Weekly Economic Commentary

November 5, 2012

Still Slow Growth

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Highlights

The labor market remains in "status quo" mode, with continued modest job growth.

Regardless of who wins the presidential election, we do not expect a sharp acceleration in job growth.

Please see the LPL Financial Research Weekly Calendar on page 3

The much anticipated October 2012 employment report was released by the U.S. Bureau of Labor Statistics on Friday, November 2, 2012, to great fanfare from both the financial and mainstream media which, appropriately, are hyper-focused on the implications of the report for this Tuesday's elections. As a reminder, the monthly jobs report is two surveys in one. The household survey generates the unemployment rate (the number of unemployed divided by the labor force), while the establishment survey (which surveys businesses) generates the monthly nonfarm payroll job count. Over short time periods (a month or two), it is not unusual to see the two surveys tell slightly different stories about the labor market. October was no exception.

The economy added 184,000 private sector jobs in October 2012, but the unemployment rate ticked higher to 7.9% from 7.8%. The private sector created a net 184,000 jobs in October, by adding a net 21,000 in the goods producing sector and 163,000 in the service sector. There were solid gains in retail, leisure and hospitality, education, and health care in October. Temporary help supply firms added 14,000 jobs, after shedding 12,000 in the prior month. This segment of jobs tends to lead the overall labor market. The government shed 13,000 jobs in October, evenly split between losses in federal and state and local employment.

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1 Labor Market Performance Before and After Presidential Election

Year	Average Monthly Increase/Decrease in Private Sector Employment in the Six Months Prior to the Election (Thousands)	Average Monthly Increase/ Decrease in Private Sector Employment in the First Six Months After Inauguration (Thousands)	Job Growth Better After Election Than Before	Incumbent or Challenger Wins/ Party of Winner
1980	65*	125	Yes	Challenger/ Republican
1984	278	165	No	Incumbent/ Republican
1988	213	128	No	Incumbent/ Republican
1992	89	179	Yes	Challenger/ Democrat
1996	238	267	Yes	Incumbent/ Democrat
2000	141	-149*	No	Challenger/Republican
2004	124	234	Yes	Incumbent/ Republican
2008	-414	-558*	No	Challenger/Democrat
2012	131	?	?	?

*Indicates that economy was in recession during at least one month of this period.

Source: Haver Analytics 11/05/12

Overall, the labor market remains in "status quo" mode. Despite the better-than-expected news on the labor market in October 2012, the October employment report does little to change the near- or medium-term picture for employment. The economy is still in slow-growth mode, and that means modest job growth at around 150,000 per month. This is not likely to be satisfactory for the Federal Reserve (Fed), which would like to see sustained job growth north of 200,000 per month.

Will the Outcome of the Election Alter the Course of the Labor Market?

With the election at hand, many investors are asking whether or not the election will significantly alter the near-term outlook for the labor market. Figure 1 details the performance of the labor market (measured by the average monthly increase/decrease in private sector employment) in the six months leading up to and including the election (June to November) compared to the average monthly increase/decrease in private sector employment in the six months after the president's inauguration the following year (February through July).

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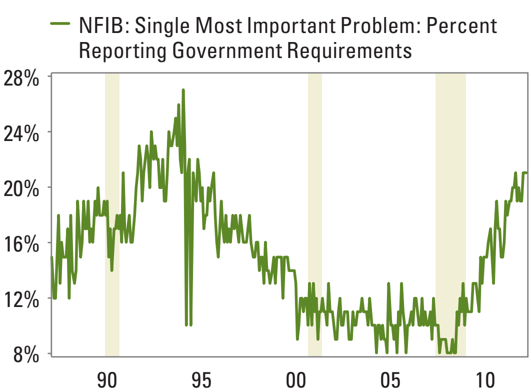
In the eight presidential elections from 1980 through 2008, job creation after the election improved relative to the pace of job creation prior to the election on four occasions: 1980, 1992, 1996, and 2004. For example, in 2004, the economy created an average of 124,000 net new private sector jobs between June and November of 2004. In the first six months after the newly re-elected President Bush took office in January 2005, job creation accelerated to 234,000 per month. Note that in 1980, the first month (June 1980) of the six months prior to the election the economy was in recession, which likely lowered the pre-election average job gain. Of course, the economy entered a new recession in July 1981, impacting the final month of the post-inauguration job count in President Reagan's first term.

