

## Boenning Morning Comment

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

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Stocks went for a wild ride yesterday opening sharply lower on a multitude of continued fears but then clawed their way back almost to break even by the end of the session. If we think back to last Friday, we had a sideways session that spiked 125 points late in the day followed by Monday which was the reverse falling about 135 points in the last 20 minutes. Then Tuesday came which saw the fear swell based on everything from Spanish bank troubles to war in Korea but calmer heads largely prevailed. This morning, the picture is brighter. Maybe all this turmoil over 3-4 days, which hasn't done a whole lot of cumulative damage, will set the stage for a temporary bottom.

The memory of the fall of 2008 is too recent. Our nerves are still very raw despite the nice rally since March 2009. Thus, when Greek debt issues hit the front pages, it hit investors probably a bit harder than it should. In 2008, toxic mortgage debt infected the entire U.S. banking system and almost caused the collapse of financial markets worldwide. It isn't very hard to extrapolate a story that says toxic Greek debt spills over to Spain, Portugal, etcetera and then infects the entire European banking community which then leads to a virtual replay of 2008. Add in the nutty trading session of March 6 to remind everyone that 1000 point drops can come out of the sky and you clearly have the seeds for investor panic.

Panic and fear are always based on some degree of truth. Greek debt is a real problem and it is highly likely that Greece will have to restructure before all is said and done. Holders of Greek bonds, including several large European banks, will have to book losses. There are other truths in the mix as well. European banks didn't raise as much capital as American banks did over the past two years and are on shakier ground. Other southern European nations have debt and deficit issues requiring correction. Ultimately even the larger developed nations like France, the U.K., Japan and even the United States have fiscal roadmaps that are unsustainable. By 2015 if the U.S. tracks its current planned budgetary course, government spending will be 26% of GDP (versus a normal range of 18-22%) and revenues will still be below 20%. Markets simply won't allow that to happen. Between now and then we are going to have to raise overall taxes a lot (not just on the rich) or government is going to have to shrink. Said differently, entitlement program expenses are going to have to be better matched to revenues. That is the only way gaps of that magnitude will get closed.

Over the past week, European nations have already begun to march down that path. We have already heard from or expect to hear shortly from Spain, Germany, France, Italy and the U.K. It is an impressive start. It won't suddenly recapitalize banks and it won't eliminate any problems overnight. But real steps are what are needed and tentative first steps have already been taken. That's good and might be all that one can expect at the moment. Some want more of the candy central banks have been handing out for years, namely quantitative easing whereby banks simply print paper and buy back the excess debt nations issue. That feels good when it happens and it is sometimes necessary at points of maximum stress. But quantitative easing doesn't solve any structural problems. Quite the contrary, it gives nations cover to avoid the pain of solving the issues.

The reality is that the debt crisis of Europe simply isn't 2008 all over again. There are no SIVs, no big synthetic loan pools built around sovereign debt, and the size of the problem isn't anywhere near the size of the U.S. mortgage market. But it is a real problem and the resolution is almost certain to do two things. First, the problem is severe

enough to create some failures. Over the past weekend a small Spanish bank failed. There will be other bigger cases along the way. Second, austerity steps nations take to begin realigning revenues and expenses will certainly slow the rate of European recovery. The world's developed nations, because of demographics and other factors, can simply no longer afford the social programs in place today. That includes us. The solutions are obvious. Since most nations aren't going to want to tax more, the benefits given will have to be rationed in some manner. Each nation will have to redesign its social fabric to best fit its nation's needs but all will have to act over the next several years. And it is clear to me that this is a several year project.

Therefore, panic aside, what markets are doing is adjusting very quickly to a new reality. Austerity subtracts from growth. So do higher taxes. So does increased financial regulation although it is still unclear how onerous that is going to be. As I said on Monday, U.S. GDP is currently growing about 3.5%. If you look forward at the negatives (higher taxes, slower growth in Europe, pressure on export growth from a weaker euro, the burdens of increased regulation, no \$787 billion stimulus package) and weigh them against the positives (lower interest rates, population growth, modest productivity gains, and perhaps a gradual recovery in housing), it is hard to see how 2011 is going to shape up to meet previous expectations of continued 3-4% growth. While analysts haven't begun to take down their 2011 earnings estimates yet, the stock market has already begun to adjust.

If you look back over the past week or so at the market, stocks hurt the hardest have been those tied closest to the economic cycle (e.g. the industrials), commodity-based companies (e.g. energy) and companies with large exposure to Europe. U.S. centric companies, those with large bases in Latin America and Asia, and growth companies in control of their own destiny have done better. It is quite possible that the bulk of the correction necessary to adjust is behind us.

As we enter earnings season a little over a month from now, don't expect managements to change their tune very much. Corporate managements relate to what they see. They don't know yet that Americans who will get a big hit to their take home pay in January 2011 will adjust spending next year. They only see what is happening in their stores today. Banks don't know when regulators will begin to relax and let them make small business loans without big up front haircuts. Indeed, new regulations on money market funds are already creating turmoil in short term financing markets and raising commercial paper costs. New regs require funds to shorten maturities and decrease credit risk. But even though managements and analysts still talk positively, markets find the truth.

As investors, all this requires staying true to your asset allocation model and to adjust your equity holdings to an environment of slower growth. I don't think it is time to abandon stocks by any means. I think the burdens mentioned will slow growth but won't terminate growth. Economies with both headwinds and tailwinds will cause investor angst at times but I suspect corporate earnings overall can still grow around 5% next year. With inflation firmly anchored, it would seem that stocks still offer more upside than bonds assuming the readjustment process is ending.

This morning stocks are likely to open higher but don't forget my two-day rule. Even if you want to say yesterday was mostly an up day after the first 15 minutes, for anyone to buy into this rally it is necessary that this morning's strength hold throughout the session. If a strong morning fizzles out later today, the correction still have a bit to go. The good news is that this market is creating some nice values. Many really good companies now offer dividend yields above 10-year Treasuries. That is almost always a good place to start. Many really good growth companies have corrected 15% or more and are attractive again. If you have cash, you don't have to buy all at one time. Use patience and discipline.

Today Pam Grier is 61. Stevie Nicks is 62. James Arness of “Gunsmoke” fame turns 87.

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Additional information is available upon request.

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