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Research Outlook for 2008

Table of Contents

Executive Summary page 1
A Brief Look Back at 2007. page 2
Forecasts for a Great 2008 page 3
Political Impact of 2008 Elections on the Markets. page 7
Where are we in the Business Cycle? page 10
What Could Go Right in 2008? page 13
What Could Go Wrong in 2008? page 16
Looking Back page 20

LPL's Outlook for 2008

S&P 500 Yearend Target	1675 - 1775
S&P 500 Total Return	10–16%
S&P 500 EPS Growth	6–8%
S&P 500 P/E	15–16
Bond Market Total Return	4–6%
10-Yr Yield Yearend Target	4.50–5.25%
Cash	3.5–4.5%
GDP	2.5–3%
CPI	1.5–2.5%
Fed Funds Yearend Target	4.00–4.50%

EXECUTIVE SUMMARY

We expect that 2008 will be a rewarding year for investors. Furthermore, we are forecasting that:

- U.S. stocks will generate a 10–16% total return, and the S&P 500® will end the year within our target range of 1675–1775;
- Bonds will provide total returns of 4–6% as measured by the Lehman Aggregate Bond Index; and
- Cash equivalents will yield about 4%.

We expect the following to occur and influence U.S. capital markets in 2008:

- 6–8% earnings per share growth for the companies in the S&P 500, matching 2007's pace – but reversing the slowing trend experienced in 2007 by accelerating to a double-digit pace by yearend as profit margins expand and magnify revenue growth.
- A continued rise in stock market valuations as the S&P 500 P/E moves toward 16 - P/Es have actually expanded historically as earnings growth slowed during the middle stage of the business cycle and also as earnings reaccelerated. Helping to drive higher valuations is a shift in earnings growth from low to high P/E sectors.

- Dividends per share growth continuing at a double-digit pace given high corporate cash balances, lean spending on acquisitions and capital, changes in executive compensation, and a renewed emphasis on corporate governance and shareholder interests.
- Economic growth likely near an average 2.5–3% as business spending and net exports sustain growth as consumer spending slows.
- Little change to interest rates from the Federal Reserve as growth continues and inflation is contained.

We recommend investors stay fully invested. We think the markets will provide investors with solid gains in the fourth quarter of 2007 and in 2008. While there have been a large number of 1–3% dips in the S&P 500 over the past three years, there have been just six notable pullbacks similar to that experienced in the third quarter of 2007. Each pullback was in the range of 5–9%, lasted three to six weeks, and preceded a market rally to a new high. While these pullbacks are likely from time to time, we believe a substantial correction that would justify holding excess cash is unlikely at this time.

We believe that growth stocks will outperform value stocks and large-cap stocks will outpace smaller caps. We also continue to recommend an underweight in international stocks, which we believe will underperform domestic equities. In addition, we recommend a neutral duration stance in the bond market.

Naturally, there are a number of factors – both positive and negative – that could skew the outcomes for global financial markets. We have assessed each of these factors. Although they do not warrant inclusion in our base case scenario for 2008, they are appropriate to discuss as key factors with a material likelihood of occurring. We will watch these factors closely and remain vigilant for new risks.

Potential Influencing Factors for the Financial Markets in 2008

What Could Go Right in 2008?

- ▲ More P/E ratio expansion than expected
- ▲ Dividend payouts rise to match share buybacks
- ▲ GDP is stronger than expected
- ▲ Corporate profit margins increase
- ▲ Gradual decline in oil prices

What Could Go Wrong in 2008?

- ▼ A collapse in oil prices
- ▼ Housing downturn leads to broad economic recession
- ▼ Congress fuels rise in protectionism
- ▼ Major terrorism event occurs on U.S. soil
- ▼ Major negative geopolitical event

A BRIEF LOOK BACK AT 2007

In general, 2007 was another rewarding year for investors. The S&P 500 is up modestly so far in 2007. The Lehman Aggregate Bond index is on track to post a gain of about 4–6%. The bull market of 2007 featured the return of volatility after a long absence.

The impact of the credit and liquidity crisis triggered by the meltdown in subprime mortgage debt weighed on the market during the summer months. However, these negatives were offset by a backdrop of strong global economic growth, the best corporate balance sheets in 40 years, and an inflation environment that granted the Fed the flexibility to cut interest rates, allowing the stock market to rebound to all-time highs. These concerns resurfaced in the fourth quarter.

In general, our recommended tactical asset allocation was rewarded during 2007. As the charts below show, growth outperformed value by nearly 12 percentage points, and large caps outperformed small caps by nearly 7 percentage points. During the second quarter, the sell-off in the bond market prompted us to shift our recommended tactical positioning and extend duration in line with that of the overall bond market, represented by the Lehman Aggregate bond index. On June 13, 2007, as bond yields reached multi-year highs, we published our recommendation to extend duration in line with that of the overall bond market, represented by the Lehman Aggregate Bond Index. As bond yields fell, that shift proved valuable; the Lehman Aggregate Bond Index rose 5%. However, not all of our forecasts proved to be accurate in 2007. U.S. stocks did not

outperform their international peers as we had expected. The sharp decline in the dollar to new all-time lows boosted the performance of the international markets in dollar terms.

Looking back at the past few decades helps to put the market turmoil of 2007 in the proper perspective. At this point in the business cycle, a liquidity crisis typically emerges after too much risk taking. The U.S. economy experienced recessions in 1980-82, 1991, and 2001 – and in 2007 the business cycle is at about the same point that it was during the liquidity crises of 1987 and 1998. In August of 1987 and July of 1998 the markets started to weaken, but began to fall into a downward spiral stemming from a liquidity crisis in October of each of those years as credit spreads widened sharply. The markets stabilized shortly after the Fed stepped in and shifted to an easing bias.

Importantly, we can take some comfort that the business cycle did not end in 1987 or 1998 – economic and profit growth rebounded along with the financial markets. In fact, the years following the liquidity crisis – 1988-89 and 1999 – were very rewarding ones for investors. Given a rebounding economy, reaccelerating profit growth, and expanding valuations, we may see gains in 2008 that echo those seen in the late stages of prior business cycle expansions.

Growth Outperformed Value in 2007 by a Wide Margin

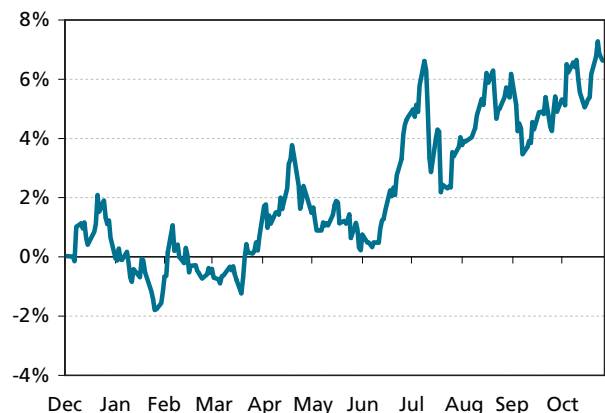
Russell 1000 Growth less Russell 1000 Value Total Return



Source: Bloomberg, LPL Financial

Large Caps Outperformed Small Caps in 2007 by a Wide Margin

Russell 1000 less Russell 2000 Total Return



Source: Bloomberg, LPL Financial

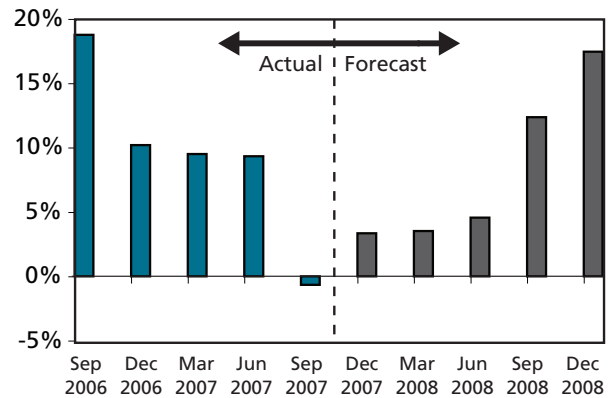
FORECASTS FOR A GREAT 2008

We expect a great 2008 for the stock market with the S&P 500 posting a gain of 10–16% to end the year within our target range of 1675-1775, and with all drivers of total return contributing: a rebound in earnings growth, rising valuations, and double-digit dividend per share growth.

- Although S&P 500 operating earnings per share growth in 2008 is likely to match the pace of 2007, the trend in growth is reaccelerating after slowing in 2007. The year-over-year growth rate went from nearly 20% in the third quarter of 2006 to flat in the third quarter of 2007. We expect EPS growth to rebound to a double-digit year-over-year pace in the second half of 2008.
- Valuation, measured by the 12 month forward price-to-earnings ratio for S&P 500 companies, is expected to rise in 2008 from the current 14. We expect the P/E to extend the gain from the trough of 13.5 in mid-2006 to 15-16 by the end of 2008. At current levels, each point that the P/E rises adds about 6–7% to the total return of the S&P 500.
- Dividend per share growth has remained in the double-digits even as EPS slowed in 2007. In fact, dividends per share for S&P 500 companies have been growing at a double-digit pace over the past 15 quarters, setting a new record. This rapid pace of dividend-per-share growth is the result of high corporate cash balances, lean spending on acquisitions and capital, changes in executive compensation, and a renewed emphasis on corporate governance and shareholder interests. We expect this double-digit pace to continue in 2008 extending the record-breaking streak.

