CHART BOOK

LPL Financial

The New Growth Engine

The gauges say the growth engine for the U.S. economy and markets is changing.
Monetary policy is powering down, business fundamentals are powering up, and fiscal policy and economic growth are on the verge of being taken off standby.

Key Themes

Monetary policy
POWERING DOWN

Slow path to normalization.
Maintaining economic growth without extraordinary central bank support will be key.

Economic growth
ON STANDBY

Confidence not enough, yet.
Business and consumer confidence has improved, but greater policy clarity may be needed to spur growth.

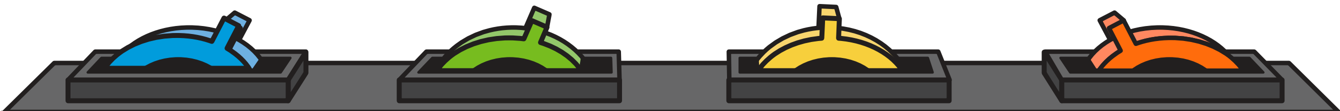
Business fundamentals
POWERING UP

Now taking control.
A focus on well-run businesses with the potential for earnings gains may favor active management.

Fiscal policy
ON STANDBY

Pro-growth potential, but when?
Fiscal policy support remains likely, but timetable may be pushed back to 2018.

Active management involves risk as it attempts to outperform a benchmark index by predicting market activity, and assumes considerable risk should managers incorrectly anticipate changing conditions.



Forecasts @ A Glance

Economy

Near 2.5% GDP Growth

Despite a weak first quarter, we still see U.S. gross domestic product (GDP) growth approaching our 2017 forecast of 2.5%, with potential for further acceleration in 2018. The recent improvement in job growth, with only moderate wage pressure, may allow for consumption growth without the need for an accommodative central bank. Meanwhile, anticipated fiscal legislation may provide further incentives for businesses to invest in the future. Policy uncertainty remains a concern, and greater clarity will be needed to convert increased confidence into economic activity. Improvements in productivity remain the key to better growth and the recent pickup in business spending is a positive development.

Stocks

6–9% Returns

As investors increasingly trust that the economy can stand on its own without the need of monetary policy support, business fundamentals should take over as the primary market driver. As a result, corporate profits will be increasingly important for stocks. Our confidence that earnings growth will come through over the balance of the year has led us to slightly raise our 2017 S&P 500 Index forecast to 6–9%, up from mid-single-digits previously, driven by: 1) a pickup in U.S. economic growth; 2) mid- to high-single-digit earnings gains; 3) a stable price-to-earnings ratio (PE) of 19–20; and 4) prospects for a fiscal policy boost to earnings in 2018.

International

Emerging over Developed

We are seeing improvements in fundamentals, both economically and in corporate earnings, across international markets. At this point, we prefer emerging markets (EM) to developed ones due to faster growth rates and lower valuations. Furthermore, there are still some political milestones yet to go in Europe, like Italian and German elections, as well as the European Central Bank's plan to extend its quantitative easing policy. There is stable growth in most of the emerging market economies, though we remain conscious of risks, most notably the Chinese debt problem.

Bonds

Limited Return Potential

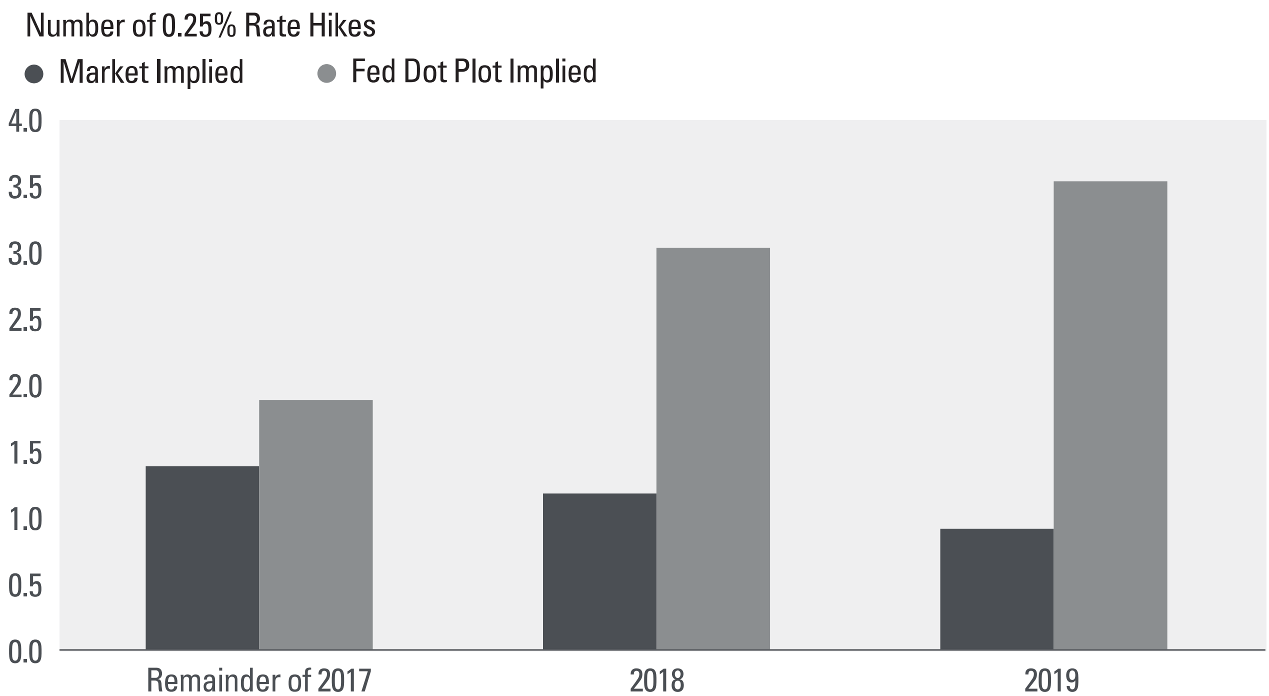
We continue to believe that government policy, central bank policy, and steady economic growth have the potential to push the 10-year Treasury yield higher, and that our year-end target of between 2.25% and 2.75% remains reasonable. Our bias is toward the upper end of the range, and we could see the 10-year Treasury yield rise as high as 3%, should Congress make meaningful progress toward enacting fiscal stimulus. Scenario analysis based on this potential interest rate range indicates low- to mid-single-digit returns for the Bloomberg Barclays Aggregate Bond Index. Despite our expectation for stability in credit markets, tight spreads versus long-term averages limit return potential and warrant caution for investors.

