

Portfolio Compass



August 28, 2013

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

- Upgraded consumer staples view to neutral from neutral/negative.
- Upgraded precious metals and agriculture commodities to neutral/positive from neutral.

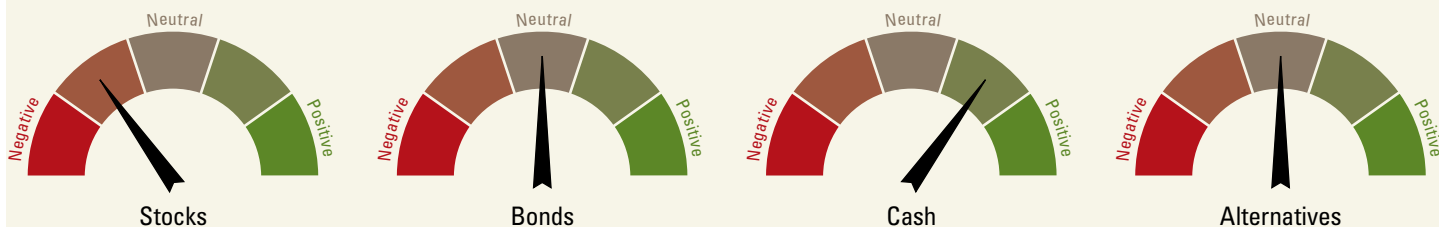
Investment Takeaways

- We expect the S&P 500 Index to grind higher in the second half of the year with increased volatility.*
- After another bout of weakness, a flattening yield curve, and aggressive Federal Reserve (Fed) rate hike expectations suggest the bond market may have priced in stronger economic growth and Fed uncertainty.
- Higher-yielding, fundamentally sound segments of the bond market such as bank loans and preferred securities remain among the more attractive fixed income options.
- Supply issues have diminished but have continued to weigh on municipal bonds. Challenges persist, but attractive valuations bode well longer term.
- We favor U.S. stocks relative to emerging markets (EM) and developed foreign, as Europe's struggles continue and EM growth slows.
- Precious metals' technicals have improved, while technical and seasonal considerations point to a short-term opportunity in agriculture commodities.
- From a technical perspective, the S&P 500 has broken below support at its 50-day simple moving average at 1659, which establishes a bearish price objective at 1573.

* As noted in our *Mid-Year Outlook 2013: Investors' Trail Map to the Markets* publication.

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

Focus on the U.S. and Improving Commodities Picture

- We expect the S&P 500 to grind higher in the second half of the year with increased volatility, supported by mid-single-digit earnings growth, buybacks, and wide profit margins, as noted in our *Mid-Year Outlook 2013: Investors' Trail Map to the Markets*.
- We favor U.S. stocks relative to EM and developed foreign, as Europe struggles to emerge from recession, and the growth trajectory in several key EM countries has deteriorated.
- In terms of market cap, large caps offer lower valuations and the potential for higher yields, but small caps should benefit from greater U.S. focus and may provide an attractive buy-the-dip opportunity.
- Our views of growth and value are more balanced due to our improving outlook for financials, although growth's tendency to outperform in slow-growth environments and our positive view of consumer discretionary are positives for growth.
- A pullback in the oil commodity amid elevated inventories and soft global demand may have to wait for resolution in Syria, but we continue to believe the commodity is above its fair value.
- After struggling with prospects for reduced bond purchases by the Fed, low inflation, higher interest rates, and slowing demand from China and India, the gold commodity has stabilized and technicals have become attractive.
- We believe a short-term opportunity has emerged in agriculture commodities based on seasonal and technical factors.

