YOUR FINANCIAL FUTURE

Your Guide to Life Planning

February 2018

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The latest Client Letter addresses the recent volatility in the equity markets. Although it can be difficult to experience these declines, the underlying fundamentals of the economy and markets are pointing to the potential for continued growth in 2018 and beyond.

Bond Market Perspectives | Week of February 5, 2018

Yields have started 2018 off on a volatile note, which has been somewhat painful and disconcerting for fixed income investors.

Weekly Economic Commentary | Week of February 5, 2018

The latest data on GDP, inflation, and the job market continue to paint a positive picture of the U.S. economy.

Weekly Market Commentary | Week of February 5, 2018

Fridays sharp stock market decline might have led us to forget that just a few days ago many claimed the stock market was melting up.

Weekly Economic Commentary | Week of January 29, 2018

The U.S. dollar was in the news after comments from Mnuchin, Draghi, and Trump created volatility in the world's reserve currency.

Client Letter | Volatility During Healthy Markets | February 2018

February 6, 2018

Dear Valued Investor:

After more than 18 months of nearly uninterrupted advances, the U.S. equity markets started declining last week, with a large sell-off on February 5, 2018. Although it is always difficult to endure these declines when they're occurring, it's important to focus on the underlying fundamentals of the economy and the markets, which are pointing to the potential for continued growth in 2018 and beyond.

There are several conditions that help explain this current sell-off. The biggest factor is a stronger than expected January jobs report showed rising wage pressures, which has increased concerns about inflation and possible changes to monetary policy. Certainly, employee costs make up the largest percentage of business expenses, which are typically passed on to consumers in the form of higher prices. Inflation can also subtract from the "fixed" income offered by bonds, causing investors to demand higher yields. In these instances, the Federal Reserve (Fed) usually attempts to slow down demand by raising interest rates. Thus, investors may now fear that monetary policymakers will increase rates more than expected in 2018.

As market interest rates started to climb in response to the wage growth concerns, this triggered further selling among some of the crowded trades. Also contributing to overall investor concerns, further deficit spending measures loom as federal budget negotiations continue, with the potential for another government shutdown set for February 8, 2018. Finally, several leading technology and energy companies reported disappointing profits, despite an otherwise strong earnings season.

While market volatility is never pleasant, it is important for investors to appreciate that market pullbacks are a normal part of investing, and we have not experienced even a 5% drop in the S&P 500 Index since the Brexit vote in June 2016. Indeed, the markets have produced a series of record-setting gains recently amid an absence of volatility. Also consider that volatility has historically increased in midterm election years and the market has a propensity to test a new Fed chair. Given these developments, this market weakness may have been overdue.

LPL Research continues to expect the Fed to increase rates three times this year. As a reminder, although interest rates have begun their climb from historically low levels, the benchmark 10-year Treasury yield has only begun to breach LPL Research's projected trading range of 2.75-3.25% for 2018. In addition, the Treasury yield curve actually steepened by more than 0.2% last week, a sign of investors' confidence in the future growth prospects of the economy; there is also a lack of stress in credit markets. As always, fixed income remains a critical part of diversified portfolios, providing liquidity, income, and an ability to help mitigate portfolio risk during periods of equity market weakness.

Investors are encouraged to focus on the many solid fundamentals supporting economic and profit growth. The *LPL Research Outlook 2018: Return of the Business Cycle* highlighted the transition from monetary to fiscal leadership as a powerful tailwind consisting of tax reform, government spending, and reduced regulation. This combination may support growth in personal consumption and business investment, enabling U.S. gross domestic product (GDP) growth to climb to 3.0% in 2018. Global growth also appears strong, projected to potentially rise 3.7%, as emerging markets continue to benefit from increased investment and Europe continues to improve.

One thing that we all have to remember, as investors, is that market volatility can still occur in healthy markets. It's important to try and resist the urge to react or let our emotions take hold. Remaining focused on the underlying fundamentals supporting the economy and markets, while maintaining a long-term view, is a valuable strategy toward a better position for potential success.

As always, I encourage you to contact me with any questions.

Important Information

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

Economic forecasts set forth may not develop as predicted.

All market indexes discussed are unmanaged and are not illustrative of any particular investment. Indexes do not incur management fees, costs and expenses, and cannot be invested into directly.

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.

Investing involves risks, including possible loss of principal. No investment strategy or risk management technique can guarantee return or eliminate risk in all market environments.

Additional descriptions and disclosures are available in the Outlook 2018: Return of the Business Cycle publication.

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Bond Market Perspectives | Week of February 5, 2018

Key Takeaways

- Though risk-off sentiment has dominated news recently and pushed yields slightly lower, yields remain broadly in an uptrend.
- Several indicators are saying that the rise in yields may be over for now, or could potentially have gone too far.
- We continue to believe that the 10-year Treasury yield could end 2018 in the 2.75-3.25% range, with some volatility along the way, as growth and inflation continue to move higher.

Will Yields Keep Rising?

Yields have started 2018 off on a volatile note, which has been somewhat painful and disconcerting for fixed income investors. The move higher in yields has been to some extent justified (and overdue) in our view. Fundamentals have largely pushed them higher, and a return of volatility (like that seen recently in equity markets) can be looked at as a sign of a healthy, normalized environment where market participants are navigating through complex risks. While the risk-off tone to the market action on February 5, 2018 has brought yields down slightly, the uptrend is still intact and worthy of further investigation.

