LPL Financial Research

Current Conditions Index

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understanding a road to recovery

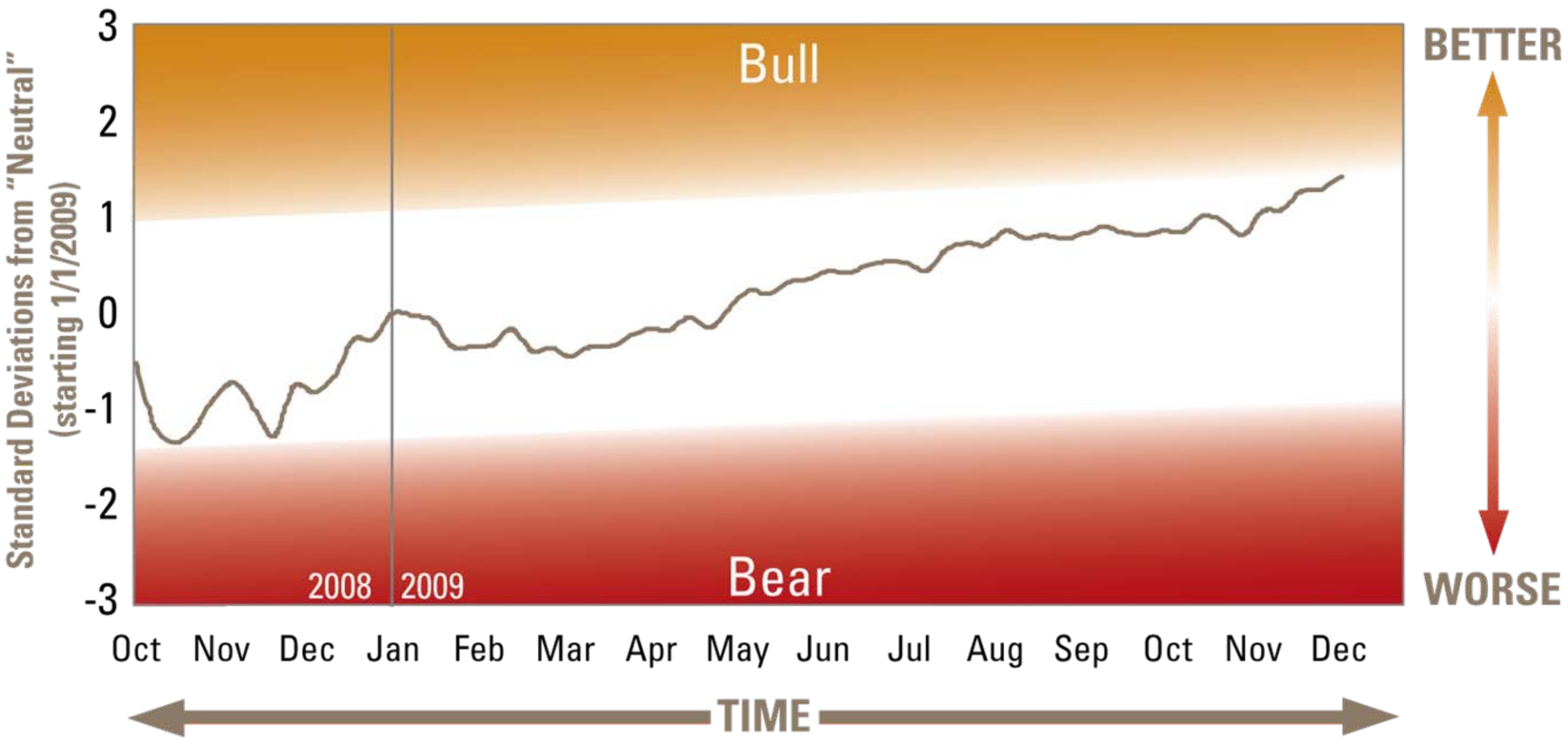
LPL Financial

The LPL Financial Research Current Conditions Index

The LPL Financial Research Current Conditions Index (CCI) is an objective and transparent measure of how the conditions are evolving relative to our base, bear, and bull cases defined in the *2009 Outlook* publication. 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 whether conditions are aligned with the expectations embedded in our investment recommendations.

There is a need for this type of measure since the stock market cannot be relied upon as an accurate gauge. The stock market can be a misleading guide to the underlying conditions. The emotions of market participants can result in an overreaction on the upside and downside. A fact-based, objective measure of conditions is necessary to understand the relative likelihood of the scenarios detailed in our *2009 Outlook* publication.

