

Compass Points

Bringing you our latest tactical investing ideas



August 17, 2011

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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.

Preparing to Re-engage

	Fundamentals	Technicals	Valuation	View			Bias
				Negative	Neutral	Positive	
Mid Growth	●	●	●	■	■	●	→
Commodities - Energy	●	●		■	○→●	■	
Energy	●	●	●	■	●	■	→
Industrials	●	●	●	■	■	●	→
Consumer Staples	●	●	●	●	■	■	
Treasuries	●	●	●	●←○	■	■	
TIPS	●	●	●	●←○	■	■	
High-Yield Corporates	●	●	●	■	■	●	
Bank Loans	●	●	●	■	■	●	←

● Negative ● Neutral ● Positive

As of 08/17/11

Please refer to the Portfolio Compass publication for complete details.

Compass Changes

- Adding a positive bias to our neutral/positive view of Mid Growth stocks
- Upgrading Energy Commodities to neutral/positive from neutral
- Adding a positive bias to our neutral view of the Energy sector
- Adding a positive bias to our neutral/positive view of the Industrials sector
- Removing a positive bias from our negative/neutral view of the Consumer Staples sector
- Downgrading Treasuries to negative from negative/neutral
- Downgrading Treasury Inflation-Protected Securities (TIPS) to negative/neutral from neutral
- Removing a negative bias from our positive view of High-Yield bonds
- Adding a negative bias to our neutral/positive view of Bank Loans



Investment Takeaways

- We are turning more positive on stocks but we remain cautiously positioned overall. Volatility may persist over the near-term but we believe financial markets have taken an overly pessimistic view of the global economy. We are biased to increase exposure to stocks and economically cyclical investments in coming weeks. We are preparing to re-engage risk and some of our favorite investment opportunities.
- We continue to believe the economy is in the midst of a slowdown and not a recession. Recent jobless claims data along with the monthly employment report argue against a double-dip recession.
- We add a positive bias both to energy commodities and the Energy sector on our belief that energy demand will remain elevated and \$80 per barrel is the low of our expected trading range for oil.
- Furious safe-haven buying of Treasuries has led to extreme valuations while economically sensitive bonds have lagged and present an opportunity.

Economy

- Recent economic data has failed to exhibit meaningful signs of improvement, but at the same time, we do not view recent reports as evidence of a return to recession. Weekly jobless claims declined below 400,000 for the first time since early April and the monthly employment showed the economy created 117,000 jobs in July. Both reports contradict a return to recession and helped temper a weaker than expected Institute of Supply Management (ISM) manufacturing survey report at the start of August. Anecdotal reports, such as the Fed's beige book of regional economic activity, indicate that debate over the debt limit resulted in certain businesses making contingency plans in the event a new debt limit was not agreed upon, which distracted from the normal course of business. A return to normal business may be reflected in August data which will be released in September. On a positive note, monthly retail sales (released last Friday, August 12, 2011) suggest the consumer continues to modestly, if unspectacularly, keep on spending. Of course, should economic data reveal the economy is on track for something more than just a slowdown we will move to a more defensive investment positioning.

Equity and Commodities Asset Classes

- We place a positive bias on our neutral/positive view of Mid Growth stocks as a potential addition when we decide to increase stock exposure. We believe Mid Growth may benefit more than Large Growth stocks in the event of a turnaround in equity markets while at the same providing less risk than small company stocks. In the event that economic growth remains sluggish, we believe Mid Growth stocks may still benefit as Merger and Acquisition (M&A) activity is likely to be most robust among mid-size company stocks. M&A activity is one way companies can attempt to boost productivity and boost profits in a slow-growth environment.
- We upgraded Energy Commodities to neutral/positive as the price of oil reached the low end of our expected trading range. We believe energy



demand will remain elevated and the price of oil range-bound between \$80 and \$115 per barrel. Based upon our view that the economy will avoid recession, oil prices in the low-80 per barrel range present an opportunity.

Equity Sectors

- Based upon our more favorable view of Energy Commodities, we place a positive bias on our neutral view of the Energy sector. However, we do not find energy equities, at this point, as attractive as energy commodities due to the fact that energy stock declined less in price during the recent downturn. Therefore, while we find energy stocks modestly more attractive we believe the greater opportunity potentially lies with the actual commodities.
- We added a positive bias on the Industrials sector. We believe the sector has been inordinately punished from the recent stock market sell-off and there is opportunity based upon our view that the economy will avoid recession. The Industrials sector remains at the heart of the economic expansion and is also more exposed to faster growing economies of emerging market countries.
- Our removal of a positive bias on the Consumer Staples sector reflects our desire to increase exposure to more economically sensitive investments in coming weeks. We believe the stock market is in the process of bottoming and the defensive properties of consumer staples stocks will be less warranted going forward.

Fixed Income

- We downgrade Treasuries to negative from negative/neutral due to the strong flight-to-safety buying that has propelled Treasury valuations to their highest levels since the fall of 2008. We similarly downgrade TIPS to negative/neutral for the same rationale and the 10-year TIPS yield approaching 0.0%. We believe current valuations are being exacerbated by flows from Europe as investors flee Europe and prefer Treasuries, rather than German Bunds, as the safe haven vehicle of choice. In addition, the Fed's announcement that they will keep interest rates exceptionally low through the middle of 2013 removes a primary driver of interest rates from the bond market. With the Fed unlikely to hike interest rates for almost two years, a major source of potential interest rate risk has been removed from the bond market. Still, we believe Treasuries do not represent an attractive investment and may still be vulnerable to a removal of safe haven buying should economic data improve.
- Treasury strength has led to weakness among more economically sensitive bonds, High-Yield bonds in particular. We removed the negative bias on our positive view of High-Yield bonds as a result. The average yield advantage of High-Yield bonds increased to 7.5% above comparable Treasuries, as of August 16, 2011, a level close to the 8% or more typically witnessed during recessions. We believe current yield levels compensate not only for current defaults but also for an increase in future defaults and therefore provides an opportunity.
- We place a negative bias on Bank Loans due to the more benign Fed. Bank Loans benefit from Fed rate hikes and delays in eventual rate hikes

dim the appeal of Bank Loans. Still, we find the sector attractive following recent weakness which has seen the average bank loan price fall to 90 cents on the dollar while still averaging an above-average 4.5% to 5.5% yield. Strong underlying fundamentals should help the sector recoup recent price declines if, as we expect, recession fears abate.

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.

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

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.

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

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

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.

Consumer Staples Sector: Companies whose businesses are less sensitive to economic cycles. It includes manufacturers and distributors of food, beverages and tobacco, and producers of non-durable household goods and personal products. It also includes food and drug retailing companies.

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.

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

Bank Loans are loans issued by below investment-grade companies for short-term funding purposes with higher yield than short-term debt and involve risk.

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.

Energy Sector: Companies whose businesses are dominated by either of the following activities: The construction or provision of oil rigs, drilling equipment and other energy-related service and equipment, including seismic data collection. The exploration, production, marketing, refining and/or transportation of oil and gas products, coal and consumable fuels.

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