Monthly Market Commentary

January saw a mixed bag of economic news for both bulls and bears to feast on—negative GDP report, positive employment adjustments, and a good long-term housing trend overshadowed by inventory shortages of homes, new or used, in the short-term. Morningstar economists believe that the market's positive reaction to the seemingly bearish but actually bullish GDP report was the correct interpretation. However, bad weather, the bad GDP report, the temporary shortage of home inventories, and the increased payroll tax and tax refund delays will likely weigh on upcoming economic reports.

GDP: The first estimate of GDP indicated that the economy shrank 0.1% in the fourth quarter of 2012, compared with growth of 3.1% in the third quarter. Consumption, business investment, and housing components of GDP all did better than expected, while government and inventories were the main detractors. While the negative GDP number was shocking, closer examination suggested that government bill payers and overly cautious businesses were largely to blame for an otherwise excellent report.

Employment: January employment grew at a satisfactory pace, with 157,000 jobs added. More importantly, significant annual revisions showed exceptionally strong employment growth in the fourth quarter of 2012. Construction and retail were standout performers after the adjustments, while most other categories did not show meaningful changes. Employment growth for the whole of 2012 averaged 181,000 per month, up from 153,000 per month prior to the upward revisions. Unfortunately, the U.S. economy has still only just recovered 5.5 million of the 8.7 million jobs lost during the recession. The unemployment rate in January inched upwards to 7.9% from 7.8% the month before.

Housing: Housing starts soared in December, coming in at 954,000 units compared with just 851,000 units the previous month. The good news is the growth was geographically dispersed and included nice improvements in both single-family homes and apartments; the bad news is that current housing starts are still well below 50-year averages (about 1.5 million units). On the other hand, new-home sales in December came in at 369,000 units sold compared with the recovery record of 398,000 in November. In case you were wondering why there is such a huge variance between housing starts and new-home sales, the biggest difference is that new-home sales only reflect single-family homes while housing starts include a range of single-family homes to giant multifamily apartment buildings. Since the bottom of the housing crash, non-single family home starts have more than quadrupled, while single-family starts were up an impressive but more modest 66%.

Manufacturing: Although U.S. manufacturing isn't generally important enough to move the economic needle at this stage of the recovery, news in the last week of January was surprisingly and uniformly positive. Morningstar economists believe that given continued strong consumer purchases and improvements in China, a rebounding manufacturing sector should come as no surprise. However, the most recent GDP report does suggest that the manufacturers badly misgauged consumer demand in late 2012, and had shrunk inventories when they probably should have been expanding them. Outside the U.S., manufacturing in China and Europe has recently improved as well, with January's data indicating 24- and 10-month highs, respectively.

Auto: Excellent auto sales in January (15.28 million units) also proved to be encouraging news for the economy, with year-over-year sales up 14%. This number came very close to the highest month of 2012, which was November (15.5 million units), although November's number was aided by restocking after Hurricane Sandy.