Market Comment *Economic Highlights for the week ended July 8, 2011*

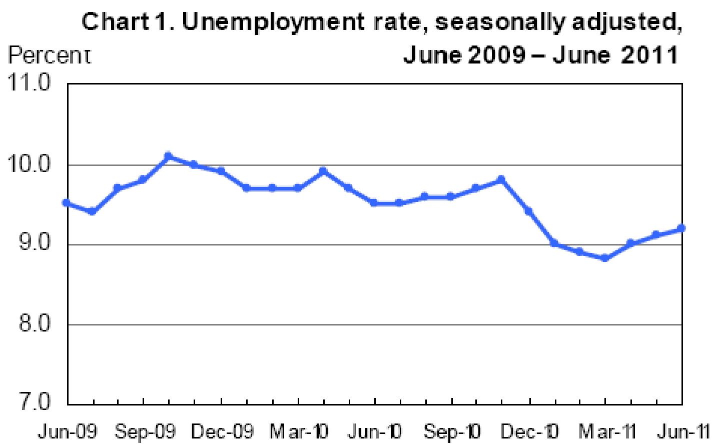
Economic Week in Review: Stalled Job Market Leaves Recovery in Low Gear

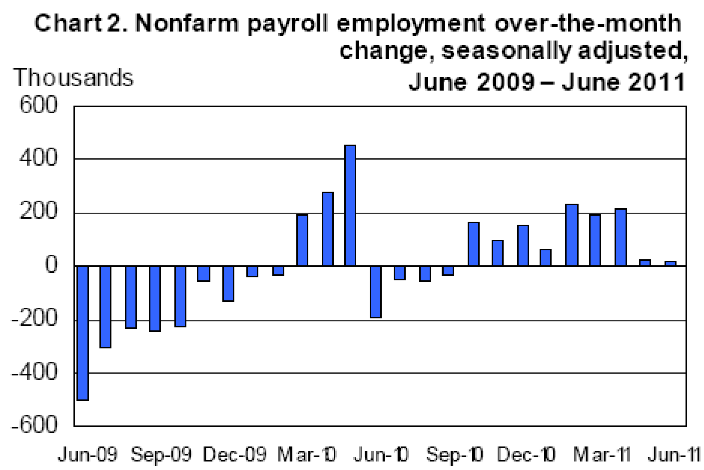
Vanguard 7/8 - The second month in a row of much-lower-than-expected job creation dimmed hopes that the economic recovery will soon pick up speed. Manufacturing showed signs of strength—orders picked up and factory employment rose modestly—but consumers, small businesses, and the public sector remained constrained by concerns ranging from the housing market to the debt and deficit struggles of governments at home and abroad. "The extremely weak job numbers are a real concern," said Vanguard economist Roger Aliaga-Díaz. "With so much uncertainty on the labor market front, it'll be difficult for consumers to become an important driver of the economic recovery during the second half of this year, as had been expected." For the week ending July 8, the S&P 500 Index rose 0.3% to 1,344 (for a year-to-date total return of about 8%). The yield on the 10-year U.S. Treasury note fell 19 basis points to 3.03% (a year-to-date decrease of 27 bps).

Nonfarm Payroll Report – June: Job Market Slows To a Crawl, Weak From All Angles

Press Release 7/8 (excerpts) - Nonfarm payroll employment was essentially unchanged in June (+18,000), and the unemployment rate was little changed at 9.2%, the U.S. Bureau of Labor Statistics reported today. Employment in most major private-sector industries changed little over the month. Government employment continued to trend down.

Vanguard 7/8 - With the economy in June adding far fewer jobs than forecast—18,000, versus 88,000 expected—the combined effect of widespread government layoffs and slow private job creation is becoming more visible. Moreover, the Labor Department reduced the number of new jobs reported for May from an already-low 54,000 to 25,000. "We would need around 200,000 jobs created each month to see any improvement in the unemployment rate," Aliaga-Díaz said. The rise in the unemployment rate occurred even though the labor force shrank slightly—which can be a sign that more people have stopped looking for work.





