



April 20, 2011

Kanaly Trust Quarterly Investment Outlook & Strategy Conference Call

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**James H. Shelton, CFA, CAIA  
Chief Investment Officer**

## Market Performance

### Index Performance as of March 31, 2011

<b>EQUITIES</b>	<b><u>1 Month</u></b>	<b><u>3 Months</u></b>	<b><u>12 Months</u></b>
S&P 500	0.0	5.9	15.6
DJIA	0.9	7.1	16.5
Nasdaq	0.0	5.0	17.2
Russell 2000	2.6	7.9	25.8
MSCI EAFE	(2.2)	3.5	10.9
MSCI Emerging Mkts	5.9	2.1	18.8
<b>FIXED INCOME</b>			
BarCap US Treasury Interm	0.0	0.0	4.1
BarCap Inv. Grade Credit	(0.1)	0.9	7.4
ML US High Yield	0.4	3.6	13.6
BarCap 1-10yr Muni	0.0	0.6	2.9
<b>ALTERNATIVES</b>			
HFRI Global Hedge Fund	(0.9)	0.4	3.9
DJ Wilshire REIT	(1.5)	6.7	24.4
DJ UBS Commodity	2.1	4.5	28.5
Gold	1.5	0.8	28.7
Crude Oil	10.1	16.8	27.4

## Kanaly Trust Investment Performance – as of 3/31/11

### 2011 YEAR TO DATE ASSET CLASS PERFORMANCE

Equity Only	5.5%
Fixed Income - Taxable	0.2%
Fixed Income - Tax Free (1)	0.6%
ALTs - No MLPs	2.9%
ALTs - With MLPs	3.2%
<b>Growth &amp; Income Portfolio - Taxable (2)</b>	<b>3.0%</b>
<b>Growth &amp; Income Portfolio - Tax Free (2)</b>	<b>3.1%</b>
S&P 500 Index	5.9%
Barclays US Aggregate Bond Index	0.4%
BarCap 1-10Yr Muni Index	0.6%
S&P 500 (60%) / Intermediate Taxable (40%)	3.7%
S&P 500 (60%) / Intermediate Tax Free (40%)	3.8%

*Footnotes:*

- (1) The figures above are comprised of a 50/50 allocation to the tax-exempt fixed income strategies at both Asset Preservation Advisors and Breckinridge Capital Advisors.
- (2) The current allocation of the Growth & Income portfolio is 35% Equity, 25% Fixed Income, 33% Alternatives, and 7% Cash.

*The asset allocation models above represent an approximation of how the portfolios perform; actual results may differ from the models. Returns are shown before fees and are not AIMR/GIPS compliant. The return information provided above represents past performance and is not necessarily indicative of future results. Further, specific client portfolio(s) investment returns and results may vary from figures noted above based on account-specific circumstances.*

## Performance Attribution – First Quarter 2011

- U.S. equities, especially small company stocks, strongly outperformed in the first quarter. Emerging markets posted negative returns through February due to inflation concerns before rallying in March.
- Our investments in mortgage-backed securities (Doubleline), convertible bonds (Calamos), and investment grade corporate bonds (Pimco) strongly outperformed. Our Treasury short position (TBT) detracted from returns.
- Performance also benefitted from investments in commodities and other inflation hedges.

### Performance Attribution - First Quarter 2011

#### Top Contributors

Domestic Equity	Geneva All Cap Growth	11.5%
Domestic Equity	Stephen's Small Growth	11.2%
Domestic Equity	VN Small Value	10.3%
Domestic Equity	Cambiar Small Value	9.2%
Fixed Income	Doubleline Total Return	2.3%
Fixed Income	Pimco Investment Grade	2.2%
Alts - Commodities	Pimco Commodity Real	7.2%
Alts - Convertibles	Calamos Convertible	5.3%
Alts - Diversified	Pimco All Asset	3.3%

#### Bottom Contributors

Int'l Equity	HL Emerging Markets	-1.7%
Int'l Equity	Hambro International	-0.2%
Int'l Equity	EV Emerging Markets	0.8%
Int'l Equity	Tradewinds Int'l Value	1.5%
Treasury Short	TBT - Proshares Ultra	-8.5%
Alts - Diversified	Absolute Strategies	-0.4%
Alts - Diversified	Absolute Opportunities	-0.2%
Alts - Commodities	SPDR Gold Trust	0.8%

## Key Investment Issues – The Eye of the Storm

- The U.S. economy continues to show surprising strength, yet few investors believe it, probably because employment and housing show little recovery
- Strong corporate earnings and very friendly Federal Reserve policy support ongoing bull market
- We expect the bull market to continue in 2011; however, rising interest rates, extended valuations and high optimism could threaten later in '11
- Key risks include the European sovereign debt crisis, rising energy prices, inflation concerns in emerging markets, and municipal market stress
- The three decade bull market in bonds is likely near an end. Fixed income investors should actively manage their portfolio, shorten duration, and seek undervalued alternatives as appropriate (i.e. not Treasuries).
- Commodity prices are likely to continue higher before rising interest rates threaten later in 2011

