LPL FINANCIAL RESEARCH

Guide to the Current Conditions Index

Will We Take Action?

We are very pleased with the success of the index to track real-time conditions in the markets and economy. The drivers of the markets and economy change both during and across business cycles. From time to time changes to the index constituents are required to ensure the index incorporates those factors that are most critical to assessing the conditions in the markets and economy going forward.

Our most recent revisions to the index included the following component changes:

FOUR OF THE 10 CCI COMPONENTS WERE REPLACED

Old Components	New Components
TED Spreads	Fed Spread
Shipping Rates	Rail Traffic
Real Money Supply Growth	Money Market Asset Growth
Consumer Confidence	Business Lending

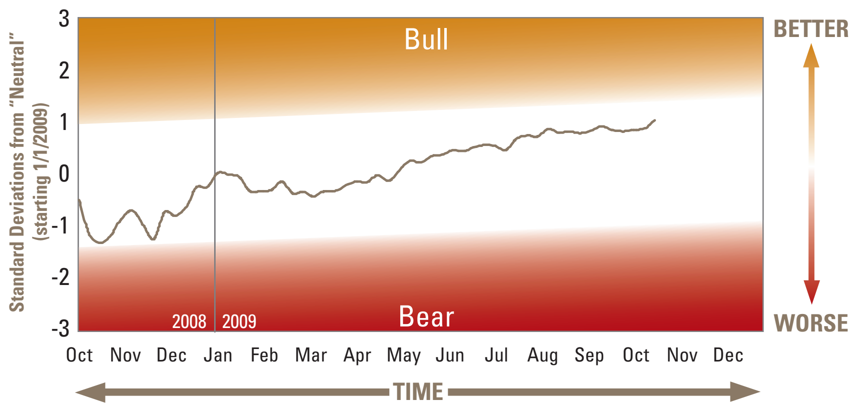
These changes will have no impact on the history of the CCI, just as with any index where the constituents change over time like the S&P 500. The replacement components will be scaled to the end points of the components they replace. Going forward the CCI will reflect the changes in the new components.

We constructed the LPL Financial Current Conditions Index early in 2009 as conditions were deteriorating in the aftermath of the financial crisis that was precipitated by the bankruptcy of Lehman Brothers in mid-September of 2009. Our goal was to create a weekly, fact-based measure of the conditions that underpin our outlook for the markets and economy in 2009 and beyond. We chose to create our own index tailored to the current environment to provide the clearest and most useful way to track how conditions are aligned with the expectations embedded in our investment recommendations.

It is not intended to be a leading index or predictive of where conditions are headed, but a coincident measure of where they are right now. We want to track the conditions in real-time to aid in investment decision making. The CCI became a useful tool to describe the conditions most relevant to investment decision making in 2009 and contributed to our decision to begin to add risk to portfolios beginning late in the first quarter of 2009 as the markets bottomed and conditions began to improve.

There is a need for this type of measure since the stock market cannot be relied upon as an accurate gauge. The stock market can be a misleading guide to the underlying economic conditions. The emotions of market participants can result in an overreaction on the upside and downside. A fact-based, objective measure of conditions is necessary to understand the relative likelihood of the scenarios detailed in our Outlook 2009 publication.

Example of the LPL Research Current Conditions Index as of 10/21/09



Source: LPL Financial

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How Is the Index Constructed?

To create the index we found 10 indicators that provided a weekly, real-time measure of the conditions in the economic and market environment. We then standardized these components compared to their pre-crisis 10-year average, equally weighted their standardized scores, and aligned the resulting index with zero at the start of 2009. These components capture how the conditions are evolving from a wide range of angles. Each component is important and measures a different driver of the environment. The 10 components of the CCI are described below:

1. Initial Claims Filed for Unemployment Benefits – Measures the number of people filing for unemployment benefits. A rise in the number of new claims acts as a negative on the CCI.
2. Fed Spread – A measure of future monetary policy, the futures market gives us the difference between the current federal funds rate and the expected federal funds rate six months from now. Typically, a rise in rate hike expectations weighs on the markets since higher rates increase the cost of bank borrowing and have tended to slow the growth in the economy and profits. A rise in the Fed Spread acts as a negative for the CCI.
3. Baa Spreads – The yield on corporate bonds above the rate on comparable maturity Treasury debt is a market based estimate of the amount of fear in the bond market. Baa-rated bonds are the lowest quality bonds still considered investment grade, rather than high-yield. Therefore, they best reflect the stresses across the quality spectrum. A rise in Baa spreads acts as a negative for the CCI.
4. Retail Sales – International Council of Shopping Centers tabulates data on major retailer's sales compared to the same week a year earlier. This measures the current pace of consumer spending. Consumer spending makes up two-thirds of GDP. Rising retail sales acts as a positive for the CCI.
5. Railroad Traffic – A measure of trade, the Association of American Railroads tracks the number of carloads of cargo that moves by rail in the U.S. each week. A growing economy moves more cargo. A rise in railroad traffic acts as a positive for the CCI.
6. Business Lending – A good gauge of business' willingness to borrow to fund growth, the Federal Reserve tabulates demand for Commercial & Industrial loans at U.S. commercial banks. More borrowing reflects increasing optimism by business leaders in the strength of demand. A rise in loan growth acts as a positive for the CCI.
7. VIX – The VIX is a measure of the volatility implied in the prices of options contracts for the S&P 500. It is a market based estimate of future volatility. While this is not necessarily predictive it does measure the current degree of fear present in the stock market. A rise in the VIX acts as a negative on the CCI.
8. Money Market Asset Growth – A measure of the willingness to take risk by investors, the year-over-year change in money market fund assets tracked by Investment Company Institute shows the change in total assets in cash equivalent money market funds. A rise in money market asset growth acts as a negative for the CCI.
9. Commodity Prices – While retail sales captures end user demand for goods, commodity prices reflect the demand for the earliest stages of production of goods. Commodity prices can offer an indicator of the pace of economic activity. The CRB Commodity Index includes copper, cotton, etc. A rise in commodity prices acts as a positive on the CCI.
10. Mortgage Applications – The weekly index measuring mortgage applications provides an indication of housing demand. With much of the credit crisis tied to housing, keeping tabs on real time buying activity can offer insight on how the crisis is evolving. A rise in the index of mortgage applications acts as a positive on the CCI.

Former components (removed as of 10/09/09):

1. **TED Spread –** The TED Spread measures the difference between 3-month LIBOR rate and the yield on 3-month Treasury bills. This is an effective measure of the liquidity available to banks. With bank capital adequacy near the center of the current crisis this is an important gauge of the stress in the banking system. A rise in the TED Spread acts as a negative on the CCI.
2. **Shipping Rates –** A measure of global trade, the Baltic Exchange compiles the Baltic Dry Freight Index which tracks the cost to ship various cargoes of raw materials on various key routes around the world. Since the supply of dry bulk ships does not change much in the short-term, the index is moved by the amount of cargo that is being traded in various global markets. A growing global economy moves more cargo which pushes up shipping rates. A rise in shipping rates acts as a positive for the CCI.
3. **Real Money Supply Growth –** measured by the year-over-year change in M2 growth adjusted for inflation, is a gauge of the Federal Reserve's actions to provide adequate liquidity for U.S. economic activity
4. **Consumer Confidence –** The weekly survey of consumer attitudes by ABC News provides a gauge of the sentiment that drives two-thirds of U.S. economic growth. While we have often stressed that confidence is not a leading indicator, it is coincident and reflects the current environment. A rise in consumer confidence acts as a positive for the CCI.

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