

LPL RESEARCH
PRESENTS

MIDYEAR OUTLOOK 2021

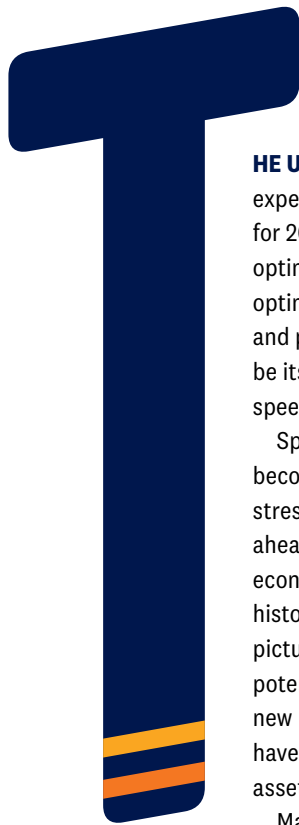
PICKING UP SPEED



PICKING UP SPEED



INTRODUCTION



THE U.S. ECONOMY powered forward faster than nearly anyone had expected in the first half of 2021. As we were writing our *Outlook* for 2021 in late 2020, our economic views were significantly more optimistic than consensus forecasts—but in retrospect, not nearly optimistic enough. Our theme was getting back on the road again and powering forward. But as the economy accelerates to what may be its best year of growth in decades, power has been converted to speed and we're trading highways for raceways.

Speed can be exhilarating, but it can also be dangerous. Traffic becomes a test of nerves. Turning a sharp corner creates added stress on drivers. Tires wear, and engines can overheat. As we look ahead to the second half of 2021, and even into 2022, we see an economy still on the move before it slowly starts to settle back into historical norms. The speed is thrilling and the overall economic picture remains sound, likely supporting strong profit growth and potential stock market gains. But the pace of reopening also creates new hazards: Supply chains are stressed, some labor shortages have emerged, inflation is heating up—at least temporarily—and asset prices look expensive compared to historical figures.

Markets are always forward looking, and in *LPL Research's Midyear Outlook 2021: Picking Up Speed*, we help you keep your eyes on the road ahead. We focus on the next 6-12 months, when markets may be looking at which latecomers to the rally have the strength to extend their run, and whether there may be new beneficiaries of the global reopening. But smart investors are always looking even further ahead, beyond the next curve, next lap, or even next race. Sound financial advice remains the key to durability. So, buckle your seatbelt and tune up your portfolio. The next stretch may be a fast one with new risks to navigate, but it's still just another step toward meeting your long-term financial goals.





WHERE WE ARE



ECONOMY: The country has reopened, and the growth rate of the U.S. economy may have peaked in the second quarter of 2021, but there is still plenty of momentum left to extend above-average growth into 2022. We forecast 6.25–6.75% U.S. gross domestic product (GDP) growth in 2021, which would be the best year in decades. We continue to watch inflation closely but believe recent price pressures are transitory and will begin to work their way off gradually later in the year. The average U.S. expansion since World War II has lasted an average of five years and much longer over the last few decades. There's nothing on the horizon to indicate the current expansion can't reach that mark.



POLICY: The economy was supported through the pandemic by more than \$5 trillion in stimulus measures and extraordinary support by the Federal Reserve (Fed). Policy will take a back seat in 2021 as private sector growth replaces stimulus checks. Tax policy, though, remains a concern. Historically higher personal tax rates have had only a modest impact on markets, but higher corporate taxes would have a direct impact on earnings growth, potentially limiting stock gains.



STOCKS: The second year of a bull market is often more challenging than the first, but historically still usually produces gains. Economic improvement should continue to support S&P 500 Index earnings, which had a stunning first quarter. While valuations remain somewhat elevated, we think they look reasonable after considering still low interest rates and earnings growth potential. Our 2021 year-end S&P 500 fair-value target range of 4,400–4,450 is based on a price-to-earnings ratio (P/E) of 21.5 and our 2022 S&P 500 earnings per share (EPS) forecast of \$205.



BONDS: Inflationary pressure and economic improvement may put additional upward pressure on the 10-year Treasury Yield, and we continue to see the 10-year yield finishing 2021 in the range of 1.75–2.00%. Such a move would leave core investment-grade bonds near flat over the rest of the year. Nevertheless, bonds still can play an important role in a portfolio as a source of income and as a diversifier during equity market declines. We are also closely watching the Fed, which may announce plans to reduce its bond purchases later in the year.

Please see last page for important disclosures.

SPEEDING AHEAD



THE U.S. ECONOMY has surprised nearly everyone to the upside as it speeds along thanks to vaccinations, reopening, and record stimulus. All have combined to produce what should be one of the best years for growth ever.

Despite the natural challenges of ramping back up, the recovery still seems capable of providing upside surprises. As a result of the strides made toward full reopening, rapid vaccine distribution, massive stimulus efforts, and support from the Fed, we maintain our 2021 forecast for U.S. GDP growth of 6.25%–6.75%. Last year’s 3.5% drop in GDP, the worst year since the Great Depression, may not be forgotten—but it has been left in the dust of 2020.

With various measures of output matching or exceeding pre-pandemic levels, it’s clear last year’s recession is in the rear-view mirror, and it may go down as the shortest one in history—even shorter than the six-month recession from the early 1980s.

Globally, Europe and Japan have been slower to move past the pandemic, but explosive growth may be forthcoming once they do. Meanwhile, emerging markets continue to be a source of solid global growth, with several Asian emerging markets being among the first to recover from the pandemic, though growth in the United States will likely be stronger [Figure 1].

THIS ECONOMIC CYCLE IS ONLY ON ITS FIRST LAP

Since World War II, economic expansions have lasted an average of five years, with the four most recent cycles going even longer. Before the pandemic, the most recent expansion was the longest ever at 11 years, and might have gone on even longer if COVID-19 hadn’t struck. However, this cycle may not continue on as long as the last one, considering this wasn’t your average recession.

Because the recession last year was likely the shortest ever, and the economy was supported by historic stimulus, some imbalances weren’t worked off like we tend to see in a normal recession. Corporate debt levels remain high, supported by low interest rates, and stock valuations never really reset. The good news is this new cycle of growth probably has enough going for it to be at least average, which would still give it another four years [Figure 2]. And there’s nothing wrong with being average!