Focusing on earnings per share growth, we expect 6–8% EPS growth in 2008 for the companies in the S&P 500, matching 2007's pace – but reversing the trend from slowing to accelerating and setting the stage for a return to double-digit growth in 2009. Historically, EPS growth has averaged 7%. But over the course of the business cycle it varies considerably from falling 20% during a recession to rebounding 20-30% following the recession, then growth pauses during the mid-cycle slowdown ('84-'86 and '96-'98) and then reaccelerates again as the cycle draws to a close. The mid-cycle slowdown in economic and profit growth has once again unfolded in 2006–07. I believe the trough in year-over-year growth was experienced in the third quarter of 2007 and growth will begin to reaccelerate.

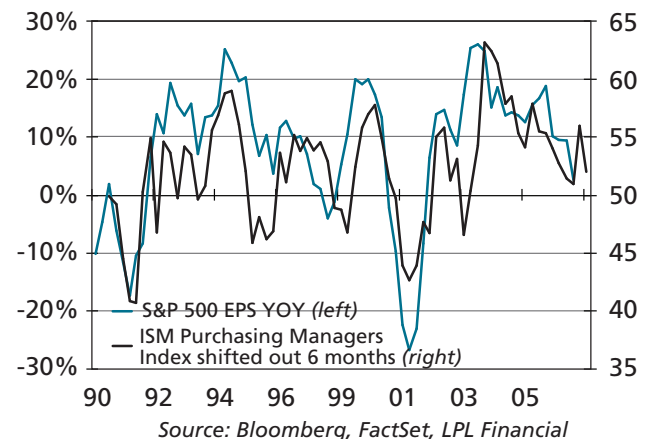
Rebounding Earnings Growth Rate in 2008
Year-over-Year Change in S&P 500 Operating Earnings per Share



How can profits begin to reaccelerate? Revenue growth should begin to rebound – particularly in the form of greater demand for industrial and technology goods and services. In addition, profit margins may remain near record highs and actually begin to expand by yearend 2008. Only the Energy, Industrial and Material sectors are at extended margins – net profit margins for most other sectors are average or low relative to their history.

Manufacturing output is a key driver for S&P 500 profits. The S&P 500 has a much higher exposure to manufacturing than the overall U.S. economy. The Institute of Supply Management Purchasing Managers Index has led S&P 500 profits by about six months, on average. This index currently points to low-single-digit profits for S&P 500 companies. As this index rises over the course of 2008, we expect profits to rise in unison.

Manufacturing Index Leads S&P 500 Earnings Growth
Institute for Supply Management Purchasing Managers Index and S&P 500 Operating EPS



Examining the key sectors for earnings reveals further support for our outlook for 2008.

- The Financial sector is the biggest contributor to S&P 500 earnings, at about 25% of the total. This sector faces some challenges to earnings growth in the quarters ahead: lingering subprime related write-offs and rising delinquencies, higher costs on cash deposits, tighter lending standards, some deleveraging of bank balance sheets, and the slowdown in underwriting as the wave of “releveraging” of corporate balance sheets slows from its breakneck pace of 2006 and the first half of 2007 – all will be to the detriment of profits for the financial sector. Yet ongoing economic growth will keep profits rising in the mid-single digits for this sector.
- Energy is the next biggest contributor to S&P 500 EPS, at about 15% of the total. The potential for a correction or further upside momentum in oil prices raises some risk to our estimates, which expect oil prices to remain roughly flat with 2007, averaging about \$70 - 80.
- The IT sector is the third largest contributor – making up 11% of S&P 500 profits – and is likely to remain a solid contributor to earnings growth in 2008. Sales of high tech products remain robust, and inventories are lean. Profit margins are on the rise as demand picks up.

What are investors willing to pay per dollar of earnings in 2008? We expect the 12-month forward price-to-earnings ratio for the S&P 500 companies (the current price of the index divided by the expected EPS of the companies in the index over the next 12 months) to rise in 2008. A look back at valuations for the S&P 500 confirms that P/Es have actually expanded historically as earnings growth slowed during the middle stage of the business cycle and also as earnings reaccelerated. The forward P/E bottomed in mid-2006 at about 13.5. Our outlook for about one point of P/E from the current 14 to 15-16 by yearend 2008 is modest compared to the rapid expansion of two to three points a year that took place in the second half of the 1980s and 1990s business cycles. At current levels, each point that the P/E rises adds about 6–7% to the total return of the S&P 500.

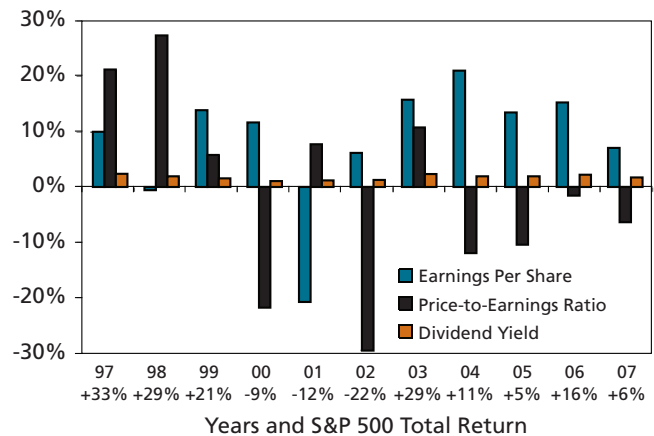
Helping to drive higher valuations is a shift in earnings growth from low to high P/E sectors. Overall valuations should rise as high P/E growth sectors, such as Information Technology, continue to post above average earnings growth, and low P/E sectors, such as Financials, reflect below average growth. The earnings growth of sectors including Information Technology, Industrials and Health Care is likely to continue to outpace the overall market as in 2007, boosted by a high percentage of foreign revenue and the benefit of a falling dollar, business spending outpacing consumer spending, and aggressive share buyback programs reducing share count and boosting earnings per share.

Dividends per share for S&P 500 companies have been growing at a double-digit pace over the past 15 quarters, setting a record. With the percentage of earnings paid out in the form of dividends at all time lows of about 30%; there is plenty of room for DPS to exceed the pace of EPS in 2008, as they did in 2007.

When all three drivers of total return (earnings growth, valuation expansion, and dividend per share growth) are moving in the same direction, it has been very positive for stock market performance. We expect above average total returns in 2008 of 10–16%.

Total Returns are Above Average When All Three Drivers are Positive Contributors

Contribution to Total Return by Component of S&P 500 Performance

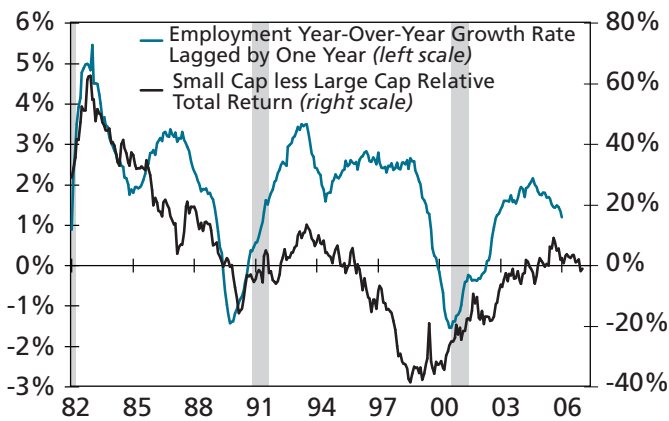


Source: Standard & Poor's, Bloomberg, FactSet, LPL Financial

We forecast that Large-Cap stocks will outpace their Small-Cap peers in 2008. Smaller-Cap stocks tend to outperform their Large-Cap peers by a wide margin in the early stage of a business cycle. However, as the business cycle matures, the relative performance reverses. This pattern can be observed in the performance of these

two asset classes relative to employment growth. In the early years of the business cycle, when the economy rebounds from recession, employment growth picks up, and so does the relative performance of Small-Cap stocks. After the mid-cycle slowdown in the economy and employment growth, Small Caps typically underperform Large Caps by a significant margin. These multi-year periods of relative performance have been consistent for the past 50 years of business cycles. Since last summer, Large-Cap stocks have led the powerful gains – the first time during this business cycle that they have led the market higher. In fact, since the end of the Fed rate hikes on June 29, 2006 – typically the shift in relative performance comes near the end of the first series of rate hikes in the business cycle – Large Caps have consistently outperformed Small Caps by a cumulative 9 percentage points. We expect Large-Cap outperformance to persist in 2008 and recommend an overweight to Large Caps. For a complete explanation of our tactical weightings see *Q407 Discussion of Recommended Asset Allocation Shifts October 1, 2007*.

Small Caps Underperform as Business Cycle Matures
Relative Total Return of Russell 2000 less Russell 1000 from Inception, and Year-Over-Year Change in U.S. Non-Farm Payroll Growth Lagged by One Year



Source: Bloomberg, LPL Financial
 Past performance is no guarantee of future results.

