Market Comment *Economic Highlights for the week ended June 24, 2011*

Economic Week In Review: Reasons For Hope And Worry

Vanguard 6/24- The U.S. economy expanded modestly in the first quarter even as weakness persisted in the housing markets and as the Federal Reserve lowered its outlook for growth. For the week ended June 24, the S&P 500 Index fell 0.2% to finish at 1,268 (for a year-to-date total return of about 1.8%). The yield of the 10-year U.S. Treasury note fell 6 basis points to 2.88% (for a year-to-date decline of 42 basis points).

AFP 6/27 - As the latest round of Federal Reserve purchases of Treasury securities was wrapping up, the Federal Open Market Committee voted as expected to allow the program to sunset even though it felt that the economic recovery was progressing “somewhat more slowly than expected.” Just a few days later, the Bureau of Economic Analysis reaffirmed this view with its latest revision to first quarter gross domestic product (GDP), which showed a tepid 1.9% growth rate on an annualized basis. Housing remained a drag on economic activity in May, while durable goods orders made a mild comeback during the same month.

Existing Home Sales- May: Existing-Home Sales Slip Again

Vanguard 6/24 – Sales of existing homes declined 3.8% in May for the second consecutive month, to an annualized rate of 4.8 million units. Home sales (including single-family dwellings, townhouses, and condos) were down 15% from a year ago. The median existing-home price fell 4.6% to about $166,500 year over year. Every region except the West Coast experienced a decline in May; the Midwest was hit hardest (–6.4%) partly because of bad weather. Several factors, including the soft job market and tighter mortgage lending practices, continued to put pressure on sales. "Spiking gasoline prices along with widespread severe weather hurt house shopping in April, leading to soft figures for actual closings in May," said Lawrence Yun, chief economist at the National Association of Realtors. "Current housing market activity indicates a very slow pace of broader economic activity, but recent reversals in oil prices are likely to mitigate the impact going forward."

Econoday 6/21 –Supply on the market, at 3.72 million, is falling but not enough relative to the decline in sales as months supply rose to 9.3 months. The heavy supply doesn't point to much pricing power in the months ahead.

The National Association of Realtors is definitely looking at the bright side, saying pending home sales data for next week’s report will show "solid gains." The NAR believes that May will prove to be the year's bottom for the housing sector.

Barclays 6/21 - A potential bright spot in the last two existing home sales reports is the ratio of distressed sales to total sales. The NAR reported that 31% of existing home sales were related to the sales of distressed properties, down from 40% in March. The share of distressed sales had been rising into Q1 11 and we saw this as one of the main reasons for the continued softness in home prices nationwide.

FHFA Housing Price Index - April

Econoday 6/22 – Home prices in April unexpectedly rose, breaking a string of monthly declines. The FHFA purchase only house price index rose 0.8% in April. April's gain followed six consecutive monthly losses. On a year-on-year basis, the FHFA HPI is down 5.7%.

AFP 6/27 - Despite April’s improvement, home prices remained 19.3% below the April 2007 (peak?) and matched those of January 2004.

FOMC Rate Decision – June: Fed Issues A Downbeat Outlook

AFP 6/27 - There was no significant shift in policy as <u>the FOMC will allow QE2 to end later this week</u> and <u>announced once again that the fed funds target rate will remain at near zero for “an extended period.</u>” The vote was unanimous. The statement noted that the recovery was moving at a “somewhat slower pace” than expected and that the jobs market had been “weaker than anticipated.” Still, “household spending and business investment in equipment and software” showed some life. <u>The FOMC believes the recent slowdown is “likely to be temporary” as will the recent spike in food and energy prices</u>.

Vanguard 6/24 - The Federal Reserve downgraded its 2011 GDP forecast from 3.2% to about 2.8%, citing prolonged difficulties stemming from the financial crisis. As planned, the FOMC said the Fed would wind down its second round of quantitative easing, the bond-buying program aimed at helping stimulate the economy, this month. The committee attributed the recent rise in inflation to higher commodity prices rather than significant increases in underlying "core" inflation; long-term inflation remains stable.

