Weekly Economic Commentary

April 30, 2012

New Paradigm in Global Growth

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Highlights

The composition of global economic growth has shifted dramatically over the past 40 years.

Economic growth in emerging markets runs about three times as quickly as growth in the developed world.

Our forecasts for economic growth in the United States, Europe, and China are unchanged from our outlook for 2012, but there have been some shifts in the consensus forecasts.

For the third year in a row, as April turns into May, global financial markets are growing concerned over a slowdown in global economic activity. From a U.S. perspective, we continue to monitor several key metrics (as first outlined in the *Weekly Market Commentary*, "10 Indicators to Watch for Another Spring Slide," dated March 22, 2012) and updated in this week's *Weekly Market Commentary*. But the U.S. economic growth profile tells only part of the story, and in this publication we outline the growth profile of the rest of the world (Europe, Japan, China, and Emerging Markets, etc.) and put the evolving composition of the global economy into perspective. On balance, while our forecasts for economic growth in the United States, Europe, and China have not changed since we first unveiled them back in November 2011, there have been some noticeable shifts in the forecasts for economic growth around the globe in 2012 and 2013 made by the consensus and by the International Monetary Fund (IMF).

Fed Forecast: Moderate but Above-Consensus Growth

Last week (April 23–28), the Federal Reserve's policymaking arm, the Federal Open Market Committee (FOMC), released its latest forecast for the U.S. economy, pegging real Gross Domestic Product (GDP) growth at around 2.6% this year and at 2.9% in 2013. The forecasts for both years were very close to the forecasts made by the FOMC in January 2012 (Figure 1). The forecast for 2012 made last week was about the same as the forecast the FOMC made last fall (November 2011), while the latest 2013 forecast (2.9%) was 0.4% lower than the 3.3% forecast by the FOMC last fall.

1 Bloomberg Consensus Forecasts for Real GDP Growth for the United States and World Economies

	2012		2013	
	U.S.	World	U.S.	World
November 2011	2.2%	3.6%	2.5%	4.0%
April 2012	2.3%	3.4%	2.5%	3.9%

Source: Bloomberg April 2012

As has been the case for the past several years, the FOMC's outlook for the U.S. economy in the next few years is a bit rosier than the consensus of Wall Street economists. Bloomberg News surveyed 75 economists in mid-April 2012, and they forecast 2.3% GDP growth for the U.S. economy in 2012, and 2.5% in 2013. The LPL Financial Research forecast for 2012 remains a below-consensus 2.0%, a forecast we first made in the fall (November) of 2011 in our 2012 Outlook publication. Back in November 2011, the Bloomberg consensus pegged GDP growth at 2.2% in 2012 and 2.5% in 2013, little changed from the most recent consensus forecasts. As an aside, this group puts the odds of recession in the next 12 months at 20%, down from 25% odds back in November 2011.

The LPL Financial Research forecast for 2012 remains a below-consensus 2.0%, a forecast we first made in the fall (November) of 2011 in our *2012 Outlook* publication.

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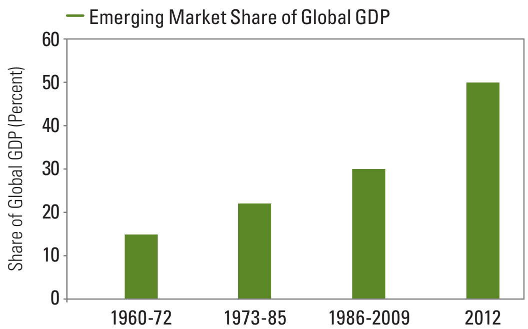
It is important to point out that economic growth in emerging markets continues to run roughly three times as fast as growth in the developed world.

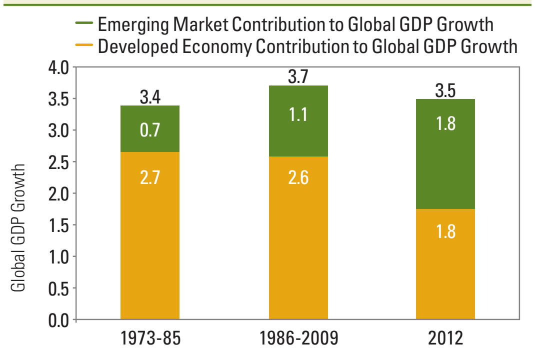
3 Emerging Market Economies Are Now the Same Size as Developed Market Economies



Source: IMF April 2012

Our forecast for Europe in 2012 has not changed. In our *2012 Outlook*, we forecast a mild recession for Europe in 2012, and that mild recession is unfolding.

