

Monthly Market Commentary

Although several bellwether stocks, such as Intel, Texas Instruments, FedEx, Norfolk Southern, and Caterpillar announced earnings warnings, investors mostly shrugged-off weaker fundamentals and placed their hopes on growth through coordinated easing. Investors were not disappointed, as additional quantitative easing (QE3) was announced on September 13th. Riots in Spain caused markets to react negatively, durable goods orders took a dive because of airline orders, and income and consumption numbers were hit hard by a quick spike in inflation rates. However, year-over-year data for almost every report continued to look a lot better than the volatile month-to-month statistics.

GDP: Second quarter real GDP growth was unexpectedly revised downward in September to 1.3%, after initially being revised upward to 1.7% from 1.5% in August. Adjustments were across the board, which included a slowdown in personal consumption, inventory growth, and negative net exports.

Employment: The recent jobs report revealed a surprise drop in the unemployment rate to 7.8%, down from 8.1% in August. In September, 114,000 jobs were added, but more importantly, the job numbers were revised substantially higher for July (+40,000 jobs) and August (+46,000 jobs). These revisions are likely to produce meaningful increases in both personal income and consumption growth.

Housing: Housing data was mixed as house prices rose but pending home sales seemed lighter than expected. The Case-Shiller 20 City Index rose 1.2% sequentially and is now 7% to 8% above lows reached this spring. The relatively consistent improvement in prices over the past few months should help the appraisal process that has kept many pending homes that went under contract from actually closing. Consistent price increases, along with near-record low mortgage rates and skyrocketing rents, could push potential buyers off the fence.

Manufacturing: New orders for durable goods were down a whopping 13%. A major air industry show in July often causes a huge boom for airline orders in that month, followed by a collapse in August. If volatile

categories such as airliner orders and other transportation equipment are ignored, new orders were down a modest 1.6% in August. Morningstar economists believe that while the export news looked particularly bleak, a combination of ramp-up in jetliner productions from Boeing and continued improvements in the auto industry (auto sales hit a new recovery high in September) should prevent a rout of the manufacturing industry in the U.S.

Quarter-end insights: The initial fears at the end of the second quarter that the U.S. would be pulled back into a recession because of slowdowns in Europe and China, has not come to pass. Markets were surprisingly strong in the third quarter, mainly from actions by central banks around the world that drove markets higher. Although the housing recovery has been improving for most of 2012, it has yet to have any significant impact on overall economic activity since residential housing only represents 2% to 3% of GDP. This excludes spending that typically follows home purchases, such as new furniture and landscaping. Morningstar sector analysts' quarter-end outlook highlighted lackluster fundamentals that showed no definitive signs of either a collapse or a boom. During the third quarter, cyclical and more economically sensitive stocks generally did well while more staid industries, such as utilities, generally underperformed the market. There is also concern of a stronger dollar undercutting sales growth with a general fear that the higher dollar may likely depress margins in the months ahead. High margins and conservative capital spending have resulted in higher levels of cash at major corporations, which is finding its way into the mergers and acquisitions space. Much of the merger and acquisition activity as well as general corporate growth stories continue to be built around emerging-markets growth, despite near-term pressures in some of those markets.