

Weekly Economic Commentary



November 14, 2011

Moving to the Muddle

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Highlights

- European developments and a full slate of U.S. economic data will vie for the market's attention this week.
- Manufacturing, housing, inflation and the consumer are in the data spotlight this week.

Economic Calendar

Tuesday, November 15	Industrial Production <i>Oct</i>
Retail Sales <i>Oct</i>	NAHB Housing Survey <i>Nov</i>
PPI <i>Oct</i>	Thursday, November 17
NY Fed Empire State Mfg <i>Nov</i>	Initial Claims <i>wk 11/12</i>
Business Inventories <i>Sep</i>	Building Permits <i>Oct</i>
Wednesday, November 16	Housing Starts <i>Oct</i>
MBA Mortgage Applications <i>wk 11/11</i>	Philadelphia Fed Index <i>Nov</i>
CPI <i>Oct</i>	Friday, November 18
Capacity Utilization <i>Oct</i>	Leading Indicators <i>Oct</i>

The ongoing political and financial turmoil in Europe is likely to draw most of the market's attention this week. Against that somewhat unsettling backdrop, market participants will digest a relatively busy slate of U.S. economic data for October and November, as well as a full docket of appearances by Federal Reserve (Fed) officials.

With only a scattering of earnings reports and guidance for the third quarter of 2011 remaining, this week's full slate of economic reports and heavy schedule of Fed speakers will compete with the economic and fiscal turmoil in Europe for the market's attention. Participants continue to assess what impact a potential recession in Europe and slowdown in emerging markets will have on the United States economy, and when that impact is likely to be felt.

The European summit of late October 2011 produced measures that were clearly a positive and removed the extreme risks in our view. However, details will be slowly forthcoming in the months ahead and implementation risks remain. Delays or disruptions could undermine market confidence and lead to bouts of safe-haven buying of Treasuries. Furthermore, should European economic growth be weaker than expected, investors may deem recently agreed upon safeguards as insufficient and peripheral European government bond weakness may create safe-haven buying of Treasuries.

Looking ahead, developments in Europe will remain a major market driver in the weeks and months ahead, and well into 2012. We believe a financial crisis and accompanying deep global recession erupting from the European debt problems has a small, but not insignificant, chance of taking place. We will continue to monitor the developments and signs of stress in the European banking and sovereign funding markets. But, as Europe muddles along, we believe investors are better served to watch the real-time indicators of economic performance as a guide to market behavior.

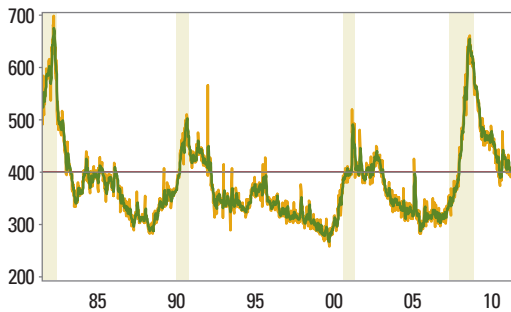
This week is a very busy week for U.S. economic data, including reports on:

- Housing:** November homebuilders sentiment, October housing starts, third quarter mortgage delinquencies and foreclosures
- Inflation:** consumer price index (CPI) and producer price index (PPI) for October
- Manufacturing:** industrial production for October, Philly Fed and Empire State Manufacturing indices for November
- The consumer:** October retail sales and weekly retail sales for the week ending November 12



1 Initial Claims Broke Below 400,000 Per Week in the Latest Week, the Fewest Number of Claims Since March 2011

— Unemployment Insurance: Initial Claims, 4-Week Moving Average, Seasonally Adjusted, Thous
 — Unemployment Insurance: Initial Claims, State Programs, Seasonally Adjusted, Thous



Source: Department of Labor, Haver Analytics 11/14/11

(Shaded areas indicate recession)

2 Although It Has Accelerated Recently, Core Inflation Remains Subdued

— CPI-U: All Items Less Food and Energy
 % Change - Year to Year, Seasonally Adjusted, 1982-4=100



Source: Bureau of Labor Statistics, Haver Analytics 11/14/11

(Shaded areas indicate recession)

The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.

