



# Weekly Market Commentary



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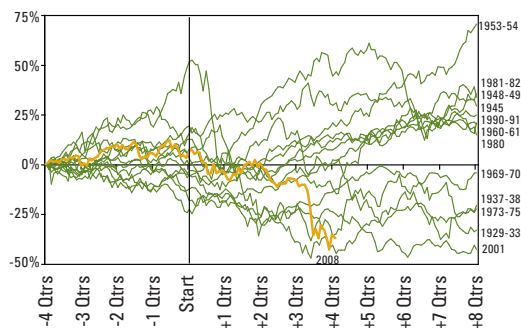
### Highlights

While we can look back and name the date a market bottom happened, the bottom was not made in a day. Stock market bottoms are defined by a process of price discovery during the months before—and after—the actual low point. Further evidence in the market's behavior last week suggests a bottoming process is underway, but it does not shed much light on when it may be over.

Friday's stock market gain despite the release of the November employment report - which showed the worst monthly job loss in decades - reflects the degree to which a severe recession has been priced into the markets.

Over the past two months, on 4 of the 5 days with huge intraday moves of 7% or more from peak-to-trough the market ended with little change from the prior day. This may be a sign that the stock market is moving through a bottoming process. During this process, we continue to recommend strategies that benefit from this volatility.

### 1 Stocks Braced For Worst Conditions of the Past 80 Years S&P 500 Perf One Yr Before, During and After Recessions



Source: LPL Financial Research, Bloomberg

December 8, 2008

## Bottoming Process Underway, but End Not Yet in Sight

While market bottoms happen on a day, they are not made in a day. Stock market bottoms are defined by a process of price discovery that often takes place over the months surrounding the actual low point. Further evidence in the market's behavior last week suggests a bottoming process is underway, but it does not shed much light on when it may be over.

Friday's stock market gain despite the release of the November employment report, which showed the worst monthly job loss in decades, reflects the degree to which a severe recession has already been priced into the markets.

Last week, the National Bureau of Economic Research, the group that is charged with officially dating recessions, announced that the slowdown began in December of 2007. With the recession now a year old, we can see that in the past few months the stock market has suffered the worst performance of any recession since the S&P 500 began in the 1920s. Braced for the worst market conditions of the past 80 years (this period includes the Great Depression), the stock market was able to weather the employment data, even though it was not only much worse than economist forecasts but the worst since 1974.

Stocks also rallied in the face of the dimming outlook for the large bailout package the "big three" U.S. automakers requested from Congress last week. The automakers sat out Friday's rally as the rescue has proven to be unpopular, with poll results showing respondents are increasingly opposed to federal assistance and Congress is locked up over the issue in the lame duck session. Democrats want to use TARP money, originally intended for the financial system, while Republicans want to provide an advance on the \$25 billion in funds from the Energy Department originally intended to help automakers develop more fuel-efficient vehicles. Whichever outcome prevails, the bailout is likely to be less than what the automakers hoped for and may not be enough to prevent more layoffs.

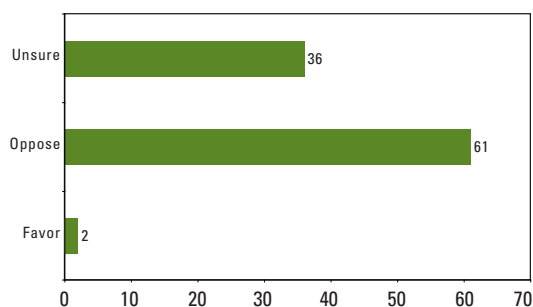
Escalating geopolitical tensions between Pakistan and India did not seem to have much direct impact on stocks or oil prices last week. The terrorist attacks in Mumbai, India by Islamist militants from Pakistan have increased tensions between these two nuclear powers. The last time a similar attack took place, in 2001, tempers flared and nuclear threats were exchanged.

