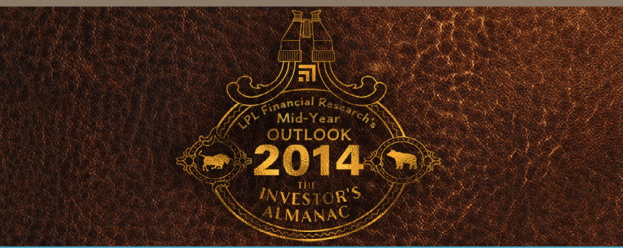
# Mid-Year Outlook 2014 Abridged




## Investor's Almanac Field Notes

At this year's halfway point, we are pleased to offer the LPL Financial Research *Mid-Year Outlook 2014: Investor's Almanac Field Notes* containing key observations and updates to our outlook for 2014. Similar to a farming almanac, our *Investor's Almanac* is a publication containing a guide to patterns, tendencies, and seasonal observations important to growing. The goal of farming is not merely to grow crops, but to sustain living things—investing shares the same goal.

As we expected, markets in 2014 have been less influenced by politics and policymakers than in 2013 and more dependent upon growth. Growth is an essential characteristic of all living things, and in 2014, growth is vital to our outlook for the economy and markets. Our notes from the field contain these key observations and reaffirm our forecasts for the second half:

- After an extreme winter weather-induced slowdown in the first quarter, the U.S. economy began to thaw with the warmer temperatures in the spring. We continue to believe U.S. economic growth is on track to accelerate by about 1% over last year, owing to the return of business spending and the elimination of the drag from fiscal policy. As a result, the Federal Reserve (Fed) is likely to continue to taper its bond purchases and end its bond-buying program in the fall, leaving rate hikes on the calendar for some time next year.
- Stocks spent the winter months dormant, but emerged in the spring rising to new highs and producing a gain of about 6% by early June—halfway to our target range of 10–15% for the full-year of 2014.* Historically, double-digit gains are typical for years in the middle stage of the economic cycle. The current mid-cycle environment has even produced double-digit gains in 4 of the past 10 quarters. Critical to our outlook, earnings for S&P 500 Index companies are on track for 5–10% growth—with 6% achieved in the relatively weak first quarter. Confidence in the durability of growth may contribute to a slight rise in valuations and, along with earnings growth, generate a low double-digit gain for stocks in 2014.
- Opportunities in the bond market have become scarce. Yields are unattractive and gains are not likely in the second half. We find fewer sectors attractive than at the beginning of the year. We expect yields to rise in the second half of 2014 as global growth strengthens and inflation picks up from the low point in the first half.

Economic forecasts set forth may not develop as predicted, and there can be no guarantee that strategies promoted will be successful.

*As noted in our *2014 Outlook: The Investor's Almanac*, the stock market may produce a total return in the low double digits (10–15%). This gain is derived from earnings per share (EPS) for S&P 500 companies growing 5–10% and a rise in the price-to-earnings ratio (PE) of about half a point from just under 16 to 16.5, leaving more room to grow. The PE gain is due to increased confidence in improved growth allowing the ratio to slowly move toward the higher levels that marked the end of every bull market since World War II (WWII).

LPL Financial Research's

# Mid-Year Outlook 2014 At A Glance


**3% Growth***

As economic drags fade and global growth improves, growth may accelerate to its fastest pace in nearly a decade.