4 The Global Economic Outlook Today Is Similar to the Growth in the Past 40 to 50 Years, but the Composition of Growth Has Shifted Dramatically



Source: IMF April 2012

2 IMF Forecasts for Real GDP Growth in Advanced/Developed Economies vs. Emerging Markets

	2012			2013		
	Global	Advanced/ Developed Economies	Emerging Markets	Global	Advanced/ Developed Economies	Emerging Markets
October 2011	4.0%	1.9%	6.1%	4.0%	1.9%	5.9%
April 2012	3.5%	1.4%	5.7%	4.1%	2.0%	6.0%

Source: IMF April 2012

Consensus Views on Global Growth Mixed

We can also turn to the Bloomberg consensus forecast to take a broader view of the global economic forecast, and how that view has shifted since last fall. The latest round of forecasts from the IMF can also shed some light on the progression of forecasts for 2012 and 2013.

The latest Bloomberg consensus puts global GDP growth in 2012 at 3.4% and growth in 2013 at 3.9%. Both forecasts have been revised down only slightly over the past six months, as the consensus forecast 3.6% growth in 2012 and 4.0% growth in 2013 back In November 2011. The IMF released its economic forecast for 2012 and 2013 in mid-April 2012. It now forecasts global GDP growth at 3.5% in 2012, and 4.1% in 2013. The IMF forecast for 2012 is 0.5% lower than the forecast made in October 2011, while the 2013 forecast is little changed over the past six months.

A closer look at the IMF forecasts reveals that the forecasts for economic growth this year and next in both developed economies (United States, Europe, the United Kingdom, Japan, Canada, Australia, etc.) and in emerging markets (Brazil, India, China, etc.) continue to get revised lower, albeit modestly so. It is important to point out, however, that economic growth in emerging markets continues to run roughly three times as quickly as growth in the developed world, and that the downward revisions to growth in developed markets are more pronounced than the downward revisions to growth in the emerging markets.

Divergence Persists in Regional Growth Forecasts

Digging a bit deeper into these IMF forecasts for 2012 and 2013, we find that the IMF continues to expect a mild recession in Europe in 2012 (-0.3% GDP growth), as modest growth in Germany and France is more than offset by moderate to severe recessions in Italy and Spain. The 2012 outlook for Europe has deteriorated markedly since last fall, mainly as a result of the slowdown in China and the fiscal austerity being imposed in many European nations. We also note that the IMF's outlook for Japan for 2012 and 2013 has held steady since last fall. Our forecast for Europe in 2012 has not changed. In our *2012 Outlook*, we forecast a mild recession for Europe in 2012, and that mild recession is unfolding. Data released this week (April 30–May 4) are likely to reveal that GDP in several Eurozone economies contracted in the first quarter of 2012. The GDP data for the entire Eurozone is due out in mid-May.

New Paradigm in Global Growth

Global GDP growth is expected to run at around 3.5% this year and 4.1% in 2013, which is a faster growth rate (3.2%) than the global economy experienced between 1970 and the onset of the Great Recession in 2009. The difference today versus the 60s, 70s, and 80s is the composition of that growth. In the 60s and 70s, developed economies accounted for 85% of global GDP. By the onset of the Great Recession in 2008-2009, emerging market's share of global GDP doubled, and made up 30% of global GDP. Today, as many developed nations struggle with the hangover from the Great Recession, emerging market nations, having addressed their deficit crises in the 90s and early 2000s, have gained share. Emerging markets now account for half of global GDP, and that share is likely to grow in the years ahead. Please see our *2012 Outlook* for an in-depth discussion of why the S&P decouples from GDP in 2012.

