



November 2009 Market Recap

Renewed surge

After a brief respite last month, financial markets returned to their winning ways in November and gave investors an early dose of holiday cheer. Markets got support from third-quarter gross domestic product (GDP), which—while scaled back to 2.80 percent from an initial estimate of 3.50 percent—was positive for the first time in five quarters, likely marking the end of the current recession. Positive contributions came from a continued rebound in manufacturing, as businesses responded to signs of improving economic conditions by rebuilding previously depleted inventories, as well as an unexpectedly strong resurgence in the residential real estate arena, as buyers rushed to take advantage of the tax credit that was set to expire in November. (Congress subsequently extended the credit through May 2010.)

For its part, the Federal Reserve (the Fed) appears poised to continue its accommodative posture in hopes of prolonging the economic rebound—giving no signs in its most recent statement that it intends to shift course anytime soon. Though some are fearful that the Fed is being too short-sighted in its decision-making—a frequent argument being that it is germinating the seeds of hyperinflation through overly accommodative policies—there are sufficiently worrying trends vis-à-vis shrinking consumer credit, a lackluster employment picture, and fading consumer confidence to help buttress the counterargument to that view.

With the holiday shopping season now upon us, the next few weeks should provide a good barometer for whether a meaningful rebound in consumption patterns is probable, or, as some believe is more likely, whether a secular, more enduring decline in consumption habits is afoot.

Domestic stocks show strength

November results should provide at least a small shot in the arm for consumers' finances; U.S. stocks outperformed their foreign counterparts for the month, countering the trend we've seen for most of the year, and virtually every stock market index posted gains for the month. The S&P 500 rallied 6 percent and now stands 24.07-percent higher for the year. The Dow Jones Industrial Average gained 6.93 percent in November, while the tech-dominated Nasdaq rose 4.86 percent. For the year, those indices are now higher by 21.52 percent and 35.99 percent, respectively. Small-cap stocks, often touted as the strongest performers in the early stages of a recovery, bucked that trend and have disappointed on a relative basis this year. The Russell 2000 has gained a respectable 17.70 percent year-to-date, but it's still a far cry from gains in large-cap indices.

Stocks in developed foreign economies, as measured by the MSCI EAFE, appreciated 2.03 percent last month—up 30.56 percent year-to-date. The MSCI Emerging Markets Index—the year's runaway winner due to investors' faith that those economies will continue to grow—gained 4.30 percent in November. It has now surged 72.20-percent higher for the year.

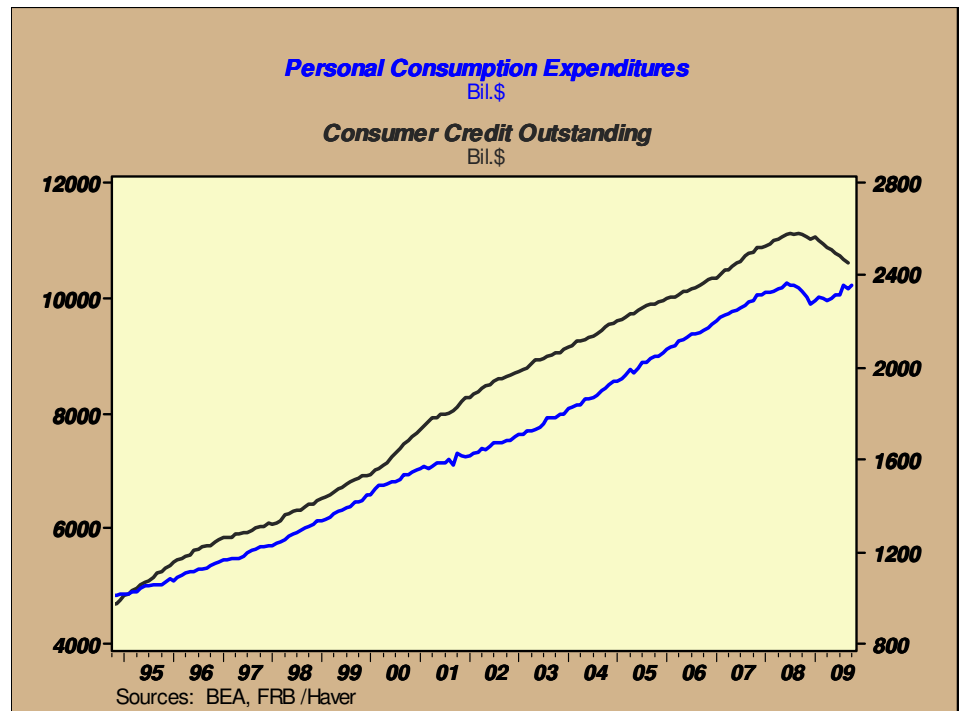
Renewed activity

Renewed business investment has been a key contributor to the economic rebound, as evidenced by the ISM Manufacturing Index, a composite measure of domestic manufacturing activity. The index rose to 55.7 as of the most recent reading, a four-year high and a strong indication that businesses are casting an eye toward future growth, believing that the worst of the downturn has passed. We expect this trend to continue—and expect sustained business investment to provide a boost to GDP in the quarters ahead.



Improvements in the much-beleaguered housing sector also helped to fuel the ever-growing rally. Combined sales of both new and existing single-family homes have risen steadily from 4.8 million units at the historic trough in January 2009 to a more normal 6.5 million units in October. With the extension of the tax credit, we expect that a stabilizing housing market could also provide a boost to GDP growth in the coming quarters.

In the longer run, concerns persist that consumers—whose finances are being pressured by persistently high unemployment, sluggish income growth, and the need to pay down existing debt—may be less willing and less able to fuel additional consumption by increasing their debt burden. Indeed, surveys measuring consumer confidence about the future fell a bit in October and November, after showing a drastic improvement from February through September. And total consumer credit outstanding (see chart), an aggregate measure of all types of consumer-held debt, has fallen for 11 of the previous 12 months—an unprecedented phenomenon in modern economic history, and a signal that increased borrowing may not play as big a role in consumer behavior as it has previously. Absent a strong rebound in consumer spending, which has been a critical underpinning for global economic growth for most of the past decade, we might well need another impetus to emerge to extend the economic rally from here.



In the coming quarters, though, we anticipate that the dominant themes will be a continued rebound in business investment, the housing market benefiting from the extension of the tax credit for first-time homebuyers, and policymakers maintaining their accommodative disposition. And as we march through 2010, it will be important to remain vigilant for conditions that will either confirm, or alternatively oppose, a sustained economic revival.

Disclosure: Certain sections of this commentary contain forward-looking statements that are based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Past performance is not indicative of future results. All indices are unmanaged and investors cannot invest directly into an index. The S&P 500 Index is a broad-based measurement of changes in stock market conditions based on the average performance of 500 widely held common stocks. The Dow Jones Industrial Average is a price-weighted average of 30 actively traded blue-chip stocks. The Nasdaq Composite Index measures all Nasdaq domestic and non-U.S.-based common stocks listed on the Nasdaq Stock Market. The Russell 2000® Index measures the performance of the 2,000 smallest market companies in the Russell 3000 Index. The MSCI EAFE Index is a float-adjusted market capitalization index designed to measure developed market equity performance, excluding the U.S. and Canada. The MSCI Emerging Markets Index is a market capitalization-weighted index composed of companies representative of the market structure of 26 emerging market countries in Europe, Latin America, and the Pacific Basin.

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