GLOBAL PORTFOLIO STRATEGY

LPL Research

APRIL 2021

UPGRADED GDP, EARNINGS, AND INTEREST RATE FORECASTS

LPL RESEARCH'S MONTHLY MARKET OUTLOOK

Key changes from March's report:

- None

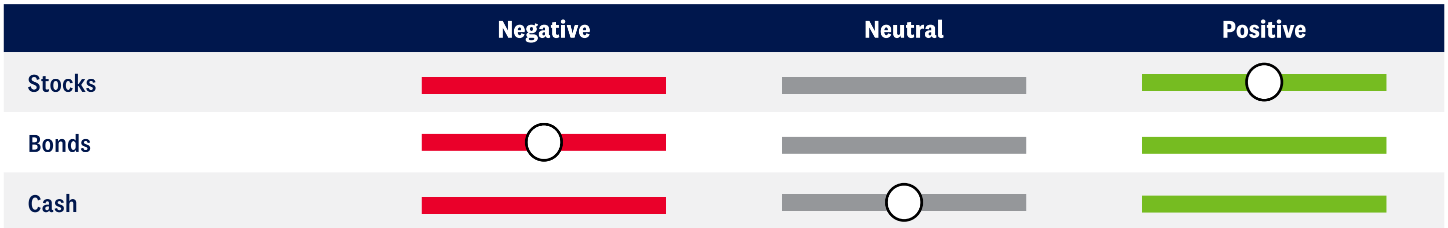
We have increased our forecast for U.S. gross domestic product (GDP) growth in 2021 to 6.25%—6.75%, up from 5%—5.5%, due to prospects for a full reopening of the U.S. economy, massive stimulus, and Federal Reserve (Fed) support. With stronger economic growth comes more revenue opportunities for corporate America, so we have also raised our S&P 500 Index earnings per share (EPS) forecast for 2021, to a range of $175–$177.50, up from $170. The stronger economic growth outlook led us to increase our year-end forecast for the 10-year Treasury yield to a range of 1.75%—2.00%, up from 1.25%—1.75%. We have left our year-end S&P 500 fair value target range unchanged at 4,050–4,100, based on a price-to-earnings (PE) multiple of 21 and our unchanged 2022 S&P 500 earnings forecast of $195 per share. We anticipate some downward pressure on valuations at higher interest rate levels and a pickup in volatility during year two of the bull market is reasonable to expect.

INVESTMENT TAKEAWAYS

- Our equities recommendation remains overweight. We continue to favor stocks over bonds based on our expectation for a very strong economic and earnings recovery in 2021, supported by an accelerating vaccine rollout, an anticipated full reopening of the U.S. economy, and massive fiscal and monetary stimulus.
- Our favored sectors include financials, technology, and materials, offering a mix of cyclical value and growth sectors. As the economic recovery progresses in 2021, we would expect cyclical value stocks to get a boost, but fundamentals remain very strong for the growth style.
- Key near-term risks include further sharp increases in interest rates from inflationary pressures, possible COVID-19 virus variants, likely tax increases (ETA 2022), and tougher regulations under a Democratic-controlled Congress.
- We continue to favor emerging markets (EM) stocks over their developed international counterparts on a superior economic growth outlook and attractive valuations, though geopolitical and regulatory threats may lead to bouts of volatility and China tariffs may remain in place.
- We continue to recommend an underweight allocation to fixed income. Although we've seen a big move higher in rates, Fed policy and manageable inflation may limit the risk of a large rate move in the near term. Further rising rates may still put some pressure on bond returns while economic improvement may help support equities going out a full year.
- We favor a blend of high-quality intermediate bonds that is underweight U.S. Treasuries with an emphasis on short-to-intermediate maturities and sector weightings tilted toward mortgage-backed securities (MBS).

BROAD ASSET CLASS VIEWS

LPL Research's Views on Stocks, Bonds, and Cash



OUR ASSET CLASS & SECTOR CHOICES

Equity Asset Classes	Equity Sectors	Fixed Income	Alternative Asset Classes
▪ Emerging Markets Equities	▪ Financials ▪ Materials ▪ Technology	▪ Mortgage-Backed Securities	▪ Event Driven

2021 MARKET FORECASTS

Stronger Growth Means More Earnings and Higher Interest Rates

	Previous	Current
10-Year US Treasury Yield	1.25%–1.75%	1.75%–2.00%
S&P 500 Earnings per Share	$170	$175-$177.50
S&P 500 Fair Value	4,050-4,100*	4,050-4,100* (no change)

Source: LPL Research, FactSet, Bloomberg

All indexes are unmanaged and cannot be invested into directly. The economic forecasts may not develop as predicted.

