Weekly Market Commentary

March 19, 2012

Stocks' Sweet Sixteen

Jeffrey Kleintop, CFA
Chief Market Strategist
LPL Financial

Highlights

It has been a sweet sixteen weeks for the S&P 500. The broad stock market index has had only three down weeks out of the past sixteen, tying a record unbroken for over 20 years.

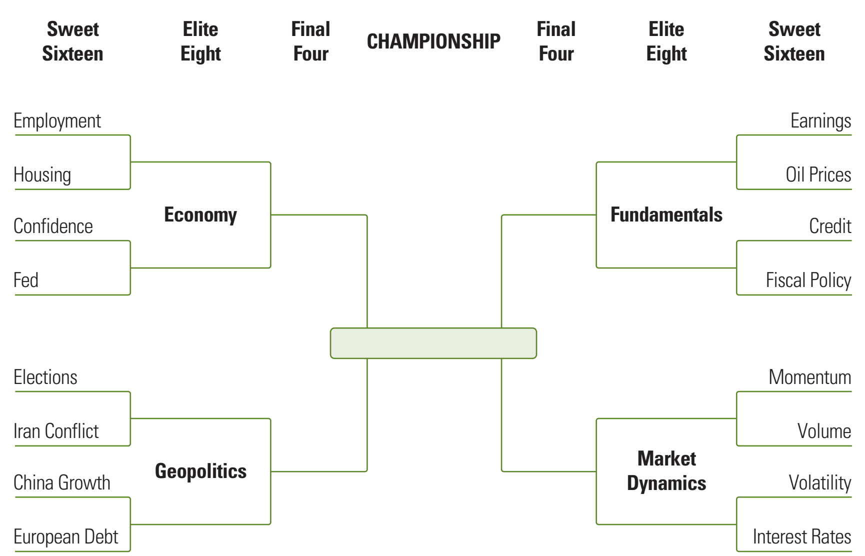
As the NCAA basketball tournament gets down to its own sweet sixteen this week, it is a good time to reflect on the sixteen competing drivers of the markets that may make for an exciting showdown in the weeks and months to come.

There will likely be some upsets that result in volatility as these factors face off against each other. In the end, we expect the positive factors are likely to win and help to support the strong gains we have already seen this year.

It has been a sweet sixteen weeks for the S&P 500. The broad stock market index has had only three down weeks out of the past sixteen. There has not been a sixteen-week period with fewer weeks of losses in over 20 years—since the period ending September 1, 1989!

As the NCAA tournament gets down to its own sweet sixteen this week, it is a good time to reflect on the competing drivers of the markets that may make for an exciting showdown in the weeks and months to come.

1 Stocks' Sweet Sixteen



Source: LPL Financial 03/19/12

The four "regions" of market moving factors vying for investor attention are: economy, geopolitics, fundamentals, and market dynamics.

Economy

- Employment – Job growth has been picking up with more than 200,000 jobs created in each of the past three months.*
- Housing – The soft housing market could grab attention, given the coming wave of foreclosures.

- Confidence – Consumer confidence has been improving, but it remains well below average.**
- Federal Reserve – As the latest stimulus program, Operation Twist, winds down will the stock market suffer the same sell-off that surrounded the ending of the prior two programs QE1 and QE2?

Geopolitics

- Elections – Upcoming elections in France and the United States potentially could have a material impact on the regulatory and legislative environment affecting the markets.
- Iran Conflict – A military conflict with Iran is a low probability "dark horse" factor that could have a major impact on the markets if it were to develop.
- China's Growth – A hard or soft landing in China's economy makes a big difference to global growth and the prospects for stocks.
- European Debt – Further progress on sovereign debt problems and budget challenges must take place in Europe, with Portugal as the next country eyeing a debt restructuring.

Fundamentals

- Earnings – The most consistent factor in recent years, earnings for S&P 500 companies, have grown about 55% since the end of 2008, in line with the gain of about 55% in the S&P 500 over the same time period, but growth has slowed sharply as we look toward the first quarter's results.
- Oil Prices – Oil prices have been over $100 per barrel for the past four weeks and may begin to negatively impact the markets the longer they linger here.
- Credit – Demand for credit has improved and credit spreads have narrowed; both trends are critical supports to growth.
- Fiscal Policy – A budget bombshell hits the economy in 2013, with tax hikes and spending cuts totaling 3.5% of GDP.

Market Dynamics

- Momentum – Stocks have been on a strong winning streak that could continue.
- Volume – Trading volume in the markets has been light, traditionally seen as a sign that a trend has become vulnerable.
- Volatility – Investors have been net sellers of U.S. stock mutual funds for much of the past month despite strong and steady gains (according to ICI data); a return to more volatile markets may further undermine individual investor support.
- Interest Rates – Interest rates are on the rise, potentially acting as a drag on everything from housing to the U.S. budget, but from very low levels.

There are quite a few listed here, but these certainly are not all the factors that are influencing the markets.

The key message for investors in considering these factors is: don't be too confident in any particular outcome. Respect the complexity of the situation. This is a time for caution and taking some profits, not for indiscriminate selling. It is a time to nibble at opportunities as they emerge; it is not a time to jump in with both feet.

Investing is not a game, but it is important also to remember that forecasting is not an exact science, and many factors can affect outcomes that are hard to predict. Last year, the Japanese earthquake had a big impact on markets and natural disasters—despite tremendous advances in technology—are very hard to predict with any degree of accuracy in once we get location or timing. Geopolitical outcomes can also be hard to foresee as we look to the stresses in the Middle East. The markets also rarely offer perfect clarity on their direction because they are driven by these factors as well as many others. Even this week's NCAA March Madness can be seen as a reminder of how it can be notoriously hard to predict winners. Historically, a team's ranking has meant nothing after we get down to the elite eight.

These factors will play out in the markets over the course of the year, not just in the coming weeks. This means there will be some upsets that result in volatility and pullbacks as these factors face off against each other. In the end, we expect the positive factors are likely to win and help to support the strong gains we have already seen this year. ■

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance reference is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

* According to U.S. Bureau of Labor Statistics data.

** According to University of Michigan Survey data.

International and emerging markets investing involves special risks, such as currency fluctuation and political instability, and may not be suitable for all investors.

The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Standard & Poor's 500 Index is an unmanaged index, which cannot be invested into directly. Past performance is no guarantee of future results.

The Federal Open Market Committee action known as Operation Twist began in 1961. The intent was to flatten the yield curve in order to promote capital inflows and strengthen the dollar. The Fed utilized open market operations to shorten the maturity of public debt in the open market. The action has subsequently been reexamined in isolation and found to have been more effective than originally thought. As a result of this reappraisal, similar action has been suggested as an alternative to quantitative easing by central banks.

Gross Domestic Product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.

Quantitative Easing is a government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital in an effort to promote increased lending and liquidity.

This research material has been prepared by LPL Financial.

The LPL Financial family of affiliated companies includes LPL Financial and UVEST Financial Services Group, Inc., each of which is a member of FINRA/SIPC.

To the extent you are receiving investment advice from a separately registered independent investment advisor, please note that LPL Financial is not an affiliate of and makes no representation with respect to such entity.

This research material has been prepared by LPL Financial.

The LPL Financial family of affiliated companies includes LPL Financial and UVEST Financial Services Group, Inc., each of which is a member of FINRA/SIPC.

To the extent you are receiving investment advice from a separately registered independent investment advisor, please note that LPL Financial is not an affiliate of and makes no representation with respect to such entity.