## Stocks Anticipating the End of Easy Money?

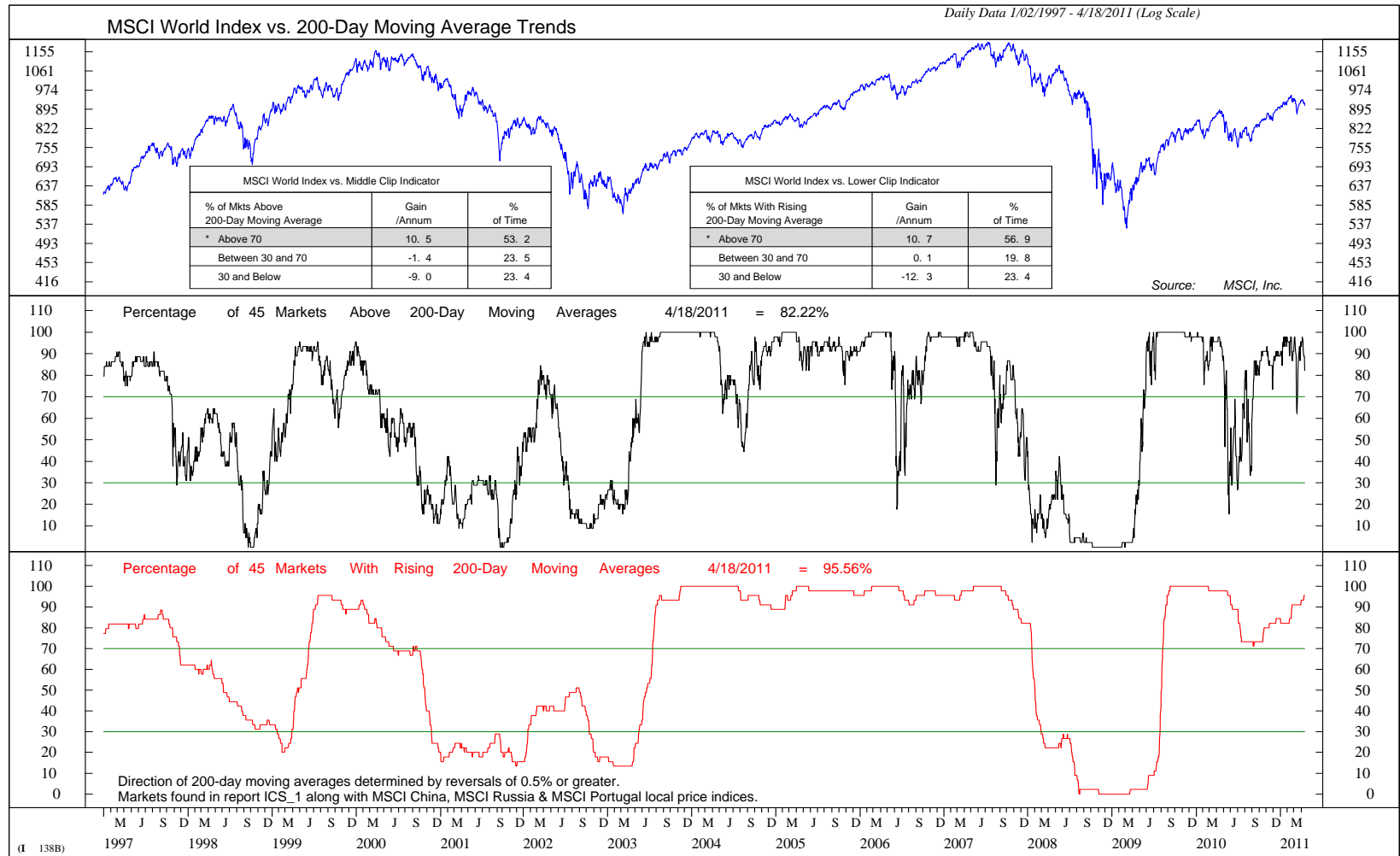


## Good Market Breadth Not Indicative of a Top



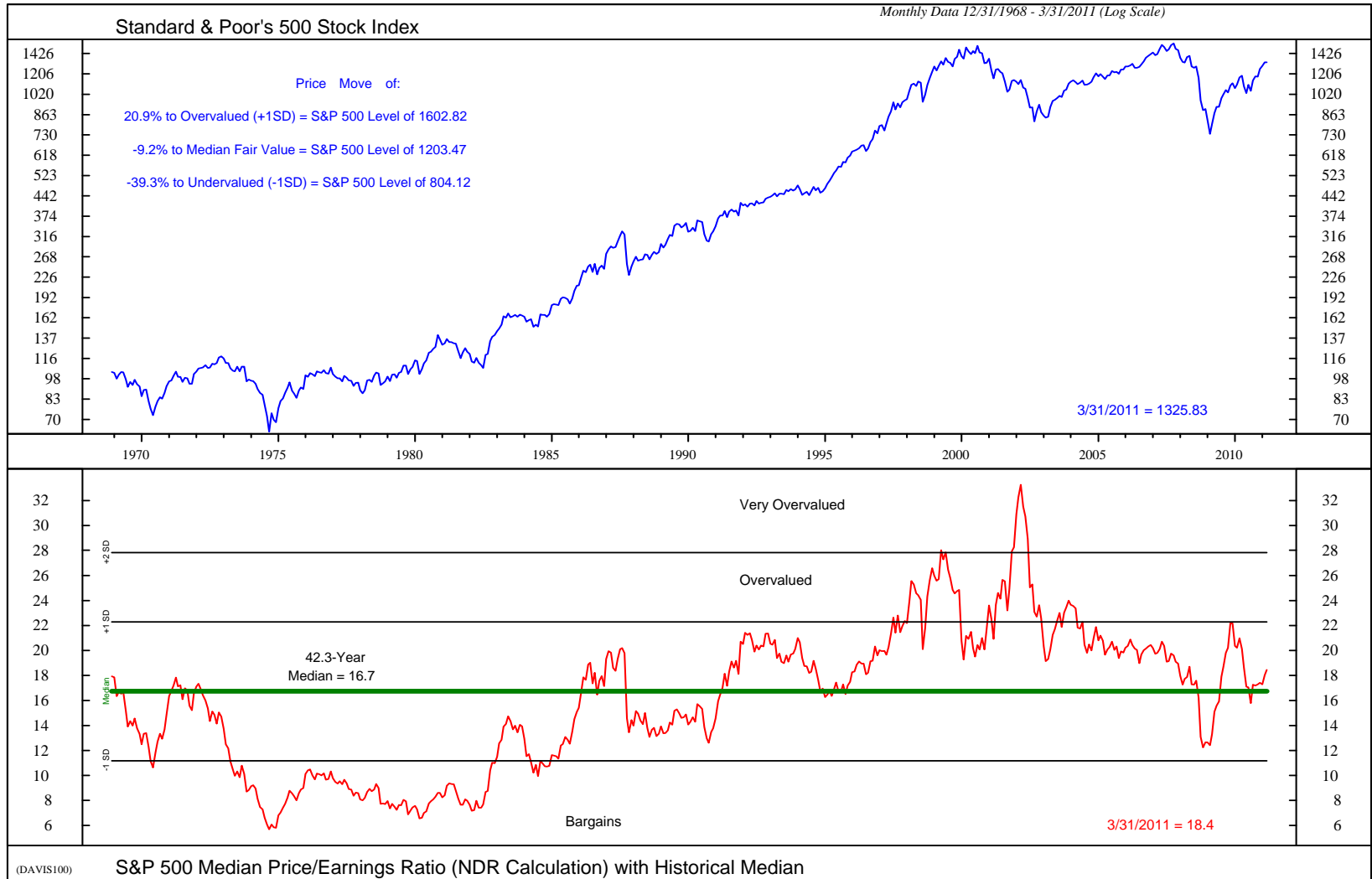
Source: Strategas Research

# Most Global Stocks Show Bullish Trends



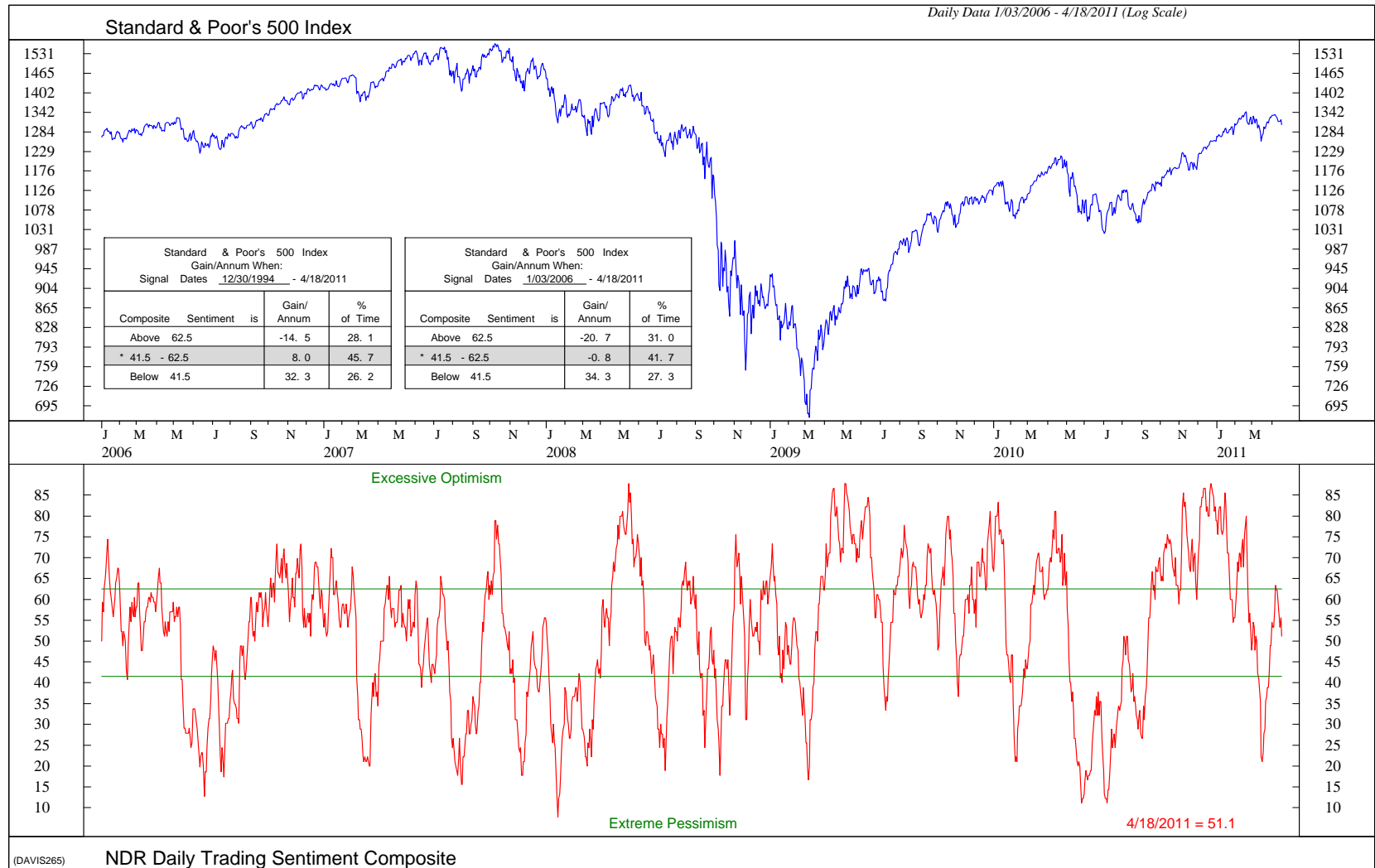
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# Equity Valuations Are Neutral



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# Overly Bullish Sentiment Has Moderated



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## Pension Plans Appear to be Underinvested in Stocks

### Mutual Funds Asset Allocation

	Equity Funds	Bond Funds
1996	72.8%	27.2%
1997	76.6%	23.4%
1998	78.2%	21.8%
1999	83.3%	16.7%
2000	83.0%	17.0%
2001	78.7%	21.3%
2002	70.2%	29.8%
2003	74.7%	25.3%
2004	77.3%	22.7%
2005	78.5%	21.5%
2006	79.8%	20.2%
2007	79.5%	20.5%
2008	70.3%	29.7%
2009	69.2%	30.8%
2010	68.5%	31.5%
<b>2011</b>	<b>68.9%</b>	<b>31.1%</b>

