INVESTMENT PERSPECTIVES
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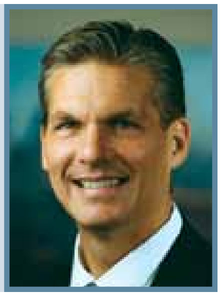
JANNEY MONTGOMERY SCOTT LLC

The Old World Beckons

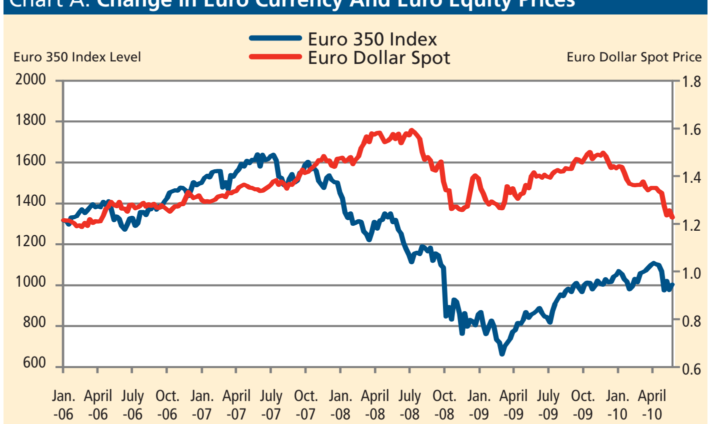
By Mark Luschini, Chief Investment Strategist



The distress radiating from Europe over the debt crisis facing Greece and other Club Med countries such as Spain and Portugal has culminated in a writedown of global equities. The concern is that the solution to the issues facing these countries, which includes strict austerity measures, higher taxes and possible debt restructuring, will lead to a marked slowdown in economic growth across the European Community. The assumption is that in turn, countries from China to the United States will experience marginal declines in export activity to Europe, which would crimp global economic activity as well. With equity prices having advanced so mightily over the past 14 months in anticipation of continuously improving economic activity, this served as a catalyst for a corrective phase in the event that those expectations may be not be fully realized.

The decline in equity prices while directionally correlated was uneven in application. For instance, in dollar terms, French CAC-40 and German DAX equity markets have fallen 24% and 15% respectively so far this year during a period when the U.S. stock market (S&P 500 index) has declined by just 1.5%. Other markets have experienced declines that vary from Brazil's Bovespa index which is down 8.5% to China's Shanghai Composite's loss of 19.0%. While the pullback in equity prices cannot be attributed solely to the fiscal imbalances on display among members of the Euro zone, it certainly was a driving force behind the correction.

Chart A: **Change In Euro Currency And Euro Equity Prices**



(Source: Janney ISG, Bloomberg)

Along with the decline in European equities the common currency of the union, known as the euro, has been battered. The euro has lost almost 20% of its value, having fallen to $1.22 since it reached its recent peak of $1.51 back in November 2009. (See Chart A). The euro is now priced at a level last seen in April 2006 and there is reason to believe it has further to drop. While the massive fiscal support package that was announced by the European Community in conjunction with the International Monetary Fund (almost $1 trillion) has dramatically reduced the risk of a sovereign default, it does not alleviate the challenges Europe is facing in its effort to overcome the economic friction brought on by the debt crisis that blossomed in Greece, but is anything but proprietary to that country. As a consequence to the headwinds Europe is facing on the domestic front, the European Central Bank may be forced to expand or at least extend its loose monetary policy. At the same time, certain countries within the Euro zone risk relapsing into recession. The International Monetary Fund, for instance, predicts the GDP growth of countries included in the Euro zone PIGS (Portugal, Italy, Greece, and Spain) to range from 0.65% to 1.2% in 2011, with the exception being Greece, which is expected to remain in recession even though next year. In the aggregate, this is likely to put further pressure on the euro vis a vis its relative value against the U.S. dollar and perhaps more so against those countries that are experiencing better economic conditions on an absolute basis like Canada, Australia and some in Latin America to the Pacific Rim.

