

Investment Perspectives

By Mark Luschini, Chief Investment Strategist



As oil prices go so goes...

The old saw used to be "as General Motors goes so goes the nation." With the current share price of GM at levels last seen in 1955, reflecting tough selling conditions, particularly for SUVs and light trucks, lately energy prices seem to be driving the direction of our economy and the stock market.

Oil demand is largely consumer driven, accounting for more than 70% of total U.S. oil consumption. As a consequence, the challenges to consumer spending, which include falling home prices, rising unemployment and tighter lending standards, are being trumped by the near daily increases in oil prices and its translation into the cost of filling up our gas tanks.

Given a rule of thumb quoted by Swiss investment bank Credit Suisse, a \$0.01 per gallon change in gasoline prices brings the equivalent of a \$1 billion change in U.S. consumer's purchasing power. In a \$14 trillion economy (as of the end of 2007) that may not seem like much. However, when you consider that gas prices have risen nationwide by about \$1 in the last four months, the impact to our economy is closer to \$100 billion if it stays at this level, or just slightly less than the \$107 billion in rebate checks the government is sending to consumers in order to help stimulate economic activity.

After doubling in last twelve months, the price of a barrel of oil has hovered close to \$140, stubbornly defying those who argue that the move cannot be supported by fundamentals alone. Clearly, global prosperity has meant that the demand for energy has increased pressuring traditional sources of crude oil supply to produce more. China alone is responsible for more than 70% of the incremental demand for crude, as it feeds its urbanization and infrastructure needs, as well as an increasing appetite for motorized vehicles. Another prominent factor is the dollar which, given its decline over the last seven years and the fact that crude oil is priced in dollars, means that the cost of oil is cheaper in many countries whose usage has increased helping to amplify the spike in prices.

But besides the conventional use of energy is a growing market for investment in commodities, including oil, created by the financial markets. It has been estimated that, in the last five years, the assets dedicated to investment in commodities through vehicles like mutual funds and exchange-traded funds, to futures contracts and other derivatives, have increased from \$13 billion to \$260 billion. This has lifted the dialogue to testimonies by oil industry executives to financial analysts in front of congressional hearings on the subject.

The prevailing question pertains to the rise in oil prices and how much of it is coming in the form of rational supply/demand decisions and how much is considered to be speculative. The speculative component is difficult to divide between the investment allocations made by investors to this burgeoning "asset class" and that which is "piling on" by short-term traders. Recent testimony before the House Energy and Commerce Committee implied that prices could be significantly inflated and efforts to curb such speculation could bring prices lower rather quickly and dramatically.

An ease in oil price pressures would alleviate one of the aforementioned headwinds facing the U.S. consumer. A drop in oil prices is effectively a "tax cut" helping to facilitate any sustainability let alone growth in consumer spending. Importantly, not only would it help to trim headline inflation but it would likely improve consumer sentiment. Predictably, this would be beneficial to both the economy and the stock market.



Stock Market Commentary

By Gregory M. Drahuschak, Vice President

June typically is one of the weakest months of most years. This June, however, was substantially weaker than most.

Since 1950, when June has been a down month, the S&P 500, on average, has fallen 2.64%. This year, the S&P 500 was off 8.60% for the worst June results in the last 50 years. Previously, this distinction belonged to June 1962, when the S&P fell 8.1%. The all-time worst June was in 1930, when the S&P 500 fell 16.5%.

Historically, July is better than June. If there is a summer rally, most of it typically comes in July. August is another story. Over the long-term, August has been the third worst month of most years.

June is often followed by a July rally—but there have been a few major exceptions. In 2002, July produced a 7.9% loss. In addition to 2002, a weak June preceded a poor July in 1963, 1966, 1969, 1971, 1974, 1981, 1982, 1990, 2001 and last year.

June's poor performance stemmed from the market revisiting some of its prior negatives, like credit market worries and energy. The nearly ceaseless slide in regional banks, however, got most of the negative attention, as the market assumed that the credit woes suffered by the major banks would work their way down through medium and smaller banks. Late in June, the regional bank index slipped below the level it hit during the Asia credit

market crisis a few years ago. The fear of dividend cuts for the major banks was a drag on the entire bank group.

To a lesser extent, June suffered from a reshuffling of the major indices during

their annual rebalancings. Weak consumer confidence that saw the Conference Board's Consumer Confidence dip to a new interim low fostered poor market sentiment, as well. It is interesting to note, however, that often a low in the Consumer Confidence Index coincides closely with the beginning of an upturn in the stock market.

Weakness in the financial sector was enough for the sector to cede its long-term role as the biggest percentage portion of the S&P 500.

The last table on page three shows the changes in sector percentages over the last eight years through the middle of this June. The second chart on page three is a comparison between the information tech sectors and financials that shows the cross of the two in their representation in the S&P 500.

