

LPL RESEARCH PRESENTS

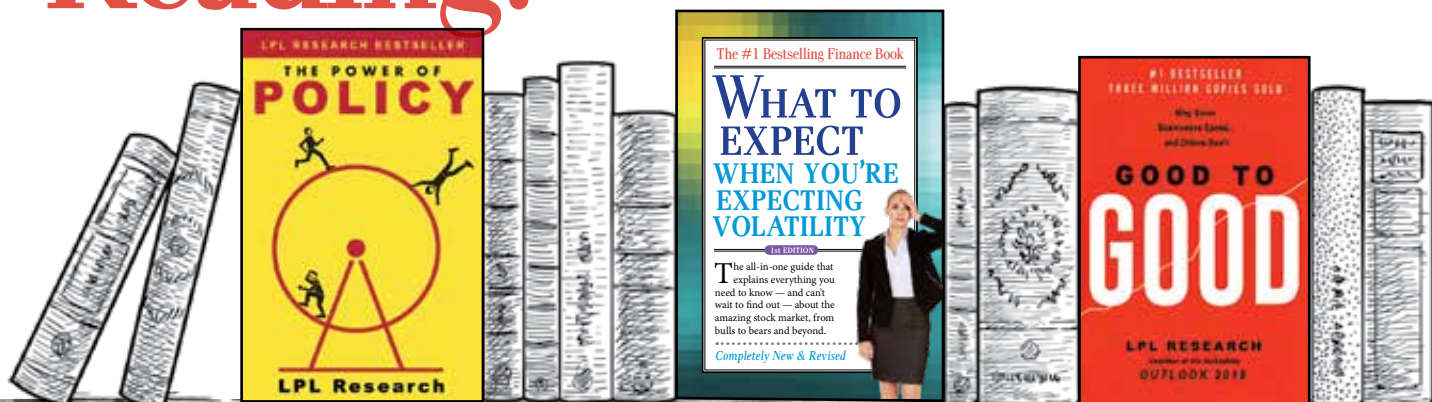
OUTLOOK 2019



FUNDAMENTAL

HOW TO FOCUS ON WHAT REALLY MATTERS IN THE MARKETS

Recommended Reading:



THE POWER OF POLICY

The Federal Reserve is expected to slow its pace of interest rate hikes next year, while fiscal policy should remain supportive of economic and profit growth. Uncertainty regarding trade policy remains a risk, although we expect an eventual resolution.

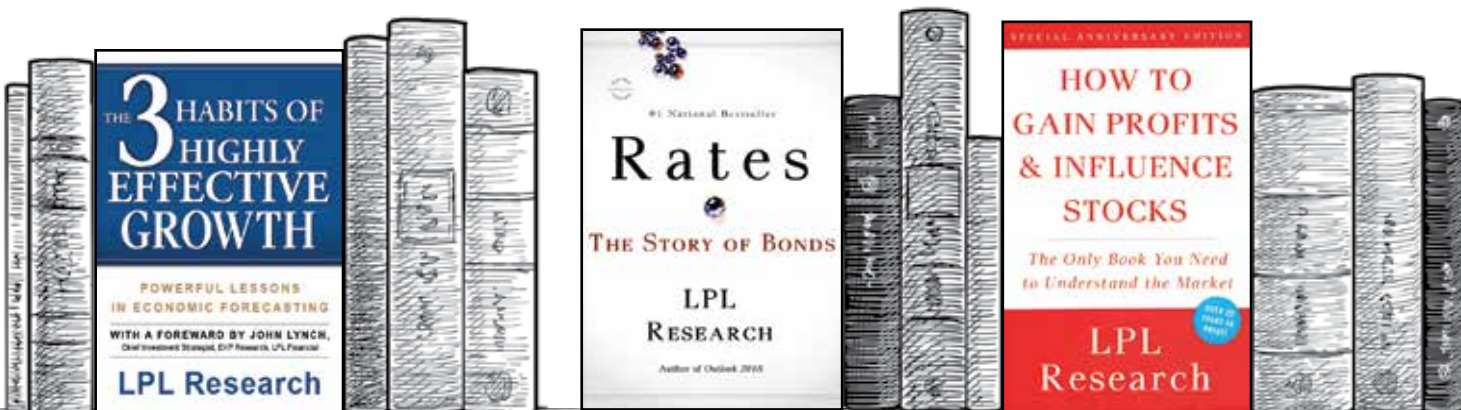
WHAT TO EXPECT WHEN YOU'RE EXPECTING VOLATILITY

Market volatility will likely persist in 2019, as investors digest the many forces impacting the economy, interest rates, and corporate profits. Focusing on the fundamentals and remembering the importance of diversification will be key to navigating any volatile times.

GOOD TO GOOD

Despite periodic slowdowns, business spending was solid in 2018 and is expected to remain so in 2019. Business spending remains a key factor supporting economic growth as we look for this cycle to elongate.

New for 2019:



THE THREE HABITS OF HIGHLY EFFECTIVE GROWTH

Consumer spending, business investment, and government spending should provide continued support for gross domestic product (GDP) growth of 2.5–2.75%.

RATES: THE STORY OF BONDS

A rising rate environment may prove challenging for bonds, and we expect flat returns for the Bloomberg Barclays U.S. Aggregate Bond Index.

HOW TO GAIN PROFITS & INFLUENCE STOCKS

Expectations for still solid corporate profits and steady economic growth support our forecast of 8–10% returns for the S&P 500 Index.

N&N

NEW & NOTEWORTHY

Your book club may thank you for these recommendations in 2019

C

CLASSICS

Don't count out these timeless tales; these investments should provide a solid background to portfolios

OOP

OUT OF PRINT

Might have to wait for the next edition; these investments aren't gaining traction yet



U.S. STOCKS

Superior economic and profit growth and fiscal stimulus provide an edge over developed international equities.

VALUE

Economic growth tailwind and attractive relative valuations compared with growth may help buoy value stocks.

CYCLICAL STOCKS

Solid economic growth may support economically sensitive sectors.

EMERGING MARKETS

Strong growth, attractive valuations, and potential U.S.-China trade agreement may help emerging market equities outperform.

INVESTMENT-GRADE CORPORATE BONDS

Economic growth may help credit-sensitive bonds; added credit risk provides incremental yield.

MORTGAGE-BACKED SECURITIES

Yield benefit relative to rate risk remains attractive among high-quality options.

SMALL CAPS

Tax reform benefits starting to fade and cycle is aging, but domestic focus may help early in 2019.

INTERMEDIATE-TERM HIGH-QUALITY BONDS

Offer some potential diversification while avoiding the rate risk of long-term bonds.

BANK LOANS

Still potentially attractive for strategic investors, but high issuance, weaker investor protections raise some concerns.

HIGH-YIELD BONDS

May be supported by further economic growth, but we prefer a combination of equities and high-quality bonds.

U.S. DEFENSIVE STOCKS

Less economically sensitive sectors may offer lower return potential amid solid economic and profit growth.

GROWTH STOCKS

After a sustained period of strong performance compared with value, the growth stock rally may be due for a pause.

DEVELOPED INTERNATIONAL STOCKS

Growth in Europe has slowed while political challenges are rising.

DEVELOPED INTERNATIONAL BONDS

Valuations remain very rich and declining central bank accommodation may create a challenging environment.

LONG-TERM HIGH-QUALITY BONDS

With rates expected to rise, the diversification benefit does not adequately compensate for added rate sensitivity.

Preface:

Focusing on What Matters



AFTER NEARLY 10 YEARS of witnessing the U.S. economy and stock market recover—and thrive—investors are starting to wonder if we’ve seen all this expansion and bull market have to offer. Despite the market weakness we saw at the end of 2018, at LPL Research we expect the U.S. economy to grow in 2019 and support gains for stocks.

Given we are a decade in and likely nearing the end of the cycle, however, it is a good time to start thinking about what the next phase for the economy and markets may look like. The intention here is not to start worrying or assuming the worst, but to remind ourselves that slowdowns and declines—even recessions and bear markets—are a normal part of our market cycle. And even more importantly, if we’re prepared for any downturns, we can be better positioned to weather any challenges that may be ahead.

That’s where *Outlook 2019: FUNDAMENTAL* comes in—because we could all use a handy guide when it comes to this market environment. We’re here to make sure you’re prepared for what may be around the corner, or further down the line, and help you through it all.



Why You Need This Book

As investors, we have all acquired a certain amount of experience with everything the economy, markets, and news headlines may throw at us. So we know that market declines are normal. We know that we'll eventually have a bear market. And we know the economy may slide into a recession before it can pick back up again. But there's a big difference between *knowing* something and actually going through it. Actually *feeling* it. As we also know from experience, these declines don't feel good.

The good news is, there are a few strategies to help us navigate those potentially difficult environments:

FIGHT THE IMPULSES. There's a long history of many investors selling near the bottom. It can be difficult to fight that urge, but a sensible plan that's realistic about risk can help you stay on course. There's a natural tendency to overestimate risk tolerance when risk is low. A realistic assessment can make it easier to navigate challenging periods.

BLOCK OUT THE NOISE. The 24-hour news cycle is aimed at creating an emotional response that will keep the audience tuning in. Not getting caught up in the news cycle and having sources that help provide perspective can make it easier to avoid costly decisions driven by strong emotions.

BELIEVE IN THE FUNDAMENTALS. Stock prices ultimately depend on corporate earnings growth. If you believe that companies will continue to grow earnings, you implicitly believe that stocks are likely to rise in the long term.

This final point is arguably one of the most important, and one we'll continue to emphasize throughout this edition. Our conviction in the fundamentals supporting the economy and corporate profits is driving our forecasts for solid GDP growth and positive stock returns. Yet, many positive fundamentals could be pressured by threatening issues such as trade, monetary policy, or global politics. As a result, we do expect to see more volatility, and continue to encourage suitable investors to embrace that volatility for its potential opportunities, rather than fear it. By managing our emotions and staying in tune with market signals, we can position ourselves for any market environment.



HOW TO USE THIS BOOK

Divided into four broad chapters, a foldout infographic, and interspersed with helpful sidebars, *FUNDAMENTAL: How to Focus on What Really Matters in the Markets* presents our expectations and guidance for 2019 in a way that's easy to digest. Be on the lookout for these other elements as you read:

LET'S RECAP: These boxes provide a high-level summary of what we saw in 2018.