While stories of equity market declines and a weakened currency are not normally associated with good news, the silver lining for investors in our opinion is that many world class franchises that are domiciled in Europe have seen their share prices decline dramatically. As a result, valuations for many Euro zone multinationals are trading at levels last seen in the midst of the dark days of late 2008 when the world seemed to go into cardiac arrest. These same multinationals derive a substantial portion of their revenues from markets like the U.S., as well as faster growing developing countries around the world. (See Chart B). As such, the decline in the Euro currency provides a beneficial tailwind to their export activity. We are generally less keen on domestic European companies, including the banks, given the prospects of slower economic

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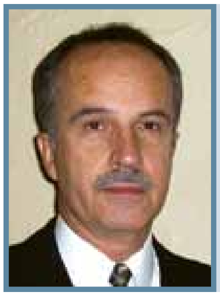


Sell in May. Then what?

By Gregory M. Drahuschak, Market Strategist

Although the old line, sell in May and go away, more often than not is wrong, this year it was spot on. The S&P 500 posted a gain on the first trading day in May and then embarked on a slide that produced the second worst May decline in 61 years. (See Chart C).

Following the nearly record-setting S&P 500 drop in May, it is natural to wonder what, if anything, this suggests for June and the rest of the summer months. History, however, suggests not basing major investment changes based on a weak May. From 1950 through last year, the S&P has been down in May 25 times. The following June was a down month 13 times. Over the prior 60 years, the SPX has posted a May gain 35 times and then fell 14 times the next month. Including in 2000, the Standard & Poor's 500 in June has been up five times and down five times in the most recent 10 years.

Of all the May periods since 1950 when the S&P 500 was down, only three times in 1966, 1974 and 1981, the S&P was down the following June, July and August. It is interesting that a down May was followed by gains in each summer month only three times also in 1955, 1979 and 2006. In all other years the market's performance in the summer was mixed following a down May. The chart below shows the S&P 500's results through the summer following the ten worst May periods. (See Chart E).

Chart C: Index Performance (Price Only)

2010 Market Data		Prior Close	Last	Change	% Daily	% Yearly	% Jan	% Feb	% Mar	% Apr	% May	1st Quarter	2nd Quarter
DJ Industries	.DJIA	10258.99	10136.63	(122.36)	(1.19)	(2.97)	(3.46)	2.56	5.15	1.40	(7.92)	4.11	(6.63)
S&P 500	SPX	1103.06	1089.41	(13.65)	(1.24)	(2.30)	(3.70)	2.85	5.88	1.48	(8.20)	4.87	(6.84)
NASDAQ Comp	COMP	2277.68	2257.04	(20.64)	(0.91)	(0.53)	(5.37)	4.23	7.14	2.64	(8.29)	5.68	(5.88)
SOX Index	SOX	361.55	355.66	(5.89)	(1.63)	(1.18)	(12.18)	7.21	8.18	2.59	(5.43)	1.85	(2.98)
Biotech Index	BTK	1057.78	1051.90	(5.89)	(0.56)	11.65	2.36	7.92	17.95	(2.34)	(12.25)	30.30	(14.31)
DJ Transports	.TRANS	4381.98	4336.06	(45.92)	(1.05)	5.77	(4.98)	6.14	5.81	6.77	(7.17)	6.71	(0.88)
DJ Utilities	.UTIL	361.79	361.19	(0.60)	(0.17)	(9.25)	(4.96)	(2.87)	3.11	2.41	(6.90)	(4.82)	(4.65)
Volatility Index	VIX	29.68	32.07	2.39	8.05	47.92	13.56	(20.80)	(9.79)	25.36	45.44	(18.87)	82.32
S&P Midcap 400	MID	771.43	763.37	(8.06)	(1.04)	5.05	(3.28)	5.06	6.98	4.20	(7.25)	8.70	(3.36)
S&P 100	.OEX	499.08	493.06	(6.02)	(1.21)	(4.09)	(3.70)	2.22	5.70	1.00	(8.74)	4.05	(7.82)
Gold ETF	GLD	118.69	118.88	0.19	0.16	10.78	(1.26)	3.27	(0.44)	5.88	3.05	1.53	9.11
Russell 1000 Index	.RUI	609.07	601.79	(7.28)	(1.20)	(1.67)	(3.69)	3.06	5.98	1.75	(8.13)	5.19	(6.52)
Russell 2000 Index	.RUT	670.51	661.61	(8.90)	(1.33)	5.79	(3.73)	4.41	7.97	5.59	(7.67)	8.51	(2.51)

