

**ECONOMIC & MARKET UPDATE: JUNE 27, 2011**  
**"EXTENDING THE EXTENDED PERIOD OF VOLATILITY"**  
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Economic Data - Previous Week					
Date	Series	Actual	Survey	Prior	
6/21	Existing Home Sales	4.81M	4.80M	5.00M	Sales lower, supply remains heavy
6/23	New Home Sales	319K	309K	326K	Continued weakness, but beats estimates
6/24	Durable Goods	1.9%	1.5%	-2.7%	Surprise May increase, also positive April revision
6/24	Q1 GDP - Final	1.9%	1.9%	1.8%	Slight upward revision on back of PCE strength

Economic Data - Upcoming Week					
Date	Series	Actual	Consensus	Previous	
6/27	Personal Spending	--	0.1%	0.4%	Retail data point to softening in spending
6/28	S&P/CS Home Price Idx	--	-0.20%	-0.23%	Prices may firm soon as distressed sales fall
6/28	Consumer Confidence	--	61.0	60.8	Falling gas prices should stabilize confidence
7/1	UMich Confidence	--	72.0	71.8	Falling gas prices should stabilize sentiment
7/1	Construction Spending	--	0.1%	0.4%	Weak housing market to constrain spending
7/1	ISM Mfg Idx	--	51.8	53.5	Regional surveys point to slowing in mfg idx

Source: Bloomberg

## NEGATIVE NEWS SLOWS IN US

Paradoxical geopolitical news and economic data yielded mixed returns for US equities last week. The S&P 500 and Dow Jones Industrial Average indices fell 0.2% and 0.6%, respectively, while small cap stocks gained 2.1%. Small and large cap stocks are down nearly 7% since the end of April, yet are still in the black year-to-date.

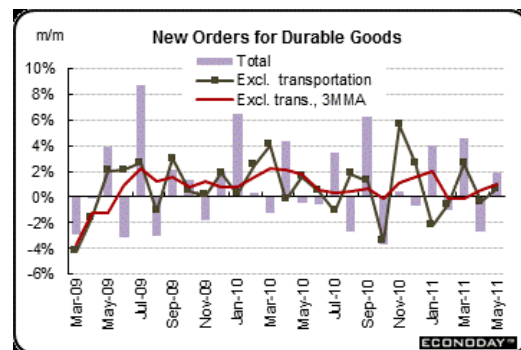


Source: Bloomberg

The CBOE Volatility Index (VIX) hit its QTD high of 23 upon market open on Monday but closed the week at 21, slightly above its long-term average.

Domestically, the week yielded more positive than negative economic data. Existing and

new home sales figures, although weak, came in ahead of expectations. Durable goods orders also surprised to the upside, assuaging fears of a manufacturing slowdown. New orders rose 1.9% after falling 2.7% in April. Also of interest, April numbers were revised upwards after the initial report pointed to a 3.6% contraction.

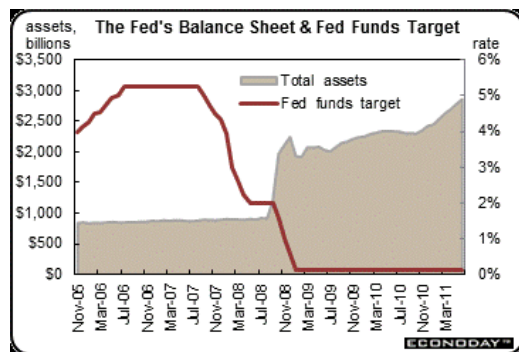


Source: Econoday

Although positive, these numbers should be taken with a grain of skepticism. Supply chains have been stressed across the globe since the Japan earthquake. Companies have

increased inventories to compensate. The result is inventory levels that are considerably higher than booked shipments. This has thrown off normal order trends. Until there is clarity from Japan, durable goods data will be less informative.

The latest FOMC meeting provided little surprise. The target federal funds rate was unchanged and, given the language - “the economic recovery is continuing at a moderate pace, though somewhat more slowly than the Committee had expected” - will likely remain untouched for the near future. The potential for QE3 was quashed by rhetoric describing the current lack of deflationary indicators, part of the impetus for QE2.