U.S. DOLLAR MAY STRUGGLE TO KEEP UP

We came into 2021 expecting a weaker U.S. dollar and that is what’s happened, but we think many more years of weakness could be in the cards. We view the “twin deficits” of the U.S. economy—the combination of the budget deficit and the current account deficit—as a long-term structural driver that continues to put pressure on the greenback versus major global alternatives. As a historical net importer, the U.S. has usually carried a trade deficit, while the flood of pandemic aid has stretched the budget deficit and ballooned the sum of the twin deficits to all-time highs, as a percent of GDP [Figure 3].

The Fed has been very clear with its dovish stance for a long time, which should be another tailwind to a lower-trending dollar. The dollar also has moved in cycles that last for years. It’s currently in the midst of a lower cycle—having made major peaks in 1985, 2001, and 2017, with years of dollar weakness after the peaks—suggesting continued weaker dollar action could be ahead.

2021 ECONOMIC FORECASTS

BIG JUMP IN U.S. GROWTH SINCE START OF 2021

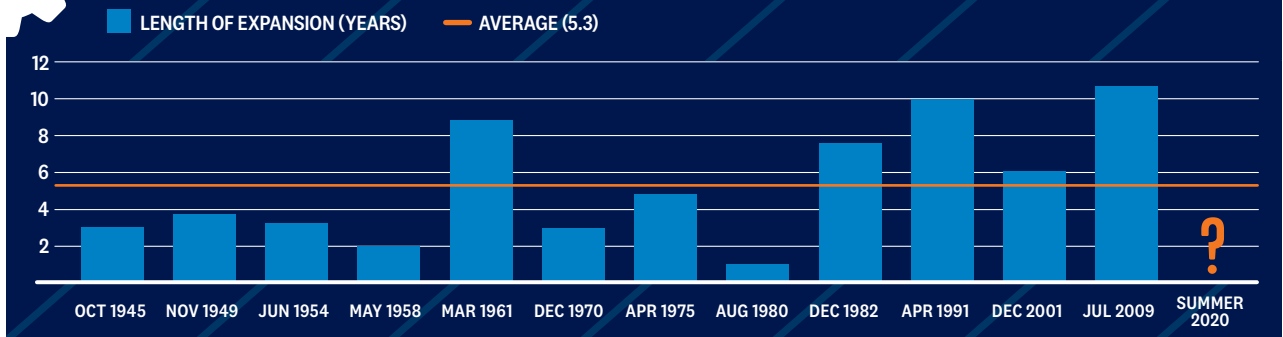
REAL GDP GROWTH FORECASTS (YoY%)	2020	Projection* 2021	Current 2021
United States	-3.5%	3.9%	6.25-6.75%
Developed ex-U.S.	-3.9%	3.6%	3.75-4.25%
Emerging Markets	-0.6%	5.1%	5.5-6.0%
Global	-3.3%	5.2%	5.5-6.0%

*As of 12/31/20

Source: LPL Research, Dallas Federal Reserve, International Monetary Fund (IMF), Bloomberg 06/28/21
Economic forecasts may not develop as predicted and are subject to change.

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THIS NEW EXPANSION COULD HAVE YEARS LEFT



Source: LPL Research, National Bureau of Economic Research 06/28/21

While NBER has not officially dated the end of the recession, and typically does not until approximately a year after the economy has troughed, on average, we are provisionally dating summer 2020 as the economic trough based on record retail sales, and expanding manufacturing and services data. Economic forecasts set forth may not develop as predicted and are subject to change.

A potentially weaker U.S. dollar would have several benefits, including boosting profits for multinational corporations and enhancing returns on international investments for dollar-based investors. The flipside is a drastically lower dollar could be inflationary, driving prices of commodities and imported goods higher.

INFLATION RUNNING HOT

Inflation has been the buzzword of 2021 so far. With record fiscal stimulus, supply chain bottlenecks, semiconductor shortages, a potentially tightening labor force, and an economy nearly fully open, the threat of inflation is very real. Given the core Consumer Price Index (CPI) (excluding volatile food and energy) in May soared to its highest year-over-year change since the 1992, the threat of higher inflation is no doubt real. Many worry the Fed is behind the curve and

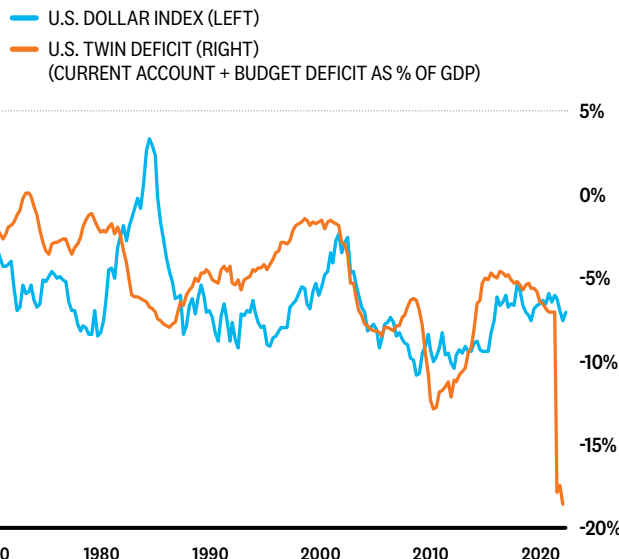
will be forced to hike rates sooner and more aggressively to prevent runaway 1970s-style inflation, though we don't share these worries.

It makes sense that we would see historically high inflation over the summer months for the simple fact that a year ago at this time CPI was negative three months in a row during the shutdowns, elevating the year-over-year comparisons.

Higher inflation will likely be "transitory" before things get back to normal later this year. Don't forget that structural forces that kept a lid on inflation for much of the past decade are still in place. Technology, globalization, the Amazon effect, increased productivity and efficiency, automation, and high debt (which puts downward pressure on inflation) are among the major structural forces that have put the brakes on inflation for more than a decade already and will likely continue to do so.

