

Portfolio Compass



October 17, 2012

Navigating the Markets

The *Portfolio Compass* provides a snapshot of LPL Financial Research's views on equity & alternative asset classes, the equity sectors, and fixed income. This biweekly publication illustrates our current views and will change as needed over a three- to 12-month time horizon.

Reading the *Portfolio Compass*

Fundamental, technical, and valuation characteristics for each category are shown by colored squares.

Negative, neutral, or positive views are illustrated by a solid black bar positioned over the color scale, while an outlined black bar with an arrow indicates change and shows the previous view.

Rationales for our views are provided beneath each category.

Compass Changes

- Downgraded mortgage-backed securities (MBS) to Negative/Neutral from Neutral.
- Upgraded Bank Loans to Neutral/Positive from Neutral.

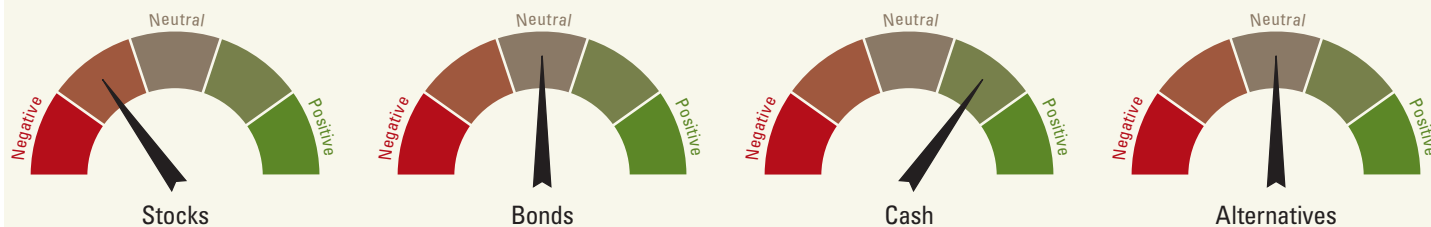
Investment Takeaways

- Our near-term stock market view remains cautious, with the S&P 500 having returned 18% this year (as of October 16, 2012).*
- Within equities, we favor growth over value, and the technology, industrials, and materials sectors.
- We expect Quantitative Easing 3 (QE3) to weaken the US dollar, strengthening the case for precious metals where our view is positive, and large foreign, which we recently upgraded to neutral.
- We have downgraded mortgage-backed securities (MBS) to negative/neutral due to valuation.
- We have upgraded bank loans, as the yield difference between other fixed income sectors has narrowed. Higher yielding segments of the bond market such as high-yield and investment-grade corporate bonds remain attractive, but we have tempered enthusiasm recently.
- The short-term technical outlook for the S&P 500 remains bullish, in an upward sloping trend channel between 1430 and 1465. Key levels to watch are 1500 on the upside and 1400 on the downside.

* LPL Financial provided this range based on our earnings per share growth estimate for 2012, and a modest expansion in the price-to-earnings ratio. Please see our *2012 Outlook* and *2012 Mid-Year Outlook* publications for further information.

Broad Asset Class Views

LPL Financial Research's views on stocks, bonds, cash, and alternatives are illustrated below. The positions of negative, neutral, or positive are indicated by the solid black compass needle, while an outlined needle shows a previous view.



Equity & Alternative Asset Classes

Favor Precious Metals as the Fed Delivers QE3

- Our near-term stock market view remains cautious, with the S&P 500 having returned 18% this year (as of October 16, 2012), above the high end of our forecast range as discussed in our 2012 *Mid-Year Outlook*.*
- Our recently upgraded, positive view of precious metals is strengthened by QE3 from the Federal Reserve (Fed), which we expect to weaken the dollar.
- Our recently upgraded large foreign view to neutral reflects recent bond policy actions in Europe, prospects for further US dollar weakness, and the improving technical picture. The large foreign (developed) benchmark, the MSCI EAFE Index, has outpaced the S&P 500 in October but still trails for the year.
- Our views are generally aligned across capitalization, with a slight preference toward large and mid. Mid caps have outperformed small and large so far in October, based on the Russell indexes, but large remains the best performer year-to-date, as the market has favored the stability and lower valuations in large cap stocks.
- We continue to favor growth over value due to its tendency to outperform in slow-growth environments, and due to our preference for technology, the biggest growth sector, over financials, the biggest value sector.

* LPL Financial provided this range based on our earnings per share growth estimate for 2012, and a modest expansion in the price-to-earnings ratio. Please see our 2012 *Outlook* and 2012 *Mid-Year Outlook* publications for further information.