On the other hand, in four of the eight elections since 1980, the labor market in the six months after the inauguration underperformed the labor market in the six months prior to the election: 1984, 1988, 2000, and 2008. For example, in the six months prior to President Reagan's re-election in 1984, the private sector economy created an average of 278,000 per month. But in the six months after President Reagan was sworn in for a second term in January 1985, the economy added an average of just 165,000 jobs per month.

We note that two of the four instances where the post-inauguration labor market underperformed the pre-election job market occurred when the economy was in recession: the six months ending July 2001 and July 2009. Overall, there are five pre- and post-election periods in the past 30 years not impacted by recession. In three of those five periods — 1992, 1996, and 2004 — the labor market was more robust after the election than it was before. In two periods — 1984 and 1988 — job growth after the election lagged job growth in the six months prior to the election. The winner's status (challenger or incumbent) or political affiliation (Democrat or Republican) had little impact on whether or not job growth improved after the election.

2 Small Businesses Continue to Cite "Government Requirements" as a Key Problem



Source: National Federation of Independent Business, Haver Analytics 11/05/12

(Shaded ares indicate recession)

LPL Financial Research Weekly Calendar

2012	U.S. Data	Fed	Global Notables
5 Nov	Service Sector ISM (Oct)	Williams* (Dove)	Australia: Central Bank Meeting
6 Nov	**Election Day** JOLTS (Sep)		**Eurozone: Service Sector PMI (Oct)** UK: Industrial Production (Sep)
7 Nov			**ECB's Draghi speaks in Frankfurt** **Germany's Merkel addresses European Parliament** Eurozone: Retail Sales (Sep) Germany: Bond Auction
8 Nov	Trade Balance (Sep) **Initial Claims (11/3)**	Bullard (Hawk)	**China: Leadership transition begins** European Central Bank Meeting **China: CPI (Oct)** China: PPI (Oct) Bank of England Meeting South Korea: Central Bank Meeting **Spain: Bond Auction**
9 Nov	Consumer Sentiment (1H Nov) Wholesale Inventories (Sep)		China: Industrial Production (Oct) China: Fixed Asset Investment (Oct) China: Retail Sales (Oct) **China: Imports and Exports (Oct) – data due out on Saturday 11/10** China: New Loan Growth (Oct) – data due out on Saturday 11/10 **China: Money Supply (Oct) – data due out on Saturday 11/10**

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

* Voting members of the Federal Open Market Committee (FOMC)

While the analysis presented above of the pre-election and post-inauguration labor market is useful, in reality many other factors (aside from the uncertainty generated by the election and the certainty provided after the result is known) impact firms' hiring decisions. While the president has the ability to set the tone for the nation's economy and highlight the legislative agenda he or she thinks will create the most favorable backdrop for job creation, many other factors impact firms' hiring decisions. Those factors include, but are not limited to:

- Actions by the Federal Reserve;
- Legislation passed (or not passed by Congress) on taxes, spending, etc.;
- Geopolitical events;
- Natural disasters;
- Global economic growth; and
- Corporate profitability and cash levels.

Where the president can have a direct impact on the backdrop for the labor market is in the regulatory environment. Relaxing /eliminating or tightening/ adding regulatory burdens for industries across the economy have a direct impact on firms' ability and willingness to expand their businesses and ultimately add workers. Recent measures of policy uncertainty and concern over regulatory burdens remain elevated, among both small businesses and large global corporations. However, while the regulatory and policy uncertainty may lift as the election concludes, history warns us not to expect a sharp acceleration in job growth regardless of who wins the election, and that the factors noted in the bullets above are likely to have a greater influence on the overall health of the labor market. ■

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.

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.

* 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 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 involves risk including loss of principal.

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

Purchasing Managers Index (PMI) is an indicator of the economic health of the manufacturing sector. The PMI index is based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment.

