Weekly Market Commentary

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The Stock Market's Favorite Season

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Highlights

The stock market should again welcome this earnings season for three key reasons: stronger guidance, dividend increases, and better international results.

Sure, the holiday season is over, but it is still the stock market's favorite season.

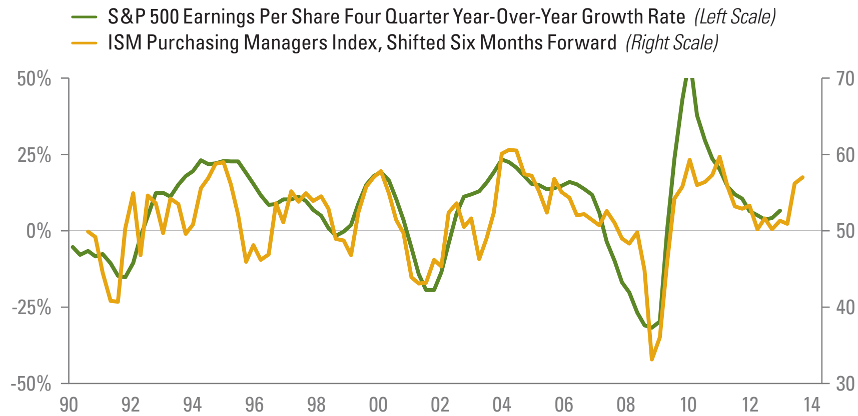
This week starts the earnings reporting season—the start of which is traditionally marked by the earnings report from Alcoa, no longer a component of the Dow Jones Industrial Average, but still a well-known company. Alcoa's report on Thursday, January 9, 2014 is joined late this week by reports from retailers Bed Bath & Beyond and Family Dollar.

The earnings season tends to be a good period for stock market performance. Stocks posted gains during the six-week period that runs from two weeks before to four weeks after Alcoa reports since the bull market began around the start of the second quarter of 2009. In fact, nearly 80% of rise in the S&P 500 Index since the second quarter of 2009 took place during these quarterly earnings periods. Moreover, since the end of 2009, the entire gain in the index came during those quarterly periods, leaving nothing on average but volatility during the other seven weeks of every quarter.

Will the stock market again welcome the news this earnings season? It should for three key reasons:

1. **Stronger Guidance.** We expect businesses to support their earnings outlook by citing the improving trend in economic data and the improved visibility now that the worst of the political brinkmanship is likely behind us. This should help boost business leaders' confidence in future earnings growth and help to improve the outlook for future quarters. Most notably, the widely followed Institute for Supply Management (ISM) Purchasing Managers' Index has a solid track record forecasting earnings growth in coming quarters, as you can see in Figure 1. The latest reading, reported last week, confirms this indicator is suggesting a rebound in earnings and revenues in the quarters ahead.
2. **Dividend Increases.** Historically, the first few months of the year tend to be the biggest months for dividend increases. Increasing dividends helped to lift stocks in the first quarter of last year. In 2013's first quarter, the S&P 500 Dividend Achievers Index, which measures the performance of companies that consistently raise their dividends, led the overall S&P 500 Index higher, outperforming by 2%. S&P 500 dividends have risen at a double-digit pace over the past year and are now about 30% above their 2008 peak. As investors seek yield in a rising rate environment, businesses are increasingly returning their strong cash flow to

1 Reliable Earnings Indicator Pointing Higher



Source: LPL Financial Research, Bloomberg, Thomson Financial 01/06/14

Past performance is no guarantee of future results.

All indices are unmanaged and cannot be invested into directly. The returns do not reflect fees, sales charges or expenses. Index performance is not indicative of any particular investment.

shareholders. We may see sizable dividend increases, especially after last year's strong price run-up effectively lowered yields.

3. **Better International Results.** About 40% of S&P 500 corporate profits are derived from global sources. U.S. companies have seen gains in export orders and economic growth in the Eurozone is expected by the consensus of economists to have been 0.4% in the fourth quarter, the fastest pace since the second quarter of 2011. This may result in better international revenue for U.S. businesses.

The consensus of Wall Street analysts' estimates is for an overall pace of about 7–8% earnings per share (EPS) growth for S&P 500 companies. Given the history of earnings results during the reporting season, companies may beat the estimates by 2–3%. If realized, the 9–10% pace of earnings growth would be the fastest in two years [Figure 2].

2 S&P 500 Earnings Per Share Growth May Be Strongest in Almost Two Years

	4Q13*	3Q13	2Q13	1Q13	4Q12	3Q12	2Q12	1Q12	4Q11
S&P 500 EPS Growth Year-Over-Year	7.6%	6.0%	4.9%	5.4%	6.3%	0.1%	8.4%	8.1%	9.2%

Source: LPL Financial Research, Thomson ONE 01/06/14

*Indicates estimate.

The S&P 500 is an unmanaged index which 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.

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We expect 3–4% global gross domestic product (GDP) growth and inflation of 1–2% in 2014 to drive sales growth for S&P 500 companies of about 5%. In conjunction with the benefit of ongoing buybacks and profit margin expansion, we expect EPS growth of 5–10% in 2014. A strong fourth quarter would be a great start to 2014, where we expect earnings growth to accelerate from a pace of around 5% for most of 2013. This pace of earnings growth, along with a slight rise in the price-to-earnings ratio, should help to drive 10–15% returns for the S&P 500 in 2014. ■

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability. Earnings per share is generally considered to be the single most important variable in determining a share's price. It is also a major component used to calculate the price-to-earnings valuation ratio.

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

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 Institute for Supply Management (ISM) index is based on surveys of more than 300 manufacturing firms by the Institute of Supply Management. The ISM Manufacturing Index monitors employment, production inventories, new orders, and supplier deliveries. A composite diffusion index is created that monitors conditions in national manufacturing based on the data from these surveys.

Purchasing Managers Index (PMI) is an indicator of the economic health of the manufacturing sector. The PMI index is based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment.

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