

Monthly Market Commentary

The U.S. stock market dropped by 2.9% in August, heavily weighed down by news out of Syria. Though Syria produces no oil to speak of, there are fears that other Middle Eastern oil producers would be drawn into the conflict, and oil prices would soar.

Federal Reserve news: There are a lot of worries in anticipation of the Fed's September meeting, when tapering seems imminent. An increasing number of Fed governors seem to believe that there has been enough bond buying. Still, some governors continue to believe that the economy is in a fragile state and are more reluctant to make any changes without clear evidence of an accelerating economy. A small tapering might represent an acceptable compromise, unless the near-term economic indicators fall apart.

GDP: The second-quarter GDP estimate was revised sharply to show 2.5% growth, compared with the previous estimate of just 1.7%. Most categories were unchanged, except for the much-anticipated change in net exports, which accounted for almost the entire 0.8% revision in the GDP.

Employment: The economy added 169,000 jobs in August, with most of the growth coming from the retail trade and health-care sectors. However, the June and July numbers were revised downward by a combined total of 74,000 jobs. Based on the new numbers, only 148,000 new jobs were created on average during the past three months. The unemployment rate dropped to 7.3% from 7.4% in July.

Housing: Pending home sales fell 1.3% between June and July, while the year-over-year tally was up 6.7%, its lowest showing in 2013. Unfortunately, pending sales are tracking lower than existing-home sales data, which means that existing-home sales are likely to show slower growth rates in the months ahead. The data also seem to indicate that the big jump in July existing homes was a result of a rush to close mortgages faster (to beat rate increases), and not actual gains in the housing market. Home prices have risen sharply over the last 15 months; however, rising interest rates and declining affordability may keep a lid on prices, at least in the near future. Affordability has

slipped from an index of 210 to 166, and that was before rates really started to increase this spring. Overall, the housing market appears to be slowing its growth rate.

Consumer spending: Consumption, which represents 70% of the U.S. economy, has been on a slow drift down during the past year. Given the limited growth in July actual data and lackluster shopping-center data so far in August, Morningstar economists estimate that consumption data will be hard-pressed to grow much faster than 1.5% in the third quarter overall, compared with increases of 2.3% in the first quarter and 1.8% in the second quarter. Given that consumption is the largest component of GDP, the data would seem to indicate a slowing in the overall GDP growth rate in the third quarter.

International: The European economy appeared to move out of recessionary territory in the second quarter as the 17-country eurozone experienced growth for the first time after an 18-month-long double-dip recession. The 2013 second-quarter annualized GDP growth rate of 1.1% was the first positive one since fall 2011. Germany, France, and the United Kingdom were the backbone of the recovery with annualized growth rates of 2.8%, 2.0%, and 2.4%, respectively. Employment data didn't show nearly as much improvement as GDP did, especially in France, but overall, the improved data should make Europe less of a headwind to world growth.

Morningstar economists are still optimistic about the long-term outlook for the U.S. economy, because of the potential of the housing, oil, aerospace, and auto industries. Manufacturing and the banking system also remain strong, and inflation appears under tight control. However, there is no denying that fiscal austerity and higher interest rates are taking at least a short-term toll.