Weekly Market Commentary

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What to Watch During the Most Important Week of the Year

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Highlights

This week features the most market-moving events of the year, so far. Not only do they hold the potential to affect the markets this week, the decisions made this week may shape the market environment for years to come.

Here we will detail what we will be watching for at each event.

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These events include:

- The Greek election on Sunday and the formation of a new government,
- The G20 meeting on Monday and Tuesday,
- The Iran nuclear program meeting on Tuesday and Wednesday,
- The last Federal Reserve (Fed) meeting before the end of Operation Twist on Thursday,
- The Supreme Court ruling on the health care law is likely this week.

The coverage of these events in the news will be hard to miss. Here we will detail what we will be watching for at each event.

Greek Election

The pro-bailout and austerity parties appear to have won enough votes in the election held on Sunday to form a government (unlike in the May 6, 2012 election). With the election unlikely to result in setting a precedent for countries leaving the Eurozone at the behest of Germany, a potential financial crisis stemming from runs on Southern European banks may be averted. This outcome was largely anticipated by the markets, based on polling data, with a 5% gain in the S&P 500 since June 1.

However, how quickly a new government emerges and what is said about renegotiating the terms of Greece's second bailout is important to whether the gain is sustained. Greece is in desperate need of funds — not only to service its debts but also to provide for drugs, food, and energy (which are mostly imported) for the Greek people. Greece will run out of money in a few weeks if an agreement is not reached to deliver the next tranche of the bailout money. So far, Germany has indicated that while the bailout targets should not be changed, the timeframe in which to reach them may be extended. However, a New Democracy/PASOK coalition government will likely seek more significant changes. Tough talk on renegotiation — from either side — could undermine the markets.

Most importantly, if a path for Greece to remain in the Eurozone becomes clear, the contagion and bank run beginning to affect Spain and Italy may recede along with their bond yields. Progress towards a long-term solution for a combined Europe can continue while Greece, a very small part of the Eurozone economy, will remain in a depression but be able to afford basic necessities for its people.

In a related action, with the vote out of the way, the European Central Bank may take action to provide economic stimulus and liquidity to banks.

G20 Meeting

There are low expectations for this meeting, so any outcome would be an upside surprise for markets. We are watching for any new efforts at stabilizing the Eurozone.

- An endorsement of a framework for a Eurozone-wide deposit insurance program, essentially linking all of the individual countries' FDIC-like programs into one program for all of the Eurozone, could be seen as progress on a banking union and would likely be welcomed by the markets and European bank stocks.
- The audit of Spanish banks' capital needs — a precursor to the 100 billion euro Spanish bailout — may be unveiled at the G20. Once assessment of the recapitalization is complete, the amount to help shore up Spain's banks can begin to be dispersed and may stem the rise in Spanish bond yields to unsustainable levels.
- Finally, the G20 could announce an increase to the $430 billion in IMF funds to combat the pressures in Europe.

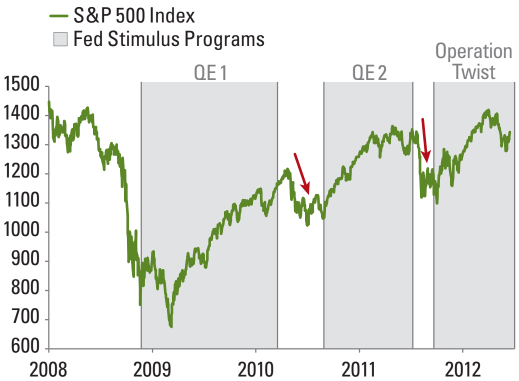
Iran Nuclear Talks

The deadline for Iran to make concessions on its nuclear program or face U.S. oil-related sanctions against Iran's central bank is scheduled to take effect on June 28, and European Union restrictions on oil imports from Iran begin on July 1. Iran has already seen oil orders fall sharply. Iran's oil exports are estimated by the International Energy Agency to have fallen by an estimated 40% since the start of the year, falling to 1.5 million barrels per day in April-May 2012 from 2.5 million at end 2011.

Yet Iran remains steadfastly against the ban on all uranium enrichment, and the market expects the talks in Moscow are unlikely to yield any more ground than the prior two talks this year. Without progress the risk rises of a military move by Israel or by an increasingly embattled Iranian president, who has seen his political power erode in the Iranian parliament.

We are watching for a potential compromise involving a freeze on highly enriched uranium while allowing Iran to produce power plant grade fuel. A modest breakthrough along these lines could be an upside surprise — though unlikely to materially further lower oil prices, it may relieve some geopolitical risk overhanging the markets.

1 Another Fed Stimulus Program Ending Soon



Source: LPL Financial, Bloomberg Data 06/18/12

(Shaded areas represent Fed programs from the date of announcement until termination)

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

2 S&P 500 Industries Likely to React More Favorably to One Party

Democrats	Republicans
S&P 500 Health Care Facilities	S&P 500 Coal & Consumable Fuels
S&P 500 Food & Staples Retailing	S&P 500 Diversified Financial Services
S&P 500 Gas Utilities	S&P 500 Oil & Gas Exploration & Production
S&P 500 Health Care Services	S&P 500 Oil & Gas Drilling
S&P 500 Life Sciences Tools & Services	S&P 500 Managed Health Care
S&P 500 Construction Materials	S&P 500 Electric Utilities
S&P 500 Homebuilding	S&P 500 Specialty Retail
S&P 500 Construction & Farm Machinery	S&P 500 Telecommunications Services

Source: LPL Financial 06/14/12

Federal Reserve

Given the weakness in recent U.S. economic data, the risks posed by the European problems, and the potential for tight fiscal policy next year including major tax hikes and spending cuts, the Fed is likely to announce a new stimulus program, such as QE3. Or the Fed may extend the current one, known as Operation Twist. If not, the markets will be disappointed. Stocks fell by 16–19%, as measured by the S&P 500 Index, after the end of each of the past two stimulus programs.

The Fed has many options, but it is the size and duration of the program that is most important. The Fed may choose a moderate-sized plan around half the size of the $400 billion Operation Twist to suggest they are keeping firepower in reserve against a further deterioration in the situation in Europe. However, a program too small—or merely opting to extend the short-rate guidance to beyond late-2014—risks disappointing the markets.

Supreme Court

A decision on the constitutionality of the Affordable Care Act will come this week—or next week at the latest—before the Supreme Court adjourns for the summer. What to watch for is not subtle: if the law is upheld, struck down, or if parts of the law are struck down.

The consensus expects the Supreme Court to strike down just the mandate requiring individuals to buy insurance with limits on pricing. This has been weighing on the stocks of HMOs and providers due to the adverse impact on profitability. However, if the court surprises investors and strikes down the entire law, HMOs would benefit while generic drug makers, hospitals, and diagnostic companies in the Health Care sector may suffer.

In addition, this decision has political implications. Striking down any of the law would be a blow to President Obama's reelection campaign. Industries tied to the outcome of the election may fare differently. In any case, expect Republicans to make it a priority to seek to dismantle the law next year.

It is important to not get caught up in the volatility that each event this week may bring and instead stay focused on what emerges to form the bigger picture. The stock market may be near an attractive point to reinvest cash—especially as clarity emerges from the events this week and the earnings season nears. ■

Quantitative Easing 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.

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.

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

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

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

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

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

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

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

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

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

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

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

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