Market Comment *Economic Highlights for the week ended November 4, 2011*

Economic Week in Review: Recovery Dogged By Usual Suspects

Vanguard 11/4 – Another weak U.S. jobs report and little clarity over Europe's debt crisis tipped a mixed week toward the glum side. After European leaders appeared to have an agreement in hand early in the week to shore up Greece, the country's political situation deteriorated markedly. By Friday, the Group of 20 had adjourned without broad backing to contain the crisis. For the week ended November 4, the S&P 500 Index fell 2.5% to 1,253.23 (for a year-to-date total return of about 1.33%). The yield on the 10-year U.S. Treasury note fell 30 basis points to 2.04% (for a year-to-date decrease of 126 basis points).

Non-Farm Payrolls – October: Too Few Jobs to Make Big Dent

Vanguard 11/4 - The creation of just 80,000 jobs overall was fewer than analysts had expected and too few even to keep up with the growth of the working-age population. While businesses created 104,000 jobs, the public sector shed 24,000, mainly at the state and local level.

Brightening the picture somewhat, <u>the Labor Department revised upward its totals from August and September. Even so, the revisions put the average number of jobs created in the past three months at only 114,000.</u> Analysts generally consider sustained job creation of around 150,000 a month as consistent with a healthy economic expansion—and closer to 250,000 a month as necessary to kick-start a robust recovery from recession.

AFP 11/7 - The U.S. economy added 80,000 workers in October, with <u>virtually all of the month's modest gain in payrolls experienced in the private service sector</u>. The Bureau of Labor Statistics estimates U.S. employers have added 1.501 million workers over the past 12 months, which includes the 102,000 workers BLS added to their previously announced August and September payroll estimates. Among the sectors with the greatest amount of job creation in October were professional/business services (+32,000), leisure and hospitality (+22,000), retail (+18,000), and health care (+12,000). The goods producing sector of the economy dropped 10,000 workers, as the 20,000 workers shed in construction outmatched the small payroll gains in manufacturing and mining. <u>Governments dropped 24,000 workers in October</u>.

The average workweek for private sector workers was 34.3 hours, not only unchanged from September but also matching the October 2010 reading. The manufacturing workweek averaged 40.5 hours, up 2/10ths of an hour from September and 1/10th of an hour from a year earlier. The average number of overtime hours worked in the manufacturing sector was 3.2 hours, matching the September 2011 reading. Wages also remained in check during October as average hourly wages increased by only five cents to $23.19. Average hourly wages have grown 1.8% over the past 12 months.

According to a separate household survey, <u>the unemployment rate dropped by 1/10th of a point to 9.0%</u>. The unemployment rate has traded within a small range of 9.0 to 9.2% since April and has been at or above 9.0% for all but two months since May 2009. The household survey also found 13.897 million people were unemployed, down 95,000 from September and 590,000 from a year earlier. The typical unemployed person has been jobless for 20.8 weeks, down 1.4 weeks from September and 0.5 weeks from October 2010. Nevertheless, 5.876 million people have been out of work for at least 27 weeks. 181,000 people (re)joined the labor force in October. Yet despite three consecutive months of big gains, the labor force has grown by only 238,000 people over the past year.

<u>BLS estimates that 8.896 million workers held a part-time job but was seeking a full-time opportunity (often referred to as "involuntary" part-time workers)</u> in October, down from the 9.270 million estimated for September but still above the 8.826 million reported for August. The broadest measure of labor underutilization (called the U-6 series, which accounts for unemployed workers, people "marginally" attached to the labor force and involuntary part-time workers) declined by 3/10ths of a percentage point to 16.2%. It was 17.0% in October 2010.

