Weekly Market Commentary

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Lies, Damn Lies, and Charts

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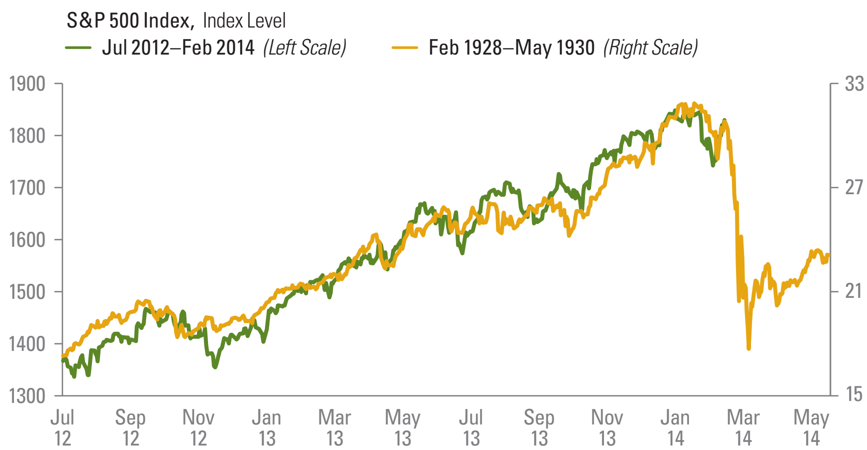
Highlights

One of the reasons that charts forecasting an imminent stock market "crash" are able to make their way around the internet almost every year is that charts can lie.

A comparison of the S&P 500 Index in 1929 just ahead of the stock market crash to the performance of stocks from 2012 through today has been making the rounds on the internet [Figure 1]. The implication by the bears is that stocks are poised for an epic crash.

1 1929 Crash to Repeat in 2014?



Source: LPL Financial Research, Bloomberg data 02/13/14

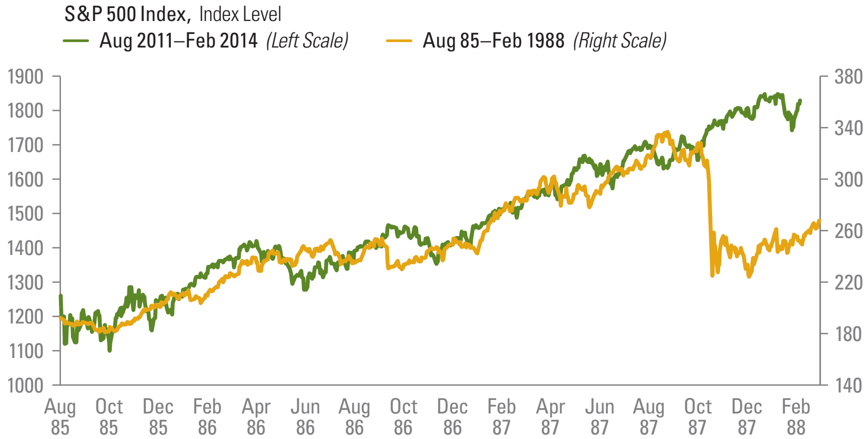
The S&P 500 is an unmanaged index and cannot be invested into directly. The returns do not reflect fees, sales charges, or expenses. The results don't reflect any particular investment.

Past performance is no guarantee of future results.

This chart is a lot like the chart that went around in the fall of last year comparing 2013 to the stock market leading up to the 1987 crash. You can see in Figure 2 that it did not pan out the way the bears expected and stocks continued to rally. Unfazed by this, they have looked for another pattern predicting an impending crash.

One of the reasons that these "crash" charts are able to make their way around the internet almost every year that stocks go up is that charts can lie. It is unfortunate, but true. The easiest way to make a chart lie is to have two different scales for the data being compared. Not all charts that do