Barclays 7/8 - The June employment report took a much weaker-than-expected tone with payroll growth, the unemployment rate, the work week and average hourly earnings all coming in worse than expected. Nonfarm payrolls rose only 18k, well below our forecast (75k) and the consensus (105k). Private payrolls rose 57k, also well below expectations. Net revisions to the previous two months totaled -44k.

The household survey was just as disappointing. The unemployment rate rose a tenth to 9.2% (9.182% unrounded), consistent with a 173k increase in the level of unemployment. This entirely reflected weakness in employment (the household measure declined 445k), partly offset by a 272k decline in the labor force (equivalent to a one-tenth drop in the participation rate to 64.1%). Elsewhere, average hourly earnings were flat on the month, softer than expected, and the work week fell to 34.3 hours, also below expectations. One glimmer of positive news is that the trend in hours and income is gradually improving: in Q2 as a whole aggregate hours rose 2.8% q/q annualized and the "payroll proxy" of labor income (the product of hours, employment and hourly earning) rose 4.6%, above the 2.2% and 3.9% observed in Q1.

All in all, an employment report with no redeeming features whatsoever - employment, unemployment, hours and wages all disappointed. A worrying development for policymakers but one consistent with the weakness of growth in the second quarter - our GDP tracking estimate current suggests that the risks to our 2.0% Q2 growth forecast are skewed clearly to the downside.

WSJ Economists React: Jobs Report an 'Unmitigated Disaster' (excerpts)

–Overall the June Employment Report was quite disappointing, with basically no positive offsets to the poor headline results. The best we can say is that other data have shown better signs in recent weeks, including jobless claims, chain-store sales, gasoline prices, and auto production. Nevertheless, the weak trend in payroll employment indicates some downside risk to our second half growth views. *–Goldman Sachs*

–As a result of the latest exodus from the labor force, the participation rate fell to a 27-year low of 64.1%. The employment-to-population ratio fell to 58.2, from 58.4, matching the lows set in December 2009 and then November 2010. The upshot is that exactly two years after the recovery began, broad labor market conditions haven't improved at all.*–Paul Ashworth, Capital Economics*

–We can see no silver lining in this employment report, which is weak, weak, weak. The three-month growth in employment is now in line with the last 12 months and the last two months have been significantly weaker. The unemployment rate edged up in June but the broader rate (including discouraged job seekers and forced part-time) surged to 16.2% from 15.8%. Total hours worked slowed and fell in manufacturing over the last three months. It is hard to excuse this report on supply-chain disruptions and it suggests that growth momentum evaporated as the second quarter drew to a close. *–RDQ Economics*

–Companies continue to focus on cost cutting instead of expanding their business in the search of profits. This confirms that CEO's have no confidence in the sustainability of the recovery/expansion. *–Steven Ricchiuto, Mizuho Securities*

--Ugly. I mean really ugly. The June employment data were stunningly weak. Job gains were the lowest since last September when payrolls declined. Given the measurement error, you cannot even say that any new hiring occurred in June. *–Naroff Economic Advisors*

–To bring the adult employment rate back to its pre-recession level, we would need to add about 11 million new jobs. At the pace of job growth we have seen since the start of the year, that task may take decades. *–Gary Burtless, Brookings Institution*

–The economy still faces significant headwinds. The turbulence in the Middle East could cause gasoline prices to shoot up again. The housing is in a double-dip. The Euro zone is not stable affecting U.S. financial markets and exports. The developing real estate bubble in China, the primary locomotive of the world economy, is another worry. The recovery path for the economy will be volatile and rocky. *–Sung Won Sohn, Smith School of Business and Economics*

Factory Orders - May: Generally Positive US Factory Orders Report

Vanguard 7/8 - Greater demand for manufactured goods in May provided some evidence that the economic recovery may perk back up this year. Both orders and shipments of durable items—such as cars and refrigerators—rose more than the Commerce Department had initially reported. Meanwhile, an increase in orders for all factory goods—durable as well as nondurable—followed a decline in April. With consumers and construction struggling, manufacturers have been shouldering much of the recovery so far.

Econoday 7/5 – May proved to be a solid bounce-back month for the factory sector where new orders rose 0.8% vs. April's disappointing 0.9% decline (revised upward from minus 1.2%). The data are split between durable goods and non-durable goods with new orders on the durable side, boosted by gains for aircraft and motor vehicles, up a very sharp 2.1% (revised upward from 1.9%) and with the non-durable side, which is the new data in this report, down 0.2%. Note that non-durable goods are especially sensitive to price changes in this case a dip back for energy prices.

