



# Weekly Market Commentary



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## Buyers and Sellers

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#### Highlights

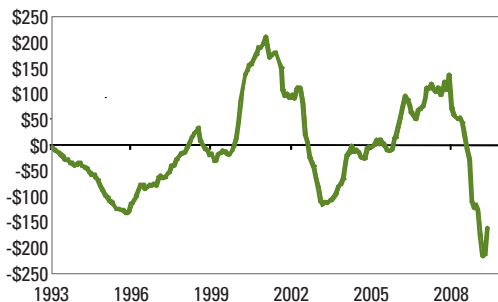
At the heart of it, all markets come down to buyers and sellers.

Since March of this year, buying from individual investors has been above trend and may mark a multi-year turning point for individual investor inflows.

The sellers include companies—company stock issuance set a record pace in May—and insiders, or top executives, of S&P 500 companies.

We believe the buying power of individual investors is likely to win out over the forces of selling during the second half of 2009.

#### 1 Individual Investors' Inflows Turn the Corner *Excess Flows into Stock funds and ETFs Above or Below \$14 Billion per Month Long-Term Trend in Billions of Dollars*



Source: LPL Financial, Haver

At the heart of it, all markets come down to buyers and sellers. Taking a look at who is buying and who is selling can tell us something about the durability of the stock market's recent performance and what may lie ahead.

Presently, there are three notable trends in buying and selling in the stock market:

- individual inflows to mutual funds and ETFs
- corporate stock issuance
- insider selling

#### Individual Investors are Buying

The power and influence of hedge funds and sovereign wealth funds is often discussed and used to explain movements in the markets. However, individual investors as a group wield far more buying power and influence over the marketplace. When individual investors make up their minds, they can be a powerful and durable force in the markets.

In recent months, cash flows for ETFs and mutual funds have turned around. After a long period of selling, those vehicles that invest in the stock market have attracted tens of billions of dollars since March of this year. These flows provide insight into what individual investors are doing. [Chart 1]

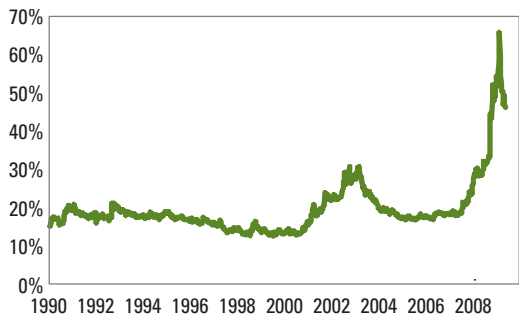
We may be on the cusp of a multi-year period of strong inflows to stocks by individual investors similar to the period from 1996 through 2000 or 2003 through 2007. Historically, investors have brought an average of \$14 billion per month into the market in the form of stock market focused mutual funds and ETFs. There were three periods when fund inflows were below this trend.

- The below-trend period of the early 1990s, was followed by strong investor demand for stocks over the following five years.
- The second recent period of below-trend inflows began in 2001, as inflows flattened and ultimately dipped well below trend until April 2003.
- The third began in late 2007, when fund flows began to fall below trend as investors withdrew an average of \$2.25 billion from equity funds each week.

Each of these periods of below-trend inflows was followed by a period of above-trend inflows. These flows have historically tended to trend, rather than roll over quickly. Since March of this year, inflows have been above trend and may mark a multi-year turning point for individual investor inflows.



## 2 Record Buying Power Money Market Fund Assets as a Percent of the S&P 500 Market Capitalization



Source: LPL Financial, Bloomberg

It is possible that given the experience of this decade, individual investors may be more cautious in their investing and allocate less to stocks than in the past. However, individual investors may also begin to save more, with resulting larger inflows to mutual funds and ETFs of all types. Even if stock market focused mutual funds and ETFs receive a smaller slice of the pie, the investing pie is likely to be larger as a result of increased savings. Therefore, inflows to stocks may not suffer from a potential change in investor behaviors.

Individual investors do not need to wait for their incomes to rise to invest more. There is plenty of fuel to power inflows sitting on the sidelines. Investors have stashed nearly \$4 trillion in cash in money market funds. This sideline cash has only just started to be drawn down as investors turn back to the stock and bond markets. Currently, money market funds hold just under 50% of the value of the stock market, as measured by the value of all the companies in the S&P 500 Index. Earlier this year their share reached nearly 70% compared to the long-term average of just about 20%. The outflows from money market funds to stocks and bonds have a long way to go—in total over a trillion dollars—before this percentage would get close to the long-term average, leaving plenty of fuel to drive above-trend inflows to stock market focused mutual funds and ETFs. [Chart 2]

## Companies are Selling

Companies are now issuing both stock and debt after having bought back stock at a tremendous pace during the mid-2000s. Many companies seem to want to pay down debt and give themselves a cash cushion, lowering the financial risk, or leverage, in the firm. According to TrimTabs Investment Research, May 2009 share issuance was a record-breaking \$64 billion—nearly double the prior record.

Although some companies are being forced to raise capital, this new share issuance is largely a response to the fact that investor appetite is back, as we noted in the previous section. With the forward price-to-earnings ratio near the long-term average, companies may feel they are getting a fair value for their shares despite the seemingly low prices.

How stocks perform in response to issuance of new shares depends upon why the companies are raising the capital and how much they are diluting current shareholders.

## Insiders are Selling

TrimTabs recently reported that insiders, or top executives, of S&P 500 companies have sold \$2.6 billion in shares so far in June, compared with only \$120 million in purchases. Some have expressed concern over whether this data should be seen as an important signal by those “in the know” of impending doom for corporate America. However, history offers a very different interpretation.

Corporate insiders were buying in 2007 at the peak, and they have been selling in the past few months as stocks have been bottoming. That fact does not suggest that they are acting on any inside information that would benefit an individual investor. Back in August of 2007, around the peak of the stock market, TrimTabs reported the most buying by insiders at Financials



companies in 12 years. At the time, this trend was interpreted by some as a buy signal for Financials just before the companies in this sector fell more than 80%. Rather than interpreting the recent insider selling as a sell signal, instead it may simply be that these executives did not get the bonuses this year they hoped for and are selling shares to pay their bills.

The buying and selling has been balanced over the past month as stocks, measured by the S&P 500, have remained in a range between the mid-800s and mid-900s. However, the buying power of individual investors is likely to win out over the forces of selling during the second half of 2009. We continue to believe the S&P 500 will end the year with modest gains after a volatile, range-bound summer.

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