the Whitepaper

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Highlights

- There is indeed a "planting" season when it comes to investment opportunities. The harsh winters on a farm serve as a means to refresh the acres of dirt tired from a season of growth to get ready for the spring plantings, which is similar to how tough economic environments, stock prices declines, and recessionary periods cultivate the investment landscape for the next potentially great investment "harvest."
- This is not the time to be hiding under rocks, but rather to be turning them over looking for the next great investment opportunities. Under many rocks are the portfolio treasures that could be the seeds that develop into attractive growth opportunities and eventually successful portfolio "harvests."
- There are many challenges, but the media, the market, and investors have overemphasized the concerns and ignored what good there is in this recovery.

What To Do With That Rock

As a kid, there was nothing that I liked more than going to my grandparents' farm in West Virginia. The animals and acres of open land offered many opportunities for a youngster to have some serious fun and, from time to time, find a bit of trouble to get into. However, I never understood springtime on the farm. Every other house along the four-hour drive from my home to the farm looked so green and adorned with flowers, while my grandparents' farm in the spring consisted of acres of dirt as far as the eye could see. It certainly didn't look like spring.

My grandfather would always remind me that on a farm there are three distinct milestones on the farmer's calendar: the time to plant, the time to grow, and the time to harvest. Sure enough, underneath that springtime dirt were the seeds of future growth. By the summer, when other yards were brown under the scorching sun, the farm was alive with the growth of those springtime plantings that continued well into the fall harvest.

I believe the same can be said for investments. There is indeed a "planting" season when it comes to investment opportunities. The harsh winters on a farm serve as a means to refresh the acres of dirt tired from a season of growth to get ready for the spring plantings, which is similar to how tough economic environments, stock price declines, and recessionary periods cultivate the investment landscape for the next potentially great investment "harvest."

There has certainly been much to be concerned about over the last few months, which could be the "winter" that opportunistic investors have been waiting for. While the childish bickering in Washington, the concerns over the debts of many nations in the developed world, and Europe's seeming inability to unify to find solutions to their economic challenges are presenting a significant headwind to economic prosperity, what typically comes out of challenges are opportunities.

What are you going to do with that rock?

My grandfather used to always remind me that one of biggest enemies of any farmer are rocks—they can damage the plow and reduce the effectiveness of the land. During the spring, when most kids were on an Easter egg hunt in colorful flower beds and green yards, I would have a different game that I would play with my grandfather in those dirt fields. Instead of eggs, we would go on a search for rocks. When we would find

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them, we would pick the rocks up and toss them into the cart we towed behind the tractor and then dispose them by the creek bed.

It was on these rock hunts with my grandfather that I learned one of the most important life (and investment) lessons that continues to steer my life today. You see, before we would toss those old rocks into the cart, my grandfather would always urge me to look under the rock. He would always say: "you never know which rocks will reveal the next treasure." As we turned over rocks together, we would find frogs, worms, caterpillars, even old arrowheads, and many other exciting things for a young boy.

But from time to time, when we looked under a rock, there would be a "real treasure," like a nickel or dime or maybe even a small toy. I never knew at the time, but, before I woke up, my grandfather would go out into the field early in the morning, search out a few special rocks, and hide the "treasure" to be discovered by me later. To this day, I still never toss a rock without looking under it first for that potential treasure.

In today's troubling economic times, many people seem to be looking for rocks, but are not turning them over. Rather, many investors are looking for rocks to hide under, similar to that Geico commercial most of us have seen. When things get tough, the natural instinct is to find a great hiding place and wait until the uncertainty passes by.

I believe this is not the time to be hiding under rocks, but rather to be turning them over looking for the next great investment opportunities. This market's "spring planting season" is likely here, or soon will be upon us, and under many rocks are the portfolio treasures that could be the seeds that develop into attractive growth opportunities and eventually successful portfolio "harvests."

The Case for Optimism

It doesn't take much effort to find someone to tell you why things are so bad and that they can only get worse. Just look at the media; many websites, newspapers, and financial television shows will give you 1,000 reasons why you should never invest again. In a sense, many have the belief that there is no end in sight for this economic "winter."