The LPL CCI is Tracking Toward our Base Case for 2009



Source: LPL Financial

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. 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 in the mid-teens, as a volatile first half of the year gives way to more consistent improvement in earnings and sentiment in the second half. We anticipate the year-end S&P 500 close to be around 1000-1050.

The bond market, as measured by the Barclays Aggregate Bond Index, posts a return in the mid- to high-single digits range.

Bear Case

The financial panic lingers well into 2010, and financial markets do not normalize at all over the course of 2009. 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 possible large decline as confidence fails to return and earnings tumble another 20%. The year-end S&P 500 close would be about 560.

Bonds return between low- to mid-single digits, with additional Treasury gains offset by price weakness in non-Treasury sectors.

In alternatives “volatility” strategies continue to benefit returns in the first part of the year.

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.

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

Stock investing involves risk including loss of principal.

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. The economy experiences a quick rebound from the recession and a rebound in the credit markets as confidence is restored.

Stocks rebound up to sharply; both earnings and valuations snap back as a mountain of cash is returned to the capital markets. The year-end S&P 500 close would be about 1365.

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.

How is it Constructed?

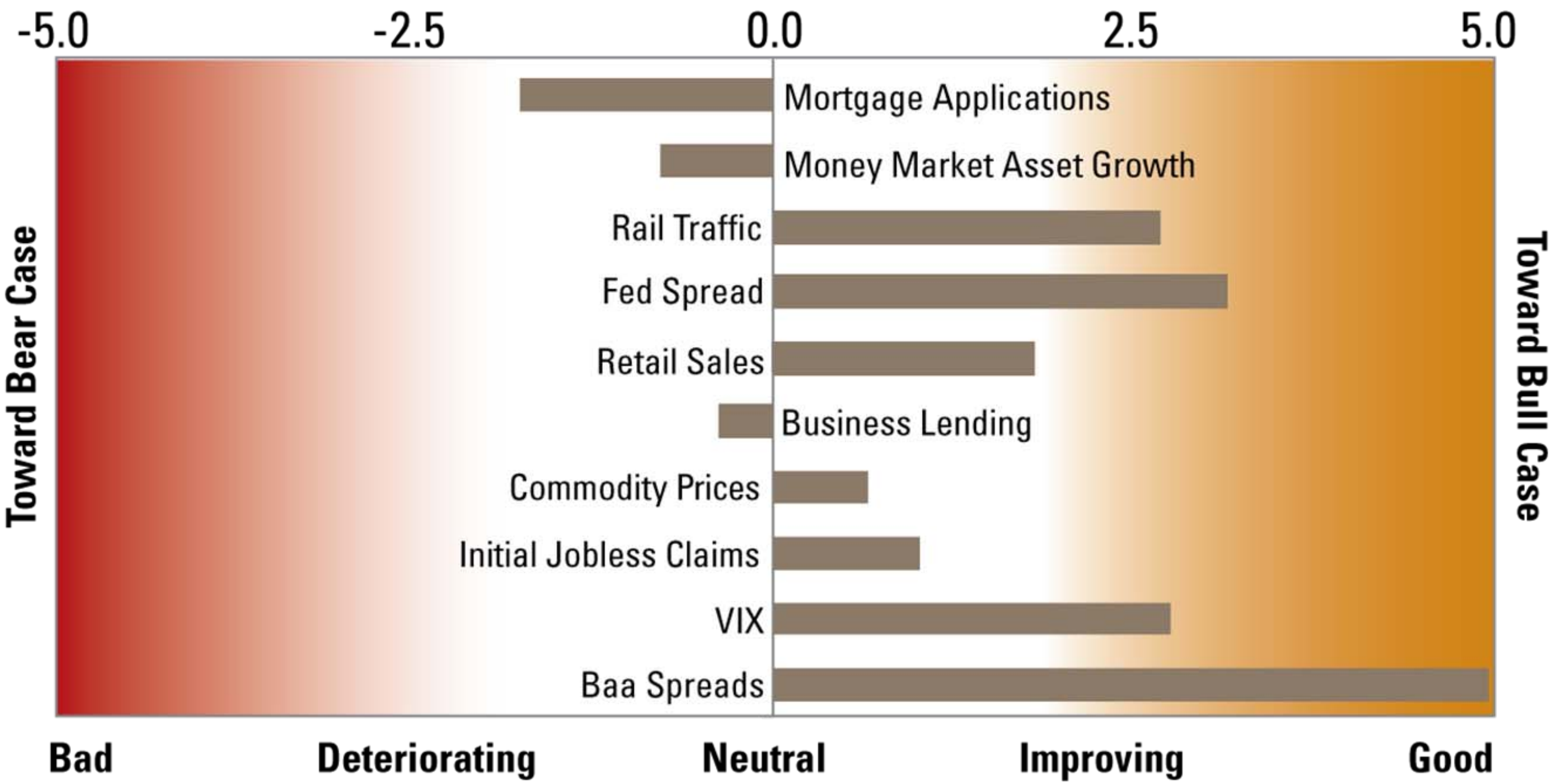
To create the index we found 10 indicators that provided a weekly, real time measure of the conditions in the economic and market environment.

