



LPL FINANCIAL RESEARCH

MIDYEAR OUTLOOK 2017

A SHIFT IN MARKET CONTROL

The New Growth Engine

Here are where these market drivers stand and the themes we'll be watching as we look ahead to the rest of 2017:

An important shift has taken place in this economic cycle. The Federal Reserve (Fed) was finally able to start following through on its projected rate hike path, raising rates twice in just over a three-month period. By doing so, the Fed showed increasing trust that the economy has largely met its dual mandate of 2% inflation and full employment, that the economy is progressively able to stand on its own two feet, and that fiscal policy may now provide the backstop to the economy that monetary policy has provided throughout the expansion. The gauges say growth engines and market drivers may have changed: power down monetary policy, power up business fundamentals, and potentially take fiscal policy and economic growth off standby.

Thus far in 2017, the consistency of this new fiscal-led dynamic has been uneven, leading to shifting market leadership amidst low volatility and a narrow trading range for major market indexes. To be sure, in the post-election rally, the financial markets began to price in many of the pro-growth policies offered by the Trump administration. Yet, despite an initial flurry of activity, political momentum slowed, and investor sentiment dampened even as consumer and business confidence remained high. It is important for investors to appreciate that despite these developments, U.S. equity indexes managed to progress through the first half of 2017 either at, or very near, all-time highs. Moreover, signs of financial stress, based on interest rates, credit spreads, and market volatility, remained largely absent. Most importantly, even with fiscal policy on standby, the return to business fundamentals, such as renewed corporate earnings growth, can now act as a market catalyst. The Fed will still have its role to play, but monetary policy is powering down as the driver of financial market strength.

Despite the significant role of monetary policy as a market driver throughout this expansion, general investing principles have held true. The ability to form a good plan and stick to it, with judicious adaptation to the market environment, is the time-tested foundation of continued progress toward financial goals. If we are shifting to new market dynamics, including a greater role for corporate profits and fiscal policy, understanding the evolving opportunities will be important for diversified investors. Use LPL Research's *Midyear Outlook: A Shift In Market Control* as your guide to the shift in growth engines fueling this market.

Monetary policy

POWERING DOWN

Slow path to normalization.

The Fed has been slowly powering down support since it started tapering its bond purchases in January 2014. Although the slow path to normalization accelerated in the first half of 2017, we expect the Federal Open Market Committee's (FOMC) gradual approach to rate hikes to continue and look for two or three rate hikes in 2017.

Business fundamentals

POWERING UP

Now taking control.

Global monetary policy has helped push equity prices higher since 2014, despite no real earnings growth. That dynamic has begun to change and we expect solid earnings gains in 2017. The central bank-driven market has become a more fundamental-driven market, which may favor active management going forward.

Economic growth

ON STANDBY

Confidence not enough, yet.

Business and consumer confidence have increased, but have not yet provided a significant boost to the economy. Trends in business spending have been encouraging. Policy uncertainty is likely partly to blame for this disconnect and therefore greater policy clarity may help unleash "animal spirits" and spur growth.

Fiscal policy

ON STANDBY

Pro-growth potential, but when?

Implementation of pro-growth policies such as tax reform, infrastructure spending, and deregulation remain likely, but the timetable may very well be pushed back due to political distractions in Washington, D.C. In terms of potential earnings impact, fiscal policy—corporate tax reform in particular—is a 2018 story.

Forecasts @ A Glance

Economy

GDP Growth Near 2.5%

We continue to look for the U.S. economy to expand up to 2.5% in 2017, although potential delays in passing major fiscal policies introduce some risk to the downside. Data on consumption, employment, housing, manufacturing, and services all point toward improvement in the months and quarters ahead following sluggish first quarter GDP growth.

Stocks

6–9% Returns

As investors increasingly trust that the economy can stand on its own without the need of monetary policy support, business fundamentals should take over as the primary market engine and corporate profits will take on increasing importance. We have slightly raised our 2017 S&P 500 Index total return forecast to 6–9%, commensurate with expected earnings gains.

International

Emerging over Developed

Though fundamentals are firming, growth in Europe and Japan has only gradually improved from low levels. Monetary policy has fueled economic and financial market gains with central bank support continuing, yet economic reforms are still needed. We remain cautious on developed international markets, but more constructive on emerging markets (EM).

Bonds

Limited Return Potential

We expect the 10-year Treasury yield to end 2017 in the 2.25–2.75% range, with the potential for moves toward 3.0% should anticipated policy support lead to a meaningful rise in economic activity. Divergent global central bank activities, moderate inflation pressures, and attractive valuations for U.S. Treasuries relative to global alternatives may support bonds at higher yields.

How to Invest

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

U.S. Small Cap Stocks

U.S. small caps have benefited from accommodative monetary policy and may benefit from fiscal policy changes, though valuations are stretched.

Emerging Markets (EM)

Near-term catalysts (global growth, monetary policy) and longer-term trends (six billion consumers) offer opportunities.

Cyclical Sectors

Technology is positioned to benefit from continued solid earnings growth as business investment potentially picks up and drives higher productivity. **Industrials** may benefit from potential spending on defense and infrastructure projects and stronger global demand. **Financials** should benefit from deregulation that may free up capital for lending and dividends, while tighter monetary policy may help profitability.

