

Sector Strategy



February 2012

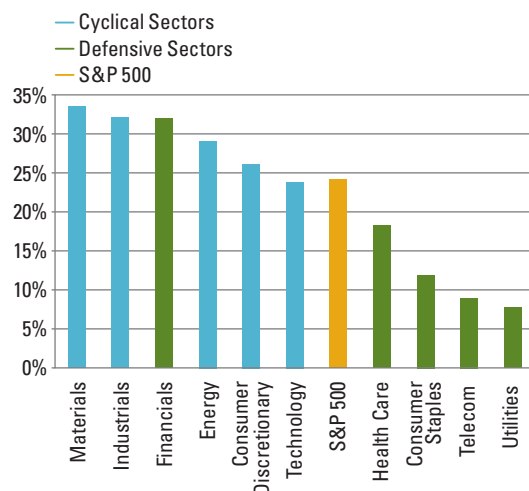
Cyclicals Leading in 2012

The Big Picture

- Strong start for cyclical sectors in 2012 as macro outlook has improved
- Favor Growth sectors such as Industrials and Technology in slow growth environment
- Natural Resources may benefit from improving Emerging Market growth outlook, weaker dollar

- We continue to favor cyclical sectors, as we still believe valuations reflect an overly pessimistic view of the global economy and corporate profits. Cyclical sectors have led this year's rally, having returned an average of 10% year-to-date (as of February 8), compared to 8% for the S&P 500 while the defensive sectors are unchanged.
- We recently lowered our view of Consumer Discretionary to neutral now that the catalyst of a strong holiday shopping season is behind us. The move also reflects our forecast for modest consumer income gains, our desire to focus on business spending-driven sectors and lofty relative valuations.
- Our outlook for business spending and expectation for only a modest slowdown in China support our positive views of the Industrials and Technology sectors with their global reach. Commentary from companies during earnings season has generally been supportive of continued resilient business spending and healthy demand from emerging economies.
- We expect steady, though not particularly robust growth in the U.S. economy over the next several quarters along with additional policy easing and solid growth in China and other emerging market countries to lift the natural resource sectors.
- We continue to under-emphasize the four defensive sectors, as we expect investors' renewed preference for cyclical investments so far this year to continue in the months ahead as economic and profit growth exceed market expectations and company fundamentals increasingly drive stock prices.

1 Cyclical Sectors Have Led the Rally From October S&P 500 Lows



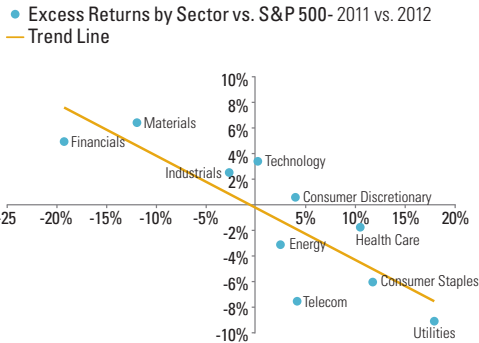
Source: FactSet, LPL Financial 10/03/11 – 02/08/12

Strong Start to 2012 for Cyclical Sectors

As is typical during equity market rallies such as the one we have experienced over the past four months, cyclical sectors have outpaced defensive sectors. While all 10 S&P 500 sectors are solidly higher during this period, the divergence is significant [Chart 1]. So what has changed since last fall when investors flocked to perceived safe haven assets such as Utilities and even Treasury bonds? First, Europe has taken positive steps to contain its sovereign debt crisis. European Central Bank (ECB) interest rate cuts, a 3-year cheap lending program for European banks, and some gradual progress toward more fiscal integration have all helped take the worst case scenarios for Europe off the table and enable investors to take more risk in the equity markets.

In addition, the U.S. economic data has improved substantially in recent months on a variety of fronts, i.e., GDP, jobs growth, unemployment,

2 The Losers of 2011 Are the Winners of 2012



Source: FactSet, LPL Financial 02/08/12

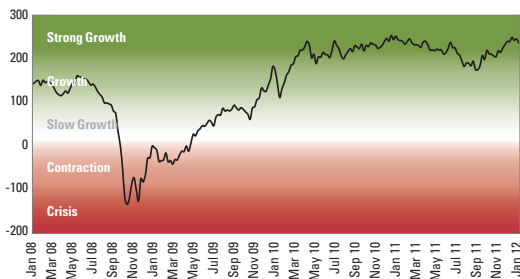
manufacturing activity, consumer spending, auto sales, and others. Gross Domestic Product (GDP) accelerated throughout 2011. The improving economic backdrop is evident in the LPL Financial Current Conditions Index, a timely measure of economic and market conditions, which has improved markedly in recent months [Chart 3].

