

Compass Points

Bringing you our latest tactical investing ideas



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Global Shocks Prompt Short-Term Defensive Stance

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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.

We downgrade our view of stocks overall and take a more cautious view of our favored areas within U.S. stocks: mid growth stocks and the technology sector.

	Fundamentals	Technicals	Valuation	View			Bias
				Negative	Neutral	Positive	
Stocks				●	◁○	●	→
Cash					○⇒●	●	
Mid Growth	●	●	●			●	←
Technology	●	●	●		●	◁○	
High-Yield Bonds	●	●	●			●	←

● Negative ● Neutral ● Positive

As of 03/17/11

Please refer to the Portfolio Compass publication for complete details.

Compass Changes

- Downgrading Stocks to negative/neutral from neutral but with a positive bias
- Upgrading Cash to neutral/positive from neutral
- Adding negative bias to Mid Growth stocks
- Downgrading Technology to neutral/positive from positive
- Adding negative bias to High-Yield Bonds

Investment Takeaways

- The tragedy in Japan has sent shockwaves across global financial markets prompting a more defensive investment approach near term. We downgrade our view of stocks overall and take a more cautious view of our favored areas within U.S. stocks: mid growth stocks and the Technology sector.
- We do not view the pullback as the start of a sustained bear market in stocks and upgraded cash to neutral positive as we maintain flexibility to take advantage of investment opportunities as they arise.
- Our placement of a cautionary bias on high-yield bonds reflects the possibility of more short-term weakness following events in Japan.



Economy

- U.S. economic data has taken a back seat to global events in the Middle East and now in Japan. Since our last publication economic data has been mixed with only modest improvement exhibited in the monthly jobs report but other economic data, such as regional manufacturing surveys and monthly retail sales exceeded forecasts. On balance, economic data has been consistent with an expanding economy. We do not believe the U.S. economy will be materially impacted by events in Japan and maintain our expectation of 2.5% to 3.0%, which is more conservative than consensus forecasts.

Equity and Commodities Asset Classes

- We downgraded stocks overall to negative/neutral following the earthquake in Japan, which comes on top of lingering Middle East turmoil. The two events have motivated investors to take profits on economically sensitive investments that enjoyed a strong six-month run. Stocks have pulled back in response to heightened uncertainty and fear. We believe stock market weakness may persist until the longer-term impacts of the Japanese earthquake and its aftermath become clearer.
- However, we do not view selling pressure as the start of a new bear market for stocks and we placed a positive bias to our negative/neutral view of stocks as we intend to reinvest in economically sensitive assets such as stocks and commodities. We view the domestic economy as strong enough to overcome any short-term disruption to Japan's economy. Japan's economic growth was already quite slow and a further deceleration may be offset by reconstruction efforts in coming months. In the United States corporate earnings remain strong and we believe 10% earnings growth for all of 2011 remains on track.
- Reflecting our desire to take advantage of potential opportunities, we upgrade cash to neutral/positive from neutral. High quality bonds jumped quickly in price and carry renewed interest rate risk going forward. We believe Treasury strength has limited additional upside and prices may decline once fear recedes. Therefore, we believe an elevated cash holding is prudent and can be quickly redeployed into economically sensitive investments in the future.
- We placed a negative bias on mid growth stocks as fear may persist over the near-term. Within the domestic stock market, mid growth stocks remain our favorite asset class but large cap stocks may outperform while fear and investor risk aversion remains high.

Equity Sectors

- We downgraded the Technology sector as fundamental factors may be adversely affected following events in Japan. Japan and broader Asia remain a critical part of the global Technology sector. Supply chain and other disruptions to technology stocks as a result of the earthquake in Japan motivate our downgrade. In addition, consensus earnings forecasts, or revisions, have decelerated indicating a potentially slower earnings growth going forward.



Fixed Income

- We placed a negative bias on high-yield bonds as part of our broader defensive positioning. As risk remains elevated over the short-term, we believe high-yield bonds may underperform high-quality bonds. On a longer-term basis, however, we continue to find high-yield bonds attractive and one of our favorite investment ideas. Fundamentals and valuations remain attractive and will likely benefit the sector again once fear subsides.

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.

Past performance is no guarantee of future results.

Stock investing may involve risk including loss of principal.

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

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

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

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 share is not guaranteed and will fluctuate.

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

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.

High Yield bond portfolios concentrate on lower-quality bonds, which are riskier than those of higher-quality companies. These portfolios generally offer higher yields than other types of portfolios, but they are also more vulnerable to economic and credit risk. These portfolios primarily invest in U.S. high-income debt securities where at least 65% or more of bond assets are not rated or are rated by a major agency such as Standard & Poor's or Moody's at the level of BB (considered speculative for taxable bonds) and below.

This research material has been prepared by LPL Financial.

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