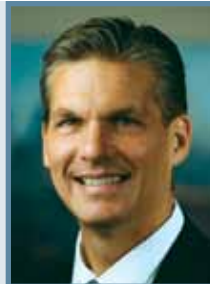


## Budding Sprouts of Economic News

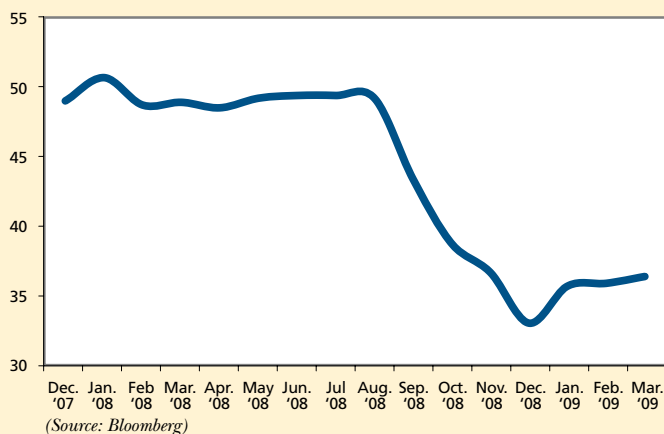
By Mark Luschini, Chief Investment Strategist



Scattered signs of green shoots in the global economy are raising hopes that the recession could bottom out later this year paving the way for an economic recovery in 2010. However, the signs remain tentative. Recessions rarely proceed in a straight line and false dawns are common before recovery finally takes hold. Still, it does appear that the rate of deterioration has slowed from the precipitous pace of decline in late 2008, when the economy looked to be in cardiac arrest.

While the charts on this page hardly exhaust the variables one can and should evaluate to detect a point of inflection, they do portray conditions that, while not great, are at least less bad than they were just a few months ago. A better tone to the economic data is visible across consumer and business activity alike.

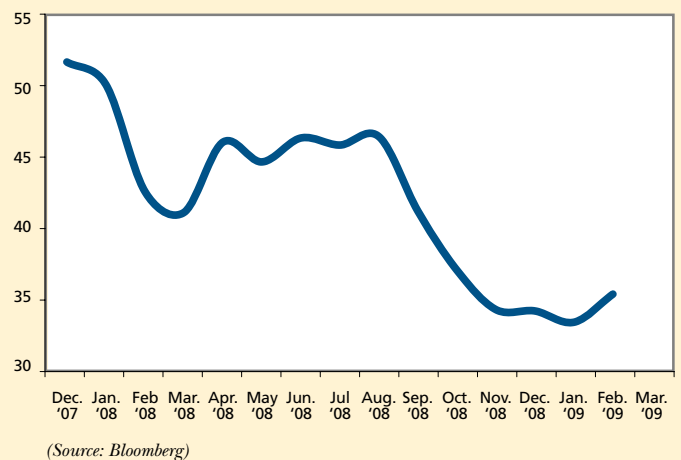
Chart A: Institute for Supply Management (ISM)



On the business side readings from the manufacturing survey (Chart A) and orders for durable goods (Chart B)—those products that last three years or more like cars and washing machines—have improved from abysmal levels but remain well below the point of concrete evidence that the economy is expanding. Interestingly, even the badly tattered

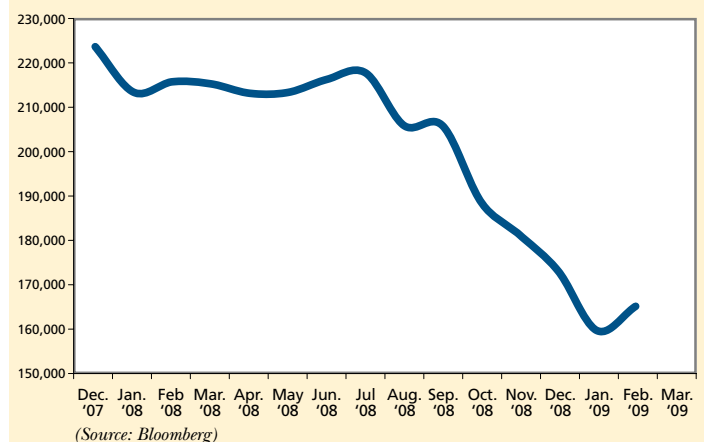
construction market may have found a bottom. The Architecture Billing Index (Chart C), which is considered an economic indicator that leads nonresidential construction activity by approximately 9–12 months, posted an increase in its latest reading for the first time in six months.

