Market Comment *Economic Highlights for the week ended August 20, 2010*

Economic Week in Review: Recovery losing momentum

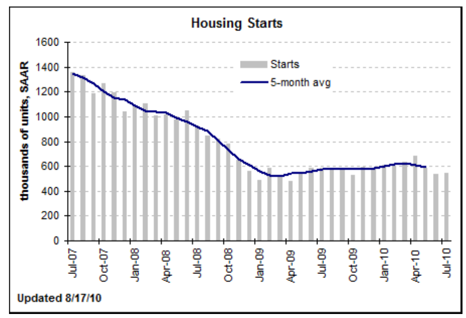
Vanguard 8/20 – The U.S. economy continues in sputter mode. While July saw some improvements in industrial production and housing starts, the most recent initial unemployment claims rose for a third straight week. For the week ended August 20, the S&P 500 Index fell 0.7%, to 1,072 (for a year-to-date total return—including price change plus dividends—of about –2.7%).

Leading Indicators

Barclays 8/19 – The index of leading indicators rose 0.1% in July, as widely expected. This gain follows a 0.3% decrease in June and brings the y/y rate to 7.1% from 8.3%. The biggest positive contributions came from the wide interest rate spread, increases in the average workweek and supplier delivery times, and a drop in initial jobless claims. Decreases in consumer expectations, the real money supply, and building permits provided some offset. Stock prices and estimated orders of consumer and nondefense capital goods were roughly flat on the month.

The pace of leading indicator improvement has clearly slowed since March, as the recovery has transitioned from strong rebound to more measured growth. Nevertheless, annualized 3-month percent change is still at a healthy 1.1%, suggesting that the recent slowdown in overall activity is not indicative of a double-dip.

Housing Starts

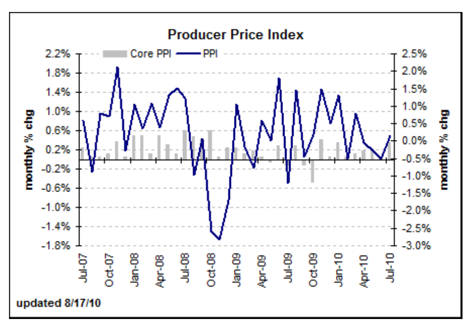


Econoday 8/17 - Housing improved in July – but well short of expectations. Housing starts in July posted a modest comeback, rising 1.7% after an 8.7% decrease in June. The July annualized pace of 0.546 million units came in below the median forecast for 0.565 million units and is down 7.0% on a year-ago basis. In fact, the latest number is also down fractionally from the initial June estimate of 0.549. That is, July would have been a decline instead of a rebound were it not for a downward revision to June.

The July improvement was led by a 32.6% bounce back in multifamily starts, following a 33.3% drop in June. The single-family component-weighed down by inventories-declined 4.2% after dipping 1.7% in June.
By region, the gain in starts was led by a 3.9% rebound in the South. Other regions declined-the Northeast, down 25.9%; the West, down 4.9%; and the Midwest, down 1.1%.

Looking ahead, permits fell back 3.1%, following a 1.6% rebound in June. Overall permits stood at an annualized rate of 0.565 million units and are down 3.7% on a year-ago basis. The housing sector improved modestly in July at the headline level. But it largely was a technical rebound in the multifamily component. Single-family construction is slipping as indicated by both starts and permits.

Producer Price Index



Econoday 8/17 - Inflation at the producer level was mixed as higher food prices caused a rebound at the headline level. The overall PPI increased 0.2% in July, following a 0.5% fall in June. The July boost matched analysts' forecast. At the core level, the PPI gained 0.3%, following a 0.1% uptick in June. The market median expectation called for a 0.1% rise.

For the latest month, energy posted a 0.9% decrease while food prices jumped 0.7%. Bumping the core rate up were light trucks, up 1.5%; autos, up 0.3%, and pharmaceuticals, up 0.7%. The surge in food prices was fresh and dried vegetables, up 9.8%; fresh fruits, up 3.8%; and fresh eggs, up 19.4%. Within energy, home heating oil dropped 3.5% while gasoline declined 2.2%. Residential gas and electricity rose 3.1% and 1.2%, respectively.

For the overall PPI, the year-on-year rate increased to 4.1% from 2.7% in June (seasonally adjusted). The core rate rose to 1.5% from 1.0% the prior month. On a not seasonally adjusted basis for July, the year-ago headline PPI was up 4.2% while the core was up 1.5%. Manufacturers managed to get through isolated price increases to retailers but based on the CPI, costs generally are not being passed on to the consumer. That could change for food in coming months as margins are slim for retailers.

Barclays 8/17 – (Excerpts) All in all, recent PPI data suggest that while the rebound in crude and intermediate input prices, particularly within food and energy, has eased somewhat in recent months, core pipeline price pressures are gradually building across most consumer-related sectors. This supports our view that the chances of a period of outright deflation in core consumer prices remain slim despite the apparent loss of momentum in the broader recovery.

Industrial Production

Econoday 8/17 - Manufacturing - which has been a key source of strength for the recovery but faltered in June – showed significant resurgence in the latest month. Overall industrial production in July jumped 1.0%, following a revised 0.1% down tick in June. The July surge topped the consensus forecast for a 0.6% spike.

By components, manufacturing posted a 1.1% comeback, following a 0.5% decline in June. The boost was broad-based as manufacturing excluding motor vehicles increased 0.6%, following a 0.3% dip the month before. Rounding out industry group components for July, utilities output was up 0.1% while mining advanced 0.9%.

