



October 26, 2011

Kanaly Trust Quarterly Investment Outlook & Strategy Conference Call

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

## Key Investment Issues

- Ongoing debt deleveraging and structural unemployment creates low growth environment
- No apparent solution to the European sovereign debt crisis
- Political gridlock in Washington
  - debt ceiling negotiations/deficit Super Committee
  - 2012 election is about austerity
- Federal Reserve is out of ammunition; additional easing risks stoking inflation
- Corporate America is healthy, but earnings are at risk as economy slows
- High quality, large capitalization stocks are attractive
- Negative real yields on Treasury securities

## Market Performance

### Index Performance as of September 30, 2011

<b>EQUITIES</b>	<b><u>3 Month</u></b>	<b><u>YTD</u></b>	<b><u>12 Months</u></b>
S&P 500	(13.9)	(8.7)	1.1
DJIA	(11.5)	(3.9)	3.8
Nasdaq	(12.7)	(8.3)	3.0
Russell 2000	(21.9)	(17.0)	(3.5)
MSCI EAFE	(19.0)	(14.6)	(8.9)
MSCI Emerging Mkts	(22.5)	(21.7)	(15.9)
<b>FIXED INCOME</b>			
BarCap US Treasury Interm	3.5	5.8	3.9
BarCap Inv. Grade Credit	2.9	6.1	4.4
ML US High Yield	(5.0)	(0.5)	1.9
BarCap 1-10yr Muni	2.0	5.1	3.4
<b>ALTERNATIVES</b>			
HFRI Global Hedge Fund	(6.5)	(8.4)	(5.5)
DJ Wilshire REIT	(7.0)	6.8	19.8
DJ UBS Commodity	(11.3)	(13.6)	0.0
Gold	8.2	14.3	24.1
Crude Oil	(17.0)	(13.3)	-1.0

## Kanaly Trust Investment Performance – as of 9/30/11

### 2011 YEAR TO DATE ASSET CLASS PERFORMANCE

	2011-Q1	2011-Q2	2011-Q3	2011
Equity Only	5.6%	-0.5%	-17.1%	-12.9%
Fixed Income - Tax Free (1)	0.6%	2.9%	2.4%	6.0%
ALTs - With MLPs	3.1%	-0.2%	-4.9%	-2.1%
<b>Income Portfolio (2)</b>	<b>3.3%</b>	<b>2.4%</b>	<b>-2.5%</b>	<b>3.2%</b>
<b>Conservative Portfolio - Tax Free (3)</b>	<b>2.1%</b>	<b>0.7%</b>	<b>-3.9%</b>	<b>-1.2%</b>
<b>Growth &amp; Income Portfolio - Tax Free (3)</b>	<b>2.9%</b>	<b>0.2%</b>	<b>-7.4%</b>	<b>-4.6%</b>
<b>Growth Portfolio - Tax Free (3)</b>	<b>3.1%</b>	<b>0.1%</b>	<b>-8.4%</b>	<b>-5.5%</b>
<i>S&amp;P 500 Index</i>	5.9%	0.1%	-13.9%	-8.7%
<i>MSCI AC World</i>	4.5%	0.4%	-17.3%	-13.2%
<i>Barclays US Aggregate Bond Index</i>	0.4%	2.3%	3.8%	6.7%
<i>BarCap 1-10Yr Muni Index</i>	0.6%	2.4%	2.0%	5.1%
<i>S&amp;P 500 (60%) / Intermediate Tax Free (40%)</i>	3.8%	1.0%	-7.7%	-3.3%

