

# INVESTORS UPDATE

SOUND INVESTMENT SOLUTIONS. A HERITAGE OF SERVICE.

## ECONOMIC COMMENT



James D. King

By James D. King,  
President & Chief Investment Officer

Economic and market trends are established when competing forces meet and one side is dominant. For example, a stock price rises when there are many more buyers than sellers. Worker wages don't increase if there is an abundance of workers relative to the number of available jobs.

For several quarters we have expressed our view that the recovery of the economy from the depths of 2008 and early 2009, while real and sustainable, will occur at a very sluggish pace. The cause of this mediocre level of growth is that competing forces are nearly equal. Let's examine two examples.

The housing market collapse was a precipitating factor leading to the recession. Activity levels have clearly improved, but only because interest rates have reached such low levels, prices became so depressed, and the government introduced attractive homebuyer incentives. Absent these circumstances, it seems likely that the housing market would further succumb to the excess supply and impaired mortgage condition that plagues the market. Competing forces offset one another and result in a flat trend.

Unemployment has been one of the most troubling results of the economic downturn. While many signs of economic improvement are apparent, this rate has yet to drop much below 10%. New jobs are being created, yet at such a slow pace that they barely offset added returning workers (those who had given up job-hunting and have now re-entered the market). Again, until the pace of job creation significantly outweighs increases in job-searchers, unemployment will remain unchanged.

National Penn Investors Trust Company (NPITC) continues to observe that competing forces leave the U.S. economy in a state of equilibrium. Growth is positive yet barely so, equities are fully valued in the current environment, short-term interest rates must remain low and unchanged, and inflation is benign. We believe time is the missing ingredient to achieve robust economic growth, and several more quarters are required. Until then, our continued focus for NPITC clients is security selection within a disciplined portfolio framework so that we are prepared to capitalize on future opportunities. ■

## EQUITY REVIEW



Harlan W. Lavin, Jr.

By Harlan W. Lavin, Jr.,  
Vice President & Portfolio Manager

Through the end of the 1st quarter of 2010, the Dow Jones Industrial Average, S&P 500 and NASDAQ have surged 68%, 76% and 90%, respectively, from their March 2009 lows. According to Standard & Poors (S&P) Equity Research Group, the performance of the markets during this time has mirrored a pattern common to every bull market since 1949. Consistent with the pattern, the initial gains have been led by small-cap and low quality common stocks as investor appetite for risk returned.

S&P Equity Research Chief Investment Strategist, Sam Stovall, further states that, "During the second year of a recovery, stocks keep rising, though not as powerfully; during this phase small- and mid-cap stocks typically continue to outperform both large-cap stocks and the S&P 500, while higher quality common stocks with stable and growing earnings reassert themselves and trump low quality names."

The 1st quarter's returns followed the recovery pattern outlined above, as NPITC's LargeCap Equity Strategy was up 4.58% versus the S&P 500 advance of 5.39%; the NPITC MidCap Equity Strategy increased 8.11%, while its S&P 400 benchmark was up 9.09%; and the NPITC AllCap Equity Strategy and its S&P 1500 benchmark advanced 5.66% & 5.80%, respectively. The best performing industry sector for the first 3 months of 2010 was Industrials up 13.06%, followed by Financials up 11.16%, Consumer Discretionary up 10.47%, Consumer Staples up 5.82%, Health Care up 3.40%, Materials up 2.88%, Technology up 1.91%, Energy up just 0.62%, Utilities down -3.54%, and lastly Telecommunications down -4.32%.

The market has continued to move upward despite areas of concern, which include those in the real estate markets, credit availability, income growth, labor conditions, European Union debt issues, health care reform, and inflation risks in China & India. There appears to be growing consensus on Wall Street that as long as none of these issues threaten to derail the cyclical recovery in corporate earnings, the markets will continue to advance in keeping with corporate profit improvement.