THE MOVE IN CONTEXT

Though the recent move in yields has been sharp, it certainly has been muted relative to other large moves higher in yields [Figure 1]. With volatility cratering in 2017, sharp moves in equity or bond markets seem more jarring than they have in previous cycles. When viewed in the context of other sharp moves higher in yields, this move is slightly less ominous, however.

In our view, the pace of weakness in this uptick could be more moderate compared with prior sell-offs, due to the fact the Federal Reserve (Fed) may continue its gradual approach to raising interest rates and inflation is similarly expected to increase gradually. So we find it unlikely that the current sell-off reaches the magnitude of prior sell-offs; however, the lower level of yields combined with lingering price pressures still signals a low-return environment for high-quality bonds in 2018.

SECTOR PERFORMANCE

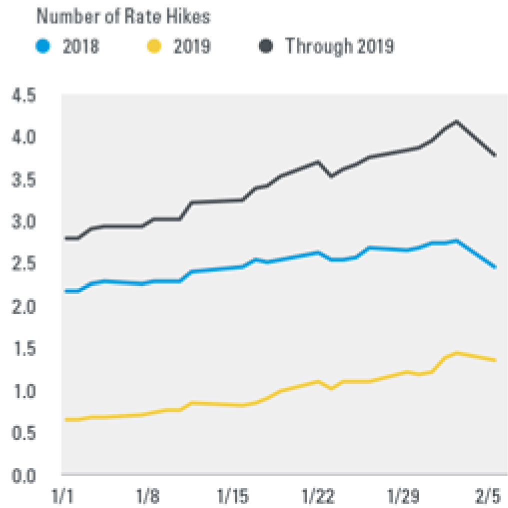
Year-to-date sector performance is evidence that although the upward trend in interest rates may be pressuring high-quality fixed income, there are opportunities for outperformance relative to the broad market. Our two favored high-quality sectors, mortgage-backed securities (MBS) and investment-grade corporates, have both outperformed the broad Barclays Bloomberg Aggregate Index year to date. Spread tightening within corporates, along with the additional yield relative to Treasuries, has driven that outperformance. MBS boasts yields higher than Treasuries, with significantly less interest rate sensitivity, leading to a favorable risk-reward tradeoff. Treasuries, our least favorite domestic high-quality fixed income sector, possess the dueling headwinds of low yields and high interest rate sensitivity.

LONG AND THE SHORT OF IT

The move in Treasury yields has been driven by multiple factors. Shorter-maturity Treasury yields have been pressured higher by rising Fed rate hike expectations. Longer-maturity yields have been driven higher by increasing concerns of a potential upside surprise to inflation and a move higher in real yields. These dynamics are certainly interrelated. The upside surprise to wage growth on February 2, 2018, spooked investors who have grown complacent to low inflation dynamics. This sent yields higher and continued the broad trajectory that yields had been in for weeks. Inflation expectations have been in a meaningful upswing since mid-December 2017.

Rising inflation expectations, and rising measures of actual inflation even more so, may necessitate a more aggressive Fed, which does not want to fall behind a rise in inflation. These dynamics have pressed rate hike expectations up meaningfully over the last month. Looking at expectations for 2018 and 2019 combined, the market has priced in an additional 1.4 rate hikes over the last month alone, from 2.7 at the end of 2017 to 4.2 as of February 2, 2018 [Figure 2]. These expectations have fallen slightly with equity market volatility, but remain elevated from 2017 year-end levels.

2 NUMBER OF EXPECTED FUTURE RATE HIKES HAS CLIMBED YEAR TO DATE



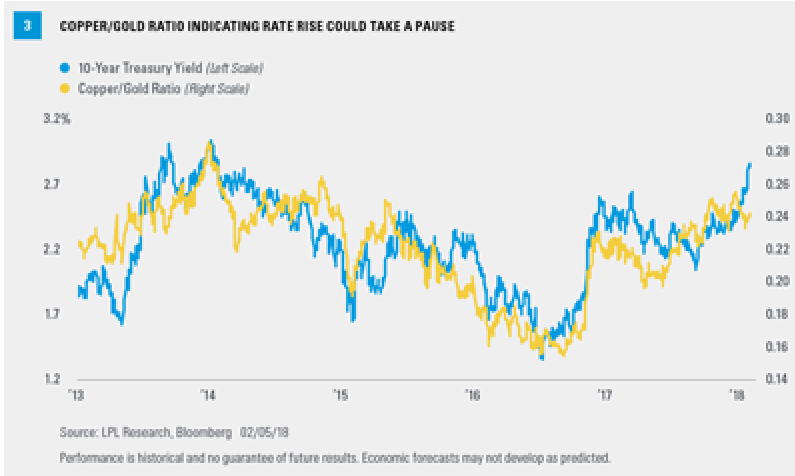
Source: LPL Research, Bloomberg 02/05/18

Market-implied rate hike expectations are calculated based on the pricing of various fed funds futures contracts. Rate hike expectations may not develop as predicted.

While much of this increase is data driven, some of it may be due to expectations for a more hawkish Fed under Fed Chair Jerome Powell, as discussed in our recent *Bond Market Perspectives*, "The Fed is Moving Forward" piece.

OTHER INDICATORS

Though this move has been largely driven by fundamentals, there are certain indicators that argue for a pause or perhaps even a slight reversal of yields. The copper/gold ratio has tracked with the 10-year Treasury yield fairly well for the last five years. The rationale behind this comparison is that the price of copper is a harbinger of global economic strength. Because copper is a key input into manufacturing and construction, it is considered to be a useful indicator of global and U.S. economic health. Generally, when copper prices rise, the economy is expanding. This has often led to higher inflation and thus lowers the demand for safe-haven assets such as gold and Treasury bonds.* Based on this relationship, the 10-year's upward run seems a bit overextended [Figure 3].