Master Limited Partnerships

The Trump administration's stance on energy deregulation is supportive; yields remain very attractive but introduce interest rate risk.

Investment-Grade Corporates

We continue to find relative value in investment-grade corporate bonds given continued strength in credit markets and the yield premium over Treasuries.

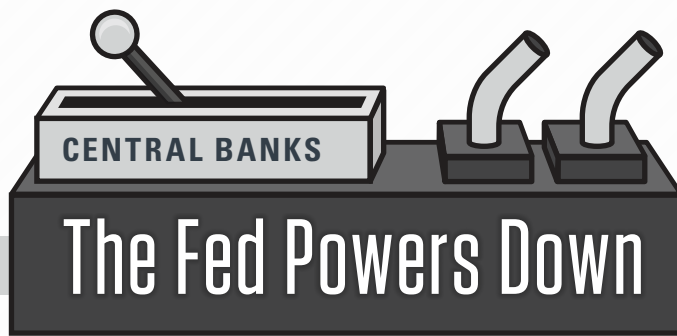
Mortgage-Backed Securities (MBS)

Among high-quality bonds, MBS continue to offer an attractive trade-off between yield and interest rate risk.

Bank Loans

Attractive yields and coupon payments that adjust with short-term rates make bank loans less likely to suffer price declines as rates rise.

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



For the U.S. and global economies alike, the ability to stand on their own without central bank support will be key for financial markets over the balance of 2017 and beyond.

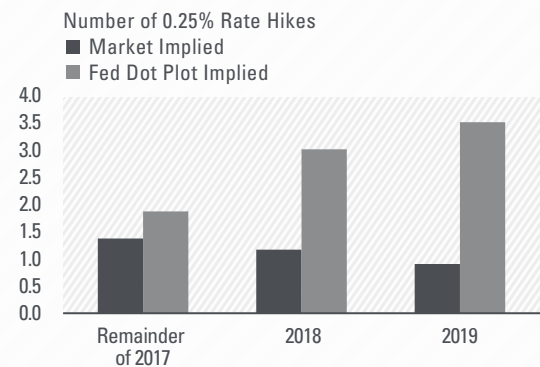
The Fed is powering down its support as it continues on the path to normalization. Considering the age of the business cycle and largely steady, though below-trend growth, the Fed no longer needs to employ emergency-level policy measures. We expect two or possibly three rate hikes in 2017 as the central bank gradually removes its support [Figure 1]. Better U.S. growth amid low unemployment will likely be accompanied by core inflation pushing somewhat above the Fed target of 2%, supporting normalization. But there are still enough forces pushing down on inflation, including excess manufacturing capacity, a low labor force participation rate, and a more stable dollar, that an extended run meaningfully above the Fed's 2% target remains unlikely.

Job creation, which has averaged about 185,000 jobs per month so far in 2017, is likely to slow at

this stage of the business cycle. But even if payroll growth were to decline to a 100,000 to 125,000 monthly pace, we suspect the Fed would still stay on track to hike rates at least twice this year. Wage growth at 2.5% remains below the 4.0% pace that has historically caused central bankers to raise rates aggressively, but has improved enough to keep the Fed on its stated track.

While such a rate hike path would be consistent with the FOMC's statements, monetary officials will need to balance their employment and inflation mandates with the potential U.S. dollar impact. Following a significant rally from late 2014 to early 2015, the dollar has been largely range bound [Figure 2]. Imbalances may occur if the dollar gets too strong relative to other currencies, particularly in EM—representing over half of global economic output—where weak currencies relative to the dollar can lead to capital flight, higher debt service payments, and food inflation. Policymakers are mindful of this, as published statements expressed a possible shift in tactics toward a market-based

1 Fed Expects Gradual Rate Hikes; Market Expects Even Slower

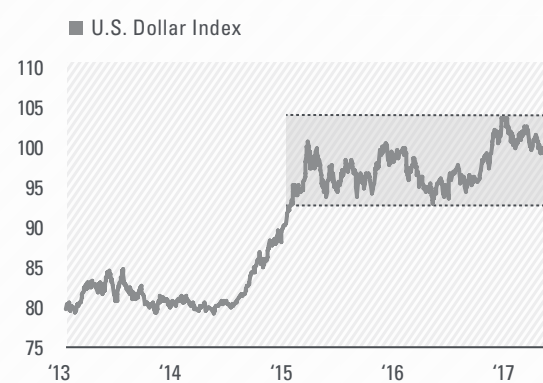


Source: LPL Research, Federal Reserve, Bloomberg 05/19/17

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

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

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



Source: LPL Research, FactSet 05/19/17

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

(ECB) appears to be in a holding pattern—not likely to loosen further (which would benefit bonds), but also not likely to tighten until inflation starts to pick up. The Bank of Japan (BOJ) is in a similar situation, providing more optimistic economic assessments, but still warning that stimulus will need to be maintained at current levels. The end result is low rates overseas may keep U.S. interest rates from moving significantly higher.

form of tightening, referred to as balance sheet runoff, whereby the central bank can reduce the size of its balance sheet by tapering the reinvestment of maturing bonds, potentially beginning in early 2018.

