

**Weekly Market Monitor**

**The Fed's View**

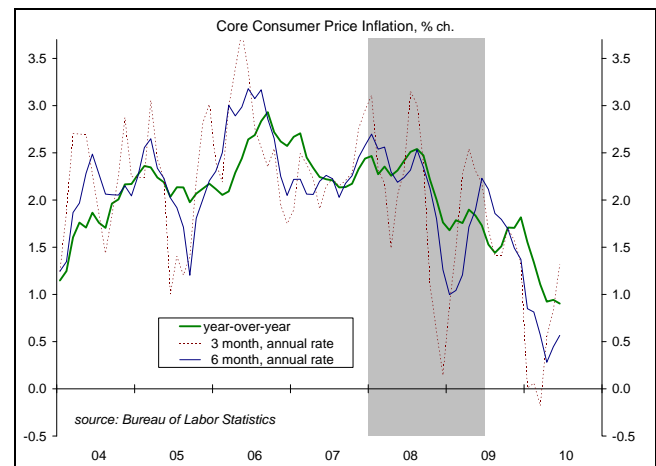
Federal Reserve Chairman Ben Bernanke will testify on the Fed's semi-annual Monetary Policy Report to Congress this week. This is usually a big deal for the markets. However, there's much less suspense this time around. The Fed's views were already included in the minutes of the June 22-23 policy meeting. Fed officials lowered their projections of near-term growth and inflation, and about half saw the risks to their growth outlooks as tilted to the downside. However, policymakers felt that the shift in the near-term outlook did not warrant stimulus.

The Fed's central tendency forecasts, which exclude the three highest and lowest forecasts of the five governors and 12 district bank presidents (growth and inflation projections are 4Q-over-4Q, the unemployment rate is the 4Q average for that year):

	2010	2011	2012	longer run
Real GDP	3.0% - 3.5%	3.5% - 4.2%	3.5% - 4.5%	2.5% - 2.8%
Apr. Proj.	3.2% - 3.7%	3.4% - 4.5%	3.5% - 4.8%	2.5% - 2.8%
Jan. Proj.	2.8% - 3.5%	3.4% - 4.5%	3.5% - 4.5%	2.5% - 2.8%
Unemp. Rate	9.2% - 9.5%	8.3% - 8.7%	7.1% - 7.5%	5.0% - 5.3%
Apr. Proj.	9.1% - 9.5%	8.1% - 8.5%	6.8% - 7.5%	5.0% - 5.3%
Jan. Proj.	9.5% - 9.7%	8.2% - 8.5%	6.6% - 7.5%	5.0% - 5.2%
PCE Prices	1.0% - 1.1%	1.1% - 1.6%	1.0% - 1.7%	1.7% - 2.0%
Apr. Proj.	1.2% - 1.5%	1.1% - 1.9%	1.2% - 2.0%	1.7% - 2.0%
Jan. Proj.	1.4% - 1.7%	1.1% - 2.0%	1.3% - 2.0%	1.7% - 2.0%
Core PCE	0.8% - 1.0%	0.9% - 1.3%	1.0% - 1.5%	
Apr. Proj.	0.9% - 1.2%	1.0% - 1.5%	1.2% - 1.6%	
Jan. Proj.	1.1% - 1.7%	1.0% - 1.9%	1.2% - 1.9%	

Economic data were generally on the strong side of expectations in the early spring, leading Fed officials to raise their forecasts of 2010 GDP growth. Recent data have been soft, suggesting a near-term moderation in the pace of growth. The Fed's longer-term growth outlook has been little changed

