Monthly Market Commentary

September was filled with uncertainty, which continued to weigh both on businesses and investors. The European debt crisis, with its unknown effects and unclear resolution, has troubled the markets, causing increased stock-market volatility and a significant decline in financial-sector stocks. Not even Federal Reserve chairman Ben Bernanke could calm market sentiments with his “twist” plan, announced after an extended two days of discussion at the Federal Open Market Committee meeting. Despite 2011 being the third year of a presidential term, which historically has been good for stocks, the S&P 500 was temporarily in bear market territory as of Oct. 4, with a 20% decline from its most-recent 2011 high.

GDP: Second-quarter GDP growth was revised up to a final reading of 1.3% from 1.0%, driven mainly by export data. A weak dollar, a revival of the manufacturing sector, strong capital goods sales in emerging markets, and powerful agricultural sales have allowed the U.S. economy to trudge along at an anemic rate with strong exports in the first half of 2011.

Employment: Employers added 103,000 jobs in September, led by gains in the professional and business services and health care, sectors, as well as the 45,000 Verizon Communications employees that returned to work. Similar to August, private-sector growth continued to be offset by contractions in the government sector. In order to effectively put a dent in unemployment rates, job growth of about 150,000 is required per month. Unemployment remained flat at 9.1%.

Manufacturing: The ISM Manufacturing Index inched up slightly—indicating that manufacturing was expanding but still very sluggishly. An ongoing concern was the lackluster performance of new orders and backlogs, which hinted at a potential contraction in demand going forward. Durable goods orders, on the other hand, pointed toward a continued moderate uptrend in manufacturing.

Quarter-end insights: The second-quarter of 2011 continued to defy predictions by economists, with the U.S. economy neither collapsing nor breaking out on the upside. In the wake of persisting uncertainty from the European debt crisis and its contagion effects, along with the U.S. budget debacle in August, investors and corporations became more cautious. Investors seeking yield continued to bid up more-defensive portions of Morningstar’s stock investing universe, seeking stocks that provided income in addition to capital gains. Riskier sectors with less good news, including financials, basic materials, and energy, continued to sell at larger discounts than the overall average. Corporations with near all-time-high profit margins and large amounts of cash were still unwilling to spend or hire significantly given the economic and political uncertainty and the lack of investor confidence. In fact, merger-and-acquisition activities as well as stock buybacks (financed with money borrowed at exceptionally low rates) started to pick up. Consumer spending remained relatively strong, pushing ahead slowly, cautiously and consistently despite setbacks from the lingering effects of earthquakes, hurricanes and budget crises. However, consumers were selective with what they purchased and consistently punished businesses that raised prices too quickly. Gasoline demand in the U.S. declined for three quarters in a row, corresponding closely with the recent acceleration in gas prices. Auto sales and apparel sales were the same, as price hikes from Japan’s supply-chain issues (for autos) and increased cotton prices (for apparel) caused sales to fall. Netflix saw its stock price drop following a pricing change. With regard to inflation, Morningstar economists believe that a slower world economy and a resolution of the Libyan situation should help drive oil prices (the key driver of high inflation) lower in the months ahead. Food prices should also begin to fall as crops are harvested and some of the dismal weather conditions around the world abate. A resumption of Japanese auto shipments should also help drive auto prices lower in the months ahead.