Overview

QRS Wealth Management LLC

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Observations

- The **bulls** make the case that the stock market is the place to be if you want to earn a decent return on your money with interest rates so low. Pessimism is healthy for a market rally. There is plenty of liquidity that is still looking for a home. Earnings are back on track and the economic recovery is slowly taking hold. World economies are growing, especially in Asia and other developing markets where demand will remain strong.
- The **bears** point to uncertainty caused by governments, especially artificially low interest rates. Earnings have improved largely due to cost cutting and not top line growth. This "sugar high" induced by governments serving punch bowls of easy money will end badly when either governments take away the punch bowls by withdrawing liquidity to fight inflation or inflation grows more than expected. Toss in a weak US dollar, rising commodity prices, high debt levels, and government budget deficits. There is your recipe for a further secular bear market.

Facts & Figures of Importance

Economic

What is a deficit? Think for example of someone purchasing a home and let's say he or she borrows money (a mortgage) to buy the home. The new homeowner will be required to make monthly payments until the loan is repaid in full. In this example, let's say the amount borrowed is $100 and annual payments including interest are $5 plus interest at 5%. However, our new homeowner only has annual income of $6. Since income is greater than expenses, that is a **current year deficit**. The homeowner has to borrow an extra $4 to meet the required payments.

The person in this example is required to make current payments of $10, plus has other expenses associated with the home. Plus, the homeowner owes an additional $95 in the future not including interest plus taxes, insurance, and other expenses. The $95 is the amount of **current debt** which is known. Future expenses include taxes, insurance, and maintenance. All of these are **unfunded future liabilities.** Typically, expenses increase over time so the liabilities will likely be higher. For this example, say the total amount comes to $100 over the next 20 years. This person better earn more money in the future or sell the home before getting stuck in a deeper financial hole.

Here comes the holy cow part. Guess what the government does?

2010 **Current Year Deficit** = $1,501,650,000,000 (**yes, TRILLION**)
The US Government must borrow money to cover 40% of its spending!

Current US Debt (what is on the books) = $12,311,000,000,000
Unfunded Liabilities (think Social Security, Medicare, Medicaid…etc.)
Estimates range between $50 TRILLION –to over $100 TRILLION

Financial

	Treasury Yields		Equity Markets	
	5 Year	10 Year	S&P 500	DJWilshire 5000
2006	4.70%	4.71%	1,336	14,257
2007	3.45%	4.04%	1,468	14,819
2008	1.94%	2.96%	896	9,087
2009	2.69%	3.85%	1,115	11,562
1/31/10	2.34%	3.63%	800	11,264
YTD Return			-3.60%	-2.57%

All Index Funds Are Not Created Equal

Investors in index funds should not expect their returns to match the return of the index. Given the trading costs and tax implications, it is nearly impossible to replicate an index return year after year. Mutual funds and exchange traded funds pass expenses on to investors (expense ratio). These funds often do not own all the stocks that comprise the index nor do they proportionally weight their investments hence the difference in returns.

In 2009, the S&P 500 index returned 26.46%. Here are sample returns and expense ratios several S&P 500 investment options.

Investment	2009 Return	Expense Ratio
SPDR (ETF)	26.27%	0.10%
iShares S&P 500 (ETF)	26.40%	0.09%
Vanguard S&P 500 Index Fund	26.49%	0.18%
Schwab S&P 500 Index Fund	26.25%	0.09%
Nationwide 500 Index Fund	26.00%	0.66%
Morgan Stanley S&P 500 Fund	26.00%	0.74%
Dreyfus S&P 500 Index Fund	26.04%	0.50%

Economic Outlook

- More of the same with risk more tilted towards slight weakening over the short-term.
- With Ben Bernanke re-confirmed as Fed chairman and 2010 being an election year, does the Fed have the fortitude to raise interest rates before November?
- Keep an eye out for a real estate bubble in China. Could throw a monkey wrench into their economic growth.

Investment Outlook

- The SEC has issued new and tighter rules for money market mutual funds that will likely reduce the interest rate these funds pay.
- Expect equity markets to stay within a trading range given the equal strength of bulls and bears. There will be triple digit days up and down, but not a prolonged break-out in either direction for the short-term.

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Insightful Thoughts of Others

Injustice anywhere is a threat to justice everywhere. We are caught in an inescapable network of mutuality, tied in a single garment of destiny. Whatever affects one directly, affects all indirectly.

- Martin Luther King

Thou shalt not be a victim. Thou shalt not be a perpetrator. Above all, thou shalt not be a bystander.

- Holocaust Museum

Facts are stubborn things; and whatever may be our wishes, our inclinations, or the dictates of our passion, they cannot alter the state of facts and evidence.

–John Adams.

Fairness is what justice really is.

- Supreme Court Justice Potter Stewart

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A Few More Things

- Both Republicans and Democrats are spinning the results of the gubernatorial races in Virginia and New Jersey, and the recent Massachusetts senatorial race. This was not a shift in voter preferences for the Republican Party. The **American public is frustrated with both parties**, hence the rise of the populist Tea Bag Party movement. What is interesting about this movement is there is no clear leader unlike populist candidates who fizzled-out (recall John Anderson, Ross Perot, and Jesse Ventura?). According to most respected polls, more voters are identifying themselves as Independents. Each party will maintain its hardcore supporters. However, as more people become better informed on issues, voters will no longer blindly support either party. Negative ads, spin, and politics as usual will fade and the substance of candidates will be more meaningful. Incumbents, watch out!
- In **eight of the last 11 mid-term election years, the S&P 500 has increased**. Each of the four elections when there was a Democrat in the White House (Johnson, Carter, and Clinton twice), the market rose.
- **Spurious correlation?** The Super Bowl Stock Market Predictor puts fourth the position that if the team that wins the Super Bowl had roots in the old NFL or is an NFC team, the stock market will rise. There have been 43 Super Bowls played and this indicator has been correct 34 times for a success rate of 80% (the success rate is 50% over the last ten Super Bowls). This year the NFC Saints play the Colts, who are an original NFL franchise. This is the first Super Bowl appearance for the Saints. The Colts won the game in 1971 and 2007; both years the market increased in value. Don't laugh; serious finance people are studying this phenomenon.
- **The Securities and Exchange Commission is requiring companies to disclose impacts of climate change**! These are the folks that created the credit ratings chaos, missed many a fraud (Madoff and others), failed to oversee Wall Street shenanigans, and issued accounting standards that contributed to the financial mess. And now the SEC is requiring companies to "evaluate for disclosure purposes the actual and potential material impacts of environmental matters on their business". How does a company respond beyond "we do not know" given the confusing data surrounding climate change? There is more than a whiff of cap-and-tax in the air along with hint of plaintiff attorneys looking for an easy mark.
- This February, there is something for everyone. The Super Bowl, Olympics, Valentine's Day, celebrities behaving badly, and the usual government comedy. Only nine months until November elections. Bet you can't wait.