

# Compass Points

Bringing you our latest tactical investing ideas



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## Boosting our Equity Outlook

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### Overview

This bi-weekly update provides an in-depth look at the latest tactical investment thoughts from LPL Financial Research as presented in the Portfolio Compass. This publication is designed to cover a broad investment landscape and present ideas to assist when considering portfolio strategy and to customize investment solutions.

	Fundamentals	Technicals	Valuation	View			Bias
				Negative	Neutral	Positive	
Stocks				○→●		●	
Alternatives						●	←
U.S. Stocks	●	●	●		○→●	●	
Small Growth	●	●	●		○→●	●	
Mid Growth	●	●	●			○→●	
Mid Value	●	●	●		○→●	●	
Small Value	●	●	●	○→●		●	
Commodities–Precious Metals	●	●			●←○		
Commodities–Agricultural	●	●			●←○		
Consumer Discretionary	●	●	●		○→●	●	
Technology	●	●	●			●	→

● Negative ● Neutral ● Positive

As of 09/28/11

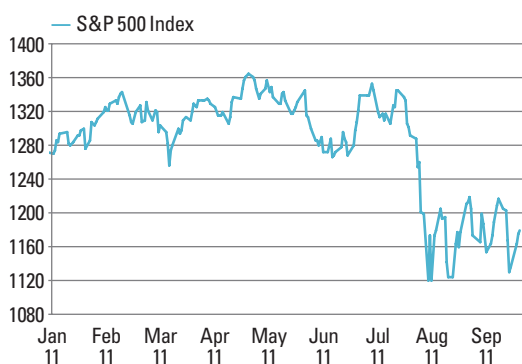
Please refer to the Portfolio Compass publication for complete details.

### Compass Changes

- Upgrading Stocks overall to neutral from negative/neutral.
- Placing a negative bias on our neutral/positive view of Alternatives.
- Upgrading U.S. Stocks to neutral/positive from neutral.
- Upgrading Small Growth to neutral/positive from neutral.
- Upgrading Mid Growth to positive from neutral/positive.
- Upgrading Mid Value to neutral/positive from neutral.
- Upgrading Small Value to neutral from negative/neutral.
- Downgrading Precious Metals to neutral from neutral/positive.

Coupled with still attractive valuations we believe a neutral weighting towards stocks is warranted rather than a defensive posture.

#### 1 Stocks Found Support at the Bottom of the Range Once Again



Source: Bloomberg, LPL Financial 09/27/11

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

- Downgrading Agricultural Commodities to neutral from neutral/positive.
- Upgrading the Consumer Discretionary sector to neutral/positive from neutral.
- Adding a positive bias to the Technology sector.

### Investment Takeaways

- We upgraded stocks overall to neutral as stock markets once again bounced off the low end of the recent trading range and we believe Europe is moving closer to a more aggressive response to the European debt problem.
- We upgraded Mid and Small Cap stocks as part of our more optimistic view of U.S. stocks.
- We further downgrade both Precious Metals and Agricultural Commodities as our outlook towards stocks improves relative to commodities asset classes.

### Economy

- Economic data continues to point towards lackluster growth but not recession. Since our last publication, regional business surveys remain weak and reflect a slowing economy. According to the Bureau of Labor Statistic, jobless claims have trended marginally higher in recent weeks but still in the low 400,000 area. On the positive side, The Index of leading economic indicators were better than expected and existing homes sales increased more than forecast but were tempered by a year-over-year decline in home prices. We continue to view the chances of recession as roughly 33% but believe that a recession is not corroborated by the bulk of economic data at this point. Another batch of top-tier economic data next week may provide additional clarity.

### Equity and Commodities Asset Classes

- We upgraded our view of stocks overall to neutral as domestic stock markets once again bottomed off key support levels and believe Europe is moving closer towards a more aggressive response to the European debt problem. The S&P 500 Index bounced off 1120, a price level that investors believe compensates for a recession risks and are willing to increase exposure to stocks [Chart 1]. This price level has provided support for stocks several times over the past several weeks. Coupled with still attractive valuations, price-to-earnings (P/E) ratios remain near multi-year lows, we believe a neutral weighting towards stocks is warranted rather than a defensive posture.
- We placed a negative bias on our neutral/positive view of Alternatives, as we find less opportunity in commodities asset classes overall over the near term. We believe commodities can be considered as we expect the US dollar to gradually weaken over the remainder of the year and into 2012. However, over the near term we believe the risk-return prospects for stocks have improved relative to commodities. Given our longer-term expectation for the US dollar to resume weakening we will likely revisit commodity investments in the future.



