LPL FINANCIAL RESEARCH

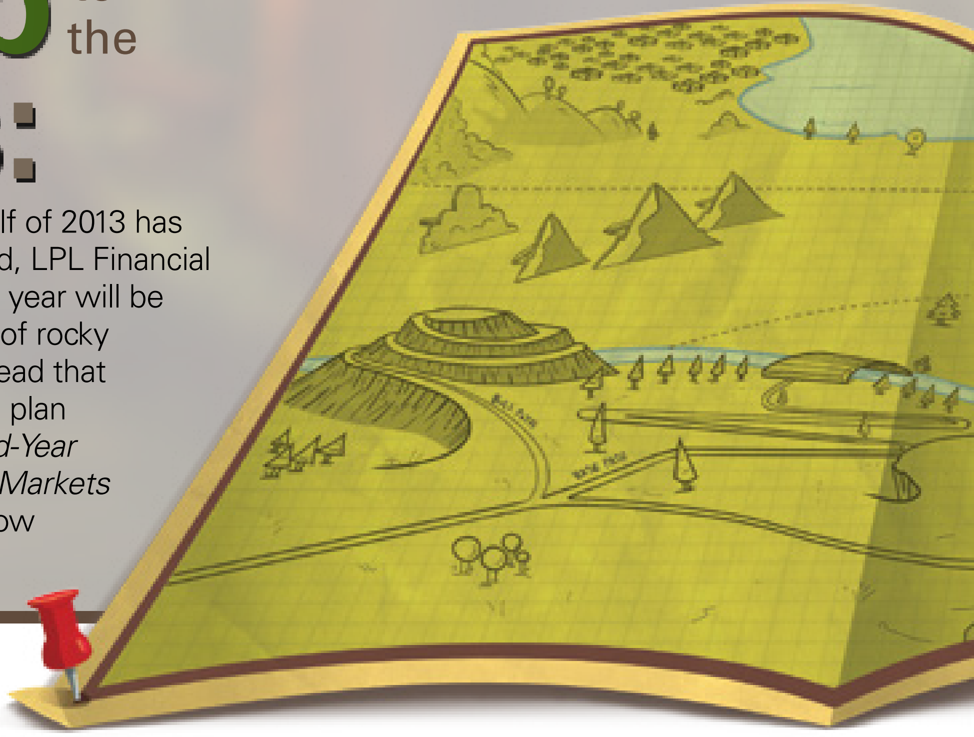
Mid-Year Outlook 2013

Converging on the Path of Least Resistance

LPL Financial

Investors' Trail Map to the Markets:

The investment landscape for the first half of 2013 has proven to be a tough one to navigate. And, LPL Financial Research believes the second half of this year will be equally difficult to navigate. There is a lot of rocky terrain and potentially some surprises ahead that investors need to prepare for. To help you plan for what lies ahead, we bring you our *Mid-Year Outlook 2013: Investors' Trail Map to the Markets* to provide you with what you need to know before you go and check before you trek.



Converging on the Path of Least Resistance

The performance of the markets is likely to converge in the second half of the year on a path that likely holds modest gains. The return of volatility will also be a key characteristic of the second half as markets follow a path with ups and downs.

In our *Outlook 2013: The Path of Least Resistance*, published in November of 2012, we laid out three paths the markets could follow in 2013 as the path of least resistance: bull, bear, and base.

- On the bull path, obstacles are overcome and investors embrace market opportunities and drive up valuations.
- On the bear path, fiscal policy results in a much weaker economic backdrop and markets plunge.
- On the base path, the path we deemed most likely to emerge, growth in the economy and earnings remains below average, and the challenged markets produce modest gains with a lot of volatility.

Rather than a single path emerging, the paths of least resistance for the economy and markets diverged in the first half of 2013. The different markets took all three paths:

- Stocks took the bull path as investor confidence rose when the worst of the fiscal cliff outcomes was avoided and the Federal Reserve's (Fed's) bond-buying program continued. This helped to lift stock valuations and prompted individual investors to put money into the market at the strongest pace in years, according to flows into domestic stock funds tracked by the Investment Company Institute (ICI).
- Commodities asset classes took the bear path on weakening economic data around the world, and as tax increases and spending cuts sunk in here in the United States, Europe's recession broadened and deepened, and China's growth slowed. Copper, wheat, and gold futures—to name just a few—all plunged during the first half of 2013.
- Bonds took the base path with the Barclays Capital Aggregate Bond Index remaining between +/-2% through June 20, 2013 and a volatile 10-year Treasury note yield that has ranged between 1.6% and 2.6% over the same time period.

This type and magnitude of disagreement among the markets has been rare. To attempt to coin a new phrase: "a market divided against itself cannot stand." In other words, the divergence in the paths taken by different markets is unlikely to continue in the second half. Instead, the markets are likely to converge in a second half that likely holds modest—but volatile—gains for investments such as stocks, bonds, and commodities. In other words, we expect the different markets to follow a similar path in the second half.

Gearing Up for the Trail

Key elements of our second half outlook:

- The U.S. economy will continue to grow at about 2% supported by housing, as well as consumer and business spending, offsetting the drag from government spending cuts. Inflation remains tame, but rises modestly from the recent 1% pace. The European economy remains in recession in the second half, but may begin to show some improvement late in the year. China's growth remains around 7%. This may support demand for raw materials.
- The Federal Reserve has communicated that it will begin to slow its bond-buying program, known as "QE" (quantitative easing), in the fall. The slowing will be dependent upon the economy meeting the Fed's forecast and is expected to end by mid-2014 as the unemployment rate falls to about 7%. The Fed will maintain zero interest rates throughout the remainder of this year and next.
- The fiscal cliff and sequester had only a small measurable effect outside of government jobs and spending in the first half and may also remain benign in the second half. The budget is improving this year and will for the next few years, according to the Congressional Budget Office (CBO), so the debt ceiling debate in the second half may not be much of an issue for the markets.
- We expect low single-digit returns for the broad bond market in the second half, resulting in flat returns for the full year. We expect yields to be rangebound over the second half following a first half increase. Slow but steady growth, combined with rising yields, favors corporate bond over government bond exposure.
- The stock market goes from a gallop to a grind higher as stocks end the year modestly higher from current levels on the S&P 500 Index after a strong first half gain of about 12% (as of June 20, 2013). The gains are primarily driven by mid-single-digit earnings growth, aided by record-breaking buybacks, wide profit margins, and contained labor costs. Those gains come with a substantial uptick in volatility, however, which may present opportunities. Soft global growth and a strong dollar favor U.S. over international stocks.

The second half of 2013 may act as a bridge to a new path for policy, the economy, and markets: the aggressive stimulus from the Fed over the past five years is likely to begin to fade, the government may shrink as a portion of the U.S. economy to the lowest levels in a decade, the economic drag from higher taxes and spending cuts implemented in the first half of 2013 starts to diminish, and corporate profit margins may reach all-time highs. The four-year-old recovery in the economy and markets is unlikely to be the end of the path, but instead a new beginning that may refresh the pace of growth in the coming years.

LPL Financial Research's

KNOW BEFORE YOU GO

Mid-Year Outlook 2013 At A Glance

2%

The U.S. economy will recycle its 2% growth rate in the second half supported by housing, as well as consumer and business spending, offsetting the drag from government spending cuts.

Pg. 6-8

Inflation Conditions

Favorable

Inflation remains tame, but rises modestly from the recent 1% pace.

Weather Report | World Economic Growth Estimates

2% GDP	0% GDP	7% GDP	2% GDP
U.S.	Eurozone*	China	Japan*

Pg. 10-13

* IMF estimates

Bear Threat

10-Year Treasury Yields

0.25% | 0.75% | 1.25% | 1.75% | **2.25%** | **2.75%** | 3.25% | 3.75% | 4.25% | 4.75%

Low Single-Digit Gains in Second Half with yields in a range.

Pg. 16-18

EVACUATION ROUTE

Fall End to Fed Bond-Buying Program

The Federal Reserve has communicated that it will begin to slow its bond-buying program, known as "QE" (quantitative easing) in the fall.

QE EXIT

Pg. 14-15

Be on the lookout for "How to Invest" Signs.

Unstable Footing

U.S. Stock Market

Modest Single-Digit Gains in Second Half accompanied by higher volatility.

