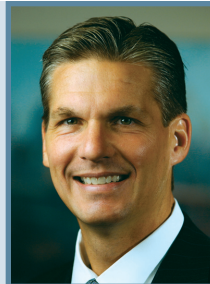


## Rags to Riches to...

By Mark Luschini, Chief Investment Strategist



For most equity and fixed income investors, 2009 turned out to be an extremely rewarding year. It did not start off that way. The year began in an off-putting fashion as financial markets were stung by a lack of confidence that anything could be done to rescue the global economy from ruin. By the end of February, the S&P 500 index (a proxy for the U.S. stock market) had fallen 18%, and most categories of non-government bonds lost considerable value as well. Once signs began to sprout that efforts by policymakers to stabilize the financial system were taking root, the convalescence began in earnest. A sharp rally in risk assets that has yet to cease pushed returns from stocks and most bonds to appreciably higher levels than many could envision just a few months before.

The following table provides full year returns for a variety of asset classes. (See Chart A). In some cases, the returns are not just remarkable, but among the top results ever produced by that sector. For instance, the S&P 500's return of 28.6% is its best performance since 2003. Meanwhile, the MSCI Emerging Markets index was up by whopping 78.3%, more than any time in the last 20 years. Non-government bonds not only benefited from the recovery in security prices but have been the primary recipient of cash flows flooding into them from money market funds in search of better returns. High yield bonds, for instance, were by far the best performing fixed income category, returning close to 60%, better than any year on record. All told, for investors that were willing to peer across the abyss and believe the resilience of the U.S. economy along with a massive intervention by policymakers would snap the grip of the Great Recession, the rewards were impressive.

Growth in the U.S. and for most of the rest of the world resumed in the third quarter of last year and has continued to gain momentum. Recently, the International Monetary Fund (IMF) raised its estimate for global growth to 3.1% in 2010 from its previous forecast of 2.5%. That is encouraging except within that forecast the IMF said that it expects the U.S. economy to grow at a 1.5% annualized pace, well below its trend line of 3%. Judging from market values today, investors are expecting, if we dare say demanding, continued economic momentum well into the New Year. When asset values in the beginning of 2009 were much lower than they are now, any piece of news that was less bad than terrible was embraced as a positive sign for the markets, giving investors a rallying point. Today, however, prices more fully reflect an improved economic picture. Arguably, the markets have already discounted good news for 2010 to the point where prices are vulnerable to a relapse of some magnitude in the event a data point or two disappoint. The graph below depicts the increase in the price-earnings ("P/E") ratio reported in Bloomberg for the 500 companies in the S&P index. Currently, the market's P/E stands at approximately 25 times trailing earnings and 18 times forward estimates. (See Chart B). By at least that common measure, the stock market overall is fully valued. Looking at the next chart, which illustrates the decline in corporate bond yields when compared to those of treasury securities, it tells a similar story about the bond market. (See Chart C). It is our opinion, therefore, that expectations for returns from stocks and bonds should be tempered, particularly when contrasted with the performance achieved during 2009. Does that mean the markets will finish the year lower or achieve only a marginal gain? No. It does suggest, however, that the markets have romanced a fair amount of good news and further advances will be predicated upon fundamental improvement in the economy coupled with benign inflationary conditions. That happens to be the very environment we expect for the early months of 2010. The trickier assessment that is difficult to handicap develops near mid-year, when it is expected that the consumer will be in shape to keep the economy chugging along after policy-infused stimuli begins to fade. ■

Chart A: Selected Index Returns for 2009

Equities		Fixed Income	
S&P 500	28.6%	Barclay's Municipal Bond	12.9%
S&P 400	37.4%	Barclay's Aggregate	5.9%
Russell 2000	27.2%	Barclay's Aggregate Gov't Treasury Long	-12.9%
MSCI EAFE (Developed Markets)	32.5%		
MSCI EM (Emerging Markets)	78.3%		

(Source: Bloomberg, Barclay's and JMS ISG)

Chart B: S&P 500 P/E Ratio 2009 (Trailing Earnings)

