

## Boenning Morning Comment

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

April 9, 2010

Stocks started off slowly continuing Wednesday's decline but rallied in the afternoon after very strong March sales reports from the nation's leading retail chains began to sink in.

On most days, during at least part of my commentary, I try and point out the clouds on the horizon that might become the rain makers that could spoil our party. Today, I am going to do something different. I am going to be blindly bullish. I want to go through the exercise because (1) it is a believable scenario, and (2) given that all of us still dance on eggshells courtesy of the two huge bear markets of the last decade, no one really wants to sound like a Pollyanna even if the cards light up in ways to support that conclusion. So let me lay out a bullish case and then see how much sense it all makes.

I will start with valuation and I will use consensus S&P 500 earnings estimates to do so. The S&P closed last night at 1186 within a whisker of its recovery high. Consensus forecasts right now going into Q1 earnings season are for earnings this year of \$78 per share and earnings next year of \$94 per share. I have little doubt that Q1 earnings will beat expectations by some margin and that the \$78 target will rise over the next few weeks. But, for now, that's the number I will use. 50-100 years of history suggest that a median P/E for stocks based on forward looking earnings is 15-16x. 15 times \$78 is 1170. 16 times is 1248. If I stop here, it would appear that stocks are reasonably priced and the story is over.

But wait. Within a few months, investors will begin to focus on 2011 earnings. 15 times \$94 is 1410. 16 times is 1504. 1504 is 27% higher than the S&P sits today. The all-time high in late 2007 is 1565. Could stocks recover all the way back to prior highs in just a couple of years?

Why not? \$94 would be record per share earnings for the S&P 500. The nation's population would be 10-15 million larger than it was at the 2007 peak. By the end of 2011, I would presume that most bank balance sheets would be healing and bank capital ratios would be much stronger than they were in 2007. Unemployment would still be high but falling. Foreclosures will be in decline, maybe even rapid decline. Ignoring for the moment some unforeseen political catastrophes which I can't deal with, there will undoubtedly be some minor sovereign fiscal issues still making front page news. But if earnings in 2007 are a record and employment is rising, then tax receipts will be rising as well. What ever fiscal problems exist at state or Federal levels, they will be on an improving path in 2011.

Bear markets are created by imbalances. They can be physical imbalances (too much demand, too little supply), or they can be credit imbalances. Looking out longer term sovereign credit imbalances will have to be dealt with. Nations like the U.S., Britain and Japan owe too much and nations like China and Brazil have too many dollars, euros and pounds. But it won't be a problem in a strong economy with strong trade flows. 2011-2012 shouldn't be a time for bear market imbalances to surface.

On a very long term basis, moving back over 1500 and not moving through all-time highs decisively would keep our stock market stuck in the same channel it has been in for over a decade. It would be consistent with the notion that markets trade in broad 15+ year cycles moving sharply higher in some periods alternating with others that look like

range bound sine waves. As we approach the top of the cycle again, and I can't tell you exactly where the current upleg will stop or when, the sovereign debt imbalances, rising inflation, or some other factor will surface in a serious enough way requiring some monetary intervention and probably another bear market. The next bear market doesn't have to be a 40-50% correction but it will likely extend the 2000-20?? cycle into one that will get to the 15+ year size before all is said and done.

How will markets break out of that pattern? I don't know yet. Clearly China can't keep its currency fixed indefinitely. Clearly, the U.S. can't run \$1 trillion deficits annual. Clearly, Japan can't allow its debt/GDP level to rise significantly higher. Clearly, the EU has to balance the needs of strong nations like Germany with its weaker members. Failure to fix any of those could seed the next crisis. Solving the problems could allow the next upleg to begin.

But I am getting way ahead of myself. For now my conclusion is clear. There is nothing that I see preventing markets from rising another 25% or even more over the relatively short term. And that does not allow for additional gains if speculative fever strikes. P/E ratios of over 20 are not uncommon at all. There is no froth whatsoever in this market. There are no superhot groups of stocks. There is no IPO boom. The American public is buying bond funds. They buy whatever worked yesterday and never look ahead. If they must buy stocks, they are buying international stocks. Both the dollar and U.S. stocks are getting no respect. In fact, this may be the most disrespected bull market I have seen in decades. No one trusts it.

That is why I think it has quite a ways to go.

It won't be a one-way street. All the issues I talk about every day will flair up here and there. But assuming the \$94 estimate for next year is even close, I think stocks will do very well over the next year. I don't have to look any farther than that right now.

Futures point to modest gains this morning.

Today Cynthia Nixon is 44. Hugh Hefner is 84.

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Additional information is available upon request.

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