Econoday 6/22 – As expected, the Fed left policy rates unchanged, is allowing QE2 to end this month, but has decided to delay the natural unwinding of its expanded balance sheet. The Fed left its fed funds target rate at a range of zero to 0.25% and retained the "extended period" language on keeping rates low for some time.

- "The Committee continues to anticipate that economic conditions--including low rates of resource utilization and a subdued outlook for inflation over the medium run--are likely to warrant exceptionally low levels for the federal funds rate for an extended period. The Committee will complete its purchases of $600 billion of longer-term Treasury securities by the end of this month and will maintain its existing policy of reinvesting principal payments from its securities holdings."
- "Information received since the Federal Open Market Committee met in April indicates that the economic recovery is continuing at a moderate pace, though somewhat more slowly than the Committee had expected. Also, recent labor market indicators have been weaker than anticipated. The slower pace of the recovery reflects in part factors that are likely to be temporary, including the damping effect of higher food and energy prices on consumer purchasing power and spending as well as supply chain disruptions associated with the tragic events in Japan."

Notably, the Fed has retained its outlier position that current sluggishness in the economy is temporary. Even more striking, the Fed not only sees the current bump up in inflation as temporary, it also sees inflation easing to below its implicit target. This belief in the direction of inflation is almost certainly due to recent declines in crude oil prices.

- "The unemployment rate remains elevated; however, the Committee expects the pace of recovery to pick up over coming quarters and the unemployment rate to resume its gradual decline toward levels that the Committee judges to be consistent with its dual mandate. Inflation has moved up recently, but the Committee anticipates that inflation will subside to levels at or below those consistent with the Committee's dual mandate as the effects of past energy and other commodity price increases dissipate."

Overall, the Fed is a little less negative than most economists and analysts, calling for improved recovery in coming quarters. Some of this clearly is the economy moving past supply disruptions from Japan. Nonetheless, the Fed is keeping monetary policy as loose as is possible without actually engaging in a third round of quantitative easing.

Barclays 6/22 - The primary source of higher headline inflation has been commodity prices, which are prices the Fed generally believes are determined by global conditions and **are largely outside the reach of Fed interest rate policy**. We believe that the committee is not inclined to lean against commodity price pressures while inflation expectations remain contained. Therefore, the information in the June statement and press conference suggests the Fed will be willing to sit patiently in neutral and examine the incoming data flow before deciding its next steps.

The committee decided to stay on the policy path it outlined in its April meeting; namely that Fed “will complete its purchases” of $600bn in longer-term Treasury securities at the end of this month and “will maintain its existing policy of reinvesting principal payments from its securities holdings.” The committee did not attach any specific language to its reinvestment policy in the statement. In the press conference, Chairman Bernanke addressed this issue specifically, saying the committee makes no commitment in regard to the length of time it will keep the balance sheet elevated. Instead, the statement said the committee “will regularly review the size and composition of its securities holdings and is prepared to adjust those holdings as appropriate.” The chairman said the committee still views a removal of the reinvestment policy as the most likely first step in the exit strategy.

In a somewhat surprising move, the committee also lowered its central tendency for real GDP growth in 2012 fairly substantially to 3.3-3.7% from 3.5-4.2%. In response to a question about why the committee lowered its growth projections when it sees the factors slowing growth as temporary, the chairman replied that some of the factors pushing growth lower are temporary, but some of the other headwinds the economy faces (e.g., leverage, financial frictions, and housing) may also have weighed on committee members’ minds.

In response to a question about why the Fed would not be considering further stimulus, the chairman replied that inflation, both actual and expected, has risen since last summer and the risk of deflation has been greatly reduced. He also suggested that the increase in the average pace of job growth since last year, although below what the committee would prefer to see at this stage, had improved enough such that the committee sees itself as closer to achieving its dual mandate now than before.

