

# STRONG 2014 FOR STOCKS AND (SURPRISINGLY) GOOD YEAR FOR BONDS

- U.S. economy has gained momentum.** The U.S. economy got off to a challenging start in 2014 after unusually severe winter weather across much of the country hindered consumer spending and business activity. But the economy has bounced back strongly since then and maintained momentum over the balance of the year. Economic soft spots overseas, tepid housing growth, and slower business spending growth have been headwinds in the fourth quarter, but data received thus far still point to GDP growth of 2.5–3.0% for the quarter.
- Stock market finished 2014 strong.** The S&P 500 produced its eighth straight positive quarter during the fourth quarter of 2014 with a 4.9% return, capping off another strong year for stocks and putting the bull market less than three months away from entering its seventh year. The S&P 500 returned 13.7% in 2014, bringing the cumulative return for this powerful bull market to 240.8%, or 23.4% annualized, since March 9, 2009.
- Stunning oil decline in worst commodities performance since Great Recession.** The Bloomberg Commodity Index followed its worst quarter in more than five years, with an even poorer showing, falling 12.1%. The

Please note: All return figures are as of December 31, 2014 unless otherwise stated.

Past performance is not indicative of future results.

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

The S&P 500 Index is an unmanaged index and cannot be invested into directly.

Stock investing entails risk including loss of principal.

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.

## 1 Q4 2014 AT A GLANCE

	Q4 2014	2014
GDP*	2.5%	2.3%
S&P 500 Index	4.9%	13.6%
Barclay's Aggregate Bond Index	1.8%	6.0%
Bloomberg Commodity Index	-12.1%	-17.0%

Source: LPL Financial Research, FactSet, Bloomberg 12/31/14

\*Bloomberg consensus as of December 31, 2014

Figures for S&P 500, Barclays Aggregate Bond Index, and Bloomberg Commodity Index are total returns from 10/1/14–12/31/14 (Q4) and 1/1/14–12/31/14 (2014).

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.

loss brought 2014 returns to -17.0%, the weakest since the Great Recession. Energy drove most of the quarter's losses, with crude tumbling more than 40% amid concerns about global oversupply.

- **Strong performance from longer, high-quality bonds.** Fixed income performance finished the year strongly with the Barclays U.S. Aggregate Bond Index up a healthy 1.8% in the fourth quarter of 2014. The quarter was a microcosm of the year with long-term, high-quality bonds, such as investment-grade corporate bonds and mortgage-backed securities, benefiting from a sharp drop in U.S. yields. For the year, the

Barclays Aggregate Bond Index returned a solid 6.0% as the 10-year Treasury yield fell more than 80 basis points to 2.17%.

- **Alternative investments plodded along in quiet 2014.** As measured by Hedge Fund Research (HFR), broad hedge fund performance delivered muted fourth quarter and 2014 results. Significant return dispersion exists at the underlying category level, with individual strategies such as managed futures and global macro generally benefiting from diverging global economic developments.

## A LOOK FORWARD

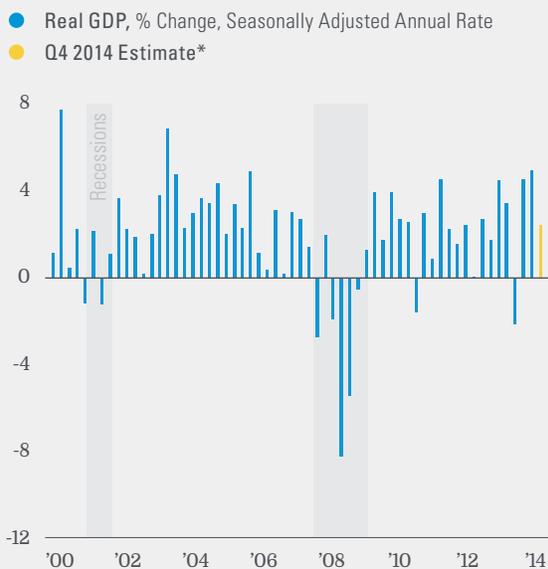
We expect the U.S. economy will expand at a rate of 3% or slightly higher in 2015, matching the average growth rate over the past 50 years, based on contributions from consumer spending, business capital spending, and housing. That economic growth forecast, along with solid earnings gains, benign global monetary policy, and a favorable policy climate in Washington, should support mid- to high-single-digit returns for stocks in 2015. We see little, if any, growth potential for bonds in 2015, due to the U.S. economic expansion and the Federal Reserve's impending interest rates hikes.