International dynamics also point to yields potentially pausing here as well. The yield advantage of U.S. Treasuries to other developed nations can be a good indicator of relative value. The investing community is global, and rising domestic yields become very attractive to foreign investors amid yields which are lower in developed foreign markets. The 10-year Treasury's yield advantage to the 10-year German bund is now at 2.08% (as of February 2, 2018), which is its highest in over 10 months. The yield advantage to the Japanese Government Bond (JGB) is even larger.

One important subplot in this dynamic is currency hedging and associated costs. In order to remove currency risk, investors can hedge their currency exposure in the futures markets. If the price of that hedge becomes more expensive, it can eat away at the yield advantage, potentially entirely, making a global investor indifferent between a U.S. Treasury and a foreign sovereign bond yielding far less. In the case of Japanese investors buying U.S. Treasuries, the recent yield pickup has made Treasuries much more appealing. Japanese investors can now get a meaningful currency-hedged yield pickup relative to the JGB, after that advantage slowly evaporated over the course of 2017.

Treasury auctions can be a good gauge of foreign demand as well. Foreign demand remained strong at the most recent 10-year auction on January 10, and the next auction on February 7, 2018, may be a good indicator of whether increased U.S. yields will spur additional demand from global investors.

CONCLUSION

Though a risk-off tone in equity markets temporarily put the brakes on the upward move in Treasury yields, the upward trend may persist. We continue to believe that the 10-year Treasury yield will end 2018 in the 2.75-3.25% range, with volatility along the way, as growth and inflation continue to move higher and the Fed continues with its gradual pace of data-dependent rate hikes. We maintain that high-quality fixed income is a potential risk mitigation tool within a diversified portfolio. Market action on Monday, February 5, 2018, could serve as a case study for that: The S&P 500 lost 4.1%, while the Bloomberg Barclays Aggregate gained 0.3%, exemplifying fixed income's main role as a ballast for equity market risk.

**U.S. Treasuries may be considered "safe-haven" investments but do carry some degree of risk including interest rate, credit, and market risk. The price of gold can be affected by developments such as currency devaluations or revaluations, central bank movements, economic and social conditions within a country, trade imbalances, or trade or currency restrictions between countries. There is no guarantee that gold will maintain its value or purchasing power in the future. Gold and other speculative investments are not appropriate for every investor.*

Please see our Outlook 2018: Return of the Business Cycle publication for additional descriptions and disclosures.

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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.

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

Mortgage-backed securities are subject to credit, default risk, 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, and interest rate risk.

Corporate bonds are considered higher risk than government bonds but normally offer a higher yield and are subject to market, interest rate, and credit risk as well as additional risks based on the quality of issuer coupon rate, price, yield, maturity, and redemption features. The risks associated with investment-grade corporate bonds are considered significantly higher than those associated with first-class government bonds.

International debt securities involve special additional risks. These risks include, but are not limited to, currency risk, geopolitical and regulatory risk, and risk associated with varying settlement standards. These risks are often heightened for investments in emerging markets.

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.

The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.

INDEX DESCRIPTIONS

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

The Bloomberg Barclays U.S. 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).

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Weekly Economic Commentary | Week of February 5, 2018

GDP, PCE, AND JOBS

KEY TAKEAWAYS

- The latest data on GDP, inflation, and the job market continue to paint a positive picture of the U.S. economy.
- The Fed's favored measure of inflation, core PCE, remains below the Fed's 2.0% target.
- Wage inflation has begun to tick higher, though it remains well below the level that has typically triggered a more active Fed.

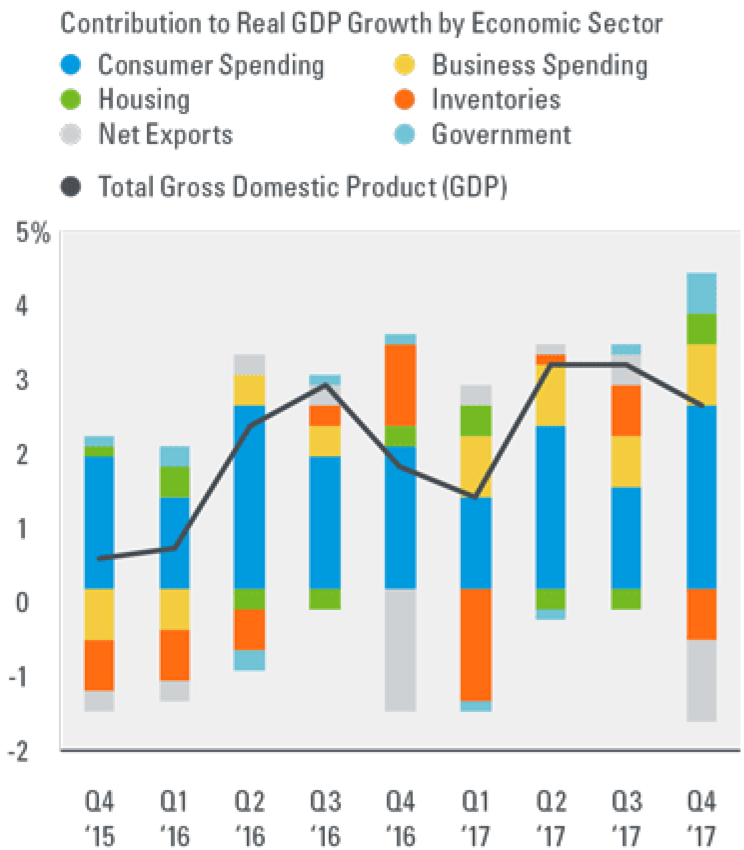
U.S. stocks and bonds were hit by inflation concerns over the past week, but what is the economic data telling us? A barrage of U.S. economic data was released over the past two weeks, including major reports such as fourth quarter gross domestic product (GDP), personal consumption expenditure (PCE) inflation, and the January employment situation report. We will discuss the impact of each individual report in more detail later, but overall the data deluge has signaled that the U.S. economy remains on stable footing. Signs of rising inflation were present in all three reports, which is one of the factors behind both stock and bond weakness over the past week. However, we would remind investors that, for now at least, inflation readings remain below the Federal Reserve's (Fed) 2.0% target, and we would need to see continued acceleration before we would expect a more aggressive path of Fed rate hikes.