In order to create an index, we 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 the year.

The ten components of the CCI are:

Baa Spreads
Fed Spread
Business Lending
Retail Sales
Mortgage Applications
Initial Claims for Unemployment Benefits
Commodity Prices
Volatility Index
Money Market Asset Growth
Rail Traffic

How are the Components Faring since the Start of the Year?



Standard Deviations from "Neutral" Since 1/1/2009

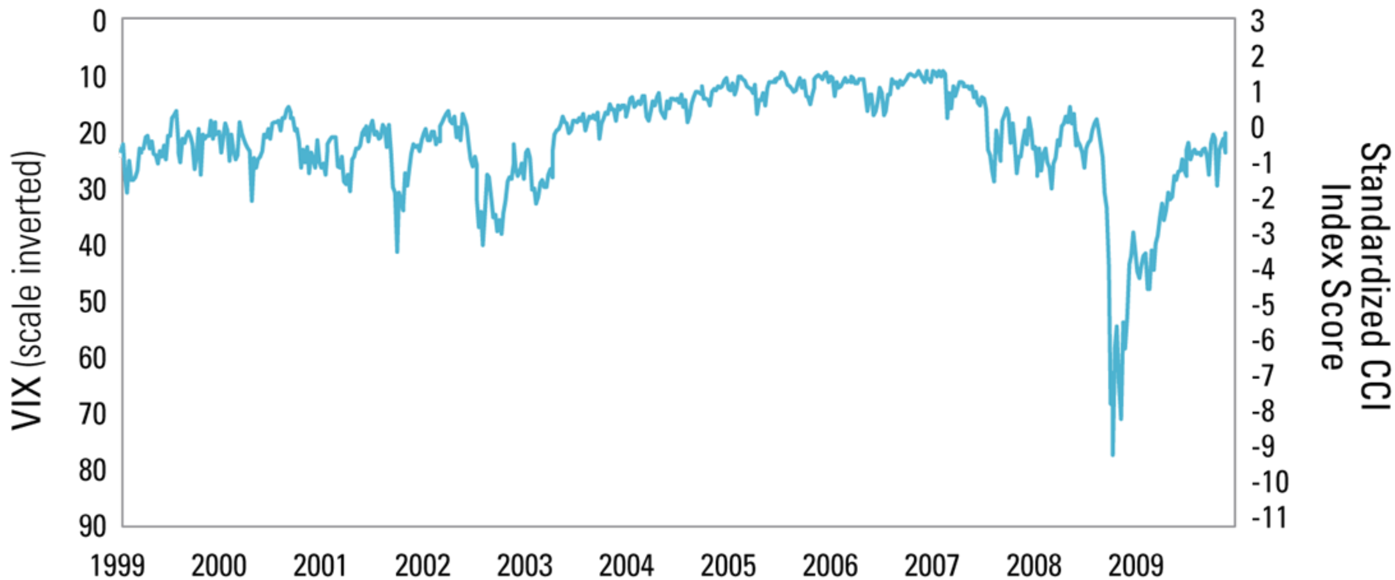
Source: LPL Financial

CCI Components

Volatility Index

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.