The bottom line is that the most likely scenario remains that global growth will continue at its modest pace, which could very well offer upside surprise for an increasingly bearish-biased market that is pricing in an almost worst-case scenario for the global economy.

No doubt, there is much to be concerned about. There is a justified concern over the debt burden of the developed world combined with the deeply divided political landscape in Washington, DC that has many investors questioning the sustainability of the economic recovery following the Great Recession of 2008. Europe remains the epicenter for concern as a varied group of Euro Countries cannot seem to find the right policies to address debt and growth challenges. Global growth has slowed and I believe the chance to revisit a recession has increased to approximately a 35% probability. There are many things to be concerned about, but is everything pointing towards doom and gloom?

The simple answer is no. There are many challenges, but the media, the market, and investors have overemphasized the concerns and ignored what good there is in this recovery. As I will discuss, the bottom line is that the most likely scenario remains that global growth will continue at its modest pace, which could very well offer upside surprise for an increasingly bearish-biased market that is pricing in an almost worst-case scenario for the global economy.

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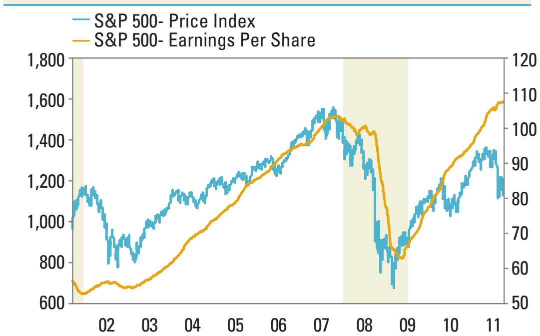
1 Prices and Earnings Tend to Move Together

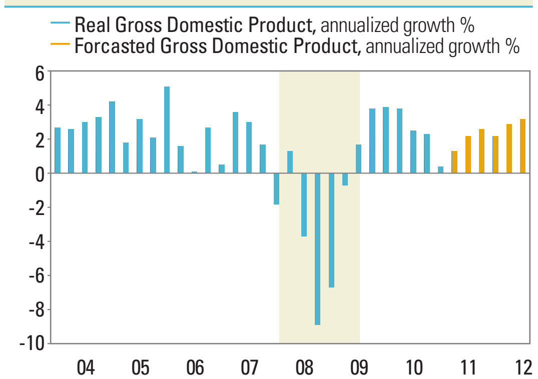


Source: FactSet/LPL Financial 01/01/96–09/12/11

(Shaded areas indicate recessions)

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

2 Economic Growth Remains Positive



Source: FederalReserve/Haver Analytics/LPL Financial 01/01/04–12/31/12

(Shaded areas indicate recessions)

One does not have to go far into the history books to find two periods where short-term fear transitioned into investment triumphs. Today's investment environment is causing investors to face similar challenges to those that haunted them in 2008 and again during the summer of 2010. In both of those periods, prices had declined further than their fundamental values and proactive policy action by central banks served as the catalyst to lure previously nervous investors back into the market. I believe that the same environment exists today. After all, the winter seems to be at its coldest and darkest just before spring and similarly, the best investment opportunities tend to uncover themselves when the fear and panic are the most crippling.

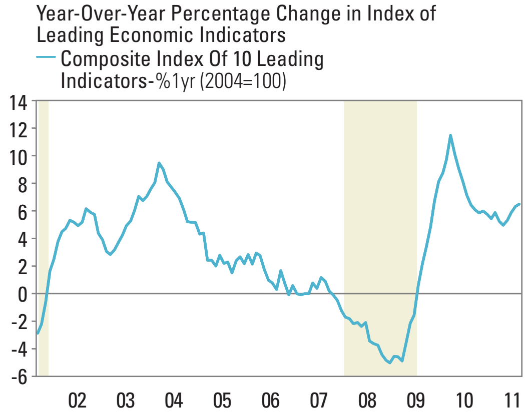
The crowded trade certainly remains bearish, but policy actions to stoke the economic growth fire have begun again in earnest. The Federal Reserve Bank announced last week that it will provide additional stimulative monetary policy through Operation Twist, an attempt to lower long-term interest rates to boost demand for new loans, fuel growth, and spur home purchases. Moreover, many central banks around the world that had been intentionally slowing their country's growth in an attempt to head off inflation are now switching from the brake to the gas pedal to provide more stimulus to jump start growth and the stalling global economic recovery.