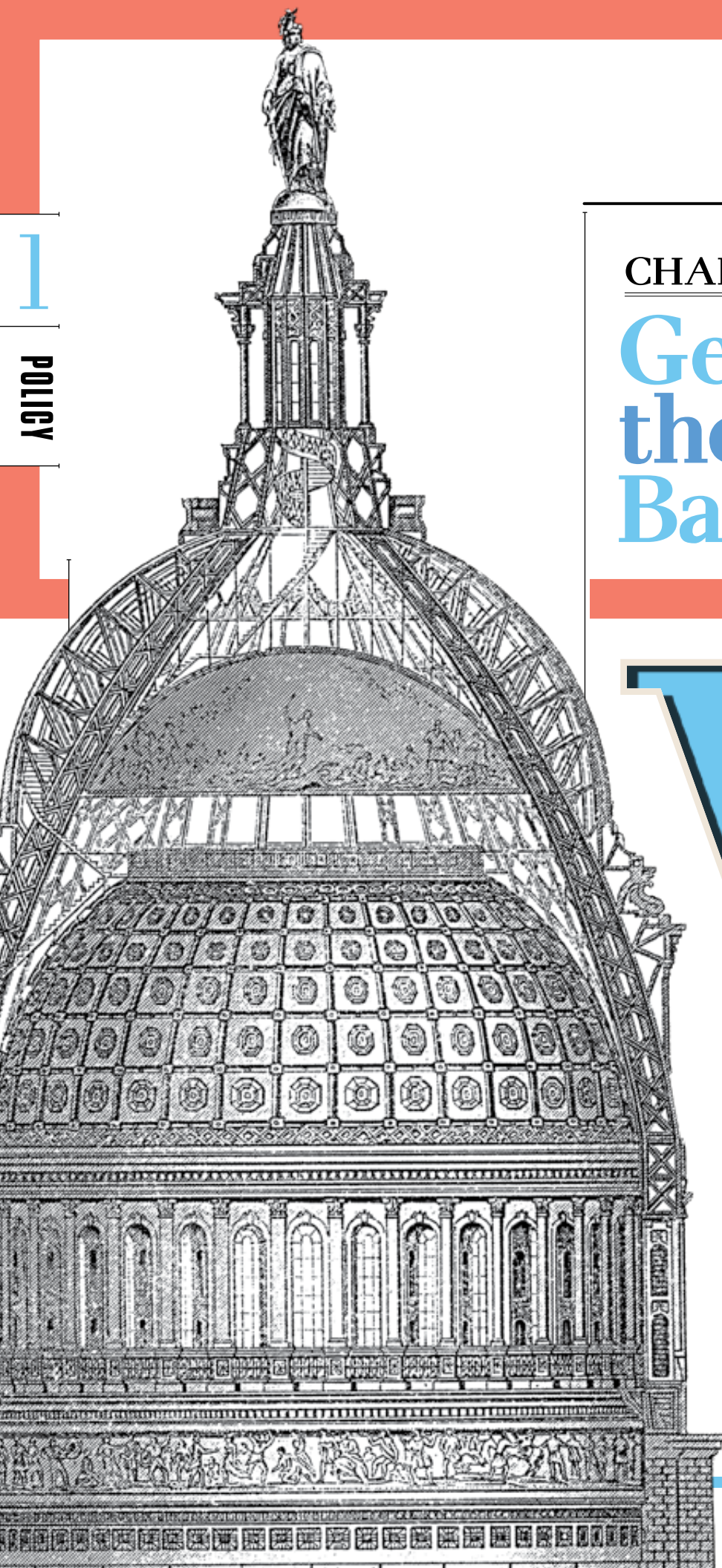
BREAKING IT DOWN: These sections present our forecasts for bonds and stocks.

HOW TO INVEST: Our high-level investment recommendations based on our expectations.

WHAT IF...: We also present a few of our unexpected scenarios—while these don't represent our base case, we offer some situational details and consequences in the event of a surprise.

CHAPTER SUMMARY: We wrap it all up for you.

The 2019 edition of LPL Research's *Outlook* provides you the actionable tips and investment recommendations you can use in 2019 and beyond. This, together with the valuable guidance of your trusted financial advisor, can ensure that you stay on the right track as you seek to reach your long-term goals.



1

POLICY

CHAPTER 1:

Get to Know the Policy Basics

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WHETHER IT'S NEWLY IMPLEMENTED, removed, or amended, policy can play an influential role in the global economy and markets. And since the financial crisis in 2008–09, policy's role has become increasingly important.

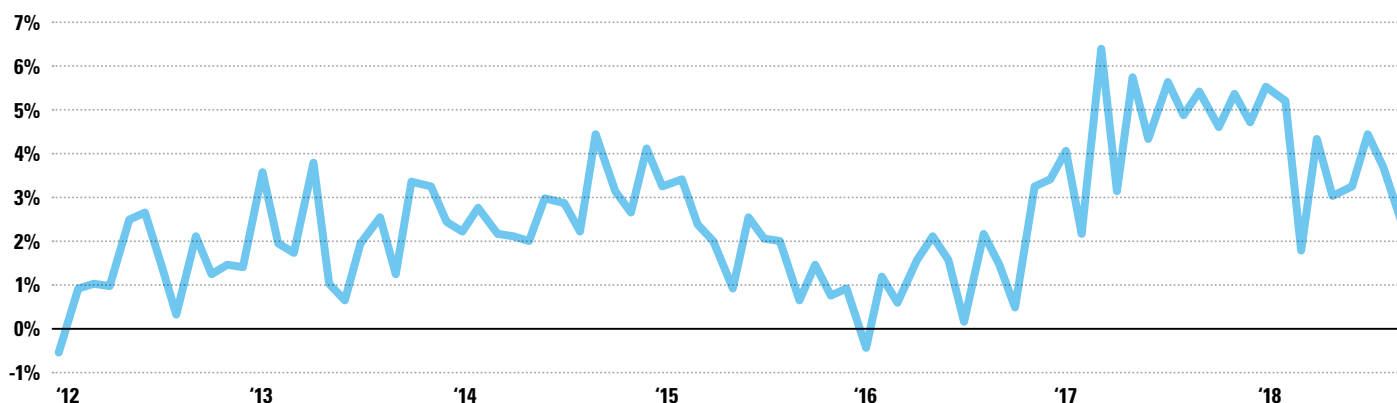
Defining Policy

When we talk about policy, we're often referring primarily to the balance of monetary policy as compared with fiscal policy. Monetary policy, typically implemented by a central bank, such as the Federal Reserve (Fed), was the dominant

fig.1

Trade Activity Holding Up Despite Tensions

WORLD TRADE VOLUME, YEAR-OVER-YEAR (YoY)



Source: LPL Research, CPB Netherlands Bureau for Economic Policy Analysis 11/30/18

force for the first nine years following the financial crisis. In the U.S., the Fed embarked on an innovative monetary policy journey, bringing its policy rate to near zero and purchasing assets (known as quantitative easing, or QE). Global central banks followed, culminating with negative interest rates in Europe and Japan, along with further balance sheet expansion through their own forms of QE.

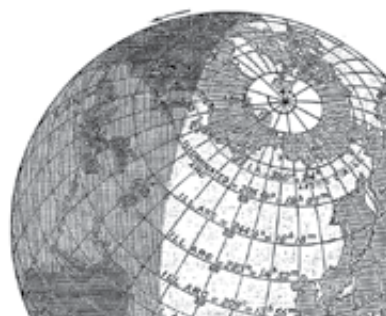
Fiscal policy, set by the national government, is typically characterized by tax reform, government spending packages, and other legislation impacting businesses (e.g., the regulatory environment). In part due to elevated debt levels, fiscal policy changes failed to keep pace with monetary policy throughout the developed world, causing monetary policy to exhaust its options over the course of a decade, particularly in the United States. Government officials have begun to enact new legislation in response [see *Let's Recap*, p.8].

As a result of these new policies, the U.S. experienced economic growth of approximately 4% during the second and third quarters of 2018, and projections for total annual growth nearly reach 3% for the full year, as measured by GDP.

This positive growth came with a cost, however. The federal budget deficit is now at \$779 billion, the largest government spending gap since the \$1.1 trillion shortfall in 2012. If the




T
R A D E



► Trade will likely continue to make headlines in 2019. Though tensions with China remain, progress has been made with South Korea, Japan, Mexico, Europe, and Canada, which supported positive market sentiment in the third quarter of 2018. Moreover, the conclusion of the G20 summit resulted in a sort of “trade truce,” whereby the U.S. and China committed to working on a more lasting trade resolution within the next few months. Although trade threats may seem scary, trade represents a small portion of the overall economy and the fiscal measures should more than offset the potential negative impact of tariffs in 2019.

Even though we expect a resolution, if it takes longer than expected to reach an agreement then it’s possible that continued trade discussions could further weigh on market sentiment. The ongoing uncertainty could have a greater impact, potentially slowing the pace of business spending or the rate at which fiscal stimulus will take effect.

Despite all the attention given to tariffs, world trade has been growing at a steady pace [Figure 1]. Concerns have risen relative to supply chains and rising input costs, yet we continue to expect any negative impact on the U.S. and global economies to be less than feared.



fiscal stimulus continues to improve economic growth, it would increase the tax base and help control the deficit; we see growth as needing to be above 3% to make a meaningful difference. Consequently, we believe policy will continue to play an important role for the economy and financial markets in 2019 and beyond.

Checking on the Fed

Monetary policy may no longer be the driving force to sustained growth, but that doesn't mean the Fed hasn't been busy. The central bank has already begun to remove its accommodative policy stance and was quite active toward the end of 2018.

SEPTEMBER 2018: The Fed raised its policy rate with the eighth hike since beginning its climb from zero in December 2015.

OCTOBER 2018: It began to maximize its balance sheet reduction plan at \$150 billion per quarter. Later this month, Fed Chair Jerome Powell stated that the U.S. economic outlook was "remarkably positive," signaling that market interest rates were going to climb, but as long as inflation remained contained, interest rate increases would remain gradual. Should inflation pick up significantly, a more aggressive approach would be warranted. His statement that rates were still "a long way from neutral," however, weighed on investor sentiment and the markets.

DECEMBER 2018: As expected, the Fed closed out 2018 by raising rates one more time to a range of 2.25–2.5%. In an earlier speech, Powell had already reversed his October comments, stating that rates were "closer to neutral," indicating that policy would not be as restrictive as many had previously feared.

Markets will be looking closely for hints at how far the Fed may push rates in 2019. When considering the Fed's expected peak for the fed funds rate, it's also important to recognize that although the Fed's official mandates are price stability and full employment, policymakers must also be cognizant of financial market volatility—one reason why the Fed's messaging and actions have consistently maintained this gradual path. In addition, the Fed must be aware of the impact that higher rates have on the U.S. dollar's strength, which can pressure emerging market currencies and place their economies at risk relative to food/energy costs, debt servicing, and capital flows. For all these reasons, we suspect the Fed will be less aggressive than some are projecting, and we look for the terminal fed funds rate on this cycle to peak around 3%.

Chapter Summary

Considering the Fed's likely path for interest rates and how that may influence the economy and markets, the onus is on federal legislators to support the durability of the current economic expansion. The setting of fiscal policy, whatever the party leadership, is always complicated, and there will always be some policies that raise concerns among market participants **[Figure 2]**. Consequently, we encourage suitable investors to base any investment decisions on existing fundamentals supporting growth in the economy and corporate profits, rather than acting on speculative headlines as the cycle matures and the 2020 presidential election now comes into increased focus.

Thanks to new policies,
the U.S. economy
has experienced
above-trend growth.





HOW TO INVEST

Although policy alone should not dictate investment decisions, here are some factors to keep in mind in 2019.

FED MAY PAUSE MIDYEAR

Rates are likely to rise, but not as quickly as the last two years.

FISCAL STIMULUS IMPACT EXTENDS BEYOND 2018

There is a potential for upside surprise on economic growth; business spending may reaccelerate.

SPLIT CONGRESS IS LARGELY NEUTRAL

This may favor different industries but economy remains on course.

TRADE POLICY RISKS REMAIN, BUT EXPECTING BETTER TONE

Uncertainty remains; impact of fiscal stimulus is still likely to remain more important.

LET'S RECAP

As part of the shift from monetary to fiscal policy, Congress put several new policies in place to support further economic growth in late 2017.

