# GLOBAL PORTFOLIO STRATEGY

LPL Research

DECEMBER 2021

# STICKING WITH STOCK OVERWEIGHT WHILE WATCHING OMICRON

## LPL RESEARCH'S MONTHLY MARKET OUTLOOK

### Key changes from November's report:

- Downgraded materials sector view from positive to neutral
- Upgraded view on Treasury securities from negative to neutral

**Stocks fell slightly in November, as the S&P 500 lost 0.8% for the month. For much of the month, stocks benefited from evidence of a strong rebound in economic activity during the fourth quarter, solid third quarter earnings results, fiscal stimulus, and generally stable interest rates, though gains were erased late in the month on COVID-19 variant fears.**

**Our year-end 2021 S&P 500 fair value target range remains 4,650—4,700, based on a price-to-earnings ratio (PE) of 21.5 and our 2022 earnings per share (EPS) estimate of $218. We expect the 10-year Treasury yield to end the year between 1.50%—1.75% and rise slightly next year. Primary risks include another COVID-19 wave in the U.S., lockdowns in Europe, prolonged supply chain disruptions, elevated inflation, higher interest rates, and geopolitics.**

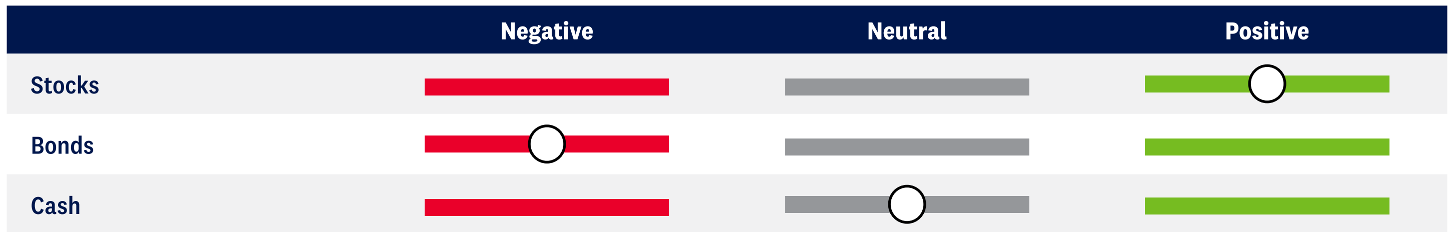
**Against this backdrop, LPL Research continues to believe that tactical investors should tilt portfolios in favor of stocks over bonds relative to their respective targets.**

## INVESTMENT TAKEAWAYS:

- We favor stocks over bonds based on our expectation for strong economic growth through year-end, continued solid earnings momentum, and still-low interest rates.
- We expect cyclical value stocks to outperform their growth counterparts near-term as economic growth picks up.
- Our materials downgrade reflects slower growth in China, the strong U.S. dollar, and recent deterioration in relative strength, while the post-pandemic pickup in global growth is being delayed by Europe's wave of COVID-19 and may be delayed further by the Omicron variant.
- Our positive views of small and midcaps are supported by the early-stage bull market and economic expansion, strong earnings, and healthy merger and acquisition environment.
- China's slowdown amid its regulatory crackdown supports our cautious view of emerging markets (EM).
- We continue to recommend a slight underweight allocation to fixed income as higher rates may put some pressure on bond returns.
- Although we've seen a move slightly higher in yields recently, reduction of Federal Reserve (Fed) policy support and a strengthening global recovery may push yields still higher in the months ahead.
- We have upgraded our Treasuries view. As interest rates have moved off last year's record lows, we no longer think a max underweight to Treasury securities is warranted. While yields may move modestly higher from current levels, the biggest moves may have already occurred.