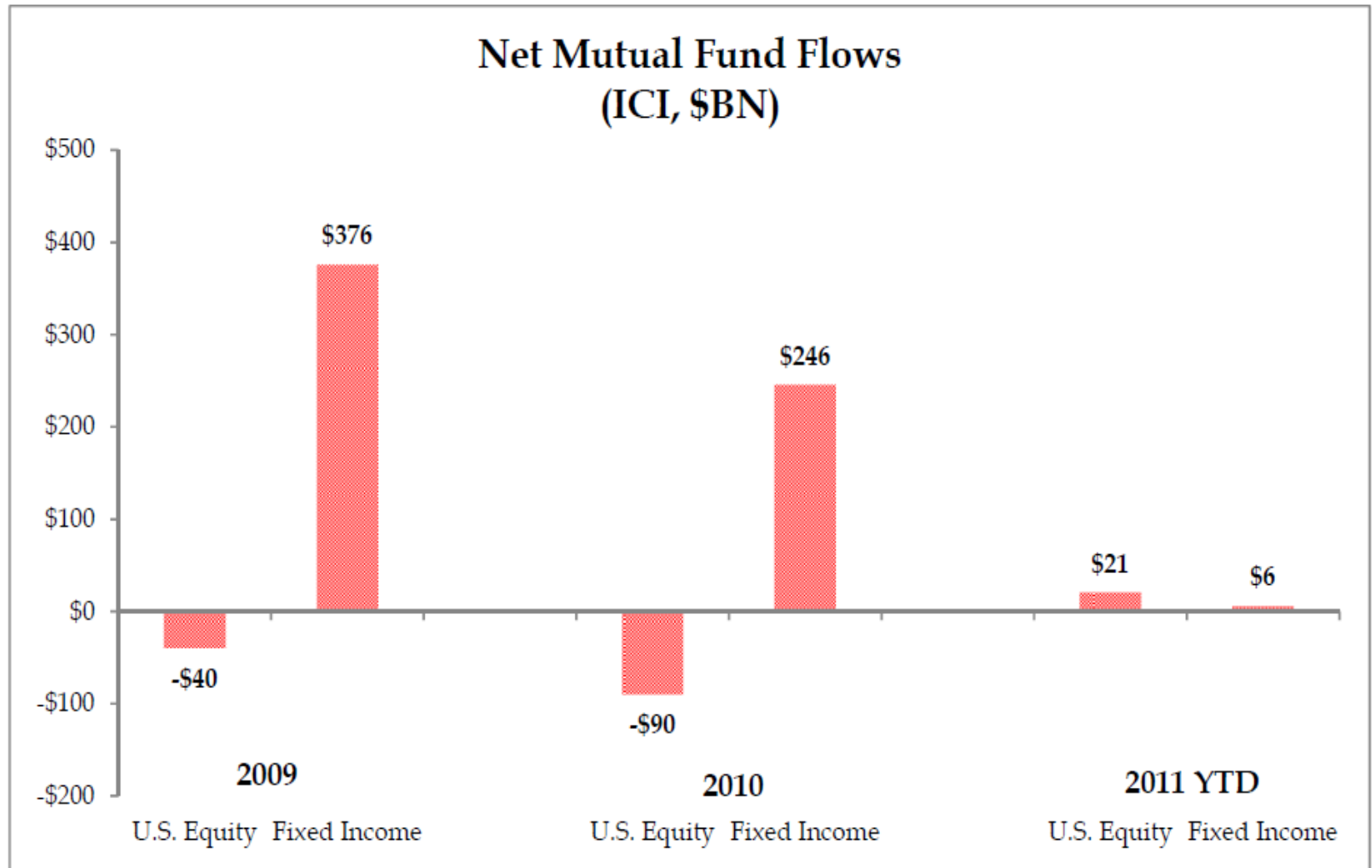
Source: Investment Company Institute

### Corporate Equity Holdings as % Financial Assets

	Private Pensions	Households
1996	43.5%	20.2%
1997	43.2%	23.0%
1998	45.1%	25.0%
1999	42.8%	28.4%
2000	44.1%	24.5%
2001	47.1%	21.2%
2002	43.2%	17.1%
2003	46.4%	19.2%
2004	47.5%	19.1%
2005	45.3%	18.7%
2006	44.8%	20.1%
2007	41.7%	19.0%
2008	35.1%	14.0%
2009	33.6%	16.6%
2010	<b>32.6%</b>	17.9%

