



OUTLOOK 2016

EMBRACE
THE
ROUTINE

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ROUTINE

What Defines a Routine?

LPL Financial
Research Dept.
November 2015
Re: Outlook 2016

When you think of a routine, what is the first thing that comes to mind? Some may think, it's the mundane, the small steps and processes you follow to accomplish all your tasks for the day. But routine is more than that. It's about forming good habits, feeling prepared. And perhaps the best part of a routine is the comfort that comes from knowing what to expect. For investors, the definition of a good routine would be knowing what to expect from the markets.

Is there such thing as a routine year for markets? Over the last 50 years, the S&P 500 Index grew at an average of about 10% a year, but its return was between 0% and 20% in any single year less than half the time. We haven't witnessed a price return of 6–11%, a range that might be considered typical for markets, since 1992, over 20 years. And even when there was a year in the routine 10–20% range, there were other things going on in the markets that made the year feel anything but routine. Yields may have been extraordinarily low, or extraordinarily high. Commodities were booming, or collapsing. There really is no such thing as a routine year for markets. However, your financial advisor and LPL Research's *Outlook 2016* can help you prepare for what we may see in the year ahead.

Incoming

Knowing What to Expect

LPL Research expects to see routine year-end outcomes in many areas of the economy and financial markets in 2016, but how we get there may be anything but routine. Certain conditions have been unusual for so long, that 2016 may hold some unexpected turns that could catch some investors unprepared, and it will take a solid investment plan to navigate it.

Some of our expectations, as we follow what may be an unfamiliar path for 2016, include:

❖ **U.S. economic growth of 2.5–3%.** However, the mix of that growth may look different than in 2015, with manufacturing, business capital spending, and net exports taking larger roles. Labor markets are almost back to long-term expectations, and inflation may be poised to accelerate. An extraordinary extended period of loose monetary policy in the United States should start to normalize.

❖ **Mid-single-digit returns for the S&P 500.** Stocks, we believe, will not collapse, as many think, or soar, as many hope, but may offer near historical routine returns. Earnings may start to normalize, and oil markets should find their equilibrium. International markets may re-emerge as a more viable investing opportunity. But we are still in the second half of the economic cycle, and investors need to be vigilant about monitoring pockets of volatility and potential signs of an economic downturn.

❖ **Limited returns for bonds.** The year as a whole may look similar to 2015, with bond prices facing the challenges of high valuations, steady economic growth, and the prospect of interest rate hikes. But bonds still play a vital role in investors' portfolios, to help with risk mitigation and diversification.

For some investors, progress toward their financial goals has been hurt by breaking with well-considered investing routines in response to one of the most maligned bull markets in history. LPL Research's *Outlook 2016* will help investors stick to their routines in the face of developments that may seem anything but routine. By maintaining our investment process, we can focus on what matters most to markets, block out short-term distractions that will quickly fade, and turn a good daily routine into the potential for successful long-term performance.

2016

AT A GLANCE

YEARLY PLANNER

DON'T FORGET!

HOW TO INVEST

Notes on Recommendations & Investment Insights

KEY THEMES TO WATCH

✓ Fed Tightening Cycle

We expect the Fed to begin a tightening cycle for the first time in over 10 years in December 2015 or early 2016. Although this may signal that the Fed believes the U.S. economy is ready to stand on its own two feet, likely providing a positive backdrop for stocks, it may also increase volatility. Expected policy divergence among major global central banks should help support global growth while also potentially creating investment opportunities.

✓ Stabilizing Oil Prices

We believe that oil prices may begin to stabilize in 2016 with a bias to the upside as supply and demand continue to move into balance. Greater stability would help support U.S. economic growth by encouraging capital spending and would impact a wide range of asset classes beyond direct energy-related investments, including emerging market stocks and high-yield bonds.

✓ Earnings Rebound

As the headwinds that have restrained earnings begin to subside, including falling oil prices, a strong U.S. dollar, manufacturing weakness, and slowing growth in China, we believe earnings growth will accelerate. Resumption of earnings growth is key to stock market performance in 2016 and we expect it to be the foundation of another year of positive returns.

ECONOMY

2.5-3% GROWTH

Manufacturing, business capital spending, and net exports are expected to take larger roles in U.S. economic growth, with continued support from consumer spending.

STOCKS

MID-SINGLE-DIGIT RETURNS

Driven by mid- to high-single-digit earnings gains, stocks may produce modest positive returns in 2016 typical of the mid-to-late stage of the business cycle.

BONDS

FLAT RETURNS

Still high valuations, low yields, and the prospect of Fed rate hikes translate to another challenging return environment.

THE 2016 AGENDA

We believe we are likely in the second half of the economic cycle, but 2016 may be the first typical mid-cycle year of the expansion. Planning around potentially increased volatility, rising interest rates, and improving global growth will help investors get back to that routine.

Things To Do Investment ideas worth adding to your calendar in 2016	Regularly Scheduled Fundamental ideas for your routine in 2016	Avoid Distractions Investment ideas that may slow down your momentum in 2016
Emerging Market Stocks ✓ Attractive valuations and likely boost from fiscal and monetary stimulus.	Large Cap U.S. Stocks - Well positioned for latter part of the business cycle and improving overseas growth.	U.S. Defensive Stocks X Defensive, income-oriented stocks may lag as the Fed raises interest rates.
Developed International Stocks ✓ Improving overseas growth and likely boost from more quantitative easing.	Cyclical Growth Stocks - Benefit from ongoing U.S. economic expansion and improving overseas growth.	Long-Term High-Quality Bonds X Low yields, expensive valuations, and greatest sensitivity to rising rates limit appeal.
Bank Loans ✓ Least sensitive to rising rates and may continue to benefit from low defaults and limited energy sector exposure.	Investment-Grade & High-Yield Corporate Bonds - Corporate bonds have historically held their value better during periods of rising rates and corporate balance sheets remain healthy.	Developed International Bonds X Lower yields compared to U.S. counterparts and currency risks make for an unattractive risk/reward.
Global Macro Alternative Strategies ✓ Current market environment—government and central bank policy divergence, with moderate volatility—should be helpful for these strategies.	Intermediate-Term Municipal Bonds - Longer-term valuations still attractive and limited growth of overall market may support prices.	Small Cap Stocks X Tend to do better earlier in the business cycle and benefit less from improved global growth.

ECONOMY

STOCKS

BONDS

NEW ROUTINE



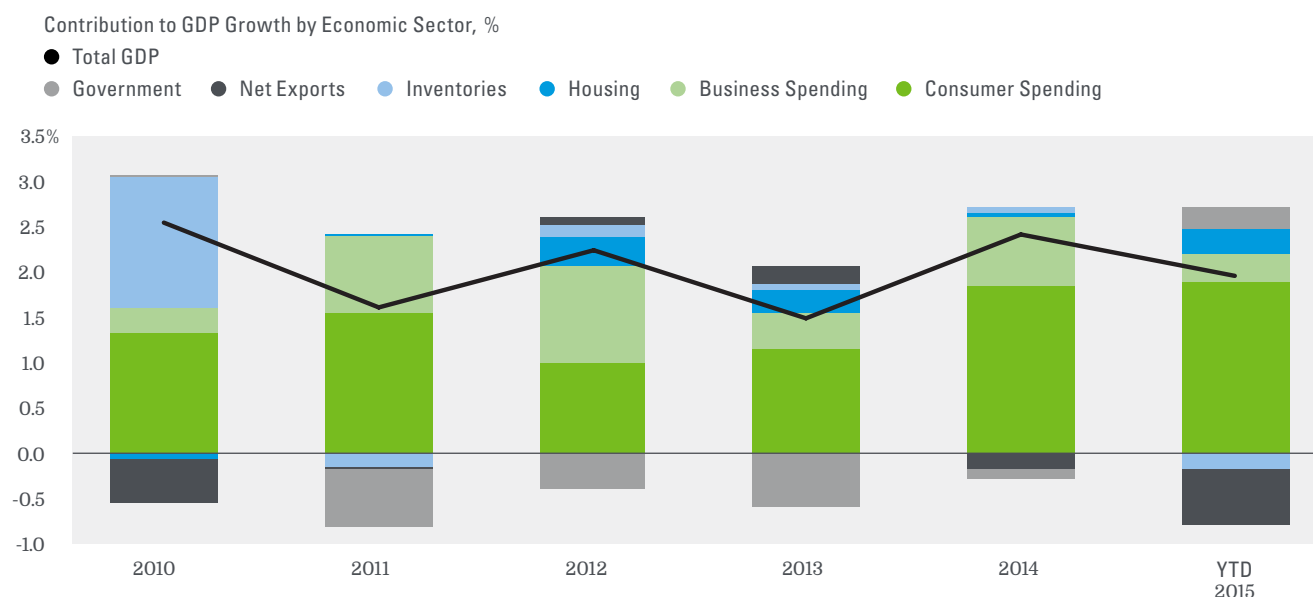
Steady Growth Ahead for U.S. and Global Economy

Our view is that the U.S. economy—as measured by real gross domestic product (GDP)—is likely to post growth of 2.5–3.0% in 2016, below its post-World War II average of 3.2%, but above the 2–2.5% average growth rate seen in the first six-and-a-half years of this expansion, based on the factors discussed below. Despite the length of the current expansion (already the fourth longest on record), it has not followed what would be considered a routine path. Supportive monetary policy from the Federal Reserve (Fed) has remained in place throughout the expansion; economic growth, while steady, has been below trend; and inflation, which often picks up near the middle of the cycle, remains near cycle lows. While we believe we are likely in the second half of the economic cycle, 2016 may be the first typical mid-cycle year of the expansion, and investors may need to figure out what it means to get back to that routine.

Returning to Our Typical Sources for Growth

As we plan ahead for 2016, the mix of economic growth may look a bit different than in 2015, with manufacturing, business capital spending, and net exports potentially taking larger roles. The manufacturing economy is stabilizing after a difficult 18-month period (mid-2014 to late 2015) and may accelerate further. The housing sector is expected to contribute to growth for the sixth consecutive year, and the consumer sector may continue adding to growth, benefiting from low energy prices, record levels of household net worth, and still low consumer interest rates. Business capital spending struggled in late 2014 and throughout 2015 amid the collapse in oil prices and stronger U.S. dollar. We believe oil prices may move modestly higher as demand remains strong and, as we've started to see in 2015, supply comes down. Business capital spending may add to growth in 2016 as commodity prices stabilize [Figure 1].