## BROAD ASSET CLASS VIEWS

### LPL Research's Views on Stocks, Bonds, and Cash




## OUR ASSET CLASS & SECTOR CHOICES

| Equity Asset Classes | Equity Sectors | Fixed Income | Alternative Asset Classes |
|---|---|---|---|
| ▪ U.S. Value<br>▪ U.S. Mid Caps<br>▪ U.S. SmallCaps | ▪ Financials<br>▪ Industrials | ▪ Mortgage-Backed Securities | ▪ Event Driven |

## 2021 MARKET FORECASTS

### Higher Earnings Support Further Gains for Stocks

| | Previous | Current (No Changes) |
|---|---|---|
| 10-Year U.S. Treasury Yield | 1.5%-1.75% | 1.5%-1.75%* |
| S&P 500 Index Earnings per Share | $205 | $205 |
| S&P 500 Index Fair Value | 4,650-4,700 | 4,650-4,700** |

Source: LPL Research, FactSet, Bloomberg

All indexes are unmanaged and cannot be invested into directly. The economic forecasts may not develop as predicted.

*As noted in our Weekly Market Commentary on September 20, 2021, our year-end 2021 forecast for the U.S. 10-year Treasury yield is 1.5%-1.75%. The lowered forecast reflects low interest rates outside the U.S. and our expectations for slower economic growth near-term.

**As noted in our Weekly Market Commentary on August 16, 2021, our year-end 2021 fair-value target range for the S&P 500 of 4,650–4,700 is based on a price-to-earnings ratio (PE) of 21.5 and our revised S&P 500 earnings per share (EPS) forecast of $218 in 2022.

## 2021 ECONOMIC FORECASTS

### Solid U.S. Growth Expected Despite Soft Third Quarter

| | Previous | Current (No Changes) |
|---|---|---|
| United States | 5.75% to 6.25% | 5.75% to 6.25% |
| Developed ex-U.S. | 3.75% to 4.25% | 3.75% to 4.25% |
| Emerging Markets | 5.5% to 6% | 5.5% to 6% |
| Global | 5.5% to 6% | 5.5% to 6% |

Source: LPL Research, Bloomberg

The economic forecasts may not develop as predicted.

All data, views, and forecasts herein are as of 11/29/21.

