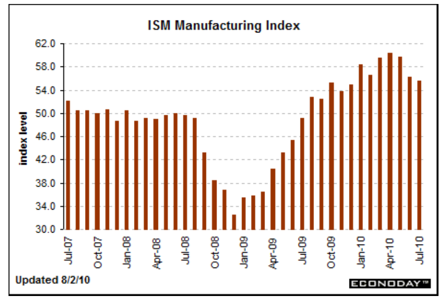
Market Comment *Economic Highlights for the week ended August 6, 2010*

Economic Week in Review: Uncertainty abounds as job losses mount

Vanguard 8/6 - <u>The economy has continued to struggle, shedding 131,000 jobs in July</u>. While the unemployment rate remained at 9.5% last month despite the job losses, this was most likely due to a drop in the number of people seeking work. Most of the other economic news that came out this week was also negative, as factory orders fell, the manufacturing sector lost momentum, and personal income was flat. Two exceptions to the otherwise disappointing news were construction spending and the service sector, both of which showed signs of recovery. For the week, the S&P 500 Index rose 1.8% to 1,122 (for a year-to-date total return—including price change plus dividends—of about 1.7%).

ISM Manufacturing Index



Econoday 8/2 - New orders slowed abruptly in July, in what is the key headline of the Institute for Supply Management report. <u>New orders fell to 53.5, still above 50 to indicate month-to-month growth but down five points from June to indicate a significantly slower rate of growth</u>. The 53.5 reading is the lowest since the manufacturing sector emerged from recession this time last year. Backlog orders also slowed, to 54.5 for a 2-1/2 point decline and its lowest reading since December.

Production slowed nearly 4-1/2 points in July to what for now is a still very strong 57.0. Employment rose nearly one point to 58.6 but the slowing in new orders and backlogs don't point to rising demand for labor. Inventories rose more than four points to 50.2 but, like production employment, aren't likely to show much strength in the months ahead. The headline composite index of 55.5 is the slowest rate so far this year. The manufacturing sector led the economy out of recession but its leadership may now be fading.

ISM Non-Manufacturing (Services) Index

Barclays 8/4 - <u>The ISM non-manufacturing index increased to 54.3 in July from 53.8 in June, above our (53.5) and consensus (53.0) expectations</u>. The new orders index increased to 56.7 from 54.4 and the employment index rose to 50.9 from 49.7, the highest since December 2007. There were some soft spots in the report, however, as the business activity index slipped to 57.4 from 58.1 and the supplier deliveries index ticked lower to 52.0 from 53.0. Outside the four equally-weighted components of the headline index, the export orders index increased to 52.0 from 48.0 while imports held at 48.0. The volatile order backlog index dropped to 52.0 from 55.5 but continued to improve on a three-month moving average basis. The prices index slipped to 52.7 from 53.8.

<u>This report indicates that service sector growth improved in July, in contrast to the moderation in manufacturing</u>. While overall economic growth may have slowed in the past couple months, the improvement in the non-manufacturing index is consistent with a moderate recovery, not a sharp slowdown. Moreover, the employment index continued its upward trend, an encouraging sign for the labor market as the service sector accounts for more than 80% of private payrolls.

Construction Spending

Econoday 8/2 **-** The headline number for construction outlays in June came in higher than expected. However, the apparent strength is overstated given the source of the gain and revisions to May. <u>Construction outlays in June edged up 0.1%, following a 1.0% drop in May</u>. The June number is better than the median forecast for a 0.5% decrease. However, May was revised down sharply from an initial estimate of a 0.2% dip.

The June rebound was led by a 1.5% jump in public outlays, following a 0.3% decline the prior month. <u>In contrast, the private residential component declined 0.8% after a 1.5% fall in May</u>. Private nonresidential outlays slipped 0.5% in June after dropping 1.3% in May. Clearly, residential outlays are weighted down by the recent decline in housing starts while nonresidential spending is still soft from high commercial vacancy rates. On a year-ago basis, overall construction outlays improved to minus 7.9% in June from down 8.8% in May.