Source: Federal Reserve Flow of Funds Accounts, Table L.118

## Early Stages of a Major Asset Class Shift?



Source: Strategas Research

## Success of QE2?

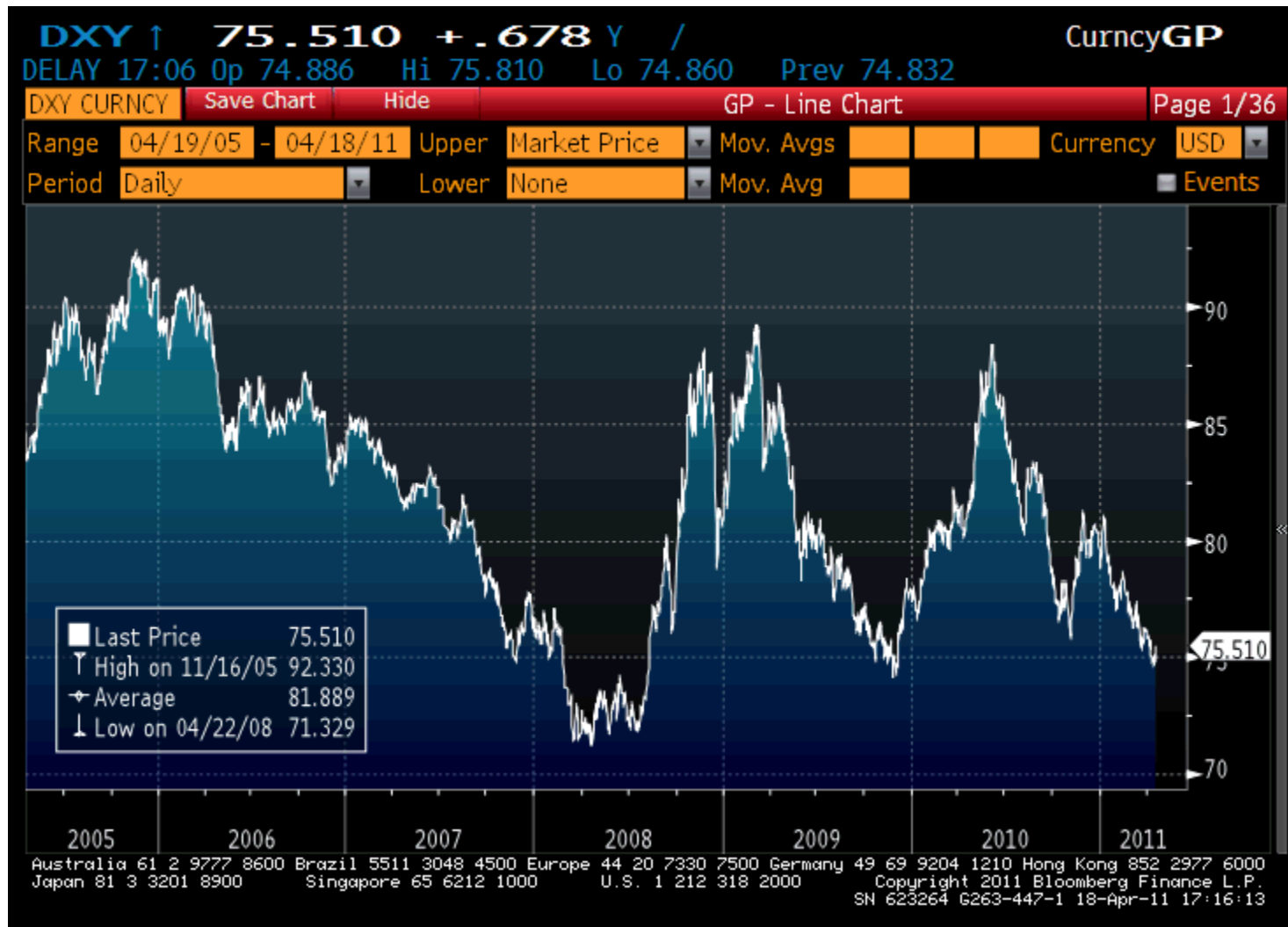
Effects of QE2:

- Higher interest rates
- Slower economic growth
- Speculation in risky assets, acceleration of capital flows to emerging markets
- Lower standard of living due to falling US dollar, rising food & energy costs

	QE1 Begins 11/25/08	QE1 Ends 3/31/10	QE2 Begins 8/27/10	QE2 3/31/11
10 Year U.S. Treasury Yield	3.1%	3.8%	2.7%	3.5%
30 Year U.S. Treasury Yield	3.6%	4.7%	3.7%	4.5%

