



Weekly Market Commentary



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Mid-Term Market Moves

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Highlights

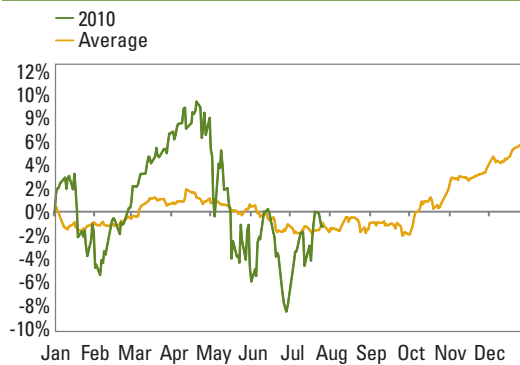
A catalyst for a late year rally could be the upcoming mid-term elections.

The market's reaction to mid-term elections has almost always been positive, with fourth quarter gains averaging 8% in mid-term election years.

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1 Mid-Term Election Pattern Unfolding

Average S&P 500 Price Performance Pattern During Mid-Term Election Years from 1950-2006 and 2010



Source: PL Financial, Bloomberg 7/30/10

The S&P 500 Index is an unmanaged index, which cannot be invested into directly. Past performance is no guarantee of future results

We continue to adhere to our long-held forecast for modest single-digit gains for the stock market in 2010, despite the lack of any year-to-date gain. As the August recess for Congress gets underway this week, the campaigning for mid-term elections heats up. A catalyst for a late year rally could be the upcoming mid-term elections. The elections may mark a shift away from the uncertainty surrounding the potential for sweeping legislative changes. In addition, as we noted last week, given the shifting sentiment on taxes the elections may be followed by Congress enacting fewer tax hikes for 2011 than are currently expected by market participants.

So far, the stock market performance in 2010 has tracked the typical pattern for U.S. stocks in mid-term election years, albeit with a bit more than the usual volatility. The path is usually range-bound and volatile, but capped by a strong fourth quarter rally averaging about 8%. [Chart 1]

The market's reaction to mid-term elections has nearly always been positive, even when the balance of power has shifted in one or both houses of Congress—as we expect this year with the Republicans having a good chance of taking the House. In four of the five years that mid-term elections resulted in a change in power (2006, when Democrats took the House and Senate; 2002, when Republicans took the Senate; 1986, when Democrats took the Senate; and 1954, when Democrats took the House), fourth-quarter returns were positive, much like those in mid-term election years when no change in power took place.

In fact, since World War II, there have been only two mid-term election years (1978 and 1994) during which U.S. equities did not experience a fourth-quarter rally. During both of these years the Federal Reserve (Fed) was aggressively hiking interest rates.

- In 1978, the lead up to the Islamic Revolution resulted in strikes and unrest in Iran. In November 1978, a strike by Iranian oil workers reduced production from 6 million barrels per day to about 1.5 million barrels. At the same time, foreign oil workers fled the country. In the United States, inflation hit 9% in the fourth quarter with no signs of stopping as it approached double-digits. In response to soaring inflation pressures, the Fed was aggressively hiking rates during 1978 with 1.25% of hikes in the fourth quarter alone (the Fed ended the quarter with a policy rate of 10%).
- In 1994, the S&P 500 turned in a flat fourth quarter on the heels of a shift in power to the Republicans. However, the performance was less of a reaction to the election results than to rising fears of recession amid



Mid-Term-Election Stock Performance

S&P 500

Mid-Term Election Year	Change in Power	Fourth-Quarter Price Performance
2006	Yes	6.2%
2002	Yes	7.9%
1998	No	20.9%
1994	Yes	-0.7%
1990	No	7.9%
1986	Yes	4.7%
1982	No	16.8%
1978	No	-6.3%
1974	No	7.9%
1970	No	9.4%
1966	No	4.9%
1962	No	12.1%
1958	No	10.3%
1954	Yes	11.4%
1950	No	5.0%
Average		7.9%

Source: LPL Financial, Bloomberg 7/30/10

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the Federal Reserve's aggressive hiking of short-term interest rates and a corresponding run-up in long-term interest rates (to nearly 8% from below 6% at the start of the year).

We expect the Fed will be on hold until next year, but past performance suggests a headwind for the stock market if the Fed does start to hike late this year.

Resolving election uncertainty—and ending the predominantly negative rhetoric surrounding the campaigns—seems to matter more to investors than election results. In addition, this resolution historically has been a positive for the stock market.

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