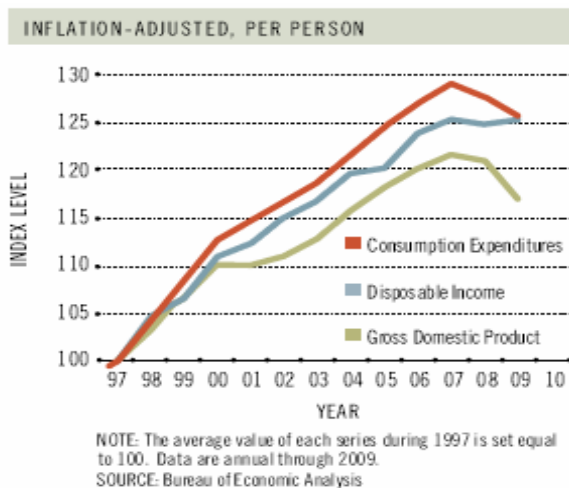


Observations

- ❑ Interest rates are likely to stay low for a time. It is not a question of if, but when the inflation beast awakens. It will be difficult to contain higher prices without higher interest rates. It is also unlikely that the economy can grow to near full employment, and both public and private debt can be brought to reasonable levels without inflation.
- ❑ The investor's dilemma will continue for some time as to how to invest in this low interest rate environment, especially with inflation around 2.2% and with one and five-year Treasuries yielding 0.4% and 2.1% respectively. Longer term bonds are more exposed to interest rate and credit risk. The dividend yield of the S&P 500 is roughly 1.8% and we all know markets offer no guarantees. Find the allocation that is best for your goals and cross your fingers.

Facts & Figures of Importance

Economic



This graph points out the obvious of how consuming more than an individual or nation's income over an extended period of time resulted in today's economic problems. As a nation, we failed a basic axiom in that we spent more than we earned.

Economic Outlook

- Dig deeper into reported unemployment figures. Look at private sector job changes for signs of future economic activity. Let's wait until later this year to evaluate unemployment, especially after the census is completed and the temporary government workers are let go.
- Audit them, hold them accountable, but don't fight the Fed. They are legally authorized to print money. You are not.
- Recent chatter is of deflation or a double-dip recession, while possible, is not probable. Stimulus funds pour into the economy along with a private sector that continues working hard. True, growth is tepid at best; however waving a white flag will not accomplish anything. The long crawl back to a strong economy continues.

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
5/28/10	2.10%	3.31%	1,089	11,466
YTD Return			-1.50%	-0.83%

Mental Accounting

You just purchased a movie ticket for \$10. As you are about to enter the theater, you cannot find the ticket; plus you discover a hole in your pants pocket. So do you now buy another ticket? Suppose while walking towards the movie theater, a gust of wind swipes away a \$10 bill from your hand. Would you still go to the movie? In either case, you lost \$10.

Experiments show only 45% of people would purchase a new ticket after losing the first ticket. Yet almost 90% of people would buy a movie ticket after just losing \$10. Fact is in either case the \$10 is gone for good. Be careful not to play mind games with your money. The reality is your money does not know or care how you intend to save or spend. You make those decisions and must live with the consequences. When you have unexpected good fortune of money in, that is not found money which you now must spend; likewise unexpected misfortune does not mean you must deny a purchase. Pay attention to the whole forest; not a few trees.