GDP MISSES, BUT UNDERLYING DATA SHOWS STRONG DEMAND

The advance release of fourth quarter GDP showed a year-over-year increase of 2.6% on an inflation-adjusted (real) basis. This was below the market's expectation of 3.0%, and also below the 3.2% reading from the prior quarter. However, the underlying data was better than the headline portrayed.

An inventory drag, possibly hurricane related following rebuilding efforts late in the third quarter, was the major reason for the shortfall versus expectations. Trade also hurt, as import growth strongly outpaced export growth and widened the trade deficit. However, the report also featured strong demand, with consumer spending (+3.8%), business equipment investment (+11.4%), and residential construction (+11.6%) all seeing strong results **[Figure 1]**. Government spending, which hasn't been a major driver of GDP in recent years, also grew by 3.0% during the quarter, which is the best since 2015. Removing the impact of inventories and trade (a measure referred to as final sales, based on annualized data), growth would have come in at a solid 4.3%.

1 FOURTH QUARTER GDP MISSED EXPECTATIONS, BUT DEMAND REMAINED ROBUST



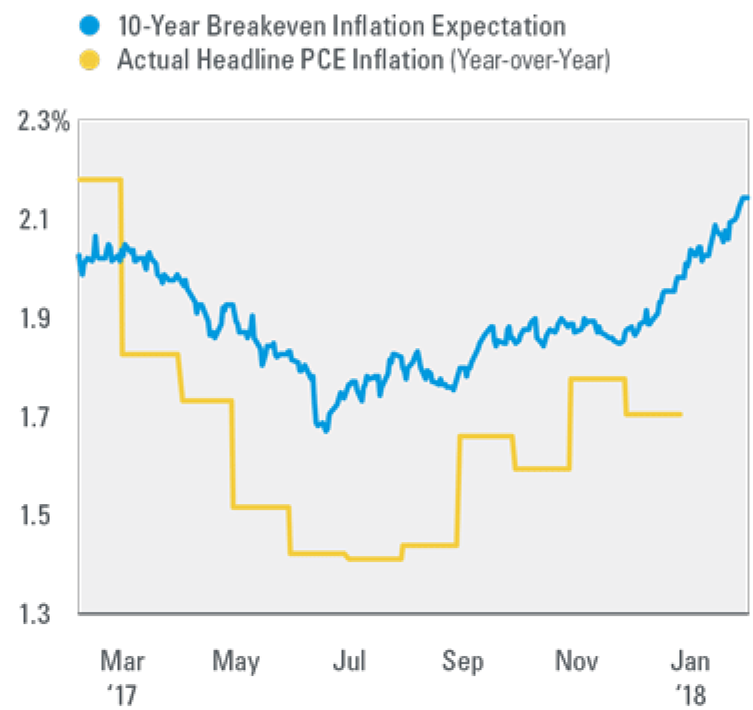
Source: LPL Research, Bureau of Economic Analysis 02/02/18

For the full year of 2017, GDP rose 2.3%, roughly in line with the expansion average, and we expect the impact of the new tax law may help push the pace up closer to 3.0% in 2018.

PCE INFLATION STABLE AT 1.7%

Rising inflation expectations are one factor behind the recent rise in interest rates. Below-target inflation has been a persistent headache for the Fed in recent years, but market-based inflation expectations, such as 10-year breakeven inflation (based on the difference between the 10-year Treasury yield and 10-year Treasury Inflation-Protected Security [TIPS] yield) have started to increase in recent months. However, higher expectations have yet to translate into higher actual inflation, as shown in **Figure 2**.

2 ACTUAL INFLATION LAGGING BEHIND EXPECTATIONS



Source: LPL Research, Bloomberg 02/02/18

Personal consumption expenditures (PCE)

Performance is historical and is no guarantee of future results. Breakeven inflation is measured by the difference between Treasury yields and TIPS yields.

This fact was again highlighted last week with the release of PCE data. Headline PCE met expectations at 1.7% year over year, but decelerated from its November reading of 1.8%. Core PCE (which excludes volatile food and energy prices, and is the Fed's preferred measure of inflation), accelerated slightly from the previous month, but at 1.5% year over year remains well below the Fed's 2.0% target. The report was broadly seen as a step in the right direction for the Fed, but a sustained upward move in inflation may be needed before the Fed can become significantly more aggressive.

