

Market Update | January 22, 2008

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On Monday, while U.S. markets were closed, stock markets in Europe and Asia (and elsewhere) took serious hits. On Monday, the Dow Jones Euro stock index fell 7.3%, the U.K. FTSE fell 5.5%, the France CAC index fell 6.8%, and the German DAX index fell 7.5%. In Asia, the Japan NIKKEI fell 3.9% and the Hong Kong Hang Seng index fell 5.5%. Many emerging market stock price indices were down by similar amounts.

The media, this time I think rightly, places the blame for the declines on fears of a U.S. recession that might curtail U.S. demand for imports and slow global growth.

After very careful consideration, LPL Financial Research continues to think that the risk of a U.S. recession at this time is not high. While we do have significant problems in housing and the financial markets' ability to deal with sub-prime mortgage issues, we also have significant positive factors at work.

Positives:

- 1) Low interest rates and a Federal Reserve that is already in easing mode with more rate cuts likely in the near future.
- 2) Low U.S. stock market valuations relative to what we consider to be conservative earnings forecasts, with the forward P/E on the S&P 500 in the 12 range.
- 3) Strength in the economy in other areas, notably exports.
- 4) Continued very careful cost control by U.S. business avoiding excessive hiring, wages, inventories and capital investment. Therefore, the "excesses" that have to be "cured" by a recession are generally not there (outside of housing, which is already two years into its correction).
- 5) Some fiscal policy stimulus has been proposed that may help.

We are seeing a continued decline in crude oil prices, which may have a very short-term negative impact on equities, but if sustained, will become a major positive. And the dollar exchange rate has continued its (small so far) rebound, despite the turmoil. We believe that falling oil prices should help the economy and that a stable-to-rising U.S. dollar exchange rate would make U.S. equity prices attractive to international investors.

So, while we cannot forecast market psychology, we can say that there are powerful factors that should prevent a slide into a full scale bear market and we do expect a substantial rebound from this period of turmoil.

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