

Observations

- There is a boatload of sour economic news to come over the next few months. Corporations that fail to properly guide investors will be punished by the market. Investors would be prudent to lower short-term investment return expectations as the negative news works through the system.
- There has been a lot of money poured into marketing "going green". There are intelligent people on all sides of the argument as to whether or not climate change is a real threat and the causes and effects. One thing is certain; it better make economic sense in real dollars before anyone invests another dime over the next few years.
- As the chart below shows, US energy consumption is not likely to decrease. Therefore, in spite of retreating oil prices, the US better remain committed to better diversifying and finding more sources of energy. It is not a question of "if" but "when" energy prices will run-up again and next time it will be even more painful.

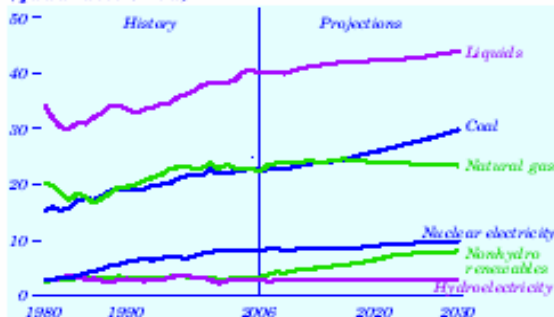
Important Figures

Economic

EIA US Energy Consumption Forecast

	Liquids	Natural Gas	Coal	Nuclear	Hydro/Other
1980	34.20	20.24	15.39	2.74	5.49
1990	33.55	19.60	19.18	6.10	6.15
2000	38.26	23.82	22.64	7.86	6.13
2010	40.46	23.93	23.03	8.31	7.43
2020	42.24	24.01	25.87	9.05	9.50
2030	43.99	23.39	29.90	9.57	10.96

Figure 3. Energy consumption by fuel, 1980-2030 (quadrillion Btu)



Financial

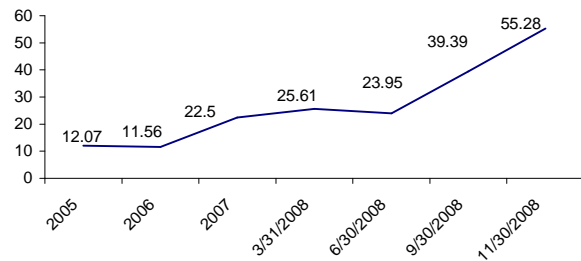
Treasury Yields

	5 Year	10 Year
2005	4.35%	4.39%
2006	4.70%	4.71%
2007	3.45%	4.04%
3/31/2008	2.47%	3.43%
6/30/2008	3.34%	3.98%
9/30/2008	2.99%	3.83%
11/30/2008	1.94%	2.96%
YTD Return		

Equity Markets

	S&P 500	DJWilshire 5000
2005	1,248	12,518
2006	1,418	14,257
2007	1,468	14,819
3/31/2008	1,323	13,332
6/30/2008	1,280	13,074
9/30/2008	1,165	11,875
11/30/2008	896	8,945
YTD Return	-38.95%	-39.64%

CBOE VOLATILITY INDEX (VIX)



Economic Outlook

- Short-term the outlook is dreary. Barring any unforeseen negative surprises, the intermediate term could begin to show signs of decline leveling off, and then growth re-emerging. Longer term, a more favorable picture will appear as adjustments are made to the new economic environment.
- Central bankers will be busy for years to come as for the first time in modern history, the U.S., Western Europe, and Japan are simultaneously in a recession. The first battle heading off deflation. Later, inflation.
- News for the U.S. consumer, especially homeowners with high debt levels concern us. Adjustable rate mortgage payments rising, home equity, credit cards, and rising state and local taxes will reduce discretionary income. Keeping unemployment from rising too high is the key to limiting the severity of this downturn.

Investment Outlook

- The VIX does not lie. Volatility will be around for quite a while in equity markets. We are going to have to adjust to wild equity market swings.
- When they say "it's different this time" it usually is not. Markets go through cycles that are motivated by fear and greed. Fear still rules the day, however successful long-term investors know how to weather market storms.
- Spreads over U.S. government bonds are appealing for a portion of a well-diversified portfolio. There will be unexpected downgrades and bankruptcies that will continue to keep funds from returning until there are signs that the economy is back on solid footing.
- Even with all the selling in the fourth quarter, there is plenty of money waiting to go to work. It would not be surprising to see a combined January effect and optimism over the a new presidential administration give markets a boost. The question is will it last?

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Insightful Thoughts of Others

Value at risk (V.A.R.) as a reliable measure of risk will hopefully be taken out and shot at dawn. - Jeremy Grantham

In developing a sensible trade policy, the U.S. should not single out countries to punish or industries to protect. - Warren Buffet

About 50% of U.S. companies have below-investment-grade credit ratings... - Wall Street Journal November 29, 2008



A Few More Things

- **Deflation** refers to a sustained fall in prices. With inflation and interest rates above zero, a dollar is worth more today than it will be tomorrow. The exact opposite is true with deflation. As prices are in a sustained state of decline, your dollar will be more tomorrow than it will today. Therefore, the incentive is to hoard dollars and not spend today. World bankers should have learned lessons from the Japan's lost decade of the 1990s when deflation was a major problem. That is why we are seeing central banks pump so much liquidity into the system.
- **Disinflation** is a decline in the rate of increase in average prices. Your dollar is still worth more today than it will be tomorrow. Depending upon which goods and services you use, you will likely see a combination of inflation, disinflation, an deflation. Over a long time period, either rapid deflation or inflation can be destructive to an economy.
- Credit worthy borrowers can still obtain loans. It may be cost more to borrow, but funds are there. Given the burden on taxpayers for the rescue/bailout plan, bankers should not be encouraged to lend to those who are not deserving of credit. Was not this how we got into this mess in the first place?
- A rescue/bailout plan for the U.S. automakers must be carefully evaluated to ensure the big three will not be back for another hand-out. However, given the economic environment outlook would it not make more sense to allow the bankruptcy route to play out and let the industry re-emerge in a form that is competitive with other world auto manufacturers? How can one truly believe that in their current form, Ford, GM, and Chrysler will begin winning back market share given the trend of the last 40 years?
- You have to wonder about Wall Street also. Citicorp for instance said the following when releasing earnings on October 16, 2008, "We end the quarter with a very strong Tier 1 ratio of 8.2% and a loan loss reserve of \$25 billion." OK then why on November 24, 2008 did we get the following news? "Citi will issue an incremental \$7 billion in preferred stock to the U.S. Treasury and the FDIC as payment for a government guarantee on \$306 billion of securities, loans, and commitments backed by residential and commercial real estate and other assets." In the span of five weeks, another \$281 billion in "assets" are suddenly risky? Did it all of a sudden get out of control or was someone sweeping the dirt under the rug? And no change in senior executive management or on the board of directors How much compensation was paid to the people that were supposed to be managing Citi over the last however many years? Long time shareholders and now the American taxpayers, deserve better. Break 'em up anyone?
- Early signs are that the Obama administration will be financially moderate. Not only taking a page from the Clinton playbook, but drafting members of the former Clinton team. As any smart politician would, President Obama will leave his options open. He knows raising taxes in 2009 is not a good idea. His most likely course of action is to simply let the Bush tax cuts expire at the end of 2010. This sends a clear signal to Wall Street and Main Street well in advance and politically, he can point the finger at the former administration.
- Unless there is a rally of historic proportions, 2008 will turn-out to be one humbug year for investors. Just remember, tough times don't last; tough people do. Happy Holidays and Best Wishes for a Prosperous 2009!

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