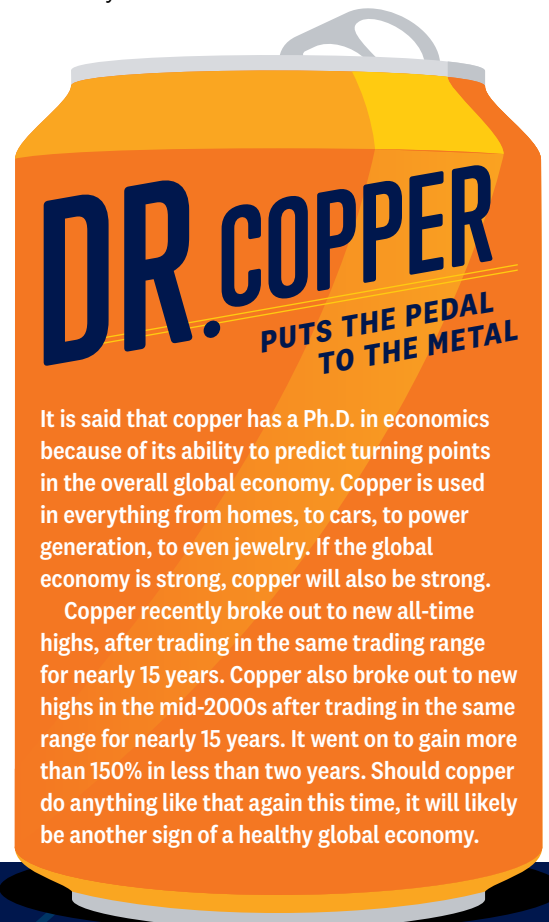
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TWIN DEFICITS CREATE STRUCTURAL PRESSURE ON THE U.S. DOLLAR



Source: LPL Research, Bloomberg 06/28/21
Current Account + Budget Deficit as of 12/31/20

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



It is said that copper has a Ph.D. in economics because of its ability to predict turning points in the overall global economy. Copper is used in everything from homes, to cars, to power generation, to even jewelry. If the global economy is strong, copper will also be strong.

Copper recently broke out to new all-time highs, after trading in the same trading range for nearly 15 years. Copper also broke out to new highs in the mid-2000s after trading in the same range for nearly 15 years. It went on to gain more than 150% in less than two years. Should copper do anything like that again this time, it will likely be another sign of a healthy global economy.



TAKING A BACK SEAT

DURING MUCH OF 2020 and early 2021, markets have been focused on fiscal policy due to massive government efforts to help the economy speed past the impact of COVID-19 restrictions. Policy still matters, but it will matter far less to markets over the rest of 2021, despite some important debates going on in Washington. Markets may anticipate an increase in government spending if Congress passes some version of the Biden administration's Build Back Better initiative, but it will likely be spread out over almost a decade. The biggest risk may be around taxes, with businesses and wealthy households both facing the prospect of a higher tax burden to pay for the plan and help manage the deficit.

FEDERAL SPENDING UNLIKELY TO CHANGE MARKET TRAJECTORY

Much of the approximately \$5 trillion in direct COVID-related stimulus in 2020 and 2021 did not flow through directly as government spending. Instead, the federal government

used its borrowing power to distribute funds to households and businesses. That impact will fade over the remainder of the year, but will be replaced by the private economy accelerating, which is where we would want it to be.

Actual government spending may continue to grow, but the direct payments will likely end and the rate of growth will not make a large difference to overall output. According to the Bureau of Economic Analysis, federal spending added an average of about 0.15% per year to GDP growth between 2000 and 2020, with defense and non-defense each contributing about half of that amount. Federal spending has not contributed more than 0.5% to GDP growth since 1986, and even in 2020 only contributed 0.29%. Stimulus was more about borrowing than government spending.

But even a small contribution to GDP growth can be massive in absolute terms. With proposals for the two pieces of the Build Back Better plan at nearly \$4 trillion—\$1.8 trillion for the American Families Plan and over \$2 trillion for the infrastructure bill (known as the American Jobs Plan)—higher taxes would be needed to help finance the new spending. Let's be clear, with a 50/50 Senate (Vice President Kamala Harris breaks ties) and the historically slim Democratic majority in the House, we think these final numbers will likely come in at \$2–2.5 trillion combined, as these initial numbers from the Democrats are starting points for negotiations.

TAXES MAY CHANGE MARKET PATH, BUT NOT DIRECTION

Federal spending is generally funded by taxes or debt, and the Biden administration plans to raise taxes to help pay for the Build Back Better initiative. President Biden has proposed increasing taxes on both corporations and wealthier households, including an increase in the capital gains tax (the tax on investment profits). Markets so far have taken the proposed changes in stride, due to expectations that the

WHAT HAPPENS AFTER HIGHER CORPORATE TAXES?

DATE OF CORPORATE TAX INCREASE	OLD RATE	NEW RATE	LEGISLATION	S&P 500 INDEX PERFORMANCE			
				THREE MONTHS BEFORE	NEXT THREE MONTHS	NEXT SIX MONTHS	NEXT 12 MONTHS
6/25/40	19.0%	22.1%	REVENUE ACT OF 1940	-19.4%	10.7%	5.9%	1.3%
10/8/40	22.1%	24.0%	SECOND REVENUE ACT OF 1940	5.7%	3.0%	-8.1%	-6.6%
9/20/41	24.0%	31.0%	REVENUE ACT OF 1941	3.3%	-18.4%	-21.7%	-14.9%
10/21/42	31.0%	40.0%	REVENUE ACT OF 1942	8.2%	8.9%	21.4%	26.0%
9/23/50	38.0%	42.0%	REVENUE ACT OF 1950	7.2%	4.5%	10.6%	19.8%
10/31/51	42.0%	51.0%	REVENUE ACT OF 1951	1.9%	5.1%	3.2%	7.5%
6/28/68	48.0%	52.8%	REVENUE & EXPENDITURE CONTROL ACT OF 1968	10.4%	2.7%	5.2%	-1.5%
8/10/93	34.0%	35.0%	OMNIBUS BUDGET RECONCILIATION ACT OF 1993	1.1%	2.4%	5.0%	1.9%
AVERAGE				2.3%	2.4%	2.7%	4.2%
MEDIAN				4.5%	3.8%	5.1%	1.6%
% POSITIVE				87.5%	87.5%	75.0%	62.5%

Source: LPL Research, Strategas, FactSet 06/28/21
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Past performance is no guarantee of future results.

proposed tax increases will be reduced during negotiations and that the economy will be strong enough to absorb the impact.

