# Weekly Market Commentary

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## Stocks Go From Great to Good as the Bull Turns Five

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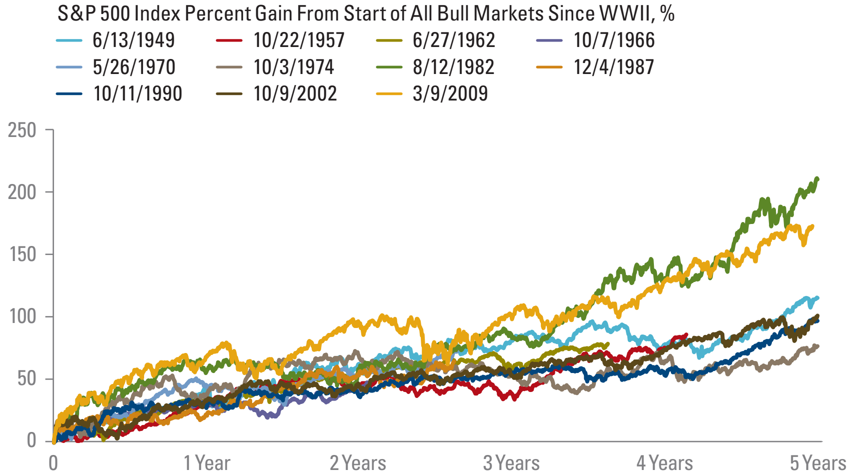
### Highlights

After five years, the second most powerful bull market in post-WWII history may be getting a second wind.

The end of this week will make it five years since the second most powerful bull market in post-WWII history began [Figure 1]. After five years, only the bull market that began on August 12, 1982 was stronger. It is not over yet. In fact, the bull market may be getting a second wind.

1 The Current Five-Year Bull Market Is the Second Strongest Since WWII




Source: LPL Financial Research, Bloomberg data 03/03/14

The S&P 500 is an unmanaged index which cannot be invested into directly. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment.

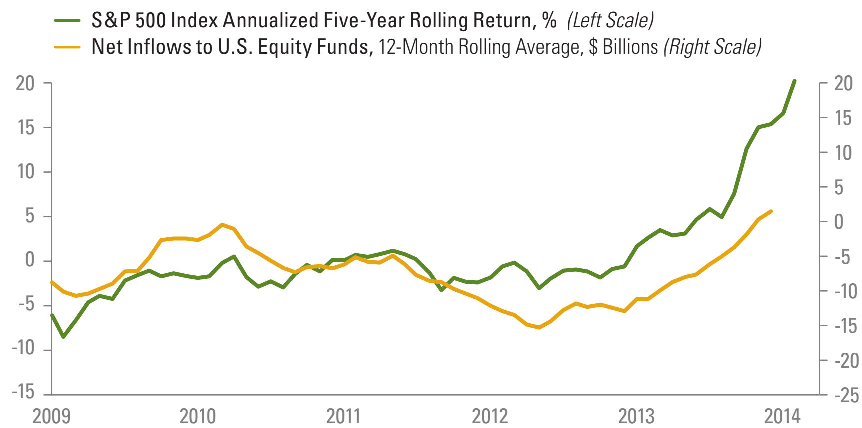
Past performance is no guarantee of future results.

## Stock Market Investors Chase Five-Year Returns

Despite its strength, the bull market has only recently been discovered by individual investors. Investors tend to chase returns. For the U.S. stock market, investors have most closely followed the rolling five-year annualized return, based upon their investing behavior [Figure 2]. The five-year trailing annualized return for the S&P 500 Index had been weak, especially when compared with bonds, in recent years. But in 2013, the five-year return began to see a dramatic change.

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.