*Footnotes*

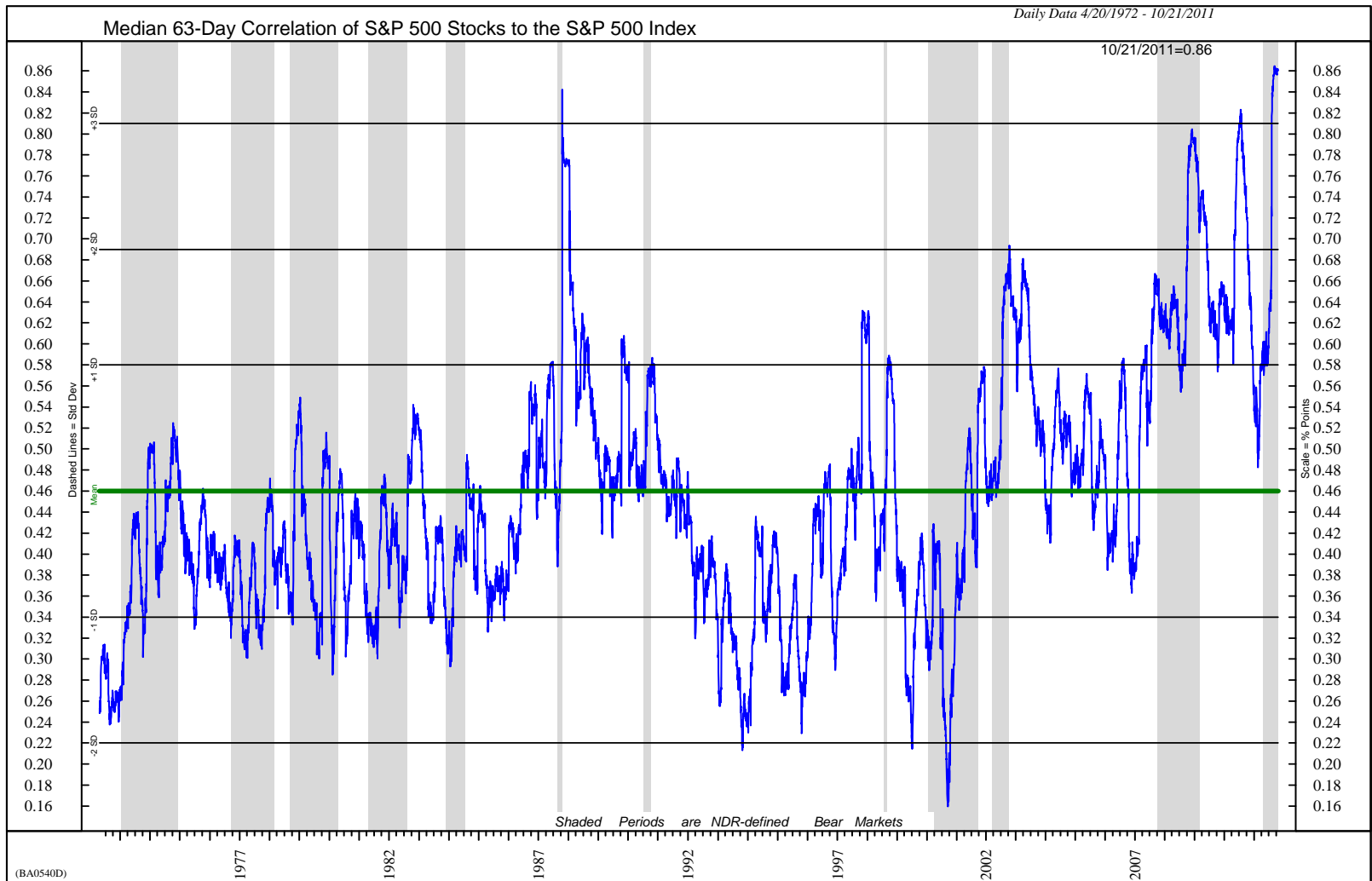
(1) The figures above are comprised of a 50/50 allocation to the tax-exempt fixed income strategies at both Asset Preservation Advisors and Breckinridge Capital Advisors.

(2) The current allocation of the Income Portfolio is 80% Fixed Income and 20% Dividend Paying Equities.

(3) The portfolio allocations are as follows (Equity/Fixed Income/Alternatives/Cash); Conservative - Tax Free (20/45/28/7), Growth & Income - Tax Free (35/25/33/7), Growth - Tax Free (40/20/33/7).

