

# Portfolio Compass

APRIL 22, 2009

The Portfolio Compass provides an easy-to-read snapshot of LPL Financial Research's views on the Economy, Equities and Fixed Income as well as our Crisis Conditions Index. This publication illustrates our current views and will change as needed, and incorporates our biases over a 3- to 12-month time horizon.

## Broad Asset Class Views

	Negative	Neutral	Positive
Stocks		•	
Bonds		•	
Cash		•	
Alternatives			•

Source: LPL Financial Research

## The Portfolio Compass is comprised of five components:

- Crisis Conditions Index:** The CCI is an objective and transparent measure of how conditions are evolving relative to our Bull, Base, and Bear case scenarios.
- Economic Compass:** The Economic Compass illustrates how the U.S. economy, financial conditions, monetary and fiscal policy, and international economies are tracking to the Bull, Bear, and Base cases for 2009.
- Equity Asset Class & Commodity Compass:** This compass evaluates the asset classes such as Large Growth, Mid Value, U.S. Stocks, REITs, and Commodities.
- Equity Sector Compass:** This compass evaluates the 10 S&P 500 equity sectors.
- Fixed Income Compass:** This compass evaluates the fixed income asset classes.

## Reading the Portfolio Compass

- In the Economic Compass the dots illustrate how each category is tracking to the Bull, Base, or Bear scenarios outlined in our 2009 Outlook.
- In the other compasses the dots illustrate our view for each category as negative, neutral, or positive, in addition to fundamental, valuation, and technical characteristics for the category.
- The bias, illustrated with a right or left facing arrow, provides an "early warning" that a change may be looming.
- The active manager performance column indicates whether active managers, as defined by the Morningstar category average, are beating the asset class benchmarks over the trailing three-month period.
- Rationales for our views are provided in the Comments section.

# Crisis Conditions Index

April 22, 2009

## Real-Time Tracking

The LPL Financial Research Crisis Conditions Index is a weekly measure of the conditions that underpin our outlook for the markets and economy in 2009. We will publish this weekly index over the course of 2009 to provide real-time context and insight into the trends that shape our recommended actions to manage portfolios. We expect this index will become a useful tool to describe the conditions most relevant to investment decision-making in 2009.

This weekly index is not intended to be a leading index or predictive of where conditions are headed, but merely a coincident measure of where they are right now. We want to track the conditions in real-time to aid in investment decision making. There are thousands of indicators—some lead the economy, some lag, while others merely offer a lot of statistical noise. We chose to create our own index tailored to the current environment to provide the clearest and most useful way to track how conditions are aligned with the expectations embedded in our investment recommendations.

## How are The Components Affecting the Index Right Now?

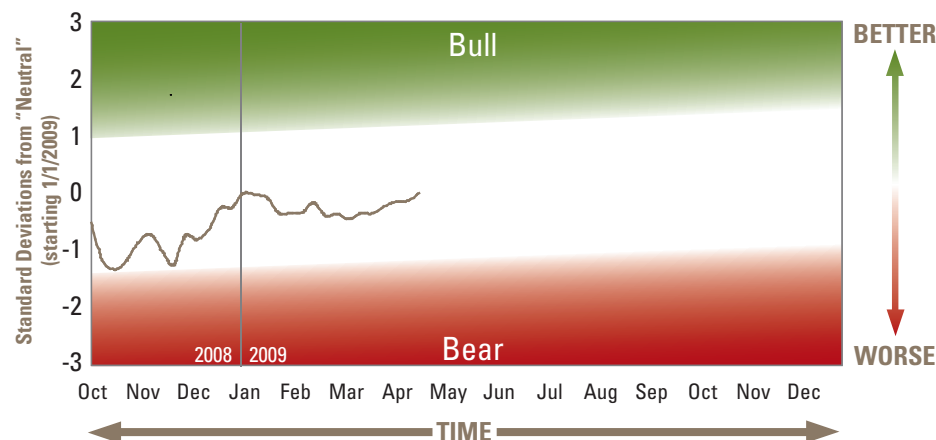
The LPL Financial Crisis Conditions Index improved over the past week extending the trend of improvement since the start of March. The improvement in conditions has been mirrored in the stock and bond market. The CCI is now inline with where it started the year — aligned with our base case for the economy and forecast for modest gains in stocks and bonds this year.

Last week’s improving components of the CCI included:

- Narrowing credit spreads: Generally better than expected first quarter earnings results bolstered the confidence of bond investors.
- Decline in the VIX: The outlook for stock market volatility has moderated.
- Resilient retail sales: Chain store sales tracked by the International Council of Shopping Centers were down only -0.1% from a year ago.
- Surging mortgage applications: Conforming mortgage rates are below 5% and at all time lows.
- Consumer confidence: Consumer sentiment improved along with an outlook for rising inflation — suggesting consumers may no longer be willing to delay purchases in anticipation of lower prices for durable goods, such as appliances and autos.

