Weekly Market Commentary

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Message From the Markets

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Highlights

Does the performance of stocks, bonds, and commodities in the first quarter forecast that booming economic growth lies just ahead? Or might these market gains risk making April fools of those expecting a sharp economic acceleration?

Examining the relationships between markets and the economy, it appears that the message from the markets is that modest economic growth is likely to continue rather than accelerate.

Stocks posted a strong first quarter. While shy of last year's 12% first quarter gain, the S&P 500 Index's 10% gain seen this year reflects very strong performance. Consistent with the powerful gains for stocks, bond yields and oil prices also rose in the quarter.

We devote careful study to the economic data to help us assess the outlook for the markets. What about the other way around? Given the average-at-best economic readings during the first quarter, the performance of the stock, bond, and commodity markets begs the question: what are the markets saying about where the economy is headed?

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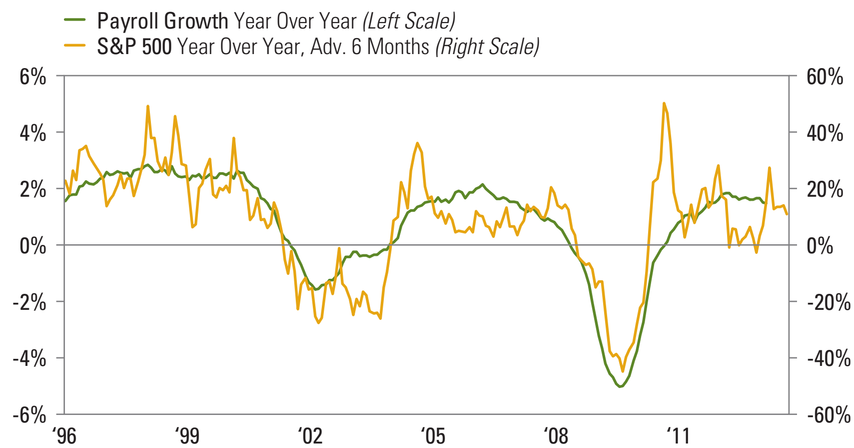
Message From Stocks

Historically, the stock market has been a very good leading indicator of future job growth with a lead of about six months, as you can see in Figure 1. Since most of last year's gain came in the first quarter, after the strong

The 11% gain suggests only about a 1–2% year-over-year growth rate for jobs or a pace of about 180,000 per month.

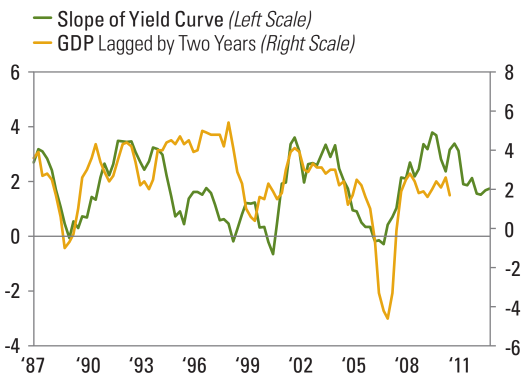
1 Stocks Predicting Slower Job Growth



Source: Bloomberg data, LPL Financial 04/01/13

The S&P 500 is an unmanaged index, which cannot be invested into directly. Past performance is no guarantee of future results.

2 Bonds Predicting Same Sluggish GDP Growth

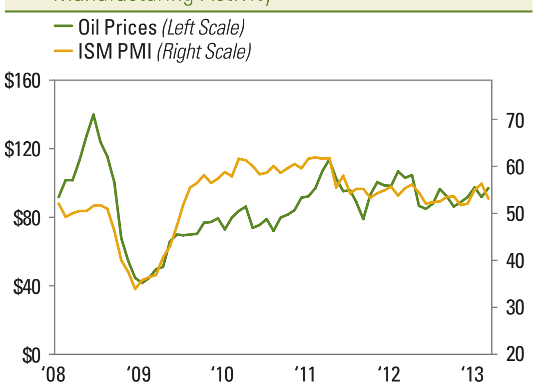


Source: Bloomberg data, LPL Financial 04/01/13

Yield curve is a line that plots the interest rates, at a set point in time, of bonds having equal credit quality, but differing maturity dates. The most frequently reported yield curve compares the three-month, two-year, five-year and 30-year U.S. Treasury debt. This yield curve is used as a benchmark for other debt in the market, such as mortgage rates or bank lending rates. The curve is also used to predict changes in economic output and growth.

This level of oil prices is consistent with the current modest pace of manufacturing activity.

3 Oil Prices Suggest Same Level of Manufacturing Activity



Source: Bloomberg data, LPL Financial 04/01/13

first quarter of this year, the S&P 500 Index is up about 11% from a year ago. This does not suggest booming job growth in the coming months. In fact, the 11% gain suggests only about a 1–2% year-over-year growth rate for jobs or a pace of about 180,000 per month. This would mark a modest slowdown—rather than a sharp re-acceleration of job growth.

Message From Bonds

Traditionally, in the bond market a rise in long-term yields relative to short-term yields is indicative of a stronger outlook for economic growth. The bigger the difference in these yields, in technical terms known as the slope of the yield curve, the stronger the expected pace of growth for the economy. This relationship can be seen in Figure 2, where the difference in yields helps to predict gross domestic product (GDP) over the coming two years.

While short-term yields did not change in the first quarter, remaining pinned down by the Federal Reserve (Fed) at just under 0.1%, the yield on the longer term 10-year Treasury note rose from an average of 1.69% in the fourth quarter of last year to 1.92% in the first quarter of this year. While on the surface an increase in the slope of the yield curve may suggest a better growth outlook, when viewed in the historical context seen in Figure 2, the modest uptick in yield predicts merely a continuation of the roughly 2% GDP growth seen, on average, over the past couple of years.

Message From Commodities

After spending much of the fourth quarter of 2012 below $90, oil prices surged to near $100 in the first quarter, ending at $97. Since oil prices and economic activity tend to move in the same direction, is this $10 surge in oil prices a sign that demand is rising with increasing economic activity? Unfortunately, the answer is no. We can see in Figure 3 that this level of oil prices is consistent with the current modest pace of manufacturing activity represented by the widely-watched Purchasing Managers' Index from the Institute for Supply Management in the low 50s.

Despite the strong performance in the first quarter, it appears that the message from the markets on the economy is that modest growth is likely to continue rather than accelerate. Just like last year, the strong first quarter led to more of the same in the economy, averaging 2% GDP growth and modest job gains. ■

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.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in price.

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

Commodity-linked investments may be more volatile and less liquid than the underlying instruments or measures, and their value may be affected by the performance of the overall commodities baskets as well as weather, disease, and regulatory developments.

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.

Yield is the income return on an investment. This refers to the interest or dividends received from a security and is usually expressed annually as a percentage based on the investment's cost, its current market value or its face value.

Yield curve is a line that plots the interest rates, at a set point in time, of bonds having equal credit quality, but differing maturity dates. The most frequently reported yield curve compares the three-month, two-year, five-year and 30-year U.S. Treasury debt. This yield curve is used as a benchmark for other debt in the market, such as mortgage rates or bank lending rates. The curve is also used to predict changes in economic output and growth.

INDEX DESCRIPTIONS

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 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.

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.

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