

## Boenning Morning Comment

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

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Stocks fell sharply yesterday after the Greek sovereign debt crisis worsened and Standard & Poor's lowered the rating on Greek debt to junk status. Seven Goldman Sachs executives, led by CEO Lloyd Blankfein, testified before a Senate panel. That certainly took center stage in the media. Judging from the price movement in Goldman's shares yesterday, its management avoided major mine fields. Its stock was up in a sharply lower session. But I doubt any real winners emerged from that performance yesterday. More in a moment. Lest we forget, the FOMC began a two-day meeting in Washington which will culminate in a 2:15 statement on interest rates and the economic outlook this afternoon. Throw in a few nice earnings reports and a nice jump in consumer confidence and it was quite an eventful day.

Let me start with the Goldman saga. After more than 10 hours of hearings, many quite contentious, it appears that the government failed to unearth anything new tawdry information that would cause Goldman any further legal risk similar to or worse than the SEC suit already filed. That is probably the immediate reason its shares managed to rise in a down market. But Goldman certainly didn't come out a winner. Anyone who watched the grilling, often very overbearing and one-sided admittedly and Goldman's indecisive responses can't feel very comfortable with today's status quo. Indeed, from a political vantage point, Goldman's harshest critics on the Senate panel yesterday, including Chairman Carl Levin, were using the hearings as a bully pulpit to push passage of financial reform legislation. Public sentiment in favor of reform was probably accelerated by yesterday's hearings. To that extent, Goldman and the investment banking community in total was a loser.

The subject of the hearings was very arcane and not everyone understood what was going on. That may include some Senators. Others who did understand clearly twisted the story to meet personal needs. Senator Levin clearly knows the difference between gross and net positions but chose to emphasize the big gross short positions to make his point. However, one thing became clear. Even though Goldman may have done little or nothing illegal, clearly it creates a lot of potential conflicts when it opts to represent both sides of the trade or when one side of the trade is Goldman itself. As the sub-prime crisis matured, Goldman went from having a very heavy long exposure to the mortgage market to taking on a healthy short position. To accomplish that, Goldman had to be large sellers for its own account and, to accomplish that, had to find a commensurate number of buyers. It would be nice and rather idealistic to assume that there was a universe of eager buyers waiting to add exposure to deteriorating housing market but more likely, Goldman's sales force had to work diligently to convince customers to buy what it didn't want to own for its own account. Any three year old can understand the obvious conflict. Goldman would like everyone to believe that it always puts its customer's interests first but conflicts like this will always persist when Goldman is on one side of the trade as principal and a customer is on the other side.

What this is likely to mean is more support for the Volcker rule that will prohibit certain forms of proprietary trading in the financial reform package. Perhaps the Volcker positions could even be strengthened after yesterday's testimony. That would further limit the profit making opportunities of Goldman and related financial institutions. What is also clear from yesterday's testimony is that some so-called sophisticated buyers aren't all that sophisticated and have to be protected from themselves. For centuries, banks and other financial institutions have made remarkably stupid investment decisions at the top of economic cycles. They have consistently lowered credit

standards at exactly the wrong time. This past cycle that was exacerbated by extreme leverage. Some safeguards are needed to protect banks and others from themselves. The Abacus transaction that is the center of the Goldman SEC suit demonstrates exactly that point. While Goldman and Paulson are portrayed as villains by the SEC, one has to question what a bank, insurance company or pension fund is doing buying any interest in a synthetic CDO built upon a pool of BAA-2 mortgages. Lest we forget, the major catalyst for a collapsing financial system was excessive leverage and inappropriate investments by major financial institutions.

While Goldman took center stage in the media yesterday, the stock market took its cue from Greece. Greek credit spreads have widened so far that it is virtually impossible for Greece to solve its liquidity needs independently any longer. It needs Eurozone and/or IMF support. Germany, the lead player in this drama, still claims the support is coming but it is still unclear how that will happen and it is uncertain whether the initial package will be sufficient.

If you think back to 1998 and the currency crises in Asia, financial vultures started with the Thailand baht and went serially through Southeast Asia attacking the currencies of Korea, Indonesia and even Russia before finally China and Japan proved strong enough to withstand attack. Today, since all the weakened and suspect European nations use the euro, there won't be attacks on the currency itself. Instead, the attacks will be on sovereign debt through short sales, credit default swaps and other derivative securities. The European Community is going to have to decide where it intends to draw its line of defense. Will one or more weakened nations be forced to restructure their debt? Will the euro itself survive? Can the strong nations like Germany and France let Greece fall on its sword and still hold the EU together? At the moment we have more questions than answers. But if there are going to be several months of serial attacks on sovereign debt, stocks could be in for a rocky ride. Whatever the outcome, it is likely that Eurozone growth rates are going to be negatively impacted as multiple nations are forced to move in the direction of austerity. At the moment the impact on U.S. GDP growth is likely to be minimal, certainly far less than a full percentage point. But the drama bears watching and has the potential (potential, not probability) of spinning out of control.

Finally, the Fed meeting today should be a relative non-event. Rates will remain unchanged and the post-meeting statement will still suggest that rates will remain low for an "extended period". Analysts will be looking to see whether the Committee gives further guidance as to how it plans to begin withdrawing liquidity. Recent reports suggest that is a fairly sharp divide as to how aggressive the Fed should be selling assets from its enlarged balance sheet back into the market. There are some who see a healthy accelerating economy ready to absorb such sales. Others think the recovery remains fragile held up by easy money and fiscal spending. I doubt whether we will learn anything earthshaking at 2:15 but I always note that stocks do strange things on FOMC meeting dates in the last hour and forty five minutes. Stay tuned.

Futures are up this morning. We have seen several one-day drops like yesterday over the past year but rarely have we experienced two real bad days in a row. After eight straight up weeks, some profit taking is in order but I want to see more than one big down day before becoming too pessimistic. The biggest mistake an investor could have made over the past year has been to bet against the market and a recovering economy. But if the sovereign debt crisis starts to move serially across the European continent, we could finally hit the rough patch many have been looking for. It shouldn't derail the economic recovery but it could cause some pretty good temporary angst.

Today Penelope Cruz is 36. Jay Leno is 60. Ann-Margret turns 69.

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Additional information is available upon request.

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