LPL Financial Research Weekly Calendar

2012	U.S. Data	Fed	Global Notables
30 Apr	Chicago PMI (Apr) Personal Income and Spending (Mar)	Fisher	**China: ISM (Apr)** **Eurozone budgets due** **Eurozone: CPI (Apr)**
1 May	Vehicle Sales (Apr) **ISM-Manufacturing (Apr)** Construction Spending (Mar)	Kocherlakota Lockhart Plosser Williams Evans	Australia: Central Bank Meeting
2 May	ADP Employment Report (Apr) Factory Orders (Mar)	Lacker Evans	China: Service Sector ISM (Apr) Eurozone: PMI (Apr) France: Presidential candidates' debate
3 May	Chain Store Sales (Apr) **Initial Claims (4/28)** ISM- Service Sector (Apr) Challenger Job Cuts (Apr)	Lockhart Williams Plosser	Europe: ECB Meeting **Spain: Debt Auction** **France: Debt Auction**
4 May	**Employment Report (Apr)**	Williams Evans	Eurozone: Retail Sales (Mar)

Hawks: Fed officials who favor the low inflation side of the Fed's dual mandate of low inflation and full employment

Doves: Fed officials who favor the full employment side of the Fed's dual mandate

According to the IMF's forecasts, China is expected to grow at 8.2% this year and 8.8% next year, and so the IMF agrees with our view (and the consensus view, as well) that China can achieve a soft landing in 2012 and 2013. But China has clearly moved into a new phase of its economic growth trajectory after GDP growth surged over the past 10 years. Looking ahead, markets and global policymakers need to adjust to Chinese GDP growth of around 7.5%, rather than the 11–12% growth seen in much of the 2000s. Chinese authorities have begun easing monetary policy again (after tightening in 2010 and 2011) and are easing lending standards in some areas of the economy as well. Risks remain in China, however, including the economic and financial implications of a possible property bubble, as China continues its transition from an export-led, externally-facing economy, to a more consumer-led, internally-driven economy, similar in composition to the economies in the developed world. China has come a long way since it burst back on to the global economic stage in the late 1990s and early 2000s, but still has a long way to go. ■

5 Economic Projections of Federal Reserve Board Members and Federal Reserve Bank Presidents (%), January 2012

	Central Tendency [1]				Range [2]			
Variable	2012	2013	2014	Longer Run	2012	2013	2014	Longer Run
Change in Real GDP	2.2–2.7	2.8–3.2	3.3–4.0	2.3–2.6	2.1–3.0	2.4–3.8	2.8–4.3	2.2–3.0
November Projection	2.5–2.9	3.0–3.5	3.0–3.9	2.4–2.7	2.3–3.5	2.7–4.0	2.7–4.5	2.2–3.0
Unemployment Rate	8.2–8.5	7.4–8.1	6.7–7.6	5.2–6.0	7.8–8.6	7.0–8.2	6.3–7.7	5.0–6.0
November Projection	8.5–8.7	7.8–8.2	6.8–7.7	5.2–6.0	8.1–8.9	7.5–8.4	6.5–8.0	5.0–6.0
PCE Inflation	1.4–1.8	1.4–2.0	1.6–2.0	2.0	1.3–2.5	1.4–2.3	1.5–2.1	2.0
November Projection	1.4–2.0	1.5–2.0	1.5–2.0	1.7–2.0	1.4–2.8	1.4–2.5	1.5–2.4	1.5–2.0
Core PCE Inflation [3]	1.5–1.8	1.5–2.0	1.6–2.0	N/A	1.3–2.0	1.4–2.0	1.4–2.0	N/A
November Projection	1.5–2.0	1.4–1.9	1.5–2.0	N/A	1.3–2.1	1.4–2.1	1.4–2.2	N/A

Source: Federal Reserve's Federal Open Market Committee 01/25/12

Projections of change in real gross domestic product (GDP) and projections for both measures of inflation are from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation and core PCE inflation are the percentage rates of change in, respectively, the price index for personal consumption expenditures (PCE) and the price index for PCE excluding food and energy. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge under appropriate monetary policy and in the absence of further shocks to the economy. The November projections were made in conjunction with the meeting of the Federal Open Market Committee on November 1–2, 2011.

1. The central tendency excludes the three highest and three lowest projections for each variable in each year.
2. The range for a variable in a given year includes all participants' projections, from lowest to highest, for that variable in that year.
3. Longer-run projections for core PCE inflation are not collected.

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.