1 ECONOMIC GROWTH HOLDING NEAR 2% DESPITE HEADWINDS



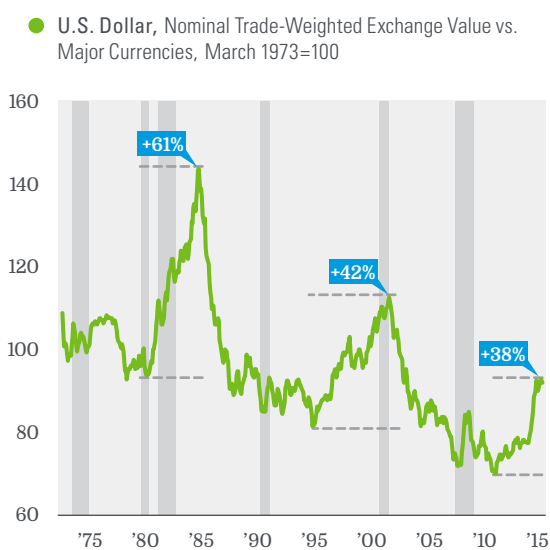
Source: LPL Research, U.S. Bureau of Economic Analysis 11/11/15
Data are as of 10/31/15.

The hallmark of this current economic expansion has been underinvesting, especially in research and development, and while we do not expect a boom in 2016, there is potential for some catch-up spending. Net exports, which were a sizable drag on growth in both 2014 and in the first three quarters of 2015, may stabilize as the dollar consolidates after the 20%+ gain between mid-2014 and mid-2015—matching the largest 12-month increase in the value of the dollar versus its major trading partners since the dollar went off the gold standard in the early 1970s [Figure 2]. We expect the dollar will begin to stabilize as central bank policies and the outcomes of those policies become clearer. A stabilizing dollar should help to boost exports and remove a key headwind for manufacturing and profits of U.S. corporations.

Continued Progress for Employment & Wages

We expect continued progress in the U.S. labor market in 2016, with the economy generating enough jobs to nudge the unemployment rate ever closer to the elusive “full employment” range, the level at which, in the past, businesses need to raise wages to attract and retain skilled employees. Wage growth has been limited but should continue to accelerate in 2016 [Figure 3]. This acceleration in wages—if not accompanied by better economic growth—may cause headaches for the Fed as it begins to normalize policy in 2016. We expect the Fed to begin raising rates in late 2015 or early 2016, with our focus on the pace of hikes throughout 2016 and beyond.

2 THE DOLLAR HAS SURGED THREE DIFFERENT TIMES OVER THE PAST 45 YEARS, INCLUDING IN 2014–15



Source: LPL Research, Federal Reserve Board, Haver Analytics 11/11/15
Shaded areas indicate recession.

Checking Off Inflation

Inflation remains in check, but commodity/goods inflation may be poised to make a comeback, which would help keep the Fed on schedule to begin raising rates. Since the middle of 2009, prices of services in the economy (as measured by the Consumer Price Index [CPI] for services) accelerated from under 1.0% to as high as 2.8% in early 2014, and then settled into a range of 2–2.5%. Prices of services (medical services, rents, etc.) account for over two-thirds of overall CPI, and history suggests that as the business cycle ages, and as the housing and labor markets tighten, service inflation may continue to accelerate. The Fed has to watch this closely.

However, the CPI for goods (prices of oil and other commodities purchased by consumers) sank along with oil prices from mid-2014 through late 2015. This kept the U.S. economy flirting with deflation (a prolonged period of falling wages and prices). Overall CPI posted a 2.1% year-over-year gain in mid-2014, and by the end of October 2015, the overall CPI was just 0.2%. Looking ahead to 2016, if oil prices move up as we expect, the goods portion of CPI may increase by 2–3%; and if the pace of service sector inflation remains between 2% and 2.5%, overall CPI will accelerate quickly and may be well over 2.0% by year-end. By then, the Fed will have already begun raising rates.

The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services, and is a commonly used measure of inflation.

3 WAGE PRESSURES ARE BEGINNING TO APPEAR FOR THE FIRST TIME IN THIS BUSINESS CYCLE, AND THE FED IS WATCHING



Source: LPL Research, Bureau of Labor Statistics, Haver Analytics 11/11/15
Average hourly earnings for production & nonsupervisory employees, total private industries
Shaded areas indicate recession.

Watching the Fed: Disruption or Distraction?

The start of a new Fed rate hike cycle may grab investors' attention in 2016, but investors must distinguish where it is more likely to disrupt their accustomed routine (bonds) and where it is more likely to be just a distraction (stocks). In addition, the market and the Fed remain deeply divided over the timing and pace of Fed rate hikes, and how that gap is resolved will determine the extent of the effects on the markets. As a reminder, the start of Fed rate hikes does not signal the end of economic expansions. Indeed, since 1950, the start of Fed rate hikes meant that the economy was still in the first half of the expansion.

We believe a rate hike in December 2015 remains a strong possibility. Our view remains that when the Fed does raise rates—likely in late 2015 or early 2016—that the timing of the first hike matters less than the pace

of the hikes; the end point for the fed funds rate in this tightening cycle (the first since 2004) and the gap between the Fed's own view of rates and the market's view remain crucial.

The Federal Open Market Committee's (FOMC) latest forecast of its own actions (September 2015) puts the fed funds rate at 1.375% by the end of 2016. As of November 23, 2015, the market (as defined by the fed funds futures market) puts the fed funds rate 0.50%–0.75% lower at around 0.81% by the end of 2016. How that gap closes—between what the market thinks the Fed will do and what the Fed is implying it will do—against the backdrop of what the Fed actually does, will be a key source of distraction for markets in 2016. Our view is that the Fed will hike rates in late 2015/early 2016, and by the end of 2016, push the fed funds rate into the 0.75–1.0% range.

Fiscal Stimulus Around the Globe

In the wake of the Great Recession (2007–09), governments across the globe, in both developed and emerging markets, increased fiscal stimulus (more government spending, tax cuts, or some combination of the two) to combat the worst global downturn in 75 years. As the global economy emerged from the Great Recession over the past half-decade or so, governments reined in—and in some cases, reversed—the fiscal stimulus put into place during and after the Great Recession, most notably in developed markets. In emerging

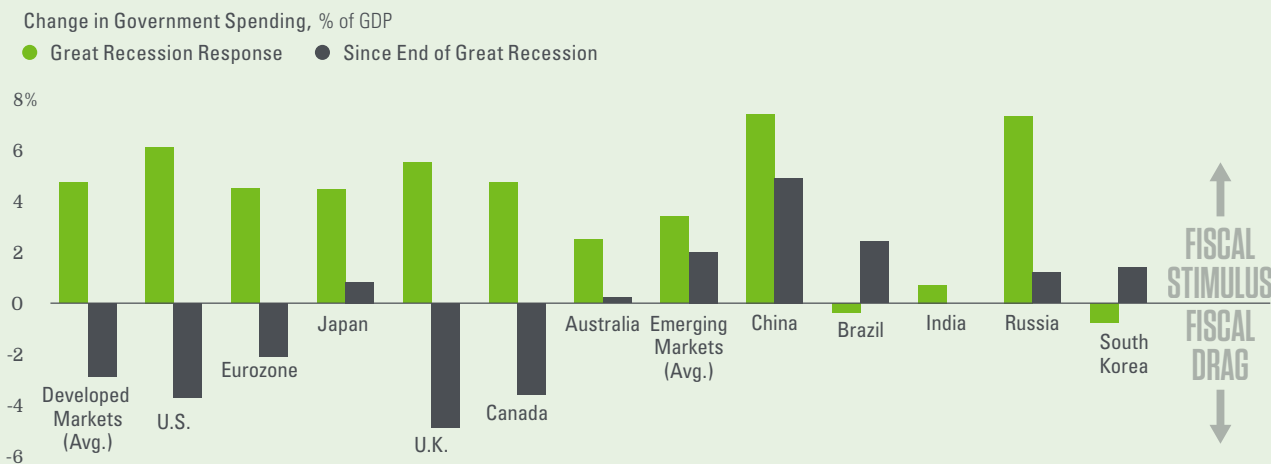
markets, fiscal stimulus continued, but at a slower pace than during the Great Recession, led by China [Figure 4].

Looking out to 2016, markets don't expect much in the way of fiscal stimulus in either developed or emerging economies. Thus, any stimulus that is enacted would likely be viewed as a positive surprise to markets looking for any boost to global growth.

Focusing on the U.S., outside of the major entitlement programs (Medicare, Medicaid, and Social Security), U.S.

fiscal policy at the federal level has been restrictive since the \$787 billion fiscal stimulus plan was enacted by Congress in 2009. While there is some historical evidence that fiscal stimulus picks up in an election year, historically, the odds of Congress passing meaningful fiscal stimulus that would impact growth before 2017 is low. However, the election of Paul Ryan (R-WI) as Speaker of the House in October 2015 increases the chances that market-friendly legislation is passed into law in 2016.

4 FISCAL STIMULUS SLOWING AROUND THE GLOBE SINCE THE GREAT RECESSION



Source: LPL Research, International Monetary Fund 11/11/15

Adding Global Growth to the Agenda

We believe that economic growth outside the U.S., in both developed and emerging economies, is likely to accelerate modestly in 2016, albeit from fairly low growth in 2015. A key differentiator is likely to be the role commodities play in a given economy. While economic growth in developed economies (generally commodity consumers) accelerated in 2014 and 2015, emerging market economies have, in aggregate, been decelerating since 2010. Though many factors are at play, China has an outsized role as the marginal consumer of commodities. While the U.S. economy is becoming increasingly sensitive to global matters, on balance, the U.S. economy is still among the least export sensitive of any major economy.

Among the largest developed market economies, we expect acceleration in the U.S. economy in 2016, and the Eurozone and Japanese economies are also set up for continued growth. The European economy is poised to post a third consecutive year of growth in 2016, marking the first time in eight years that the Eurozone has posted gains in three consecutive calendar years. Despite debt challenges in Greece and other peripheral countries, GDP growth forecasts have been revised higher for 2015 and 2016, and are expected to accelerate further in 2016. The European Central Bank's (ECB) introduction of quantitative easing (QE) in 2015 helped to thaw the European financial transmission mechanism, providing credit to smaller companies and contributing to positive growth prospects. The prospects for further monetary easing and low energy prices have been benefiting the economy and the equity markets.

Global Economies at a Glance

Policy: Monetary policy is still mostly supportive abroad. Fiscal policy may contribute to growth in 2016.

Short-Term: Oil stabilization may help exporters. China's neighbors and commodity producers are most vulnerable to China slowdown.

Long-Term: Lower debt levels and demographics support emerging markets long term.

