Market Comment *Economic Highlights for the week ended November 25, 2011*

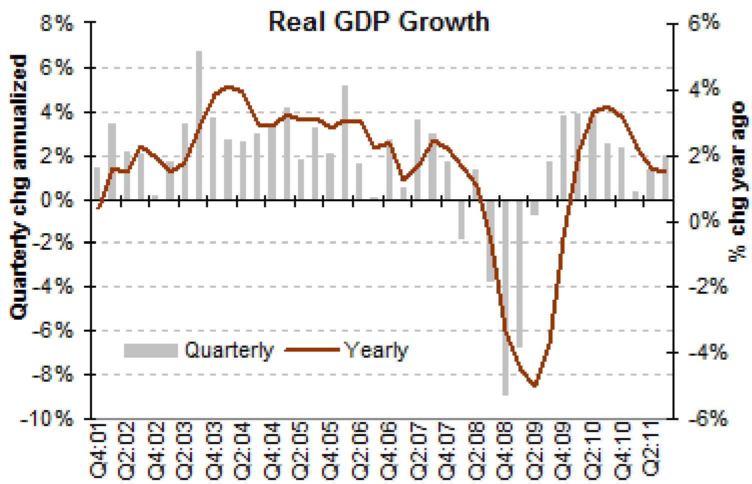
Economic Week in Review: Worry Seasoned With A Few Signs of Hope

Vanguard 11/25 – Third-quarter gross domestic product was revised downward, largely the result of a decline in inventories that nevertheless bodes well for future production. Weighing on the markets were government debt-related events: the failure of the congressional deficit-reduction "super committee," the continuation of Europe's fiscal dilemmas, and the Federal Reserve's announcement of forthcoming stress tests for 31 U.S. banks. For the week ended November 25, the S&P 500 Index fell 4.7% to 1,159 (for a year-to-date total return of about –6.2%). The yield on the 10-year U.S. Treasury note fell 4 basis points to 1.97% (for a year-to-date drop of 133 basis points).

Gross Domestic Product – Q3

Econoday 11/22 – The economy got a moderate downgrade for the third quarter but the downgrade largely came from where there is the least damage to forward momentum. The Commerce Department's second estimate for third quarter GDP growth was bumped down to an increase of 2.0% annualized, compared to the initial estimate of 2.5% and to second quarter growth of 1.3%. Analysts had forecast a revision to 2.4% annualized.

The downward revision primarily was due to a downward revision to inventory investment-from plus $5.4 billion initially to minus $8.5 billion. This revision is the equivalent of a 0.43 percentage point lower contribution to GDP growth.



Minor downward revisions also were made to personal consumption, nonresidential fixed investment, residential investment, and government purchases. Net exports were revised up to minus $400.7 billion from minus $409.4 billion.

The net effects of revisions to inventories and other components (notably net exports) leave demand numbers still relatively healthy. Final sales of domestic product were unrevised from the initial estimate of 3.6%. Final sales to domestic purchasers were down to 3.0% from the original estimate of 3.2% annualized.

Economy-wide inflation was unrevised at 2.5% and compares to the second quarter rise of 2.5%. The market median forecast was for 2.5%.

Turning to current quarter strengths and weakness (as opposed to component revisions), the economy was still gaining modest momentum. The acceleration in real GDP in the third quarter primarily reflected accelerations in PCE and in non-residential fixed investment, a smaller decrease in state and local government spending, a deceleration in imports, and an acceleration in exports that were partly offset by a larger decrease in private inventory investment.

The key points today are that there is no significant change in underlying demand in the third quarter and recent monthly data indicate further strengthening.

Barclays 11/22 - The downward revision was largely accounted for by the inventory component, which is now estimated to have been a drag of 1.6pp (previously 1.1pp).

There were also downward revisions within the household income accounts. Personal income growth is now estimated to have risen only 0.6% (previously 0.9%), driven by a downward revision to the wages and salaries component (to 1.5% from 2.0%). This was also reflected in real disposable income, now estimated to have fallen 2.1% (previously 1.7%), and the savings rate (revised down to 3.8% from 4.1%).This provides a very weak backdrop for the household sector and will likely bring uncertainty concerning the extension of the payroll tax cut and extended unemployment benefits into sharper focus for policymakers.