The Tax Cut and Jobs Act (TCJA), signed into law by former President Trump in December 2017, reduced the top tax rate on corporations from 35%, where it had been since 1993, to 21%. The top U.S. statutory corporate tax rate had not been under 30% since the 1940s prior to the TCJA. There were also other structural reforms included, such as changes to the way U.S. corporate profits from abroad are taxed in an attempt to make U.S. companies more competitive.

President Biden has proposed increasing the corporate tax rate to 28%, but that should be viewed as a bargaining position and we believe the more likely outcome is that we see the rate end up closer to 25%. The negative news for markets is that corporate earnings growth will take an approximately proportional direct hit. Since the stock market is fundamentally driven by earnings, the tax impact will likely be a headwind for equity markets. On the positive side, this move has been anticipated for quite some time and should not be much of a surprise to markets. Further, excluding the rate introduced by the TCJA, this will still be the lowest tax rate in about 70 years. Historically, markets have absorbed higher corporate tax rates, although with below-average returns [Figure 4]. While we don't think higher rates would be retroactive, they could take away some of the momentum from recent upside surprises in earnings growth that we've seen so far in 2021 and contribute to a choppy market.

Proposed tax provisions to raise funds for Build Back Better on the household side include increasing the top tax rate on ordinary income to 39.6% from 37%, and capital gains and taxes on those who earn more than \$1 million to a maximum of 43.4% from the current 23.8%. Fun statistic: Only 0.32% of the population makes more than \$1 million a year, so the truth is this won't impact the other 99.68% of the population.

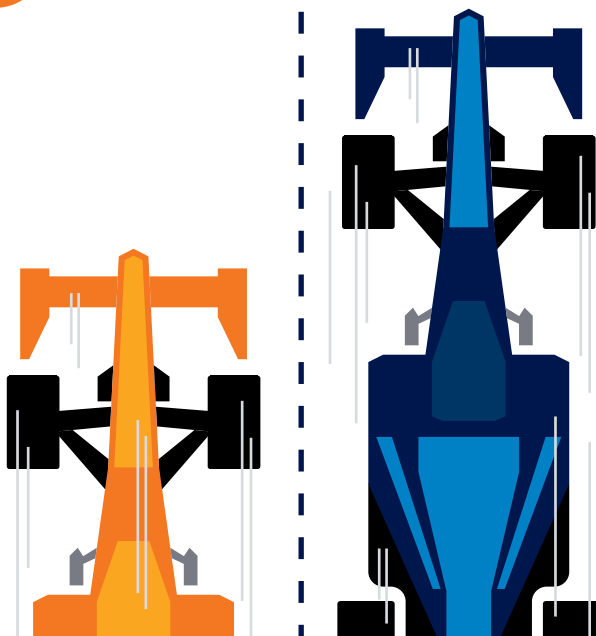
Looking at history, capital gains taxes did increase in 1986 and 2013, but the economy was on a firm footing, compared with the 1970s hikes, which saw an economy marred by higher inflation and sluggish growth. Not surprisingly, the two more recent hikes saw solid stock market performance, while the 1970s hikes didn't [Figure 5]. Is it as simple as how the economy is doing? Policy matters, but broader economic trends matter more. If we see a capital gains tax increase, we do expect some investors may rotate out of equities and seek more tax-friendly opportunities—but at the cost of accelerating capital gains. Long-term investors may simply wait out the new rate, on expectations that it may be changed again by a subsequent administration.

HIGHER CAPITAL GAINS HAVEN'T HURT STOCKS LATELY

DATE OF CAPITAL GAINS INCREASE	S&P 500 INDEX PERFORMANCE		
	THREE MONTHS BEFORE	NEXT THREE MONTHS	NEXT TWELVE MONTHS
12/30/69	-1.6%	-1.7%	-0.6%
10/4/76	0.5%	1.6%	-7.7%
10/22/86	-0.7%	15.9%	9.4%
1/1/13	1.5%	6.7%	25.3%
AVERAGE	-0.1%	5.6%	6.6%
MEDIAN	-0.1%	4.1%	4.4%
% POSITIVE	50.0%	75.0%	50.0%

Source: LPL Research, Ned Davis Research, FactSet 06/28/21
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GAINING GROUND



2021 U.S. MARKET FORECASTS

6 HIGHER EARNINGS SUPPORT FURTHER GAINS FOR STOCKS

10-Year U.S. Treasury Yield	1.75-2.00%
S&P 500 Earnings per Share	\$195
S&P 500 Fair Value	4,400-4,450

Source: LPL Research 06/28/21
 All indexes are unmanaged and cannot be invested into directly. Economic forecasts may not develop as predicted. Our year-end 2021 fair-value target range for the S&P 500 Index of 4,400-4,450 is based on a price-to-earnings (PE) ratio of 21.5 and our 2022 S&P 500 earnings per share (EPS) forecast of \$205.

WE EXPECT THE strong economic recovery to continue to drive strong earnings growth and support further gains for stocks [Figure 6]. However, after one of the strongest starts to a bull market in history—including a nearly 90% gain off the March 23, 2020 lows through June 28, 2021—stock prices reflect a lot of good news. As inflationary pressures build and interest rates potentially rise further, the pace of stock market gains may slow.

HISTORY DOESN'T REPEAT BUT IT OFTEN RHYMES

Although no one would argue that this cycle looks like any other we have experienced in modern history, studying the second years of historical bull markets—as we also did in our *Outlook 2021*—can be instructive.

Looking back at all of the bull markets since 1950, the average S&P 500 gain during the second year has been about 13% [Figure 7]. Achieving that return would put the index slightly over 4,400 and within our target range. However, when focusing on bull markets that followed 30% or greater declines, as the current one did, the average gain during the second year has actually been 17%. Following that pattern would put the index near 4,600 and well above the high end of our year-end fair value target range.