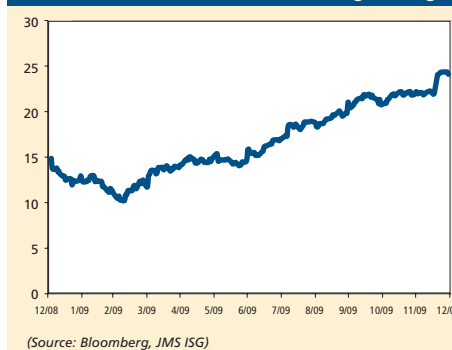
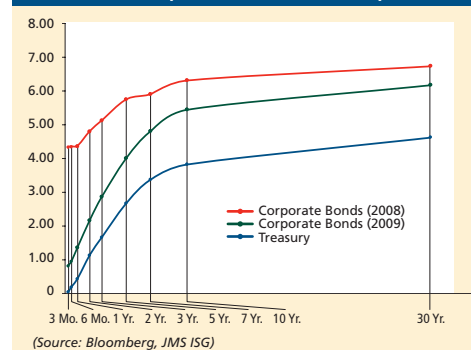


Chart C: 2009 Corporate Yield Curve Compression





## All's Well that Ends Well?

By Gregory M. Drachusak, Market Strategist

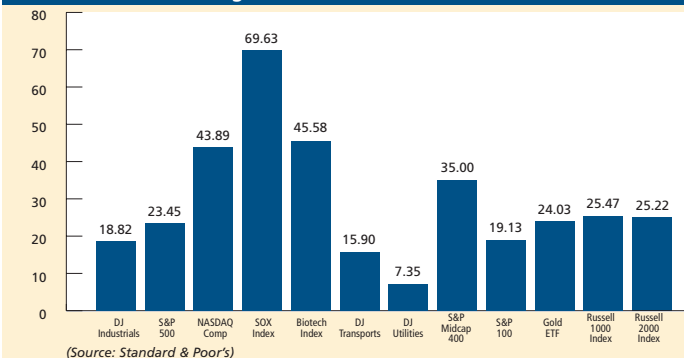
Hope springs eternal so they say, but after a 37.2% loss in 2008 and respective losses in both January and February of 2009 of 8.57% and 10.99% and a 7.15% loss six days into March, it looked like hope had sprung a leak.

Little did anyone know on March 6th that the market was about to embark on one of its best turnarounds on record. The S&P ended March 2009 with an 8.54% gain, the first of seven consecutive monthly gains that also began a stretch of nine monthly gains out of the last 10 months of the year. (See Chart D).

By any measure, living through the early part of 2009 was a harrowing experience. Even as the market began its recovery, the news wires hummed with stories of pending financial calamity. An old cliché says that the market likes to climb a wall of worry, but last year it faced a formidable task overcoming what some people dubbed, "The Great Recession."

But in the end all the major averages scaled the wall better than anyone dreamed was possible and ended 2009 with all but one of the major averages posting double digit percentage gains. (See Chart E).

Chart E: 2009 Percentage Results



The market's 2009 gyrations might seem to make the title of Irving Stone's "The Agony and the Ecstasy" an appropriate description for last year. 2009, however, did not end with many investors feeling anything like ecstasy. A sigh of relief might have been more appropriate.

But 2009 is now ancient history as the market sets its sights well into 2010. From our perspective, the view is more optimistic than it was a year ago, but the picture is far from clear. Some trends that began last year bode well for the early part of 2010. The employment pattern tops the list. The final 2009 report on unemployment claims showed new claims at their lowest level since September 2008 while continuing claims were the lowest in 10 months. (See Chart F and G).

Chart H: 2009 Final Sector Results

Sector	December	4th Quarter	2009	
TOTAL RETURNS S&P 500 (TR)	1.93%	6.04%	26.46%	
PRICE RETURNS S&P 500	9,927,564.42	1.78%	5.49%	
23.45%				
FINAL 2009 SECTOR RESULTS				
Information Technology	1,971,224.34	5.58%	10.45%	59.92%
Materials	357,206.05	1.41%	6.89%	45.23%
Consumer Discretionary	950,773.84	4.33%	8.59%	38.76%
Industrials	1,017,059.78	1.12%	4.77%	17.27%
Health Care	1,254,196.90	1.91%	8.53%	17.07%
Financials	1,427,379.27	-1.64%	-3.68%	14.80%
Energy	1,139,926.07	-0.99%	5.04%	11.29%
Consumer Staples	1,127,767.57	-0.66%	4.22%	11.20%
Utilities	368,048.09	5.21%	6.08%	6.80%
Telecommunication Services	313,982.52	4.58%	5.87%	2.63%

