Market Comment *Economic Highlights for the week ended August 27, 2010*

Economic Week in Review: Not much to cheer about

Vanguard 8/27 – The saying "No news is good news" probably would have served the economy well after another week of dismal economic reports. The government's revised benchmark indicator of economic growth dropped, durable-goods orders slowed to a crawl, and the housing market endured a double-whammy as new-and existing-home sales plunged. For the week ended August 27, the S&P 500 Index fell 0.7% to 1,064.59 (for a year-to-date total return—including price change plus dividends—of about –3.3%). The yield of the 10-year U.S. Treasury note climbed 4 basis points to 2.66% (for a year-to-date drop of 119 basis points).

GDP - revision

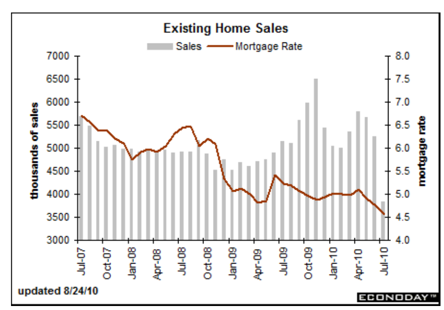
Econoday 8/27 - The Commerce Department confirmed the claim by many economists that second quarter growth was softer than initially believed. Second quarter GDP growth was revised down to 1.6% annualized from the advance estimate of 2.4%. The new figure was higher than analysts' expectation for 1.3%. The downward revision was primarily due to a higher net export deficit and a smaller gain in inventories. Also getting downgrades were residential investment and government purchases. Partially offsetting were modest upward revisions to personal consumption and nonresidential fixed investment.

Many traders are focusing on final sales. Real final sales to domestic purchasers was revised up to 4.3% from the initial estimate of 4.1% while final sales of domestic product (adds in net exports) was revised down to 1.0% from the advance figure of 1.3%. Year-on-year, real GDP is up 3.0%, compared to up 2.4% in the first quarter. On the inflation front, the GDP price index was bumped up marginally to 1.9% annualized from the initial estimate of 1.8%. The median market forecast called for a 1.8% figure for the second estimate.

Even though overall economic growth slowed substantially from the first quarter's 3.7% pace, domestic demand was actually stronger-4.3% compared to 1.3% in the first quarter. Certainly, there will be some slowing in domestic demand growth in the second half but a rebound in exports could help support the overall growth rate. The bottom line is that the latest GDP revisions are more supportive of continued recovery-albeit modest-than a double dip.

Barclays 8/27 – (Excerpts) The upside surprise, relative to our forecast, in part reflected an upward revision to consumer spending, to 2.0% from 1.6%. This, in turn, was driven by stronger growth within services consumption, revised up to 1.2% from 0.8%. Elsewhere, revisions were broadly as expected, with less growth in structures investment but more in equipment and software investment. All in all, the newly estimated make-up of Q2 GDP growth paints a picture of a gradual improvement in consumption, still strong business spending, a fading boost from inventory accumulation, and surprisingly strong import growth. Looking ahead, the drag from net trade (particularly the strength of imports) is unlikely to persist, a positive for GDP. However, timely indicators of activity have, on net, taken a softer-than-expected tone in July, suggesting that GDP growth is unlikely to be significantly stronger in Q3 than in Q2.

Existing Home Sales



Econoday 8/24 - It doesn't get worse than this. Existing home sales fell 27.2% in July to a 3.83 million annual rate for the lowest level in 15 years. The 3.83 million rate compares with expectations for 4.65 million. Supply at the current sales rate ballooned from June's already swollen 8.9 months to 12.5 months for the worst reading in 11 years.

Yet prices showed little effect, down only 0.2% to a median $182,600 and reflecting relative strength for higher priced homes. The year-on-year median price edged lower but was still positive at 0.7%. Yet "was" is the word to note as extremely heavy supply, together with heavy foreclosures and distressed sales, point squarely at price pressures ahead. There's nothing to explain away July's collapse. Single-family and condo sales show nearly the same deterioration. Regional data show no substantial variation.

Barclays 8/26 - (Excerpts) Existing home sales plummeted 30% m/m in July raising further concerns of an impending slowdown in housing. We discuss implications for home prices and non-agency valuations.

- Tax credits potentially brought forward 300-600k of housing demand. Most of these sales would have otherwise occurred through this summer and some over the coming winter.

- Accelerating a purchase to take advantage of tax credit made most sense for those who intended to buy in the summer of 2010. The tax credit likely had only a marginal effect on the decisions of potential buyers in 2011 and 2012.
- The demand pulled forward is likely to result in commensurate declines in coming quarters, and the effect should be most significant for front months.
- Existing home sales track the MBA purchase index very well after accounting for a two-month lag due to mortgage processing times. The MBA purchase application index plunged about 30% in May, in line with a 30% decline in July closings.
- With liquidation rates only 15% lower and existing home sales down 30%, the share of distressed sales likely went up in July. This should result in weak headline home-price prints in coming months. Given the lags in reporting and three-month averaging, the first significant decline in the S&P/Case-Shiller home price index is likely to happen in the September data release, and if not, definitely in October.
- While the risk of a more severe drop in prices has increased with the recent data, we still assign a low probability to a 15-20% decline from here. Housing is close to a bottom based on equilibrium measures, and in our view, the administration is likely to take steps to prevent a collapse in the housing sector should things worsen.

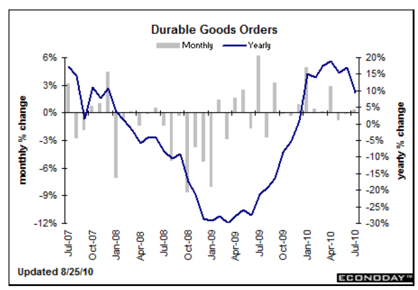
New Home Sales

Econoday 8/25 - The mid-year dip that everyone expected following the April expiration of second-round housing stimulus is proving to be very deep.