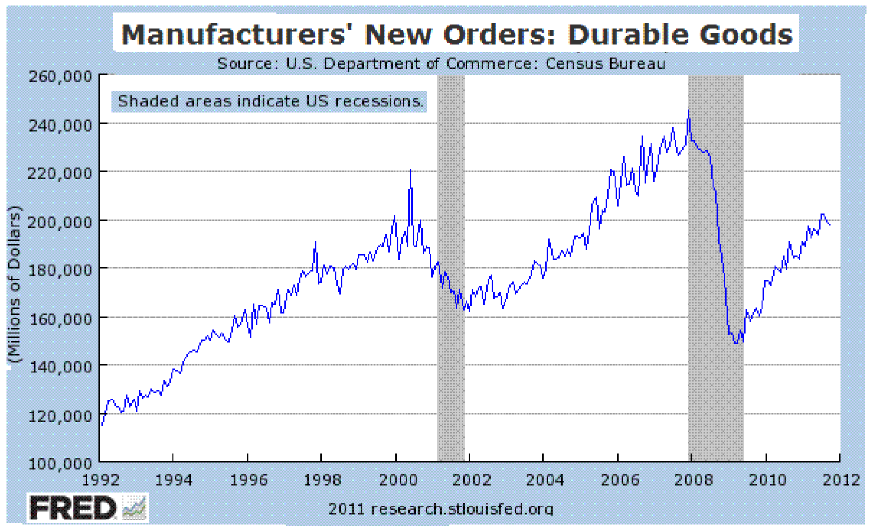
Durable Goods Orders – October: Soft Start to Q4

Econoday 11/23 – Durables orders in October were pulled down by a drop in civilian aircraft orders. Otherwise, durables orders were moderately positive net. New factory orders for durables fell 0.7%, following a decline of

1.5% the prior month (previous estimate, down 0.6%). The October decline was less negative than the consensus forecast for a 1.0% fall. Excluding transportation, durables advanced 0.7% after a 0.6% rebound in September. The October increase topped the consensus forecast for no change in durables excluding transportation.

Weakness in October was led by transportation which fell 4.8% after dropping 7.6% in September. Within transportation, weakness was in non-defense aircraft which declined 16.4% after a 26.8% fall in September. These are essentially swings in orders for Boeing aircraft. Defense aircraft rebounded 10.2%, following a 34.8% drop in September. Motor vehicles rebounded 6.2% after a 2.4% dip the month before.

Outside of transportation, orders were mixed but net positive. Increases were seen in primary metals, up 3.0%; machinery, up 1.6%; and "other" durables, up 1.2%. On the downside were fabricated metals, down 0.3%; computers & electronics, down 0.1%; and electrical equipment, down 5.2%.



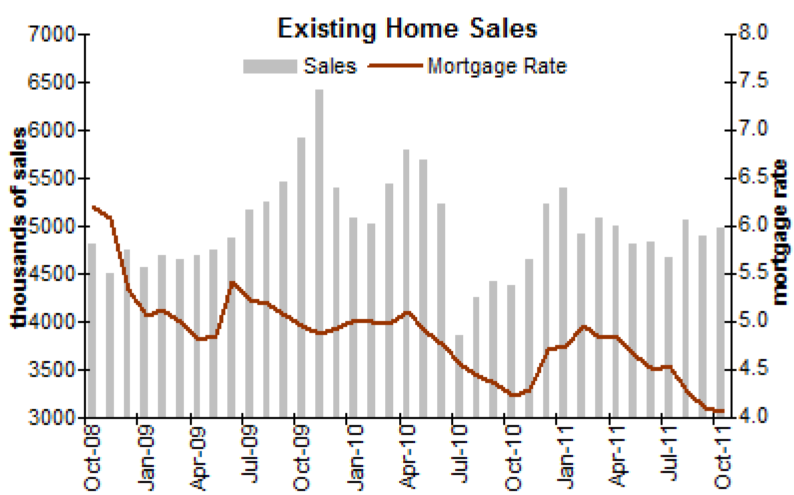
Turning to private investment numbers, non-defense capital goods orders excluding aircraft declined 1.8%, but followed increases of 0.9% in both August and September. Shipments for this series decreased 1.1% in October, following a 3.1% boost in August and a 1.0% dip in September. While volatile, nondefense capital spending appears to remain on a mild uptrend.

Given the fact that Boeing recently announced sizeable new orders and that auto sales remain healthy, the underlying trend for manufacturing looks moderately healthy.

Existing Home Sales – October: U.S. Existing Home Sales Up In October

Barclays 11/21 - Existing home sales rose 1.4% m/m in October, to 4.97m units (saar) from 4.90m in September. The increase was solely driven by single family units, which were up 1.6%, to 4.38m units. Sales of condos/co-ops were flat on the month.

