Monthly Market Commentary

Economic data from the past month revealed some positive trends, with upbeat employment numbers for June being the biggest headline. In addition, weekly shopping center data from the ICSC have now broken out to new highs; auto sales exceeded all expectations in June despite some strong headwinds, and pending home sales made one of their biggest jumps in the history of the now 5-year-old recovery.

GDP: The last GDP revision was a huge bomb, now showing a massive and unexpected first-quarter decline of 2.9%, from a previously estimated rate of decline of just 1.0% and the original estimate of 0.1% growth. Two thirds of the revision was due to negative revision to the effects of the Affordable Care Act, and a third was due to an expected revision in net exports. Based on the nature and size of this revision, plus a poor consumption report for April and May, economic growth of 2% in 2014 is now starting to look aggressive even to the most optimistic. Because of the consumption data in April and May, it looks like the best-case scenario for the second quarter is now somewhere around 3% GDP growth.

Employment: The June employment report was strong as the economy added 288,000 total jobs compared with the 12-month average of 208,000. Professional and business services, which tend to be higher-paying jobs, were the strongest sector with a gain of 67,000 versus a 12-month average of 53,000. Despite all the positive news, the longer-term private payroll growth rate, using an average of three months of data compared year over year, ticked up to 2.1%, which is right in line with the slow and steady pace we have experienced over the past two years.

The unemployment rate decreased by 0.2%, to 6.1%. The labor force participation rate was unchanged at 62.8%, which is a positive because it means that the unemployment rate went down because of increased employment and not workers leaving the job force. Over the past year, the unemployment rate has dropped 1.4%.

Housing: Both new homes and existing homes moved nicely higher in May than in April and were considerably above expectations. This may be a sign that interest in housing in general is improving. With the labor market growth continuing, weather improving, mortgage rates down again, and home price growth slowing, the picture looks good over the next several months, and housing may be a bright spot in the second-quarter GDP report after negative results in the fourth quarter of 2013 and the first quarter of 2014.

Home price growth, however, continues to slow. Some of the more drastic slowing in growth rates has been on the West Coast where annually growth rates that may have soared as much as 30% at one point have now moderated to 20% or less, according to Case-Shiller. The rest of the nation in general has seen a slowing in price increases, but not nearly as dramatic. Remember, we are talking about slowing growth rates and not price declines. For the full year, Morningstar economists are expecting 5%–6% increases in home prices, a much more palatable level for homebuyers.

Consumption and Personal Income: The poor GDP report for the first quarter was followed by even more disappointing consumption data, which now showed consumption expenditures slumped 0.2% in April and 0.1% in May. (The May data had a lot of quirks including a large drop in food spending and a massive swing in utility bills.) However, the month-to-month data has proven to be exceptionally volatile, while year-over-year data averaged over three months has shown almost rulerlike growth at around 2.0%. The income report provided at least a small antidote to the GDP and consumption reports, notching its fourth consecutive month of growth. Income growth for May was 0.2% (or 2.4% annualized), which should have fueled more spending growth than it did.