Market Comment *Economic Highlights for the week ended September 2, 2011*

Economic Week In Review: Labor Day Forecast Clouded By Bleak Jobs Report

Vanguard 9/2 – The long Labor Day weekend got off to a shaky start on Friday because of a weaker-than-expected report from the Labor Department, which indicated that <u>the U.S. economy produced no net job growth in August</u>. In other news, minutes from the Federal Open Market Committee's August meeting <u>revealed that members were split over how best to help the economy</u>. Meanwhile, consumer confidence hit its lowest point in more than two years last month. On a brighter note, consumer spending and factory orders both increased in July. For the week ended September 2, the S&P 500 Index fell 0.2% to 1,174 (for a year-to-date total return of about –5.4%). The yield of the 10-year U.S. Treasury note fell 17 basis points to <u>2.02% (for a year-to-date decrease of 128 basis points</u>).

Nonfarm Payrolls – August: U.S. Job Market At A Standstill

Vanguard 9/2 – The end of the week brought discouraging news for the U.S. economy with the release of the latest unemployment data. The Labor Department's report revealed that, on a net basis, no jobs were added during the month of August. The unemployment rate held steady at 9.1%, the same as in July. <u>This news was unexpected; economists had anticipated that 80,000 new jobs would be added in August.</u>

"This was a big negative surprise, and even the positive private payroll number is not larger than the survey's statistical error, so statistically that one is also at zero," Vanguard senior economist Roger Aliaga-Díaz said. "In particular, the negative manufacturing jobs number is a concern, as manufacturing exports have been a key contribution to growth in previous quarters. Clearly, we're at a critical and difficult juncture in terms of the economic outlook for the rest of the year."

AFP 9/5 - The jobs report cannot be described as anything but another sign that the U.S. economy is teetering on the edge of a recession.

WSJ 9/2 *Economists React: 'Disturbing' Way to Start Labor Day Weekend*

– Job creation is the lifeblood of an economy... Without it, people should really cease acting surprised that consumers aren't spending a ton of money, think we're still in a recession and find their confidence falling through the floor.*–Dan Greenhaus, BTIG LLC*

– Declining labor force participation has kept the unemployment down to the 9.1% rate — not the way you want to keep the unemployment down. *–John Silvia, Wells Fargo*

– …today's weak number – flat employment in August plus downward revisions to the previous two months – clearly raises the specter that the US has already entered or is at least close to enter another recession. *–Harm Bandholz, Unicredit*

– We all know that Bernanke is predisposed to act, and today's data will only reinforce the resolve of Bernanke and the doves on the FOMC to push another button. In fact, I find it hard to imagine that the Fed would hold back from acting again over the next meeting or two. *–Stephen Stanley, Pierpoint Securities*

– We see today's report as increasing the probability of further monetary policy stimulus at the September FOMC meeting. *–Michael Gapen, Barclays Capital*

FOMC Minutes – August 9: Fed Officials Split Over Next Move

Vanguard 9/2 – Earlier this week, the Federal Open Market Committee (FOMC) released the minutes from its August 9 meeting, after which it announced that it would likely keep the fed funds rate close to zero until mid-2013. Because economic growth in the first half of the year was slower than expected, the committee decided explicit guidance about the time frame over which the fed funds target would remain near zero was "a measured response to the deterioration in the outlook over the intermeeting period," according to the minutes.

<u>For the first time since 1992, however, three committee members dissented, arguing against the more explicit guidance, preferring the vaguer language in earlier Fed statements. While some other committee members wanted more aggressive monetary policy action, they still supported the move.</u>

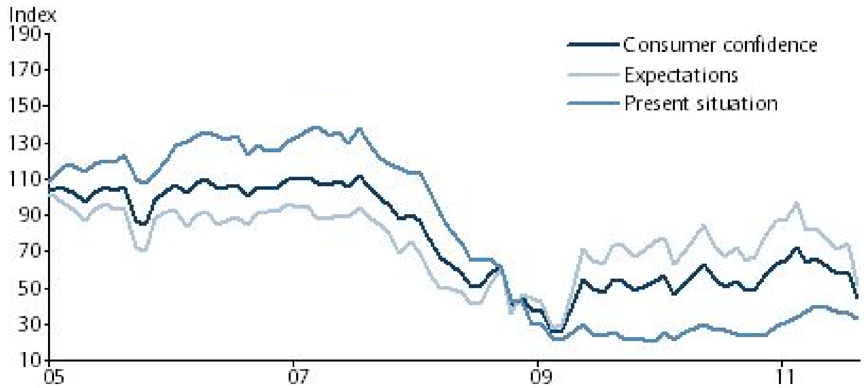
"While all felt the monetary policy could not completely address the various strains on the economy, most members thought that it could contribute importantly to better outcomes," the minutes said.

AFP 9/5 - That meeting also was notable for the division among the voting members. Three voting members disagreed with the decision to all but guarantee that the target rate would remain at near-zero until mid-2013, while others were poised to launch a third round of quantitative easing. These members thought further accommodation was warranted because —they expected the unemployment rate to remain well above, and inflation to be at or below, levels consistent with the Committee's mandate. The next several meetings of the FOMC are sure to be interesting.