EMPLOYMENT REPORT SHOWED CONTINUED STRENGTH

The final major data release last week, and arguably the most impactful, was the January Employment Situation Report. This monthly report indicates how many jobs were created over the prior month, and also gives details on other important measures of labor market strength including the unemployment rate, the labor force participation rate, and wage growth. Wage growth is a particularly important indicator to watch in the current environment, as it is often viewed as a leading indicator of inflation. A tightening labor market typically means that there are fewer workers available, and companies have to pay more when hiring. Given that wages make up a large portion of employer expenses, a strong rise in wages can also mean an increase in overall inflation as companies raise prices in order to maintain profit margins. This chain of events has yet to unfold in the current economic expansion, though last week's employment report did finally show some signs of wage pressure.

The U.S. economy created 200,000 jobs in January, better than the 180,000 consensus expectation and above the upwardly revised 160,000 number in December (which was previously reported at 148,000), although a downgrade to November's job growth made the total revision negative. The unemployment rate remained unchanged at a multi-decade low of 4.1%, but wage pressures did finally start to show, as average hourly earnings hit an expansion high of 2.9%, well above the consensus expectation of 2.6%.

The higher than expected wage growth number helped push bond yields higher, and also led to some weakness in stocks as markets theorized that a sustained growth in wages could give the Fed more ammunition for a faster path of rate hikes. While this number definitely represents acceleration in wages, history suggests that wage growth may need to move considerably higher, toward the 4.0% range, before triggering a significantly more aggressive Fed. In addition, faster wage growth may have been impacted by an increase in the minimum wage in several states and tax-law related bonus increases, which don't necessarily reflect wage pressure from tighter labor markets. We continue to believe that the Fed may raise rates three times in 2018, though this will be an area to watch in the coming months.

CONCLUSION

The large amount of economic data released over the past few weeks shows that the U.S. economy continues to expand at a steady pace. Inflation expectations have been rising over the past few months, and the economic data, including January's employment report, are finally showing some signs that inflation may be starting to move in the right direction (for the Fed). However, actual inflation, as measured by the PCE price deflator, remains below the Fed's 2% target, and we believe that we will need to see a sustained path toward that number, or alternatively at least a stronger move in wage growth, before we are likely to see a significantly more aggressive path of Fed rate hikes.

DEFINITIONS

Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments, and exports less imports that occur within a defined territory.

Personal consumption expenditures (PCE) is a measure of price changes in consumer goods and services. Personal consumption expenditures consist of the actual and imputed expenditures of households; the measure includes data pertaining to durables, nondurables, and services. It is essentially a measure of goods and services targeted toward individuals and consumed by individuals.

Treasury Inflation-Protected Securities (TIPS) help eliminate inflation risk to your portfolio, as the principal is adjusted semiannually for inflation based on the Consumer Price Index (CPI), while providing a real rate of return guaranteed by the U.S. government. However, a few things you need to be aware of are that the CPI might not accurately match the general inflation rate; therefore, the principal balance on TIPS may not keep pace with the actual rate of inflation. The real interest yields on TIPS may rise, especially if there is a sharp spike in interest rates. If so, the rate of return on TIPS could lag behind other types of inflation-protected securities, like floating rate notes and T-bills. TIPS do not pay the inflation-adjusted balance until maturity, and the accrued principal on TIPS could decline, if there is deflation.

Weekly Market Commentary | Week of February 5, 2018

KEY TAKEAWAYS

- Friday's sharp stock market decline might have led us to forget that just a few days ago many claimed the stock market was melting up.
- Now concerns have turned to whether last week's sell-off is the start of something much bigger.
- We discuss whether stocks have melted up or if they are about to melt-down, and share some thoughts on the sharp move higher in interest rates.

MELT-UP OR MELT-DOWN?

Did stocks just melt-up, setting up a possible melt-down? Friday's sharp decline, the biggest since the Brexit vote in June 2016, might have led us to forget that just a few days ago many claimed the stock market was melting up. The strong finish to 2017 followed by big gains in January certainly made this a reasonable characterization. (Though we continue to believe stock valuations are well supported by fundamentals here.)

Concerns have now turned to whether last week's sell-off is the start of something much bigger, or dare we say a meltdown. This week we discuss whether stocks have melted up or if they are about to melt-down.

DID STOCKS JUST MELT-UP?

There is no standard definition of a melt-up, a phrase used to describe a sharp and swift move higher in the stock market (think late 1990s). The logical implication of a melt-up is that stocks are stretched and poised to fall. Our friends at Strategas Research Partners have defined a melt-up as a top five percentile rally in the S&P 500 Index within six months when the index is at new highs. Based on data back to 1985, the top five percentile of 6-month performance for the S&P 500 is 21%. The recent peak in 6-month rolling S&P 500 performance, on January 26, 2018, was 16%, well short of that breakpoint.

Even if we assume stocks just melted up, it does not preclude further gains. Using the melt-up definition above, the S&P 500 experienced 13 of them since the mid-1980s. If you bought the S&P 500 on all of those melt-up dates, you generally ended up doing well. The S&P 500 was up an average of 4% six months after those melt-up dates (median +6%) with gains 75% of the time. And over the next year, the S&P 500 was up an average of 6% (median also 6%) with gains two-thirds of the time. The exceptions were in 1987 and 2007, environments that bear little resemblance to today in our opinion.

ARE STOCKS MELTING DOWN?