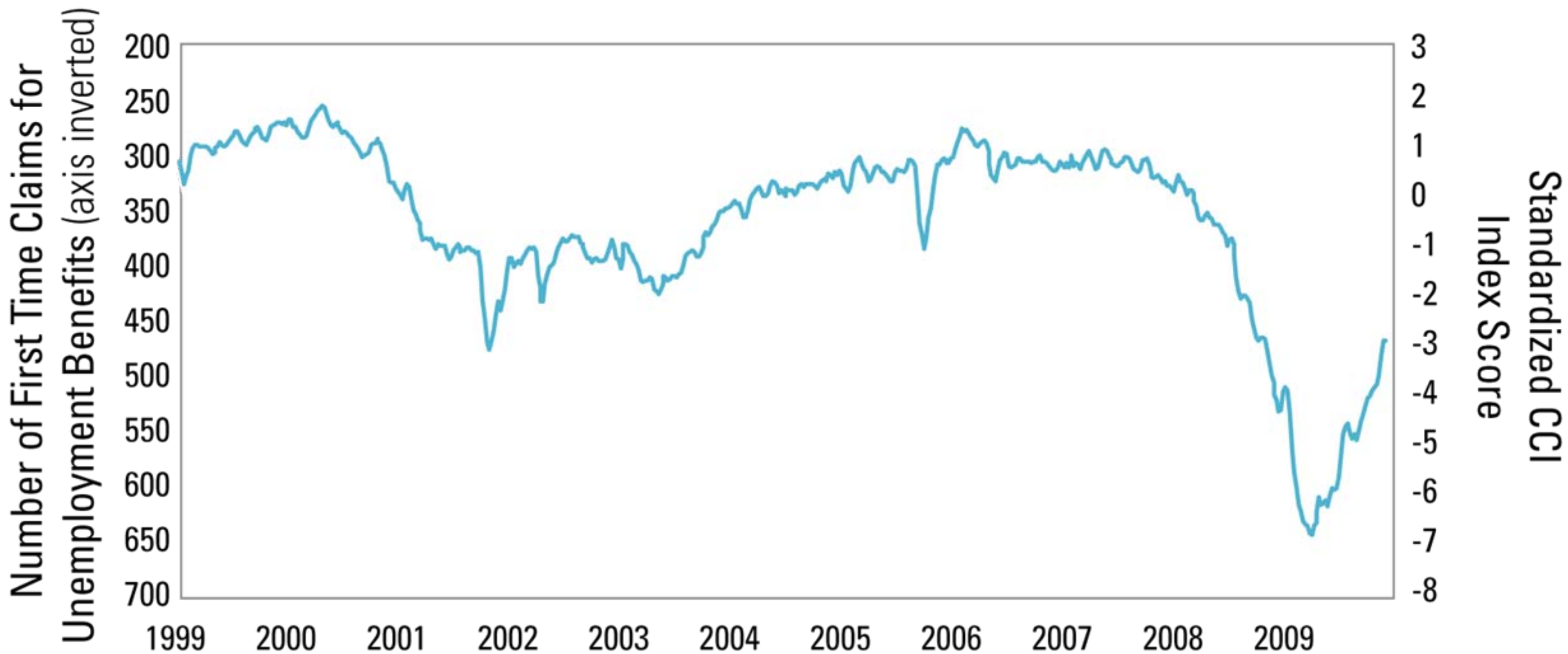
Source: Bloomberg, LPL Financial

CCI Components

Initial Claims Filed for Unemployment Benefits

Measures the number of people filing for unemployment benefits.

A rise in the number of new claims acts as a negative on the CCI.