Given the environment we expect over the second half of 2017, our preferred investments include:

U.S. Small Cap Stocks	U.S. small caps have benefited from accommodative monetary policy and may benefit from fiscal policy changes, though valuations are stretched.
Emerging Markets (EM)	Near-term catalysts (global growth, monetary policy) and longer-term trends (six billion consumers) offer opportunities.
Cyclical Sectors	**Technology** is positioned to benefit from continued solid earnings growth as business investment potentially picks up and drives higher productivity. **Industrials** may benefit from potential spending on defense and infrastructure projects and stronger global demand. **Financials** should benefit from deregulation that may free up capital for lending and dividends, while tighter monetary policy may help profitability.
Master Limited Partnerships	The Trump administration's stance on energy deregulation is supportive; yields remain very attractive but introduce interest rate risk.
Investment-Grade Corporates	We continue to find relative value in investment-grade corporate bonds given continued strength in credit markets and the yield premium over Treasuries.
Mortgage-Backed Securities (MBS)	Among high-quality bonds, MBS continue to offer an attractive trade-off between yield and interest rate risk.
Bank Loans	Attractive yields and coupon payments that adjust with short-term rates make bank loans less likely to suffer price declines as rates rise.

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

Federal Reserve (Fed) Expects Gradual Rate Hikes: Market Expects Even Slower

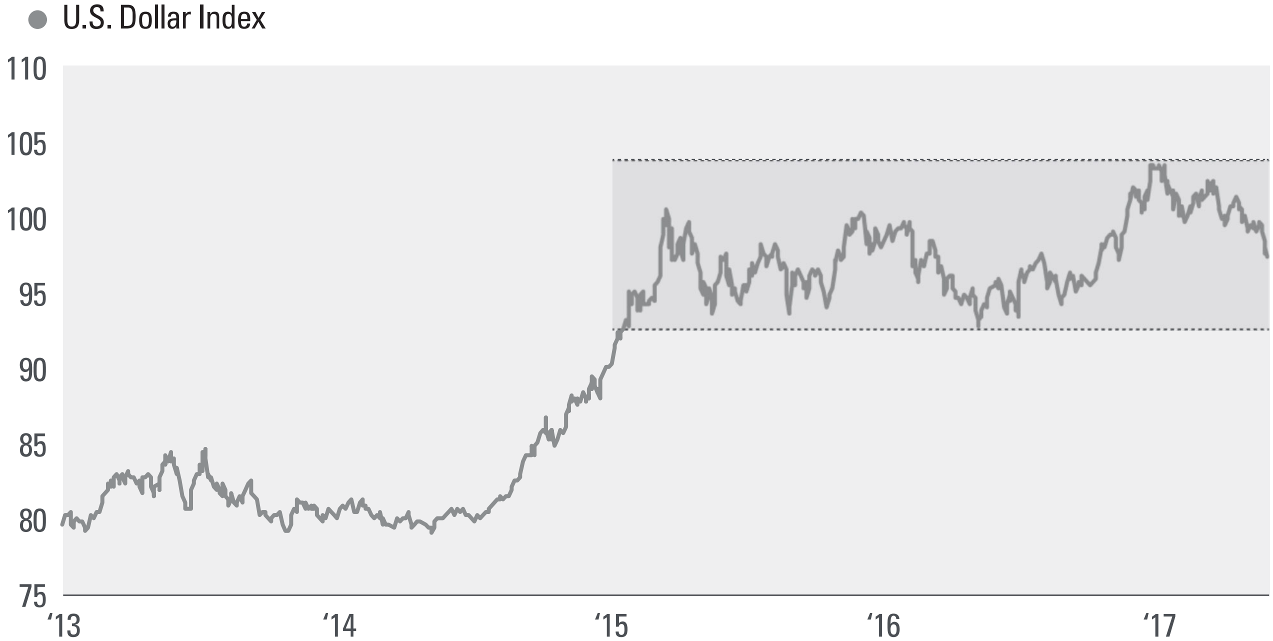


Source: LPL Research, Federal Reserve, Bloomberg 05/19/17

Market implied rate hike expectations are calculated based on the pricing of various fed funds futures contracts.

Fed Dot Plots are predictions of the fed funds rate by Federal Open Market Committee (FOMC) participants plotted in a chart.

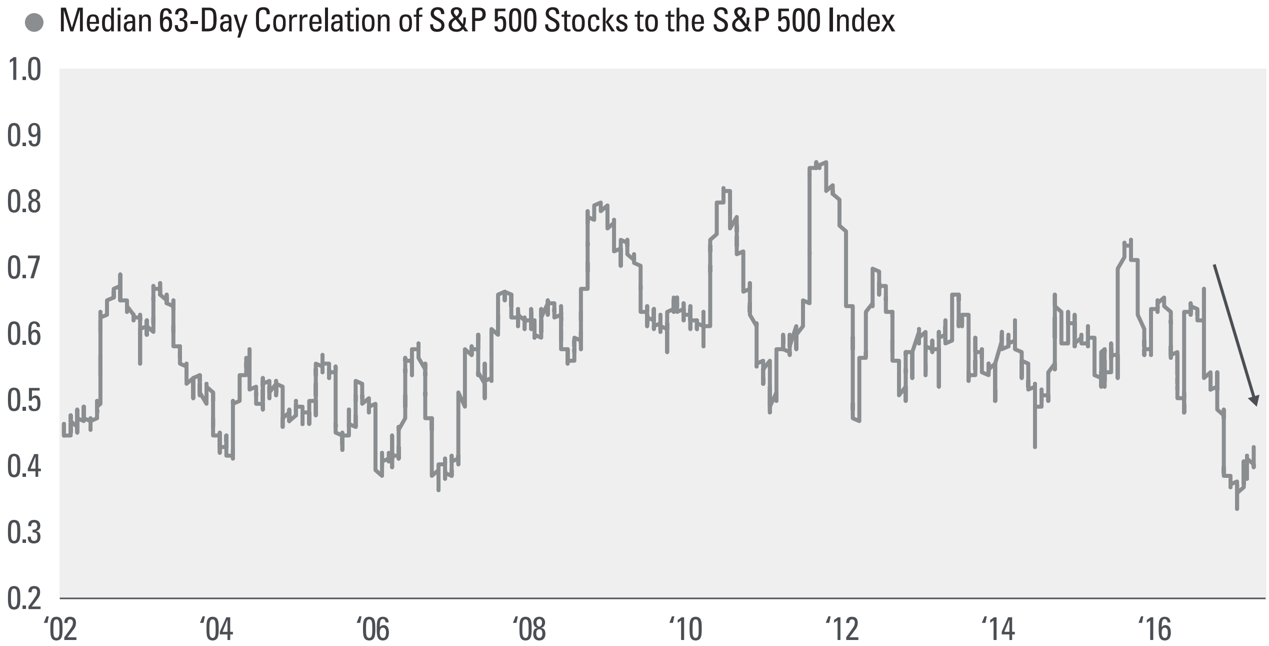
The U.S. Dollar Has Been Largely Range Bound Since 2015



Source: LPL Research, FactSet 05/19/17

Currency risk is a form of risk that arises from the change in price of one currency against another. Whenever investors or companies have assets or business operations across national borders, they face currency risk if their positions are not hedged.