## LPL RESEARCH STRATEGIC AND TACTICAL ASSET ALLOCATION COMMITTEE

**LPL Research Tactical Asset Allocation as of 12/01/2021**

**INVESTING STYLE**

| | Aggressive Growth | | | Growth | | | Growth with Income | | | Income with Moderate Growth | | | Income with Capital Preservation | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | TAA | Benchmark | Difference | TAA | Benchmark | Difference | TAA | Benchmark | Difference | TAA | Benchmark | Difference | TAA | Benchmark | Difference |
| STOCKS | 98.0% | 98.0% | 98.0% | 98.0% | 98.0% | 98.0% | 98.0% | 98.0% | 98.0% | 98.0% | 98.0% | 98.0% | 98.0% | 98.0% | 98.0% |
| U.S. EQUITY | 82.3% | 76.0% | 6.3% | 71.4% | 64.0% | 7.4% | 54.6% | 48.0% | 6.6% | 37.8% | 32.0% | 5.8% | 20.0% | 16.0% | 4.0% |
| Large Value | 12.3% | 10.5% | 1.8% | 10.8% | 8.8% | 2.0% | 8.4% | 6.6% | 1.7% | 5.8% | 4.4% | 1.4% | 3.2% | 2.2% | 1.0% |
| Large Blend | 19.6% | 18.5% | 1.0% | 16.9% | 15.6% | 1.3% | 12.9% | 11.7% | 1.2% | 8.9% | 7.8% | 1.1% | 4.7% | 3.9% | 0.8% |
| Large Growth | 18.9% | 19.0% | -0.1% | 16.2% | 16.0% | 0.2% | 12.2% | 12.0% | 0.2% | 8.4% | 8.0% | 0.4% | 4.2% | 4.0% | 0.2% |
| Small/Mid Value | 10.7% | 8.9% | 1.8% | 9.4% | 7.5% | 1.9% | 7.3% | 5.6% | 1.7% | 5.1% | 3.8% | 1.4% | 2.8% | 1.9% | 0.9% |
| Small/Mid Blend | 13.6% | 12.1% | 1.5% | 11.8% | 10.2% | 1.7% | 9.1% | 7.6% | 1.5% | 6.3% | 5.1% | 1.2% | 3.4% | 2.5% | 0.9% |
| Small/Mid Growth | 7.2% | 7.0% | 0.3% | 6.2% | 5.9% | 0.4% | 4.7% | 4.4% | 0.3% | 3.3% | 2.9% | 0.3% | 1.7% | 1.5% | 0.2% |
| INTERNATIONAL EQUITY | 15.7% | 19.0% | -3.3% | 13.6% | 16.0% | -2.4% | 10.4% | 12.0% | -1.6% | 7.2% | 8.0% | -0.8% | 5.0% | 4.0% | 1.0% |
| Developed (EAFE) | 12.4% | 12.0% | 0.4% | 10.6% | 10.0% | 0.6% | 8.7% | 8.0% | 0.7% | 5.6% | 5.0% | 0.6% | 5.0% | 4.0% | 1.0% |
| Emerging Markets | 3.3% | 7.0% | -3.7% | 3.0% | 6.0% | -3.0% | 1.7% | 4.0% | -2.3% | 1.6% | 3.0% | -1.4% | 0.0% | 0.0% | 0.0% |
| BONDS | 0.0% | 0.0% | 0.0% | 13.0% | 15.0% | -2.0% | 33.0% | 35.0% | -2.0% | 53.0% | 53.0% | 0.0% | 73.0% | 70.0% | 3.0% |
| U.S. CORE | 0.0% | 0.0% | 0.0% | 12.5% | 15.0% | -2.5% | 31.7% | 35.0% | -3.3% | 50.9% | 53.0% | -2.1% | 70.1% | 70.0% | 0.1% |
| Treasuries | 0.0% | 0.0% | 0.0% | 5.5% | 6.7% | -1.1% | 14.1% | 15.6% | -1.5% | 22.6% | 23.6% | -0.9% | 31.2% | 31.1% | 0.0% |
| MBS | 0.0% | 0.0% | 0.0% | 3.9% | 4.4% | -0.5% | 10.0% | 10.3% | -0.3% | 16.1% | 15.6% | 0.4% | 22.2% | 20.7% | 1.5% |
| IG Corporates | 0.0% | 0.0% | 0.0% | 3.0% | 3.9% | -0.9% | 7.6% | 9.1% | -1.5% | 12.2% | 13.8% | -1.6% | 16.8% | 18.2% | -1.4% |
| NON-CORE | 0.0% | 0.0% | 0.0% | 0.5% | 0.0% | 0.5% | 1.3% | 0.0% | 1.3% | 2.1% | 0.0% | 2.1% | 2.9% | 0.0% | 2.9% |
| TIPS | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| International | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| Preferred | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| High-Yield Corporates | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| Bank Loans | 0.0% | 0.0% | 0.0% | 0.5% | 0.0% | 0.5% | 1.3% | 0.0% | 1.3% | 2.1% | 0.0% | 2.1% | 2.9% | 0.0% | 2.9% |
| Emerging Markets | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| CASH | 2.0% | 5.0% | -3.0% | 2.0% | 5.0% | -3.0% | 2.0% | 5.0% | -3.0% | 2.0% | 7.0% | -5.0% | 2.0% | 10.0% | -8.0% |

For investors who have their own benchmarks, we would recommend emphasizing underweights or overweights relative to the individual benchmark at the most similar overall risk level.

Equity benchmark style box allocations are based on lookthrough analysis of the domestic equity indexes used in our benchmark. While the indexes stay constant, style box allocations may drift over time.