		Fundamentals	Technicals	Valuations	Negative	Neutral	Positive	
Style/Capitalization	Large Growth	■	■	■				
	Large Value	■	■	■				
	Slight preference for growth, which tends to perform better in slow-growth environments, but with less conviction due to a more balanced sector mix. We have a slight small bias in terms of market cap.							
	Mid Growth	■	■	■				
	Mid Value	■	■	■				
	Greater U.S. focus, the potential for faster earnings growth than large caps, and a likely pickup in acquisition activity help, although above-average valuations and potentially higher stock market volatility are risks.							
	Small Growth	■	■	■				
	Small Value	■	■	■				
Risk of increased stock market volatility remains, and valuations are on the high side, but with their U.S. focus, we believe small caps represent an attractive buy-the-dip opportunity.								
Region	U.S. Stocks	■	■	■				
	Large Foreign	■	■	■				
	Small Foreign	■	■	■				
	Emerging Markets	■	■	■				
	We favor the U.S. over large foreign and EM. Europe's growth outlook remains challenged, while growth trajectories in several key EM economies are deteriorating, although recent signs of stabilization in China are worth noting.							
REITs	REITs	■	■	■				
	Job growth, housing, and yield are offset by interest rate risk; valuations have become more reasonable.							
Commodities	Industrial Metals	■	■	■				
	Precious Metals	■	■	■				
	Energy	■	■	■				
	Agricultural	■	■	■				
	A pullback in the oil commodity may have to wait for resolution in Syria, but we continue to believe oil (WTI Crude) is above fair value. The gold commodity has stabilized, and technicals have improved. We believe a short-term opportunity has emerged in agriculture commodities.							
Other	Non-Correlated Strategies							
	Favor long/short equity vehicles as the market is rewarding fundamentals. High corporate cash levels and industry shifts create opportunities for shareholder activism. Global macro strategies have been underperforming but may provide diversification benefits in the event of a pullback.							

All performance referenced herein is as of August 27, 2013, unless otherwise noted.

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

Consumer Discretionary, Financials, and Health Care Well Positioned for Second Half

- As highlighted in our *Mid-Year Outlook 2013* publication, we favor the more U.S.- and consumer-oriented sectors over the more global, export-focused sectors in the second half as EM growth slows.
- Our consumer discretionary view remains positive as spending continues to increase, albeit modestly, and the housing recovery remains in pace, although the recent rise in oil prices raises the risk profile.
- Our financials view has become incrementally more positive due to our focus on the United States, the steeper yield curve, and still-attractive valuations.
- Our recently upgraded health care view reflects our U.S. focus, gradually improving sector growth outlook, and robust pace of product innovation.
- Our modestly negative materials and energy views reflect deteriorating growth trajectories throughout many EM economies and our bearish view of crude oil prices.
- We expect a potential pickup in business spending to help industrials sector performance, although uneven growth in China tempers our enthusiasm some.
- We remain cautious on the yield sectors (telecom and utilities) due to their interest rate sensitivity, while utilities valuations still look rich despite the sector's losses since May 2013.
- Above-average valuations, EM exposure, and higher oil prices temper our enthusiasm some for consumer staples, although our bias is positive due to the resilience of U.S. consumers, favorable seasonality, and the potential for attractive yields.

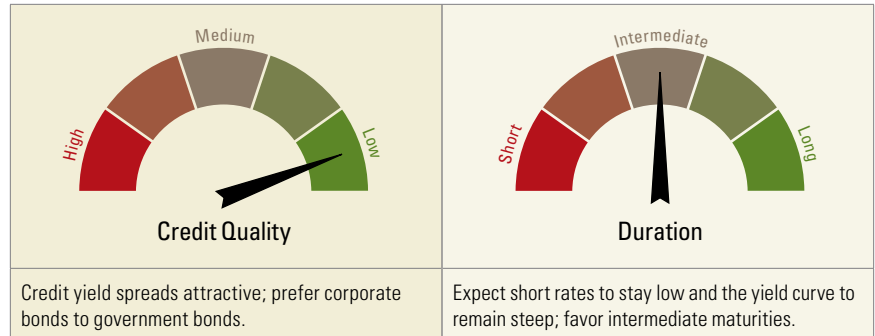
	Fundamentals	Technicals	Valuations	Negative	Neutral	Positive	S&P 500 Weight (%)
Cyclical	Materials	■	■	■	■	■	3.4
	Slower EM growth and a shift toward a more consumer-led economy in China temper the growth outlook.						
	Energy	■	■	■	■	■	10.5
	Uneven growth in EM and our forecast for a pullback in oil back into the \$90s drive our cautious view.						
	Industrials	■	■	■	■	■	10.4
	Housing and U.S. energy renaissance help, but EM growth is slowing, and business spending is tepid.						
	Consumer Discretionary	■	■	■	■	■	12.2
	Wealth effect benefit (housing, stocks), improving labor market, and domestic focus offset rich valuations.						
	Technology	■	■	■	■	■	18.2
Positive bias amid attractive valuations, improving technicals, and favorable seasonality.							
Defensive	Financials	■	■	■	■	■	16.6
	Earnings gains, U.S. focus, steeper yield curve, and valuations offset regulatory risk and slow loan growth.						
	Utilities	■	■	■	■	■	3.2
	Weakness in latest bond market sell-off highlights interest rate risk; valuations are still high.						
	Health Care	■	■	■	■	■	12.9
	U.S. focus, gradually improving growth outlook amid policy clarity, and innovation are supportive.						
	Consumer Staples	■	■	■	■	■	10.1
Valuations, EM exposure, and high oil prices are concerns, but seasonals and yields are attractive.							
Telecommunications	■	■	■	■	■	2.5	
Valuations now fair, but interest rate sensitivity, competition, and a mature wireless market are concerns.							