For more insight into our forecasts, please see our *Outlook 2015: In Transit*.

## U.S. ECONOMY HAS GAINED MOMENTUM

The U.S. economy got off to a challenging start in 2014 after unusually severe winter weather across much of the country hindered consumer spending and business activity. But the economy has bounced back strongly since then and has maintained momentum over the balance of the year. Although the extra bounce from pent-up demand off of first quarter weakness has faded, recent economic reports, on balance, have been positive. Based on data for October and November, consumer spending, as measured by real personal consumption expenditures, is off to its best quarterly start since 2009, while industrial production data over the same period were the strongest since 2010. Economic soft spots overseas, tepid housing growth, and slower business spending growth were headwinds in the fourth quarter, but data received thus far still point to GDP growth of 2.5–3.0% for the quarter [Figure 2].

### 2 U.S. ECONOMY GAINS MOMENTUM



Source: LPL Financial Research, Bureau of Economic Analysis, Haver Analytics 01/02/15

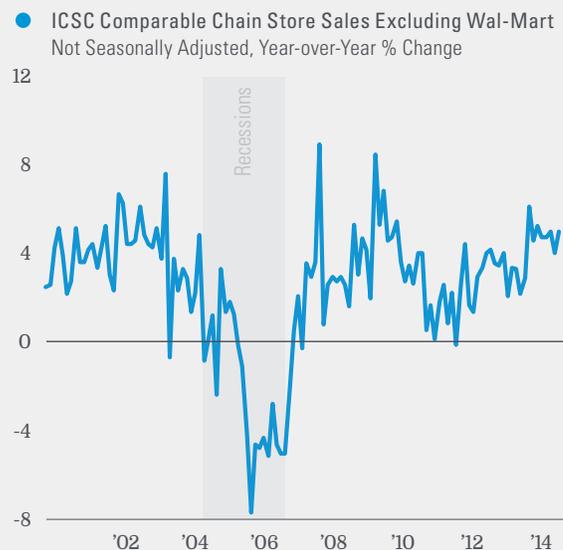
Shaded areas indicate recession.

\*Reflects Q4 2014 Bloomberg-tracked consensus of economic forecasters at 2.5%.

## Job Market Gains Help Support Consumer Spending

Solid consumer spending growth in the fourth quarter was supported by a steadily improving labor market, lower oil prices, and continued stock market gains. As of the November employment report, the unemployment rate fell from 7% to 5.8% over the past 12 months, while total nonfarm payroll growth topped 200,000 every month last year except for January, including a much better than expected 321,000 jobs added in November 2014. Despite the improvement, some areas of the labor market are still struggling: wage growth remains modest and the labor participation rate (percentage of working age population that is working) has fallen to levels not seen since the 1970s. Nevertheless, labor markets are healing, the consumer spending component of GDP strengthened in both the second and third quarters, and data received for the fourth quarter to date are encouraging, including retail sales during the first half of the important holiday shopping season [Figure 3].

### 3 ON TRACK FOR SOLID HOLIDAY SHOPPING SEASON



Source: LPL Financial Research, ICSC, Haver Analytics 01/02/15

Shaded areas indicate recession.

The International Council of Shopping Centers (ICSC) is a global trade association of the shopping center industry.

## Inflation Remains Well Contained

Broad measures of inflation remained well contained this quarter, helped by limited wage pressure, falling oil prices, and generally slower growth in the global economy. The Consumer Price Index (CPI) has risen only 1.3% year over year as of the December 2014 release (1.7% excluding food and energy). Although lower oil prices have certainly contributed to low inflation, excess industrial capacity and limited wage pressures remain important drivers. We have, however, started to see some modest incremental pressure on key inflation drivers during the third and fourth quarters, suggesting that if the U.S. economy remains on track and oil finds a floor, inflation may begin to slowly accelerate toward the Federal Reserve's (Fed) 2% target. This would give the Fed cover to begin hiking interest rates during the latter half of 2015, as the consensus of economic forecasters generally expects.

## Business Spending Rebound

Nonresidential fixed investment, a proxy for business capital spending in the government's GDP data, grew by an average of over 9% annualized in the second and third quarters of 2014, as healthy cash balances, still low borrowing costs, generally healthy credit markets, and improved business confidence all contributed to a strong rebound in business investment after the slow start to the year. Although fundamentals for business investment remained positive as 2014 ended, and lower energy costs help most manufacturers, spending slowed in October and November (based on the durable goods report), and capital spending reductions by the oil and gas industry present a headwind.

