MUFG

Financial Market Weekly

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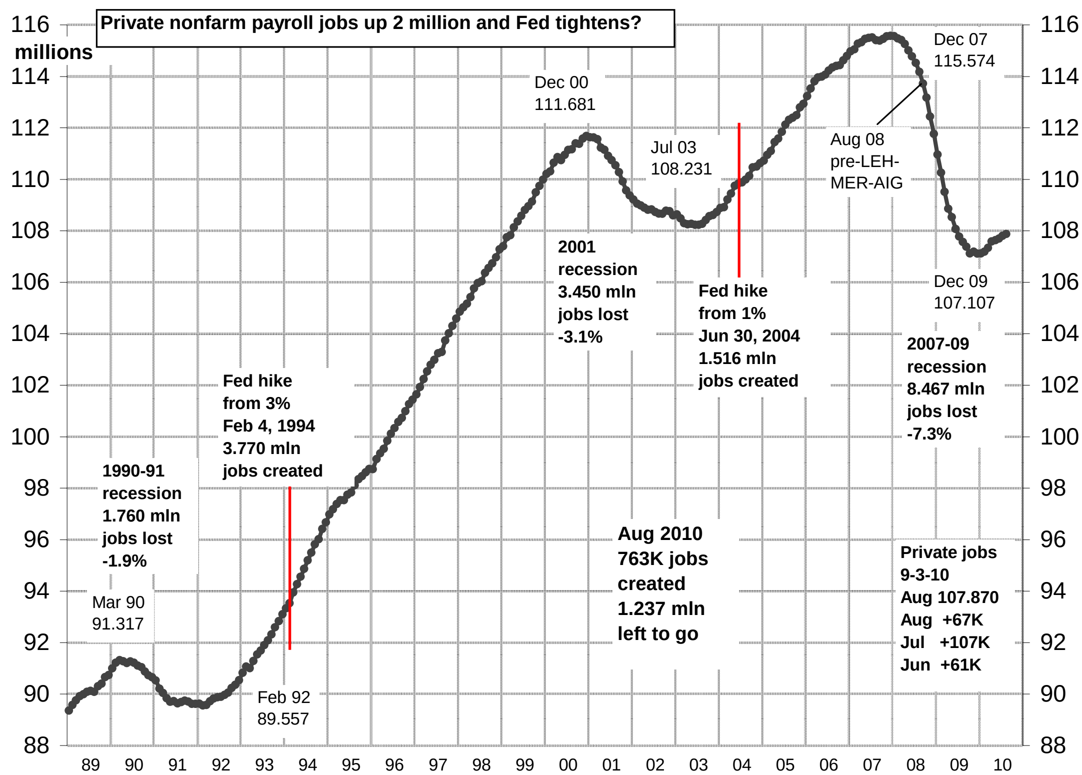
LABOR MARKET STILL ON THE RECOVERY TRACK



It did not look good for the labor markets earlier in August. Weekly initial unemployment claims went as high as 504K in the August 14 week, a sharp reversal from 460K three weeks earlier in the July 24 week. The double-dip signal level using claims is 525K so there was some reason for risk managers to worry. But it still looks like the recovery is moving ahead after today's jobs data for August… even if the soft patch for private payroll jobs did get extended for a fourth month. A soft patch is not a double-dip and 10-yr yields of 2.42% on August 25 are really a bet on a double dip and the Fed restarting its quantitative easing where they buy Treasury securities outright. The last two recoveries were jobless ones. Analysts and policymakers kept trying to explain why those recessions were jobless while if they had waited a few more months, the recoveries hit with some big monthly payroll jobs numbers and the recoveries lost their jobless characterizations. If we stay patient, the same thing might be happening now, even though it looks like the recovery was hit with the blow of a new external shock in May from the European debt crisis. The jobs numbers in prior recessions started to gain momentum as they put together a string of positive monthly readings. By the end of the year with 12 consecutive monthly positive numbers, there were a few big private jobs numbers of over 250K. This year private payroll jobs have increased for 8 consecutive months which means by the end of the year, December 2010, we should get some pretty strong monthly increases. This recovery is tracking the first 8 months of the last two so far.

