Market Comment *Economic Highlights for the week ended July 16, 2010*

Economic Week in Review: Signs point to a very gradual recovery

Vanguard 7/16 – The Federal Open Market Committee (FOMC) released the minutes from its June meeting this week, which stated that many committee members have downgraded their expectations on economic growth and believe that inflation remains a distant threat. Other economic reports released this week are strong indicators that the FOMC's thoughts are right on target.

FOMC foresees a continued moderate recovery, additional policy moves appear unlikely

Barclays 7/14 - The most important message in the June minutes is that although many FOMC members viewed the outlook as having "softened somewhat", Committee members saw incoming data "as consistent with a continued, moderate recovery in economic activity." Committee members pointed to incoming data - particularly in the areas of manufacturing, transportation, and business spending on equipment and software - as supportive of growth, though members also noted that "inventory accumulation...appeared likely to provide less impetus to growth in coming quarters." Against this backdrop, members undertook a modest downward revision in the outlook, lowering estimates for real growth in 2010 to 3.0-3.5% from 3.2-3.7% in April. The FOMC modestly lowered its 2010 core PCE inflation forecast (0.8-1.0% from 0.9-1.2%). Some saw near-term downside risks to inflation and a few cited "some risk" of deflation, but most participants saw inflation risks as balanced.

Treasury Budget

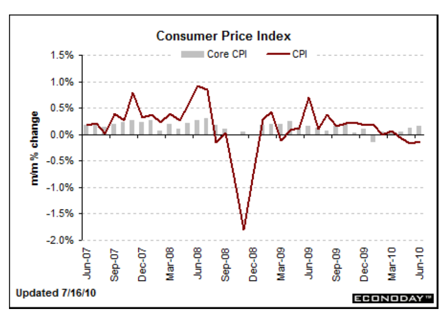
Econoday 7/13 - The Treasury's budget gap for June totals $68.4 billion, a bit lower than expected and brings the fiscal year-to-date gap to $1.004 trillion vs. $1.086 trillion this time last year. Corporate and excise taxes are higher vs. last year as are payroll taxes. June also benefited from the Memorial weekend calendar shift that pushed receipts into the month. The improvement isn't great, but the nation's deficit, due to the economic recovery, is accumulating at a slightly slower rate.

Barclays 7/13 – (Excerpts) Looking at the broader trend, however, the y/y percent change for the six-month moving average of personal income taxes continued to increase steadily, up to 4.0% from -2.0% in May. The same measure for corporate tax income surged to 92.2%, from 30.9% last month, showing that the cyclical components of the federal budget are recovering robustly. On the spending side, outlays for the Unemployment Trust Fund, which includes federally sponsored unemployment insurance benefits, were an elevated $12.7bn in June (compared with $12.1bn in 2009 and $3.4bn in June 2008). Nonetheless, the growth rate has decelerated to 4.4% y/y (last: 9.7% in May, 12.8% in April). Other increased outlays include those of the Bureau of the Census, which came in at $12.5bn for June and $12.0bn in May, but these spikes likely owe to the 2010 Decennial Census project. Today's report brings our fiscal-year-to-date tracking of the 2010 federal deficit to $1.0 trillion.

Treasury International Capital

Econoday 7/16 – Foreigners eased back on their purchases of U.S. securities in May, at a net $35.4 billion vs. inflows of $81.5 billion in April (revised from $83.0 billion) and a whopping $141.4 billion in March (revised from $140.5 billion). Foreign purchases of Treasuries eased though purchases of government agency debt were very strong. Foreigners turned sellers of corporate bonds and equities. Economic softness here in June and especially this month point to continued easing in foreign demand for U.S. securities. Including short-term securities, the net inflow totaled $17.5 billion in May vs. $13.0 billion in April.