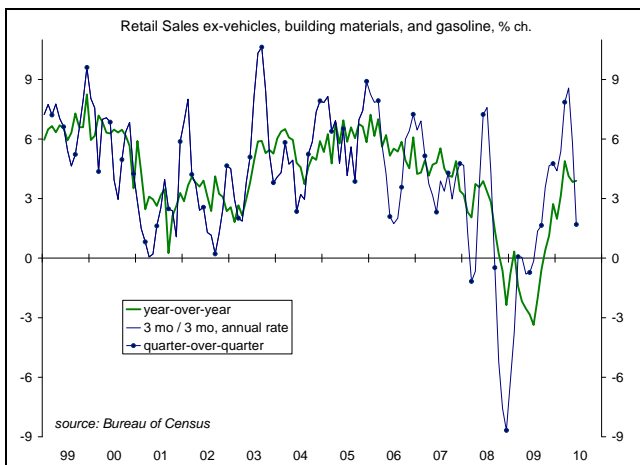
Bernanke's testimony will present the Fed's view of where things stood at the June 22-23 policy meeting. What's happened since? Private-sector payrolls were reported to have risen by 83,000 in June – disappointing, but still positive. Retail sales fell 0.5% in June. Core retail sales, which exclude autos, building materials, and gasoline, edged up 0.2%, after falling 0.4% in April and 0.2% in May. Industrial production rose 0.1% in June, but manufacturing activity fell 0.4%. One month does not make a trend. However, these figures are consistent with a more moderate pace of economic growth in the near term. They do not indicate a double dip recession, but they do suggest some increase in downside risks to the growth outlook.



The Fed's inflation outlook has continued to shift lower. The core CPI rose at a 0.6% annual rate over the first six months of 2010. In June, the Fed saw inflation as "likely to stabilize near recent low readings in coming quarters and then gradually rise toward more desirable levels." The risk of deflation (a sustained decline in the overall price level) is small. That would depend on a more serious downturn in economic activity (possible, but the odds seem rather small). Still, Bernanke has previously spoken about the need to act swiftly and forcefully to counter the possibility of deflation. Fed officials appear to be divided on the risks and whether further policy efforts would be effective.

Further quantitative easing (purchasing long-term Treasuries or mortgage-backed securities) would seem pointless given that long-term interest rates are already low. Still, the Fed could lower the rate it pays on bank reserves to 0% and also expand efforts to improve securitization of consumer and business debt.

With conventional monetary policy exhausted for a while now and unconventional policy seen as difficult to achieve and of questionable impact, that leaves fiscal policy as the only game in town. Unfortunately, the odds of further fiscal stimulus are low. The economic recovery will likely take a lot longer.

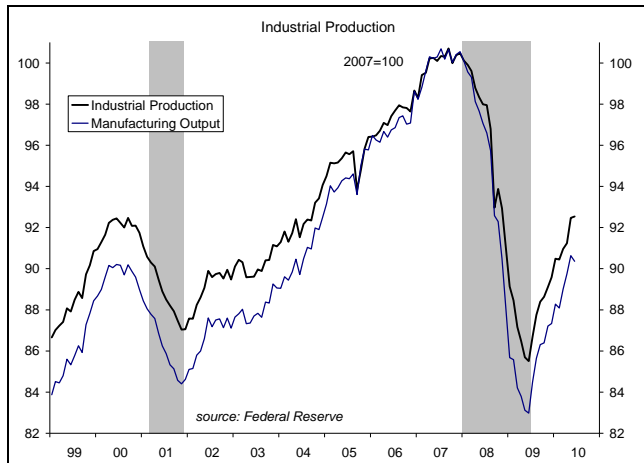


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	Treasury Yields								Dollar				Equities		
	13-wk	26-wk	52-wk	2-yr	3-yr	5-yr	10-yr	30-yr	\$/Euro	\$/BP	JY/\$	CD/\$	NASD	SPX	DJIA
6/18/10	0.08	0.15	0.26	0.70	1.19	2.01	3.22	4.15	1.236	1.479	90.79	1.024	2309.80	1117.51	10450.64
7/09/10	0.14	0.18	0.28	0.63	1.00	1.83	3.05	4.04	1.264	1.510	88.48	1.033	2196.45	1077.96	10198.03
7/16/10	0.14	0.17	0.25	0.59	0.92	1.67	2.93	3.94	1.293	1.530	86.68	1.054	2179.05	1064.87	10097.90

## Recent Economic Data and Outlook

Earnings reports were positive, fueling stock market gains early in the week. However, concerns about the economic outlook are still with us, leading the major market averages back down.