	Developed						Emerging				
	U.S.	Eurozone	Japan	U.K.	Canada	Australia	China	Brazil	Russia	India	South Korea
Economy											
% of Global GDP (2014)	22.4	17.2	5.9	3.8	2.3	1.9	13.3	3.0	2.4	2.7	1.8
GDP per Capita (Current USD, 2014, \$)	54,629	39,564	36,194	45,603	50,271	61,887	7,594	11,385	12,736	1,596	27,970
Growth (2016 Estimated, %)	2.5	1.6	1.1	2.4	2.0	2.6	6.5	-0.9	0.2	7.4	3.3
Long-Term Factors											
Public Debt to GDP (2014, %)	71	92	232	79	93	35	15	59	13	51	34
Dependency Ratio (2040 Projected)	35	49	62	39	41	34	38	26	28	15	52
Short-Term Factors											
% Exports to China	8	10	18	5	4	34	-	18	7	4	25
Policy											
Net Oil Importer/Exporter	Importer	Importer	Importer	Importer	Exporter	Importer	Importer	Exporter	Exporter	Importer	Importer
Fiscal	Looser	Looser	Looser	Tighter	Looser	Tighter	Looser	Tighter	Looser	Looser	Tighter
Monetary	Tighter	Looser	Looser	Tighter	Tighter	Looser	Looser	Looser	Tighter	No Change	Looser

Source: LPL Research, World Bank, CIA Factbook, U.N. Comtrade, U.S. EIA 11/16/15

The dependency ratio is the number of people 65 years and older per 100 people 15–64 years old.

Unless there is meaningful acceleration in Eurozone inflation and economic growth, we believe the ECB is likely to extend, and even possibly increase, its QE program in 2016, or even at its final policy meeting of 2015 (set for December 3, 2015), to head off deflation. Another round of monetary stimulus in the European banking system. Despite positive progress, risks loom in the Eurozone, and in the wider European Union (EU). The recent influx of immigration from outside the EU into key EU economies will continue to generate headlines and skew political discussions (and elections) away from pro-growth economic policies and reforms. Though there are no national elections in major countries scheduled for 2016, regional elections in the U.K. and Germany are giving voice, if not power, to the more radical and populist parties that cast doubt on the future of the EU.

While teetering on recession for most of 2015, we expect marginal improvement in Japan in 2016. How well its economy and stock markets perform will likely be determined by a combination of three factors: additional QE, substantive economic reform, and a weaker yen to benefit exports. The Bank of Japan (BOJ) is in "wait and see" mode after enacting QE in early 2013 and increasing its size in late 2014, and is promising to do more if GDP growth falters or deflation persists. Although deteriorating demographics and large public debt levels will continue to weigh on Japanese growth in the coming years and decades, Japan is in a somewhat unique position as most of its debt is held internally.

With respect to emerging markets, it's important to realize that there is really no such thing as "emerging markets." Instead, there are a group of countries with some common attributes, but just as many differences. Emerging market equity valuations have been largely stagnant since 2011, whereas developed markets, including the U.S., have seen a marked increase in equity market valuation. The major difference across the countries is the extent to which they are impacted by commodity prices. There are major splits between

DEVELOPED INTERNATIONAL

We believe developed international markets may outperform the U.S. in 2016. Europe, in particular, is earlier in its recovery than the U.S., suggesting potentially stronger earnings growth overseas, while valuations are relatively more attractive. Dollar strength may reward investors who choose to hedge currency exposure.

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.

EMERGING MARKETS

Favorable valuations, strong demographic trends, and potential for stimulus are supportive of growth for emerging market stocks.

commodity exporters, such as Brazil and Russia, and commodity importers, particularly China, South Korea, and Taiwan. Expected stabilization in commodities should enable commodity exporters to fare better in 2016, though this may take several months, or even quarters, to fully develop.

Monitoring China's Growth Prospects

We expect China's official growth to continue to slow in 2016 to the 6–7% range, in contrast to an average annualized growth rate of 9.5% over the past 10 years. Concerns about a significant slowdown in the Chinese economy captured investors' attention over the summer of 2015. We believe that China's true GDP growth rate is probably 2–3 percentage points below official numbers. However, what happened in 2014 or 2015 is less important than where we go in the future. Independent analysis

of Chinese GDP suggests that the economy is stabilizing, again at lower than official levels. Though China needs to be monitored, we view the potential for a "hard landing" as remote.

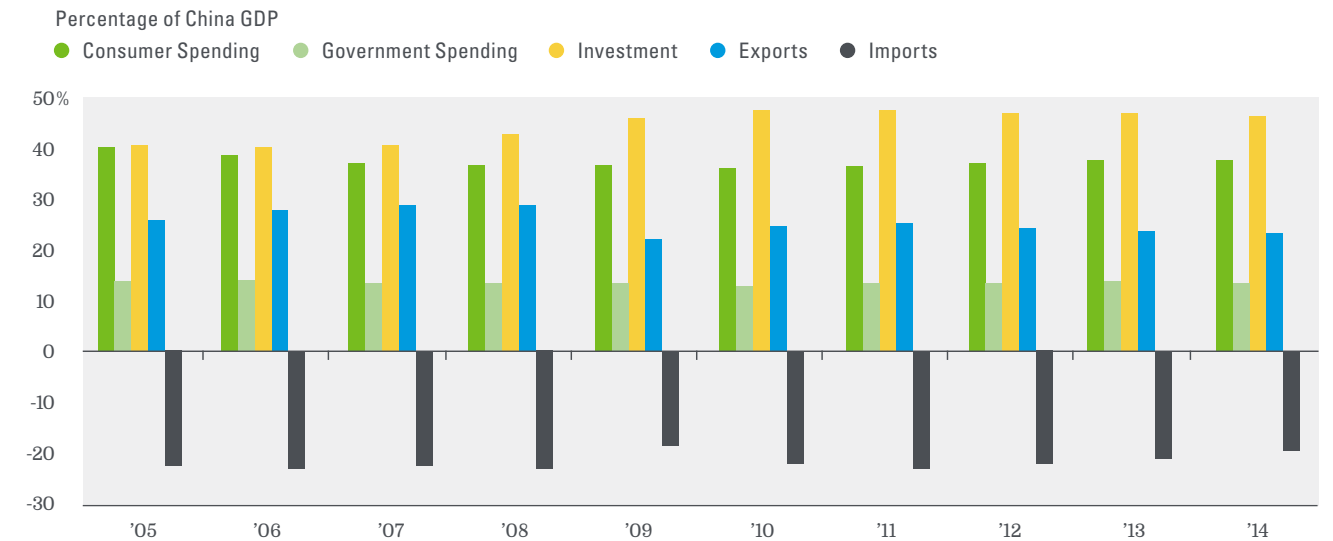
These concerns related to China's growth are understandable given that China has provided approximately 40% of the world's economic growth over the past five years (according to the World Bank). Considering that impact, a hard landing (which we

define as 2% growth for the Chinese economy) would represent a significant reduction in contribution to global growth.

Just as important as the absolute level of growth in China is the composition of that growth.

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, disease, and regulatory developments.

5 REBALANCING THE CHINESE ECONOMY TO CONSUMER SPENDING



Source: LPL Research, China National Bureau of Statistics, Haver Analytics, World Trade Organization 11/11/15

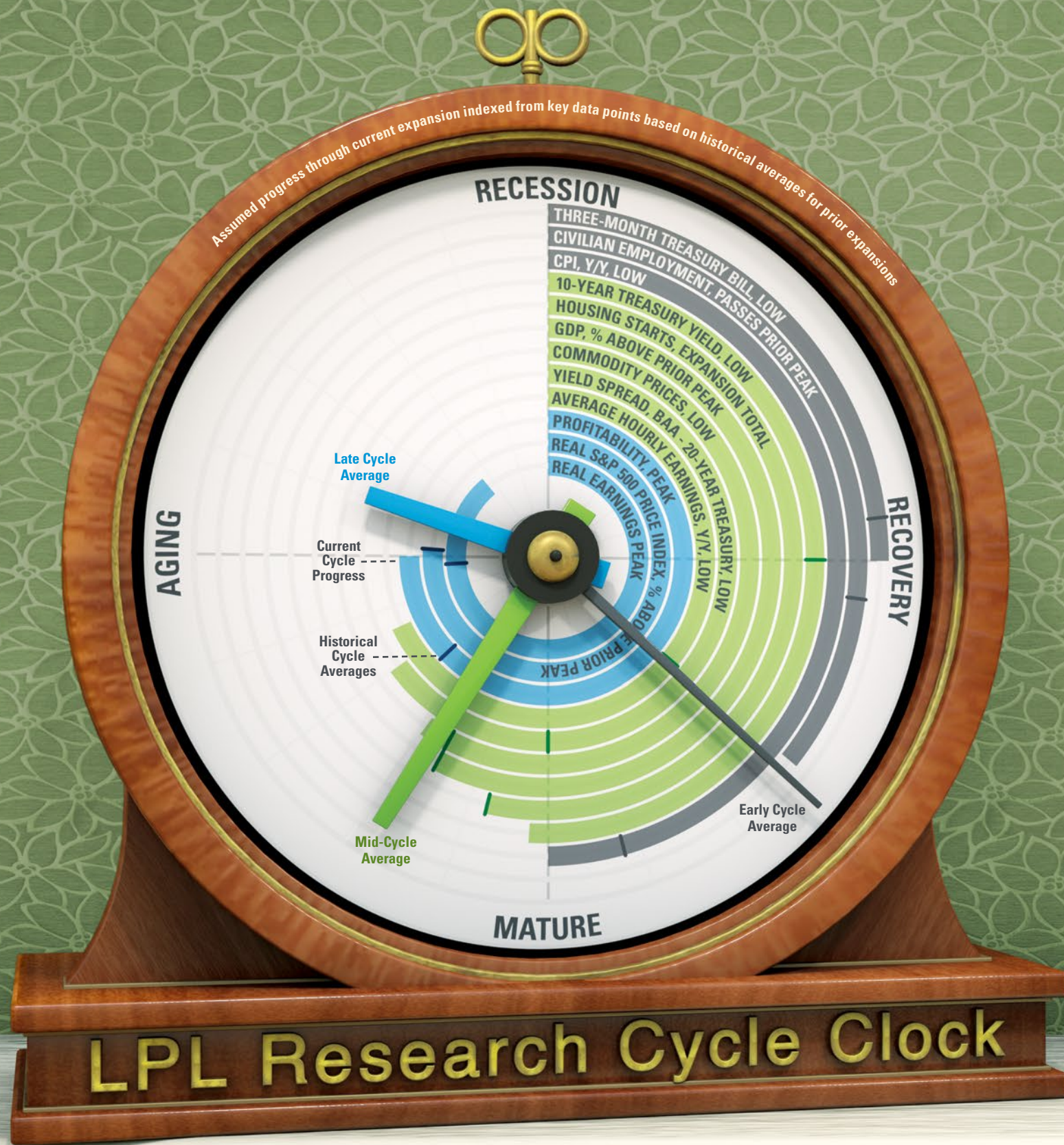
Data are as of 12/31/14.

