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Steadier sailing?

January 2—Stock market investors around the world were cheering as 2013 came to a close. Markets were up all over:

- S&P 500-stock index up 32.39%;
- Dow Jones Industrial Average up 29.65%;
- Japan's Nikkei Stock Average up 57%;
- Germany's DAX up 25%;
- France's CAC 40 up 18%.

These advances far outstripped the growth in the world economy and represent a continuing recovery from the collapse in stock prices in 2008. The DJIA set a new record 52 times in 2013. The question for investors now is how much upside potential is left in stocks.

The big losers in 2013 were precious metals—gold was down 28.65%, and silver fell 36.63%. The long-term Treasury index was down 12.66%., and the municipal bond index was off 2.55%.

Falling prices for bonds are inevitable as the Federal Reserve Board begins tapering off its bond purchases under Quantitative Easing. As yields and interest rates rise, as they must as the economy becomes healthier, the value of existing bonds must decline. An unknown for investors concerns the extent to which central banks in Japan or Europe might step in to offset the monetary moves made by the Fed.

Housing

In the 12 months through October 2013, average home prices rose 13.9%, according to the S&P/Case-Shiller home price index. However, the rate of increase was leveling off, indicating that the market is stabilizing.

Many housing markets have reached or exceeded the price peaks last seen in 2007. A study of Zillow housing data by The Wall Street Journal revealed that in 10 of the nation's 50 largest metropolitan areas, average home prices equal or exceed earlier highs. Nationally, home prices fell 23.8% from 2007 to 2011, according to Zillow; overall, prices remain down 16.3%. In about 1,500 cities that experienced especially severe housing busts, the current prices are 25% or more below the top.

Although the firming up of prices in the housing sector is welcome news, there is an important caveat. Buyers have the benefit of exceptionally low mortgage interest rates, giving them more buying power. As the Fed tapers off bond buying, and interest rates begin to rise, home prices could be adversely affected.

Unemployment

The unemployment rate fell from 7.3% to 7.0% in November, the lowest rate in five years. The labor force participation rate was unchanged, at 63.0%. That figure is well below what it was before the last recession began and suggests one reason why the economy is performing well below its potential.

An emergency federal unemployment benefit expired on December 28. The program provided an extra 47 weeks of benefits. Given that the recession ended 55 months ago, one might well think that the emergency is over. However, for the estimated 1.4 million still collecting this benefit, a new personal emergency may be starting. There is a chance that Congress will revisit the question in January; Republicans have indicated willingness to restore the benefit if the cost can be offset by other spending cuts.

Interestingly, economists project that ending the benefits will reduce the unemployment rate by another quarter point. That's because benefits are only paid to those who are actively seeking a job. If those whose benefits are ended stop looking for work, they'll no longer be counted as unemployed.

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