HBK Wealth Management

Haire · Bohmer · Kilcoyne

WEEKLY ECONOMIC COMMENTARY

This Week's Economic Review and Outlook

July 2014

I hope this educational resource proves helpful. I believe an educated investor is a better investor. Please call me if you have questions.

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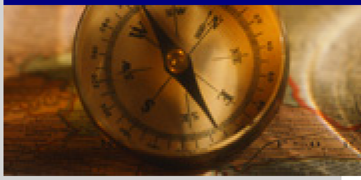


Weekly Economic Commentary | Week of June 30, 2014

Highlights

- We do not think the weather-related economic weakness in the first quarter was the start of another recession or even a slowdown in growth.
- The statistical evidence of the LEI indicates that the risk of recession in the next 12 months is small at about 4%, but not zero.

Disappointing GDP, but No Early Warnings of Recession on Horizon

On June 25, 2014, the Bureau of Economic Analysis of the U.S. Department of Commerce released revised figures on economic growth for the first quarter of 2014, as measured by gross domestic product (GDP). The GDP data are closely watched, as GDP is the broadest measure of the nation's economic output. The pace of GDP growth is a critical driver of corporate earnings, which, in turn, are the key driver of stock market performance.

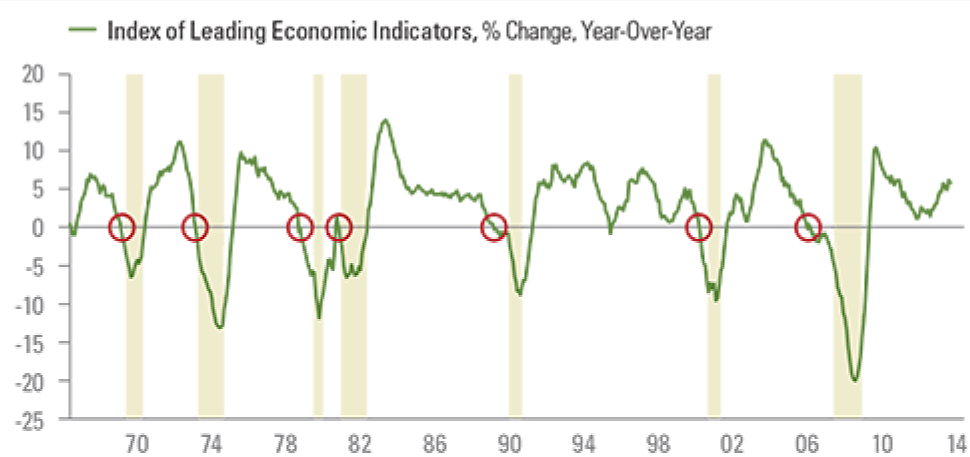
The GDP data revealed the economy contracted at an annualized 2.9% pace in the first quarter, just the second time that the economy contracted during a quarter since the end of the Great Recession in mid-2009. Could the first quarter GDP report be a harbinger of another wrenching recession? We do not think the weather-related economic weakness is the start of another recession or even a sign of a growth slowdown over the rest of the year. We continue to expect that economic growth will rebound and expand 3% in all of 2014.* In fact, the return to a more normal weather pattern nationwide has already led to a sharp snapback in economic activity. The U.S. economic data released thus far for April, May, and June 2014 suggest that economic growth will accelerate in the second quarter to well above the economy's long-term average growth rate after a weather-induced slowdown in growth in the first quarter of 2014.

While first quarter GDP was both unusual and disappointing, it does not change our view on the economy. Second quarter GDP is due out in late July. With that release, the GDP data (including the first quarter of 2014) will be revised back as far as 1999 to incorporate new data, methodological and definitional changes, and updated seasonal factors. This annual revision to GDP happens every year in late July.

LEI Reveals No Red Flags

Importantly, many of the other indicators that can provide an early warning of recession are not signaling a downturn in the economy. The Index of Leading Economic Indicators (LEI) -- compiled by the Conference Board, a private sector think tank -- is comprised of 10 primarily fundamental economic indicators and is designed to predict 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 and begins to fall, a recession has historically followed by anywhere from zero to 14 months [Figure 1].