Just one week after a possible melt-up peak, Friday's 2.1% loss for the S&P 500 (and ominous 666-point Dow drop) has sparked fears of a melt-down. After a record run, more volatility is to be expected. The S&P 500 just set the all-time record for trading days without a 5% correction, breaking the 1990s record. (The count is now over 400 and the current pullback is at 3.9% through Friday's close.) The S&P 500 generated a positive return every month last year for the first time ever. Although the S&P 500 endured two 1% or more drops last week, the 113-day streak without one through January 29, 2018, was the longest since the mid-1980s. Finally, January was one of the best starts to a year ever.

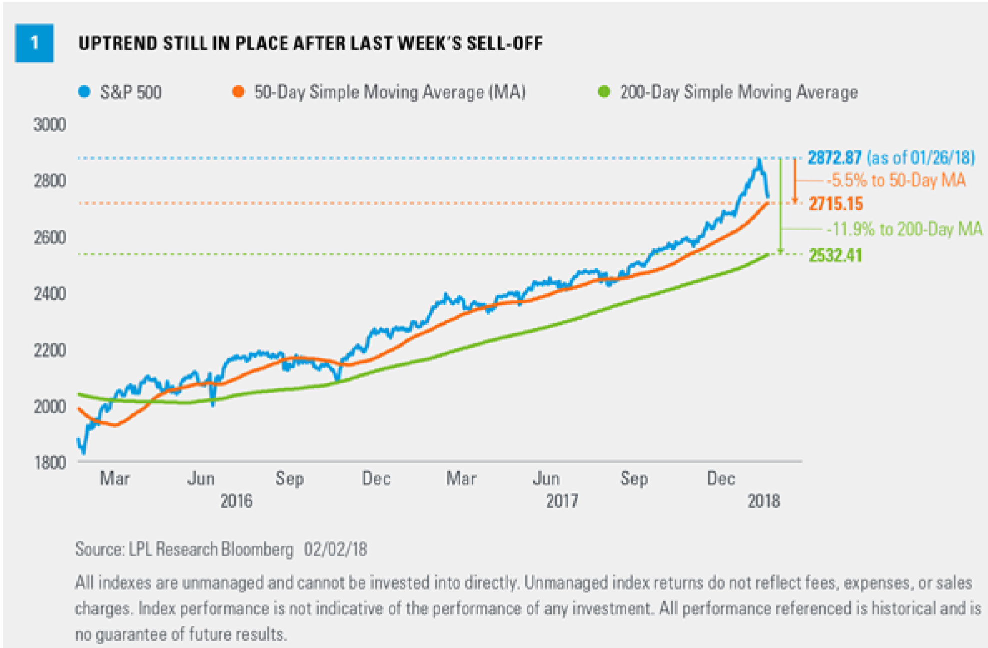
Despite all of that record breaking, we do not see the makings of a significant market top or a possible melt-down:

- **Breadth is healthy.** The percentage of stocks at new highs recently reached a five-year high while a healthy percentage of stocks are in uptrends-about 80% of stocks in the S&P 500 have 50-day moving averages above their 200-day averages even after last week's decline.
- **Credit spreads are tight.** Despite the rise in yields, credit spreads remain well behaved. We do not expect spreads to widen meaningfully this year because of improving economic growth and strong expected gains in corporate profits.
- **Deal activity is muted.** At a bull market top, one would expect heightened levels of merger and acquisition (M&A) and initial public offering (IPO) activity. M&A and IPO activity are historically low and below the pace of two years ago.
- **Earnings revisions are very strong.** Earnings estimates are experiencing very strong positive revisions. S&P 500 earnings estimates have increased by more than 5% year to date, bolstered by the new tax law, accelerating global growth, and a weaker U.S. dollar.
- **Speculation does not appear excessive.** Investor surveys such as that from the American Association of Individual Investors (AAII) are optimistic but not off the charts. Equity inflows have been subdued overall.

We do not see the makings of a significant stock market top or major downturn and continue to believe stocks are well supported by fundamentals.

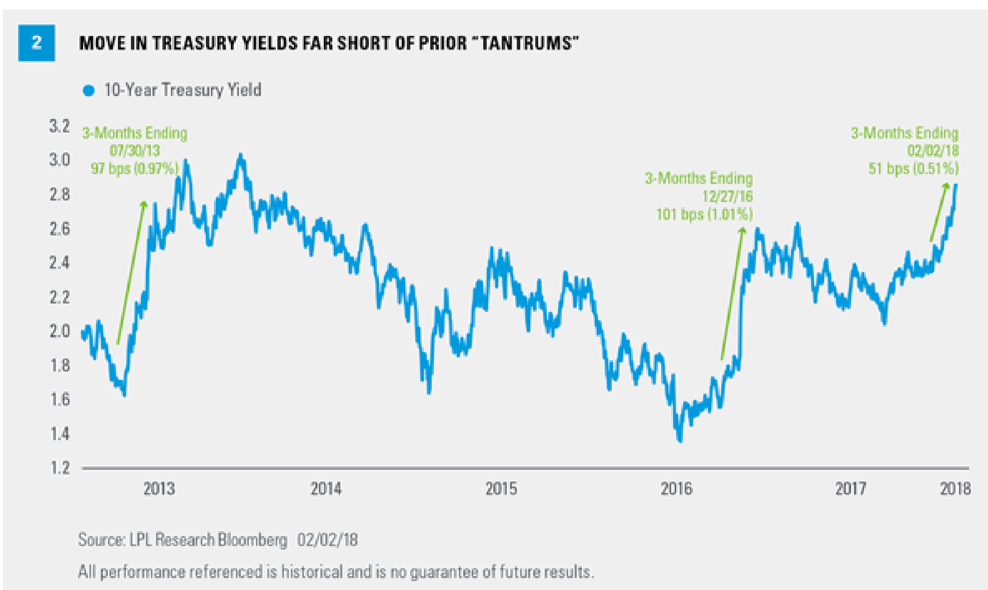
Factoring all of this in, we do not see the makings of a significant stock market top or major downturn and continue to believe stocks are well supported by fundamentals. We expect global growth to accelerate this year, led by a pickup in U.S. growth. Corporate America is in excellent shape, with profits poised for a potential mid-teens increase in 2018, supported by the new tax law. Stock valuations remain well supported by low interest rates despite the latest jump in Treasury yields, and inflation remains well contained.

