Boenning Morning Comment

This report is prepared for us by Tower Bridge Advisors June 16, 2010

Stocks rallied sharply yesterday. For the past week, it has been a pattern of one good day followed by a pause. With yesterday's move above the 200-day line, a technical barrier technicians love to watch, it would appear that while we haven't had two big days in a row, the bulls have regained control of this market.

Does that mean we are ready to make another assault on the April highs? It's possible. But I think that is putting the cart before the horse. While the gloom that prevailed just a week or so ago was probably excessive, it is clear that the horizon isn't quite as clear as it might have seemed during April when company after company was reporting better than expected earnings and raising guidance. Since then, the European sovereign debt crisis has blossomed. While far from becoming a hurricane, at least not yet, it isn't going away any time soon. EU efforts to create a $1 trillion backstop have stopped the bleeding for the moment but it has provided no cure. Many countries have begun to adopt austerity measures designed to begin the process of getting their fiscal houses in order, something that is going to take several years to implement fully. There are some early signs that business in Europe may be slowing a bit but not enough to suggest any significant change in U.S. GDP. In fact, while the countries along Europe's southern tier may be slowing a bit, the weak euro is helping export demand overall. That has led to some surprisingly strong numbers out of Germany, the most important EU member.

Over the past month, several market watchers have begun to talk about the increased likelihood of a double dip recession. I am not sure whether the market decline created those thoughts or whether economic data suggested a significant deterioration in outlook. My suspicions are more the former than the latter. But I think it is important to understand that recessions are not part of the natural order of economic behavior. In the most basic terms, the rate of sustained growth is a function of changes in population and productivity. About the only major country in the world where population isn't rising is Japan. Most developed nations have a growth related to birthrate of 0.5-1.0%. Most also have net immigration pushing the total population growth rate to 1% or maybe a smidge more. As for productivity, or the output per individual, it climbs sharply in the early part of an economic cycle as sales rebound faster than the willingness of companies to hire. Gradually, however, business gets too large for the current workforce to handle and new hiring begins. Even when companies begin to hire, improved technology can lead to increased productivity. Machines and computers can handle a myriad of tasks faster than humans. If you combine the two, the natural order suggests that growth of 2-4% is normal. That doesn't mean that normal is an economic constant. Events happen to disturb normal. Cost of capital can restrict spending. Economic upheaval can create fear that pushes consumers to spend less. Inflation can dilute purchasing power. Deflation has an even worse impact. But without sudden changes in the economic backdrop, moderate growth is the natural order.

In 2007 and 2008, a series of events took place, which we all know all too well, that created a near panic in financial markets and caused consumers to freeze in place. Post the Lehman Brothers failure, individuals didn't even know whether their bank deposits were safe. Companies laid off workers so fast that virtually no one had confidence that his or her job was safe either. Home values were falling at a rate of 2-3% per month. Americans hoping to retire at age 60 now looked at the prospects of having to work forever. No wonder we suffered through the worst recession in over 60 years.

But as times change so does behavior. We all adjusted. We kept our cars a bit longer. We went out to expensive dinners less frequently. We shopped the closet. Companies shut down all but the most essential capital investment. We traveled less and do-it-yourself replaced do-it-for-me. After a time, things began to stabilize. Layoffs stopped. Credit markets opened up again. And behavior changed once more. We crawled out of the bunkers and took a deep breath. We started going out a bit more. That deferred vacation went back on the calendar. But make no mistake about it. We aren't back to the excesses of 2007 or before. No one is building or buying McMansions. Demand for large Mercedes cars is still well off the peak. High end retailers are pushing lower price points. So is Wal-Mart.

Simply put, we have collectively reset the bar to a level we can sustain. We are saving 3-4% of what we make, not a huge amount but certainly within the range of prudent. Business today is better than a year ago and even better than a month or two ago. Businesses are willing to spend again. Part of the adjustment process was to rebalance inventories. In some businesses, inventories got so lean that when sales began to recover, companies were left short. Part of the nice economic rebound in the fourth quarter of 2009 and early 2010 came from inventory rebuilding. There were other influences that helped to spur growth in recent months such as Federal stimulus, Federal subsidies aimed to boost sales of homes, cars and appliances, super low interest rates, and some tax breaks. Those are going away. The one-time incentives for home, car and appliance purchases are now over. Federal stimulus dollars are half spent and the rest will pass through the economy over the next 12 months or so. Taxes are going to rise sharply in 2011. State and local governments are being forced to layoff workers to balance budgets. Thus, growth that was running a little ahead of normal during the early catch-up phase of economic recovery is now likely to slow to a bit below normal over the next year or so.

A slow recovery doesn't always feel so great but it is still a recovery. The stock market has spent the last six weeks or so dealing with that. It is starting to show up in earnings reports. Yesterday, Best Buy said TV sales were a bit weaker than one might have expected. That doesn't mean the company isn't growing nor should one put too much weight on what TV sales are doing in March or April. But it serves as a sober reminder that what looked great when you compare Christmas 2009 to Christmas 2008, when everyone was in shock, is now going to be different and more sobering. Comparisons are going to get tougher. This morning Fedex said that its growth outlook, while still positive, isn't up to Wall Street's expectations. The stock market corrected last month for exactly the right reasons and now companies are beginning to see why. Not all companies will be affected in the same way. Best Buy and Fedex are two companies very exposed to modest changes in expectations and confidence. They may be the poster children of what we should expect a month from now as companies with conventional calendar quarters begin to report earnings. My guess is that after the June earnings reports and commentary from managements, analysts will recast expectations that the stock market already priced in over the past month. But as these changes are made company by company, there may be a bit of a bump or two in the road.

That brings me full circle. I think the spring stock market correction is largely over unless we are hit by some new external events. Certainly if the European debt crisis suddenly takes a turn for the worse, that could send stocks reeling once again. A terrible June employment report, which I don't expect, could do the same. President Obama is trying to use the Gulf oil spill to push once again for new tax on carbon emissions. I don't expect that to make any real headway on top of all the reform and taxes already in place but if it did, that would not be good news. But the most likely path is the one I laid out already, one of moderating but positive growth. Earnings expectations for 2010 have come down a bit and should moderate further after Q2 earnings season. After that, I suspect that 2010 will fade in importance and 2011 will begin to dominate. As 2011 expectations moderate, I suspect that stocks will appear pretty fairly priced.

As I noted on Monday, we are staying with our forecast for market growth of 5-15% for the year. That suggests a return to the April highs but not a whole lot more for now. Stocks in recent days have climbed back almost to break even for the year. That suggests a decent outlook for the second half of the year. Given the structural changes in the market with more and more domination by traders, I expect volatility to remain above historic norms and rather quick moves of 5-10% in either direction are quite possible. Note that markets have recovered about 5% in little more than a week. Volatility works both ways; it only feels bad when markets go down. As investors, volatility requires discipline. You cannot chase and you cannot panic. Over the intermediate term, I remain the same timid bull that I have been for most of this year. Longer term, we cannot sustain forward momentum until our nation solves the major structural issues created by deficit spending, underfunded entitlements, and too much spending on wars. Collectively those structural holes add up to over $1 trillion per year and are unsustainable. The sooner we solve them, the sooner our economy can move forward in an unhindered fashion. But history suggests that efforts to solve them won't happen until crisis forces a solution. That is probably a few years away but not far over the horizon.

Futures point to a lower opening today.

Author Joyce Carol Oates is 72 today.

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.