

Observations

- The pendulum has swung too far in the opposite direction. Several years ago, if you could fog a knife, you got a loan no questions asked. In this environment, obtaining a loan is akin to eating jell-o with chopsticks. Where is George Bailey when you need him? Just maybe if regulators and bankers would impose responsible lending standards (neither overly restrictive nor everyone gets a loan) additional credit for those who are worthy would perk-up the economy. It would also help if the government would stop pumping money into dud projects.
- China's announcement that it was loosening the reins on the yuan is a long run positive. However, one of the largest buyers of US Treasury debt could have lower currency reserves, which translates into fewer funds to buy US debt. Think higher US interest rates over time. It's not fun party conversation, but private and more so public debt is a threat to our standard of living both today and in years to come. Let's see how serious the Chinese are.

Facts & Figures of Importance

Economic

It's All About Interest Rates

A Real Quandary

Federal-funds rate
adjusted for inflation



Source: Nomura

In economics and finance, interest rates drive many decisions. The cost of capital, expected return on investment, and all other real measures include interest rates in their formula. Over the past two years, the Federal Reserve and US Government have bet big on more debt with low interest rates to get the economy moving. So far, the taxpayer return on investment

has been poor. Japan 1990s – today is a prime example of a leveraged economy with low interest rates and no growth. Prolonged low interest rates could scare stock investors into moving more of their portfolios into Treasuries thereby driving interest rates down further. Talk alone will not jump start an economy without proof that risk-taking (buying stocks) offers real rewards.

Economic Outlook

- Don't fight the Fed remains the mantra, however their low rates for an "extended period" of time comment is telling that they have no idea when or how the economy gets perking again. They're making it up as they go along.
- Rising industrialization and urbanization of developing markets should continue to increase per capita income and living standards. The US and developed Europe may not be the consumers they once were, so the gap must be filled by the world's new middle classes. The US better figure out how to export to and serve these markets.

Financial

| | Treasury Yields | | Equity Markets | |
|------------|-----------------|---------|----------------|-----------------|
| | 5 Year | 10 Year | S&P 500 | DJWilshire 5000 |
| 2005 | 4.35% | 4.39% | 1,248 | 12,518 |
| 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 |
| 6/30/10 | 1.79% | 2.97% | 1,031 | 10,823 |
| YTD Return | | | -6.65% | -6.39% |

- The end of June swoon in equity markets contains much window dressing as investment managers present their quarterly and first half of the year numbers. Expect the summer to be slow as market volume tends to be lower. The real action starts in September.
- July kicks off second quarter earnings. Pay more attention to what company managements think about the future. In this environment, expect the operative words to include "uncertain" and "unknown".
- CNBC reports that the bail-out cost to the US taxpayer for Fannie Mae and Freddie Mac is \$145 billion. The CBO projects this figure increasing to \$400 billion. Some "experts see \$1 trillion. In a nutshell, the great housing bust cost homeowners and taxpayers as the government bails out the lenders. Where is all this money going and how does it not contribute towards future inflation? To be continued in a sham Congressional hearing years from now.

Investment Outlook

- Congress will fail us again. The Dodd-Frank Bill will have unintended consequences of huge proportions. How could they ignore the \$6.5 trillion debacles that are Fannie Mae and Freddie Mac? This bill will not fix what is broken.
- While risks are higher in tax-free bonds, and the level of defaults will increase, it should not be a massive problem. Any states or municipality that defaults will be committing financial hara-kiri. Strong political leadership with private investment can rejuvenate an area. Think New York City's comeback from the 1970s.

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Insightful Thoughts of Others

Government is not reason; it is not eloquent; it is force. Like fire, it is a dangerous servant and a fearful master.

-George Washington

Remember, democracy never lasts long. It soon wastes, exhausts, and murders itself. There never was a democracy yet that did not commit suicide.

-John Adams.

Experience hath shown that even under the best forms of government those entrusted with power have, in time, and by slow operations, perverted it into tyranny.

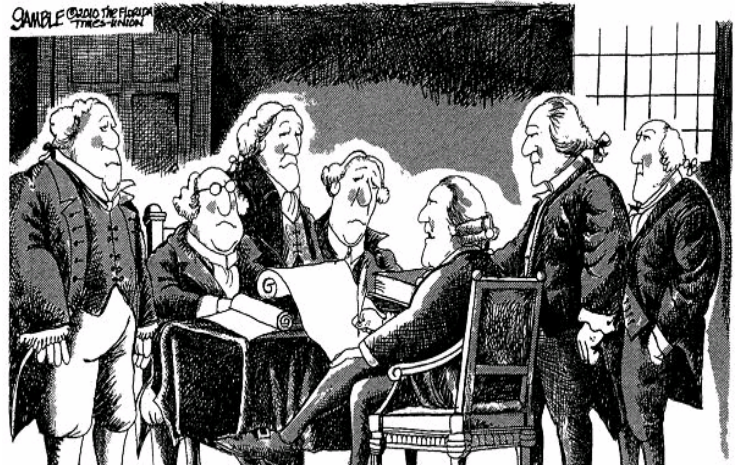
-Thomas Jefferson

It is only when the people become ignorant and corrupt, when they degenerate into a populace, that they are incapable of exercising their sovereignty.

-James Monroe

America will never be destroyed from the outside. If we falter and lose our freedoms, it will be because we destroyed ourselves.

-Abraham Lincoln



"Let's take out this line that says Government should be in charge of health care, home loans, student loans, banks, insurance companies, auto makers, etc. It sounds like we're back in Europe!!"

A Few More Things

- ❑ **Why owning stocks makes sense for the long-run.** The combination of capitalism and a republic form of government, may not be perfect, however it has worked far superior to any other economic model and system of government tried by man. Planned economies inevitably fail whereas in a free market, capital can be invested more efficiently without political pressures. Market forces should be free to reward and punish participants for their actions. This view is not to say that the inmates should take over the asylum. By all means, there needs to be regulation to ensure the playing field is level for all participants. Cheaters should be severely punished. And yes, the regulators should be regulated with a system of checks and balances so that all market participants may have faith in a fair marketplace. Rules should be clear, concise, and easily understood; not subjective to overly broad interpretation. The "rule book" should be reasonable number of pages with a readable size font.

Ownership under this type of legal and economic system offers each participant the opportunity to pursue or maintain economic success by providing a claim against a businesses assets and future cash flows. Owners will be free to decide to invest for short-term or long-term profits (long-term usually wins when it comes to investing). Failure would be an option. We do not nor cannot live in a world without risk. For those who think there is no risk in only holding cash or bonds (especially government bonds), history has taught and will continue to teach us how wrong that line of thought can be. And don't forget, valuations matter. Buy low, sell high does work.

- ❑ The recent three day G-20 summit in Toronto came with a **price tag of almost \$1 billion**. Why would any city or country desire to hold a summit for the G-8, G-20, WTO, or any organization with that price tag attached? Just book a cruise ship for a weekend next time.
- ❑ **Happy Birthday America.** Bit of trivia for you. July 2, 1776 is the day that the Continental Congress actually voted for independence. John Adams, in his writings, even noted that July 2 would be remembered in the annals of American history and would be marked with fireworks and celebrations. The written Declaration of Independence was dated July 4 but wasn't actually signed until August 2.

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