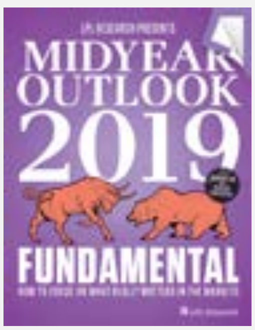
LPL RESEARCH
MIDYEAR
OUTLOOK
2019

June 2019

OUTLOOK 2019
EXECUTIVE SUMMARY

Read the full *Midyear Outlook 2019: FUNDAMENTAL: How to Focus on What Really Matters in the Markets*



LPL Research's *Midyear Outlook 2019* provides our updated views of current fundamentals and the things that should persist as shorter-term concerns fade, and emphasizes our four primary pillars for fundamental investing—policy, the economy, fixed income, and equities. As the headlines change daily, look to these pillars and our *Midyear Outlook 2019* to help provide perspective on what really matters in the markets.

WHERE WE ARE NOW

Policy

We believe fiscal stimulus from the Tax Cuts and Jobs Act of 2017, along with decreased regulation and increased government spending, will continue to support the U.S. economy in 2019, and that the potential impact is both larger and more durable than consensus expectations. At the same time, uncertainty around global trade continues to dampen the benefits of fiscal support and may be discouraging productivity-enhancing capital investment. We still believe self-interest is likely to bring the United States and China back to the negotiating table, but until we see progress, trade tensions remain the primary risk to our forecasts.

While fiscal policy has taken the lead, monetary policy grew more supportive in the first half of 2019. The Federal Reserve (Fed) indicated earlier this year that it would likely hold on raising interest rates for the rest of 2019, partly in response to the market's poor reaction to last December's rate increase. With inflation low, global growth slowing, and trade risk still present, monetary policy may be too tight for the current environment. Even if not fully justified by the data, the Fed may choose to lower rates later this year to provide a buffer against increased uncertainty.

Economy

Domestic: U.S. economic growth in the first quarter was better than expected, with early readings showing gross domestic product (GDP) growth of 3.1%. Data have weakened in the second quarter but bright spots remain. Supported by strong labor markets, consumer sentiment remains upbeat and consumer spending continues to be an important driver of growth; manufacturing, however, has seen a larger negative impact from trade. We still believe fundamentals are supportive of moderate GDP growth this year. Again, progress on trade concerns is central to our growth projections, so we've slightly reduced our GDP forecast to 2.25–2.5%.

Inflation: We believe the current pace of growth is consistent with an economy that is able to generate solid demand without adding excessive pricing pressures. Consumer inflation has slipped as global demand has softened, outweighing any broader price impact from tariffs. While headline inflation data remain sluggish, wages and wholesale prices continue to grow at a healthy clip. We expect core Consumer Price Index (CPI), which excludes food and energy prices, to grow 2–2.25% year over year in 2019, on pace with what it did in 2018.

Employment: Hiring has continued at an above-average pace for the expansion, with employment growth averaging around 200,000 jobs per month. Weekly claims for unemployment benefits have dropped to cycle lows several times this year, and this tight labor market will likely lead to increased wage growth in the coming months. Wages represent the largest cost for businesses, and it is difficult to have a sustainable inflation threat if wages are not climbing at a fast rate. Currently wage growth is just above 3%, suggesting hourly earnings are not yet a threat to the economy.

Global: We still expect emerging markets (EM) to continue to lead developed markets in economic growth, given the challenges in developed markets. Europe faces Brexit challenges, France is contending with "yellow vest" protests, Germany is battling weaker manufacturing, and Italy is struggling with difficult budget negotiations. In Japan, programs to increase government spending and reduce rates have supported growth, but true structural reforms remain elusive, and a value-added tax (VAT) increase is scheduled for the fourth quarter. We expect India's GDP growth to outpace the rest of EM and Mexico to continue to lead growth in Latin America.

Fixed Income

Fixed income investors have benefited from falling rates due to subdued consumer inflation, a pause in rate hikes, and demand for U.S. Treasuries. Although a flattening yield curve has been troubling for some investors, we believe the flattening is due more to global investors searching for better yields than it is an indicator of looming recession. Considering the Fed, inflation, and our expectation for progress on trade, we now look for the 10-year Treasury yield to reach the 2.5–2.75% range in the next 6 to 12 months.

Currently we favor an emphasis on investment-grade (IG) bonds in fixed income allocations, with a focus on a balance of IG corporates and mortgage-backed securities (MBS). We believe the extra yield in the MBS market given the degree of risk remains attractive and economic growth continues to support IG corporate bonds.

Equities

The overall U.S. economic picture has supported continued expansion. Modest inflationary pressures helped boost demand and support corporate profit margins in the first quarter. Given solid fundamentals, we continue to believe corporate profits will exceed the current consensus expectations.

The Fed's decision to pause rate hikes boosted sentiment and increased demand for equities. Market technicals provided support for stocks' rebound earlier this year, and historical patterns suggest the possibility for strength in 2019.

We have slight preferences for large cap over small cap, value over growth, and EM over developed markets. We continue to lean cyclically, favoring industrials, financials, and technology.

Market valuations remain favorable, with the S&P 500 Index's forward 12-month price-to-earnings (P/E) ratio within historical norms. We reduced our S&P 500 earnings per share (EPS) forecast to $170 for year-end 2019, mainly because of trade uncertainty, and our year-end S&P 500 fair value estimate remains at 3,000. We will revisit this forecast if clarity on trade and monetary policy result in an improved outlook for corporate profits.

For more investment insights, read the full *Midyear Outlook 2019: FUNDAMENTAL: How to Focus on What Really Matters in the Markets*.

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.

Our recommendations are subject to change at any time based on market and other conditions. Economic forecasts set forth may not develop as predicted, and there can be no guarantee that strategies promoted will be successful.

All performance referenced is historical and is no guarantee of future results.

All information is believed to be from reliable sources; however, we make no representation as to its completeness or accuracy.

RISK DISCLOSURES

Investing involves risks including possible loss of principal. No investment strategy or risk management technique can guarantee return or eliminate risk in all market environments.

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

The prices of small cap stocks are generally more volatile than large cap stocks. Value investments can perform differently from the market as a whole. They can remain undervalued by the market for long periods of time. 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.

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. Bond yields are subject to change. Certain call or special redemption features may exist, which could impact yield.

Municipal bonds are federally tax-free, but other state and local taxes may apply. If sold prior to maturity they are subject to market and interest rate risk and capital gains tax could apply. Mortgage-backed securities (MBS) are subject to credit, default, prepayment, extension, market, and interest rate risk.

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.

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

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.

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. EPS 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 price-to-earnings (P/E) 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. Price to forward Earnings is a measure of the P/E ratio using forecasted earnings for the P/E calculation.

INDEX DEFINITIONS

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.

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.

Additional descriptions and disclosures are available in the *Midyear Outlook 2019: FUNDAMENTAL: How to Focus on What Really Matters in the Markets* publication.