The strength in cyclical sectors also reflects the market's increasing focus on fundamentals, a key component of our investment process. During 2011, investors favored defensive stocks such as Consumer Staples and Utilities, with slower earnings growth and less sensitivity to the economy [Chart 4]. The cyclical sectors, on average, grew earnings 20% in 2011 while defensive sectors grew earnings by a mere 4%. How were cyclical sectors rewarded for their stronger growth? They weren't. Cyclical sectors lost 2% on average in 2011, compared to the stellar 13% average return for the defensive sectors last year.

Investors also favored high dividend payers in 2011, stocks that tend to make up a bigger portion of the defensive sectors. Within the S&P 500, stocks that do not pay dividends lost 2% last year, while those in the top quartile of dividend yield (2.5% or higher) returned 15%. Interest rates collapsed last year, increasing the attractiveness of dividends. Though we expect interest rates to remain low in 2012 thanks to the super-accommodative Federal Reserve, a repeat of the sharp decline experienced last year that provided a strengthening tailwind for these stocks is highly unlikely.

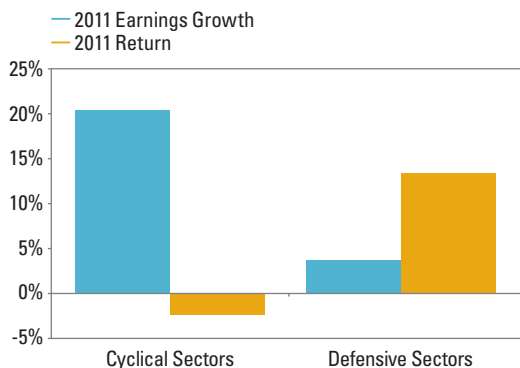
While we believe some of these types of investments should be present in diversified portfolios, especially for more conservative, income-oriented investors, there are times when these areas would not be expected to fare as well as more economically sensitive investments. We would argue that 2012 will be a period when these types of defensive investments may not work as well, based on where we are in the business cycle and the economic and profit outlook the market is pricing into valuations. We see the U.S. economy in the middle stages of a continued expansion, albeit a frustratingly slow one, and expect 2% GDP growth this year. We forecast mid-to-high single digit profit growth this year (based on our forecast for business spending, which is correlated to corporate profits, as we have previously discussed in our 2012 Outlook publication), with much faster growth among cyclical sectors with leverage to business spending and developing economies, which may provide a favorable backdrop for these sectors to perform well in 2012.

3 LPL Current Conditions Index Indicative of Improving Economic Backdrop



Source: LPL Financial 02/08/12

4 Lackluster Earnings Growth for Defensive Sectors Was Rewarded in 2011



Source: LPL Financial 01/31/12

Past performance is no guarantee of future results.

S&P 500 Sector Snapshots

Consumer Discretionary	Reduced view reflects post-holiday shopping lull, sluggish consumer income growth and spending outlook and lofty relative valuations.
Consumer Staples	Challenging profit margin environment, while above-average valuations and the market's renewed preference for cyclicals present headwinds.
Energy	Middle East tensions (particularly Iran) and improving China growth outlook keeping U.S. crude oil at the high end of its recent range between \$90 and \$100.
Financials	Benefiting from mean reversion in early 2012 and solid loan growth, although interest rate and regulatory pressures are not abating.
Health Care	Global public spending pressures are a concern, although Biotech view is positive on acquisition activity and improving innovation.
Information Technology	Standout performer during fourth quarter earnings season. Company guidance suggests continued technology spending growth and valuations are attractive.
Industrials	Expect business spending to grow mid-to-high single digits near-term, outpacing consumer spending. Improving manufacturing activity is supportive.
Materials	Favor Commodities stocks for the benefit from strong demand in Emerging Markets, as China and other Emerging Market nations adopt more stimulative monetary and fiscal policies.
Telecom	Valuations, slow growth and a failed acquisition in the sector that tempered pricing expectations are among several concerns.
Utilities	Best sector of 2011 among the worst so far in 2012 along with Telecom; earnings are falling, valuation is rich and investors are rotating into cyclicals.

