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The U.S. an Energy *Exporter*? *Really*?

The long-running narrative of America's voracious appetite for, and declining production of, energy resources is looking a bit outdated. The *Wall Street Journal* recently reported that the U.S. is on track to be a net exporter in 2011 of such petroleum products as gasoline, diesel, and other oil-based fuels. It could be the first year since 1949 that the nation shipped more of such products than it brought in.

Demand from emerging markets has been booming compared to relatively slack demand at home. The U.S. Energy Information Administration reports that in the first nine months of the year the U.S. shipped 753.4 million barrels of gasoline, jet fuel, and related products while importing 689.4 million barrels. Just six years ago the U.S. was a net importer of nearly 900 million barrels of petroleum products. Of course we're still the largest net importer of crude oil at nine million barrels per day.

But there's much more to the global energy market than crude. The U.S. boasts the world's largest coal reserves. But as we tightening emissions standards for power plants, many utilities are looking to cleaner fuels, especially the increasingly ample domestic supplies of natural gas. Meanwhile, China and India have been rapidly adding coal-fired power generation, and Europe remains a key market. U.S. coal exports are projected to hit a 20-year high of more than 105 million tons.

Relatively high oil and gas prices and a slack economy also helped set the stage for the U.S. to re-emerge as a major energy exporter. American drivers are using 7-8% less gas than the peak levels last seen in mid-2007. The last decade also saw a push for the production of corn-based ethanol, now a meaningful component of domestic supply.

Sustained higher prices and new technology also have boosted U.S. and Canadian production of crude. Increases are coming from the deep waters of the Gulf of Mexico, the oil sands of Alberta, and a near doubling of production in just two years from Texas and North Dakota. Increased regional supply feeds U.S. refineries that are more efficient than many foreign facilities.

Perhaps the biggest development in energy is the unlocking of potentially vast supplies of natural gas as well as oil in shale rock. Breakthroughs in horizontal drilling and hydraulic fracturing have brought this resource to the fore. Estimates run to as much as 1,000 trillion cubic feet of recoverable gas in North America; Europe may have even more.

As with practically all energy production, hydraulic fracturing, deep-water drilling, and the mining of oil sands raise environmental concerns. Producers and regulators will need to work together on effective safeguards. But these new technologies applied to resource discoveries across the globe may help dilute the influence of certain oil-rich nations that haven't always shared our world view.

Not long ago U.S. ports were building out facilities to receive large imports of liquefied natural gas. Now they're refitting those facilities to *export* the stuff. As some songwriter wrote back in the 1960s, "The times they are a-changin'." ■

A Transformation in Energy

Major petroleum products	Millions of barrels, Jan-Sept 2011	Versus 2010
Distillate fuel oil (diesel, heating)	Export: 215 Import: 51	+28% -23%
Residual fuel oil (shipping, power gen.)	Export: 121 Import: 100	+ 6% - 3%
Gasoline	Export: 121 Import: 32	+71% -19%
Kerosene-type jet fuel	Export: 26 Import: 20	+19% -26%

Source: *Energy Information Administration*

Squaring a Circle in the Euro Zone

Depending on the day, the European Monetary Union is either heading for a cataclysmic break up or crafting a grand solution to its contagious sovereign debt crisis. This scrum started nearly two years ago when Greece disclosed a budget situation much more dire than previously admitted. At the time we noted that this was but "the first major calling of a question at the heart of the EMU project: How does a common currency handle very divergent fiscal stresses among member countries?"

The rolling crisis has continued to illuminate certain genetic flaws in the common currency scheme. For starters, there is no real lender of last resort positioned to stop a sustained run on the financial and payments system itself. European banks are primarily governed by and closely associated with their respective home governments. Yet their key role in commercial lending and their significant holdings in cross-country, euro-denominated debt create systemic risk across the continent.

Although today's biggest concerns are focused on the likes of Greece, Portugal, Spain, and Italy, it was France and Germany who

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It's Been Pretty Tough to Beat Bonds

If you sense that the bond market has been a kinder and gentler place than the stock market lately, your sense is pretty good. And it's not just lately. As of the end of the third quarter, the *30-year* total return on long-term Treasury securities edged ahead of returns for the Standard & Poor's 500, a market-weighted index of 500 large, publicly traded U.S. companies. The last 30-year stretch when that occurred was back before the Civil War.

It's not that stocks have done badly over those three decades; the S&P 500 annualized 10.8%, not far below its longer term average. But the period featured an epic bull market for bonds with long Treasuries posting annualized total return of 11.5% according to Bank of America Merrill Lynch's U.S. Master Treasury Index.

Bonds certainly have had a better 2011 than stocks as shown by the accompanying table of one-year trailing returns for major mutual fund categories. The five- and ten-year trailing numbers illustrate the edge that fixed income investments have had over the past decade.

A long-awaited reversal of the historic decline in interest rates has yet to materialize here. But in Europe the bond market "vigilantes" are insisting on higher yields to finance over-indebted governments. Markets were unnerved recently when even Germany, Europe's largest and strongest player, had trouble floating a bond offering as it began to look more likely that the euro zone crisis would ultimately tap German resources to a significant extent.

