Boenning Morning Comment

This report is prepared for us by Tower Bridge Advisors June 7, 2010

Stocks fell sharply on Friday after a weaker than expected employment report raised fears of some that a double-dip recession was imminent. A perceived threat that Hungary might default on its debt and rumors of a major derivatives based loss at a large French bank only added to investor woes. It was just a real bad thumping that lasted all day. Bad Fridays in down markets set the table for scary Mondays. Many of the stock market's worst days in history happened on a Monday including in 1929 and 1987, both times after very bad Fridays. Overnight, Asian markets tumbled early on but overseas markets have since recovered and futures suggest a degree of relative calm as today's session gets set to begin. But emotions as raw as those investors bear today make us aware that this market cannot withstand many more disappointments.

With that said, there is a flip side which simply says that the recent correction is more emotional that factually based. Readers of this letter know that I attribute the correction to a sobering reality that economic growth in 2011 is going to be less than in 2010. The reasons are taxes, more regulation, sharply higher benefits expenses and a withdrawal of fiscal stimulus. The offsets, improved productivity, population growth, and rising wages, should keep the economy moving forward albeit at a slower rate than previously expected. But the difference between a percentage point or two up and a flat or slightly shrinking economy are not that great so modest changes in assumptions have to be measured constantly. Today investors only consider the negative; hence violent reactions to perceived bad news. But anyone who has been in the market for long knows that emotion can change 180 degrees in a moment.

I want to take a look back at Friday's employment report for a moment. It was a big disappointment. Depending on how you look at the numbers, the number of new private sector jobs created was anything from zero to 80,000, a level too small to move the needle on the overall unemployment rate or to insure ongoing robust growth. The number was below almost everyone's predictions including those of VP Joe Biden who last week seemed to put his foot in his mouth yet again suggesting a big blowout number on Friday. He couldn't have been more wrong. But with that said, Friday's report doesn't match up well with all the other employment data that has been coming out suggesting that maybe it was off a bit. Monthly employment report figures bounce around a lot and are subject to large subsequent revisions.

Let me tick off some of the incongruities. The ADP survey had suggested that private sector growth would be close to April levels. Since ADP pays one out of every six private sector employees, it is not a survey to be taken lightly. Second, Christmas Challenger & Gray compilations of layoff data showed layoffs in May at the lowest level in 4 years. PMI manufacturing surveys showed solid growth. Indeed, the manufacturing sector did grow in May according to the government as well. But the non-manufacturing survey also suggested growth and the government's employer survey suggested otherwise. What the government survey did show was a rise in temporary workers, higher hourly wages and a longer work week. Put these numbers together and it suggests that employers are seeing improved business but remain reluctant to hire except to meet immediate demand. Moving to the subjective, I suspect the reluctance to hire stems from several factors. First, after a severe recession punctuated by large layoffs, no one wants to go through that again implying that one will only make permanent hires when they are absolutely sure of their outlook. Second, weather was cool and rainy mid-month. That might have had a modest impact. Third, the new health insurance reform bill is going to add costs related to permanent employees. That may push employers

to use more temporary workers on a consistent basis going forward. Fourth, the European debt crisis and shaky financial markets may have caused some employers to defer decisions on new hires until they got a better vision going forward.

As for the economy itself, most data suggests no real change in the growth curve. Trucker surveys, railroad car loadings and the Baltic Dry Index all suggest strong movement of product. Investment spending and construction spending are good. Airline bookings are up and so are hotel reservations. The one major concern is in retailing where there has been a definite slowdown in the rate of improvement. Sales are still rising, but not as fast as they were in March and April. I will point out that tax refunds are highest in March and April while those who must pay taxes defer filing and paying until the last moment, April 15. It is quite possible that big refunds spurred some added spending in March and April while tax payment sapped some strength in May and perhaps even into June. I have seen this pattern before especially during tentative recoveries.

The bottom line is that we all want to believe that what we are witnessing is a recovering economy whose growth is constrained by high unemployment and ongoing debt reduction that still has the strength to grow through the rest of 2010 into 2011. I still believe that is the best bet. There is little evidence to suggest that the European debt crisis is spilling over into our economy in the slightest. In fact, there is little evidence that Europe is slowing down itself in any accelerated manner. In addition, we are in an economy that is still seeing job creation on an ongoing basis. Housing may take a temporary dip down because of the expiration of the tax credit for new home purchases but we believe home construction activity has bottomed. That should be a source of job growth in the future. Banks are starting to lend once again. All evidence continues to point to an improving economy. The only debate is over the rate of growth. We have been saying that growth would be subpar since the recovery began and continue to think that is the case. Certainly Washington’s anti-business attitude isn’t helping.

We are not changing our outlook after Friday’s report but obviously want to see job growth improve a bit in coming months. We have seen positive number for five months; that shouldn’t be lost. The monthly employment report is the most watched economic indicator but it is only one and when it is inconsistent with others, it usually gets sorted out in subsequent months.

As for the stock market, today is an important day. This market is dominated by emotion and technical factors at the moment. As long as the S&P 500 stays above 1040 and the Dow stays above 9800, we are still range bound. But any serious violation of those levels could create a harsh downside move. Conversely, if these levels hold, a decent rally in front of what should be very nice second quarter earnings would be a good guess. Today, we won’t guess; we’ll watch. Note that my two-day rule still suggests being on the sidelines and not in the fray. With that said however, disciplined value investors should find nice values here. Many leading blue chips now sport dividend yields at or higher than 10-year Treasury returns. That almost always suggests a good bargain price. If Congress were to move to moderate the dividend tax going forward from a peak of over 40% for many, that would only make these stocks more attractive.

Futures point to a modestly higher opening but expect a volatile session. I don’t even want to hazard a guess as to where the market will end this afternoon. As noted above, we will watch and react.

Today Allen Iverson is 35. Liam Neeson is 58. Tom Jones is 70.

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Additional information is available upon request.

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