Looking overseas, central bank policy, particularly in Europe and Japan, continues to result in low yields for developed overseas economies. With better growth emerging in many European countries, but inflation still subdued, the European Central Bank

Active Management Spark

Global monetary policy has been an important force helping to push equity prices higher since 2014. As central bank balance sheets expanded, stock prices benefited as bonds became less attractive in a low-yield world. Consequently, equity prices climbed despite flat earnings, resulting in a market driven by a climbing price-to-earnings ratio (investors willing to pay more for potential future earnings).

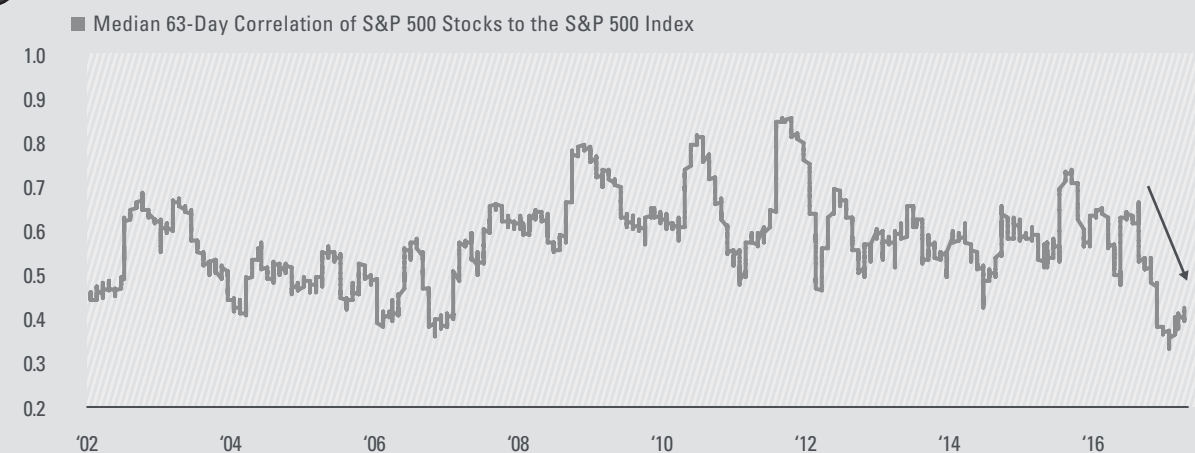
As the Fed has begun to tighten its policy, the central bank-driven market has become more of a fundamentally-driven market. In a fundamental environment, which includes fiscal policy, businesses have a more differentiated response to the macro environment and investors take cues from business fundamentals (earnings, sales, cash flow, etc.). The return of a more "classic" business cycle where fundamentals drive stock performance should favor active strategies going forward.

Reduced reliance on monetary policy has also led to falling correlations between stocks [Figure 3], which has helped drive improved performance for active strategies. It is much easier to find a winner when the market produces a good number of them. A market where everything moves together provides a challenging environment for stock pickers to differentiate themselves versus the indexes.

Broader market leadership is another encouraging development for active managers. When the S&P 500 leads all investment alternatives, diversifying asset classes can detract from performance. More areas, such as international and EM equities, have been outpacing U.S. large caps this year and providing more opportunities to enhance returns.

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

3 Lower Correlations and More Dispersion May Mean Opportunity



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

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

Regularly Scheduled Maintenance Due

We continue to look for the U.S. economy to expand near 2.5% in 2017, although potential delays in passing major fiscal policies introduce some risk to the downside. This below-trend pace is still somewhat stronger than the trajectory that the economy has experienced throughout the expansion [Figure 4], as employment, income, production, and sales have failed to reach levels achieved in prior economic cycles.

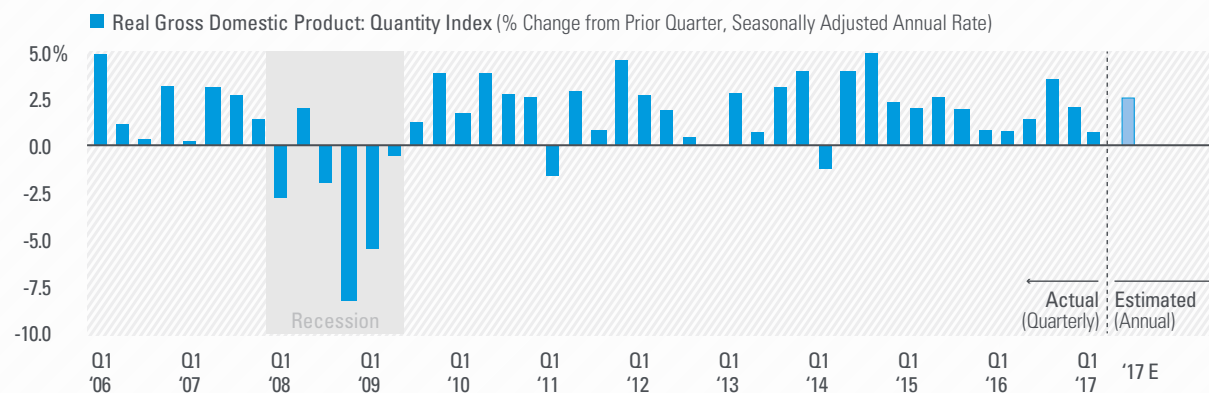
Despite the weak first quarter, we still see U.S. GDP growth approaching our 2017 forecast with potential for further acceleration in 2018. First quarter GDP growth, at 1.2%, was disappointing, but a pattern of first quarter weakness has been evident these past several years as a combination of weather-related events and perhaps an ineffective, seasonal-adjustment process has led to higher revisions and improved growth in ensuing quarters. Recent data on consumption, employment, housing, manufacturing, and services

all point toward potential improvement in the months and quarters ahead following sluggish first quarter GDP growth.

