

# SECOND QUARTER 2017 IN REVIEW

## HIGHER EQUITY PRICES AMID HISTORICALLY LOW VOLATILITY

- Economic data received over the last three months has generally signaled that U.S. economic activity improved over the second quarter of the year compared to modest gross domestic product growth of 1.4% in the first quarter. The Citigroup Economic Surprise Index, an aggregate measure of economic surprises, did fall to its lowest level since 2011 in mid-June, but disappointments were against elevated expectations; the consensus estimate of Bloomberg-surveyed economists still has growth accelerating to 3.0% in the second quarter. The more subdued expectations are 2.2% growth for all of 2017, near the expansion average of 2.1%. Measures of consumer confidence remain strong and consumer spending picked up after a weak first quarter. However, wage growth remains only modestly above inflation despite a low unemployment rate. Business confidence likewise remains strong and purchasing manager surveys have indicated continued expansion of both the services and manufacturing sectors of the economy. Economic prospects were strong enough for the Federal Reserve (Fed) to continue to slowly scale back accommodative policy, raising rates at its June meeting for the second time this year.

### 1 Q2 2017 AT A GLANCE

	Q2 2017
GDP*	3.0%
S&P 500 Index	3.1%
Bloomberg Barclays Aggregate Bond Index	1.5%
Bloomberg Commodity Index	-3.0%

Please note: All return figures are as of June 30, 2017, unless otherwise stated.

Past performance is not indicative of future results.

The economic forecasts set forth in the presentation may not develop as predicted.

Stock investing entails risk including loss of principal.

Source: LPL Research, Bloomberg, FactSet 06/30/17

\*Bloomberg consensus as of June 30, 2017.

Figures for S&P 500, Bloomberg Barclays Aggregate Bond Index, and Bloomberg Commodity Index are total returns from 03/31/17–06/30/17 (Q2).

All indexes are unmanaged and cannot be invested into directly. The returns do not reflect fees, sales charges, or expenses. The results don't reflect any particular investment.

- Stocks gained 3.1% during the second quarter, based on the S&P 500 Index; continued steady growth in the U.S. economy, generally improving economic conditions overseas, and ongoing central bank support helped offset ebbing enthusiasm for pro-growth policies from Washington, D.C.** Growth outpaced value during the quarter due to biotech strength helping healthcare turn in the top performance. Technology gained as well, but started to show some cracks late in the quarter. Energy weakness hurt value, even though financials did well on optimism overcoming deregulation. Large caps bested their mid and small cap counterparts, but from a global perspective, emerging markets and large foreign markets more than doubled the Russell 3000, building on a strong first quarter as well. The Bloomberg Barclays Aggregate Bond Index returned 1.45%, with longer maturities outpacing short, while more economically sensitive fixed income, including investment-grade corporates and high yield, outpaced high quality. In the end, the theme for 2017 remains: higher equity prices amid historically low volatility.
- Long-term rates decline as bond markets become cautious.** The Treasury yield curve flattened for the second consecutive quarter as short-term yields rose due to the latest Fed rate hike in June. Long-term rates gradually declined over the quarter on declining inflation expectations, which were pushed even lower by oil's 9% decline in price over the quarter. The decline in longer-term yields was a tailwind for fixed income generally. The Bloomberg Barclays Aggregate Bond Index returned 1.5%, outperforming Treasuries which returned 1.2% (Bloomberg Barclays U.S. Treasury Index). The

longer duration profile of the corporate sector boosted the sector to 2.4% over the quarter (Bloomberg Barclays U.S. Investment Grade Corporate Index). Economically sensitive, lower credit quality sectors continued to rally, with high yield returning 2.2% (Bloomberg Barclays U.S. Corporate High Yield Index) and bank loans gaining 0.6% (Bloomberg Barclays U.S. High Yield Loan Index). Similar to the first quarter, many sectors hardest hit in late 2016 continued to rally during the second quarter. Emerging market debt returned 2.2% (JPMorgan Emerging Markets Bond Index), preferreds rallied 3.8% (BofA Merrill Lynch Hybrid Preferred Securities Index), and high-yield municipals returned 2.0% (Bloomberg Barclays Municipal High Yield Index). The U.S. dollar's -4.7% return during the quarter benefited unhedged foreign bonds, which returned 3.8% (Citigroup Non-US World Gov. Bond Unhedged Index) despite rising rates in many foreign developed markets.

- Alternative investment returns were led by the HFRX Event Driven Index, which gained 1.61% during the second quarter.** Positive returns within the category's sub-strategies were widespread, with Merger Arbitrage, Distressed, and Special Situation specialists all profiting during the period. The HFRX Equity Hedge Index gained 1.01%, which trailed the S&P 500 on an absolute basis. However, given most strategies exhibiting a beta profile between 0.35–0.45, relative returns were in-line with the market. The HFRX Systematic Diversified CTA Index led category declines, falling 1.47%. Losses were concentrated in the last week of the quarter, as the sell-off in equity and fixed income markets resulted in steep losses for those strategies positioned long in both asset classes.