Source: Econoday

The Fed reiterated the end of QE2, but did not provide a timeline for when it will stop reinvesting interest in MBS and agency debt (QE2.5).

As anticipated, Fed officials downwardly revised the GDP forecast for 2011 for a second time – this time from 3.1% - 3.3% to 2.7% - 2.9%. GDP expectations for 2012 were also reduced. Chairman Bernanke did not point to a specific driver for slower growth, but did note that headwinds should be temporary.

Lastly, the third and final Q1 GDP number came in on Friday at 1.9%. This was 10 bps higher than the previous release but in line with expectations. The higher number was driven by a larger increase in inventories, smaller trade deficit and stronger durable goods orders. Notably, a 4.2% drop in state government spending demonstrated that states were well ahead of the central government in austerity implementation.

## TEMPORARY REPRIEVE FOR GREECE

News from abroad came fast and furious. Early in the week, lawmakers in Greece voted 155 to 143 to back Prime Minister George Papandreou. Within 24 hours, the European Council, the IMF, the ECB and Greek authorities reached a tentative austerity agreement that would close Greece’s fiscal gap by 2014 and prevent the country from defaulting on its debt.

The real test will come next week when the plan goes to the floor of the Greek Parliament. Although many expect that this

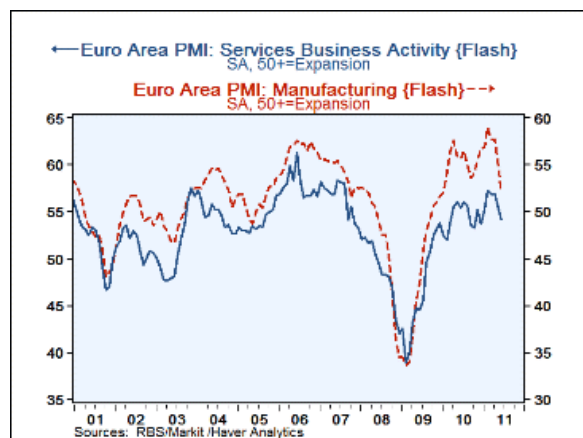
plan will pass, implementation could be difficult given the recent violent outbursts in Athens.

Contagion reared its ugly head outside of Greece. Moody’s announced that it might downgrade several Italian banks and government institutions. A survey from Germany’s Center for European Research (ZEW) showed that European economic sentiment reached a reading of -5.9 in June. This is its lowest level in two years, and is

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down sharply from +13.6 in May (0 dictates neutral).

Early numbers for European PMI were also worrisome. Manufacturing activity decelerated tremendously over the past few months, and the index is now approaching the all-important 50 number (signifying the sector is no longer expansionary).



Source: Haver Analytics

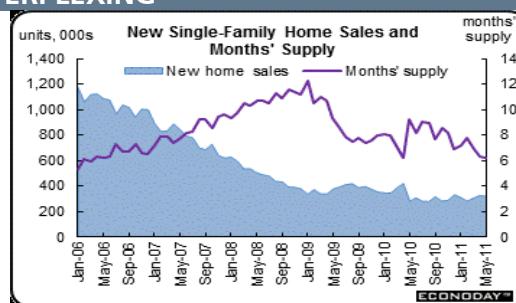
On a positive note, Chinese Premier Wen Jiabao reiterated that China would remain a long-term investor in European sovereign

debt. Mr. Wen made additional headlines when in a Financial Times article he wrote that China had won its battle with inflation. This sent Chinese stocks rallying as it portends less rate tightening in the coming months.

Finally, one of the most interesting developments during the week was the International Energy Agency (IEA) decision to release 60 million barrels of oil from member countries' strategic petroleum reserves. The move is designed to offset disturbed supply out of Libya. The US will contribute 30 million of those barrels. The US did this twice before, in 1991 during the Persian Gulf War and in 2005 during Hurricane Katrina. The IEA announcement resulted in a quick \$4 decline in crude before prices rebounded. Markets likely realized that a 60 million barrel shot in the arm is less than a day's worth. IEA estimates that daily consumption for 2011 will near 89.3 million barrels.