Pg. 19-21

Trail Recommendations

	Favor	Caution
Stocks		
Location	U.S.	International
Size	Small Cap	Large Cap
Bonds		
Sector	Yield	Quality
Term	Intermediate	Long

Trail Advisories

While every attempt will be made to keep the above information current, changing conditions can occur at any time on any section of the trail. All users should be alerted to these possible conditions, including:

- Geopolitical Threats
- Fiscal Policy Developments
- Election Outcomes
- Central Bank Shifts

The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Stock investing involves risk including loss of principal.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values and yields will decline as interest rates rise and bonds are subject to availability and change in price.

International and emerging market investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors.

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

Yield is the income return on an investment. This refers to the interest or dividends received from a security and is usually expressed annually as a percentage based on the investment's cost, its current market value or its face value.

Surveying the Landscape

Before starting from base camp on any trek, it is necessary to understand the basics of your journey and what may lie in the landscape ahead. The basic surroundings and landscape where investment opportunities reside is determined by the economic environment. In the second half of 2013, LPL Financial Research believes that the landscape will not be easy to trek, but obstacles will not be insurmountable.

1 Tame Inflation Expected

	2013	2014	Long Term*
Federal Reserve	1.0%	1.7%	2.0%
Market Consensus	1.5%	1.9%	2.2%
CBO	1.5%	2.0%	2.2%

Source: Federal Reserve, Bloomberg, Congressional Budget Office, Consumer Price Index (CPI) 06/20/13

*Long Term: For the **Federal Reserve forecasts**, long-term projections represent each participant's assessment of the rate to which each variable would be expected to converge under appropriate monetary policy and in the absence of further shocks to the economy. For the **Market Consensus forecasts**, long-term forecasts are from the Philadelphia Fed's Survey of Professional Forecaster forecast for inflation over the next 10 years. For the **CBO forecasts**, long-term forecasts are the Consumer Price Index (CPI) inflation forecast over the years 2012–2022.

The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.

A low-and-steady path for the economy and inflation appears likely in the second half of 2013, as continued strength in housing combines with other economic and market indicators to make a recession a low probability. While the United States faces another decision over what direction to take on the debt ceiling in the second half, we do not expect the market to be any more sensitive to that outcome than it was in the first half.

As the first half of 2013 draws to a close, the available information on the U.S. economy suggests:

- continued growth of around 2%;
- low, but gently rising, inflation; and
- low odds of a recession in the next 12 to 18 months.

In particular, housing and consumer spending have been solid and remain a bright spot for the economy. On the other hand, government spending cuts have acted as a drag on growth. Looking out over the remainder of the year, we see the U.S. economy continuing a modest pace of growth, impacted by a mix of factors including: Fed stimulus, a pick-up in manufacturing, a solid housing market, the modest pace of consumer spending, tepid net exports, and ongoing fiscal consolidation—driving a continued modest pace of growth.

A dramatic deterioration of the fiscal and financial situation in Europe, a fiscal or monetary policy mistake here in the United States, a greater-than-expected slowdown in Chinese economic growth, or an exogenous event (such as a major terror attack or natural disaster) may cause us to change our view. However, as of now, we continue to expect the economy to plod along at a 2% growth rate.

Not Too Many Pitfalls: Economic Recession Unlikely

A recession in the United States remains highly unlikely despite the impact of spending cuts, known as sequestration, the lingering effects of the fiscal cliff, the recession in Europe, and the slowdown in China. The Leading Economic Index (LEI) can be a useful, fact-based, forward-looking tool to determine where the U.S. economy may be headed.

The LEI attempts to predict the future path of the economy, with a lead time of between 6 and 12 months. The latest reading on the LEI (April 2013) puts the index 2.3% above its April 2012 level, and since 1960, the U.S. economy was never in recession when the year-over-year increase in the LEI has been at least 2.3%. Looking out 12 months after the LEI was up 2.3% or more, the economy was in recession just 7% of the time. Therefore, based on LEI history, the odds of a recession within the next 12 months are very low.

Campgrounds Abound: Housing Lends a Boost

The U.S. housing market is likely to continue to make a positive contribution to economic growth during the second half of 2013. Housing remains supported by several factors, including record housing affordability, low inventories of new and unsold homes, a rapidly diminishing inventory, a wide gap between household formation rates and new home construction, and a stable labor market.

Housing construction added 0.3% to U.S. economic growth in the first quarter of 2013 (as measured by residential investment per the U.S. Bureau of Economic Analysis' GDP report), marking the eighth quarter in a row that housing has added to GDP (gross domestic product) following a five-year period (from first quarter 2006 to first quarter 2011) where housing was a drag on GDP. Our view remains that housing is still in the early stages of a long recovery.

Taking the Low Road: Inflation to Remain Contained

Our view remains that the economic backdrop does not support a sustained major rise in inflation anytime soon, although some factors may push readings modestly higher in the coming months. Wages have not materially increased: the year-over-year pace of personal income in the United States is a mere 2.8% (per U.S. Bureau of Economic Analysis data as of 4/30/13), near the low end of the range of the past three years. This is a key factor in business costs and in determining the overall pace of inflation.

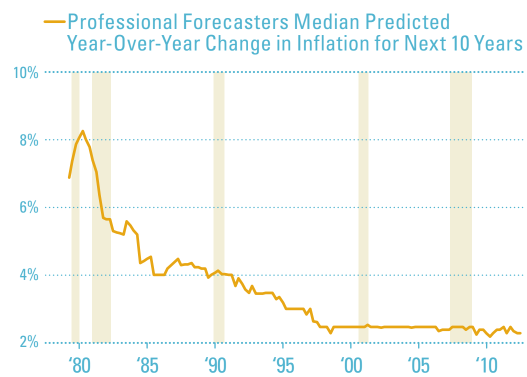
There are many factors today working to keep inflation low. Forecasts for inflation from the Fed, the consensus of economists and market participants, and the Congressional Budget Office all suggest ongoing tame inflation over the next several years and over the long term [Figure 1]. Factors likely to keep inflation low and stable include:

- Low and stable inflation. Simply put, current low and stable inflation fosters future low and stable inflation. The public's expectations on inflation are often cited by Fed Chairman Ben Bernanke and other Fed officials as one of the key weapons against inflation. Inflation expectations have been moving lower for 30 years [Figure 2].
- Fed's inflation-fighting credibility. Over the last 30 years, the Fed has gained the public's trust, often by "taking away the punchbowl" (i.e.,

Household Formation

Measures individuals grouping together to form a household. A household can be made up of an individual, a couple, or either one of these with children. Generally mirrors demographic changes, including adult children moving out and elderly parents moving in, and characteristics such as marriage and divorce.

2 Inflation Has Been Low and Stable for Well Over a Decade



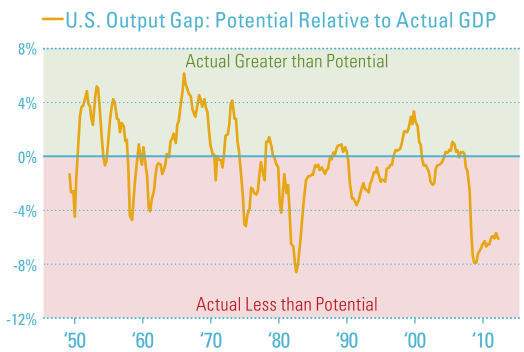
Source: Federal Reserve Bank of Philadelphia, Haver Analytics, LPL Financial Research 03/15/13

Shaded areas indicate recessions.

Past performance is no guarantee of future results.

Purchasing power risk is the risk that unexpected changes in consumer prices will penalize an investor's real return from holding an investment. Because investments from gold to bonds and stock are priced to include expected inflation rates, it is the unexpected changes that produce this risk. Fixed income securities, such as bonds and preferred stock, subject investors to the greatest amount of purchasing power risk since their payments are set at the time of issue and remain unchanged regardless of the inflation rate.