If further stimulus were required, the chairman said that it could come in a variety of forms, including a reduction in interest paid on excess reserves, additional asset purchases of a similar or different structure, guidance on the balance sheet, and a more concrete time frame attached to the "extended period" language. Notable in its absence was a reference to targeting Treasury yields as opposed to quantities of assets purchased. The chairman also said that the committee continues to discuss the relative merits of a formal inflation target, noting that it could credibly anchor long-term inflation expectations. He felt that the Fed had the authority to specify its own target, although he also felt strongly that Congress would need to be consulted prior to any change in policy. He also stressed that no change was imminent.

Regarding risks emanating from Europe, the chairman stated that the Fed has examined the exposure of banks and money market mutual funds to the peripheral and core countries in Europe. He also said that the Fed had asked institutions to conduct rigorous stress tests. The chairman then mentioned that he sees banks and money market funds as having little direct exposure to the European periphery, but significant exposure to the core countries. Therefore, the US economy faces low direct risk and significant indirect risk.

Unemployment Insurance Weekly Claims Report – week ended June 17

Press Release 6/23 (excerpt) - In the week ending June 18, the advance figure for seasonally adjusted initial claims was 429,000, an increase of 9,000 from the previous week. The 4-week moving average was 426,250, unchanged from the previous week.

The advance seasonally adjusted insured unemployment rate was 2.9% for the week ending June 11, unchanged from the prior week.

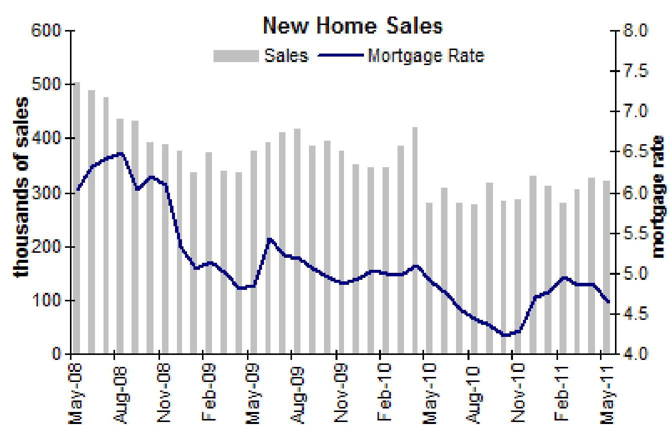
The advance number for seasonally adjusted insured unemployment during the week ending June 11 was 3,697,000, a decrease of 1,000 from the preceding week. The 4-week moving average was 3,709,500, a decrease of 5,250 from the preceding week.

WEEK ENDING	June 17	June 10	Change	June 3	Prior Year
Initial Claims (Seasonally Adj)	429,000	420,000	9,000	430,000	463,000
4-Wk Moving Average (SA)	426,250	426,250	0	424,750	466,250

Econoday 6/23 – It's an uncertain jobless report though the headline news isn't good. The Labor Department had to estimate results for six states, which is a sizable number, due to what it says are "technology issues" which must mean computer problems. Hopefully, the department erred to the high side and the total will come down with next week's revision. It's a disappointment that initial claims aren't moving lower and have been over 400,000 for 11 straight weeks.

New Home Sales – May: New Home Sales Down But Better Than Last Year

Vanguard 6/24 – Sales of new homes fell 2.1% in May to an annualized pace of 319,000 units. Although monthly sales remain weak, new home sales were up 13.5% from May 2010—the first year-over-year rise since April 2010. The gain is noteworthy because the government's homebuyer tax credit ended in April 2010, and many homebuyers last year pushed their sales from May to April to take advantage of the tax credit. The supply of unsold homes declined slightly to 6.2 months—the lowest since mid-2010. The median sales price of new houses sold in May was $222,600. Monthly home sales were weakest in the Northeast; the South was the only region to experience a gain. On a year-ago basis, every region experienced a sales gain except the Northeast.