## HOUSING STILL PERPLEXING

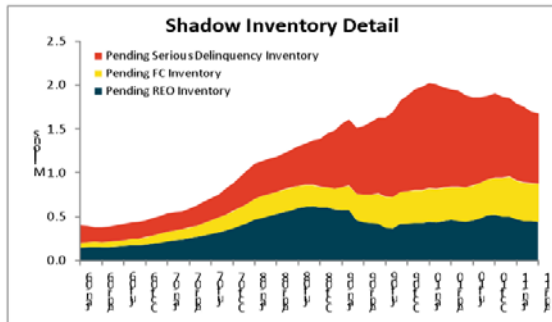
The never-ending flux that is the US housing market is one of the most perplexing problems for investors and economists alike. On the positive side, though existing home sales fell to 4.81M units, it was slightly ahead of expectations. New home sales also beat expectations, coming in 10 thousand units ahead. Distressed sales as a percentage of total sales fell to 31%, compared to 40% in March and 50% in early 2009. This signals a potential stabilization in price, which should be confirmed by the Case-Schiller Home Price index release next week. The index broke below its 2002 level with its last print.



Source: Econoday

On the other side of the coin, the foreclosure backlog is dampening longer-term optimism. According to CoreLogic, shadow inventory is about 1.7 million properties. Add 3.7 million

homes already available for sale, and the inventory level jumps to 14 months of supply, more than double the historical norm.



Source: CoreLogic

Commercial real estate (CRE) faces even greater questions. CRE prices tend to trail residential over the long-term. As of the most recent data according to Moody's, CRE prices are down 13% from last year and nearly 50% from peak. Without stabilization in residential, the picture may become more dire.



Source: [calculatedriskblog.com](http://www.calculatedriskblog.com)

Like the residential market, more than 30% of CRE sales involved distressed properties. However, the distressed sales and low prices were not absolute. New York office prices rallied 24% in Q1 compared to a year earlier. Similar positive trends were seen in San Francisco and Washington DC.

Another positive for CRE is that it did not have the same artificial support as residential housing did with the homebuyer tax credit. This means no artificial double dip. In general, intervention in the CRE space has been less intrusive compared to residential, which has yielded more transparent pricing. Obfuscation associated with residential mortgage foreclosures has been cited by many as a large reason why residential housing prices have not bottomed. Clarity may result in weaker CRE pricing over the short term, but should benefit the market in the intermediate- to long-term.

## THE WEEK AHEAD

This week will be busy with economic data and global announcements. Personal income (PCE) and consumer confidence will start the week with expectations of slightly higher numbers for both. On Tuesday, Case-Schiller data is expected to show moderate declines in home prices for April relative to March.

The Treasury will follow its regular auction schedule this week with auctions of \$35 billion worth of 2-yr notes (Tuesday), \$35 billion of 5-yr notes (Wednesday) and \$29 billion of 7-yr notes (Thursday).

All eyes will be on Greece on Wednesday and Thursday, when Parliament will vote on the latest austerity plan. July 3<sup>rd</sup> is the deadline for

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Parliamentary acceptance. If the plan fails to gain acceptance, an alternative solution will have to be crafted quickly. Greece noted that they will default if a new loan tranche is not available by mid month.

Several global PMI's are on deck for the end of the week with contraction likely across the board. The latest Philly fed index numbers hint toward a potential sub 50 number for ISM (Friday) – consensus is 51.7. China PMI will come out on Friday with expectations of a

one-point decline to a slightly above water reading of 51.

Lastly, while many in the US will be preparing for BBQ and fireworks over Fourth of July weekend, Eurozone finance ministers will be busy in Brussels. The extraordinary Eurogroup meeting scheduled for July 3 will focus on Greece, coinciding with the deadline for Greece's acceptance of the latest austerity package.



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