\* 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.

# Stocks at Record High Correlation

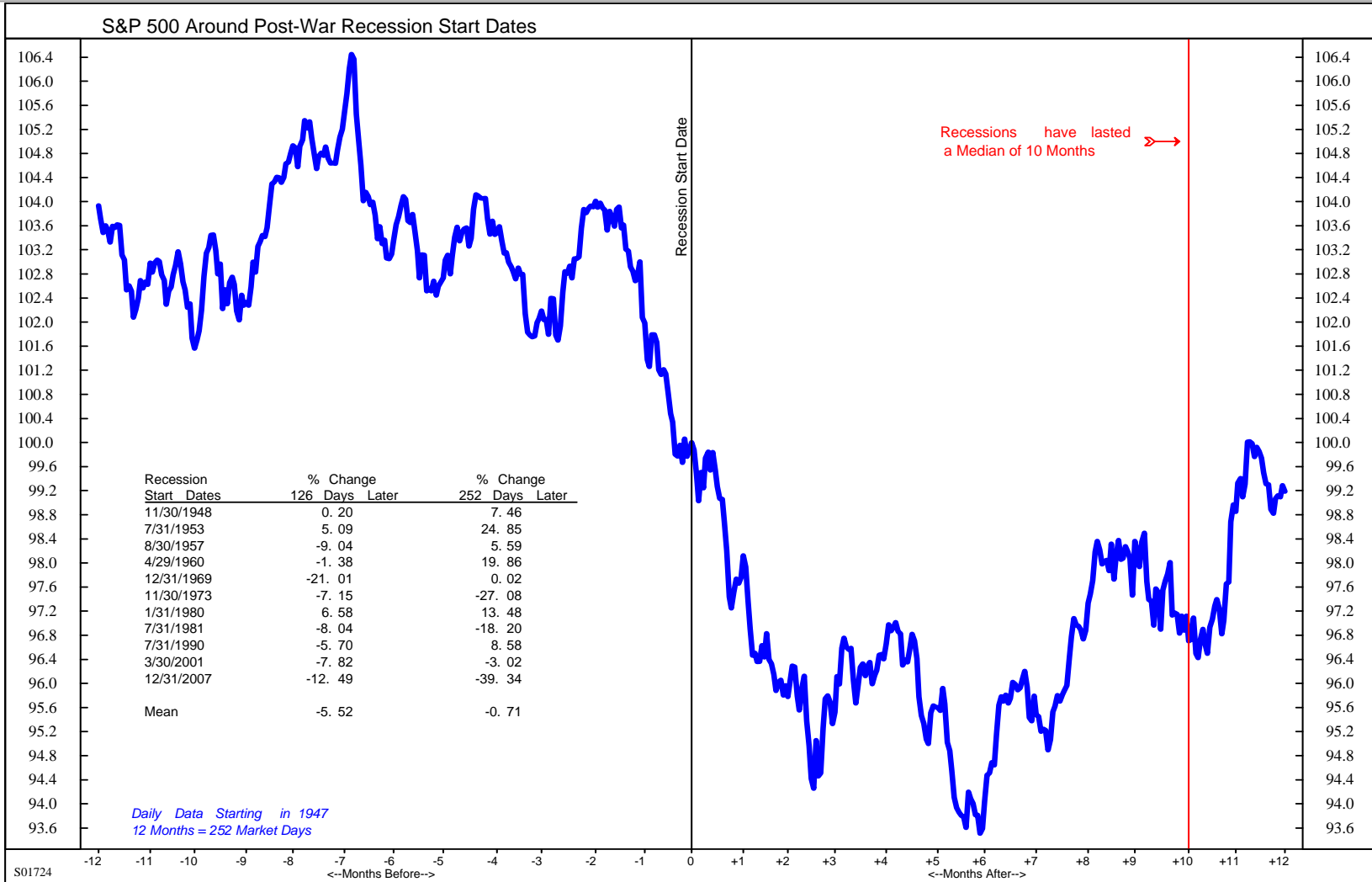


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# S&P 500 Breaking Out of Range