We recommend favoring Growth over Value at a 60%/40% style bias in 2008. Forward price-to-earnings ratios for the S&P 500 have expanded as the business cycle matured and earnings growth slowed – leading to Growth stock outperformance. For example, take the middle stage of the 1980s business cycle. After peaking in June 1984, earnings growth slowed and did not reaccelerate until June 1987. During this three-year period, the P/E ratio of the S&P 500® rose steadily from 8 to 14 times earnings, and Growth stocks outperformed. Again, during the mid-cycle pause in earnings growth of the 1990s (September 1995 through December 1998),

the market's P/E ratio steadily rose from 14 to 24 times earnings, and Growth stocks outperformed Value stocks. Ahead of the mid-cycle slowdowns in the 1980s and 90s, the P/E ratio contracted slightly as earnings growth was peaking – during these periods Value stocks outperformed. Likewise, Value stocks outperformed until 2007 as the double-digit pace of earnings growth helped to compress P/E ratios. However, in 2007 earnings per share for S&P 500 companies slowed into the single digits after tying the record for 13 consecutive quarters of double-digit growth. In 2007, P/E multiples for the S&P 500® have been rising, supporting Growth stock outperformance. In 2007, Growth has outperformed Value by 10 percentage points, and we expect this trend to continue in the years ahead.

International Relative Performance Tracks Style Cycle

Year-over-Year Change in S&P 500 less MSCI EAFE and S&P 500 Growth less S&P 500 Value



Source: Bloomberg, LPL Financial
 Past performance is no guarantee of future results.

We recommend underweighting the international markets, since we believe the period of international outperformance has now passed. Stretched international valuations are suggested by the fact that valuations overseas are now in line with the U.S. market. International markets tend to be more value-oriented than U.S. markets – with higher weightings in Financials, Telecommunications, Energy and Utilities sectors and much lower weightings in Growth sectors like Health Care and Information Technology. Given this sector breakdown, international stock outperformance tends to track Value style outperformance. – and we anticipate that as the style cycle turns to Growth, international stock performance is likely to weaken. In addition, we believe a further sharp decline in the value of the dollar is unlikely – removing the huge boost to the returns on international stocks for U.S.-based investors since 2002. In fact, despite the falling value of the dollar in the third

quarter, U.S. stocks outperformed international stocks, measured by the S&P 500 and MSCI EAFE. We continue to recommend U.S. stocks over their international counterparts; however, we recommend maintaining exposure to emerging markets.

For the last two years, the 10 Year T-note has traded between 4.25% and 5.25%. We expect this range to hold next year as well, with yields averaging 4.75%. We expect the Lehman Aggregate Bond Index to return 4–6% in 2008 – similar to the performance in 2007. Although yields may creep modestly higher, the lingering concern surrounding the pace of economic growth in the aftermath of the subprime bubble is likely to keep yields from rising sharply in 2008. The housing market acts as a counterweight against a further sharp rise in real yields, since for every basis point the bond yield rises, more pressure is placed on the fragile housing market – potentially slowing the real rate of growth for the U.S. economy. In addition, demand for longer duration assets by institutions remains strong, as they seek to match their long duration pension and health care liabilities. Inflation pressures remain muted, and core

inflation has declined into the Fed's "comfort zone" of 1–2%. We recommend a neutral duration stance to allow the allocation to benefit fully from the diversification provided by bonds. This negative correlation proved valuable during 2007, as stocks pulled back during the summer months while bonds rallied. During the volatile third quarter, stocks and bonds posted similar yet low-correlation returns that could reduce overall portfolio volatility.

We expect cash equivalents, measured by the 3 month T-Bill and currently yielding just below 4%, to yield 3.5–4.5% in 2008. The cash equivalents market is currently discounting rate cuts by the Fed.

In summary, we expect that 2008 will be another rewarding year for investors. We are forecasting that U.S. stocks will generate a 10–16% total return and the S&P 500® will end the year within our target range of 1725–1825, bonds will provide total returns of 4–6%, and cash equivalents will yield about 4%.

POLITICAL IMPACT OF 2008 ELECTIONS ON THE MARKETS

While we believe the impact of the elections on the markets' performance is likely to be secondary to the influence of the fundamentals of economic and profit performance, it may be useful to reflect on the historical patterns of market performance around presidential elections.

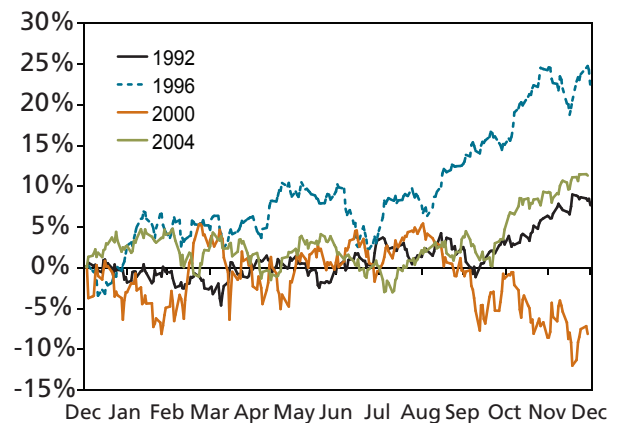
It is interesting that while there does appear to be some degree of predictability for stock market performance depending on an election outcome, there is little predictability in the outcome of a presidential election based on stock market performance. Franklin D. Roosevelt was re-elected in a landslide victory in 1940 despite losses in the S&P 500 in the third and fourth years of his term. Harry Truman and Richard Nixon also were re-elected in the face of lackluster stock market results. Moreover, vigorous performance in the markets does not guarantee election for the incumbent party. Adlai Stevenson lost even though the market rose 75% in 1949-52 under his party's administration, George H. W. Bush lost in 1992 even with a 57% gain in the stock market during his tenure, and despite the nearly 80% gain in the S&P 500 in the four years from 1997 through 2000, incumbent party candidate Al Gore was unable to hold onto the White House in 2000.

Stock market returns are typically strongest in the election year and the year leading up to the election relative to the first and second years of the presidential term. A key reason for this historical pattern of stock market performance during a presidential term is the greater amount of economic stimulus, in the form of both monetary and fiscal policy, applied during year two and three, which then begins to fade in year four. Since this stimulus affects the economy with a lag of around a year, stock market performance tends to follow this pattern of stimulus, leaving years one and two paying the price for the better years three and four leading up to the election. As you can see from the chart, stocks have tracked the typical presidential cycle pattern of performance during the current four-year term, and monetary and fiscal stimulus is turning more stimulative.

A relatively flat, range-bound stock market leading up to the fourth quarter has been a common occurrence during election years – occurring in five of the past six. The market usually breaks out of the range to the upside no matter who wins the election. In fact, there has only been one instance since World War II when the

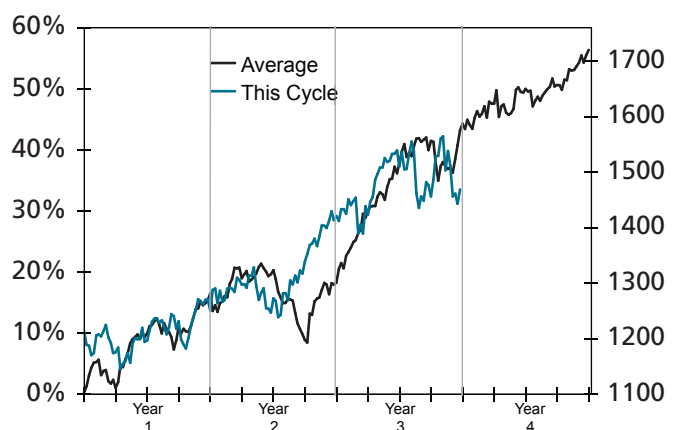
S&P 500 suffered a decline in the fourth quarter of an election year. The sole loss took place in 2000 as the market began to price in the looming 2001 recession. The stock market in 2008 may be range-bound until the fourth quarter when it breaks out to the upside, as investors shift their focus beyond the political and regulatory uncertainties posed by the presidential race.

Stocks Tend to be Range Bound until Fourth Quarter in Election Years
S&P 500 Index Price Performance in Last Four Election Years



Source: Bloomberg, LPL Financial
Past performance is no guarantee of future results.

Presidential Pattern of Market Performance
S&P 500 During Current Cycle and Average of Past Five Presidential Terms



Source: Bloomberg, LPL Financial
Past performance is no guarantee of future results.

While stock market performance in an election year has not been dependent upon the winner of the election, in the year following the election the markets have demonstrated some impact from the election. Over the long term, there has been no significant performance difference in the year after the presidential election based purely on which political party won the White House. Instead, the stock market has been more likely

to respond to whether the incumbent political party won or lost. This result is intuitive, since another term for the same party is likely to result in a more consistent political, legislative, and regulatory environment than a shift in the balance of power to a new administration, raising the level of uncertainty. The uncertainty can be seen, when incumbents lose, in greater risk aversion for both corporate leaders in pursuit of earnings growth and investors in the form of valuations. S&P 500 earnings-per-share growth has been positive on average during the first year of an incumbent's term, but negative when an incumbent loses. Likewise, price-to-earnings multiples have typically expanded during the first year of an incumbent's term and contracted when the incumbent loses. Interestingly, 2008 will mark the first presidential election since 1952 that the incumbent President or Vice President is not seeking his party's nomination. This unique characteristic makes it challenging to draw conclusions about what the market impact of the 2008 may be, since changes are likely no matter who wins.