The unemployment rate is the percentage of the total labor force that is unemployed but actively seeking employment and willing to work.

Personal Consumption Expenditures is a measure of price changes in consumer goods and services. Personal consumption expenditures consist of the actual and imputed expenditures of households; the measure includes data pertaining to durables, non-durables and services. It is essentially a measure of goods and services targeted toward individuals and consumed by individuals.

LPL Financial Research 2012 Forecasts

- GDP 2%*
- Federal Funds Rate 0%^
- Private Payrolls +200K/mo.†

Please see our *2012 Outlook* for more details on LPL Financial Research forecasts.

The Federal Open Market Committee (FOMC)

The Federal Open Market Committee (FOMC) is the policymaking arm of the Federal Reserve. The FOMC consists of 12 members—the seven members of the Board of Governors (which includes the Chairman Ben Bernanke) of the Federal Reserve System; the president of the Federal Reserve Bank of New York; and four of the remaining 11 Reserve Bank presidents, who serve one-year terms on a rotating basis. The rotating seats are filled from the following four groups of Banks, one Bank president from each group: Boston, Philadelphia, and Richmond; Cleveland and Chicago; Atlanta, St. Louis, and Dallas; and Minneapolis, Kansas City, and San Francisco. Nonvoting Reserve Bank presidents attend the meetings of the Committee, participate in the discussions, and contribute to the Committee's assessment of the economy and policy options. The FOMC holds eight regularly scheduled meetings per year. At these meetings, the Committee reviews economic and financial conditions, determines the appropriate stance of monetary policy, and assesses the risks to its long-run goals of price stability and sustainable economic growth.

* 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.

^ Federal Funds Rate is the interest rate at which depository institutions actively trade balances held at the Federal Reserve, called federal funds, with each other, usually overnight, on an uncollateralized basis.

† Private Sector – the total nonfarm payroll accounts for approximately 80% of the workers who produce the entire gross domestic product of the United States. The nonfarm payroll statistic is reported monthly, on the first Friday of the month, and is used to assist government policy makers and economists determine the current state of the economy and predict future levels of economic activity. It doesn't include:
- general government employees
- private household employees
- employees of nonprofit organizations that provide assistance to individuals
- farm employees

The Federal Open Market Committee (FOMC), a committee within the Federal Reserve System, is charged under the United States law with overseeing the nation's open market operations (i.e., the Fed's buying and selling of United States Treasure securities).

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.

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LPL FINANCIAL RESEARCH

Weekly Market Commentary

April 30, 2012

Spring Slide Indicators Update

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Highlights

In each of the past two years the stock market began a slide in the spring that lasted well into the summer months.

This week we update the status of the 10 indicators we identified that foreshadowed the declines in 2010 and 2011.

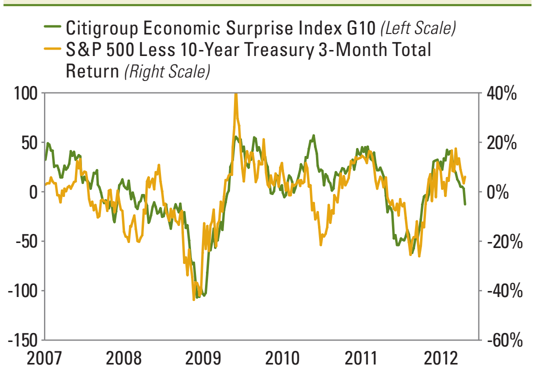
So far, about half of the 10 indicators are waving a red flag, while four are yellow for caution, and only one is green. On balance the indicators point to a significant risk of a repeat of the spring slide this year.

One month ago we provided our list of the 10 indicators to watch that seemed to precede the stock market declines in 2010 and 2011 and may warn of another spring slide. In both 2010 and 2011 an early run-up in the stock market, similar to this year, pushed stocks up about 10% for the year by mid-April. On April 23, 2010 and April 29, 2011, the S&P 500 made peaks that were followed by 16–19% losses that were not recouped for more than five months, a phenomenon often referred to by the old adage "sell in May and go away." Now that the time the prior slides have begun has arrived it is time to revisit the status of the indicators.