The Chinese economy is very dependent on investment spending, largely driven by the government, even if the entity involved is theoretically a private company [Figure 5]. China's large population means its economic future may be driven by consumer spending, similar to the shift that occurred in the U.S. after World War II. However, it will be years or even decades before Chinese consumers are able to spend on par with their developed nation counterparts. The Chinese government has put a lot of emphasis on the transition to a consumer economy, and we believe it will ultimately be successful, though challenges remain and the economic road ahead is likely to remain bumpy. More recently, China altered its "one child" policy to allow people to have two children. It will be years before any change impacts the workforce. But should there be an increase in the number of children, this may increase domestic spending.

One risk is that China's notoriously volatile stock market will cause a pullback in consumer spending. Although Chinese stocks are not closely tied to the global economy, a significant downdraft could cause ripple effects in

global markets. The Chinese government was widely criticized internally and externally for its heavy-handed actions in dealing with declines in the stock market. Some of those policies, such as the suspension of initial public offerings (IPO), have already been rescinded.

Another China-related risk is its debt levels. China's investment boom was spurred by additional debt to counter the impact of the global recession in 2008. While this increase in debt is problematic, China has vast financial resources (more than \$3 trillion in foreign reserves, plus assets of state-owned enterprises (SOE)) that the government could use to mitigate the risk of a catastrophic, 2008-like event. Importantly, most of China's debt is held internally. Should the Chinese government need to intervene to help manage any debt-related issues, it will not need approval from any outside sources of funding. In this respect, China is more like Japan and less like Greece or some of the other heavily indebted European countries.



THE BIGGER PICTURE

LPL Research's Cycle Clock compares where we are in the current economic expansion with prior expansions across several important measures of economic activity. The Cycle Clock highlights different ways of looking at the current expansion and is not meant to be predictive. Each perspective is measured either against a key event (how far into an expansion a peak or trough takes place, on average) or by comparing a current value (how far into previous expansions we were, on average, when we reached that value). For events, the model assumes the peak or trough has already

been established for the current expansion, but if a new peak or trough were to be set (a new peak for real earnings, for example), we will in fact be earlier in the cycle.

The Cycle Clock suggests we are in the mid-to-late stage of the current expansion, but we are still seeing some early cycle and late cycle behavior. Extended loose monetary policy, inflation, and employment growth are still exhibiting early cycle behavior, while some items relating to corporate profits are showing late cycle behavior, although they may be reset if profits improve.

Early Cycle

Extraordinary monetary support by the Fed has kept short-term rates, which usually start to rise early in the cycle as the Fed begins to tighten policy, low for an extended period of time. The Great Recession also had a deep impact on the job market; despite the steady but slow job recovery, we only reached the prior peak in total employment in September 2014. Inflation, which is off its lows, remains well contained for now.

Mid-Cycle

Lows for wage growth and the 10-year Treasury yield, usually early cycle events, were pushed back in the current expansion, but were consistent enough with typical timing to indicate we are mid-cycle. Commodity prices tend to rise toward the end of the cycle when the economy starts to overheat, and current levels are more typical of mid-cycle behavior.

Late Cycle

U.S. corporations have been able to increase efficiencies to help drive earnings in the current cycle, and the stock market has responded, but further margin expansion may be limited. If energy sector earnings stabilize and we hit new peaks for earnings, we'll be earlier in the cycle than indicated, but corporate America will once again have to show the resilience it's exhibited in the current economic cycle.

Sources: LPL Research, Federal Reserve, U.S. Bureau of Economic Analysis (BEA), U.S. Bureau of Labor Statistics, U.S. Bureau of the Census, Standard and Poor's, Robert Shiller, National Bureau of Economic Research, Haver Analytics 11/11/15

Data for all series are as of October 31, 2015. Starting point for all series is June 1954 except housing starts (March 1961), hourly earnings (December 1970), and commodity prices (December 1970). Real prices and real earnings determined using the Consumer Price Index for all urban consumers (CPI-U). Commodity prices are based on the GSCI Total Return Index. Profitability is based on real profit per unit value added for non-financial corporate business based on current production as calculated by the BEA.



Gains May Require Tolerance for Volatility

Stocks historically have offered a tradeoff of higher return for higher risk, the gain of more upside than high-quality bonds versus the pain of market volatility and losses.

For the last few years, U.S. stock markets provided below-average returns, while still providing strong returns. Between October 2011 and July 2015, the S&P 500 Index went nearly four years without a "correction" of more than 10%, while climbing an average of 20% a year.

Although we expect average returns for stocks in 2016, the path to reach them will be anything but routine. LPL Research expects stocks to produce mid-single-digit returns for the S&P 500, consistent with historical mid-to-late economic cycle performance, driven by mid- to high-single-digit gains in earnings and a largely stable price-to-earnings ratio (PE). This return to a more normal market may mean more volatility, challenging investors' ability to stay focused on their goals.

How Is 2016 Shaping Up?

In 2016, we expect the macroeconomic environment to be molded by a mid-to-late cycle U.S. economy, modest inflation, and the start of a Fed rate hike

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.

LARGE CAP U.S. STOCKS

As the business cycle matures, large cap, higher-quality companies have historically benefited. Overseas exposure may be a positive in 2016.

Investing in U.S. equities includes numerous specific risks including: the fluctuation of dividend, loss of principal and potential illiquidity of the investment in a falling market.

CYCLICAL GROWTH STOCKS

A continued economic expansion should favor economically sensitive sectors, such as industrials and technology.

campaign. If the U.S. does not enter recession in a given year, the probability of an S&P 500 gain is 82%, based on historical data from 1950 to present. Heading into 2016,

there have been scant signs of excesses in the U.S. economy that may signal vulnerability to recession. We are always on watch for economic deterioration, but would be surprised if the U.S. economy begins to contract in 2016. In short, this low recession risk points to a potentially positive year for stock markets.

Given our view on the economy, we have high confidence that the range of potential market outcomes in 2016 will fall into those highlighted in Figure 6 (p. 15), characterized as mid-cycle years. We believe the worst returns during these years are unlikely. These years included shocks such as severe Fed rate hikes

(1994), an inflationary oil shock (1977), and a European debt crisis (2011). We believe the high end is also unlikely, since it also includes several years with unusual circumstances such as a bounce back from an accounting scandal (2003),

several years inflated by a stock bubble (1995, 1996, 1998), or recovery from the fiscal cliff crisis (2013).

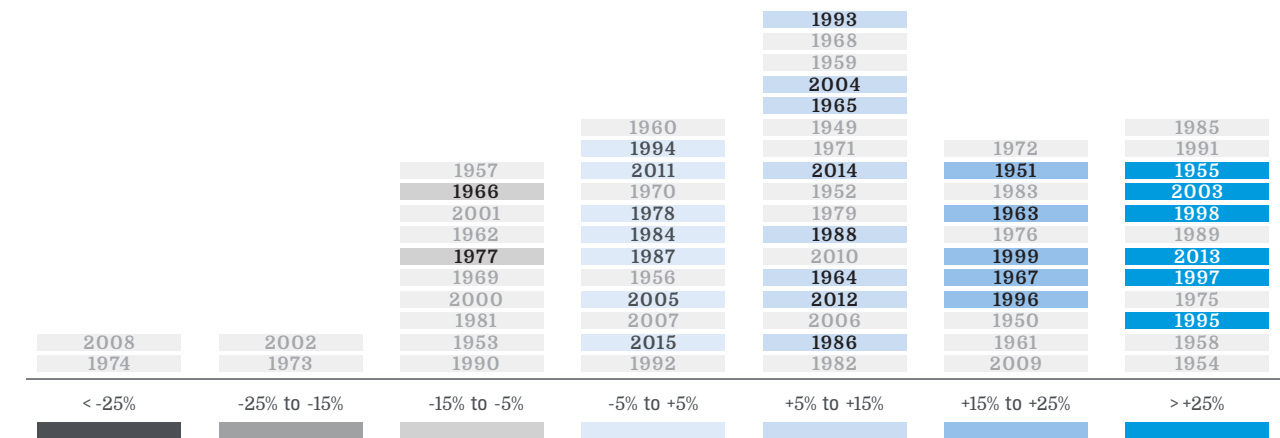
That leaves -5% to +25% as a reasonable range of outcomes, with +5% to +15% the most likely based on these observations alone.

Because of its narrow focus, specialty sector investing, such as healthcare, financials, or energy, will be subject to greater volatility than investing more broadly across many sectors and companies.

6 HISTORICAL MID-CYCLE RETURNS SUGGEST MODEST GAINS FOR STOCKS IN 2016

Annual S&P 500 Gains/Losses Without Dividends Since 1950

● Mid-Cycle Years



Source: LPL Research, FactSet 11/11/15

Indexes are unmanaged and cannot be invested directly.

Mid-cycle years (highlighted) are defined as more than a year away from the start or end of a recession.

The historical likelihood of a positive year coupled with our low-return expectations for the bond market support our positive stock market view for 2016.

Earnings Ramp-Up

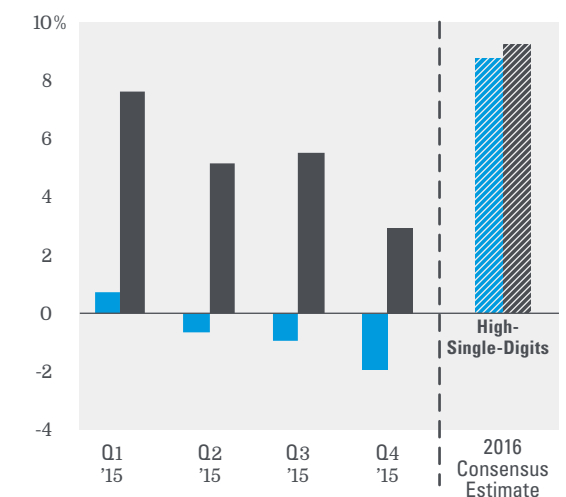
Getting the most out of a routine usually requires a little variety. Corporate profits felt stagnant in 2015, largely due to the drag from a strengthening U.S. dollar and the impact of the drop in oil prices on energy sector profits. Because we expect 2016 U.S. GDP growth near its long-term trend, corporate America should get back to delivering solid profits with mid- to high-single-digit earnings growth (in-line with Thomson Reuters consensus estimates), helping to push the stock market higher. Earnings growth in 2016 is expected to be similar with and without energy included, as shown in Figure 7.

Steady GDP growth in 2016 would set the tone for corporate revenue growth, which historically has correlated well with the growth of the overall economy. Adding in improving growth overseas and a more stable dollar should provide a solid macroeconomic backdrop for revenue, which, through operating leverage, may help support profit margins. Profit margins remain near multi-decade highs and we expect corporate America to maintain strong margins through a combination of: 1) limited wage pressure, 2) cost efficiency, 3) widespread use of automation/technology, 4) low input cost inflation, 5) low borrowing costs due to low interest rates, and 6) falling tax rates as more profits are earned overseas in lower tax countries.