While confidence among consumers and businesses remains very high (so called “soft data”), measures of actual economic activity (“hard data”), such as GDP, have not been as strong in the first part of 2017. The soft data needs to translate into stronger economic activity to reach our GDP growth forecast for 2017. One likely reason for this disconnect is continued policy uncertainty, although we have seen a recent pickup in business investment. While enacting effective pro-growth policy would almost certainly benefit the economy, greater policy clarity may be enough to unleash “animal spirits” and help spur growth.

The recent improvement in job growth with moderate wage gains allows for consumption growth without the need for an accommodative

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

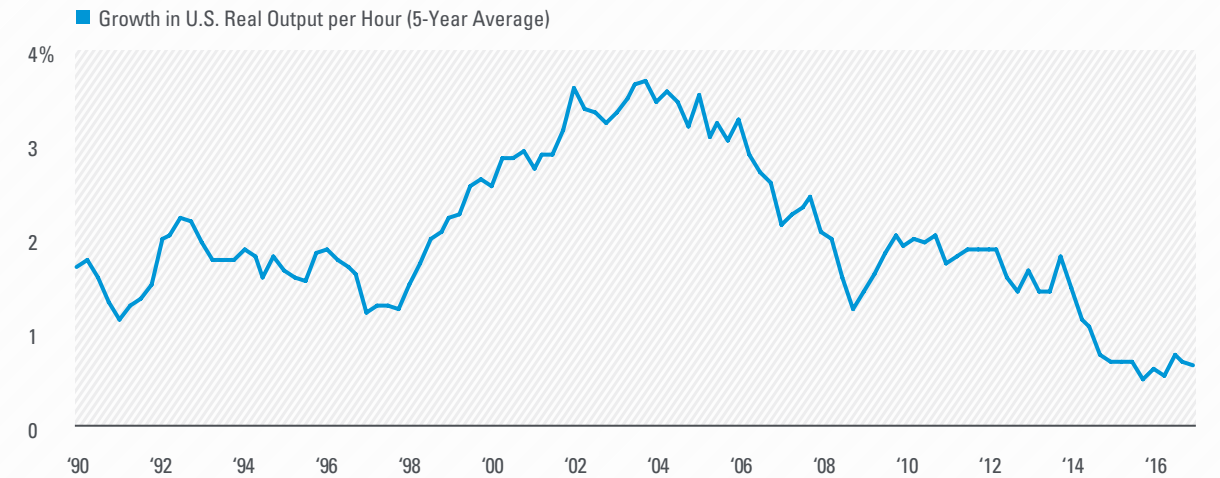


Source: LPL Research, U.S. Bureau of Economic Analysis 05/19/17

Shaded areas indicate recession.

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

5 Growth Needs a Productivity Injection



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

central bank. Meanwhile, anticipated fiscal legislation may provide further incentives for businesses to take economic risks, such as investing in property, plant, and equipment, to position for future growth. This would be a change from recent years, where many businesses used low rates to return cash to investors by issuing debt and buying back shares or paying dividends, choosing the financial risk from more debt on their balance sheets over the economic risk of investing in their businesses. An improvement in capital investment trends would also likely boost productivity, which is essential for raising living standards.

Productivity growth remains the key to any sustainable increase in the rate of economic growth over the long term. There are two primary drivers of economic growth: a larger workforce and an increase in what a member of the workforce can produce, through better training or better resources. The latter is what we call productivity and it has slowed considerably throughout the expansion

[Figure 5]. There are many possible reasons for this, including diminishing returns from technology development and lost skills during the deep contraction in employment during the financial crisis. Business investment is a key element of improving productivity, and we have seen it pick up in the first quarter. Businesses that drive productivity will have an important role to play if we are to see improved economic growth.

Fiscal policy could also enable government spending to help drive GDP, while the Fed's gradual approach may limit upward pressure on the U.S. dollar, eliminating the potential for currency gains to interfere with export growth (a stronger U.S. dollar makes domestic goods more expensive for foreign buyers). Global GDP growth has also been trending positive so far in 2017 and further improvements could also benefit the U.S. economy by boosting exports. Considering these trends for consumption, investment, government spending, and trade, we are sticking with our forecast for near 2.5% GDP growth in 2017.