3 Output Gap the Widest It Has Been Since the Early 1960s

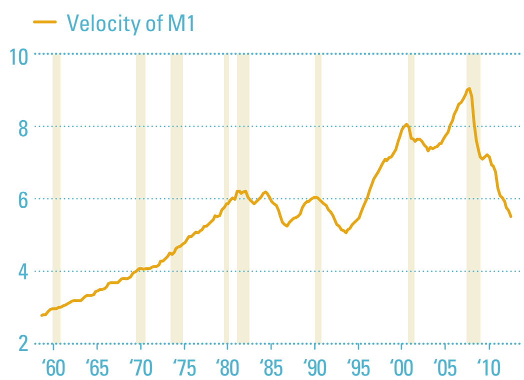


Source: Haver Analytics, LPL Financial Research 03/15/13

Past performance is no guarantee of future results.

Note: Excess capacity means companies are likely to expand output before raising prices to meet demand.

4 Velocity of Money Has Plummeted: Financial Crisis of 2007–2009 Damaged the Monetary Policy Transmission Mechanism, Causing Money to Move Through the Economy Slower



Source: Haver Analytics, LPL Financial Research 03/15/13

Past performance is no guarantee of future results.

Shaded areas indicate recessions.

The velocity of M1 is personal income divided by the M1 money supply. The M1 money supply consists of: (1) currency outside the U.S. Treasury, Federal Reserve Banks, and the vaults of depository institutions; (2) travelers' checks of nonbank issuers; (3) demand deposits at commercial banks (excluding those amounts held by depository institutions, the U.S. government, and foreign banks and official institutions) less cash items in the process of collection and Federal Reserve float; and (4) other checkable deposits (OCDs), consisting of negotiable order of withdrawal (NOW) and automatic transfer service (ATS) accounts at depository institutions, credit union share draft accounts, and demand deposits at thrift institutions.

raising interest rates) before the party got out of hand and inflation became problematic.

- **Globalization.** When inflation was surging from the mid-1960s through the early 1980s, the U.S. economy was relatively insular. Today, the United States has a much more open economy, and there is now plenty of overseas competition in both wages and prices. In general, the push toward globalization has put downward pressure on prices.
- **Spare capacity in product and labor markets.** Slack in product and labor markets is one of the key drivers of low inflation today. High unemployment rates here in the United States and in Europe, along with very high levels of unused factory and office space around the globe, make it very difficult to pass along higher input prices to consumers.
- **Economy growing below long-term potential.** For the past five years, the U.S. economy has been growing more slowly than its long-term potential growth rate, pushing the "output gap" wider [Figure 3]. The more negative the output gap, the less upward pressure on capacity constraints in the economy and, in turn, the less upward pressure on wages and prices.

However, the Fed's actions have the potential to push inflation higher. As a result of the successive rounds of bond-buying programs, known as QE, from the Fed over the past five years, nearly $1.8 trillion is sitting on banks' balance sheets waiting to be lent out to consumers and businesses (according to the Fed). This is an enormous amount of money, and if it were lent out quickly, this would result in too many dollars chasing too few goods and services, resulting in a spike in prices, which is the definition of inflation.

Importantly, this is not happening, as the velocity of money, or how quickly the cash on banks' balance sheets moves through the economy, has dropped dramatically over the past five years [Figure 4]. The gap between saving and borrowing is the widest it has ever been, meaning that the QE-related money is largely staying locked up in banks rather than being unleashed into the economy.

Detour: Fiscal Cliff

Fiscal Policy and Sequester Had Limited Effect in the First Half

The impact of the feared tax increases from the fiscal cliff and the spending cuts that accompanied the sequester did not seem to do much damage to the economy, employment, or markets in the first half of 2013.

- The first quarter GDP report of 1.8% showed that the cuts in government spending only led to a 0.9% drag on the economy in the first quarter. Thus, the private economy (total GDP excluding government impact) grew at 2.7%, which is a solid pace of growth. While the consensus of economists expects GDP in the second quarter to slow to 1.7% overall, we estimate that this includes about a 2% drag from the additional impact of the government spending cuts known as the sequester that began in March. Adding back that 2% gives us a growth rate of 3.7% for the private economy in the second quarter, reflecting accelerating growth in the private sector rather than a slowdown. As the government sector shrinks as a portion of the economy, the private sector is expanding.
- Government employment is declining, but private employment is doing well as it maintains the 180,000 per month average growth rate of the past three years, according to the U.S. Bureau of Labor Statistics. Also, it is worth noting that the sequester is being implemented primarily through furloughs that avoid major headcount cuts and the loss of consumer confidence that may accompany them.
- Markets fared well despite the spending cuts. The impact of the sequester was most directly felt in the defense sector. But, these stocks performed well, as measured by the broad Philadelphia Defense Index outperforming the S&P 500 Index since the sequester kicked in. Also heavily impacted by the sequester were the Medicare HMOs. However, the S&P 500 Managed Health Care Index also has outperformed the S&P 500 Index.

It appears the tax increases and spending cuts have affected the government, but not the private sector. This is not an anomaly. For much of the 1990s, federal spending as a percent of GDP and government employment fell steadily, but the private sector grew rapidly.

However, the tax increases and spending cuts did improve the budget picture. The CBO estimates that the federal budget deficit will be $642 billion, or 4.0% of GDP, in 2013. This is a dramatic downward move from the 8–10% range of 2009–2011. The CBO states the deficit is lower mostly as a result of higher-than-expected tax revenues and an increase in payments to the Treasury by Fannie Mae and Freddie Mac. Revenues are expected to increase by 15% in 2013 in large part due to:

- The expiration of the 2% payroll tax cut in January 2013.
- The increase in income tax rates on high earners.
- Some high-income taxpayers intentionally realizing more income late in calendar year 2012, in anticipation of changes in tax law, and therefore, paying taxes on that income in fiscal year 2013.

Spending cuts are helping too, according to the CBO. Discretionary spending is projected to fall about 6% in 2013 and another 4% in 2014, assuming the sequester remains in place. Over the next several years, the deficit continues to fall to 2.1% of GDP by 2015, then begins to rise again due to the unaddressed entitlement spending programs. And, though the shrinking deficit lowers the likelihood of a credit downgrade of the United States, it also makes a long-term grand bargain less likely, perhaps delaying a compromise until after the 2014 mid-term elections.

In the second half of 2013, the debt ceiling will need to be addressed. The Treasury Department's extraordinary measures for extending the time frame until it must be addressed will likely run out in October or November. While a debate will ensue, we do not expect the market to be as sensitive to the outcomes, given the improvement in the budget and the resilience of the private sector of the economy.

Preparing for Inclement Weather

In any trek, the weather can be a wild card. LPL Financial Research believes that outside the United States, the economic outlook is more cloudy. Investors may want to take precautions and seek some shelter from the risks presented by Japan's new path, China's growth trajectory, and Europe's stumbles that could quickly develop like a sudden storm.

The latest Bloomberg-tracked economists' consensus forecast for 2013 global economic growth stands at 3.0%. This sluggish pace of growth is down from the 3.2% forecast made at the start of 2013 and the 3.7% prediction made in June 2012. Outside the United States, the downgrade to growth expectations for 2013 reflects the combination of several factors:

- Japan's growth is projected to be a bit stronger as a result of new fiscal and monetary stimulus, despite a sharp contraction in the second half of 2012.
- China's economy has slowed in response to policies implemented in 2010 and 2011 along with a transition from export- and infrastructure-led growth, to more internally led consumer-oriented growth.
- Europe remains mired in recession, and growth projections have been lowered as weakness has spilled over from the peripheral countries to the core ones.
- Emerging markets are facing slower growth largely as a result of the slowdown in the developed world.

Japan: Changing From Sunny to Foggy

Partially offsetting the factors that are weighing on global growth are the actions taken by the Japanese government and central bank beginning in late 2012 to combat decades-old deflation. As of October 2012, the consensus forecast for Japanese GDP growth in 2013 stood at just 1.1%. Now, in mid-June 2013, the consensus expects real GDP to grow by 1.7% in 2013. While the mark-up in the consensus view of Japan's 2013 growth prospects is noteworthy, the shift in the consensus view for 2014 is even more stunning. A year ago, the consensus expected just 0.8% real GDP growth in Japan in 2014. Today, the consensus now expects 1.5% real GDP growth in Japan in 2014. To put this in perspective, over the past 20 years, Japan's economy has grown, on average, by just 0.9% per year.

