LPL RESEARCH
GLOBAL PORTFOLIO STRATEGY

February 2020

LPL GPS – GLOBAL PORTFOLIO STRATEGY

A monthly global review and look forward

Data reported in January and early February reflected continued, moderate growth in the U.S. economy. U.S. manufacturing data improved from weak levels, defense drove durable goods order growth, and underlying data on the U.S. consumer and job growth was solid. The S&P 500 Index was flat for the month while the 10-year Treasury yield fell 0.31% basis points to 1.51% amid coronavirus outbreak fears.

Investment Takeaways

- Our S&P 500 Index year-end 2020 fair value target is 3,250–3,300, based on a price-to-earnings (P/E) ratio of 18.75 and our 2020 S&P 500 earnings forecast of $175 per share.* With stocks already at our target, a potential further **stock market advance** in 2020 may be limited.
- We favor large cap **stocks** as the business cycle ages and recommend balanced exposure between the growth and value styles in equity allocations where suitable.
- Attractive valuations and solid economic growth may favor **emerging markets** over foreign developed markets, although coronavirus impact is temporarily offsetting the benefits of the phase-one trade deal with China.
- Slower but still solid economic growth and modest inflation may put upward pressure on **yields**, but geopolitical uncertainty and global appetite for U.S. Treasuries may keep yields range bound.
- We favor a blend of high-quality intermediate **bonds**, focused on mortgage-backed securities (MBS), where appropriate, for a diversifying source of yield that may help mitigate risk of higher interest rates.
- While **economic growth** is supportive of investment-grade corporates, we take a neutral view because of the tight credit spreads and declining credit quality.
- The **global stock rally** continues to be buoyed by strong participation. With overly optimistic sentiment becoming a tactical risk, however, we see technical support near 3,030 on the S&P 500 Index.
- **Key changes** from January's report: Upgraded our views on financials and industrial metals to positive.

Our Asset Class & Sector Choices

Equity Asset Classes	Equity Sectors	Fixed Income	Alternative Asset Classes
Emerging Markets Equities Large Cap Equities	Industrials Technology Financials	Mortgage-Backed Securities	Event Driven

Data as of January 31, 2020
*As noted in our Outlook 2020: Bringing Markets Into Focus, our year-end fair value target for the S&P 500 of 3,250–3,300 is based on a trailing price-to-earnings ratio (P/E) of 18.75 and S&P 500 earnings per share forecast of $175.

LPL Financial

Economy: Steady Growth Amid Geopolitical, Outbreak Fears

January data reflected continued, steady growth as the U.S. economy battled geopolitical uncertainty and a global health scare. Global economic data continued to reflect stabilization, aided by the U.S.-China phase-one trade deal, while the coronavirus outbreak weighed on Chinese economic activity.

- **Conference Board's Leading Economic Index (LEI)** rose 0.1% year over year in December. The slight increase in the LEI signaled continued economic growth.
- **Payrolls and Labor.** Nonfarm payrolls increased 225,000 in January, above expectations for a gain of 163,000. The gain, which is sufficient to maintain the current, low unemployment rate, was well above the 175,000 average payrolls change in 2019.
- **Inflation.** Consumer inflationary pressures remained benign based on December data. The core Consumer Price Index (CPI), which excludes food and energy prices, climbed 2.3% year over year, near a cycle high and in line with the fourth-quarter-2019 pace.

  On the **wholesale** side, the core Producer Price Index (PPI) increased 1.1% year over year in December, excluding food and energy, the slowest pace since August 2016. Prices for core personal consumption expenditures (PCE), the Fed's preferred inflation gauge, increased 1.6% year over year in December, within the Fed's 2% growth target. In the most recent look at inflation, **wages** rose 3.1% year over year in January, slightly below the cycle high.
- **U.S. manufacturing** data improved in January. The Institute for Supply Management's (ISM) Purchasing Managers' Index (PMI) for January rebounded and moved into expansionary territory for the first time since July 2019.
- **U.S. Consumer.** The Conference Board's Consumer Confidence Index rose a better-than-expected three points in January to a six-month high and an elevated level historically. Retail sales climbed 0.3% in December, in line with consensus estimates. A measure of retail sales' contribution that is more closely mapped to gross domestic product (GDP) rose 0.5%, its biggest month-over-month gain since July 2019.
- **U.S. Business.** U.S. capital equipment orders rebounded in December on strong defense orders, masking weakness related to the grounding of the Boeing 737 Max airplane. Bookings for all durable goods rose 2.4% month over month, the best since August 2018, but orders for nondefense capital goods (excluding aircraft) fell 0.9% month over month and reflected lackluster capital investment from corporate America.
- **Federal Reserve (Fed).** At its late-January meeting, the Fed announced it would keep rates unchanged while signaling current policy would be appropriate to lift inflation to policymakers' 2% target. Fed Chair Jerome Powell stated in his post-meeting press conference that downside risks (like the coronavirus outbreak) are still prevalent, hinting that policy may stay accommodative for a while. Powell also slightly downgraded his assessment of consumer spending.