Business Fundamentals Back At The Controls

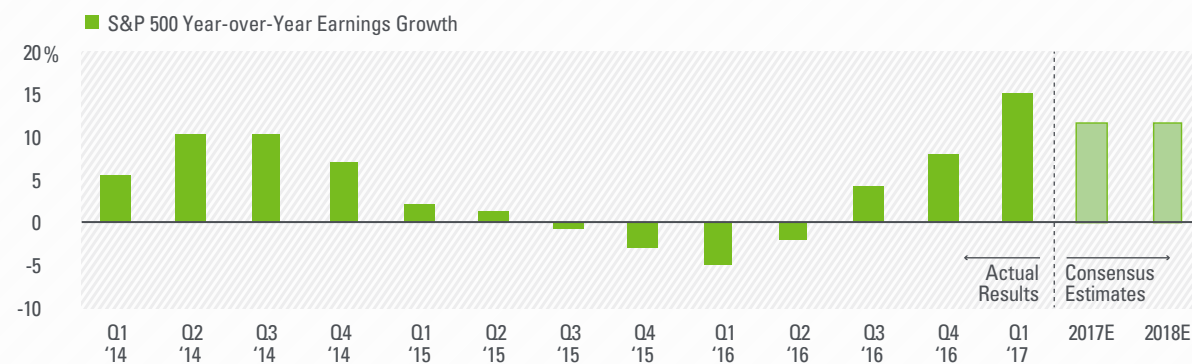
As investors increasingly trust that the economy can stand on its own without the need of monetary policy support, business fundamentals should take over as the primary market driver. As a result, corporate profits will be increasingly important for stocks over the balance of 2017 and into 2018. Our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

Over the past three years, operating earnings for the S&P 500 have been basically flat, at around \$118 per share. Consequently, market returns over this period have been largely due to the combination of price-to-earnings ratio (PE) expansion and dividends. This dynamic has already begun to change. In 2017, we expect solid gains in corporate profits, driven

by potential improvement in economic growth, resilient profit margins, a stable U.S. dollar, and rebounding energy profits. We believe S&P 500 earnings growth near 10% is attainable, putting earnings for the index in the range of \$130 per share, even without any material impact from fiscal policy changes this year.

Corporate America is off to a good start toward hitting our earnings target. First quarter earnings season was a very good one, with S&P 500 profits rising by a much better than expected 15% year over year (Thomson data) [Figure 6] while company guidance for the remainder of the year was also positive. The bar for growth was fairly low, as the comparison was relatively easy considering the struggles of early 2016, particularly in the energy sector. But even excluding the strong contribution from rebounding energy sector profits, S&P 500 earnings were still up over 10% year over year in the first quarter. Even if the earnings trajectory slows some over the course of the year as comparisons with 2016 get tougher, business

6 Earnings Shifting to Higher Gear

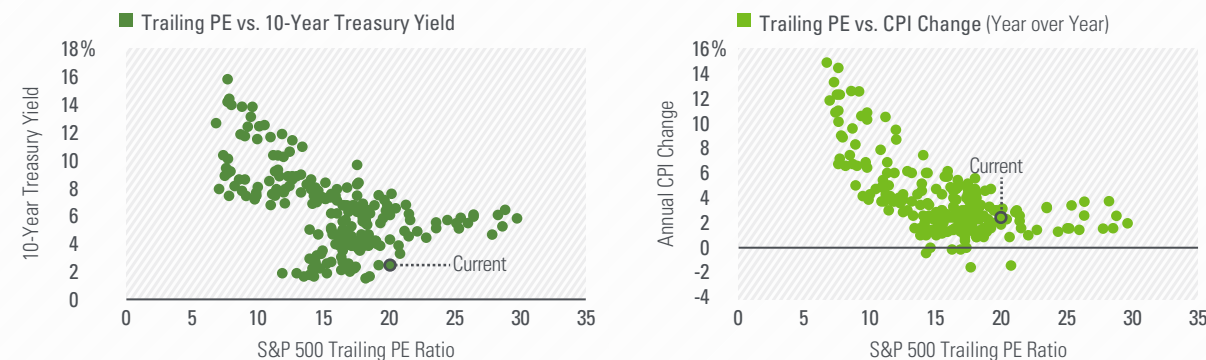


Source: LPL Financial, Thomson Reuters 05/19/17

All indexes are unmanaged and cannot be invested into directly. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment. All performance referenced is historical and is no guarantee of future results. Estimates may not develop as predicted.

7 Higher Valuations Have A Fair Amount of Support

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



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

Data are monthly going back to 1962.

The PE ratio (price-to-earnings ratio) is a measure of the price paid for a share relative to the annual net income or profit earned by the firm per share. It is a financial ratio used for valuation: a higher PE ratio means that investors are paying more for each unit of net income, so the stock is more expensive compared to one with lower PE ratio.

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

fundamentals may still point toward further growth in output and profits.

We look for stocks to see gains commensurate with profit growth, consistent with historical mid-to-late economic cycle performance. At 19–20 times trailing S&P 500 earnings, stocks are expensive relative to their long-term history. However, when viewed against interest rates and inflation still near historic lows [Figure 7], valuations look fair to us. Moreover, the potential policy upside to earnings in 2018 on top of an already upward trajectory for corporate profits could provide further support for equities. Remember, history is littered with examples showing that valuations have been poor predictors of one-year stock market performance.

Additional clarity on corporate tax reform in the coming months will provide further insight into 2018 profit growth and potentially justify elevated stock market valuations. In fact, although we have little more than a high-level framework to go on as June begins, the potential exists for corporate tax reform to boost S&P 500 earnings by 5% or more in 2018, with the obvious condition that the Trump administration and Congress can come together on a package

that can get enough votes to pass the House and Senate. Far from a slam dunk but still, we believe, more likely than not.