The Institute for Supply Management (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.

Job Openings and Labor Turnover Survey (JOLTS) is a survey done by the United States Bureau of Labor Statistics to help measure job vacancies. It collects data from employers including retailers, manufacturers and different offices each month. Respondents to the survey answer quantitative and qualitative questions about their businesses' employment, job openings, recruitment, hires and separations. The JOLTS data is published monthly and by region and industry.

The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.

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Weekly Market Commentary

November 5, 2012

How Wall Street Is Voting

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Highlights

The stock market has priced in a close election. As the race has tightened over the past month, the market has slipped lower while Republican-favored industries have outperformed Democrat-favored industries.

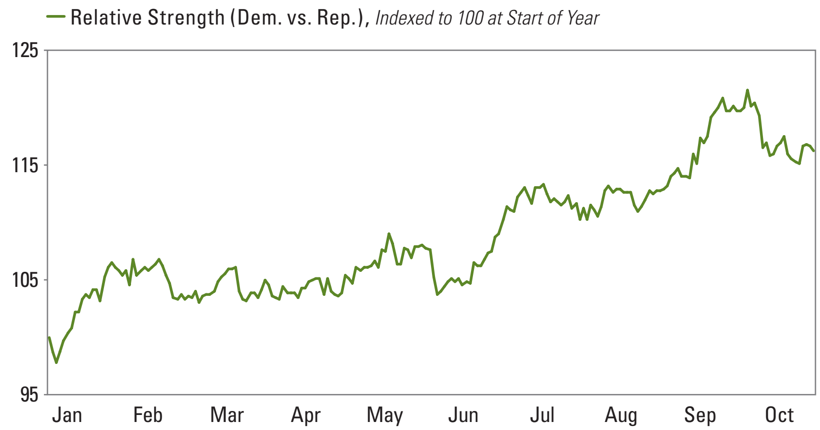
While much attention has been focused on the White House, the dwindling prospects for Republicans in the Senate may have limited the outperformance by Republican-favored industries in recent weeks and helped contribute to the modest pullback in the overall market.

The outcome of the elections will define the political context and leadership for policies that address the looming fiscal imbalances coming to a head in early 2013. Last week, we explored the post-election environment and what it could mean for the markets and economy. This week, we will take a look at what the market is pricing in regarding the election outcome. In short, the stock market has priced in a close election compared with where it was a month ago ahead of the debates. As the race has tightened over the past month, the market has slipped lower while Republican-favored industries have outperformed Democrat-favored industries.

While there are many "man on the street" polls, what matters most to investors is what is priced in on Wall Street rather than what people are saying on Main Street. Rather than merely looking at the direction of the overall market, our *"Wall Street" Election Poll* analyzes the market by the industries most likely to be impacted one way or another by the election outcome and can provide insight into what the market is pricing in regarding the election.

Based upon these legislation-sensitive industries, we created two indexes early this year to help us track the market's implied forecast of the election outcome reflected in the performance of these industries. Each index was composed of an equal weighting among eight industries that combine to include over 100 large U.S. company stocks. To track what the market has priced in for the Democrats' odds of retaining the White House and Senate,

1 Relative Strength of Democrat vs. Republican Industries



Source: FactSet Research Systems, LPL Financial 11/01/12

Components are equally weighted.

2 Industries Likely to React More Favorably to One Party

Democrats	Republicans
S&P 500 Health Care Facilities	S&P 500 Coal & Consumable Fuels
S&P 500 Food & Staples Retailing	S&P 500 Diversified Financial Services
S&P 500 Gas Utilities	S&P 500 Oil & Gas Exploration & Production
S&P 500 Health Care Services	S&P 500 Oil & Gas Drilling
S&P 500 Life Sciences Tools & Services	S&P 500 Managed Care
S&P 500 Construction Materials	S&P 500 Electric Utilities
S&P 500 Homebuilding	S&P 500 Specialty Retail
S&P 500 Construction & Farm Machinery	S&P 500 Telecommunications Services

Source: LPL Financial 11/01/12

we divided the Democrats index by the Republicans index. While other factors may influence the relative performance of these indexes on a daily or even weekly basis, over time, the election consequences have become paramount as investors increasingly vote with their money.