Investors in July face the normal onslaught of earnings reports. Minus the financials, corporate results for the first quarter were better than many people had feared.

First quarter 2008 earnings growth for the S&P 500 Index was -16.7%, which was the third consecutive quarter of negative growth since the third quarter of 2001. Excluding the financials sector, however, the first quarter growth rate was 5%, which was good considering the myriad number of negative influences.

Three hundred fifteen companies in the S&P 500

reported first quarter earnings surprises, while 135% reported negative surprises and 50 reported in line results.

In the industrial and information technology sectors, 80% and 75% of the firms produced positive surprises, respectively. Among small cap stocks represented in the Russell 2000, 50% reported positive surprises, 39% had negative surprises and 11% reported in-line numbers. The energy and materials sectors led the small cap list with 59% and 58% positive surprises, respectively.

Already, expectations for the soon-to-be completed quarter are less robust than the final first quarter numbers. A guide to potential earnings results comes from firms that issue earnings guidance.

As of June 13, 188 S&P 500 firms had offered guidance about their potential second quarter results. 63% of these firms raised their earnings guidance which, coincidentally, matched the percentage of firms that produced positive earnings surprises in the first quarter.

Nearly three-quarters of the consumer discretionary (mostly homebuilders and retailers), energy, healthcare, utilities and industrial firms that offered revised guidance have lowered their earnings estimates.

More than 50% of the firms in information technology, telecom services and materials sectors that have changed their earnings guidance have raised their estimates.

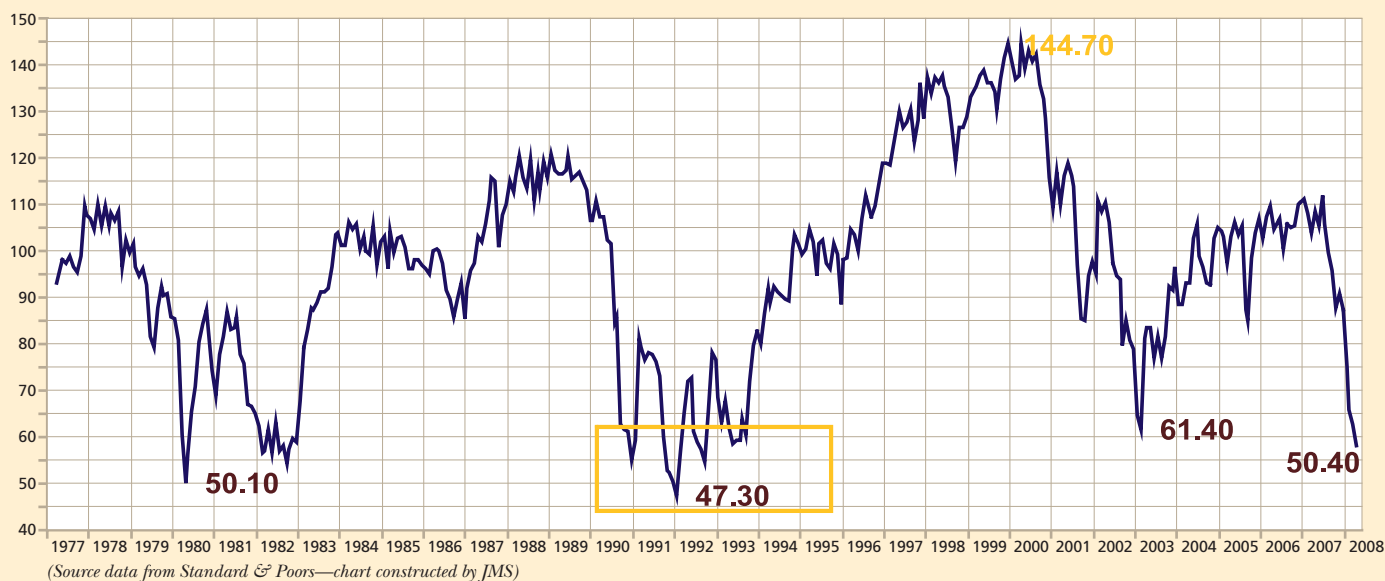
For S&P 500 index members, the number of positive earnings estimate revisions peaked in the middle of 2007 and has been consistently declining since then. Analysts have been revising estimates for Russell 2000 index member firms downward since the second half of 2006. This May, however, showed the first notable reversal, when upward revisions finally