While accelerating earnings growth may provide further support for stocks, challenges implementing President Trump's agenda and additional Fed rate hikes could lead to periodic bouts of stock market volatility and may prevent stocks from adding meaningfully to year-to-date gains. Fiscal policy is therefore a wildcard, but meaningful progress toward implementation of corporate tax reform could provide upside for corporate profits in 2018, adding potential fundamental justification for forward PE ratios.

Investors should feel good about where the stock market is as the halfway point of 2017 approaches. The economic expansion is poised to continue and, powered by business fundamentals, this eight-year-old bull market will probably continue as well. Fiscal policy may not help much this year, and there may be bouts of volatility as monetary conditions tighten further, but we think stocks are in a good position to stand on their own as monetary policy support is removed and deliver modest additional gains in the second half of 2017.

Don't Push Until Ready

International markets are also contending with challenges related to the balance between monetary and fiscal policies. Fundamentals are firming in Europe and Japan, and economic growth has been gradually improving from low levels, as these economies attempt to recover from the financial crisis. Monetary policy has been a primary driver of economic and financial market gains with central bank support continuing, yet economic reforms are still needed to address structural challenges. Therefore, we remain cautious on developed international markets. That said, the relative performance between international and domestic markets have a long cycle; we may be poised for a reversal [Figure 8].

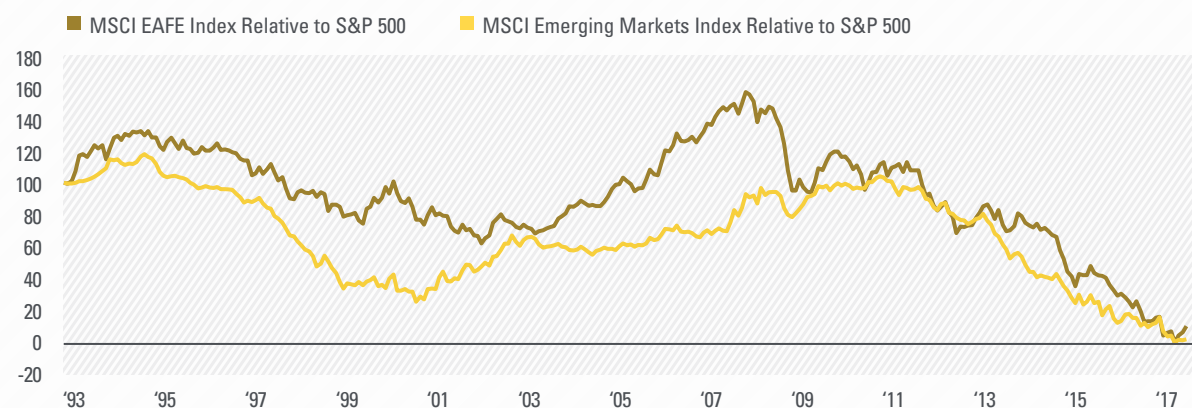
Historically, developed markets have offered relative stability compared to the risks endemic to the emerging space, such as varying economic growth, currency volatility, and uncertain politics. Yet more recently, in part because of limitations on the impact of monetary policy in Europe, EM

may provide more stability, while potential risks related to "Brexit," upcoming elections in Italy and Germany, and structural challenges such as immigration and labor market reform may weigh on developed markets.

Politics and policy aside, fundamentals are firming in Europe and the ECB has given no clear signal regarding when the inevitable reduction of support will take place. Valuations and dividend yields in Europe appear attractive while firming global demand, improving earnings, and the elimination of the worst-case scenarios from the French and Dutch elections have also provided market support.

The backdrop looks to be more favorable for global equity investors in Japan, where political leadership was strengthened last year. The combination of government spending, monetary policy, and structural reforms appears to be supportive of economic and profit growth, while policy tailwinds remain in place as the BOJ maintains

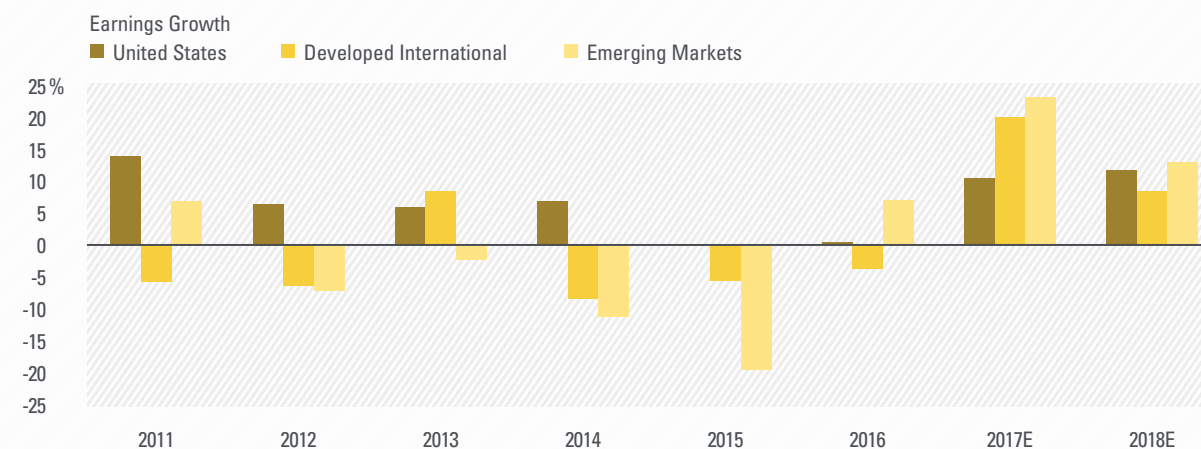
8 International Performance Runs in Cycles



Source: LPL Research, FactSet 05/19/17

Investing in foreign and emerging markets securities involves special additional risks. These risks include, but are not limited to, currency risk, geopolitical risk, and risk associated with varying accounting standards. Investing in emerging markets may accentuate these risks.