Perhaps more important than the outcome of the presidential election to the markets is the potential for Congress to get the power to make sweeping legislative changes. With the large number of seats Republicans have to defend (22) versus Democrats (12) and the five Republican's announcing that they plan to retire versus none for the Democrats, the 2008 elections are likely to result in significant Democratic gains. However, it is very unlikely the Democrats will pick up the nine seats needed to have a 60-seat filibuster-proof majority. A pickup of even five or six seats could have a material impact in that they would only need support from a few moderate Republicans to get a filibuster-proof majority, substantially increasing the odds of far-reaching health care and climate change legislation.

It is often said that "gridlock is good," since the performance of the markets after World War II had tended to be better when governmental power was divided among the parties – virtually eliminating the potential for sweeping changes. A shift of the political party in power in the White House to that of both the House and Senate, magnified by near filibuster-proof margins, is the polar opposite of gridlock. We may see Congress shift from "gridlock" to "unlock".

A key issue for the next administration will be tax policy, given the expiration of the 15% tax rate on capital gains and dividends, reduced marginal tax rates in 2010, |the creeping reach of the Alternative Minimum Tax (AMT), and the phase-out of the estate tax in 2010. It

is doubtful that the existing tax rates will simply be extended. More likely, rates on higher income households will rise, including the top marginal tax rates, capital gains rates and dividend rates. The market impact of the "investor tax cuts" in 2001 and 2003 that lowered dividend and capital gains tax rates to 15% was difficult to discern, so the impact of the reversal of these provisions may be equally difficult to determine, but are unlikely to be dramatic.

Political Impact By Sector

The following is what the investment environment for various sectors might look like under a Democratic sweep:

Utilities: A focus on climate change will increase support for alternative energy. Odds increase significantly for a federal renewable power standard that imposes a mandate on utilities to generate a portion of their power from renewable sources, perhaps 15% by 2020. A program for greenhouse gas emissions that auction allowances at declining levels may be a negative for utilities since they are big coal users in addition to stricter and more costly environmental regulation.

Financial Services: We may see increased scrutiny and liability for many of the companies in the financial services area, ranging from credit card fees to subprime lending practices. Credit rating agencies may be negatively affected by the potential to legislate a change from an issuer to subscriber-based business model. The potential for a cap on the tax exemption for annuities above \$1 million may be a negative for insurers. However, Fannie Mae and Freddie Mac would almost certainly see a more favorable political climate with their portfolio caps lifted and the conforming loan limit increased. In addition, the potential for expansion of retirement savings plans may benefit asset management companies.

Health Care: The threat to government control of pricing for pharmaceuticals has been priced in for years – with U.S. drug stocks trading at a discount to counterparts in Europe where health care is socialized. Negatives for this industry include regulations making private health insurance less profitable and shifting market share to government plans. More importantly, managed care could be hurt by Medicare Advantage changes to reimbursements. However, even under comprehensive health care reform, many healthcare industries would likely benefit. For example, drug companies could experience increased demand as they did after Medicare Part D

was introduced. Other industries including providers (hospitals, nursing homes), diagnostic labs, and even generic makers may benefit from Democratic healthcare proposals expanding healthcare coverage, emphasis on preventative care, and emphasis on generics.

Telecommunications Services: A change in the head of the FCC along with Democrats' preference for network neutrality could be a positive for the smaller competitors at the expense of the three large players.

Materials: Climate change legislation may be a negative for coal producers.

Consumer Discretionary: Potential copyright legislation under a Democrat-controlled congress is likely to favor entertainment content providers.

Consumer Staples: Expanding ethanol use to 85% ethanol blends via tax incentives or mandates benefits ethanol producers beyond the current ethanol blends. Potential extension of FDA mandate to tobacco products could result in restricted advertising potentially benefiting producers by saving billions while only slowing domestic consumption marginally as international growth continues. An increase in the tobacco tax could be a slight negative.

Energy: We doubt oil and gas firms will be subject to any especially negative actions, such as a windfall profits tax, but headline risk will rise. However, increased royalty payments paid by oil and gas companies for use of public land and offshore sites may be an incremental negative for major integrated oil companies. An incremental positive for natural gas producers may be a program for greenhouse gas emissions raising the cost of using coal.

Industrials: Congress may demand through regulation, taxation, and incentives that environmentally-friendly technologies like carbon capture and as solar and wind become a much larger portion of U.S. power generation. This creates opportunities for companies that provide alternative power and delivery of alternative fuels. The companies tied to large defense programs could come under additional pressure, although companies that benefit from port security, chemical plant security and homeland security spending and regulation in general should benefit, as Democrats may increase funding in these areas.

A president often sets the tone on trade and fiscal policy, and the bond market's sensitivity to these issues results in a response to the election outcome. In the bond market, the political party of the winner of the election, rather than whether the incumbent or challenger was elected, has historically affected performance. However, this effect has been delayed until the year after the election. Since the late 1920s, during the year after a presidential election the bond market has fared better under a Republican president, with government bond returns of 6.8%, than a Democrat, 4.3% as measured by the Ibbotson Intermediate Term Government Bond Index. It is notable that the best years for bonds have been during the first two years of a presidential term, no doubt related to the more stimulative (and potentially inflationary) fiscal and monetary policy that takes effect in years three and four.

We believe the impact of the election on the markets' performance is likely to be secondary to the influence of the fundamentals of economic and profit performance. However, the historical pattern of election year performance for the S&P 500 suggests gains on tap for 2008, with much of the performance coming in the fourth quarter and the potential for wide variations in industry performance during the year.

WHERE ARE WE IN THE BUSINESS CYCLE?

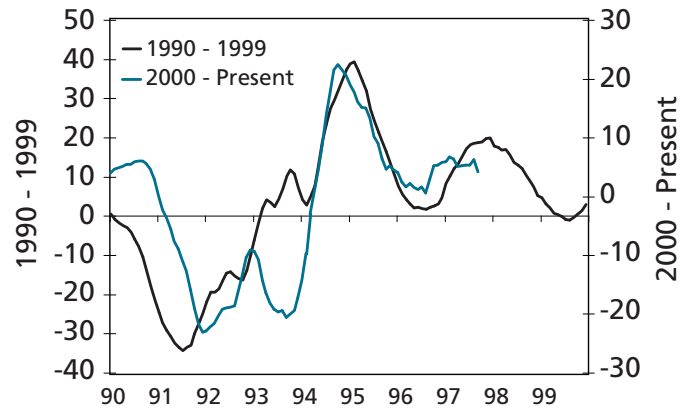
It has been said that while history may not repeat itself, it does rhyme. Many of our forecasts and recommendations are supported by our analysis of patterns of market behavior during similar periods in the past. The business cycle, the period between recessions (general downturns in the economy and profits), provides the context for patterns of behavior in the financial markets. Key measures of the economy and profits often exhibit similar patterns of growth over business cycles. After all, that is why they are called cycles in the first place.

For example, the current business cycle, which began following the 2001 recession, rhymes with the prior business cycle, which began following the 1991 recession. Their similarity is best illustrated by the accompanying charts that show key measures of the current business cycle have been closely tracking the pattern of the 1990s business cycle. These measures include:

- Consumer confidence
- Institute for Supply Management Purchasing Managers Index
- Real federal funds rate
- S&P 500 profit growth
- The slope of the yield curve
- Capacity utilization

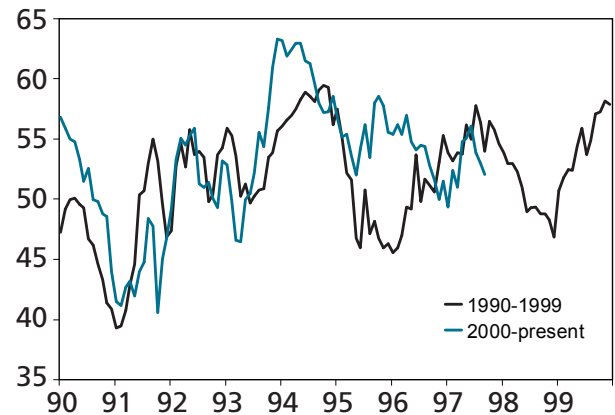
Driven by the similarities in the business cycle, market behavior has also followed the same path as the 1990s cycle. In the first half of the 1990s cycle, value and small-cap stocks led the stock market. Then, as the cycle matured, growth and large-cap stocks took the lead. A similar shift in relative performance is taking place now in the financial markets, as growth and large-cap stocks are leading the market in 2007 for the first time this business cycle.

