

Boenning Morning Comment

This report is prepared for us by Tower Bridge Advisors

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The Dow made it 8 in a row yesterday, one of its longest winning streaks in recent memory. Everyone is beginning to feel good. So it is probably time to start cashing in a few chips. While a lot of market watchers worried that traders might begin to take profits once we passed the one-year anniversary of the start of the bull market, the reality is that not that many investors started buying on March 10, 2009. Those that claim they did are the same people who swore they were at Woodstock or seated right behind home plate when Tug McGraw struck out Willie Wilson to win the World Series.

To be sure, there are good reasons for the solid market. In a nutshell the economic problems we all face are getting less bad. Housing isn't improving much but it isn't getting worse. Prices are actually starting to rise in markets like California. Employment isn't shrinking anymore. Soon will it will begin to grow. Bank losses are moderating. Even the national deficit will start to fall as tax revenues begin to increase. Recessions and bear markets happen when problems increase, not when they decrease.

But that doesn't mean the stock market is immune from correction. It is very hard to find bargains today. A 10% rally has a way of clearing off the bargain shelf. The phrase "I missed it" is being uttered a lot today. A 2-5% correction will once again provide an entry point. I am not smart enough to tell you today is the precise top or not nor can I tell you the size of the next correction. But with an improving economy, I can say that intermittent corrections are healthy, they are part of the process, and there is no need to make any serious changes in your portfolio in front of a modest downward move. If there is to be a 4% correction, for instance, and you are two percentage points late getting out and getting back in (that could be just one-day at each end for all we know), you would end up spinning your wheels. Over the past couple of years, traders have been screaming that buy-and-hold was a dead concept. I would argue that since March 2009, it has been the best concept of all. Obviously, when the market goes down 50% buy-and-hold or, for that matter, anything-and-hold doesn't work. Only cash works. If a hurricane approaches one boards up the windows and heads out of town. The same applies to investments. Yet here we are just a year later and it is amazing how many stocks have recovered back to rather normal levels.

However, since we don't live within a fairy tale, there must be something to concern ourselves about and indeed there is. In a word, I think that something is taxes.

This economy already has its share of headwinds as recovery evolves. Americans are overleveraged and have begun to do a rather good job of paying down some of their debts while moderating spending to live within their means. But now Congress is set to add a few more headwinds. The President would like us to believe that couples earning less than \$250,000 per year are immune but that really isn't quite accurate. Let me delineate what is already on the table.

With the pending expiration of the Bush tax cuts, the capital gains rate next year reverts to 20%. That affects everyone in theory but most Americans don't directly buy stocks and bonds and many of those that do have loss carryforwards courtesy of the last bear market. So I won't make a big deal of that change for the moment. Dividends have been taxed at 15%. If the Bush tax cuts end as things now stand, the rate on dividends becomes the marginal

rate of the taxpayer. That can go as high as 39.6%, a rate that also represents an increase from current levels. Most insidious may be the last minute change swept into the House package being voted upon this weekend. Medicare taxes for anyone earning more than \$200,000 (or for couples earning more than \$250,000) will go to 2.9% on all unearned income including dividends, interest, rents and royalties and it will start from dollar one. Couples making \$249,000 needn't worry. Those making \$250,001, all from dividends, interest, etc., will pay a brand new tax of \$7,250. I can throw in taxes and penalties for individuals and companies that don't buy adequate insurance.

Can they afford these taxes? Sure. But the money has to come from somewhere and clearly the vast majority will come from consumption spending. Assuming health care reform passes this weekend as appears increasingly likely, start changing your economic models for 2011 and beyond to reflect these tax changes. There is other tax legislation pending but after health care is a done deal, up or down, it is questionable how willing Congress is going to be in an election year to do anything tax-related. There have been proposals to raise the capital gains tax further. There have been proposals to limit the increase on the tax on dividends. The federal estate tax is zero in 2010 as things now stand and goes to 55% in 2011 and beyond. Everyone wants to alter that but there remains no consensus how. Cap and trade (or more appropriately, cap and tax) is still out there as is financial reform.

The bottom line is that taxes on the moderately wealthy are going to rise sharply while taxes on the middle class will rise modestly. Private health insurance premiums will also continue to rise sharply as more Medicaid and Medicare deficits are shifted to the private sector. At some point there will be obvious pushback. The new law sets up review panels to keep insurance companies from earning excessive returns. But as states can fund less and less of their Medicaid burden and as the Federal government cuts its own Medicare payments but hundreds of billions of dollars, the cost shifting appears inevitable.

What is also interesting about the new bill is the politics. The House revisions, just disclosed in the last 24 hours, are less onerous to the drug, hospital and device companies than previous versions of the bill. I am sure that can be credited to the lobbying efforts of the health care industry. The offset is the higher Medicare tax just noted. By the way, please note that the higher Medicare tax doesn't go to cover Medicare costs. Only part does. The rest goes into the grand pot to cover the overall cost of the new legislation even though the Medicare gap remains enormous. So much for math and logic. Also note that many of the provisions that cost the government money are being deferred for an extra year or two to make the numbers work. It is all part of the game Washington plays, a game Americans are hating more and more every day.

So what's the bottom line as the health care debate reaches its conclusion. In simplistic terms, the bill represents a vast expansion of the government's role paying for health care. It is essentially an expansion of Medicaid funded by higher taxes on those earning over \$200,000 and by required insurance premium payments by those young and healthy able to afford the insurance premiums. The costs to health care providers are likely to be modest. Higher taxes and levies will be mostly offset by higher volumes. Unless the Federal and state governments can cover a greater portion of the costs (mostly Medicare and Medicaid), the cost shifting toward the private sector will ultimately create such a huge skew that further changes will be required, either to move toward a national health insurance scheme or to vastly alter in some other fashion the way health care is delivered in our country. But that is a story for another day farther down the road.

Let me finish and just outline process as I understand it. The House, presumably on Sunday or very early next week, will vote on two measures. One is the Senate bill already passed. The other is on a set of changes. If it passes the Senate bill, that goes to the President for signature. The bill containing the changes goes back to the Senate under reconciliation procedures that only require 51 votes for passage. But reconciliation can only be used for budgetary

matters and it is quite possible that certain House changes don't qualify for reconciliation. That is a decision to be made by the Senate Parliamentarian. If the Senate alters the House changes in any way, the changed bill will have to go back to the House to approval again. In other words, the bill containing changes must be identical in both Houses. Whatever changes are passed goes to the President for signature. If no changes are passed, the Senate bill becomes the law of the land. That is a concern of many House members on the fence today.

Futures suggest a flat opening.

Today Bruce Willis is 55. Glenn Close is 63. Ursula Andress turns 74.

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