2020 REAL GDP GROWTH FORECASTS

Our real U.S. gross domestic product (GDP) growth forecast for 2020 is 1.75%.

Our forecast for developed international markets (ex. U.S.) is 1.5%.

For emerging markets, we forecast 4.6%, and 3.5% globally.

U.S. and global GDP estimates are LPL forecasts. Other GDP estimates are International Monetary Fund projections.

Equity Asset Classes: Modest Gains in Up-and-Down Month

The **S&P 500 Index** was marginally lower in January, as the signing of the phase-one trade deal with China, continued steady economic growth, and support from the Fed outweighed the major escalation in the U.S.-Iran conflict and outbreak of the coronavirus. On January 27, the global health scare led to the first 1% decline for the S&P 500 since October 8, 2019, which broke a streak of 30-consecutive trading days without back-to-back declines. The start of fourth-quarter earnings season was generally well received.

Style/Capitalization

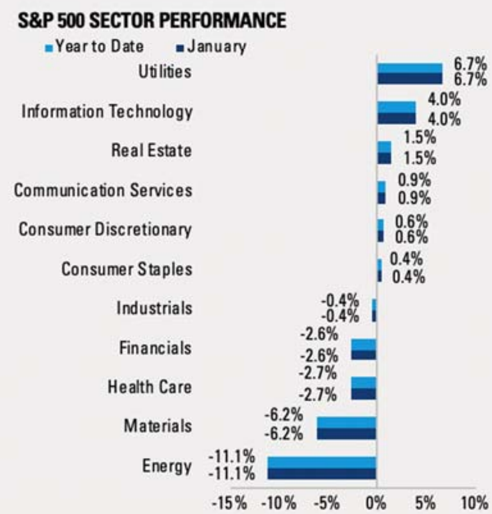
Large cap stocks outperformed **small cap** and **midcap stocks** during January, as the Russell 1000 Index outperformed the Russell Midcap Index, while the Russell 2000 Index lagged both. Progress on trade helped the larger, more global companies, while the market favored more defensive, less economically sensitive stocks.

Global Equities

Stocks in developed international and emerging markets fell in January and trailed the S&P 500 Index. A strong U.S. dollar detracted from performance in international-developed and emerging markets.

International developed equities lost 2.1% for the month**,** based on the MSCI EAFE Index. The Swiss market held up relatively well based on the MSCI country indexes, while stocks in the **United Kingdom** and **France** lagged behind.

Emerging markets equities lost 4.7% in January, based on the MSCI Emerging Markets Index. Progress on trade helped emerging markets over the first half of the month before the coronavirus outbreak weighed on China and the rest of Asia later in the month. Based on the MSCI country indexes, **China**, **Korea**, and **Brazil** detracted most from performance.



Source: FactSet 12/31/19

Indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

Stock investing involves risk, including loss of principal. Because of its narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies.

Equities Asset Classes: Favor U.S. Large Caps and Emerging Markets

Asset Class	Comments
Market Cap	We favor U.S. large caps over their small cap counterparts as the business cycle ages and financial conditions potentially tighten. Easing U.S.-China trade tensions could also help large caps, while larger companies offer a superior corporate profit outlook, in our view.
Style	We maintain a balanced view of growth and value. Relative valuations and the potential move higher in interest rates favor value stocks, but the recent series of Fed rate cuts and slowing economic growth may favor growth.
Region	Among developed markets, we remain U.S. focused, supported by stronger but slowing economic growth, low inflation, improving earnings growth, and a supportive Federal Reserve. Fiscal deficits, populism, and exhausted monetary policies could weigh on sentiment, spending, and investment in Europe. In Japan, structural reforms have had limited success and the recent consumer tax hike may pressure sentiment. Attractive valuations and solid economic growth favor emerging markets over developed foreign markets. The phase-one trade deal with China is supportive, even though we acknowledge the risk of possible re-escalation in trade tensions and the temporary impact of the coronavirus outbreak on Chinese economic output.