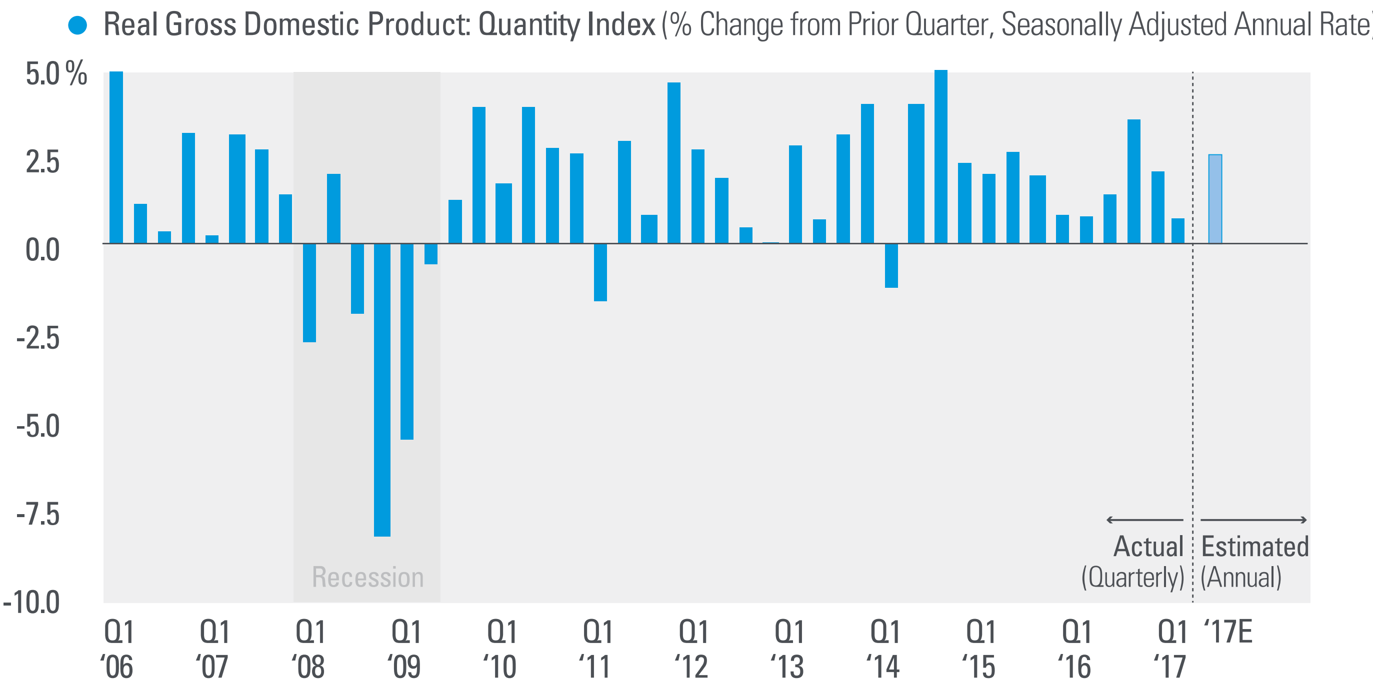
Lower Correlations and More Dispersion May Mean Opportunity



Source: LPL Research, Ned Davis Research 05/19/17

Correlation ranges between -1 and +1. Perfect positive correlation (a correlation co-efficient of +1) implies that as one security moves, either up or down, the other security will move in lockstep, in the same direction. Alternatively, perfect negative correlation means that if one security moves in either direction the security that is perfectly negatively correlated will move in the opposite direction. If the correlation is 0, the movements of the securities are said to have no correlation; they are completely random.

