Monthly Market Commentary

July and early August saw mixed economic and earnings news along with a time-sensitive U.S. debt ceiling discussion and Standard & Poor's downgrade of U.S. government debt. Stronger international demand and a weaker dollar enabled some companies, such as IBM, McDonald's, and Apple, to announce better-than-expected earnings that left the market feeling positive. On the other hand, companies including Juniper, Terex, Ingersoll Rand, and Caterpillar all reported disappointing results. Much of the earnings disappointments happened because of a softer European market, a modestly slowing China, poor government spending, and poor results in the U.S. construction industry.

GDP: GDP grew sluggishly, at 1.3% for the second quarter, after being revised sharply downward to 0.4% from 1.9% in the first quarter. The depressed second-quarter growth rate was based on a multitude of factors including an abysmal consumer sector, a large gain in net exports, a rebound in defense spending, poor weather, high oil prices, and the continuing problems in Japan. A significant portion of the first-quarter GDP adjustment was related to inventories and a downward revision to net exports, which are not key drivers of economic growth. Consumption and business spending remained virtually unchanged from the previous GDP report, indicating that the unusually large revision may not be as scary as originally thought.

Employment: July, a month that was reasonably untouched by seasonal adjustment factors, saw a better than expected jobs report—117,000 jobs were added in July, a significant bump from June's 18,000 jobs added. With an improving auto industry and a stronger gas production industry, employment data indicated that the economy was still growing positively, albeit at a modest pace. The unemployment rate fell slightly, to 9.1% from 9.2%.

Housing: Prices and pending home sales both increased better than expected, while new home sales disappointed and remained depressed. Housing continued to disappoint both the bulls and the bears; it failed to fully collapse, but it did not show any signs of an upward breakout. According to Morningstar economists, if pricing stability can be maintained over the coming months, higher unit production may result in the near future, although today's housing market has been prone to disappoint at every turn.

Durable goods: Overall new orders for durables fell by 2.1% for June, although the main reasons were mainly weaknesses in transportation and machinery. When taking those out, June numbers looked positive. Most of the recent decline was caused by poor auto sales, which are closely related to the poor supply of Japanese autos, causing remaining auto inventories to increase in prices.

Manufacturing: The ISM Manufacturing Index fell in July as it was affected by the weakness in new orders. This should come as no surprise, since a fair number of manufacturers reported disappointing earnings and the auto industry was out of commission for a good part of the month. The extension of the U.S. debt ceiling may give manufacturing a boost for August.

Domestic news: However unthinkable a U.S. debt default may be, national borrowing has reached the $14.3 trillion limit (or debt ceiling) this year. Since Congressional approval is required for the government to keep borrowing, President Obama and leaders of both parties announced an agreement on July 31 that would raise the debt ceiling by as much as $2.4 trillion. This measure would enable the government to keep borrowing until 2013, but the downside is that it requires major spending cuts that are likely to slow down the already-weak economic recovery. On Aug. 5, U.S. debt was downgraded by Standard & Poor's to "AA+" from its coveted "AAA" credit rating for the first time in history. Reasons cited include increased political risk and rising public debt burden as challenges to sustaining an appropriate debt/GDP ratio in the next decade. Global markets fell as a result.