*As noted in our Weekly Market Commentary dated 04/5/2021, our year-end 2021 fair-value target range for the S&P 500 of 4,050–4,100 is based on a price-to-earnings ratio (PE) of 21 and our S&P 500 earnings per share (EPS) forecast of $195 in 2022.

2021 ECONOMIC FORECASTS

U.S. Economic Boom Likely Coming as Vaccine Rollout Accelerates

	Previous	Current
United States	5% to 5.5%	6.25% to 6.75%
Developed ex-US	3.75% to 4.25%	3.75% to 4.25%
Emerging Markets	5.25% to 5.75%	5.5% to 6%
Global	5% to 5.5%	5.5% to 6%

Source: LPL Research, Bloomberg

The economic forecasts may not develop as predicted.

All data, views, and forecasts herein are as of 4/06/21.

EQUITY ASSET CLASSES

Stocks Over Bonds Remains Our Highest Conviction Idea

We favor stocks over bonds in 2021 based on our expectation for a very strong economic and earnings recovery this year, supported by an accelerating vaccine rollout, an anticipated full reopening of the U.S. economy, and massive fiscal and monetary stimulus. We expect the economic rebound to pick up steam as the economy more fully reopens, which may help boost performance for cyclical value stocks in the near term. We continue to favor emerging markets (EM) stocks over their developed international counterparts on a superior economic growth outlook and attractive valuations.

	Sector	Overall View	Relative Trend	Rationale
Market Capitalization	Large Caps			The relatively greater financial strength enjoyed by most large cap companies helped during the pandemic. But smaller market cap companies tend to perform better early in economic expansions and during the early stages of bull markets, which has driven significant small cap outperformance since fall 2020.
	Mid Caps			Mid caps enjoy some of the early cycle characteristics of small caps, and therefore, should perform well as a more durable recovery develops. We believe mid cap stock valuations are more attractive than those of small caps in general.
	Small Caps			We maintain our neutral view of small caps with a positive bias. The early-stage bull market and economic expansion and strong earnings rebound provide tailwinds for small cap stock relative performance. Although valuations appear reasonable and small caps are down since mid-March, further weakness is possible with the Russell 2000 Index up roughly 125% since its March 18, 2020 lows.
Style	Growth			Our style views remain balanced between growth and value. We believe growth stocks will continue to be bolstered by strong earnings trends and favorable positioning for the pandemic in the near term. But as more of the economy reopens and economic growth accelerates in the spring, cyclical value stocks may get a boost.
	Value			A durable economic recovery is emerging, which we expect to support cyclical value stocks in the near term. Value stocks remain attractively valued relative to their growth counterparts and tend to perform relatively well when economic growth accelerates. Our recent upgrades of financials and energy tilted toward value.
Region	United States			Among developed markets, we remain U.S.-focused. We see solid gains for U.S. stocks in 2021, but the gap between U.S. and developed international stocks has started to narrow and may close further as the pandemic is brought under control globally.
	Developed International			Our outlook for developed international equities remains negative, but we could potentially warm up to European equities once the pandemic is brought under control in the Eurozone, particularly if the U.S. dollar weakens. Among non-U.S. developed markets, we prefer Japan over Europe based on the country's massive stimulus efforts and relative success containing COVID-19.
	Emerging Markets			We continue to favor emerging markets (EM) stocks over their developed international counterparts on a superior economic growth outlook and attractive valuations, though geopolitical and regulatory threats may lead to bouts of volatility and tariffs may remain in place.

Trend is measured by relative performance of the index for the past 12 months, minus the most recent month, compared to the other indexes in a particular sector or asset class grouping.

EQUITY SECTORS

Rising Rates and Improving Growth Outlook Fuels Financials

We continue to favor cyclical sectors in general for 2021 based on the early cycle stage of the economic expansion, and a bull market, and improving prospects for a strong economic rebound this year. In general, we recommend a mix of cyclical value sectors (energy, financials, and materials) that are well positioned for accelerating economic growth and rising interest rates, and growth sectors (communication services, consumer discretionary, and technology) which are better positioned for the pandemic.