Geographically, sales rose in the Midwest (2.8%), South (2.1%), and West (4.4%) but declined in the Northeast (5.1%). The months' supply of inventory declined to 8.0 months, from 8.3 months, with 3.33 million units remaining on the market. This was the third consecutive decline, although supply levels remain elevated as a result of the high level of distressed properties on the market and still weak demand.



Econoday 11/21 –At $162,500, the median price is down 2.0% on the month for a year-on-year decrease of 4.7%. The year-on-year contraction is slightly deeper than the prior two months and shows deeper deterioration when compared with this time last year when the rate was just popping into positive ground.

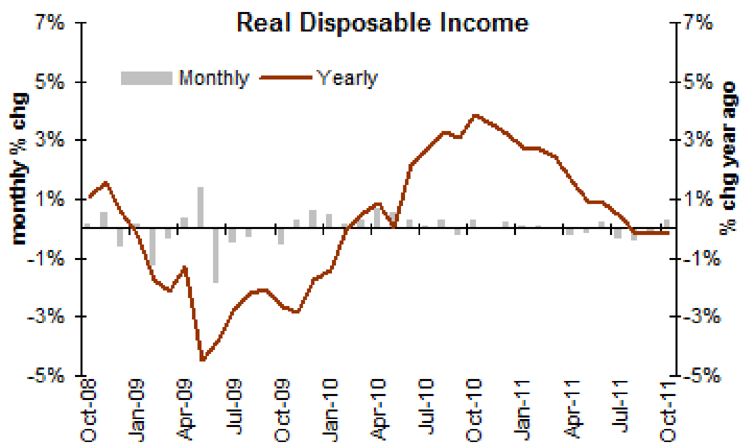
The National Association of Realtors is upbeat on the results but notes that last-minute cancellations, for unknown reasons, spiked in the month to 33% from September's 18%. Closing cancellations have also been heavy in prior months and have been tied to limited availability of financing and low appraisals that prevent buyers from selling their own homes.

Personal Income and Outlays – October

Econoday 11/23 – Personal income and spending posted additional gains in October. Inflation was tame. Personal income in October advanced 0.4%, following a 0.1% increase in September. The October rise came in higher than the market median projection for 0.3%. The wages & salaries component posted an even stronger 0.5% boost after rebounding 0.4% the month before.

The pace of consumer spending eased in October but followed a strong gain the prior month. Personal consumption expenditures rose 0.1% in October, following a 0.7% surge in September. Market expectations were for a 0.3% gain. By components, personal spending was led by durables, up 0.8% after a 2.9% jump in September. On a drop in gasoline prices, non-durables decreased 0.2%, following a 1.0% jump the month before. Services rose 0.1% after a 0.2% gain in September.

Headline inflation turned negative while the core rate was soft. The headline PCE price index declined 0.1%, following a 0.2% increase in September. The core rate firmed modestly to a 0.1% rise in October from no change the month before.



Year-on-year, headline prices are up 2.7%, compared to 2.9% in September. The core is up 1.7% on a year-ago basis versus 1.6% the month before.

The October personal income report is moderately strong, taking into account that the easing in spending came off a strong September. Within income, the robust gain in the wage & salaries component is particularly encouraging. While unemployment remains high, for consumers that are employed, the fundamentals for spending continue to improve.

Barclays 11/23 - All in all, a softer start to Q4 for consumer spending than expected, but the rebound in real income and the likely boost to consumption from auto sales later in the quarter provide reasons for encouragement.

Consumer Sentiment – November: Lower, Remains Susceptible To Fiscal Policy Actions

Press Release 11/23 - Consumer confidence continued to improve in November from its August low when pessimism was dominated by negative reactions to the Congressional debate on the debt ceiling. The failure of the super committee to reach an agreement comes at a time when consumers had anticipated a slowly improving economy, and more importantly, slow gains in employment. While it is too early to determine how the failure will influence consumers' economic expectations, the lack of an extension of the payroll tax cut and unemployment benefits will have an immediate negative impact on consumers and, unless extended, could further dampen holiday spending.

Stagnant Personal Finances - More households reported that their finances had worsened rather than improved for the 48th consecutive month, and income declines were spontaneously mentioned more frequently than income gains as the primary reason. When asked about prospects for the year ahead, just 22% of consumers expected their finances to improve. And even with the lower level of anticipated inflation, half of all families expected falling living standards in 2012.