Bottom line, we believe the latest downdraft in equities appears to be an emerging buy-the-dip opportunity rather than the start of a significant sell-off. Keep in mind, a 5% drop in the S&P 500 still puts the index slightly above its 50-day moving average, while even a 10% correction could leave the index above its 200-day moving average **[Figure 1]**.



QUICK THOUGHTS ON THE JUMP IN YIELDS

Regarding the latest bond market sell-off, we would point out that the 10-year yield, at 2.85%, remains well within our 2.75-3.25% forecast for year-end. As shown in **Figure 2**, the roughly 50 basis point (0.50%) jump in rates over the past three months is still well short of the swift 1% moves over 90 days in 2013 (the "taper tantrum") and 2016 (presidential election). By historical standards, rates around 3% are still low and should not noticeably impair economic activity.



The wage increase (2.9%) in Friday's jobs report spooked some market participants and some volatility is to be expected as markets price in more Federal Reserve (Fed) rate hikes and digest higher interest rates. But typically wage gains need to be 4% or higher before inflation and the Fed become a real challenge for stocks. Also encouraging, the yield curve steepened last week despite the volatility in markets, a positive economic growth signal going forward.

Finally, stocks have proven historically that they can rise along with bond yields at these-or even higher levels.

CONCLUSION

Whether stocks have experienced a melt-up or not is open to debate. But there is no doubt stocks have experienced record-breaking gains and tranquility over the past 12 months, and a pullback was overdue. While we do not know how much longer this sell-off will last, we believe stocks are well supported here by economic and earnings fundamentals. Despite the latest rise, interest rates remain historically low and within the range of our expectations. Wage pressures are not sufficient in our view to significantly change the Fed's plans this year. We see the potential for further gains for stocks over the remainder of 2018 and maintain our fair value S&P 500 range of 2850-2900.

LPL Research also expects the 10-year Treasury yield to end 2018 in the 2.75–3.25% range, based on its expectations for a modest pickup in growth and inflation. Please see the Outlook 2018: Return of the Business Cycle publication for additional descriptions and disclosures.

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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.

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

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.

All investing involves risk including loss of principal.

DEFINITIONS

The 200-day moving average (MA) is a popular technical indicator which investors use to analyze price trends. It is the security or index's average closing price over the last 200 days.

INDEX DESCRIPTIONS

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.

The Dow Jones Industrial Average (DJIA) Index is comprised of U.S.-listed stocks of companies that produce other (nontransportation and nonutility) goods and services. The Dow Jones Industrial Averages are maintained by editors of The Wall Street Journal. While the stock selection process is somewhat subjective, a stock typically is added only if the company has an excellent reputation, demonstrates sustained growth, is of interest to a large number of investors, and accurately represents the market sectors covered by the average. The Dow Jones averages are unique in that they are price weighted; therefore, their component weightings are affected only by changes in the stocks' prices.

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Weekly Economic Commentary | Week of January 29, 2018

Highlights

- Looking forward, we continue to believe the dollar may see moderate strength in 2018, based on tightening monetary policy and pro-growth fiscal policy in the United States.
- A stronger dollar could at some point be a small headwind for otherwise strong corporate earnings in 2018, and may keep downward pressure on inflation.
- The dollar's direction over the long run will be driven by fundamentals, including economic growth, budget and trade deficits, and monetary policy.

Dollar Volatility Persists

The U.S. dollar was in the news recently after comments from Treasury Secretary Mnuchin, European Central Bank (ECB) President Draghi, and President Trump created volatility in the world's reserve currency. Mnuchin indicated that a weak dollar could benefit the United States as it relates to trade and opportunities. Draghi said that a strong euro (and by extension a weaker dollar) is understandable given strong European growth, but he also raised concerns that if other countries start targeting specific currency levels, it could have an impact on the ECB's ability to meet its inflation goals. Trump then followed up saying that he ultimately wants a strong dollar. This mixed messaging has led some to ask why there seems to be disagreement on the path the dollar should take, and what it means for markets.

Historically, a strong dollar has been beneficial for the United States, as it makes foreign goods and services cheaper and helps to keep inflation low; however, some dollar weakness may serve a purpose by improving the trade deficit (as U.S. goods become more attractive to overseas buyers, potentially increasing exports). A weak dollar can also help corporate earnings. In 2016 (the last year for which data are available), approximately 43% of S&P 500 Index revenues came from overseas. Relatively cheaper U.S. goods for foreign buyers can help corporations increase sales, and it also means that more dollars can be purchased with the proceeds of foreign sales, which can serve to boost revenue and earnings per share numbers. That said, we wouldn't want to see too much weakness in the dollar, as it could lead to higher than expected inflation-driven both by higher commodity costs and more expensive imports-and a number of other issues.

WHAT IS DRIVING DOLLAR WEAKNESS?

