

STRENGTHENING OUR VALUE TILT

LPL RESEARCH'S MONTHLY MARKET OUTLOOK

Key changes from May's report:

- Upgrade Value from Neutral to Positive, Downgrade Growth to Negative from Neutral.
- Upgrade Industrials from Neutral to Positive, Downgrade Technology to Neutral from Positive.
- Upgrade Developed International from Negative to Neutral, Downgrade Emerging Markets to Neutral from Positive.

We expect stocks to continue to grow into their valuations on the back of tremendous earnings momentum as the economy fully reopens, vaccine distribution continues, COVID-19 cases plummet in the United States, and stimulus spending continues to work its way through the economy. As economic growth accelerates, we believe conditions will remain favorable for cyclical value stocks to continue their recent run of outperformance.

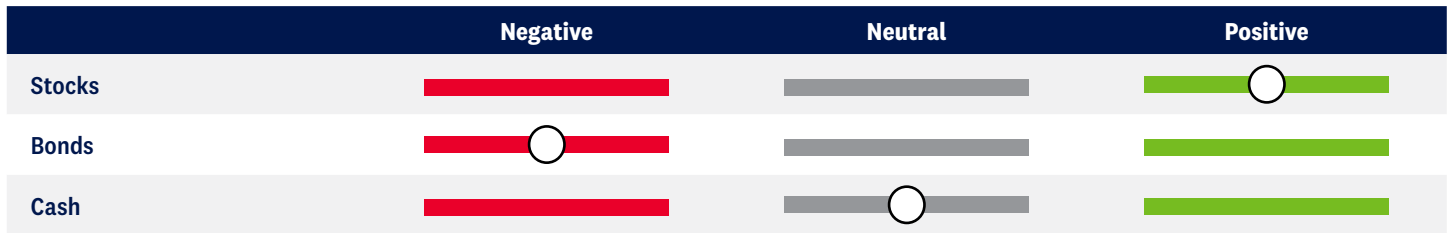
Our S&P 500 earnings per share forecast for 2021 is \$187.50 to \$190, and our 2021 year end S&P 500 fair value target range is 4,400–4,450. After a nearly 90% gain since the March 2020 lows, the S&P 500 may be due for a pause, consistent with the second years of post-WWII bull markets that were characterized by increased volatility. Key risks include COVID-19 spread outside the United States, inflation, rising interest rates, higher taxes, and geopolitics.

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 the full reopening of the U.S. economy and massive fiscal and monetary stimulus.
- As the economic recovery progresses in 2021, we would expect cyclical value stocks to lead. Our favored sectors—mostly on the value side of the ledger—include financials, industrials, and materials.
- Our positive view of small caps is supported by the early-stage bull market and economic expansion and strong earnings. Valuations appear reasonable and recent weakness creates a potentially attractive entry point.
- After upgrading our international developed view and downgrading emerging markets (EM), our regional views are aligned at neutral.
- U.S. stocks enjoy a better economic growth outlook than developed international, but better value-style performance may enable international stocks to match U.S. returns.
- Geopolitical and regulatory threats and a shrinking economic growth advantage have left us with less conviction on EM.
- We continue to recommend an underweight allocation to fixed income. Although we've seen a big move higher in rates this year, Fed policy and manageable inflation may limit the risk of further large moves in the near term. Higher 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
<ul style="list-style-type: none"> U.S. Value U.S. Small Caps 	<ul style="list-style-type: none"> Financials Industrials Materials 	<ul style="list-style-type: none"> Mortgage-Backed Securities 	<ul style="list-style-type: none"> Event Driven

2021 MARKET FORECASTS

Higher Earnings Support Further Gains for Stocks

	Previous	Current (no change)
10-Year U.S. Treasury Yield	1.75-2.00%	1.75-2.00%
S&P 500 Earnings per Share	\$187.50-\$190	\$187.50-\$190
S&P 500 Fair Value	4,400-4,450	4,400-4,450*

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 05/10/2021, our year-end 2021 fair-value target range for the S&P 500 of 4,400-4,450 is based on a price-to-earnings ratio (PE) of 21.5 and our revised S&P 500 earnings per share (EPS) forecast of \$205 in 2022.