9 Earnings Boost: Not Just a U.S. Story



Source: LPL Research, FactSet 05/19/17

Earnings forecasts are based on Thomson Reuters and FactSet consensus.

its accommodative stance. Stronger earnings in Europe and Japan have powered earnings growth for the MSCI EAFE Index solidly higher in 2017 after earnings declines in five out of the last six years [Figure 9].

As has typically been the case, emerging market economies are dependent on Chinese demand, yet given massive investment across EM, fueled in large part by dollar-denominated debt, they remain sensitive to changes in U.S. monetary policy. Steady global demand has boosted output for the largely export-driven economies and driven renewed earnings growth, while falling commodity prices can have mixed results for producers and exporters.

Fortunately, these fundamentals have been largely supportive of global equities, driving what can be

Expectations for earnings globally have increased. More evidence they will be met is required for us to increase investment.

described as a global bull market. Indeed, U.S. indexes remain at, or near, all-time highs and strength is also evident in developed and emerging markets. Global stock market indexes are at or near record highs while both the MSCI EAFE and MSCI EM indexes have outpaced the S&P 500 year to date.

Despite prospects of better global growth, with regard to investments outside the U.S., there are a number of risks that will need to be monitored closely. These include a policy mistake by a central bank or government, the possibility of a trade war, elections in Europe, potential mistakes as the U.K. negotiates leaving the European Union (EU), debt-driven vulnerabilities in China's financial system, and geopolitical uncertainty in places such as North Korea and Syria.

Careful Not To Overload

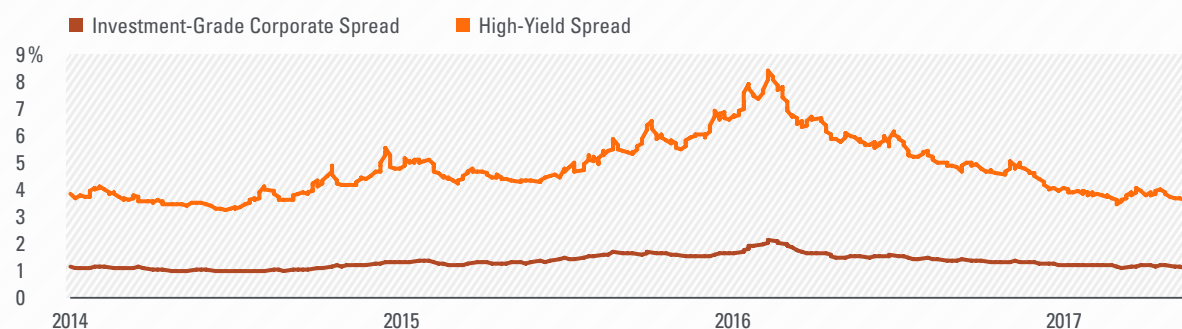
Historically, the bond market has been a pretty good indicator of increased potential for economic and geopolitical risk and thus far, we see little stress evident in the fixed income markets. Of course, year-to-date, short-term U.S. Treasury prices have weakened as the front-end of the yield curve adjusted to the Fed's gradual approach to tightening. For longer-dated Treasuries, following a sharp move lower immediately after the election, periodic increases in demand due to geopolitical threats, European elections, mild inflation, and attractive valuations relative to other sovereigns, have kept prices relatively stable. Moreover, the spread between high yield and investment-grade corporate bond yields relative to Treasuries, and the cost to insure against potential corporate defaults have failed to signal potential looming threats [Figure 10].

Nonetheless, higher rates of economic growth and inflation, along with our base case for one to two additional Fed rate hikes in 2017 (making two to three for the year) may put bond prices under pressure moving forward. As such, we continue

to favor fixed-income positioning with neutral to below-benchmark interest rate sensitivity. Despite our expectation for stability in credit markets, outperformance of the high-yield sector relative to high-quality fixed income has led to tight spreads versus long-term averages, limiting return potential and warranting caution for investors. With little additional room for capital appreciation, yield is poised to be the dominant driver of return.