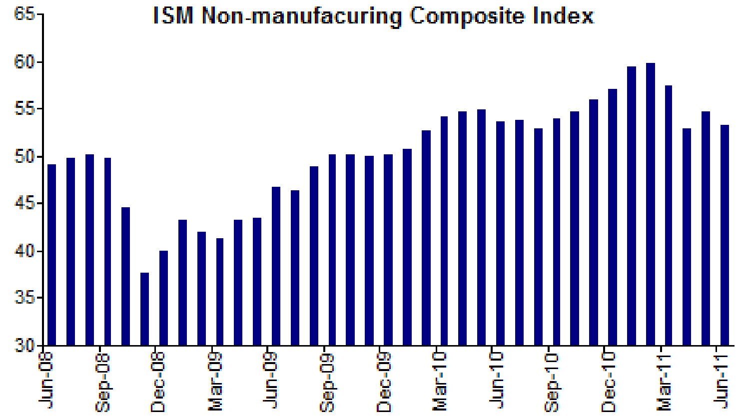
Data on unfilled orders are very positive, up 0.9% and adding further to strong levels that will help guarantee consistent strength in shipments should new orders ease.

ISM Services Index – June: Service Sector Displays Little Momentum

Vanguard 7/8 - Signs of strength in manufacturing didn't extend to the nation's service economy. The Institute for Supply Management's non-manufacturing index—which in addition to service firms covers agriculture, construction, mining, and utilities—suggested that lackluster demand was impeding growth in services, which account for most U.S. employment. Though the index showed the service sector had expanded in June, the reading was lower than in May and below what economists had expected. Most notable was a sharp drop in backlogged orders—a sign of slower activity.

Econoday 7/6 – Steady is a good description for June's non-manufacturing report from the Institute For Supply Management whose composite index slipped back to 53.3, above 50 to indicate month-to-month growth but 1.3 points below May to indicate <u>a slowing rate of monthly growth</u>. New orders slowed more than three points to 53.6 which is the second sub-55 reading of the last three months to confirm that the pace of demand has slowed from the first quarter when this reading averaged 64.5. The ISM isn't too concerned about this slowing and argues that the first-quarter pace was unsustainably high.

Barclays 7/6 - All in all, there are some encouraging signs in this report despite the decline in the headline index. The resilience of the employment component in particular suggests that firms do not see the recent soft patch as persisting. While Q2 concluded on a soft note, with energy prices having moderated and auto supply chain disruptions easing, the outlook for growth in Q3 is brighter.



ADP National Employment Report - June

Press Release 7/7 - Employment in the U.S. nonfarm private business sector rose 157,000 from May to June on a seasonally adjusted basis, according to the latest ADP National Employment Report® released today. The estimated advance in employment from April to May was revised down, but only slightly, to 36,000 from the initially reported 38,000.

Today's ADP National Employment Report estimates employment in the service-providing sector rose by 130,000 in June, nearly three times faster than in May, marking 18 consecutive months of employment gains. Employment in the goods-producing sector rose 27,000 in June, more than reversing the decline of 10,000 in May. Manufacturing employment rose 24,000 in June, which has seen growth in seven of the past eight months.

<u>These figures are above the consensus forecast for today's report and for Friday's jobs number from the BLS</u>. Payroll employment growth at this pace usually implies a steady unemployment rate, perhaps even a modest decline. <u>June's figures suggest that the economic recovery, which slipped in the spring, might have found new traction in early summer</u>.

Unemployment Insurance Weekly Claims Report (Initial Jobless Claims) – week of July 2

Press Release 7/7 (excerpts) – In the week ending July 2, the advance figure for seasonally adjusted initial claims was 418,000, <u>a decrease of 14,000</u> from the previous week's revised figure of 432,000. The 4-week moving average was 424,750, a decrease of 3,000 from the previous week's revised average of 427,750.

The advance seasonally adjusted insured unemployment rate was 2.9% for the week ending June 25, a decrease of 0.1 percentage point from the prior week's revised rate of 3.0%.