(Source: Standard & Poor's and Janney)

Chart F: Continuing Claims

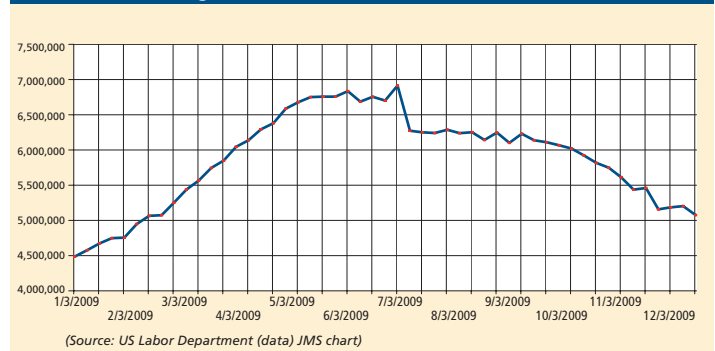
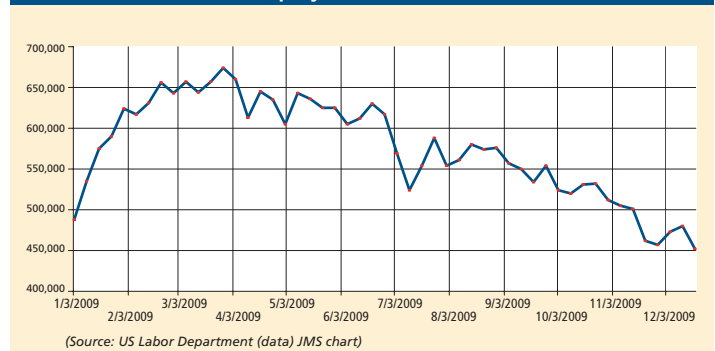


Chart G: 2009 Initial Unemployment Claims

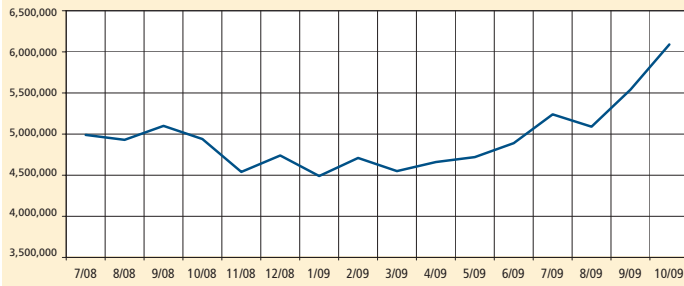


Manufacturing is improving. The latest Chicago Purchasing Manager's Index reached its highest level in more than two years and nearly 10% above its monthly average since 1967. New homes sales remain stuck at a low level, but existing home sales rebounded to their best level in about two years. (See Chart I).

The ISM Index reported the first business day of 2010 was better than expected and more than three Index points above its monthly average for the last 62 years. (See Chart J).

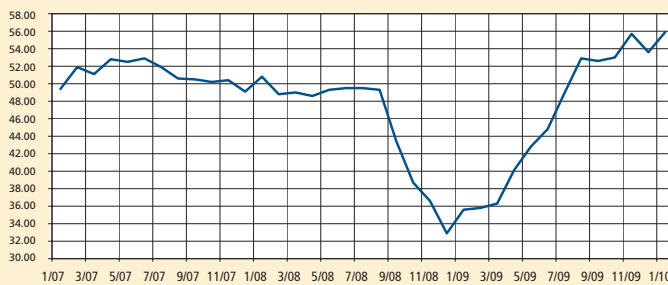
As Mark Luschini noted in his article for this publication, "... expectations for returns from stocks and bonds should be tempered,

**Chart I: Existing Home Sales**



(Source: Data from the National Association of Realtors, JMS)

**Chart J: ISM January 2007 – Current**



(Source: Institute for Supply Management, JMS)

particularly when contrasted with the performance achieved during 2009.” This is completely in line with our view for 2010.

Based on consensus earnings estimates for the S&P 500 (\$75–76) as well as technical factors, we anticipate that the S&P 500 at some point in the year could trade 8–10% above its 2009 close. This translates to a 1250–1300 range for the S&P. On the low end 950–975 is not out of the question if the market encounters significant headwinds.