Business Cycle Comparison – Consumer
Year-over-Year Change in the Conference Board's Consumer Sentiment (12 Month Moving Average)



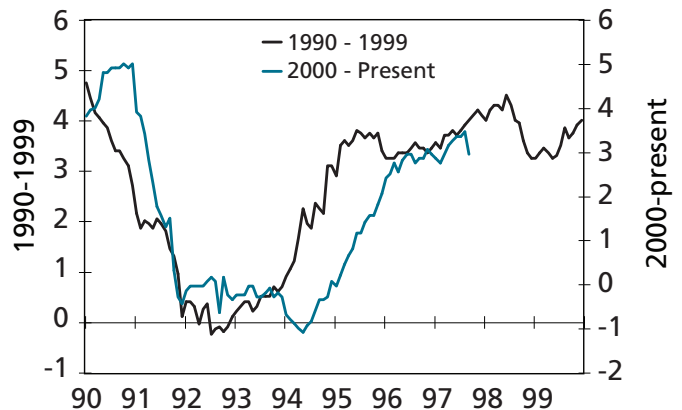
Source: Bloomberg, LPL Financial

Business Cycle Comparison – Manufacturing
Institute for Supply Management Purchasing Managers Index



Source: Bloomberg, LPL Financial

Business Cycle Comparison – Federal Reserve
Year-over-Year Change in Real Federal Funds Rate



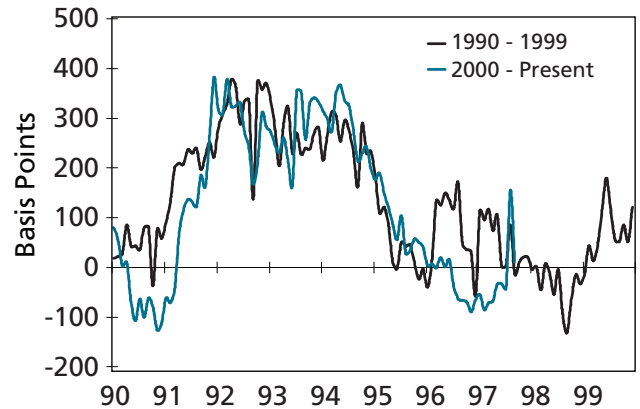
Source: Bloomberg, LPL Financial

The S&P 500 operating earnings growth is following the typical sawtooth pattern during this business cycle – and closely mirroring the path of the 1990s. However, there are now fundamental differences from the 1990s with implications for profit growth – as profit growth stalled in 1998, the underlying drivers differed from those of the current slowdown.

- U.S. corporate profits earned abroad fell in 1998 – now, they are boosting overall results.
- The primary source of profit decline back then was the collapse in energy prices leading to a dramatic decline in profits for the energy sector. This year, energy companies are posting small, but positive, profit growth.
- Sharp gains in the US dollar's value and a sharp slowdown in international demand contributed to weaker repatriated U.S. profits in 1998. By contrast, weakness in the dollar's value and solid international demand now is resulting in a boost to repatriated profits.
- In 1998, companies were issuing shares on a net basis; in 2007, companies are buying back stock on a net basis – reducing share count and boosting earnings per share.

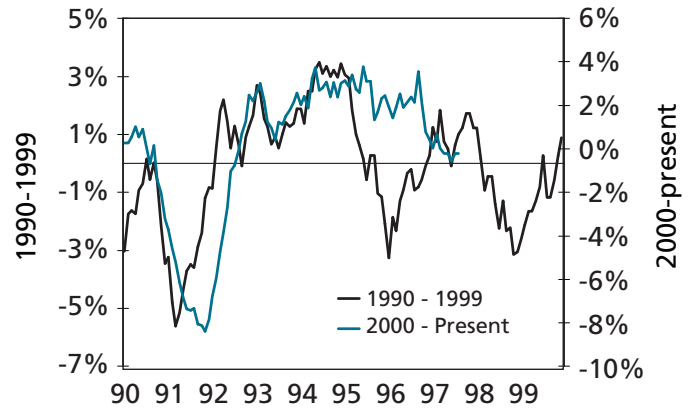
These factors have boosted EPS growth relative to the 1990s mid-cycle slowdown, contributing to our expectation for EPS growth to trough in the low single-digits rather than turn slightly negative as they did in 1998. For the same reasons, the profit rebound in 2008 may be more muted than that of 1999. While financial sector profits may remain soft in 2008, weakness in financial sector EPS growth in 1998 and 1999 did not inhibit overall profit growth from reaccelerating.

Business Cycle Comparison – Yield Curve
Slope of Yield Curve (10 Year less Fed Funds)



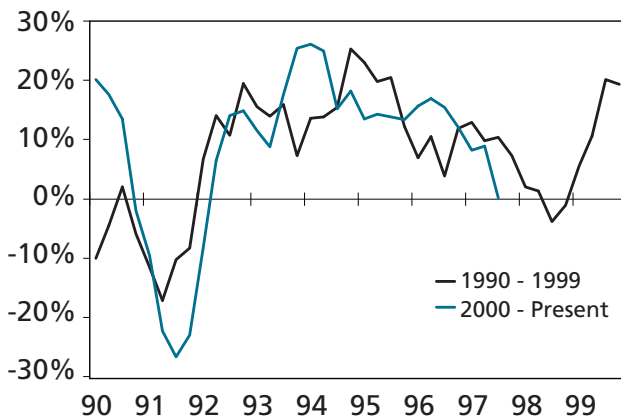
Source: Bloomberg, LPL Financial

Business Cycle Comparison – Resource Use
Year-over-Year Change in Capacity Utilization



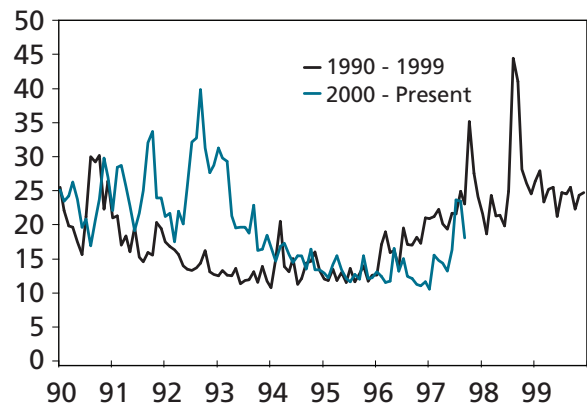
Source: Bloomberg, LPL Financial

Business Cycle Comparison – Profits
Year-over-Year Change in S&P 500 Operating Earnings Per Share



Source: FactSet, LPL Financial

Business Cycle Comparison – Volatility
Year-over-Year Change in CBOE VIX

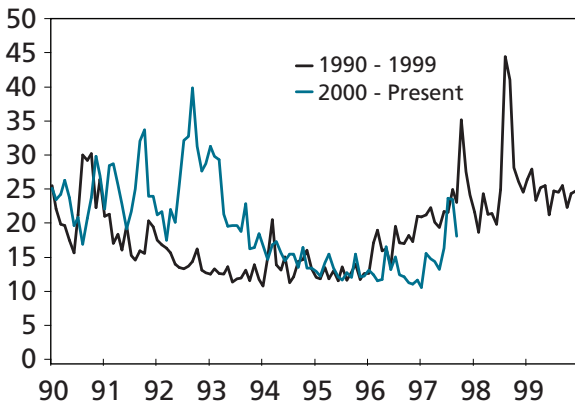


Source: Bloomberg, LPL Financial

Stock market volatility is also following the pattern of the 1990s. The Chicago Board Options Exchange VIX, or volatility index, measures the amount of volatility priced into options contracts for the S&P 500. The uptick in this index in 2007 mirrors the trend of the late 1990s.

In the bond market, corporate credit spreads have started to rise, echoing the pattern seen in the late 1990s. Back then, the rise in credit spreads was associated with concerns over the credit crisis outside the U.S.; this time those same worries have stemmed from the domestic subprime loan crisis.

Business Cycle Comparison – High Yield Spread
Lehman High Yield Corporate Bond Credit Spread

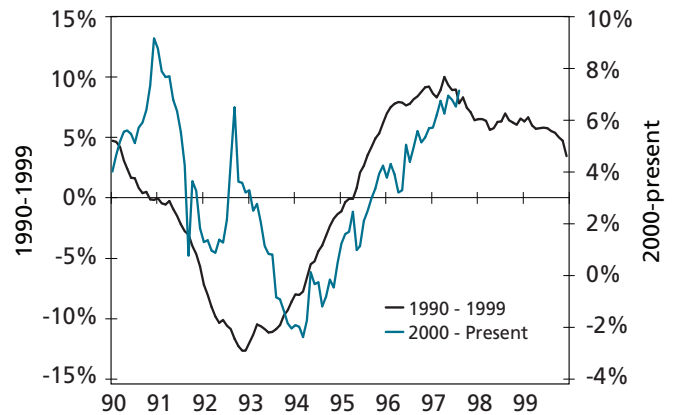


Source: Bloomberg, LPL Financial

Will the 1990s continue to provide a historical guideline for the relative performance of financial assets as we look to 2008 and beyond? It is likely that history will rhyme, not repeat. The liquidity that has been added to the world's financial system by the Federal Reserve and other central banks to avert a spillover from the subprime debt crisis is similar to the liquidity added in 1998 to avert a contagion from the emerging market financial crisis. This cycle, we do not expect excessive amounts of liquidity to flood into the U.S. Technology sector and create a speculative bubble (although some of it will likely end up there). Instead, this time the abundance of global liquidity may create a speculative bubble in emerging market stocks. The good news for investors is that this potential bubble is in the early stages, with additional gains likely.