Investment Outlook

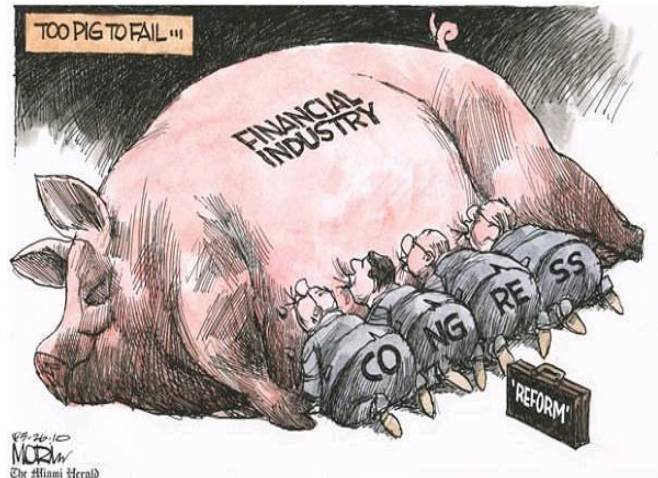
- Expect more cracks in the EU and Euro countries. The great unknown is how serious and how effective countries can be in addressing their fiscal problems. If successful, look for positive returns throughout European markets. If a country is only paying lip service, sovereign debt defaults mean unpleasant things for markets.
- When a particular asset class is a "must have" it usually becomes overvalued. What are the "hot" asset classes today? Arguably gold and long term bonds. At some point, interest rates will rise (meaning bond prices will fall). Too many gold ads on TV should be a sign that prices could be forming a bubble (recall gold prices 1980s).

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Insightful Thoughts of Others

- Philosophy is common sense with big words.
- The truth is that all men having power ought to be mistrusted.
- We are right to take alarm at the first experiment upon our liberties.
- Since the general civilization of mankind, I believe there are more instances of the abridgment of the freedom of the people by gradual and silent encroachments of those in power than by violent and sudden usurpation”
- Liberty may be endangered by the abuse of liberty, but also by the abuse of power.

James Madison, US president and author of the Constitution.



A Few More Things

- ❑ Those **expecting President Obama to fix the economic woes** all by himself had might as well expect him to turn into a superhero, take a deep breath, and dive down to plug the oil leak in the Gulf of Mexico. The administration along with Congress (aside item – the opposite of progress is?) should be setting the table for economic growth. Instead we are seeing legislation and proposals that are hampering recovery efforts. How does one have respect for 2,000+ page bills like healthcare reform or the proposed financial reform bill? Does anyone seriously read it, understand it, let alone can it be implemented or enforced? Quantity does not equal quality. Knee jerk reactions to current events have later unintended consequences. Eventually, we will learn that instant gratification and the “right now” world mentality is not a path to a better future. Try stuffing the leaking oil pipeline with the rubbish coming out of Washington and state & capitals. That’ll plug the darn thing.
- ❑ Can the grown-ups acknowledge that **all forms of energy present both physical and environmental risks?** There will be oil spills, coal mining catastrophes, fires from solar energy, hydro dam breaks, nuclear accidents, and wind turbine mechanical failures (when blades spin off, run fast). As Forrest Gump said, “stuff happens”. There are no perfect energy solutions. Let’s keep trying to make all energy sources safer and more efficient.
- ❑ **How do we address the conflicts of interest for the credit rating agencies?** The Securities and Exchange Commission (yes, the SEC with porn surfing employees) recognizes ten Nationally Recognized Statistical Rating Organizations (NRSRO or CRA) such as Standard & Poor’s, Moody’s, Fitch, and others. These NRSROs told investors that pools of sub-prime loans should be considered high quality investments. We have seen that did not turn out so well. So the question arises, who should pay for the services of a CRA to eliminate conflicts of interest? Should the issuer of the security, the user who wants a rating, or some combination of both?

Our solution proposes to regulate the NRSROs to ensure that they have the proper people, procedures, and resources to adequately rate securities. Next, the issuer pays and pricing would be regulated (within a range) so that no CRA could undercut the market with an implication of providing a more favorable rating. Finally, an issuer must have two or three agencies review a security at issue and throughout the life of the issue. The issuer would be allowed to choose only one or two CRAs and the second or third would be assigned at random by the SEC. CRAs could be rated for their accuracy in assessing securities as an incentive to maintain credibility.
- ❑ Happy Father’s Day to all the Dads and Congratulations to all the new College and High School Grads.

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