LPL RESEARCH
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A VERY DIFFERENT NASDAQ

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KEY TAKEAWAYS

The Nasdaq Composite just hit 5000 today as this report was going to press and is nearing its all-time record closing high of 5048.

Even with the Nasdaq at 5000, we do not believe stocks have reached bubble territory.

The Nasdaq has a much stronger foundation today of valuations, profits, and sentiment.

The Nasdaq Composite just hit 5000 today as this report was going to press and is nearing its all-time record closing high of 5048 set during the peak of the internet bubble in March 2000. The 15-year journey back to these highs after the bubble burst included two recessions along the way—one of them "Great." This accomplishment has sparked renewed concerns that the Nasdaq's ascent reflects a stock market bubble that may soon burst. Even with the Nasdaq at 5000, based on valuation and sentiment measures, we do not believe stocks have reached bubble territory. As we walk down memory lane to the days when we got stock picks from cab drivers and chat rooms, we see that the Nasdaq's foundation is much stronger today.

ANOTHER BUBBLE?

To assess whether the Nasdaq reflects excessive speculation that has historically characterized bubbles, we look at several measures of valuation and sentiment. A comparison between where these measures stand today and their levels back in 2000 reveals that the environment then was very different. This comparison enhances our comfort with our positive stock market view, based on our investment process incorporating fundamentals, valuations, and technical analysis.

See our infographic, A Very Different Nasdaq, on page 5 for more comparison of 2000 and 2015.

Valuations Then Versus Now

The Nasdaq valuation comparison between 2000 and 2015 is dramatic based on a variety of different valuation metrics. The March 2000 price-to-earnings ratio (PE) of 107, based on then current year estimates, bears no comparison to the latest reading at 25 (as of February 27, 2015). The forward PE, based on the following year estimates, tells the same story, with a PE of 75 then and 21 now. No comparison. Underlying these lofty valuations then was a set of Nasdaq companies that was much less profitable. The top 10 holdings today generate nearly five times the earnings of the top 10 as of December 31, 1999 (excluding WorldCom and its cooked books).

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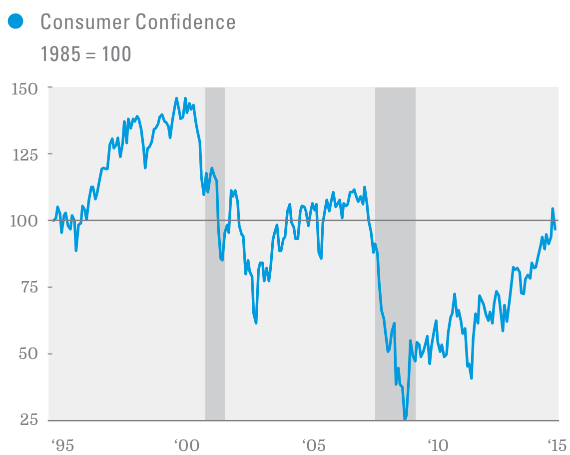
Valuation measures based on book value, or the value of company assets minus liabilities, also reveal a much more expensive Nasdaq then versus now. One of the symptoms of the internet bubble was the lack of assets supporting valuations (though there were plenty of page views, eyeballs, and clicks). The price-to-book value ratio (market cap divided by book value) at the peak in March 2000 was over 7, compared with 3.9 as of February 27, 2015.

Nasdaq cash flow valuations tell the same story, highlighting the lack of cash generated by many of the richly valued internet companies in the early 2000s. The Nasdaq Composite's price-to-cash flow ratio (market value divided by operating cash flow generated) approached 100 at the March 2000 peak, compared with roughly 20 currently.

1 CONSUMER CONFIDENCE A FAR CRY FROM INTERNET BUBBLE LEVELS



Source: LPL Research, Haver Analytics 02/27/15
Shaded area indicates recession.
All indexes are unmanaged and cannot be invested into directly.
Data are seasonally adjusted.

The significant amount of dollars going into technology sector investments then versus now is also instructive. The significant investment flows into the sector pushed the Nasdaq up 189% during the two years leading up to the peak on March 10, 2000, a much steeper ascent than the 57% gain in the index during the past two years. The technology sector represented 35% of the S&P 500 at the Nasdaq's peak, compared with a current level near the long-term average at about 19%. The Nasdaq had a 57% technology weighting then, versus 43% today. Clearly, some of the more popular valuation measures demonstrate that the modern day Nasdaq is much more reasonably valued than it was when it last reached 5000.