Source: Hoisington Investment Management Company

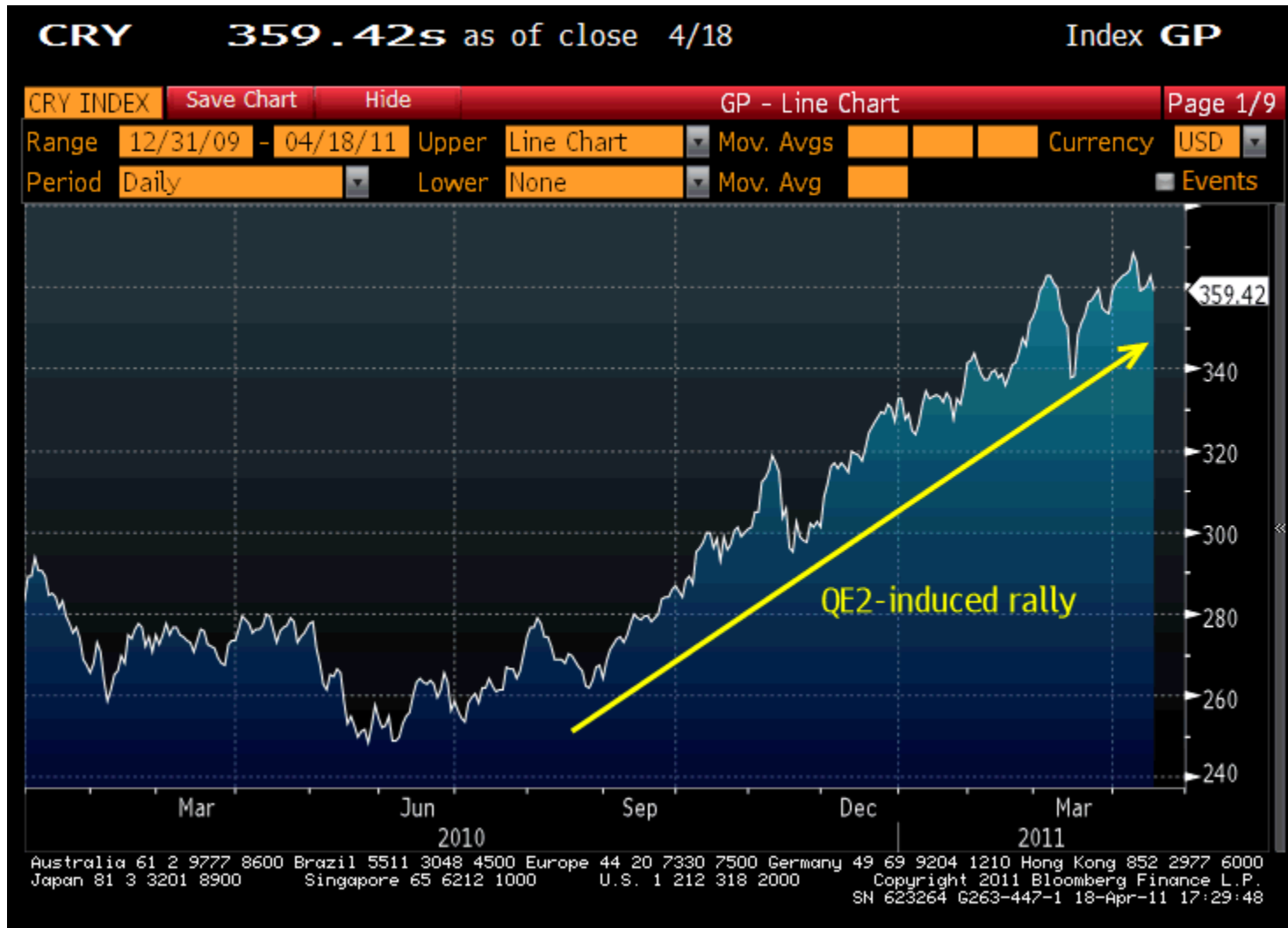
## The Fed Has Crushed the U.S. Dollar



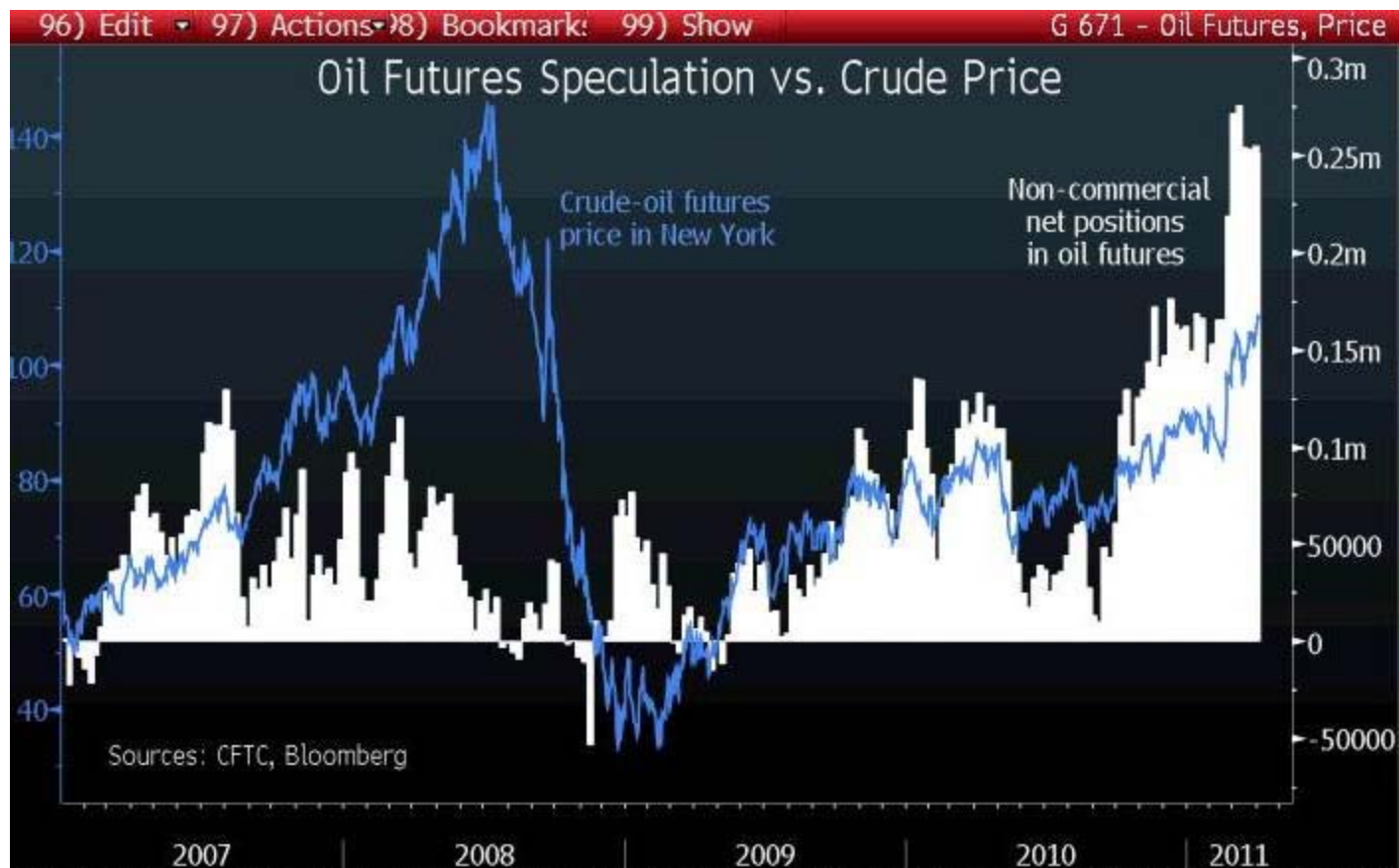
## Central Banks Can't Print Gold



# Commodities



## Substantial Speculation Exists in Commodities



## Municipal Bond