VOLATILITY (CAUTION—SLIPPERY AHEAD)

Looking at pullbacks (5-10% decline) and corrections (10-20% decline) during the second years of historical bull markets, we can get an idea of the type of volatility the stock market might experience in the second half of 2021 or early in 2022. The average maximum drawdown for the index during those two-year-old bull markets has been about 10%. In the second year of the 2009 bull market, the index corrected about 17% [Figure 7].

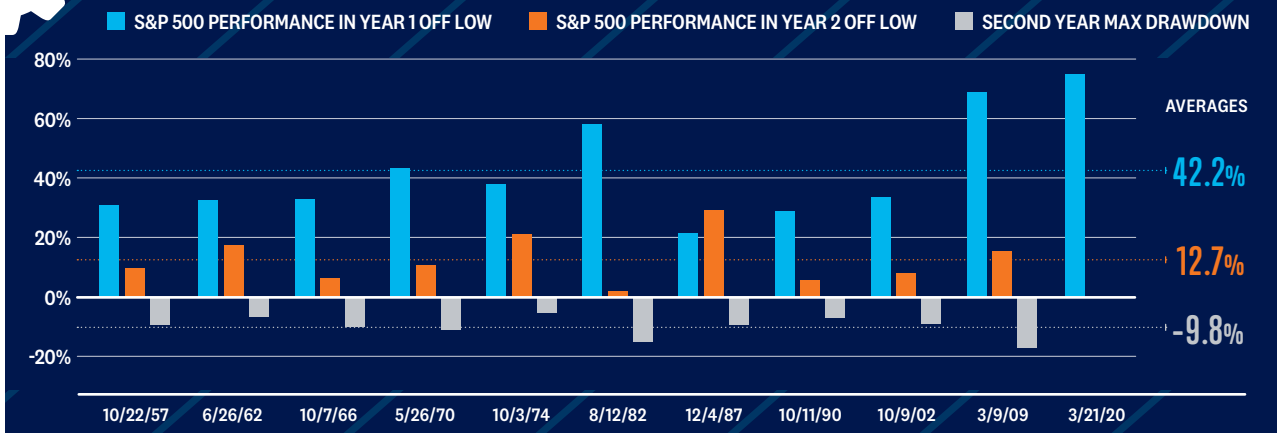
Given the jolts from the reopening and the stimulus still working its way through the economy, pullbacks may be short lived and corrections less severe. Inflation that proves longer lasting than the Fed expects, which could drive interest rates sharply higher, ranks at the top of the list of potential causes of a correction. Tax increases, COVID-19 spread outside the U.S., and geopolitics are among other possible bumps in the road.

EARNINGS OUTLOOK GATHERS STEAM

Coming off of a stunning first-quarter earnings season with one of the biggest upside surprises ever recorded, corporate America is firing on all cylinders. Not only are earnings expected to ramp up significantly over the remainder of 2021 as the economic rebound continues, but estimates have risen significantly since the start of the year [Figure 8].

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SECOND YEAR OF BULL MARKETS TYPICALLY SEE MODERATING GAINS AND SHALLOW CORRECTIONS



Source: LPL Research, Strategas 06/28/21

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

Reflecting the tremendous strength in corporate profits, our forecast for S&P 500 earnings per share (EPS) in 2021 is \$195, a 36% increase from 2020, and up from our \$165 estimate at the start of the year. We believe our forecast, which is above the current consensus estimate, is reasonable given the strong economic growth outlook and massive amount of fiscal stimulus still working its way through the economy. We expect corporate America to build on its strong earnings performance in 2022. Our 2021 year-end S&P 500 fair-value target range of 4,400–4,450 is based on a PE of 21.5 and our 2022 S&P 500 EPS forecast of \$205.

While the economic recovery looks very likely to drive strong revenue growth, inflation could present risk to corporate profit margins and weigh on earnings. Companies may see upward pressure on wages if the labor market tightens further as more of the economy reopens. Supply shortages, higher commodity prices, and rising borrowing costs could also erode the profitability of U.S. companies. And U.S. businesses are closely monitoring policy developments, as a potential increase in the corporate tax rate would have immediate impact on their bottom lines.

LOW INTEREST RATES PROVIDING SHOCK ABSORBER FOR VALUATIONS

Strong earnings have helped stocks grow into their valuations but based on the most common valuation metrics such as the price-to-earnings ratio (P/E), stock valuations remain elevated. The S&P 500 Index is trading at a forward P/E of 21 times the consensus earnings estimate for the next 12 months, above the post-1980 average of 17 (source: FactSet).

But when incorporating interest rates to get a more complete picture, we find stocks are actually reasonably priced. Based on 2021 forecasts, the S&P 500 earnings yield (the inverse of the price-to-earnings ratio) is about three percentage points higher than the 10-year Treasury yield, or the “earnings” that Treasuries generate. This “equity risk premium” is well above the long-term average of 0.8%, indicating stocks are cheaper than bonds on an apples-to-apples basis.

If inflation risk remains manageable through year-end, as we expect, and yields rise only gradually, we would expect earnings growth to continue to support stock market gains.

THE ROAD AHEAD

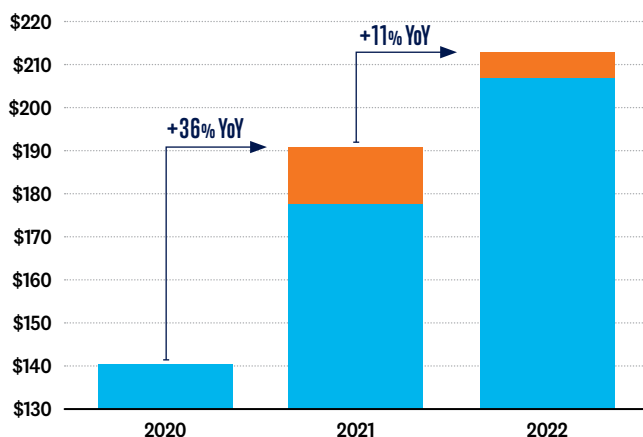
We expect additional gains for stocks in the second half of the year, but they are likely to come at a slower pace and with more bumps along the way as inflation picks up and concerns about the Fed pulling back monetary support intensify.