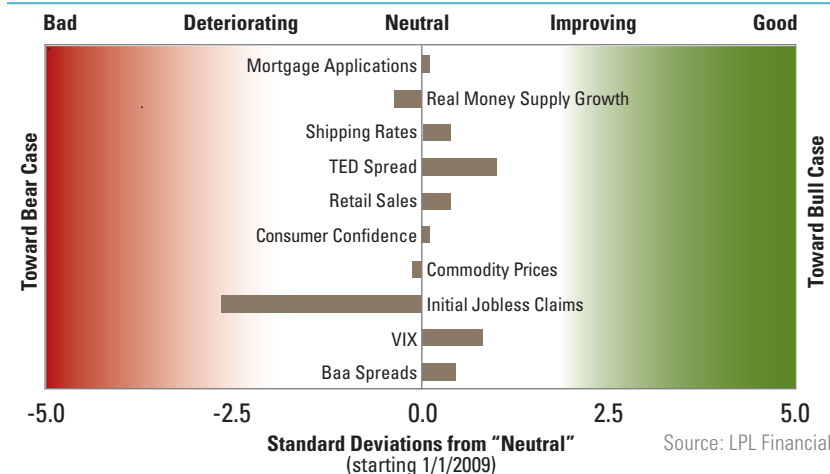
Initial jobless claims have reflected some modest improvement in the past two weeks, but remain the weakest component of the CCI since the start of the year.

## LPL Financial Research Crisis Conditions Index



Source: LPL Financial

## LPL Financial Research Crisis Conditions Index Components



Source: LPL Financial

# Economic Compass

April 22, 2009

## U.S. Economy Still Tracking to Base Case; Upgrading Emerging Market Economies

The U.S. economy is still tracking to our “base case,” with the “front end” of the economy (defined as consumer spending) holding up well. As measured by retail sales, real consumer spending (two-thirds of real GDP) in the first quarter was 1.5% to 2.0% higher than its fourth quarter average. However, the “back end” of the economy, defined as business spending on plant and equipment, is still struggling, meaning that more pain for the labor market is in store. Notably however, the jobless claims data in early- to mid-April suggests that the pace of the decline in the labor market may be subsiding a bit. The economy has just begun to feel the impact of the \$787 billion fiscal stimulus package, as payroll tax cuts took effect on April 1. The Fed is aggressively pursuing its money supply expansion program, which will help to offset any possible deflation. On the government policy front, markets are now awaiting the results of the bank “stress tests” which are due in early May, and for the first round of toxic asset purchases as part of the P-PIP (Public-Private Investment Program), which are slated for mid May. Overseas economies remain weak, but the stirring in commodity-based emerging market economies has gained momentum in the past few months.

	Tracking to the 2009 Outlook Scenarios			Bias	Comment
	Bear	Base	Bull		
ECONOMY	Consumer Spending	●	●	●	Consumer spending surprised to the upside in Q1 2009. Early data for Q2 looks promising.
	Business Spending	●	●	●	Business capital spending still looks awful. Q109 looks worse than Q408. Signs of stabilization are emerging.
	Housing	●	●	●	→ Housing affordability is at all-time high; mortgage rates below 5%, at 40-yr lows. Bottoming process continues.
	Export Sector	●	●	●	← Trade sector could surprise to the upside in Q1; major export partners (Europe and Japan) still a mess.
	Labor Market	●	●	●	→ Some stabilization in labor market evident in the jobless claims data in April.
	Inflation	●	●	●	Deflation not likely. Headline inflation near zero and core inflation driven lower by excess global capacity.
POLICY	Fiscal	●	●	●	→ \$787B stimulus package passed in Feb. now impacting economy via payroll tax cuts and infrastructure projects.
	Monetary	●	●	●	Fed ramped up quantitative easing to increase money supply/avoid deflation; aggr. buying Treasuries/Agency MBS.
	Government	●	●	●	→ Details of Financial Stability plan are known; waiting results of bank "stress tests" and first round of P-PIP.
INTERNATIONAL	US Dollar	●	●	●	Recent strength in the dollar is mainly due to disarray in the Eurozone among policymakers, politicians.
	Overseas Economies – Developed	●	●	●	← ECB late to game on quantitative easing; Japan enacted new dose of fiscal stimulus in April.
	★ Overseas Economies – Emerging Markets	○	●	●	→ Massive policy stimulus in China in early 2009 felt in the Pacific Rim, boosting local economies.
FINANCIAL CONDITIONS	Credit Conditions	●	●	●	Back to pre-Lehman levels, but still not normal.
	LPL Financial Crisis Conditions Index	●	●	●	Tracking toward the base case (See chart on page 2).
	Yield Curve	●	●	●	Steep curve helping banks, financial system regain operating profitability.
	<b>Overall Economy</b>	●	●	●	Consumer spending stabilized at a low level, business spending still weak, but showing signs of stabilizing.