Update

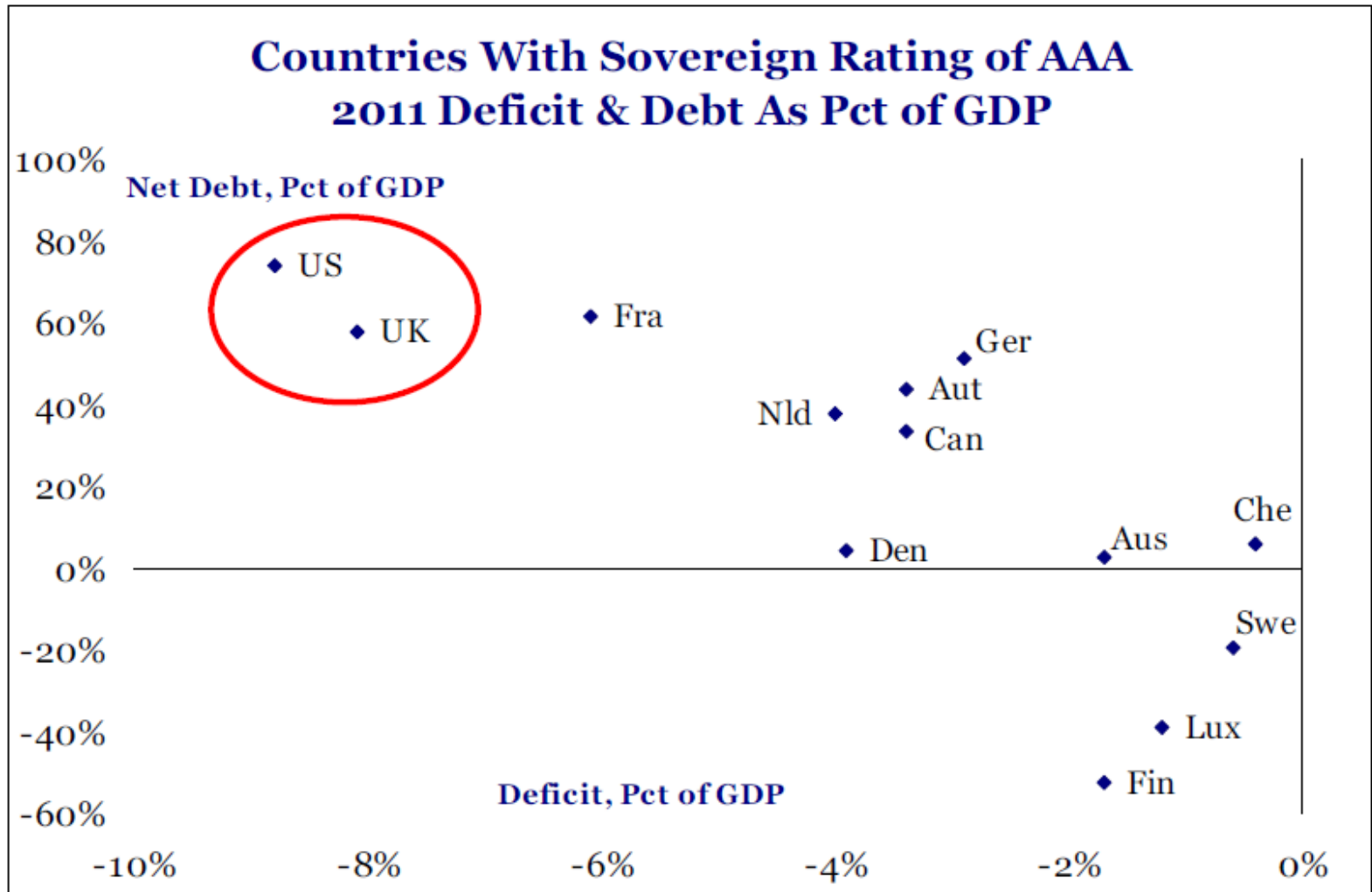
### NEGATIVES

- Unrelenting budget deficits
- High Pension/Healthcare Obligations
- Continued Negative Headlines
- Credit Quality Continues to Diverge
- Defaults: Uptick Likely; "Wave" Unlikely
- Fundamental Analysis More Important Now Than Ever