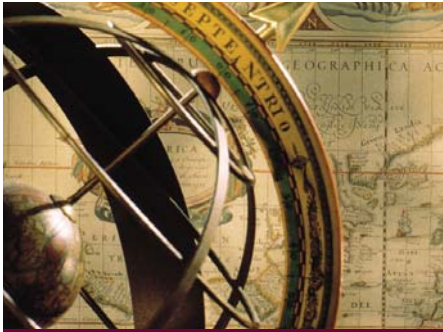
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## OFFICE LOCATIONS:

WYOMISSING	2201 Ridgewood Road, #180	610.372.6414
ALLENTOWN	1620 Pond Road	610.366.9934
DOYLESTOWN	171 North Broad Street	215.230.4405
HAZLETON	12 East Broad Street	570.459.6716
OXFORD	24 South Third Street	610.998.1565
YORK	140 East Market Street	717.771.5566



## EQUITY REVIEW

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National Penn Investors Trust Company continues to encourage equity ownership. While equity prices appear fully valued at quarter's end, we anticipate that when further evidence of economic growth appears, equity returns will respond in-kind. In the event growth fails to materialize or meet expectations, we recognize that investors would likely re-assess the strength of the economic recovery and market volatility could rapidly return.

We remain focused on and sensitive to each client's needs and risk tolerance in order to establish and affirm an appropriate investment objective, a thoughtful asset allocation, broad diversification, and a quality investment program within the framework of our disciplined, proven strategies. ■

## FIXED INCOME REVIEW — MUNICIPAL BONDS

By Debra L. Hippensteel,  
Vice President & Senior Portfolio Manager

Municipal bonds (issued by state or local governments) have long been an attractive investment vehicle for investors seeking income free from Federal and, in many instances, state income taxes. Over the last six months, the yields on high quality municipal bonds have been rising, pushing the price of these bonds lower, and making the purchase of these securities even more appealing.

Weakening municipal bond prices are the result of two factors. First, a shift to equity investing by many investors has caused demand for municipal bonds to soften. Second, a new ➤

For the period ended March 31, 2010				Compound, Annualized Returns			Growth of	
	Quarter	YTD	1-Year	3-Year	5-Year	10-Year	\$10,000	Since
<b>Equity Strategies</b>								
<b>LargeCap Core Equity</b>	<b>4.6%</b>	<b>4.6%</b>	<b>43.5%</b>	<b>(0.1%)</b>	<b>4.6%</b>	<b>1.3%</b>	<b>\$36,140</b>	1/1/1995
S&P 500 Stock Index	5.4%	5.4%	49.8%	(4.2%)	1.9%	(0.7%)		
<b>MidCap Core Equity</b>	<b>8.1%</b>	<b>8.1%</b>	<b>52.5%</b>	<b>(1.3%)</b>	<b>5.3%</b>		<b>\$15,750</b>	1/1/2002
S&P 400 Stock Index	9.1%	9.1%	64.1%	(0.8%)	5.2%			
Russel Mid-cap Stock Index	8.7%	8.7%	67.7%	(3.3%)	4.2%			
<b>SmallCap Equity</b>	<b>2.3%</b>	<b>2.3%</b>	<b>43.4%</b>	<b>(0.0%)</b>			<b>\$10,794</b>	2/1/2006
Russell 2000 Stock Index	8.8%	8.8%	62.7%	(3.8%)				
<b>AllCap Core Equity<sup>1</sup></b>	<b>5.7%</b>	<b>5.7%</b>	<b>46.0%</b>	<b>0.3%</b>	<b>5.1%</b>		<b>\$18,806</b>	1/1/2003
S&P 500 Stock Index	5.4%	5.4%	49.8%	(4.2%)	1.9%			
S&P 1500 Stock Index	5.8%	5.8%	51.3%	(3.9%)	2.3%			
<b>International Equity</b>	<b>(1.4%)</b>	<b>(1.4%)</b>	<b>50.5%</b>	<b>(6.5%)</b>	<b>4.7%</b>		<b>\$12,346</b>	3/1/2005
MSCI EAFE Index	0.9%	0.9%	55.2%	(6.5%)	6.0%			
<b>DM Equity</b>	<b>3.5%</b>	<b>3.5%</b>	<b>52.0%</b>	<b>(1.5%)</b>	<b>4.5%</b>	<b>2.9%</b>	<b>\$36,156</b>	7/1/1994
S&P 500 Stock Index	5.4%	5.4%	49.8%	(4.2%)	1.9%	(0.7%)		
Blended Stock Index <sup>2</sup>	5.9%	5.9%	54.5%	(3.8%)	3.3%	1.8%		
<b>Fixed Income Strategies</b>								
<b>Taxable Fixed Income</b>	<b>1.6%</b>	<b>1.6%</b>	<b>8.8%</b>	<b>6.7%</b>	<b>5.7%</b>	<b>6.9%</b>	<b>\$29,996</b>	1/1/1995
Barclays Gov't/Credit Index	1.5%	1.5%	7.5%	5.8%	5.2%	6.2%		
<b>Core Fixed Income</b>	<b>1.8%</b>	<b>1.8%</b>	<b>8.1%</b>	<b>7.3%</b>	<b>6.4%</b>	<b>7.1%</b>	<b>\$29,025</b>	1/1/1995
Barclays Aggregate Index	1.7%	1.7%	7.7%	6.1%	5.4%	6.3%		
<b>Intermediate Fixed Income</b>	<b>1.1%</b>	<b>1.1%</b>	<b>6.4%</b>	<b>6.2%</b>	<b>5.4%</b>		<b>\$13,910</b>	8/1/2003
Barclays Int Gov't/Credit Index	1.5%	1.5%	6.9%	5.9%	5.2%			
<b>Municipal Income</b>	<b>1.1%</b>	<b>1.1%</b>	<b>6.0%</b>	<b>3.4%</b>	<b>4.0%</b>	<b>5.8%</b>	<b>\$24,438</b>	1/1/1995
Barclays Municipal Index	1.3%	1.3%	9.7%	4.6%	4.6%	5.6%		
<b>DM Taxable Income</b>	<b>2.0%</b>	<b>2.0%</b>	<b>9.0%</b>	<b>3.1%</b>	<b>3.6%</b>	<b>5.5%</b>	<b>\$25,765</b>	7/1/1994
Barclays Aggregate Index	1.7%	1.7%	7.7%	6.1%	5.4%	6.3%		
<b>DM Tax-Free Income</b>	<b>0.5%</b>	<b>0.5%</b>	<b>7.2%</b>	<b>2.6%</b>	<b>3.4%</b>	<b>4.6%</b>	<b>\$21,034</b>	7/1/1994
Barclays Municipal Index	1.3%	1.3%	9.7%	4.6%	4.6%	5.6%		

