Monthly Market Commentary

The worst of the fiscal cliff crisis was averted as Congress managed to come to a deal at the eleventh hour. As part of the deal, tax rates will go up for high-income earners, and the payroll tax holiday will expire, affecting income earners across the board. The new tax rates may slow the economy, but also decrease some of the uncertainty. Markets reacted positively, with the S&P 500 jumping more than 4% in the first week of January.

GDP: The third and final estimate for third quarter real GDP growth was revised sharply higher to 3.1%, from an initial estimate of 2.0% and also higher compared with the second quarter real GDP growth rate of 1.3%. This makes it the third-best quarter of the 13-quarter recovery. Consumption and import/export figures were revised upwards, while inventories were less of a contributor than previous estimates.

Employment: In December, 155,000 jobs were added, mainly from strong growth in the health-care and construction sectors. More importantly, hours worked and hourly wage rates were also up. Taking into consideration average hours, average wages, and employment, Morningstar economists believe that total private wages grew at a stunning 0.7% in December (8.4% annualized). Given that there was limited inflation in December, these gains may flow almost immediately to consumers. Going into January, with higher taxes, this large income growth will provide consumers with a substantial cushion. The unemployment rate in December inched up slightly to 7.8%.

Housing: Original housing market forecasts for 2012 ranged from more doom and gloom to minuscule improvements. Instead, the U.S. got a year of considerable advancement, with home inventories down significantly, which has led to higher prices across the board. With inventories so low, it is now difficult to buy a home in many markets, especially on the West Coast. Home builders are also constrained by raw material prices going up, as well as a shortage of construction workers. Morningstar economists believe that home price gains of 5% or more for all of 2012 are pretty much certain, but volume-related housing metrics will slow in 2013 given these supply constraints.

Auto: Auto sales in December were at about 15.4 million units, down slightly from the 15.6 million units sold in November, which benefited from required replacements associated with Hurricane Sandy. The auto industry has been a real plus for the U.S. economy. The durable goods sales category (mainly comprised of autos), has been the single largest contributor to the economic recovery so far. While much of Europe is struggling with declining auto sales, the U.S. managed to pull out another year of very impressive growth.

Retail: Holiday sales (essentially November and December) were up 3.1% from a year ago. Sales in December showed a sharp improvement compared with November, which reflected the impact of accounting for layaway sales, Hurricane Sandy, and the timing of Cyber Monday this year. Overall, the holiday season was good, but not great. Consumer headwinds were substantial, ranging from Hurricane Sandy at the beginning of the season to worries about the fiscal cliff at the end of it. Thankfully, improved consumer incomes, falling gasoline prices, cooler temperatures, and more discounting at the end of the season, all helped boost sales.

Year-end insights: Despite odd weather patterns, presidential election jitters, and fiscal cliff concerns, 2012 was filled with much positive news for the U.S. economy. This included higher oil production, an improved auto industry, decreased commodity prices, and a stabilizing housing market. Unfortunately, the same could not be said about Europe, which entered a recession, or China, whose growth slowed dramatically. The relative strength of the U.S. economy also translated into benefits for consumers, who experienced steady employment growth, stable inflation, rising financial assets, and a nicely improving real estate market.