Weekly Market Commentary

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The Rally Is Getting Old, but a New Trend May Be Emerging

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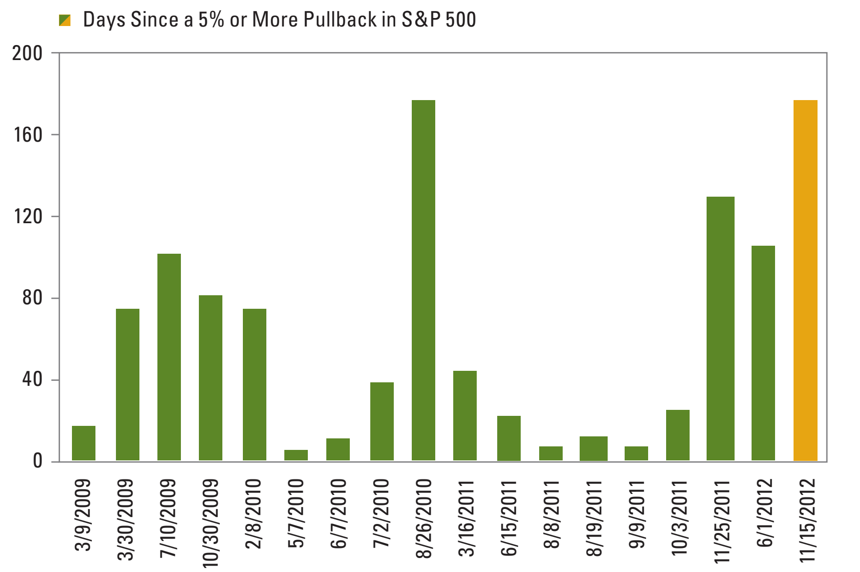
Highlights

The overall stock market has only seen a couple of 2–3% dips this year, but there have been 5–10% pullbacks among cyclical sectors.

It may be time to begin to buy some of the laggard cyclicals, especially on any pullback in the overall market.

Will stocks have a pullback? Eventually sure—but when? This past Friday, May 10, 2013 marked 176 days since a 5%+ pullback in the S&P 500, tying the record for stretches without a pullback in this 50-month-old bull market [Figure 1], so it may be close. Also, in the spring of each of the past three years, a stock market slide of 10–19% began, and the S&P 500 is about 11% above the 200-day moving average, as it was ahead of each of those slides. These indicators suggest the stock market may be due for a pause or a pullback.

1 Current Rally Is Tied for Longest of Current Bull Market



Source: LPL Financial, Bloomberg data 05/13/13

The S&P 500 is an unmanaged index, which cannot be invested into directly. Past performance is no guarantee of future results.

Of course, as with almost every week, there are a number of catalysts this week that could prompt a stock market slide. This week's potential catalysts include:

- The return of fiscal cliff worries, as the tough talk over the debt ceiling may begin again as we cross the May 19 expiration of the debt limit this week;
- This week's economic releases may renew concerns that China's growth is slowing and the European recession is broadening and deepening; and
- A jump in geopolitical risk stemming from North Korea and Syria could surprise the markets with oil prices already elevated.

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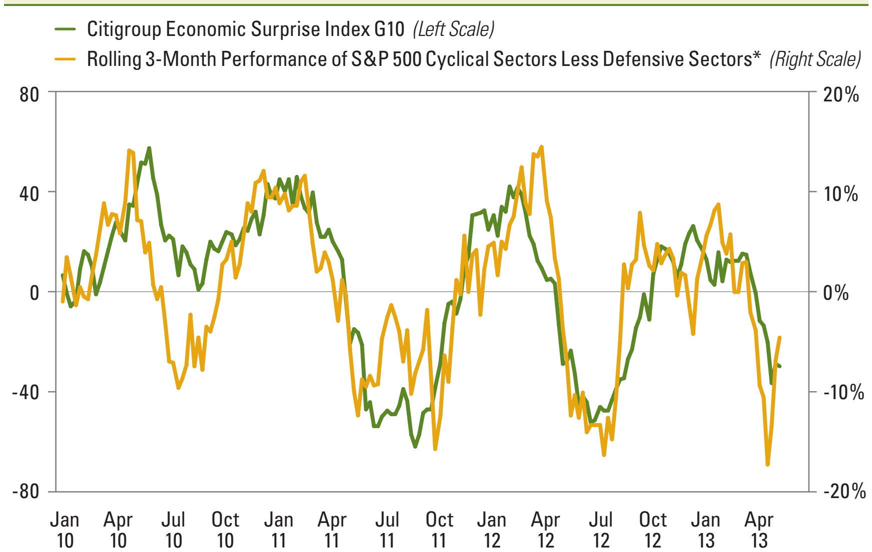
The data may now be signaling a meaningful and durable shift in the market favoring the more economically sensitive sectors that we call "cyclicals."