The market appears to be suffering much more from a lack of clarity and a wave of uncertainty than a degradation in economic fundamentals. While growth has undoubtedly slowed, most corporations are still on pace to post near-record profits for the third quarter—eclipsing the pre-recession 2007 levels. In fact, the balance sheets of corporate America are the strongest they have been in many decades as strict cost controls, decent sales growth, and a deleveraging of debt have left businesses with more cash in their coffers than ever before. This strong position for companies means they may be better poised now than before to withstand economic downdrafts and are better situated to fuel growth through enhanced spending, share buybacks, acquisitions, raising dividends, and hopefully soon, additional hiring of staff.

However, despite the strong earnings (profits) of corporate America, the prices of stocks have disconnected from these fundamentals. As Chart 1 illustrates, over most periods, the prices of stocks follow their profits quite well, which makes sense because the more a company earns, the more it is worth and vice versa. That said, from time to time, earnings and prices of stocks separate for a period of time, but they shortly find their way back into alignment. This was true following the Tech Bubble in the late 1990s, when prices surged much higher than their fundamentals supported. In that period, stock prices were disconnected higher than fundamentals, which represented overvaluation of equities by overconfident investors. The exact opposite is true today, where stock prices have disconnected lower than fundamentals, suggesting a market that is undervalued as a result of investors' lack of confidence. This disconnect, in my opinion, represents an opportunity to purchase companies that have earnings growing at attractive rates priced at dramatic discounts. Said simply, this appears to be an attractive entry point for stocks.

Buoyed by surging auto production and sales following the disruption caused by Japan's springtime natural disaster, economic growth this quarter for the

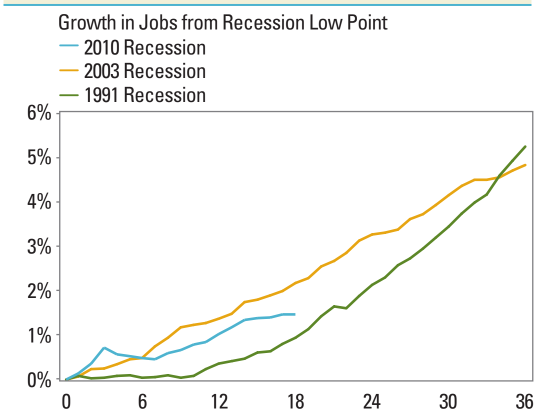
3 Leading Economic Indicators Point Toward Growth, Not Recession



Source: Haver Analytics/LPL Financial 01/01/04–09/23/11

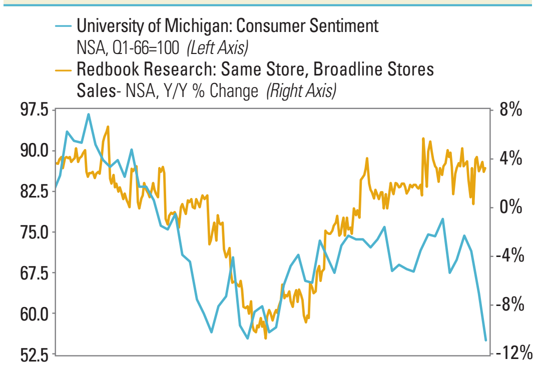
(Shaded areas indicate recessions)

4 Job Recovery Consistent with Past Recessions



Source: Bloomberg/LPL Financial 09/14/11

5 Consumers Say They Lack Confidence, But Continue to Spend



Source: University of Michigan/Redbook/Haver Analytics/ LPL Financial 08/17/2011

United States is poised to be not only the fastest of the year, but also to be faster than the first two quarters of the year combined [Chart 2]. The U.S. economy grew at a 1.0% pace in the first quarter and 0.4% in the second quarter. The third quarter is on pace to grow at a 2–2.5% rate and the fourth quarter looks to be a tad lower, but still strong, in the 1.5% range; definitely slower growth, but certainly not flashing recession concerns. Boosting third-quarter growth is favorable net exports, strong business spending, inventory restocking, and a steady consumer.

