

Observations

- **We want it all and we want someone else to pay for it** according to recent polls of the American public. Federal spending on Social Security, healthcare, defense, infrastructure, and research funded at both current and future levels is not sustainable. Yet, politicians and our society cannot agree on a combination of spending cuts and tax rates that will exit this road to failure. Too much emphasis on politics combined with ignorance of basic economics will doom us.

Facts & Figures of Importance

Economic

The Energy Information Administration released its short-term outlook last month. We think there will be greater volatility than the EIA projects and retail gas prices will rise higher. Ten bottom line observations from the report:

1. Retail gasoline prices are expected to peak at \$3.91 per gallon. They will average in the \$3.85 range thru 2012.
2. There is a 33% probability that retail gas prices top \$4 this July.
3. A barrel of oil is expected to average \$112.50 through 2012.
4. For each \$1 dollar increase in crude oil, retail prices rise 2.4 cents
5. As of April 1, gasoline inventory was down 4% from last year, however it remains higher than the 5 year average.
6. In 2010, the world consumed 86.7 million barrels of oil a day. This figure is projected to rise by 1½ mb/d this year and another 1.6 mb/d in 2012.
7. The largest increase in consumption of oil will come from China, Brazil, and the Middle East. Only a slight increase in the US.
8. Production is projected to remain fairly steady in 2011, with OPEC likely to increase production in 2012 or sooner depending upon how political events unfold.
9. The natural gas forecast calls for average prices of \$4.10 in 2011 and rising to \$4.55 in 2012.
10. Steady coal prices along with modest natural gas increases should allow electricity prices to rise by 1%.

Economic Outlook

- The political game of chicken with debt ceilings and deficits is keeping the US economy stuck between neutral to first gear. Unable to plan for the longer term, businesses and consumers continue to de-leverage while being non-committal for future spending.
- Gov't deficit negotiations and QE II ending are primary drivers of expectations for the second half of 2011.

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 |
| 2010 | 2.06% | 3.38% | 1,258 | 13,360 |
| 4/29/11 | 1.97% | 3.32% | 1,364 | 14,495 |
| YTD Return | | | 8.43% | 8.48% |

When Quantitative Easing II Ends June 30th

Where do interest rates go when the Federal Reserve ends its QE II purchasing of US government debt? Bill Gross the manager of PIMCO's \$235 billion Total Return Fund has not only sold all US debt, but even holds 3% in short positions. With the #1 bond buyer exiting the market and with US government debt becoming a "riskier" investment, it is only a matter of when bond prices fall (and interest rates rise).

Jeffrey Gundlach of DoubleLine believes rates will fall as they did when QE I ended. His premise being the economy will slow and investors will seek the safety of US government bonds. The government is tangled amongst a desire for low interest rates so it can borrow and pay interest versus inflationary pressures versus a slowing economy. Gundlach believes eventually inflationary pressures will push up interest rates, however inflation will not unfold anytime soon. Rick Rieder of BlackRock echoes much of Gundlach's thesis and adds in during elevated periods of market uncertainty, money flows to the safety of US Government debt.

Investment Outlook

- There is still a good deal of cash looking for a home. The investor's dilemma remains in that committing to stocks and long term bonds offers greater rewards, but comes with increased risks. Short-term bonds and cash while short on risk, do not offer much in returns.
- When European debt steps back into the spotlight, expect the dollar to rally as the currency battle continues.

Insightful Thoughts of Others

Gas prices, aren't they crazy? It's so expensive that rats are carpooling in from New Jersey.

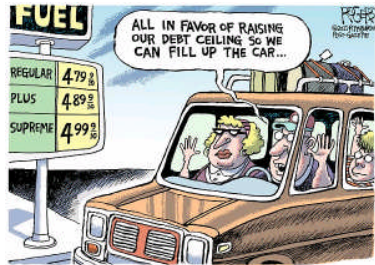
--David Letterman

Gas prices continue to rise. At the gas station near my house they have a slot for your credit card and one right next to it for your 401K..

--Jay Leno

I was out driving just a taking it slow
Looked at my tank it was reading low
Pulled in a Exxon station out on Highway One
Held up without a gun

-- Bruce Springsteen



A Few More Things

- ❑ **How to fix it.** A 72,000 page tax code is lunacy. Enough with all the classes of taxes. Simplify for Americans. A combination of a flat tax on income and on consumption (national sales tax) without loopholes so that it is easily understood will set us on the right path. A flat income tax of 10% on all income and expenses (everybody has skin in the game), plus an estate tax at 10% on estates above \$1 million better be enough for the Feds!

Turning to government spending, that is the key to solving the problems. Leave entitlements in place for those who have them. Next, design a phase-out program that could take up to 50 years to eliminate Social Security, Medicare, and other government redistribution schemes. We have longer life spans. Those under age 55, must wait a year or two in order to collect Social Security and Medicare. Teach people to save and prepare for their future rather than depending upon the government. We have many excellent private charities in America. Let them do their job.

- ❑ There is an old joke that the way you can tell when a politician is lying is that his lips are moving. Along that same vein, hold your wallet and beware to the following statements:
 - "It is for (or will harm) the children." Translation – you have to pay more in taxes for what is usually a politician's boondoggle project that was either designed to steal money or the result of pure ignorance.
 - "We have to invest in our future." – Translation – you will be being more in taxes. Similar to "it's for the children" and count on whatever "it" is, being way over-budget and not delivered on time.
 - "(Fill in the blank) is a (some combination of the following: Nazi, racist, wife-beating, environmentally polluting, substance abusing, puppy hating, with a (fill-in the blank) political philosophy)". The one who utters the line can no longer win the battle with a sensible argument and resorts to name calling. Although if you strongly disagree with the person being attacked, you may be inclined to agree with the name calling.
 - "It is for (or will harm) the poor." - Translation – no matter how you do the math there will always be poor people. Examine how the figures were derived. Some mathematical truisms. People are either above, below, or average in a particular category. There is always a top 10% and a bottom 10%. Reality is most people do not remain in the bottom for long as they advance their economic condition. Never let the facts get in the way of an agenda. Focus more on standard of living. Everyone cannot afford a Bentley. Yes, there are truly needy in our society and through better coordination of private charitable services and trustworthy oversight and management of public funds, we can be assured their basic requirements can be met. The complete story uncovers the truth.
- ❑ **Happy Mother's Day** to all Mom's and **Memorial Day** gratitude to those who served in our armed forces.

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