Market Comment *Economic Highlights for the week ended June 17, 2011*

Economic Week in Review: Slower Growth Amid Signs Of Strength

Vanguard 6/17- Inflation showed signs of decelerating and the pace of retail sales weakened, giving more evidence that economic growth has slowed recently. At the same time, some data—including the widely followed leading economic indicators and new housing starts—suggested that the economy is still making headway despite the challenges it has faced in recent months. For the week ended June 17, the S&P 500 Index rose less than one-hundredth of a percentage point to finish at 1,272 (for a year-to-date total return of about 2.0%). The yield of the 10-year U.S. Treasury note fell 5 bps to 2.94% (for a year-to-date decline of 36 basis points).

Retail Sales – May: Retail Customers Tap the Brakes

Vanguard 6/17 – Retail sales pulled back 0.2% in May, the first reversal in 11 months. Excluding a marked slowdown in auto sales, sales were actually up 0.3%, the lowest number in 10 months but higher than the corresponding figure from a year ago, when the economy hit its previous soft patch. Weakness was seen in electronics and appliance stores, furniture stores, and grocery stores. Non-store retailers and building supply stores did better. Total sales were 7.7% higher than a year ago (8.2% excluding auto sales).

Barclays 6/14 - The upside surprise was driven by a 1.2% increase in building materials and a 0.3% increase in gasoline sales. The main driver of the decline was a 2.9% drop in auto sales. We believe this largely reflects the effect of supply constraints in the aftermath of the Japan earthquake and expect auto sales to bounce back over the summer.

Econoday 6/14 – Headline retail sales slipped in May, tugged down largely by auto sales. Motor vehicle sales dropped 2.9%. Overall, the trend is upward but at a modest pace the last two months.

Producer Price Index (PPI) - May

Vanguard 6/17 - The producer price index and its core rate for finished goods both rose 0.2% in May. The PPI's increase—the slowest rise since last summer—was almost entirely because of higher prices for finished energy goods. Some analysts believe producers have become more confident about their ability to pass along their increased costs within the supply chain, before they hit consumers.

Barclays 6/14 - Within the headline, energy prices rose 1.5% and food prices fell 1.4%. The former reflected a 2.7% increase in gasoline prices, partly offset by a 3.5% decline in home heating oil. The latter was driven by greater than 10% declines in fruit and vegetable prices, which are likely temporary. Elsewhere, the recent picture of small, broad-based price increases across most consumer-related components was evident. Further back on the production line, core intermediate goods prices rose 0.9% but core crude goods prices declined 0.9%.

Econoday 6/14 –On a not seasonally adjusted basis, the year-ago PPI was up 7.3% while the core was up 2.1%.

The latest PPI report softened but not with any help from energy. And the underlying trend for consumers is still on the high side with the year ago pace for consumer goods excluding food and energy at up 2.7%. Manufacturers currently may have difficulty passing along costs but they certainly have incentive to try.

Consumer Price Index (CPI) – May: Inflation Threat Seems To Ease A Bit

Vanguard 6/17 - The consumer price index rose 0.2% in May, the slowest pace since November's 0.1% reading. However, excluding volatile food and energy prices, core consumer prices rose 0.3%, their largest monthly uptick in more than 4 years. Over the past 12 months, core CPI was up 1.5%, the highest 12-month result since January 2010 but still a modest number by historical standards. The data show that food price increases have moderated and energy prices have started to retreat, which may indicate that the near-term threat of accelerating inflation has passed.

Econoday 6/15 – Consumer price inflation softened in May on a decline in energy costs. Energy came down 1.0%. Gasoline declined 2.0%. Food prices rose 0.4%.

Within the core, indexes for apparel, shelter, new vehicles, and recreation all contributed to the acceleration, rising more in May. New & used vehicles rose a strong 1.0% but this may be a temporary effect of supply disruptions of parts from Japan and less availability of some auto models.

Year-on-year, overall CPI inflation worsened to 3.6% (seasonally adjusted, see graph next page). Today's inflation report lowers the odds of the Fed engaging in QE3 as there clearly are some warm spots within the CPI. With energy softening a bit, food price inflation is standing out more.