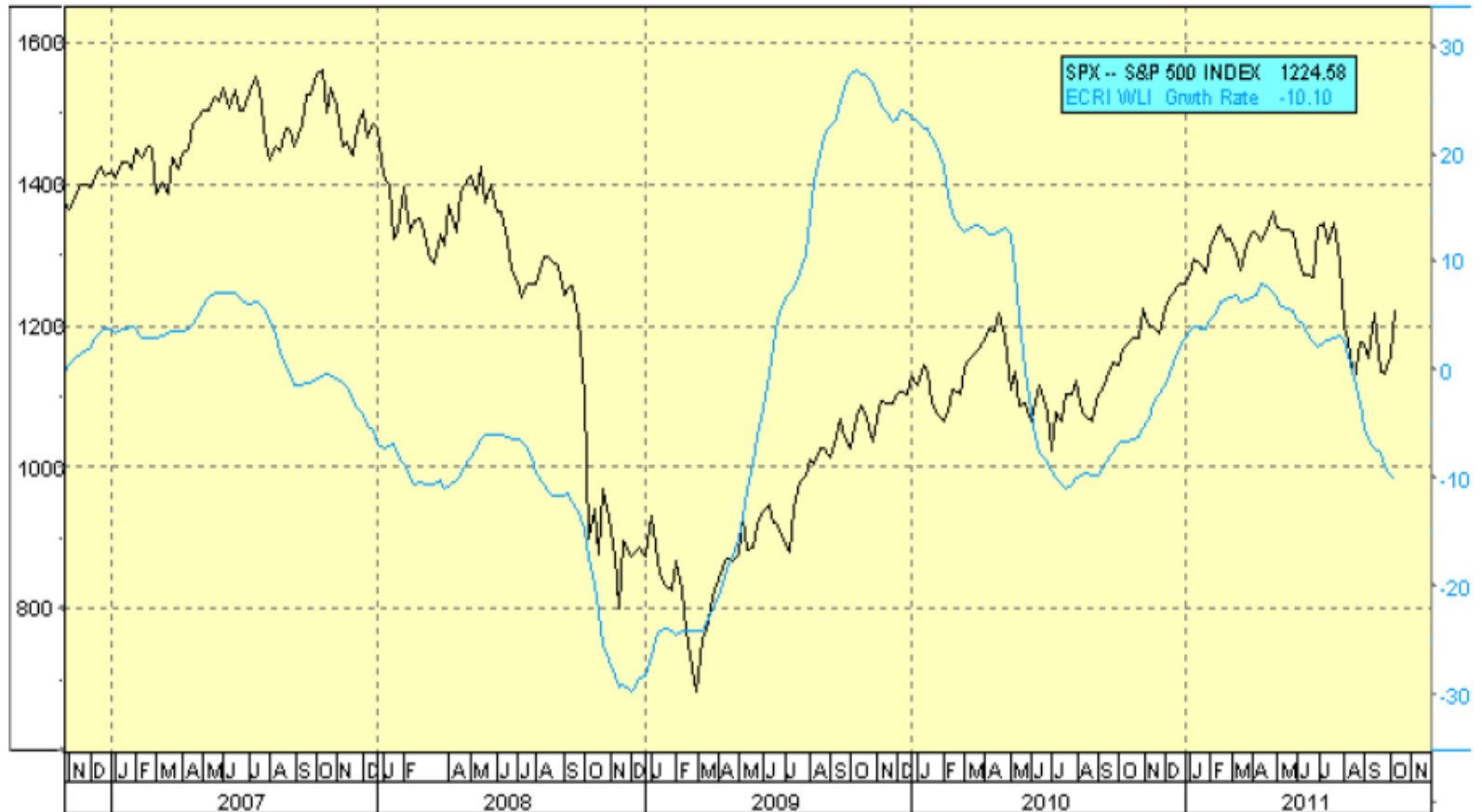


# Economic Outlook is Critical – Recession or Not?



