

## Boenning Morning Comment

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

May 3, 2010

Stocks fell sharply on Friday after news leaked that Federal prosecutors were investigating whether to indict Goldman Sachs (GS-\$147) and/or some employees for criminal fraud relating to trading of mortgage related securities. In addition, the scope of the environmental and economic disaster in the Gulf precipitated by the explosion of an oil rig continued to expand. Those two events clearly highlighted the day. Greece took a back seat for a moment.

Over the weekend we got some answers but not a lot. There was no further news/leaks out of the government related to Goldman. Clearly, as Congress moves towards legislating financial reform, the government is choosing to make Goldman Sachs the poster child for all the excesses, mistakes, avarice and greed of the past several years. Goldman may prove to be guilty of something but I suspect that Goldman's behavior wasn't any different than that of any other major broker or bank. Nor is Goldman or the other major institutions entirely responsible for what occurred. The government itself deserves a lot of the blame both for its actions and non-actions but it is a cardinal political sin for any government entity to accept blame for just about anything and no one in the White House, Congress, the SEC or the Federal Reserve is about to start now. Since blame has to be deflected somewhere, Wall Street is an obvious target. The fact that most in the financial community demonstrate little in the way of remorse, contrition or compassion makes it a rather easy target.

With that said, I think there is very little to be gained and a lot to lose with all the name calling and blame attachment taking place in Washington. Calling the leaders of Wall Street "fat cats" or accusing them of civil fraud plays well on Main Street, generates populist support, and may even help enhance the chances that financial reform legislation will pass. But when the President speaks, he speaks to many audiences. He is heard around the world. During the health insurance reform battle, his target was the greed demonstrated by the insurance industry. If you simply listened to the rhetoric, the avarice and uncaring behavior of the insurance industry, and its lobbyists, was the primary cause of spiraling health care costs. The insurance companies were the Satan of the moment. Now that we are on to financial reform, Goldman is the named Satan. All this bashing of American business isn't understood overseas in the same context as it is understood here. Telling the world to distrust our insurers, our banks and our investment banks isn't real smart policy. Who knows? Maybe they will believe us and do less business with our leading financial institutions. I doubt that is or should be anyone's intent.

A lot went wrong in 2005-2009 and I am not absolving Goldman or anyone else. But unless it can be demonstrated convincingly otherwise, Wall Street played by the rules of the game. In capitalism, government sets the rules and the private sector then sets out to maximize its own gain. That gain can be measured in many ways. Maybe it is measured in how many hamburgers are sold or how many smartphones are bought. But in a capitalist society, money somehow gets to the top of the list. The Abacus transaction was among a bunch of very sophisticated investors. Some won and some lost. Everyone knew there were two sides to the trade and there were going to be winners and losers. The buyers had every reason to assume that the sellers were sophisticated and knowledgeable. No one held back any details regarding the investments themselves. If there was fraud or deception, in my mind it would have to relate to the package of investments themselves. But a court will make the ultimate decision. Now, however, the government threatens to raise the stakes. The simple act of filing a criminal fraud indictment against a company is tantamount to a death sentence. No one is saying that is going to happen to Goldman but clearly the innuendo in the

press reports hangs a threat over Goldman's head and it is almost certainly intended to force Goldman to act in a manner that best suits the government.

Threats of indictment often have unwanted consequences. Eliot Spitzer used that threat to get brokers to separate investment banking from research. The end result is that many top paid analysts left and what remains is lower quality research that is less biased. I am not sure that can be declared a victory. Hank Greenberg was forced to resign as CEO of AIG to avoid another Spitzer threatened criminal indictment. Mr. Greenberg hasn't been charged or convicted since. As for AIG, new management may have been less careful of the credit default swap risks AIG was taking and the rest is well documented history. Whether the charges lead to conviction or not is irrelevant. The mere act of criminal indictment puts a company on death row since most businesses won't transact business with a company facing political indictment.

The reality is that I suspect the government won't indict Goldman but, of course, I don't know for sure. First, to indict a firm rather than an individual requires the government to present a pervasive and widespread intent to defraud, not a one-off event. That's a pretty high bar. Second, if the government did uncover such a plot, it is unlikely that it would slowly leak its intent weeks or months ahead of time. So my guess is that last week's news/rumor/leak was more political than real. Yes, someone probably is combing millions of documents looking for something but simply looking for a problem and finding a pervasive pattern are two very different things.

Here's the bottom line, at least in my view. For the most part, businesses play by the rules. You may not like the outcome but companies don't make the rules, they play by them. In good times, there are plenty of people and companies taking short cuts and, for the most part, they end up getting punished for their deeds. There were probably more crimes falsifying sub-prime mortgages than there were trading them. In capitalism, good rules motivate people and companies to do good things. Bad rules do the opposite. Over the past two decades, there has been excessive motivation to create all sorts of fancy financial derivatives that served little or no economic purposes. In my mind the Abacus transaction was a perfect case in point. It was a side bet that created no economic value. One side won and the other side lost an equal amount. Congress can and should change the rules that motivate more creation of economic value and less trading. It should limit risk where appropriate and reward wanted behavior. No one needs to call others evil to accomplish this. No one has to be indicted for playing by yesterday's rules. Change the rules and the game will change. Change the rules correctly and the quality of the game will be improved.

It's that simply. Hopefully pending financial reform moves us in the right direction.

America is the world's great innovator. It is the technology innovator, the industrial innovator, the health science innovator, and it has the most robust and capable financial systems in the world. Our leaders can and should improve our regulatory framework whenever possible but it should stop spending all the energy denigrating our companies to the rest of the world. If any company or individual has broken the laws, they can and should be punished. But there has to be a better way to describe American businessmen other than "fat cats".

Today Frankie Valli is 73. Pete Seeger is 91.

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Additional information is available upon request.

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