Equities Sectors: Cyclical Leadership

Sector	View	S&P 500 Weight (%)	Comments
Materials	Neutral	2.5	The U.S.-China trade deal and stabilizing global growth have our attention, but we would like to see better performance including sustained commodity price gains.
Energy	Negative	3.7	The U.S.-China trade deal helps but the coronavirus outbreak and U.S. dollar strength present strong headwinds.
Industrials	Positive	9.0	U.S.-China trade deal, stabilizing global economic growth, potential pickup in capital investment, and valuations are supportive.
Communication Services	Neutral	10.5	High valuations, regulatory risk for internet companies, and telecom exposure keep us neutral.
Consumer Discretionary	Neutral	9.8	Though valuations are rich, robust consumer spending and still-low interest rates are beneficial.
Technology	Positive	24.6	Productivity enhancements in areas such as mobile, cloud, automation, and artificial intelligence (AI) are driving demand. Earnings poised to improve.
Financials	Positive	12.5	Our upgraded view reflects attractive valuations and our expectation that the interest-rate environment is poised to improve.
Utilities	Negative	3.4	We continue to favor cyclical sectors, valuations are high, and we expect interest rates to move higher.
Healthcare	Neutral	13.9	Ebbing policy fears gave the sector a lift in Q4. Positive bias is driven by a solid healthcare spending outlook, favorable demographics, and attractive valuations.
Consumer Staples	Negative	7.1	Our preference for cyclical sectors, sluggish growth, and rich valuations offset attractive yields.
Real Estate	Negative	3.0	Sound fundamentals and rich yields offset by interest-rate sensitivity and our preference for cyclicals.

Fixed Income, Currencies, and Commodities

U.S. Treasury yields tumbled in January as the coronavirus outbreak in China drove a safe-haven rally in U.S. Treasuries. The 10-year yield slid 39 basis points (0.39%) during the month to end January at 1.52%. Most of the drop occurred after January 21 as the virus spread.

Nine of ten fixed income sectors we track rose in January, as shown in the **Fixed Income Performance Table.** Municipal bonds led with a 2.4% gain, while local currency EM debt lagged a 1.3% loss. The Bloomberg Barclays U.S. Aggregate Index (Agg) returned 1.9%.

Credit Quality: Medium

We're maintaining a more cautious approach as the cycle ages, but we still prefer corporate bonds to government bonds.

Duration: Short to Intermediate

We prefer below-benchmark interest-rate sensitivity due to our rising rate view and the flat yield curve.

Bonds: Taxable

We suggest a blend of high-quality intermediate bonds in tactical portfolios emphasizing MBS. We expect modestly higher rates in 2020 on steady growth and contained inflation. Compensation for longer-maturity bonds remains unattractive. Profit-growth outlook and interest coverage buoy corporate bonds, but valuations appear less attractive at narrow credit spreads.

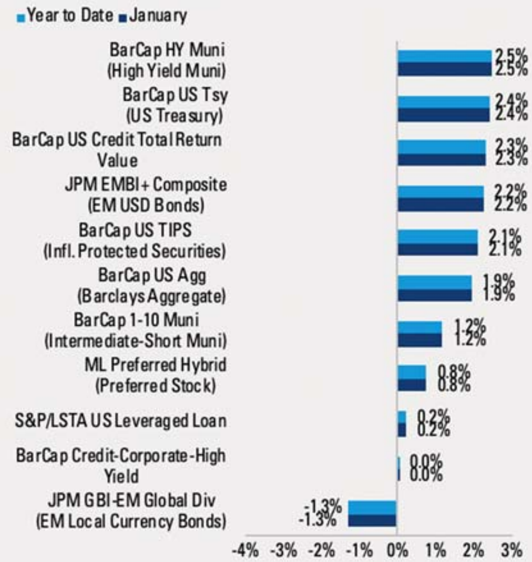
Bonds: Tax Free

We favor municipals bonds as a high-quality option for taxable accounts. Supply dynamics still look attractive, although valuations relative to Treasuries lean toward the expensive side.

Commodities and Currencies

Potential **U.S. dollar** weakness is a possible catalyst for precious metals, where our view is positive. Our outlook for industrial metals is also positive on improved U.S.-China trade relations, though coronavirus containment is a key factor. Our crude **oil** outlook is negative on supply concerns and lack of sustained impacts from prior supply shocks.