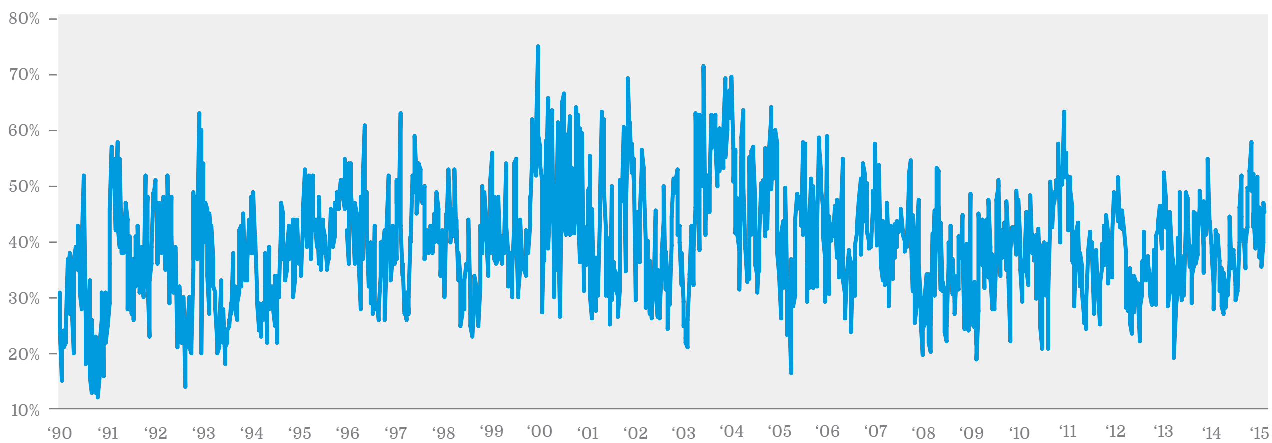
Sentiment Then Versus Now

Another way to gauge a potential speculative bubble is to look at measures of sentiment, which in 2000 far exceeded today's levels based on most metrics. Excessive consumer and investor confidence during the internet bubble led market participants to push valuations to unsustainable levels. For example, the Conference Board's reading on consumer confidence peaked at an all-time record high of 145 during January 2000 (data back to 1969), compared with the most recent reading of 96 in February [Figure 1]. More caution among consumers is indicative of a much more rational market environment and an absence of the types of excesses that lead to significant stock market downturns.

Measures of investor sentiment can also help distinguish between these two very different market environments. According to the American Association of Individual Investors (AAII) survey of bulls and bears, the percentage of bulls reached a record high of 75% during January 2000 (a record that still stands), versus a much more rational level of 42% today (as of the latest reading on February 26, 2015) [Figure 2].

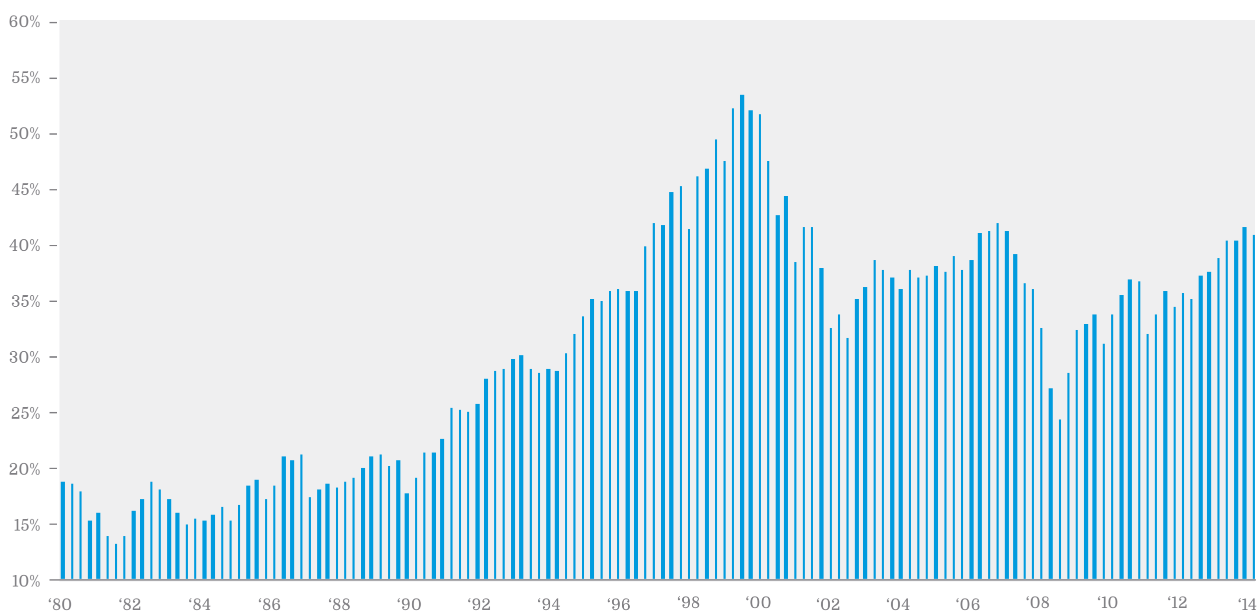
How much investors invest in equities is another way to assess sentiment. Based on data from the Investment Company Institute (ICI), net purchases of equity mutual funds by individuals exceeded $25 billion per month at the peak in early 2000, compared with just $6.5 billion during the latest reported month (January 2015). The ICI has reported net outflows to equity mutual funds in aggregate since the financial crisis (2008–2014), reflecting a healthy dose of investor skepticism.