Monthly Private Payroll Jobs Recoveries from 1990-91, 2001, and 2007-09 Recessions: Momentum builds over 12 months													
Jobs Lost 1990-91	**Feb 92**	**Mar 92**	**Apr 92**	**May 92**	**Jun 92**	**Jul 92**	**Aug 92**	**Sep 92**	**Oct 92**	**Nov 92**	**Dec 92**	**Jan 93**	**Feb 93**
1.760 million, 1.9%	-67	24	134	112	51	16	75	89	178	127	174	287	241
Cumulative		24	158	270	321	337	412	501	679	806	980	1267	1508
Jobs Lost 2001	**Jul 03**	**Aug 03**	**Sep 03**	**Oct 03**	**Nov 03**	**Dec 03**	**Jan 04**	**Feb 04**	**Mar 04**	**Apr 04**	**May 04**	**Jun 04**	**Jul 04**
3.450 million, 3.1%	-2	35	155	149	41	113	158	31	300	224	310	94	42
Cumulative		35	190	339	380	493	651	682	982	1206	1516	1610	1652
Jobs Lost 2007-09	**Dec 09**	**Jan 10**	**Feb 10**	**Mar 10**	**Apr 10**	**May 10**	**Jun 10**	**Jul 10**	**Aug 10**	**Sep 10**	**Oct 10**	**Nov 10**	**Dec 10**
8.467 million, 7.3%	-83	16	62	158	241	51	61	107	67	**No new normal yet… same**			
Cumulative		16	78	236	477	528	589	696	763	**speed for jobless recovery**			

So this jobless recovery is tracking closely with the last two. In the first eight months of this year, private payroll jobs have increased a total of 763K, where in the first 8 months of sustained recovery from the 1990-91 recession 679K jobs were created, and 982 million jobs in the first eight months of recovery from the 2001 recession. The market thought the jobs numbers were good on Friday. The consensus estimates were beaten down to only 40K for private payroll jobs, and the initial unemployment claims recently and weakness in some surveys like the Philly Fed had the market fearing an actual decline. So the +67K reading in August added to the upward revisions totaling 66K to June and July meant 133K additional private payroll jobs had been created after the August jobs report was released. The unemployment rate did rise from 9.5% to 9.6%, just missed 9.7% (9.642%), but this could be a statistical anomaly associated with the recent gyrations in the emergency unemployment claims which congress let expire and then with a lag reinstated.

Payroll jobs lost in recession begin recovery

Dec. 2009 Totals millions		Aug 10	July 10	June 10	8 months Dec 09 to Aug 10	12 months Dec 08 to Dec 09
129.588	Nonfarm Payroll Employment	-54	-54	-175	723	-4740
107.107	Total Private (ex-Govt)	67	107	61	763	-4660
17.906	Goods-producing	0	37	1	125	-2388
11.534	Manufacturing	-27	34	4	145	-1288
0.652	Motor Vehicles & parts	-22	22	-5	30	-124
5.696	Construction	19	-4	-9	-85	-1008
89.201	Private Service-providing	67	70	60	638	-2272
24.653	**Trade, transportation, utilities**	-9	25	-1	104	-966
14.360	Retail stores	-5	7	-16	74	-503
2.912	General Merchandise	-5	13	8	38	-77
2.800	Food & Beverage stores	3	1	-4	8	-44
4.172	Transportation/warehousing	-7	12	12	7	-226
1.231	Truck transport	0	5	0	9	-108
0.454	Air transport	1	-1	1	0	-19
0.557	Utilities	0	-2	-2	-5	-5
2.748	**Information**	-1	4	-14	-34	-160
7.657	**Financial**	-4	-11	-11	-81	-343
2.220	Insurance	-1	-4	-4	-42	-64
1.404	Real Estate	-3	-2	-8	-29	-62
1.311	Commercial Banking	2	1	1	5	-34
0.796	Securities/investments	1	1	1	4	-58
16.488	**Professional/business**	20	-3	33	226	-732
1.911	Temp help services	17	-1	19	206	-143
1.820	Management of companies	-3	-4	0	-1	-66
1.292	Architectural/engineering	0	0	-1	-15	-111
1.105	Legal	1	0	-3	-2	-47
19.350	**Education and health**	45	34	30	261	317
4.694	Hospitals	9	-1	6	27	26
3.107	Educational services	5	5	8	49	37
12.991	**Leisure and hospitality**	13	11	30	133	-257
1.733	Hotel/motels	5	11	13	46	-87
9.371	Eating & drinking places	12	-2	-9	70	-113
22.481	Government	-121	-161	-236	-40	-80
2.160	Federal ex-Post Office	-111	-139	-220	108	108
5.178	State government	-14	15	2	-18	-14
14.479	Local government	4	-33	-15	-117	-113