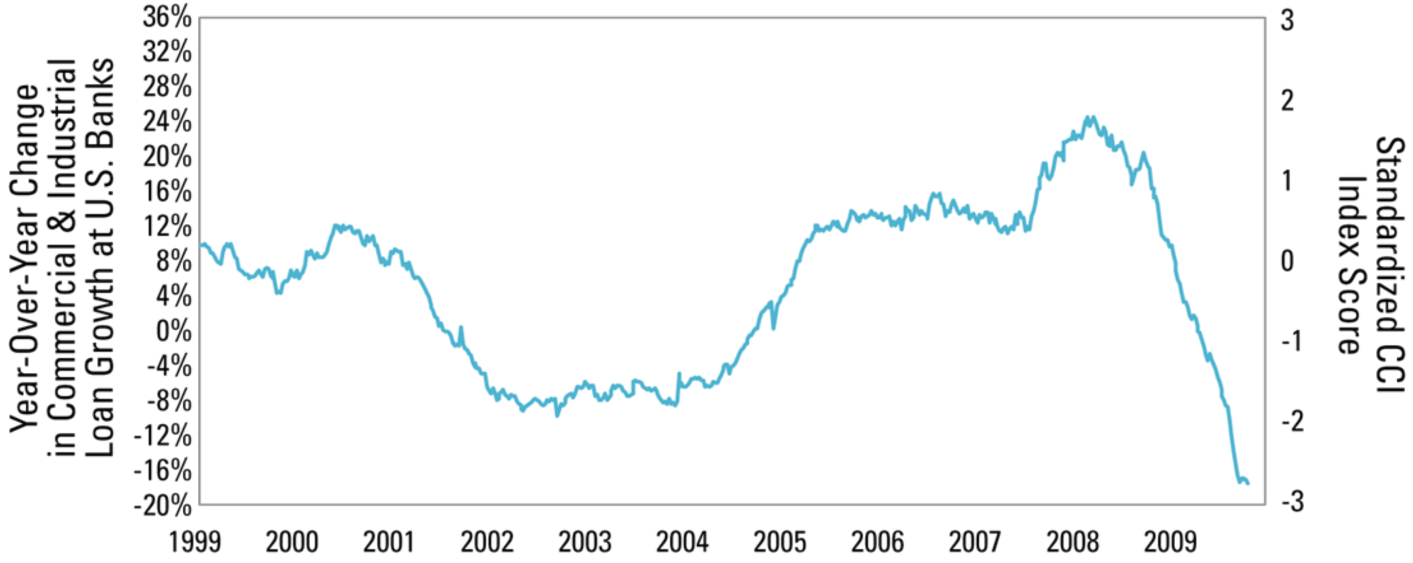
Source: Bloomberg, LPL Financial

CCI Components

Business Lending

A good gauge of business' willingness to borrow to fund growth, the Federal Reserve tabulates demand for Commercial & Industrial loans at U.S. commercial banks. More borrowing reflects increasing optimism by business leaders in the strength of demand.

A rise in loan growth acts as a positive for the CCI.



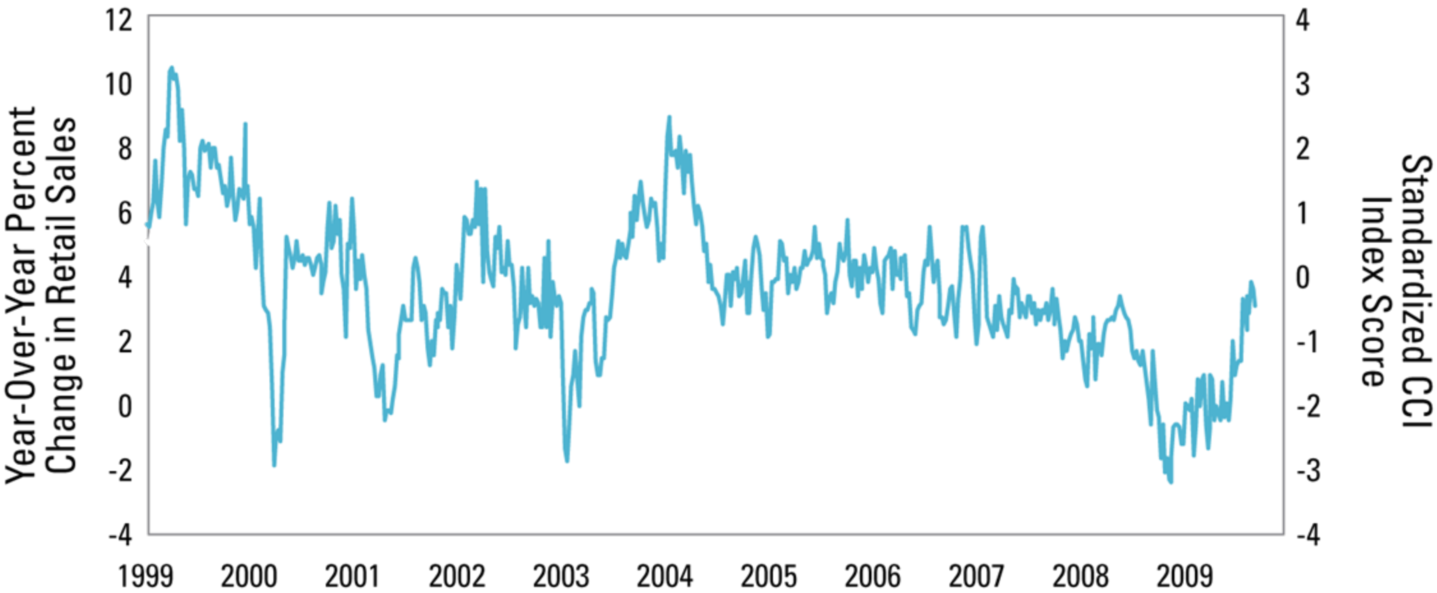
Source: Bloomberg, LPL Financial

CCI Components

Retail Sales

The International Council of Shopping Centers tabulates data on major retailer's sales compared to the same week a year earlier. This measures current pace of consumer spending. Consumer spending makes up two-thirds of GDP.

Rising retail sales acts as a positive for the CCI.