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VERY STRONG EARNINGS RAMP IS LIKELY AS EXPECTATIONS HAVE RISEN DRAMATICALLY

CONSENSUS S&P 500 PER SHARE (EPS) ESTIMATES:

- AS OF DECEMBER 31, 2020
- AS OF JUNE 28, 2021



Source: LPL Research, FactSet 06/28/21

The economic forecasts may not develop as predicted.



STYLE ROTATION HAS MORE HORSEPOWER

The economy's transition to a durable and lasting expansion positions cyclical stocks to outperform defensives in the second half of the year. In this environment, the value style will likely outperform growth and the financials, industrials, and materials sectors may be positioned for solid gains, through the growth style won't go quietly given technology's tremendous earnings power.

SMALL CAPS TO SET THE PACE

Small cap stocks historically have outperformed early in bull markets. Small cap valuations are still reasonable despite strong gains since March 2020, in our view, supported by a strong earnings rebound.

DEVELOPED INTERNATIONAL NO LONGER SPINNING ITS WHEELS

The improved value-style performance has opened the door for developed international stocks to potentially outperform U.S. stocks for the first time in over a decade. The recovery the U.S. is currently experiencing from COVID-19 still lies ahead for Europe and Japan.

EMERGING MARKETS COULD HIT SOME SPEED BUMPS

As the developed world continues to recover from the pandemic, emerging markets may lose some relative appeal. While valuations are attractive and the U.S. dollar may weaken, geopolitical and regulatory threats may limit gains for the China-heavy emerging markets index.

SAFETY FEATURES



INTEREST RATES HAVE moved off their historically low levels to start the year, but we believe they can still go higher. Higher inflation expectations, the strong economic recovery, less involvement in the bond market from the Fed (more on this below), and a record amount of Treasury issuance this year are all reasons why we believe interest rates can move higher. Our target for the 10-year Treasury Yield at the end of 2021 is between 1.75% and 2.0%.

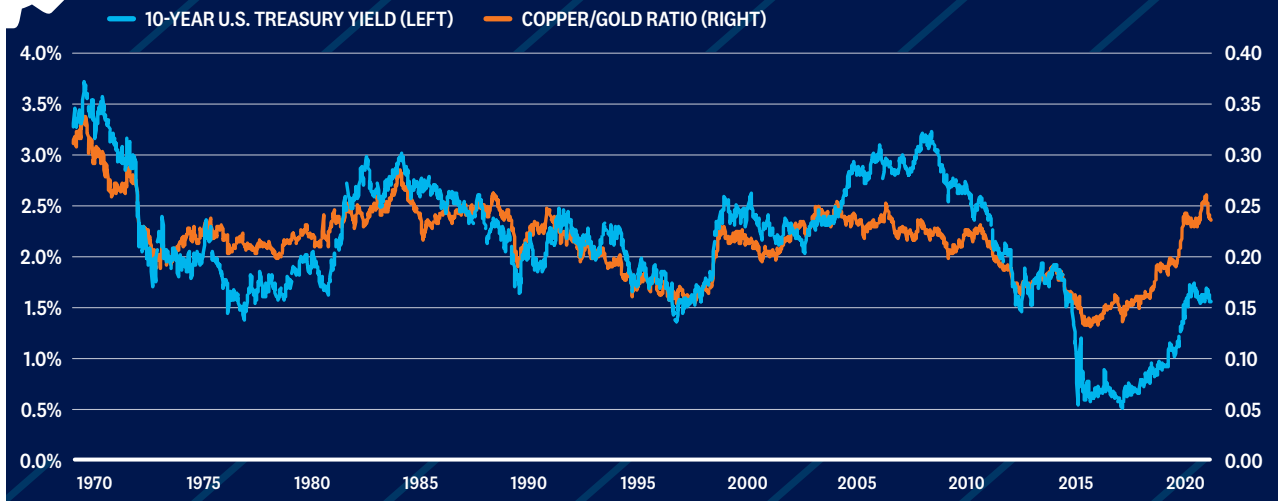
THE CASE FOR (STILL) HIGHER YIELDS

Inflationary pressures are building as the economy continues to recover. As a bondholder's main nemesis—inflation—erodes the "real" value of principal and interest payments, making them worth less. While we don't believe inflation will be a lasting problem, we do expect higher consumer prices in the near term, which should nudge interest rates higher over the rest of this year.

We are also keeping a close eye on copper prices. The ratio of copper prices to gold prices has been an important predictor of where the yield of the 10-year Treasury Yield could be [Figure 9]. Copper is an important input price for a number of products, so as copper prices increased due to the strengthening of the global economy, 10-year Treasury Yields haven't quite kept up. While not a perfect predictor, the copper/gold ratio has been a reliable one and suggests interest rates can still move higher from current levels.

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HIGH COPPER TO GOLD PRICES IMPLY 10-YEAR TREASURY YIELDS COULD BE HIGHER



Source: LPL Research, Bloomberg 06/28/21

Past performance is no guarantee of future results.

STALLING OUT

Rising Treasury yields have been a headwind to core fixed income returns this year, with the first quarter going down as one of the worst quarters ever for bond returns. Generally speaking, the yield spread between Treasury securities and non-Treasury bond securities can help cushion losses when interest rates move higher (and bond prices fall). However, with valuations within most fixed income sectors already at lofty levels, there hasn't been enough spread to offset rising Treasury yields. This has caused the prices of many bond sectors to fall as interest rates have moved higher. Unfortunately, we expect the trend of higher interest rates to continue, albeit at a much slower pace than what

we've experienced so far this year, putting further downward pressure on core fixed income returns.

Expected returns for core fixed income (as defined by the Bloomberg Barclays U.S. Aggregate Bond Index) through the remainder of the year are low to even negative in certain scenarios [Figure 10]. Because we believe interest rates will move higher from current levels, core fixed income returns may add more negative returns to the already negative year-to-date returns. If core fixed income returns are negative for the year, it will be the first time since 2013, which was a great year for stocks, but was also the last time the Fed started talking about tapering its bond buying programs. History may be rhyming again.