At the moment, the best-case scenario remains continued recovery from recession with the odds favoring a pickup in monthly jobs creation by the end of the year. The census worker hiring and firing is about done for the year, so we can go back to watching total private payroll jobs instead of just private ones shortly. At the moment state and local government job reductions are not as severe as the newspaper stories portray them.

Census Workers Hired/Fired in 2010 Census (this year)

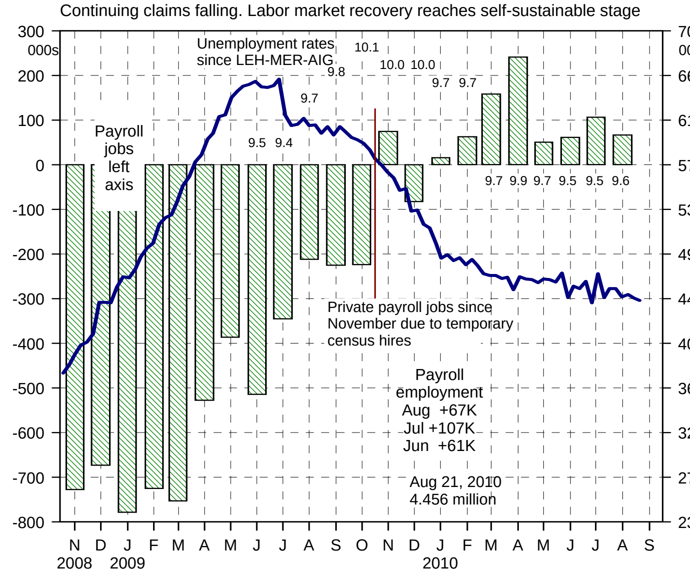
2010	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
Total Level, 000	24	39	87	153	564	339	196	82	Due
Monthly Change	9	15	48	66	411	-225	-143	-114	Oct 8

INITIAL UNEMPLOYMENT CLAIMS LEVEL NOT CONSISTENT WITH DOUBLE-DIP… YET

Initial unemployment claims were still lower at 472K versus 504K in the August 14 week. The overall upswing from 460K in the July 24 week was consistent with a fourth month of a private payroll jobs soft spot with the +67K reading reported Friday for August… but nothing worse than that. Continuing unemployment claims have not moved up with initial unemployment claims which is a good sign, suggesting the initial claims rise is not a new double-dip like the one that started prior to the 2003 Iraq War slowdown.