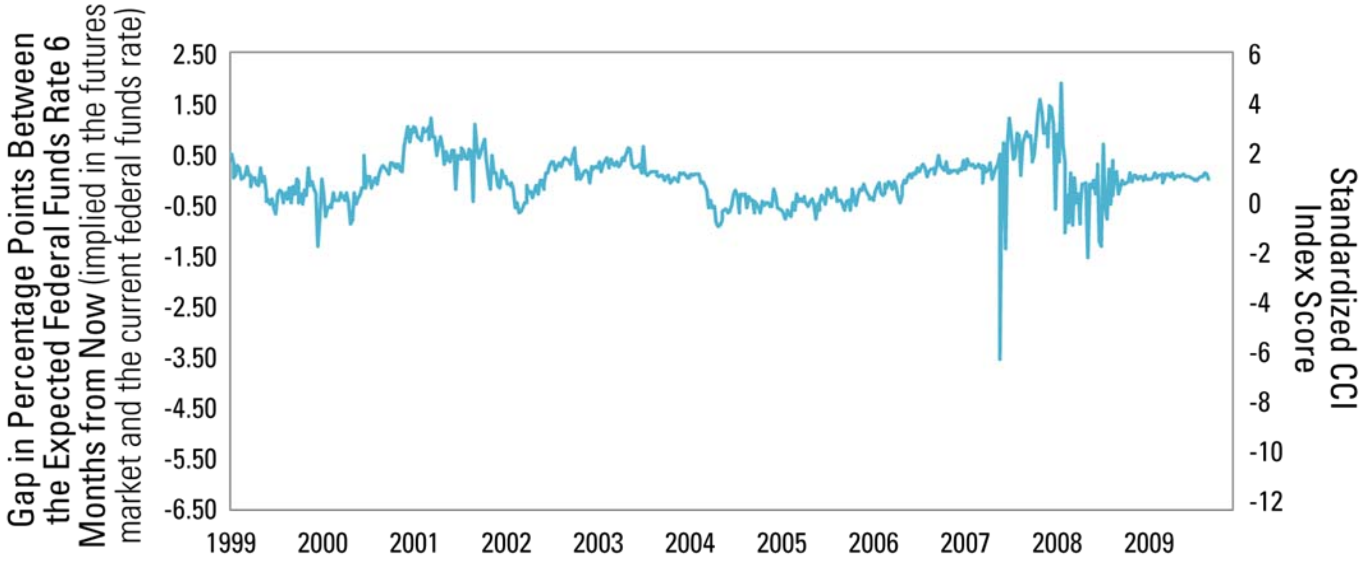
Source: ICSC, LPL Financial

CCI Components

FED Spread

A measure of future monetary policy, the futures market gives us the difference between the current federal funds rate and the expected federal funds rate six months from now. Typically, a rise in rate hike expectations weighs on the markets since higher rates increase the cost of bank borrowing and have tended to slow the growth in the economy and profits.

A rise in the Fed Spread acts as a negative for the CCI.



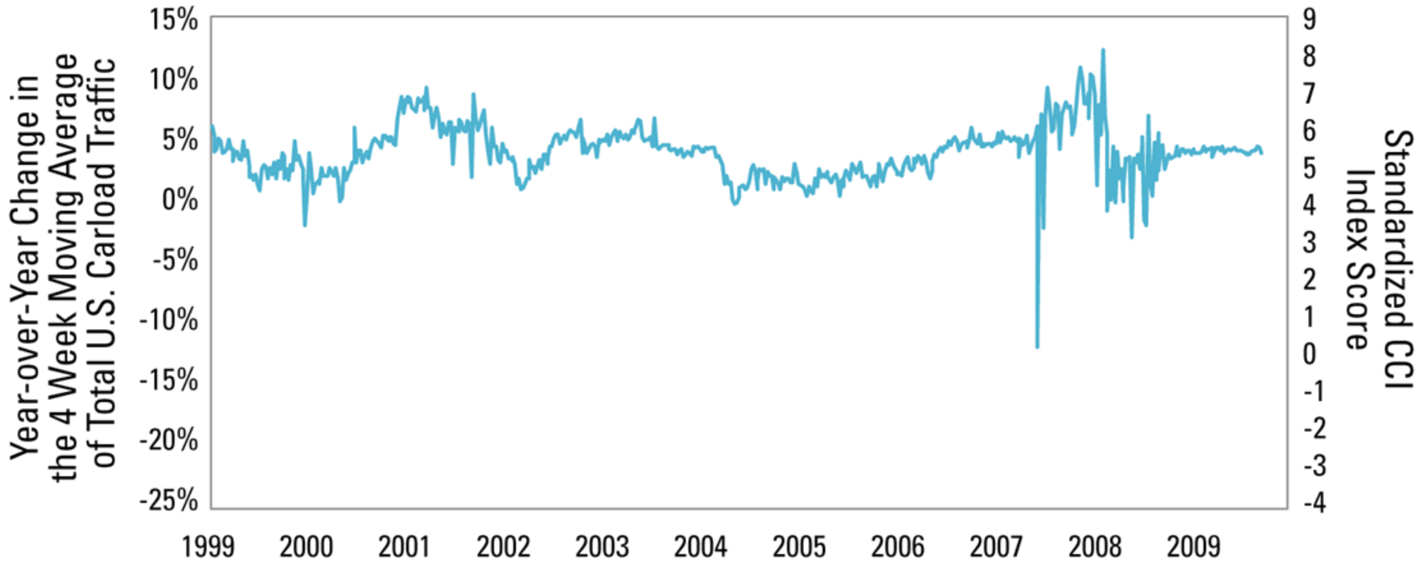
Source: Bloomberg, LPL Financial

CCI Components

Rail Traffic

A measure of trade, the Association of American Railroads tracks the number of carloads of cargo that moves by rail in the U.S. each week. A growing economy moves more cargo.