Federal Reserve Open Market Committee Meeting: Nov. 2

AFP 11/7 - Members of the Federal Open Market Committee <u>do not foresee a particularly strong rebound in the labor market in the near future</u>. While the statement released at the conclusion of last week's meeting noted that business conditions had "strengthened somewhat" during the summer and early fall, <u>"continuing weakness" in the labor market continued to weigh on the recovery</u>. Even with the predicted "moderate pace of economic growth" in the coming quarters, <u>the unemployment rate will only decline "gradually"</u> (more on both below). The statement noted that housing spending was increasing while business investment in equipment and software was expanding, but that real estate remained a drag on the economy. Further, inflation has "moderated" in recent months.

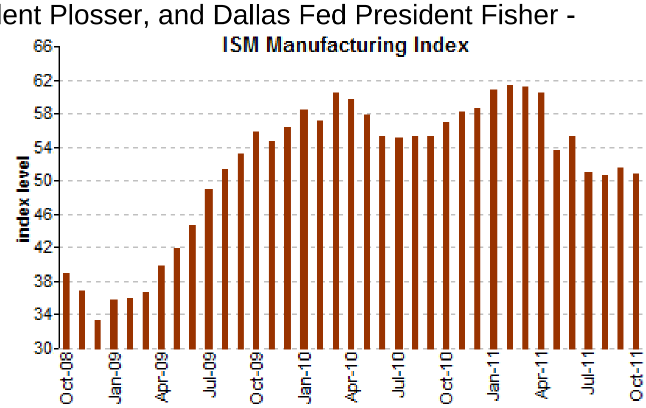
At the same meeting, the FOMC decided to continued its "twist" operation by selling some of the shorter maturity Treasury securities its currently holds in its portfolio and reinvesting those proceeds into longer maturity securities and that it would reinvest principal payments made on its portfolio holdings. In addition, the fed funds target rate was once again kept at near-zero percent, with the statement reaffirming the committee's intention to maintain the "exceptionally low" target rate until at least mid-2013. One voting FOMC member does not believe that this strategy is sufficient given the current environment. Federal Reserve Bank of Chicago President Charles Evans dissented from the majority decision as he "supported additional policy accommodation at this time." On the other hand, the three dissenting voters at the last several FOMC meetings supported the majority decision at last week's meeting. Is this a sign that momentum is building towards another round of securities purchases by the Fed? Time will tell, but a clue may be in the next paragraph.

The Fed also released on Tuesday its updated economic forecast, which had a gloomier tone than the forecast released just a few months earlier. The Fed now expects real gross domestic product (GDP) will grow between 1.6 and 1.7 percent for all of 2011 and by a range of 2.5 and 2.9 percent in 2012. This was down sharply from the forecast released back in June, which had 2011 growth in the range of 2.7 and 2.9 percent and 2012 growth pegged between 3.3 and 3.7 percent. Further, the unemployment rate for 2011 now is expected to be in the range 9.0 and 9.1 percent for all of 2011, dropping to a still very elevated 8.5 to 8.7 percent range in 2012. Back in June, the 2011 forecast was for the unemployment rate to be between 8.6 and 8.9 percent, with the rate dropping to a range of 7.8 and 8.2 percent in 2012. To show just how pessimistic the Fed is about the future outlook, it foresees the unemployment rate to range between 6.8 and 7.7 percent as late as 2014. As recently as early 2008, the unemployment rate was under five percent.

Vanguard 11/4 – A potentially stronger tonic—such as a third round of asset purchases, known as quantitative easing (QE)—could still be prescribed in the months ahead. "The downgrade in the Fed's growth expectations, along with a tame inflation outlook, tells us that another round of QE is definitively not out of the question," said Vanguard senior economist Roger Aliaga-Díaz.

Econoday 11/2 – Essentially, the Fed is leaving the door open for additional ease with the emphasis on significant downside risks remaining. Also supporting possible future action is the Fed's belief that inflation is going to be relatively low in coming quarters. And the new angle of dissent coming from a dove instead of from hawks on the FOMC adds to the view that QE3 is still possible. But the comments that the economy is getting better suggest that QE3 is not imminent.