Forward looking indicators are also not pointing to a recession in the United States. The Index of Leading Economic Indicators (LEI), which is a grouping of several economic statistics that are usually predictive of future economic conditions, continues to suggest slow growth and not a double-dip recession. In fact, LEI posted a solid and better-than-expected 0.5% gain in August—marketing the third straight month of re-acceleration in the year-over-year growth of the LEI. In Chart 3, notice how the LEI is at levels well above pre-recessionary levels and is even accelerating, which suggests that a recession is unlikely.

Obviously employment remains an important statistic. Job growth has decelerated over the last few months. However, decelerating growth is not the same as job loss—layoffs remain low and weekly unemployment claims are not worsening as they do during impending recessionary periods. More importantly, while the recovery in jobs has been frustratingly slow, it has been at levels consistent with employment recoveries coming out of other recessions. As Chart 4 illustrates, the growth in jobs of about 1.5% since the 2008 recessionary low point matches the labor market recoveries of the past two recessions at this point (18 months into the recovery). Both those recoveries supported long-term economic expansions rather than returns to recession.

Recession of Confidence

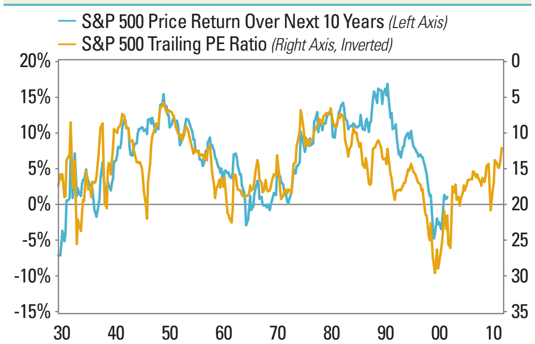
Given that corporations are enjoying profit success, economic growth is growing modestly, the muted employment improvement is actually in line with previous recoveries, and economic indicators are signaling modest growth, why has the market continued to lose ground as of late? The issue is that we are indeed in a recession—but, not an economic recession. We are in a recession of confidence.

With the mood decidedly bearish, the market does not believe in this recovery and investors do not have faith that policy makers can avert the second recession in three years. The bottom line is that investors do not believe in Washington and global policymakers, who have certainly done little to earn the public's trust. As a result, uncertainty has outweighed optimism and question marks have outpaced clarity. The market is essentially suffering from a recession of confidence.

Chart 5 illustrates well the emerging disconnect between the bearish lack of confidence investors feel and the continued modest economic growth this environment is showing. The blue line in the chart plots the University of Michigan Consumer Sentiment Survey results, which are indications of how confident consumers say they are about their current and future prospects. The orange line is year-over-year growth in sales at retail stores. It should not be a surprise that over time these two measures are highly correlated. The more confident consumers feel, the more likely they are to spend money. However, the recent periods have seen a near-historic disconnect, as consumers are filling out surveys suggesting a dismal outlook, but not significantly adjusting their spending.

The "therefore" is that consumers are acting differently than they are feeling. At some point, however, feelings and actions will converge. The market is clearly pricing in that consumer spending will follow sentiment lower and that is certainly possible. However, it takes a lot less effort to change a frown to a smile (sentiment) than it does to significantly alter spending patterns (cancel the cable subscription and the vacation plans, stop going to the movies and out to eat, etc.). As such, there is a better-than-average chance, in my opinion, that confidence and moods improve before consumer actions dramatically deteriorate because of the modestly chugging along economy and the fact that it is difficult to keep Americans pessimistic for long.

6 Gains Predicted for Long-Term Equity Investors



Source: Bloomberg/Thomson Financial/LPL Financial 09/02/2011

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

What should you be planting now?

It is fear and emotional disbelief that often serve as the catalysts to lower expectations—and stock prices—to levels that even market bears see the value of owning. While the market still faces a challenging environment and has a wall of worry to overcome, I believe that now is not the time to search for rocks to hide under, but rather the time to be flipping them over looking for the next potential investment "treasure." So, what are some of these investment considerations?

