Weekly Market Commentary

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What's It Worth?

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Highlights

Only three things have really mattered to the markets: the Federal Reserve's stimulus, the outlook for earnings, and the labor market.

The movements in these three have been aligned on a week-to-week basis with stock market value about 90% of the time during this bull market.

As we move through the second half of the year, it is worth reflecting on what a change in each of these drivers is worth to the U.S. stock market.

What has mattered most to the market in recent years? What has explained the ups and downs and how the market got back to all-time highs? There are a lot of drivers that could be argued as critical components of the markets' rise, such as the European fiscal issues, the housing rebound, and U.S. fiscal policy developments. But, setting emotion and headlines aside and measuring statistically, there are three things that have really mattered to the markets: the Federal Reserve's (Fed) stimulus, the outlook for earnings, and the labor market. The movements in these three have been aligned on a week-to-week basis with stock market value about 90% of the time during this bull market.

Specifically, there has been a 90% correlation on a weekly basis since the bull market began on March 6, 2009 between the value of the U.S. stock market, measured by the market capitalization of all U.S. stocks according to Bloomberg data, and each of the following: the size of the assets on the Fed's balance sheet, initial filings for unemployment benefits, and the Wall Street analysts' consensus estimate for next 12 months' earnings per share for the S&P 500. These have explained the short-term and long-term movements very well. As we move through the second half of the year, it is worth reflecting on what a change in each of these drivers is worth to the U.S. stock market [Figure 1].

1 What's It Worth?

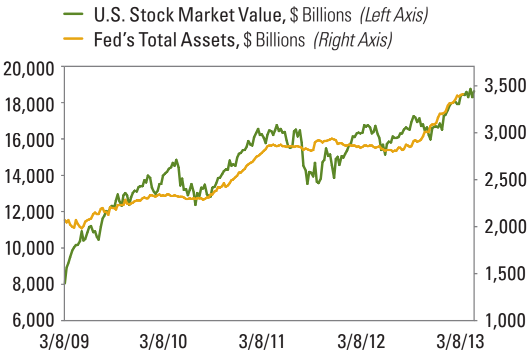
Driver	Change in U.S. Stock Market Value
+$1 Fed balance sheet assets	+$7.93
+$1 expected S&P 500 EPS	+$220B
-1 initial claim for unemployment benefits	+$33,253

Source: LPL Financial, Federal Reserve, Factset Data Systems, Bloomberg data 06/17/13

EPS: Earning Per Share

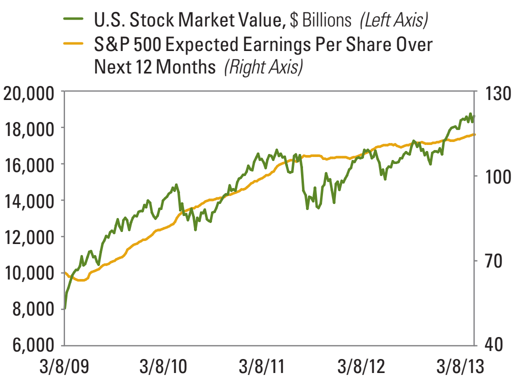
The return of volatility in recent weeks can be linked to market participants changing expectations about the duration of the Fed's bond-buying program, often referred to as QE (quantitative easing). While we are likely to be at least three months away from any change in the Fed's QE program, the markets have tended to react three months in advance of changes, mainly due to communications from the Fed. The stock market has responded very closely to changes in the size of the Fed's balance

2 The Fed's Bond Buying Has Been a Major Driver of Stock Market Value



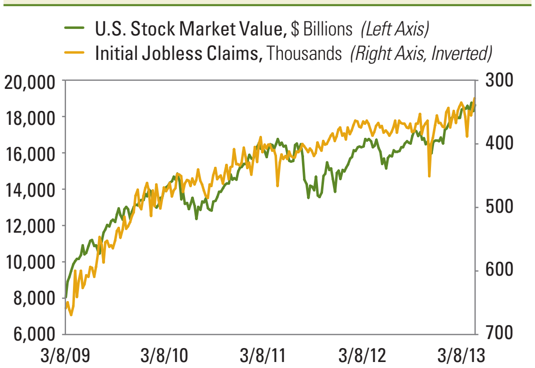
Source: LPL Financial, Federal Reserve, Bloomberg data 06/17/13

3 Earnings Remain a Key Fundamental Driver of Stock Market Value



Source: LPL Financial, FactSet Data Systems, Bloomberg data 06/17/13

4 The Improving Labor Market Has Closely Mirrored Stock Market Value



Source: LPL Financial, Bloomberg data 06/17/13

sheet (shifted three months forward to account for the signals about future direction and the lagged impact on the economy as the bond purchases work their way through the financial system). Since the beginning of the bull market on March 6, 2009, each dollar of assets added to the Fed's balance sheet has driven U.S. stock market value up by $7.93, on average.

Earnings are the most fundamental driver of stock prices, and that has proven to be true again during the current bull market. As companies' profits grow, so does the value of their shares. Not surprisingly, expectations for future profit growth have a closer relationship to the performance of stocks than actual growth. Wall Street analysts' estimates for the next twelve months' total earnings per share for S&P 500 companies have risen from $65 at the start of the bull market on March 6, 2009 to about $115 presently. During this bull market, each dollar of expected earnings growth has coincided with a rise in U.S. stock market value of $220,064,362,000.

While often a lagging indicator of the health of the economy, the labor market has proven to be critical to the health of the stock market during this bull market. The focus of the Fed's monetary policy, fiscal policy deliberations in Congress, and consumer and investor confidence have all been tied closely to conditions in the labor market. The weekly data on initial filings for unemployment benefits are an excellent real-time gauge of these conditions. During this bull market, one less initial claim for unemployment benefits has been worth $33,253 to U.S. stock market value, on average.

These three important market factors should remain so at least through year-end and all may continue to show growth. But it is important to note that this does not mean they all must move higher together for stocks to post gains. For example, if the Fed were to suddenly stop QE rather than merely slow it, this one negative for the markets might likely be offset by an improvement in the other two, as job growth and the profit outlook would likely be improving rapidly enough to warrant such a halt of stimulus from the Fed. Likewise, a major deterioration in the jobs or earnings outlook might warrant the Fed stepping up the pace of QE as an offset to help maintain market momentum. ■

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 involves risk including loss of principal.

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

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability. Earnings per share is generally considered to be the single most important variable in determining a share's price. It is also a major component used to calculate the price-to-earnings valuation ratio.

The company names mentioned herein was for educational purposes only and was not a recommendation to buy or sell that company nor an endorsement for their product or service.

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.

Correlation is a statistical measure of how two securities move in relation to each other. Correlations are used in advanced portfolio management.

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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