Expect a Slight Pickup in U.S. Economic Growth in 2017

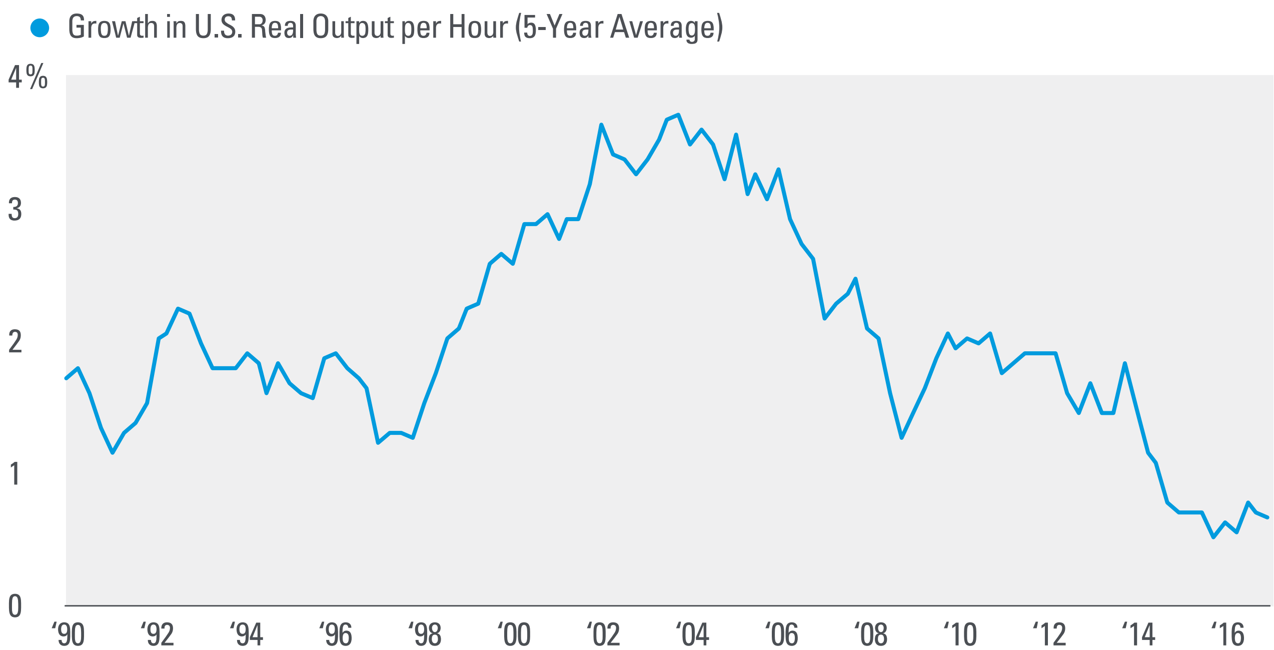


Source: LPL Research, U.S. Bureau of Economic Analysis 05/19/17

Shaded areas indicate recession.

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.

Growth Needs a Productivity Injection



Source: LPL Research, Bureau of Labor Statistics 05/19/17

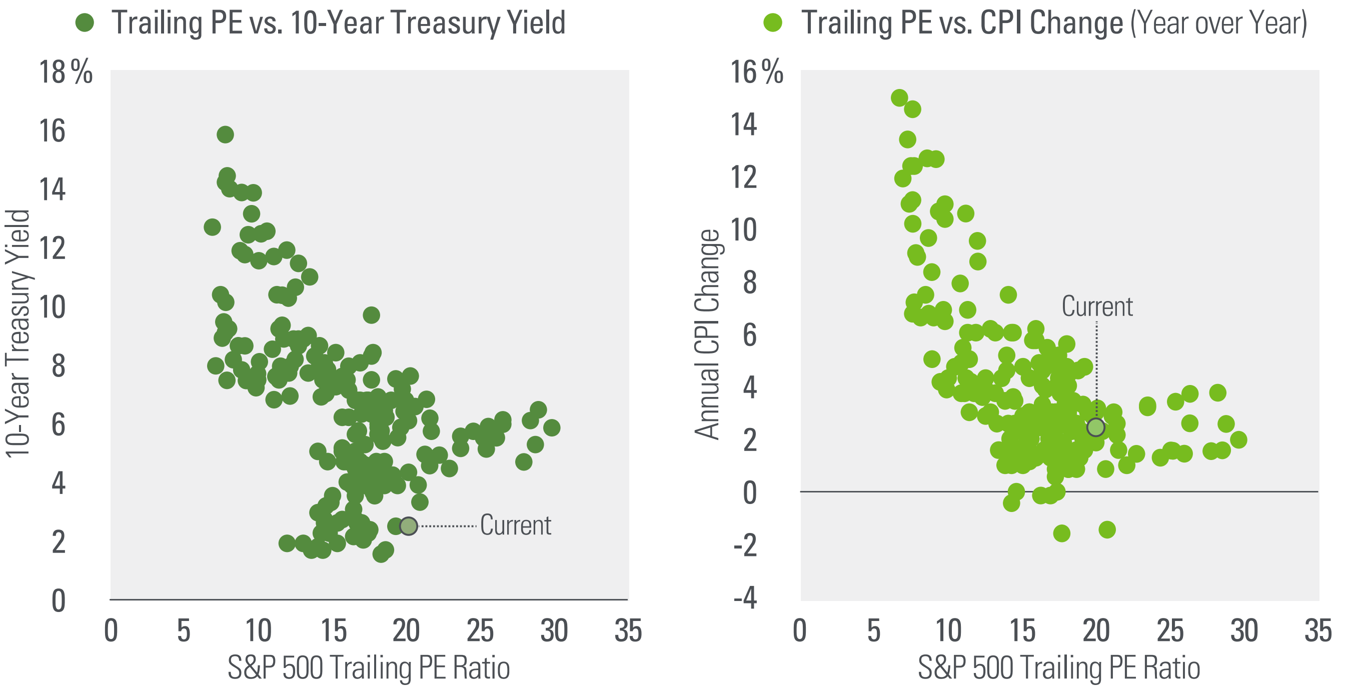
Earnings Shifting to Higher Gear

Source: LPL Financial, Thomson Reuters 05/19/17

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. All performance referenced is historical and is no guarantee of future results. Estimates may not develop as predicted.