These factors likely contributed to the big intraday swings in the stock market similar to those of the past few months. In fact, over the past few months about one-third of the trading days have posted an intraday swing of greater than 5%, as measured by the S&P 500, while there was only one day during January through August with such a large swing. Since the failure of Lehman Brothers on September 15, 53 of 58 days have experienced daily



## 2 CNN/ORC Poll

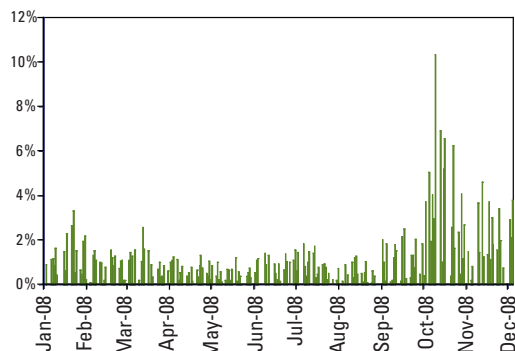
*"The major U.S. auto companies have asked the government for a program that would provide them with several billion dollars in assistance. The auto companies say they may go into bankruptcy without that assistance. Based on what you have read or heard, do you favor or oppose this program?"*



Source: Pollingreport.com, LPL Financial Research

## 3 Intraday Price Movements Have Been Exceeding Daily Price Movements by a Wide Margin in Recent Months

*Intraday Change Less Change for the Day*



Source: LPL Financial Research, Bloomberg

volatility greater than the post-WWII average, and only on nine days have the markets moved by less than 1%. However, despite fueling intraday volatility, these factors did not result in material declines in the stock market. This has been a unique characteristic of the recent volatility in the stock market. Over the past two months, on four of the five days with huge intraday moves of 7%, as measured by the S&P 500, or more from peak-to-trough, the market ended with little change from the prior day. This may be a sign that the stock market is moving through a bottoming process similar to what took place during past bear markets.

This bottoming process may last well into 2009. To move beyond it we would likely need to see:

- A decline in intraday volatility relative to the change for the day in the stock market. A narrowing spread between the daily high and low compared to the change from the prior day may be a sign that the important price discovery process part of finding a bottom is underway, as buyers and sellers are coming closer to agreeing on prices.
- Improvement in credit markets—there has been little improvement outside of the markets, such as with interbank lending, where the Federal Reserve and Treasury have directly intervened. For example, mortgage and corporate bond spreads have not improved and stand near record wide levels. The seizure of the credit markets tipped the economy into recession, and signs of improvement here would be an important confirmation that healing is underway.
- Stabilization in the economic data—in the past, major policy actions, such as rate cuts and the FDIC taking over a large bank, have most often been the catalyst to market rebounds during a recession. Investors interpret these actions as limiting the depth and duration of the recession and move to price in a recovery that is usually about five to six months away. This recession, investors seem to require more assurance that the actions will have an effect potent enough to turn around what may be the worst recession in several decades. A month or two of stabilization in the data (very weak, but not worsening) may convince investors that the worst is over.
- An increase in the number of companies that provide earnings guidance, and more confidence in those expectations—there are two themes that we have seen over the past few months. First, many companies have stopped providing earnings guidance, citing increased economic uncertainty. Second, for those companies that do continue to issue profit outlooks, we have seen forecast ranges widen. We believe this trend reflects both a lack of confidence from corporate executives as well as their inability to predict where the economy is headed. Therefore, we will look for these trends to subside as an indication that this bottoming process is concluding.

Until we see evidence in these indicators that that the bottoming process has marked an actual bottom, we continue to recommend a focus on benefitting from the ongoing volatility in an up-and-down market, rather than positioning for a market that trends in one direction.



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Investing in international and emerging markets may entail additional risks such as currency fluctuation and political instability. Investing in small-cap stocks includes specific risks such as greater volatility and potentially less liquidity.

Stock investing involves risk including loss of principal. Past performance is not a guarantee of future results.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rate rise and are subject to availability and change in price.

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