(Source: Janney)

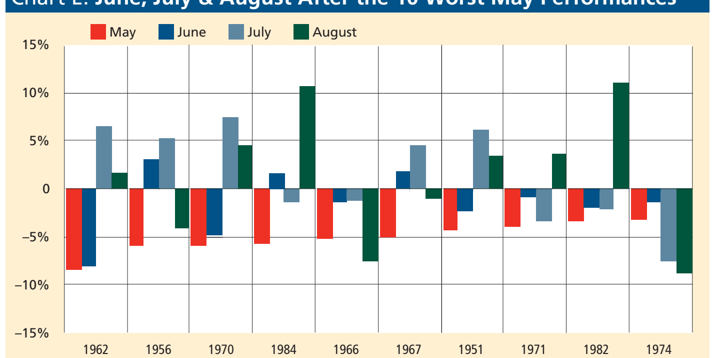
May's weakness was rooted in many causes, but the main one was the worry that Greece's sovereign debt problem could spread to Spain, Portugal, Italy and Ireland. The likelihood of this happening took on greater significance due to the nearly incestuous relationship these nations have in terms of the amount of debt each nation holds in the other troubled countries. The most obvious manifestation of the sovereign debt worries was the sharp decline in the euro and the resulting rise in the dollar, which became a safety haven for nervous investors.

Chart D: Sector Results

28-May	Market Cap	1 Day	MTD	QTD	YTD
S&P 500	9,849,365.39	-1.24%	-8.20%	-6.84%	-2.30%
Cons Disc	1,051,241.70	-1.36%	-7.14%	-1.55%	8.34%
Industrials	1,040,819.80	-1.48%	-9.83%	-6.14%	5.55%
Financials	1,603,925.17	-2.15%	-9.25%	-8.07%	1.88%
Cons Staples	1,114,157.20	-0.42%	-4.73%	-6.22%	-1.49%
Info Tech	1,860,133.06	-0.85%	-8.27%	-6.66%	-5.10%
Materials	337,430.47	-1.70%	-9.65%	-9.28%	-7.09%
Energy	1,057,880.15	-2.00%	-11.81%	-7.09%	-7.83%
Health Care	1,152,404.86	-0.63%	-6.99%	-10.63%	-8.04%
Utilities	350,533.53	-0.03%	-6.12%	-3.84%	-8.27%
Telecom Svc	280,839.46	-0.92%	-3.94%	-5.28%	-10.64

(Source: Standard & Poors, Janney)

Chart E: June, July & August After the 10 Worst May Performances



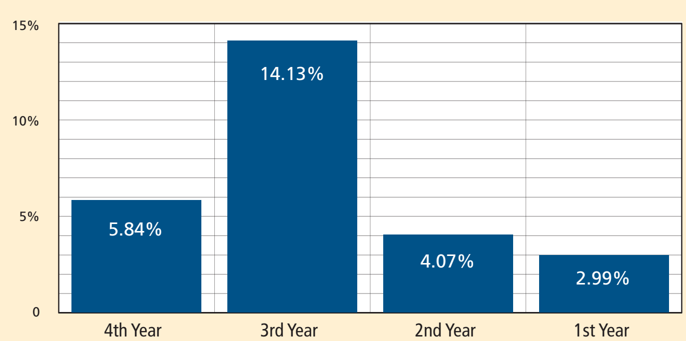
(Source: Standard & Poor's, Janney)

Data on summer results following a weak May are inconclusive, but when you look at all summer months since 1949, June, July and August all show more monthly gains than losses. These types of data, more often than not, are curiosity items, but it is interesting to note that when all summer months were down following a losing May the economy was in a recession. It equally is interesting that consecutive summer month gains came during periods when the economy was relatively vibrant. The current economic situation is not optimal by any means, but it is not a recessionary environment either.