7 EARNINGS POISED TO ACCELERATE IN 2016 AS ENERGY DRAG ABATES

Earnings, Year-over-Year % Change

● Change ● Change Ex-Energy



Source: LPL Research, FactSet 11/06/15

Based on the consensus of analysts' estimates collected by FactSet.

This is for illustrative purposes only and is not representative of the performance of any index or investment product. The economic forecast may not develop as predicted.

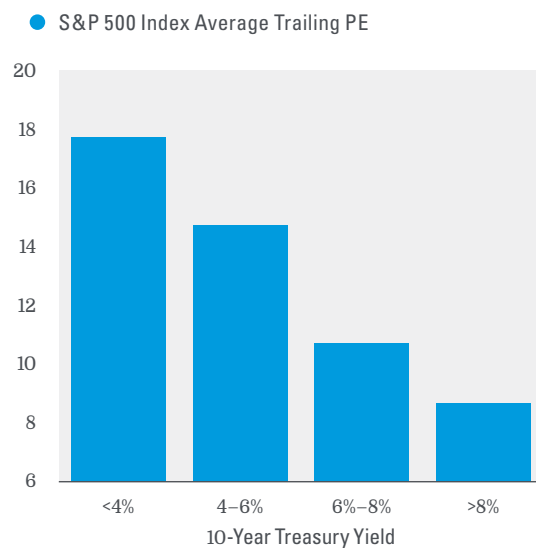
PRODUCTIVITY

We expect the market to reward firms with high or improving margins and strong balance sheets.

Stretching Out the Bull Market

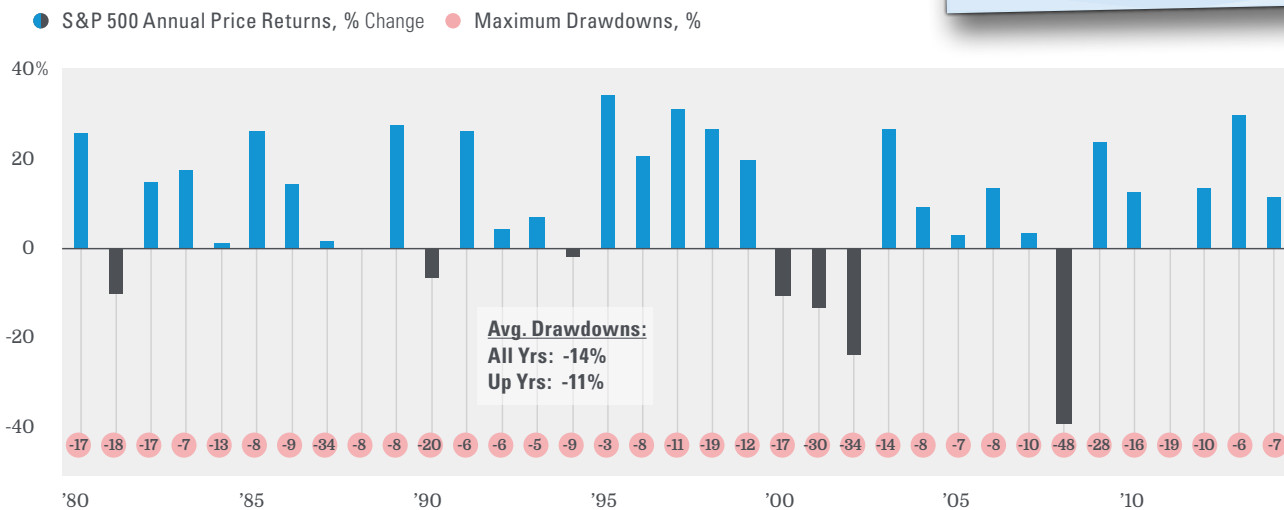
We expect the generally favorable macroeconomic backdrop to lead to potential stock gains in 2016 and possibly bring the current bull market, one of the most powerful in the S&P 500's history, to its seventh birthday. The age of the bull market and above-average valuations have led some to question whether stocks may be too expensive to continue to rise. Valuations have not historically been good predictors of stock market performance over the coming 12 months; but, like a

8 STOCK VALUATIONS HISTORICALLY HIGHER AT LOW INTEREST RATE LEVELS



Source: LPL Research, FactSet 11/06/15

9 STOCK MARKET CORRECTIONS ARE NORMAL EVEN IN POSITIVE YEARS



Source: LPL Research, FactSet 11/06/15

Maximum drawdown is calculated as maximum peak-to-trough decline in a given calendar year.

The performance data presented represents past performance and is no guarantee of future results. All indexes are unmanaged and cannot be invested into directly.

regular warm-up, monitoring valuations can help investors' long-term health.

At 17.6 as of November 23, 2015, stocks are above their long-term average trailing PE of 15.3 (based on S&P 500 data back to 1950), though they are only slightly above the average since 1980 of 16.4.

However, these valuations look more reasonable when put in context of low interest rates [Figure 8]. Since 1962, the average trailing PE ratio when interest rates are low (below 4% on the 10-year Treasury) is 17.7 versus 8.6 when they are high (above 8%), suggesting stocks are fairly valued. The relationship is similar when inflation is low.

Sticking With Your Habits — Even Through Volatility

One characteristic of the stock market that is customary, but certainly does not feel that way, is volatility. The S&P 500's peak-to-trough decline of 12% (May 21 to August 25, 2015) did not feel typical. But this type of pullback is actually quite normal, even in positive returning years. In fact, since 1950, the average peak-to-trough decline for the S&P 500 is 14%; even in positive returning years, the average is 11%, and the index suffered at least a 10% correction in 41% of those positive years [Figure 9].

Another way to show that the volatility experienced in 2015 is closer to the norm is by looking at the VIX, a measure of implied stock market volatility. The year-to-date average for the VIX

ENERGY

The energy sector is poised for a rebound as the gradual oil supply adjustment process continues and demand remains steady.

in 2015 is 16.6, above the average of the prior two years between 14 and 15, but below the 20-year average (20.9) and the average during the current bull market (19.6).

We expect volatility to be with us again in 2016 as the business cycle ages, making sticking to your long-term investment habits even more important to avoid locking in losses and missing out on opportunities. A number of factors beyond the aging business cycle could lead to increased market volatility in 2016. The Fed is about to embark on its first rate hike campaign since 2004–06. A further pronounced drop in oil prices—though not our expectation—could negatively impact the global economy and markets. And recent terrorist attacks in Paris and the associated military response highlight the heightened geopolitical risk in the Middle East and throughout the world.

Stretch, But Don't Strain, When It Comes to Energy

Oil has become a critical factor for financial markets. The drop in oil prices has significantly impacted overall corporate profits, capital spending, emerging market economies, and even the credit markets. As a result, oil has the potential to be either a source of disruption or a key driver of stock market gains.

We do not think it is a stretch to expect oil prices to potentially produce double-digit gains in 2016. On the supply side, the decline in capital investment by energy producers will likely result in reduced production.

The marginal cost of the majority of U.S. shale production ranges between \$40 and \$60; prices in the lower end of this range may discourage production and force higher cost producers to exit the market. Though some have worried that low prices may be indicative of weak demand, to the contrary, global oil consumption remains strong, with oil demand 1.8 million barrels per day higher in 2015 than 2014, and an expected increase of 1.2 million barrels per day in 2016, according to International Energy Agency (IEA) forecasts.

A surprise cut to production targets from OPEC (the Organization of Petroleum Exporting Countries), though a low probability event, may push oil substantially higher in 2016. Potential violence in the Middle East, sparking fears of supply disruptions, could also provide a positive catalyst for the commodity price. Two of the more prominent risks on the downside include Iran's impending return to global oil markets, which may increase supply by an additional 800–900 thousand barrels of oil per day, and the potential drag from further appreciation in the U.S. dollar, which makes oil more expensive to foreign buyers.

HEALTHCARE

Demographic trends, ACA demand, global reach, and continued innovation may lead to above-market earnings growth and returns for healthcare stocks.

2016 ELECTION

In 2016, the political cycle brings us a presidential election that is likely to deliver more of the usual. Since 1950, S&P 500 returns during election years have historically been routine—averaging about 7%. Election years also tend to be a difficult time for a divided Congress to pass legislation. However, specific political issues may influence the market in 2016:

Healthcare Reform

Political headline risk is perhaps most acute in the healthcare industry as lawmakers and presidential candidates focus on drug pricing. Regulatory changes are unlikely, potentially creating an opportunity for the healthcare sector. The Affordable Care Act (ACA) is likely to remain largely intact and support demand for healthcare products and services.

Tax Reform

Although comprehensive corporate tax reform is unlikely in 2016, targeted measures may be reached, such as a deal to allow multinational companies to repatriate foreign earnings at a lower tax rate, given Paul Ryan's election as Speaker of the House.

Energy Policy

Energy issues will command significant attention in 2016. The oil export ban is unlikely to be lifted amidst opposition in the White House and among Democratic leaders, who believe exports will raise gasoline prices. This may delay the pace of the market's supply adjustment. The outgoing administration will seek to cement environmental initiatives, a headwind for coal producers and utilities.



Bond Returns Expected to Remain Flat

Some routines are more challenging than others and sticking with bonds may be one of them. A limited return environment is likely to persist in 2016 and the year as a whole may look similar to 2015. High valuations, steady economic growth, and the lingering threat of Fed rate hikes will likely keep pressure on bond prices in 2016. We do not envision a recession developing, which we believe is ultimately needed for a sustained move higher in bond prices.

A bond routine should nonetheless be maintained and plays a vital role in investors' portfolios despite prospects of low returns. Even in a low-yielding environment,

high-quality bonds can play an important diversification role and help mitigate risk [Figure 10]. Over the past 12 years, high-quality bonds provided a key buffer during periods of stock market weakness. Specifically, high-quality bonds outperformed stocks by more than 13%, on average, when the broad stock market declined by 5% or more over a period of three or more weeks. This relationship has held even during the very low-yield environment of the past five years. While the average absolute return from bonds was low, risk mitigation was still notable.

