# Monthly Market Commentary

The market endured yet another month of Fed-watching as investors moved markets upward when more quantitative easing looked possible and downward when it looked like tapering of bond purchases was around the corner. In the past, easing and tightening measures by the Fed have been nearly perfect predictors of stock- and bond-market moves in the short run. At some point, however, bond purchases will inevitably end and rates will move somewhat higher. There is a high probability that bond purchases will end in the next 12 months. (There simply won't be enough bonds left to buy.) And while the positive effect of quantitative easing on markets remains undeniable, gross domestic product growth remains mired in the 2% range.

GDP: The headline third-quarter GDP growth rate of 2.8% came in ahead of the consensus estimate and second-quarter result, which both showed growth of 2.5%. To put this in perspective, the long-term average GDP growth rate is 3.1%. Morningstar economists' year-over-year GDP growth calculation (versus the government's method of annualizing quarter-to-quarter growth) shows a softer 1.6% growth rate.

Despite the powerful rate, the composition of GDP growth was far from optimal. Most of the growth came from net exports and inventory increases. Worse, consumer spending growth rates continued to slump, and businesses' spending for equipment actually decreased for the quarter. The government sector had no net contribution to GDP growth, after three quarters of being a meaningful detractor. Looking ahead, Morningstar economists suspect that GDP growth will drop to 2% or maybe a little less in the fourth quarter, as inventories turn neutral, consumers remain stingy, and net exports make little, if any, contribution to GDP growth.

Employment: Between the furlough and a couple of below-average reports in August and September, everyone braced for the worst with regard to the October jobs report. However, the private sector, expected to increase jobs by only about 130,000, added 212,000 jobs, slightly better than the 196,000 average over the past year. Upward revisions to the prior two months counted an additional 70,000 private-sector jobs. Nevertheless, the report was less than inspiring in aggregate. There was almost no hourly wage growth, and hours worked were flat, which will keep income growth in check. Year-over-year job growth remained stuck around the 2% level, where it has been for some time. Unfortunately, the real strength was again in retail and leisure and entertainment, which are not generally the highest-paying jobs.

Housing: Pending home sales continued to plummet, both month to month and year over year. Weaker existing-home sales have already begun to follow suit, and more deterioration is likely in the short run. The short-term increase in existing-home sales (in July and August), caused by a rush to beat rising rates, could boost GDP growth by 0.2% in the third quarter and subtract a like amount in the fourth quarter, as sales dip back to more sustainable levels. Higher mortgage rates and, more importantly, higher prices, have begun to affect housing affordability in a dramatic way.

Consumer spending: The five-week moving average for weekly shopping center data has been stuck at 2% versus the three-year trend of 2.5%–4.0%, despite lower gasoline prices and the return of furloughed government workers. Retail sales dropped 0.1% in September overall (ex-autos, they increased by 0.4%). Adjusted for inflation, the 2.5% growth rate matched the average of the past 12 months.

One of the few recent pieces of good news was that the federal budget deficit fell dramatically in fiscal year 2013, dropping to $0.7 trillion from $1.1 trillion in just one year, the largest dollar drop in history by a factor of two. Another really good piece of news is that health-care inflation continues to run far, far below long-term projections.