Our accompanying individual sector profiles are delivered individually or as a full analysis. Our sector views are outlined in Portfolio Compass, published on a bi-weekly basis. The Compass highlights the three components of our investment philosophy—fundamentals, valuation and technical analysis—for equity sectors as well as equity, fixed income and commodities asset classes. For more details on our macroeconomic and market views, please refer to our 2012 Outlook publication and our weekly market and economic commentaries. For help implementing our sector advice, please refer to our Exchange-Traded Product (ETP) models or the currently recommended sector funds.

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide or be construed as providing specific investment advice or recommendations for any individual. To determine which investments may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

Stock investing involves risk including loss of principal.

Investments in specialized industry sectors have additional risk such as credit, regulatory, operational, business, economic and political risk which should carefully be considered before investing.

Investors should consider the investment objectives, risks, charges and expenses of the investment company carefully before investing. The prospectus contains this and other information about the investment company. You can obtain a prospectus from your financial representative. Read carefully before investing.

Principal Risk: An investment in an Exchange Traded Fund (ETF), structured as a mutual fund or unit investment trust, involves the risk of losing money and should be considered as part of an overall program, not a complete investment program. An investment in ETFs involves additional risks: not diversified, the risks of price volatility, competitive industry pressure, international political and economic developments, possible trading halts and Index tracking error.

Consumer Discretionary: Companies that tend to be the most sensitive to economic cycles. Its manufacturing segment includes automotive, household durable goods, textiles and apparel, and leisure equipment. The service segment includes hotels, restaurants and other leisure facilities, media production and services, consumer retailing and services and education services.

Consumer Staples: Companies whose businesses are less sensitive to economic cycles. It includes manufacturers and distributors of food, beverages and tobacco, and producers of non-durable household goods and personal products. It also includes food and drug retailing companies.

Energy: Companies whose businesses are dominated by either of the following activities: The construction or provision of oil rigs, drilling equipment and other energy-related service and equipment, including seismic data collection. The exploration, production, marketing, refining and/or transportation of oil and gas products, coal and consumable fuels.

Financials: Companies involved in activities such as banking, consumer finance, investment banking and brokerage, asset management, insurance and investment, and real estate, including REITs.

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Healthcare Sector: Companies are in two main industry groups — healthcare equipment and supplies or companies that provide healthcare-related services, including distributors of healthcare products, providers of basic healthcare services, and owners and operators of healthcare facilities and organizations. Companies primarily involved in the research, development, production, and marketing of pharmaceuticals and biotechnology products.

Industrials: Companies whose businesses manufacture and distribute capital goods, including aerospace and defense, construction, engineering and building products, electrical equipment and industrial machinery. Also, companies that provide commercial services and supplies, including printing, employment, environmental and office services, or provide transportation services, including airlines, couriers, marine, road and rail, and transportation infrastructure.

Manufacturing Sector: Companies engaged in chemical, mechanical, or physical transformation of materials, substances, or components into consumer or industrial goods.

Materials: Companies that are engaged in a wide range of commodity-related manufacturing. Included in this sector are companies that manufacture chemicals, construction materials, glass, paper, forest products and related packaging products, metals, minerals and mining companies, including producers of steel.

Technology Software & Services: Includes companies that primarily develop software in various fields such as the internet, applications, systems and/or database management and companies that provide information technology consulting and services; technology hardware & Equipment, including manufacturers and distributors of communications equipment, computers and peripherals, electronic equipment and related instruments, and semiconductor equipment and products.

Telecommunications Services: Companies that provide communications services primarily through a fixed line, cellular, wireless, high bandwidth and/or fiber-optic cable network.

Utilities Sector: Companies considered electric, gas or water utilities, or companies that operate as independent producers and/or distributors of power.

International and emerging market investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors.

The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.

Precious metal investing is subject to substantial fluctuation and potential for loss.

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.

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.

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.

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