Meanwhile the cross currents potentially affecting U.S. interest rates are tricky. Recent economic numbers look encouraging which normally would be expected to nudge rates higher. And it's not as if we don't have our own debt concerns. But the euro zone crisis and investors' general risk aversion has continued to drive money into the sovereign debt of the keeper of the world's reserve currency. Plus there's the Federal Reserve's express commitment to keeping rates low. Maybe Uncle Sam can evidence just enough fiscal and economic progress to keep investors from souring on *his* IOUs as well. ■

Investment Performance Review	**TOTAL RETURN *** **(dividends and capital gains reinvested)**			
Selected Mutual Fund Categories *	**--- Annualized thru Dec. 2, 2011 ---**			
	1 yr.	***3 yr.***	***5 yr.***	***10 yr.***
Large-Cap Stocks (Core)	1.5 %	15.2 %	– 0.7 %	2.5 %
Mid-cap Stocks (Core)	– 0.5	21.7	1.2	5.8
Small-cap Stocks (Core) †	– 0.1	21.0	0.5	6.5
Foreign Stocks (multi-cap) †	– 9.3	13.2	– 3.0	6.0
Emerging Market Stocks †	–14.3	24.4	2.2	14.2
Natural Resources	– 0.6	19.6	2.0	10.0
Real Estate related	4.6	28.9	– 3.1	9.4
Flexible Portfolio	1.2	13.8	1.7	4.6
General Bond	6.3	9.7	5.0	7.1
Int'l Fixed Income †	4.3	9.1	5.6	6.6
High-Yield Taxable Bond †	2.7	21.1	5.0	6.8
General Municipal Debt	4.1	15.1	0.4	4.4

* Source: Lipper, as reported in the *Wall Street Journal*, Dec. 3, 2011. **Past performance is NOT indicative of future results.**

† Small-cap stocks and high-yield (lower rated) bonds pose more risk and price volatility than those of larger, established companies. Securities of companies based outside the U.S. may be affected by currency fluctuations and political or social instability to a greater extent than U.S.-based companies.

Easier Access to Muni Credit Ratings

Fifteen months ago the *Quarterly* took a broad look at the financial prospects for states and municipalities. Since then there have been a few high-profile crack-ups in that sector. Jefferson County, Alabama, with the state's most populous city of Birmingham, recently filed the largest municipal bankruptcy in history. It was joined by Pennsylvania's capital city of Harrisburg. And officials in Detroit have warned that it could be insolvent by April without significant spending cuts.

Yet the muni bond market has been a pretty hospitable place this past year. And now there's more information available to investors and advisors. In November the Municipal Securities Rulemaking Board (MSRB) rolled out free public access to muni credit ratings on its EMMA® website at *www.emma.msrb.org*. Ratings from Fitch and Standard & Poor's are displayed for all individual municipal securities rated by the two firms. Fitch and S&P are two of the agencies registered with the Securities and Exchange Commission (SEC) as Nationally Recognized Statistical Rating Organizations.

The municipal market contains a huge number of issues, and regulatory and market authorities have long pursued greater transparency. The EMMA database has some information on about 1.5 million issues with access to disclosure documents, snapshots of daily trade data based on security size, sector, maturity and source of repayment, plus educational material on munis.

A muni bond's credit rating represents the rating agency's opinion of the issuer's creditworthiness. Market prices for those securities also can be affected by changes in marginal tax rates, trends in interest rates, and other factors. For conservative investors who primarily value muni bonds for their tax-exempt interest and return of principal at maturity, readily available credit information is a welcome addition. ■

Retirement Plan Contribution Limits Edge Higher, For Now

Amidst discussions of how to scare up more tax revenue for the federal government, some have proposed curtailing the amount of deductible contributions working Americans can make to their retirement plan accounts. But it's unlikely that any such reductions will be adopted for this year and next, so it's worth reviewing those limits while they're still relatively generous.

The table below updates limits for the most common types of plans in which individuals and employers participate. If you are covered by a retirement plan at work, the income threshold below which you can *also* deduct a traditional IRA contribution has edged higher in recent years from $90,000 (single) and $110,000 (joint) in 2011 to $92,000 and $112,000 for 2012.

If one spouse does not have a retirement plan at work, he or she can fully deduct an IRA contribution as long as household adjusted gross income is less than $169,000 in 2011 and $173,000 in 2012. Change may be in the wind at some point, but for now the breaks are there. ■

Pressing Plan Contributions to the Limit

Elective Salary Deferrals	**2011**	**2012**
401(k), 403(b), 457 & SEP SIMPLE IRA	$16,500 / $22,000* $11,500 / $14,000*	$17,000 / $22,500* $11,500 / $14,000*
Personal IRA Contributions	**2011**	**2012**
Traditional & Roth IRA	$5,000 / $6,000*	$5,000 / $6,000*
Employer Contributions	**2011**	**2012**
Indiv. 401(k) / SEP IRA	*Lesser* of $49,000 or 25% of compensation**	*Lesser* of $50,000 or 25% of compensation**

* Higher amounts are for individuals 50 or older.
** Maximum considered compensation: $245,000 for 2011; $250,000 for 2012.

