Weekly Market Commentary

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What To Expect When You're Expecting

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Highlights

The market is behaving like it is nervously expecting a big event. The stock market has been jumpy with frequent reversals in direction.

August is the peak month for new babies to arrive. It has also been the month when the markets have definitively moved one way or the other in recent years.

August may again mark a turning point for the stock market; however, investors are awaiting a number of key events including those surrounding: the election, Europe, earnings, and the economy.

What To Expect When You're Expecting is the title of a best-selling book for expectant parents. It is also a comedy about pregnancy that is one of the top-20 grossing films this year. But more importantly for investors, it is a theme for the stock market's recent behavior.

The market is behaving like it is nervously expecting a big event. The stock market has been jumpy with frequent reversals in direction. In the first quarter of 2012, only rarely did the S&P 500 move 1% in either direction (just seven of the 61 trading days). But since mid-May 2012 when the S&P 500 was at a similar level to Friday's (July 6, 2012) close, about half the time (14 of 27 trading days) the stock market has moved by 1% in either direction. Over that same time period, we have seen about the same number of up and down days for the market—often as reversal in direction of the prior day's move.

August is the peak month for new babies to arrive. It has also been the month when the markets have definitively moved one way or the other in recent years. It was August 30, 2010, when the market definitively turned around after a bout of summer weakness that had resulted in a 16% peak-to-trough decline. It was during the first few days of August 2011, when the S&P 500 plunged 13%, accounting for most of the 19% peak-to-trough decline experienced last year.

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Election

The sense of nervous expectation surrounding the election is likely to linger if history is a guide. Of the last nine presidential contests, the winner has consistently led in the polls during the summer months in only two, 1984 and 1996. In the other seven elections, the loser of the election was ahead sometime in the summer—by an average of 6 points—and four of them were ahead in late October. Market volatility may continue as the markets grapple with the changing expectations of who the president will be in 2013.

1 Poll Leader Switched Hands Ahead of Election Seven Out of Nine Times

Election Year	Winner	Loser	Loser's Widest Lead		Loser's Last Lead
			Margin	Month	
1976	Carter	Ford	1	October	October 30
1980	Reagan	Carter	8	May	October 26
1984	Reagan	Mondale	N/A	N/A	N/A
1988	H.W. Bush	Dukakis	17	July	August 7
1992	Clinton	H.W. Bush	10	May	July 8
1996	Clinton	Dole	N/A	N/A	N/A
2000	W. Bush	Gore	11	October	October 23
2004	W. Bush	Kerry	6	June	October 31
2008	Obama	McCain	6	May	September 15

Source: Gallup, LPL Financial 06/20/12

Europe

The waiting game in Europe seems endless. A series of bank bailouts and lifelines to southern European countries this year have slowed, but not reversed, the rising pressure on these economies. In Italy, the 10-year government bond yield has returned to around 6%, and in Spain it is about 7%. This is far higher than the 1.6% in the U.S. and U.K., and 1.3% in Germany and is unsustainable.

Additional actions must be taken, but it appears that decision makers are not close to a groundbreaking solution. Investors may be waiting a long time for the birth of a new definitive agreement in Europe.

Economy

The economy continues to disappoint as growth slows and misses economists' estimates.

- June was the third month in a row U.S. job creation fell between 0 and 100,000. Investors are increasingly expecting a move back up closer to 200,000 (our forecast) or a return to job losses. (Please see this week's *Weekly Economic Commentary* for more details)
- Another key indicator, the Institute for Supply Management Purchasing Managers Index came in at 49.7, at the dividing line of 50 between expansion and contraction in the manufacturing sector of the U.S. economy. Investors are awaiting a return to growth in the coming months or a drop below 50 not seen since the recession of 2008 and 2009.

Investors will have to wait until the first week of August for the next release of these two key economic statistics.

Earnings

Earnings are the most important driver of the stock market. The degree to which the slowdown in Europe and caution on hiring are reflected in earnings will likely impact the market. Investors are anxiously awaiting the earnings season.

Second quarter earnings are expected by the consensus of Wall Street analysts to grow about 6% from a year ago. However, this growth rate is being boosted by the Bank of America mortgage lawsuit settlement of a year ago. When excluding this company, second quarter growth for the other 499 companies is estimated to be just 0.7%. In addition, the ratio of negative-to-positive pre-announcement earnings guidance by corporate leaders is 3.3 for the S&P 500 Index, the weakest ratio since the fourth quarter of 2008.

This week, only six S&P 500 companies are expected to report earnings. Investors will have to wait until the start of August to have a clearer sense of how second quarter earnings are faring.

What to expect while the market is expecting these events is continued volatility. Ultimately, we believe the market will deliver a bundle of joy to investors and finish the year with an 8–12%* gain. ■

*LPL Financial Research provided this range based on our earning per share growth estimate for 2012, and a modest expansion in the price-to-earnings ratio. Additional explanation can be found in our *2012 Outlook.*

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.

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