Bond benchmark sector allocations are based on a look-through analysis of the major sector components of the Bloomberg Barclays US Aggregate Bond Index.

Treasuries include other government related debt. MBS includes other securitized debt.

Abbreviations: TAA - tactical asset allocation; MBS - mortgage-backed securities; IG corporates - investment-grade corporates; TIPS - Treasury inflation-protected securities.

Style box allocations only include domestic allocations.

## EQUITY ASSET CLASSES

### Maintaining Stocks Overweight, Slight Preference for Value and Small/Mid Caps

We continue to favor stocks over bonds based on our expectation for strong economic growth through year end, continued solid earnings momentum, and still-low interest rates, though the Omicron COVID-19 variant remains a wildcard. We expect cyclical value stocks to outperform their growth counterparts near-term as economic growth picks up and interest rates potentially rise further. Our positive views of small and midcaps are supported by the early-stage bull market and economic expansion, strong earnings, and healthy merger and acquisition environment. China's slowdown amid its regulatory crackdown supports our cautious view of emerging markets (EM).

| | Sector | Overall View | Relative Trend | Rationale |
|---|---|---|---|---|
| Market Capitalization | Large Caps | | | Well-positioned for the pandemic due to greater financial strength, but smaller market cap companies tend to perform better during the early stages of economic expansions and bull markets. May consider a more positive view as economy shifts to mid-cycle in 2022. |
| | Mid Caps | | | Mid caps enjoy some of the early cycle characteristics of small caps, and therefore, should perform well as a more durable recovery develops. We believe mid cap stock valuations are more attractive than those of small caps in general. |
| | Small Caps | | | Our small cap view is positive, supported by the early-stage bull market and economic expansion. Valuations still appear reasonable based on strong earnings growth prospects through 2022, bolstered by more benign 2022 tax increases than anticipated in the BBB plan. |
| Style | Growth | | | We believe growth stocks will continue to garner support from strong earnings trends. However, demand for growth stocks may wane if economic growth picks up and interest rates rise as we expect. |
| | Value | | | We expect the resurgence in U.S. economic growth in the fourth quarter and accompanying higher interest rates to provide a favorable environment for value-style stocks. We believe value stocks are overly discounted relative to growth stock valuations. |
| Region | United States | | | We maintain our preference for U.S. stocks over their developed international counterparts. Once a synchronized, global expansion materializes post-pandemic, prospects for developed international stocks to outperform U.S. stocks would greatly improve, in our view |
| | Developed International | | | We maintain our neutral view of developed international equities, though renewed COVID-19 restrictions cloud the near-term outlook. As the end of the pandemic comes into view and a synchronized global economic expansion materials, attractively valued international equities would likely garner more support. Sustained outperformance may require value style leadership and a pause or reversal of the U.S. dollar rally. |
| | Emerging Markets | | | Our negative view of EM equities largely reflects China's slowing economy amid its regulatory crackdown and ongoing U.S.-China tensions. Negative signals from our technical analysis work are also a factor, while valuations remain quite attractive. |

Trend is measured by relative performance of the index for the past 12 months, minus the most recent month, compared to the other indexes in a particular sector or asset class grouping.



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## EQUITY SECTORS

### Continue to Favor Cyclical Sectors over Defensives Despite Tempered Enthusiasm for Materials

We favor economically sensitive "cyclical" sectors for the rest of 2021 based on the early cycle stage of the economic expansion and bull market. We recommend overweighting the two biggest cyclical value sectors (financials and industrials) that we believe are best positioned for a near-term pickup in economic growth and higher interest rates. Our downgraded view of materials reflects recent deterioration in relative strength, slower growth in China, and the strong U.S. dollar. Our positive real estate view reflects the benefits of reopening, the sector's tendency to effectively navigate inflation, and technical momentum. We recommend benchmark-like exposure to the biggest growth sectors (communication services, consumer discretionary, and technology) and remain underweight defensive value sectors, particularly consumer staples and utilities.

