LPL RESEARCH
WEEKLY MARKET COMMENTARY

KEY TAKEAWAYS

This week we pay tribute to David Letterman's last *Late Show* with our own top 10 list: the top 10 keys for stocks.

A potential snapback in the U.S. economy is the number one issue for the stock market, but here we list nine other issues that will be important in determining where stocks go in the near term.

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LETTERMAN TRIBUTE: TOP 10 KEYS FOR STOCKS

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This week we pay tribute to David Letterman's last *Late Show* on May 20, 2015, with our own top 10 list: the top 10 keys for stocks. Mr. Letterman has had quite a long and successful run as a late night TV host on two networks. *Late Night with David Letterman* debuted on NBC on February 1, 1982 (when the S&P 500 closed at a mere 117.78), followed by *Late Show with David Letterman* that debuted on August 30, 1993 (S&P 500 closed at 461.90). With earnings season largely behind us, here is our list of 10 keys for the stock market over the next several months.

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TOP 10 KEYS FOR STOCKS

Drum roll please!

10) Greece. After making its latest payment to the International Monetary Fund (IMF), the coast may be clear for a few weeks in terms of the potential for Greece's financial troubles to cause a hiccup in the global financial markets. The next big payment, due to creditors in mid-June 2015, has the potential to drive increased global stock and bond market volatility, due to the uncertainty created by a possible default and departure from the Eurozone (though not our expectation). One member potentially leaving the Eurozone may spark speculation of other possible departures.

9) Seasonality. We are not big believers in the "sell in May" adage, but May has historically marked the end of a favorable period for the S&P 500, based on many decades of historical return data. Strong seasonal patterns can also be observed for certain segments of the market, such as consumer discretionary, which has historically performed very well during the first five months of the year before falling off beginning in June, and energy, which has historically benefited from strong gasoline demand ahead of the start of the summer driving season.

8) Oil prices. We believe oil is another key for the broad stock market, at least in the near term, although lower prices bring both positives and negatives. Negatives include lower energy sector profits, reduced demand for crude oil transport for rails and trucks, and reduced capital spending, which is a drag on industrials sector profits. But lower fuel costs put more cash in consumers' pockets (see our *Weekly Economic Commentary*, "Consumer Consistency," on May 4, 2015) and reduce transportation costs for businesses. We believe stable or gradually rising oil prices—our expectation—may be the best scenario.

We do not expect a rallying dollar, should it continue, to prevent the stock market from going higher.

7) U.S. dollar. A strong and rising U.S. dollar, as we have seen much of the past year until very recently, has many implications. Profits earned overseas by U.S. multinational corporations are reduced. Returns for U.S. investors in international investments are reduced. U.S. exports become more expensive to overseas buyers. Import prices fall, contributing to lower inflation. And a strong dollar puts downward pressure on commodity prices that are priced in dollars for buyers globally. We do not expect a rallying dollar, should it continue, to prevent the stock market from going higher. Historically the S&P 500 has performed well in dollar bull markets (see our March 16, 2015, *Weekly Market Commentary*, "Dollar Strength Is a Symptom, Not a Cause"), but we believe a stable dollar would be most welcomed by investors.

6) Geopolitics. In the world we live in today, geopolitics should probably have a permanent place on the list of things stock investors should be watching. Headlines in Russia have died down and we all know the U.S. is not as dependent on Middle Eastern oil, but geopolitics and terrorism no doubt have the potential to cause a stock market pullback at any time.

5) China. We have become more positive on China and emerging markets (EM) as an investment in recent months. Three interest rate cuts by the People's Bank of China, the new Hong Kong–Shanghai trading link, low oil prices, attractive valuations, and our technical analysis all support our positive view. We acknowledge China is at risk of a more pronounced slowdown in economic growth. But if that occurs, we would not expect it to be anytime soon, as the Chinese government would likely enact additional stimulus to prolong acceptable growth as long as possible.

4) Affordable Care Act Supreme Court decision. Though still likely a month away, the upcoming Supreme Court ruling regarding the legality of tax subsidies for the federal exchanges under the Affordable Care Act (aka Obamacare) is a big deal for the healthcare sector and may impact the broader market, depending on Washington's potential response to an unfavorable ruling. We would be buyers on healthcare sector weakness in anticipation of a rework that keeps the main structure of the law in place.

3) Interest rates. A gradual rise in rates may be good for stocks. When rising interest rates are driven by higher economic growth expectations, those rates tend to bring expectations of higher corporate profits and rising stock prices. But as we witnessed during the "taper tantrum" in 2013, stock investors do not like sharp and swift increases in interest rates. Stable or gradually rising interest rates, backed by firming economic growth expectations, is likely the best scenario for stocks, especially considering interest rates are still low enough to make stocks relatively attractive compared with bonds.

2) Federal Reserve (Fed) timetable. We agree with the fed fund futures market, which suggests that the Fed's first rate hike is unlikely to come until at least September 2015, while October or December 2015 remain within the range of the market's expectations. Should investors be surprised by an earlier or bigger than expected rise in rates, stocks would likely pull back. Historically, stocks have dipped right around the first rate hike of an economic cycle (based on the past nine occurrences since 1950), although stocks have done well over intermediate periods (6–12 months) following those first hikes.

1) U.S. economic snapback. After depressed U.S. growth during the first quarter, a potential snapback in the U.S. economy over the next couple quarters will go a long way toward determining whether this summer is a rewarding one for stock investors. Better economic growth is needed to help drive a rebound from the sluggish S&P 500 earnings growth in the first quarter of 2.0% year over year.

CONCLUSION

There you have it, our stock market top 10 list tribute to David Letterman. Look for updates on these key issues and others in future weekly publications and our upcoming *Midyear Outlook* due in mid-June. ■

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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