Consumer Price Index

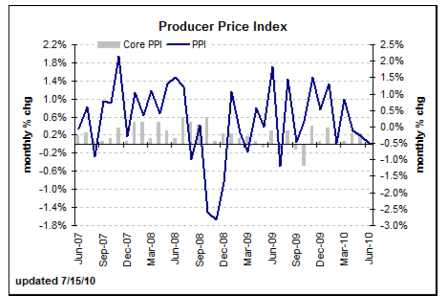


Econoday 7/16 - Lower energy costs tugged down on the consumer price index in June, resulting in a third consecutive decline in the headline number. In June overall CPI inflation dipped 0.1%, following a 0.2% decline in May. The latest month matched the market projection for a 0.1% decline. Excluding food and energy, the CPI edged up to 0.2% after a 0.1% uptick in May. This was higher than analysts' forecast for a 0.1% rise.
By components, energy component dropped 2.9%, equaling the May decrease. Gasoline fell 4.5% after a 5.2% decrease the previous month. Food prices overall were flat for the last two months. Year-on-year, overall CPI inflation eased to 1.1% (seasonally adjusted) from 2.0% in May. The core rate in June remained at 1.0%. On an unadjusted year-ago basis, the headline number was up 1.1% in June while the core was up 0.9%.

Barclays 7/16 – (Excerpts) Within the core, most components posted small increases. The most significant was a 0.1% rise in the shelter component, reflecting 0.1% gains in both rent and owners equivalent rent (OER), the latter the first rise since August 2009. Elsewhere, apparel prices rose 0.8%, vehicle prices 0.3% and medical care 0.3%. These were only partly offset by small declines in communication (-0.2%) and household furnishing (-0.4%). Cut another way, both core goods and core services rose 0.2%.

Looking ahead, we judge that the period of disinflation in core CPI (as reflected in the %y/y rate) is close to an end. Today's report suggests that prices have stabilized or are beginning to rise, albeit gradually, across most core components. Most important, given its sizable weight in the index, is the shelter component. We believe that both rent and OER have stabilized and will post positive price gains in the second half of the year. This should help cement the view among policymakers that disinflationary pressures have faded.

Producer Price Index



Econoday 7/15 - Lower food costs unexpectedly weighed on producer prices with energy also helping. Overall PPI inflation fell 0.5%, following a 0.3% drop in May. The June decrease was larger than the market consensus forecast for a 0.1% decline. At the core level, the PPI eased to 0.1% from a 0.2% boost in May. Analysts projected a 0.1% rise.

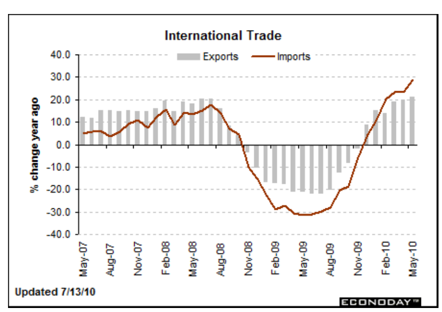
For the latest month, food prices fell 2.2% while energy dipped 0.5%. Softening the core rate are a 0.5% decrease in passenger car prices and a 1.0% drop in light motor trucks. The fall in food prices was broad based but led by a monthly 21.8% plunge in prices for fresh and dried vegetables. Fresh fruits and eggs also declined sharply. Within energy, home heating oil fell 8.1% while gasoline dipped 1.6%. Residential gas and electricity were actually up.

For the overall PPI, the year-on-year rate decelerated to 2.7% from 5.1% in May (seasonally adjusted). The core rate eased to 1.0% from 1.3% the month before. On a not seasonally adjusted basis for June, the year-ago increase for the headline PPI was up 2.8% while the core was up 1.1%. Overall, the PPI report shows little price pressure. However, markets are focusing on a large drop in initial unemployment claims, partially offset by a less positive Empire State manufacturing number.

Empire State manufacturing index plummets in July

Barclays 7/15 - The Empire State manufacturing index dropped to 5.08 in July from 19.57, well below our and the consensus forecasts (18.00). The component indices, which do not contribute directly to the headline index, were similarly soft. The shipments index sank to 6.31 from 19.67, the lowest since June 2009, and the employment index decreased to 7.94 from 12.35. The new orders index slipped to 10.13 from 17.53, indicative of some slowing but still a solid level of demand growth. The inventories index improved to 6.35 from -1.23, which may indicate some unwanted inventory buildup, as the index of unfilled orders dropped to -15.87. The index of supplier delivery times, which has been oscillating wildly about the breakeven point of 0 for the past year, fell to -7.94 from 9.88. The average employee workweek index fell to -9.52 from 8.64, the first negative reading in 2010. On the inflation front, prices paid edged lower to 25.40 from 27.16, and prices received decreased to -1.59 from 4.94. This is a soft report, with the headline and all components indicating a slowing in New York-area manufacturing growth.

