LPL RESEARCH
MARKET INSIGHT QUARTERLY

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THIRD QUARTER 2017 IN REVIEW

STOCKS CONTINUE THEIR STEADY RISE

- **Economic data received over the last three months reflected steady economic growth.** The Citigroup Economic Surprise Index, an aggregate measure of economic surprises, rebounded from spring weakness as data mostly surpassed expectations. The last month of the quarter was marred by hurricanes Harvey and Irma, but Bloomberg's consensus estimates still reflect 2.6% annualized real gross domestic product (GDP) growth in the third quarter, down just 0.5% from the strong 3.1% final reading for the second quarter and still above the 2.1% expansion average. Measures of consumer confidence remain strong and steady—consumer spending gains continued up until the hurricanes hit. Job growth in July and August further tightened labor markets, pushing wage growth higher and supporting consumer spending. Survey data suggest manufacturing activity picked up over the past three months while businesses generally remained quite confident. Despite the modest negative impact of the hurricanes, as the quarter ended the Federal Reserve (Fed) remained on track to raise interest rates in December, supported by tightening labor markets and related accelerating wage gains.
- **U.S. stocks returned 4.5% during the third quarter, based on the S&P 500 Index (including dividends).** Continued steady growth in the U.S. economy, solid earnings gains, and increasing optimism surrounding tax

1 Q3 2017 AT A GLANCE

	Q3 2017
GDP*	2.6%
S&P 500 Index	4.5%
Bloomberg Barclays Aggregate Bond Index	0.9%
Bloomberg Commodity Index	2.5%

Source: LPL Research, Bloomberg, FactSet 09/30/17

*Bloomberg consensus as of September 30, 2017.

Figures for S&P 500 Index, Bloomberg Barclays Aggregate Bond Index, and Bloomberg Commodity Index are total returns from 06/30/17–09/30/17 (Q3).

All indexes are unmanaged and cannot be invested into directly. The returns do not reflect fees, sales charges, or expenses. The results don't reflect any particular investment.

Please note: All return figures are as of September 30, 2017, unless otherwise stated.

Past performance is not indicative of future results.

The economic forecasts set forth in the presentation may not develop as predicted.

Stock investing entails risk including loss of principal.

reform in Washington, D.C., provided a favorable macroeconomic environment for domestic stocks during the quarter, despite hurricane impacts, tightening monetary policy, and geopolitical risks. Growth beat value for the third straight quarter on technology strength; even though the biggest value sector, financials, also outperformed during the quarter. Small caps outpaced large caps for the first time since the fourth quarter of 2016, as smaller, domestic companies generally stand to benefit more from potentially lower corporate tax rates. Strong earnings and semiconductor gains drove technology, while energy was also a strong performer, benefiting from the 13% jump in WTI crude oil during the quarter. Foreign stocks outperformed domestic, as the MSCI EAFE and MSCI Emerging Markets (EM) Indexes returned 5.5% and 8.0%, respectively. Overseas markets benefited from improving global growth, rebounding earnings, and a weaker U.S. dollar.

- **Fixed income investors experienced three different market environments in the third quarter:** a period of relative calm in July, several flight-to-safety events in August, and a resumption of risk taking in September as August risks faded. The net result during the quarter was little movement in longer-term interest rates and a flattening of the yield curve, leading to positive returns for all major segments of fixed income. Short-term rates were pressed higher by the Fed's commitment to a continuation of gradual rate hikes and monetary policy normalization.

  The Bloomberg Barclays Aggregate Bond Index returned 0.9%, outperforming Treasuries which returned 0.4% (Bloomberg Barclays U.S. Treasury Index). Richening valuations helped investment-grade corporates outperform the broader market, returning 1.4% (Bloomberg Barclays Corporate Index). Economically sensitive, lower credit quality sectors continued to rally, with high yield returning 2.0% (Bloomberg Barclays High Yield Index), bank loans returning 0.9% (S&P/LSTA US Leveraged Loan Index), and emerging market debt returning 2.3% (Bloomberg Barclays EM USD Aggregate Index).

- **Alternative investment strategies were led by the HFRX Equity Hedge Index, which gained 3.2% during the quarter.** The 7.0% year-to-date gain now represents the best start since 2008. The HFRX Event Driven Index gained 1.9%, with continued strength seen in the merger arbitrage and special situations subcategories. Distressed strategies were down 0.13% in the third quarter, as weakness in the consumer sectors offset moderate energy-related gains. The HFRX Systematic Diversified CTA Index gained 0.9%, with long equity exposure continuing to provide a majority of the positive returns.

- **Commodities rebounded from second quarter weakness to gain 2.5% during the third quarter.** Oil rallied 13% in the quarter after falling 9% during the second quarter, thanks to firming global demand, Saudi-led production caps, and slower U.S. production early on. Oil's strength, however, did not translate over to natural gas which fell 3%. Improved global manufacturing activity and tighter supplies supported gains in industrial metals, notably copper, while precious metals pared July and August gains in September, as the dollar rose and the odds of a Fed rate hike increased. Agriculture prices fell as better weather conditions led to strong crop yields, although supply pressures in Latin America and winter weather risks helped grain prices stabilize in September. ■

Bonds are subject to market and interest rate risk if sold prior to maturity.