★ Denotes change in tracking from last issue.



# Equity Asset Class & Commodity Compass

April 22, 2009

## Improving M&A Environment Supports Mid Cap Outlook; Looking to Add Emerging Markets

We maintain a roughly balanced view of Growth and Value in the near term due to the tendency for Value to rebound strongly off the bottom in recessionary bear markets. Longer-term, our outlook for Growth is more bullish. We favor Small Caps over Large Caps to capitalize on an early cyclical recovery, though Large Caps may outperform in the short run if the market consolidates recent gains. An improved M&A climate is supportive of Mid Caps. Our expectation that U.S. economic recovery precedes that in developed Europe and Japan supports our preference for U.S. equities. Our Emerging Markets outlook has improved on stronger commodities prices, rising growth in China, and improving financial conditions in the U.S.

		Fundamentals	Technicals	Valuation	View			Bias	Active Manager Performance	Comment
					Negative	Neutral	Positive			
STYLE / CAPITALIZATION	Large Growth	●	●	●	■	○	■	→	+	Preference for early- and mid-cyclical investments favors Growth, though our short-term view is more balanced due to the tendency for Value to rebound more sharply off of bear market recession lows.
	Large Value	●	●	●	■	○	■		+	
	★ Mid Growth	●	●	●	■	○→●	■		-	Mid Cap stocks tend to outpace Large Caps early in market recoveries. Improving M&A environment and strong relative performance are positives. Mid Growth likely to beat Mid Value once recovery becomes more visible.
	★ Mid Value	●	●	●	■	○→●	■		+	
	Small Growth	●	●	●	■	○	■	→	-	Our preference for early cyclicals favors Small Cap stocks. Credit market healing, domestic focus, and strong recent performance are positives. Small Growth likely to beat Small Value once recovery becomes more visible.
	Small Value	●	●	●	■	○	■		+	
REGION	U.S. Stocks	●	●	●	■	○	■	→		Remain defensively positioned to reflect global macroeconomic risks. U.S. economy is poised to recover before developed foreign economies. Emerging Markets outlook is improving on China's strength and higher commodity prices. Eastern Europe and US dollar strength are risks to European equities.
	Large Foreign	●	●	●	■	○	■		+	
	★ Emerging Markets	●	●	●	■	○→●	■	→	-	
REITS	★ REITs	●	●	●	■	○→●	■		+	Valuations are now more tempting but credit is tight and fundamentals lag.
COMMODITIES	★ Commodities - Industrial Metals	●	●	●	■	○→●	■			Emerging market growth, especially in China, and signs of stability in the U.S. are supportive of industrial metals. Inflation fears driving gold have faded some, though defensive characteristics may be attractive in the near term. Oil likely to remain range bound (\$40 to \$60) until growth outlook improves. Reversal of US dollar strength could help.
	Commodities - Precious Metals	●	●	●	■	○	■			
	Commodities - Energy	●	●	●	■	○	■			

★ Denotes change in view from last issue. ● Negative ● Neutral ● Positive

Investing in real estate/REITs involves special risks such as potential illiquidity and may not be suitable for all investors. There is no assurance that the investment objectives of this program will be attained. The fast price swings of commodities will result in significant volatility in an investor's holdings. International investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors. Small-cap stocks may be subject to a higher degree of risk than more established companies' securities. The illiquidity of the small-cap market may adversely affect the value of these investments.

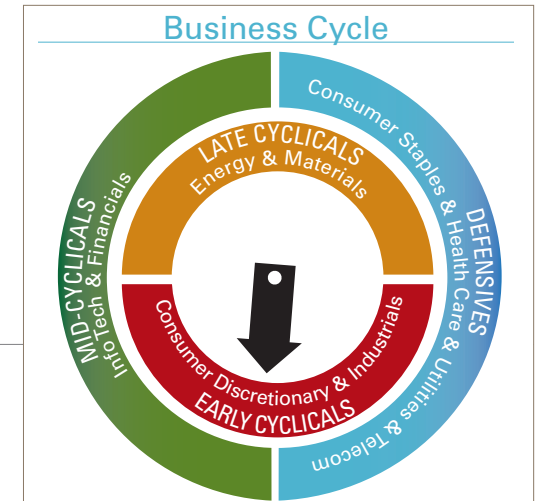


# Equity Sector Compass

April 22, 2009

## Keeping Early Cyclical Positioning Though A Pause May Be In Order

We continue to favor the more economically sensitive Consumer Discretionary, Industrials, and Technology sectors to capitalize on an early cyclical recovery. But the key defensive Consumer Staples and Health Care sectors are attractively valued and could match or beat the market in the short term if stocks pull back following the recent rally. The outlook for Financials is still challenged and post-rally valuations are less compelling; but the potential for more policy-driven appreciation and strength among the leaders keeps us at neutral. We continue to recommend exposure to commodities stocks through the metals & mining industry and the recently upgraded Energy sector.



