



# Weekly Market Commentary



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## Buyers and Sellers

### Jeffrey Kleintop, CFA

Chief Market Strategist  
LPL Financial

#### Highlights

- At the heart of it, all markets come down to buyers and sellers.
- Since March of 2009, buying from individual investors has been rising and may mark a multi-year turning point for individual investor inflows.
- Purchases of U.S. stocks by foreigners have risen back to the prior peaks in 2000 and 2007.
- The sellers include companies and insiders, or top executives, of S&P 500 companies.
- We believe the buying power of individual investors is likely to win out over the forces of selling in the coming months.

At the heart of it, all markets come down to buyers and sellers. Taking a look at who is buying and who is selling can tell us something about the durability of the market's performance and what may lie ahead.

Presently, there are four notable trends in buying and selling in the stock market.

The Buyers:

- Foreigners have been net buyers of U.S. stocks.
- Individuals have been buying mutual funds and exchange traded funds (ETFs) that invest in stocks.

The Sellers:

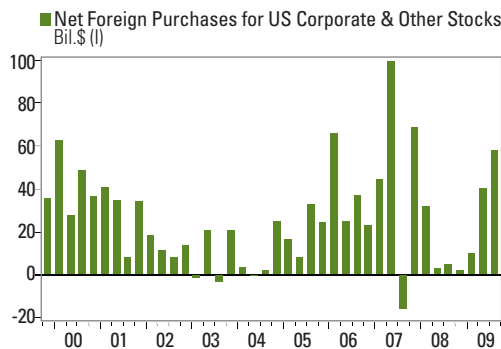
- Corporate stock issuance is beginning to ebb.
- Corporate insiders are selling.

### Foreigners are Buying

Purchases of U.S. stocks by foreigners in the third quarter of 2009, the latest data available, shows that demand by foreigners is well above the 10-year average. Foreigners were likely equally strong buyers in the fourth quarter. In fact, the pace of demand during the third quarter (\$56.3 billion in net purchases of US stocks) has only been exceeded in the past by the surge in buying around the market peaks in 2000 and 2007. However, rather than signify a market top, we believe this healthy demand is an encouraging sign since foreign holdings of US stocks remain below average unlike the elevated levels of 2000 and 2007.

#### 1 Foreign Demand is Strong

*Foreign Net Purchases of US Equities in \$ Billions by Quarter*



Source: Department of the Treasury/Haver Analytics 01/04/10

### Individual Investors are Buying

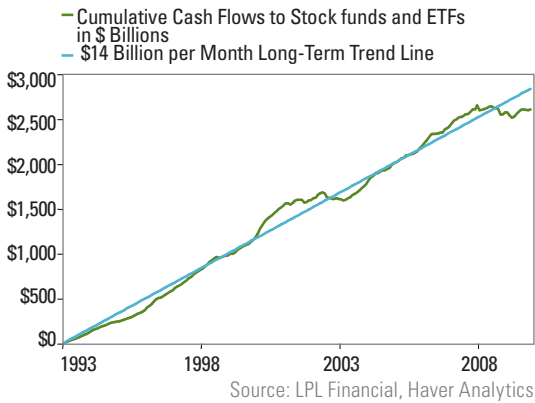
The power and influence of hedge funds and sovereign wealth funds is often discussed and used to explain movements in the markets. However, individual investors as a group yield far more buying power and influence over the marketplace. When individual investors make up their minds, they can be a powerful and durable force in the markets.

In early 2009, cash flows for ETFs and mutual funds began to turn around. After a long period of selling, those vehicles that invest in the stock market have attracted over \$90 billion. These flows provide insight into what individual investors are doing.

We may be on the cusp of a multi-year period of strong inflows to stocks by individual investors, similar to the period from 1996 through 2000 or 2003 through 2007. Historically, investors have bought an average of \$14 billion per



## 2 Individual Investors' Inflows Begin to Turn the Corner



Since March of 2009, inflows have been rising and may mark a multi-year turning point for individual investor inflows.

month of stock market focused mutual funds and ETFs. There were three periods when fund inflows were below this trend.

- The below-trend period of the early 1990s, which was followed by strong investor demand for stocks over the following five years.
- The second period of below-trend inflows began in 2001, as inflows flattened and ultimately dipped well below trend until April 2003.
- The third period began in late 2007, when fund flows began to fall below trend as investors withdrew an average of \$2.25 billion from equity funds each week.

Each of these periods of below-trend inflows was followed by a period of above-trend inflows. These flows have historically tended to be sustained above or below their long-term trend for extended periods, rather than frequently reverse course. Since March of 2009, inflows have been rising and may mark a multi-year turning point for individual investor inflows. It is interesting to note that much of the inflows to stocks from these individuals have been to foreign and emerging market funds and ETFs rather than those that invest in the U.S.

Given the experience of the past decade, individual investors may be more cautious in their investing and allocate less to stocks than in the past. However, individual investors may also begin to save more, resulting in larger inflows to mutual funds and ETFs of all types. Even if stock-market-focused mutual funds and ETFs receive a smaller slice of the pie, the investing pie is likely to be larger because of increased savings. Therefore, inflows to stocks may not suffer from a potential change in investor behaviors.