Econoday 8/30 – The Fed has expanded the next meeting to be a two-day meeting on September 20-21, instead of the originally planned one-day meeting. The additional time was agreed upon by FOMC members to allow more in-depth discussion of policy options.

Consumer Confidence – August: Consumer Anxiety Increases

Vanguard 9/2 – The Conference Board's index of consumer confidence dropped to 44.5 in August, its lowest level since April 2009. Consumer expectations for the next six months declined dramatically, plummeting from 74.9 in July to 51.9. The present situation component fell to 33.3 from July's already low reading of 35.7, indicating that consumers continued to feel anxious over current economic conditions. Consumers' views on the job market also worsened during the month.

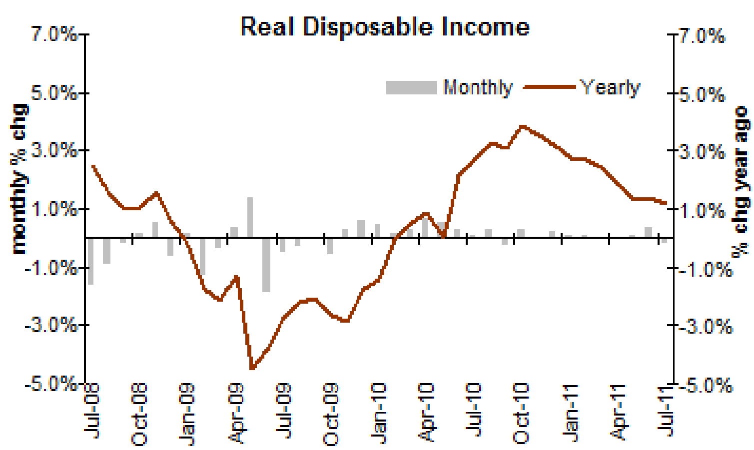


"Consumer confidence deteriorated sharply in August, as consumers grew significantly more pessimistic about the short-term outlook. The index is now at its lowest level in more than two years," said Lynn Franco, director of the Conference Board Consumer Research Center. Consumers' assessment of current conditions, on the other hand, posted only a modest decline as employment conditions continue to suppress confidence."

Econoday 8/30 – The debt-ceiling drama and the S&P downgrade of the US did in fact pull down consumer confidence which fell a very steep 14.7 points in August.

Personal Income and Spending – July: Encouraging Start to US Q3 Consumption

Econoday 8/29 – In July, the consumer made a nice comeback in terms of income growth and spending. PCE inflation, however, was on the warm side. Personal income in July rose a moderately healthy 0.3%. Wages & salaries grew a little more robust 0.4%.



Consumer spending rebounded a sharp 0.8% after slipping 0.1% in June. By components, durables jumped 1.9%. Clearly, motor vehicle sales are up as the supply constraint related parts shortages from Japan is easing. Nondurables increased 0.7%. Services rose 0.7%. The latest numbers on spending should allay concern about a double-dip recession.

On the inflation front, the headline Personal Consumption Expenditures (PCE) price index jumped 0.4%. The primary reason was energy costs with food also contributing. The core rate posted a 0.2% gain. Year-on-year, headline prices are up 2.8%. The core is up 1.6%. Inflation and taxes did outpace income with real disposable income edging down 0.1%.

The bottom line is that the consumer sector is not down and out but actually adding to economic growth. Of course, the strength is coming from those with jobs and job growth would add to momentum.

Barclays 8/29 - All in all, a strong report, representing a solid start to Q3 for household spending and supporting our view that real consumption will be notably stronger in Q3 than Q2, boosted by a rebound in auto sales and softer consumer price inflation.

Construction Spending – July: Spending Fell Sharply, Previous Data Revised Higher

Econoday 9/1 - Construction spending fell in July but following a sharply upwardly revised June. Construction outlays in July declined 1.3%, following a revised 1.6% advance in June (originally a 0.2% increase. However, the June revision essentially offsets that miss. The July decrease was led by a drop in public sector outlays with private residential and private nonresidential also slipping.

Public construction fell 2.1% in July. Private residential outlays declined 1.4%. July weakness in this component was led by alterations and improvements which had surged in recent months. New one-family outlays in July edged up 0.1%, new multifamily construction rebounded 1.4%, and non-new residential outlays fell 2.9%.

On a year-ago basis, overall construction outlays improved to up 0.1% in July from down 1.3% in June. Year-on-year, public construction is down 8.8% in July; private residential spending is up 5.3%; and private nonresidential spending is up 5.7%.

Factory Orders – July: Solid US Factory Orders Report

Econoday 8/31 - July was a very strong month for the manufacturing sector which got a boost from a snap-back in the auto sector which in prior months had been held down by Japanese shortages. New orders rose 2.4%, split between a 4.1% rise for durable goods and a 1.0% rise on the non-durables side.