		Fundamentals	Technicals	Valuation	View			Bias	S&P 500 Weight (%)	Comment	Industry Views	
					Negative	Neutral	Positive				Most Favored	Least Favored
DEFENSIVE	Consumer Staples	●	●	●	■	●	■		12.2	Continue to lean away from defensives as recovery develops. Stronger dollar and input costs are concerns.	Food & Staples Retail	Household & Personal Products
	Health Care	●	●	●	■	●	■		14.2	Defensive characteristics and reform uncertainty partially offset by resilient earnings growth.	Biotech, Equipment & Supplies	Managed Care, Pharmaceuticals
	Telecom	●	●	●	■	●	■	→	3.8	Pricing pressure suggests caution, though dividends are attractive.	Diversified	Wireless Services
	Utilities	●	●	●	■	●	■		4.0	Leverage, interest rate sensitivity, "green" initiatives and lower natural gas prices all create headwinds.	Regulated	Independent Power Producers
EARLY	Consumer Discretionary	●	●	●	■	■	●	■	9.3	Valuation tempers enthusiasm some, but firming spending outlook and policy initiatives are supportive.	Retail	Autos
	Industrials	●	●	●	■	■	●	→	10.2	Early cyclical well positioned for recovery. Stimulus is a catalyst, though construction weakness is a risk.	Machinery, Transportation	Aerospace & Defense
MID	Financials	●	●	●	■	■	●	■	12.5	While near-term challenges are onerous, policy actions may continue to support the group.	Banks, Diversified Financials	Insurance, REITs
	Technology	●	●	●	■	■	●	■	18.0	Strong balance sheets and productivity initiatives make this sector a defensive cyclical.	Software, Hardware	IT Services
LATE	★ Energy	●	●	●	■	○→●	■		12.6	Oil is likely range-bound between \$40 and \$60. Sector likely to keep pace in a sideways or down market.	MLPs	Exploration & Production, Refiners
	Materials	●	●	●	■	■	●	■	3.2	Though a late cyclical sector, emerging market growth and signs of U.S. recovery are positive.	Metals & Mining	Paper & Forest Products

★ Denotes change in view from last issue. ● Negative ● Neutral ● Positive

# Fixed Income Compass

April 22, 2009

## Wide Spreads and Improving Liquidity Favors an Overweight to Credit

Investment-Grade Corporate Bonds remain our favorite sector among bonds despite recent spread widening, which has largely been confined to Financials. Fears that holders of bank debt might be forced to take a principal reduction should be limited to select issues in our view, not the broad market. Overall, yield advantages to Treasuries remain well above the historical average and more than double the 2002 peak. Liquidity is slowly improving and investors are being paid to wait. High-Yield Bonds appear attractive and we are biased favorably but we await cheaper valuations, better liquidity, and improvement in economic data before adding. Emerging Market Debt will benefit from the IMF fiscal stimulus plan. EM Debt spreads have tightened in recent months but yields are still attractive.

	Fundamentals	Technicals	Valuation	View			Bias	Active Manager Performance	Comment		
				High		Low					
				Short		Long					
Credit Quality	●		●			●	→		Credit spreads near record wide levels; flight-to-quality rally has made government bond valuations rich.		
Duration	●		●		●				Expect short rates to stay low and yield curve to steepen; favor interm maturities. Prefer sector exposure.		
				Negative	Neutral	Positive					
TAXABLE BONDS	U.S.	Treasuries	●	●	●	●			+	Fed to buy \$300B to keep rates low, but valuations expensive. Record supply inflationary over time.	
		TIPS	●	●	●	●		→	-	Prefer to conventional Treasuries. Pricing in very low inflation, but real yields are still low.	
		Agency Debt	●	●	●	●		←		Prefer to Treasuries but yields low. Fed's commitment to buy \$200B provides continued support.	
		Investment-Grade Corporates	●	●	●	●				Spreads wide at +510 bps. Fundamentals for non-financials stronger than past credit market downturns.	
		★ Agency Mortgages	●	●	●	●		←	○	Performance to be more muted going forward. Fed's \$1.25 trillion purchase plan still provides support	
		Non-Agency Mortgages	●		●	●				Government programs such as the TALF and P-PIP target these assets.	
		Preferred Stocks	●	●	●	●				Still attractive after recent rally. Fears of nationalization and suspension of dividends drove record selloff.	
		High Yield	●	●	●	●			→	-	Expected peak default rate (15%) lower than current pricing (19%) implies; spreads wide at +1400 bps.
		Bank Loans	●	●	●	●			→	-	Deleveraging sent loan prices to record lows; default rates increasing but recovery rates exceed HY.
		FOREIGN	Foreign Bonds - Hedged	●	●	●	●				Concerns about sovereign credit quality downgrades; market has fully priced in rate cuts.
Foreign Bonds - Unhedged	●		●	●	●				Volatile asset class that benefits from a weakening US dollar.		
Emerging Market Debt	●		●	●	●		→	-	Fundamentals remain challenged, despite recent rally. IMF fiscal stimulus plan is beneficial.		
TAX-FREE BONDS	Munis - Short Term	●	●	●	●			+	Muni curve is steep, and short-term yields are very low.		
	Munis - Intermediate Term	●	●	●	●			+	Pressured by supply concerns; an attractive yield advantage to Treasuries; not pricing in tax increases.		
	Munis - Long Term	●	●	●	●			-	30-year AAA-rated GO bond yield at 5.13%, well above Treasuries, but below the recent peak of 5.99%.		
	Munis - High Yield	●	●	●	●		→		Did not participate in Muni market rally; priced near record high yields, despite low default rates.		

