

Monthly Market Commentary

Geopolitical news out of Egypt took stage and dwarfed recent economic news and earnings reports. Unrest in the Middle East tends to result in higher oil prices, which created problems for the economy.

GDP: Because of an inventory adjustment, the 3.2% fourth-quarter GDP growth appeared to disappoint investors. GDP growth did accelerate, however, from 2.6% in the third quarter of 2010. On the positive side, GDP has now officially recaptured all that was lost during the 18-month recessionary period. According to Morningstar economists, rock-bottom inventories and the payroll tax cut should lead to higher GDP growth rates in the first quarter of 2011. Export growth remained strong thanks to strong emerging-markets and agricultural categories, contributing about 1% to GDP growth. Business spending was also a small contributor to growth while government spending fell 0.6%, resulting in a small negative impact on GDP. To summarize, consumer goods and services, exports, and imports had a positive impact on GDP, while change in private inventories negatively impacted GDP.

Earnings: Technology and manufacturing sectors showed positive results, while retailers and financial institutions have had a hard time meeting expectations. Companies such as Ford Motors and Amazon revealed disappointing results.

Consumer spending: The savings rate declined to 5.4% in the fourth quarter of 2010 from 5.9% in the previous quarter. This decline may suggest that purchases were made from stock market profits and, possibly, in anticipation of the 2011 payroll tax cut. Consumer spending growth accelerated to 4.4%, the fastest growth rate in consumer spending in more than five years.

Durable goods: December orders for durable goods dropped by 2.5% from November on a seasonally adjusted basis. Recent data suggests a 7% increase above last year's result. However, if

the volatile transportation sector is excluded, annual growth could be estimated at 11.5%.

House prices: The Case-Schiller 20-city price index fell by 1% at the end of November 2010. On a year-over-year basis house prices were down 1.6%. However, house prices are up 3.3% compared with the lows of 2009. Morningstar's housing team notes that the rate of decline in markets slowed in November. The real-time listing database has showed signs of improvement, which should start to show in the delayed Case-Schiller statistics in the months ahead.

Home sales: New home sales jumped by 17.5% in December 2010 to reach 330,000. However, this number appeared inflated by an upcoming change in California building code, which makes new homes more expensive and may have caused a sales acceleration in the Western region report. Pending home sales increased by 2%, and the index has moved up during five out of the past six months. Data on the existing home sales indicates an increase to 5.28 million units in a six-month period from the homebuyer-credit-expiration bottom of 3.8 million units.

Employment: Initial jobless claims fell by 42,000, to 415,000. Alabama, Georgia, North Carolina, and South Carolina posted the biggest declines after the four states posted large increases in the prior week because of snow effects. The unemployment rate fell to 9% from 9.4% in December 2010. The most recent employment report suggested that, on a year-ago basis, overall payroll job growth rose to up 0.8% in January from up 0.7% in December. Overall payroll employment increased a meager 36,000 in January, which fell well short of analyst's estimates. Data from ADP, the company that prints payroll checks, indicated that the job market is doing better than the employment report suggests. ADP data suggests that payrolls grew by 247,000 in December and 187,000 in January. According to Morningstar economists, the recent economic data appears positive, and the payroll tax cut should keep the economy humming for a few more months.