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.

Alternative strategies may not be suitable for all investors. The management of alternative investments may accelerate the velocity of potential losses.

- **Despite a nearly 5.0% decline in the U.S. Dollar Index, the Bloomberg Commodity Index declines 3.0%.** Oil prices were lower as production cuts from OPEC were met with increased production from other sources, particularly in the U.S., casting doubt on the ability of the oil market to balance. Master limited partnerships (MLP) were particularly

vulnerable, with the Alerian MLP Index losing 6.4%. Gold prices fell marginally, which again is not what would normally be expected given the weak U.S. dollar. Copper prices climbed .9%, due in part to signs of stability from China. Agriculture prices were lower most of the quarter, but showcased a significant rebound in the last few days of June to pare losses. ■

Commodity-linked investments may be more volatile and less liquid than the underlying instruments or measures, and their value may be affected by the performance of the overall commodities baskets as well as weather, geopolitical events, and regulatory developments.

## A LOOK FORWARD

Our confidence that earnings growth will continue 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, as laid out in our [Midyear Outlook 2017: A Shift In Market Control](#).<sup>\*</sup> 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. We continue to believe that government policy, central bank policy, and steady economic growth have the potential to push the 10-year Treasury yield higher, and that our year-end target of between 2.25% and 2.75% with a potential rise as high as 3%, remains reasonable. ■

<sup>\*</sup>As noted in our *Midyear Outlook 2017* publication, we expect the S&P 500 Index total return to be 6–9%, 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.

## 2 BIOTECH STRENGTH HELPED HEALTHCARE TURN IN TOP SECTOR PERFORMANCE

S&P 500 Sector Performance, Ranked by Second Quarter Returns

Sector	Q2 2017
Healthcare	7.1%
Industrials	4.7%
Financials	4.3%
Technology	4.1%
Materials	3.2%
<b>S&amp;P 500</b>	<b>3.1%</b>
Real Estate	2.7%
Consumer Discretionary	2.4%
Utilities	2.2%
Consumer Staples	1.6%
Energy	-6.4%
Telecom	-7.1%

## 3 STRONG QUARTER FOR INTERNATIONAL MARKETS

Domestic & International Asset Class Performance, Ranked by Second Quarter Returns

Asset Class	Q2 2017
Emerging Markets	6.4%
Large Foreign	6.4%
U.S. Large Growth	4.7%
U.S. Small Growth	4.4%
U.S. Mid Growth	4.2%
U.S. Mid Value	1.4%
U.S. Large Value	1.3%
U.S. Small Value	0.7%

Sources: LPL Research, FactSet 06/30/17

All indexes are unmanaged and cannot be invested into directly. The returns do not reflect fees, sales charges, or expenses. The results don't reflect any particular investment. Past performance is no guarantee of future results.

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

The sectors are represented by the 10 S&P 500 Global Industry Classification Standard (GICS) indexes.

Asset classes based on Russell 1000, Russell 3000 Growth and Value Indexes, Russell 2000, Russell Midcap Index, MSCI EAFE, MSCI Emerging Markets Index.

## 4 ECONOMICALLY SENSITIVE FIXED INCOME OUTPACED HIGH QUALITY

Bond Market Performance, Ranked by Second Quarter Returns

Sector	Q2 2017
Foreign Bonds (Unhedged)	3.8%
Preferred Securities	3.8%
Investment-Grade Corporates	2.4%
Emerging Market Debt	2.2%
High-Yield Bonds	2.2%
Municipal High-Yield	2.0%
Municipal Bonds	2.0%
<b>Bloomberg Barclays U.S. Aggregate</b>	<b>1.5%</b>
U.S. Treasuries	1.2%
Mortgage-Backed Securities	0.9%
Bank Loans	0.6%
Foreign Bonds (Hedged)	0.6%
TIPS	-0.4%

Asset class returns are represented by the returns of indexes and are not ranked on an annual total return basis. It is not possible to invest directly in an index so these are not actual results an investor would achieve.

Bond Market Asset Class Indexes: Foreign Bonds (hedged) – Citigroup Non-U.S. World Government Bond Index Hedged for Currency; Preferred Securities – Merrill Lynch Preferred Stock Hybrid Securities Index; Treasury – Bloomberg Barclays U.S. Treasury Index; Mortgage-Backed Securities – Bloomberg Barclays U.S. MBS Index; Investment-Grade Corporate – Bloomberg Barclays U.S. Corporate Bond Index; Municipal – Bloomberg Barclays Municipal Bond Index; Municipal High-Yield – Bloomberg Barclays Municipal High Yield Index; TIPS – Bloomberg Barclays Treasury Inflation-Protected Securities Index; Bank Loans – Bloomberg Barclays U.S. High Yield Loan Index; High-Yield – Bloomberg Barclays U.S. Corporate High Yield Index; Emerging Market Debt – JP Morgan Emerging Markets Global Index; Foreign Bonds (unhedged) – Citigroup Non-U.S. World Government Bond Index (unhedged)

## 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.

### General Stock & Debt Equity Risks

Stock investing may involve risk including loss of principal.

