Monthly Market Commentary

As winter draws to a close, we're all looking forward to spring and a sustained recovery. Not all the news is good, however, especially with growing concerns over spreading violence in the Middle East and rising oil prices. In reaction to the global climate of economic uncertainty, the market experienced a few violent swings recently, but a positive jobs report helped stabilize it. On a more positive note, the S&P 500 has now officially doubled from its low in March 2009.

Employment: The economy added 192,000 jobs in February, the third-best monthly number of the recovery. The unemployment rate dropped to 8.9% from 9% in January. The private sector added 222,000 jobs, the second-best performance of the recovery. Averaging the January and February numbers together, the resulting private-sector employment growth of 145,000 jobs exceeded the past 12 months' average of 127,000. The bad news is that, while the private-sector portion of the economy is accelerating, the government portion appears to be doing the opposite. State and local governments lost 30,000 jobs in February, and the federal government is debating the need for more job cuts.

Consumer spending: More bad news is that hourly wages basically stagnated in February after a decent increase in January. So, even though more people have jobs, the average wage and consumers' buying power are staying low. Upper-income consumers account for the lion's share of the recovery, and it's also these consumers who drive the increase in consumer spending. The problem is that a lot of upper-income spending is discretionary and volatile, and it can fall as fast as it has risen. If the spending of the average consumer was growing as well, that could be considered a more sustainable long-term trend, but this is not the case.

Retail sales: The difference in where consumer spending is coming from can explain some of the February retail trends. Some high-end retailers like Nordstrom and Saks posted near-double-digit growth, while discount retailers like Target and Wal-Mart showed little to no growth this month. It seems that the more dependent a sector was on upper-class consumers, the better it performed.

Oil prices: Oil has risen to $104 per barrel from a low of $65 in May 2010 (it may be of interest to note that a $1 rise in the price of gasoline equates to about $25 billion of consumer spending per year). Although some fear that rising oil prices may kill the recovery, Morningstar economists estimate this will probably not happen until prices reach the $120 range. On the other hand, a slightly elevated oil price may curb commodities speculation and help the market readjust.

Housing market: Pending home sales showed yet another small decline, forecasting more gloomy home statistics over the next few months, as well. At this point it looks like 2011 won't be a wonderful year for housing, but if employment continues to improve and financing remains accessible, 2012 and 2013 could be better.

Economic growth and inflation: GDP growth for the fourth quarter of 2010 was revised down to 2.8% from the first estimate of 3.2%, because of inflation-adjusted inventories and a sharper-than-expected drop in government spending. Recent inflation estimates indicate that year-over-year inflation may approach 2.5% by June. When prices of goods rise faster than incomes, consumers are forced to cut back on consumption (or dip into savings). Slowing consumption in turn slows overall GDP growth and forces manufacturers to cut back on production and employment. Until recently both wage growth and inflation were muted, but rising inflation with no increase in wages could mean really bad news in the months ahead.