After many years of deflation and little to no growth, the new government has announced:

- aggressive QE;
- a positive inflation target;
- fiscal stimulus; and
- structural reforms.

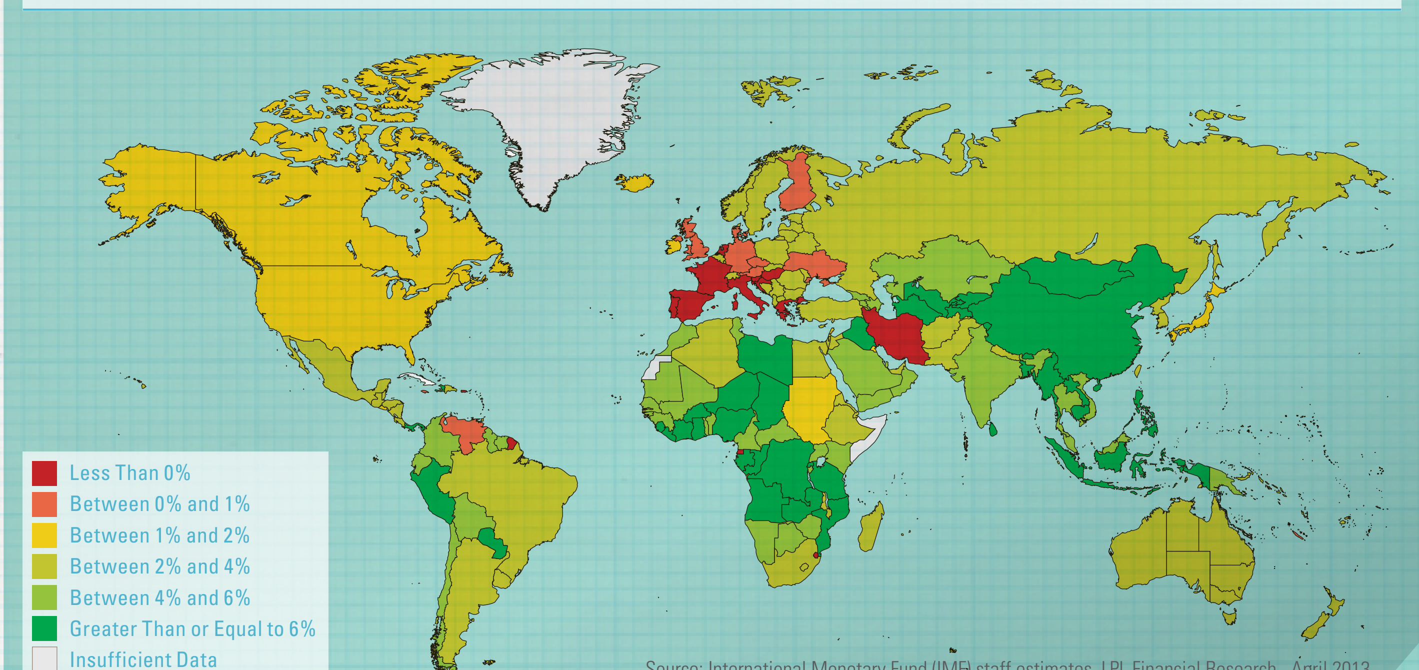
These policies are likely to bring sun in the short term by boosting growth — causing financial markets to expect a lot of Japan's economy over the next 18 months or so. The yen has depreciated by more than 20% versus the dollar since the fall of 2012 — helping to make Japan's exports more attractive to global markets — while Japan's Nikkei stock market index has risen by 50% (in yen terms) from the low in mid-November 2012 through mid-June 2013.

However, the success of these programs in the world's third-largest economy is a bit foggy and far from assured, especially given the high level of public debt. Increasing market skepticism of a commitment to the programs necessary to achieve success has resulted in a sharp move lower in Japanese stocks as the first half of the year drew to a close.

China: Partial Sun, Partial Clouds

Investors waiting for a re-acceleration in Chinese economic growth to the more than 10% pace seen in the early- to mid-2000s have been disappointed, and market participants continue to mark down their GDP growth outlooks for China for 2013 and 2014. The consensus GDP growth estimate for 2013,

5 2013 World Economic Growth Estimates



Source: International Monetary Fund (IMF) staff estimates, LPL Financial Research April 2013 as of June 2013, stands at 7.7% versus the 8.0% forecast made in late 2012 and the 8.5% forecast made in mid-2012.

China is in the process of transitioning its export-led economy to a more domestically focused, consumer-led economy. The good news is that the recent muted inflation readings provide Chinese authorities the latitude to cut interest rates further. China's Consumer Price Index (CPI) was up just 2.1% year over year in May 2013, down from a recent high of 6.5% in mid-2011. Also, the Chinese government remains well stocked with capital reserves to increase spending to stimulate the economy if it chooses to do so, which may limit downside risks to economic growth.

The bad news for Chinese growth is that it remains dependent on foreign demand for much of that growth, and domestically, concerns about its overheated property market remain, which could prevent more fiscal or monetary stimulus. In addition, as the first half of the year drew to a close, there were increased indications that the Chinese banking system was suffering from a rise in bad loans and a shortage of capital. We do not expect a "hard landing" (a sharp deceleration to 5–6% GDP growth) in China over the next few years, which would have a pronounced impact on global markets, given that it is the second-largest economy in the world. Instead, we expect growth of about 7% on average in China. This is in line with the government's stated policy goal as downside risks may be managed with new spending projects and upside risks are mitigated by tighter capital controls. Investors expecting China to return to the 10% or higher growth rates of the early-to-mid-2000s will likely continue to be disappointed.

Europe: Severe Storm Warning Remains in Effect

The Eurozone economy contracted by -0.2% in the first quarter of 2013, following the -0.6% drop in the fourth quarter of 2012. The Eurozone's economic contraction was its sixth consecutive quarter of recession, dating back to the fourth quarter of 2011. Some European countries are stagnant, many in recession, and others in a depression. Among the larger economies in Europe, only Germany (+0.1%) and Belgium (+0.1%) saw first quarter 2013 growth in their economies. France (-0.2%), Italy (-0.5%), and Spain (-0.5%) all saw their economies contract in the first quarter of 2013, along with the continuing plunge in economic activity in Greece (-5.5%) and Portugal (-4.0%).

Looking ahead, financial markets seem to suggest that the double-dip recession in Europe—recession in 2008 and 2009, a modest, halted recovery in 2010 and early 2011, followed by another recession since mid-2011—may be ending, and that the Eurozone economy may eke out small gains in the second half of 2013. The consensus of economists (as compiled by Bloomberg) sees GDP in the Eurozone contracting in both the second and third quarters of 2013, before a modest upswing begins in the fourth quarter. Our view remains that the Eurozone is likely to be in a recession throughout 2013, as policymakers have only successfully addressed the risk of a financial crisis, but have not avoided an economic one.

Staying Close to Home

Soft global growth and a strong dollar favored U.S. stocks over international in the first half [Figure 6]. U.S. stocks are likely to remain outperformers in the second half as these conditions continue.

Commodities Asset Classes Unlikely to See Strong Gains

The performance of many "hard" commodities, such as copper and steel, fell by a double-digit percentage during the first half of 2013 (based on futures contracts). This weakness reflected downwardly revised expectations for global GDP growth, but even more closely reflected the weaker outlook for Chinese demand. While economic growth in China may stabilize in the second half and lend some support to commodity prices, a snap-back rebound that would drive commodity prices sharply higher is unlikely.

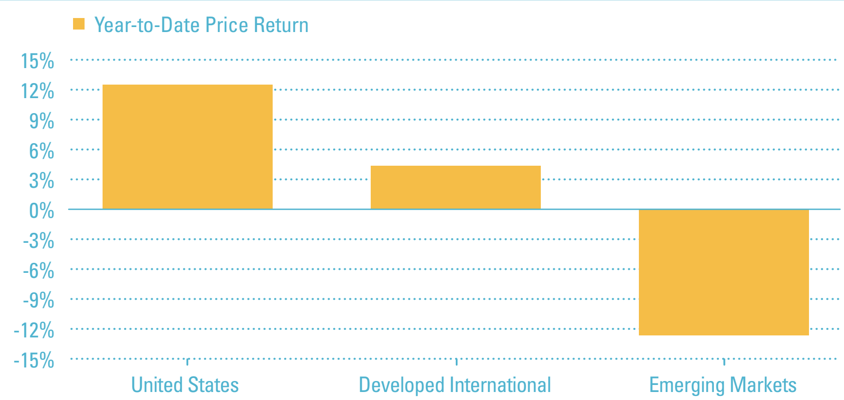
Favor U.S. Over International Stocks

While investors should monitor international markets—developed and emerging markets—for signs of recovery to trigger investment, U.S. markets should continue to be favored over international in the second half.

