



# Weekly Market Commentary



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## America's Latest Pastime

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#### Highlights

The attraction of a summer day at the ballpark endures, but it is no longer the most common topic of conversation during these early days of summer. The boys of summer are taking a backseat to the Dogs of the Dow.

After six weeks of market declines, totaling almost 7%, as measured by both the Dow and the S&P 500, we believe we are the middle innings of this pullback with a few left to go.

The good news is that we do not expect this pullback to extend into extra innings and, despite the tough season, stocks are likely to have a winning year.

Before television, the internet, football, cars and movie stars, Americans were obsessed with baseball. Baseball was the one thing that everyone could talk about with family, neighbors, and co-workers. It became America's favorite summer pastime one hundred and fifty years ago.

The attraction of a summer day at the ballpark endures, but it is no longer the most common topic of conversation during these early days of summer. Instead, the six-week decline in the U.S. stock market seems to be the topic on everyone's lips. The boys of summer are taking a backseat to the Dogs of the Dow. The big question about the stock market pullback is: what inning are we in?

After six weeks of declines, totaling almost 7% in both the Dow and S&P 500, we believe we are in the middle innings with a few weeks and percentage points left to go. The pressure on stocks may continue for a few more innings due to the following:

- **Soft economic data** – Economic data remaining soft in the next few weeks as the data continues to be negatively impacted by the lagged effect of high oil prices, the Japanese earthquake and tsunami, and severe weather and natural disasters in the United States.
- **Pre-announcement season** – The so-called earnings “pre-announcement season” is coming up in the next few weeks when corporate leaders often pre-announce any bad news ahead of their second quarter earnings reports that begin in mid-July. For the past couple of years, the pre-announcement season has been relatively quiet and not acted as a negative for stocks. However, due to the slowdown during the second quarter and supply chain problems extending from the disaster in Japan, the next few weeks may feature more bad news than in recent quarters as companies lower their earnings outlook.
- **End of QE2** – With the Federal Reserve due to cease being the biggest buyer of debt issued by the Treasury to fund the government on June 30, 2011, low rates are dependent upon foreigners stepping back in to buy the increasing quantities of Treasuries. The end of QE2 (Quantitative Easing) may heighten concerns about the US dollar, interest rates, and debt levels adding to the environment of uncertainty.
- **Debt ceiling debate** – The battle is likely to heat up in the coming weeks in Washington over raising the debt ceiling and making budget cuts with the threat of a potential U.S. default looming if an agreement is not forthcoming and implemented by August 2.



While these negatives are not new, they may continue to pressure stocks until they begin to recede by mid-July. At that point, we expect that:

- The debt ceiling debate should be nearing an end,
- Earnings reports will get underway for what was likely to have been another solid quarter for profits, and
- Economic data is likely to rebound from the negative effects of the earthquake and tsunami in Japan and the unusual weather patterns.

The lifting of these negatives may coincide with an end to the pullback and the start of a rebound.

While we do not expect this pullback to extend into extra innings, there are alternative outcomes that we are on the lookout for that could lengthen and deepen the decline. These outcomes include the following:

- Earnings reports accompanied by significant downward guidance on earnings for the second half of the year.
- The economic data continuing to soften and come in weaker-than-expected throughout July and August.
- A banking crisis emerges from the European debt problems.
- More bad weather, natural disasters, or other unforeseen negative events posing additional shocks to the economy as the transition away from the support of fiscal and monetary stimulus takes place.

The season is far from over and there will be wins to balance out the losses as a volatile, but range-bound, summer ensues. Despite the tough season, stocks are likely to have a winning year. We continue to expect the stock market to post a high single-digit rate of return this year, accompanied by high volatility.

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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.

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.

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