# Boenning Morning Comment

*This report is prepared for us by Tower Bridge Advisors* March 29, 2010

Stocks finished mixed on Friday. The weekend was dominated more by political rhetoric than anything else. The euro has rallied a bit overseas and that is helping commodity prices and futures this morning. This will be a shortened week for equity investors with the Good Friday holiday coming on Friday. It is also a week that finishes out the first quarter of 2010.

In many ways this will be a bit of an unusual week. With the quarter ending on Wednesday, there will only be two days at the end for early March data to be released. Sometimes, during the first week of a month, investors feast on all sorts of numbers from employment to manufacturing data, from auto sales to retail chain store sales. But equity markets will only be open on Thursday so the only data traders can digest will be the ISM manufacturing survey and monthly auto sales. The big employment survey numbers come out Friday when U.S. equity market closed although currency markets will be open and the bond market will be open until noon. Non-manufacturing ISM data and weekly chain store sales will have to wait until next week. We will get a hint on the employment numbers Wednesday when the ADP forecast comes out but that has not correlated so well with the Federal numbers and because it only reflects private sector jobs, the survey cannot account for a likely jump in census workers. This month's employment data is particularly important because estimates are very buoyant. A combination of a recovering economy, a surge in census workers and a recovery from bad winter weather are all expected to show that March created 100,000-300,000 jobs depending on which forecast one reads. Clearly, some of that optimism has been built into stock prices over the past couple of weeks. I note always that the Federal numbers for any given month offer a lot of variation that gets adjusted in subsequent months. Thus, I would take whatever number comes down the pike on Friday in context. It should be positive and it should be consistent with a recovering economy.

Indeed, while bears don't hibernate in the stock market in winter or in any other season and I will get to some of the bear fodder in a moment, it is my belief that the overriding conclusion one can make about the current state of the U.S. economy is that it is growing at a moderate pace and it is surprising most observers by its quality, durability and persistence. Don't take that statement to be predictive in any way. I don't mean it to be. I mean it to be an observation.

You don't have to read the numbers. All you have to do is leave the Walden Pond cabin, head down to Main Street and look around. Stores are active. Restaurants are full. People's moods are 180 degrees different than they were a year ago. Certainly consumers developed a sense of caution and thrift during the recession and they aren't abandoning it now. But all the abject fear of a year ago is gone. I used the word all and probably I shouldn't. Clearly those unemployed or those in dire straits otherwise aren't impacting my visual image because I don't see them so easily. But with that said, we appear to be entering a point in the cycle when businesses will start to invest and grow, when employment will start to rise, and when the economy can begin to sustain itself as government's wean us off of stimulus.

Last week, the big health care reform package finally became law. The Democrats beat their collective chests and celebrated while conservatives went to Tea Party rallies and talked of repeal. But there isn't going to be any repeal and the Tea Parties make for interesting (?) conversations on the Sunday talk shows but really have very narrow total appeal. Trying to stay out of the political fray, at least for the moment, the economic reality is that most of the pieces of the economic puzzle are falling into place. We know the Bush tax cuts are going to end next year although it isn't clear yet what taxes will be on dividends. Taxes associated with health care are scheduled to phase in over the next 3-4 years. That schedule is law as are requirements employers face relative to health care coverage. Cap and trade appears dead. Some sort of financial reform is likely to pass but away from banks and Wall Street, that won't be particularly pertinent. Thus, most companies now know the rules of the game and, as I have been contending for some time, once the rule book is written, companies can make their plans and map out strategies. Some may hire less than they would have without the new tax and health care requirements but that doesn't mean they intend to stop hiring or stop growing. Good companies adjust. They adjust continually.

As for all the bearish mantras that the world is coming to an end, I think I can offer two instructive cases demonstrating how the bears overstate their case and that investors fearfully sit on the sidelines in cash earning just a few basis points are suffering as a result. First, I will point you to a lead story in today's Wall Street Journal. The title says it all. "Mortgage Increases Blunted". The opening paragraph reads, "The struggling housing market appears as if it will sustain less damage than expected this year from a spike in the monthly payments on hundreds of thousands of exotic adjustable-rate mortgages." For months, maybe even longer, the Chicken Littles of this world have been warning of a foreclosure explosion resulting from a crest in adjustable rate mortgages. But the bears forgot two lessons. The first I just mentioned. People adjust. Second, as I have pointed out many times, lenders don't want to foreclose and borrowers don't want to be foreclosed. This headline follows the fact that the commercial real estate lending market never collapsed either for precisely the same reasons.

The other instructive lesson takes place in New Jersey. Under Jon Corzine, New Jersey spent heavily to expand services right into and through an ugly recession. It got to a point where, despite the highest tax structure in the nation, it still faced huge deficits. It became crisis time. Voters revolted. People began to move. A new governor, Chris Christie was elected and he has moved quickly to whack away at the fiscal mess. He cut all the fat he could. He stopped some programs in their tracks. He angered a lot of people and businesses along the way. He even cut some muscle. Crisis forces that sort of action. Is he doing the right thing? Like all major political transformations including the most recent health care reform, some steps are right and some will require mid-course adjustments. But it is refreshing to see a politician do what he was elected to do. My point is that most problems are fixable although the pain becomes greater if you wait too long. Eventually, the Federal deficits and debt will force action. When? When the politics and economics dictate change. Were last week's weak Treasury auctions a harbinger? Maybe but to overstate a 10-15 basis point increase in rates is probably going too far. However, if rates do jump too far too fast, Washington will have to adjust. At first, the adjustments will be in the form of rhetoric but if rhetoric doesn't work, clearly overt steps will have to be undertaken.

But I really don't believe this is a 2010 or a 2011 problem. A rising economy and higher tax rates are likely to yield an upside surprise to Federal revenues over the next 12-18 months. The increase in capital gains rates may even create a revenue bubble as some investors seek to take last advantage of 15% long term gain rates before the end of 2010. That doesn't mean that I don't believe we are on a road to economic calamity. We are on that path. But we don't have to reach the end and I see little likelihood that we will get to that point in the next 2-3 years. It would be nice if President Obama addressed fiscal responsibility before his first term ends. At times he talks the game but at other times he clearly looks the other way. Everyone, even the most liberal Democrat knows the gamesmanship that took place getting health insurance reform passed. But now that it is passed, it has to get funded legitimately to work and that remains a task at hand. The entitlement programs that have been off limits for so long can't be off limits forever. The President has hinted that Social Security reform is going to be on the agenda. I hope so. We'll see.

But that isn't today's problem and today equity investors are rightfully optimistic. First quarter earnings will be good but more importantly, we are beginning to see top line growth as well. We are still a consumer driven economy and the consumer is spending once again, not at the rates of two years ago but spending nonetheless. As long as that continues the path of least resistance is up.

Futures point to a higher opening.

Happy birthday to my son Eric. Also celebrating today are Jennifer Capriati who, like my son, turns 34 today, and model Elle MacPherson who is 46. Closer to home for equity investors, today marks the 92nd anniversary of the birth of Sam Walton.

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