Weekly Market Commentary

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Quarterly Pattern to Repeat

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Highlights

- In the first quarter, the stock market followed a volatile path that looks to be on track to end with a solid gain. We believe this pattern of performance may repeat in the second quarter given the conditions and events that are likely to unfold during the quarter.
- April presents a number of challenges to the rally driven by the earnings season, the Fed, China, European credit conditions, and the uncertainty surrounding actions on financial reform legislation.
- Given these factors, a 5-10% pullback within the second quarter would not be unusual as the stock market tracks a pattern similar to the first quarter. However, we expect a pullback to be followed by a rally to a new high for the year, as conditions remain positive with above-average economic growth, improving credit trends, low interest rates, and the return of job growth.

In the first quarter, the stock market followed a volatile path that looks to be on track to end with a solid gain. We believe this pattern of performance is likely to be repeated in the second quarter. Specifically, as the first quarter began the upward momentum of the fourth quarter of 2009 continued, with the S&P 500 rising until January 19. Over the following three weeks, stocks fell 8% as a combination of factors weighed on investor sentiment, including: the earnings reporting season, Federal Reserve comments, actions by China to slow loan growth, sovereign credit concerns in Europe, and actions in Washington. Stocks made the low for the quarter on February 8 then posted steady gains demonstrating remarkable momentum through the remainder of the quarter. This first quarter pattern of performance also echoes the fourth quarter of 2009.

We believe this pattern of performance may repeat in the second quarter given the conditions and events that are likely to unfold during the quarter. The momentum from the first quarter is likely to continue into early April. However, April presents a number of challenges to the rally driven by the earnings season, the Fed, China, European credit conditions, and the uncertainty surrounding actions on financial reform legislation.

- **Market participants may sell the earnings news.** "Buy the rumor, sell the news" is an adage often used to describe stock market behavior. This adage well describes the market performance around the past several earnings seasons, when companies reported their financial results for the quarter. It is worth noting that the last three 5-10% stock market pullbacks occurred leading into or during each of the last three earnings reporting seasons. The first quarter earnings season kicks off around mid-April.
- **Fed may signal coming rate hikes.** One of the major headwinds that we have cited for this year is the shift from the environment where "the Fed is our friend", while they maintain low rates, to the inevitable shift to "don't fight the Fed", as they begin to hike interest rates later this year. During prior episodes of rate hikes, the market began to change behavior when the Fed made a change in their statement signaling the rate hikes that were to come. The Fed has already taken steps they refer to as "normalization" of conditions during the first quarter. These have included raising the discount rate (the rate at which the Fed makes direct loans to banks) by 0.25 to 0.75 percent, closing four emergency lending facilities, and ending the massive $1.25 trillion Mortgage-Backed Securities purchase program. The next step on the path to normalization may be to shift the language in the statement issued at their April 26 meeting, such

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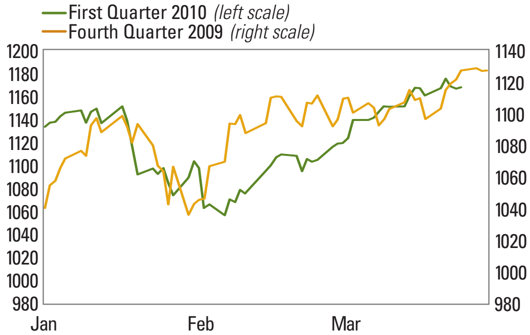
1 S&P 500 Quarterly Pattern Repeat

S&P 500 Index in the Fourth and First Quarters



Source: LPL Financial, Bloomberg 3/26/10

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

as the removal of the "for an extended period" phrase as it refers to how long the Fed will keep rates at extraordinarily low levels.

- **China may take additional steps to slow growth.** Policy makers in China are reining in credit growth after banks lent one-fifth of this year's $1.1 trillion annual lending target in January. The accompanying money supply growth in excess of 25% has given rise to inflation pressures. China is forcing banks to hold more cash by raising capital requirements in December 2009 and hiking bank reserve requirements. We expect more announcements intended to slow economic growth to accompany the monthly economic reports scheduled for April 9-11, stoking fears that the sudden withdrawal of stimulus to one of the world's biggest growth engines may be premature and tip the global economy back into recession.
- **Financial stress may continue to spread in Europe.** The credit downgrade of Portugal last week reflects the ongoing credit problems in Europe. In contrast to the United States, financial stress is intensifying in Europe. Credit for the countries in peripheral Europe, most notably in the PIIGS (Portugal, Ireland, Italy, Greece, and Spain), is tightening. Most of these countries are likely to agree to tough budget cuts to remain in the Eurozone. This fiscal austerity is likely to prolong the pain of recession in Europe. The combined Gross Domestic Product (GDP) in the 16 countries that use the euro rose by a weaker-than-expected 0.1% in the fourth quarter, and was down 2.1% on a year-over-year basis. The weakness, and the fact that there was no growth in any of the PIIGS, suggests that the recovery in Europe may already have run out of steam.
- **Financial reform bill likely to grab attention in April.** The financial regulatory reform bill passed through the Senate Banking Committee last week. The most contentious issue is the new government agency that would be responsible for protecting consumers. The impact of this agency could be far-reaching and some would like to see the agency also responsible of the safety and solvency of the banks (and therefore balance consumer protections with profitability). With the banks still at the center of the healing from the financial crisis, legislation that impacts them or raises the uncertainty around their prospects, will likely move the markets.

Given these factors, a 5-10% pullback in the second quarter would not be unusual as the stock market tracks a pattern similar to the first (and fourth) quarter. However, we expect a 5-10% pullback to be followed by a rally to a new high for the year as was the case in the first quarter. The LPL Financial Current Conditions index reflects conditions favorable for strong economic and profit growth. We expect these conditions to remain positive in the second quarter with above-average economic growth, improving credit trends, low interest rates, and the return of job growth.

In fact, the improving backdrop has resulted in some strong recent data points:

- The U.S. Commerce department has reported that retail sales are up about 4% over last year.
- Over the past year, home sales are up 7% and prices are up slightly according to data from the National Association of Realtors.
- Orders for manufactured goods are up 10% and exports from the United States are up 18% over the past year, per the Commerce department.

- The Labor department reported that first-time filings of claims for unemployment benefits are down 32% over the past year and 50,000 temporary workers were hired in each of the past three months along with an increase in the number of overtime hours being worked.

The conditions supporting continued growth, combined with stock valuations at long-term averages (but below where they normally are at this early stage of the economic cycle), are likely to support further gains to new highs for the year as the second quarter matures. We continue to believe the market will be on an upward—but volatile—path in the first half of 2010 before peaking and giving up some of the gains in the second half of the year.

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