## Struggles for Developed International Economies Continue

Eurozone economic growth remained lackluster throughout 2014, and Bloomberg-tracked consensus estimates for the fourth quarter suggest

the region's growth will remain under 1%. The European Central Bank (ECB) continued to take steps to try to boost growth, but these measures have not flowed through to the economy, due to still fairly tight lending standards and a fragmented financial system. The Japanese economy has also been trying to find firmer footing after contracting in the second and third quarters. Data out of Japan have pointed to potential growth in the fourth quarter, based on consensus estimates as of December 31, 2014, but the economy remains fragile and Prime Minister Abe's bold efforts to stimulate the economy have failed to gain much traction thus far.

## Still a Mixed Picture for Emerging Markets

Diverging paths of economic growth for emerging markets (EM) during the fourth quarter were exacerbated by the sharp drop in oil prices, which hit commodity-producing countries like Russia, Brazil, and Venezuela hardest. Falling oil prices tipped the Russian economy into recession in the fourth quarter, where growth already faced headwinds due to international sanctions and an increasingly unattractive business environment. The impact of falling oil prices, however, has been minimal to positive for many EM countries that are net commodity importers, notably China and India. Despite a stalling housing market, China continues to avoid a hard landing as it tries to transition to a more consumer-led economy and engages in targeted stimulus measures. Economists' consensus sees fourth quarter growth remaining near 7%. The economic backdrop remains challenging for many EM countries and risks increased in the fourth quarter, but collectively they are still growing faster than developed economies.

## Brief Look Ahead: Leading Indicators Continue to Suggest Low Likelihood of Recession

The Index of Leading Economic Indicators (LEI)—compiled by the Conference Board, a private

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, disease, and regulatory developments.

International and emerging markets investing involves special risks, such as currency fluctuation and political instability, and may not be suitable for all investors.

sector think tank—is comprised of 10 primarily fundamental economic indicators and is designed to forecast the future path of the economy with a lead time of between 6 and 12 months. When the year-over-year rate of change in the LEI turns negative, a recession has historically followed by anywhere from 0 to 14 months. The year-over-year increase in the LEI of 6.2% in November 2014 (from an LEI of 99.3 in November 2013 to 105.5 in November 2014) [Figure 4], supported by better economic growth and less policy uncertainty in Washington, suggests a less than 5% probability of recession over the next 12 months. We agree with the LEI's signal that the U.S. economy is in the middle of an expansionary cycle that began in mid-2009.

## STOCK MARKET FINISHES 2014 STRONG

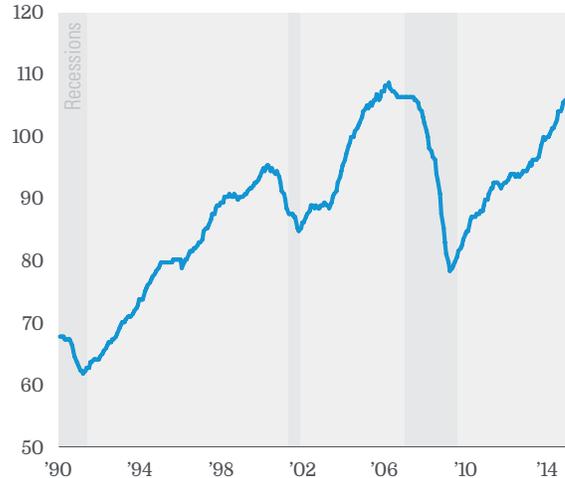
The S&P 500 produced its eighth straight positive quarter during the fourth quarter of 2014 with a 4.9% return, capping off another strong year for stocks and putting the bull market less than three months away from entering its seventh year. The S&P 500 returned 13.7% in 2014, bringing the cumulative return for this powerful bull market to 240.8%, or 23.4% annualized, since March 9, 2009 [Figure 5].

Stock market gains in 2014 were supported more by earnings than price-to-earnings ratio (PE) expansion. S&P 500 earnings, based on Thomson Reuters consensus estimates, are on track to grow 8% during 2014 compared with the prior year. Despite a drag from the energy sector beginning in the fourth quarter, earnings are still expected to grow by mid-single digits during that period. Profit growth has been driven by better economic growth, including a pickup in capital spending as well as high and stable profit margins, with an ongoing boost from companies buying back their own shares to reduce share counts.