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

10 BONDS PROVIDE KEY DIVERSIFICATION BENEFITS EVEN IN A LOW-YIELD ENVIRONMENT

In Reverse Chronological Order

Stock Market Peak-Trough	Duration (Weeks)	S&P 500 Total Return	Barclays Aggregate Bond Total Return	Difference
8/17/15-9/28/15	6	-10.5%	0.3%	10.8%
9/18/14-10/15/14	4	-7.4%	2.4%	9.8%
5/21/13-6/24/13	5	-5.8%	-3.1%	2.7%
9/14/12-11/14/12	9	-7.5%	1.2%	8.7%
4/2/12-6/1/12	9	-9.9%	2.2%	12.2%
7/7/11-10/3/11	13	-18.8%	4.2%	23.0%
4/23/10-7/2/10	10	-16.0%	3.0%	19.0%
Average		-10.8%	1.5%	12.3%

Source: LPL Research, Bloomberg, Standard & Poor's, Barclays 11/06/15
All performance referenced is historical and is no guarantee of future results.

INTERMEDIATE-BONDS

High-quality intermediate bonds offer important diversification benefits and help anchor portfolios. Intermediate bonds, rather than short- or long-term bonds, offer an appropriate blend of yield for a given amount of interest rate 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.

11 BARCLAYS AGGREGATE BOND INDEX SCENARIO ANALYSIS

Change in Bond Yields	-0.75%	-0.50%	-0.25%	0.00%	0.25%	0.50%	0.75%	1.00%
Total Return	7.4%	6.0%	4.6%	3.2%	1.8%	0.4%	-1.0%	-2.4%

Source: LPL Research, Barclays 11/06/15

Scenario analysis is based on a return of 3.2% as of 11/6/15 for the Barclays Aggregate, based upon one-year time horizon, parallel shift in the yield curve, no change to yield spreads, and no reinvestment of interest income.

This is a hypothetical example and is not representative of any specific situation. Your results will vary. The hypothetical rates of return used do not reflect the deduction of fees and charges inherent to investing.

Indexes are unmanaged and cannot be invested into directly.

Planning for What May Be Ahead

A simple 2016 scenario analysis using existing yields and characteristics of the broad Barclays Aggregate Bond Index shows the potential diversification benefits offered by high-quality bonds [Figure 11]. Even a small 0.25% decline among intermediate Treasury yields may produce a gain of 4.6%, and if interest rates fall further, gains would increase from there.

However, our expectation is that average intermediate-term Treasury yields rise by approximately 0.25% to 0.50%, with a lesser probability of a 0.75% increase possible, as three main challenges facing bonds persist: high valuations, steady economic growth, and the prospect of Fed rate hikes. These three factors should exert upward pressure on bond yields and downward pressure on bond prices. Our interest rate expectations correspond to a range of high-quality bond total returns from a modest loss to a small gain of 1.8%; thus, our "flat" return expectation.

More specifically the three challenges that may pressure bond prices in 2016 include:

High valuations. Inflation-adjusted yields, one of our key valuation barometers, remain very low by historical comparison [Figure 12]. The lower the inflation-adjusted (or real) yield, the more expensive bonds are, and vice versa. We believe bonds may remain expensive by historical comparison; however, current valuations have gone a long way to price in weak economic growth, as well as a delayed start to Fed interest rate hikes. Much of the good news is priced in and absent a recession, upside for high-quality bonds is limited and we remain cautious. The last time valuations were more expensive than late 2015 levels was in late 2011 and into 2012 in the aftermath of European debt fears and a "double-dip" recession in Europe.

Steady economic growth. In 2016, we expect the U.S. economy to continue to grow 2.5-3% and avoid a recession. Although inflation remains low by historical comparison with wage pressures still limited, continued global economic expansion is likely to slowly lift actual

inflation and inflation expectations. Therefore, growth concerns that supported high-quality bond prices in 2015 may begin to fade.

Prospect of Fed rate hikes. The gap between market expectations and Fed forecasts regarding timing of a first Fed rate hike has narrowed, but expectations on the pace of rate hikes remain wide and imply a much more gradual pace of

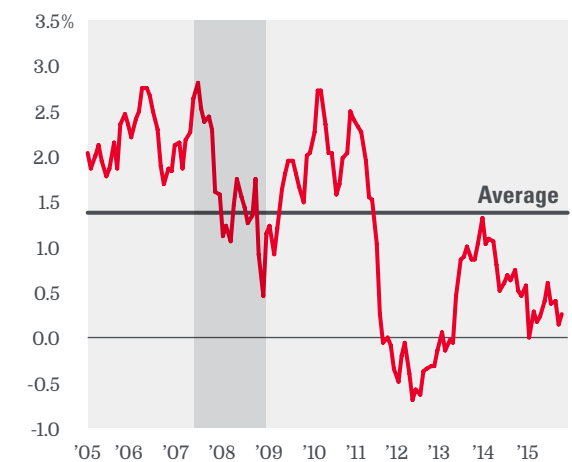
BANK LOANS

Bank loans are the least sensitive to rising rates and may continue to benefit from low defaults and limited energy sector exposure.

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.

12 REAL YIELDS REMAIN VERY LOW BY HISTORICAL COMPARISON AND REFLECT AN EXPENSIVE VALUATION

● Real Yield
10-Year Treasury Yield Minus Core CPI, Year-over-Year



Source: LPL Research, Bloomberg 11/06/15
Shaded area indicates recession.

rate increases compared to Fed forecasts [Figure 13]. Much of the good news about a go-slow approach from the Fed is already priced in and removes a potential upside catalyst to bond gains.

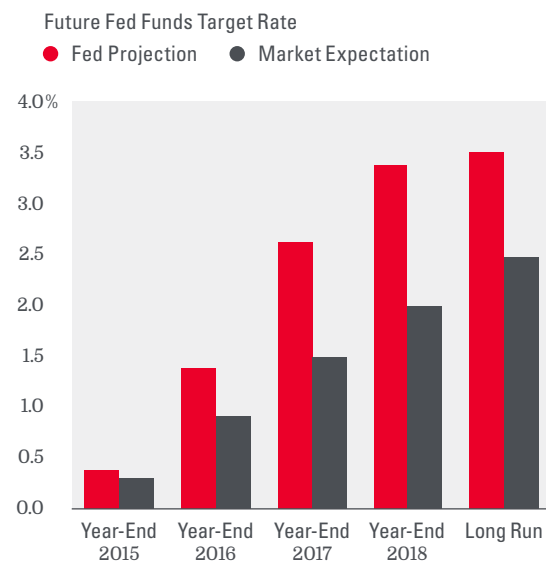
These three factors, prevalent at the start of 2015, conspired to produce low returns in 2015. All three are expected to continue and are likely to influence the bond market once again in 2016.

Finding Value in Your Routine

High-yield bonds may be a beneficiary of sticking to a plan. Roiled by a renewed decline in oil prices and overseas growth concerns during the third quarter of 2015, high-yield bond prices weakened as default fears increased. The energy sector was the primary driver of high-yield weakness during the third quarter of 2015, and prices reversed some of what we viewed as an overly severe reaction. As of November 23, 2015, the average yield spread of high-yield bonds was approximately 6.4%, above the historic average of 5.8%, despite low defaults.

Much of the bad news regarding the high-yield energy sector is likely factored into current pricing. Defaults increased in 2015 and are likely to increase further in 2016, but market pricing suggests an overly pessimistic outcome in our view. The implied default rate for the energy sector is a staggering 16% over a one-year time horizon. Although energy issuers have contributed to rising defaults, the current annualized rate of energy-related defaults is 5%, and in our view, unlikely to reach the high end of market implied expectations.

13 ALTHOUGH THE GAP HAS NARROWED, FUTURES ALREADY REFLECT A SLOWER PACE OF RATE HIKES



Source: LPL Research, Chicago Board of Trade, Federal Reserve 11/06/15
Long run is defined as five years.

HIGH-YIELD BONDS

In a world of limited value, high-yield bonds offer a substantial yield advantage to U.S. Treasuries. With defaults likely to remain low by historical standards in 2016 and valuations adequately compensating for rising default risks, we find value in high-yield bonds, a sector that has historically offered a buffer against rising interest rates.

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

This is not the first time a decline in oil prices has translated into rising default expectations. In late 1985, oil prices began to decline with the price per barrel falling by nearly two-thirds from \$30 per barrel to just over \$10 per barrel. While the high-yield bond market was in its infancy then, the default rate climbed by 2%, nowhere near the double-digit default rates witnessed as a result of a recession. A rise in the default rate by 2% would be a headwind for high-yield bonds, but that outcome has largely been factored into current valuations.

Tune In for Potential Volatility

Changing investor expectations in response to oil prices, Fed guidance, and economic data could translate into bond volatility remaining elevated. The pendulum, however, swings both ways, with volatile periods pushing yields higher or lower. Bond volatility increased in 2015 as interest rates rose during the spring and subsequently fell over the summer. High-yield bonds have been marked by periods of strength and weakness since the middle of 2014. Each move ultimately proved inconclusive, providing investors opportunities along the way. In 2016, more opportunities may come investors' way as market forces may push prices and yields too far in either direction. While the path of interest rates is gradually higher, investors may have to be more active in 2016 to take advantage of opportunities in a low-return, limited opportunity environment.

Opportunities may similarly arise in emerging markets debt (EMD), which witnessed its share of volatility

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.

MUNICIPAL BONDS

Municipal valuations improved in late 2015 but remain attractive relative to Treasuries on a long-term basis. Taxable equivalent yields remain attractive compared to taxable alternatives and limited net supply may help support prices.

Municipal bonds are subject to availability, price, and to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rate rise. Interest income may be subject to the alternative minimum tax. Federally tax-free but other state and local taxes may apply.

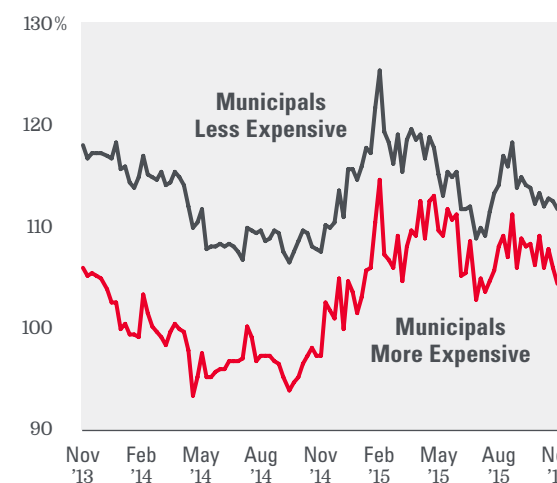
in 2015. An average yield spread of 4% has proven to be a barometer of value, with spreads rarely staying notably above that level for any sustained period of time. Our view is that many emerging economies will likely stabilize in 2016, providing a floor for EMD. While we prefer high-yield bonds for their much lower interest rate sensitivity, EMD may provide opportunity given cheaper valuations. Local currency EMD remains more volatile, and valuations are not compelling enough to take on this added risk.