Higher Valuations Have a Fair Amount of Support

Lower Inflation and Lower Interest Rates Have Historically Correlated to Higher Price-to-Earnings Ratios



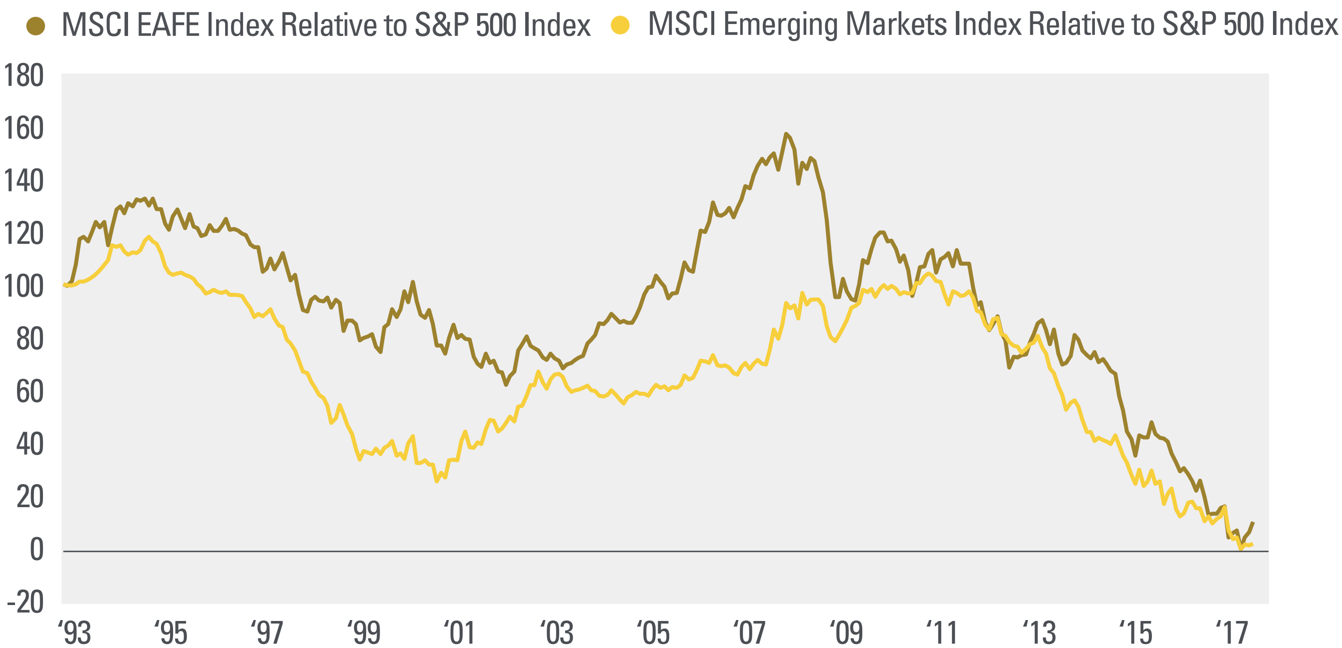
Source: LPL Research, FactSet, Thomson Reuters, Haver Analytics 05/19/17

Data are monthly going back to 1962.

The PE 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 PE ratio means that investors are paying more for each unit of net income, so the stock is more expensive compared to one with lower PE ratio.

Consumer price inflation is the retail price increase as measured by a Consumer Price Index (CPI).

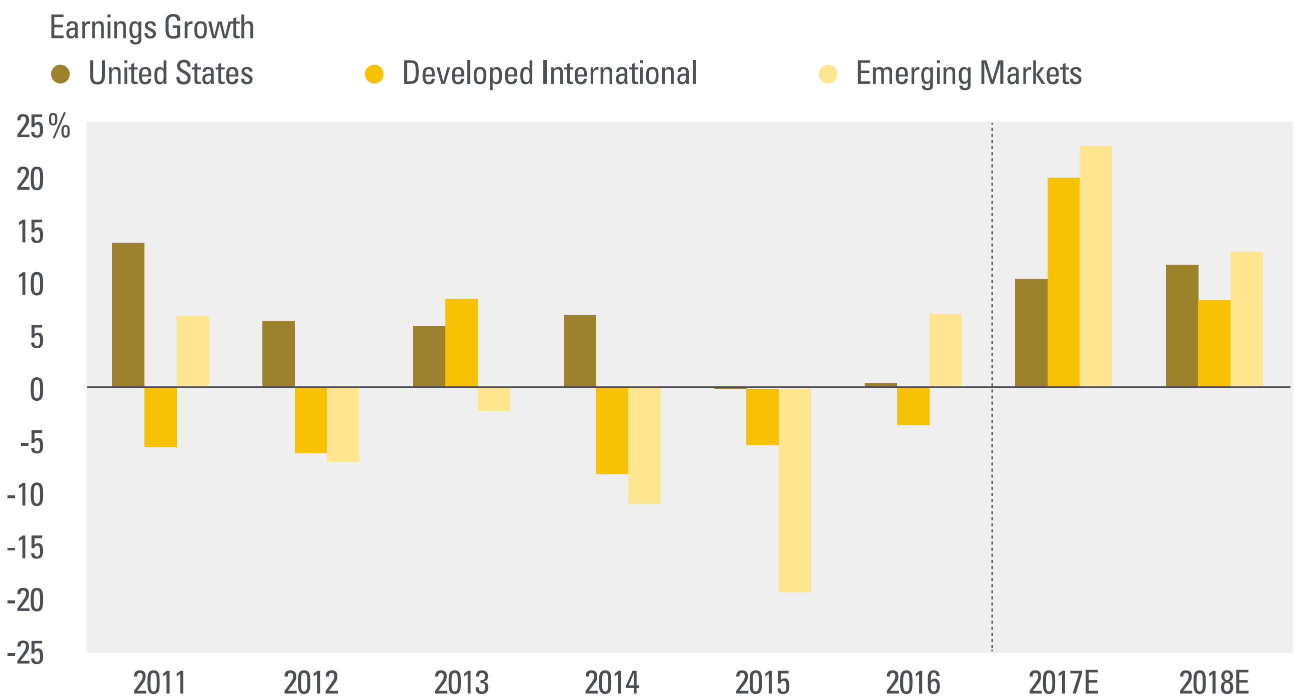
International Performance Runs in Cycles



