



Weekly Market Commentary



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Suit Yourself

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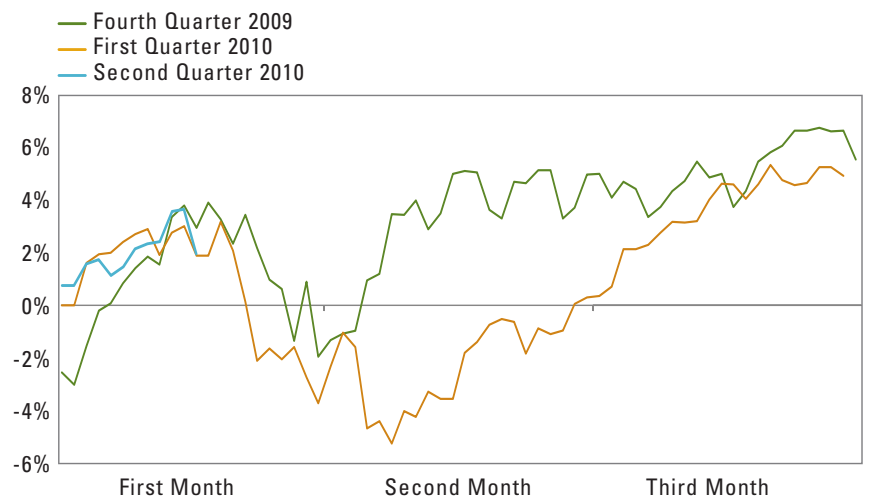
Highlights

- The stock market, as measured by the S&P 500, fell 1.6% on Friday as news that the SEC filed a lawsuit against Goldman Sachs roiled financial markets, sending stocks and commodities asset classes lower.
- The news appeared to be prompting action from those suited to look for a reason to take some profits after an extended rally.
- The lawsuit may have ignited selling fueled by a number of potential negatives, including: financial reform legislation, earnings season, peaking leading indicators, the Fed's upcoming meeting, China's actions to slow growth, and worsening European credit problems.

The stock market, measured by the S&P 500, fell 1.6% on Friday as news that the Securities & Exchange Commission (SEC) filed fraud charges against Goldman Sachs. This news roiled financial markets, sending both stocks and commodities asset classes lower. Friday's snapback was the most significant daily decline since February 4, 2010 when the stock market fell 3.1% as part of a 8.1% peak-to-trough decline from January 19 to February 8. The drop was a jolt to market participants who had been lulled by the recent steady climb and lack of volatility. In fact, Friday's drop was only the third daily decline in the past three weeks.

Quarterly Performance Pattern May Repeat

S&P 500 Performance During Current and Prior Two Quarters



Source: LPL Financial, Bloomberg 4/16/10

The SEC's lawsuit, rather than merely affecting the targeted company, acted as a catalyst for a broad market pullback. Every sector of the stock market fell along with other asset classes like commodities. The news appeared to be prompting action from those suited to look for a reason to take some profits after an extended rally. The fraud charges may have ignited selling fueled by a number of potential negatives:

- Financial reform bill likely to grab attention. The issue currently before Congress that has the most market impact is the financial regulatory reform legislation. The fraud charges likely drive this legislation toward clamping down on the business of Wall Street. The SEC said Goldman



Sachs failed to disclose information about a synthetic collateralized debt obligation, or CDO, based on subprime mortgage-backed securities. The legislation would likely affect the regulation of the products that are the subject of the lawsuit. With the banks still at the center of the healing from the financial crisis, legislation that impacts their profitability or raises the uncertainty surround their prospects will likely move the markets.