2017 TAX CUT & JOBS ACT

- Delivered tax cuts for individual taxpayers and small businesses, while making corporate tax rates more competitive globally
- Included provisions to encourage companies to invest in capital projects (thanks to immediate expensing) and bring their overseas profits back to the U.S. (known as repatriation)—providing further stimulus for economic growth

GOVERNMENT SPENDING PACKAGE

- Worth \$300 billion over 2018 and 2019

REGULATORY ENVIRONMENT

- Became less burdensome for many businesses, especially in energy and financial services sectors

fig.2

What to Expect from Congress

► The 2018 midterm election resulted in the Democrats taking control of the House of Representatives and the Republicans maintaining their majority in the Senate. We believe there are several important policy implications for investors to consider as we look ahead into 2019.

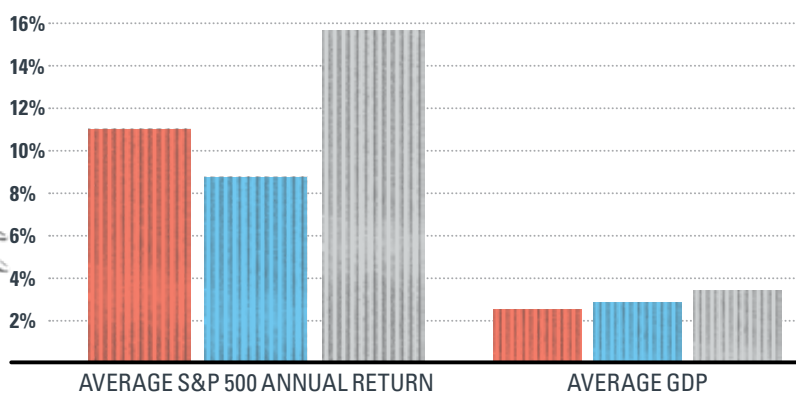
With the Democrats taking control of the House, “gridlock” may in fact mean a better sense of political balance for many market participants, as it limits the potential for the policy pendulum to swing too far in any one direction. We may also see an infrastructure spending deal and progress on trade, which could provide further support for the markets. On the other hand, the debt ceiling debate may create renewed uncertainty if the Democrats attempt to roll back some of the recent tax cuts in order to reach a deal on the federal budget, and increased scrutiny of the administration may periodically weigh on market sentiment.

Providing some additional context, the historical performance of the S&P 500 and U.S. economy, as measured by GDP, suggests the potential for added gains under a split Congress and Republican president.

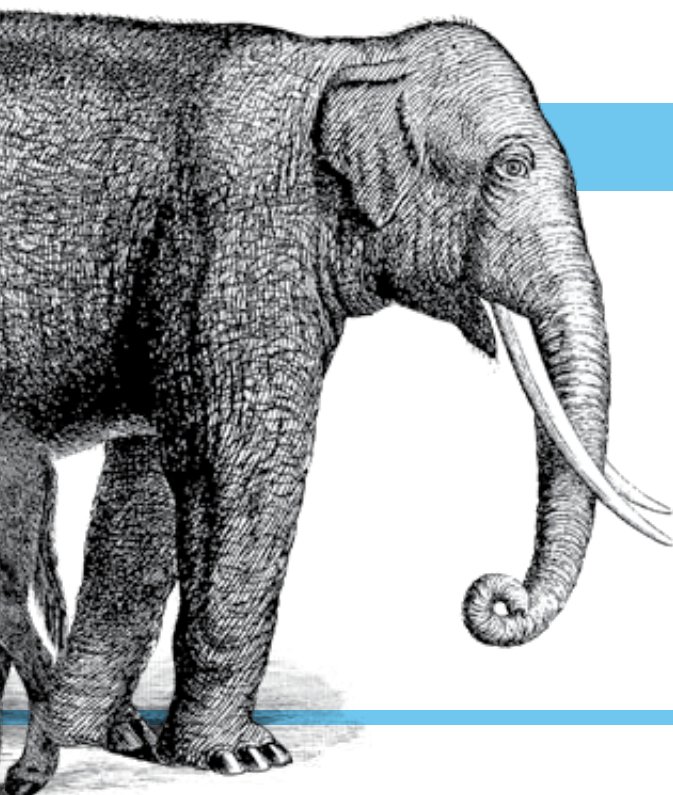
HISTORICALLY, A REPUBLICAN PRESIDENT WITH A SPLIT CONGRESS IS POSITIVE FOR ECONOMY AND STOCKS

PERFORMANCE UNDER A REPUBLICAN PRESIDENT BASED ON CONGRESS MAKEUP

■ REPUBLICAN CONGRESS ■ DEMOCRATIC CONGRESS ■ SPLIT CONGRESS



Source: LPL Research, Bloomberg 11/30/18; Data are from 1950–2017.



CHAPTER 2:

Master the Keys to Economic Growth

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FISCAL STIMULUS DID ITS JOB IN 2018, with the U.S. economy growing at an average of 3.3% over the first three quarters, compared with the expansion average of 2.3% GDP growth. While we believe expectations should be lowered in 2019, we continue to expect that the ongoing impact of fiscal stimulus will be readily apparent. We are looking for GDP growth of 2.5–2.75% in 2019, supported by consumer spending, business investment, and government spending [Figure 3].

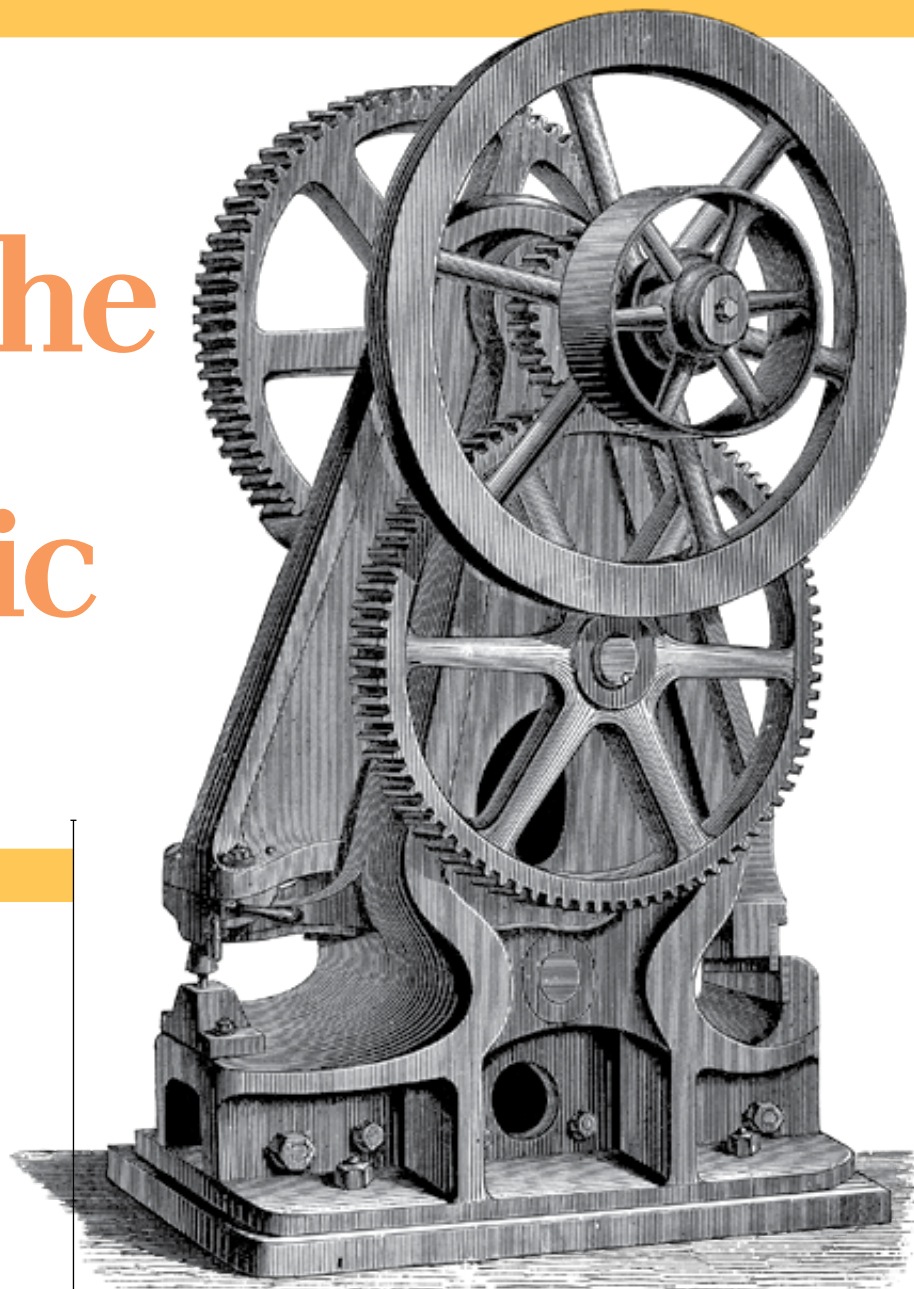


fig.3

Economic Forecasts

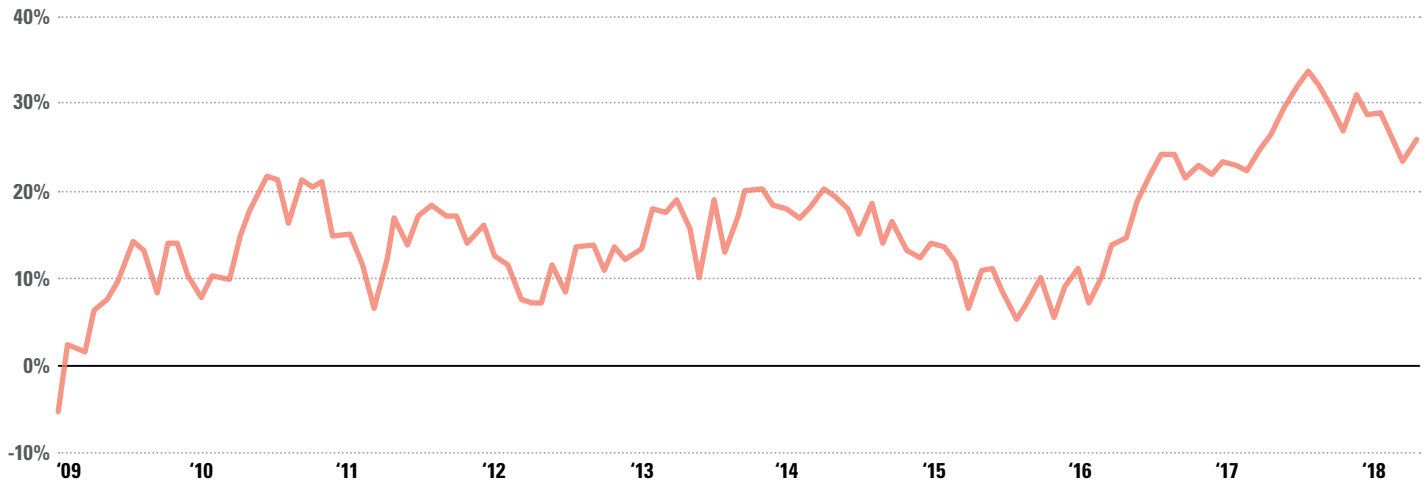
REAL GDP (YoY%)	2017	2018 (EST.)	2019 (LPL EST.)
U.S.	2.2%	2.9%	2.5–2.75%
Developed ex-U.S.	2.4%	2.1%	1.9%
Emerging Markets	4.7%	4.7%	4.7%
Global	3.7%	3.7%	3.7%
U.S. ECONOMIC DATA			
Inflation (YoY%)	2.1%	2.4%	2.25–2.5%
Unemployment	4.4%	3.7%	3.6%

Source: LPL Research, Bloomberg, International Monetary Fund (IMF) 11/30/18; 2018 GDP based on IMF estimates; 2018 inflation and unemployment based on Bloomberg-surveyed economist consensus given year-to-date data; 2019 economic data and U.S. and global GDP estimates are LPL Research forecasts. Other GDP estimates are IMF projections. Inflation is measured by the Consumer Price Index.

fig.4

Businesses Still Showing Plans for Robust Spending

PLANNED INCREASE/DECREASE IN CORPORATE CAPITAL EQUIPMENT SPENDING*



Source: LPL Research, Strategas Research Partners 11/30/18

*Based on regional surveys. Above 0 indicates more respondents are expecting increases than decreases in the next 6–12 months.