The PE ratio (price-to-earnings ratio) is a valuation ratio of a company's current share price compared with its per-share earnings. A high PE suggests that investors are expecting high earnings growth in the future, compared with companies with a lower PE.

### 4 LEADING ECONOMIC INDICATORS CONTINUE TO SUGGEST LOW PROBABILITY OF RECESSION

● Conference Board Index of Leading Economic Indicators (Year over Year)



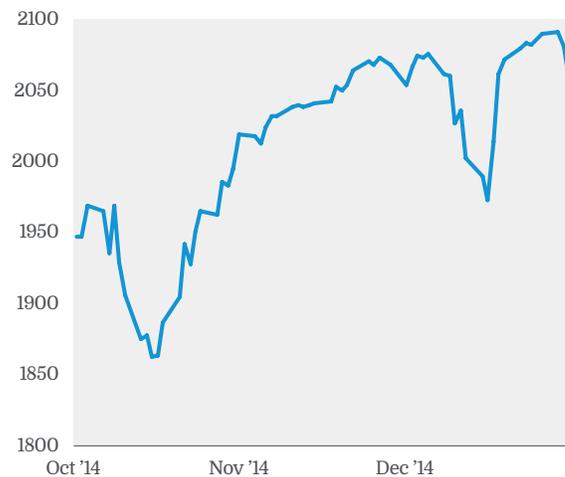
Source: LPL Financial Research, Bloomberg, Conference Board 12/31/14

Shaded areas indicate recession.

The Index of Leading Economic Indicators (LEI) is an economic variable, such as private-sector wages, that tends to show the direction of future economic activity.

### 5 ANOTHER POSITIVE QUARTER FOR STOCKS

● S&P 500



Source: LPL Financial Research, FactSet 12/31/14

The S&P 500 Index is an unmanaged index, which cannot be invested into directly. Past performance is no guarantee of future results.

## 6 DEFENSIVE SECTORS PERFORMED BETTER IN 2014; ENERGY AN OUTLIER

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

Sector	Q4 2014	2014
Utilities	13.2%	29.0%
Consumer Discretionary	8.7%	9.7%
Consumer Staples	8.2%	16.0%
Healthcare	7.5%	25.3%
Financials	7.3%	15.2%
Industrials	6.8%	9.8%
Technology	5.2%	20.1%
S&P 500	4.9%	13.7%
Materials	-1.8%	6.9%
Telecom	-4.2%	3.0%
Energy	-10.7%	-7.8%

Source: LPL Financial Research, FactSet 12/31/14

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

**Cyclical sectors** are economically sensitive and typically have stronger performance as economic and market conditions improve.

**Defensive sectors** typically are less economically sensitive and tend to perform relatively better in more challenging economic and market environments.

The Fed, which is taking its time paring back stimulus, has provided additional support for the stock market by helping to keep interest rates low, as low interest rates help make stocks relatively more attractive versus bonds. Midterm Congressional election results in the United States, which brought more policy certainty and greater potential for compromise in Washington, also helped the stock market backdrop.

Energy's sharp decline late in 2014 was the biggest sector story of the year, nearly matched by the sector-leading 29% return of the utilities sector. Energy fell 10.7% during the fourth quarter, dramatically trailing the other nine equity sectors, as both oil and natural gas prices fell sharply and producers reduced capital spending plans for 2015. Master limited partnerships (MLP) were caught in this downdraft with the Alerian MLP Index losing 12.3% during the quarter. Excluding energy, fourth quarter performance for the economically sensitive (cyclical) and defensive (less economically sensitive) sectors was generally in-line, although the top performer (utilities) was defensive.

Even excluding the outlier energy sector, which lost 7.8% for the year, defensive sectors produced better returns in 2014 than their cyclical counterparts, a historically unusual pattern in a rising stock market, but one that has become more common as bond yields have fallen. Lower bond yields made the dividends offered by utilities, consumer staples, and real estate investment trusts (REIT) more attractive. Lower bond yields also led some market participants to use higher-yielding equities as a substitute for bonds (despite their higher volatility), providing support for these income-oriented equity sectors. Healthcare, a lower-yielding defensive sector, benefited from strong new drug development and additional new patients covered under the Affordable Care Act (ACA) [Figure 6].

Investing in real estate/REITs involves special risks such as potential illiquidity and may not be suitable for all investors. There is no assurance that the investment objectives of this program will be attained.