The June 22-23 **FOMC Minutes** showed that policymakers viewed that *“the economic outlook had softened somewhat and a number of members saw the risks to the outlook as having shifted to the downside.”* Still, *“the changes to the outlook were viewed as relatively modest and as not warranting policy accommodation beyond that already in place.”* However, *“members noted that in addition to continuing to develop and test instruments to exit from the period of unusually accommodative monetary policy, the Committee would need to consider whether further policy stimulus might become appropriate if the outlook were to worsen appreciably.”*

The **Consumer Price Index** fell 0.1% in June (+1.1% y/y). Food prices were flat (+0.7% y/y). Energy fell 2.9% (+3.0% y/y). Ex-food & energy, the CPI rose 0.2% (+0.1588% before rounding, +0.9% y/y and a 0.6% annual rate over the first six months of 2010). Homeowners' equivalent rent (a quarter of the overall CPI and nearly a third of the core) edged up 0.1% (-0.2% y/y), although mixed across regions (up 0.3% in the Northeast, flat in the Midwest and the South, down 0.1% in the West).

**Real Weekly Earnings** fell 0.2% in June, up 1.5% y/y.

The **Producer Price Index** fell 0.5% in June (+2.8% y/y), led by a 2.2% drop in food (+2.4% y/y) and a 1.5% decrease in energy (+8.0% y/y). Ex-food & energy, the PPI rose 0.1% (+1.1% y/y).

**Import Prices** fell 1.3% in July (+4.5% y/y), held down by a 4.4% decline in petroleum (+11.7% y/y). Ex-fuels, import prices fell 0.5% (+3.1% y/y). Ex-fuels, prices of imported industrial supplies and materials fell 1.5% (+16.0% y/y), capital goods fell 0.3% (-0.7% y/y), and consumer goods fell 0.4% (-0.1% y/y).

**Retail Sales** fell 0.5% in June (+4.8% y/y), down 0.1% ex-autos (+4/4% y/y). Auto dealership sales fell 2.3% (+6.8% y/y). Sales of building materials fell 1.0% (+2.7% y/y). Sales at gasoline service stations fell 2.0% (+8.8%), reflecting lower prices. Ex-motor vehicles, building materials, and gasoline, sales rose 0.2%, vs. -0.2% in May and -0.4% in April – a 1.7% annual rate 2Q10-over-1Q10 (vs. +7.9% 1Q10-over-4Q09).

**Business Inventories** rose 0.1% in May (-1.5% y/y). Manufacturing inventories (reported earlier) fell 0.4% and wholesale inventories (reported earlier) rose 0.5%. Retail inventories, the only new information in the report, rose 0.3%.

**Industrial Production** rose 0.1% in June, following a 1.3% rise in May (+8.2% y/y). Utility output rose 2.7% (+7.1% y/y), reflecting warmer temperatures. Mining edged up 0.4% (+8.5%), despite a 4.7% decline in oil and gas drilling (which accounts for just 0.4% of overall industrial production). Manufacturing output fell 0.4% (+8.3% y/y), with results mixed across industries.

The **Small Business Optimism Index** fell to 89.0 in June, vs. 92.2 in May and 90.6 in April – weak by historical standards.

The **U.S. Trade Deficit** rose to \$42.3 billion in May, vs. \$40.3 billion in April. Imports rose 2.9% (+29.1% y/y) and exports rose 2.4% (+21.0% y/y). The figures suggest that net exports will likely subtract from 2Q10 GDP growth (although higher imports are a sign of strength).

**Economic Outlook (3Q10):** +2.0% to +2.5% GDP growth.

**Employment:** The trend in jobless claims remains stubbornly high. Private-sector job growth is positive, but the pace has been relatively moderate. Hiring at small firms is weak.