Sustaining Growth

We believe a combination of positive factors may help maintain business and consumer spending levels that are above the expansion average.

Overall, the combination of lower individual and business tax rates, immediate expensing provisions, repatriation, reduced regulation, and increased government spending may help maintain business and consumer spending levels that are above the expansion average. That should more than compensate for slower global growth, flat housing growth, and uncertainty from trade and budget deficits. In addition, consumers are supported by full employment and improving wages; as a result, we expect the bulk of recent consumer spending patterns to persist, and that consumers will continue to provide a solid foundation for economic growth.

Fiscal incentives for business spending help lay the foundation for improved productivity, which will be important in 2019, as rising output per worker helps offset inflationary pressures. Although we expect current consumer spending patterns to persist, job growth may start to moderate, so the burden for boosting GDP will fall on higher business investment, which leads to greater productivity.

Despite periodic slowdowns, business spending was robust in 2018. If the trend persists, it's possible the cycle may elongate even further. Surveys suggest that business spending may grow at a solid rate of about 7% in the year ahead, such that signs of a slowdown could prove to be temporary.* High business confidence should support increases in capital equipment purchases **[Figure 4]**.


An increase in government spending may provide added support. Growth in federal spending over the trailing four quarters made its largest contribution to GDP growth since 2010. While the overall contribution may slow slightly, increases in federal spending may continue to play a meaningful role in 2019.

Inflation concerns may surface at times, and we'll be watching wage growth. It's hard to have a sustainable inflationary threat without the participation of wages. Historically, wages have needed to rise in excess of 4.0% annually before the Fed has felt the need to raise rates aggressively. With wage growth trending near 3.0% annually, we believe there is still plenty of time before inflation contributes to the end of this cycle.

Consequently, we look for the increase in the Consumer Price Index to hover within the



*Per the Institute for Supply Management manufacturing Purchasing Managers' Index



range of 2.25–2.50% in 2019. Stable prices at this level should not alarm the Fed, which is why we expect monetary policy to continue on its gradual path of rate increases. If we were to see runaway inflation, that is when we might expect more aggressive rate hikes, which can slow down the economy much more and create the potential for a shock.

Taking a World View

We look for the global economy, measured by GDP, to expand at a healthy rate of about 3.7% in 2019, led by growth in the U.S. and emerging markets (EM), while developed markets in Europe and Japan may continue to lag.

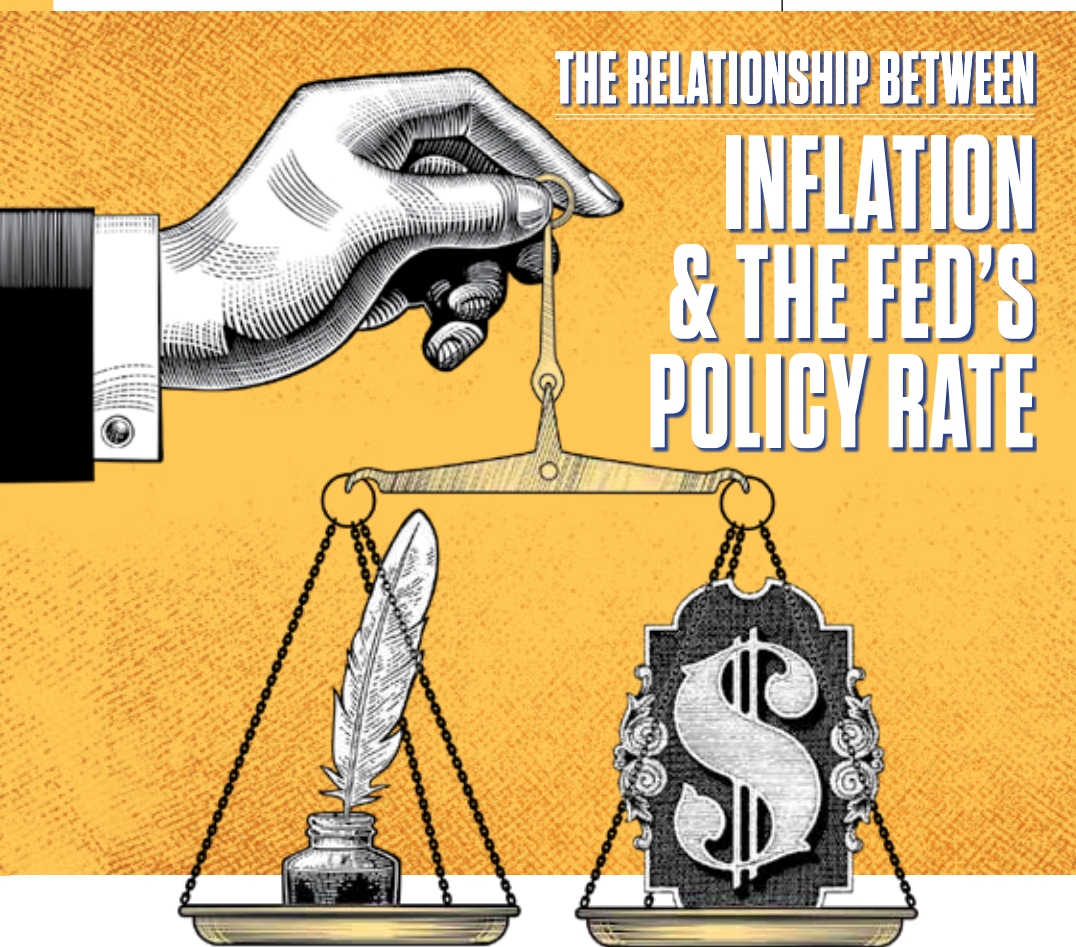
We expect Europe to wrestle with some of the biggest policy issues for developed markets this year. A tighter regulatory environment and labor laws that restrict business growth remain structural concerns, but there are also several more immediate issues that may weigh on growth, including Brexit, Italian budget concerns, and a rise in populism. Considering these issues, we suspect Europe may have difficulty exceeding 2.0% GDP growth in 2019.

Japan continues to benefit from a strong combination of fiscal and monetary policy initiatives, including government spending and an accommodative monetary policy stance from the Bank of Japan. Yet structural reforms have proved elusive and another increase in the value added tax (VAT) is on tap for October 2019. As a result, the economic growth trajectory for Japan may peak by midyear.

EM economies continue to perform relatively well, despite concerns around trade, currency weakness amid dollar strength, and moderating demand from Europe and China.

As the world's second-largest economy, China is always a major factor in EM growth. China's growth has slowed recently, in part due to the uncertainties surrounding the tariff disputes with the U.S. If growth does not stabilize, we expect Chinese officials to launch a variety of programs to offer support, including funds for lending, government spending on infrastructure, and possibly lower corporate tax rates to incentivize investment.

In the coming year, we think it will prove important to distinguish between emerging Asia, emerging Europe, and Latin America. In emerging Asia, we remain encouraged by solid



► When the economy heats up, inflation starts to rise: Businesses want to put people to work, labor gets scarcer, wages increase, and there's more demand for goods and services. So prices go up.

As inflation rises, the Fed steps in and raises rates. This is an effort to decrease borrowing and encourage saving. That slows down the economy.

If that happens too quickly, and inflation gets too high before the Fed steps in, then policymakers may react too aggressively, making a policy mistake. That can slow the economy down so much that it triggers a recession.

Right now, the Fed is keeping it gradual, helping keep inflation near the target for price stability as part of its dual mandate (along with full employment). The Fed wants to let the economy become as strong as it can without doing damage down the road. This is a delicate balancing act.



HOW TO INVEST

The global expansion continues but may be slowing. The U.S. likely remains a leader among developed economies, while emerging markets have upside.

U.S. GROWTH REMAINS ABOVE TREND...

...but is likely to slow. Rates still expected to rise at a moderate pace.

POLITICAL CONCERNS PERSIST IN EUROPE...

...but growth may stabilize. Political uncertainty is delaying structural reforms needed to make environment more business friendly.

JAPAN FACES HEADWINDS...

...from slower Chinese growth and an expected tax increase. Improving opportunity but 2019 may present challenges.

EMERGING MARKETS ARE GROWTH LEADERS...

...but China likely to slow. China and trade risk remain in focus but diverse space may present opportunities.

GDP growth prospects, despite slower demand from China. Currency risks persist in Argentina and Turkey, causing those nations with current account deficits to weigh more broadly on their regions. Emerging Europe has weak growth prospects, but Latin America, despite Argentina and Venezuela, is likely to experience improved momentum coming from Brazil and Mexico.

Emerging markets is a deceptive term, since different emerging market regions have widely divergent economic drivers. Therefore, we look to distinguish opportunities in different emerging markets, viewing in order of preference emerging Asia, Latin America, and then emerging Europe.

Chapter Summary

We do not anticipate a recession in 2019, thanks to the fundamentally driven economic momentum, combined with fiscal incentives and government spending programs on tap for the coming year. But given the length of the



What's the Alternative?

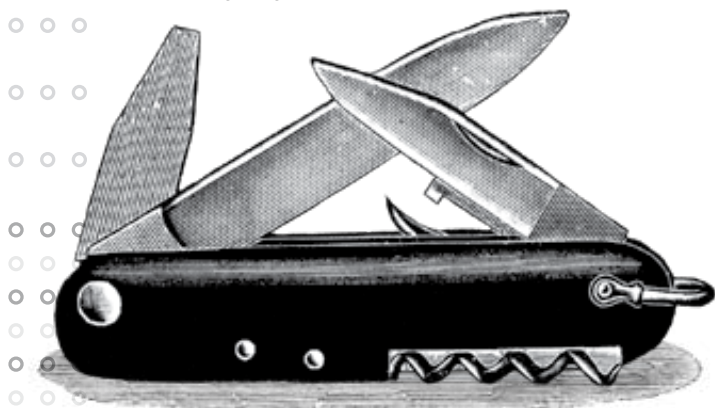
We look at two alternative investment strategies you can implement in a diversified portfolio and their distinct purposes: long/short equity and event-driven strategies.

LONG/SHORT EQUITY

We maintain a positive equity outlook for 2019, and therefore we think long/short equity can be an attractive option for participating in broader market gains while also helping to provide an additional layer of downside risk management. Long/short equity can be used to complement traditional long-only equity exposure, especially when picking stocks based on their potential to generate returns. A potential decrease in correlation—the degree to which stocks move together—plus greater levels of return dispersion (uncertainty and risk) may support a more favorable stock-picking environment. We continue to favor strategies with a conservative or variable net exposure that may help add risk control, as well as some exposure to a broad set of global markets to provide more robust opportunity.

EVENT-DRIVEN STRATEGIES

Investors looking for a risk-return profile similar to a fixed income portfolio but without the interest rate and credit sensitivity may consider event-driven investing. This strategy benefits from a competitive corporate-deal environment, and tax reform may continue to support the industry for the medium term. Historically, event-driven strategies have maintained extremely low equity-like exposure, which has resulted in returns more dependent on idiosyncratic deal flow rather than the broader market direction. The ongoing U.S.-China trade dispute and regulatory uncertainty represent additional risks; however, we believe skilled managers can add value in navigating these uncertainties.





current expansion and where we are in the economic cycle, it is natural that investors are looking for the signs of a recession on the horizon.