| | Sector | Overall View | Relative Trend | S&P Wgt | Rationale |
|---|---|---|---|---|---|
| Cyclical | Materials | | | 2.5 | Recent deterioration in relative strength, slower growth in China, and the strong U.S. dollar temper our enthusiasm. Post-pandemic pickup in global growth is being delayed by COVID-19 restrictions in Europe, though infrastructure spending still lies ahead. |
| Cyclical | Energy | | | 2.8 | Improving global demand as economies open up and gradual global supply increases are supportive. However, we believe caution is warranted given the magnitude of recent gains which introduce more risk of unanticipated supply. |
| Cyclical | Industrials | | | 8.0 | A big beneficiary of the global economic reopening. Additional infrastructure spending helps. We see a pickup in capital investment in early 2022. Improved earnings outlook keeping valuations in line with the S&P 500. |
| Cyclical | Communication Services | | | 10.4 | Our preference for value and a toughening regulatory environment for this digital media-heavy sector keep us from a more positive view. Technical analysis trends are no worse than neutral and valuations are fair overall. |
| Cyclical | Consumer Discretionary | | | 13.1 | Historically strong early-cycle performer. Excess consumer savings support our neutral view despite rich valuations and a slowing housing market. Further recovery in hospitality, travel, and leisure will help. |
| Cyclical | Technology | | | 28.6 | We expect the market to favor the value-oriented reopening sectors near term over technology and other pandemic winners, despite strong fundamentals. Higher interest rates may pressure growth-stock valuations. |
| Cyclical | Financials | | | 11.2 | Prospects for rising interest rates, a steeper yield curve, and improving loan demand as economic growth picks up through year-end and into 2022 are keys to our positive view. Higher shareholder payouts and reasonable valuations are also supportive. |
| Defensive | Utilities | | | 2.4 | Valuations are reasonable and more green-energy spending may help boost growth, but the market's preference for cyclical stocks is a headwind and the sector carries interest rate risk. Favor real estate among defensives. |
| Defensive | Healthcare | | | 12.7 | Policy risk has been a drag on performance recently. Longer-term spending growth and demographics are attractive. With low valuations, policy clarity forthcoming, and the economy moving to mid-cycle, a sector to watch. |
| Defensive | Consumer Staples | | | 5.7 | Historically poor relative performer early in economic cycles and carries interest-rate risk as an income play. Staples companies could get squeezed by rising wholesale prices and wages. May not outperform until eventual market correction. |
| Defensive | Real Estate | | | 2.6 | Technical analysis trends, benefits of reopening, the sector's tendency to effectively manage inflation, and healthy credit markets are supportive; interest rate sensitivity is the key risk. |

Because of its narrow focus, specialty sector investing, such as healthcare, financials, or energy, will be subject to greater volatility than investing more broadly across many sectors and companies.

## FIXED INCOME

### Limit Rate Sensitivity with Intermediate Focus

We suggest a blend of high-quality bonds with limited exposure to non-investment grade bonds in tactical portfolios. While we think the 10-year Treasury yield can still end this year between 1.50%—1.75% and move slightly higher next year, we think the big move higher in yields has already taken place. As such, we think it is no longer necessary to maintain a max underweight to interest rate sensitive fixed income assets. We've upgraded our view on Treasury securities to neutral. We still see some value in high quality corporate bonds but credit spreads have little room for further tightening. For income-oriented investors willing to take on more risk, we think bank loans still make sense, where appropriate.