Investing is about being prepared and taking calculated risks. How do we invest if we do not get a pullback—or perhaps even more importantly—what do we buy when the pullback occurs?

So far this year, "defensive" stocks—those that are less sensitive to economic growth—such as those in the health care and consumer staples sectors, have led the markets higher, and they historically outperform more economically sensitive sectors during a pullback. However, the data may now be signaling a meaningful and durable shift in the market favoring the more economically sensitive sectors that we call "cyclicals," which includes technology, industrials, consumer discretionary and materials.

The Citigroup Economic Surprise Index for the 10 major world economies tracks how data are faring compared to expectations. It rises when economic data come in better than economists' estimates and falls when it is worse. This index may have stopped the plunge seen in recent months and started to stabilize—the economic activity reflected in the data has not improved much, but economists' expectations may finally be low enough. Historically, when economic data are weaker than expected, investors tend to favor defensive stocks, since they are more insulated from the pace of economic activity, and when data exceed expectations they favor cyclicals. The very tight relationship between the economic surprises and the performance of cyclicals suggests cyclicals may be starting to make a comeback relative to more defensive sectors [Figure 2].

2 Economic Data Surprises May Point to a Revival for Cyclicals



Source: LPL Financial Research 05/13/13

*Cyclical Sectors: Technology, Industrials, Materials, Consumer Discretionary; Defensive Sectors: Utilities, Telecommunications, Health Care, Consumer Staples

Note: A declining line means the economic data are weaker than expected. A rising line indicates data are stronger than expected.

All indexes mentioned are unmanaged and you cannot invest into them directly.

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

The Citigroup Economic Surprise Index is unmanaged and you cannot invest into directly.

The overall stock market has only seen a couple of 2–3% dips rather than a 5–10% pullback this year, but that does not mean there have not been any 5–10% pullbacks within specific sectors. There have been 5–10% pullbacks this year in cyclicals such as homebuilders, technology, and even overseas in emerging market stocks. It may be time to begin to buy some of the laggard cyclicals, especially on any pullback in the overall market. ■

The Consumer Discretionary Sector: Companies that tend to be the most sensitive to economic cycles. Its manufacturing segment includes automotive, household durable goods, textiles and apparel, and leisure equipment. The service segment includes hotels, restaurants and other leisure facilities, media production and services, consumer retailing and services, and education services.

Consumer Staples Sector: Companies whose businesses are less sensitive to economic cycles. It includes manufacturers and distributors of food, beverages and tobacco, and producers of non-durable household goods and personal products. It also includes food and drug retailing companies.

Health Care Sector: Companies are in two main industry groups—Health care equipment and supplies or companies that provide health care-related services, including distributors of health care products, providers of basic health care services, and owners and operators of health care facilities and organizations. Companies primarily involved in the research, development, production, and marketing of pharmaceuticals and biotechnology products.

Industrials Sector: Companies whose businesses manufacture and distribute capital goods, including aerospace and defense, construction, engineering and building products, electrical equipment and industrial machinery. Provide commercial services and supplies, including printing, employment, environmental and office services. Provide transportation services, including airlines, couriers, marine, road and rail, and transportation infrastructure.

Materials Sector: Companies that are engaged in a wide range of commodity-related manufacturing. Included in this sector are companies that manufacture chemicals, construction materials, glass, paper, forest products and related packaging products, metals, minerals and mining companies, including producers of steel.

Technology: Companies include those that primarily develop software in various fields such as the Internet, applications, systems and/or database management and companies that provide information technology consulting and services; technology hardware & Equipment, including manufacturers and distributors of communications equipment, computers and peripherals, electronic equipment and related instruments, and semiconductor equipment and products.

Telecommunications Services Sector: Companies that provide communications services primarily through a fixed line, cellular, wireless, high bandwidth and/or fiber-optic cable network.

Utilities Sector: Companies considered electric, gas or water utilities, or companies that operate as independent producers and/or distributors of power.

INDEX DESCRIPTIONS

Citigroup Economic Surprise Index (CESI) measures the variation in the gap between the expectations and the real economic data.

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.

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