Barclays 8/2 – (Excerpts) Although the nonresidential component is still broadly contracting, the decline in the y/y rate has moderated somewhat to -15.2% from a low of -18.3% in February of this year. The improvement has also been reflected in the Q2 GDP data which showed a 5.1% q/q saar increase in nonresidential structures investment after having fallen for seven consecutive quarters. We expect this component to post further gains in H2 2010 and throughout 2011 as the sector recovers.

Personal Income and Outlays

Econoday 8/3 - According to Fed Chairman Ben Bernanke, the Fed is hoping that a bump up in consumer spending will help strengthen the recovery. Apparently, that will have to wait until at least next month. Personal income in June was unchanged, following a 0.3% boost the month before. The median market forecast was for an incremental 0.1% gain. The wages & salaries component slipped 0.1% after posting a healthy 0.4% advance in May. June weakness was partially due to the cutting of temporary Census workers.

Consumer spending has softened over the last three months due to varying reasons. For the latest month, weakness partially was price related-notably for gasoline. Overall personal consumption was flat, following a 0.1% rise in May. The June number just fell short of the consensus projection for a 0.1% increase. By components, durables was stronger than many expected, rising 0.1% despite an earlier released report of a drop in motor vehicle sales in June. Weakness was in nondurables which fell 0.4%. But services were sluggish, gaining only 0.1%. In chain dollars, overall spending was slightly positive for June, gaining 0.1%, following a 0.2% rebound in May.

Inflation was not an issue in June. The headline PCE price index dipped 0.1%, matching May's decrease. The core rate was flat after a 0.1% gain in May. Year on year, personal income growth for June came in at up 2.6%, improving from up 1.5% in May. PCEs growth stood at 3.1% in June, compared to 3.7% in May. Year-ago headline PCE inflation eased to 1.4% from 2.1% in May. Year-ago core PCE inflation softened to 1.4% in June from 1.5% the month before. Consumer spending softened in the latest month. For consumers to start opening their wallets again, we need to see improvement in employment.

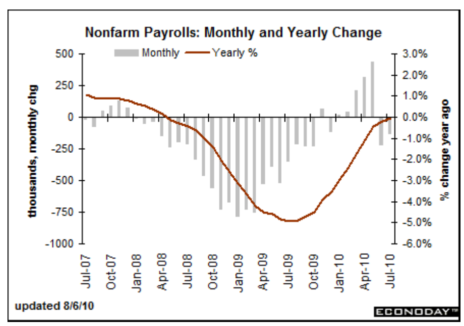
Pending Home Sales

Econoday 8/3 - Pending home sales index fell 2.6% in June to 75.7. Year-on-year the index is down 18.6%. Sales were down in three regions. The National Association of Realtors is warning that near-term sales of existing homes are likely to be "notably lower" in contrast to the spring surge, which was fed by government stimulus.

Barclays 8/3 – (Excerpts) We see this number as ongoing evidence that the housing market is continuing to find the bottom after the expiration of the homebuyer tax credit in April. Since the vast majority of pending home sales go to settlement in two to three months, the June reading suggests that some further weakness in existing home sales may be in store.

Employment Situation

Econoday 8/6 - The July jobs report disappointed and weakness was largely in the government sector – and it was not all just temporary Census workers being laid off. But there were a few bright spots, including gains in wages, the workweek, and earnings. Overall payroll jobs in July declined 131,000 after falling a revised 221,000 in June and after a 432,000 boost in May. The decline in July was worse than the market forecast for a 125,000 decline. The May and June revisions were net down 97,000.



Turning to the household survey, the unemployment rate was unchanged at 9.5 percent in July. For detail in the payroll numbers, the big weakness in July came from a 202,000 drop in government jobs, following a 252,000 fall the month before. Of the July government plunge, 143,000 came from a drop in Census Bureau payrolls.