International Trade



Econoday 7/13 - The trade gap unexpectedly worsened in May but the really good news is a rebound in exports. Also, businesses apparently are a little more confident about demand as nonoil imports picked back up. The overall U.S. trade deficit expanded to $42.3 billion from $40.3 billion in April. The latest trade gap was worse than the consensus forecast for a $39.0 billion shortfall. Exports rebounded 2.4% while imports bounced back 2.9%. Nonoil imports jumped 6.1%, following a 0.5% dip in April.

The worsening in the deficit was in the nonpetroleum portion. The nonpetroleum deficit widened to $32.3 billion in April from $27.8 billion the prior month. The petroleum goods gap, however, narrowed to $21.5 billion from $24.1 billion in

April. By end-use categories, the gain in goods exports was led by a $2.0 billion boost in capital goods excluding autos. Exports of industrial supplies, consumer goods, and autos also posted increases. The foods, feeds & beverages category edged down incrementally but essentially was unchanged.

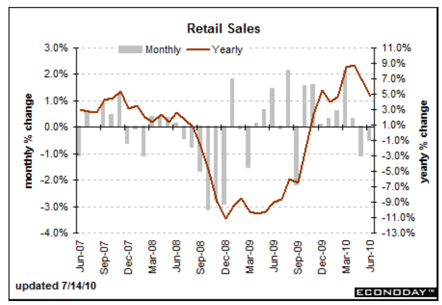
Overall, the May trade report is quite favorable even though the gap worsened. Manufacturers will be happy that exports are up across the board. And businesses are importing to boost both capital spending and inventories for consumers to purchase. Today's report is a vote of confidence that the recovery is still on.

US import prices drop 1.3% in June

Barclays 7/14 - Import prices fell 1.3% in June after a revised 0.5% decrease in May, a steeper drop than we (-0.2%) or the consensus (-0.4%) had expected. While much of the decline was due to a 4.4% decrease in petroleum prices, nonpetroleum import prices declined 0.5%, much softer than the 0.1% increase we had forecast. Import prices declined in all major categories, with foods and beverages dropping 1.7%, capital goods slipping 0.3%, industrial supplies ex-petroleum falling 1.3%, autos and parts edging 0.2% lower, and consumer goods import prices decreasing 0.4%.
It is possible that the June drop in nonpetroleum import prices is reflecting the effects of the increase in the value of the dollar over the past few months. While import prices were quite soft in May and June, it is worth noting that this comes on the heels of several quarters of rapid import price inflation. Today's report brings the y/y headline rate down to 4.5% from 8.7% and the y/y ex-petroleum rate to 3.1% from 3.7% - both still near the upper end of the range seen over the past decade.

Retail Sales

Econoday 7/14 - The headline retail sales number was disappointing but there were a number of cross currents in the detail. Overall retail sales in June shrank 0.5%, following a 1.1% decline in May. The June figure posted lower than the market forecast for a 0.2% decline. Auto sales were a big part of the June decrease as sales ex autos only edged down 0.1%, following a 1.2% drop in May. Analysts had projected no change in sales excluding autos. Weak gasoline prices came into play also. Sales excluding autos and gasoline rebounded 0.1%, following a 1.0 contraction in May. The June decline was led by a 2.3% fall in motor vehicle sales. A decline in gasoline prices also pulled down gasoline station sales which eased 2.0%. Also showing decreases were furniture & home furnishings, building materials & garden equipment, food & beverage stores, and sporting goods & hobby stores.



But it was not all negative. There were a number of clear winners. Consumers are still plopping money down for HD TVs, and new cell phones, and other electronic goodies as electronics & appliance store sales jumped 1.3%. Miscellaneous store retails saw a 1.1% boost while nonstore retailers gained 1.0%. Also seeing increases were health & personal care, clothing, food services & drinking places, and general merchandise. Within general merchandise, department store sales jumped 1.1%. Overall retail sales on a year-ago basis in June slowed to 4.8% from 6.9% the month before. Excluding motor vehicles, the year-on-year rate eased to 4.4% from 5.7% in May. The bottom line is that the consumer in hanging in with the recovery although the monthly gyrations are more noticeable since overall growth has a low trajectory.