**10–15% Growth**

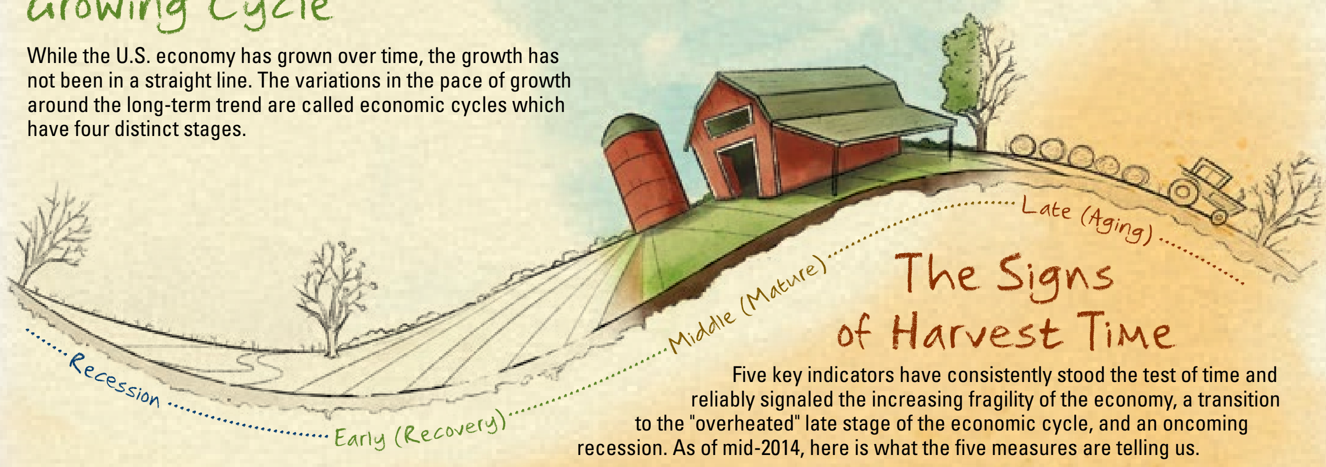
This annual return forecast is based on high single-digit earnings growth and a modest rise in the PE.

**Flat Returns**

Interest rates will move higher and bond prices lower as economic growth improves.

## Middle of the Growing Cycle

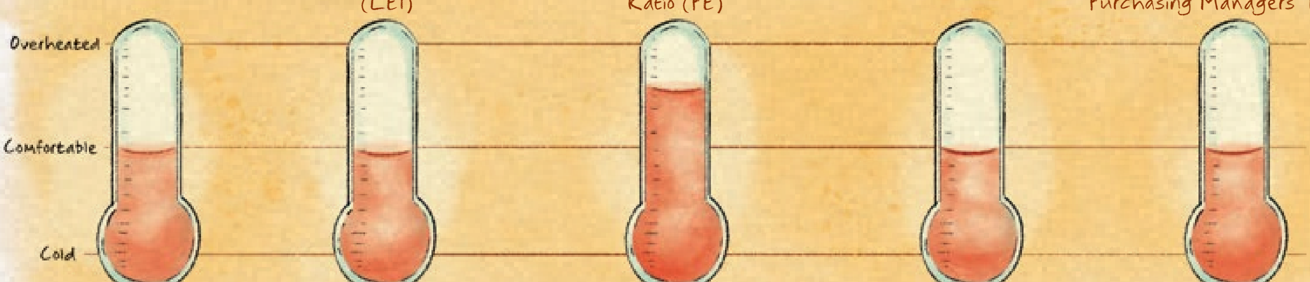
While the U.S. economy has grown over time, the growth has not been in a straight line. The variations in the pace of growth around the long-term trend are called economic cycles which have four distinct stages.




## The Signs of Harvest Time

Five key indicators have consistently stood the test of time and reliably signaled the increasing fragility of the economy, a transition to the "overheated" late stage of the economic cycle, and an oncoming recession. As of mid-2014, here is what the five measures are telling us.

| Market | Fundamental | Valuation | Technical | Sentiment |
|---|---|---|---|---|
| Treasury yield curve | Index of Leading Economic Indicators (LEI) | S&P 500 Trailing Price-to-Earnings Ratio (PE) | Market Breadth | Institute for Supply Management (ISM) Purchasing Managers' Index |




| Market | Fundamental | Valuation | Technical | Sentiment |
|---|---|---|---|---|
| Every recession over the past 50 years was preceded by the Fed hiking rates enough to invert the yield curve. | When the year-over-year change in the LEI turns negative a recession has usually followed. | Since WWII, every bull market but one has ended with a PE of 17–18. | A peak in market breadth, followed by a peak in the Index, has almost always preceded a recession and bear market. | ISM has a solid record forecasting earnings growth, warning of the weakness that may lead to a recession and bear market. |

Source: LPL Financial Research 06/18/14

*As noted in the *Outlook 2014: The Investor's Almanac*, LPL Financial Research expects GDP to accelerate from the 2% pace of recent years to 3% in 2014. Since 2011, government spending subtracted about 0.5% each year from GDP growth. Government spending should be less of a drag on growth which when combines with better global growth and business spending would result in +1% increase for 2014.