★ Denotes change in view from last issue. ● Negative ● Neutral ● Positive

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rate rise and are subject to availability and change in price. High yield/junk bonds are not investment grade securities, involve substantial risks and generally should be part of the diversified portfolio of sophisticated investors. Muni Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise. Interest income may be subject to the alternative minimum tax. Federally tax-free but other state and local taxes may apply.

Duration: A measure of the sensitivity of the price (the value of principal) of a fixed-income investment to a change in interest rates. Duration is expressed as a number of years. Rising interest rates mean falling bond prices, while declining interest rates mean rising bond prices. The bigger the duration number, the greater the interest-rate risk or reward for bond prices.

## Appendix I - CCI Components

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To create the index we found 10 indicators that provided a weekly, real-time measure of the conditions in the economic and market environment. We then standardized these components compared to their pre-crisis 10-year average, equally weighted their standardized scores, and aligned the resulting index with zero at the start of 2009. These components capture how the conditions are evolving from a wide range of angles. Each component is important and measures a different driver of the environment. The 10 components of the CCI are described below:

- 1. Initial Jobless Claims** – Measures the number of people filing for unemployment benefits. A rise in the number of new claims acts as a negative on the CCI.
- 2. TED Spread** – The TED Spread measures the difference between the 3-month LIBOR rate and the yield on 3-month Treasury bills. This is an effective measure of the liquidity available to banks. With bank capital adequacy near the center of the current crisis this is an important gauge of the stress in the banking system. A rise in the TED Spread acts as a negative on the CCI.
- 3. Baa Spreads** – The yield on corporate bonds above the rate on comparable maturity Treasury debt is a market-based estimate of the amount of fear in the bond market. Baa-rated bonds are the lowest quality bonds still considered investment grade, rather than high-yield. Therefore, they best reflect the stresses across the quality spectrum. A rise in Baa spreads acts as a negative for the CCI.
- 4. Retail Sales** - International Council of Shopping Centers tabulates data on major retailers' sales compared to the same week a year earlier. This measures the current pace of consumer spending. Consumer spending makes up two-thirds of GDP. Rising retail sales act as a positive for the CCI.
- 5. Shipping Rates** – A measure of global trade, the Baltic Exchange compiles the Baltic Dry Freight Index which tracks the cost to ship various cargoes of raw materials on key routes around the world. Since the supply of dry bulk ships does not change much in the short-term, the index is moved by the amount of cargo that is being traded in various global markets. A growing global economy moves more cargo which pushes up shipping rates. A rise in shipping rates acts as a positive for the CCI.
- 6. Consumer Confidence** – The weekly survey of consumer attitudes by ABC News provides a gauge of the sentiment that drives two-thirds of U.S. economic growth. While we have often stressed that confidence is not a leading indicator, it is coincident and reflects the current environment. A rise in consumer confidence acts as a positive for the CCI.
- 7. VIX** – The VIX is a measure of the volatility implied in the prices of options contracts for the S&P 500. It is a market based estimate of future volatility. While this is not necessarily predictive it does measure the current degree of fear present in the stock market. A rise in the VIX acts as a negative on the CCI.
- 8. Real Money Supply Growth** – The year-over-year change in M2 growth adjusted for inflation is a measure of the Federal Reserve's actions to provide adequate liquidity for U.S. economic activity. A rise in the change in real M2 acts as a positive on the CCI.
- 9. Commodity Prices** – While retail sales captures end user demand for goods, commodity prices reflect the demand for the earliest stages of production of goods. Commodity prices can offer an indicator of the pace of economic activity. The CRB Commodity Index includes copper, cotton, etc. A rise in commodity prices acts as a positive on the CCI.
- 10. Mortgage Applications** – The weekly index measuring mortgage applications provides an indication of housing demand. With much of the credit crisis tied to housing, keeping tabs on real time buying activity can offer insight on how the crisis is evolving. A rise in the index of mortgage applications acts as a positive on the CCI.