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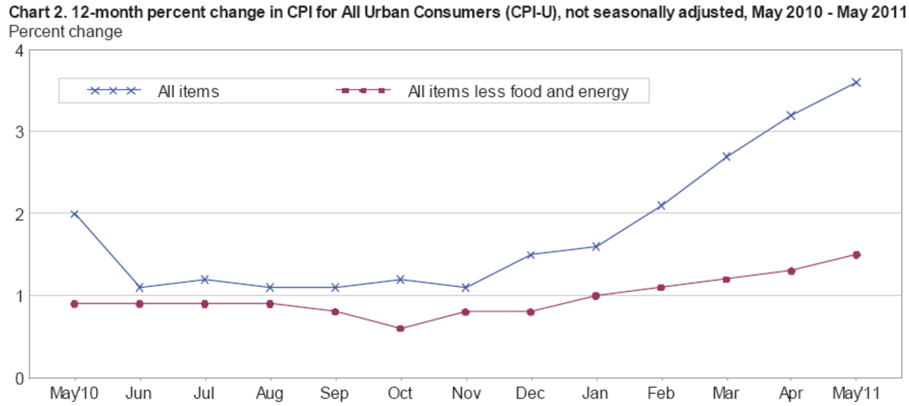
Barclays 6/15 - <u>Today's report provides further evidence of building price pressures across a broad range of goods and services.</u> The trend of small monthly increases in core service prices is likely to continue, underpinned by persistent gains in the shelter component. Core goods prices (particularly vehicles and apparel) are likely to be more volatile, but we believe these are also now on a firm upward trend.



Leading Indicators - May

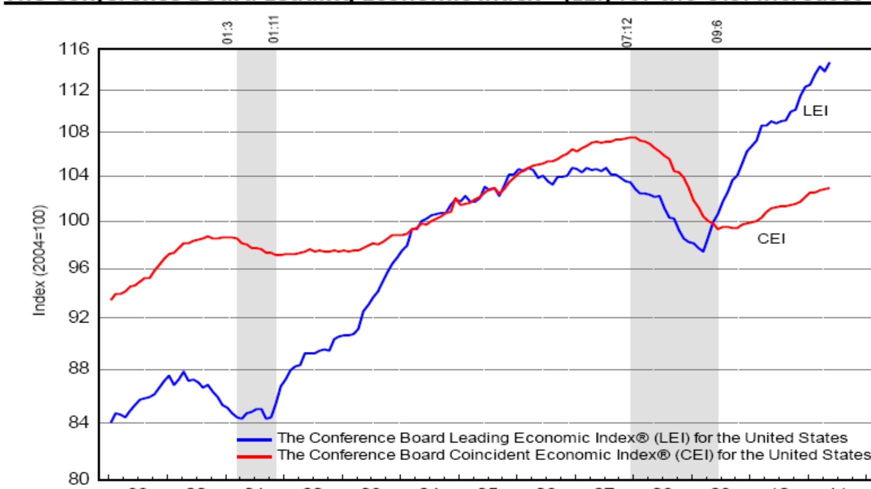
Vanguard 6/17 – <u>The index of leading economic indicators bounced back from April's negative reading to post a surprisingly strong 0.8% rise</u>. The largest contributions came from the interest rate spread, consumer expectations, and housing permits, more than offsetting the negative contribution from supplier deliveries. The return to positive territory seemed to confirm the view that last month's pullback reflected temporary factors and did not indicate the start of a downward trend.

"Modest economic growth is being buffeted by some strong headwinds, including high gas and food prices and a soft housing market," said Ken Goldstein, economist at The Conference Board. "The economy will likely continue to grow through the summer and fall. However, it will be choppy."

Econoday 6/17 - <u>On the clearly positive side are jobless claims which are continuing to improve this month</u>. And hopefully building permits will add to their big improvement in May and hopefully stock prices can recover by month end.