Equities Look Attractive: Stocks look attractively valued from both a long- and short-term viewpoint. Of all the thousands of strategies used by investors to determine when stocks look appealing, history has made it clear that the most consistently accurate predictor of long-term stock market returns is the S&P 500 Index price-to-earnings ratio (P/E). The P/E is obtained by taking the price level of the Index and dividing it by the earnings per share over the past four quarters. Essentially, the P/E is how many dollars investors are currently willing to pay per dollar of earnings. It makes sense that the price you pay when you buy a stock can have a big impact on your future return. As you can see in Chart 6, the level of the P/E and the annualized return on stocks over the next 10 years have a very close relationship; in essence, the lower the P/E, the higher the return over the next 10 years. Currently, this relationship predicts that high single-digit gains are likely, on average per year, for the stock market over the next 10 years.

Despite the fact that the P/E has a compelling track record of forecasting long-term market performance, many investors have been selling and believe that it is different this time given the debt troubles of developed nations, European credit problems, and uneven economic data, among other concerns. We do not dismiss these issues. However, investors have always faced challenges. Since 1928, the S&P 500 has weathered massive bank failures, a dozen European countries defaulting, a world war, double-digit inflation, top marginal income and dividend tax rates of about 90 percent, the percentage of U.S. government debt-to-GDP at double the current level, not to mention the Great Depression. And yet, through all of these unprecedented events the P/E remained a consistently accurate forecaster of future long-term returns and it is currently flashing that stocks look attractively valued from a long-term perspective.

In Bonds, Are Treasuries Really Risk-Free?: There is only one way to make money in investing: buy opportunities at a low price and sell them at a higher price. Treasury bonds are currently trading at the highest prices and the lowest yields in their history. Widely viewed as a "risk-free" asset, virtually any investment trading at historically high valuations is hard-pressed to be considered free of risk. Nervous investors have piled into Treasuries and are even bidding against central bank buyers (the Federal Reserve Bank has bought approximately $2 trillion — that is $2,000,000,000,000 — in Treasuries over the last three years), which has resulted in record high valuations and historically low yields. Much better opportunities exist in the world of fixed income compared to the crowded trade into Treasuries. For some, high-yield bonds and bank loans offer attractive entry points from a price perspective and have sizeable yields. For others, municipal bonds have offered higher yields relative to Treasuries and the bonus of tax advantages.

Conclusion

Recently, uncertainty has outweighed optimism and question marks have outpaced clarity. With the mood decidedly bearish, the market does not believe in this recovery and investors do not have faith that policymakers can avert the second recession in three years. But, it is fear and emotional disbelief that often serve as the catalysts to lower expectations — and stock prices — to levels that even market bears see the value of owning. While the market still faces a challenging environment and has a wall of worry to overcome, I believe that turning over rocks in search of the next potentially great investment opportunity could be the best strategy to help take advantage of this bout of uncertainty and serve as yet another example of the resiliency of the markets, the global economy, and American business.

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance reference is historical and is no guarantee of future results. All indices 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.

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

Correlation is a statistical measure of how two securities move in relation to each other. Correlations are used in advanced portfolio management.

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.

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.

The Federal Open Market Committee action known as Operation Twist began in 1961. The intent was to flatten the yield curve in order to promote capital inflows and strengthen the dollar. The Fed utilized open market operations to shorten the maturity of public debt in the open market. The action has subsequently been reexamined in isolation and found to have been more effective than originally thought. As a result of this reappraisal, similar action has been suggested as an alternative to quantitative easing by central banks.

Debt-to-GDP is a measure of a country's federal debt in relation to its gross domestic product (GDP). By comparing what a country owes and what it produces, the debt-to-GDP ratio indicates the country's ability to pay back its debt. The ratio is a coverage ratio on a national level.

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

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 a fund shares is not guaranteed and will fluctuate.

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

The index of leading economic indicators (LEI) is an economic variable, such as private-sector wages, that tends to show the direction of future economic activity.

The University of Michigan Consumer Sentiment Index (MCSI) is a survey of consumer confidence conducted by the University of Michigan. The Michigan Consumer Sentiment Index (MCSI) uses telephone surveys to gather information on consumer expectations regarding the overall economy.

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

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