

Compass Points

Bringing you our latest tactical investing ideas



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Anthony Valeri, CFA

Market Strategist
LPL Financial

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.

Moving Forward

Compass Changes

- No changes this period

Investment Takeaways

- After recently upgrading stocks to neutral, we sit tight awaiting further developments from Europe and the upcoming earnings reporting season. Earnings season will provide a gauge of how much the European debt problem may have impacted companies' bottom line. Top-line revenue growth will provide a key gauge of consumer and business demand.
- Economic data in the United States has improved since our last publication and European leaders seem to be getting the message from markets, as we thought they would, and are moving forward with more aggressive and specific steps to address the euro-zone debt problem.

Economy

- Economic data has improved since our last publication with top-tier economic reports surpassing consensus forecasts. The ISM manufacturing index increased to 51.6 in September and has remained above the key 50 expansion/contraction line, let alone the typical recessionary readings of 42–44, despite widespread fears of recession. The monthly jobs report also exceeded forecasts. Although job creation remains sluggish the report contradicts a return to recession. Elsewhere, durable goods orders, weekly jobless claims, and auto sales also exceeded expectations. We expect the economy may expand at a 2.0% to 2.5% annualized rate during the third quarter.

Equity and Commodities Asset Classes

- Once again the stock market, as measured by the S&P 500 Index, found support at the bottom end of the trading range and has moved higher on better economic data and incremental positive steps in Europe. We believe stocks will challenge the upper-end of the trading range but we maintain a neutral approach overall until we receive further clarity on Europe. Over the past two weeks European leaders have taken important steps forward: approval of the expanded European Financial Stability Facility (EFSF) appears likely in coming days, banks may receive capital injections, and the European Central Bank's (ECB) reopening of one-year lending operations will provide a greater backstop and alleviate funding pressure



for European banks. We need to see more details, tentatively scheduled to be announced in early November, but recent developments are a positive for stocks.

- We expect corporations to show additional earnings gains that will contradict the decline in earnings implied by the summer decline in stock prices. Earnings season kicks off as this publication goes to print. We will be closely scrutinizing revenue as it will likely reveal the strength of consumer and business demand in the economy in light of European debt issues.

Equity Sectors

- We make no change to equity sectors and continue to remain exposed to the more cyclical sectors. Our bias remains on Industrials, Materials, Consumer Discretionary and Technology sectors that may benefit from an economy that continues to grow even if modestly. We find valuations on these sectors compelling and expect the upcoming earnings season to reveal companies' resiliency in the face of sluggish economic growth.

Fixed Income

- After failing to match the consolidation of stocks during September, high-yield bonds have begun the fourth quarter on a robust note. Much of the recent improvements represent not only the better macroeconomic backdrop as discussed above but a reversal of overly pessimistic expectations that led to extremely attractive valuations. Liquidity, the ease with which investors are able to trade bonds, has room for further improvement, and could act as an additional catalyst going forward. High-yield bonds have much more room for improvement.
- Intermediate- and long-term Treasury yields are nearly 0.5% higher compared to the lows of mid-September as investors remove the safe-haven premium built into Treasuries. Over the past two weeks, the 10-year Treasury Inflation Protected Security (TIPS) yield has increased from 0.0% to 0.23% while the implied inflation rate on 10-year TIPS increased by 0.25% to 2.0%. The message is that the Treasury market has begun to price in both better economic growth expectations, as well as higher inflation expectations, but expectations overall remain quite modest.



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.

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.

High yield/junk bonds (grade BB or below) are not investment grade securities, and are subject to higher interest rate, credit, and liquidity risks than those graded BBB and above. They generally should be part of a diversified portfolio for sophisticated investors.

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.

Treasury inflation-protected securities (TIPS) help eliminate inflation risk to your portfolio as the principal is adjusted semiannually for inflation based on the Consumer Price Index - while providing a real rate of return guaranteed by the U.S. Government.

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

The ISM index is 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.

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.

Materials Sector: Companies that are engaged in a wide range of commodity-related manufacturing. Included in this sector are companies that manufacture chemicals, construction materials, glass, paper, forest products and related packaging products, metals, minerals and mining companies, including producers of steel.

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.

Industrials Sector: Companies whose businesses manufacture and distribute capital goods, including aerospace and defense, construction, engineering and building products, electrical equipment and industrial machinery. Provide commercial services and supplies, including printing, employment, environmental and office services. Provide transportation services, including airlines, couriers, marine, road and rail, and transportation infrastructure.

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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