We continue to find high-quality municipal bonds attractive due to still cheap valuations relative to

14 MUNICIPAL VALUATIONS IMPROVED IN 2015 BUT REMAIN ATTRACTIVE ON A LONG-TERM BASIS

AAA Municipal-to-Treasury Yield Ratio

● 10-Year ● 30-Year



Source: LPL Research, Municipal Market Advisors 11/06/15

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

Treasuries, with most top-quality issuers yielding slightly more than comparable maturity Treasuries [Figure 14]. The relative strength of U.S. Treasuries over the second half of 2015 put municipal valuations on more attractive footing. Bear in mind, municipal bonds will take their cues from the Treasury market, but more attractive valuations can provide a buffer against rising interest rates in addition to an attractive level of after-tax yields.

The municipal market is on track to post limited overall debt growth in 2015 but any meaningful increase is unlikely. States and municipalities battle with still tight budgets that will likely keep bond issuance for new infrastructure projects limited. Net supply of the municipal bond market is likely to see only limited growth once again in 2016, which should provide support to prices. However, like taxable bonds, municipal bonds are likely to witness a low-return environment as well and not escape the challenges facing all bond investors in 2016.

ALTERNATIVE STRATEGIES

Our overall market view is positive, but with increased volatility and divergent policies in different countries. We believe this will be a favorable environment for global macro strategies. Global macro strategies apply macroeconomic-driven investment processes seeking to capitalize on the impact of movements in different asset classes or segments. We also believe that trend following strategies (also referred to as managed futures) may be successful for many of the same reasons. Both strategies rely on changing trends and volatility in the markets. The difference is that global macro strategies are generally discretionary and based on economic analysis, whereas managed futures strategies are quantitative and based on previous price movements. Both can be very volatile.

For more conservative investors interested in adding alternative strategies to their portfolio, we recommend multi-strategy. As the name implies, these contain a number of different trading strategies across a number of different underlying asset classes. Their goal is a relatively stable, constant return with relatively low volatility and low correlation to stocks and bonds.

Global macro strategies attempt to profit from anticipated price movements in stock markets, interest rates, foreign exchange and physical commodities. Global macro risks include but are not limited to imperfect knowledge of macro events, divergent movement from macro events, loss of principal, and related geopolitical risks.

Managed futures strategies use systematic quantitative programs to find and invest in positive and negative trends in the futures markets for financials and commodities. Futures and forward trading is speculative, includes a high degree of risk that the anticipated market outcome may not occur, and may not be suitable for all investors.



Embrace “The New Routine”

Since the start of the bull market for stocks that began in early 2009, the investing environment has been filled with plenty of distractions, some serious disruptions, and occasional risks of derailment, from the lingering shock of the Great Recession to extraordinary central bank intervention around the world, a debt crisis in Europe, slowing growth in China, falling oil prices, and plenty of political drama. As we progress into the latter half of the business cycle, a good routine will continue to serve as a steady guide as investors work toward their financial goals, but it will become increasingly important for a good routine to be flexible enough to adjust to a changing environment. As we look ahead to 2016, we present some “new routines,” including those principles we believe investors should continue to rely on, some areas that may require some flexibility, and some important changes we see in the coming year and beyond.

There are some investing principles that remain in place no matter what the environment. These principles remain holdovers from the prior routine:

- **Think like an investor, not like a speculator.** An investor is providing capital to businesses, or even individuals, with the expectation that it will help provide opportunities that deliver a fair return.
- **Stay committed to a long-term plan.** Dollar cost averaging (investing a relatively fixed amount steadily over time) and rebalancing, when practical, are still good practices to help manage market ups and downs and help mitigate risk.
- **Getting added return requires taking on added risk.** (It doesn’t necessarily work the other way around. Sometimes a risky investment is just risky without providing additional return.) Investors are more likely to get added return for the risk they take on if risk is diversified and fairly priced.
- **Know your goals.** Every investor is different. Some are retired; some just starting to save for retirement. Some

are more sensitive to taxes; some are very sensitive to risk. Investors need a portfolio that matches their goals and personal circumstances as they change over time. Different goals can lead to different approaches to managing a similar investment environment. An investor’s goals need to come first; figuring out how current opportunities line up with those goals follows.

The New Routine

- **Brace for lower stock returns.** The annual total return for the S&P 500 over the next 10 years will likely be below its long-term average of over 11% (going back to 1928); but a slow recovery following a deep recession means the economy may have room to run, despite entering the second half of the cycle. That potential, together with a likely rebound in profits, creates a strong possibility of stocks providing an average to above-historical premium to bonds in 2016 and beyond.
- **Volatility on the rise.** With the Fed likely ending its near zero interest rate policy in late 2015 or early 2016, volatility is likely to pick up. Investors need to review

There is no guarantee that any strategy will be successful.

their risk tolerance and understanding of economic cycles. Emotionally challenging pullbacks like we saw in August and September 2015 may become more frequent, even in an advancing market. Fed rate hike cycles have also impacted the performance of stock and bond sectors and investors need to have a game plan.

- **Turn down the noise.** As volatility increases, being able to discern potential disruptors from headline noise will become increasingly important. The press often focuses on producing headlines that will attract an audience, not necessarily on what is most important for investors; smart investors will try to focus on actual underlying risk.
- **Be more opportunistic.** Increased volatility can create opportunities for skilled investors who have the tools to understand when market dislocations create opportunities and the patience to let markets rebalance. Investors may be able to find ways to harvest the value of that experience through well-chosen active management and sound professional advice.
- **Bonds still work as a diversifier.** Performance in 2015 has provided further confirmation that the bull market for bonds is nearing an end. Quality bonds remain an important diversifier, but returns modestly below yields are likely to be the norm for some time to come.
- **Alternative strategies are a tool, not a solution.** Alternative strategies, which typically can’t keep up in a booming market environment, have more value as a diversified source of returns in a lower-return environment. But they must be viewed in the context of a total portfolio, not on a stand-alone basis.

Two other important changes that investors will need to make will be adjusting to the start of a rate tightening cycle and planning for a likely long-term lower return environment.

Fed Policy Tightening Game Plan

International and domestic investments, large and small company stocks, and stocks and bonds sectors have all exhibited their own routine in response to Fed rate hikes [Figure 15]. In some cases, the same routine to handle Fed rate hikes may serve investors well; but in others, changing times requires new routines.

We have discussed how stock market returns are, on average, positive the year following the start of rate hikes, but focusing on specific areas of the stock market may boost the odds of success. A look back over the last three Fed rate hike campaigns (February 1994–February 1995, June 1999–May 2000, and June 2004–June 2006) reveals patterns across the stock market.

15

TOTAL RETURNS OF VARIOUS INDEXES AFTER THE START OF RATE HIKES

GLOBAL

	6-Month	12-Month	18-Month
U.S. Stocks	2.8%	2.7%	7.4%
International Stocks	12.0%	7.0%	11.8%
Emerging Markets	12.1%	6.2%	10.6%

MARKET CAP

	6-Month	12-Month	18-Month
Large Cap	6.5%	9.9%	9.4%
Mid Cap	5.1%	9.0%	20.8%
Small Cap	4.7%	5.9%	12.9%

EQUITY SECTOR

	6-Month	12-Month	18-Month
Consumer Discretionary	4.0%	-4.4%	-2.7%
Technology	13.7%	18.7%	18.4%
Healthcare	-5.2%	10.0%	21.9%
Consumer Staples	-3.8%	-2.2%	10.6%
Financials	-1.5%	-4.1%	12.6%
Industrials	1.9%	-1.3%	10.1%
Telecom	3.7%	-5.3%	-11.7%
Materials	3.8%	-10.5%	3.9%
Utility	-2.9%	6.8%	20.0%
Energy	3.9%	12.1%	23.5%
S&P 500	3.8%	4.7%	10.7%

BOND SECTOR

	6-Month	12-Month	18-Month
Treasuries	0.0%	3.1%	8.6%
Mortgage-Backed Securities	1.1%	3.6%	9.1%
Investment-Grade Corporates	0.5%	2.5%	7.9%
High-Yield	2.1%	2.7%	5.7%
Municipals	0.1%	2.6%	7.7%
Emerging Markets Debt	2.4%	6.0%	14.5%
International Bonds	6.0%	4.6%	8.9%
Barclays Aggregate	0.5%	3.0%	8.5%

Source: LPL Research, S&P, Barclays, MSCI, Russell, Bloomberg 11/11/15

The performance data presented represents past performance and is no guarantee of future results. All indexes are unmanaged and cannot be invested into directly.

Asset class returns are represented by the indexes defined in the disclosure section.

Domestic and International Stocks

International stocks have fared notably better than their domestic counterparts over the last three rate hike cycles. The U.S. Fed and international central banks appear set to follow different paths and this pattern may repeat.

New Routine: We believe divergent central bank policy and improving global growth are two key drivers for improving international stock performance in 2016. Still, we do not expect the disparity of performance witnessed in prior periods as U.S. economic growth is likely to remain strong relative to many developed counterparts. Valuations among emerging market equities remain particularly attractive and potential earnings acceleration in Europe and Japan boost the allure of international stocks.

Large and Small Company Stocks

Large company stocks have weathered the start of Fed rate hikes better than small and mid cap companies over the 6- and 12-month periods following a rate increase.

New Routine: Our large cap bias is fundamentally in response to large cap strength over the second half of the business cycle, but resilience during rate tightening cycles also plays a role. Over a longer 18-month time frame, small and mid cap stocks have enjoyed a resurgence, but this is in part due to small and mid caps anticipating an economic recovery in the aftermath of an economic slowdown. We believe the current hike is taking place in an aging economic cycle and we remain skeptical of a repeat of small and mid cap strength, maintaining a slight bias to large caps.

Stock Sectors

During the first six months following a Fed rate hike, technology is the only sector showing notable outperformance relative to the broad market as measured by the S&P 500. One year after the first rate hike, the technology sector has continued to exhibit strength, as have both the healthcare and energy sectors, while the consumer discretionary sector has underperformed.

New Routine: We believe technology will prove resilient in the face of rate hikes once again. Technology returns have varied significantly over rate hike periods, in part due to the late 1990s tech bubble, but we believe valuations, earnings potential, and increased corporate spending on technology as companies try to remain competitive may support performance. While stabilizing oil prices may limit the upside of consumer discretionary stocks in 2016, a strengthening job market may provide a lift to the sectors'

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

historical trend of underperformance. On the other hand, stabilizing oil prices may help the energy sector start to rebound, although headwinds from the supply overhang may cap outperformance. Finally, the financials sector, a notable laggard one year after rate hikes, may follow a different drumbeat in this cycle. Financials are fundamentally stronger heading into this rate hike cycle than in the past and may weather rate hikes better, but the sector still faces some uncertainty if financial regulation continues to limit growth opportunities.

