



June 26, 2008

On the Oily Brink of a Tipping Point

Dear friends,

Warnings of catastrophe tend to lose their punch when not much of anything occurs. In a way, that's what happened to unsettling predictions about the oil supply over the years. For decades – remember the oil crises of the 1970s? – we've all been warned that the supply of oil is finite, that it should be conserved, that developing countries would one day actually develop to the point that their populations would place heavy demands on existing supplies and that prices would rise to unimaginable heights. Like teenagers with ineffective parents, we, collectively, paid little heed. But \$4 gasoline got our attention.

The consensus is that it's not going to "settle back down" this time, that increasing demand is here to stay and that modest short-term increases in supply, if possible, won't accomplish much. Americans finally seem to have gotten the message. Driving is down. In April, Americans drove 1.4 billion miles fewer than in April 2007 – the sixth consecutive month of a year-by-year comparison decrease. In 2007, ridership on public transit hit a 50-year high. Car manufacturers have cut back on truck and sport utility vehicle production; sales of gas-sipping cars are up while SUVs collect dust on dealers' lots. And there's anecdotal evidence that home buyers are choosing locations close to work rather than face the financial hardship built in by a long commute.

Even if you live near a mass transit line, you're not immune to the effects of high oil prices. Cereal and most other foodstuffs cost more not simply because corn is being used to make ethanol, but because the price of oil – it briefly hit \$139.89 a barrel on June 16 – influences packaging and transport costs of food items and most other things you buy.

China recently raised its government-regulated gasoline and diesel prices by 16.7% (new cost, approximately \$2.89 a gallon) and, guess what, angry motorists protested. But will price hikes to consumers in developing countries temporarily lower demand and slow worldwide price increases? What about the inflationary effects of all of this?

Perhaps only one thing is clear: for Americans, the days of cheap oil and gasoline are gone, and their costs are going to loom much larger in the family budget. For investors, these are unsettling times not only because of continuing market volatility, but also because future energy directions are unclear. These are changing times, but there are suitable investments out there for those who take a long-term view. If you have questions about the content of your portfolio, please give us a call.

Sincerely,



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