A rise in railroad traffic acts as a positive for the CCI.



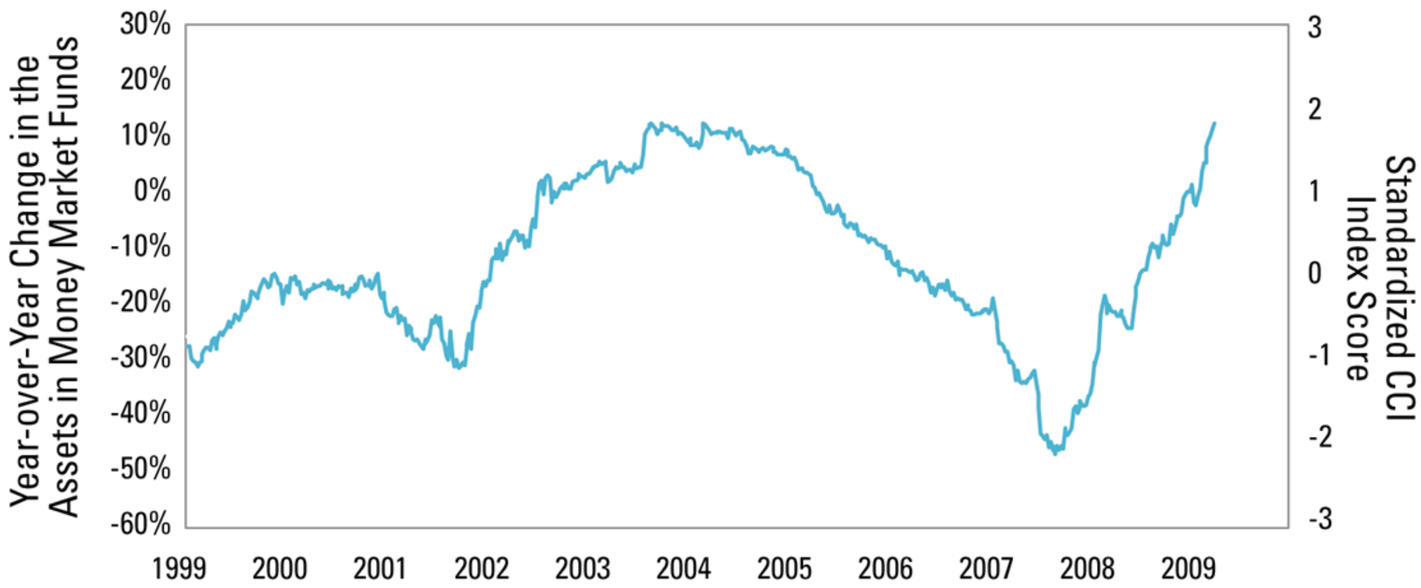
Source: Bloomberg, LPL Financial

CCI Components

Money Market Asset Growth

A measure of the willingness to take risk by investors, the year-over year change in money market fund assets tracked by Investment Company Institute shows the change in total assets in cash equivalent money market funds.

A rise in money market asset growth acts as a negative for the CCI.