There are some late cycle indicators that we're seeing now: Inflation and wages are picking up and the Fed is in tightening mode (raising rates). Housing and auto sales have weakened, but personal consumption, business investment, and government spending remain solid and have not yet moderated to levels that would raise concerns.

At the same time, we have this large fiscal stimulus that's very supportive for economic growth. There's never been a time when the U.S. had this much stimulus this late in the cycle and then went into a recession. So far, all the indicators are showing that the economy has been responding well to the stimulus (through the first three quarters of 2018) and we should see more of those effects ahead because it typically takes more time for these structural forces to really come into play. This first push we've seen already is likely due to the confidence in these initiatives.

In addition, although we are late in the economic cycle, that period can last for a long time and these late stages can be positive for investors. We're not seeing the excesses or "red flags" that would normally put us on watch; at the same time, we are carefully watching for the signs that could precipitate those red flags eventually, such as heavy overborrowing accompanied by overspending, so we do need to be more aware at this stage. And of course, it's always important to be mindful of where we are in the cycle, so that we can be prepared for the next transition.



WHAT IF...

THE RISK OF RECESSION RISES?

► There are a few scenarios that could indicate a recession may come sooner than we expect:

- ☐ *Wages rise sharply*
- ☐ *Inflationary pressures increase*
- ☐ *Fed becomes more aggressive*
- ☐ *Consumer spending cools*
- ☐ *Business spending stalls*
- ☐ *Trade rhetoric escalates*
- ☐ *Leading indicators weaken significantly*

Although we don't expect these conditions, it's prudent for investors to be on the lookout.

We're on the lookout, but not yet seeing red flags that could indicate an impending recession.





A Snapshot of Stock Market History

Bulls & Bears

Market returns can be looked at from a lot of different levels: intraday moves, daily changes that bring new highs and lows, and the longer-term trends—the bears and the bulls—that define broad market movements.

As we follow the market's twists and turns, it's important to know what these movements mean today, as well as how they've played out over time. What does the history of stock market returns look like? What kind of perspective does it provide? And how might that influence how we feel as we experience market advances and declines from day to day?

Look Inside!

Open this page to take a look at the history of the S&P 500 Index since 1950. The blue graph represents the index's total return, including both price changes and dividends. Historically, there's been a long-term pattern of market gains, and in fact even very volatile periods appear less dramatic at this scale. This pattern is not just magic—it's had a firm basis. Stocks ultimately represent ownership of a small slice of corporate profits, and corporate America has been able to grow its profits over the years as the economy

has expanded, and occasionally contracted during periods of recession. This has resulted in a trajectory that has included peaks and valleys—a few higher or deeper than others—but that over the long term, has advanced.

But what about those bear markets (declines of 20% or more) and less extreme but still meaningful corrections (declines of 10% or more)? Bear markets and even corrections do cause real economic damage, but should also be viewed in relation to the history around them and the long-term performance of the market. Past recessions accompanied by bear markets have certainly felt worse than they look here, but that's the point—sometimes our emotional reactions to market changes overwhelm the broader perspective a longer-term view can provide.

Be Calm & Prepared

We believe we're in the later stages of the market cycle, which can last several years, but we're watching all the indicators to make sure we're prepared for the next transition. To help you keep perspective, here are a few things to remember about bear markets, corrections, and recessions:

- ▶ Bear markets start as market corrections, but about 70% of the corrections since 1950 did not go on to become bear markets.
- ▶ 70% of the bear markets since 1950 have been associated with recessions. When this has happened, the start of the bear market has preceded the onset of the recession by several months.
- ▶ Bear markets associated with recessions typically bottom in the heart of the recession, which means the market begins its upturn while the recession is still going on.

Eventually, this cycle will transition to the next. On a total return basis, the S&P 500 has taken an average of a little less than 1.5 years to recover from a bear market. And that's one of the main reasons to consider staying invested in the market—even during downturns—to attempt to regain the value of your portfolio as the market moves from a bear market to its expansion phase.

Keeping a focus on the market as a whole and being prepared are fundamental for riding out eventual downturns and reaching long-term investment goals.



OPEN HERE!

100,000



A SNAPSHOT OF STOCK MARKET HISTORY

The S&P 500 has taken an average of a little less than 1.5 years to recover from a bear market.

10,000

1,000

100

10

1950

1952

1954

1956

1958

1960

1962

1964

1966

1968

1970

1972

1974

1976

1978

1980

1982

19



0.7

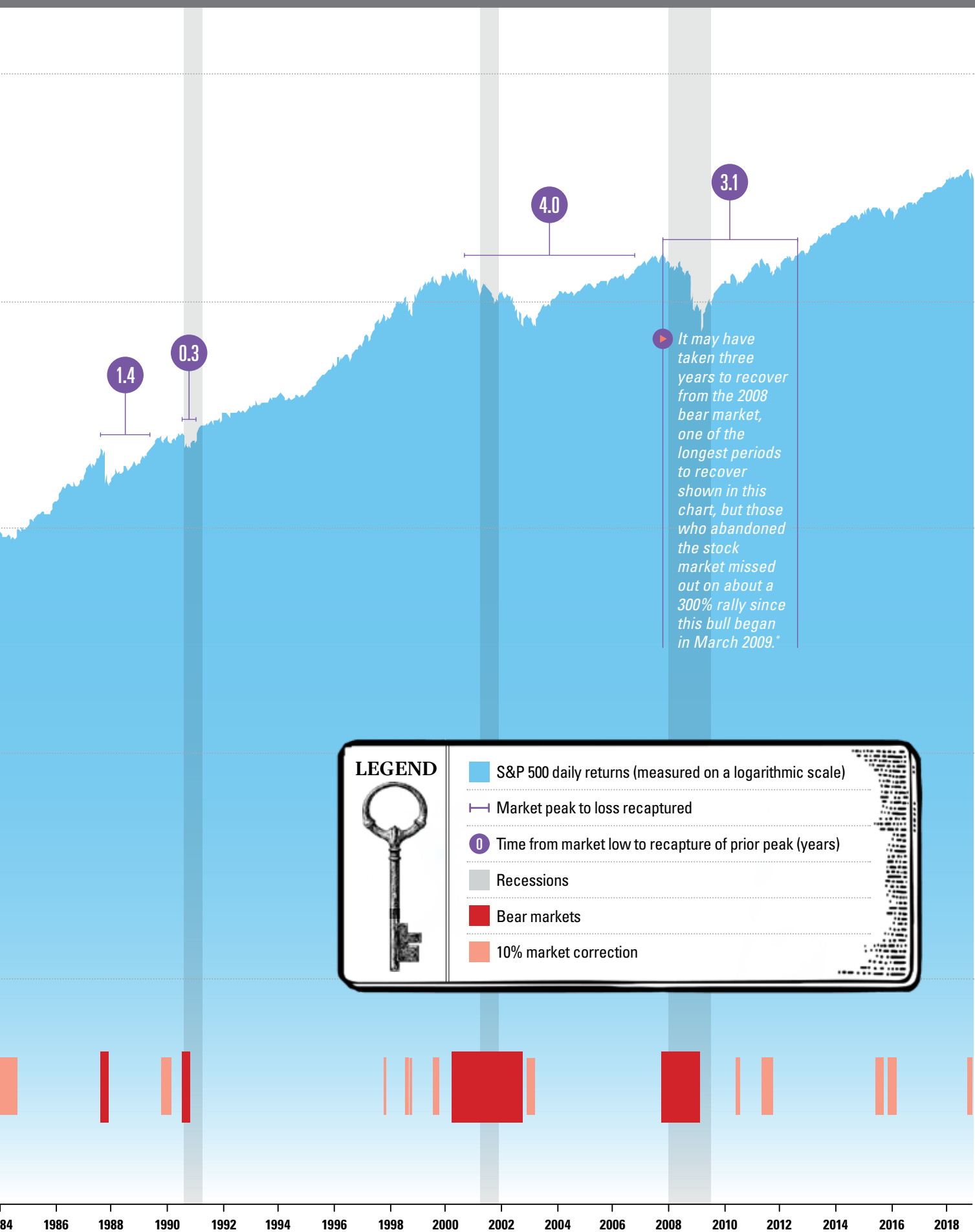
0.8

0.5

0.8

1.8


0.2



*As of November 30, 2018, the S&P 500 is up 308% cumulatively since March 9, 2009.



Manage Expectations for Bonds



for bond investors over the last several years, and it all comes down to interest rates—in terms of rates both staying low and rising. Low rates have meant less income from fixed income securities, while rising rates pushed bond prices down, lowering the value of the securities.

While both low and rising interest rates will still be in play in 2019, we believe the worst is likely over. The somewhat higher interest rates we have now come with higher bond income; and although we are still concerned about rising rates, we think that upward pressure will moderate compared to what we've seen since mid-2016. Fixed income

fig.5

Yield Curve May Stay Flat Due to Higher Trending Rates



Source: LPL Research, Federal Reserve 11/30/18; the yield curve is a line that plots the interest rates, at a set point in time, of bonds having equal credit quality, but differing maturity dates. The yield spread is the difference between yields on differing debt instruments, calculated by deducting the yield of one instrument from another.

positioning should still be somewhat insulated against rising rates, in our view, but investment-grade bonds look more attractive than they have in years, and they can continue to play a role in a well-diversified portfolio.

Reading the Yield Curve

Investors' obsession with the flattening U.S. Treasury yield curve dominated headlines for much of 2018. A flattening yield curve occurs when short-term rates are rising faster than long-term rates, which may eventually lead to an inverted yield curve, where short-term rates are higher than long-term rates. Historically, this has been a negative signal for the U.S. economy, often providing an early warning of an eventual recession, which is why the yield curve has been garnering so much attention recently.

We believe these concerns were overstated given the positive economic environment. We do expect both short- and long-term rates to gradually rise in 2019, keeping the yield curve somewhat flat [Figure 5]. However, if that continues to occur in the context of solid economic growth and modest inflation, we don't think a flat yield curve should be read as a signal of rising recession risk.

Understanding what's driving short-term rates higher provides further valuable context



LET'S RECAP



The yield on the benchmark 10-year U.S. Treasury jumped roughly 60 basis points (0.60%) in 2018 (as of 11/30) from 2.40% to 3% [Figure 6, p.19]. Market interest rates moved higher as economic growth gained traction and inflation measures approached the Fed's target for price stability. The rising federal budget deficit also caused Treasury auction bidders to demand higher yields for the risk they were taking, particularly since the Fed, with the end of QE, was no longer backstopping the U.S. Treasury market. While rising rates are a signal of good economic growth, they can cause volatility, especially when rates periodically surge.

to the yield curve. Changes in short-term rates largely reflect Fed policy, and in 2018, short-term rates moved higher in anticipation of gradual rate hikes. We expect the Fed to raise rates only twice in 2019, roughly in line with the consensus and the Fed's updated December guidance.

Market forces may create conditions that enable the Fed to pause and reassess the rate hike path that best serves the economy. These forces include the lack of threatening wage pressures, delayed effects of previous hikes, policymakers' awareness of the impacts of dollar strength, the impact of balance sheet reduction, and the increase in Treasury issuance (driven by deficit spending). We are encouraged by the Fed's recent emphasis on flexibility, which will allow it to be more responsive to market conditions.

