

Boenning Morning Comment

This report is prepared for us by Tower Bridge Advisors

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The market yesterday looked like a replay of last Friday when stocks opened lower, recovered part or all of their losses, and then collapsed in the last 20 minutes of trading. If you remember back to October and November 2008 (who wants to do that?), the pattern today is frighteningly similar to the late day swoons experienced back then.

Computer trading, high volatility and the ability to close out via buy-on-close orders is a toxic combination for markets steeped in fear. And the tactics will continue to be employed until they no longer work. Stocks may be oversold on a technical basis and may appear very cheap based on fundamentals. But without a catalyst to turn things around, the short term path of least resistance is lower. If stocks don't hold near current levels, there are no real solid technical support levels left. Does that mean stocks have to fall in free fall back to some horrid level? Not necessarily. But it does mean that compelling valuations are what will lift stocks and it is going to take some pretty strong values to provide the incentive to overcome current bearish sentiment. As long as traders "know" that stocks will end at the low of the day, buyers will step back in fear. But once that "knowledge" is invalidated by some sustained buying, a rally every bit as steep as the recent decline could ensue. Many fear readings today are as extreme as they were in March 2009. Once the psychology reversed, you know what happened. I don't want to imply that the next rally, whenever it begins, will replicate the 14 month rally that began in March 2009. But right now we are in a market that can only see the bad side and it is fed by a media that only likes to report bad news. In today's Wall Street Journal today I could find exactly two stories with a positive economic tone. One discussing a very strong ISM manufacturing report for April released yesterday spent most of the article's space wondering when a downturn in Europe would weaken U.S. manufacturing. The other talked of strong economic growth in Germany with a surprised tone that Germany could possibly due well amid Europe's sovereign debt problems. Needless to say, there were pages devoted to oil spills, Mideast conflicts, failed merger talks, lawsuits, and criminal investigations. Hewlett-Packard said it would spend \$1 billion to modernize its enterprise unit. As part of the process 9,000 jobs would be eliminated over 4 years. What was the headline? You guessed it, the job losses.

Despite all the gloom, it wasn't fundamentals that drove stocks lower yesterday. The bad news was old news. New data were encouraging. ISM manufacturing data were excellent for April as were construction data. Exports rose. Later this week, we are likely to get the best employment report in three years. Layoffs are minimal. I noted Germany's good numbers. But in the short run, emotion will always trump the facts. Traders will rationalize what the market is doing by saying that stock prices are forward looking. Good manufacturing and employment numbers today are already built in, they will say. Second quarter earnings won't matter either, unless they are bad. Just as bad news was ignored when the bull market began, all good news, every last little bit, is being ignored right now.

The good news, however, is that states of extreme emotional frenzy don't usually last too long. Let's hope now is no exception. In time, fundamentals do matter. S&P 500 earnings this year are estimated at \$80+. Unless one expects that number to fall (and we do not) or a significant recession in 2011 to drag earnings down (we aren't forecasting that either), then at some point close to here, valuations get pretty compelling.

Washington certainly isn't helping the situation; it rarely does. Fiscal policy is a mess. So far, Congress and the President act as if high debt and deficits are a European problem, not one we will have to deal with. Most of us know

better. The Fed isn't helping much either. M3 is the broadest measure of money supply growth and the one most coordinated with stock price movement. The government stopped releasing M3 data about 3 years ago but others still collect the data and it shows M3 money supply falling rapidly, a situation not conducive to sustained growth. Yet there is pressure within the Fed to sell securities into the market, further soaking up money in order to prevent inflation before it begins. Right now inflation is near zero and deflation looks to be a lot bigger possibility. Too much Fed tightening could create a big mess.

But the biggest noise coming from Washington right now is all about regulation. Here are three truisms. First, Washington never accepts blame for anything. Second, that means some other entity has to be the fall guy. In health care, that entity this time around was the insurance industry. Out of control medical costs are entirely the fault of greedy insurers according to Washingtonspeak. How about the recession? Again, government holds itself blameless. That makes Wall Street the bad guys and Goldman Sachs the poster child. Now, we have a terrible oil spill in the Gulf. Once again, Washington is blameless. BP is the poster child but every company that drills for oil or anything deeper than 2 feet of water is now viewed with suspicion. All drilling at depth of over 500' is ceasing, criminal action is threatened, and who knows where the bashing will stop. What is almost certain is that for years, perhaps decades, US offshore oil drilling is likely to stop. Washington will push programs to increase certain alternative fuel sources but unless my new car can run with solar panels on the roof, the end result is going to be a massive increase in oil imports. Needless to say, our friends in Iran, Saudi Arabia and Venezuela couldn't be happier. That leads me to the third truth and that is that all the fuss always ends up with a massive amount of new regulation.

While some new rules may be needed to deal with new technology (think fast trading in the stock market), in almost all cases, the fault isn't a lack of regulation, it is the lack of enforcement of existing regulation.

The Gulf oil spill is a perfect example. The Minerals Management Service is responsible for overseeing oil production in the Gulf. Regulators literally live on the large deep water rigs, and that includes the Horizon rig that BP was operating. Regulators were fully aware what was going on but failed to do their job. Congress established OFHEO in the early 1990s to oversee Fannie Mae and Freddie Mac. That was its sole mission. Even as both were unable to produce generally accepted accounting statements, they were permitted by OFHEO under White House pressure to increase leverage and increase sub-prime lending. As both Bear Stearns and Lehman Brothers were within days of complete collapse, Chris Cox, the Chairman of the SEC, said publicly that both were in solid financial shape. The list goes on and on. For capitalism to work fairly and properly rules are necessary but good enforcement is critical. There are Federal agencies that seem to do their jobs better than others. Rich people and powerful companies don't get exemptions for the tax collector. The FAA keeps U.S. skies the safest in the world. The FDA has a strong record as well. Problems arise when the companies being regulated exert undue influence over the regulators. Fannie Mae and Freddie Mac were abusive examples. Even Congressmen and Senators got favorable mortgage terms.

The Gulf oil spill wasn't an act of God. BP took shortcuts and regulators let it go by. Other countries require second tier blowout preventer technology. Other countries require deep water drillers to drill a secondary relief well simultaneously. Since everyone has access to the same technology, maybe the fact that the spill occurred here and not overseas is testimony to our weak regulatory environment. There is no reason to shut down a huge multi-billion industry and increase reliance on foreign imports because of lax oversight. Simply enforce the rules. I realize the politics demands a harsh response for appearance purposes but Washington is supposed to do what's right, not what is expedient, especially if the expedient response is costly in the end.

So let's cap the well, do a post-mortem, and figure out how to save American industry and jobs. In a matter of months, all those Gulf rigs will be in places like Brazil and Angola and tens of thousands of jobs will be lost unless level heads prevail. I'm not optimistic. Hopefully, once the well is capped, calm and reason can return. Hopefully.

Futures point to a flat opening.

Today Jerry Mathers is 62. Beaver is close to retiring. Sally Kellerman, the original Hot Lips Hoolihan, is 73. Happy anniversary, Susan.

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