The advance number for seasonally adjusted insured unemployment during the week ending June 25 was 3,681,000, a decrease of 43,000 from the preceding week's revised level of 3,724,000. The 4-week moving average was 3,705,250, a decrease of 3,750 from the preceding week's revised average of 3,709,000.

WEEK ENDING	July 2	June 25	Change	June 18	Prior Year
Initial Claims (SA)	418,000	432,000	-14,000	429,000	460,000
4-Wk Moving Average (SA)	424,750	427,750	-3,000	426,250	467,250

Barclays 7/7 - The report <u>continues to suggest that the improvement in labor market conditions has slowed relative to this spring; claims data have been trending sideways</u>, while continuing claims data have slowly moved lower. The Labor Department reported that several states data were estimated due to the July 4 holiday, and Minnesota indicated that about 2500 of their reported initial claims are a result of state employees filing due to the recent state government shutdown.

Wholesale Inventories – May: Surge in US Wholesale Inventories

Barclays 7/8 - Wholesale inventories rose 1.8% in May, much stronger than our forecast (0.8%) and the consensus (0.7%). April was revised up to 1.1% from 0.8%. The jump in May largely reflected a sharp rebound in the auto sector, up 4.7% following a 2.3% decline in April. This drove a 1.8% increase in durable good inventories, which came alongside a 1.7% rise in nondurables.

Consumer Credit – May: Surprising Strength in US Consumer Credit

Barclays 7/8 - Consumer credit increased $5.1bn in May, following a downwardly revised $5.7bn expansion in March (previously $6.2bn). This was above our forecast ($2.5bn) and the consensus ($4.0bn). Both revolving and non-revolving credit rose. The former, related to credit card borrowing, was up $3.4bn, the first positive reading this year. The latter, driven by vehicle and student loans, rose $1.7bn, the softest since August 2010, perhaps reflecting the weakness of auto sales in May. We expect the overall consumer credit backdrop to continue to improve in a gradual and choppy fashion, but this channel of finance is unlikely to be a strong driver of consumer spending for some time to come.

The Economic Week Ahead: July 11 – July 15, 2011

Vanguard 7/8 - The Federal Reserve, which will release the minutes of its June meeting (Tuesday), will also be watching whether underlying inflation (Thursday and Friday) remains subdued as expected. Another Fed report (Friday) on industrial production for June will help gauge whether manufacturing is expanding enough to turn around some of the recent slowdown in hiring and overall economic growth. The latest trade numbers (Tuesday) will signal the strength of U.S. exports, and retail sales (Thursday) may suggest whether consumers are weathering the sluggish job market well enough to spur business.

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

Date	ET	Release	For	Briefing.com Forecast	Briefing.com Consensus	Prior
Jul 12	08:30	Trade Balance	May	-$44.0B	-$44.0B	-$43.7B
Jul 13	08:30	Export Prices ex-ag.	June	NA	NA	0.5%
Jul 13	08:30	Import Prices ex-oil	June	NA	NA	0.4%
Jul 13	14:00	**FOMC Minutes**	June 22			
Jul 14	08:30	Initial Claims	07/09	425K	419K	418K
Jul 14	08:30	Continuing Claims	07/02	3700K	3700K	3681K
Jul 14	08:30	**Retail Sales**	June	-0.3%	-0.2%	-0.2%
Jul 14	08:30	Producer Price Index (PPI)	June	-0.2%	-0.3%	0.2%
Jul 14	08:30	Core PPI	June	0.2%	0.2%	0.2%
Jul 14	10:00	Business Inventories	May	0.9%	0.9%	0.8%
Jul 15	08:30	**Consumer Price Index (CPI)**	June	-0.1%	-0.1%	0.2%
Jul 15	08:30	Core CPI	June	0.2%	0.2%	0.3%
Jul 15	08:30	Empire Manufacturing	July	0.0	0.8	-7.8
Jul 15	09:15	**Industrial Production**	June	0.3%	0.2%	0.1%
Jul 15	09:15	Capacity Utilization	June	77.0%	76.8%	76.7%
Jul 15	09:55	U of Michigan Sentiment	July	70.0	71.3	71.5