Confidence in Fiscal and Monetary Policies at Record Lows - In each of the past four months, the majority of consumers unfavorably rated the policies of the Obama administration, and in the past two months, the majority voiced less confidence in the Federal Reserve. Consumers who lost confidence in both the administration and the Fed were extraordinarily pessimistic about the outlook for the national economy—half as optimistic as those who remained confident in both fiscal and monetary policies.

Consumer Sentiment Index - The Sentiment Index rose to 64.1 in the November 2011 survey, up for the third consecutive month from the August low of 55.7, but it was still well below the 71.6 recorded last November. Most of the November gain was in the Expectations Index, a component of the Index of Leading Economic Indicators, which rose to 55.4 in November, up from 51.8 in October, but still below last November's 64.8. The Current Conditions Index was 77.6 in November, up from 75.1 last month but below last year's 82.1.

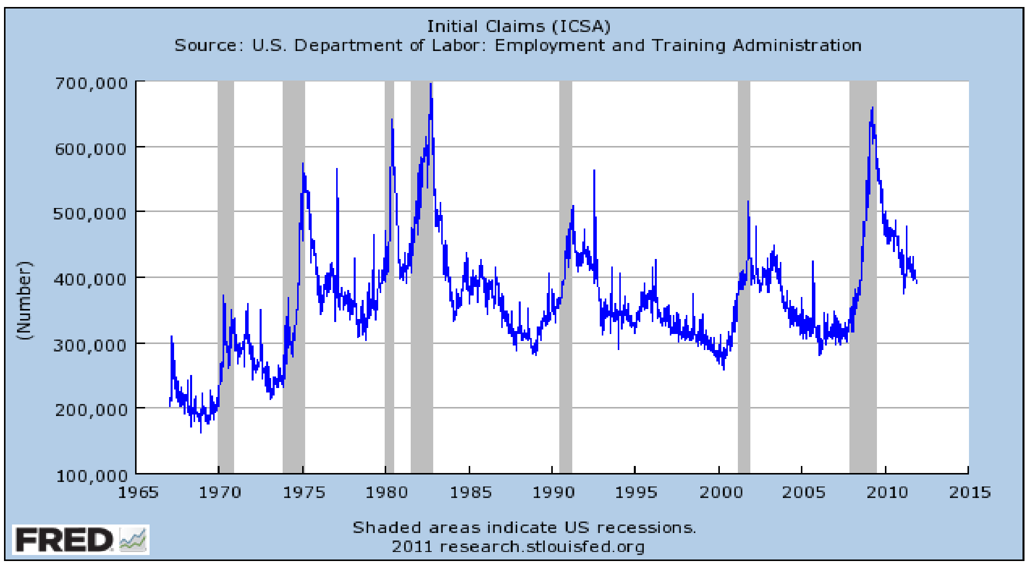
Barclays 11/23 - It is worth noting that the survey showed a much stronger increase in sentiment for families with incomes under $75,000 per year, rising to 61.6 from 57.5 in the preliminary estimate, than it did for families making more than that amount, where the index posted a more modest increase to 69.0 from 68.3. This suggests that the gains in consumer sentiment in November could be easily reversed if the extensions of either the payroll tax cuts or unemployment benefits do not get passed, as both of these measures would have a more significant impact on lower-income families. While consumer sentiment continues to track the gradual improvements in the economic data, policy decisions will be the factor to watch.

Unemployment Insurance Weekly Claims Report (Initial Jobless Claims) – week of Nov 19

Press Release 11/23 (excerpts) - In the week ending November 19, the advance figure for seasonally adjusted initial claims was 393,000, an increase of 2,000 from the previous week's revised figure of 391,000. The 4-week moving average was 394,250, a decrease of 3,250 from the previous week's revised average of 397,500.

WEEK ENDING	Nov 19	Nov 12	Change	Nov 5	Prior Year
Initial Claims (SA)	393,000	391,000	+2,000	392,000	416,000
4-Wk Moving Average (SA)	394,250	397,500	-3,250	400,750	436,750

Econoday 11/23 – Initial jobless claims are below 400,000 for a third straight week in what is a hopeful sign that the jobs market is improving. The four-week average of 394,250, down four weeks in a row, is below 400,000 for a second week in a row. The Labor Department describes today's report as straight forward and without special factors.