2009 began with the market facing gale-force headwinds. These headwinds eased considerably through the year, but the atmosphere is far from completely calm. On the plus side, the economy should experience real but subdued GDP growth.

One of the headwinds the market could face this year is valuation. As Mark Luschini pointed out, at today’s level the market is fairly valued, but even assuming that the consensus earnings expectation is reached, considering what we think will be modest economic growth, price-earnings ratio expansion will be difficult to achieve.

One of our biggest concerns is a major legislative misstep. The progress the healthcare proposal made last year suggests that passage of some form of healthcare reform will occur this year. Perhaps more importantly, however, debate over the tax code is likely to be a key issue that could derail the market for a time.

The Federal Reserve will remain in the forefront of the market’s attention as the market attempts to determine when and how the Fed backs away from the stimulus it has applied to the economy. Our view is that the Fed will not do anything of substance before late this year, and we could see a Fed move postponed until 2011.

At some point, commodity prices could become a drag as rising prices sap discretionary buying power from the economy. We doubt that the core inflation rate will move notably higher this year, but should the late-year move up in energy prices continue, consumer spending will be impacted.

Overall, the best characterization of our view of 2010 is that it will be moderately positive year for the market. It also will be a year in which sector and individual stock selection will be the major determinants of portfolio performance. At this time we see a conservative sector bias as the most appropriate posture.

As for this month, since 1950 the S&P 500 has produced a positive return for 60% of the Januarys with an average gain of 1.07%. January, on average, is the fourth best month of the year. Undoubtedly the old adage, as January goes so goes the year, will become a talking point in the press, but the market’s dismal performance last January clearly did not serve as a harbinger of the outcome for the year. Historic precedents like the January effect in recent years have proven to be far less reliable than they had been for decades.

Please note that one of our *Market View Daily* reports will have a more detailed 2010 outlook. That report will be available from your Janney Financial Consultant. ■

**Chart D: 2009 Index Performance**

2009 Market Data		Prior Close	Last	Change	% Daily	% Yearly	% Jan	% Feb	% Mar	% Apr	% May	% June	% July	% Aug	% Sep	% Oct	% Nov	% Dec	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
DJ Industries	.DJIA	10548.51	10428.05	(120.46)	(1.14)	18.82	(8.84)	(11.72)	7.73	7.35	4.07	(0.63)	8.58	3.54	2.27	0.00	6.51	0.80	(13.30)	11.01	23.45	7.37
S&P 500	SPX	1126.42	1115.10	(11.32)	(1.00)	23.45	(8.57)	(10.99)	8.54	9.39	5.31	0.02	7.41	3.36	3.57	(1.98)	5.74	1.78	(11.67)	15.22	21.30	5.49
NASDAQ Comp	COMP	2291.28	2269.15	(22.13)	(0.97)	43.89	(6.38)	(6.68)	10.94	12.34	3.32	3.42	7.82	1.54	5.64	(3.64)	4.86	5.81	(3.07)	20.05	23.66	6.91
SOX Index	SOX	361.39	359.91	(1.48)	(0.41)	69.63	(1.84)	(5.11)	13.89	9.63	7.86	(3.01)	14.66	1.47	6.39	(8.95)	4.53	16.08	8.14	14.69	36.77	10.49
Biotech Index	BTK	948.38	942.13	(6.25)	(0.66)	45.58	(1.95)	(6.01)	7.55	(0.69)	1.83	7.47	24.83	6.35	(0.29)	(11.04)	8.17	6.08	(0.88)	8.69	35.14	2.09
DJ Transports	.TRANS	4176.51	4099.63	(76.88)	(1.84)	15.90	(16.16)	(15.73)	7.40	17.14	1.85	1.00	10.68	2.43	3.62	(4.91)	8.98	4.11	(24.12)	20.51	26.74	7.89
DJ Utilities	.UTIL	404.12	398.01	(6.11)	(1.51)	7.35	(0.29)	(12.37)	1.67	1.47	2.03	4.93	3.26	1.05	1.04	(3.76)	4.45	4.96	(11.16)	8.63	11.24	5.51
Volatility Index	VIX	19.96	21.68	1.72	8.62	(45.80)	12.10	3.37	(4.77)	(17.31)	(20.77)	(8.89)	(1.63)	0.35	(1.54)	19.84	(20.14)	(11.55)	10.35	(40.30)	(17.72)	(15.35)
S&P Midcap 400	MID	736.17	726.67	(9.50)	(1.29)	35.00	(7.36)	(9.87)	9.75	13.76	2.56	0.46	8.63	4.22	5.57	(4.61)	3.89	6.12	(8.36)	17.21	25.69	5.16
S&P 100	.OEX	518.91	514.09	(4.82)	(0.93)	19.13	(9.33)	(11.01)	8.37	7.59	5.31	0.49	7.12	3.14	2.87	(1.24)	5.89	0.66	(12.56)	13.86	19.65	5.27
Gold ETF	GLD	106.93	107.31	0.38	0.36	24.03	5.54	1.45	(2.54)	(3.33)	10.23	(5.22)	2.38	0.05	5.84	3.72	12.79	(7.20)	4.35	1.00	17.69	8.56
Russell 1000 Index	.RUI	618.29	612.01	(6.28)	(1.02)	25.47	(8.29)	(10.67)	8.52	9.95	5.27	0.06	7.49	3.40	3.90	(2.32)	5.63	2.27	(11.09)	15.82	21.85	5.52
Russell 2000 Index	.RUT	633.41	625.39	(8.02)	(1.27)	25.22	(11.20)	(12.29)	8.67	15.53	2.88	1.34	9.53	2.76	5.63	(6.87)	3.01	7.88	(15.36)	20.23	23.04	3.49

