Monthly Market Commentary

Majority of the needle-moving economic indicators over the past month were roughly in line with expectations, and the chances of an interest rate increase at the next Fed meeting remain high. Nonetheless, the interest rate hike is not a done deal, and the potential of a bad economic report, such as low August employment numbers, could delay the Fed's move.

Employment: According to the BLS the economy added 215,000 jobs in July, close to the consensus estimate of 220,000 jobs. The pace was a bit off of the 249,000-per-month average of the past 12 months, which Morningstar economists never viewed as sustainable. Two barn-burner months at the very end of 2014, especially the 423,000 jobs added in November, are still having a dramatic impact on the averages. Also, the revisions to the prior two months were minimal. After a big drop in June, the unemployment rate remained steady at 5.3% even as the labor force increased by more than 100,000 people.

This headline data should be enough to keep the Fed on pace to raise interest rates in 2015, most likely as early as September given that the employment market looks healthy and inflation is moving slowly toward the Fed target. However, the July data, which is relatively stable with small seasonal adjustment factors, was never really our worry in terms of derailing the Fed. It is the August report, which will be the last report to come out before the Fed's September meeting, that remains the last major impediment for a September rate hike. The August jobs report has been a very rough one over the past several years. This has been especially true for the first version of the August labor report, with subsequent revisions eventually eliminating some of the shortfalls. One recent report actually showed a job loss on the first cut and just last year the originally reported August data was below 100,000 jobs. If this August's job report shows 150,000 or fewer jobs added, the Fed may choose to delay action at its September meeting. Again, it seems extremely likely that rates will be increased in 2015, but the exact meeting date at which it happens is largely irrelevant to the longer-term outlook for the economy.

GDP: Headline GDP growth rate for the second quarter on a sequential, annualized basis increased a modest 2.3% versus expectations of an increase of 2.8% and Morningstar economists' forecast of 3.0%. The metric also ran below the long-term average of 3.1%. However, the goal posts were moved substantially, as the first quarter now showed growth of 0.6% instead of shrinkage of 0.2%, a rather substantial swing of 0.8%. Adding that 0.8% revision to the reported growth rate of 2.3% produces 3.1%, which seems more like an apples-to-apples comparison. So the second quarter wasn't the disappointment that some commentators are making it out to be. In addition, it was a relatively clean quarter with minuscule and offsetting adjustments for inventory and net exports. These two categories have often wreaked havoc on the interpretation of the GDP reports in many recent quarters. For example, falling exports and rising imports deducted almost 2% from the first-quarter GDP report.

China: After moving sharply higher over the past several years, the Chinese government devalued its currency by 1.8%, which is just a drop in the proverbial bucket. If it did one of these each week for the next five, then we might be more concerned. Nevertheless, it is recognition that Chinese growth is not nearly as robust as the government had hoped. And that weakness is not great news for other emerging-market trading partners or commodity producers. Meanwhile, the U.S., which receives just 1% or so of its GDP from sales to China, stands to benefit from cheap commodities more than it will be hurt by weak sales to China. Also, because China has kept such tight control over foreign investment, financial dislocation in China will not reverberate around the world financial markets in the way that U.S. subprime mortgages did.