



Weekly Market Commentary



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Five Reasons Not To Panic

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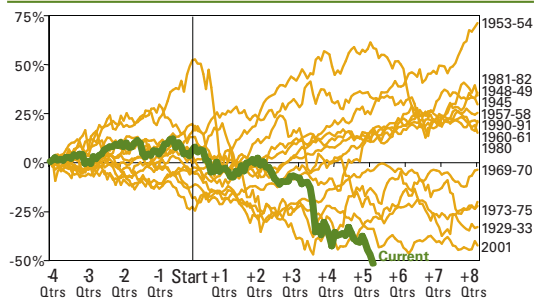
Highlights

Why Stay Invested?

1. Investors have priced in a scenario even worse than the Great Depression - the current recessionary bear market holds the record for the worst overall decline in the S&P 500.
2. The two previous times in the past 80 years that a bear market like this one has wiped out more than 10 years of gains, stocks provided solid gains in the years that followed.
3. The stock market has only stayed this cheap (P/E ratio under 10) if inflation was in the double-digits compounding the stresses of a recession – currently inflation is 0%.
4. Although the stock market has made new lows other key components of the macro environment have not - stocks may be overreacting.
5. Technical indicators show that the stock market may be overdue for another bounce.

1 What is Priced In?

S&P 500 One Year Before, During, and After Recessions



Source: Bloomberg, LPL Financial

The urge to panic has not been this intense in a generation. If you are willing to stay invested we think there are five reasons why you may benefit.

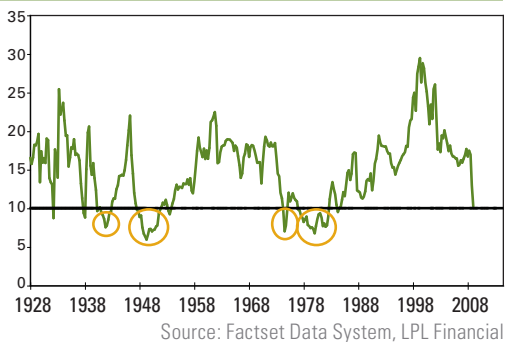
1. Investors braced for the worst. Measured from one year before the start of each one of the past 13 recessions, the current recessionary bear market holds the record for the worst overall decline in the S&P 500 at 50%. It is even worse than the Great Depression. That sounds bad. But while the current recession may be referred to by future historians as the Great Recession, market participants may have priced in even this dire scenario. A record-breaking 70% of investors surveyed by the American Association of Individual Investors bearish on the stock market last week, showed pessimism may be nearing a peak and the stock market may be due for a bounce. [Chart 1]
2. This bear market is very deep by historical terms and it has wiped out a long history of gains. The S&P 500 has returned to levels last seen in late 1996. While it took many years to reach new highs, the low that wiped out more than a decade of equity gains, like the bear market in 1974 which took the index back to where it was in 1962, signalled the nearing end of that decline and the markets provided solid gains in the years that followed. It is also important to keep in mind that earnings per share are more than 50% higher than they were when the index was last at this level in 1996. [Chart 2]
3. The stock market has only stayed this cheap if inflation was in the double-digits compounding the stresses of a recession. Over the entire 80 year history of the S&P 500, the periods that the price-to-earnings ratio (the current level of the index divided by the prior four quarters of earnings) stayed below the 10 it at now for more than a quarter or two was during 1941-42, 1947-51, 1974, and 1977-1982. During each of these four periods, inflation reached over 10%. During other years when P/Es briefly fell to current levels inflation was not a problem and valuations rebounded. Currently, inflation is not a problem at 0%. [Chart 3]
4. Although the stock market has made new lows other key components of the macro environment have not.
 - Credit spreads, which have been an important barometer of the credit crisis which precipitated the recession, have not made new wides— these include investment grade Corporate Bond spreads and 3-month LIBOR spreads.
 - While lagging economic data like jobless are reflecting the decisions made a few months ago, leading economic data which offer a more



2 When S&P 500 Wiped Out 10+ Years of Gains
 Bear Market Was Near The End
S&P 500 From Inception With Periods When 10+ Years of Gains Were Wiped Out



3 Only With Double-Digit Inflation Did Valuations Stay Below 10
S&P 500 Price to Earnings Ratio on Trailing Four Quarters Earnings Per Share



4 Economically Sensitive Commodity Prices Heading Higher
Commodity Research Bureau Metal Index



real time perspective on the pace of economic activity have not made new lows—these include the ISM Manufacturing Index and the pace of retail sales.

- Also, measures of economically sensitive commodity markets have not made new lows—these include the baltic freight index, oil prices, and primary metal prices. [Chart 4]

5. The market is very oversold on a technical basis and could bounce sharply. We have seen 5 bounces in the S&P 500 over the past five months following similar oversold conditions. We did not get a bounce in February and may be overdue. The frequent bounces in the S&P 500 that followed similar conditions over the past five months have been around 10 to 20% and worth participating in:

Bounce	Trading Days	Gain in S&P 500
10/10-10/13	1	12%
10/27-11/4	6	19%
11/20-11/28	6	19%
12/1-12/8	5	12%
1/20-1/28	6	9%
Average	5	14%

Source: LPL Financial, Bloomberg

There are policy actions and stimulus in the pipeline that should soon begin to have a measurable impact on the economy. The \$800 billion fiscal stimulus package passed in February has been determined by the non-partisan Congressional Budget Office to add 4% to GDP in the third and fourth quarter of this year. The mortgage modification plan went into effect last week and appears likely to reduce the number of foreclosures by a substantial amount and alleviate some pressure on house prices. The TALF will begin to help restore lending to consumers on March 25 as the first funding is dispersed. As these measures to alleviate the effects of the crisis take effect the stock market may react positively. Market participants have “sold the rumor” that these plans will work, and be waiting to “buy the news” when they begin to show up in the economic data.

What do we recommend? We remain defensively positioned on the stock market, but generally do not recommend dramatically raising allocations to cash. Also, we continue to recommend underweighting stock market exposure given the obvious risks, but believe we are nearing an opportunity to increase exposure to stocks rather than go entirely to cash.



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

Investing in alternative investment 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, potential liquidity. There is no assurance that the investment objective will be attained.

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Small-cap stocks may be subject to higher degree of risk than more established companies' securities. The illiquidity of the small-cap market may adversely affect the value of these investments.

*Such a plan involves continuous investment in securities. An investor should consider their ability to continue purchasing through periods of low price levels. Such a plan does not assure a profit and does not protect against loss in declining markets.

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