By market group, business equipment jumped 1.8% and consumer goods posted a 1.1% gain. Nonindustrial supplies advanced 0.4% and materials were up 0.9%. On a year-on-year basis, overall industrial production slipped to 7.7% from 8.2% in June. Capacity utilization jumped to 74.8% in July from 74.1% the prior month. Analysts had projected a 74.5% figure for July.

Treasury: International Capital

Econoday 8/16 - Chinese disinvestment of U.S. Treasuries extended into June and at an aggressive rate. Chinese holdings of Treasuries fell 2.8% in June to $843.7 billion, only slightly less severe than the 3.6% month-to-month decline posted in May. Offsetting Chinese selling was aggressive buying by Japanese accounts, which increased their Treasury holdings by 2.2% to $803.6 billion. Still, Chinese Treasury selling is a reminder of the political clout that nation has in setting its own currency policy in opposition to U.S. export interests.

Net inflow of long-term securities into the U.S. totaled a solid $44.4 billion, reflecting nearly $34 billion of net foreign purchases of U.S. securities and more than $10.4 billion of net selling of foreign securities by U.S. residents. Again apart from China, foreigners were big net buyers of long-term Treasuries and, once again, were also big net buyers of Federal agency paper. In a negative though, foreigners were sellers of U.S. equities and aggressive sellers of U.S. corporate & other bonds. Total flows, which include short-term securities, came in at negative $6.7 billion in June vs. a $17.1 billion inflow in May.

Fed's Kocherlakota calls unemployment "disturbing" but expects to avoid deflation

Barclays 8/17 - Minneapolis Fed President Kocherlakota (FOMC non-voter) gave remarks Tuesday on the basic structure of the Fed, as well as the economic outlook. Kocherlakota said that while he expects "a slight but welcome uptick" in inflation over the next 18 months and believes that "a modest recovery is under way and is likely to continue," he sees "current and future problems in labor markets that are likely to prove resistant to the tools of monetary policy." Specifically, Kocherlakota cited mismatch between workers and jobs as responsible for "most of the existing unemployment," noting that despite increasing job openings, unemployment has remained very high. Crucially, however, he said that there is little the Fed can do to address mismatch, as "the Fed does not have a means to transform construction workers into manufacturing workers." As such, Kocherlakota forecast that unemployment "will remain above 8% into 2012."

On the FOMC's decision to reinvest payments from MBS into long-term Treasuries, Kocherlakota opined that it "had a larger impact on financial markets than [he] would have anticipated," inferring that investors had interpreted it as suggesting that the economic outlook was worse than they had imagined. He described this reaction as "unwarranted," asserting that "there is no new information about the current state of the economy to be learned from the FOMC's actions or its statement."

Jobless Claims

Barclays 8/19 - Initial jobless claims increased sharply to 500k for the week ending August 14 from an upwardly revised 488k the prior week (previous: 484k). This number was well above our forecast (480k) and consensus (478k) estimates and brings the level of claims back to that in late 2009. The four-week moving average now stands at 483k, up from 474k in the prior week. Continuing claims fell 13k during the week, to 4478k, and the four-week moving average declined marginally, to 4527k from 4528k. The insured unemployment rate was unchanged at 3.5%. This report indicates that the pace of firings and layoffs has increased and is a negative signal for the employment report in two weeks' time, as the current level of claims (500k) and the four-week moving average (483k) are above the levels in the week of July 12 (468k and 457k, respectively).

Econoday 8/19 – (Excerpts) The four-week average of 482,500 is the largest since December. A month-to-month look shows significant deterioration of 25,000 for a percentage change of nearly six percent. The Labor Department said special factors are playing no part in the data.

The four-week average of 4.527 million is the lowest of the recovery. Today's report points to trouble but not catastrophic trouble for the monthly employment report. Note the rise in initial claims betrays a lack of business confidence in the economic outlook.

Week Ending	Aug. 14	Aug. 7	Change	July 31	Year
Initial Claims	500,000	488,000	+12,000	482,000	575,000
4-Wk Moving Average	482,500	474,500	+8,000	459,250	567,250

Economic Week Ahead: August 23 - 27

Vanguard 8/20 - Next week, a series of reports will offer more insight into the direction of the U.S. economy. The highlight of the week will be the release of growth domestic product figures on Friday. Other reports released next week include figures on existing-home sales (Tuesday) and new-home sales and durable goods (Wednesday).

Date	ET	Release	For	Briefing.com	Consensus	Prior
Aug 24	10:00	Existing Home Sales	July	NA	5.14M	5.37M
Aug 25	08:30	Durable Orders	July	NA	3.4%	-1.2%
Aug 25	10:00	New Home Sales	July	NA	338K	330K
Aug 26	08:30	Initial Claims	08/21	NA	NA	500K
Aug 26	08:30	Continuing Claims	08/14	NA	NA	4478K
Aug 27	08:30	GDP - Second Estimate	Q2	NA	1.4%	2.4%

FFCB Weekly Debt Issuance Activity

Week Ended Date	Discount Notes ($ million)	New Bonds ($ million)	Issue Count	Called Bonds Par ($ million)	Issue Count
2-Jul	9,945	831	12	862	10
9-Jul	6,030	1,812	13	220	4
16-Jul	8,297	3,766	21	1,694	17
23-Jul	10,145	2,690	20	1,414	9
20-Aug	9,625	3,335	18	1,230	13