LPL FINANCIAL RESEARCH

Weekly Market Commentary

January 12, 2009

The First Days of 2009

Jeffrey Kleintop, CFA
Chief Market Strategist
LPL Financial

Highlights

Despite last week's modest decline, the S&P 500 rallied above its 50 day moving average.

Of the bear markets since 1950, 10 of 11 retested after a relief rally. The time until the retested low averaged three months after rebounding to (or close to) the 50 day moving average.

While signs of healing continue, volatility may remain a characteristic of the markets in the coming months.

The first full week of stock and bond trading in 2009 and the start of the 111th Congress are now behind us and may hold implications for the markets.

On Tuesday of last week, the S&P 500 relief rally reached 25% above its November 20 low point, moving above its 50 day moving average. This relief rally may be tested in the coming weeks, as the fourth quarter economic and earnings data are reported and guidance on the outlook for 2009 comes from corporate leaders.

Of the bear markets since 1950, 10 of 11 retested after a relief rally. Only after the August 1982 end of the long bear market did the stock market move steadily higher without retesting the low. Retests do not always revisit the prior low, but result in a pullback of at least 50% of the relief rally that followed the low point for the bear market. The relief rallies were all a little different, but the time until the retested low averaged three months. Nearly every case resulted in the S&P 500 rebounding to (or close to) its 50 day moving average before peaking out. While signs of healing in the credit markets are evident (and we believe they will continue), volatility may remain a characteristic of the markets in the coming months.

The first full week of stock and bond trading in 2009, and the start of the 111th Congress, are now behind us and may hold implications for the markets.

Stocks

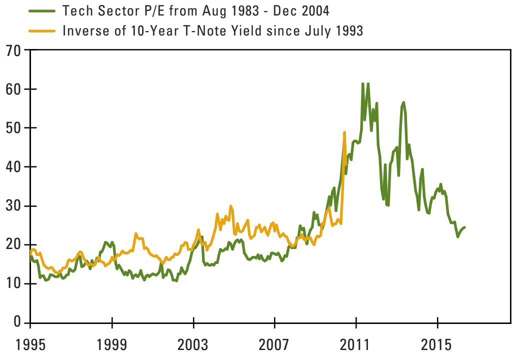
We do not place much value on indicators like the "Super Bowl indicator" or "As goes January, so goes the year", but we are often asked about them. Another one that you may hear about is the indicator known as "January's first five days," which suggests that if the first five days of the year are a net positive then the market is likely to result in a gain for the year. The support for that indicator comes from the fact that of the 36 times the first five days of January have posted a net gain since 1950, 31 were followed by full year gains for the S&P 500 – at first glance an 86% accuracy level.

How significant is that? Not very. Here are a few things to keep in mind:

- The S&P 500 has posted a gain for the year about 75% of the time, no matter what the first five days have done.
- A decline in the first five days has been only about 50% accurate at predicting a down year.
- The most recent exception was in 2007, when stocks were down for the first five days but posted a modest gain for the year. In 2002, stocks posted a gain for the first five days only to end up with one of the worst years on record.

The first five days of 2009—which ended last Thursday—posted a gain, with the S&P 500 rising modestly above the 2008 year-end level of 903.25.

1 Bond Bubble Brewing



Source: LPL Financial, Factset Research Systems, Bloomberg

A good omen? Perhaps. However, the week ended with a modest loss. Regardless, we believe 2009 will be a rewarding one for patient investors, with a gain in the mid-teens for the S&P 500 if the base case for the economy and financial conditions described in our Outlook for 2009 publication unfolds.

Bonds

The first five days of 2009 also may have brought us the beginning of the bursting of the Treasury bubble. Back on November 10, 2008 Weekly Market Commentary was entitled Bubbles and explored financial bubbles past, present, and future. In that publication, we cited two bubbles that may be developing: cash equivalents and Treasury bonds. At that time, the bond yield on the 10-year Treasury note was near 4%. In the weeks that followed the yield dropped as low as 2.055%, as Treasury prices soared into bubble territory—valued nearly as high as Technology stocks during the dot-com bubble of the late 1990s. In the past week, as Treasury prices fell, the 10 year Treasury note yield began climbing back, to about 2.5%.

The moves in the Treasury market do not necessarily mean the potential bubble will burst. The increasing debt load and potential for inflation in 2010 may apply increasing pressure to yields, and rates may return to 4% quickly. A bubble could continue to develop, as the Fed may buy Treasuries in an effort to keep rates low to stimulate the economy and housing.

Congress

Last week was also the first for the 111th Congress, during which key priorities and timing were discussed. Most significantly, the Democratic leadership has made it clear they hope to pass a major fiscal stimulus bill within the next several weeks. While market participants seem to be pricing in swift passage, the timing will be dependent upon the size of the package and how inclusive it is of controversial measures involving an auto bailout, housing, and various TARP provisions. Signs of steady improvement in credit conditions over the past week reflect the ongoing actions of the Federal Reserve and Treasury along with the expectation of additional stimulus to be delivered in the coming months.

Three key issues high on the Congress priority list and likely to see some legislative action are taxes, health care, and climate change. In 2009, we expect the markets to react to developments as bills take shape in the coming months on these topics.

IMPORTANT DISCLOSURES

Investing in international and emerging markets may entail additional risks such as currency fluctuation and political instability. Investing in small-cap stocks includes specific risks such as greater volatility and potentially less liquidity.

Stock investing involves risk including loss of principal. Past performance is not a guarantee of future results.

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.

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

This research material has been prepared by LPL Financial.

The LPL Financial family of affiliated companies includes LPL Financial, UVEST Financial Services Group, Inc., Mutual Service Corporation, Waterstone Financial Group, Inc., and Associated Securities Corp., each of which is a member of FINRA/SIPC.

Not FDIC or NCUA/NCUSIF Insured | No Bank or Credit Union Guarantee | May Lose Value | Not Guaranteed by any Government Agency | Not a Bank/Credit Union Deposit