Source: LPL Financial, FactSet 05/19/17

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.

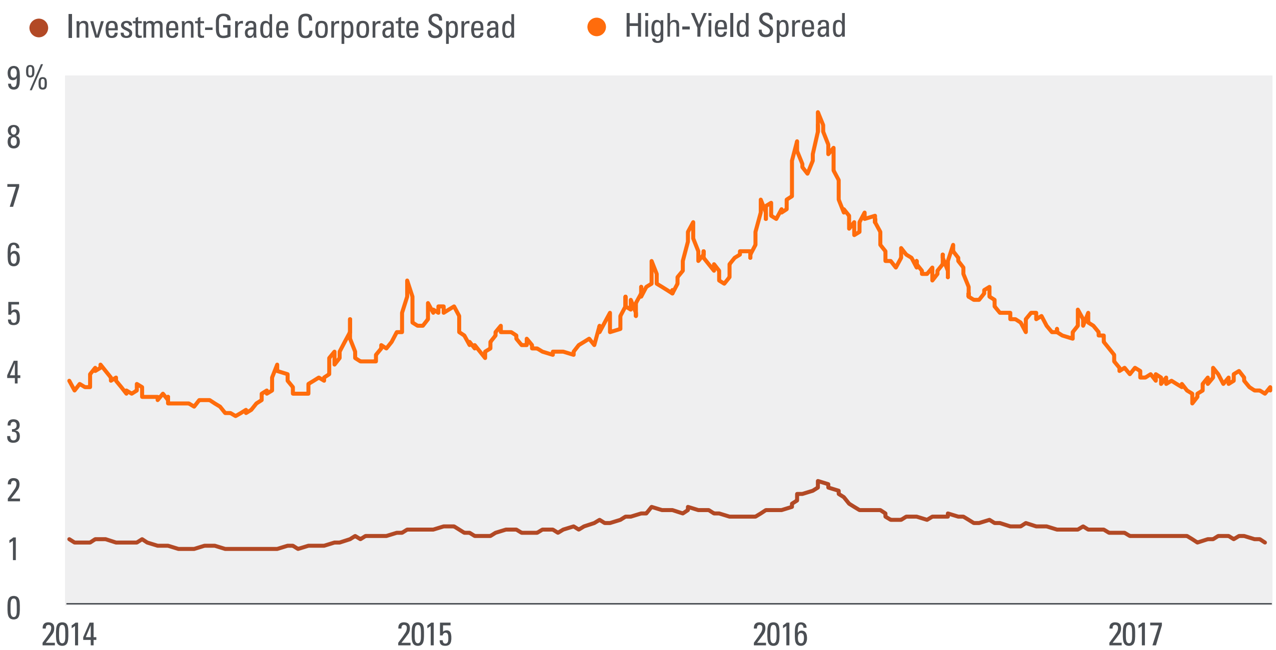
Earnings Boost: Not Just a U.S. Story



Source: LPL Research, FactSet 05/19/17

Earnings forecasts are based on Thomson Reuters and FactSet consensus.

Credit Gauges Are Signaling Confidence in Credit Markets, but Expensive Valuations