<sup>1</sup> Prior to 1/1/2007, the NPITC AllCap Equity strategy was managed by National Penn Capital Advisors.

<sup>2</sup> Comprised of the S&P 500, S&P 400, and MS EAFE equity indices.

Performance reported above is that of NPITC's model investment accounts.

Investment returns are time-weighted and calculated prior to assessing account level fees.

Stocks and bonds are not bank deposits, are not insured by the FDIC and can fluctuate in value each day.

Past performance is neither a guarantee nor a prediction of future results.

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investment vehicle known as Build America Bonds ("BABs") was authorized by The American Recovery and Reinvestment Act of 2009 (ARRA). BABs, a new type of **taxable** bond issued by state and local governments, allows municipalities to offer higher interest rates on their debt than they could typically afford. Why? The Federal Government provides a direct subsidy of 35% of the interest payments to bondholders. The higher interest rate and security of the Federal subsidy have made BABs attractive not only to domestic taxable bond investors, but also to global investors. Thus, even as the supply of traditional municipal bonds has declined, their yields have trended higher as a result of reduced demand.

In the month of February 2010 alone, BABs represented approximately 26.5% of all municipal bond issuance. California, New York and Texas have been the largest issuers of these bonds since the program's inception. Because, at this point in time, BABs can only be issued in 2009 and 2010 (there is proposed legislation that would extend the BAB program), we expect many municipalities to take advantage of the program, resulting in a lower than normal issuance of traditional municipal bonds.

BABs have distinct limitations. They typically have maturities of 20 years or more, and so, have heightened sensitivity to changes in interest rates. Additionally, they are not as liquid as corporate and government bonds with similar maturities due to the small number of bonds normally issued. Finally, income generated by BABs is taxable and therefore less appealing to tax-paying investors. NPITC has carefully reviewed the structure and risk of BABs and has concluded that in most cases they are not attractive substitutes for traditional, tax-free municipal bonds that we own for our clients.

Traditional municipal bonds present attractive buying opportunities. The continued issuance of BABs throughout 2010 and our anticipation of sluggish growth and stability in the domestic economy should cause prices on traditional municipal bonds to remain attractive for the remainder of the year. ■