Rising global liquidity and rising consumer spending within emerging economies has helped to decouple emerging markets from the slower pace of U.S. growth in recent quarters and fueled powerful growth in equity values. In fact, emerging economies now account for 29% of world GDP – slightly more than the U.S. portion. In addition, strong commodity prices continue to support emerging market performance, given their higher concentration in the Energy and Materials sectors than the developed markets. Emerging market nations have improved fiscal conditions, supporting more balanced growth. Formerly net debtors, many emerging market nations now have trade surpluses and substantial foreign currency reserves. Valuations are on the rise.

Business Cycle Comparison – Excess Money Supply
*Year-over-Year Change in OECD U.S. Broad Money
M3 less Narrow Money M1*



Source: Bloomberg, LPL Financial

The lessons of the 1990s remind us that speculative bubbles end badly; we remain vigilant for signs that emerging market stocks are becoming vulnerable to “irrational exuberance”. We continue to recommend exposure to emerging markets, even as we recommend an underweight to the developed international markets.

The pace of economic and profit growth has slowed since mid-2006, as is typical for this stage of the business cycle. In the 1990s, profit growth for S&P 500 companies slowed from 1996 to 1998. We expect the business cycle to rev up in 2008 – with a rebound in earnings per share growth for S&P 500 companies and a return to trend-like real GDP growth of around 3%.

WHAT COULD GO RIGHT IN 2008?

As 2008 begins, a number of factors could provide some upside to our forecast for financial market performance. Fears that the economy may slide into recession (as a result of a housing collapse) may fade, allowing blooming optimism that growth in the economy is on track for years to come. Investor worries regarding the pace of inflation may also diminish.

The fundamental backdrop for corporations remains favorable. Lean inventory levels and low debt-to-cash flow ratios are contributing to healthy corporate balance sheets. Contained labor costs and efficient capital spending have driven profit margins to all-time highs. High returns on equity help to prolong and strengthen the business cycle. Stock market valuations have room for expansion from where they now stand at around 15 times earnings (based on consensus 12-month-forward earnings estimates).

We cite the following as positive factors that could cause the performance of the financial markets to exceed our base-case expectations.

More P/E ratio expansion than expected

During past mid-cycle slowdowns in EPS growth and subsequent rebounds, P/Es have expanded by 2 to 3 points per year. EPS slowed from 1984 to the start of the rebound in 1986, and as EPS growth rebounded to the double digits in 1987, forward P/Es expanded from 8 to 14. During the mid-1990s, as EPS slowed from double digits in 1996 to the start of the rebound in 1998 and into the return of double digit growth in 1999, P/Es rose from 14 to 24.

The current slowdown in EPS growth started in mid-2006 when P/Es stood at around 13.5 – they have since risen to 14. We believe they can rise by about 1 point to 15-16 by the end of 2008 – but if they were to rise 2 to 3 points, the S&P 500 could post a gain of 30% in 2008! Factors that could push valuations higher by the historical average amount include:

- Stronger than expected earnings growth in sectors with historically above average valuations would lift the overall P/E for the S&P 500. A driver of this growth could be stronger than expected global economic growth and a decline in the dollar, since these high P/E sectors have a greater proportion of foreign sales.

- The superior ability of higher P/E companies to re-leverage their balance sheets and remove the drag on returns due to excess cash holdings boosts earnings per share growth.
- As a result of share buybacks, merger and acquisition activity, and leveraged buyouts – along with relatively light initial public offerings and secondary issuance – the supply of outstanding shares has been shrinking in the past couple of years, for the first time in over a decade. Some companies are committing to huge buybacks. For example, P&G said it expects to buy back \$24 billion to \$30 billion in stock over three years, amounting to more than 10% of the outstanding shares. Our base case 2008 forecast includes a 1–2% reduction in the supply of outstanding shares for S&P 500 companies. Nevertheless, we believe that the potential for much more sizable share shrinkage exists.
- A return of the individual investor to the stock market would boost demand for shares. Individuals have been net sellers, based on the outflows from money managers tracked by Trim Tabs. Renewed demand for U.S. stocks at the same time the supply is shrinking due to buybacks creates a positive supply/demand dynamic, pushing up valuations.

The potential for stronger than expected earnings per share growth at high P/E companies, a much larger-than-expected reduction in the supply of stocks, along with rising individual investor demand, could exert a powerful upward force on stock prices in 2008.

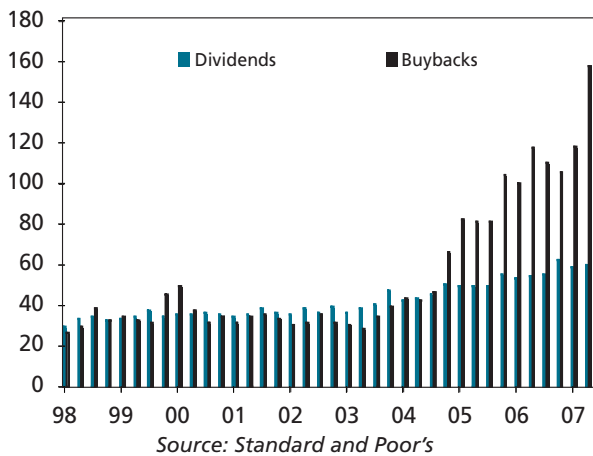
Dividend Payouts Rise to Match Share Buybacks

The return of the dividend is well under way. Dividends per share for S&P 500 companies have been growing at a double-digit pace over the past 15 quarters, setting a new record. This rapid pace of dividend-per-share growth is the result of:

- high corporate cash balances,
- lean spending on acquisitions and capital,
- changes in executive compensation, and
- renewed emphasis on corporate governance and shareholder interests.

However, during the past three years, corporate leaders have favored share buybacks over dividends as a way of returning value to shareholders. Prior to the fourth quarter of 2004, S&P 500 companies spent about the same amount annually on share buybacks and dividends. Since then, spending on buybacks has soared to double the amount spent on dividends, which may be due to the flexibility offered by share buybacks – they are more discretionary compared with the long-term commitment reflected in a dividend.

Spending on Buybacks Outpacing Dividends
S&P 500® Spending on Dividends and Buybacks (in billions)



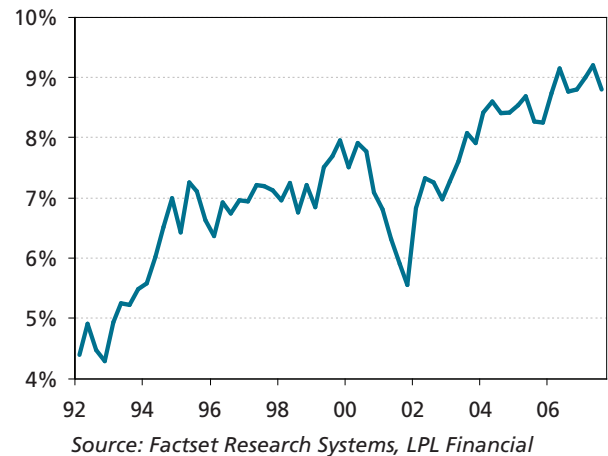
Since the accounting scandals of 2002, investors have remained wary of corporation-reported earnings because of all-too-frequent restatements or write-offs. In contrast, dividends are a cash outlay and not exposed to the same accounting subjectivity. Investor caution regarding earnings accuracy, coupled with the slowdown in EPS growth into the single digits, may spur corporate leaders to shift their focus toward dividend-per-share growth and away from share buybacks. Moreover, dividends per share are likely to grow faster than EPS in 2008, as they did in 2007. If corporate leaders devote more cash flow to dividends, stock market valuations may rise, given the value investors have been placing on yield in recent years.

Corporate Profit Margins Are Sustained or Increase

U.S. corporations are enjoying the widest corporate profit margins in history, due to a number of factors, including:

- strong revenue growth,
- contained labor costs,
- solid productivity gains, and

Profit Margins Remain Near Record High
S&P 500® Net Profit Margin



- a strong credit environment.

Profit margins are cyclical and tend to contract as U.S. economic growth slows. However, while the U.S. economy slowed over the past year, sales growth has been resilient, due to strong international demand (boosted by the decline in the dollar).

Historically, manufacturing capacity utilization has been a good leading indicator of profit margins. Capacity utilization has stalled at a high level over the past year and a half. We expect profit margins to remain near record levels in 2008. Only companies in the Energy and Industrial sectors of the stock market have extended profit margins, margins for companies in other sectors are near average or below average, leaving room for potential margin expansion. In addition, unit labor cost growth may subside in 2008 – potentially boosting profit margins.

A faster pace of profit growth driven by sustained or rising profit margins would be good news for investors in 2008.

