



Weekly Market Commentary



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A European Christmas Carol

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Highlights

Europe's leaders have seen the ghost of Christmas Past (2008), Present (Greece, etc.) and Yet to Come (break up).

Their pursuit of Scrooge-like austerity measures may allow the leaders of Germany and France to see the light and let the ECB buy the turkey (troubled debt) in the window for the troubled countries (Spain, Italy, etc.).

If not, it will scare the Dickens out of the market.

Last week, the stock market had the best week since the week ending March 13, 2009, which marked the beginning of the rebound from the long 2007–2009 bear market. The S&P 500 Index regained 7.4% last week after a similarly steep slide in the prior week and a half. Volatility remains high as investors focus on every development in Europe.

With the holiday season arriving, Europe appears to be experiencing a transformation worthy of a classic tale. Europe's leaders have seen the ghost of Christmas Past (in the form of the financial crisis of 2008), Present (the spreading troubles plaguing Greece, Portugal, Spain, Italy and others) and Yet To Come (the possibility of a break up of the eurozone has been discussed). While these countries are pursuing Scrooge-like austerity measures as they cut spending to close their budget deficits, the market recognized last week that the leaders of France and Germany may have seen the light. German Chancellor Merkel and French President Sarkozy are pursuing treaty changes to enforce budget limits that they continue to hint will allow them to permit the European Central Bank to buy the turkey (troubled debt) in the window for the troubled countries (Spain, Italy, etc.).

The ongoing European debt dilemma will continue to affect the market in 2012, as it did in 2010 and 2011. In 2012, we expect:

- The U.S. economy to grow about 2%, while emerging markets post stronger growth and Europe experiences a mild recession.
- The U.S. stock market is likely to post an 8–12%* gain, supported by a boost from a slight improvement in valuations and mid-to-high single-digit earnings growth.
- Corporate bonds post modest single-digit gains as interest rates rise and credit spreads narrow. The yield on the 10-year Treasury is likely to end the year around 3%^.

For further insight into what 2012 holds for investors, please see the *2012 Outlook*, published last week. This comprehensive take on 2012 reveals what investors can expect in the coming year and how to position to seek to profit from the opportunities and protect from the risks.

While the S&P 500 ended November basically unchanged, it took a wild ride during the month as a number of major events played out. The event calendar for December is not as prone to disappoint or create as much volatility as November did. For example, November saw government

*LPL Financial Research provided this range based on our earnings per share growth estimate for 2012, and a modest expansion in the price-to-earnings ratio. Additional explanation can be found in the *2012 Outlook* publication.

^LPL Financial Research provided this forecast based on current corporate bond yields of 4-5% and our estimate for a modest rise in yields in 2012 and continued credit improvement narrowing yield spreads. Additional explanation can be found in the *2012 Outlook* publication.



changes in Italy and Spain, a large number of European bond auctions, and the super committee failure in the United States. In December, no elections in Europe, fewer bond auctions will be held, and the likelihood of a relatively quiet passage of year-end business in Washington (a continuing resolution to extend government funding and legislation to extend payroll tax cuts and unemployment benefits along with the annual AMT and physician Medicare fixes) may make for a quieter month for investors.

However, there is a risk that the market rebound and decline in European bond yields takes some pressure off of the efforts to cut spending and risks the loss of critical momentum. The leaders of the troubled countries—especially those with new governments—must continue these efforts in order to secure support from Germany and France. If not, it will scare the Dickens out of the market.

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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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