(Source: Standard & Poor’s)

## Fixed Income 2010 Outlook

By Guy LeBas, Chief Fixed Income Strategist



This past year was one of tremendous flux, both in terms of economic conditions and in terms of capital markets happenings. To name but a few, The Great Recession reached a low point and subsequently eased in 2009, marking the culmination of credit pressures and consumer balance sheet weakness that was building for years; interest rate markets have begun pricing in growing uncertainty about conditions much further out than five years down the road; and corporate bond markets were the beneficiaries of a rubber band bounce back, after nervousness got the better of rational analysis in the early days of 2009.

But as 2009 is now in the history books, it's time once again to put the cart before the horse. Aside from upsetting equine enthusiasts and cornhuskers the world across, our annual Fixed Income Outlook aims to provide a template for evaluating the economic and fixed income environments in the New Year. The full version of our Outlook is available from your Janney Financial Consultant, but as is the latest vogue, we thought it interesting to share what we believe to be the Top Potential Surprises of 2010.

Forecasting is an imprecise art. That much was evident in the numerous mis-estimates of just how ugly the recently-finished Great Recession and coinciding credit pullback proved to be. In recognition of that imprecision, we're providing a list of the most significant potential unexpected developments for 2010, as well as a qualitative assessment of their probability and impact. Each of these events has a greater chance of occurring than the markets appear to have priced in:

- 1 Rising unemployment does feed back into first quarter consumer spending, pushing the domestic economy back into a double dip recession and forestalling Fed rate hikes (low-moderate probability, high impact).
- 2 Core inflation again refuses to materialize amid limited end user demand for goods and services, limiting the Fed's need to raise rates (high probability, moderate impact).
- 3 Oil prices rally past \$110 per barrel by May on demand for industrial chemicals and limited refining capacity (high probability, moderate impact).
- 4 Higher mortgage rates have a greater than anticipated impact on housing demand and lead to another leg downward in U.S. home prices (low probability, high impact).
- 5 Policy actions successfully tame fears of long term inflation, leading to a rally on the long end and a sharp flattening of the yield curve, particularly in the 5–30 year range (low probability, moderate impact).
- 6 The U.S. dollar rallies back aggressively versus major currencies—especially the Euro—and gold prices slide sharply as a result (high probability, moderate impact).
- 7 European Union members bail out a member country to stave off default risk, thereby further stretching the economic fabric of the EU and the Euro (low probability, high impact).
- 8 Commercial real estate defaults fail to materialize at the predicted pace as liquidity conditions improve and lenders offer greater concessions to avoid ruthless defaults (low-moderate probability, moderate impact).
- 9 The Fed/Treasury elect not to provide support for a financial institution that met the \$100 billion “systemically important” threshold and instead unwind the offending institution (low probability, moderate impact).
- 10 A Middle East sovereign default triggers a range of concerns in the region and in the emerging market sector in general (low probability, moderate impact). ■

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