1 LEI Provides Early Warning of Recession



Source: LPL Financial Research, Federal Reserve 06/06/14

The year-over-year increase in the LEI in April 2014 was 5.9%. Since 1960, the year-over-year increase in the LEI has been at least 5.9% in 211 of 652 months. Not surprisingly, the U.S. economy was not in recession in any of those 211 months. Thus, it is highly unlikely that the economy is in a recession today, despite the below zero reading on real GDP in the first quarter of 2014. Looking out 12 months after the LEI was up 5.9% or more, the economy was in recession in just 9 of the 211 months, or 4% of the time.

On balance then, we would agree with the statistical evidence of the LEI that the risk of recession in the next 12 months is small at about 4%, but not zero. The LEI suggests the U.S. economy is in the middle of the cycle that began in mid-2009.

IMPORTANT DISCLOSURES

Mid-Year Outlook 2014 | Investor's Almanac Field Notes

Dear Valued Investor,

At this year's halfway point, we are pleased to offer the LPL Financial Research 2014 Mid-Year Outlook: Investor's Almanac Field Notes containing key observations and updates to our outlook for 2014. Similar to a farming almanac, our Investor's Almanac is a publication containing a guide to patterns, tendencies, and seasonal observations important to growing. The goal of farming is not merely to grow crops, but to sustain living things-investing shares the same goal.

As we expected, markets in 2014 have been less influenced by politics and policymakers than in 2013 and more dependent upon growth. Growth is an essential characteristic of all living things, and in 2014, growth is vital to our outlook for the economy and markets. Our notes from the field contain these key observations and reaffirm our forecasts for the second half:

- After an extreme winter weather-induced slowdown in the first quarter, the U.S. economy began to thaw with the warmer temperatures in the spring. We continue to believe U.S. economic growth is on track to accelerate by about 1% over last year, owing to the return of business spending and the elimination of the drag from fiscal policy. As a result, the Federal Reserve (Fed) is likely to continue to taper its bond purchases and end its bond-buying program in the fall, leaving rate hikes on the calendar for some time next year.
- Stocks spent the winter months dormant, but emerged in the spring rising to new highs and producing a gain of about 6% by early June-halfway to our target range of 10-15% for the full-year of 2014.* Historically, double-digit gains are typical for years in the middle stage of the economic cycle. The current mid-cycle environment has even produced double-digit gains in 4 of the past 10 quarters. Critical to our outlook, earnings for S&P 500 Index companies are on track for 5-10% growth-with 6% achieved in the relatively weak first quarter. Confidence in the durability of growth may contribute to a slight rise in valuations and, along with earnings growth, generate a low double-digit gain for stocks in 2014.
- Opportunities in the bond market have become scarce. Yields are unattractive and gains are not likely in the second half. We find fewer sectors attractive than at the beginning of the year. We expect yields to rise in the second half of 2014 as global growth strengthens and inflation picks up from the low point in the first half.

The primary risk to our outlook, the possibility that better growth in the economy and profits do not develop, has gained even sharper focus as we move from the threshold of the new year into the midst of 2014. That risk is likely to be more significant in the second half of the year than the distractions posed by the end of the Fed's bond-buying program and the mid-term elections.

Farmers' almanacs have been a source of wisdom, rooted in the core values of independence and simple living, for American growers for over 200 years. In our Investor's Almanac Field Notes, we seek to provide a trusted guide to the second half of the year filled with a wealth of wisdom for investors. We forecast a healthy investment environment in which to cultivate a growing portfolio.

Please enjoy the enclosed Mid-Year Outlook 2014, that provide a comprehensive perspective on the markets and economy, and the many factors that will influence them in the remainder of the year ahead.

**As noted in our 2014 Outlook: The Investor's Almanac, the stock market may produce a total return in the low double digits (10-15%). This gain is derived from earnings per share (EPS) for S&P 500 companies growing 5-10% and a rise in the price-to-earnings ratio (PE) of about half a point from just under 16 to 16.5, leaving more room to grow. The PE gain is due to increased confidence in improved growth allowing the ratio to slowly move toward the higher levels that marked the end of every bull market since World War II (WWII).*

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.

No strategy assures success or protects against loss.

Economic forecasts set forth may not develop as predicted, and there can be no guarantee that strategies promoted will be successful.

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 stock representing all major industries.

This research material has been prepared by LPL Financial.

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