New orders for motor vehicles jumped 14.8% in the month with shipments of autos up 4.8% and light trucks up 21.1%. July also got a big lift from civilian aircraft with new orders up 43.4% and shipments up 7.9%.

Total shipments rose a very solid 1.6% in the month with a big 0.8% rise in unfilled orders another big positive. Inventories rose a moderate 0.5% pointing, in what is another positive, to the need for an inventory build should new orders extend their strength. These results are very positive but August is another question, given not only the tough comparison with July but also early anecdotal indications.

Vanguard 9/2 –Overall, factory orders exceeded analysts' expectations following a 0.4% revised decline in June. Shipments, unfilled orders, and inventories also increased.

Productivity -2Q: Productivity Continues Slide

Vanguard 9/2 – U.S. worker productivity dropped 0.7% in the second quarter, more than the 0.3% decline previously estimated. After several years of growth, productivity has now dropped for two straight quarters, partially because of higher costs for labor. The output of goods and services increased 1.3%, but hours worked rose a bit faster. Workers' hourly wages dropped 1.4%, adjusted for inflation during the period. Unit labor costs were below their peak levels of late 2008, a potentially promising sign for hiring.

Econoday 9/1 - Today's revisions are a reminder that the economy is soft (sluggish output) and that businesses likely see labor as expensive, reducing the incentive to hire.

Barclays 9/1 - On a y/y basis, compensation per hour is estimated to have risen 2.7%, and indicates firms are beginning to face some cost pressures. Rising labor costs may appear unusual in a labor market with a 9.1% unemployment rate. In our view, however, the rise reflects a labor market that has less spare capacity than may be commonly perceived, in which case, rising labor costs are likely to continue.

ISM Manufacturing Index - August: Weak, But Better Than Expected

Vanguard 9/2 – The Institute of Supply Management's manufacturing index fell slightly to 50.6 in August. While manufacturing activity was slower than a month ago, the sector as a whole continued to expand. Analysts had expected the index to dip below 50, which would have indicated a contraction in manufacturing. Growth remained unspectacular, however.

Barclays 9/1 - The decline was centered in the production component, which fell to 48.6. This was partly offset by gains in new orders (to 49.6), supplier deliveries (to 50.6) and inventories (to 52.3). The employment index fell to 51.8. While indicative of a soft pace of manufacturing output growth, this report provides reason for reassurance. If demand rebounds in the 2nd half of 2011 as we expect, production should follow and also be supported by a rebound in auto production as supply constraints ease.

Case-Shiller Home Prices – June: Home Price Index Shows Modest Decline in US Home Prices

Econoday 8/30 – Home prices were trending flat in June with Case-Shiller's adjusted composite 10-city index, holding unchanged for a second straight month. The composite 20-city index edged 0.1% lower for a second straight month with 11 of the 20 cities showing decline. Seasonality is at play during spring and summer which is a strong time for home sales. Unadjusted data show 1.1% gains for both the composite 10- and 20-city indexes.

Unemployment Insurance Weekly Claims Report (Initial Jobless Claims) – week of Aug 27

Press Release 9/1 (excerpts) – In the week ending August 27, the advance figure for seasonally adjusted initial claims was 409,000, a decrease of 12,000 from the previous week. The 4-week moving average was 410,250, an increase of 1,750.

The advance seasonally adjusted insured unemployment rate was 3.0% for the week ending August 20, unchanged from the prior week.

The advance number for seasonally adjusted insured unemployment during the week ending August 20 was 3,735,000, a decrease of 18,000 from the preceding week. The 4-week moving average was 3,726,000, a decrease of 3,250.

WEEK ENDING	Aug 27	Aug 20	Change	Aug 13	Prior Year
Initial Claims (SA)	409,000	421,000	-12,000	412,000	468,000
4-Wk Moving Average (SA)	410,250	408,500	+1,750	403,500	475,750

Barclays 9/1 - The Labor Department reported that the labor dispute between Communication Workers of America and Verizon Communications was not a special factor in this week's claims data. Net of this special factor, the underlying trend in claims data has remained stable and suggests that labor market conditions have remained little changed in recent weeks.

The Economic Week Ahead: Aug 29 – Sept 2, 2010

Vanguard 9/2 – Next week will be fairly light in terms of economic reports. The news will include the latest on the ISM's nonmanufacturing index (Tuesday), the Beige Book report (Wednesday), international trade, and consumer credit (both on Thursday).

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

	TIME (ET)	REPORT	PERIOD	FORECAST	PREVIOUS
MONDAY, SEPT. 5		Labor Day holiday			
TUESDAY, SEPT. 6	10 am	ISM services	Aug.	51.2%	52.7%
WEDNESDAY, SEPT. 7	2 pm	Fed Beige Book		--	--
THURSDAY, SEPT. 8	8:30 am	Initial Jobless Claims	9/3	N/A	N/A
	8:30 am	Trade deficit	July	-$50.9 bln	-$53.1 bln

	3 pm	Consumer credit	July	--	$15.5 bln
FRIDAY, SEPT. 9	10 am	Wholesale inventories	July	--	0.6%