Claims peak 651K March 28, 2009... waiting for +250K payroll jobs signal

Continuing claims falling. Labor market recovery reaches self-sustainable stage

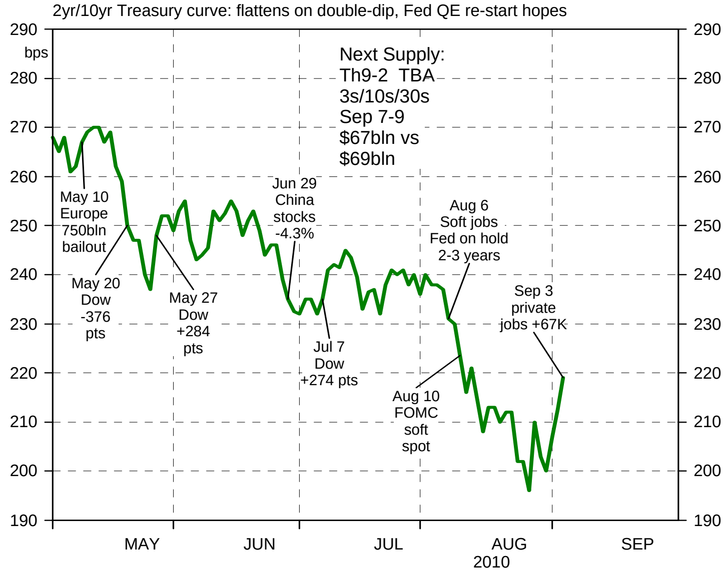


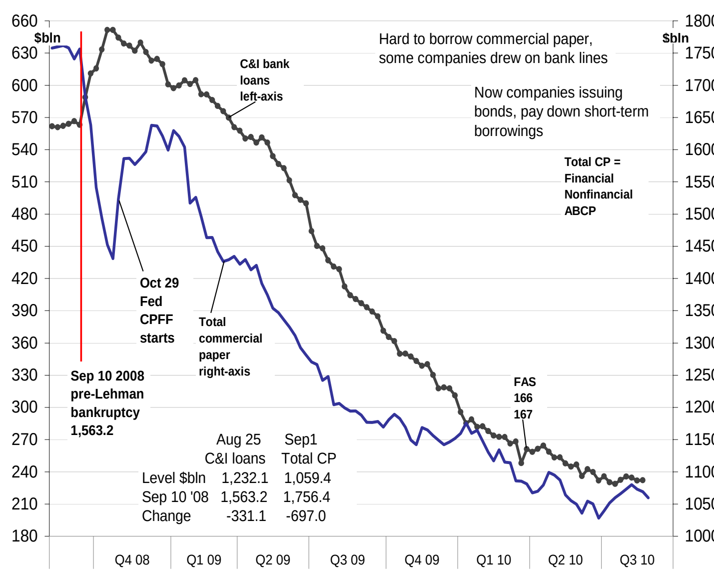
10YR HIGHER YIELDS FORECAST LOWERED WITH FED EXIT STRATEGY DELAY

The yield curve between 2-yrs and 10-yrs was +219 bps on Friday versus +210 bps last week. The 10-yr Treasury yield has backed up as high as 2.76% Friday from the 2.42% low on August 25. A sustained yield rally generally needs for the Fed to start tightening and that requires stronger 200K-plus payroll jobs numbers. The Treasury sells $67 billion 3s/10s/30s next week; foreign central banks bought $66.0 billion the last three weeks ending September 1.

	30-Jun 2010	Q3 2010	Q4 2010	Q1 2011	Q2 2011	Q3 2011
10-Yr Note	2.93	3.00	3.40	3.50	4.00	4.10
2-Yr Note	0.61	0.65	0.90	1.10	1.75	2.00
3-month Libor	0.53	0.40	0.40	0.40	0.90	1.35
Federal Fund Rate	0.25	0.25	0.25	0.25	0.50	1.00
2s/10s spread	233	235	250	240	225	210