## Appendix II - 2009 Outlook Scenarios

The three scenarios for 2009 we presented late last year include our base case, the scenario we believe to be most likely, a bear case or continued downturn, and a bull case or market rebound.

### Base Case

The financial panic that began in September 2008 will subside in early 2009 allowing a normalization of financial markets by mid-year 2009.

#### Why would the base case prevail?

- Intervention policies implemented by the U.S. government begin to take effect.
- Market sentiment remains cautious through volatile January markets.
- Consumers remain cautious after a dismal 2008 holiday sales season.
- Unemployment remains relatively high through much of the first half of the year.

#### The base case scenario:

- The economy emerges from recession in the second half of 2009.
- Inflation turns negative early in 2009, but rises by the end of the year.
- The stock market, as measured by the S&P 500, posts a return that enters into the double digits, as a volatile first half of the year gives way to more consistent improvement in earnings and sentiment in the second half.
- The bond market, as measured by the Barclays Aggregate Bond Index, posts a return in the mid- to high-single digits range.
- Alternative mutual fund, “volatility” strategies continue to help returns in the first part of the year.

### Bear Case

The financial panic lingers well into 2010, and financial markets do not normalize at all over the course of 2009.

#### Why would the bear case prevail?

- Foreign bank failures continue without the type of intervention seen in the United States.
- Housing sales break down from the stable levels of the past year and follow the path of auto sales sharply downward.
- Increasingly aggressive forced selling by financial institutions or a major negative geopolitical event further disrupts the markets.

#### The bear case scenario:

- The economy lingers in a recession throughout 2009 and into 2010 with a frozen lending market.
- Stocks post another year similar to 2008, marked by a substantial decline as confidence fails to return and earnings tumble another 20%.
- Bonds return low- to mid-single digits, with additional Treasury gains offset by price weakness in non-Treasury sectors: Corporate Bonds, Mortgage-Backed Securities (MBS), and Agency Bonds.
- The alternative investment areas of opportunity are: Long/Short, Covered Calls, Managed Futures, Global Macro, Absolute Return, and Market Neutral—all those mutual fund strategies that help with volatility.

### Bull Case

The financial panic that began in September 2008 dissipates at the very start of 2009, and financial markets begin to normalize early in the year.

#### Why would the bull case prevail?

- Evidence of a sharp rebound in market sentiment comes in late 2008 or early 2009.
- Policy actions take effect sooner than expected.
- Falling mortgage rates help to deliver a bottom in home prices.
- The Federal Reserve injects more capital into financial institutions, and lending accelerates.

#### The bull case scenario:

- The economy experiences a quick rebound from the recession and a rebound in the credit markets as confidence is restored.
- Stocks rebound: both earnings and valuations snap back as a mountain of cash is returned to the capital markets.
- The bond market returns high-single digits as income and price appreciation, from Corporate Bonds in particular, more than offsets Treasury weakness.
- Most alternative strategies provide positive results but trail the strong stock market in this bullish scenario.

Alternative investment mutual fund strategies are subject to increased risks due to the use of derivatives and/or futures.

Alternative investments may not be suitable for all investors and should be considered as an investment for the risk capital portion of the investor's portfolio. The strategies employed in the management of alternative investments may accelerate the velocity of potential losses.

## Portfolio Compass Definitions

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### ECONOMIC DEFINITIONS

Consumer Spending: Real Personal Consumption Expenditures from the U.S. Government's National Income and Product Accounts.

Business Spending: Business Investment in Equipment and Inventories from the U.S. Government's National Income and Product Accounts.

Housing: Amalgamation of housing prices and housing construction activity.

Export Sector: Real Net Exports from the U.S. Government's National Income and Product Accounts.

Labor Market: Unemployment Rate and Nonfarm Payroll job count from the U.S. Bureau of Labor Statistics.

Inflation: Consumer Price Index, overall and excluding food and energy, from the U.S. Bureau of Labor Statistics.

Fiscal Policy: The U.S. Federal government's spending and tax policies.

Monetary Policy: The U.S. Federal Reserve's policies on interest rates and the money supply.

Government Policy: Overall U.S. government policy as it relates to the banking and housing crises.

US dollar: Broad measure of the US dollar versus the currencies of its major trading partners (Canada, Eurozone, Japan, UK, etc.)

International Economies – Developed: Proxy for economic, fiscal, and monetary health of major developed international economies (Canada, Eurozone, Japan, UK, etc.)

International Economies – Emerging: Proxy for economic, fiscal, and monetary health of major emerging international economies (China, India, Russia, Brazil, Eastern Europe, Latin America, etc.)

Financial Conditions: A measure of the health of the financial system relative to "normal" times. Indicators include, but are not limited to: short term credit spreads, overnight bank lending rates, spreads on corporate debt, willingness of banks to lend to each other, willingness of banks to lend to customers, and the ability of corporations to finance themselves in the short-and long-term debt and equity markets

Yield Curve: Difference in basis points between the 10-year Treasury note and the 3-month T-Bill.