**Consumers:** Real wage income growth has trended higher this year. Consumer attitude measures remain low. Credit is still relatively tight and many households with good credit are reluctant to take on additional financial obligations.

**Manufacturing:** The inventory correction has run its course. Exports are expanding. Recent figures on production and new orders have been more spotty.

**Housing/Construction:** Near-term weakness is seen, as the April 30 expiration of the homebuyers tax credit shifted some activity from May and June into March and April. Mortgage rates are at a record low, but we need to see better job growth.

**Prices:** Core inflation trended lower in the first half of 2010, but may be stabilizing at a low level.

**Interest Rates:** The Federal Reserve will keep the overnight lending rate near zero for *“an extended period,”* likely well into 2011 (conditional on an elevated unemployment rate, a low trend in inflation, and well-anchored inflation expectations). Long-term interest rates are down on a flight to safety amid concerns about the pace of the economic recovery.

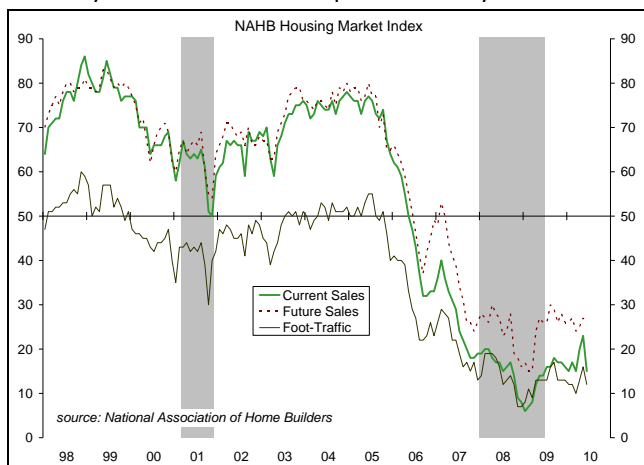
This Week:					<i>forecast</i>	last	last -1	comments
Monday	7/19	1:00	Homebuilder Sentiment	Jul	<b>NF</b>	17	22	likely to remain depressed
Tuesday	7/20	8:30	<b>Building Permits, th.</b>	Jun	<b>560</b>	574	610	likely to have fallen further
			% change		<b>-2.4</b>	-5.9	-10.9	risks tilted to the downside
			<b>Housing Starts</b>		<b>570</b>	593	659	seen lower
			% change		<b>-3.9</b>	-10.0	+3.9	watch for revisions
		9:00	BOC Policy Decision		<b>?</b>	0.50%	0.25%	market has priced in another 25 bps
Wednesday	7/21	10:00	<b>Bernanke M Pol Testimony</b>					to Senate Banking Committee
Thursday	7/22	8:30	Jobless Claims, th.	7/17	<b>440</b>	429	458	fewer seasonal layoffs in autos
		9:30	<b>Bernanke M Pol Testimony</b>					to House Financial Services Committee
		10:00	<b>Existing Home Sales, mln</b>	Jun	<b>5.25</b>	5.66	5.79	likely to have fallen
			% change		<b>-7.2</b>	-2.2	+8.0	weaker post-homebuyer tax credit
		10:00	Leading Economic Indicators	Jun	<b>-0.4%</b>	+0.4%	0.0%	supplier deliveries and workweek down
Friday	7/23		no significant data					
<b>Next Week:</b>								
Monday	7/26	10:00	<b>New Home Sales, th.</b>	Jun	<b>310</b>	300	446	sales fell sharply in May
			% change		<b>+3.3</b>	-32.7	+14.7	watch for revisions
Tuesday	7/27	9:00	S&P/C-S Home Prices	May	<b>NF</b>	+0.4%	-0.2%	may soften post homebuyer tax credit
			year-over-year		<b>NF</b>	+3.8%	+2.3%	still up y/y
		10:00	<b>Consumer Confidence</b>	Jul	<b>53.0</b>	52.9	62.7	likely to remain soft
		1:00	Treasury Note Auction					2-year notes
Wednesday	7/28	8:30	<b>Durable Goods Orders</b>	Jun	<b>+2.0%</b>	-0.6%	+2.9%	a rebound in aircraft orders
			<b>ex-transportation</b>		<b>+0.4%</b>	+1.6%	-0.9%	a moderate trend otherwise
			nondef cap gds ex-aircraft		<b>+0.8%</b>	+3.9%	-2.8%	choppy
		1:00	Treasury Note Auction					5-year notes
		2:00	<b>Fed Beige Book</b>					still mixed, generally lackluster
Thursday	7/29	8:30	Jobless Claims, th.	7/24	<b>470</b>	<b>440</b>	429	choppy and still distorted
		1:00	Treasury Note Auction					7-year notes
Friday	7/30	8:30	<b>Real GDP (advance)</b>	2Q10	<b>+1.8%</b>	+2.7%	+5.6%	will include annual benchmark revisions
			Domestic Final Sales		<b>+2.5%</b>	+1.6%	+1.4%	underlying demand moderately strong
		8:30	Employment Cost Index	2Q10	<b>+0.5%</b>	+0.6%	+0.4%	mild labor cost pressures
			year-over-year		<b>+1.8%</b>	+1.7%	+2.1%	a low trend
		9:45	Chicago PM Index	Jul	<b>NF</b>	59.1	59.7	likely to slip in July
		9:55	Consumer Sentiment	Jul	<b>68.0</b>	76.0	73.6	66.5 at mid-month