- Market participants may sell the earnings news. “Buy the rumor, sell the news” is an adage often used to describe stock market behavior. This adage describes the market performance around the past several earnings seasons, when companies reported their financial results for the quarter. The last three 5-10% stock market pullbacks took place leading into or during each of the last three earnings reporting seasons. The sell offs began as the bulk of the quarterly earnings season got underway on the 19th of the month following quarter end. The last two 5-10% pullbacks were from October 19-October 30 and on January 19-February 8. With April 19 falling at the start of this week, it is possible investors may have started selling a day early compared to prior quarters.
- Peaking leading indicators. Leading economic and market indicators may be close to peaking which may result in weaker market returns going forward. Last Thursday’s Institute of Supply Management (ISM) reading for the month of March at 59.6 may be at or near a peak. Historically, over the six months following the peak in the ISM, stocks were up only 1%, on average, after posting strong gains leading up to the peak. Now that we are passing the reports with the easiest year-over-year comparisons the coming economic data will begin to show slowing momentum. This Monday’s release of the index of Leading Indicators for March is likely to mark the peak in momentum. With leading indicators at or near a peak stock market price momentum may begin to fade and a focus on yield may be more appropriate.
- Fed may signal coming rate hikes. One of the major headwinds that we have cited for this year is the shift from the environment where “the Fed is our friend,” while they maintain low rates, to the inevitable shift to “don’t fight the Fed,” as they begin to hike interest rates later this year. The next step on the path to normalization may be to shift the language in their statements during the second quarter. The next Fed statement will be issued on April 28.
- China may take additional steps to slow growth. The Chinese economy grew 11.9 percent from a year earlier, the biggest gain since the second quarter of 2007 according to official data released last week. Policy makers in China are reining in credit growth after banks lent a large portion of this year’s \$1.1 trillion annual lending target in the first quarter. The accompanying money supply growth of about 25% has given rise to inflation pressures with CPI rising near 3% in recent months. Within hours of releasing the data, the government announced policy measures to cool the real estate market. We expect more announcements intended to slow economic growth, stoking fears that the sudden withdrawal of stimulus to one of the world’s biggest growth engines may be premature and tip the global economy back into recession.
- Financial stress may continue to spread in Europe. Credit is worsening for



the countries in peripheral Europe. Most of these countries are likely to agree to tough budget cuts. This fiscal austerity is likely to prolong the pain of recession in Europe. Although growth may have been slightly positive in the first quarter, the combined Gross Domestic Product (GDP) in the 16 countries that use the Euro was flat in the fourth quarter, as the recovery in Europe may already have run out of steam. The Greece financial rescue by the Eurozone may still have to clear some hurdles and investors may turn to signs of stress in Portugal next. The credit situation may be potentially made worse by the eruption of a volcano in Iceland, stalling travel, tourism, and economic activity in the near-term but potentially having a medium-term negative impact on European agricultural output.

Given these factors, a 5-10% pullback in the second quarter would not be unusual as the stock market tracks a pattern similar to the first (and fourth) quarter. We have recently become modestly defensive on the near-term environment and recommended a 10% underweight to the stock market with a shift of assets to bonds. Specifically, we favor reducing small, mid-cap and emerging market stocks and adding to corporate bonds and higher yielding large-cap stocks. However, we expect a 5-10% pullback to be followed by a rally, as was the case in the first quarter. We expect conditions to remain positive in the second quarter which may lead to above-average economic growth, improving credit trends, low interest rates, and the return of job growth. We continue to believe the market will be on an upward—but volatile—path in the first half of 2010 before peaking and giving up some of the gains in the second half of the year.



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.

Stock investing involves risk including loss of principal.

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

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 fast swings of commodities will result in significant volatility in an investor's holdings.

Securities and Exchange Commission (SEC): A government commission created by Congress to regulate the securities markets and protect investors. In addition to regulation and protection, it also monitors the corporate takeovers in the U.S. The SEC is composed of five commissioners appointed by the U.S. President and approved by the Senate. The statutes administered by the SEC are designed to promote full public disclosure and to protect the investing public against fraudulent and manipulative practices in the securities markets. Generally, most issues of securities offered in interstate commerce, through the mail or on the internet must be registered with the SEC.

Synthetic Collateralized Debt Obligation (CDO): A form of collateralized debt obligation (CDO) that invests in credit default swaps (CDSs) or other non-cash assets to gain exposure to a portfolio of fixed income assets. Synthetic CDOs are typically divided into credit tranches based on the level of credit risk assumed. Initial investments into the CDO are made by the lower tranches, while the senior tranches may not have to make an initial investment.

All tranches will receive periodic payments based on the cash flows from the credit default swaps. If a credit event occurs in the fixed income portfolio, the synthetic CDO and its investors become responsible for the losses, starting from the lowest rated tranches and working its way up.

ISM Manufacturing Index: An index 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.

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