Consumer Sentiment

Econoday 7/16 - The economic recovery is slowing and consumer spirits are falling. Consumer sentiment literally plunged in the mid-July reading, down nearly 10 points to a 66.5 reading that pushes this index back to the lows of last year. Both the expectations and current-conditions components show roughly 10 point drops. The stock market has been holding up so this report is likely picking up troubles in the jobs market. One positive is today's apparent capping of the Gulf spill, a disaster which hit regional confidence in the monthly consumer confidence report for June. In the end, consumer confidence is tied to income expectations which, given the now fizzling recovery, are in question. Stocks are moving lower following this report with money moving into the safety of Treasuries.

Industrial Production

Econoday 7/15 - After almost a year of strong gains, industrial production slowed in June. And it would have been negative without a surge in utilities output-likely weather related. Overall industrial production in June edged up 0.1%, following a 1.3% gain the prior month. The June increase was above the market forecast for a 0.2% drop.

However, manufacturing fell 0.4% in June, following a 1.0% jump in May. For other sectors in June, utilities output was up 2.7% while mining gained 0.4%. By industry, motor vehicles and parts weighed on overall production, dropping 1.9%. Manufacturing excluding motor vehicles declined 0.3%, following a 0.8% boost in May. Market group data suggest at least a temporary shift in production. While production of consumer goods fell 0.6% in June, output for business equipment gained 0.9%. Apparently, businesses are boosting investment in equipment as consumer spending is wavering. On a year-on-year basis, industrial production rose to 8.2% from 7.9% in May. Capacity utilization was unchanged at 74.1% in June. Analysts called for a 74.0% capacity utilization rate in June.

Overall, the industrial sector slowed in June, indicating that the recovery has lost a little momentum. The question is whether June's easing is temporary. Today's Empire State manufacturing index shows production still positive for July but growing only slowly.

US jobless claims decline amid fewer auto factory shutdowns

Press Release 7/15 - In the week ending July 10, the advance figure for seasonally adjusted initial claims was 429,000, a decrease of 29,000 from the previous week's revised figure of 458,000. The 4-week moving average was 455,250, a decrease of 11,750 from the previous week's revised average of 467,000.

Econoday 7/15 – (Excerpts) Whatever improvement there is on the initial side is offset by a big 247,000 jump in continuing claims to 4.681 million in data for the July 3 week. The four-week average for this reading is up 22,000 to 4.581 million for the highest reading since mid June. The unemployment rate for insured workers rose two tenths to 3.7%. Summer retooling, which allows laid off workers to file claims, makes adjustments to this series very difficult at this time of year and will cloud its indications for the July employment report.

Barclays 7/15 – (Excerpts) As we expected, some of the decline in claims can be attributed to the cancellation of its usual two-week summer shutdown by GM, which results in fewer jobless claims than the seasonal factors would suspect. However, the Labor Department indicated that the decrease in the number of factory shutdowns this year was not widespread, signaling that the decline in claims reflected more than just special factors in the auto sector. Smoothing through the volatility with the four week moving average indicates that continuing claims has edged up only slightly. Overall, this claims report is consistent with a gradually improving labor market.

WEEK ENDING	July 10	July 3	Change	June 26	Prior Year
Initial Claims	**429,000**	**458,000**	**-29,000**	**475,000**	538,000
4-Wk Moving Average	455,250	467,000	-11,750	467,250	581,500

Economic Week Ahead

Vanguard 7/16 - Next week's economic news will include the latest on the nation's housing situation, including reports on new residential construction (Tuesday) and existing-homes sales (Thursday). The Conference Board will release its most recent report on leading economic indicators on Thursday.

Week of July 19 - July 23

Date	ET	Release	For	Briefing.com	Consensus	Prior
Jul 20	08:30	Building Permits	Jun	560K	572K	574K
Jul 22	08:30	Initial Claims	07/17	440K	445K	429K
Jul 22	08:30	Continuing Claims	07/10	4600K	4600K	4681K
Jul 22	10:00	Existing Home Sales	Jun	5.40M	5.09M	5.66M