Chart C: U.S. Architecture Index



Ultimately the spending behavior of the beleaguered consumer is the most important variable, as consumption represents 70% of economic activity here in the United States. On the positive side, consumers are benefiting from lower energy prices, temporary tax cuts and the ability to refinance mortgages at historically low levels. The Federal Reserve opened the spigots of its Term Asset-Backed Securities Loan Facility ("TALF") by purchasing mortgages and treasury bonds directly in the market to suppress interest rates. This has led to a tsunami of refinancing activity

Chart B: U.S. Durable Goods

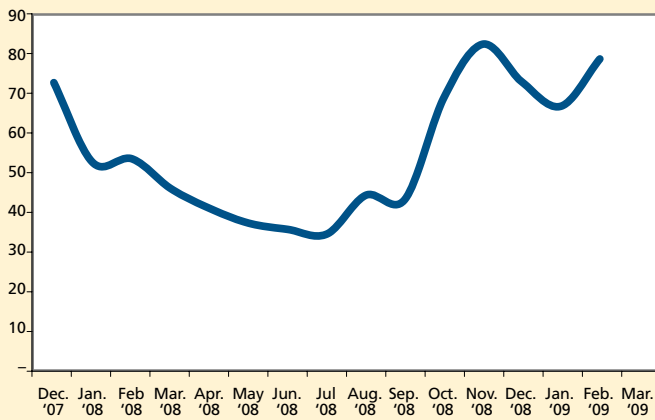


(Continued on page 2.)

(Continued from page 1.)

(Chart D). It has been estimated that \$1 trillion of mortgage loans may be refinanced at lower rates in 2009—allowing significant resources to be redirected from servicing mortgage debt toward savings or spending. That is an enormous windfall that will no doubt be beneficial in stabilizing the fragile state of consumers' finances.

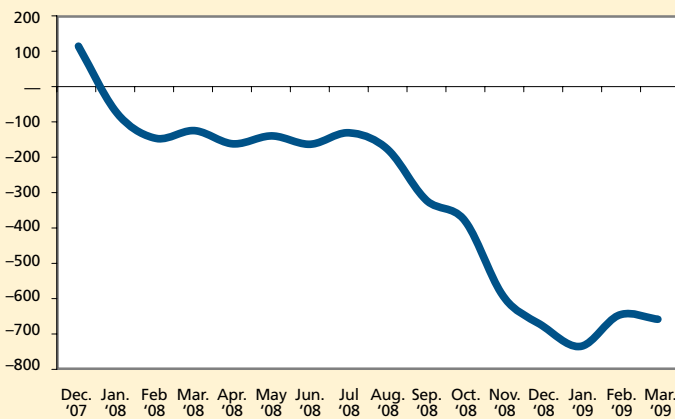
**Chart D: MBA Refinance as Percentage of Total Applications**



(Source: Bloomberg)

The sharp drop-off in the economy, which has now lasted 16 months through March, also implies consumers and businesses are wringing out their excesses. Households have increased their savings rates while the liability side of their balance sheets has begun to de-lever. For the first time since data were collected beginning in 1952, the volume of outstanding debt shrank in the fourth quarter of last year. Less borrowing and spending by consumers has forced businesses to make adjustments. Companies have cut costs by slashing payrolls, paring inventories, and deferred spending plans. As a consequence consumers and businesses are becoming better positioned to benefit from even a modest pickup in economic activity. ■

**Chart E: Nonfarm Payrolls**



(Source: Bloomberg)



## A March for the Record Books

By Gregory M. Drahuschak, Market Strategist

March brought investors much-awaited relief in nearly precedent-setting style. After sinking to an intraday low at 666.79 for the S&P 500, stocks began a rally that by the end of the month allowed the S&P to rise nearly 20% above the low. This March found a spot in the record books (Table A). It ended as the second best month for the S&P 500 over the last 60 years with an 8.54 percent gain.

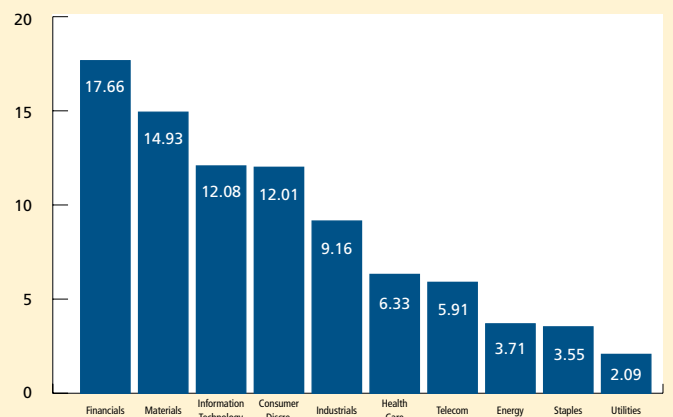
**Table A: Best March Gains Since 1950**