## Small Caps Fell Short in 2014 Despite Fourth Quarter Rally

After struggling all year relative to large caps, small caps (represented by the Russell 2000) staged a strong comeback during the fourth quarter of 2014 with a near double-digit return on strength in the financials, healthcare, and technology sectors. Despite the comeback, small caps still only produced a 4.9% return for the full year, trailing the large cap S&P 500 by more than eight percentage points [Figure 7]. For much of 2014, small caps were hurt by valuation concerns, which offset the benefits small caps enjoyed from the healthy merger and acquisition environment and their domestic focus.

## Little Distinction Between Growth and Value

Growth and value performed similarly during the fourth quarter and throughout 2014, based on the Russell 3000 Growth and Value indexes. During the quarter, growth benefited most from lower energy exposure and a higher consumer discretionary weight, while value got a boost from the strong relative performance of its consumer discretionary and technology holdings. A higher technology weight and lower energy exposure benefited growth the most over the entire year, while value was helped most by its utilities exposure and strong relative performance from its consumer discretionary and technology holdings. The Russell 3000 Value Index returned 5.3% in the fourth quarter and 12.6% for 2014, compared with 5.2% (Q4) and 12.4% (2014) for the Russell 3000 Growth Index [Figure 7].

## Weak Growth and Deflation Fears Continued to Weigh on European Markets

Developed foreign markets trailed the U.S. stock market indexes by a sizable margin during the fourth quarter and in 2014, due to subpar economic growth in the Eurozone and weakness in the euro currency as the ECB continued to have limited success

Growth-oriented funds may underperform when value investing is in favor, and growth stocks may be more volatile than other stocks because they are more sensitive to investor perceptions of the issuing company's growth of earnings potential.

Value investments can perform differently from the market as a whole. They can remain undervalued by the market for long periods of time.

fighting deflation. Led down by Europe, the MSCI EAFE Index fell 3.5% during the fourth quarter and 4.5% for the full year [Figure 7], significantly behind the positive 4.9% and 13.7% returns for the S&P 500. While Europe was the biggest laggard, benchmarks in Japan and for the Asia-Pacific region also suffered losses for the quarter and year.

## EM Equities Hit by Falling Oil Prices

Emerging markets also lagged behind the U.S. stock market indexes in both the fourth quarter and 2014. The latest bout of weakness was driven by the sharp drop in oil prices and the significant challenges that presented for oil-exporting EM nations, Russia in particular. Throughout the year, EM was hurt by prospects of the Fed raising interest rates, a strong U.S. dollar, and escalating geopolitical risk in such places as Ukraine, Syria, Iraq, and Israel. Led down by Russia, South Korea, and Brazil, the MSCI EM Index fell 4.4% during the fourth quarter, bringing its 2014 loss to 1.8% [Figure 7]. China and India were bright spots with solid reform-driven gains.

## 7 U.S. STOCKS FAR OUTPACED INTERNATIONAL AND EM IN Q4 AND 2014

Ranked by Fourth Quarter Returns

Asset Class	Q4 2014	2014
U.S. Small Cap	9.7%	4.9%
U.S. Mid Cap	5.9%	13.2%
U.S. Value	5.3%	12.6%
U.S. Growth	5.2%	12.4%
U.S. Large Cap	4.9%	13.2%
Emerging Markets	-4.4%	-1.8%
Developed Foreign	-3.5%	-4.5%

Source: LPL Financial Research, FactSet 12/31/14

Based on Russell 1000, Russell 3000 Growth and Value Indexes, Russell 2000, Russell Mid Cap Index MSCI EAFE, MSCI Emerging Markets Index Total returns from 10/1/14–12/31/14 (Q4) and 1/1/14–12/31/14 (2014).

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.

## STUNNING OIL DECLINE IN WORST COMMODITIES PERFORMANCE SINCE GREAT RECESSION

The Bloomberg Commodity Index followed its worst quarter in more than five years with an even poorer showing in the fourth quarter, falling 12.1%. The loss brought 2014 returns to -17.0%, the weakest since the Great Recession.

Energy drove most of the quarter's losses, with crude tumbling more than 40% [Figure 8]. Concerns about global oversupply that sparked the sell-off came to a head when OPEC (Organization of Petroleum Exporting Countries) proved unwilling to curb its 2015 output quota. The Thanksgiving Day announcement caught many market participants by surprise, spurring a wave of selling that also took down gasoline and heating oil prices. Natural gas also sold off, although this was primarily due to

warmer weather and rising inventories rather than oil glut concerns.

