INVESTMENT STRATEGY GROUP

WEEKLY BULLETIN

JANNEY MONTGOMERY SCOTT LLC

AUGUST 30, 2010

MARK LUSCHINI
MLUSCHINI@JANNEY.COM

JOSEPH G. WITTHOHN, CFA
JWITTHOHN@JANNEY.COM

GREG DRAHUSCHAK
GDRAHUSCHAK@JANNEY.COM

BRAD DURKO
BDURKO@JANNEY.COM

WHEN BAD IS GOOD

While reports on the beleaguered housing industry and durable goods orders left investors with little to get enthused about, Friday's news on second quarter GDP reignited interest in equities. By mid-morning, when Federal Reserve Chairman Ben Bernanke spoke about the Fed's attentiveness to the flailing economy, investors really got excited. On Friday, the market rose 1.7% by the closing bell, but it was not enough to turn the full week positive. The Dow Jones Industrial Average lost 63 points or 0.6%, to close at 10,151, registering its third consecutive weekly decline. While the Treasury bond market sold off hard on Friday in conjunction with the "risk on" bet being wagered in equities, bonds were little changed for the week overall. The yield on the 10-year bond rose just 0.03% to close at 2.64%.

INDEX	WTD	YTD	1-YR
DOW JONES	(0.6)	(0.8)	8.9
S&P 500	(0.6)	(3.3)	5.4
S&P 400	(0.3)	2.0	12.6
RUSSELL 2000	1.0	(0.6)	7.0
MSCI EAFE	(0.2)	(7.4)	(0.6)
MSCI EM	(1.8)	(0.2)	17.5
TYPE	CURRENT	12/09	12/08
3 – MO TREASURY	0.14	0.07	0.08
2 – YR TREASURY	0.55	0.81	0.76
10 – YR TREASURY	2.64	3.58	2.21
30 – YR TREASURY	3.69	4.49	2.68

SOURCE: BLOOMBERG AS OF 8/27/2010

Under normal conditions, an announcement on the rate of domestic economic growth that begins with a one-handle is usually not good. Furthermore, following a severe contraction, economic growth is typically quite strong for many quarters, and yet this recovery has been marked by its underwhelming pace. So when GDP was finalized for the second quarter to a 1.6% annualized growth rate from its previous estimate of 2.4%, one would think this should sink the market. Instead, expectations had been set sufficiently low so this reading was actually viewed positively. In fact, it does represent the fourth straight quarter of positive economic growth. Additionally and importantly, it helps to provide market participants some concrete evidence that while the economy has hit a soft patch, it is still growing. We had expected the contour of this recovery to be well below "escape velocity" due to the unusual circumstances that differentiated this recession from many of its predecessors. We think an economic double-dip can be averted as long as global growth remains intact and business activity remains robust enough to avoid further slashing of payrolls. If that holds, then equities can advance in anticipation of continued economic expansion.

With the Federal Reserve prepared to mobilize further means of reinforcing the current recovery, the stock market should move higher given today's undemanding valuations. For investors, strong consideration should be given to those sectors represented by large, high-quality companies where, in many cases, juicy dividend yields can be found. Namely, we prefer to barbell classic defensive sectors like Consumer Staples, Utilities, and Telecommunications, with growth sectors like Energy and Technology.