



Weekly Market Commentary

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Lame Duck Could Move Markets

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Highlights

While the major headlines are out of the way, what happens in Washington during the remainder of the year will still hold influence over the markets.

The most important item facing Congress is the looming expiration of the Bush tax cuts. We expect an extension of the tax cuts (including the dividend tax cut) will be passed before the end of the year.

Last week's performance may be a sign that investors may begin to migrate from high-yield bonds toward high dividend-paying stocks, possibly ending the U.S. equity buyers strike.

The long-awaited events of last week included the mid-term elections and Federal Reserve (Fed) announcing the details of another stimulus program. Stock market momentum had stalled out in the two weeks leading up to last week as investors held their breath awaiting the outcome. The events unfolded just as the markets had anticipated and mostly priced in during the double-digit gain in the S&P 500 that took place during September and October. As investors breathed a sigh of relief last week, the stock market posted a solid 3.5% gain resulting in a new two-year high in the S&P 500 as pent-up demand for stocks was invested.

While the major headlines are out of the way, what happens in Washington during the remainder of the year will still hold influence over the markets. Some of the lame duck agenda items with potential market-moving impact include the expiration of unemployment benefits, government funding, and the Bush tax cuts.

Extended unemployment benefits will expire at the end of November if Congress fails to renew them in the coming weeks. People who exhaust their 26 weeks of regular state unemployment benefits can then receive up to 73 weeks of federally funded benefits, for a total of 99 weeks in high-unemployment states. This summer, when the emergency benefits were last renewed, Republicans temporarily allowed extensions to expire for nearly two months. They objected to the extension because the cost to do so was not offset by other spending cuts and therefore added to the federal deficit, in violation of the pay-as-you-go rules. Since Republicans gained seats in the Senate last week, it could be even tougher to pass a renewal of the program potentially leaving millions without benefits during the peak consumer spending holiday season, posing risks to retailers and overall economic growth.

Before the mid-term elections, Congress passed a resolution funding the government until December 3, setting up a showdown over spending in the lame duck session. Also, the fiscal commission established by President Obama is due to report on December 1. There are indications that leading Democrats on the panel are seeking to present major changes to Social Security intended to ensure the program is solvent for the long run.

The most important item facing Congress is the looming expiration of the Bush tax cuts. Congress is likely to address the tax cuts in some way. Both parties risk a huge backlash if no action is taken and all tax rates revert to higher levels, which puts pressure on the 70% of the economy that is driven by consumer spending. This is a concern given that current economic



S&P Sector Performance for the Week of 11/1 – 11/5

S&P 500 Sector	Performance
Financials	6.94
Energy	5.09
Materials	4.32
Industrials	3.75
Consumer Discretionary	3.61
Information Technology	3.36
Telecom Services	2.55
Consumer Staples	1.39
Utilities	1.05
Health Care	0.92

Source: Bloomberg data

growth is already sluggish. We continue to believe it is likely that Congress will pass a one or two-year extension of all the Bush tax cuts during the lame duck session, but admit it is a close call.

The potential for extending the dividend tax rate at 15% (as opposed to reverting up to 39.6% for the top bracket) and the ability of the companies in the Financials sector to boost dividend payouts made the sector the best performer last week. Financial companies that received TARP money must get regulatory approval to boost their dividend which may soon be forthcoming. The first quarter of the year has traditionally been when companies announce increases to their dividend payments. Last week, the Energy, Materials, and Industrials sectors benefitted from the Fed's actions on Wednesday that weakened the dollar.

Investors' appetite for yield has prompted strong inflows into the high-yield bond market this year. Perhaps last week's performance is a sign that investors may migrate from high-yield bonds toward high dividend-paying stocks, possibly ending the U.S. equity buyers' strike that has resulted in outflows from U.S. equity mutual funds every week during the second half of 2010. We will be watching money flows closely to see how they react to the changes in Washington.

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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.

High-Yield/Junk Bonds are not investment-grade securities, involve substantial risks, and generally should be part of the diversified portfolio of sophisticated investors.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and are subject to availability and change in price.

Stock investing may involve risk including loss of principal.

Energy Sector: Companies whose businesses are dominated by either of the following activities: The construction or provision of oil rigs, drilling equipment and other energy-related service and equipment, including seismic data collection. The exploration, production, marketing, refining and/or transportation of oil and gas products, coal and consumable fuels.

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.



Financials Sector: Companies involved in activities such as banking, consumer finance, investment banking and brokerage, asset management, insurance and investment, and real estate, including REITs.

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.

Manufacturing Sector: Companies engaged in chemical, mechanical, or physical transformation of materials, substances, or components into consumer or industrial goods.

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 Software & Services Sector: 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.

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