2 October 1987 Crash Was Supposed to Repeat in October 2013; It Didn't



Source: LPL Financial Research, Bloomberg data 02/13/14

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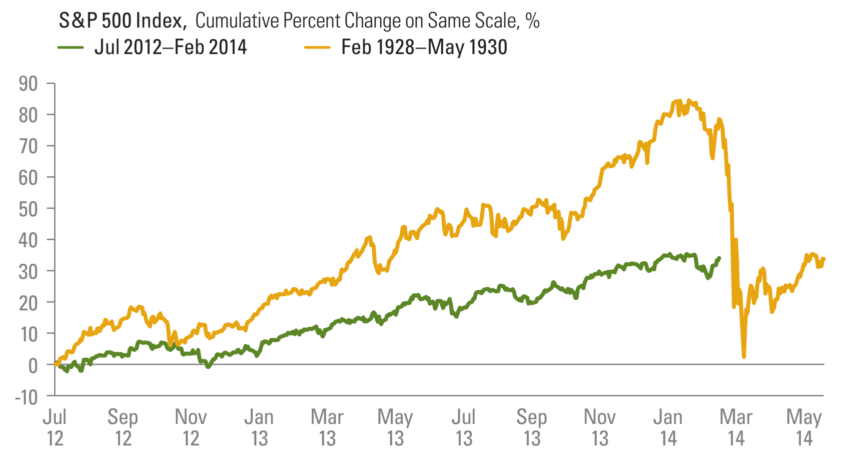
this are lying, but be very careful taking them at face value. Another look at that 1929 chart with both 1929 and 2014 on the same percentage scale illustrates this. Figure 3 shows that the comparison becomes a lot less convincing and a lot less fearsome. Thankfully, these charts debunking the crash charts often make it around the internet as well.

3 Scale Matters: 1929 and 2014 Do Not Actually Look All That Similar



Source: LPL Financial Research, Bloomberg data 02/13/14

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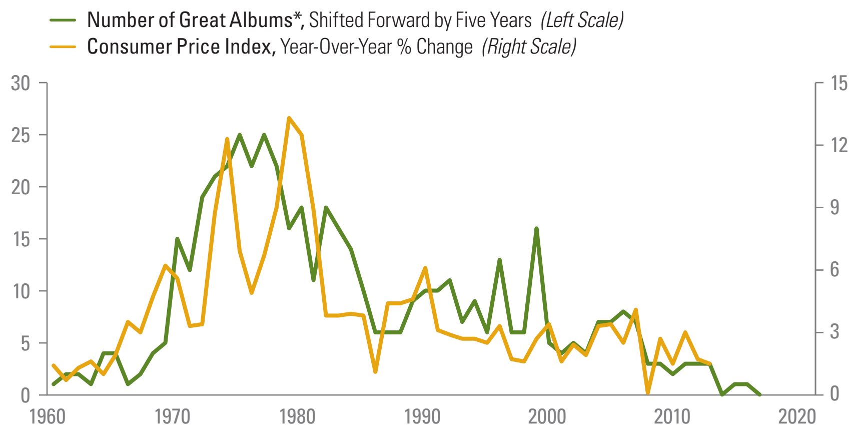
We remain vigilant for signs that stock prices no longer reflect fundamentals or that sentiment has become overheated.

We wish we could assure you that all charts told the truth and data could never mislead. But then we would be lying. If that were true, then all the Federal Reserve and new Chair Janet Yellen would have to focus on is whether the music industry cranks out some better albums in the coming years. Since, as you can clearly see in Figure 4, U.S. inflation simply follows the quality of music with a lag of about five years.

4 No More Inflation Until the Music Improves



Source: LPL Financial Research, *Rolling Stone*, Bloomberg data 02/13/14

**Rolling Stone Magazine* greatest 500 albums by year of release

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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.

We continue to see 10–15% gains for the S&P 500 in 2014, as earnings grow solidly and valuations edge higher on improving sentiment.

The truth is, currently little would suggest the potential for a stock market crash. Nevertheless, we remain vigilant for signs that stock prices no longer reflect fundamentals or that sentiment has become overheated. We think it is still early to expect an overheated market with the potential to plunge, given many signs only point to the beginning of the upturn in sentiment that usually then surges for a while before the potential for major downside exists. For example, individual investors are only beginning to come back to the U.S. stock market in the past few months after years of net selling, according to flow data from the Investment Company Institute; initial public offerings (IPOs) are only now starting to tick up again; and merger and acquisition deals are finally beginning to show signs of life with a solid January. We continue to see 10–15% gains for the S&P 500 in 2014^, as earnings grow solidly and valuations edge higher on improving sentiment.

^Please see our *Outlook 2014: The Investor's Almanac* for more information.

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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.

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