FOMC Minutes: Fed Considers New Tools for Its Policy Toolbox

Vanguard 11/25 - While the Federal Open Market Committee made no major policy changes at its November 1–2 meeting, the minutes released this week showed that a number of committee members were in favor of additional policy accommodation to stimulate the economy. The Committee debated a number of ways it might better use communication as a tool of monetary policy. Ideas included setting a target for nominal GDP, publishing forecasts for short-term interest rates, and establishing an explicit inflation goal. While none of these suggestions were adopted, analysts expect that the debate will likely resume, as Chairman Ben Bernanke has repeatedly spoken out for increasing transparency regarding FOMC forecasts and policy plans.

Super Committee Fails Raising Risks Short-Term Stimulus Will Expire

Barclays 11/22 - The Co-Chairs of the Joint Select Committee on Deficit Reduction, or so-called "super committee," released a statement formally acknowledging that the committee was unable to reach agreement on any deficit reduction measures over the next 10 years. As a result of the Budget Control Act (BCA - i.e., the agreement to raise the debt ceiling) passed last August, failure of the super committee framework now sets in motion a process of sequestration that will further reduce the caps on discretionary spending starting in 2013. Thus, the direct near-term economic implications are minimal. The exception, of course, is what the failure implies for the possible extension of the payroll tax cut and unemployment benefits for the long-term unemployed. Our baseline assumption is that both of these stimulus measures are extended. With the failure of the super committee framework, however, we see an elevated risk that they will expire. To pass extensions, Congress will now likely need to find offsetting measures to pay for these programs. Given the political climate, finding $160bn of deficit savings needed to extend the payroll tax cut and the extended unemployment benefits at their current levels could be a high bar. The end of these stimulus measures would pose a noticeable headwind to disposable personal income growth early next year.

In terms of sequestration, the failure of the super committee will trigger restrictions on federal spending that will reduce the deficit by at least $1.2trn over the next 10 years. The Congressional Budget Office estimates federal spending will be cut by about $110bn per year starting in 2013, with the cuts split equally between defense and non-defense spending. The BCA does not specify cuts to particular agencies or programs, but sets separate limits on security and non-security outlays. Under the sequestration procedure, Congress will continue to allocate funds to particular programs via appropriation bills, but all spending must remain under the designated limits. Outlays related to Social Security will not be affected, but payments to Medicare providers could see as much as a 2% cut in payments. Of course, the question remains as to whether such spending cuts will actually occur, or whether Congress and the Administration will find some way to pass legislation to avoid sequestration. Repealing the measures, however, carries with it the risk that the ratings agencies may re-evaluate the U.S. sovereign credit rating.

By the end of 2012, the current Congress and Administration will also need to address whether or not to extend the tax reforms first passed in 2001 and 2003. We expect, however, that these issues are unlikely to be addressed in a meaningful way until after the November elections, leaving a cloud of policy-induced uncertainty hanging over the economy for the better part of 2012.

The Economic Week Ahead: Nov 28– Dec 2, 2010

Vanguard 11/25 - Closely watched reports up for release include **new-home sales** (Monday) and the Fed's **Beige Book** nationwide survey of economic activity (Wednesday). The remaining reports are scheduled as follows: consumer confidence (Tuesday), productivity and labor costs (Wednesday), construction spending and the Institute for Supply Management's manufacturing index (Thursday), and unemployment rate and nonfarm payrolls (Friday).

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

RELEASE DATE	TIME (ET)	REPORT	PERIOD	FORECAST	PREVIOUS
MONDAY, NOV. 28	10 am	**New Home Sales**	October	325,000	313,000
TUESDAY, NOV. 29	9 am	Case-Shiller Home Prices	September	--	0.2%
	10 am	Consumer Confidence	November	45.5	39.8
WEDNESDAY, NOV. 30	8:30 am	Productivity	3Q	2.6%	3.1%
	8:30 am	Unit Labor Costs	3Q	-1.9%	-2.4%
	9:45 am	Chicago PMI	November	58.0%	58.4%
	2 pm	**Fed “Beige Book”**	--	--	--
THURSDAY, DEC. 1	8:30 am	Jobless Claims	11-26	N/A	N/A
	10 am	ISM Manufacturing	November	52.0%	50.8%
	10 am	Construction Spending	October	-0.1%	0.2%
FRIDAY, DEC. 2	8:30 am	Nonfarm Payrolls	November	110,000	80,000
	8:30 am	Unemployment Rate	November	9.0%	9.0%
	8:30 am	Average Hourly Earnings	November	0.2%	0.2%