2021 ECONOMIC FORECASTS

U.S. Economy Poised to Outgrow the Rest of the World

	Previous	Current (no change)
United States	6.25 to 6.75%	6.25 to 6.75%
Developed ex-U.S.	3.75% to 4.25%	3.75% to 4.25%
Emerging Markets	5.5% to 6%	5.5% to 6%
Global	5.5% to 6%	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 06/04/21.

EQUITY ASSET CLASSES

Squaring up Regional Asset Allocation Views and Upgrading the Value Style

We favor stocks over bonds in 2021 based on our expectation for a very strong economic and earnings recovery this year, supported by vaccine distribution, 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. Our regional views are all aligned at neutral. U.S. stocks enjoy a better economic growth outlook than developed international, but better value-style performance may enable international stocks to match U.S. returns. Geopolitical and regulatory threats and a shrinking economic growth advantage have left us with less conviction on EM.

	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 during the early stages of economic expansions and bull markets.
	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			Our small cap view is positive, supported by the early-stage bull market and economic expansion and a strong earnings rebound. Valuations appear reasonable and we believe recent underperformance creates a potentially attractive entry point.
Style	Growth			We believe growth stocks will continue to garner support from strong earnings trends as the pandemic—we hope and pray—winds down. However, we expect the rotation away from growth stocks to continue as the rest of the economy opens, which underpins our downgraded technology sector view.
	Value			A durable economic recovery is emerging, which we expect to support cyclical value stocks that tend to perform well as economic growth accelerates. Value stocks remain attractively valued relative to their growth counterparts. Our upgrades of financials and energy earlier this year, and this month's technology downgrade, tilt toward value. Favor cyclical value over defensive value.
Region	United States			We see solid gains for U.S. stocks in 2021, but the gap between U.S. and developed international stocks has narrowed to the point where our regional views are now aligned. As the end of the pandemic approaches, global economic growth accelerates, and the environment for value stocks potentially improves, developed international stocks may keep up with U.S.
	Developed International			Our upgraded view of developed international equities reflects further progress in Europe toward bringing the pandemic under control, an improving environment for value-style stocks, attractive valuations relative to U.S. stocks, and our expectation that the US dollar will weaken further.
	Emerging Markets			We have tempered our enthusiasm for emerging markets stocks despite attractive valuations. Our downgraded view reflects deteriorating relative strength, ongoing geopolitical and regulatory challenges, and the diminishing economic growth advantage relative to the developed world.

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

Strengthening our Preference for Cyclical Value Sectors with Industrials Upgrade, Tech Downgrade

We increasingly favor economically sensitive “cyclical” sectors for the rest of 2021 based on the early cycle stage of the economic expansion and bull market and continued progress toward a fully reopened economy. Specifically, we recommend overweighting cyclical value sectors (financials, industrials, and materials) that we believe are best positioned for accelerating economic growth and rising interest rates, along with benchmark-like exposure to the pandemic “winners” on the growth side (communication services, consumer discretionary, and technology). Technical analysis trends point to real estate as an emerging opportunity and suggest energy’s recent strong run may continue.