Barclays 6/17 - Rising stock prices and falling jobless claims provided modest positive contributions, as did estimated orders of consumer and nondefense capital goods. The only drag on the index was the manufacturing supplier deliveries index; the average workweek held steady in May and was neutral. <u>This rebound in the leading indicators index is an encouraging sign that the recent slowdown in the economy may be short lived, as the index has continued to trend higher at a 4.3% annualized pace over the past three months</u>.

<u>The Conference Board Leading Economic Index® (LEI) for the U.S. Increases in May</u>



Latest LEI Trough March 2009, Latest CEI Trough June 2009
Shaded areas represent recessions as determined by the National Bureau of Economic Research.

Industrial Production and Capacity Utilization - May

Vanguard 6/17 – <u>Industrial production rose 0.1% in May.</u> May's gain was concentrated in non-auto industries, where production rose 0.6%. Auto production declined 1.5%, indicating the supply chain disruptions triggered by the Japanese earthquake eased during the month. Overall <u>capacity utilization held steady at 76.7%</u>.

"This report is great news, because the manufacturing sector and related manufacturing exports have been the key drivers of the U.S. recovery," said Vanguard senior economist Roger Aliaga-Díaz. "The recent slowdown in this sector was the chief reason growth expectations were lowered for the second quarter. Going forward, a strengthening manufacturing sector could unleash businesses' pent-up demand for capital goods, all of which could turn out to be a key driver of economic growth over the remainder of 2011."

Econoday 6/15 – Manufacturing made a comeback, rebounding 0.4% in May. On a year-on-year basis, overall industrial production slowed to 3.4%.

The details for the production report are quite encouraging as the headline number was weighed down by utilities and manufacturing excluding autos was very healthy. Taking into account that auto assemblies eventually will work around current parts shortages, forward momentum looks good.

Barclays 6/15 - The strength in manufacturing outside of autos in May is an encouraging sign.

Business Inventories - April

Vanguard 6/17 – Business inventories rose a modest 0.8% in April. The increase came primarily from manufacturers and wholesalers, as retail inventory growth was minimal. All of these measures were lower than March's, showing that business inventories were reacting to the recent slowdown in demand. Total inventories were 10.6% higher than a year ago.

Empire Manufacturing Index

Econoday 6/15 – For the first time since November, monthly business conditions in the New York manufacturing region contracted in what is an ominous, though nevertheless still isolated, indication for the national economy. The Empire State index fell nearly 20 points in the June reading to minus 7.79 in what the report describes as a "steep" decline. New orders fell nearly 21 points, indicating month-to-month contraction compared to May. Shipments are even worse, down nearly 35 points.

Philadelphia Fed Manufacturing Index

Econoday 6/16 – There's confirmation of bad news in the manufacturing sector as the Philly Fed general business conditions index moves into negative ground signaling month-to-month contraction in the manufacturing sector. The index came in at minus 7.7 for the first negative reading since September. Weakness is centered in orders. New orders are minus 7.6 with unfilled orders at minus 16.3. Shipments and employment both rose in the month but at a slower rate, and the decline in orders points to further slowing, if not contraction, in future reports.

Another negative is a big decline in the six-month outlook as expectations for very solid growth are turning into expectations for marginal growth. Japanese supply effects may be at play to some extent but transportation equipment is not a dominant industry in either the Mid-Atlantic or New York regions.

Barclays 6/16 - While respondents continue to report small increases in shipments and employment, the overall weakness of this report corroborates the Empire State manufacturing survey's discouraging tone, signaling that the manufacturing slowdown worsened in June.

Housing Starts - May

Vanguard 6/17 – Home-building took a positive turn as the start of construction on new U.S. homes rose 3.5% in May to an annualized rate of 560,000. April's figure was revised upward by nearly 3%. The West experienced a strong bounce of 18%, while the South saw housing starts rise 1.5%. Starts declined about 4% in the Midwest and 19% in the Northeast. Construction permits rose 8.7%, mostly due to the multifamily sector. Although housing starts were down 3.4% from a year ago, the data have stabilized and revisions have tended to be upward. Rising issuance of permits could mean housing starts will pick up in the near future.