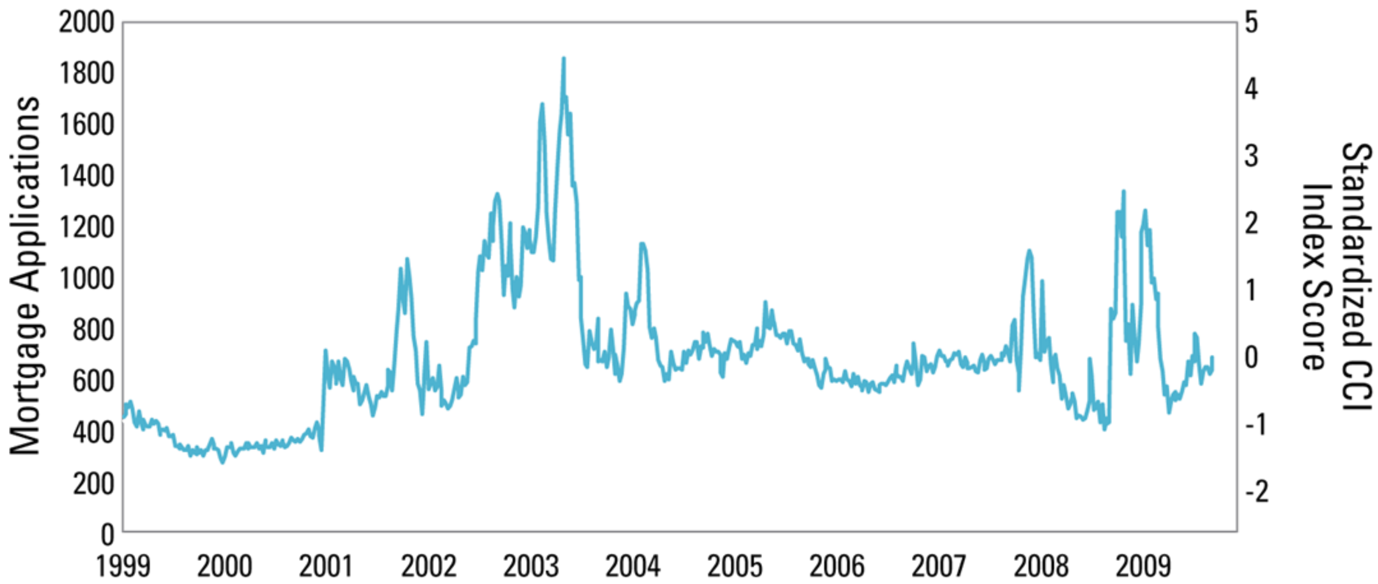
Source: Bloomberg, LPL Financial

CCI Components

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.



Source: Mortgage Bankers Association, LPL Financial

CCI Components

Commodity prices

While retail sales captures end user demand for goods, commodity prices reflect the demand for the earliest stages of production for 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.

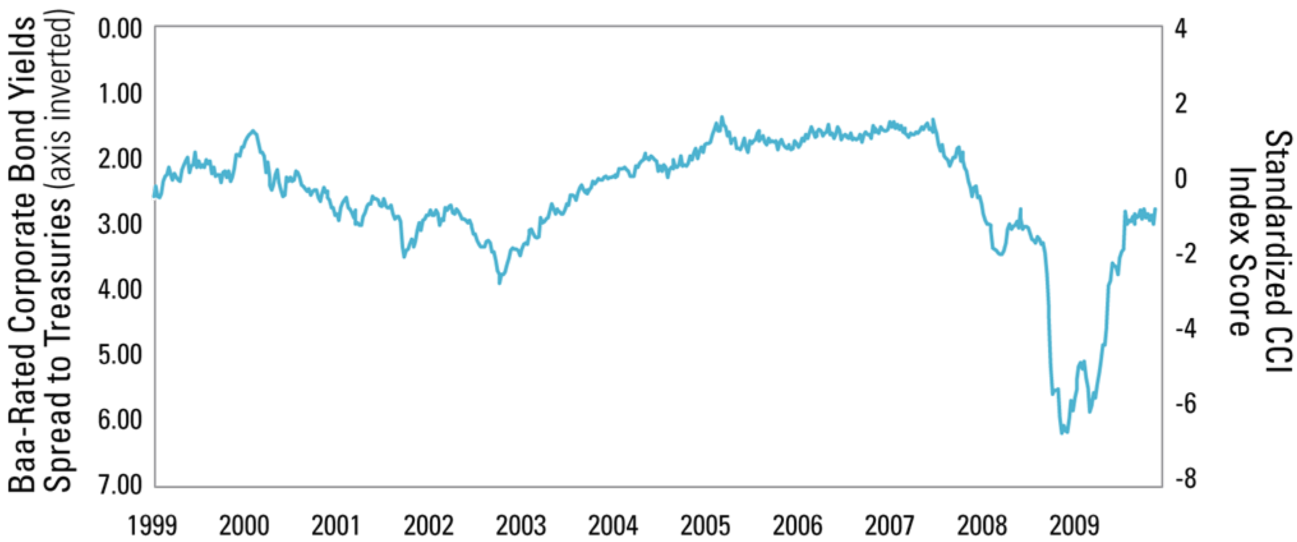
Source: Bloomberg, LPL Financial

CCI Components

Baa Spread

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.



Source: Bloomberg, LPL Financial

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 into directly.

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.

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

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

Stock investing involves risk including loss of principal.

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.

High Yield/Junk Bonds are not investment grade securities, involve substantial risks and generally should be part of the diversified portfolio of sophisticated investors.

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