Boenning Morning Comment

This report is prepared for us by Tower Bridge Advisors June 9, 2010

For six hours, yesterday's market looked like a repeat of Monday. Stocks vacillated rising a bit and then falling a bit waiting for the real action in the last half hour. But the ending changed yesterday as the Dow rose over 120 points late in the day essentially reversing a similar decline on Monday. Volume was surprisingly strong. It felt good after the slaughter we all experienced Friday and Monday but in and of itself wasn't very meaningful. A half hour rally, no matter how strong, doesn't exactly constitute a market reversal.

But there are some hopeful signs we can salvage from yesterday's action. Stocks stopped going down at almost the same level as stocks stopped going down in February. If you can remember back to the beginning of the year, January was a rather big disappointment after a wonderful last nine months of 2010. The January barometer said 2010 was going to be a down year. But all of a sudden in mid-February the gloom faded and buyers returned sending stocks to new highs by the end of April. Then the gloom came back. Health insurance reform became law. Greek debt made front page headlines. The euro tumbled. A BP well in the Gulf of Mexico literally exploded and is still spewing oil seven weeks later. Employment growth has failed to accelerate. Stocks responded by giving back all the gains since February.

Now we are at a crossroads. Is the May swoon the start of a new bear market destined to take us all the way back the abyss of 2008 or is it just part of the market's back and forth motion that might prove to be typical of a pattern we are likely to see in a fragile economy destined to move forward at a much slower pace than usual facing headwinds of ongoing deleveraging and higher taxes?

We think the latter is most likely.

It may be early but there is virtually no evidence so far that the European sovereign debt crisis is spilling over into any major economy in a serious way. Maybe it is simply too early. Austerity measures making their way through Europe haven't been fully implemented yet. Maybe that means the pain is yet to come. We'll see. But last night, for instance, Texas Instruments held a mid-quarter conference call. TI is major worldwide semiconductor company with products in nearly anything with an on-off switch. It is big around the globe. Thus, if anyone is going to see economic sea changes in real time, it should be TI. The company not only reiterated guidance but suggested that the quarter could even be going slightly better than originally anticipated. Analysts tried to ask in a million different variations whether there was even a hint of slowing in Europe related to the debt crisis or not. TI said no to every question. I'm not a real linguist but to me no means no. McDonald's said earlier that May sales in Europe were better than expected. Yes, I realize McDonald's doesn't serve high end gourmet meals but if times are bad, people eat home not in restaurants. To be fair, we have also heard that computer notebook sales in Europe have weakened a bit, but I suspect (a) that follows a huge pop in sales around year end into the first quarter of the year, (b) inventories probably got a bit swollen as a result, and (c) notebooks may be losing some market share to net books and tablets like the iPad which is doing very well.

In the U.S. May retail sales were rather lethargic after a couple of pretty good months in March and April. The bears were quick to warn that it was the beginning of a slowdown but I beg to differ and will make three points to support

my view. The first relates to taxes. Those who get refunds logically file as early as they can. They file in February and March, getting refunds in March and April. They spend part and put part away. That spending shows up in March and April. It didn't show in 2009 for obvious reasons related to the economy at that time. So the gains this year were welcome and larger than expected. Those of us who owe money wait until April 15th. Some have to write big checks. They swallow hard and spend less in May. The second reason relates to weather. May is a transitional month usually starting out cool and rainy and, hopefully, ending up sunny and warm. It got sunny and warm by the end of May this year but only near the very end. Seasonal shopping wasn't very busy in the first half of the month. Weather may not have hurt much but it certainly didn't help. Third, look at survey data for the past two weeks. It has been excellent. Warm summer-like weather has gotten Americans out again. The bottom line is that there is no evidence that the consumer is going back into hibernation. He may be frugal and it certainly isn't 2007 all over again. But we aren't headed back to the bunkers either.

Thus, while the bears found a lot to worry about in May, there isn't a lot of evidence that the economy is ready to roll over into a double dip recession. And if that is true, then it would seem to be that the correction we have experienced over the last six weeks may have about run its course. I do think risks are elevated compared to what they were a month ago and I do believe, as I have said many times in this letter, that 2011 is going to be a relative disappointment compared to 2010 because of less stimulus spending and higher taxes. ***Deleveraging continues. It neither adds nor subtracts from momentum already in place. But the big difference is that a few weeks ago, my view was contrarian. Today that view is consensus and priced into stocks.***

That leads me to a review of my two-day rule, my simplistic trading guideline. Just to repeat the rule, you invest offensively after the market goes up strongly two days in a row until the market goes down strongly two days in a row and then you play defense taking some profits and staying on the sidelines. You stay on defense until we get two strong up days in a row. We have been in defensive mode since the beginning of May. Yesterday qualifies as a nice up day but it is only one. In fact, it was only a good 40 minutes but that is the way most trading days have gone lately. So we need another nice day today to put the offense back on the field. Maybe it will happen. Futures started out weak overnight but have strengthened all morning. But it isn't the morning that is going to matter. It's that last hour. The morning buying can just be short covering. If there is a real turn in sentiment, the buying has to become sustained at least through a second full day. So we are hopeful but we have played this record before. Today may be no different than last Thursday. If today isn't a strong day, the bears will be back again tomorrow challenging the 1040 S&P 500 level yet again. Tomorrow ECB President Trichet will speak and weekly unemployment claims will be announced before the market opens. So buyers today are taking risks. They may be good risks. We'll see. The chicken that I am, I prefer to take a day off and watch. One day isn't going to make that big a difference. However, I go into this morning hopeful.

While most investors have been focusing on the overall market for the past six weeks because it has been so bad, clearly the market hasn't been acting in a completely homogeneous fashion. Those companies whose fortunes are most tied to economic activity have suffered the most. Think industrials, financials, basic materials, energy and some tech. One might argue they were the leaders going in so they had the most to give back, but I disagree. Some hot stocks, notably technology companies tied to hot markets like smartphones, virtual software and multi-media delivery are near 52-week highs. I think the market is making a very clear statement that slow and steady isn't a bad place to be. So food stocks, utilities, consumer non-durables and health care names have been leaders. Not only are these steady Eddies in terms of earnings performance, but many have great balance sheets, great cash flow, and big dividends. With 10-year Treasuries now yielding only 3.2%, dividend yields anywhere near 3% with growth potential look very attractive both offensively and defensively.

If we get a sharp snap-back rally, the steady Eddies won't lead but they should participate. If, however, our economic forecast is right and economic growth through at least 2011 is going to be subpar, in the range of 1-3%, companies who depend on overall economic growth as their primary engine are going to have a tough time and earnings estimates for many of these companies are going to come down. ***I would use the next rally to realign portfolios into more defensive stocks.*** If you want to buy growth aggressively, you should buy stocks whose fortunes are not reliant on overall economic growth but rather are self-generated. It isn't so hard to sleep with stocks that grow 5-10% per year, pay a 2-4% dividend yield and can increase dividends annually at the same pace as earnings.

As noted, futures point to a higher opening. We want to see a good session today or we will be force to remain defensive.

Today, Johnny Depp is 47. Michael J. Fox is 49. Jackie Mason is 82. A movie with Jackie Mason and Johnny Depp might be a wild thought to ponder.

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