



Weekly Market Commentary



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Kicking the Cannes

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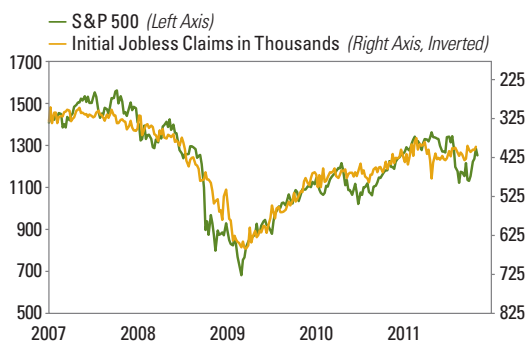
Highlights

Stock market volatility was driven by last week's political brinkmanship derailing plans to secure funding support from China and other countries for the European debt rescue plan, kicking the implementation of the plan down the road well past the G20 meeting in Cannes.

With every move in the stock market seeming to coincide with a headline coming out of Europe, it would be easy to conclude that this is the only issue that matters to investors.

By stepping back from the day-to-day and week-to-week trading, it appears the issues in Europe over the past couple of years have merely created volatility around the true focus of investors on the fundamental economic backdrop that continues to slowly improve.

1 Stock Market Tracking Economic, Rather Than European, Developments



Source: LPL Financial, Bloomberg data 11/04/11

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

The S&P 500 Index had a bumpy ride last week as it tumbled 5% in the first two days on the eve of the Group of 20 summit in Cannes, France, as the Greek Prime Minister proposed a referendum on the European debt deal. This political move risked scuttling the hard-fought deal that had been unveiled the prior week that contributed to the powerful stock market rally. Stocks recovered most of the lost ground later in the week as the Prime Minister withdrew his call for a referendum and moved toward establishing a new government for Greece that is very likely to approve the controversial debt rescue package.

However, the political brinkmanship derailed plans by the leaders of Germany and France to showcase the new plan in order to secure funding support from China and other countries. The French President said it may take until February 2012 for a funding deal to be reached, kicking the implementation of the plan down the road well past the meeting in Cannes.

While hurdles to implementation of the debt plan are materializing, Italy's 10-year borrowing costs are slowly nearing the 7% threshold that forced Greece, Ireland and Portugal to seek bailouts last year. The yield on Italy's 10-year bond rose to 6.35%, the highest since the creation of the euro currency in January 1999. We expect the delay will force changes in the Italian government and result in the passage of the difficult, but necessary reforms to return to a sustainable fiscal path.

With every move in the stock market seeming to coincide with a headline coming out of Europe, it would be easy to conclude that this is the only issue that matters to investors. By stepping back from the day-to-day and week-to-week trading, we can see a different, longer-term pattern of performance emerging—one that reflects a different focus entirely.

If we look back at the past five years, we can see that stocks have very closely tracked real-time economic data, as measured by the weekly tally of initial claims for unemployment benefits as seen in [Chart 1](#). It appears the issues in Europe over the past couple of years have merely created volatility around the true focus of investors on the fundamental economic backdrop that continues to slowly improve.

What else does this chart tell us? That the October rally was justified based on the underlying economic fundamentals and that stocks may have additional modest gains in the months ahead—barring distractions that



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cause stocks to again deviate from the underlying driver. In fact, based on this relationship, if initial jobless claims fall to a more normal level of 350,000 by year-end 2012, the S&P 500 would be around 1400, well above Friday's closing level of 1253.

This would seem to suggest that what the market really cares about are jobs. But we believe that would put too fine a point on it. Initial jobless claims do measure the conditions in the job market, but they are also a real-time, weekly reflection of economic conditions. While the President and GOP presidential candidates focus on promoting their job plans, we think it is important to keep in mind that job growth does not make for a healthy economy; a healthy economy makes jobs grow (see this week's *Weekly Economic Commentary* for a look at the October employment report). The health of the economy reflected in initial jobless claims is critical to gauging the outlook for the magnitude and sustainability of profit growth critical to long-term stock market performance.

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