Private nonfarm employment, which discounts the effects of hiring and firing temporary Census workers, accelerated moderately to a 71,000 increase, following a 31,000 gain in June. The latest number came in below the consensus expectation for a 100,000 boost in private payrolls. Improvement was evenly divided between the goods-producing and services-providing sectors. Good-producing rose 33,000 with manufacturing up 36,000, mining up 7,000, and construction down 11,000. Services-providing jobs rose 38,000 with strength led by health care, up 27, 000, and transportation & warehousing, up 12,000.

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There were some notable positives in the latest employment report. Average hourly earnings improved to up 0.2 percent, following no change in June and matching the market projection for a 0.2 percent gain. The average workweek for all workers rose to 34.2 hours from 34.1 hours in June. Analysts had called for 34.1 hours. Aggregate weekly earnings are a positive for July personal income, jumping 0.6 percent after dipping 0.3 percent in June.
On a year-ago basis, overall payroll jobs came in at unchanged in July, improved from down 0.2 percent in June.

Although the headline payroll number disappointed, the private sector detail was not so negative. Now, it appears that the government sector in terms of employment is a drag on the economy, which should not be a surprise given the revenue shortfalls for state and local governments.

WSJ 8/6 - Although some might take comfort in the jobless rate holding steady at 9.5% after a surprising 0.2% drop in June, the underlying details confirm our expectations that the temporary end of the emergency unemployment compensation program (EUC) would temporarily reduce the labor force. As it happened, the number of workers unemployed for more than 27 weeks fell by 179,000, accounting for virtually all the net decline in the size of the labor force. However, the overall count of unemployed workers fell by just 24, implying that the number unemployed who were not affected by the end of the EUC increased by about 155,000. Since Congress reinstated the EUC program through November and retroactive to June 2, we look for the labor force and total count of unemployed to rebound in the months ahead though most of that rebound is likely to come in September and October.

Initial Claims for Unemployment Insurance Benefits – Week of July 31

Econoday 8/5 - The labor market remains weak, at least based on initial jobless claims which rose 19,000 in the July 31 week to 479,000. The prior week was revised 3,000 higher to 460,000. The four-week average rose 5,250 to 458,500 but is still slightly lower than this time last month in what is one of the few positives of today's report. There are no special factors in the latest week. Continuing claims fell 34,000 to 4.537 million in data for the July 24 week. Here the four-week average rose 26,000 to 4.576 million. The unemployment rate for insured workers is unchanged at 3.6%.

Barclays 8/5 - With no special factors cited by the Labor Department, this report is indicative of weakness in labor market conditions as claims continue to trend sideways. We do not expect this reading to affect tomorrow's payroll numbers, since the survey week was the week of July 12.

Week Ending	July 31	July 24	Change	July 17	Prior Year
Initial Claims	479,000	460,000	+19,000	468,000	559,000
4-Wk Moving Average	458,500	453,250	+5,250	457,000	559,750

Economic Week Ahead

Vanguard 8/6 – Economists will be busy next week, as key reports on the Consumer Price Index and retail sales come out on Friday. Other key economic releases include information on productivity and costs (Tuesday), the trade deficit (Wednesday), and business inventories (Friday). Also on Tuesday, the Federal Open Market Committee meets to determine the near-term direction of monetary policy.

Week of August 9–13

Date	ET	Release	For	Briefing.com	Consensus	Prior
Aug 10	08:30	Productivity-Preliminary	Q2	0.1%	0.1%	2.8%
Aug 10	14:15	FOMC Rate Decision	Aug 10	0.25%	0.25%	0.25%
Aug 11	08:30	Trade Balance	June	-$43.0B	-$42.5B	-42.3B
Aug 12	08:30	Initial Claims	08/07	465K	465K	479K
Aug 13	08:30	CPI	July	0.1%	0.2%	-0.1%
Aug 13	08:30	Retail Sales	July	0.5%	0.5%	-0.5%
Aug 13	10:00	Business Inventories	June	0.2%	0.2%	0.1%

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