Bond values and yields will decline as interest rates rise, and bonds are subject to availability and change in price.

Alternative strategies may not be suitable for all investors. The management of alternative investments may accelerate the velocity of potential losses.

Commodity-linked investments may be more volatile and less liquid than the underlying instruments or measures, and their value may be affected by the performance of the overall commodities baskets as well as weather, geopolitical events, and regulatory developments.

A LOOK FORWARD

During the fourth quarter we believe the stock market may be susceptible to event-driven risks from budget negotiations, a policy mistake by a major central bank, or geopolitical tensions. Still, with the potential for tax reform—or tax cuts—in early 2018 and a still favorable global economic and earnings environment, potential dips may present opportunities. Our favorable intermediate-term stock market view is driven by: 1) improving economic growth, 2) mid- to high-single-digit earnings gains with the potential for a boost from fiscal policy in 2018, and 3) a stable price-to-earnings ratio of 19–20. We expect the 10-year Treasury yield to end 2017 in the range of 2.25–2.75%, with the potential for 3%. We believe the Fed may hike rates one more time in 2017 assuming economic growth or inflation doesn't falter. Importantly, rising interest rates, along with a potential pickup in the pace of economic growth and inflation, may limit bond market return potential. Updates to our stock and bond market views will be released in LPL Research's *Outlook 2018,* coming in November. ■

As noted in our *Midyear Outlook 2017* publication, we expect the S&P 500 Index total return to be 6–9%, driven by 1) a pickup in U.S. economic growth; 2) mid- to high-single-digit earnings gains; 3) a stable price-to-earnings ratio (PE) of 19–20; and 4) prospects for a fiscal policy boost to earnings in 2018.

2 TECHNOLOGY TOPS Q3 SECTOR RANKINGS

S&P 500 Sector Performance, Ranked by Third Quarter Returns

Sector	Q3 2017
Technology	8.7%
Energy	6.8%
Telecom	6.8%
Materials	6.1%
Financials	5.2%
S&P 500	4.5%
Industrials	4.2%
Healthcare	3.7%
Utilities	2.9%
Real Estate	0.9%
Consumer Discretionary	0.8%
Consumer Staples	-1.4%

3 INTERNATIONAL MARKETS OUTPERFORM DOMESTIC IN Q3

Domestic & International Asset Class Performance, Ranked by Third Quarter Returns

Asset Class	Q3 2017
Emerging Markets	8.0%
U.S. Small Growth	6.2%
U.S. Large Growth	5.9%
Large Foreign	5.5%
U.S. Mid Growth	5.3%
U.S. Small Value	5.1%
U.S. Large Value	3.1%
U.S. Mid Value	2.1%

4 ECONOMICALLY SENSITIVE SECTORS PACED Q3 BOND MARKET PERFORMANCE

Bond Market Performance, Ranked by Third Quarter Returns

Sector	Q3 2017
Foreign Bonds (Unhedged)	2.6%
Emerging Market Debt	2.4%
High-Yield Bonds	2.0%
Municipal High-Yield	1.5%
Investment-Grade Corporates	1.4%
Preferred Securities	1.2%
Municipal Bonds	1.1%
Mortgage-Backed Securities	1.0%
TIPS	0.9%
Bank Loans	0.9%
Bloomberg Barclays U.S. Aggregate	0.9%
Foreign Bonds (Hedged)	0.7%
U.S. Treasuries	0.4%

Asset class returns are represented by the returns of indexes and are not ranked on an annual total return basis. It is not possible to invest directly in an index so these are not actual results an investor would achieve.

Bond Market Asset Class Indexes: Foreign Bonds (hedged) – Citigroup Non-U.S. World Government Bond Index Hedged for Currency; Preferred Securities – Merrill Lynch Preferred Stock Hybrid Securities Index; Treasury – Bloomberg Barclays U.S. Treasury Index; Mortgage-Backed Securities – Bloomberg Barclays U.S. MBS Index; Investment-Grade Corporate – Bloomberg Barclays U.S. Corporate Bond Index; Municipal – Bloomberg Barclays Municipal Bond Index; Municipal High-Yield – Bloomberg Barclays Municipal High Yield Index; TIPS – Bloomberg Barclays Treasury Inflation-Protected Securities Index; Bank Loans – Bloomberg Barclays U.S. High Yield Loan Index; High-Yield – Bloomberg Barclays U.S. Corporate High Yield Index; Emerging Market Debt – JP Morgan Emerging Markets Global Index; Foreign Bonds (unhedged) – Citigroup Non-U.S. World Government Bond Index (unhedged)

Sources: LPL Research, FactSet 09/30/17

All indexes are unmanaged and cannot be invested into directly. The returns do not reflect fees, sales charges, or expenses. The results don't reflect any particular investment. Past performance is no guarantee of future results.

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

The sectors are represented by the 10 S&P 500 Global Industry Classification Standard (GICS) indexes.