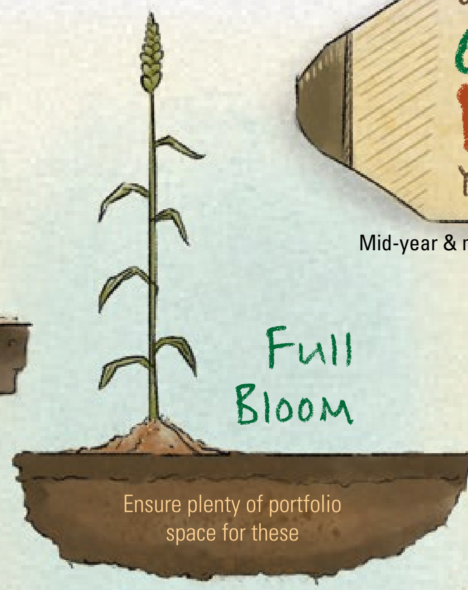
# Guide to Growing & Preserving Your Portfolio

Mid-year & mid-cycle portfolio investment considerations

## Sowing Seeds

Consider adding some of these to your growing portfolio

- International (Developed Market) Stocks
- Emerging Market Stocks
- Fixed Income Alternatives
- Emerging Market Bonds
- Bank Loans



## Full Bloom

Ensure plenty of portfolio space for these

- U.S. Large Cap Stocks
- Cyclical Stocks
- Intermediate-Term Bonds
- High-Yield Bonds
- U.S. Small Cap Stocks

## Harvest Time

Consider reaping these that are not in season

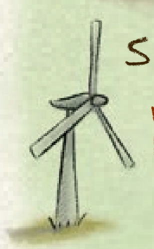
- Defensive Stocks
- High-Quality Bonds
- Long-Term Bonds
- International (Developed Market) Bonds
- Investment-Grade Corporate Bonds
- Municipal Bonds


## Beyond the Cycle

The economic cycle is relevant for managing risk and return over the short and intermediate term. However, it also makes sense to look beyond the economic cycle to investing themes that may reward investors over a longer time horizon.

## Super Themes

We believe there are three broad categories of long-term investment opportunities, which we call "super themes"



### Waves of Innovation

What new inventions are likely to impact companies?

### Consumer Currents

What are consumers likely to increasingly spend their money on?

### Global Policy & Income Climate

What impact will changes in global policies have on the markets and economies?

Source: LPL Financial Research 06/18/14

Investing involves risk including loss of principal.

The primary risk to our outlook, the possibility that better growth in the economy and profits does not develop, has gained even sharper focus as we move from the threshold of the new year into the midst of 2014. That risk is likely to be more significant in the second half of the year than the distractions posed by the end of the Fed's bond-buying program and the mid-term elections.

Farmers' almanacs have been a source of wisdom, rooted in the core values of independence and simple living, for American growers for over 200 years. In our *Investor's Almanac Field Notes*, we seek to provide a trusted guide to the second half of the year filled with a wealth of wisdom for investors. We forecast a healthy investment environment in which to cultivate a growing portfolio.

Please see our full LPL Financial Research *Mid-Year Outlook 2014: Investor's Almanac Field Notes* publication for details about our Five Forecasters and Super Themes.

## Looking Over the Horizon

There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not protect against market risk. Asset allocation does not ensure a profit or protect against a loss. No strategy assures success or protects against loss.

Much of the investing industry remains focused on allocating to investments based on their characteristics, diversifying among large and small companies or growth and value types of companies, for example. While there are differences in the performance of these individual asset classes during the economic cycle, there is relatively little differentiation over the long-term.

In contrast, long-term diversification is more likely to come from incorporating different long-term themes that may include multiple asset classes. Including some exposure to long-term thematic investments may help to provide a more complete strategy that looks beyond the economic cycle.





RES 4669 0614
Tracking #1-284852 (Exp. 06/15)