Barclays 11/2 - The main change in the statement came from the dissenters. Previously, three members - Minneapolis Fed President Kocherlakota, Philadelphia Fed President Plosser, and Dallas Fed President Fisher - had registered dissents against the strengthening of the guidance on the federal funds rate at the August meeting and the implementation of "Operation Twist" at the September meeting. These three members dropped their dissent at today's meeting, likely due to the fact that these policy actions had already been taken and further dissents against prior actions would be viewed as not constructive. We doubt they have changed their mind on whether these actions were needed, but have decided against registering an ongoing dissent. In contrast, Chicago Fed President Evans dissented against today's decision to stay on hold, favoring "additional policy accommodation at this time." The dissent by Evans suggests there may be an easing bias in place on the committee and we look to the upcoming press conference by the chairman to see where the committee stands in adjusting its communications strategy and the need for further asset purchases of agency mortgage-backed securities to support the housing market.



ISM Manufacturing Index – October: Manufacturing Loses Some Steam

Vanguard 11/4 – A key index showed that manufacturing is barely expanding, though analysts saw signs that production could soon quicken. The Institute for Supply Management reported that new orders rose while inventories accumulated more slowly—possible signals that factories may need to step up the pace.

Econoday 11/1 – Manufacturing may be about to pick up new steam based on the ISM's new orders index which, after three straight of months of marginal contraction, moved to the plus column with a nearly three point gain to 52.4, to show month-to-month expansion. With new orders up, manufacturers worked down their backlogs to an easing degree with the index up six points to 47.5. Employment is little changed at 53.5 to indicate moderate hiring in the sample. Production is steady as are supplier deliveries. New export orders show no change.

A big plus in the report is sharp contraction in prices paid, down 15 points to 41.0 which is the lowest reading in 2-1/2 years. Lower costs reflect slowing demand but they will give manufacturers more leeway to invest in their businesses and workforces. The headline composite index of 50.8 is below the expectations but the new orders gain is an offsetting plus.

Barclays 11/1 – While the decline in the production index suggests only very modest growth in manufacturing output in October, the rebound in new orders is an encouraging sign for later in the quarter, as producers respond to the rebound in domestic demand evident in Q3.

ISM Non-Manufacturing (Services) Index: Service Sector Plods Forward

Vanguard 11/4 – The latest national survey of non-manufacturers showed little improvement, but neither did it suggest general retrenchment.

Econoday 11/3 – Steady growth but no better than mild is the news from the ISM's non-manufacturing report where the headline composite index for October is little changed at 52.9. Monthly growth in new orders slowed to 52.4 from September's 56.5 while backlog orders moved back to monthly contraction at a sub-50 reading of 47.0. But employment, though a lagging indicator, is very positive, up 4.6 points to 53.3 to show the strongest rate of monthly expansion in five months.

Factory orders - September: Factory Orders Report Encouraging for Q4

Econoday 11/3 – Strength in non-durable goods and an upward revision on the durables side made for a better-than-expected 0.3% rise in factory orders for September. New orders for nondurables, up a strong 1.0%, got a lift from petroleum and coal, products that are sensitive to price changes. The durables side, revised to minus 0.6% from an initial reading in last week's durable goods report of minus 0.8%, got a lift from an upward revision to transportation where monthly contraction, reflecting monthly swings in aircraft orders, was trimmed nearly ½ percentage point to 7.1%.

Other data show a solid new order rise for core capital goods which confirms that businesses continue to invest in their equipment if not in their workforces. Another positive in the report is a strong 0.9% gain, a third straight, for unfilled orders. The manufacturing sector isn't on fire but it is providing solid support for the economy.

Productivity – 3Q2011: Businesses Running Tight Ship

Barclays 11/3 - US productivity in the nonfarm business sector increased 3.1% q/q (saar) in Q3. Hours increased a tepid 0.6%, though firms were able to boost output 3.8%. The increase in productivity comes after two consecutive quarterly declines (Q1: -0.6%, Q2: -0.1%). It has now risen 1.1% on a y/y basis, which is still below its historical average, but better than its Q2 pace of 0.9%.