	Sector	Overall View	Relative Trend	S&P Wgt	Rationale
Cyclical	Materials			2.7	The Chinese economy is firing on all cylinders and the U.S. economy is on the verge of a full reopen, supporting commodity prices. Beneficiary of the strong housing market and potential infrastructure package later this year.
	Energy			2.7	Demand outlook has improved and technical analysis signals have turned more positive, but the supply overhang may limit oil price upside as production has become more profitable.
	Industrials			8.7	A likely big beneficiary of an eventual durable U.S. economic recovery, especially if accompanied by more infrastructure spending. China exposure is a positive, though recent earnings weakness has left valuations expensive.
	Communication Services			11.2	Beneficiary of the stay-at-home environment, but the market's rotation toward cyclical value stocks as the economy reopens is a concern and the regulatory environment may toughen. Valuations are reasonable.
	Consumer Discretionary			12.6	Historically a strong early-cycle performer. E-commerce and housing are booming, supporting our neutral view despite rich valuations. Eventual recovery in hospitality, travel, and leisure industries will help.
	Technology			27.0	Benefiting from work-from-home environment and powerful secular trends, but the market's rotation toward value stocks remains a risk, especially if interest rates continue to rise and pressure valuations. Negative bias.
	Financials			11.3	Upgrade to view in March was driven by rising interest rates, steepening yield curve, and strong technical momentum, while economic reopening supports rotation into value style. Valuations remain attractive. Tepid loan demand a concern.
Defensive	Utilities			2.6	Valuations are reasonable and more green energy spending may help boost growth, but rising interest rates and the market's preference for cyclical stocks are headwinds. Favor healthcare among defensives.
	Healthcare			12.7	The healthcare spending outlook, demographics, and valuations are supportive, and policy clarity may help performance at some point, but economic cycle, earnings, and technical trend considerations temper enthusiasm.
	Consumer Staples			61	Historically a poor relative performer early in economic cycles as a defensive sector. Rising interest rates don't help given the sector's attractive yields. Likely outperformer in an eventual market correction.
	Real Estate			2.4	Like consumer staples, likely underperformer early in economic cycles. Mixed fundamentals and interest rate sensitivity suggest caution, though technology and industrial segments are strong.

Investing in real estate/REITs involves special risks such as potential illiquidity and may not be suitable for all investors. There is no assurance that the investment objectives of this program will be attained.

Because of its narrow focus, specialty sector investing, such as healthcare, financials, or energy, will be subject to greater volatility than investing more broadly across many sectors and companies.

FIXED INCOME

Limit Rate Sensitivity With Intermediate Focus

We suggest a blend of high-quality short-to-intermediate bonds in tactical portfolios. We raised our forecast for the 10-year Treasury yield to a range of 1.75%—2.00%, up from 1.25%—1.75% as economic activity continues to impress to the upside. Compensation for longer-maturity, rate-sensitive bonds remains unattractive, in our view, supporting our positive view of MBS. We still see incremental value in corporate bonds over Treasuries, but credit spreads have little room for further tightening.

We favor **municipal bonds** as a high-quality option for taxable accounts, although valuations relative to Treasuries have normalized. Additionally, for appropriate investors, **high yield municipal bonds** offer an attractive yield. The latest proposed stimulus package is expected to provide additional muni-related support.

		Low	Medium	High	Rationale
Positioning	Credit Quality				Credit spreads have tightened significantly, but the economic outlook may be supportive.
		Short	Int.	Long	
	Duration				Concerns over rising interest rates with the prospects of economic acceleration increase interest-rate risk.
		Neg.	**Neutral**	**Pos.**	**Rationale**
Sectors	US Treasuries				Yields still low but increasing and we expect yields to continue to increase from current levels. Yield spreads to international sovereigns remain attractive. Inflation breakeven rates leave TIPS fairly valued.
	MBS				Fed buying is supportive and refinancing and prepayment slowing. MBS may provide some resilience if rates rise. Valuations are stretched so excess returns are limited.
	Investment-Grade Corporates				Risks tempered as economy improves and vaccine deployment progresses. Leverage metrics have increased, but cash levels are high. Interest-rate sensitivity has increased. Tight credit spreads limit attractiveness.
	Preferred Stocks				Higher credit quality among the riskier fixed income options. Bank fundamentals sound overall. Can be rate sensitive but may be able to tolerate graduate increases.
	High-Yield Corporates				Valuations have grown rich versus history but fundamentals remain sound. More attractive for income-oriented investors. We believe equities have more upside and high-quality options may be better diversifiers.
	Bank Loans				Economic environment supportive and better sector mix than high yield. Economic acceleration may support demand. Fewer investor protections and illiquidity of individual loans remain concerns.
	Foreign Bonds				Rich valuations, interest-rate risk, and potential currency volatility are among the negatives.
	EM Debt				Dovish central banks improve the valuation picture and stronger global growth, commodity prices, could be supportive, but spreads no longer attractive. Liquidity can be an added risk during periods of stress.

