Monthly Market Commentary

The U.S. market returned 8.3% so far this year (as of the end of the third quarter). The U.S economy appears to be holding its own despite setbacks in the rest of the world.

Employment: Private sector employment growth has been stuck in an exceptionally narrow range of 2.0%–2.2% year-over-year growth since 2011. As suggested by a falling unemployment rate (5.9%), recovery-low initial unemployment claims, and wage growth in select categories, Morningstar economists believe the economy may face spot labor shortages in 2015. That could mean that pay rates in some industries will need to go up. That could also pressure corporate earnings in the year ahead, along with rising interest rates and an increase in the trade-weighted dollar that has now appreciated by close to 12%. 2015 could be the first year when it might be better to be an employee than an employer.

Consumption and Income: For most of 2014, income growth has been excellent while consumption growth has been volatile and much slower. Between December and August real wages are up 3.1%, real disposable income is up 2.8%, and consumption a meager 1.4%. The premise and reason for optimism, at this point, is that incomes don't grow faster than consumption for long in the United States. As inflation backs down again and the job market continues to improve, consumers are likely to increase spending in the back part of 2014, which in turn should help push overall third-quarter GDP growth.

Trade: The trade deficit shrank from $40.3 billion in July to $40.1 billion in August. The inflation-adjusted deficits for July and August are running considerably lower than the slightly inflated numbers of the second quarter. Net trade took 0.4% off of GDP growth in the second quarter and is likely to add 0.2% in the third quarter, providing potential for a meaningful swing. Unfortunately, trade may hurt the U.S. economy in the fourth quarter because of a stronger dollar.

Quarter-End Insights: 2014 was to have benefited from a huge swing in the government category as well as a continued big rebound in housing and a strengthening world economy. That didn't happen. Housing slowed because of affordability and credit tightness. Government did get a little better, but not nearly as much as hoped, as last year's budget agreement weighed on spending. In fact, as fiscal 2014 draws to a close, federal government spending looks to be lucky to grow at 1%, before adjusting for inflation.

Furthermore, world growth has been a big disappointment. After just one year of mediocre growth, Europe didn't show any growth at all in the second quarter. China, too, has been a disappointment, with both exports and real estate turning in poor results. China's currency has been weaker, also, which has helped exports to the U.S. and hurt imports. The bright side to this surprising world weakness has been more liberal central banks, falling inflation rates, and lower interest rates.

Lately, there was some fear that in the long term, U.S. GDP growth could slip well under 2%. That is as overblown as the expected return to 3%-plus growth was just a few short years ago. First and foremost, residential spending has yet to return to its normal level (5% of GDP), despite population growth and five years of economic recovery. Exports to the rest of the world will also help keep the U.S. growth story afloat. Airliners are likely to be in strong demand throughout the world over the next 10 years. With long production and design cycles, competition for the U.S. airliners will prove minimal. Growing agricultural demand and growing oil-related exports should also keep the U.S. ahead of the developed world growth rates. Demographics, however, including lower population growth rates and an unfavorable shift to older, lower-spending consumers, may keep a lid on long-term economic growth.