Vanguard 11/4 – Productivity among the nation's nonfarm businesses increased more than analysts had expected last quarter—a plus for profits but a minus for near-term hiring, as companies still showed little need to expand their workforces. Businesses' labor costs fell as the number of hours worked rose only slightly and compensation didn't keep up with inflation.

Still, productivity is not rising as sharply as it had when employers were shedding workers en masse during the recession, giving firms more leeway to add workers once demand for their goods and services picks back up.

Construction Spending – September: Home Construction Shows Signs of Life

Vanguard 11/4 – Though the housing market remains deeply troubled, builders have been anticipating a modest pickup in demand. Publicly funded construction languished in September as all levels of government cut back, but spending on private building projects rose for the second month in a row. Home-building led the way.

Builders still face stiff competition for buyers from a glut of previously owned homes, many of them distress sales. Office construction is also struggling amid a surplus of vacant space, though private nonresidential spending overall picked up.

The construction industry's ongoing woes following the real estate crash and subsequent recession have helped keep unemployment stubbornly high, since construction workers are normally among the first to be rehired following a recession.

Chicago PMI - October: Small Decline in the Chicago PMI

Barclays 10/31 - The Chicago PMI declined to 58.4 from 60.4 in October. The details revealed small declines in production (to 63.4 from 63.9) and new orders (to 61.3 from 65.3), but both remain at very strong levels. Meanwhile, the employment index rose to a six-month high of 62.3 (from 60.6 in September). While the Chicago PMI historically has a slightly closer correlation with the national ISM than the Philadelphia Fed or Empire State surveys, it has taken a consistently stronger tone than other measures of manufacturing activity in recent months, although that gap closed partly in October with the small decline in today's report and the solid rebound in the Philadelphia Fed.

Unemployment Insurance Weekly Claims Report (Initial Jobless Claims) – week of Oct 29

Press Release 11/3 (excerpts) - The advance seasonally adjusted **insured unemployment rate** was 2.9% for the week ending October 22, unchanged from the prior week's unrevised rate.

The advance number for seasonally adjusted **insured unemployment** during the week ending October 22 was 3,683,000, a decrease of 15,000 from the preceding week's revised level of 3,698,000. The 4-week moving average was 3,703,250, a decrease of 10,500 from the preceding week's revised average of 3,713,750.

WEEK ENDING	Oct 29	Oct 22	Change	Oct 15	Prior Year
Initial Claims (SA)	**397,000**	406,000	**-9,000**	404,000	454,000
4-Wk Moving Average (SA)	404,500	404,500	-2,000	403,750	451,000

Econoday 11/3 –The four-week average is slowly approaching the 400,000 level, down 2,000 in the week to 404,500. This level is more than 10,000 lower than the month-ago comparison.

The Economic Week Ahead: Nov 7– Nov 11, 2010

Vanguard 11/4- Vanguard 11/4 – On Monday, the Federal Reserve releases its monthly consumer credit report. On Thursday, the monthly foreign trade figures come out.

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

RELEASE DATE	TIME (ET)	REPORT	PERIOD	FORECAST	PREVIOUS
MONDAY, NOV. 7	3 pm	**Consumer Credit**	September	--	-$9.5 billion
WEDNESDAY, NOV. 9	10 am	Wholesale Trade	September	--	0.4%
THURSDAY, NOV. 10	8:30 am	Jobless Claims	Nov. 5	N/A	N/A
	8:30 am	**Foreign Trade Balance**	September	-$46.0 billion	-$45.6 billion
	8:30 am	Import Price Index	October	-1.0%	0.3%
	2 pm	Federal Budget	October	--	-$140 billion
FRIDAY, NOV. 11	9:55 am	Consumer Sentiment	November	N/A	60.9