As you can see in Figure 1, an upward sloping line for much of the year (particularly after the Supreme Court upheld the Affordable Care Act in June) suggested the market was pricing in a rising likelihood of the Democrats retaining the White House and their majority in the Senate. The downward sloping line, since the time of the first debate on October 3, suggests improving prospects for the Republicans as the election nears. As the results from the election become known this week, the market may continue or reverse the industry moves tracked in our *"Wall Street" Election Poll*, depending on the outcome.

Most polls reflect a tight race for the White House as Governor Romney's odds have improved relative to those of President Obama since the first debate. However, we can see that the likelihood that the Senate may stay in the hands of the Democrats has risen with Republicans appearing less likely to pick up the four seats necessary for control. An easier way to see this, rather than looking at many individual state polls, is to observe the

Republican-Favored Industries

S&P 500 Coal & Consumable Fuels/Electric Utilities – Mentioned several times by Governor Romney in the debates, a GOP win could benefit coal producers with more favorable Environmental Protection Agency (EPA) regulations. We could see lower regulatory costs for users of coal such as utilities.

S&P 500 Managed Care – Health care is the biggest driver of the long-term budget problems at the Federal level, and states are already cutting Medicaid to balance their budgets. A sweeping win for the GOP may benefit managed care providers as regulatory risks ease and investors increase the odds for a repeal of all or part of the Affordable Care Act (ACA) and lift the HMO tax.

S&P 500 Diversified Financial Services – We may see a relief rally among the banks in the legislation-sensitive Diversified Financial Services industry. If the GOP takes the Senate it will result in the change of chairmanships of key committees. While major changes to the financial reform law, Dodd-Frank, are unlikely, an all-GOP Congress might influence regulations implementing the law.

S&P 500 Exploration & Production/Drilling – Companies in the energy sector may be impacted by a strong election for the GOP through increased permits and more favorable regulations.

S&P 500 Specialty Retail – The specialty retailers could benefit from less risk of tax hikes on higher end consumers.

S&P 500 Telecommunications Services – The potential extension of Bush tax cuts would mean the dividend tax rate may remain closer to 15% instead of going to 43.4%, a plus for companies with lots of cash to distribute. High dividend-paying sectors such as telecommunications services may benefit.

Democrat-Favored Industries

S&P 500 Health Care Services/Facilities/Life Sciences Tools & Services – Diagnostic labs, generic drug makers, hospitals, and nursing homes may benefit if the ACA is upheld and from Democrats' leadership, given expanded health care coverage and an emphasis on preventative care and legislation to speed up the introduction of generic drugs to market.

S&P 500 Homebuilding/Construction Materials – Democrats may also provide more housing support programs benefitting homebuilders and construction materials providers.

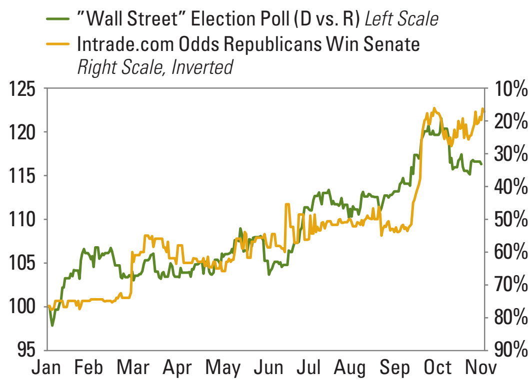
S&P 500 Food and Staples Retailing – Some food and staples retailers may benefit from the potential for a further extension of unemployment benefits.

S&P 500 Gas Utilities – Users of natural gas may see a relative benefit from stricter coal regulations under the Democrats.

S&P 500 Construction & Farm Machinery – Infrastructure spending may fare better under the Democrats, given the relative emphasis on raising tax revenue compared with Republicans' focus on spending cuts.

The dwindling prospects for Republicans in the Senate may have limited the outperformance by Republican-favored industries in recent weeks and helped contribute to the modest pullback in the overall market.