So far, about half of the 10 indicators are waving a red flag, while four are yellow for caution, and only one is green. On balance the indicators point to a significant risk of a repeat of the spring slide this year. We will continue to monitor these closely in the coming weeks.

1. **Fed stimulus** – In each of the past two years, Federal Reserve (Fed) stimulus programs known as QE1 & QE2 came to an end in the spring or summer, and stocks began to slide until the next program was announced. The current program known as Operation Twist was announced on September 12, 2011 and is coming to an end. It is scheduled to conclude at the end of June 2012. The Fed's communications in April appeared no closer to announcing QE3, raising the risk of a repeat of the spring slide.
2. **Economic surprises** – The Citigroup Economic Surprise index [Figure 1] measures how economic data fares compared with economists' expectations. The currently falling line suggests expectations have become too high; this typically coincides with a falling stock market relative to the safe haven of 10-year Treasuries.
3. **Consumer confidence** – In 2010 and 2011, early in the year the daily tracking of consumer confidence measured by Rasmussen [Figure 2] rose to highs just before the stock market collapse as the financial crisis erupted. The peak in optimism gave way to a sell-off as buying faded. Investor net purchases of domestic equity mutual funds began to plunge and turned sharply negative in the following months. This measure of confidence is once again beginning to fall from the highs.
4. **Earnings revisions** – Last week was about earnings and the news was good. S&P 500 profits were up 7% (4.7% ex-Apple) from a year ago with 72% of companies beating expectations, relative to 68%

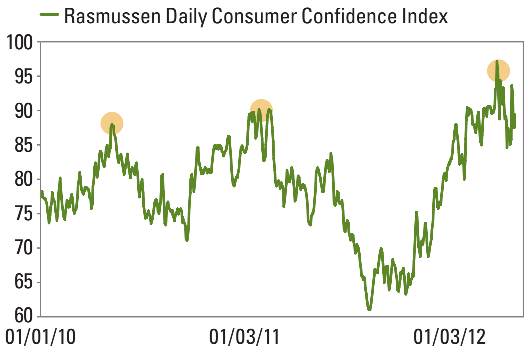
1 Economic Surprises and Market Performance



Source: LPL Financial, Bloomberg data 04/30/12

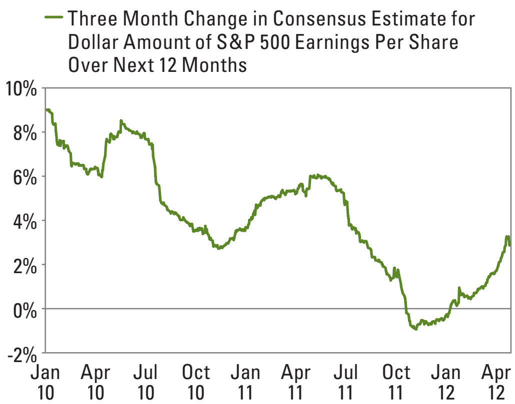
The Citigroup Economic Surprise Index is an unmanaged index, which cannot be invested into directly. Past performance is no guarantee of future results.

2 Consumer Confidence



Source: LPL Financial, Bloomberg data 04/30/12

3 Earnings Revisions



Source: LPL Financial, FactSet Research Systems 04/30/12

in the past four quarters. However, strong first quarter earnings reported in April of 2010 and 2011 were not enough to avoid the spring slide. The first couple of weeks of the first quarter earnings season in April 2010 and April 2011 drove earnings estimates for the next 12 months higher, but as the second half of the earnings season got underway in May 2010 and May 2011, guidance disappointed analysts and investors as the pace of upward revisions began to decline. This year the earning revisions have followed a similar pattern, so far. It is too early to say whether this indicator is flashing a warning sign. We will be watching to see if estimates begin to taper off now that earnings expectations have risen on the initial reports.