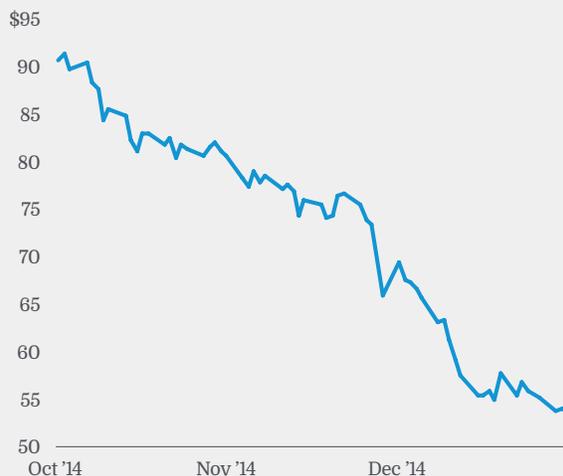
Precious metals (-3.1%) fell in dollar terms (the U.S. dollar rose 5% during the fourth quarter), including a 2.3% loss in gold [Figure 9], but were quite positive in yen and euro terms as geopolitical concerns (Russia and Greece) coupled with weakness in the yen (driven by the Bank of Japan) drove incremental buying overseas. Industrial metals, which slipped 5.9% during the fourth quarter, held up relatively well considering the strong U.S. dollar, as losses were mitigated by hopes of Chinese stimulus.

Grains were standout performers during the fourth quarter with a 17% gain, aided by a technical rebound (including short covering) in October and farmers' unwillingness to sell inventories at depressed prices. The space was subsequently supported by a poor weather forecast for Russian winter wheat and multiyear high prices for meat, resulting in increased demand for livestock feed.

8

### STUNNING DROP IN OIL AS OPEC MAINTAINED PRODUCTION

● West Texas Intermediate Crude Price (\$/Barrel)



Source: LPL Financial Research, FactSet 12/31/14

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

9

### STRONG DOLLAR KEPT GOLD DOWN IN VOLATILE END TO 2014

● Gold Price (\$/Oz.)



Source: LPL Financial Research, FactSet 12/31/14

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

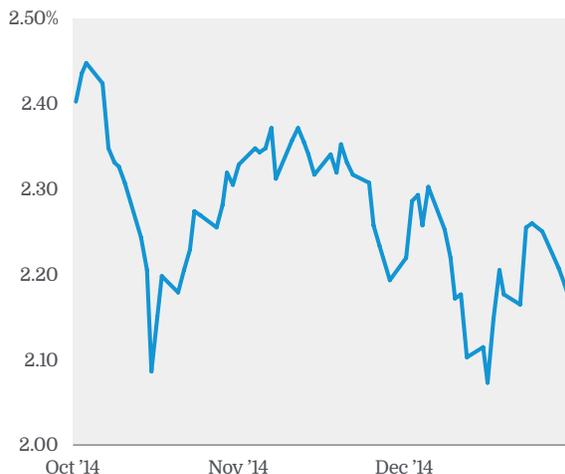
Precious metal investing is subject to substantial fluctuation and potential for loss.

## FIXED INCOME – TAXABLE: STRONG PERFORMANCE FROM LONGER, HIGH-QUALITY BONDS

Fixed income finished the year strongly with the Barclays U.S. Aggregate Bond Index up a healthy 1.8% in the fourth quarter of 2014. The quarter was a microcosm of the year with long-term, high-quality bonds, such as investment-grade corporate bonds and mortgage-backed securities, benefiting from a sharp drop in U.S. yields. Short-term bonds, along with bonds tied to lower-quality investments and global economic growth—such as emerging markets sovereign debt and high-yield bonds—tended to lag [Figure 10]. The strong U.S. dollar bolstered Treasuries performance by attracting demand from foreign investors. For the year, amid widespread expectations for higher interest rates, the Barclays Aggregate Bond Index returned a solid 6.0% as the 10-year Treasury yield fell more than 80 basis points (0.80%) to 2.17% as of year-end [Figure 11].