2 PERCENTAGE OF BULLS BASED ON AAII SURVEY



Source: LPL Research, American Association of Individual Investors 02/27/15

3 STOCKS AS A PERCENT OF HOUSEHOLD FINANCIAL ASSETS



Source: LPL Research, Federal Reserve Board, Ned Davis Research 02/27/15

Data series adjusted for pension assets, series through September 30, 2014.

Yet another way to assess what investors are doing is based on stocks held as a percentage of household assets, data tracked by the Federal Reserve. This statistic reached an all-time high during the first quarter of 2000 at 53.6% (data back to 1952), while the most recent reading for the third quarter of 2014 stood at 40.8% [Figure 3, page 3]. This reading is in the middle of its 20-year range and, given the relatively less attractive value in fixed income markets, seems reasonable.

Margin balances provide another sense of investor enthusiasm. This is the one statistic that looks like it did during 2000, partly due to lower interest rates that make margin debt cheaper to carry. As a percentage of market value, according to Ned Davis Research data, margin debt peaked at 1.7% during the internet bubble, and stood at a similar 1.9% as of year-end 2014. As a percentage of gross domestic product (GDP), margin debt was between 2.5% and 2.6% both during early 2000 and as of the latest reading (January 31, 2015). This statistic is one to watch, but we believe the risk may be manageable, based on strong consumer balance sheets and the overall valuation picture.

There are a number of other ways to assess market sentiment, including looking at initial public offerings (remember the Pets.com IPO), venture capital and private equity deal activity, CNBC ratings, and many others. Regardless of the metric used, almost without exception, the difference in sentiment between 2000 and 2015 is dramatic.

CONCLUSION

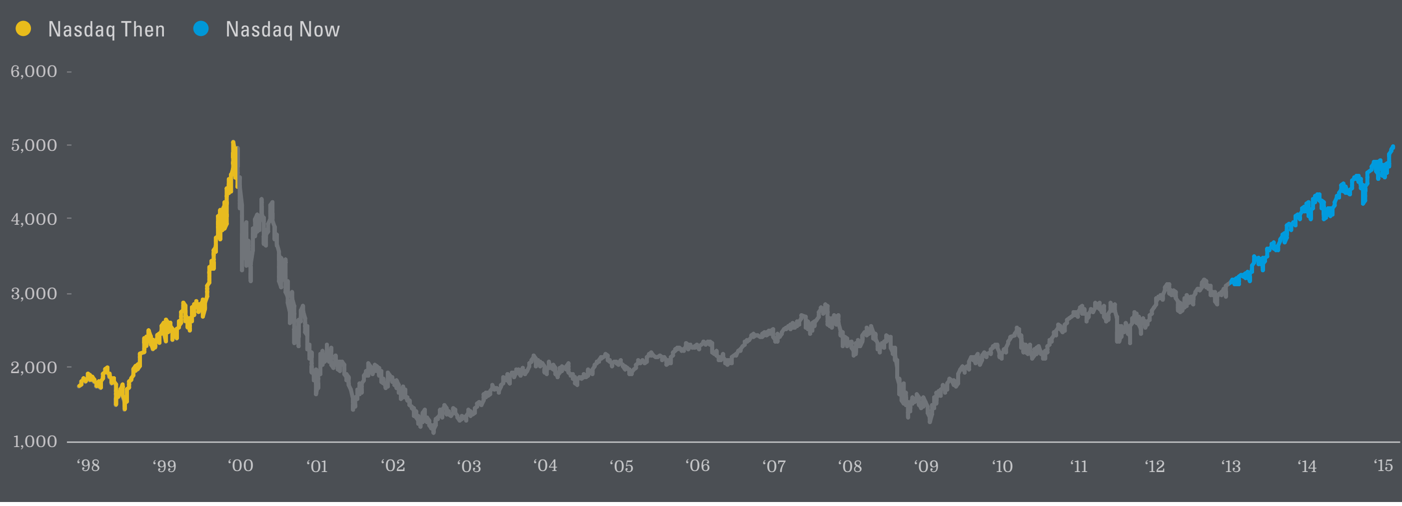
The stark differences between the internet bubble environment when the Nasdaq last hit 5000 and today are evident when comparing valuation and sentiment measures. The Nasdaq has a much stronger foundation of valuations, profits, and sentiment today. We maintain our positive stock market view for 2015, as noted in our *Outlook 2015: In Transit* publication, with a preference for the now attractively valued technology sector. And for those of you looking for stock picks, please consult your LPL Financial advisor, and not a cab driver or a chat room. ■