### EQUITY AND COMMODITY ASSET CLASSES

Large Growth: Stocks in the top 70% of the capitalization of the U.S. equity market are defined as Large Cap. Growth is defined based on fast growth (high growth rates for earnings, sales, book value, and cash flow) and high valuations (high price ratios and low dividend yields).

Large Value: Stocks in the top 70% of the capitalization of the U.S. equity market are defined as Large Cap. Value is defined based on low valuations (low price ratios and high dividend yields) and slow growth (low growth rates for earnings, sales, book value, and cash flow).

Mid Growth: The U.S. mid-cap range for market capitalization typically falls between \$1 billion and \$8 billion and represents 20% of the total capitalization of the U.S. equity market. Growth is defined based on fast growth (high growth rates for earnings, sales, book value, and cash flow) and high valuations (high price ratios and low dividend yields).

Mid Value: The U.S. Mid Cap range for market capitalization typically falls between \$1 billion and \$8 billion and represents 20% of the total capitalization of the U.S. equity market. Value is defined based on low valuations (low price ratios and high dividend yields) and slow growth (low growth rates for earnings, sales, book value, and cash flow).

Small Growth: Stocks in the bottom 10% of the capitalization of the U.S. equity market are defined as Small Cap. Growth is defined based on fast growth (high growth rates for earnings, sales, book value, and cash flow) and high valuations (high price ratios and low dividend yields).

Small Value: Stocks in the bottom 10% of the capitalization of the U.S. equity market are defined as Small Cap. Value is defined based on low valuations (low price ratios and high dividend yields) and slow growth (low growth rates for earnings, sales, book value, and cash flow).

U.S. Stocks: Stock of companies domiciled in the U.S.

## Portfolio Compass Definitions (CONT.)

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### EQUITY AND COMMODITY ASSET CLASSES (CONT.)

**Large Foreign:** Large-cap foreign stocks have market capitalizations greater than \$5 billion. The majority of the holdings in the large foreign category are in the MSCI EAFE Index.

**Emerging Markets:** Stocks of a single developing country or a grouping of developing countries. For the most part, these countries are in Eastern Europe, Africa, the Middle East, Latin America, the Far East and Asia.

**REITs:** REITs are companies that develop and manage real-estate properties. There are several different types of REITs, including apartment, factory-outlet, health-care, hotel, industrial, mortgage, office, and shopping center REITs. This would also include real-estate operating companies.

**Commodities – Industrial Metals:** Stocks in companies that mine base metals such as copper, aluminum and iron ore. Also included are the actual metals themselves. Industrial metals companies are typically based in North America, Australia, or South Africa.

**Commodities – Precious Metals:** Stocks of companies that do gold- silver-, platinum-, and base-metal-mining. Precious-metals companies are typically based in North America, Australia, or South Africa.

**Commodities – Energy:** Stocks of companies that focus on integrated energy, oil & gas services, oil & gas exploration and equipment. Public energy companies are typically based in North America, Europe, the UK, and Latin America.

### EQUITY SECTORS

**Consumer Discretionary:** Companies that tend to be the most sensitive to economic cycles. Its manufacturing segment includes automotive, household durable goods, textiles and apparel, and leisure equipment. The service segment includes hotels, restaurants and other leisure facilities, media production and services, consumer retailing and services and education services.

**Consumer Staples:** Companies whose businesses are less sensitive to economic cycles. It includes manufacturers and distributors of food, beverages and tobacco, and producers of non-durable household goods and personal products. It also includes food and drug retailing companies.

**Energy:** Companies whose businesses are dominated by either of the following activities: The construction or provision of oil rigs, drilling equipment and other energy-related service and equipment, including seismic data collection or the exploration, production, marketing, refining and/or transportation of oil and gas products, coal and consumable fuels.

**Financials:** Companies involved in activities such as banking, consumer finance, investment banking and brokerage, asset management, insurance and investment, and real estate, including REITs.

**Health Care:** Companies in two main industry groups: Health Care equipment and supplies or companies that provide health care-related services, including distributors of health care products, providers of basic health care services, and owners and operators of health care facilities and organizations or companies primarily involved in the research, development, production and marketing of pharmaceuticals and biotechnology products.

**Industrials:** Companies whose businesses: Manufacture and distribute capital goods, including aerospace and defense, construction, engineering and building products, electrical equipment and industrial machinery; provide commercial services and supplies, including printing, employment, environmental and office services; provide transportation services, including airlines, couriers, marine, road and rail, and transportation infrastructure.

**Technology:** Companies that primarily develop software in various fields such as the Internet, applications, systems and/or database management and companies that provide information technology consulting and services. Technology hardware & equipment include manufacturers and distributors of communications equipment, computers and peripherals, electronic equipment and related instruments, and semiconductor equipment and products.