Seasonal market tendencies often fall short of being worthwhile in predicting what a month will produce in market direction and magnitude; especially when you consider that even the strongest seasonal biases run into a major exception often enough not to be totally reliable. But what about a "seasonal" pattern that has been 100% accurate through the last 70 years and 90% correct since the late 1920's?

It may seem to be early to consider the next presidential election cycle, but in only seven months the third year of the presidential election cycle begins. From a market perspective, the third year of the cycle may be the most important.

Chart F: **Election Year Cycle Percentage Returns by Each Year**



(Source: Janney)

Of the 20 times since 1927 that there has been a third year of an election cycle, the S&P 500 has fallen only in two of those years and one of them was in the midst of the Depression. The other was on the cusp of the start to WW II. On average, returns in the third year of a presidential cycle dwarf returns in the other three years. The chart below details the average results for each of the four years of the presidential cycle. (See Chart F).

If you take out the 1931 loss for the SPX, the average for all other third years of the cycle go from a plus 14.13% to 17.35%. It is equally interesting that the best period within the entire 16-quarter presidential cycle was the three quarters from the fourth quarter of the second year of the cycle through the second quarter of the third year. This suggests that we are only four months away from the effect of the president election cycle beginning to exert market influence.

Coincidentally, this period also could encompass the time frame in which corporate earnings growth could reach an interim peak. Through most if not all of this period, interest rates are unlikely to interfere with the market.

At this time it seems wise to maintain an intermediate-term perspective and not worry about what happens this month. Instead it might be wiser to be focused on the potential impact the presidential election could have as we approach 2011.

From a short-term technical standpoint, the 200-day moving average for S&P 500 (1104 as of June 1) stands as potential resistance while the 1000-1040 range should limit downside probes. The 1104 level for the S&P 500 could restrain the market temporarily, but the S&P 500 reaching 1160-1180 this year, and probably higher early in 2011, remains a good likelihood in our view. ■

(The Old World Beckons, Continued from page 1.)

growth and the potential writedowns that could occur if the sovereign debt issues aren't cured without the need for an outright restructuring. But the companies that are well positioned to grow from increased global activity and in many cases offer a plum dividend because of their size and maturity can be found at appetizing discounts to their U.S. peers. We believe that this combination of reasonable valuations, along with the incremental uptick from the currency translation, presents a timely opportunity for investors to add globally-geared Old World equities to a portfolio. ■

Chart B: **S&P Euro 350 Largest Companies by Market Cap —Distribution of Revenue**

Company	Sector	Europe	Rest of World
Nestle SA	Consumer Staples	22%	78%
HSBC Holdings	Financials	36%	64%
Royal Dutch Shell	Energy	37%	63%
Roche Holdings	Health Care	40%	60%
Novartis	Health Care	41%	59%
BP PLC*	Energy	65%	35%
Total SA	Energy	70%	30%
Vodafone Group PLC	Telecom	72%	28%
Rio Tinto PLC	Materials	17%	83%
GlaxoSmithKline PLC	Health Care	64%	36%
Average		**47%**	**53%**

** BP does not break out European revenues instead this number includes everything outside of North America*
(Source: Janney ISG, Bloomberg)

European Economic Whoaaaas

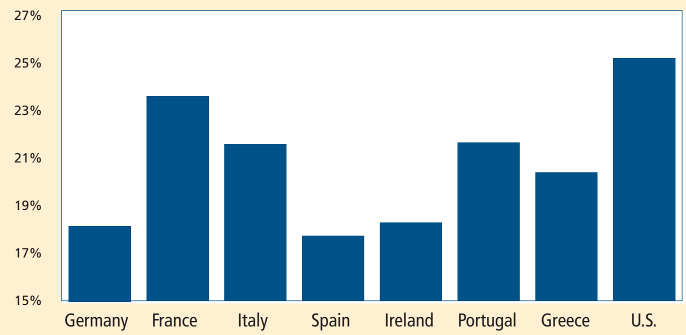
By Guy LeBas, Chief Fixed Income Strategist