Stronger than expected economic growth

2008 could bring better than expected growth as the long heralded demise of the consumer fails to materialize. Housing activity has been declining for over two years without tipping the U.S. economy into recession or causing consumers to retrench.

A key source of support for the consumer has been solid job and income growth. Withheld tax receipts currently imply about a 6–8% year-over-year pace of wage growth. The consumer spending data shows that spending tracked income in recent years – not housing

prices or cash-out refinancing. If robust consumer spending joins renewed business spending and ongoing healthy export growth, U.S. GDP could surprise with above average growth.

A gradual decline in oil prices

Oil prices soared 50% to a new all-time record high in late 2007 of over \$90 after starting the year at around \$60. On average in 2008, we expect oil prices to decline slightly from their year-earlier levels, the first year-over-year decline since 2001. However, if oil prices experience a true bear market by declining 20%, the stock market would likely enjoy a strong rally. Note that a more substantial decline could actually pose a risk to the financial markets – which we discuss in the section *What Could Go Wrong in 2008?*

OPEC members have cut production over the past year, reflecting OPEC’s concerns regarding:

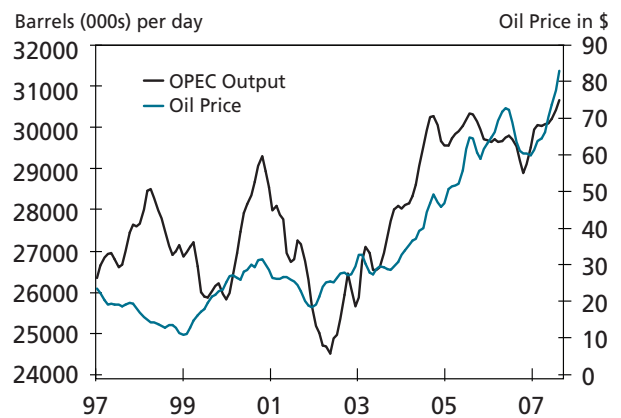
- the buildup of oil inventories, because production has outstripped global demand;
- two quarters of outright year-over-year declines in global oil demand;
- the largest rise in non-OPEC oil supply since the 1970s; and
- slower global economic growth in 2007, which weakened global oil demand.

Some investors are concerned that potential production cuts may lift oil prices. Our outlook for a year-over-year decline in oil prices from 2007 levels factors in current and projected production cuts. Five key factors support our oil outlook:

- OPEC production cuts have not stemmed falling crude prices in the past. For instance, following production cuts of 2.5 million bpd that began in 1998 and cuts of 5 million bpd in 2001, crude oil prices continued to fall for about a year.

- Production cuts undermine what has been a key support for oil prices in recent years – spare capacity. As production is cut, spare capacity rises. For the past several years, low levels of spare capacity (and geopolitical risks to capacity) have been key to driving oil prices higher – even more important than the balance of actual supply and demand. The International Energy Agency forecasts that spare capacity will be back to the level it reached prior to the run-up in oil prices that occurred during the past three years.

OPEC Production and Oil Prices
OPEC Output and West Texas Intermediate Crude Oil Price



Source: U.S. Department of Energy, Bloomberg

- Production cuts are likely to be in heavier grades that are more costly to refine and less in demand by U.S. refiners.
- Global demand for oil will likely continue to decline if, as expected, global economic growth slows.
- Global supply should remain strong, given ample current inventory and several years of intensive investment by companies in non-OPEC countries.

These factors could combine to result in a gradual decline in oil prices from record highs. A decline in oil prices would be welcomed by financial markets, given the potential for better economic growth and tamer inflation pressures.

WHAT COULD GO WRONG IN 2008?

As 2008 begins, a number of factors could provide downside to our forecast for financial market performance. Potential negative pressures on market performance may come from areas ranging from a sustained decline in the housing market to a rise in protectionism. We fully recognize that unforeseen risks often have the most negative market impact. We cite the following potential negatives for investors and remain vigilant for new risks.

A Collapse in Oil Prices

A collapse in oil prices could result in a financial crisis. A freefall in oil may make the subprime fallout look minor by comparison.

Oil has now become a crowded trade. Recent Commitment of Traders data show the speculators have shifted to sizeable net long positions in crude oil. We have seen the role and dangers of leverage in 2007 with the financial exposure to subprime debt and related derivatives. The sudden reversal of what had been a “one-way trade” for so long took Wall Street by surprise and resulted in the write off of tens of millions of dollars. Much of the gains at Wall Street investment firms in recent years have been driven by trading for the firm’s own account – many of these may be “one-way trades” in oil. In addition, many hedge funds have been aggressively buying oil with leveraged bets – bets that are backed by borrowings from many of the Wall Street investment houses. It is impossible to know the full extent of the market’s exposure to oil prices, but by all available measures it is in uncharted territory.

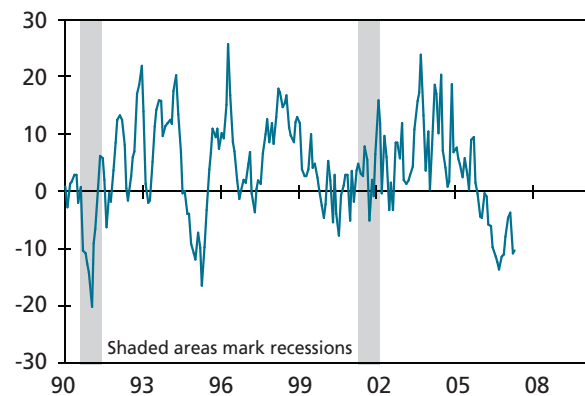
Beyond potential financial contagion on Wall Street, a sudden stop in the flow of petrodollars invested in U.S. Treasuries may cause interest rates to rise sharply. The Energy sector of the S&P 500 contributes about 15% of the index earnings, which would likely decline by a tremendous amount. In addition, investments by many private equity companies into oil infrastructure may appear to be fruitless.

Note that we cite a bear market for oil as a positive and a collapse as negative. We don’t consider a rise in oil prices to be as significant a threat to the markets in 2008 – unless it is the result of a weather or geopolitics induced supply shock – since a demand-driven rise in the price of oil implies strong enough economic growth to absorb the higher cost.

Housing Downturn Leads to Broad Economic Recession

The housing market peaked more than a year ago, measured by the year-over-year change in home prices and the pace of new and existing home sales. Housing activity and prices have now fallen by as about much as they did in the mid-1990s. That period did not result in a recession for the U.S. economy. If housing activity does begin to level off, the economy is likely to experience the soft landing reflected in our base-case scenario. However, if the pace of the housing downturn experienced over the past year continues throughout 2007, then a broad economic recession could be triggered.

Housing Correction Mirrors Mid-1990s
Existing Single Family Home Sales Year over Year



Source: Bloomberg, LPL Financial

While there is likely to be more bad news to come on the housing market, investing always involves uncertainty. The question is what news is already reflected in the market?

- The Homebuilders Index is down about 70% from the peak of the housing market in July of 2005. The carnage in that industry has wiped out about five years’ worth of gains and taken the stocks back to where they were in 2002 and early 2003.
- How about the mortgage lenders? They have lost over a quarter of their value just since mid-June of this year.
- Investment Banks are in bear market territory, down by over 20%.
- Retailers have fallen by over 20%.

That doesn't seem like the kind of performance where investors are idly whistling past the graveyard. In fact, the homebuilders and mortgage lenders have fared worse this time than they did during the bear market surrounding the last recession.

Some might say that comparing the performance of these industries recently to their performance during the last recession is not a fair, since the bubble this time was concentrated in these industries like it was in Tech prior to the last downturn, and that to be fair we should compare these losses to those experienced by the Tech sector. To make that argument you have to believe valuations were comparable - which they weren't. Homebuilders forward price-to-earnings ratios were around 10 at their peak, compared to the 30 of Tech stocks at their peak. However, if we ignore valuations and make the comparison, we can still see that the markets have fully discounted the housing bubble bursting. For example, peak-to-trough the Tech sector was down 80% during the two and one-half year bear market from March 24, 2000 to October 9, 2002 - not far from the 70% decline experienced since the peak of over two years ago on July 20, 2005 for the homebuilders. With a recession already fully priced into these industries, additional downside may be limited.

Major Negative Geopolitical Event

Geopolitical risks once summed up as the "Axis of Evil" are constantly evolving, and new threats and opportunities - at least for investors - are always emerging. Investors need to be prepared to manage geopolitical risk in their portfolios by understanding the current status of new and ancient conflicts. It's important to recognize how risk is priced into investments, and anticipate how developments in the conflicts will affect the value of these investments.

In the past, the financial markets have reacted to geopolitical events with the potential to draw the U.S. into armed conflict or slow the movement or production of oil. While the events are often unpredictable and the countries involved vary, the markets' reactions are often predictable.

Iran, Iraq, Russia, China, Venezuela, Israel, Lebanon, Afghanistan, Pakistan and North Korea are the most probable locations for geopolitical conflicts, but plausible threats exist elsewhere, including operations in Sudan, Turkey, and Nigeria, among others. While these particular conflicts may flare up or fade and affect the markets, it is the unexpected event that has the most

impact. A thorough presentation of our outlook for geopolitical event risk is featured in the LPL white paper *Geopolitical Risk: How to profit and protect portfolios from geopolitical events*.

