Dear Valued Investor,

Oil prices may be turning into the Grinch of this holiday season. Oil has dropped by more than 40% in just the past three months and contributed to volatile stock markets. LPL Financial Research does not believe the sharp drop in oil prices is a sign of significant deterioration in the U.S. or global economy. The stunning collapse does have wide-ranging impacts on the economy and markets, but LPL Research believes the risks associated with low oil prices can be manageable and that the positives outweigh the negatives.

Lower oil prices benefit the U.S. economy in a number of ways. By saving U.S. consumers tens of billions of dollars at the gas pump and in home energy bills, it is estimated that the $50-plus drop in the price of oil since June 2014 boosts U.S. gross domestic product by roughly 0.5%. That is significant, but it is important to keep in mind that U.S. consumer spending totals $12 trillion per year, and that consumers spend an average of just 4% of their incomes on energy. Still, this is a benefit to consumers, especially for those at lower income levels who spend a bigger portion of their incomes on energy.

The U.S. manufacturing sector is also a beneficiary of lower energy costs. Although not nearly as energy intensive as they used to be, industrial companies benefit from lower oil prices via lower transportation and production costs. Just a penny drop in fuel prices can save tens of millions of dollars for an airline. And lower oil and other commodity prices mean lower raw material costs.

These are all good things, but there are offsetting factors. Lower energy prices will slow—but not stop—the U.S. energy renaissance. Less U.S. energy production may mean slightly fewer energy jobs (energy jobs are about 2% of total U.S. jobs) and less business investment for future projects or expansion. The oil and gas industry drives a significant portion of business investment, so services, equipment, and infrastructure companies that service the oil producers will feel some impact.

Sharply lower oil has already impacted financial markets. The roughly 20% drop in the S&P 500 energy sector, which composes 8.3% of the S&P 500, may continue to drive increased volatility for the broad stock market indexes. The fixed income markets are also impacted, as energy composes about 15% of the high-yield bond benchmark, the Barclays High Yield Bond Index. Lower oil prices are likely to crimp profitability and may impact the ability of weaker companies to meet their debt obligations. However, it is expected that much of this negative impact is factored into market prices, and widespread defaults across the sector are not expected, should oil prices stabilize somewhere near current prices.

Most importantly, the U.S. economy is doing quite well and I think it may get a bit better in 2015, as highlighted in LPL Research’s recently published *Outlook 2015: In Transit* publication. I do not believe oil’s sharp decline should be interpreted as a sign that an economic downturn is forthcoming. It is very difficult to predict where oil prices are going from here, but the oil market has likely overreacted to supply pressures and should begin to stabilize over the next several months, as lower prices help buoy demand and discourage some of the higher cost production. Although the severity of the drop in oil prices has been alarming and brings some risk to markets, at this point, in terms of what it means for the economy, I believe the positives outweigh the negatives.

As always, if you have questions, I encourage you to contact me.

Sincerely,

Rick Fisher, CFP

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual security. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results. Indexes are unmanaged and cannot be invested into directly.

Economic forecasts set forth may not develop as predicted.

All investing involves risk including loss of principal.

Because of its narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies.

The Barclays U.S. Corporate High Yield Index measure the market of USD-denominated, noninvestment-grade, fixed-rate, taxable corporate bonds. Securities are classified as high yield if the middle rating of Moody’s, Fitch, and S&P is Ba1/BB+/BB+ or below, excluding emerging markets debt.

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