Monthly Market Commentary

August saw market participants reacting wildly to any economic news, good or bad. As new worries in Europe, compounded by a European slowdown in second-quarter GDP growth, developed, investors were concerned that it would be more difficult for Europe to deal with its intractable debt crisis. On the other hand, factory orders, home prices, and consumer spending looked positive, and equity markets followed the news flow. Markets collapsed on the Friday before Labor Day long weekend because the overall economic news was bad, but not bad enough for Bernanke to reconsider another round of quantitative easing.

GDP: Second-quarter GDP was revised downward to 1.0% from 1.3%. The reduction was mainly because of changes in export data and inventory adjustments caused by slowing inventory growth. While a lower GDP growth number is never good news, consumption and business spending actually improved, setting us up for a better third quarter. Growth of 2.5%–3% is generally considered normal growth for the U.S. economy, indicating that we've so far had a lackluster recovery in the first half of 2011.

Employment: August reported no job growth, although the report was distorted by the 45,000 striking Verizon Communications employees who were considered unemployed. The government sector continued to contract, and that was offset by growth in the private sector—led by health-care and business services in August. Hourly wages and hours worked were down, partially because of falling inflation and summer vacations. Unemployment remained flat at 9.1%.

Housing: After a yearlong decline, housing industry prices began to turn upward in the second quarter and in June specifically. With fewer homes entering the foreclosure process, higher rents and a low interest-rate environment could combine with stabilizing home prices, and the construction market may see improvements as early as 2012 given small (165,000 units) new-home inventories and the 110 million or so existing households.

Manufacturing: The ISM Manufacturing Index fell in August, although to a lesser degree than expected, which indicated continued monthly expansion albeit at a very slow rate. One of the causes of concern was a drop in exports, which were a major driver of our economic recovery earlier on in the year. The anemic manufacturing industry also depressed manufacturing employment.

Consumers: Retail consumption continued at a healthy pace in August, led by luxury goods and wholesale clubs, despite Hurricane Irene. Despite Hurricane Irene, supply problems from Honda and Toyota, and weak consumer confidence, August auto sales remained remarkably resilient and stayed flat, though up almost 8% compared with last August. Inflation continued to decline with cheaper gasoline and cheaper cars, indicating stronger inflation-adjusted consumption numbers in the months ahead.

Domestic News: Fed chairman Ben Bernanke's speech at Jackson Hole, Wyo., where the annual global central banking conference was held, resulted in no immediate third round of quantitative easing but a reaffirmation that low policy rates will be maintained until mid 2013. It was also announced that the Federal Open Market Committee meeting in September will be extended from one to two days, indicating a more thorough discussion in evaluating if further measures will be necessary to help the U.S. economy. Market participants initially reacted negatively to the quantitative easing announcement but later took some solace with the announcement of the no-interest-rate-increase-until-mid 2013 pledge, allowing for a continued cheaper cost of borrowing in the next two years.