Two potential geopolitical events that could take place in 2008 and are not priced into the markets are a conflict with Venezuela and military action in Pakistan.

Venezuela This summer, Venezuelan President Hugo Chavez visited Russia and Belarus to discuss purchasing submarines from Russia and an air defense system from Belarus. If all nine submarines are delivered, Venezuela would have a submarine force in the Western Hemisphere second only to the U.S. Navy - which may be useful in forging closer ties with Cuba. However, it is more likely that air operations would be more significant in any U.S. military activity against Venezuela, and so the air defense system may be of more significance to the U.S. than the submarines. Of course, the submarine and air defense sales could be called off or scaled back either by Venezuela, Russia, or Belarus.

Given Venezuela's dependence on U.S. oil demand for the cash flow it needs and rampant anti-U.S. rhetoric by Hugo Chavez, it is both difficult and easy to imagine what might prompt an armed conflict with the U.S. Hugo Chavez's rule in Venezuela is underwritten by the oil business. When Chavez took office in 1999, Venezuelan oil output stood at a record 3.5 million barrels per day - through nationalization and neglect, the country now produces only two-thirds of its former output. This challenge to the socioeconomic viability of the Chavez regime (along with the year-over-year decline in oil prices) makes increasing political tensions likely along with the related potential for Chavez to prompt a conflict with the U.S. As the country spirals into political disarray and the government attempts to deflect attention from domestic concerns, the risk of outside conflict rises.

Pakistan While operations against the Taliban in Afghanistan continue, U.S. military advisors are increasingly focused on the senior leaders of Al-Qaeda believed to be in northwest Pakistan. U.S. pressure on Pakistani President Pervez Musharraf to conduct operations to eliminate the Jihadists has yielded unsatisfactory results, due to internal political strife likely to result in the ouster of Musharraf. The U.S. increased the pressure in July by suggesting that if the Pakistani government was unable to take aggressive action against the Jihadists a unilateral U.S. military operation in Pakistan was not out of the question.

If undertaken, rooting out Al-Qaeda operatives would be a labor-intensive process for U.S. forces. In order to conduct the operation, U.S. troops would likely have to come from eastern Afghanistan, leaving the Afghan and predominantly British and Canadian NATO force to contain the Taliban. Unlike in Afghanistan, the operation could put U.S. forces in conflict with Pakistan's military – depending on the unfolding political situation. Such a conflict is unlikely to be a minor issue given Pakistan's nuclear arsenal.

Based on reports of successful raids, it is likely that enough progress against the Jihadists can be demonstrated by the Pakistanis so that when considered with the very significant challenges to a U.S. operation, the U.S. will have insufficient incentive to do anything more than press for action. However, a shift in troops from southeast Afghanistan to northwest Pakistan would likely entail significantly greater geopolitical risk than market participants have embedded in asset prices.

Geopolitical events are nothing new, but they do present investment challenges, given the pace of change and the increasingly interconnected global financial markets.

Major Terrorism Event Occurs on U.S. Soil

A major terrorist attack that disrupts economic activity and raises security fears would be a major negative for the capital markets. With an average of 300 terrorist attacks around the world per year over the past 25 years, we have a lot of history to examine when looking at the economic or capital-market impact of an attack. Historically, major acts of terrorism have not had lasting long-term negative effects on financial markets. In the countries where these attacks have occurred, the stock market has fully recovered in one week, on average (excluding the 1990 London Stock Exchange bombing, when an unrelated recession emerged around the same time).

Major Terrorist Attacks Have Had No Lasting Impact on Stocks

Weeks to Return to Pre-Attack Level for Stock Market Index in Country in Which Attack Occurred

Terrorist Attack	Date	Weeks to Return to Pre-Attack Level
Munich Olympics	9/5/72	0
Muslim Terrorists Seize D.C. City Hall	3/9/77	1
Harrod's Bombing in London	12/1/83	0
Pan Am Bombing (Lockerbie, Scotland)	12/21/88	0
London Stock Exchange Bombing	7/20/90	31*
World Trade Center Bombing	2/26/93	0
Tokyo Subway Sarin Gas Attack	3/20/95	1
Oklahoma City Bombing	4/19/95	0
9/11 Attacks	9/11/01	4
HSBC & British Consulate Bombing, Turkey	11/20/03	1
Madrid Train Bombing	3/11/04	3
London Public Transit Bombing	7/7/05	0
Average		4
Average excluding 1990		1

**The London Stock Exchange Bombing was followed two weeks later by Iraq's invasion of Kuwait, and July marked the start of a recession in the United States.*

Source: Bloomberg

With the exception of the 9/11 attacks on the United States, there has never been a terrorist attack that has materially and negatively affected economic activity. The 9/11 attacks depressed economic activity for a very short period; however, the fourth quarter of 2001 marked the end of the recession, when economic activity reaccelerated from the third-quarter loss of 1.4% in real GDP with a fourth-quarter gain of 1.6%, followed by a 3.4% gain in the first quarter of 2002. The stock market responded similarly; within a week of reopening, the stock market was rallying – in the following nine weeks, the S&P 500® posted a gain of 20%.

Nevertheless, there is still the risk that, for the first time in history, a major terrorist attack would result in a serious disruption of economic activity and cause substantial declines in the capital markets. While al-Qaeda forces have not carried out a successful terrorist attack on U.S. soil in years, the potential for reorganization is a concern. The U.S. has communicated fears of a strengthening Taliban in the northeast of Pakistan and is pressuring the Pakistani government to act.

A Rise in Protectionism

Nothing spooks the stock market like protectionism – investors are haunted by memories of the Smoot-Hawley Tariff lead-in to the crash of 1929, the dispute between the U.S. and Germany preceding the 1987 crash, and last year's concern over Congress' blocking of the Dubai Ports World/P&O deal that preceded the May 2006 market pullback. Comments from the 2008 presidential candidates and recent polls suggest a rise in protectionist sentiment.

Leading Democratic presidential candidate U.S. Senator Hillary Clinton, who recently voted against CAFTA (Central America Free Trade Agreement) in the Senate, solidified the rise in anti-trade sentiment within her party by calling for a pause in negotiations on future free trade agreements. Clinton's remarks and commitment to increased protectionism reflect key themes of the Democratic Party's labor and environmental

constituencies. What is new is the increased skepticism on trade deals among Republicans. In the Oct. 9 Republican U.S. presidential debate, some candidates advocated a more cautious approach to trade. A recent Wall Street Journal-NBC News poll found that 60% of Republicans think free trade is bad for the U.S. economy.

The potential exists for an increasingly populist U.S. Congress, which consists of many newly elected members who ran on an anti-free trade platform, to halt progress on any new free trade negotiations and possibly seek to revise existing agreements. This may have significantly negative implications for U.S. corporations.

While we do not believe we will see significantly protectionist legislation, markets generally do not respond well to tough talk about trade. We will monitor the outlook for protectionist legislation that would be unwelcome by the financial markets.

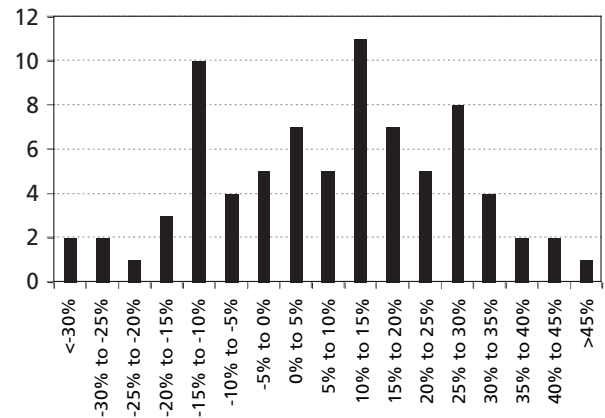
LOOKING BACK

In 2008, we expect the stock market to post gains of 10-16%.

From a historical context how common are returns in this 10-16% range? Looking back over the past 80 years, the stock market – measured by the price change of the S&P 500 (which excludes dividends) - has averaged an annual rise in the index of 7.5%. However, this average is misleading, as averages often are. In fact, only six percent of the time did the S&P 500 index rise between 5 and 10%. Instead, the range of return with the highest frequency was 10-15%, occurring more than twice as often as returns in the 5-10% range.

We are looking forward to a great 2008 with returns for the stock market consistent with the most common annual range of performance, well above the historical average.

10-15% Most Common Range of Annual Return for Stock Market
Distribution of Annual Price Returns for S&P 500 Index Since 1928



Source: Bloomberg, LPL Financial
 Past performance is no guarantee of future results.

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.

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.

Stock investing involves risk including loss of principal.

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

The Lehman Brothers Aggregate Bond Index is composed of securities from the Lehman Government/Credit Bond Index, Mortgage Backed Securities Index and Asset Backed Securities Index.

The Standard & Poor's 500 Stock Index (S&P 500) is an unmanaged index generally representative of the U.S. Stock Market, without regard to company size.

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