3 Democrats' Senate Odds Appear to Remain Strong



Source: LPL Financial, Intrade.com, FactSet Research Systems 11/05/12

pricing of the futures contracts for Democrats retaining the Senate on the online betting website Intrade.com. As you can see in Figure 3, the odds the Democrats fare well in the Senate races have fully recovered after the debates that marked a turning point for President Obama.

As we have noted in the past, the outcome of the Senate is of key importance in this election. The Republicans are very likely to retain control the House, and increasingly, it appears the Democrats may retain control of the Senate. Markets may fear another two years of a divided Congress. A Congress that can act promptly, get bills to a vote on the floor, work on them in conference between the chambers, and bring them swiftly to the president's desk would be a dramatic and welcome change to the last two years of gridlocked government. After all, Congress writes the laws. A Congress that is able to work together is critical after what happened with last year's debt ceiling debacle and debt downgrade of the United States by Standard & Poor's. This matters a lot to investors because the 2013 budget is going to have the biggest impact of any budget in decades. The fiscal headwind composed of tax increases and spending cuts already in the law is likely to result in a recession and bear market for stocks if no action is taken. Congress has important decisions to make, and the stakes are very high. The dwindling prospects for Republicans in the Senate may have limited the outperformance by Republican-favored industries in recent weeks and helped contribute to the modest pullback in the overall market.

The hard-fought election will likely be followed by more fighting in Congress, resulting in higher volatility and a potential pullback for the stock market. A mildly defensive posture may benefit investors heading into the final months of the year, as markets may provide attractive buying opportunities. ■

Consumer Discretionary Sector: Companies that tend to be the most sensitive to economic cycles. Its manufacturing segment includes automotive, household durable goods, textiles and apparel, and leisure equipment. The service segment includes hotels, restaurants and other leisure facilities, media production and services, consumer retailing and services and education services.

Consumer Staples Sector: Companies whose businesses are less sensitive to economic cycles. It includes manufacturers and distributors of food, beverages and tobacco, and producers of non-durable household goods and personal products. It also includes food and drug retailing companies.

Energy Sector: Companies whose businesses are dominated by either of the following activities: The construction or provision of oil rigs, drilling equipment and other energy-related service and equipment, including seismic data collection. The exploration, production, marketing, refining and/or transportation of oil and gas products, coal and consumable fuels.

Financials Sector: Companies involved in activities such as banking, consumer finance, investment banking and brokerage, asset management, insurance and investment, and real estate, including REITs.

Health Care Sector: Companies are in two main industry groups—Health Care equipment and supplies or companies that provide health care-related services, including distributors of health care products, providers of basic health care services, and owners and operators of health care facilities and organizations. Companies primarily involved in the research, development, production, and marketing of pharmaceuticals and biotechnology products.

Industrials Sector: Companies whose businesses manufacture and distribute capital goods, including aerospace and defense, construction, engineering and building products, electrical equipment and industrial machinery. Provide commercial services and supplies, including printing, employment, environmental and office services. Provide transportation services, including airlines, couriers, marine, road and rail, and transportation infrastructure.

Manufacturing Sector: Companies engaged in chemical, mechanical, or physical transformation of materials, substances, or components into consumer or industrial goods.

Materials Sector: Companies that are engaged in a wide range of commodity-related manufacturing. Included in this sector are companies that manufacture chemicals, construction materials, glass, paper, forest products and related packaging products, metals, minerals and mining companies, including producers of steel.

Technology Software & Services Sector: Companies include those that primarily develop software in various fields such as the Internet, applications, systems and/or database management and companies that provide information technology consulting and services; technology hardware & Equipment, including manufacturers and distributors of communications equipment, computers and peripherals, electronic equipment and related instruments, and semiconductor equipment and products.

Telecommunications Services Sector: Companies that provide communications services primarily through a fixed line, cellular, wireless, high bandwidth and/or fiber-optic cable network.

Utilities Sector: Companies considered electric, gas or water utilities, or companies that operate as independent producers and/or distributors of power.

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