



Weekly Market Commentary



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Favorable Policy Environment for Stocks in 2015

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Highlights

We expect the policy environment in 2015 to be supportive for stocks.

The transfer of power to Republicans may have a meaningful impact on broad policy measures.

Regardless of the political party in power, the year before the presidential election has historically been a good one for stocks.

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

We would view any ACA-driven weakness as a potential buying opportunity in the healthcare sector, and we are watching for opportunities to take advantage of attractive growth prospects and strong innovation momentum.

We expect the policy environment in 2015 to be supportive for stocks. As discussed in our *Outlook 2015: In Transit*, Republican control of Congress sets up a different policy dynamic in Washington that could have a meaningful impact on broad policy measures such as the Affordable Care Act (ACA), tax reform, the federal budget, and regulations in certain sectors such as energy and financial services. President Obama's interest in building a legacy may lead to more compromise between the White House and Congress than seen in recent years.

Key Policy Issues to Watch in the Year Ahead

Here are our thoughts on the key policy issues for the rest of 2014 and through 2015:

- **ACA.** The president's signature policy initiative, the ACA (also known as Obamacare), is unlikely to be repealed next year, although there is a strong chance that the most unpopular parts of the law will be repealed. The impending Supreme Court ruling in mid-2015 about the legality of ACA subsidies affecting more than 7 million subscribers may force the Obama administration to work with Congress to make significant changes to the law. We would view any ACA-driven weakness as a potential buying opportunity in the healthcare sector, and we are watching for opportunities to take advantage of attractive growth prospects and strong innovation momentum.
- **Tax reform.** Broad tax reform, which would likely take the form of closing corporate, personal, and other tax loopholes while lowering the overall tax rate, would be welcomed by markets. However, the Republican majority in the Senate is not large enough to deliver more than piecemeal changes at this point. Bipartisan agreement exists to lower the corporate tax rate; however, without a filibuster-proof Republican majority in the Senate in 2015, the path to accomplishing this is murky. The Republican win in the runoff election in Louisiana this weekend brings the total Republican Senate seats to 54, short of the 60 needed for a filibuster-proof majority.
- **Federal budget.** Attempts to address the country's long-term structural budget problems in 2015 may lead to a return of some policy-induced uncertainty. The big unknown is whether President Obama and the Republican-led Congress will find common ground in 2015 and cut a long-awaited, long-term deal on the budget. Though a long-term deal is unlikely,



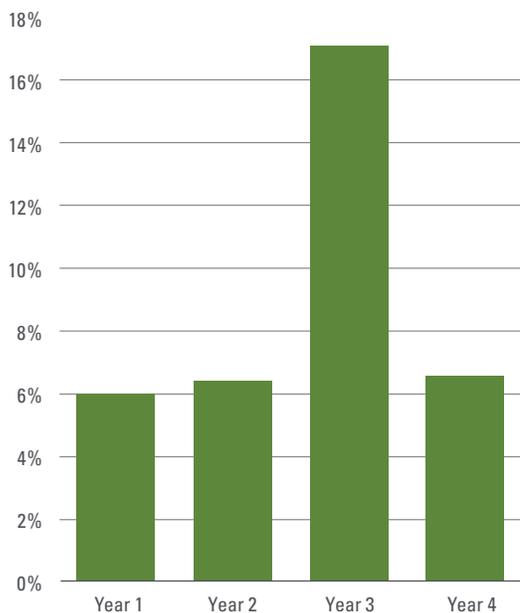
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we are confident a short-term deal to fund the government will be reached ahead of this week's deadline on December 11, 2014, which would avoid a government shutdown. The odds of another debt ceiling debacle (such as we had in 2011), when the U.S. Treasury reaches the debt ceiling in March 2015, are very low based on the rhetoric coming from both political parties, but the possibility does exist.

- **Energy.** The Republican-controlled Congress may help quicken the pace of permitting for oil and gas production, encourage petroleum exports, and could push through the approval of the controversial Keystone XL Pipeline. Progress toward crude oil exports may be slow, given current low prices, although the risk that the pipeline would drive prices higher is a key reason why the project has been delayed. The potential build-out of the Keystone Pipeline, which enjoys bipartisan support, would be positive for energy and industrial companies—creating construction jobs, facilitating exports, and alleviating the U.S. oil inventory glut. Transportation stocks such as rails should continue to chug along as they benefit from increasing U.S. energy production.
- **Financial services.** Under a Republican-controlled Congress, regulatory requirements for regional banks related to the Systemically Important Financial Institution (SIFI) criteria may be eased. The breakpoint for the designation may be raised, potentially to \$100 billion in assets from \$50 billion, alleviating some of the regulatory burden. Community banks may benefit from a reduction in loans they must retain on their balance sheets. Insurance companies with the SIFI designation may benefit from customized and less onerous capital adequacy guidelines.
- **Defense spending.** Operations in Iraq and Syria and the Republican control of Congress help firm up the defense spending outlook and may give the industrials sector a small boost.

1 Year Three Has Been the Best Year of the Four-Year Presidential Cycle

Average Returns for the S&P 500 Since 1950



Source: LPL Financial Research, Bloomberg data 12/04/14

Past performance is not indicative of future results. Indexes are unmanaged and cannot be invested in directly.

A Systemically Important Financial Institution (SIFI) is any firm, as designated by the Federal Reserve, whose collapse would pose a serious risk to the economy.

Presidential Cycle Tailwind

Beyond specific policies, the political calendar in 2015 may also potentially hold good news for stocks. In 2015, we will enter year three of the presidential cycle, historically the best of the four years. This performance pattern, which we believe is at least partly related to pre-election posturing, is shown in [Figure 1](#). Since 1950, during the other three years of the presidential cycle (inauguration year, year two, and the election year), stocks gained an average of about 6%. But during year three (the year prior to the presidential election), stocks have historically produced an average gain of 17%.

These patterns don't always hold of course. But with year three ahead in 2015, investors have this possible tailwind to add to other potentially positive policy developments under a Republican-controlled Congress. Given the generally favorable fundamental picture we see, including an improving economy, a low probability of recession, growing corporate profits, and well-contained inflation, we expect 2015 could be rewarding for stock investors. ■



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Stock investing involves risk including loss of principal

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.

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