		Fundamentals	Technicals	Valuations	Negative	Neutral	Positive	
Style/Capitalization	Large Growth	■	■	■				
	Large Value	■	■	■				
	Favor growth over value due to superior earnings trends in slow-growth economy, attractive relative valuations, and our positive technology view. Our views across capitalizations are fairly balanced.							
	Mid Growth	■	■	■				
	Mid Value	■	■	■				
	Lull in merger & acquisition activity, our expectation of more stock market volatility, and weakening relative strength have tempered our enthusiasm some for mid caps in recent months.							
	Small Growth	■	■	■				
	Small Value	■	■	■				
Risk of further stock market volatility and valuations temper our near-term view of small caps, which have lagged in October and year-to-date.								
Region	U.S. Stocks	■	■	■				
	Large Foreign	■	■	■				
	Small Foreign	■	■	■				
	Emerging Markets	■	■	■				
Our recently upgraded large foreign view to neutral reflected recent bold policy actions in Europe, prospects for further US dollar weakness, and the improving technical picture, while valuations remain reasonable. Large foreign, as measured by the MSCI EAFE Index, has outpaced the S&P 500 in October and over the past three months, but the S&P 500 still leads year-to-date.								
REITs	REITs	■	■	■				
	Mixed jobs picture, interest rate risk and below average yields temper our enthusiasm.							
Commodities	Industrial Metals	■	■	■				
	Precious Metals	■	■	■				
	Energy	■	■	■				
	Agricultural	■	■	■				
Our recently upgraded precious metals commodities view was strengthened by the Fed's QE3 announcement in mid-September, which should put pressure on the US dollar. Our recent agriculture commodities downgrade reflected our view that weather-related crop damage was reflected in grain prices. We do not see much value in the oil commodity in the low-to-mid \$90s.								
Other	Non-Correlated Strategies							
	Favor distressed assets for volatile environment, long/short equity vehicles as market increasingly rewards fundamentals, and merger-arbitrage/event-driven strategies on increased corporate activity.							

Real Estate/REITs may result in potential illiquidity and there is no assurance the objectives of the program will be attained. The fast price swings of commodities will result in significant volatility in an investor's holdings. International and emerging markets involve special risks such as currency fluctuation and political instability. The price of small and mid-cap stocks are generally more volatile than large cap stocks. Value investments can perform differently from the market as a whole. They can remain undervalued by the market for long periods of time. Precious metal investing is subject to substantial fluctuation and potential for loss. These securities may not be suitable for all investors. Alternative strategies 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. Stock investing may involve risk including loss of principal.

Equity Sectors

Continue To Favor Cyclical Sectors for Balance of 2012

- We continue to favor cyclical sectors in general, which we find attractively valued relative to the overall market and defensive sectors. Cyclical sectors have continued to perform better than their defensive counterparts so far in October in general.
- We recently upgraded the materials sector to modestly positive from neutral. The Fed's latest policy action was more aggressive than expected and is likely to drive commodity-related investments higher.
- Our technology view remains positive. PC-related weakness has hurt the sector this month, but it remains very attractively valued and is benefiting from powerful mobility trends. The sector is still one of the best performers year-to-date with a 21% return (as of October 16, 2012).
- Financials is the top-performing sector so far in October (+3%) and year-to-date (+26%), as recent bold policy actions in Europe have created important backstops for global financial markets. Our view remains modestly negative, but we are becoming increasingly constructive as technicals have improved and the global macroeconomic outlook has improved.
- Our industrials view remains modestly positive, as we continue to expect a pickup in business spending later this year and only a modest slowdown and more stimulative monetary policy from China.
- We continue to under-emphasize defensive sectors but remain watchful for a potential stock market pullback in which these sectors would likely outperform.