Europe, which accounted for 26% of the world's GDP in 2008, is in trouble, and as was the case with the U.S. financial crisis, the fears represent a greater threat in the short-term than the underlying fundamental problems. In the longer-term, however, there are a great number of questions beginning to emerge from Europe's woes. And while it's too early to get a good handle on the regional economic implications, rest assured that nothing good will come of this mess.

The main connection between the financial markets and the real economy is interest rates and lending supply/demand. As the domestic economy so painfully recognized, liquidity fears leading to a subsequent lending pullback has the potential to drive modest economic distresses to the extreme and greatly exacerbate what might have otherwise been a modest downturn. While we don't see the direct effects here in the U.S., the European banking sector appears to be in the early stages of a second round of a substantial lending pullback, particularly in the smaller EU economies. Uncertainty over the terminal value of sovereign debt, which many Eurozone banks use for borrowing collateral, is behind much of this concern. As the market value of, say, Spanish government debt declines, banks which hold that debt can't borrow as much against it and therefore can't lend as much to their end customers. So in some sense, the sovereign credit woes are bleeding over into private lending as well. At the same time, a direct analogy between a U.S. credit pullback and a European one doesn't take into account the differing lending structures: the U.S. lending markets are far more consumer-centric, while the Euro lending markets tend to be more corporate-driven.

While the potential for lending pullbacks represent the greatest economic threat for EU growth in the wake of the ongoing credit fears, the probability of reduced spending among the more distressed governments creates an additional recessionary risk. Greece, as part of its much-needed austerity measures, will be cutting €30 billion of government spending, equivalent to more than 4.2% of the country's annual GDP. Portugal meanwhile, enacted spending reductions equal to about 3.5% of the country's annual output, and while these two examples are the most extreme to date, government expenditure cuts are likely to become the norm throughout the region. The fact that these cuts will likely come on top of a lending pullback means the probability of a double-dip recession for the Eurozone economy is growing substantially. (See Chart G).

Chart G: Government Spending as a Pct of Economic Output in 2009



(Source: Janney Fixed Income Strategy, U.S. Commerce Dept., Government Statistical Bureaus in Respective Countries)

Cultural differences between the U.S. and Europe introduce a complex and hard to predict element into the government spending equation. The modern conception of government from Lockeian times as a contract between the government and the governed has taken on different meanings in different regions. In Europe, the meaning of that contract is more about providing a safety net—in some countries, a net strung well above subsistence level—in exchange for tax rates that U.S. consumers might find exorbitant. This contract implicitly values economic equality over economic efficiency. It also means that a government which cuts social security benefits is effectively breaking off its contract with the governed. In Greece, this breaking resulted in protests, riots, violence, and even death, while in Portugal, this breaking was acknowledged as a necessary cost to support long-term sustenance. Different popular responses to austerity measures in those two countries exemplify how hard it is to paint the EU with a single brush, but it's encouraging to see governments stand up for fiscal conservativism despite its unpopularity.

Differing reactions aside, the fact remains that when a government removes a heavily-used safety net from underneath its populace, that populace will need to adjust. How the populace adjusts now becomes the more important question. Here in the U.S., consumers reacted to the changing environment by adopting a more conservative, less spendthrift attitude, and it's reasonable to believe that changing government spending positions abroad will engender a similar response. The U.S. transition in consumer spending philosophy entailed a painful process with a nearly 8% spending decline from peak to trough. The potential for Eurozone consumers to rebel against a changing social contract represents a third reason why an EU double dip recession is not only increasingly likely, but now downright probable. ■

JANNEY MONTGOMERY SCOTT LLC
1801 Market Street, Philadelphia, PA 19103 • 215.665.6000
WWW.JANNEY.COM • Member: NYSE • FINRA • SIPC