One of the reasons U.S. stocks may continue to outperform developed markets, particularly Europe, is the difference in the health of the financial sector. While financials have benefitted from a steepening yield curve in the United States and the ongoing boom in housing, banks in Europe are struggling. U.S. banks have much higher capital buffers and a much smaller percentage of bad loans on their books, according to the International Monetary Fund (IMF). In other words, European banks are undercapitalized and burdened with bad debts. As a result, they are not lending much, and that is keeping Europe from getting back on a growth trajectory. The European Central Bank (ECB) has been focused on avoiding bank collapses—as with the bailout of Cyprus in the first half of 2013—and therefore, has not been able to extend funds to would-be borrowers. While it appears efforts are being made to ease the budget austerity issues among countries, there is no such recipe in the works for the crippled banking sector.

Additionally, investors are backing away from emerging markets (EM), based on the performance of the MSCI Emerging Markets Index and capital outflows from these markets, especially those with higher deficits and weaker growth. India, Brazil, and South Africa are a few of many examples of weak growth. In addition, EM customers in Europe remain in recession. Finally, speculation that the Fed will pull back QE is pushing up yields on U.S. Treasuries, reducing the yield advantage of holding emerging market securities and demand for the currencies needed to buy them. The weakness in EM currencies is weighing on the dollar-based returns of EM investments.

6 U.S. Was the Place To Be for Stocks in the First Half



Source: Bloomberg, LPL Financial Research 06/20/13

Past performance is no guarantee of future results. The indexes listed above are unmanaged and cannot be invested into directly. The returns do not include fees, expenses, or sales charges. Index performance is not indicative of any particular investment.

United States return as measured by the S&P 500 Index, Developed international return as measured by the MSCI EAFE Index, and Emerging Markets return as measured by the MSCI Emerging Markets Index.

The Fed's Evacuation Route

On most treks, there are clearly marked evacuation routes, which are the most direct and well-marked routes away from potential hazards. The Fed has played a very active role in the markets since the financial crisis began in 2008. It has attempted to exit this role a couple of times before. As the first half came to a close, the Fed was preparing the markets for an eventual evacuation that is likely to begin late in 2013 and end by mid-2014.

The Benefits of QE

Quantitative easing, or QE, is a process where a central bank creates money and uses this new money to purchase bonds from financial institutions. As a result of this bond-buying program, several positives can be highlighted:

- Commercial banks have seen a rise in their capital reserves, staving off the threat of insolvency and potential bank runs.
- Banks have more capital to lend (although they have not lent out much of their new reserves—limiting the effect of QE on the wider economy).
- The lessened risk of a financial meltdown helped boost stock market prices and encouraged risk taking and investment by businesses.
- Interest rates have come down—benefitting the housing market and borrowers at the expense of savers.
- The increased money supply has helped to prevent deflation—a downward move in prices that can pull wages and the economy down with it.

The benefits of QE have been widely touted by policymakers, and it is being implemented in various forms by central banks in economies around the world.

The return of some volatility in the stock market late in the first half of the year was linked to market participants changing expectations about the duration of the Fed's bond-buying program. While as of mid-year we are likely to be at least three months away from any change in the Fed's QE program, the markets have tended to react three months in advance of changes, mainly due to early communications from the Fed. The stock market has responded very closely to changes in the size of the Fed's balance sheet (shifted three months forward to account for the signals about future direction and the lagged impact on the economy, as the bond purchases work their way through the financial system) [Figure 7]. Interestingly, since the beginning of the bull market on March 6, 2009, every $1 of assets added to the Fed's balance sheet has driven U.S. stock market value up by $7.93, on average.

Too Much of a Good Thing

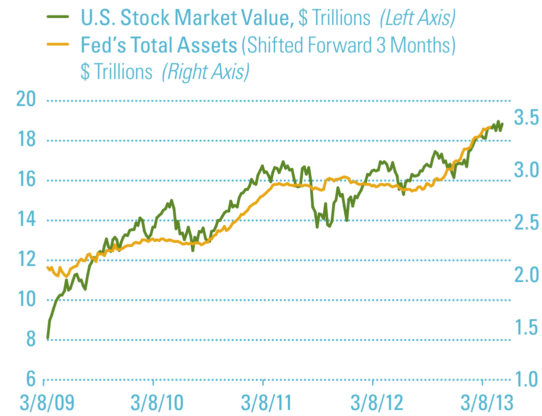
In addition to making management of the money supply increasingly more of a challenge, a key reason the Fed is contemplating an end to QE is that the potential costs of implementing the program are rising. The potential for losses that the Fed could sustain as interest rates rise are an important concern for the Fed. To try to assess the sensitivity to losses, we can try to gauge how much the assets on the Fed's balance sheet would be able to expand before the probability of losses from raising short-term interest rates would become too high. (This is now expected by the majority of the members of the Federal Open Market Committee [FOMC] to be sometime in 2015).

If the economy fails to meet the Fed's expectations over the second half of the year, the Fed may not begin to slow QE by the end of this year. However, letting it run for an additional year at the current pace could present problems. By year-end 2014, the Fed's assets would total about $5 trillion with a weighted average coupon of about 3% and a sizable portion in long-duration securities (those having maturities over 10 years), based on our analysis of the data published by the Fed. This portfolio of assets exposes the Fed to potentially large losses that may threaten the independence of the Fed from Congress—an outcome that markets would not welcome.

The Evacuation Route

The Federal Reserve has communicated that it will begin to slow QE in the fall. The slowing will be dependent upon the economy meeting the Fed's forecast and is expected to end by mid-2014 as the unemployment rate falls to about 7%. Even as the Fed begins to withdraw extraordinary stimulus by slowing QE, it is continuing to support the economy by maintaining a zero interest rate policy throughout the remainder of this year and next. In the past few years, the Fed has overestimated the economic momentum and stopped earlier iterations of QE before the recovery had become self-sustaining. In those two other instances, markets fell in response, and the Fed was forced to reinstate QE. This time the Fed may be more realistic in its expectations for growth and slow, or stop, QE without expecting much of a further acceleration in growth from current levels. A continuation of the recent pace of labor market improvement, at 176,000 jobs per month (according to the U.S. Bureau of Labor Statistics) over the past year (May 2012 through May 2013) would likely meet the Fed's definition of "real and sustainable" economic growth. This would warrant a reduction in bond purchases by the Fed in the fall, but may not meet expectations held by market participants, leading to volatility as the Fed begins taking the evacuation route.

7 The Fed's Bond Buying Has Been a Major Driver of Stock Market Value



Source: Bloomberg, Federal Reserve, LPL Financial Research 06/17/13

Avoiding a Bond Bear Attack

Bear attacks on treks are rare. But, it is smart to be prepared for them. LPL Financial Research believes that we are likely to be on the cusp of a long-term bear market for bonds as interest rates begin to reverse some of the past 30 years of steady declines (and rising prices). The Bear took a swipe at bond investors during the first half, but we do not expect investors to be mauled in the second half of 2013. Though taking some reasonable precautions may be a good idea.

The bond market saw a rise in interest rates over the first half of 2013. The bond market suffered a "tapering tantrum" in response to the Fed signaling it will reduce, or taper, the pace of bond purchases later this year. In addition, the economy proved resilient to higher tax rates and government spending cuts. Both factors contributed to bond market weakness. This was particularly evident during the month of May when the Barclays Capital Aggregate Bond Index posted a -1.8% decline, one of the worst monthly performances over the past 10 years.

After a difficult first half of 2013, we expect the fixed income markets to stabilize but continue to offer a low reward to accompany the ups and downs in the second half of 2013. A focus on yield and intermediate-term bonds is likely to help investors find a manageable path across a volatile landscape. We expect high-quality bonds to produce slight gains in the second half of 2013, but they may still finish the year flat to slightly down, as measured by the Barclays Capital Aggregate Bond Index. We expect interest income to offset some of the losses from recent price declines.

