index which really surged the last part of this month. The index for May came in at 74.3, well up from a mid-month 72.4 and implying a 76.2 reading over the last two weeks. This is just shy of February's recovery best level of 77.5 which was registered of course before the spike in oil took hold and before the disaster in Japan struck.

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Market Comment *Economic Highlights for the week ended May 27, 2011*

In an especially good sign, May's gain is centered in expectations, which is the report's leading component. This reading suggests that consumers may have already adapted to \$100 oil and \$4 gas.

Barclays 5/27 - The surprise in the headline was driven by both the current conditions component (81.9 vs 80.2 previously) and the index of expectations (69.5 from 67.4 previously). Furthermore, inflation expectations also ticked lower in today's report. One-year median inflation expectations fell to 4.1% from 4.4% previously, and five-year median inflation expectations also ticked lower, to 2.9% from 3.0%.

Unemployment Insurance Weekly Claims Report – week ended May 21

Press Release 5/26 (excerpt) - In the week ending May 21, the advance figure for seasonally adjusted initial claims was 424,000, an increase of 10,000 from the previous week's revised figure of 414,000. The 4-week moving average was 438,500, a decrease of 1,750 from the previous week's revised average of 440,250.

The advance seasonally adjusted insured unemployment rate was 2.9% for the week ending May 14, a decrease of 0.1 percentage point from the prior week's unrevised rate of 3.0%.

The advance number for seasonally adjusted insured unemployment during the week ending May 14 was 3,690,000, a decrease of 46,000 from the preceding week's revised level of 3,736,000. The 4-week moving average was 3,742,250, an increase of 7,750 from the preceding week's revised average of 3,734,500.

WEEK ENDING	May 21	May 14	Change	May 7	Prior Year
Initial Claims (Seasonally Adj)	424,000	414,000	10,000	438,000	467,000
4-Wk Moving Average (SA)	438,500	440,250	-1,750	437,750	464,750

Econoday 5/26 – With no special factors to blame, initial jobless claims rose 10,000 in the May 21 week to a 424,000 level that's 20,000 higher than expected. Revision to the May 14 week is also a negative, up 5,000 to 414,000. The Labor Department isn't citing any weather or auto-related factors for the results.

Barclays 5/26 - Initial claims had been pushed up over the prior few weeks by a variety of special factors, but Bloomberg reported that the Labor Department stated that no such factors affected the May 21 report, leaving us to conclude that the trend in initial claims has indeed worsened somewhat from the sub-400k weekly rate of March and February.

FHFA Housing Price Index – March: Recent weakness in FHFA home prices abates in March

Econoday 5/25 – The recent downtrend in house prices continues as the FHFA purchase only house price index dipped another 0.3% in March, following a decrease of 1.5% in February. This index has declined for five months in a row after scattered improvement in 2009. On a year-on-year basis, the FHFA HPI is down 5.8%, compared to down 5.5% in February. Overall, home prices continue to suffer from sluggish demand and heavy supply.

Pending Home Sales - March

Econoday 5/27 – In what could be the first signal of another breakdown in the housing market, April's pending home sales index fell nearly 11 points to 81.9, down 11.6% from a downward revised 92.6 in March. Regionally the decline is centered in the largest region which is the South where pending sales fell more than 17%.

The Economic Week Ahead: May 30 – June 3, 2011

Vanguard 5/27 - Following the Memorial Day holiday, there's a full slate of economic news on tap. Scheduled reports include the Conference Board's consumer confidence survey on Tuesday; construction spending and the Institute for Supply Management's manufacturing index on Wednesday; productivity, labor costs, and factory orders on Thursday; and the employment situation and the ISM's nonmanufacturing index on Friday.

This Week's U.S. Economic Calendar Week of May 30 - June 03 Source: Briefing.com

Date	ET	Release	For	Briefing.com	Consensus	Prior
May 31	09:00	Case-Shiller 20-city Index	Mar	NA	NA	-3.33%
May 31	09:45	Chicago Purchasing Manager's Index	May	NA	NA	67.6

Market Comment *Economic Highlights for the week ended May 27, 2011*

Date	ET	Release	For	Briefing.com	Consensus	Prior
May 31	10:00	Consumer Confidence	May	NA	NA	65.4
Jun 01	08:15	ADP Employment Change	May	NA	NA	179K
Jun 01	10:00	ISM Manufacturing Index	May	NA	NA	60.4
Jun 01	10:00	Construction Spending	Apr	NA	NA	1.4%
Jun 02	08:30	Initial Claims	05/28	NA	NA	NA
Jun 02	08:30	Continuing Claims	05/21	NA	NA	NA
Jun 02	08:30	Productivity-Rev.	Q1	NA	NA	1.6%
Jun 02	08:30	Unit Labor Costs-Rev.	Q1	NA	NA	1.0%
Jun 02	10:00	Factory Orders	Apr	NA	NA	3.4%
Jun 03	08:30	Nonfarm Payrolls	May	NA	NA	244K
Jun 03	08:30	Unemployment Rate	May	NA	NA	9.0%
Jun 03	10:00	ISM Services	May	NA	NA	52.8