March Year	S&P 500 result %	March Year	S&P 500 result %
2000	9.67	1998	4.99
2009	8.54	1952	4.68
1956	6.46	1967	3.94
1979	5.52	1999	3.88
1986	5.28	1971	3.68

(Source: Janney Montgomery Scott)

Not surprisingly the financial sector posted the best gain in March (Chart F)—a gain that was extended notably on the news that the Financial Accounting Standards Board (FASB) agreed to modify the much-debated mark to market accounting rule. Sector results for the entire quarter, however, were notably different than they were for March (Chart G).

**Chart F: March Sector Results**



(Source: Janney Montgomery Scott)

The March rally had some economic underpinnings. Employment data remained weak, but some of the regional manufacturing indexes and other data either slowed their rates of descent or actually rebounded modestly. The ISM Index, for example, posted its third-straight monthly gain. In a market as severely depressed as the current market has been even modestly positive change was enough to generate some market improvement.

The initial move off the March low was fueled in part by the Treasury Department's attempt to ease pressure on banks through the Public-Private Investment Program (PPIP). The potential for the reinstatement of the uptick rule on short sales and easing in the mark-to-market rule added to the improved psychology that allowed stocks to move higher. In our view the focus on FASB and the uptick issue were great examples of unintended consequences.

In principle FASB 157, which began the process of asset write downs that have plagued the banks, and the uptick rule removal on short sales make sense. But we were opposed to both.

We noted our concern with FASB 157 as long as nearly two years ago due to the potential that the rules could have a seriously negative impact on banks. The uptick rule likewise opened the door for bear raids on stocks. This was manifested in the steep and in many cases unjustified declines in many financial stocks.



As often is the case, implementation of regulations can take a basically sound principle to an absurd level that generates negatives no one considered at the time the changes were made.

The most irritating aspect of FASB 157 and the uptick rule has been that they have contributed to enormous and potentially unnecessary disarray. Overly aggressive lending combined with greedy borrowers impaired banks and the credit markets. Neither FASB 157 nor the uptick rule on their own were the root causes of the bank and stock market problems, but they clearly served to make a bad situation much worse.

The economy and the stock market face a period of "damage repair"—a process that will take more time. Confidence will be a key element in the repair process. If individuals and corporations start to believe that the worst is over, the stock market has the potential for considerable improvement.

At the same time it is likely that traditional economic measures will improve at a very slow pace. Employment, which is a key element in restoring confidence, is likely to be lackluster for several quarters ahead. It also is wise to keep in mind that the major averages face significant overhead supply that could impede stocks on a short-term basis. The stock market, however, as it traditionally does, will discount improvement well in advance, but the key will be how far ahead it is willing to look.

We suspect it is likely that after an initial adjustment upward the major averages will stall and could retrace some of the initial move. It, however, is unlikely in that the March low will be breached even in a sharp retracement. In our view a pullback from an initial market rally probably would not move below the 740–750 range.

April's prospects are appealing. In 27 of the 38 years in which the S&P posted a March gain, April followed with a gain. Historically of all the months of the year, April has the third highest probability of producing a gain in the S&P 500. It also typically produces the fourth best monthly percentage gain in most years. Table B shows the ten best all-time results for the S&P 500 in April.

**Table B: Ten Best All-time Gains in April**

April Year	S&P 500 result %	April Year	S&P 500 result %
1978	8.55	1997	5.84
2003	8.10	1951	5.21
2001	7.68	1989	5.01
1983	7.53	1963	4.85
1968	6.97	2008	4.75

(Source: Janney Montgomery Scott)

In sum we view the market as remaining in a long-term process of establishing a firm base upon which ultimately the market can begin a lasting recovery. We, however, also believe that volatility will remain high and that interim bouts of selling will continue to characterize market activity before a new bull market truly begins. ■

