



Weekly Market Commentary



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Blowing Bubbles

Jeffrey Kleintop, CFA

Chief Market Strategist
LPL Financial

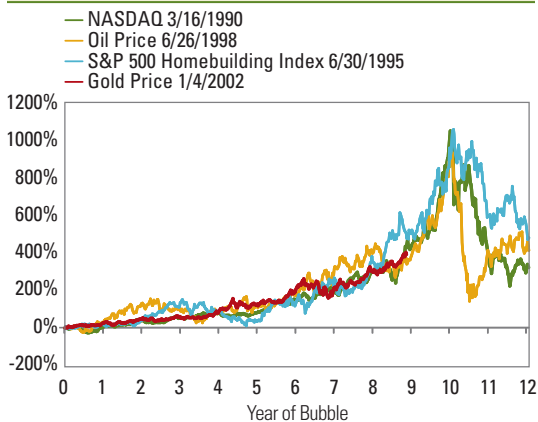
Highlights

The return of volatility to gold and emerging market stock prices has raised a question among some market participants: is the relentless climb pushing gold and emerging market stock prices into bubble territory? We do not think so. If they are bubbles they still have a long way to inflate before they burst, based on history.

While not in historical bubble territory, gold prices and emerging markets do have risks.

If gold and emerging market stocks continue to track the bubble pattern they have reached the stage of the pattern where volatility picks up and sudden, sharp moves become more common as the bubbles inflate and risks build.

1 Gold Not Yet in Historical Bubble Territory NASDAQ, Oil Price, and S&P 500 Homebuilding Index Bubbles and Gold Price



Source: LPL Financial, Bloomberg data 11/12/10

All indices are unmanaged and cannot be invested into directly. Past performance is not indicative of future results.

This week the attention of most market participants will be on what action Congress takes in their sole week of session for the month of November. The most important item facing Congress is the looming expiration of the Bush tax cuts. Some progress is likely this week with both parties facing a backlash if no action is taken and all tax rates revert to higher levels. We believe this week will set the stage for Congress to pass a one or two-year extension of all the Bush tax cuts, but, as we noted last week, it is a close call.

The uncertainty over the fate of the tax cuts, along with faster-than-expected inflation in China, stoking fears of a rate hike, and the ongoing debt problems in the eurozone, contributed to volatility last week. Stocks, as measured by the S&P 500, gave back 2.1% after gaining 3.6% in the prior week. Last week also saw two markets that have been immune to these considerations, demonstrate higher volatility:

- Gold prices fell 1.8% after gaining 2.5% the week before (according to Bloomberg data).
- Emerging market stocks, measured by the MSCI Emerging Markets index, were down 3.0% after being up 4.6% in the prior week.

The return of volatility to gold and emerging market stock prices has raised a question among some market participants: is the relentless climb pushing gold and emerging market stock prices into bubble territory? We do not think so. If they are bubbles, historically they still have a long way to inflate before they burst.

Gold Prices

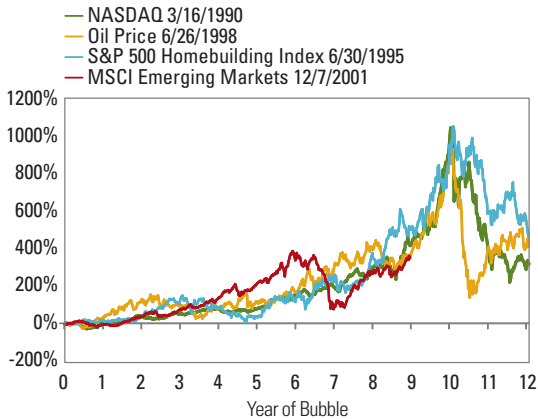
As you can see in [Chart 1](#), gold prices have tracked the classic bubble pattern but have yet to enter the parabolic stage where the bursting of the bubble and the ensuing sharp losses begin to become a risk. The investment bubbles of the past experienced far more inflation than what gold prices have experienced so far. The technology bubble of the 1990s (measured by the NASDAQ), the oil bubble of the late 1990s/early 2000s (measured by oil futures prices), and the housing bubble (measured by the S&P 500 Homebuilding Index) took 10 years and posted gains of about 1000% before they burst and quickly surrendered most of those gains.

What could push gold prices into historical bubble territory? While rising central bank demand, higher mining costs, and demand for gold as both a luxury and a savings vehicle from a rising middle class in China and India all help to support gold, the potential driver of a bubble would likely be driven by



2 Emerging Market Stocks Not Yet in Historical Bubble Territory

NASDAQ, Oil Price, and S&P 500 Homebuilding Index Bubbles and MSCI Emerging Market Index



Source: LPL Financial, Bloomberg data 11/12/2010

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currency. Part of the rise in the price of gold is due to the decline in the value of the dollar. As the dollar goes down, the price of gold in dollars goes up. While gold has surged to an all time high over the past five months in dollar terms, gold denominated in euros remains below the levels reached five months ago. The move to record highs in the price of gold is more because we measure it in terms of a weakening US dollar. A sharp drop in the dollar would boost gold prices in dollar terms and may also result in upward pressure on interest rates and slow economic, growth boosting demand for gold as a perceived safe haven. While we expect the Federal Reserve's (Fed) program of stimulus will continue to weaken the dollar well into 2011, we do not expect a sudden devaluation that would propel gold sharply higher.

Emerging Markets

Emerging markets suffered during the financial crisis of 2008-2009 when they experienced similar losses to developed markets. However, emerging market stocks have rebounded to prior peaks stoking fears of overvalued markets due for another sharp downturn. As you can see in [Chart 2](#), emerging market stocks have not yet entered the parabolic stage where the bursting of the bubble historically becomes a risk.

What could push emerging market stocks into historical bubble territory? A flood of money has been pouring out of slow-growing developed economies into rapidly growing emerging market economies. As a result, the currencies of emerging market nations have been rising, elevating the risk of their exports, and becoming less competitive in world markets. As emerging market countries succumb to increasing pressure to reduce the strength of their currencies asset bubbles may inflate due to the excessive stimulus from domestic actions in addition to inflows from abroad.

Volatility

While not in historical bubble territory, gold prices and emerging markets do have risks. For example, a contraction in growth in the emerging markets would weigh on both asset classes. And, importantly, if gold and emerging market stocks continue to track the bubble pattern, they have reached the stage of the pattern where volatility picks up and sudden, sharp moves become more common as the bubbles inflate and risks build.



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.

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

Stock investing may involve risk including loss of principal.

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 MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets. As of May 2005 the MSCI Emerging Markets Index consisted of the following 26 emerging market country indices: Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Jordan, Korea, Malaysia, Mexico, Morocco, Pakistan, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, Turkey and Venezuela.

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

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The Standard and Poor's 500 Homebuilding Index is a capitalization-weighted index. The index was developed with a base level of 10 for the 1941-43 base period, the parent index is SPX.

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