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.

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

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.

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

Long/short equity funds are subject to normal alternative investment risks, including potentially higher fees; while there is additional management risk, as the manager is attempting to accurately anticipate the likely movement of both their long and short holdings. There is also the risk of "beta-mismatch," in which long positions could lose more than short positions during falling markets.

Distressed Debt is an investment in companies in or near bankruptcy. The investment is often made to gain control of the company with the goal of either improving the operations of the company or disposing of assets. The risks associated with distressed investing arise from several factors including: limited diversification, the use of leverage, limited liquidity, and the possibility that investors may be required to accept cash or securities with a value less than their original investment and/or may be required to accept payment over an extended period of time.

### 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.

### Index Definitions

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

The Bloomberg Barclays U.S. High Yield Loan Index tracks the market for dollar-denominated floating-rate leveraged loans. Instead of individual securities, the U.S. High-Yield Loan Index is composed of loan tranches that may contain multiple contracts at the borrower level.

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

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).

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

The Bloomberg Barclays U.S. Treasury TIPS Index is a rules-based, market value-weighted index that tracks inflation-protected securities issued by the U.S. Treasury.

The BofA Merrill Lynch Preferred Stock Hybrid Securities Index is an unmanaged index consisting of a set of investment-grade, exchange-traded preferred stocks with outstanding market values of at least \$50 million that are covered by Merrill Lynch Fixed Income Research.

The Bloomberg Commodity Index is calculated on an excess return basis and composed of futures contracts on 22 physical commodities. It reflects the return of underlying commodity futures price movements.

The Citigroup Economic Surprise Index (CESI) measures the variation in the gap between the expectations and the real economic data.

The HFRX Equity Hedge Index, also known as long/short equity, combines core long holdings of equities with short sales of stock or stock index options. Equity hedge portfolios may be anywhere from net long to net short, depending on market conditions. Equity hedge managers generally increase net long exposure in bull markets and decrease net long exposure (or even are net short) in a bear market. Generally, the short exposure is intended to generate an ongoing positive return in addition to acting as a hedge against a general stock market decline. Stock index put options are also often used as a hedge against market risk. Profits are made when long positions appreciate and stocks sold short depreciate. Conversely, losses are incurred when long positions depreciate or the value of stocks sold short appreciates. Equity hedge managers' source of return is similar to that of traditional stock pickers on the upside, but they use short selling and hedging to attempt to outperform the market on the downside.

The HFRX Macro: Systematic Diversified CTA Index strategies have investment processes typically as function of mathematical, algorithmic and technical models, with little or no influence of individuals over the portfolio positioning. Strategies which employ an investment process designed to identify opportunities in markets exhibiting trending or momentum characteristics across individual instruments or asset classes. Strategies typically employ quantitative process which focus on statistically robust or technical patterns in the return series of the asset, and typically focus on highly liquid instruments and maintain shorter holding periods than either discretionary or mean reverting strategies. Although some strategies seek to employ counter trend models, strategies benefit most from an environment characterized by persistent, discernible trending behavior. Systematic Diversified strategies typically would expect to have no greater than 35% of portfolio in either dedicated currency or commodity exposures over a given market cycle.

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

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

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

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

The Russell 3000 Index measures the performance of the largest 3,000 U.S. companies representing approximately 98% of the investable U.S. equity market."

The Russell 3000 Growth Index measures the performance of the broad growth segment of the U.S. equity universe. It includes those Russell 3000 companies with higher price-to-book ratios and higher forecasted growth values.

The Russell 3000 Value Index measures the performance of the broad value segment of U.S. equity value universe. It includes those Russell 3000 companies with lower price-to-book ratios and lower forecasted growth values.

The MSCI EAFE Index is recognized as the pre-eminent benchmark in the United States to measure international equity performance. It comprises the MSCI country indexes that represent developed markets outside of North America: Europe, Australasia, and the Far East.

The MSCI Emerging Markets Index captures large and mid cap representation across 23 emerging markets (EM) countries. With 822 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

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. Municipal Index covers the USD-denominated, long-term, tax-exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and prerefunded bonds.

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

The Citigroup Non-U.S. World Government Bond Hedged Index measures the performance of fixed-rate, local currency, investment grade sovereign bonds. This index is a widely used benchmark that currently comprises sovereign debt from over 20 countries, denominated in a variety of currencies, and has more than 25 years of history available. It provides a broad benchmark for the global sovereign fixed income market, excluding the U.S., with currencies hedged against the U.S. dollar.

The USD Index measures the performance of the U.S. dollar against a basket of foreign currencies: EUR, JPY, GBP, CAD, CHF and SEK. The U.S. Dollar Index goes up when the dollar gains "strength" compared to other currencies.

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