Low Mountain Range: 10-Year Treasury Yield to Vary Between 2.25% and 2.75%

After rising notably over the first half of 2013, we expect bond yields to stabilize in a new higher range over the second half of 2013. Despite fears

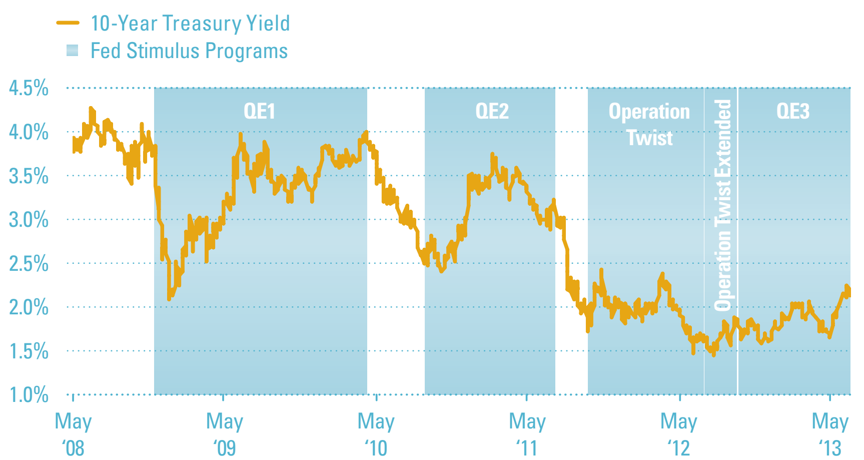
Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values and yields will decline as interest rates rise and bonds are subject to availability and change in price.

over Fed policy, several factors are likely to restrain any sharp and sustained rises in interest rates. These include:

- sluggish economic growth of 2%;
- low inflation; and
- the Fed remaining committed to keeping short-term interest rates near zero.

As a result, we expect recent bond market weakness to ease over the second half of 2013. Fears over an earlier-than-expected end to QE appear overdone, and a short-term opportunity in high-quality bonds may emerge as yields may have shot too high given the factors outlined above. Should market concerns over a slower pace of Fed bond purchases subside, bond prices may rise and yields may decline. The last two times the Fed stopped QE, high-quality bond prices rose and yields declined [Figure 8].

8 The Bond Market Has Responded to Changes in the Fed's Stimulus Programs: Prior Terminations of QE Have Led to Lower Yields and Higher Prices



Source: Bloomberg, Federal Reserve, LPL Financial Research 05/24/13

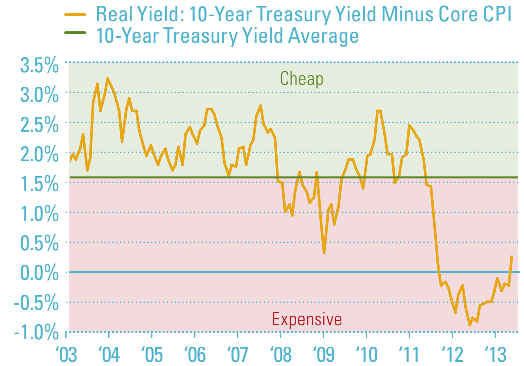
Quantitative easing is a government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital in an effort to promote increased lending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

Operation Twist is the name given to a Federal Reserve monetary policy operation that involves the purchase and sale of bonds. "Operation Twist" describes a monetary process where the Fed buys and sells short-term and long-term bonds depending on their objective.

Nonetheless, still-high bond valuations [Figure 9], stabilization in European economies, and a gradual reduction in QE may result a in a further, but modest, increase in bond yields in the second half of 2013. We expect yields to finish the year in a new higher range defined by a 2.25–2.75% 10-year Treasury yield [Figure 10].

Given our expectation of stabilization in bond yields, we expect interest income to offset price declines and result in low single-digit returns for high-quality bonds in the second half. Yields may rise higher in the event the Fed follows through with an earlier-than-expected reduction in QE, and if the private sector of the economy continues to exhibit no harm from higher tax rates and reduced government spending. Although we place a lower probability of this more bullish bond outcome, the 10-year Treasury yield may rise to 2.75% under that scenario. Such a result would likely translate to flat or negative total returns.

9 Bond Valuations Remain Expensive by Historical Comparison

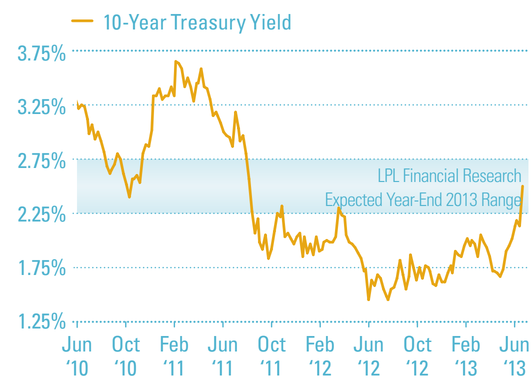


Source: Bloomberg, LPL Financial Research 06/21/13

Core CPI is a subset of the total Consumer Price Index (CPI) that excludes the highly volatile food and energy prices. It is released by the Bureau of Labor Statistics around the middle of each month.

Past performance is no guarantee of future results.

10 Treasury Yields Likely To Finish 2013 in a New, Higher Range



Source: Bloomberg, LPL Financial Research 06/21/13

High-yield/junk bonds are not investment-grade securities, involve substantial risks, and generally should be part of the diversified portfolio of sophisticated investors.

The risks associated with investment-grade corporate bonds are considered significantly higher than those associated with first-class government bonds. The difference between rates for first-class government bonds and investment-grade bonds is called the investment-grade spread. The range of this spread is an indicator of the market's belief in the stability of the economy.

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.

*Please see our Municipal Moment video on YouTube for further information about the summer seasonal period.

Favor Municipals for Quality

Within the high-quality bond market, municipal bonds continue to offer value. Valuations remain attractive, and the summer months usher in one of the more consistently favorable periods to own municipal bonds.* Attractive valuations helped the municipal bond market better withstand the rise in interest rates over the first half of 2013 and may once again provide a buffer in the second half of the year. Many investors could consider municipal bonds in taxable and tax-free portfolios alike to take advantage of these benefits, as total returns (interest income plus price changes) may be greater than high-quality taxable bonds.

Balance Risk/Return With Intermediate-Term Bonds

We believe intermediate-term bonds offer the most favorable balance of return and risk in the form of interest rate sensitivity. However, we acknowledge the potential for the Fed's communications and actions—and the markets' interpretation of them—may make it necessary to shift to shorter-term bonds in favor of a more defensive stance. At this juncture, many investors should consider being in intermediate-term bonds, but be ready to move shorter as warranted.

Bear Repellent: Seek Out Higher-Yielding Investments

With relatively modest changes in prices ahead, we believe yield will be a key driver of return in the second half of 2013. Strong corporate credit measures, such as interest coverage and debt-to-equity ratios, peaked in 2012, but witnessed only modest deterioration and remain strong relative to history. Flashes of why high-yield bonds are often referred to as "junk" were evident in some spurts of new bond issuance over the first half of 2013, but such activity was both minor and rare and nowhere near the degree witnessed just prior to the 2008 financial crisis. Valuations for both investment-grade corporate bonds and high-yield bonds are slightly expensive compared with long-term history, but may continue to offer a potential opportunity in a low-yield landscape.

Remain on the Trail: Avoid Short Cuts and Long Walkabouts

We remain focused on intermediate-term bonds, as we believe they continue to represent a solid amount of yield for a given level of interest rate risk. Given our expectation of only a modest rise in interest rates, we believe short-term bonds offer too low of a yield to be attractive. Furthermore, should the economy falter or Fed bond-buying fears prove misguided, intermediate-term bond prices may increase more and help provide better portfolio diversification benefits. Longer-term bonds offer only slightly higher yields in exchange for the potential of significantly larger losses if rates rise more than what we expect on our base path.