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EXPECT SUBPAR RETURNS FOR CORE FIXED INCOME THROUGH YEAR-END

BLOOMBERG BARCLAYS U.S. AGGREGATE TOTAL RETURN INDEX RETURN ILLUSTRATION

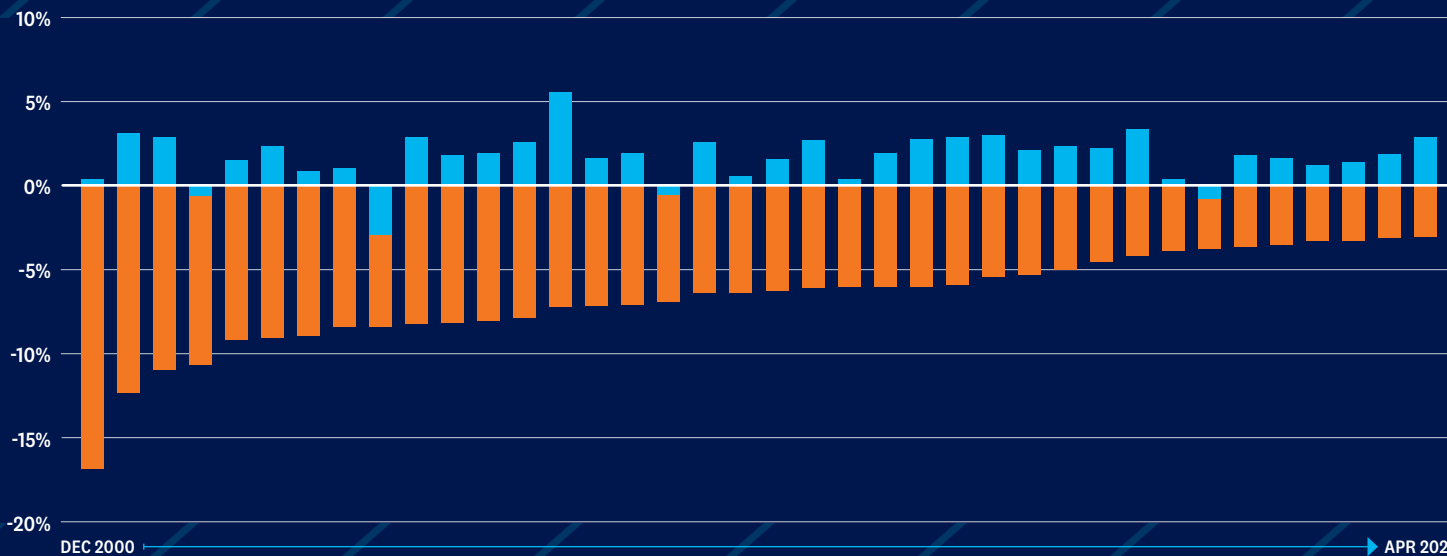
		INTEREST RATE CHANGES					
		-20%	-10%	0%	+10%	+20%	+30%
SPREAD CHANGES	-20%	2.97%	2.28%	1.52%	0.75%	-0.09%	-1.02%
	-10%	2.80%	2.12%	1.35%	0.58%	-0.26%	-1.18%
	0%	2.62%	1.93%	0.98%	0.40%	-0.44%	-1.37%
	+10%	2.43%	1.74%	0.98%	0.21%	-0.63%	-1.56%
	+20%	2.23%	1.54%	0.77%	0.01%	-0.83%	-1.76%

Source: LPL Research, Bloomberg, 06/28/21

All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results. This is a hypothetical illustration and is not representative of any investment. The hypothetical rates of return used do not reflect the deduction of fees and charges inherent to investing.

TREASURY SECURITIES HAVE BEEN MOSTLY POSITIVE WHEN EQUITIES WERE NEGATIVE

MONTHLY S&P 500 AND TREASURIES PERFORMANCE WHEN STOCKS DOWN >3% ■ S&P 500 INDEX ■ BLOOMBERG BARCLAYS TREASURY INDEX



Source: LPL Research, Bloomberg 06/28/21.

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

FIXED INCOME THROUGH YEAR-END

We still recommend investors reduce the interest-rate sensitivity in their portfolios. Mortgage-backed securities (MBS) do not offer the upside of corporate bonds, but they can be more resilient in a rising-rate environment. Investment-grade corporates tend to be more rate-sensitive than MBS, and their credit sensitivity may make them more vulnerable than MBS if stocks pull back, but we still think the short-to-intermediate part of the corporate credit universe makes sense. Remember, longer-term bonds are more impacted by higher rates, which is why we recommend an underweight to Treasuries.

For suitable income-oriented investors, adding more credit-sensitive sectors, such as bank loans and emerging market debt, to their portfolios may help compensate for the reduced income potential of a low-rate environment, but we would still recommend that high-quality bonds make up the bulk of any bond allocation.

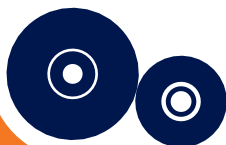
USE BONDS AS YOUR SAFETY BELT

So, if we're expecting higher Treasury yields and low-to-negative returns for core fixed income, why would anyone want to own bonds? Frankly, in case something bad happens to cause equity markets to sell off. Simply put, bonds help you stay in stocks and make progress toward your long-term goal. Core bonds, and more specifically Treasury

securities, continue to be the best diversifier during equity market declines. As we look at how Treasury securities have performed during periods when the S&P 500 Index was down 3% or more, we see that Treasury security returns have been mostly positive [Figure 11]. When you consider stocks are in the second year of a bull market and that, historically, has brought increased volatility, core fixed income can help dampen and potentially offset some of those losses. While we still like stocks over bonds over the course of the year, we do think high-quality fixed income continues to serve a purpose in portfolios.

ALL EYES ON THE FED'S ROAD AHEAD

When we evaluate the economic and financial landscapes, the Fed is a key risk we're keeping our eyes on. Since March 2020, the Fed has supported the economy and financial markets by purchasing \$80 billion in Treasuries and \$40 billion in mortgage securities, and keeping short-term interest rates near zero. As the economy continues to recover, however, the need for continued monetary support wanes. While we still think it's too early for the Fed to begin to increase short-term interest rates, we do think the discussion around reducing the size and scope of bond purchases (also known as tapering) will start to take place soon. How the market will react to these discussions is unclear at this point and there is the risk that a communication error by the Fed could cause interest rates to move higher.