FIXED INCOME PERFORMANCE



U.S. TREASURY YIELDS

Security	12/31/19	1/31/20	Change in Yield
3 Month	1.55	1.55	0.00
2 Year	1.58	1.33	-0.25
5 Year	1.69	1.32	-0.37
10 Year	1.92	1.51	-0.41
30 Year	2.39	1.99	-0.40

AAA MUNICIPAL YIELDS

Security	12/31/19	1/31/20	Change in Yield
2 Year	1.18	0.91	-0.27
5 Year	1.23	0.93	-0.30
10 Year	1.57	1.27	-0.30
20 Year	2.06	1.74	-0.32
30 Year	2.19	1.88	-0.31

Source: FactSet 12/31/19

Indexes are unmanaged and cannot be invested into directly. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment. Past performance is no guarantee of future results.

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 subjec t to availability and change in price.

Fixed Income and Alternative Investments: Limit Rate Sensitivity

Sector Views	View	Comments
U.S. Treasuries	Negative	Yield spreads to international sovereigns remain elevated, but hedging costs reduce attractiveness. Supply, economic growth, and inflation normalization could be headwinds.
Mortgage-Backed Securities (MBS)	Positive	Diversifying source of yield among high-quality options.
Investment-Grade Corporates	Neutral	We still find incremental value in corporate bonds due to the economic backdrop. Tight credit spreads and overall credit quality remain concerns.
Preferred Stocks	Neutral	Fundamentals for U.S. banks are firm. Higher interest-rate sensitivity and valuations are concerns.
High-Yield Corporates	Neutral	Yields are attractive, and the economy is supportive, but high-quality options may be better diversifiers, and credit spreads are tight.
Bank Loans	Negative	Weaker investor protections and the end of rate hikes have reduced attractiveness, though economic conditions remain supportive.
Foreign Bonds	Negative	Rich valuations, interest rate risk, and potential currency volatility are among negatives. Slight preference for hedged to help reduce volatility.
Emerging Markets Debt	Neutral	Dovish central banks improve the valuation picture. Trade policy and geopolitical tensions remain risks.

Alternative Investments

The event-driven investing outlook remains promising as healthy deal flow, low tax rates, and available private equity support the strategy. We continue to prefer strategies with balanced risk profiles, as well as those that have flexible net exposure mandates to capitalize on market volatility

IMPORTANT DISCLOSURES

This material has been prepared for informational purposes only, and is not intended as specific advice or recommendations for any individual. There is no assurance that the views or strategies discussed are suitable for all investors and they do not take into account the particular needs, investment objectives, tax and financial condition of any specific person. To determine which investment(s) may be appropriate for you, please consult your financial professional prior to investing. Any economic forecasts set forth may not develop as predicted and are subject to change.

Stock investing involves risk including loss of principal. Because of their narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies. Value investments can perform differently from the market as a whole and can remain undervalued by the market for long periods of time. The prices of small and mid-cap stocks are generally more volatile than large cap stocks. Bonds are subject to market and interest rate risk if sold prior to maturity.

Bond values will decline as interest rates rise and bonds are subject to availability and change in price. Corporate bonds are considered higher risk than government bonds. Municipal bonds are subject to availability and change in price. Interest income may be subject to the alternative minimum tax. Municipal bonds are federally tax-free but other state and local taxes may apply. If sold prior to maturity, capital gains tax could apply. U.S. Treasuries may be considered "safe haven" investments but do carry some degree of risk including interest rate, credit, and market risk. Bond yields are subject to change. Certain call or special redemption features may exist which could impact yield.

Mortgage backed securities are subject to credit, default, prepayment, extension, market and interest rate risk.

Credit Quality is one of the principal criteria for judging the investment quality of a bond or bond mutual fund. Credit ratings are published rankings based on detailed financial analyses by a credit bureau specifically as it relates the bond issue's ability to meet debt obligations. The highest rating is AAA, and the lowest is D. Securities with credit ratings of BBB and above are considered investment grade. Duration is a measure of the sensitivity of the price (the value of principal) of a fixed-income investment to a change in interest rates. It is expressed as a number of years.

Alternative investments may not be suitable for all investors and should be considered as an investment for the risk capital portion of the investor's portfolio. The strategies employed in 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. The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.

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. All information is believed to be from reliable sources; however, LPL Financial makes no representation as to its completeness or accuracy.

For a list of descriptions of the indexes referenced in this publication, please visit our website at lplresearch.com/definitions.

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