2yr/10yr Treasury curve: flattens on double-dip, Fed QE re-start hopes





FEDERAL RESERVE POLICY

Selected Fed assets and liabilities					2008	9/1/10
Fed H.4.1 statistical release					pre-LEH	to Sep 10
billions, Wednesday data	1-Sep	25-Aug	18-Aug	11-Aug	10-Sep	Change
Factors adding reserves						
U.S. Treasury securities	786.283	784.498	779.549	777.009	479.782	306.501
Federal agency debt securities	156.502	156.502	157.211	159.381	0.000	156.502
Mortgage-backed securities	1103.168	1103.167	1113.017	1119.459	0.000	1103.168
Term auction credit (TAF auctions)	0.000	0.000	0.000	0.000	150.000	-150.000
Asset-backed TALF	33.883	36.846	38.288	38.470		
Maiden Lane (Bear)	29.047	28.990	28.981	29.469	29.287	-0.240
Central bank liquidity swaps	0.440	0.039	0.434	1.246	62.000	-61.560
Loans (selected)						
Banks	0.009	0.004	0.057	0.001	19.000	-18.991
Primary dealer credit facility	0.000	0.000	0.000	0.000	0.000	0.000
ABCP $ mkt funds	0.000	0.000	0.000	0.000	0.000	0.000
Commercial Paper (CPFF)	0.000	0.000	0.000	0.001	0.000	0.000
AIG	20.057	19.444	23.487	23.674	0.000	20.057
Preferred interest in 2 AIG SPVs	25.733	25.733	25.733	25.733		25.733
Maiden Lane III (AIG)	23.337	23.327	23.324	23.299	0.000	23.337
Maiden Lane II (AIG)	16.029	16.030	15.967	15.961	0.000	16.029
MMIFF	0.000	0.000	0.000	0.000	0.000	0.000
Federal Reserve Assets	2344.2	2343.6	2356.2	2369.9	961.7	1382.5
3-month Libor %	0.30	0.30	0.35	0.38	2.82	-252 bps
Factors draining reserves						
Term Deposit Facility	2.119	2.119	2.119	2.119		2.119
Treasury supplemental bill auctions	199.956	199.954	199.955	199.957	0.000	199.956
Reserve Balances (Net Liquidity)	1010.535	1050.854	1039.307	1055.744	24.964	985.571
September 10, 2008 is pre-Lehman bankruptcy of 9-15-08						

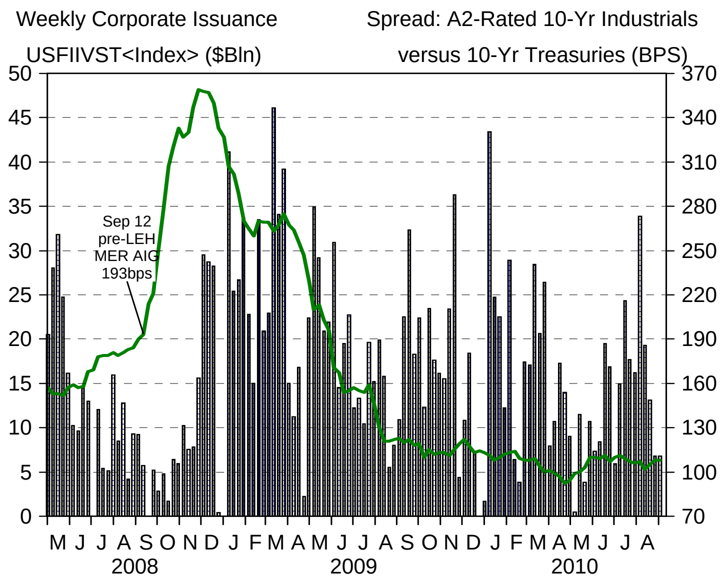
The Fed meets September 21 to consider its monetary policy. Despite the second week of a non-double-dip level of initial unemployment claims and a 67K rise in August private payroll jobs, there is probably still likely to be some impatience with the speed of the recovery on the part of Fed officials. The unemployment rate peak was 10.1% in October 2009, it is 9.6% in August 2010, and the FOMC forecasts say full employment is 5.2%. Fed Chairman Bernanke said in his August 27 Jackson Hole remarks that the committee had not yet "agreed on specific criteria or triggers for further action," but we think they could start moving the language in that direction at the September 21 meeting in case they feel the need to move at the November 2-3 meeting, with Election Day being Tuesday, November 2. For instance before they announced they would start the purchase of $300 billion Governments at the March 2009 FOMC meeting, they sent the message two meetings earlier that they were "also evaluating the potential benefits of purchasing longer-term Treasury securities.