We favor **municipal bonds** as a high-quality option for taxable accounts, although valuations relative to Treasuries remain elevated. Additionally, for appropriate investors, **high yield municipal bonds** offer an attractive tax-equivalent yield. Federal stimulus and prospects of higher personal tax rates provide support to muni markets.

| | | Low / Medium / High | Rationale |
|---|---|---|---|
| Positioning | Credit Quality | Medium | Credit spreads remain elevated, but the economic outlook may be supportive. |
| | | Short / Int. / Long | |
| | Duration | Short | We think marginally reducing the underweight to interest-rate sensitive assets makes sense at this point in the cycle. |
| | | **Neg. / Neutral / Pos.** | **Rationale** |
| Sectors | U.S. Treasuries | Neutral (upgraded from Neg.) | Yields have traded slightly higher recently but we expect them to continue to increase marginally from current levels. However, we think the big move higher in yields has already happened and have increased our view of Treasuries to neutral. Yield spreads to international sovereigns remain attractive. Inflation breakeven rates leave TIPS fairly valued. |
| | MBS | Pos. | The Fed has started to reduce its MBS purchases, which may temporarily put upward pressure on yields. Valuations remain relatively attractive to fair value so may attract additional yield buyers. |
| | Investment-Grade Corporates | Neutral | Risks temper as economy improves and vaccine deployment progresses. Leverage metrics have increased, but cash levels are high. Interest-rate sensitivity has increased. Tight credit spreads limit attractiveness. |
| | Preferred Stocks | Neutral | Higher credit quality among the riskier fixed income options. Bank fundamentals sound overall. Can be rate sensitive but may be able to tolerate gradual increases. |
| | High-Yield Corporates | Neg. | Valuations have grown rich versus history but fundamentals remain sound. May be more attractive for income-oriented investors. We believe equities have more upside and high-quality options may be better diversifiers. |
| | Bank Loans | Neutral | Economic environment is supportive and better sector mix than high yield. Economic acceleration may support demand. Fewer investor protections and illiquidity of individual loans remain concerns. |
| | Foreign Bonds | Neg. | Rich valuations, interest-rate risk, and potential currency volatility are among the negatives. |
| | EM Debt | Neutral | Central banks are becoming less accommodative as inflationary pressures in emerging markets are building, which provides a headwind to prices. Valuations are relatively attractive but idiosyncratic risks remain. Liquidity can be an added risk during periods of stress. |

**Yield spread** is the difference between yields on differing debt instruments, calculated by deducting the yield of one instrument from another. The higher the yield spread, the greater the difference between the yields offered by each instrument. The spread can be measured between debt instruments of differing maturities, credit ratings, and risk. **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. For the purposes of this publication, **intermediate-term bonds** have maturities between 3 and 10 years, and short-term bonds are those with maturities of less than 3 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. **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. Investing in **foreign and emerging market debt (EMD)** securities involves special additional risks. These risks include, but are not limited to, currency risk, geopolitical and regulatory risk, and risk associated with varying settlement standards. **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 bonds** are subject to availability, price, and market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise. Interest income may be subject to the alternative minimum tax. Federally tax-free but other state and local taxes may apply. **Mortgage-backed securities (MBS)** are subject to credit, default, 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, market and interest rate risk.

## COMMODITIES

### Crude Oil Rally May Run out of Steam

Our view of **industrial metals** remains positive, as prospects for a pickup in economic growth in the U.S. and more infrastructure spending help offset prospects for slowing demand from China and the headwind of a strong U.S. dollar.

Our **precious metals** view is neutral. Our strong economic outlook presents a headwind for defensive assets. While low interest rates are supportive, our technical analysis assessment of gold is less positive than copper and inflation may be nearing its peak, potentially removing a positive catalyst.

Our **crude oil** view is neutral. Our downgrade last month was primarily driven by technical analysis signals that suggested limited near-term upside after such a strong rally. Historically weak seasonal factors and the potential for increased supply at higher price levels also played a role.