Breaking It Down

Taking all of these factors into account, we anticipate gradually increasing interest rates as U.S. economic growth moderates from the strong pace of 2018. Consequently, we expect the 10-year Treasury yield to eventually trade within a range of 3.25–3.75% in 2019. We may periodically see spikes above or drops below, but we suspect the bulk of time will be spent within this range, as domestic and global investors attempt to find balance among Fed guidance, U.S. Treasury issuance, wage pressures, and relative valuations with other sovereign bonds.

Tying back to the yield curve, the demand for U.S. Treasuries also points to the yield curve remaining flat. Because of its attractive



HOW TO INVEST

We expect interest rates to continue to rise at a moderate pace in 2019, but more slowly than in recent years. Higher-quality bonds have become more attractive as rates rise, but we still emphasize above-benchmark credit risk and below-benchmark rate sensitivity.

POSITIVE

INVESTMENT-GRADE CORPORATE BONDS

Economic growth may help credit-sensitive bonds; added credit risk provides incremental yield.

MORTGAGE-BACKED SECURITIES

Yield benefit relative to rate risk remains attractive among high-quality options.

NEUTRAL

INTERMEDIATE-TERM HIGH-QUALITY BONDS

Offer some potential diversification while avoiding the rate risk of long-term bonds.

BANK LOANS

Still potentially attractive for strategic investors, but high issuance, weaker investor protections raise some concerns.

NEGATIVE

HIGH-YIELD BONDS

May be supported by further economic growth, but we prefer a combination of equities and high-quality bonds.

DEVELOPED INTERNATIONAL BONDS

Valuations remain very rich and declining central bank accommodation may create a challenging environment.

LONG-TERM HIGH-QUALITY BONDS

With rates still expected to rise, diversification benefit does not adequately compensate for added rate sensitivity.

We expect the 10-year Treasury to spend the bulk of 2019 in the range of 3.25–3.75%.



valuations relative to other global sovereigns, the benchmark U.S. Treasury above a 3.0% rate often has experienced good demand when compared to other, more expensive developed market alternatives.

Against this backdrop, we expect near flat returns for the Bloomberg Barclays U.S. Aggregate Bond Index. Although we do recommend generally moving closer to the benchmark given the potential for later cycle volatility, we continue to position portfolios with below-benchmark interest rate sensitivity and above-benchmark credit risk to help manage rising rates while positioning for continued economic growth.

Picking a Position

Given our expectations of rising interest rates, yet at a slower pace than in recent years, here is a breakdown of how bond sectors may perform in 2019.

U.S. TREASURIES: U.S. Treasuries do have high interest rate sensitivity, meaning that a sharp rise in rates could have a large and negative impact on total return. However, we believe it is important not to fully abandon this fixed income sector, because U.S. Treasuries can help provide portfolios with diversification, income, and liquidity, and can help smooth out volatility during periods of equity market stress.

MUNIS: Despite 2017 tax cuts potentially weighing on demand, municipal securities

Digging Deep

Commodities may remain volatile and are unlikely to be attractive unless an upside inflation surprise acts as a catalyst for hard assets.

► Oil prices are likely to remain volatile in 2019, mainly because technological innovations continue to make it challenging for markets to find a stable price range. We believe West Texas crude (WTI) is still a fair value in the \$60-per-barrel range, and we anticipate some pickup in demand in 2019. Geopolitical risk potentially could provide some support for prices.

At current price levels, we think gold can play a role as a hedge against inflation or a sharp rise in economic uncertainty, but right now we don't see either of those as looming factors. In addition, more attractive yields from other investments increase the opportunity cost of holding gold, and the potential for the dollar to at least hold at its current levels removes some support for going for the gold.

Industrial metals may benefit from fiscal efforts to spur growth; however, demand from China could continue to diminish as its economy transitions from manufacturing toward services and consumption. With global growth unlikely to accelerate, upside may be limited.



WHAT IF...

RATES MOVE SHARPLY HIGHER?

► Several factors could indicate that interest rates may experience a sharper increase than expected:

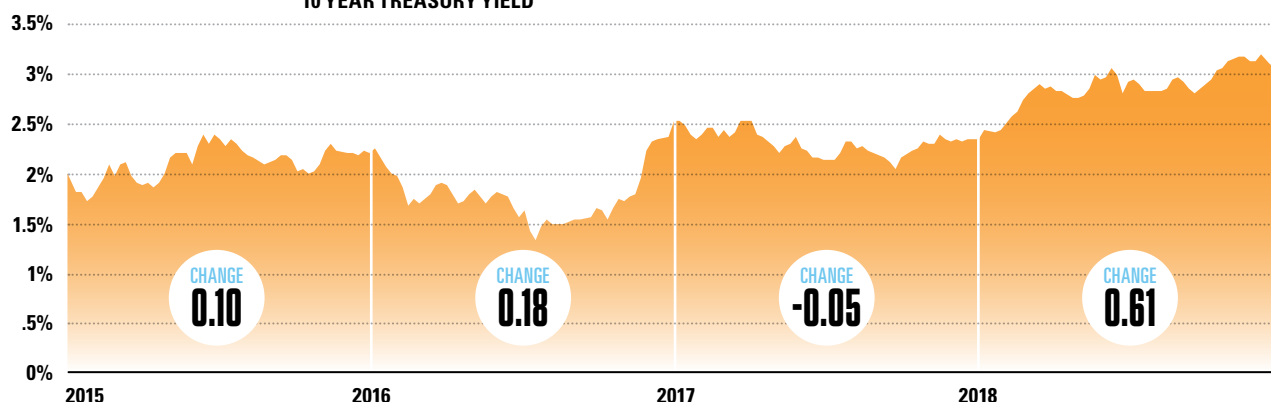
- Stronger than expected economic growth
- A tightening job market
- Competition for labor pushing up wages significantly
- Companies raising prices to offset tariff costs
- Rising inflation expectations

If we see rapidly rising rates, bond performance will likely suffer and borrowing costs would increase, creating a challenge for consumers and businesses. We may also see heightened stock market volatility.

fig.6

Although Rates Are Climbing, Increases Have Been Gradual

10 YEAR TREASURY YIELD



Source: LPL Research, Federal Reserve 11/30/18

performed better than we anticipated. We still view tax-exempt fixed income as relatively attractive for suitable investors.

MBS: Mortgage-backed securities (MBS) have a history of strong performance during periods of rising rates as prepayment risk diminishes. Mortgage supply has been weaker than expected in 2018, while the period of slow curve flattening helped minimize volatility in the space. Despite expectations that rising rates will moderate, we believe adding MBS over the coming year may help provide added diversification.

HIGH YIELD & INVESTMENT-GRADE: As we move into the later part of the business cycle, we are increasing our focus on investment-grade (IG) fixed income, with a modest allocation to high yield only for strategically oriented investors. High yield historically provides extra return for the greater risk it carries and typically outperforms during periods of rising rates; however, we believe IG corporates may provide some of the potential benefits of the added credit exposure while avoiding some of the risk of high yield. Up to half of the sector now carries a rating of BBB—essentially one notch away from being categorized as high yield. As a result, IG bonds may offer the potential to exceed their average performance during previous periods of rising market interest rates.

BANK LOANS: Bank loans carry below investment-grade credit risk but have been a popular choice to insulate portfolios against rising

rates. We still prefer bank loans to high yield, but given our bias toward quality, we recommend only marginal exposure for suitable investors.

INTERNATIONAL: Developed market sovereign bonds continue to look expensive to us. Central bank policy has made yields unattractive and rising rates may become an additional challenge as the European Central Bank reduces its monthly asset purchase program. Emerging market debt (EMD), denominated in dollars, looks attractive when considered through the lens of relative valuation. EMD spreads are currently at a slight premium to high yield, compared to history, and appear poised to rally in the coming quarters.

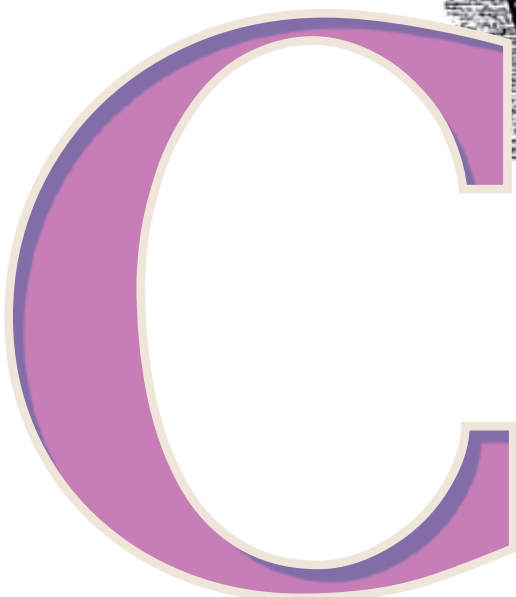
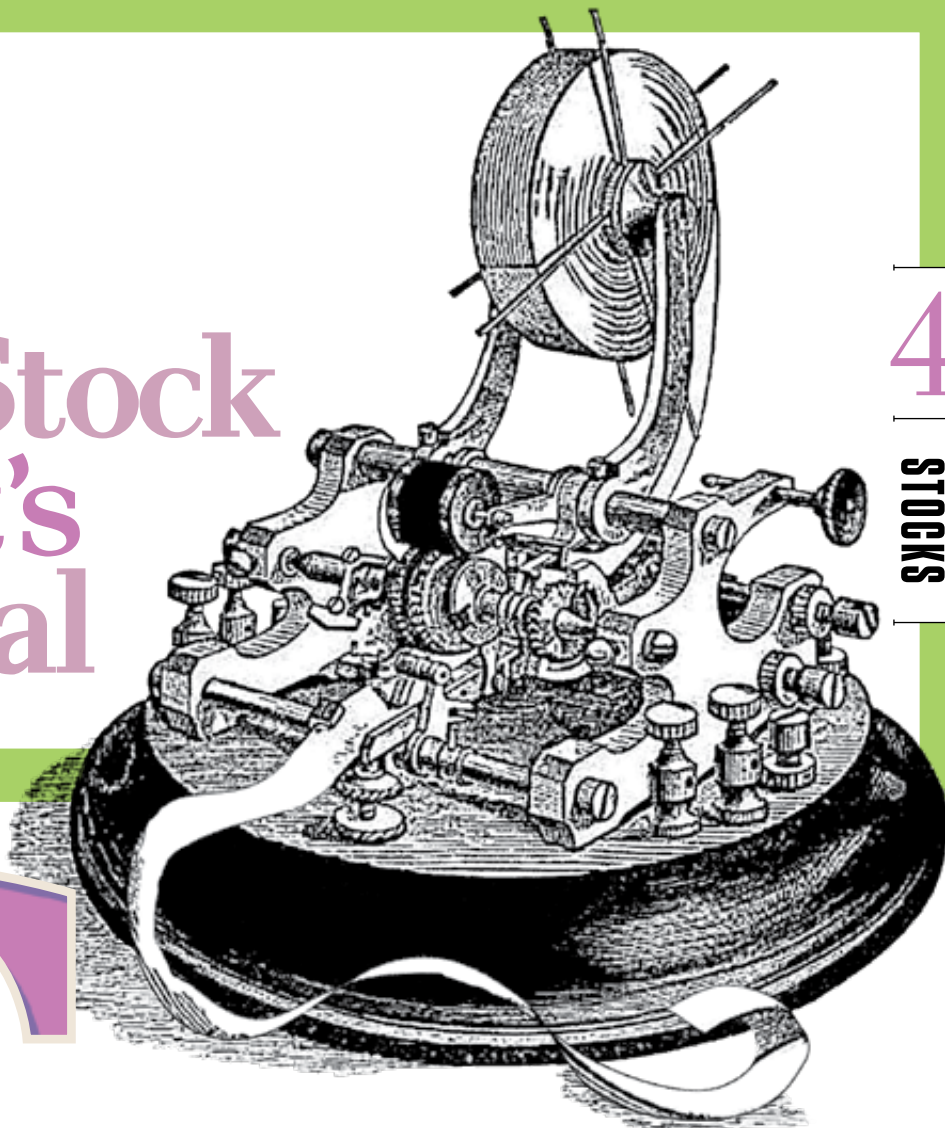
Chapter Summary

While the 37-year-old bull market in bonds may be over, we're not convinced a full-on bear market has begun. The income-generation (coupon clipping) phase of the credit cycle may last longer than in previous experiences, given the extent of monetary policy accommodation over the past decade. Nonetheless, we acknowledge that it will prove more difficult to make money in bonds going forward, as a variety of trends conspire to push market interest rates higher. Therefore, for diversified fixed income portfolios, we will try to employ active strategies to identify fixed income investments that may perform better in an environment of rising rates, dollar strength, and fiscal stimulus.