## 2 Stock Market Investors Chase Five-Year Returns

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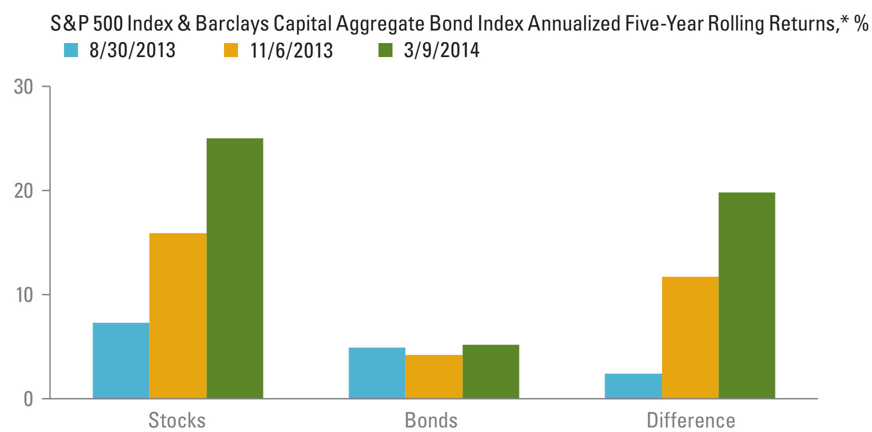
Even as recently as the end of August 2013, the difference in the five-year annualized return between stocks and bonds was only about 2%, hardly enough to compensate investors for the volatility they experienced. By November 2013, the five-year return soared into the double digits—reflecting not only a strong recent gain in the stock market, but the dropping off of much of the horrific declines in the fall of 2008, when the financial crisis took hold. This week as we approach the March 9, 2014 five-year anniversary from the bear market low in the S&P 500—assuming no change in the S&P 500 between now and then—the five-year annualized return will have exceeded bonds by 20% [Figure 3].

## 3 Stocks' Five-Year Returns Exceeding Bonds by Increasing Amount




Source: LPL Financial Research, Bloomberg data 03/03/14

*Assuming zero total return between 2/24/14 and 3/9/14 for stocks and bonds.

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The Barclays 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.

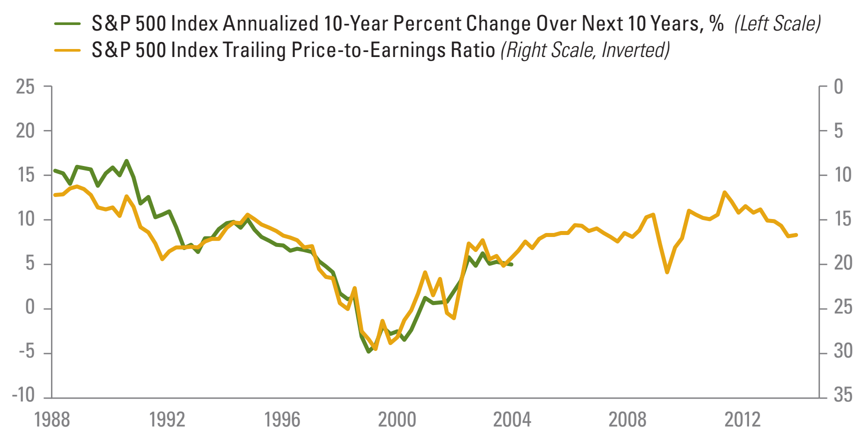
With the five-year trailing annualized returns for stocks in the double digits for the first time this cycle, investors are beginning to pour money into funds that invest in U.S. stocks after years of selling, according to data from the Investment Company Institute (ICI). It is no surprise that this took place just as the five-year trailing return for stocks began to soar into double digits. In fact, even during this year's January stock market pullback that peaked out at about a 6% decline, U.S. stock funds saw inflows during three of January's four weeks. This may be because the five-year return investors tend to focus on actually rose despite the decline in the stock market in January (since the even steeper decline in January 2009 rolled off the five year period).

Corporate share buybacks have accounted for much of the stock buying in recent years, and corporations will likely remain buyers in 2014. However, individual investors as a group may finally be starting to buy stocks again in contrast to much of the past five years. This may help to continue a rise in valuations and sustain the bull market.

## The Next 10 Years

The last five years have been outstanding, but what do the next five or 10 years look like for the stock market? Many investors who avoided stocks during much of the past five years did so because they thought stocks may not ever again produce gains like they did in the 20th Century. Historically, the valuation of the stock market, measured by the trailing price-to-earnings ratio, has been a very good indicator of long-term returns. Currently, the S&P 500 valuation suggests that over the next 10 years, stocks may produce mid- to high-single-digit gains, as you can see in Figure 4. This does not include dividends, which may add another 2%, based on current

4 Stocks May Offer Mid- to High-Single-Digit Annualized Gains Over the Next 10 Years Based on Current Valuation




Source: LPL Financial Research, Thomson Reuters, Factset data Systems, Bloomberg data 03/03/14

