

Boenning Morning Comment

This report is prepared for us by Tower Bridge Advisors

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Stocks advanced again on Friday capping another solid week. Already this morning there has been a string of solid earnings reports led by Dow component Caterpillar (CAT-\$69#). Futures suggest the winning streak, now eight weeks long, will continue.

The headlines in the newspapers continue to center on financial reform. Over the weekend, Democrats agreed to toughen the measures surrounding derivatives trading. The first major procedural vote in the Senate takes place tonight and it will be interesting to see whether Republicans can hold together as a block to prevent debate from moving to the Senate floor. Although they could succeed the first time around, public sentiment for some comprehensive form of regulation is growing as is Congress' unfinished agenda of business. Thus, it is doubtful whether Republicans can kill reform altogether. Indeed, there are probably relatively few Republicans who believe the status quo is the best solution. Ultimately, I would expect some modest changes, perhaps surrounding the bank funded pool of money to help support big banks labeled as systemically risky, and then the bill will move fairly quickly to completion. More comments and e-mails from major banks, particularly Goldman Sachs, are being used to stoke to anti-business sentiment but the notion that betting the short side of the trade is bad is not only not illegal, it is the market's own self-policing mechanism. The e-mail quotes splashed across The New York Times and other sources are mostly taken out of context and shouldn't help or restrict legislative efforts.

Greece still remains in the news. Greece wants Eurozone members to bail it out of its own mess and most don't want to do anything more than they have to. Greece is a minor player even within Europe. One side suggests a bailout is the right idea to prevent contagion to other nations. Others suggest to let Greece fend for itself and be forced to restructure its own debt. Such a move would send a clear message to the rest of Europe, particularly those nations still spending beyond their means, to get their houses in order quickly. My own guess is that a bailout is simply a case of kicking the can down the road. No matter how big the support package might be, Greece would still be a nation with too much debt, an albatross that won't disappear quickly. I don't see how bailing out Greece is going to convince anyone that Portugal and others won't simply be the next in line. Plenty of nations in the past have been forced to restructure debt without creating a worldwide crisis. If that becomes necessary for Greece and a few others, it is a rather small price to pay for the fact that a few nations got too greedy and too leveraged in good times. But with that said, the odds that Greece will get some sort of bailout are increasing and that suggests the sovereign debt mess won't go away any time soon. As soon as Greece gets economic relief, if it does, you can count on the market to put pressure on Portugal and then other Eurozone nations in serial fashion.

The tax credit for first time home buyers ends this Friday. To be eligible for the credit homes to be purchased must be under contract by Friday at midnight and the sale must close by the end of June. There has been an obvious flurry to meet the deadline and skeptics suggest that a nascent housing recovery will end at the stroke of midnight on Friday. But while there will almost certainly will be a temporary lull in home sales to follow, just as there was a temporary drop in car sales after the cash for clunkers program ended, I believe the housing recovery is finally with us. Obviously, the tax credit will pull purchases from first time home buyers forward and will affect trends in the short run. But just as not all that many people had 10-year old gas guzzlers to sell and take advantage of the clunkers credit last summer, many potential home buyers and sellers are not first times.

Looking at decades of historic data, it is our belief that there are approximately 1 million more vacant housing units today than normal. Add to that about 500,000 more foreclosures than normal and there is an excess of about 1.5 million housing units that have to be absorbed before housing can return to normal. There are some who will argue that my 500,000 incremental foreclosure number is way too low but I would counter and note that I am looking at actual bank repossessions, not short sales, not foreclosure filings and not delinquencies. That is because I am focusing on the excess supply of vacant units. Short sales and delinquencies don't result in vacancies. Housing starts today are running at a bit over 600,000 annualized or about 1.0-1.2 million units below what normalized housing starts should be if I consider population growth, new household formations and teardowns. So let's do the math. If production is about 1.0-1.2 million units and the excess inventory is about 1.5 million units, then the gap should close in a bit more than a year. Housing is very regional in nature. Some markets will reach equilibrium a lot sooner than others. Places like Las Vegas or Miami may not get there before 2013 while others will get there in 2011.

What I find fascinating about the housing story is how it will potentially be reflected in the overall economy. Normally, low interest rates spark new demand for housing and that is why homebuilding is considered an early cycle industry. But not this time around. We are already many months into a recovery and new home construction is still less than half of normal. But it will return to normal at some time. If that means at least 1 million additional annual housing starts, the boost to GDP directly would be over \$200 billion. To that one would have to add a multiplier effect because new home construction benefits mortgage bankers, title insurance companies, makers of everything from paint to appliances, and the home improvement stores. Thus, the boost may be \$300 billion or even more. I cannot recall a time when housing provided an economy a mid-course boost of this size. It will go a long way toward offsetting the removal of fiscal stimulus. In theory, that is exactly what should happen. Fiscal stimulus becomes unnecessary when the economy can stand on its own two feet.

Futures this morning point to a modestly higher opening.

Today Bobby Rydell is 68. Carol Burnett is 77. Architect I.M. Pei turns 93. Among his work is L'Enfant Plaza in Washington, the Society Hill Towers in Philadelphia, the Kennedy Library, and the glass Pyramid at the Louvre.

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Additional information is available upon request.

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