2008 Market Data		Prior Close	Last	Change	% Daily	% Yearly	% Jan	% Feb	% Mar	% Apr	% May	% June	1st Quarter	2nd Quarter
DJ Industries	.DJIA	11346.51	11350.01	3.50	0.03	(14.44)	(4.63)	(3.04)	(0.03)	4.54	(1.42)	(10.19)	(7.55)	(7.44)
S&P 500	SPX	1278.38	1280.00	1.62	0.13	(12.83)	(6.12)	(3.48)	(0.60)	4.75	1.07	(8.60)	(9.92)	(3.23)
NASDAQ Comp	COMP	2315.60	2293.00	(22.60)	(0.98)	(13.55)	(9.89)	(4.95)	0.33	5.87	4.55	(9.11)	(14.07)	0.61
SOX Index	SOX	370.00	369.09	(0.91)	(0.25)	(9.89)	(12.48)	(0.28)	(5.18)	15.26	4.04	(9.28)	(17.25)	8.79
Biotech Index	BTK	734.94	737.81	2.87	0.39	(6.19)	(4.72)	(3.66)	2.14	1.10	1.78	(2.76)	(6.24)	0.05
DJ Transports	.TRANS	4909.12	4948.03	38.91	0.79	8.26	3.97	(4.24)	5.13	8.03	5.21	(9.00)	4.67	3.43
DJ Utilities	.UTIL	506.99	520.85	13.86	2.73	(2.19)	(5.61)	(5.01)	0.31	6.58	2.18	(0.15)	(10.05)	8.74
Volatility Index	VIX	23.44	23.95	0.51	2.18	6.44	16.44	1.30	(3.50)	(18.82)	(14.24)	34.32	13.82	(6.48)
S&P Midcap 400	MID	823.28	818.99	(4.29)	(0.52)	(4.57)	(6.24)	(2.00)	(1.14)	7.61	5.14	(7.14)	(9.17)	5.06
S&P 100	.OEX	579.62	581.09	1.47	0.25	(15.25)	(6.21)	(4.58)	0.01	4.45	(0.29)	(9.08)	(10.49)	(5.32)
Gold EFT	GLD	91.47	91.40	(0.07)	(0.08)	10.84	10.84	5.23	(6.00)	(4.16)	0.92	4.52	9.64	1.10
Russell 1000 Index	.RUI	702.71	703.22	0.51	0.07	(12.08)	(6.11)	(3.27)	(0.84)	4.96	1.62	(8.47)	(9.94)	(2.37)
Russell 2000 Index	.RUT	698.14	689.66	(8.48)	(1.21)	(9.97)	(6.88)	(3.80)	0.26	4.10	4.48	(7.83)	(10.19)	0.25

Data source: Standard & Poor's

Consumer Confidence: Conference Board Index

For year ending in February



outnumbered estimate cuts. Interest rates and earnings expectations share a common element that often means more than the absolute numbers. Very low earnings that are on an upswing can be positive catalysts for stocks even if earnings are relatively low. Interest rates may be very low; but if they are rising even from very depressed levels, the market tends to focus on the direction, not the actual current cost of capital.

The Federal Reserve's interest rates decision and policy statement June 25 largely was expected. The statement that gave a more noticeable nod to inflation concerns, which probably will lead to higher rates in time. This, however, should benefit the dollar and put some pressure on the price of oil.

Our major concern is that inflation expectations increase notably. Inflation, more than any other issue, we think, is the market's biggest potential restraint.

Traders last month increasingly worried about the deterioration of the market's technical condition. In mid-June, the S&P 500 breached the lower end of a trading range that put the January-March reaction lows in focus. On a very near-term basis, the erosion in June pushed the major averages toward oversold

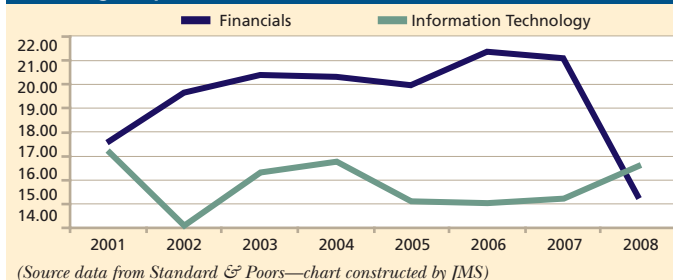
conditions that often generate at least a temporary lift. The fact that this was happening as some averages set new reaction lows and others edged toward them added hope that the combination might produce a more substantive rally than would be true if the market merely reached an oversold level.

It also is interesting to note that fourteen times since 1945, in the 21 months that the S&P 500 has declined by 8% or more in a single month, the S&P has rallied an average of 1.0% the next month.

Despite the potential for an interim market rally, exiting the top end of the range that had been in place since January will need additional catalysts than are present now. The price of crude oil will be an important element during any rally attempt, but the market may need to see solid second-quarter corporate results in order to start and sustain an upside move.

Despite the possibility for a near-term rally, retaining a cautious near-term approach to the

Percentage Representation in the S&P 500



market makes sense. If the market rallies at some point this month, it will be important to assess the strength of the rally. We will report on internal market conditions in our *Market View Daily*, which is available from your Janney Financial Consultant.