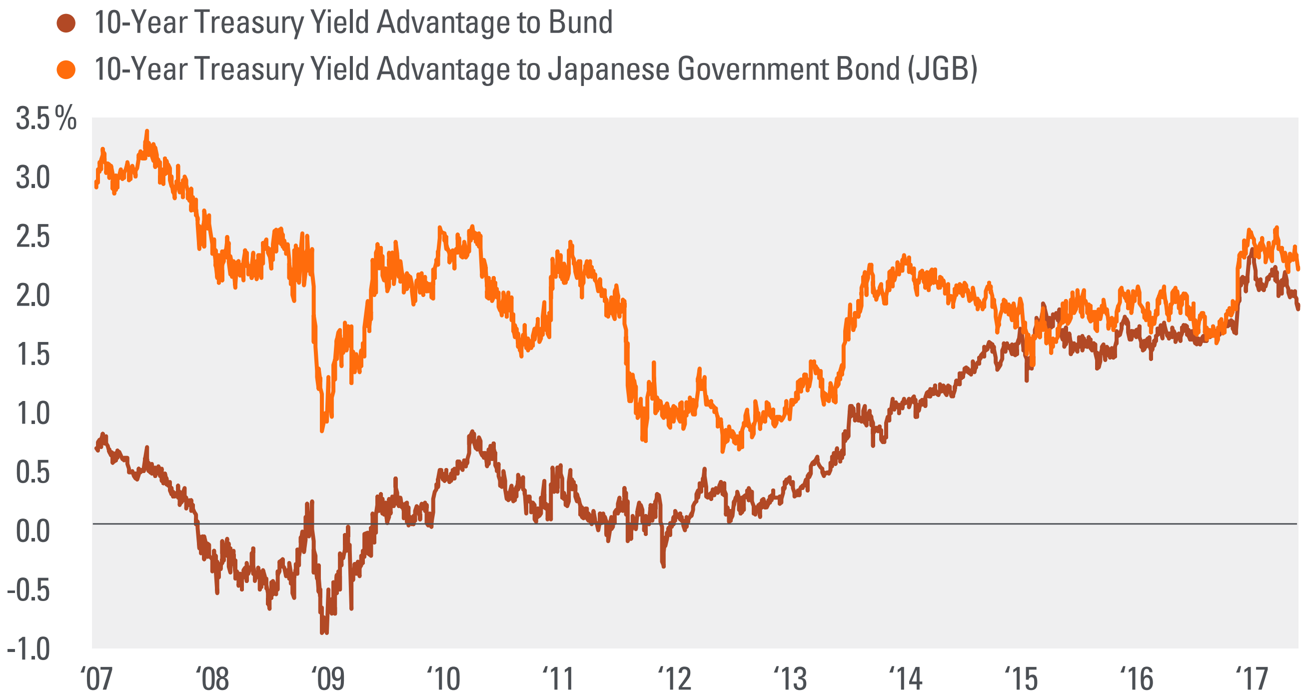


Source: LPL Research, Bloomberg 05/19/17

High-Yield spread is the yield differential between the average yield of high-yield bonds and the average yield of comparable maturity Treasury bonds.

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

Treasuries Showing Power Relative to German Bund and JGB



Source: LPL Research, Bloomberg 05/19/17

Investing in foreign and emerging markets debt securities involves special additional risks. These risks include, but are not limited to, currency risk, geopolitical and regulatory risk, and risk associated with varying settlement standards.

Striving To Efficiency

The gauges say the growth engine for the U.S. economy and markets is changing. We can see monetary policy powering down, business fundamentals powering up, and fiscal policy and economic growth on standby.

The Fed has shown increasing trust that the economy has recovered and that market forces can keep it steady. Consequently, we look for fiscal policy to supplement corporate profits as the market's next drivers.

With this in mind, it is important for investors to appreciate the implications of a new stock market driver. Much like a portfolio can benefit from diversification, the economy and markets can benefit from different drivers working at different times.

Click here to read the full publication: *Midyear Outlook: A Shift In Market Control*. We hope it will enable you to identify opportunities that may arise, navigate the challenges that will inevitably come, and help you stick to your long-term investing plan.

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. All performance referenced is historical and is no guarantee of future results. All indexes are unmanaged and cannot be invested into directly.

Economic forecasts set forth may not develop as predicted, and there can be no guarantee that strategies promoted will be successful.

Investing in stock includes numerous specific risks including: the fluctuation of dividend, loss of principal, and potential liquidity of the investment in a falling market.

There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not ensure against market risk.

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.

Government bonds and Treasury bills are guaranteed by the U.S. government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value. However, the value of fund shares is not guaranteed and will fluctuate.

Mortgage-backed securities are subject to credit, default, prepayment risk that acts much like call risk when you get your principal back sooner than the stated maturity, extension risk, the opposite of prepayment risk, 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.

Investing in MLPs involves additional risks as compared with the risks of investing in common stock, including risks related to cash flow, dilution, and voting rights. MLPs may trade less frequently than larger companies due to their smaller capitalizations, which may result in erratic price movement or difficulty in buying or selling. MLPs are subject to significant regulation and may be adversely affected by changes in the regulatory environment, including the risk that an MLP could lose its tax status as a partnership. Additional management fees and other expenses are associated with investing in MLP funds.

INDEX DEFINITIONS

The U.S. Dollar Index (DXY) indicates the general international value of the U.S. dollar. The DXY Index does this by averaging the exchange rates between the U.S. dollar and six major world currencies.

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 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 ARM pass-throughs), ABS, and CMBS (agency and non-agency).

The Bloomberg Barclays U.S. Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes U.S. dollar-denominated securities publicly issued by U.S. and non-U.S. industrial, utility and financial issuers.

The Bloomberg Barclays U.S. Corporate High Yield Bond Index measures the U.S. dollar-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on Barclays EM country definition, are excluded.

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

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 United States and Canada.

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