The U.S. economic situation would seem to augur for a stronger dollar, but that has not been the case over the past year. The dollar did see significant strength in 2014 as the Federal Reserve (Fed) ended its most recent quantitative easing program known as QE3. That momentum continued into late 2016 as rates moved higher and markets started pricing in the potential for pro-growth policies that could push inflation higher [Figure 1]. However, even though many market participants expected a stronger dollar heading into 2017, the dollar weakened instead, and has since given up about half of its post-2014 gains. What has caused this recent weakness?

1 THE DOLLAR WEAKENED IN 2017

Source: LPL Research, Bloomberg, DXY Dollar Index 01/26/18

All indexes are unmanaged and cannot be invested into directly. Unmanaged index returns do not reflect fees, expenses, or sales charges.

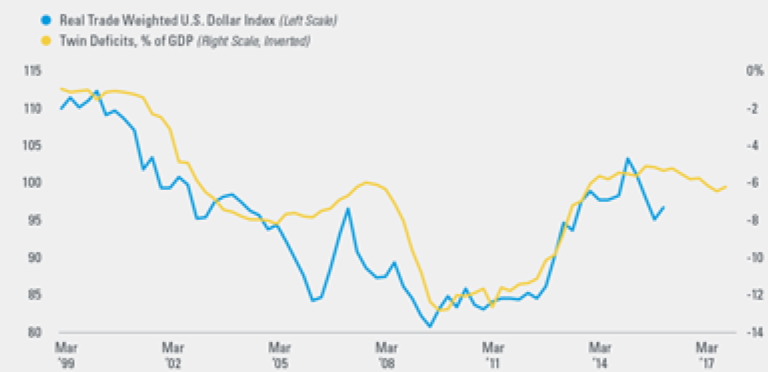
Index performance is not indicative of the performance of any investment.

All performance referenced is historical and is no guarantee of future results.

The value of the dollar is measured relative to other currencies, and stronger global growth led the currencies of many major trading partners to strengthen. The euro makes up 57.6% of the DXY dollar basket (which is often used to measure movement in the dollar); and stronger than expected economic growth, along with a cut to ECB bond purchases announced in October 2017, led the euro to significant gains versus the dollar. The Japanese yen, which makes up another 13.6% of the dollar basket, also saw strength versus the dollar on better-than-expected economic growth, as did the British pound (with an 11.9% weight in the basket) as increasing inflation pushed the Bank of England to raise rates in November 2017 for the first time in 10 years.

Uncertainty around inflation expectations (and the resultant impact on Fed policy), the potential for rising U.S. budget deficits, and an increasing trade deficit have likely been additional reasons for dollar weakness in 2017 and early 2018. Although the DXY dollar basket is often used to measure the dollar's moves versus other major currencies, another way of looking at dollar strength is with a basket of currencies weighted by trade volume with the United States, such as the Fed's Real Trade Weighted U.S. Dollar Index. This measure has historically tracked with an indicator known as the twin deficits which is simply the combined federal budget deficit and trade deficit as a percentage of gross domestic product (GDP). According to analysis done by Strategas Research Partners based on this data, the current weakness in the dollar may be overdone [Figure 2].

2 RECENT DOLLAR WEAKNESS MAY BE OVERDONE



Source: LPL Research, Strategas Research Partners 01/26/18

GDP – Gross Domestic Product

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WEAKNESS EXPECTED TO ABATE IN 2018

As outlined in our *Outlook 2018*, we expect that the dollar may see moderate strength in 2018. The Fed is allowing maturing assets to roll off its balance sheet at a measured pace (as opposed to the ECB and Bank of Japan [BOJ], which are still buying assets), and we continue to expect three Fed rate hikes in 2018, with the first likely in March, while we don't expect any rate hikes from the ECB or BOJ. Additionally, as markets get more clarity around new Fed leadership, the impact of tax reform, and the potential for additional pro-growth policies such as an infrastructure plan and a pivot toward regulatory relief for banks (see this week's *Bond Market Perspectives*, due out tomorrow, for more on this topic), we believe we may see dollar stabilization, or even some outright strength, in the year ahead. This also feeds into our slightly below consensus view on S&P 500 earnings growth given that dollar stabilization could introduce a headwind for earnings that the market isn't necessarily expecting.

CONCLUSION

Even though the past week has been a tough one for the dollar, we expect that we may see some dollar strength over the balance of 2018 as markets get more clarity on U.S. monetary and fiscal policy. Markets have already largely priced in stronger global growth, including higher expectations (relative to the beginning of last year) for Europe, Japan, and China, which may make it harder for these countries to beat their current economic targets, perhaps limiting strength in those currencies. And finally, we believe the market's expectations of slow removal of monetary accommodation in Europe, and continuing accommodation in Japan, may prove out in 2018, limiting the potential for a major upward move in the euro or yen.

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 indexes are unmanaged and cannot be invested into directly.

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

International investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors. These risks are often heightened for investments in emerging markets.

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

The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.

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

Quantitative easing (QE) refers to the Federal Reserve's (Fed) current and/or past programs whereby the Fed purchases a set amount of Treasury and/or mortgage-backed securities each month from banks. This inserts more money in the economy (known as easing), which is intended to encourage economic growth.

INDEX DESCRIPTIONS

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.

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

The Federal Reserve's Trade Weighted U.S. Dollar Index, also known as the broad index, is a measure of the value of the U.S. dollar relative to other world currencies. It improves on the older U.S. Dollar Index by using more currencies and then updating the weights yearly.

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