In addition, the weekly reading in initial claims for unemployment insurance will be closely watched as this data set in recent weeks has suggested some positive momentum in the labor market.

In addition to the data, there are a number of Fed speakers on tap this week, although Fed Chairman Bernanke is not among them. This week's Fed speakers lean a bit toward the "dovish" side (Fed officials who favor the full employment side of the Fed's dual mandate of low inflation and full employment), although some notable "hawks" (Fed officials who favor the low inflation side of the Fed's dual mandate) are on the schedule as well. We will continue to watch the "center of gravity" at the Fed - Chairman Bernanke, Vice-Chair Yellen and New York Fed President Dudley - for any shift in tone. Of the three, only Dudley is slated to speak this week. The Fed will release the minutes of the November 1–2 Federal Open Market Committee (FOMC) meeting on November 22, and the next Beige Book, a qualitative assessment of business and financial conditions in each of the 12 regional Fed districts, is due out on November 30. The next FOMC meeting is December 13.

We continue to expect the Fed to pursue historically accommodative monetary policy in the period ahead. Even if the economy tracks to the market's expectations (roughly 2.0% real gross domestic product growth in 2012 and 2.5% in 2013), the Fed is likely to ease even more in 2012 (via additional purchases of Treasury securities or mortgage-backed securities in the open market), as the Fed's forecasts for economic growth and the unemployment rate remain more optimistic than the market's.

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Core CPI is a subset of the total Consumer Price Index (CPI) that excludes the highly volatile food and energy prices. It is released by the Bureau of Labor Statistics around the middle of each month. Compare to Personal Consumption Expenditures (PCE); Core PPI; Producer Price Index (PPI).

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Weekly Market Commentary



November 14, 2011

The Best Year-End Strategy May be to Invest by the Book

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Highlights

All of the time-worn stock market trading axioms based on the calendar actually were worth following this year, including the “January effect,” “sell in May and go away” and October the “bear killer” month.

This textbook pattern of calendar-driven performance by the stock market may mean that the best year-end strategy is to invest by the book as a “Santa Claus rally” unfolds in December.

It has been a textbook year. That is, if your textbook is the Stock Trader’s Almanac. The old stock market chestnut “sell in May and go away” proved to be good advice this year. But that was not the only old adage of Wall Street traders that worked in 2011 — they all worked.

This has been the year of the stock market cliché in that all of the time-worn axioms based on the calendar actually were worth following this year:

- The “January effect” (the market tends to rise in January attributed to individual investors putting money to work after taking tax losses in December) worked this year as the S&P 500 posted a 2.3% gain in January. The “January barometer” (stock gains in January often lead to a gain for the year) and the overlapping “first five days” indicator (stocks rising during the first five days of the year indicate a high probability for a gain for the year) have both proven accurate, so far.
- “Sell in May and go away” (suggests investors sell and avoid the summer months) worked with stocks peaking for the year on April 29.
- October, the “bear killer” month (stock market downturns famously end and reverse in the month of October), ended the 19% peak-to-trough stock market decline with stocks bottoming for the year on October 3.

If this “year of the market axiom” pattern continues, what comes next? Perhaps a “Santa Claus rally” is in store for December. Markets must still move past the uncertainty of November that includes key policy events:

- Government transitions in Europe.
- Action by Congress to avoid a government shutdown.
- The Super Committee proposals to find \$1.5 trillion in deficit reduction measures.

But then a year-end “Santa Claus rally” may cap off a volatile year of modest single-digit returns for stock market investors.

What may be the trigger for the textbook year-end rise in the market known as a “Santa Claus rally?”

- A rebound in investor sentiment as Europe takes long overdue actions to avoid a financial crisis.
- Improvement in the job market as foreshadowed by the recent decline in initial jobless claims below the 400,000 level in recent weeks.

1 The Year of the Cliché



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

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



- The holiday shopping season surprises by exceeding retail sales estimates, as it did last year.

This textbook pattern of calendar-driven performance by the stock market may mean that the best year-end strategy is to invest by the book.

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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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