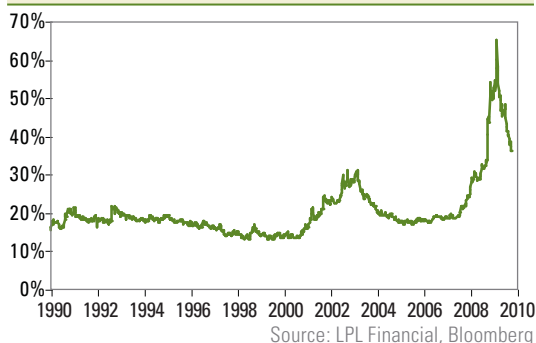
Individual investors do not need to wait for the return of job growth or a rise in their incomes to invest more. In fact, investors stashed \$2 trillion in cash into money market funds in the two and a half years leading up to the early 2009 market bottom. This cash has been drawn down by about \$700 billion as investors have been turning back to the stock and bond markets. However, cash levels remain elevated and may be drawn down further. Currently, the cash in money market funds is equivalent to over 30% of the value of the stock market, as measured by the value of all the companies in the S&P 500 Index. In early 2009, this reached nearly 70% compared to the long-term average of roughly 20%. The outflows from money market funds into stocks and bonds still have a way to go—totaling a trillion dollars—before this percentage would near the long-term average, leaving plenty of fuel to continue to drive inflows to stock market focused mutual funds and ETFs.

## Companies Have Been Selling

Companies issued both stock and debt in 2009 after having bought back stock at a tremendous pace during the mid-2000s. Many companies have opted to pay down debt and give themselves a cash cushion, lowering the financial risk, or leverage, in the firm. Share issuance set records during 2009 as many financial companies were forced to raise capital through stock issuance. In general, despite the net, new issuance stocks have performed well. The peak for new issuance is now likely past with buybacks likely on the way in 2010 and 2011. Corporations may become net buyers of shares in

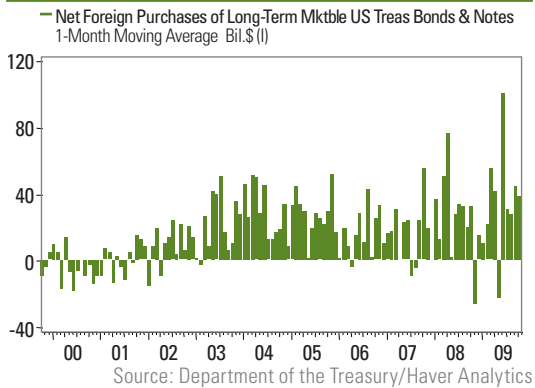
## 3 Buying Power

Money Market Fund Assets as a Percent of the S&P 500 Market Capitalization





#### 4 Foreign Purchases of Treasuries have been Strong



2010 as rising cash flow and wide profit margins compel them to shrink their share count to boost earnings per share.

#### Insiders are Still Selling

The ratio of selling to buying by insiders, or top executives, of S&P 500 companies has been well above average during each month in 2009. Some have expressed concern over whether this data should be seen as an important signal by those “in the know” of impending doom for corporate America. However, history offers a very different interpretation. Corporate insiders were buying in 2007 at the peak, and they have been selling in 2009 as stocks have been bottoming. That fact does not suggest that they are acting on any inside information that would benefit an individual investor. Back in August of 2007, around the peak of the stock market, insiders at Financials companies were doing the most buying in 12 years. At the time, this trend was interpreted by some as a buy signal for Financials just before the companies in this sector fell more than 80%. Given this track record, we do not interpret the insider selling in 2009 as a signal of impending losses.

#### Projecting the Trends

Overall, the buying and selling in the stock market has been balanced over the past month as the S&P 500 has remained in a range of 1090-1125. While there are many factors influencing our outlook for 2010, including the pace of economic and profit growth and the changes in global monetary and fiscal policy, we believe the buying power is likely to win out over the forces of selling in the coming months.

Similar to the stock market, the bond market has seen inflows from individuals and foreigners balanced in part by additional borrowing by issuers, including companies, and, of course, governments. Demand has been robust for corporate bonds, which led to the narrowing of the record wide spread between corporate and government bond yields early in 2009. Nevertheless, demand has been more balanced for government bonds with the negatives of rising issuance and investor risk appetite offsetting the increasing purchases by foreigners. Government bond yields have moved higher (and prices have moved lower) over the past year, but remain low by historical comparison. We expect that these trends, driven by the buying and selling, will moderate in 2010, but will continue directionally with rates rising modestly for government bonds, and spreads narrowing modestly for corporate bonds.

For greater insight into our outlook for 2010, please see our comprehensive publication entitled *2010 Outlook: From Tailwinds to Headwinds*.



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Stock investing involves risk including loss of principal. Past performance is not a guarantee of future results.

Small-cap stocks may be subject to higher degree of risk than more established companies' securities. The illiquidity of the small-cap market may adversely affect the value of these investments.

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Principal Risk: An investment in Exchange Traded Funds (ETFs), structured as a mutual fund or unit investment trust, involves the risk of losing money and should be considered as part of an overall program, not a complete investment program. An investment in ETFs involves additional risks: not diversified, the risks of price volatility, competitive industry pressure, international political and economic developments, possible trading halts, Index tracking error.

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