



Weekly Market Commentary



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Stock Market's Flat 2011 May Suggest Booming 2012

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Highlights

During the last trading day of 2011, volatility drove the S&P 500 down in the final seconds to leave the Index unchanged from where it started the year and the total return at a mere 2%.

There have been four years since WWII when the total return for the S&P 500 was roughly flat. All three of these years that preceded 2011 were followed by strong gains in the following year, averaging 38%.

While the historical pattern suggests that a strong 2012 may follow a flat 2011, our outlook remains for an average gain of about 8–12% in 2011.

The last trading day of 2011 seemed to be a fitting way to end the year. The S&P 500 Index remained in positive territory for the year until the last seconds of the day when a batch of sell trades produced the quick drop that left it to close at 1,257.60. This left the S&P 500 to end 2011 unchanged from the 1,257.64 closing level of 2010.

The volatility on the final day of 2011 was characteristic of a year in which the daily volatility of the S&P 500 was nearly double the average since WWII. Stocks produced gains early in the year and rose to a three-year high of 1,363.61 at the end of April, up about 9% for the year. Then the Index began a rocky decline that culminated at the beginning of October, at 1099.23, down about 12% for the year, before climbing back to where it began the year. While the Index price was unchanged in 2011, the total return for the S&P 500, which includes dividends received, was a mere 2% [Chart 1].

This reflects a stall in what had been a powerful two-year winning streak for the stock market as it rebounded most of the way back from a closing low of 676.53 to the peak of 1565.15 that preceded the financial crisis.

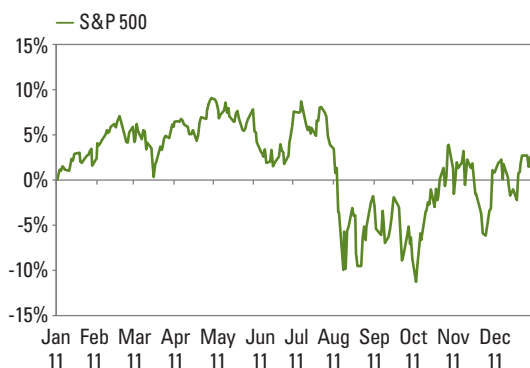
Does the pattern of performance exhibited by stocks in 2011 bode ill for 2012? Not historically, as the last time we saw a year with similar performance was 1994. Similar to 2011, in 1994:

- The S&P 500 was basically unchanged for the year with a total return of 1.32%
- Earnings for S&P 500 companies grew at a double-digit rate
- Defensive sectors, such as Consumer Staples and Health Care outperformed

While things may have looked bleak in 1994, it turned out to be far from the end of the business cycle. In fact, 1994 turned out to be the set up for the strongest five-year run in history for stocks as valuations soared, starting with a 38% total return in 1995. Recall that as of the end of 1994, the price-to-earnings ratio measured on the past four quarters of earnings, had fallen below average [Chart 2] and was setting up for a surge in valuations in the years ahead.

Moreover, valuations, as measured by the forward price-to-earnings ratio on the consensus forecast for the next four quarters of earnings, had dropped to 12.4 as of the end of 1994. This is a similar level to today's 11.7.

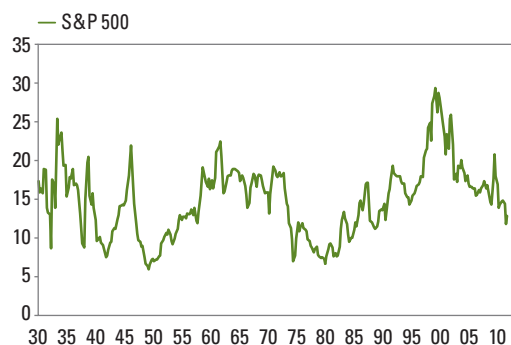
1 S&P 500 Total Return in 2011



Source: LPL Financial, Bloomberg data 12/31/11



2 S&P 500 Price-To-Earnings Ratio

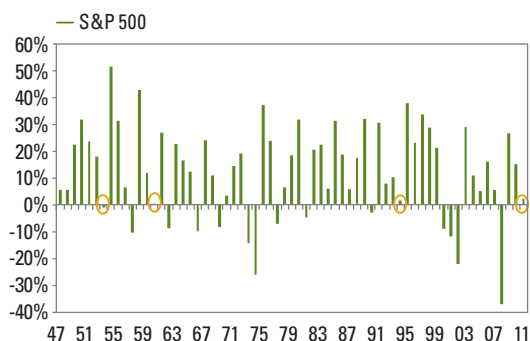


Source: LPL Financial, Bloomberg data, Thomson Financial data 12/31/11

Looking back further, we can see that in total there have been four years since WWII when the total return for the S&P 500 was basically flat: 1953, 1960, 1994, and 2011. All three of these years that preceded 2011 were followed by strong gains in the following year, averaging 38%.

While the historical pattern suggests that a strong 2012 may follow a flat 2011, our outlook remains for an average gain for the S&P 500 of about 8–12% in 2011, as detailed in our *2012 Outlook* publication. We see these gains supported by a slight improvement in valuations and mid-to-high single-digit earnings growth as the pessimistic outlook for profits reflected in the markets rise to converge with a slide in the lofty expectations for earnings projected by Wall Street analysts.

3 S&P 500 Total Return Roughly Flat in Four Years Since WWII



Source: LPL Financial, Bloomberg data 12/31/11

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

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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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