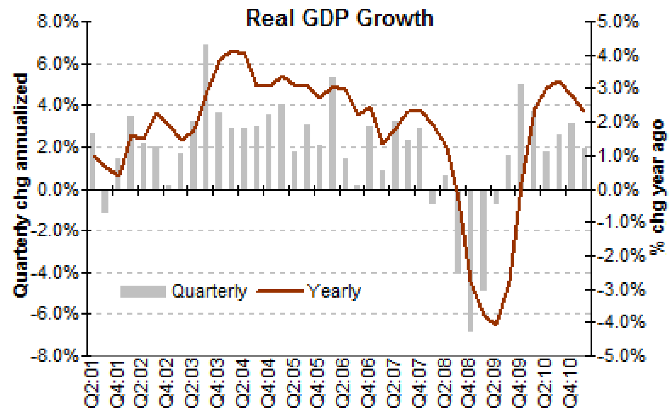
Econoday 6/23 – Supply in terms of the number of homes on the market, down 6,000 to 166,000, has never been lower in nearly 50 years of data. Bumping along the very bottom is a good description for the new home sales market and for the residential market in general.

AFP 6/27 - New home sales were up 13.5%, but that gain was the result of a slow May 2010 that had been hurt by the aftermath of the homebuyer tax credit program ending in April. There were 166,000 units for sale at the end of the month—a 6.2 month supply.

GDP - Third Estimate – Q1: 1st-Quarter GDP Grew A Bit Faster Than Thought

Vanguard 6/24 – The nation's Gross Domestic Product grew at an inflation-adjusted annual rate of 1.9% in the first quarter of 2011—a slight uptick from the original estimate of 1.8%. Still, this represented a significant slowdown from the fourth quarter of 2010, when GDP grew 3.1%.

AFP 6/27 - Even with the uptick, this was the smallest increase in GDP since Q3 2009. The two biggest positive contributors to Q1 growth were consumption and the change in private inventories (adding 1.52 and 1.31 percentage points of growth, respectively) while the biggest drag was the decline in government spending (knocking 120-basis points off the pace of growth). Real final sales of domestic product (GDP net the change in private inventories) grew just 0.6% versus an increase of 6.7% in Q4. The core PCE deflator—a measure of inflation—was up 1.6% on an annualized basis.



Durable Orders – May: Factory orders rebound

AFP 6/27 - Orders for durable goods totaled $195.6 billion, up 9.0% from a year earlier. Orders increased for most categories of goods. Transportation orders jumped 5.8%, while orders net of transportation were up 0.6%. Shipments grew for the 5th time in 6 months (+0.3%) while unfilled orders expanded for the 13th time in 14 months (+0.9%). Inventories swelled for the 14th straight month (+1.2%) to hit a high water mark for the 19-year old data series.

Vanguard 6/24 – New orders for durable goods advanced 1.9% in May after slipping 2.7% in April. Transportation was the key component behind the gain. The increase in new orders supports the Fed's statement earlier this week that the lull in economic expansion may be due to temporary factors, including supply disruptions in Japan.

Econoday 6/24 –Yes, durables orders are volatile but the gains were widespread and were not dependent on a rebound in autos. Once supply disruptions are cleared, autos will add to underlying strength in coming months.

The Economic Week Ahead: June 27 – July 1, 2011

Vanguard 6/24 – Next week opens with reports on personal income (Monday) and consumer confidence (Tuesday). Friday will bring an update on construction spending and the ISM Manufacturing Index.

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

Date	ET	Release	For	Briefing.com	Consensus	Prior
Jun 27	08:30	Personal Income & Spending	May	0.3%	0.3%	0.4%
Jun 27	08:30	PCE Prices - Core	May	0.2%	0.2%	0.2%
Jun 28	09:00	Case-Shiller 20-city Index	April	-3.8%	-3.9%	-3.61%
Jun 28	10:00	Consumer Confidence	June	59.0	60.0	60.8
Jun 29	10:00	Pending Home Sales	April	2.0%	0.7%	-11.6%
Jun 30	08:30	Initial Claims	06/25	420K	421K	NA
Jun 30	08:30	Continuing Claims	06/25	3700K	3700K	NA
Jun 30	09:45	Chicago PMI	June	51.0	53.5	56.6
Jul 01	09:55	U of Mich. Consumer Sentiment - Final	June	71.0	71.8	71.8
Jul 01	10:00	ISM Manufacturing Index	June	49.5	51.0	53.5
Jul 01	10:00	Construction Spending	May	0.3%	-0.1%	0.4%