Monthly Market Commentary

As May saw spring slowly roll into summer, bond markets were sent into a tailspin by strong consumer confidence reports and real estate price data. Stocks managed to do better than bonds, but were still a little off as Germany and the rest of Europe decided to ease up on some of their austerity measures.

Employment: The U.S. economy added 175,000 jobs in May, just a little better than 149,000 in April, and the consensus forecast of 169,000. That's not far off the average for the previous 12 months, which is 179,000 jobs. Year-over-year average data has shown steady growth of around 1.9%–2.0% for almost two years, which is consistent with GDP growth of 2.1%–2.3%. Equity markets reacted positively to the employment numbers, but commodity and bond markets were not as thrilled. The jobs report was high enough to convince investors that the next recession wasn't around the corner, and just weak enough that Fed bond-buying programs are not likely to be eliminated in the very near future. The unemployment rate climbed to 7.6% in May from 7.5% in April.

Housing: Pending home sales showed a modest uptick in April, which should bode well for existing home sales in the months ahead. The Case-Shiller Home Price Index posted a 10.5% increase for April (calculated in year-over-year, 3-month average terms), indicating that the 6%–8% price appreciation seen in 2012 could be followed by a potential 8%–10% move in 2013. However, the Case-Shiller 20 is still about 28% below its all-time high, affordability remains near record-high levels, and not every geographic market is participating uniformly in the large increases. Also, low inventories and still-tight lending conditions are two major factors currently holding back the housing market.

Consumer Spending: The most important thing to remember when measuring this type of economic indicator is that month-to-month numbers fluctuate a lot and are not nearly as significant as long-term trends. Year-over-year data has been exceptionally stable and telling a story of slow and steady improvement. However, there is a sizable gap between income and spending. Spending itself remains stuck in the same 2% annual growth trajectory it has been on for more than two years. Meanwhile, income growth remains considerably below that level, which suggests that even if the consumer is optimistic, the fuel necessary for more spending is running a little low. Consumers in the top income quartile (who are big savers) really need to step it up spending-wise, and weather and gas prices need to cooperate to keep the U.S. economy from settling back a little in the second quarter and in the second half of 2013.

Trade: The U.S. trade deficit as a percentage of GDP has continued to shrink from 5.7% in 2005 to 2.9% in 2012 and 2.85% in the first quarter of 2013. The deficit has remained steady the last several years, even as the U.S. economy has entered a recovery (the trade deficit generally increases in a recovery and decreases in a recession). Continuing good news on the U.S. oil and gas front could improve the deficit even further. A smaller trade deficit points to a smaller need to borrow money from outside the U.S. and also generally means a stronger currency, which in turn helps control inflation.

Overall, Morningstar economists believe that 2013 may still turn out OK, with 2.0%–2.25% GDP growth, inflation well below 2%, and employment growth of about 1.8%. Real estate and consumer spending (especially on housing-related items) remain the bedrock to forecasts for the rest of the year. Government, business spending on structures and technology, and exports are likely to provide a headwind for most of 2013. The Affordable Care Act could be either a headwind or a tailwind. To get GDP growth much in excess of 2% now will require a few lucky breaks in weather, inflation, and Europe. All possible, but it's hard to take that to the bank. In fact, just a couple of bad breaks and the Fed's next move might be more loosening, not tightening.