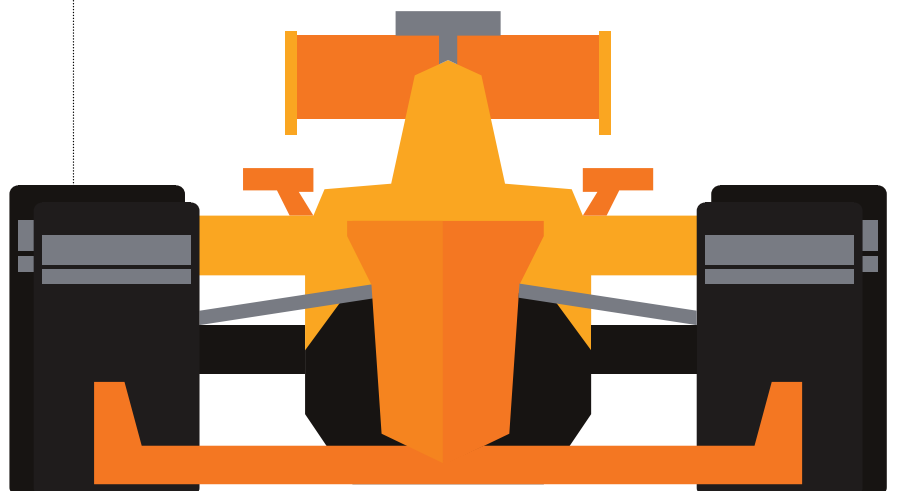


OPEN ROADS AHEAD

WE'VE BEEN SEEING it around us for months now. The U.S. economy is well on its way to fully reopening and much of the rest of the globe isn't that far behind. We're also experiencing the transition to normalcy, the burst of pent-up demand for everything that's been on hold, including just ordinary, everyday life outside the pandemic. In its own way, that transition itself feels like it's moving fast. And if you're looking to go fast and want to navigate the challenges that come with speed, it's always smart to bring a crew. To keep you fueled. To calm your nerves when you hit some traffic. To help plan your strategy and potentially change course. And to share your successes at the finish line.

In 2020, a year in which planning anything seemed impossible, having a financial plan and sticking to it was more valuable than ever. But that plan didn't suddenly just appear. The time to make a plan isn't when navigating a tricky environment. We build our plans when times are easier so that we can stick with them when times are hard, or just enjoy the benefits when times are good.

Looking out over the rest of 2021, it seems like the worst of the hard times are behind us. Now we're going full-speed ahead, and we all want to take some time to enjoy the thrill after a long period of caution. But these are also the times when planning is most effective—early in the economic cycle, with the next recession potentially years away, a strong start to a bull market in full gear, and a relatively calm market environment. Right now, in fact, is the ideal time to consult your financial professional on your financial goals, the most effective way to reach them, and how to be prepared for market volatility down the road. *LPL Research's Midyear Outlook 2021: Picking Up Speed* is here to help you navigate the risks and opportunities over the rest of 2021 and beyond, but your crew remains the key to progressing toward your long-term goal.





GENERAL DISCLOSURES

The opinions, statements and forecasts presented herein are general information only and are not intended to provide specific investment advice or recommendations for any individual. It does not take into account the specific investment objectives, tax and financial condition, or particular needs of any specific person. There is no assurance that the strategies or techniques discussed are suitable for all investors or will be successful. To determine which investment(s) may be appropriate for you, please consult your financial professional prior to investing.

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All index data from FactSet.

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

GENERAL RISK DISCLOSURES

Investing involves risks including possible loss of principal. No investment strategy or risk management technique can guarantee return or eliminate risk in all market environments. There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not protect against market risk. Investing in foreign and emerging markets debt or 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.

GENERAL 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.

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.

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability. Earnings per share is generally considered to be the single most important variable in determining a share's price. It is also a major component used to calculate the price-to-earnings valuation ratio.

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 Bloomberg Barclays U.S. Aggregate Bond Index is an index of the U.S. investment-grade fixed-rate bond market, including both government and corporate bonds.

EQUITY RISK

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

EQUITY DEFINITIONS

Cyclical stocks typically relate to equity securities of companies whose price is affected by ups and downs in the overall economy and that sell discretionary items that consumers may buy more of during an economic expansion but cut back on during a recession. Counter-cyclical stocks tend to move in the opposite direction from the overall economy and with consumer staples which people continue to demand even during a downturn.

Growth stocks are shares in a company that is anticipated to grow at a rate significantly above the average for the market due to capital appreciation. A value stock is anticipated to grow above the average for the market due to trading at a lower price relative to its fundamentals, such as dividends, earnings, or sales.

Value stocks are anticipated to grow above the average for the market due to trading at a lower price relative to its fundamentals, such as dividends, earnings, or sales.

Large cap stocks are issued by corporations with a market capitalization of \$10 billion or more, and small cap stocks are issued by corporations with a market capitalization between \$250 million and \$2 billion.

FIXED INCOME RISKS

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. Bond yields are subject to change. Certain call or special redemption features may exist which could impact yield. 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. Corporate bonds are considered higher risk than government bonds but normally offer a higher yield and are subject to market, interest rate, and credit risk, as well as additional risks based on the quality of issuer coupon rate, price, yield, maturity, and redemption features. Mortgage-backed securities are subject to credit, default, prepayment, extension, market and interest rate risk.

FIXED INCOME DEFINITIONS

Credit Quality is one of the principal criteria for judging the investment quality of a bond or bond mutual fund. As the term implies, credit quality informs investors of a bond or bond portfolio's credit worthiness, or risk of default. 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. The credit spread is the yield the corporate bonds less the yield on comparable maturity Treasury debt. This is a market-based estimate of the amount of fear in the bond market. Base-rated bonds are the lowest quality bonds that are considered investment-grade, rather than high-yield. They best reflect the stresses across the quality spectrum.

The Bloomberg Barclays Aggregate US Bond Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment-grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities.

International debt securities involve special additional risks. These risks include, but are not limited to, currency risk, geopolitical and regulatory risk, and risk associated with varying settlement standards. These risks are often heightened for investments in emerging markets.

High yield/junk bonds (grade BB or below) are not investment grade securities, and are subject to higher interest rate, credit, and liquidity risks than those graded BBB and above. They generally should be part of a diversified portfolio for sophisticated investors.

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





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