		Fundamentals	Technicals	Valuations	Negative	Neutral	Positive	S&P 500 Weight (%)
Cyclical	Materials	■	■	■	■	■	■	3.5
	Aggressiveness of QE3 should offset risk of more pronounced global growth slowdown.							
	Energy	■	■	■	■	■	■	11.3
	Our bias remains positive following QE3; Mideast tensions and valuations are supportive.							
	Industrials	■	■	■	■	■	■	9.9
	Still expect business spending pick up, although fiscal cliff, global slowdown remain concerns.							
	Consumer Discretionary	■	■	■	■	■	■	11.0
	Back-to-school sales suggest consumers continue to hang in despite weak job market, high gas prices.							
	Technology	■	■	■	■	■	■	19.7
Solid 2012 performer on powerful mobility trend and attractive valuations, despite PC weakness.								
Financials	■	■	■	■	■	■	14.9	
Top-performing sector of 2012 amid progress in Europe, cheap valuations, better housing data.								
Defensive	Utilities	■	■	■	■	■	■	3.5
	Valuations and interest rate risk are biggest concerns for worst performing sector in 2012.							
	Health Care	■	■	■	■	■	■	12.2
	Affordable Care Act clarity and low valuations help, but expect volatility around November elections.							
	Consumer Staples	■	■	■	■	■	■	10.9
Renewed margin pressure from rising commodities prices hurts, seasonal tailwind abating.								
Telecommunications	■	■	■	■	■	■	3.1	
Worst sector performer in October on rich valuations, intensifying competition, despite big yields.								

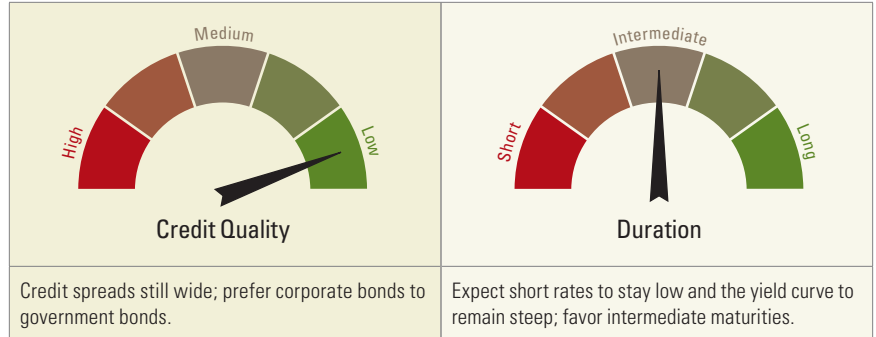
* For more detailed information, please refer to the quarterly *Sector Strategy* publication.

Because of their narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies.

Fixed Income

Favor Economically Sensitive Sectors To Help Take Advantage of Higher Yields

- We remain focused on intermediate bonds. The Fed’s commitment to refrain from raising interest rates until mid-2015 may benefit intermediate maturity bonds as investors seek higher yields amidst a low-yield world.
- A still-sluggish economy, Spain’s pending formal request for aid, and uncertainty over the economic impact of the fiscal cliff all augur for a stable rate environment, which also favors intermediate bonds that still possess a substantial yield advantage relative to short-term bonds.



		Fundamentals	Technicals	Valuations	Negative	Neutral	Positive
Tax-Free Bonds	Munis–Short-term	■	■	■	[Gauge: Needle in Negative zone]		
	Muni curve is steep, and short-term yields are very low.						
	Munis–Intermediate-term	■	■	■	[Gauge: Needle in Neutral zone]		
	Attractive valuations partially offset by lower yields.						
	Munis–Long-term	■	■	■	[Gauge: Needle in Neutral zone]		
	Valuations attractive but yields at record lows.						
Munis–High-Yield	■	■	■	[Gauge: Needle in Neutral zone]			
Yield to be bigger driver of return. Defaults to remain isolated.							

continued on next page

All bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates 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. Municipal interest income may be subject to the alternative minimum tax. Federally tax-free but other state and local taxes may apply. Corporate bonds are considered higher risk than government bonds but normally offer a higher yield and are subject to market, interest rate and credit risk as well as additional risks based on the quality of issuer coupon rate, price, yield, maturity and redemption features.

Fixed Income (CONT.)

Favor Economically Sensitive Sectors To Help Take Advantage of Higher Yields

- Mortgage-backed securities have become expensive in response to aggressive Fed purchases.
- Higher yielding, fundamentally sound segments of the bond market such as high-yield bonds and investment-grade corporate bonds remain attractive, but we temper our enthusiasm due to lower yields, strong year-to-date performance, and higher valuations.
- We upgrade bank loans as the yield difference between other fixed income sectors has narrowed and the sector stands out as a more conservative option to high-yield bonds.
- Over the short term, we are cautious on municipal bonds due to a coming seasonal increase in new issuance, which may weigh on prices. Weakness is likely to be limited, as valuations remain attractive with top-rated municipal bonds yielding more than comparable Treasuries.