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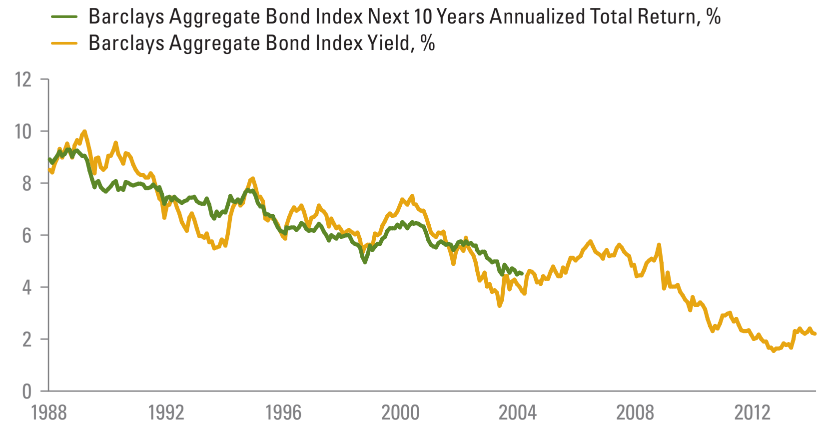
The P/E ratio (price-to-earnings ratio) is a measure of the price paid for a share relative to the annual net income or profit earned by the firm per share. It is a financial ratio used for valuation: a higher P/E ratio means that investors are paying more for each unit of net income, so the stock is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

Trailing P/E is the sum of a company's price-to-earnings, calculated by taking the current stock price and dividing it by the trailing earnings per share for the past 12 months. This measure differs from forward P/E, which uses earnings estimates for the next four quarters.

5 Bond Yields Point to Low Single-Digit Total Returns Over the Next 10 Years

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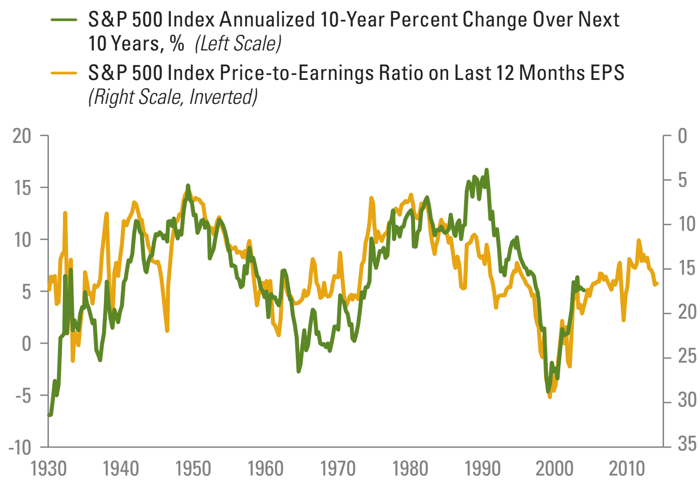
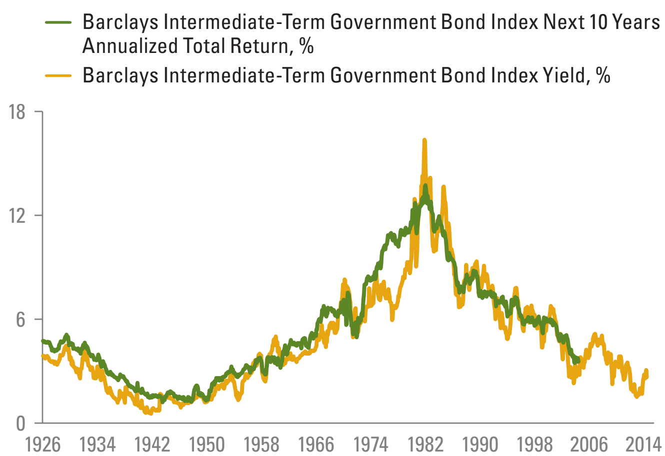
yields. Even though this is likely to come with volatility including a possible recession and bear market along the way, this performance would be substantially better than the next 10 years of low single-digit gains of 2–3% suggested by current values for bonds in Figure 5.

While the relationships highlighted over the past 25 years in Figures 4 and 5 are compelling, the longer-term look back in Figures 6 and 7 show that the predictive relationship of valuation and performance has worked consistently in the many different economic, political, and demographic environments of

6 A Long Look Back Shows How Well Valuation Forecasts S&P 500 Index Gains




7 A Long Look Back Shows How Well Current Yield Forecasts Bond Market Total Returns

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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.

the 20th Century—and into the 21st as well. The Barclays Aggregate Bond Index does not go all the way back to the early or middle part of the 20th Century, so instead we have used intermediate-term government bonds as a proxy for all high-quality bonds.

New investors in the stock market and those that have participated for many years can take heart. While a great five years of stock market performance is now behind us, we have the potential for a good 10 years to look forward to based on predictive relationships that have withstood the test of time. ■



INDEX DESCRIPTIONS

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The Barclays Government/Credit Intermediate Index is a market value weighted performance benchmark for government and corporate fixed-rate debt issues with maturities between one and 10 years.





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