INFOGRAPHIC

A VERY DIFFERENT NASDAQ

THEN 2000 VS. NOW 2015

	THEN 2000	NOW 2015
Nasdaq Trailing 2-Year Gain	189%	57%
Nasdaq Trailing PE	107	25
Nasdaq Forward PE	75	21
Nasdaq P/Book	7.1	3.9
Biggest Stock	**Cisco**	**Apple**
Tech Sector Weight in Nasdaq	57%	43%
Tech Sector Weight in S&P 500	35%	19%
Consumer Confidence	145	96
Percentage of Bulls	75%	42%
Net Purchases of Equity Mutual Funds at Monthly Peak / Net Purchases of Equity Mutual Funds in January 2015	**$25 Billion**	**$6.5 Billion**
Stocks as Percent of Household Assets	53.6%	40.8%
Margin Debt as Percent of Market Value	1.7%	1.9%
Tech Trends / Tech Trend	**Flip Phones & Dial-Up Internet**	**iPhones, WiFi & The "Cloud"**
Source of Investment Advice	**Cab Drivers & Chat Rooms**	**LPL Advisors of Course!**



Source: LPL Research, Haver Analytics, FactSet, Ned Davis Research, Nasdaq OMX 02/27/15
2-year gains are as of March 10, 2000 and February 27, 2015.

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 referenced is historical and is no guarantee of future results.

The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

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

All investing involves risk including loss of principal.

Because of its narrow focus, specialty sector investing, such as healthcare, financials, or energy, will be subject to greater volatility than investing more broadly across many sectors and companies.

All indexes are unmanaged and cannot be invested into directly.

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 Nasdaq Composite Index measures all Nasdaq domestic and non-U.S.-based common stocks listed on the Nasdaq stock market. The index is market-value weighted. This means that each company's security affects the index in proportion to its market value. The market value, the last sale price multiplied by total shares outstanding, is calculated throughout the trading day, and is related to the total value of the index. It is not possible to invest directly in an index.

DEFINITIONS

American Association of Individual Investors (AAII) is a nonprofit organization that arms individual investors with the education and tools they need to build wealth.

The Investment Company Institute (ICI) is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETF), and unit investment trusts (UIT). Members of ICI manage total assets of $11.18 trillion and serve nearly 90 million shareholders.

The Consumer Confidence Index is a monthly survey of 5,000 U.S. households, published by the Conference Board since 1967, measuring American consumer outlook and confidence.

The PE 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 PE ratio means that investors are paying more for each unit of net income, so the stock is more expensive compared to one with lower PE ratio.

Trailling PE is the sum of a company's price-to-earnings, calculated by taking the current stock price and dividing it by the trailing earnings per share for the past 12 months.

Forward price-to-earnings is a measure of the price-to-earnings ratio (PE) using forecasted earnings for the PE calculation. While the earnings used are just an estimate and are not as reliable as current earnings data, there is still benefit in estimated PE analysis. The forecasted earnings used in the formula can either be for the next 12 months or for the next full-year fiscal period.

Price-to-book ratio is the stock's capitalization divided by its book value. The value is the same whether the calculation is done for the whole company or on a per-share basis. This ratio compares the market's valuation of a company with the value of that company as indicated on its financial statements.

Price-to-cash flow is a measure of the market's expectations of a firm's future financial health.

To purchase on margin is to borrow money used for the purchase of securities. Margin debt represents of the dollar value of the securities purchased and carries an interest rate. This means the value of margin debt will change each day as interest accrues and the values of the underlying securities fluctuates.

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