		Fundamentals	Technicals	Valuations	Negative	Neutral	Positive
Taxable Bonds – U.S.	Treasuries	■	■	■	■	■	■
	European issues putting downward pressure on yields, keeping Treasuries expensive.						
	TIPS	■	■	■	■	■	■
	Prefer to nominal Treasuries as easy monetary policy is inflationary over time.						
	Mortgage-Backed Securities	■	■	■	■	■	■
	Currently most attractive government bond option. Stable yield range a positive.						
	Investment-Grade Corporates	■	■	■	■	■	■
	Yield spreads still attractive. Credit quality stable.						
	Preferred Stocks	■	■	■	■	■	■
	Good income generator. European bank risks manageable.						
High-Yield Corporates	■	■	■	■	■	■	
Earnings season should support fundamentals and 6.0% yield spread is attractive.							
Bank Loans	■	■	■	■	■	■	
Prefer high-yield for income, with rising rate catalyst delayed with Federal Open Market Committee (FOMC) on hold until late 2014.							
Taxable Bonds – Foreign	Foreign Bonds – Hedged	■	■	■	■	■	■
	Sovereign risks still a concern.						
	Foreign Bonds – Unhedged	■	■	■	■	■	■
	Low yields and euro currency risk a concern.						
Emerging Market Debt	■	■	■	■	■	■	
Fundamentals and valuations attractive but sensitive to European risks.							

All bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates 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. Mortgage Backed Securities are subject to credit, default risk, prepayment risk that acts much like call risk when you get your principal back sooner than the stated maturity, extension risk, the opposite of prepayment risk, and interest rate risk. International and emerging market investing involves risks such as currency fluctuation and political instability and may not be suitable for all investors. Bank loans are loans issued by below investment grade companies for short term funding purposes with higher yield than short-term debt and involve risk. Treasury inflation-protected securities (TIPS) help eliminate inflation risk to your portfolio as the principal is adjusted semiannually for inflation based on the Consumer Price Index - while providing a real rate of return guaranteed by the U.S. Government. Corporate bonds are considered higher risk than government bonds but normally offer a higher yield and are subject to market, interest rate and credit risk as well as additional risks based on the quality of issuer coupon rate, price, yield, maturity and redemption features. 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.

DEFINITIONS:

EQUITY AND ALTERNATIVES 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.

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.

Small Foreign: Small-cap foreign stocks typically have market capitalizations of \$250M to \$1B. The majority of the holdings in the small foreign category are in the MSCI Small Cap 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.

Merger Arbitrage is a hedge fund strategy in which the stocks of two merging companies are simultaneously bought and sold to create a riskless profit. A merger arbitrageur looks at the risk that the merger deal will not close on time, or at all. Because of this slight uncertainty, the target company's stock will typically sell at a discount to the price that the combined company will have when the merger is closed. This discrepancy is the arbitrageur's profit.

EQUITY SECTORS

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.

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.

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.

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.

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.

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

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

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

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.

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

FIXED INCOME

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.

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.

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).

Mortgage-Backed Securities: A type of asset-backed security that is secured by a mortgage or collection of mortgages. These securities must also be grouped in one of the top two ratings as determined by a accredited credit rating agency, and usually pay periodic payments that are similar to coupon payments. Furthermore, the mortgage must have originated from a regulated and authorized financial institution.

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.

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.

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 indexes are unmanaged and cannot be invested into directly.

Past performance is no guarantee of future results.

Stock investing involves risk including loss of principal.

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

MSCI EAFE is made up of approximately 1,045 equity securities issued by companies located in 19 countries and listed on the stock exchanges of Europe, Australia, and the Far East. All values are expressed in U.S. dollars. All values are expressed in US dollars. Past performance is no guarantee of future results.

The Russell 1000 Index consists of the 1,000 largest securities in the Russell 3000 Index, which represents 90% of the total market capitalization of the Russell 3000 Index. It is a large-cap, market oriented index and is highly correlated with the S&P 500 Index.

The Russell 2500 Index is a broad index featuring 2,500 stocks that cover the small and mid cap market capitalizations. The Russell 2500 is a market cap weighted index that includes the smallest 2,500 companies covered in the Russell 3000 universe of United States-based listed equities.

The Russell 3000 Index measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market. As of the latest reconstitution, the average market capitalization was approximately \$4 billion; the median market capitalization was approximately \$700 million. The index had a total market capitalization range of approximately \$309 billion to \$128 million.

Quantitative Easing is a government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital in an effort to promote increased lending and liquidity.

This research material has been prepared by LPL Financial.

To the extent you are receiving investment advice from a separately registered independent investment advisor, please note that LPL Financial is not an affiliate of and makes no representation with respect to such entity.

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