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Squaring a Circle in the Euro Zone

first violated the fiscal guidelines in the Stability and Growth Pact under which the currency union was launched in the 1990s. The EU Commission has not been inclined, then or now, to impose censure and/or sanctions on members of the club.

The EMU has sometimes been characterized as a "United States of Europe," with some of its more fiscally impaired countries compared to states with high profile budget and debt challenges (e.g., California, New Jersey, Illinois, et al). But there are key differences. In the U.S. the federal government can tax the residents of *all* states and borrow on their full faith and credit. Many states are precluded from sustained deficit spending by their respective constitutions. Perhaps most importantly, in a fully integrated national economy with a common language, American taxpayers and businesses can much more easily abandon a state whose fiscal profligacy leads to onerous levels of taxation or an unacceptable decline in public services.

At this writing the euro zone's largest players are struggling to pull together a consensus plan that can overcome its genetic defects while respecting the sovereignty of member countries. All eyes are on Germany, justifiably proud of its global competitiveness due in part to its own painful labor and economic reforms of a decade ago. But as it touts the virtues of reform and fiscal rectitude, Germany knows that its economy draws heavily on the viability of its euro zone neighbors. Pressing for a level of austerity that ends up tanking the region's growth prospects would be a Pyrrhic victory indeed. That's the circle they hope to square. ■

Social Security Giveth and Taketh Away

A tough job market has tended to keep a lid on wages for many workers. And low inflation has meant no cost-of-living adjustment for recipients of Social Security benefits since the beginning of 2009. This January those monthly benefits will rise 3.6% or about $43 for the average Social Security recipient.

It was thought that the boost in benefits might be offset by a rise in Medicare Part B premiums which have been frozen the past three years at $96.40. But the base increase will be just $3.50 per month. Beneficiaries with higher income (above $85,000 single, $170,000 couple) are subject to an income-related surcharge. The premium for a Medicare Part D prescription drug plan is expected to stay flat at about $30 monthly. Medicare Advantage premiums tend to run about 4% less.

Seniors aren't immune to the trend of contributing more to one's healthcare costs. While the Medicare Part B deductible will drop slightly, Part A deductibles and copayments will be modestly higher for stays in hospitals and skilled nursing facilities.

If you are among the gainfully employed you may or may not see an increase in the Social Security (FICA) tax withheld from your paycheck starting in January. The maximum yearly wage subject to the tax rises from $106,800 this year to $110,100 for 2012. Unless Congress and the President can agree on an extension of 2011's reduction in the employee share of that tax, the combined effect would represent a $2,341 tax increase for anyone with at least $110,100 in wages. And a Happy New Year to you. ■

Follow-up on College Costs

Our Fall issue's recap of the long-running escalation in college tuitions and the parallel rise in federal subsidy of those costs resonated in the media and the political arena in the ensuing weeks. That's not surprising. The College Board reported that costs for the current academic year are up 8.3% over last year despite the modest level of inflation across the broader economy.

Rather than dwell on last quarter's discussion, we'll simply note a positive development on the information front. A new federal rule just went into effect requiring colleges to post "net price calculators" on their websites to give students and parents a better estimate of what they might really expect to pay net of needs-based grants and other probable aid.

These cost calculators provide nonbinding estimates by gathering a quick family financial profile without taking you through the entire, standardized financial aid form. If you're in the college shopping phase you might want to locate the net price calculator on each institution's web site and start generating some rough comparisons of what you're really up against.

In related news, and with rather inauspicious timing, the Treasury Inspector General for Tax Administration recently announced that the IRS has erroneously accepted education tax credit claims from over two million taxpayers who were *not* entitled to those credits. The initial cost estimate is in the billions of dollars and may rise by billions more. It must be devilishly difficult to stay on top of all these programs. ■

Pictures Worth a *Million* Words?

Do you think you'd save more if you just didn't look so darned good? For decades all kinds of publications, experts, and advisors have exhorted Americans to boost their retirement savings. It seems to have had only modest effect. But a study published in the American Marketing Association's "Journal of Marketing Research" suggests we just need a visual dose of reality.

In the study, working adults were shown *age-progressed* images of themselves as they'll look at 65. Those respondents were then willing to allocate almost 33% more of their paychecks to retirement savings than individuals who did *not* get a sneak peak at their senior selves. In a related online virtual reality experiment, exposure to such images appeared to about *double* the amount people were willing to sock away.

So, are all our efforts to look and feel young actually dampening our propensity to save for our golden years? Maybe so, but it shouldn't take a lot of sophisticated image doctoring to remind us that time keeps marching on. Before blowing the budget on the holidays, and while there's still the time to boost those 2011 retirement plan contributions, we might just try using a little old-fashioned imagination. ■

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