A market rally on weak underlying technical conditions would taint the move. After the recent market weakness, we would suggest that cash-heavy portfolios gradually scale buy equities with initially small percentage purchases.

In accounts that have their equity component fully invested, a near-term market rally would be an opportune time to cull out the weakest positions to increase the cash component of the portfolio as a partial hedge. We would, however, earmark this cash for a return to equity positions once market conditions suggest that redeploying the cash clearly is advisable.

	Energy	Materials	Industrials	Consumer Discretionary	Staples	Health Care	Financials	Info Tech	Telecom	Utilities
June 01	6.98	2.56	11.65	13.23	7.57	13.88	17.63	17.25	5.42	3.83
June 02	7.19	3.11	11.00	13.86	10.10	13.99	19.70	14.03	3.96	3.05
June 03	5.80	2.67	10.45	10.95	11.59	14.91	20.45	16.38	3.81	2.99
June 04	6.56	2.90	11.32	11.09	11.27	13.52	20.38	16.85	3.45	2.66
June 05	8.97	3.03	11.38	11.49	10.15	13.39	20.00	15.12	3.15	3.32
June 06	9.67	2.96	11.73	10.30	9.61	12.49	21.45	15.02	3.36	3.42
June 07	10.84	3.10	11.34	10.12	9.25	11.73	21.15	15.22	3.69	3.54
June 08	14.87	3.84	11.42	8.57	10.78	11.43	15.29	16.68	3.33	3.79

Commodities, Inflation and Interest Rates: A Bedtime Story

By Guy LeBas, Vice President



The month of June was a volatile one for the fixed income markets, not only because of a retrenchment in fears of weakening credit quality, but because of an increased concern over higher prices. The net result was that the Fed brought about a halt to its course of interest rate cuts, and interest rates fluctuated widely during the course of the month. As of the close on June 30, the ten-year Treasury was trading with a yield of 3.97%, which was just 0.09% below its opening level of 4.06%. During the course of the month, however, ten-year yields varied over a 0.37% range. The short end of the yield curve exhibited even greater volatility, as, while the two-year Treasury declined just 0.02% during the month to 2.62%, yields spanned a wide 0.67% range. Credit markets generally underperformed Treasuries, as talk of further writedowns at domestic and global banks and investment banks surfaced in analyst reports. Those concerns culminated with the Goldman Sachs sector-wide equity analyst downgrades for financial firms on June 26.

Though resurgent writedown concerns were a highlight of the month from a credit perspective, the specter of elevated inflation remains the most substantial risk facing bond investors. This assessment stems not from the expectation that inflation will rise rapidly—we believe that core inflation remains relatively contained for the short term—but rather from the fundamentally corrosive nature of an increase in price levels. Just as a rising tide lifts all boats, a falling tide can prove quite destructive. And inflation is one of the few things that can truly be called a tidal force for the asset markets.

Fears of higher inflation in the month of June were driven, as is often the case, by the headline-grabbing increases in the price of a barrel of oil. During the month, the average price of crude measured \$134.02, well above that at any other point in history. More important for consumers during the summer holiday season is that the cost of gasoline remained north of the psychologically-important \$4 per gallon mark for all but six days in June. Corn prices similarly reached record highs, while gold, at \$912 per ounce, once again approached its March peak. In light of higher commodity prices, it's not tremendously surprising that investors' biggest fear has once again become inflation.

To date, however, the price increases have remained largely exogenous. Translated from economist into English, this means that higher commodity prices represent shocks which are unlikely at this point to flow through into broader price increases. What's more, it makes little sense, at a time when consumer demand is clearly impaired, for higher prices to infiltrate deeply into higher sectors. As such, while we regard inflation as a major risk, we nonetheless believe that it will remain relatively contained to higher commodity prices through the balance of the consumer slowdown. That slowdown, which is in full force, looks set to extend well into 2009. Our assessment of the inflation situation suggests that the recent increases in interest rates—the ten year Treasury yield is well above the March low of 3.31%—are somewhat overblown. That said, the corrosive nature of inflation does mean that the interest rate markets are more risky today than they were six months ago, so some portion of the increase in interest rates is fundamentally justifiable.

While inflation looks set to remain stable for the short run, in the longer-term, higher commodity prices remain a serious threat. The world's population is growing, but more important is that industrialization in emerging markets means that global resource demand is on the rise. Commodities exist in more-or-less fixed quantities, so as demand increases, supply has little room to grow, and prices must rise. When commodity prices increases become consistent and not an "exogenous shock," is exactly when they feed into higher prices in the broader economy. That prospect remains arguably the most significant long-term concern for not just the bond markets, which are likely to see higher rates in the years and decades down the road, but for all asset classes across the board.

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