**This Week...**

The focus will be on Bernanke’s monetary policy testimony, although (following the release of the June 22-23 FOMC meeting minutes) there may not be any significant revelations.

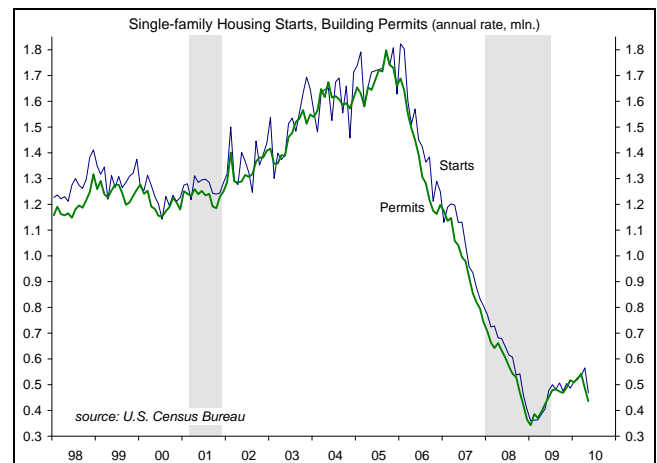
**Monday**

**Homebuilder Sentiment (July)** – Sentiment fell sharply in June and is likely to have remained depressed in July.



**Tuesday**

**Building Permits, Housing Starts (June)** – Residential construction activity slumped sharply in May following the April 30 expiration of the homebuyers tax credit. The June figures are likely to show further softness.



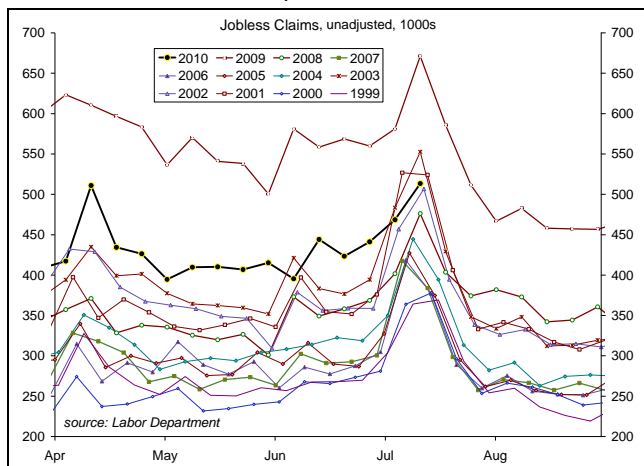
**Bank of Canada Policy Meeting** – The BOC raised rates at its previous meeting, making good on a promise. Strong growth has led the market to expect another hike at this meeting.