Yield spread is the difference between yields on differing debt instruments, calculated by deducting the yield of one instrument from another. The higher the yield spread, the greater the difference between the yields offered by each instrument. The spread can be measured between debt instruments of differing maturities, credit ratings, and risk. **Bank loans** are loans issued by below investment-grade companies for short-term funding purposes with higher yield than short-term debt and involve risk. For the purposes of this publication, **intermediate-term bonds** have maturities between 3 and 10 years, and short-term bonds are those with maturities of less than 3 years.

All bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and are subject to availability and change in price. **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. Investing in **foreign and emerging market debt (EMD)** securities involves special additional risks. These risks include, but are not limited to, currency risk, geopolitical and regulatory risk, and risk associated with varying settlement standards. **High-yield/ junk bonds** are not investment-grade securities, involve substantial risks, and generally should be part of the diversified portfolio of sophisticated investors. **Municipal bonds** are subject to availability, price, and 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. Federally tax-free but other state and local taxes may apply. **Mortgage-backed securities (MBS)** are subject to credit, default, prepayment risk that acts much like call risk when you get your principal back sooner than the stated maturity, extension risk, the opposite of prepayment risk, market and interest rate risk.

COMMODITIES

Positive Outlooks for Industrial Metals and Crude Oil

Our view of **industrial metals** is positive, reflecting China's strong economic growth outlook, an improving outlook for growth in the United States, and the strong technical momentum of copper. A potential resumption of the U.S. dollar's downtrend could provide a boost to industrial metals and commodities broadly.

Our **precious metals** view is neutral. Our December 2020 downgrade of this asset class was driven primarily by our technical analysis work that suggested less upside potential in the near term. The attractiveness of precious metals is further reduced by the improving economic outlook, rising interest rates, and recent firmness in the U.S. dollar.

Our **crude oil** outlook is positive primarily due to positive signals from our technical analysis work. At the same time, the global demand outlook has improved recently as the end of the pandemic comes into view, and higher oil prices have increased the amount of profitable available production. Our concerns remain that the U.S. supply overhang may limit further upside potential for prices and the potential for more production internationally as prices rise. The latest jump in travel bookings is encouraging.

ALTERNATIVE INVESTMENTS

Lackluster End to Strong First Quarter

After a strong first two months of the year, performance in the alternative investment industry was rather muted in March and we saw even more dispersion than usual at the underlying sub-category level. Event Driven strategies, which remain our preferred alternative investment solution, did encounter their first monthly decline (HFRX Event Driven down 0.24%) in six months. First quarter 2021 global merger and acquisition volume hit $1.3 trillion, representing a 94% increase from first quarter 2020, the second largest quarter, and the largest first quarter figure ever. This provides active managers with a strong pipeline of deals to choose from, as well as reduces industry concentration in specific transactions.

Going forward, a further increase in interest rates is a development that can impact the event driven space in several ways. First, a large increase in corporate borrowing costs could potentially slow down the current pace of new merger activity. While interest rates are moving up from extremely low levels, and it is difficult to predict at what level higher rates might impact markets, this is important to watch. Rising rates, however, may also lead to more attractive deal spreads, on average. This is a result of the market using a higher risk-free rate in discounting the probability of a deal closing. Overall, we maintain a constructive view of the merger and acquisition environment, as it remains supported by access to cheap funding, private equity dry powder to use for deals, and the ability to use near all-time high share prices for stock transactions.

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.

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.

All index data from FactSet.

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