Bond Sectors

Treasuries have been the most sensitive to Fed rate hikes in the past and the current period is likely to be similar given still expensive valuations. More resilient sectors include emerging markets debt and high-yield bonds. The added income of these sectors has historically provided a buffer against rising rates.

New Routine: More attractive valuations still make corporate bonds, high-yield in particular, part of a game plan to play defense against rising rates. Among high-quality bonds, mortgage-backed securities have shown resilience to Fed rate hikes, but more expensive valuations during the current environment leave us neutral on the sector. We expect municipal bonds to fare better during this rate hike cycle as limited net supply and attractive valuations on a long-term basis may continue to support the sector. Lower absolute yields and higher valuations of developed foreign bond markets limit the appeal of international bonds this period, and a break from the old routine may be warranted.

Thinking About 2026, Not Just 2016

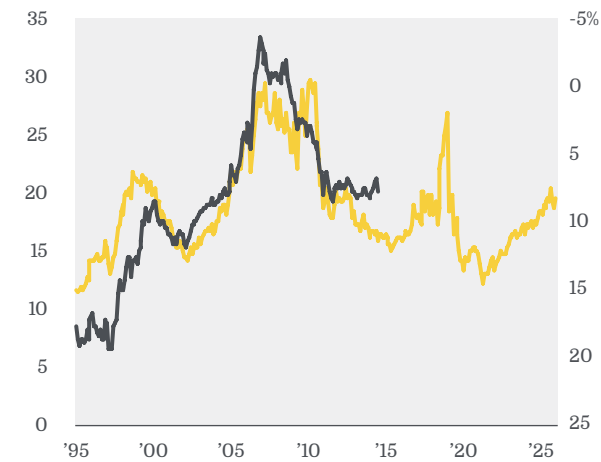
Many investors think about the year ahead, but also the long term, and this dual perspective will be especially important in 2016. For stocks, valuations, most commonly measured by the PE ratio, can have a strong influence on returns over the long term [Figure 16]. In general, the lower the PE ratio, the greater the prospective long-term return, and vice versa. The current PE ratio on the S&P 500 Index suggests investors may expect average returns in the high-single-digit range if the relationship holds, although this is only one factor influencing returns.

A similar forecast can be done with bonds. While stocks are moderately expensive, bond yields are sitting near historical lows with valuations near historical highs. Over the long term, yield has been the dominant

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.

16 PE RATIOS HAVE BEEN A GOOD FORECASTER OF LONG-TERM STOCK RETURNS

- PE Ratio, Shifted 10 Years Forward (Left Scale)
- S&P 500 Annualized 10-Year Total Return (Right Scale, Inverted)



Source: LPL Research, S&P, FactSet, Haver Analytics 11/11/15

PE Ratio = S&P 500 Price/Operating Earnings Ratio

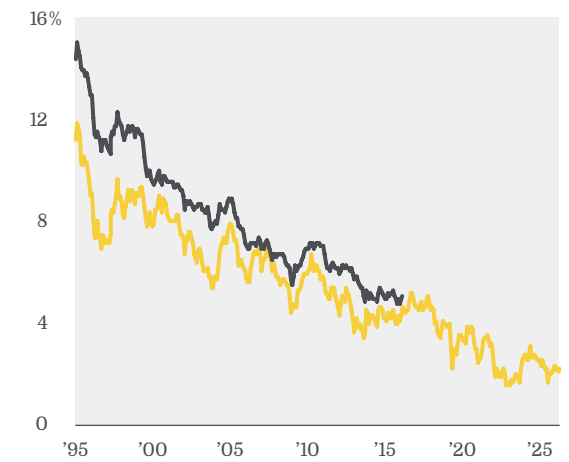
driver of expected returns [Figure 17], although there are other things that can have an impact, such as default levels and changing interest rate environments. Pushing the 10-year Treasury yield out over the next 10 years shows that high-quality bond investors may expect a modest 2% annualized return, on average, over the next 10 years.

The difference between the expected return on stocks and quality bonds is often called the equity risk premium [Figure 18]. It reflects the additional return investors expect for taking on the added riskiness of equities. Looking at stock PEs and bond yields, while stock return expectations need to be lowered over the next 10 years, so do bond return expectations, and the added return for the added risk of stocks remains fair, with a tilt toward an above-average premium relative to history.

Understanding the current economic and overall return environment, both in the short and the long term, will help investors understand where they can stick with current routines, and where they need to show flexibility. The unusual nature of the current cycle, the likely launch of a rate tightening cycle, and the impact of relative stock and bond valuations will all require investors to make adjustments in 2016 and beyond, but sound fundamentals based on a long-term view may continue to help orient them as they navigate changing markets and seek to make progress toward their financial goals.

17 YIELD IS THE DOMINANT DRIVER OF HIGH-QUALITY BOND RETURNS OVER THE LONG TERM

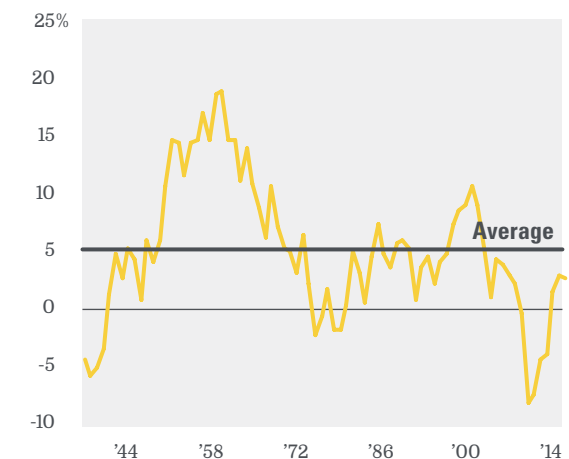
- 10-Year Treasury Yield, Shifted 10 Years Forward
- Barclays Aggregate Annualized 10-Year Total Return



Source: LPL Research, Barclays, FactSet 11/11/15

18 STOCK PEs AND BOND YIELDS POINT TO A LIKELIHOOD OF AN AVERAGE HISTORICAL RISK PREMIUM

- Historical Equity Risk Premium



Source: LPL Research, Standard and Poor's, Federal Reserve, Aswath Damodaran 11/11/15

The performance data presented represents past performance and is no guarantee of future results. All indexes are unmanaged and cannot be invested into directly.

The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Routine



DINER



NEW!

Routines help us focus on the bigger picture during times of change and stress. It is why after a long hotel-laden, cross-country trip we yearn for the contentment of our daily routine back home. And it is the reason we peruse the menu at our favorite restaurant in great detail, but so often order the same dish over and over because it never disappoints. Routines can be comforting, but if unchecked, they can turn into complacency.

We believe the key to success, in life and investing, is juggling the familiarity of old routines with the need for change that is brought on by an ever-evolving world, market, and life. At the center of this strategy is finding the ideal balance between old versus new, habits versus adaptations, process versus progress. In fact, the very spelling of the word "routine" showcases this pursuit for optimal balance, as its middle letters include both the words "out" and "in," which perhaps signifies this balance between the good routines we need to keep in and the adaptation of tired routines that need to work their way out.

It is likely that 2016 will offer a menu full of items that will require changes to the routine we have grown accustomed to. For the first time in eight years, the U.S. will elect a new president. The Fed will most likely embark on its first rising interest rate campaign since 2004, which could create headwinds for rate-sensitive investments like long-term bonds and some defensive-oriented equity sectors. And the complexion of the market itself could offer changes, as Europe's economic improvement may shift market leadership toward international and emerging market investment themes.

Regardless of the changes in the investment landscape, some good habits never fade, including the guidance of a well-formulated investment plan, a portfolio comprised of diversified investments, a longer-term focus, and using LPL Research's *Outlook 2016: Embrace the Routine* to help identify the thought leadership ideas that may guide you toward success.

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.

Quantitative easing (QE) is a government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital in an effort to promote increased lending and liquidity.

Asset classes represented: U.S. Stocks: S&P 500 Index; International Developed Stocks: MSCI EAFE Index; Emerging Market Stocks: MSCI Emerging Markets Index; Large Cap Stocks: Russell 1000 Index; Mid Cap Stocks: Russell Midcap Index; Small Cap Stocks: Russell 2000 Index; Treasuries: Barclays U.S. Treasury Index; Mortgage-Backed Securities: Barclays U.S. MBS Index; Investment-Grade Corporate Bonds: Barclays U.S. Corporate Bond Index; High-Yield Bonds: Barclays U.S. Corporate High-Yield Bond Index; Municipals: Barclays Municipal Bond Index; Emerging Markets Debt: JP Morgan Emerging Markets Global Index; Foreign Bonds: Barclays Global Aggregate ex-USD Index

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 Russell Midcap Index offers investors access to the mid cap segment of the U.S. equity universe. The Russell Midcap Index is constructed to provide a comprehensive and unbiased barometer for the mid cap segment and is completely reconstituted annually to ensure that larger stocks do not distort the performance and characteristics of the true mid cap opportunity set. The Russell Midcap Index includes the smallest 800 securities in the Russell 1000.

The Russell 2000 Index measures the performance of the small cap segment of the U.S. equity universe. The Russell 2000 Index is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index.

The Russell 1000 Index measures the performance of the large-cap segment of the U.S. equity universe. It is a subset of the Russell 3000 Index and includes approximately 1000 of the largest securities based on a combination of their market cap and current index membership. The Russell 1000 represents approximately 92% of the U.S. market.

The 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 Barclays U.S. Treasury Index is an unmanaged index of public debt obligations of the U.S. Treasury with a remaining maturity of one year or more. The index does not include T-bills (due to the maturity constraint), zero coupon bonds (strips), or Treasury Inflation-Protected Securities (TIPS).

The Barclays U.S. Mortgage Backed Securities (MBS) Index tracks agency mortgage backed pass-through securities (both fixed rate and hybrid ARM) guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

The Barclays U.S. Corporate Index is a broad-based benchmark that measures the investment-grade, U.S. dollar-denominated, fixed-rate, taxable corporate bond market.

The Barclays U.S. Corporate High Yield Index measures the market of USD-denominated, noninvestment-grade, fixed-rate, taxable corporate bonds. Securities are classified as high yield if the rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below, excluding emerging markets debt.

The Barclays Municipal High Yield Bond Index is comprised of bonds with maturities greater than one year, having a par value of at least \$3 million issued as part of a transaction size greater than \$20 million, and rated no higher than 'BB+' or equivalent by any of the three principal rating agencies. (The long and the short are subindexes of the Municipal Bond Index, based on duration length.)

The JP Morgan Emerging Markets Bond Index is a benchmark index for measuring the total return performance of international government bonds issued by emerging markets countries that are considered sovereign (issued in something other than local currency) and that meet specific liquidity and structural requirements.

The Barclays Global Aggregate ex-USD Index is an unmanaged index considered representative of bonds of foreign countries.

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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