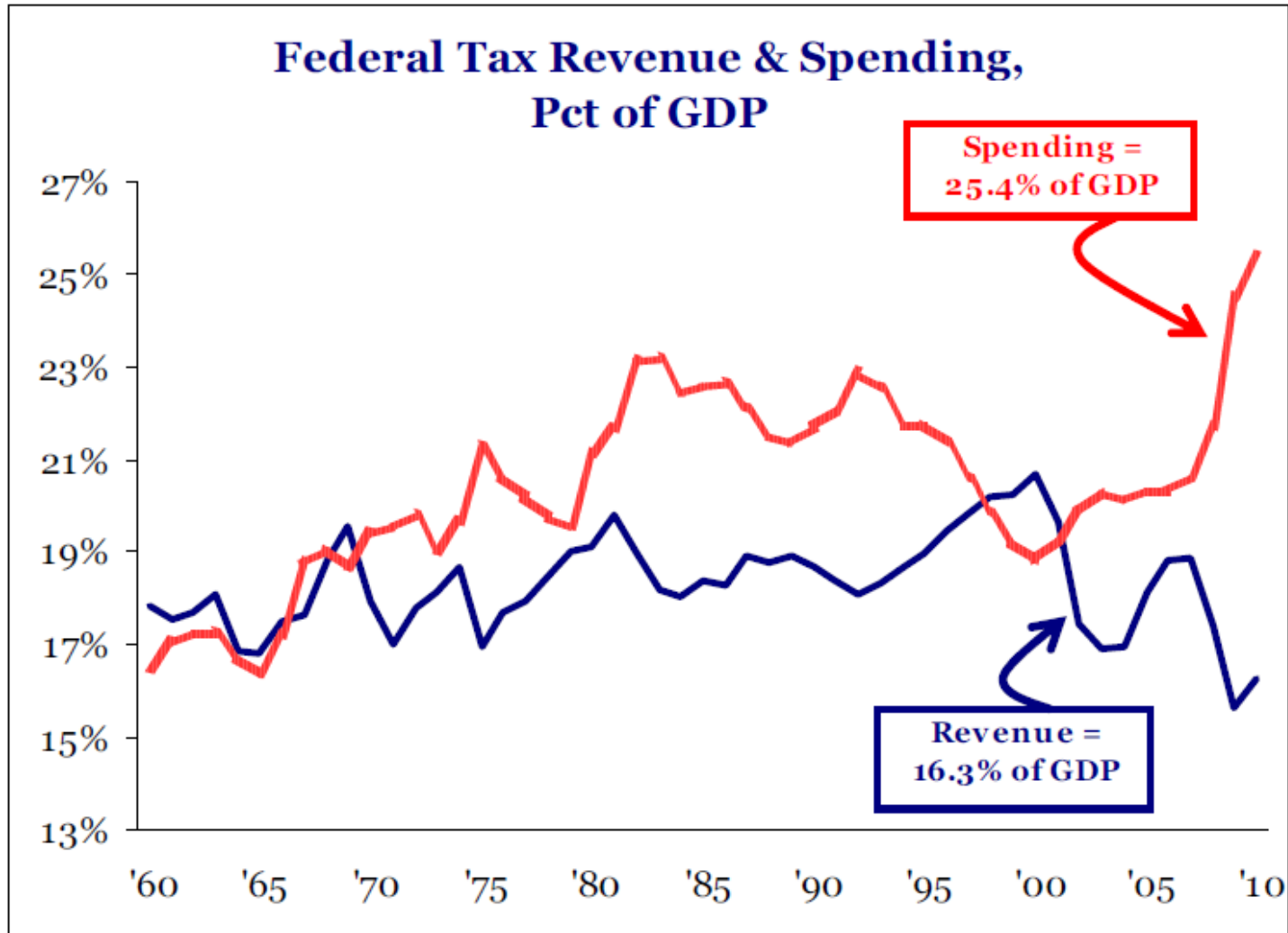
### POSITIVES

- State & Local Tax Revenues Stabilizing (Revenues up 5.2% in Q3-10)
- Debt Levels Manageable (12%-18% of US GDP)
- Overall Credit Quality Sound (value of defaults down 50% in Q1)
- Liquidity Adequate
- Pension Obligations Remain Controllable

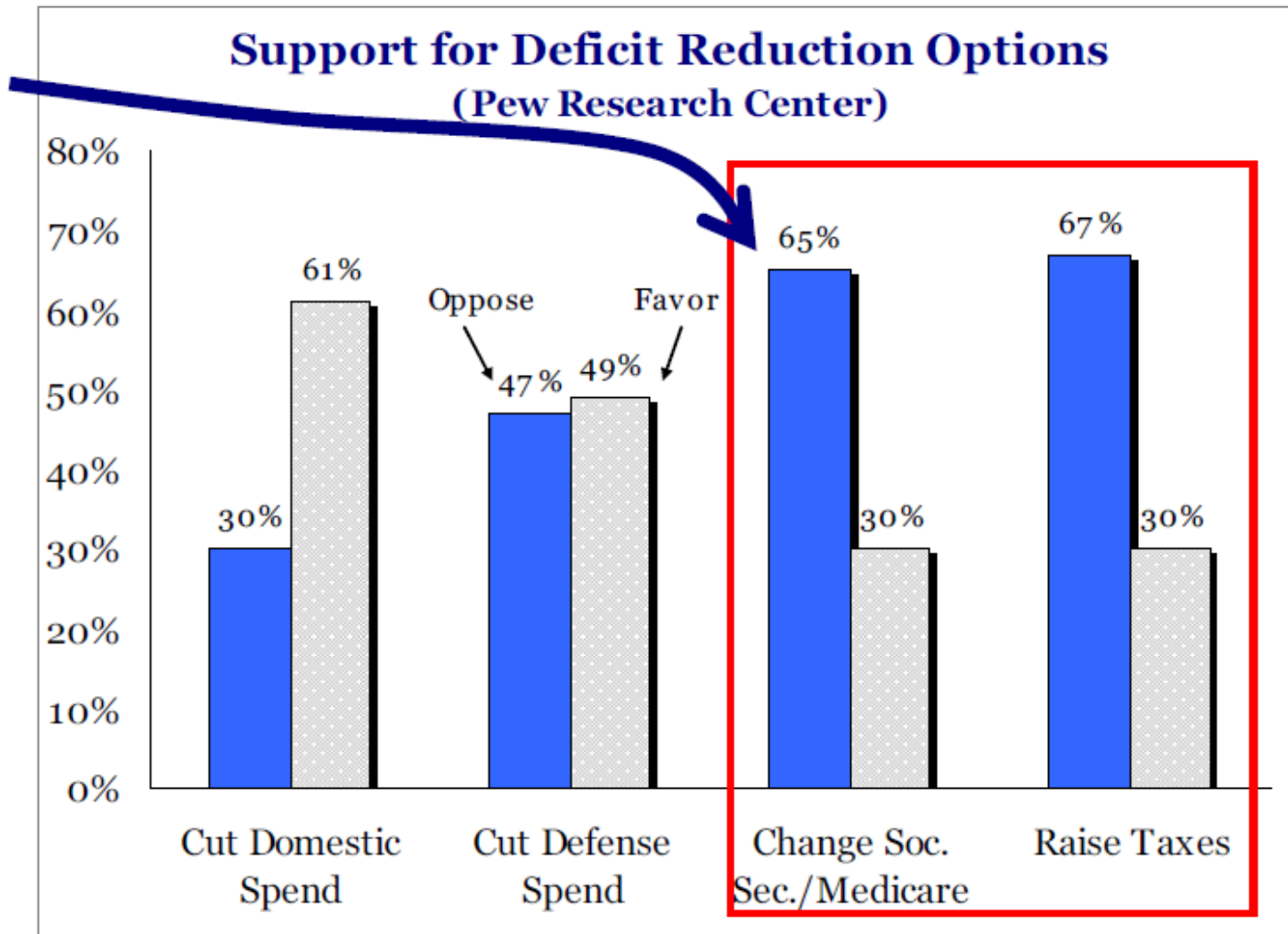
## S&P Warning Simply Pointed Out the Obvious...



## Deficit & Debt Reduction Requires Tough Decisions



## Voters Oppose Both Parties' Deficit Cutting Plans



## Questions & Answers

### Questions

Click on the arrows at the top right of your screen to show your control panel and type your question into the question box.

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