

JUNE 20, 2011



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Rates remained relatively stable as overnight, one-month, three-month, six-month and 12-month London interbank offered rates (Libor) ended the week at 0.128%, 0.185%, 0.246%, 0.395% and 0.727%, respectively.

Among the numerous economic issues at hand, the U.S. debt level has been generating considerable attention. It is likely that the game of chicken between Congress and the Obama administration over raising the debt ceiling will continue over the next several weeks, leading to market uncertainty and speculation about the prospects of a technical default by the Treasury. That's because raising the debt ceiling has become intertwined with the desire to make significant strides toward credible fiscal reform. Federated considers the probability of a technical default by the Treasury to be virtually nonexistent. We are confident that the debt ceiling will be raised by August 2, the date upon which the U.S. Department of the Treasury will have, according to Treasury Secretary Timothy Geithner, exhausted the extraordinary measures that it has at its disposal to meet the financial obligations of the federal government.

With respect to interest rates, we also expect the Federal Reserve to keep the federal funds rate effectively at zero into at least this year's fourth quarter, but the weak May employment numbers might have pushed the commencement of the rate-hike cycle into early 2012.

Also, the ongoing sovereign-debt crisis in Greece renewed concerns of its potential impact on economic progress in the United States and beyond. While the easiest solution would be to simply let the Greeks default and allow them to exit the euro zone, we continue to believe that a negotiated solution is the most likely scenario.

In the meantime, a wide range of economic data reported during the week offered some hope the economy could be starting to move ahead, although the data remained weak overall.

Retail Sales

Early in the week, retail sales data showed that consumer spending dropped 0.2% in May following a 0.3% gain in April. Much of the decline was due to weaker auto sales, which dropped 2.9% due to the damage wrought by Japan's earthquake. Excluding autos, sales advanced 0.3%, following a 0.5% rise in April. Overall, sales are trending modestly upward after a strong February and March.

Consumer Prices

On the related subject of consumer prices, the Labor Department reported that the Consumer Price Index rose 0.2% in May, less than April's 0.4% increase. While it cost Americans more for food, cars and clothing in May, the increase was the smallest amount in six months. Food rose 0.4% while energy fell 1%. Core prices, which exclude food and energy, rose 0.3% for the month, the largest increase in nearly three years. For the year between April 2010 and May 2011, consumer

Views are as of June 20, 2011, and are subject to change based on market conditions and other factors.

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prices rose 3.6%, the biggest one-year gain since October 2008. Again, excluding food and energy, core prices rose only 1.5% in the year.

Manufacturing

U.S. factories produced 0.4% more goods in May, the Federal Reserve announced mid-week. The gain follows April's 0.5% decline. Business equipment and construction materials increased, which countered a decline in auto production impacted by parts shortages resulting from Japan's crises. Industrial production has risen nearly 11.5% since its recession low in June 2009. The report provided some encouragement for the manufacturing sector, suggesting that the April's decline reflected temporary disruptions.

Employment

The labor market produced mixed numbers, the Department of Labor reported later in the week. The number of Americans signing up for jobless benefits fell 16,000 during the prior week to 414,000 after a very difficult May. However, unemployment rates declined in fewer than half of all U.S. states—dropping in 24 states, rising in 13 states and Washington, D.C. and remaining flat in 13 states. And only 22 states experienced an increase in jobs in May, while 27 states lost jobs and in one state the number of jobs remained flat. The national jobless rate was essentially unchanged at 9.1%, but was 0.5% lower than the previous 12-month period.

Housing

The troubled housing market showed a glimmer of life in May, as the Commerce Department reported that housing construction rose 3.5% to an annual rate of 560,000 homes, compared to April's steep decline. New building permits also point to some optimism, as they jumped 8.7% in May--the highest level since December.

Consumer Sentiment

On Friday it was reported that U.S. consumer sentiment weakened more than expected during the first two weeks of June due to concerns about the economy. The Reuter's/University of Michigan's Consumer sentiment index fell 2-1/2 points to 71.8, which nearly canceled out the strong improvement for May. The current level is still greater than that of March and April.