Monthly Market Commentary

The economy ended 2010 on a high note, with positive data from a range of indicators such as retail sales, auto sales, inflation, and manufacturing. Clarity on the extension of the Bush tax cuts and unemployment benefits, sharply improved markets, and new stimulus money (in the form of a 2% cut in the payroll tax) should give consumers even more cash to spend. Inflation also remained well under control--consumer prices increased by about 1% on a year-over-year basis, as they have for the past several months. However, recent jumps in food and energy prices could potentially mean that we have seen the low for year-over-year inflation growth for this cycle. The number of jobs created was disappointing, but the unemployment rate was better than expected.

Consumer confidence: The consumer confidence index posted an unexpected decline last month with 46.8% of consumers sampled saying jobs are hard to come by. This report was the worst reading since February. The survey is compiled to determine consumer attitudes on present economic conditions and future expectations.

Consumer spending: Holiday retail sales as reported by MasterCard and the International Council of Shopping Centers, revealed an increase in consumer spending. MasterCard indicated that holiday sales increased by 5.5% (measured from early November until Christmas Day) led by jewelry and apparel. Luxury goods vendors such as Saks and Nordstrom did exceptionally well while those serving the lower end of the market, like Gap and Target, showed lower rates of growth. The key issue in the months ahead is whether consumers will continue to spend post-holiday season. Consumer spending growth beyond January and February would have to come from growth in employment, hours worked, and hourly wages.

Snowstorms in the Northeast impeded sales during the critical post-Christmas shopping season. A look at sales numbers for October, November, and December in aggregate, revealed an increase in sales of about 3.5% per month on average, a modest improvement from the 3% gains that characterized most of the rest of 2010.

December was a positive month for new U.S. light-vehicle sales. The results were the best monthly results of 2010 with an 11% increase in total sales from December 2009. The full-year sales also increased 11% with total of 11.6 million units sold.

Employment: The recent jobs report was disappointing, with employment growing by 103,000 jobs, barely above the 94,000 average of the past year. On the positive side, the unemployment rate dropped to 9.4% from 9.8%, a 19-month low.

Quarter-end insights: According to Morningstar economists, the economy could move into a stronger and more sustainable recovery mostly led by acceleration in consumer spending. This could result in a forecasted GDP growth estimated at 3.5% for 2011. The lifting of many hiring bans and salary freezes at the turn of the year combined with a great holiday season and better sentiment may drive job growth of 200,000 to 300,000 by the middle of 2011.Morningstar economists predict a continued growth in emerging markets, a stronger U.S. economy, and rising commodity prices that could drive inflation up by 2% or more.

The Morningstar equity sector team predicts a slightly more bullish 2011 on a fundamental basis, though most teams believe their stocks are close to fair value. Further, merger-and-acquisition activity remains strong across all sectors. According to Morningstar's technology team, there may be dramatic increases in business capital spending, especially for software. The industrial team expects a substantial improvement in capital spending in the years ahead.