Asset classes based on Russell 1000, Russell 3000 Growth and Value Indexes, Russell 2000, Russell Midcap Index, MSCI EAFE, MSCI Emerging Markets Index.

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.

General Stock & Debt Equity Risks

Stock investing may involve risk including loss of principal.

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.

There is no guarantee that a diversified portfolio will enhance overall returns or outperform a nondiversified portfolio. Diversification does not ensure against market risk.

Government bonds and Treasury bills are guaranteed by the U.S. government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value. However, the value of fund shares is not guaranteed and will fluctuate.

High-yield/junk bonds are not investment-grade securities, involve substantial risks, and generally should be part of the diversified portfolio of sophisticated investors.

Long/short equity funds are subject to normal alternative investment risks, including potentially higher fees; while there is additional management risk, as the manager is attempting to accurately anticipate the likely movement of both their long and short holdings. There is also the risk of "beta-mismatch," in which long positions could lose more than short positions during falling markets.

Distressed Debt is an investment in companies in or near bankruptcy. The investment is often made to gain control of the company with the goal of either improving the operations of the company or disposing of assets. The risks associated with distressed investing arise from several factors including: limited diversification, the use of leverage, limited liquidity, and the possibility that investors may be required to accept cash or securities with a value less than their original investment and/or may be required to accept payment over an extended period of time.

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.

Index Definitions

The Bloomberg Barclays U.S. High Yield Loan Index tracks the market for dollar-denominated floating-rate leveraged loans. Instead of individual securities, the U.S. High-Yield Loan Index is composed of loan tranches that may contain multiple contracts at the borrower level.

The Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS, and CMBS (agency and non-agency).

The Bloomberg Barclays U.S. Corporate Index is a broad-based benchmark that measures the investment-grade, U.S. dollar-denominated, fixed-rate, taxable corporate bond market.

The Bloomberg Barclays U.S. Treasury Index is an unmanaged index of public debt obligations of the U.S. Treasury with a remaining maturity of one year or more. The index does not include T-bills (due to the maturity constraint), zero coupon bonds (strips), or Treasury Inflation-Protected Securities (TIPS).

The Bloomberg Commodity Index is calculated on an excess return basis and composed of futures contracts on 22 physical commodities. It reflects the return of underlying commodity futures price movements.

The Citigroup Economic Surprise Index (CESI) measures the variation in the gap between the expectations and the real economic data.

The HFRX Equity Hedge Index, also known as long/short equity, combines core long holdings of equities with short sales of stock or stock index options. Equity hedge portfolios may be anywhere from net long to net short, depending on market conditions. Equity hedge managers generally increase net long exposure in bull markets and decrease net long exposure (or even are net short) in a bear market. Generally, the short exposure is intended t generate an ongoing positive return in addition to acting as a hedge against a general stock market decline. Stock index put options are also often used as a hedge against market risk. Profits are made when long positions appreciate and stocks sold short depreciate. Conversely, losses are incurred when long positions depreciate or the value of stocks sold short appreciates. Equity hedge managers' source of return is similar to that of traditional stock pickers on the upside, but they use short selling and hedging to attempt to outperform the market on the downside.

The HFRX Event Driven Index managers maintain positions in companies currently or prospectively involved in corporate transactions of a wide variety including but not limited to mergers, restructurings, financial distress, tender offers, shareholder buybacks, debt exchanges, security issuance or other capital structure adjustments. Security types can range from most senior in the capital structure to most junior or subordinated, and frequently involve additional derivative securities. Event Driven exposure includes a combination of sensitivities to equity markets, credit markets and idiosyncratic, company specific developments. Investment theses are typically predicated on fundamental characteristics (as opposed to quantitative), with the realization of the thesis predicated on a specific development exogenous to the existing capital structure.

The HFRX Macro: Systematic Diversified CTA Index strategies have investment processes typically as function of mathematical, algorithmic and technical models, with little or no influence of individuals over the portfolio positioning. Strategies which employ an investment process designed to identify opportunities in markets exhibiting trending or momentum characteristics across individual instruments or asset classes. Strategies typically employ quantitative process which focus on statistically robust or technical patterns in the return series of the asset, and typically focus on highly liquid instruments and maintain shorter holding periods than either discretionary or mean reverting strategies. Although some strategies seek to employ counter trend models, strategies benefit most from an environment characterized by persistent, discernible trending behavior. Systematic Diversified strategies typically would expect to have no greater than 35% of portfolio in either dedicated currency or commodity exposures over a given market cycle.

The MSCI EAFE Index is recognized as the pre-eminent benchmark in the United States to measure international equity performance. It comprises the MSCI country indexes that represent developed markets outside of North America: Europe, Australasia, and the Far East.

The MSCI Emerging Markets Index captures large and mid cap representation across 23 emerging markets (EM) countries. With 822 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

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.

The S&P/LSTA U.S. Leveraged Loan 100 index is a market value-weighted index designed to measure the performance of the U.S. leveraged loan market. The index consists of 100 loan facilities drawn from a larger benchmark - the S&P/LSTA (Loan Syndications and Trading Association) Leveraged Loan Index (LLI).

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