## TARP—Version 2.1

By Guy LeBas, Chief Fixed Income Strategist

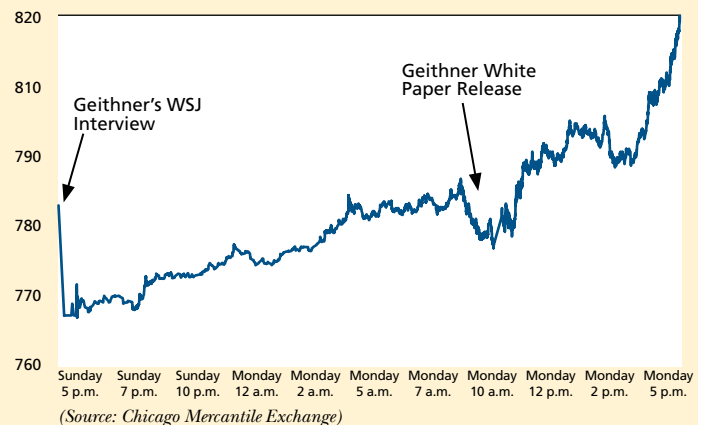


On February 10—virtually eons ago in the burgeoning world of government intervention—we wrote on then wet behind the ears Treasury Secretary Tim Geithner’s disappointing announcement on a restructuring of the Bush administration’s Trouble Asset Relief Plan. That announcement was disappointing primarily in its lack of detail, but fortunately for the financial system, it looks like Geithner forgot how to stay within the lines of opacity (Chart H). The resulting TARP-2 details, which we’re calling in the collective TARP-2.1, are filled with market-friendly pronouncements designed to please, but perhaps for the first time, contain an acknowledgement of the fact that, in the long run, government capital can never supplant the private markets. Still, while in principle TARP-2.1, unlike its more opaque predecessor, should provide a very much needed mechanism to remove problem assets from bank balance sheets, execution risk remains a potential roadblock that could prevent full effectiveness.

Geithner’s TARP-2.1 details focused around the fleshing out of a previously-described program to remove problem assets from bank balance sheets. Under the Geithner plan, there are two separate programs within this bad fund framework, the first involving bank-owned mortgage loans and the second distressed securities held on balance sheets at financial institutions. The single most crucial aspect to understand about the TARP-2.1 programs is the degree of involvement of private capital. While we’ll detail the potential problems with pricing later on, the creation of a subsidized private market for distressed assets represents an important step along the way of returning securitization, the engine of greatest liquidity, to some semblance of normality, and thereby restoring credit availability and reducing lending rates to tolerable levels.

The major problem with the TARP-2.1 is that it does little to dispatch with the 900 billion dollar gorilla in the room: pricing. Subsidizing the creation of a private market for distressed loans and RMBS/CMBS does not ensure that pricing on those loans and securities will improve substantially. In theory, creating this market with strong liquidity support should allow potential purchasers to take an investment (be it loan or bond) that is priced with both liquidity and credit risk, strip out the liquidity risk thanks to government support, and value that investment based primarily on its credit risk. With this shift in valuation mechanism comes a probable increase in market values. Since TARP-2.1 depends on this theory for success, it also depends on the implicit assumption that financial institutions have, on average, marked down assets low enough (or, in the case of loans, reserved enough) to account for not only credit risk, but liquidity risk as well. If this is in fact the case, the asset manager bids for loans and RMBS/CMBS should be above banks’ carrying values on the assets, which would allow banks to book gains on sales to the asset managers. Essentially, TARP-2.1 depends on the adequacy of prior markdowns—and we’re skeptical that many financial institutions have

Chart H: S&P 500 Futures Immediate Response to Geithner Plan



been aggressive enough on their markdowns, particularly after having seen the lobbying effort being put into encouraging flexibility in mark-to-market accounting requirements. The involvement of private capital doesn’t make the pricing problems “go away,” but it does at the least provide for a highly efficient pricing mechanism, provided, of course, that there’s no collusion among the bidders.

While there are significant details that need resolving, as a whole, we’re heartened by the greater clarity offered under Treasury Secretary Geithner’s TARP-2.1 plan. The greater involvement of private capital serves to create an exit strategy for government involvement in the private markets and to create an efficient pricing mechanism. Moreover, the addition of loans to the program allows smaller banks and other asset classes to participate. But the single biggest plus we see from the announcement of TARP-2.1 is the fact that the banking system is one step closer to reducing the amount of distressed higher risk assets still on balance sheets. We’ll see a bigger plus once the purchases actually begin. ■

### JANNEY MONTGOMERY SCOTT LLC

1801 Market Street, Philadelphia, PA 19103 • 215.665.6000

WWW.JMSONLINE.COM • Member: NYSE • FINRA • SIPC

The information is sent to you for informative purposes only and in no event should be construed as a representation by us or as an offer to sell, or solicitation of an offer to buy any securities.

The factual information given herein is taken from sources that we believe to be reliable, but is not guaranteed by us as to accuracy or completeness. Opinions expressed are subject to change without notice and do not take into account the particular investment objectives, financial situation or needs of individual investors. Employees of Janney Montgomery Scott LLC or its affiliates may, at times, release written or oral commentary, technical analysis or trading strategies that differ from the opinions expressed within.