Our view on interest rates remains unchanged from the first half of 2017. We continue to believe that the combination of government policy, central bank policy, and steady economic growth has the potential to push the 10-year Treasury yield higher, and that our year-end target of between 2.25% and 2.75% remains reasonable. Our bias is toward the upper end of the range, and we could see the 10-year Treasury yield rise as high as 3%, should Congress make meaningful progress toward enacting fiscal stimulus. Scenario analysis based on this potential interest rate range and the duration of the index indicates low- to mid-single-

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



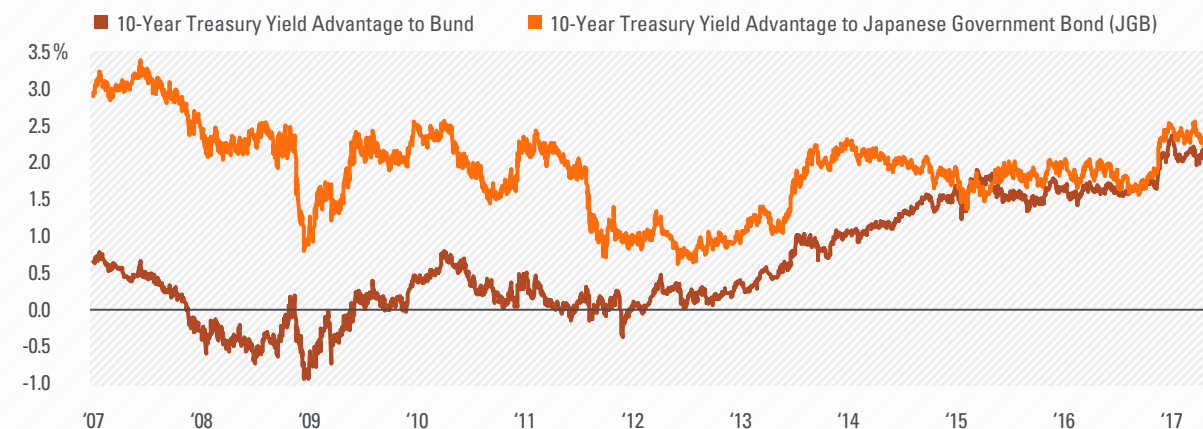
Source: LPL Research, Bloomberg 05/19/17

Option adjusted spread for Bloomberg Barclays U.S. Corporate Bond Index. Option adjusted spread for Bloomberg Barclays U.S. Corporate High Yield Bond Index.

Yield of each index over comparable maturity Treasuries.

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

11 Treasuries Still Showing Power Relative to German Bund and JGB



Source: LPL Research, Bloomberg 05/19/17

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

digit returns for the Bloomberg Barclays Aggregate Bond Index. At that level, however, international demand may once again return as valuations would become very attractive relative to other sovereigns, most notably to Japanese Government Bonds (JGB) and German Bunds [Figure 11].

Risks to our rate call include delays in pro-growth policies, geopolitical risk, and potentially mixed messages from economic data. As demonstrated earlier in the year, delays in pro-growth policy could drag down longer-term yields and support U.S. Treasuries. Geopolitical tensions could flare up at any time (e.g., North Korea, Syria) and drive demand for

We continue to believe that the combination of government policy, central bank policy, and steady economic growth has the potential to push the 10-year Treasury yield higher, and that our year-end target of between 2.25% and 2.75% remains reasonable.

Treasuries. Finally, the disconnect between “soft data” (confidence) and “hard data” (employment and manufacturing) could persist, leaving rates lower longer than we would otherwise expect.

Despite our expectation for muted bond market performance in 2017 based on our yield outlook, we continue to believe fixed income plays a vital role in a well-diversified portfolio, providing income and liquidity during times of equity market stress. High-quality bonds serve as an important diversifier, also helping to manage portfolio risk. Although the absolute return may be minimal, high-quality fixed income's value as a risk mitigation tool should be emphasized in the fixed income portion of one's diversified investment portfolio.



Striving To Efficiency

The gauges say the growth engine for the U.S. economy and markets is changing. Monetary policy is powering down, business fundamentals are powering up, and fiscal policy and economic growth are on the verge of being taken off standby. The Fed has shown increasing trust that the economy has recovered and that market forces can keep it steady. Consequently, we look for fiscal policy to supplement corporate profits as the market's next drivers. In general, consumers and businesses feel pretty good about economic conditions. Consumer and business confidence is high, likely providing the next boost to consumption and investment.

But attempts at a full transfer away from monetary policy have stalled some, evident in headlines in the media about how the Trump administration's agenda may be in danger. Stock market leadership has turned away from those areas of the market best positioned to benefit from the proposed fiscal policies. The latest stall could push the key fiscal policy pillars into 2018, or possibly derail them. The odds still favor corporate tax reform being achieved, while prospects for the rest of the agenda may become tenuous.

It is important for investors to appreciate the implications of a new stock market driver. Much like a portfolio can benefit from diversification, the economy and markets can benefit from different drivers working at different times. As monetary policy powers down, business fundamentals power up, and we wait for fiscal policy to help get the U.S. economy off of standby mode, we hope LPL Research's *Midyear Outlook: A Shift In Market Control* will enable you to identify opportunities that may arise, navigate the challenges that will inevitably come, and help you stick to your long-term investing plan.

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide or be construed as providing specific investment advice or recommendations for any individual security. To determine which investments may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results. All indexes are unmanaged and cannot be invested into directly.

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

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

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

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

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

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

Bank loans are loans issued by below investment-grade companies for short-term funding purposes with higher yield than short-term debt and involve risk.

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

INDEX DEFINITIONS

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

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

The Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS, and CMBS (agency and non-agency).

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

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

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

The MSCI EAFE Index is a free float-adjusted, market-capitalization index that is designed to measure the equity market performance of developed markets, excluding the United States and Canada.

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