CHAPTER 4:

Believe in the Stock Market's Potential

4 STOCKS



CONSIDERING OUR VIEWS ON ECONOMIC

growth, monetary policy, and the fiscal tailwinds of government spending, reduced regulation, and lower taxes, we expect 2019 to be a good year for stocks. Market volatility will likely persist, as investors digest the many forces impacting the economy, interest rates, and corporate profits. We also believe that during volatile periods, investors must focus on the fundamentals supporting earnings, interest rates, valuations, and income, and remember the importance of diversification.

Tracking This Bull

The current bull market is officially the longest in history, and the economic expansion is quickly approaching that milestone as well—it'll be the longest expansion ever as of May 2019 [Figure 7]. So what does age have to do with it? Considering that on average the typical bull market and expansion last approximately 5 years, reaching the 10-year mark is quite a feat. But for those who are concerned that the cycle has gone on too long, there is some interesting context to consider. Assuming the start of the current bull market began after the lows achieved in March 2009, then it is the longest in duration, but not magnitude.

While the current bull market has exceeded the 10-year life of the 1990s bull, that period generated returns in excess of 400%, compared to the current more than 300% return. Yet in late summer and early fall of 2011, the S&P 500



Index fell by 19.9%. Some could suggest we're splitting hairs here, but it sure felt like a bear market! Another factor to consider is that stock prices, as measured by the S&P 500, did not make new highs again until 2013, which would indicate the current bull is not nearly as old as originally thought.

Though volatility is a characteristic of a late cycle stock market environment, in our opinion, corporate profitability is the most important determinant of equity prices, followed by interest rates. Though profits rose by approximately 25% in the first three quarters of 2018, and growth of more than 20% is expected for the full year based on FactSet consensus estimates, concerns have escalated that profits have peaked. Investors must make the distinction that, while the rate of growth in profits may have peaked, absolute profits remain at record levels and are expected to rise. Also, a look back at the past 10 profit cycles reveals that after a peak in the year-over-year profit growth rates, it has taken about four years before the economy slipped into recession. Perhaps more important, equity prices climbed by an average of more than 50% during that intermediate period. Clearly, peak profit growth does not indicate the cycle is nearing its end.

In reality, we can't say for sure how long this bull will keep running, but given the fundamentals of the U.S. economy and corporate America, we believe the odds favor solid potential gains for stocks next year.

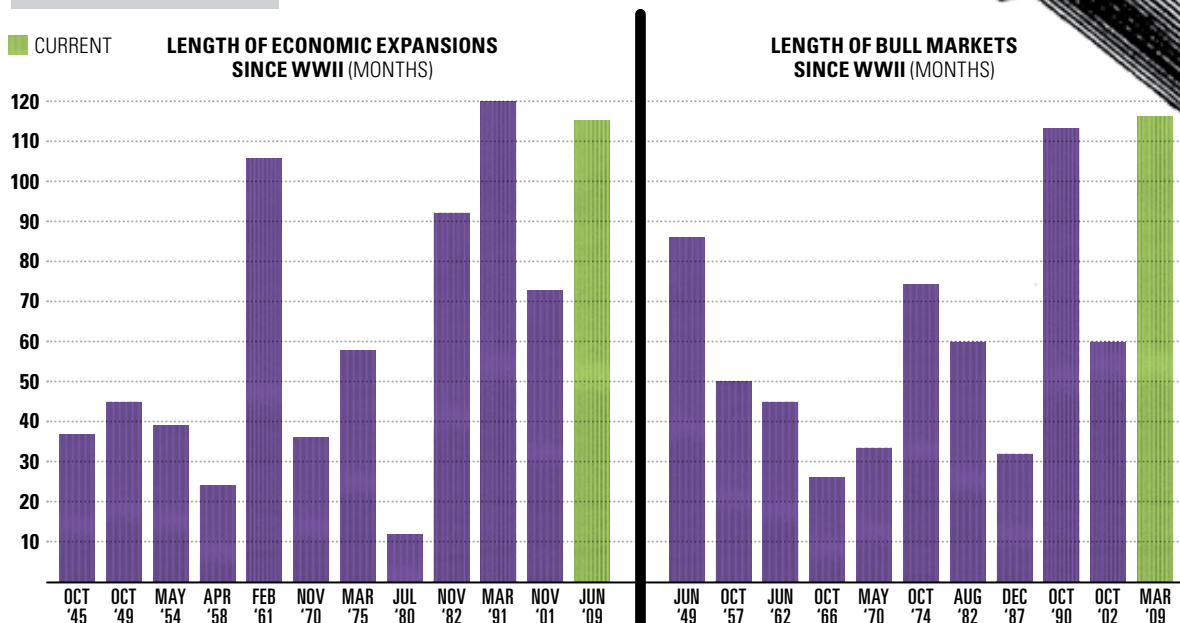
Breaking It Down

After watching tax reform boost S&P 500 operating profit growth to over 20% in 2018, we believe the pace of earnings gains will moderate in 2019 to 6–7%, essentially in line with historical averages. This would bring index profits to \$172.50 in 2019, up from roughly \$162 per share that we expect for 2018. These estimates could prove conservative depending on clarity on trade and the path of interest rates and commodities prices.

Given our belief that the Fed will raise rates more slowly in 2019, with the economy expected to generate 2.25–2.5% inflation, we believe a price-to-earnings ratio (PE) for the S&P 500 of 17.5 times trailing earnings is appropriate. Thus, we believe the S&P 500

fig.7

Economic Expansions & Bull Markets



Source: LPL Research, NBER, FactSet 11/30/18; economic expansions are based on GDP growth, bull markets on S&P 500 returns.



HOW TO INVEST

Our expectations for equity market leadership in 2019 are based on our forecast for solid but slightly slower growth in the U.S. and global economies and corporate profits, tighter monetary policy, and a gradual rise in interest rates.

POSITIVE

CYCLICAL STOCKS

Favor cyclical sectors over defensives as the economic expansion is likely to continue through 2019. Industrials are poised to benefit from resolution of the U.S.- China trade dispute, technology may continue to deliver strong earnings growth, and financials appear attractively valued.

VALUE

Value may benefit from solid U.S. economic growth and relatively attractive valuations after a sustained period of growth outperformance.

EMERGING MARKETS

Emerging markets may benefit from solid economic growth, favorable demographics, attractive valuations, and prospects for a U.S. trade agreement with China.

U.S. STOCKS

Fundamentals are positive for U.S. stocks amid a solid economic and corporate profit backdrop. Suitable investors may consider dedicating the majority of equity allocations to the U.S.

U.S. DEFENSIVE STOCKS

Defensive sectors are likely to lag their more cyclical counterparts as the economic expansion and bull market continue, potentially pushing interest rates higher.

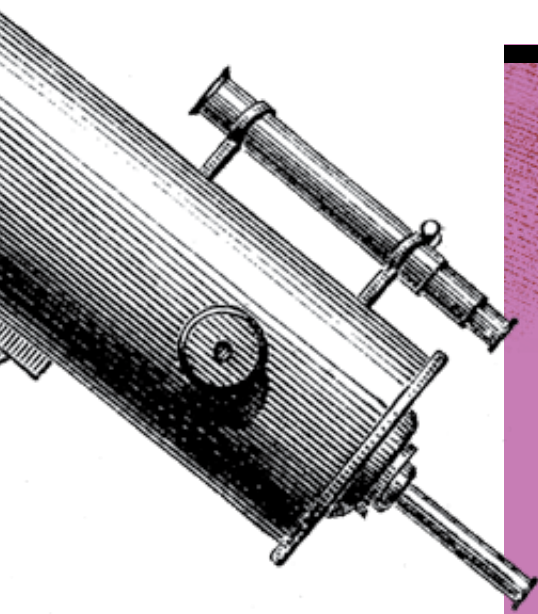
GROWTH

After a sustained period of strong performance compared with value, the growth stock rally may be due for a pause. We favor the biggest value sector, financials, over the biggest growth sector, technology.

DEVELOPED INTERNATIONAL

Growth in Europe has been slowing and may not reach 2% in 2019, while political uncertainty is high. Growth in Japan is also slowing despite stimulus and corporate reform efforts.

NEGATIVE



LET'S RECAP

In our *Outlook 2018* publication, we discussed the possibility of increased volatility ahead. To be sure, market volatility escalated in early February, after a strong start to the year, as monthly wage growth climbed higher than expected. Market interest rates jumped and equity prices dropped, experiencing their first correction (a 10% fall from the market's previous high). Stocks and rates tried to stabilize for several weeks before tariff concerns escalated, and stocks again dropped about 10% in late March through early April.

An essentially flat market persisted throughout the second quarter. In early summer, the U.S. administration began to make progress on trade, which reassured investors, and the S&P 500 Index jumped more than 7% in the third quarter. Tariff concerns with China remained, however, and stocks experienced further volatility in the final months of the year, as trade issues weighed on investor sentiment and Fed officials reiterated plans for gradual rate increases following their December rate hike.



would be fairly valued in the range of 3,000 over the coming year, representing an 8–10% return from levels heading into December (2760 as of 11/30/18).

Picking a Position

Against a backdrop of steady economic growth, strong corporate profits, and a rising rate environment, here is a high-level look at our views when it comes to positioning for 2019.

LARGE VS. SMALL CAPS: Small caps generated outperformance early in 2018, aided by being relatively more insulated from trade tensions than large caps. However, as trade issues mitigate, the business cycle ages, and the dollar's uptrend potentially hits resistance, market leadership may shift back toward large caps. In addition, a rising interest rate environment, potentially with tightening financial conditions, may create a challenge for small cap companies that have higher costs of capital and a greater reliance on debt. Accordingly, over the next several months, we suggest suitable investors shift toward target allocations across market capitalization with benchmark-like exposures to small, mid, and large cap stocks.

GROWTH VS. VALUE: We maintain our slight preference for value despite its underperformance relative to growth in 2018. We expect value in 2019 to benefit from the pickup in economic growth that began in mid-2018, relatively attractive valuations after a sustained period of growth outperformance, and our positive view of financials.

SECTORS: We favor cyclical sectors over defensives, specifically cyclical value, as we expect the economic expansion to continue through 2019. Industrials are poised to benefit from resolution of the U.S.-China trade dispute and a potential pickup in capital spending,

supported by fiscal stimulus. We believe financials are attractively valued and remain well positioned to benefit from steady economic growth and deregulation efforts. Finally, we expect technology to continue to deliver strong earnings growth and enable productivity gains for corporate America.