## Wednesday

**Bernanke Testimony (Senate Banking Committee)** – The Fed Chairman’s semi-annual monetary policy testimony to Congress is often a big deal for the markets, but there’s less suspense this time. The June 22-23 FOMC minutes showed policymakers lowering their projections of growth and inflation and about half saw increased downside risks to the growth outlook. Bernanke is likely to recognize that the pace of the recovery appears to have moderated, but he should remain moderately optimistic.

## Thursday

**Jobless Claims (week ending July 17)** – The previous week’s data suggest that there were fewer seasonal layoffs in the auto industry this year, resulting in a seasonally adjusted drop in jobless claims. Figures are likely to remain volatile and unreliable over the next couple of weeks.

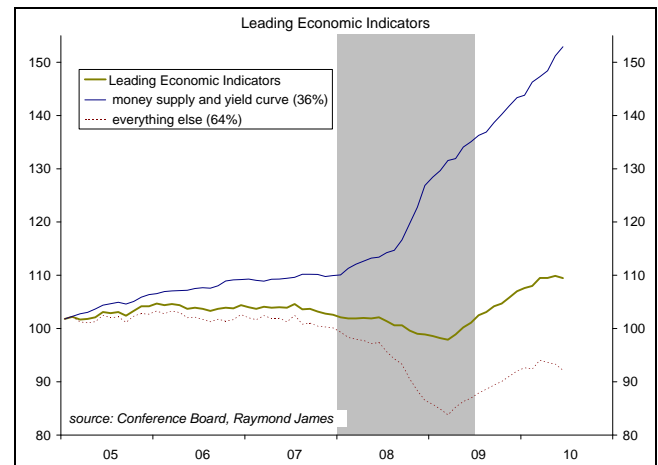


**Monetary Policy Testimony (House Financial Services Committee)** – Bernanke will present the same written testimony. There’s some small chance that something new could come up in the Q&A. This is an election year, so expect some grandstanding.

**Existing Home Sales (June)** – Existing home sales represent closings. So, following the April 30 expiration of the homebuyers tax credit, a larger drop is expected in June than in May. Anecdotal evidence suggests a sharp contraction in housing activity in May and June. Low mortgage rates should help over time, but we need to see better job growth.



**Leading Economic Indicators (June)** – The LEI should post a moderate decline in June. Components were mixed, but a drop in the factory workweek, a decrease in supplier deliveries, and lower stock prices should lead the headline figure lower. Note that over the last several months, the two most highly regarded indicators, the slope of the yield curve and the money supply, have signaled improvement. However, the LEI was designed to predict business cycle turning points, not the level of activity.



## Friday

No significant economic data.

## Next Week ...

The advance estimate of 2Q10 GDP growth, along with annual benchmark revisions to the national income and product accounts, will be released on July 30. There’s always a lot of uncertainty in the advance estimate. The government will have to make assumptions about foreign trade and inventories for June and benchmark revisions typically shift some growth from one quarter to the next. Most importantly, the key components, consumer spending and business fixed investment, are likely to show continued growth (although recent monthly figures suggest a somewhat slower pace into 3Q10). The following week, on August 6, we’ll get the July Employment Report, which should show further declines in temporary census jobs, but moderate private-sector job gains.

## Coming Events and Data Releases

August 2	ISM Manufacturing Index (July)
August 3	Personal Income and Spending (June)
August 4	ISM Non-Manufacturing Index (July)
August 6	Employment Report (July)
August 10	FOMC Meeting
September 6	Labor Day Holiday (markets closed)
September 21	FOMC Meeting
November 2-3	FOMC Meeting
December 14	FOMC Meeting