### 11 VOLATILE DOWNWARD PATH FOR U.S. YIELDS AS 2014 ENDED

● 10-Year Treasury Yield



Source: LPL Financial Research, FactSet 12/31/14

### 10 HIGH-QUALITY BONDS PACED FOURTH QUARTER BOND MARKET GAINS

Bond Market Performance, Ranked by Fourth Quarter Returns

Sector	Q4 2014	2014
Foreign Bonds (Hedged)	3.0%	9.8%
Preferred Securities	2.6%	13.7%
U.S. Treasuries	1.9%	5.1%
Barclays Aggregate	1.8%	6.0%
Mortgage-Backed Securities	1.8%	6.1%
Investment-Grade Corporates	1.8%	7.5%
Municipal Bonds	1.4%	9.1%
Municipal High-Yield	1.2%	13.8%
TIPS	0.0%	3.6%
Bank Loans	-0.5%	1.5%
High-Yield Corporates	-1.0%	2.5%
Emerging Market Debt	-1.9%	5.5%
Foreign Bonds (Unhedged)	-2.9%	-2.7%

Source: LPL Financial Research, FactSet 12/31/14

The indexes mentioned are unmanaged and you cannot invest 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.

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.

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 – Barclays U.S. Treasury Index; Mortgage-Backed Securities – Barclays U.S. MBS Index; Investment-Grade Corporate – Barclays U.S. Corporate Bond Index; Municipal – Barclays Municipal Bond Index; Municipal High-Yield – Barclays Municipal High-Yield Index; TIPS – Barclays Treasury Inflation-Protected Securities Index; Bank Loans – Barclays U.S. High-Yield Loan Index; High-Yield – 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)

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.

## Lower Long-Term Rates, Short-Term Rates Inched Higher

The shape of the U.S. yield curve flattened slightly during the quarter, reflecting the conundrum facing bond investors today. U.S. long-term rates moved aggressively lower relative to other global developed nations. Global investors continued to seek the higher yield and safety offered by U.S. Treasuries, as worries regarding global growth continued to mount and inflation concerns remained limited. As a result, long-term yields fell during the quarter with the U.S. 10- and 30-year Treasury yields falling approximately 30 and 40 basis points, respectively. Conversely, short-term rates increased. U.S. economic growth remained relatively robust despite troubles around the world, while the markets seemingly prepared for Fed rate hikes in the latter half of 2015, pushing the 2-year U.S. Treasury yield 10 basis points higher to finish the year near 0.70%. Quarterly U.S. Treasuries performance reflected these adjustments with long-term Treasuries returning a healthy 8.6%, while intermediate Treasuries were up just 1%, as measured by Barclays Long U.S. Treasury Index and Barclays Intermediate U.S. Treasury Index.

## Energy Concerns Weighed on High-Yield Bonds

Credit fundamentals remained sound and defaults low across most high-yield sectors during the fourth quarter. Nevertheless, investor worries regarding 2015 weighed on this market and yields for high-yield bonds moved higher as investors demanded greater yield premiums. Average yield spreads for the Barclays High Yield Index increased approximately 70 basis points to near 5.2%. This activity was largely due to concern around the energy sector, which represented about 17% of the index at the start of the quarter, as investors worried about the impact of oil's precipitous

decline on the health of energy companies. Energy weakness spread to the broader high-yield market, sending the Barclays High Yield Index down 1% for the quarter and paring its 2014 gain to 2.5%.

## FIXED INCOME – TAX-FREE: MUNICIPAL BONDS FOLLOWED THE POSITIVE TREND

Municipal bonds were up 1.4% in the fourth quarter, as measured by the Barclays Municipal Bond Index, keeping pace with their taxable high-quality brethren but not matching U.S. Treasuries. Short- and intermediate-term municipal bonds were hurt by rising yields during the quarter (a flattening yield curve) after starting the quarter with slightly higher relative valuations compared with U.S. Treasuries. For the year, the sector benefited from attractive valuations to begin the year, low defaults, and improved supply-demand conditions.

## ALTERNATIVE INVESTMENTS PLODDED ALONG IN QUIET 2014

As measured by Hedge Fund Research (HFR), broad hedge fund performance delivered muted fourth quarter and 2014 results. Significant return dispersion exists at the underlying category level, with individual strategies such as managed futures and global macro generally benefiting from diverging global economic developments. Specifically, managed futures and macro funds finished with their highest calendar year of performance in more than three years, as these strategies capitalized on global economic trends, such as the swift appreciation in the U.S. dollar, precipitous declines in energy markets, and long Japanese equity positions.

High-yield spread is the yield differential between the average yield of high-yield bonds and the average yield of comparable maturity Treasury bonds.

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.

Municipal bonds are subject to availability, price, and to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rate rise. Interest income may be subject to the alternative minimum tax. Federally tax free but other state and local taxes may apply.