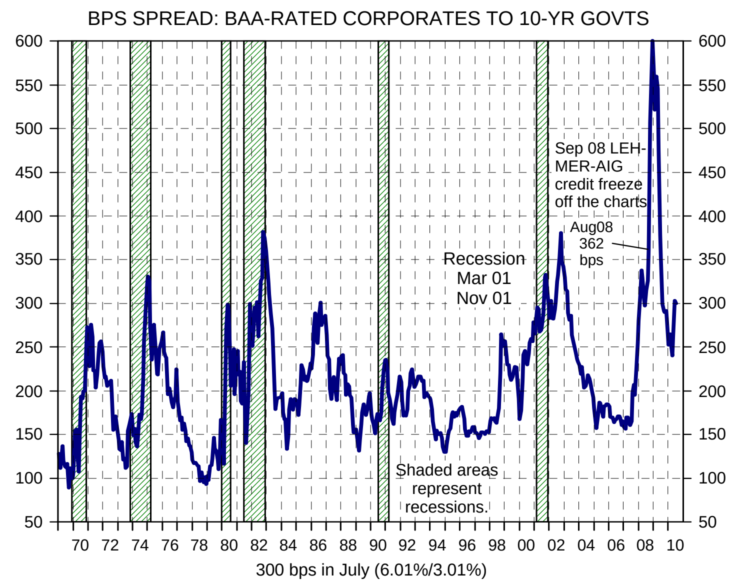
At the moment, the August 10 meeting statement just says they will keep constant the holdings of securities at the current level "to help support the economic recovery in the context of price stability." We cannot rule out that they will say they are evaluating the potential benefits of purchasing longer-term Treasuries again in the September statement. There were three FOMC officials who did not sound like they were interested in restarting the Treasury purchases in comments this week. Dallas Fed President Fisher said additional purchases might be pushing on a string and he was reluctant to do this unless fiscal policy changes were made to aid job seekers. Philadelphia Fed President Plosser said further easing through purchases would not be effective at lowering the unemployment rate and should not be considered unless there was an increase in deflation risks that he currently did not foresee. Atlanta Fed President Lockhart said Friday that the decision to keep the Fed's balance sheet constant at the August 10 meeting does not necessarily mean a new period of balance sheet expansion is in the offing. He said, "I think the decision has been over-interpreted in some quarters. These interpretations, along with alarmist commentary about deflation and a double-dip recession, are feeding an exaggerated sense of foreboding." Finally, earlier this week retiring Vice Chairman Kohn gave a long interview to CNBC. He did sound like he might be favoring additional quantity easing if the situation deteriorates. Buying Government securities would bring down long term rates and hopefully bolster asset prices, equity prices, and housing prices. Monetary policy could still play a part if they aren't making progress towards their two objectives, full employment and stable prices, as set by congress. He does not sound like we are seeing enough progress on meeting those two objectives, namely lowering the unemployment rate and raising the core CPI inflation rate. He seems to be concerned about the latest soft patch and while more time is needed to see if the soft patch is temporary, he seemed to be concerned about "household spending in particular." In this regard, the retail sales data for August due out on September 14 will be important for policymakers.

[While in publication Kohn gave an interview to the NY Times Monday, September 6 saying even if one accepted it was going to be a long recovery, there was no reason the Fed could not "help the recovery along."]

CORPORATES LIGHT WEEK: STANLEY BLACK & DECKER 30-YRS; SARA LEE $800B 5s/10s

Corporate bond offerings were $6.8 billion in the September 3 week versus $6.8 billion in the August 27 week. On Tuesday, Stanley Black & Decker priced $400 million 5.2% 30-yrs (m-w +25bps, put@101) at 165 bps (Baa1/Ae). The global toolmaker, Stanley Works acquired Black & Decker in March, will use the proceeds to reduce borrowings and for other general corporate purposes. Corporate bond yields (10-yr Industrials rated A2) were 108 bps above 10-yr Treasuries on Friday versus 108 bps last Friday.