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

Fixed Income

Signs of Stability Emerge

- After another bout of weakness so far in August, a flattening yield curve and aggressive Fed rate hike expectations suggest the bond market has gone a long way to price in stronger economic growth and uncertainty from the Fed. We find current yield levels offer fair value.
- We believe intermediate maturity bonds provide a better risk/return trade-off compared to short-term bonds.
- Supply issues have diminished but nonetheless continued to weigh on municipal bonds in August. Challenges persist but attractive valuations bode well for longer-term improvement.
- We find high-yield municipal bonds attractive, but high-quality municipal bonds possess more attractive valuations and compelling taxable-equivalent yields.



		Fundamentals	Technicals	Valuations	Negative	Neutral	Positive	
Tax-Free Bonds	Munis-Short-Term	■	■	■	[Gauge: Needle at Negative]			
	Muni curve is steep, and short-term valuations are unattractive.							
	Munis-Intermediate-Term	■	■	■	[Gauge: Needle at Neutral]			
	Supply pressures easing, and valuations are attractive.							
	Munis-Long-Term	■	■	■	[Gauge: Needle at Positive]			
	Supply pressures easing, and valuations are attractive.							
Munis-High-Yield	■	■	■	[Gauge: Needle at Positive]				
Defaults remain isolated despite Detroit.								

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For the purposes of this publication, intermediate-term bonds have maturities between three and 10 years, and short-term bonds are those with maturities of less than three years.

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.)

Signs of Stability Emerge

- High-yield bond valuations are fair after recouping most of May–June underperformance but remain resilient to higher interest rates.
- Higher-yielding, fundamentally sound segments of the bond market such as bank loans and preferred securities remain among the more attractive fixed income options.
- Among high-quality bonds, we favor investment-grade corporate bonds due to the combination of higher yields and good fundamentals.

	Fundamentals	Technicals	Valuations	Negative	Neutral	Positive	
Taxable Bonds – U.S.	Treasuries	■	■	■	■	■	
	Valuations are fair with yields at the top of the range and several Fed rate hikes priced in.						
	TIPS	■	■	■	■	■	■
	Unappealing due to deceleration in inflation and greater interest rate sensitivity.						
	Mortgage-Backed Securities	■	■	■	■	■	■
	Valuations attractive; shorter duration a positive.						
	Investment-Grade Corporates	■	■	■	■	■	■
	Yield spreads fair. Credit quality stable.						
	Preferred Securities	■	■	■	■	■	■
	Good income generator. Bank credit quality improving.						
	High-Yield Corporates	■	■	■	■	■	■
	Credit quality metrics are good, valuations are fair, and defaults are on pace to be low in 2013.						
Taxable Bonds – Foreign	Bank Loans	■	■	■	■	■	
	Attractive due to short-term nature and attractive yield.						
	Foreign Bonds – Hedged	■	■	■	■	■	■
	Yields are low compared to domestic bonds, and sovereign risks remain.						
	Foreign Bonds – Unhedged	■	■	■	■	■	■
Still-low yields and euro currency risk are a concern.							
Emerging Market Debt	■	■	■	■	■	■	
Growth concerns are still a risk. Valuations are fair.							

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.

Long/Short is an investment strategy generally associated with hedge funds. It involves buying long equities that are expected to increase in value and selling short equities that are expected to decrease in value.

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.

Health Care: 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.

Preferred stock investing involves risk, which may include loss of principal.

Distressed investing involves significant risks, including a total loss of capital. The risks associated with distressed investing arise from several factors including: limited diversification, the use of leverage, limited liquidity, and the possibility that investors may be required to accept cash or securities with a value less than their original investment and/or may be required to accept payment over an extended period of time.

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.

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