Noteworthy category laggards included credit and the event-driven space (such as merger arbitrage strategies that attempt to capitalize on spreads between acquiring firms and potential acquisition targets). Within the latter, the high volume of merger and acquisition activity and corporate activism continued; however, more deals failed to reach completion, leading to outsized losses on those particular positions. As 2015 began, managers in this space were generally optimistic about the coming year due to strong corporate balance sheets and ongoing access to cheap financing, which could potentially bolster companies' desire for acquisitions, restructurings, and other corporate actions.

Long/short equity managers lagged long-only indexes, primarily due to exposure to sectors such

as energy and industrials late in the year and bullish positioning within EM equities. Long/short equity managers employed net market exposure equal to roughly half that of long-only indexes, so their more conservative posture acted as a headwind. On the positive side, alternative managers generally held long exposure to the S&P 500 healthcare and technology sectors, which both outperformed the broad S&P 500.

While broad hedge fund performance lagged during 2014, shifting market dynamics may be starting to create a more constructive backdrop for the space as 2015 begins, as correlations across asset classes have fallen from historically high levels and central bank policies are diverging globally. ■

#### 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.

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.

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.

Credit risk is the risk of loss of principal or loss of a financial reward stemming from a borrower's failure to repay a loan or otherwise meet a contractual obligation. Credit risk arises whenever a borrower is expecting to use future cash flows to pay a current debt. Investors are compensated for assuming credit risk by way of interest payments from the borrower or issuer of a debt obligation. Credit risk is closely tied to the potential return of an investment, the most notable being that the yields on bonds correlate strongly to their perceived credit risk.

#### Definitions

Default rate is the interest rate charged to a borrower when payments on a revolving line of credit are overdue. This higher rate is applied to outstanding balances in arrears in addition to the regular interest charges for the debt.

Master limited partnership (MLP) is a type of limited partnership that is publicly traded. There are two types of partners in this type of partnership: The limited partner is the personal or group that provides the capital to the MLP and receives periodic income distributions from the MLP's cash flow, whereas the general partner is the party responsible for managing the MLP's affairs and receives compensation that is linked to the performance of the venture.

Global macro strategy is a hedge fund strategy that bases its holdings—such as long and short positions in various equity, fixed income, currency, and futures markets—primarily on overall economic and political views of various countries (macroeconomic principles).

Merger arbitrage is a hedge fund strategy in which the stocks of two merging companies are simultaneously bought and sold to create a riskless profit. A merger arbitrageur looks at the risk that the merger deal will not close on time, or at all. Because of this slightly uncertainty, the target company's stock will typically sell at a discount to the price that the combined company will have when the merger is closed. This discrepancy is the arbitrageur's profit.

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 Alerian MLP Index is a composite of the 50 most prominent energy master limited partnerships (MLP) that provides investors with an unbiased, comprehensive benchmark for this emerging asset class. The index, which is calculated using a float-adjusted, capitalization-weighted methodology, is disseminated in real time on a price-return basis (NYSE: AMZ) and on a total-return basis (NYSE: AMZX).

The 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 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 Barclays Long U.S. Treasury Index includes all publicly issued, U.S. Treasury securities that have a remaining maturity of 10 or more years, are rated investment grade, and have \$250 million or more of outstanding face value. In addition, the securities must be denominated in U.S. dollars, fixed rate, and nonconvertible.

The Barclays Intermediate U.S. Treasury Index includes all publicly issued, U.S. Treasury securities that have a remaining maturity of greater than or equal to 1 year and less than 10 years, are rated investment grade, and have \$250 million or more of outstanding face value. In addition, the securities must be denominated in U.S. dollars, fixed rate, and nonconvertible.

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 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 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 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 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 Russell Mid Cap Index offers investors access to the mid cap segment of the U.S. equity universe. The Russell Mid Cap 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 Mid Cap Index includes the smallest 800 securities in the Russell 1000.

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 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 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 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 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.

This research material has been prepared by LPL Financial.

To the extent you are receiving investment advice from a separately registered independent investment advisor, please note that LPL Financial is not an affiliate of and makes no representation with respect to such entity.

Not FDIC or NCUA/NCUSIF Insured | No Bank or Credit Union Guarantee | May Lose Value | Not Guaranteed by Any Government Agency | Not a Bank/Credit Union Deposit

RES 4935 0115 | Tracking #1-341890 (Exp. 05/15)