	Sector	Overall View	Relative Trend	S&P Wgt	Rationale
Cyclical	Materials			2.8	Strong economic growth outlooks in the United States and China, surging copper prices, prospects for US dollar weakness, and the strong relative performance trend are supportive. Potential infrastructure package later this year may help.
	Energy			3.0	Demand outlook has improved and technical analysis signals remain positive. More production is coming globally as prices rise, though our view is biased to the positive.
	Industrials			9.0	One of the biggest beneficiaries of the global economic reopening. The possibility of an infrastructure spending package offers upside. After early-year weakness, earnings are starting to pick up, offsetting elevated valuations.
	Communication Services			11.0	As the market increasingly shifts toward reopening plays and away from the stay-at-home winners, this growth-heavy sector focused on digital media may struggle. The regulatory environment may toughen, though valuations are reasonable.
	Consumer Discretionary			12.0	Historically a strong early-cycle performer. E-commerce and housing strength support our neutral view despite rich valuations. Eventual recovery in hospitality, travel, and leisure will help. Strong Q1 earnings season.
	Technology			26.1	Downgraded view reflects shift toward reopening beneficiaries and away from work-from-home environment, which has led to deteriorating technical analysis conditions. Solid fundamentals likely to mitigate potential downside risk. Valuations are fair overall.
	Financials			12.1	Prospects for accelerating economic growth, rising interest rates, a steeper yield curve, and possible additional rotation into cyclical value stocks are all supportive. Valuations remain reasonable. Tepid loan demand a concern.
Defensive	Utilities			2.6	Valuations are reasonable and more green energy spending may help boost growth, but the market’s preference for cyclical stocks is a headwind and the sector carries interest rate risk. Favor real estate among defensives.
	Healthcare			12.8	The sector is more of a mid-to-late-cycle play, while recent underperformance suggests policy risk may be greater than expected. Longer term, growing healthcare spending and demographics may be more attractive to investors. Low valuations will eventually provide support but maybe not in 2021.
	Consumer Staples			6.0	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			2.6	Strong technical analysis trends and benefits of reopening support a neutral view, though sector fundamentals are still mixed and interest rate sensitivity suggests caution.

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 think the 10-year Treasury yield can end the year between 1.75%–2.00% as economic activity, while uneven, continues to improve as the economy re-opens. 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 remain elevated. Additionally, for appropriate investors, **high yield municipal bonds** offer an attractive yield. Federal stimulus and prospects of higher personal tax rates provide support to muni markets.

		Low	Medium	High	Rationale
Positioning	Credit Quality				Credit spreads remain elevated, but the economic outlook may be supportive.
	Duration				Concerns over rising interest rates with the prospects of economic acceleration increase interest-rate risk.
		Neg.	Neutral	Pos.	Rationale
Sectors	U.S. Treasuries				Yields have traded sideways recently but we expect them to eventually 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 are 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 gradual 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. Valuations are relatively attractive but idiosyncratic risks remain. 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 the strong economic growth outlooks in both the U.S. and China. Prospects for an increase in infrastructure spending and a weaker US dollar provide additional support for the outlook. Copper's technical momentum remains strong.

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, in addition to the improving economic outlook that presented a headwind for defensive assets. However, recent stability in interest rates and US dollar weakness have helped gold prices rebound, improving the technical analysis picture and potentially signaling further gains ahead. Positive bias.

Our **crude oil** outlook remains positive due to: 1) the improved global demand outlook as more of the global economy reopens and travel activity increases, 2) positive signals from our technical analysis work after crude oil broke recently above its 2019 highs, and 3) the potential for additional US dollar weakness. Our primary concern is on the supply side, as higher prices could lead to increased U.S. shale production, while more OPEC+ (including Russia) production is on the way.

ALTERNATIVE INVESTMENTS

Increasingly Constructive on Managed Futures and Long/Short Equity

Alternative investment performance was mixed in April, with a large dispersion in returns between sub-strategies. Event Driven funds, our preferred alternative investment implementation, underperformed during the month, however, we maintain a positive view going forward. Our three main tailwinds for the industry, including high corporate cash balances, low borrowing rates, and the private equity industry's dry powder, remain in place. Year-over-year deal flow continues to experience an incredible recovery, providing active managers with a strong pipeline of deals to choose from while reducing industry concentration in specific transactions.

Outside of the Event Driven space, managed futures and long/short equity have become increasingly attractive. An increase in prices across a large swath of the commodity complex has supplemented gains in the equity and credit market allocations for many managed futures strategists. Long/short equity strategies have and, in our view, will continue to benefit from further strength in value-related sectors. In addition to the gains for holdings on the long side, short stock selection in growth sectors has become more appealing. For much of the past several years, any type of short exposure to growth stocks was a drag on most portfolios; however, with a more balanced outlook between styles, long/short managers should be able to find additional sources of alpha.

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.

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Not Insured by FDIC/NCUA or Any Other Government Agency	Not Bank/Credit Union Guaranteed	Not Bank/Credit Union Deposits or Obligations	May Lose Value
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