## ALTERNATIVE INVESTMENTS

### Mixed Performance

Alternative investment strategy performance was mixed during November, with month end volatility weighing on returns across the industry. Event-driven funds, our preferred alternative strategy declined 0.73% as announced deal spreads widened on news of a the Omicron variant. Overall, we maintain a positive view on the space and our three main tailwinds for the industry—high corporate cash balances, low borrowing rates, and the private equity industry’s dry powder—remain in place. A robust deal flow environment like this one allows event-driven strategies to be more selective in choosing underlying transactions and also moderates position crowding within the industry. Expectations are for 2021 to end up being one of the biggest years in history—if not the biggest—for mergers and acquisitions. Ongoing risks associated with event-driven strategies include the price impact of transactions failing, regulatory risk, and the potential impact of changes in the tax landscape.

Outside of the event-driven space, we maintain a constructive and improving view on managed futures and long/short equity. An increase in prices across a large swath of the commodities complex has supplemented gains in the equity and credit market allocations for many managed futures strategists. While the growth style has once again begun to outperform value, year-to-date performance has been more balanced between the two. This has diminished the negative impact of the industry’s value tilt and provided a more attractive environment for short exposure.

## IMPORTANT DISCLOSURES

This material has been prepared for informational purposes only, and is not intended as specific advice or recommendations for any individual. There is no assurance that the views or strategies discussed are suitable for all investors and they do not take into account the particular needs, investment objectives, tax and financial condition of any specific person. To determine which investment(s) may be appropriate for you, please consult your financial professional prior to investing. Any economic forecasts set forth may not develop as predicted and are subject to change.

Stock investing involves risk including loss of principal. Because of their narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies. Value investments can perform differently from the market as a whole and can remain undervalued by the market for long periods of time. The prices of small and mid-cap stocks are generally more volatile than large cap stocks. Bonds are subject to market and interest rate risk if sold prior to maturity.

Bond values will decline as interest rates rise and bonds are subject to availability and change in price. Corporate bonds are considered higher risk than government bonds. Municipal bonds are subject to availability and change in price. Interest income may be subject to the alternative minimum tax. Municipal bonds are federally tax-free but other state and local taxes may apply. If sold prior to maturity, capital gains tax could apply. U.S. Treasuries may be considered “safe haven” investments but do carry some degree of risk including interest rate, credit, and market risk. Bond yields are subject to change. Certain call or special redemption features may exist which could impact yield. Mortgage-backed securities are subject to credit, default, prepayment, extension, market and interest rate risk.

Credit Quality is one of the principal criteria for judging the investment quality of a bond or bond mutual fund. Credit ratings are published rankings based on detailed financial analyses by a credit bureau specifically as it relates to the bond issue’s ability to meet debt obligations. The highest rating is AAA, and the lowest is D. Securities with credit ratings of BBB and above are considered investment grade. Duration is a measure of the sensitivity of the price (the value of principal) of a fixed-income investment to a change in interest rates. It is expressed as a number of years.

Alternative investments 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.

Event driven strategies, such as merger arbitrage, consist of buying shares of the target company in a proposed merger and fully or partially hedging the exposure to the acquirer by shorting the stock of the acquiring company or other means. This strategy involves significant risk as events may not occur as planned and disruptions to a planned merger may result in significant loss to a hedged position.

Commodity-linked investments may be more volatile and less liquid than the underlying instruments or measures, and their value may be affected by the performance of the overall commodities baskets as well as weather, geopolitical events, and regulatory developments. The fast price swings in commodities and currencies will result in significant volatility in an investor’s holdings.

Investing in foreign and emerging markets securities involves special additional risks. These risks include, but are not limited to, currency risk, geopolitical risk, and risk associated with varying accounting standards. Investing in emerging markets may accentuate these risks. All information is believed to be from reliable sources; however, LPL Financial makes no representation as to its completeness or accuracy.

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.

Gross Domestic Product (GDP) is the monetary value of all the finished goods and services produced within a country’s borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.

All index data from FactSet.

For a list of descriptions of the indexes referenced in this publication, please visit our website at lplresearch.com/definitions.

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