Stay Close to Home

Economic growth concerns weighed on emerging market bonds over the first half of 2013, a trend that may continue over the remainder of 2013. While emerging market (EM) economies generally offer more rapid growth than their developed market peers, the pace of that growth continues to decelerate with no signs of stabilization as of yet. Weaker growth may lead to additional price declines as many investors demand still-cheaper valuations. Growth concerns are more problematic among local currency EM bonds, which often see exaggerated price weakness due to illiquidity. Despite slowing growth, in many cases EM central banks cannot respond with interest rate cuts to stimulate their economies due to stubbornly high inflation. Until signs that EM growth is likely to rebound, EM bonds may remain under pressure. On a positive note, EM bond valuations are the most attractive they have been since August 2012. However, we favor a neutral stance as we await further stability.

Currency is likely to be the dominant driver of developed market foreign bond returns over the second half of 2013, just as it was during the first half. For much of the first half of 2013, strong appreciation in the US dollar drove the poor performance of international bond investments. A strong US dollar in the second half may cause further currency volatility and continue to make international bond investments unattractive. We also find currency-hedged international bonds unappealing, given their government-only focus and generally lower yields compared to diversified domestic bonds.

There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not ensure against market risk.

Currency risk is a form of risk that arises from the change in the price of one currency against another. Whenever investors or companies have assets or business operations across national borders, they face currency risk if their positions are not hedged.

Municipal bonds are subject to availability, price, and to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rate rise. Interest income may be subject to the alternative minimum tax. Federally tax-free but other state and local taxes may apply.

Tough Climb Ahead for Stock Market

On most treks, climbing hills, and sometimes mountains, it is essential to get where you are going. In all instances, you need to be aware of how high you are climbing and be prepared for what that might mean with regard to steepness and difficult footing. LPL Financial Research believes that the stock market's easy climb to new all-time highs in the first half of the year is likely to turn more challenging. The modest, single-digit stock market gain we expect in the second half of the year is likely to come with a substantial uptick in volatility that was absent until late in the first half. The ups and downs may make all but the most surefooted investors a little cautious.

We have experienced the most powerful bull market in history. As of June 6, 2013, the S&P 500 Index has gained about 140% since its low on March 6, 2009—delivering the largest four-and-a-quarter year gain of any bull market since WWII [Figure 11]. The bull run has been dependent in part upon extraordinary support from the Fed. What is next for the bull market may depend upon the actions by the Fed.

Rocky Terrain: Fed Fluctuations Could Impact Markets

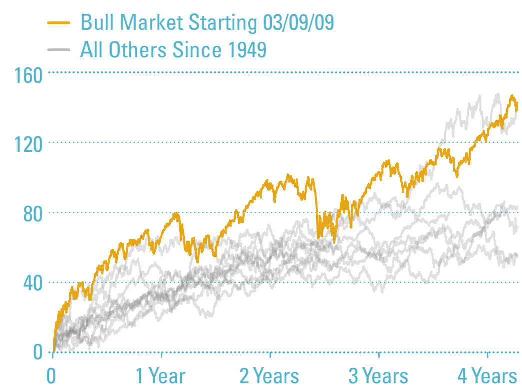
The Fed's intention to stop or slow its bond-buying program later this year introduces the potential for greater volatility and makes a strong rally in the S&P 500 Index in the second half of the year similar to that seen in each of the past four years unlikely. The S&P 500 Index fell 10–20% following the end of the QE1 and QE2 bond-buying programs in 2010 and 2011 [Figure 12], as economic growth weakened, ultimately prompting the Fed to reinstate stimulus and the market to rebound.

If the market believes the Fed's end of extraordinary stimulus is premature, the market may again deliver a wide swing in volatility. If instead the U.S. economy and earnings of U.S. companies deliver better-than-expected performance in the coming months, the market may ultimately welcome the end of the Fed's program. We continue to see the pace of growth in the economy and earnings to be modest and expect the Fed's actions to introduce some long-absent volatility.

With the 10-year Treasury yield rising more than half a percentage point in the first half of 2013, many investors are beginning to wonder how much rising interest rates may negatively affect stock prices. Higher yields can slow borrowing and spending, weighing on economic and profit growth. While higher rates are bad news for bond investors—the spike in bond yields seen in June coincided with losses for stocks—the good news is that a slow-and-steady rise in yields from the current very low levels may not rule

11 The Most Powerful Bull Market in Recent History

S&P 500 Index Performance During All Bull Markets Since WWII



Source: Bloomberg, LPL Financial Research 06/14/13

Past performance is no guarantee of future results.

The S&P 500 Index is unmanaged and you are unable to invest into it directly. The returns do not reflect any fees, expenses or sales charges. Index performance is not indicative of any particular investment.

Stock investing involves risk including loss of principal.

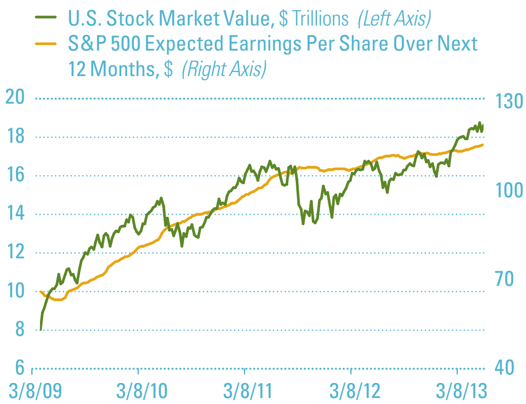
12 The Stock Market Has Responded to Changes in the Fed's Stimulus Programs:
Prior Terminations of QE Have Led to Market Drops and Volatility

Source: Bloomberg, LPL Financial Research 06/19/13

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.

Operation Twist is the name given to a Federal Reserve monetary policy operation that involves the purchase and sale of bonds. "Operation Twist" describes a monetary process where the Fed buys and sells short-term and long-term bonds depending on their objective.

13 Earnings Remain a Key Fundamental Driver of Stock Market Value

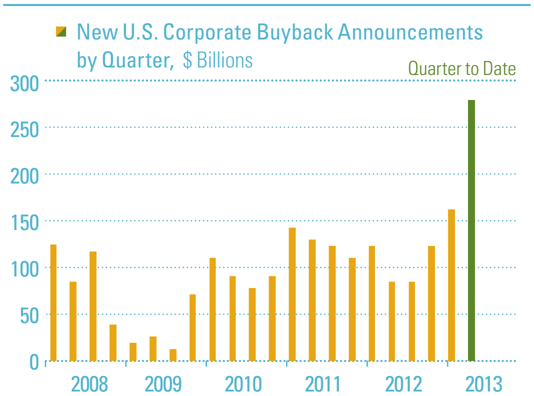


Source: LPL Financial Research, FactSet, Bloomberg 06/17/13

Past performance is no guarantee of future results.

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability. Earnings per share is generally considered to be the single most important variable in determining a share's price. It is also a major component used to calculate the price-to-earnings valuation ratio.

14 Corporations Are Buying Back Shares Aggressively



Source: Bloomberg, LPL Financial Research 05/20/13

out rising stock prices in the second half of 2013. This is because rising yields from the current low levels reflect:

- improving prospects for economic growth;
- low current inflation with a falling risk of future deflation; and
- falling prices for bonds, which may prompt investors to sell bonds and buy stocks.

As economic data continue to reflect modest growth in the coming quarters, allowing the Fed to slow its pace of bond buying, bond yields and stock prices are likely to continue their climb—though the rapid pace seen in the first half is likely to slow and volatility is likely to return.

Slow Trekking: Earnings Growth Slow and Steady

Earnings have been an important support for the bull market [Figure 13]. Earnings per share are likely to grow at a mid-single-digit pace in 2013. Earnings are likely to be driven by a combination of low single-digit revenue growth tied to sluggish global economic growth, and profit margins maintaining or even modestly expanding their current high levels, as inflation picks up modestly while labor costs remain well contained.

