



Weekly Market Commentary



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Extended Period For the Rally?

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Highlights

- Next week's shift in focus to the Federal Reserve (Fed) threatens to break the eight week winning streak for the stock market.
- The last time we saw eight weeks of stock market gains was January 2004. That rally ended as the Fed changed the statement language to remove the "considerable period" phrase.
- The statement the Fed issues on April 28 will be parsed closely by market participants for any change in language that may signal rate hikes later this year.
- Fed Chairman Ben Bernanke has omitted the "extended period" phrase from his prepared remarks in recent weeks. It was replaced with language similar to the last time the Fed altered their statement in response to a recovering economy back in January 2004.
- If the Fed does change the statement the stock market's upward momentum may stall and result in a 5-10% pullback.

Stocks have now posted eight straight weeks of gains, measured by the broad Russell 3000 stock index. The good news on earnings and the economy helped sustain market momentum for another week. Last week, about 80% of S&P 500 companies' earnings per share exceeded consensus analyst estimates. On the economic front, business spending and home sales were strong. However, this week's shift in focus to the Federal Reserve (Fed) threatens to break the winning streak for the stock market.

The statement the Fed issues on April 28 will be parsed closely by market participants for any change in language that may signal rate hikes later this year. The focus will be primarily on the extended period phrase that refers to how long the Fed intends to keep rates extraordinarily low. Fed Chairman Ben Bernanke has omitted the "extended period" phrase from his prepared testimony and speeches in recent weeks. It was replaced with conditional language similar to the last time the Fed altered their statement in response to a recovering economy back in January 2004.

Excerpts from FOMC Statements

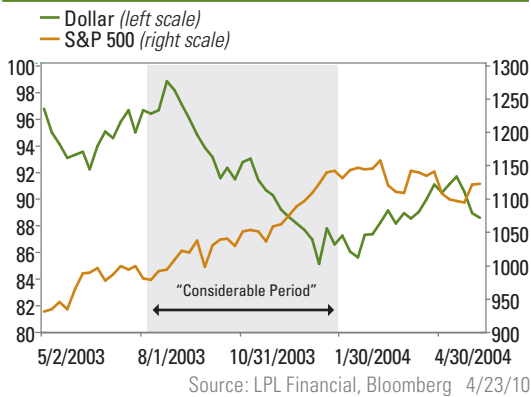
December 9, 2003	January 28, 2004
"However, with inflation quite low and resource use slack, the Committee believes that policy accommodation can be maintained for a considerable period. "	"With inflation quite low and resource use slack, the Committee believes that it can be patient in removing its policy accommodation."
March 16, 2010	April 28, 2010
"The Committee...continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the federal funds rate for an extended period. "	We expect the Fed to cite improving economic conditions and will be watching to see if they drop the extended period phrase in favor of signaling the pending, gradual series of rate hikes we expect will begin late this year.

When the Fed refers to inflation in the statement, they are primarily referring to "core" inflation, meaning general price changes excluding food and energy prices. It is worth noting that core inflation over the past 12 months, while low at 1.1%, is at the same level it was when the Fed changed the language in the statement and removed the "considerable period" phrase in early 2004.

While the Fed used the phrase "considerable period" in the statement from August 2003 to January 2004, stocks moved steadily higher—just as they have since March 2009 when the "extended period" phrase was incorporated into the statement. However, once the Fed removed that phrase at the end of January 2004, the S&P 500 stock market rally stalled



1 Performance of the U.S. Dollar and S&P 500 Around the Time the Fed Used the Phrase "Considerable Period"



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

2 Year-Over-Year Percent Change in S&P 500 and Non-Farm Payrolls



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and began a series of 5-10% pullbacks as volatility reemerged. Back in 2004, the stock market began to price in the transition from a recovery driven by policy in Washington to sustainable growth driven by private sector businesses and consumers. These economic transitions have often been uneven and lead to a more volatile pattern of stock market performance.

One of the reasons the Fed has kept monetary policy so accommodative—with the federal funds rate near zero—is the weak job market. However, last month's gain of 162,000 U.S. non-farm jobs finally marked the first month of material job creation since the recovery began. The stock market disagrees with the Fed's tepid outlook for job growth. The stock market had a very good track record of predicting what job growth will be in six months. Stocks have priced in a powerful rebound in job growth by the fourth quarter.

While stocks point to gains of 4-5% for U.S. payrolls, even if job growth rebounds to just 3% year-over-year over the next six months, job gains by November would be up to 390,000 per month! If the market is right, then the Fed seems sure to begin to hike rates by year end. If the market is wrong, stock market investors may be in for some disappointment. While strong gains of about 400,000 jobs per month seems a bit stronger than may actually be achieved by year end, we believe the economy will be better than the Fed's current official forecast which is for little to no improvement in the unemployment rate, implying only very modest job growth. Which may prompt them to continue to revise their growth expectations higher and push their conditional criteria in the direction of rate hikes?

Whether there will be an extended period for the rally in the stock market depends upon the Fed. We believe there is a strong chance the Fed will change the statement language, although a hold on the change until the next meeting is probably equally likely. If the Fed does change the statement language to remove or modify the "extended period" phrase, it may stall the stock market's current upward momentum. Stocks may suffer a 5-10% pullback after eight weeks of consecutive gains not seen since... yes, you probably guessed it...when it ended in January 2004 as the Fed changed the statement language.



IMPORTANT DISCLOSURES

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Stock investing involves 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 Russell 3000 Index measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market. As of the latest reconstitution, the average market capitalization was approximately \$4 billion; the median market capitalization was approximately \$700 million. The index had a total market capitalization range of approximately \$309 billion to \$128 million.

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