



Weekly Market Commentary



October 19, 2009

Persistent Pessimism

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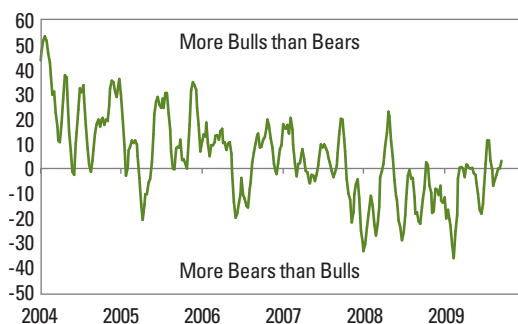
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Highlights

- There remains a surprising amount of pessimism among individual investors given the powerful rally and clear improvement in so many economic data points.
- Individual investors typically focus on lagging indicators such as employment or home prices and often miss turning points in the markets and economy by up to a year and sometimes more.
- Local personal experiences rather than merely news headlines may be the more potent driver of sentiment. However, analysis shows that even at the local level investors tend to focus on lagging indicators rather than leading ones.

1 Investor Sentiment Remains Tempered Despite Record Rally

American Association of Individual Investors Survey: Percent of Bulls minus Bears (4 Week Moving Average)



Source: Bloomberg, LPL Financial

After crossing 10,000 for the first time in a year, the Dow finished the week just below that threshold—but up for the second straight week, gaining 1.3%. The S&P 500 added a similar 1.5% on the week, up 61% since early March but still off 31% from the October 2007 peak.

The stock market gain was solid, but clearly reflects lofty expectations for earnings since a record-breaking 79% of the 61 companies in the Standard & Poor's 500 that have reported third-quarter earnings so far managed to beat analysts' profit projections. Based on last week's reception, companies appear to have to present revenue growth combined with much better than earnings expected results to generate anything more than a yawn from the stock market—which appears to be nearly saturated with good news.

How can we characterize the market as becoming complacent when individual investors appear to be cautious in embracing the recovery? In fact, there is still a surprising amount of pessimism among individual investors given the powerful rally and clear improvement in so many economic data points. Last week, the consumer confidence reading from the University of Michigan fell in early October, a reminder that individuals remain nervous about the strength and durability of the emerging economic recovery. While it has started to improve, the American Association of Individual Investors survey still reflects a historically low spread between bulls and bears and trillions in cash remains uninvested, languishing in Money Market Funds.

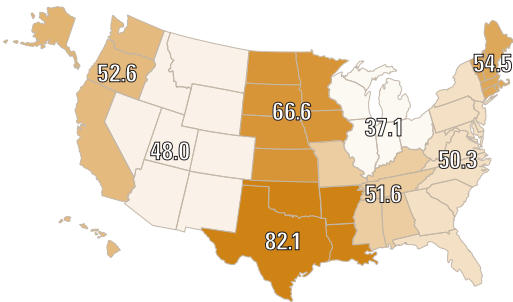
Why the pessimism? Individual investors typically focus on lagging indicators such as employment or home prices and often miss turning points in the markets and economy by up to a year and sometimes more. In 10 out of the last 10 recessions the unemployment rate continued to rise well after the stock market bottomed and the economy emerged from recession. Also, housing typically continues to worsen well after the recession ends and stocks rally – in some cases for an additional two years.

A focus on lagging indicators—often attributed to “bad headlines” on employment or housing—is not the only reason some investors remain pessimistic. In general, investors pay too much attention to the local economy than the national or global one and miss out on opportunities and important turning points. Local personal experiences rather than merely news headlines may be the more potent driver of sentiment. This personal experience, real or perceived, appears to have a powerful effect on investor psychology. It is easy to see why.

- It may be hard to get excited by the investment opportunities created by the powerful global growth engine in emerging Asia when suffering with

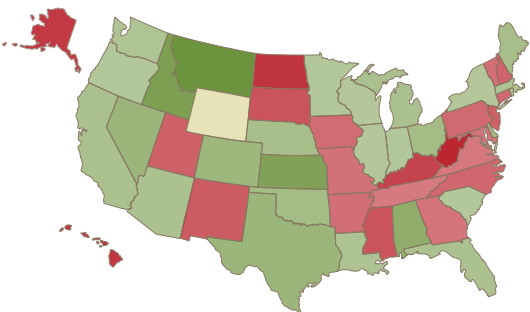
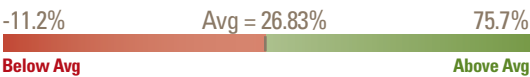


2 Confidence Varies by Region
Regional Consumer Confidence Reading from the Conference Board



Source: Bloomberg, LPL Financial

3 State-by-State Stock Returns
Russell 3000 Companies Median YTD Performance by State of Domicile



Source: Bloomberg, LPL Financial
 Please Note: WY has no Russell 3000 companies

a 15% unemployment rate in Michigan, according to the Bureau of Labor Statistics (BLS), but the MSCI Asia ex-Japan index is up over 65% this year.

- The resilient demand for high-tech manufactured products must look like a mirage when industrial manufacturing employment in Ohio has fallen 19% in the past year, according to the BLS, but the S&P 500 Information Technology Hardware & Equipment Industry is up 55% this year.
- It must be difficult to believe that anyone is buying houses in the U.S. if you live in Florida. In September, 1 out of every 158 homes was in foreclosure, according to RealtyTrac, yet homebuilder stocks are up over 30% this year, as measured by the S&P 500 Home Builder Index.

However, even at the local level investors tend to focus on lagging indicators rather than leading ones. Statistical analysis shows that on a regional and state basis, consumer confidence is influenced more by the unemployment rate and the state's bond rating (which is a reflection of the outlook for state taxes and political handwringing) and other lagging indicators of the local economy than by leading indicators such as the stock price performance of local companies—arguably a harbinger of future improvement in hiring and other local economic trends.

We expect individual investors to become a more potent investor force in the coming quarters as more and more cash gets put to work in the markets helping to change the complexion of the markets from the institutional investors.

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

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