TREASURY MARKET OUTLOOK

EXPECTED 10-YR 2-3 WEEK TRADING RANGE 2.50% to 2.90%

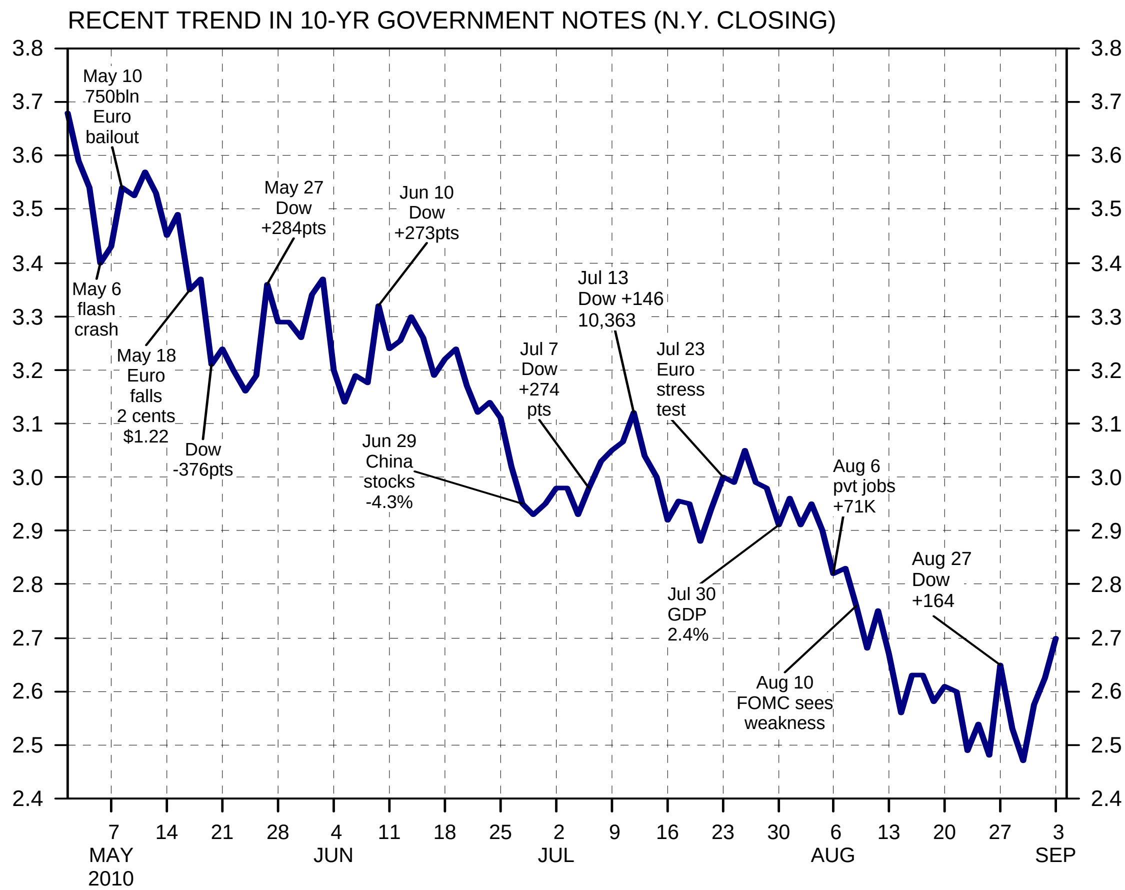
Week's 10-YR Range

HIGH 101-13 2.465%

Tuesday, August 31, stock market weakness after Dow industrials fall 140 points Monday

LOW 98-25+ 2.76%

Friday, September 3, August private payroll jobs up 67K, +133K counting July/June revisions, versus +40K estimated



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