**Materials:** Companies that engage in a wide range of commodity-related manufacturing. Included in this sector are companies that manufacture chemicals, construction materials, glass, paper, forest products and related packaging products, metals, minerals and mining companies, including producers of steel.

**Telecommunications:** Companies that provide communications services primarily through a fixed line, cellular, wireless, high bandwidth and/or fiber-optic cable network.

**Utilities:** Companies considered electric, gas or water utilities, or companies that operate as independent producers and/or distributors of power.

## Portfolio Compass Definitions (CONT.)

### FIXED INCOME ASSET CLASSES

**Credit Quality:** An individual bond's credit rating is determined by private independent rating agencies such as Standard & Poor's, Moody's and Fitch. Their credit quality designations range from high ('AAA' to 'AA') to medium ('A' to 'BBB') to low ('BB', 'B', 'CCC', 'CC' to 'C').

**Duration:** A measure of the sensitivity of the price (the value of principal) of a fixed-income investment to a change in interest rates. Duration is expressed as a number of years. Rising interest rates mean falling bond prices, while declining interest rates mean rising bond prices. The bigger the duration number, the greater the interest-rate risk or reward for bond prices.

**Treasuries:** A marketable, fixed-interest U.S. government debt security. Treasury bonds make interest payments semi-annually and the income that holders receive is only taxed at the federal level.

**TIPS (Treasury Inflation Protected Securities):** A special type of Treasury note or bond that offers protection from inflation. Like other Treasuries, an inflation-indexed security pays interest every six months and pays the principal when the security matures. The difference is that the underlying principal is automatically adjusted for inflation as measured by the consumer price index (CPI).

**Agencies:** Securities issued by corporations and agencies created by the U.S. government, such as the Federal Home Loan Bank Board and Fannie Mae.

**Investment-Grade Corporates:** Securities issued by corporations with a credit rating of BBB- or higher. Bond rating firms, such as Standard & Poor's, use different designations consisting of upper- and lower-case letters 'A' and 'B' to identify a bond's investment grade credit quality rating. 'AAA' and 'AA' (high credit quality) and 'A' and 'BBB' (medium credit quality) are considered investment grade.

**Mortgage-Backed Securities:** A Mortgage Backed Security (MBS) is an asset-backed security whose cash flows are backed by the principal and interest payments of a set of mortgage loans. Payments are typically made monthly over the lifetime of the underlying loans.

**Agency MBS:** These are issued by agencies created by the U.S. Government. Non-agency MBS are issued by private companies and include jumbo, Alt-A, and sub-prime mortgages.

**Preferred Stocks:** A class of ownership in a corporation that has a higher claim on the assets and earnings than common stock. Preferred stock generally has a dividend that must be paid out before dividends to common stockholders and the shares usually do not have voting rights.

**High-Yield Corporates:** Securities issued by corporations with a credit rating of BB+ and below. These bonds generally offer higher yields than investment grade bonds, but they are also more vulnerable to economic and credit risk.

**Bank Loans:** In exchange for their credit risk, these floating-rate bank loans offer interest payments that typically float above a common short-term benchmark such as the London interbank offered rate, or LIBOR.

**Foreign Bonds – Hedged:** Non-U.S. fixed income securities generally from investment grade issuers in developed countries, with hedged currency exposure.

**Foreign Bonds – Unhedged:** Non-U.S. fixed income securities normally denominated in major foreign currencies.

**Emerging Market Debt:** The debt of sovereigns, agencies, local issues, and corporations of emerging markets countries and subject to currency risk.

**Munis – Short-term:** Bonds issued by various state and local governments to fund public projects. The income from these bonds is generally free from federal taxes. These bonds generally have maturities of less than three years.

**Munis – Intermediate:** Bonds issued by various state and local governments to fund public projects. The income from these bonds is generally free from federal taxes. These bonds generally have maturities of between 3 and 10 years.

**Munis – Long-term:** Bonds issued by various state and local governments to fund public projects. The income from these bonds is generally free from federal taxes. These bonds generally have maturities of more than 10 years.

**Munis – High Yield:** Bonds issued by various state and local governments to fund public projects. The income from these bonds is generally free from federal taxes. These bonds generally offer higher yields than other types of bonds, but they are also more vulnerable to economic and credit risk. These bonds are rated BB+ and below.

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide or be construed as providing specific investment advice or recommendations for any individual. To determine which investments may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested in directly.

Treasury Bills are guaranteed by the U.S. government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value.

The market value of Corporate Bonds will fluctuate, and if the bond is sold prior to maturity, the investor's yield may differ from the advertised yield.

Investing in alternative investments may not be suitable for all investors and involve special risks such as risk associated with leveraging the investment, potential adverse market forces, regulatory changes, and potential illiquidity. There is no assurance that the investment objective will be attained.

Long positions may decline as short positions rise, thereby accelerating potential losses to the investor.

Stock investing involves risk including loss of principal.

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