

Boenning Morning Comment

This report is prepared for us by Tower Bridge Advisors

June 11, 2010

Stocks rallied sharply yesterday. The economic backdrop was decent but hardly good enough to explain a move of over 270 Dow points. As has been the case for weeks, moves in either direction have been exaggerated by high velocity traders. Yesterday's upside move was punctuated by short covering. A lot of so-called pros were betting on a continuation of the market correction. When prices went the wrong way, they had to scramble to cover. A lot of traders are confused this morning trying to figure out the market's pending short term gyrations.

But for investors, I think the picture is a bit more clear, something hard to say in a world that seems to get more confusing by the day. The bad news certainly hasn't gone away. The sovereign debt crisis hasn't been solved and there are certain to be more related shockwaves in the future. The Gulf oil mess only gets bigger. Estimates of the amount of oil gushing from the ocean floor keep rising. Washington continues to confuse. Right now with no answer to the Gulf mess, it has been much more reactive than proactive and until the well is capped and some semblance of normal can return, we have no idea whether business can return to semi-normal within a year or so or whether the Gulf will be shut to deepwater drilling for years to come. But if you look just a bit beyond all the flashy headlines, you see an economy that's doing OK and a stock market that just had a 15%+ correction. Maybe, just maybe, that's what is beginning to attract investors once again. I suspect if it weren't for the heightened volatility that has nothing to do with investing more people would be willing to stick a toe back in the water.

Consensus earnings estimates for the S&P 500 got up into the mid-\$80s just a few weeks ago. If for no other reason, that number has to come down a bit because the stronger dollar will result in increased foreign currency accounting losses in the second half of the year. Next year estimates which were approaching the mid-\$90s probably have to come down more. Economists are taking their forecasts down for reasons we have been delineating for weeks including higher taxes, less stimulus, the Gulf oil mess, more regulatory costs, and currency impact. But the number should still be close to 2010 levels or a bit higher. If I use \$85 for next year or even just \$80, stocks simply don't look expensive at 13-14 times realistic estimates against a backdrop of 10-year Treasury yields of just 3.25%. I can easily construct a fine blue chip portfolio with a combined dividend yield close to the yield on Treasuries. I can feel very comfortable with that sort of portfolio sprinkled, perhaps, with one or two real good growth names.

But I still want to pay attention to my two-day rule. Tuesday was a nice last half hour of trading and yesterday looked real pretty. But we still haven't put two honest good days together back-to-back. Last night listening to traders talk, none believed yesterday's rally was for real. That may mean it was. But at this hour, futures have rolled over into the red again. So while we may be near the end of the correction, we may not be there yet. Often the end can be the most painful so if you want to nibble here based on valuation, that's fine but don't dive in head first quite yet.

Congress is at the point of trying to reconcile the House and Senate versions of financial reform. Wall Street is hopeful that intense lobbying will result in a watered down bill. I hope otherwise. Capitalism requires rules to protect most of us from predators and it requires regulators that can and will enforce the rules. Most of the breakdowns we have seen lately have related to breakdowns in regulatory enforcement. The Gulf oil mess is an example. So was the coal mine disaster a few months ago in West Virginia. The SEC paid lip service to its oversight

responsibility of brokers in 2008 and OFHEO never seriously held Fannie Mae or Freddie Mac back from doing anything. As for banks, they have shot themselves in the foot so many times in the past it seems like a movie in continuous loop. The sub-prime mortgage crisis is really no different than the savings and loan mess two decades previous to that. In good times, banks make dumb loans and dump investments. Call it the law of bank stupidity. It always happens.

After the Great Depression Congress passed Glass-Steagall to prevent at least efforts by banks to combine dumb lending with addition high risk activities like proprietary securities trading. That law was repealed in the Clinton administration and led to a stream of changes designed to strip away the regulatory framework and allow banks and Wall Street to police itself. The end result was exactly as one should expect. Moreover, Wall Street, banks and other institutions found out that superfast computers could be used to make gobs of money most of the time. Lost in the fine print is the notion that the few times when fast trading doesn't work it can lead to a lot of unintended consequences. The May 6 "flash crash" is simply a warning shot, one so far that has gone unheeded. A few single stock circuit breakers may eliminate the absurdities of stocks trading down to a penny per share but they don't deal at all with the systemic problems of liquidity and heightened volatility.

Paul Volcker has pushed Congress to include rules to limit proprietary trading. Banks and brokers hate this because that is how they make money today. But as we see with all the CDO investigations of Goldman Sachs and others, these trading profits are being made at someone's expense, often the customers of the banks and brokers. Moreover, when times cause the banks and brokers to experience big losses themselves, which get exaggerated by incredible leverage, taxpayers have been asked to bail banks out. So the Volcker rule makes perfect sense. Wall Street whines that banning proprietary trading means a ban on useful functions like market making. The obvious and fair retort is that any reasonable person can differentiate between true market making and trading for one's own account in about a second and a half. That complaint and others similar to it and simply red herrings advocated for self-centered reasons of protecting huge profit centers. But markets and banks have to be protected and sometimes they have to be protected from themselves. Fool me once shame on you; fool me twice shame on me. There is an end game to all this nonsense and it won't work out well for anyone. It is time for Congress to stand up with a broad based reform bill that forces clearing, transparency and accountability for all derivatives. It should require as many derivatives as possible to trade on exchanges. It should ban true proprietary trading at banks. I can go on. The details are in the bills being reconciled. But it is equally as important that the regulatory framework be strengthened to enforce the bill. The SEC in particular needs to select its primary master. Is it the investor or the trader? It cannot be both. It may serve both but one must come first and one must come second. For the past decade, the trader has come first. I would contend that must change and the sooner the better.

Washington gets one shot to get this right. What we will get won't be perfect but I would like to get a robust start. Right now the winds suggest that Washington, finally, is willing to get tough. Hopefully, that won't change over the next month or so.

Futures point to a fairly weak opening. May retail sales were weaker than expected according to government surveys. Fear not. May is history and we have explained it. June is starting out better amid warmer weather. As we have come to learn, it is not how stocks open, it is the last hour that counts. Stay tuned.

Today Joe Montana is 54. Gene Wilder is 75.

James M. Meyer, CFA 610-260-2220

Additional information is available upon request.

- * - Boenning and Scattergood may act as principal in buying this stock from or selling it to the public.
- # - The author of this report or accounts under his management at Tower Bridge Advisors owns this security.

Additional information on companies in this report is available on request. This report is not a complete analysis of every material fact representing company, industry or security mentioned herein. This firm or its officers, stockholders, employees and clients, in the normal course of business, may have or acquire a position including options, if any, in the securities mentioned. This communication shall not be deemed to constitute an offer, or solicitation on our part with respect to the sale or purchase of any securities. The information above has been obtained from sources believed reliable, but is not necessarily complete and is not guaranteed. This report is prepared for general information only.

It does not have regard to the specific investment objectives, financial situation or the particular needs of any specific person who may receive this report. Investors should seek financial advice regarding the appropriateness of investing in any securities or investment strategies discussed in this report and should understand that statements regarding future prospects may not be realized. Opinions are subject to change without notice.