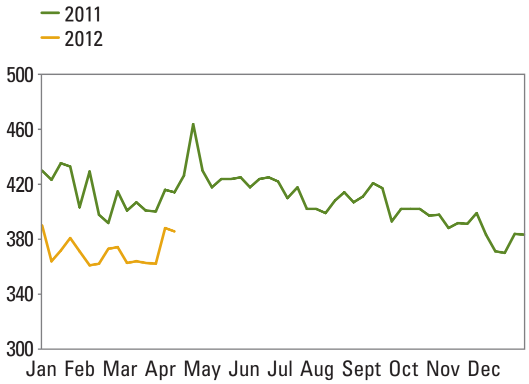
5. **Yield curve** – In general, the greater the difference between the yield on the 2-year and the 10-year U.S. Treasury notes, the more growth the market is pricing into the economy. This yield spread, sometimes called the yield curve because of how steep or flat it looks when the yield for each maturity is plotted on a chart, peaked in February of 2010 and 2011 at 2.9%. Then the curve started to flatten, suggesting a gradually increasing concern about the economy, as the yield on the 10-year moved down to around 2%. This year the market is pricing a more modest outlook for growth, but we will be watching to see if the recent flattening in the yield curve continues with the yield on the 10-year having moved back to 2% during April 2012.

6. **Oil prices** – In 2010 and 2011, oil prices rose about $15–20 from around the start of February, two months before the stock market began to decline. This year oil prices have climbed back to the levels around $105 that they reached in April of last year. However, they have risen only about $10 since around the start of February 2012 and seem to have stabilized. A further surge in oil prices would make this indicator more worrisome.

7. **The LPL Financial Current Conditions Index (CCI)** – In 2010 and 2011, our index of 10 real-time economic and market conditions peaked around the 240-250 level in April and began to fall by over 50 points. This year, the CCI recently reached 249 and has started to weaken and currently stands at 224.

8. **The VIX** – In each of the past two years the VIX, an options-based measure of the forecast for volatility in the stock market, fell to a low around 15 in April before ultimately spiking up over 40 over the summer. Last week, the VIX declined once again to 16. This suggests investors have again become complacent and risk being surprised by a negative event or data.

4 Initial Claims for Unemployment Benefits Tracking Last Year's Pattern



Source: LPL Financial, Bloomberg data 04/23/12

9. **Initial jobless claims –** It was evident that initial filings for unemployment benefits had halted their improvement by early April 2010, and beginning in early April 2011, they deteriorated sharply. In 2012, April has again led to deterioration in initial jobless claims as they have jumped by about 30,000 to nearly 390,000 [Figure 4]. A continued climb this week would echo last year's spike.

10. **Inflation expectations –** The University of Michigan consumer survey reflected a rise in inflation expectations in March and April of the past two years. In fact, in 2011, the one-year inflation outlook rose to 4.6% in both March and April. This year, inflation expectations also jumped higher in March, but receded a bit from the March jump that echoed what we saw in 2010 and 2011.

Finally, one issue not addressed specifically in the indicators, but important in the markets, is the rising European stresses—evident in the spring of 2010 and 2011. European policymakers including those at the European Central Bank, who meet later this week (May 3, 2012), have been facing a lot of pressure to act and do something about the renewed fears evident in the yields on Spanish and Italian debt and European stocks. European leaders have once again refocused away from unpopular austerity to talk of stimulating growth, at the expense of rising bond yields. If leaders continue to do little to address the market's concerns it could again accelerate the bond market sell-off and begin to affect stocks here in the U.S. similar to the spring slides in 2010 and 2011.

This week most of the attention will be directed towards the Institute for Supply Management (ISM) and employment reports for April 2012. But as we pointed out a month ago, these measures did not deteriorate ahead of the market decline, but along with it. It is not that they are not important; it is just that they did not serve as useful warnings of the slide to come, while the above 10 indicators did.

The return of daily volatility in April 2012 and the fact that April 2012 ended up as a flat month for stocks after six months of strong gains may suggest we are near a turning point. Given this year's double-digit gains and the possibility of another spring slide for the stock market, investors may want to watch these indicators closely for signs of a pullback. ■

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.

Stock investing may involve risk including loss of principal.

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 ISM index is based on surveys of more than 300 manufacturing firms by the Institute of Supply Management. The ISM Manufacturing Index monitors employment, production inventories, new orders, and supplier deliveries. A composite diffusion index is created that monitors conditions in national manufacturing based on the data from these surveys.

The VIX is a measure of the volatility implied in the prices of options contracts for the S&P 500. It is a market-based estimate of future volatility. When sentiment reaches one extreme or the other, the market typically reverses course. While this is not necessarily predictive it does measure the current degree of fear present in the stock market.

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