

## Boenning Morning Comment

*This report is prepared for us by Tower Bridge Advisors*

February 1, 2012

For the past several weeks, stocks have followed a familiar pattern, weak in the morning on days when worries fester in Europe and then a rally in the afternoon once European markets close. The last two sessions followed that pattern exactly but both times stocks finished with small losses. Despite the modest weakness, stocks had their best January in about 15 years, perhaps a harbinger of a good year if one of the most reliable indicators, the January barometer, works as it should this year.

Europe hasn't been the only concern. The strong and surprising economic data we saw just a few weeks ago has subtly shifted back to a slow upward grind. Perhaps the data item that best describes the world today came out this week when December personal income was reported to have risen by 0.5% but consumption was virtually flat. That resulted in an increase in the savings rate from 3.5% to 4.0%. Investors shouldn't take this as bad news. Bad news is when Americans spend beyond their means and dig a hole so deep that it takes a massive recession to clear the damages. It is a sign of prudence. I realize that a dollar not spent today is a haircut off of GDP growth. But it is a good haircut, if that is the proper term. Prudence leads to long term sustainable growth.

What is both curious and interesting is that this spending and savings pattern flies completely in the face of Federal Reserve policy that tries to convert savings either to spending or investment. Fed policy of zero or near zero interest rates that still possesses both risk and inflation, is one meant to penalize anyone who chooses to save rather than spend. It takes a strong will to resist the temptations. But after what we all went through in 2008-2009 when we all failed to resist the devil's offerings, maybe our behavior today makes sense.

Have you ever gone to dinner and stuffed yourself completely? We all have. Then the waiter comes by with a dessert menu that includes your all time favorite double rich chocolate cake. Not only is it on the menu, it's today's special at 50% off. But you can't eat another bite. You push yourself away from the table. But the waiter gives it one last try. He tells you that this is the end of the evening and, since the cake is going to waste if you don't eat it, he will give it to you for 70% off, may even for nothing. But you can't put another bite in your mouth. You refuse.

In business, there are similar times when we have enough. When warehouses are full, you can't take on any more inventory. When credit lines are stretched, you can't buy anything else. We went through that three years ago. We don't want to repeat it. Today, warehouses aren't full and we usually don't stuff our mouths so completely that we can't eat even one more bite. But we don't care to ride at the edge of cliff anymore and we back away sooner. Time and experience trains us to be more prudent. Once burned, twice shy.

But the Fed keeps trying. It expands the money supply as fast as it dares and it tries to push interest rates as low as it can. Around the edges, the policy works. Some give in to temptation, just not enough to make the cost worth while. Savers are robbed of approximately \$300 billion per year in interest income, money that can be spent. That sum isn't tiny. It approximates 2% of GDP. Does all the added spending and investment from those taking advantage of easy money offset the loss in interest income? Economists will argue both sides for years to come. From my own standpoint, I don't see how the pluses outweigh the minuses. Nor do I see how imprudent behavior (excess borrowing to foster today's spending) should be viewed as "better" than the act of saving in moderation.

Thus, when I look at our economy today and see (a) steady but modest growth, (b) moderate declines in the unemployment rate, and (c) prudent savings and expense control, I see an economy healing. It will be a long multi-year process but everything is moving in the right direction.

Remember that markets go up as problems get smaller and go down as they get bigger. Europe has added liquidity measures that drastically reduce the near term risk of catastrophic default. Portuguese interest rates may be rising but Portugal doesn't have refunding needs until next year. There is little question that the country will require EU and ECB assistance. But it is a problem that can be dealt with after the Greek fiasco is put to bed. Italy and Spain still have lots of problems but both are able to fund current needs at lower interest rates than just a few months ago. In the U.S., we continue to grow, we continue to hire, and profits are rising slowly. Problems are getting smaller. There aren't getting smaller rapidly and they aren't disappearing. But the fact that they are getting smaller is the key.

That doesn't mean the stock market is going straight up. It never does. But it may mean that corrections will be more moderate than we have seen the last two years unless a new fundamental problem of large proportions emerges. Europe isn't that far out of the woods to preclude that from happening. But there aren't any indications that efforts to move ahead are unraveling. There will be days when discussions to solve the Greek debt crisis break down. There will be days when Italian and Spanish interest rates rise. There may be a change of leadership in France that will require some adjustment to dynamics. And there is always the threat of floods, earthquakes and storms to react to. But these red herrings never go away. After rising 10-15% in about three months, stocks need a rest. Some time has to pass to allow investors to adjust to new price levels. If prices fall 5% plus or minus, it may get bargain hunters off the fence. It is a time to wean losers and a time to get one's shopping list ready. I don't think it is a time for unwarranted fears.

Today Lisa Marie Presley is 44. Don Everly of the Everly Brothers is 75.

**I will be away until February 18. The next letter from me will be on February 22. In my absence other Tower Bridge Advisors portfolio managers will be writing periodic comments. I hope you enjoy what they say.**

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Additional information is available upon request.

\* - Boenning and Scattergood may act as principal in buying this stock from or selling it to the public.

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