Econoday 6/16 – Housing starts remain at low levels but the May numbers for starts and permits indicate that there is modest demand in some local markets for new construction-likely built to order rather than spec. But the fundamentals are unchanged: there is still enormous supply on the market.

NAHB Index – May: Residential Construction Turns Around

Econoday 6/15 – Home builders are reporting the worst conditions since last year's post housing-stimulus fade. The housing market index fell a very sharp three points to 13. Components show a sweep of declines with future sales the weakest. Low prices for existing homes are the biggest obstacle for home builders who say their selling prices are going down at the same time that material costs are rising. The economy had been recovering without the housing sector but a deepening dip for the sector could pose a risk to a slowing economy.

Unemployment Insurance Weekly Claims Report – Week Ended June 11

Press Release 6/16 (excerpt) - In the week ending June 11, the advance figure for seasonally adjusted initial claims was 414,000, a decrease of 16,000 claims. The 4-week moving average was 424,750, unchanged.

The advance seasonally adjusted insured unemployment rate was 2.9% for the week ending June 4, unchanged from the prior week's unrevised rate of 2.9%.

The advance number for seasonally adjusted insured unemployment during the week ending June 4 was 3,675,000, a decrease of 21,000 from the preceding week. The 4-week moving average was 3,709,000, a decrease of 15,250.

WEEK ENDING	June 10	June 3	Change	May 28	Prior Year
Initial Claims (Seasonally Adj)	414,000	430,000	-16,000	426,000	474,000
4-Wk Moving Average (SA)	424,750	424,750	0	426,750	467,250

Econoday 6/16 – In what is very good news for the economy, the number of unemployed filing for first-time jobless claims fell 16,000 in the June 11 week. There are no special factors skewing this report, one that should help boost confidence in the economic outlook and help limit the troubles underway in the financial markets.

Barclays 6/16 - The four-week average at 425k remains about 30k above the recent lows observed in March and April, suggesting that the underlying trend in claims has flattened somewhat after accounting for some of the special factors that had propelled claims higher in previous weeks. Until the four-week moving average begins to clearly trend lower, we continue to expect recent trends in initial jobless claims to indicate some loss of momentum in labor markets.

U of Michigan Consumer Sentiment - June

Barclays 6/17 - The University of Michigan's index of consumer sentiment fell to 71.8 in the June. The decline in the headline index was broad-based as current conditions fell to 79.6 and the index of expectations also decreased, to 66.8. Consumers became more pessimistic about the economy this month, with only 37% of households citing that they heard favorable economic developments, down from 50% in May. Similarly, only 25% of households reported that their financial situation had bettered over the past year. On the inflation expectations front, one-year median inflation expectations edged lower to 4.0%, while five-year median inflation expectations ticked higher to 3.0%. This was an overall disappointing report and is consistent with the general trend of weak data over the recent period.

The Economic Week Ahead: June 20 – June 24, 2011

Vanguard 6/17 – The Federal Open Market Committee's latest report on monetary policy is due out on Wednesday, sandwiched between updates on existing-home sales (Tuesday) and new-home sales (Thursday). Friday will bring an update on real gross domestic product for the first quarter and the durable goods report.

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

Date	ET	Release	For	Briefing.com	Consensus	Prior
Jun 21	10:00	Existing Home Sales	May	4.70M	4.78M	5.05M
Jun 22	10:00	FHFA Housing Price Index	April	NA	NA	0.3%
Jun 22	14:15	**FOMC Rate Decision**	June	0.25%	0.25%	NA
Jun 23	08:30	Initial Claims	06/18	425K	418K	NA
Jun 23	08:30	Continuing Claims	06/11	3700K	3680K	NA
Jun 23	10:00	New Home Sales	May	290K	305K	323K
Jun 24	08:30	GDP - Third Estimate	Q1	1.8%	1.8%	1.8%
Jun 24	08:30	GDP Deflator - Third Estimate	Q1	1.9%	1.9%	1.9%
Jun 24	08:30	Durable Orders	May	2.5%	1.0%	-3.6%
Jun 24	08:30	Durable Orders -ex Transportation	May	-0.5%	0.6%	-1.5%