New home sales fell 12.4% in July to a record low 276,000 unit annual rate. Like the existing home sales report, declines swept all regions. Also like the existing home sales report, supply rose steeply, to 9.1 months from June's 8.0 months. Unlike the existing home sales report, new home prices show weakness. The median price is down 6.0% to $204,000 for a minus 4.8% year-on-year comparison. The median price is the lowest since 2003.Today's report together with yesterday's report may begin to trigger new talk in Washington for third-round housing stimulus.

Durable Goods Orders

Econoday 8/25 - Manufacturing is not as strong as hoped-based on July durables. New factory orders for durable goods in July rebounded 0.3%, following a 0.1% decline the prior month. The July rebound came in significantly below the consensus forecast for a 2.5% comeback.



The bounce back in July was led by the transportation component. Most other components slipped. Excluding transportation, new durables orders dropped 3.8%, following a 0.2% rise in June. While durables orders are a volatile series and some month-to-month dips are to be expected, the latest news is disappointing.
Most of new orders strength came from transportation, which jumped 13.1%, following a 1.0% decrease in June. Nondefense aircraft spiked 75.9% after falling 25.3% in June. Defense aircraft orders declined 8.3% in the latest month. Analysts often focus on the ex-transportation component to see the underlying trend without the sharp monthly swings from aircraft. But excluding transportation also excludes one of the other few big positives in the report. Looking for a silver lining, the ex-transportation series may actually overstate weakness a bit. Within transportation, motor vehicles continued to post healthy gains, rising 5.3% in July after increasing 4.0% in June.

Other components were mostly down for the latest period. Declines were seen in fabricated metals, machinery, computers & electronics, and electrical equipment. Advances were seen in primary metals and in "all other." Businesses may be hitting the pause button on equipment investment. Nondefense capital goods orders excluding aircraft in July fell 8.0%, following a 3.6% jump the month before. Shipments slipped 1.5% in July, following a 1.0% rise in June. However, orders and shipments for this series have shown strength for several months. Year-on-year, overall new orders for durable goods in July were up 9.3%, compared to 17.1% in June. Excluding transportation, new durables orders came in at up 9.5%, compared to 16.1% the prior month.

Bernanke continues to see modest recovery; bar for further policy action remains fairly high

Barclays 8/27 – (Excerpts) The bottom line of Fed Chairman Bernanke's speech at the Jackson Hole Symposium was, in our view, that the Fed expects a continuation of the economic recovery, albeit at a more modest pace than thought a month or two ago, and judges that the risks of deflation remain small. In this situation, a further round of policy stimulus is not seen as appropriate, but the Fed stands ready to move in this direction if the outlook deteriorates further and deflation risks rise. As we have written recently, we believe that such a deterioration would necessitate a combination of below-trend growth, declines in private payrolls, and evidence of a further decline in inflation expectations and that a further policy loosening would take the form of balance sheet expansion through asset purchases (most likely Treasuries). Bernanke's comments support this view.

Jobless Claims

Econoday 8/25 - Jobless claims swung lower in the August 21 week in what should slow the deepening pessimism. Initial claims fell 31,000 for the second biggest decline of the year. Yet the 473,000 level is still on the high side when compared to levels in July, evident in the four-week average of 486,750 which is the worst since November. The prior week was revised 4,000 higher to 504,000, also the highest level since November.

On the continuing side, continuing claims fell 62,000 in data for the August 14 week. The 4.456 million level is the best of the recovery as is the four-week average of 4.509 million. The unemployment rate for insured workers fell one tenth to 3.5%. The continuing news is probably good news for the jobs outlook, suggesting that those who have been out of work are increasingly finding jobs. But some of the decline also reflects the expiration of benefits as job seekers simply fall out of the insured labor pool.

Week Ending	Aug. 21	Aug. 14	Change	Aug. 7	Year
Initial Claims	473,000	504,000	-31,000	488,000	567,000
4-Wk Moving Average	486,750	483,500	+3,250	474,500	564,500

Economic Week Ahead: August 30 – September 3

Vanguard 8/27 - The calendar is loaded with reports next week, beginning with Personal Income on Monday. Tuesday features Consumer Confidence and minutes of the Federal Open Market Committee, followed by Construction Spending and the ISM Manufacturing Index on Wednesday. The heavy week continues with Initial Jobless Claims, Productivity and Costs, and Factory Orders on Thursday, and capped Friday by the Employment Situation and the ISM Nonmanufacturing Index.

Date	ET	Release	For	Briefing.com	Consensus	Prior
Aug 30	08:30	Personal Income	Jul	0.2%	0.2%	0.0%
Aug 31	10:00	Consumer Confidence	Aug	49.5	50.0	50.40
Aug 31	14:00	Minutes of FOMC Meeting	08/10			
Sep 01	10:00	Construction Spending	Jul	-0.5%	-0.7%	0.1%
Sep 01	10:00	ISM Index	Aug	53.0	52.9	55.5
Sep 02	08:30	Initial Claims	08/28	475K	475K	473K
Sep 02	08:30	Productivity-Rev.	Q2	-1.4%	-1.7%	-0.9%
Sep 02	10:00	Factory Orders	Jul	0.1%	0.3%	-1.2%
Sep 03	08:30	Nonfarm Payrolls	Aug	-106K	-120K	-131K
Sep 03	08:30	Unemployment Rate	Aug	9.6%	9.6%	9.5%
Sep 03	10:00	ISM Services	Aug	51.0	53.0	54.3