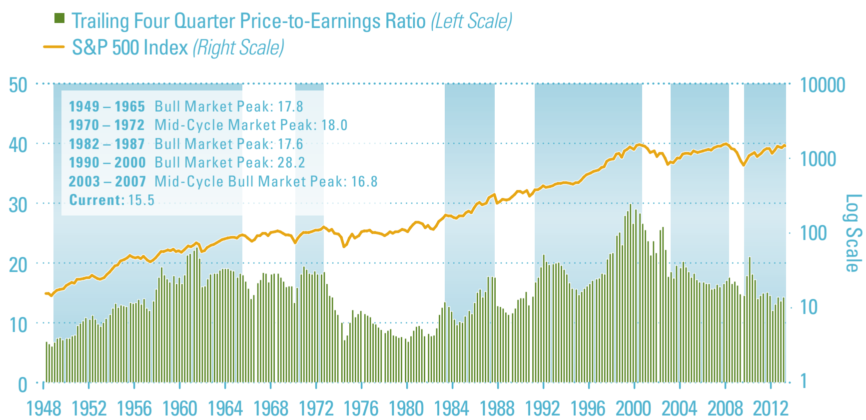
Earnings per share are also likely to benefit by a few percentage points from record-breaking share buybacks that reduce the number of shares outstanding and boost earnings on a per-share basis. Corporations have become net buyers of shares as rising cash flow and wide profit margins compel them to shrink their share count to boost earnings per share as revenue growth slows. Companies themselves have been the biggest buyers of stocks in the first half of 2013. Companies reduced purchases during the financial crisis of 2008 and 2009, as they were focused on hoarding their capital. Now, corporations have returned to near-record levels of net share repurchases. New buyback announcements have surged this year [Figure 14]. Corporations have been aggressively buying back shares, adding up to hundreds of billions of dollars in purchases each quarter.

Higher Ground: Overbought, but Not Overvalued

The trailing price-to-earnings ratio had not changed much in recent years, as investors' skepticism of the durability of the recovery kept them unwilling to pay more for each dollar of current earnings. But in the first half of 2013, for the first time in this four-year bull market, valuations rose above the long-term average level of around 15.

While stocks could be said to be overbought and due for a modest pullback after such a strong run to record highs in the first half, they are not overvalued. At a price-to-earnings ratio of 15.5, the S&P 500 Index may stand slightly above the long-term average valuation, but it remains well below the levels (typically around 17–18) that marked the end of each bull market since WWII [Figure 15].

15 **Bull Is Not Over Yet:** Bull Markets Have Ended at 17–18 Price-to-Earnings Ratios



Source: Bloomberg, LPL Financial Research 06/21/13

Shaded areas indicate bull markets.

Past performance is no guarantee of future results.

The S&P 500 Index is unmanaged, and you are unable to invest into it directly. The returns do not reflect any fees, expenses, or sales charges. Index performance is not indicative of any particular investment.

The price-to-earnings ratio is a measure of the price paid for a share relative to the annual net income or profit earned by the firm per share. It is a financial ratio used for valuation: a higher P/E ratio means that investors are paying more for each unit of net income, so the stock is more expensive compared to one with lower P/E ratio.

Tougher Climb Ahead

The path to potential further gains in the second half of 2013 may have a lot of ups and downs as the easy terrain in the first half becomes rough and uneven in the second. The volatility may come from well-known risks, such as changes to the Fed's bond-buying program, legislators' travails over the debt ceiling, European efforts to deal with its broad recession, and the upcoming election in Germany. However, these could be exacerbated by the less widely-known risks, ranging from the rise in geopolitical tension to the rise in mortgage rates, that could threaten growth.

Get Active

The slight decrease in macroeconomic policy uncertainty in the second half of the year should result in an improved backdrop for fundamentally driven active management, which struggled in the first half of the year. The slow-growth economic environment should also re-focus investor attention on individual company fundamentals. In principle, active managers tend to devote more of their focus to the microeconomic differentiators among companies than on the common macroeconomic factors that prevailed in the first half of the year.

Stay Local

Given the increase in share buybacks, U.S. companies now have higher total yields (sum of all distributions to shareholders, including dividends and buybacks) than non-U.S. companies. This makes domestic equities an attractive consideration for many investors seeking yield.

Small Is Beautiful

While they may see wider swings than the overall market and could suffer greater losses in the event of a bear market in the second half, smaller companies may benefit more from the stronger and more durable growth in the United States than their more globally exposed, larger cap peers. Investors willing to tolerate a bit more risk presented by small caps will likely be rewarded with higher returns.

We Are Not Out of the Woods Yet

While the dark forest depths of the financial crisis of 2008 are long behind us, we are not out of the woods yet. Many obstacles still need to be overcome, or they could impede the market's hike toward further gains and the economy's path toward further stability. The challenges for the second half of 2013 are numerous, including the slowing of historic levels of stimulus from the Fed, testy deliberations over the debt ceiling, slowing growth in China, and the broadening and deepening recession in Europe.

There is no clear or easy trail in the second half of 2013. The markets and global economy remain in uncharted territory with geopolitical, monetary, and fiscal policy at significant crossroads. Despite a recovering housing market and improving job growth, sluggish economic growth persists and creates uneven footing and potential hazards ahead.

On journeys filled with as many twists and turns as we have navigated over the last five years, uncertainty is a natural emotion. And, so is apprehension — even doubt. But with LPL Financial Research and your advisor as your trusted guides, you are never alone on this trek. Even in the deepest of forests, in places where hiking trails cannot be forged, markers of experience, integrity, and perseverance exist. To the most veteran of hikers these markers are called cairns, which are small piles of rocks serving as the rustic signposts directing the lost to a trail and the uncertain to confidence.

The path ahead is far from obvious, but a lack of clarity does not need to lead to a lack of action or direction. Simply standing around, as opposed to trekking on, only leads to disappointment. This is also true in investing — staying on the sidelines leads to missed opportunities. LPL Financial Research stands poised to navigate this uncharted investment landscape and leave the investment cairns for you and your advisor to follow with confidence.

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 security. 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.

By using a combination of assets, debt, equity, and interest payments, leverage ratios are used to understand a company's ability to meet it long-term financial obligations. The three most widely used leverage ratios are the debt ratio, debt-to-equity ratio, and interest coverage ratio. The debt ratio gives an indication of a company's total liabilities in relation to their total assets. The higher the ratio, the more leverage the company is using and the more risk it is assuming.

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

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

The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.

Precious metal investing is subject to substantial fluctuation and potential for loss.

The Barclays Capital Aggregate Bond Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment-grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities.

International and emerging market investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors.

Investing in foreign securities involves special additional risks. These risks include, but are not limited to, currency risk, political risk, and risk associated with varying accounting standards. Investing in emerging markets may accentuate these risks.

Tactical portfolios are designed to be monitored over a shorter time frame to potentially take advantage of opportunities as short as a few months, weeks, or even days. For these portfolios, more timely changes may allow investors to benefit from rapidly changing opportunities within the market.

The strategic asset allocation process projects a three- to five-year time period. While the strength of the asset allocation decisions is retested often, we do not anticipate making adjustments until midway through the strategic time frame, which generally is about every two to three years. If significant market fluctuations warrant a change, adjustments may be made sooner.

The MSCI EAFE Index 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 MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. The MSCI Emerging Markets Index consists of the following 21 emerging market country indices: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey.

Government bonds and Treasury Bills are guaranteed by the U.S. government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value. However, the value of fund shares is not guaranteed and will fluctuate.

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.

The Leading Economic Index (LEI) is an economic variable, such as private-sector wages, that tends to show the direction of future economic activity.

The Philadelphia Defense Sector Index (PHLX) is designed to track the performance of companies who are engaged in the defense and aerospace sector.

S&P 500 Managed Health Care Index: Companies involved in providing health care benefits including group insurance and other diversified health care services.

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 information is not intended to be a substitute for specific individualized tax, legal or investment planning advice. We suggest that you discuss your specific tax issues with a qualified tax advisor.

International Monetary Fund (IMF) is an international organization created for the purpose of promoting global monetary and exchange stability, facilitating the expansion and balanced growth of international trade, and assisting in the establishment of a multilateral system of payments for current transactions.

The Nikkei Index is short for Japan's Nikkei 225 Stock Average, the leading and most-respected index of Japanese stocks. It is a price-weighted index comprised of Japan's top 225 blue-chip companies on the Tokyo Stock Exchange. The Nikkei is equivalent to the Dow Jones Industrial Average Index in the U.S. In fact, it was called the Nikkei Dow Jones Stock Average from 1975 to 1985.

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

RES #4220 0713
Tracking #1-177886 (Exp. 07/14)