EMERGING VS. DEVELOPED MARKETS: We favor EM equities over developed international equities for their solid economic growth trajectory, favorable demographics, attractive valuations, and prospects for a U.S. trade agreement with China, with a bias toward emerging Asia. Growth in Europe has been slowing and may struggle to reach even 2% in 2019, while growth in Japan is also lagging, despite stimulus and corporate reform efforts. GDP growth in China and broader EM may more than double the pace of developed international economies in 2019, supporting better earnings growth, and we believe political uncertainty is actually lower in EM than in Europe [Figure 8].

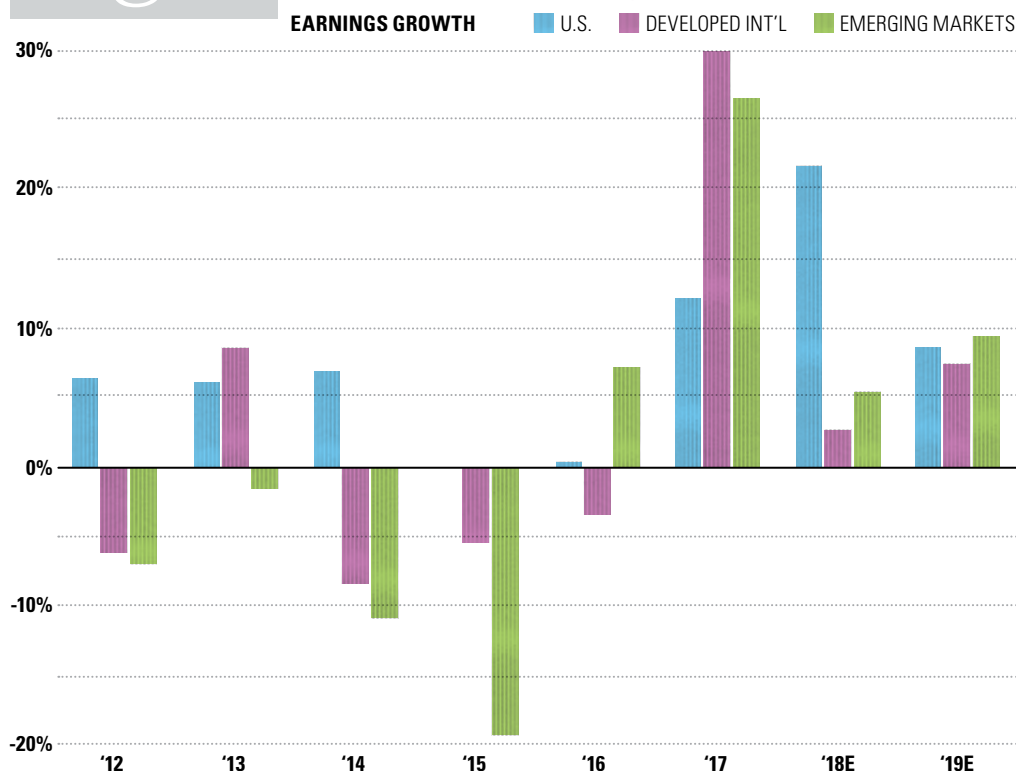
Chapter Summary

Overall, we do expect that 2019 may be a good year for stocks, with the potential for 8–10% returns for the S&P 500. Like 2018, however, we expect volatility to remain as the business cycle ages. We recommend investors weather these ups and downs by focusing on the fundamentals and diversifying portfolios where appropriate. We believe stocks may find support from continued steady growth in the U.S. economy and corporate profits as the impacts of fiscal stimulus continue to flow through. We will continue to look for any signs of weaker economic or profit growth that could drag stock prices lower. Potential escalation in U.S.-China trade tensions, including more and higher tariffs, remains a key risk to corporate profits and therefore global stock markets in 2019.

Although volatility will persist, we expect 2019 may be a good year for stocks.

fig.8

U.S. & Emerging Markets Lead Earnings Growth



Source: LPL Research, FactSet 11/30/18; indexes: S&P 500 (U.S.), MSCI EAFE (developed international), MSCI EM (emerging markets). Estimates may not develop as predicted.



The Dollar Winds Down

Given our thoughts on monetary policy for 2019, we believe the bulk of the dollar's advance is behind us. We are less sanguine on the dollar longer term given structural forces such as federal deficit spending.

► Given our thoughts on monetary policy for 2019, extended dollar positioning by institutional traders, and uncertainty about trade, we believe the bulk of the dollar's advance is behind us. To the degree that U.S. economic growth exceeds forecasts and global policy remains largely accommodative, modest upside is possible in the coming year. As a result, the dollar may not provide much support to those asset classes that benefit from its decline, nor do we expect any potential dollar advance over the full year will be much of a headwind for dollar-sensitive assets. Longer term, our position is less sanguine for the greenback given federal deficit spending and structural trade imbalances.



WHAT IF...

STOCKS STUMBLE?

► Although we expect corporate profits and a steady economy to support stocks in 2019, there are a few potential scenarios to watch for:

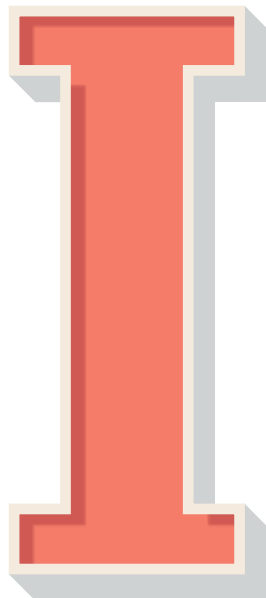
- *Margin pressure increases sharply, hurting profits*
- *Trade risk escalates*
- *Global economy slows more than expected*
- *Business and consumer spending slow significantly*

Should these circumstances arise, stocks could be negatively impacted. It is during these challenging times when we have to be mindful that we don't react emotionally and sell stocks when they've hit a bottom.

Diversified portfolios may help navigate these challenging environments. Asset classes that may provide diversification benefits during a challenging period, such as high-quality bonds, defensive equity sectors, and alternative strategies often look very unattractive when markets are rising. Position for the expected environment, but realize you don't need everything in a portfolio all the time. Diversification still matters.

Epilogue:

Preparing for the Next Phase



IN FUNDAMENTAL: HOW TO FOCUS ON

What Really Matters in the Markets, we aimed to provide the useful context, informed expectations, and key insights to help prepare investors for 2019 and beyond. As a result, we hope our readers will look forward to the future of the markets and economy with a renewed sense of optimism. And even with the important awareness that further bouts of volatility may be on the horizon, we hope this guide offers the reassurance and helpful tips to navigate what may lie ahead.

Despite this aging cycle and the presence of heightened market volatility, we maintain a positive outlook for 2019, thanks to our conviction in the fundamentals supporting continued economic growth and stock market gains. At the same time, we remain on watch for any threatening issues, such as trade or geopolitical events, and will keep a close eye on our trusted market signals.

We understand that experiencing market declines—or the frequent ups and downs we saw at the end of 2018—can be unnerving for any investor. These can be the hardest times to remember that volatility does not necessarily mean that the bull market is over or that a recession is looming, and that it is in fact a normal part of investing. The feeling of actually going through these times is not always easy, which is why at LPL Research, we strive to help investors prepare for what's ahead and provide the appropriate guidance to weather any market environment.

In addition to staying calm and focusing on the long term, we can all use a handy guide or how-to book now and then. So we're arming investors with the investment insights and actionable tips in LPL Research's *Outlook 2019*. Along with the support and expertise of a trusted financial advisor, we hope this book helps investors focus on what really matters in the markets and remain positive about the future of their investment portfolios.



► **LPL RESEARCH** is one of the largest independent research teams in the industry. This team of expert analysts, strategists, and investment specialists delivers objective advice and insightful commentary.

The LPL Research team understands that investing is both a financial and emotional effort, and it can be difficult to cut through all the clutter. They keep a pulse on the global markets to keep up with the rapid pace of change and make sure investors feel informed and ready for what may lie ahead. They also strive to communicate their perspective in a way that's not only timely and useful, but also engaging and relatable.

The LPL Research team divides its time and resources across three cities: Boston, Fort Mill, and San Diego. Look for more from LPL Research in their publications, charts, videos, blog posts, infographics, and podcasts.



Important Disclosures

The opinions voiced in this material are for general information only and are not intended to provide or be construed as providing specific investment advice or recommendations for any individual security. To determine which investments may be appropriate for you, consult your financial advisor prior to investing.

Our recommendations are subject to change at any time based on market and other conditions. Economic forecasts set forth may not develop as predicted, and there can be no guarantee that strategies promoted will be successful.

All performance referenced is historical and is no guarantee of future results. All information is believed to be from reliable sources; however, we make no representation as to its completeness or accuracy.

RISK DISCLOSURES

Investing involves risks including possible loss of principal. No investment strategy or risk management technique can guarantee return or eliminate risk in all market environments.

Investing in stock includes numerous specific risks including the fluctuation of dividend, loss of principal, and potential illiquidity of the investment in a falling market. The prices of small cap stocks are generally more volatile than large cap stocks. Value investments can perform differently from the market as a whole. They can remain undervalued by the market for long periods of time.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond and bond mutual fund values and yields will decline as interest rates rise, and bonds are subject to availability and change in price. Bond yields are subject to change. Certain call or special redemption features may exist, which could impact yield.

High-yield/junk bonds (grade BB or below) are not investment-grade securities and are subject to higher interest rate, credit, and liquidity risks than those graded BBB and above. They generally should be part of a diversified portfolio for sophisticated investors.

Municipal bonds are subject to availability and change in price. Interest income may be subject to the alternative minimum tax (AMT). Municipal bonds are federally tax-free, but other state and local taxes may apply. If sold prior to maturity they are subject to market and interest rate risk and capital gains tax could apply.

Mortgage-backed securities (MBS) are subject to credit, default, prepayment, extension, market, and interest rate 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.

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. Because of their narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies. 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.

DEFINITIONS

Credit ratings are published rankings based on detailed financial analyses by a credit bureau specifically as it relates 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.

The credit spread is the yield of the corporate bonds less the yield on comparable maturity Treasury debt. This is a market-based estimate of the amount of fear in the bond market. Baa-rated bonds are the lowest quality bonds that are considered investment-grade, rather than high-yield. They best reflect the stresses across the quality spectrum.

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. EPS 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.

INDEX DEFINITIONS

All indexes are unmanaged and 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. The S&P 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. The modern design of the S&P 500 stock index was first launched in 1957. All performance back to 1928 incorporates the performance of predecessor index, the S&P 90.

The Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid adjustable-rate mortgage [ARM] pass-throughs), asset-backed securities (ABS), and commercial mortgage-backed securities (CMBS) (agency and non-agency).

The Morgan Stanley Composite Capex Plans Index is a population-weighted composite index compiled from various monthly Federal Reserve Bank surveys of manufacturers.

The MSCI EAFE Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada.

The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.

“If you read one investment book this year, make it *FUNDAMENTAL!*”

“LPL Outlooks are a valuable addition to my investment research for the year ahead.”

“Investment guidance, actionable takeaways, and amazing graphics—what more could you ask for?”

“LPL Research Outlooks tell a great story and deliver valuable advice. I look forward to reading them every year!”

“*FUNDAMENTAL* will be a go-to resource on my bookshelf in 2019.”

“A must-have addition to your bookshelf this year!”

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