- The negative bias on Alternative Strategies overall stems follows our downgrade of both Precious Metals and Agricultural commodities to neutral from neutral/positive. Precious metals enjoyed a strong performance run over the summer and current consolidation may persist. Recent margin requirement increases were a catalyst for weakness, in addition to dollar strength, and market focus for safe-haven assets appears to have shifted towards Treasuries and the US dollar. Given that precious metals prices are still notably higher than at the start of the year, we believe stocks may present a more attractive opportunity over the near term.
- We downgraded Agricultural Commodities following a weaker supply-demand outlook, deteriorating technical indicators, and the arrival of unfavorable seasonal tendencies. The recent World Agriculture Supply and Demand Estimates (WASDE) report indicated supply may be greater than expected and may offset firm demand. An increase in international supply offset a decline in U.S. supply from weather-related crop damage. Since futures markets already reflect rising prices we believe upside is limited. Technical indicators have flashed warning signs as several agricultural commodity prices have fallen below 50- and/or 200-day moving averages. Finally, the first two months of autumn typically represent a modest period of performance as harvest season winds down and positive catalysts are few.
- We upgraded Mid and Small Cap stocks as outlined above as part of our upgrade of stocks overall. We continue to find Mid Cap stocks our favorite area within domestic equity markets. We believe merger and acquisition (M&A) activity is a potential catalyst in a low growth environment and mid-size companies are likely to experience the greatest M&A activity. We also find valuations on mid-size companies more attractive relative to large and small company stocks.
- Nonetheless, we upgraded Small Cap stocks as well as we find valuations more attractive relative to large company stocks and prefer their greater sensitivity to the economy. Small Cap stocks have significantly lagged their Large Cap counterparts, by nearly 5% according to Russell Indexes, in recent months over fears of recession. We believe the economy will avoid recession providing greater near-term potential in small company stocks. Furthermore, both Mid Cap and Small Cap companies have less exposure to Europe and reduced exposure to financial companies, two areas we continue to limit exposure to.

## Equity Sectors

- We upgraded the Consumer Discretionary sector to neutral/positive from neutral. Recession fears have lowered market expectations and we believe the consumer will remain resilient. The recent decline in oil prices may support consumer spending going forward and technical indicators are firmly positive. Consumer Discretionary stock prices have remained relatively resilient and the sector as a whole continues to exhibit good relative strength compared to other equity sectors.



## Fixed Income

- The Fed's announcement of Operation Twist produced a further short-term boost to intermediate- and long-term Treasury prices but we do not believe the program will have much long-term impact. In fact, as this publication goes to print, the 10-year Treasury yield is above pre-Operation Twist announcement levels and the 30-year Treasury is holding only to minor gains. We believe the 10-year Treasury is finding equilibrium around the 2.0% level until clarity over the economy and Europe materializes. In the meantime, we continue to find much better value in corporate bonds and our strategy remains unchanged. The approach of quarter-end has kept a damper on corporate bond prices as financial firms typically clean up balance sheets and refrain from actively participating in corporate bond markets thereby contributing to lackluster or weak trading. Investor demand for limited new issuance remains strong and a potential positive catalyst once quarter-end passes and liquidity improves.

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### IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide or be construed as providing specific investment advice or recommendations for any individual. To determine which investments may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

The Federal Open Market Committee action known as Operation Twist began in 1961. The intent was to flatten the yield curve in order to promote capital inflows and strengthen the dollar. The Fed utilized open market operations to shorten the maturity of public debt in the open market. The action has subsequently been reexamined in isolation and found to have been more effective than originally thought. As a result of this reappraisal, similar action has been suggested as an alternative to quantitative easing by central banks.

Mid-capitalization companies are subject to higher volatility than those of larger capitalized companies.

Small Cap stocks may be subject to a higher degree of risk than more established companies' securities. The illiquidity of the Small Cap market may adversely affect the value of these investments.

Value investments can perform differently from the market as a whole. They can remain undervalued by the market for long periods of time.

Precious metal investing is subject to substantial fluctuation and potential for loss.

Stock investing involves risk which may include loss of principal.

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

Government bonds and Treasury Bills are guaranteed by the U.S. government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value. However, the value of a fund shares is not guaranteed and will fluctuate.

Corporate bonds are considered higher risk than government bonds but normally offer a higher yield and are subject to market, interest rate and credit risk as well as additional risks based on the quality of issuer coupon rate, price, yield, maturity and redemption features.

Nontraditional investments may not be suitable for all investors and should be considered as an investment for the risk capital portion of the investor's portfolio. The strategies employed in the management of alternative investments may accelerate the velocity of potential losses.

Because of their narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies.

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

An economic indicator that changes before the economy has changed. Examples of leading indicators include production workweek, building permits, unemployment insurance claims, money supply, inventory changes,



and stock prices. The Fed watches many of these indicators as it decides what to do about interest rates.

**Consumer Discretionary Sector:** Companies that tend to be the most sensitive to economic cycles. Its manufacturing segment includes automotive, household durable goods, textiles and apparel, and leisure equipment. The service segment includes hotels, restaurants and other leisure facilities, media production and services, consumer retailing and services and education services.

**Technology Software & Services Sector:** Companies include those that primarily develop software in various fields such as the Internet, applications, systems and/or database management and companies that provide information technology consulting and services; technology hardware & Equipment, including manufacturers and distributors of communications equipment, computers and peripherals, electronic equipment and related instruments, and semiconductor equipment and products.

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 2000 Index is an unmanaged index generally representative of the 2,000 smallest companies in the Russell Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index.

The P/E ratio (price-to-earnings ratio) is a measure of the price paid for a share relative to the annual net income or profit earned by the firm per share. It is a financial ratio used for valuation: a higher P/E ratio means that investors are paying more for each unit of net income, so the stock is more expensive compared to one with lower P/E ratio.

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