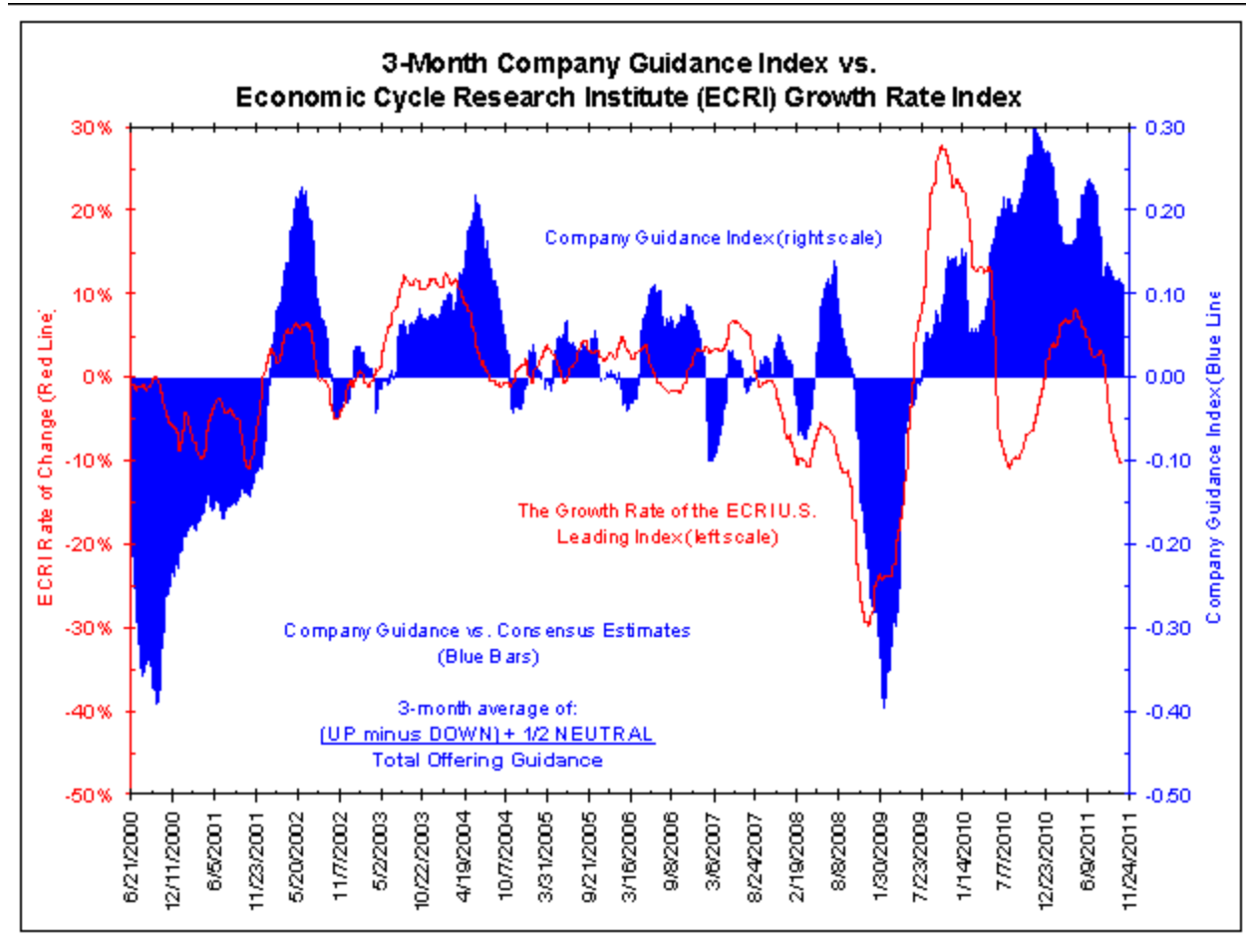
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## Recession in 2012?

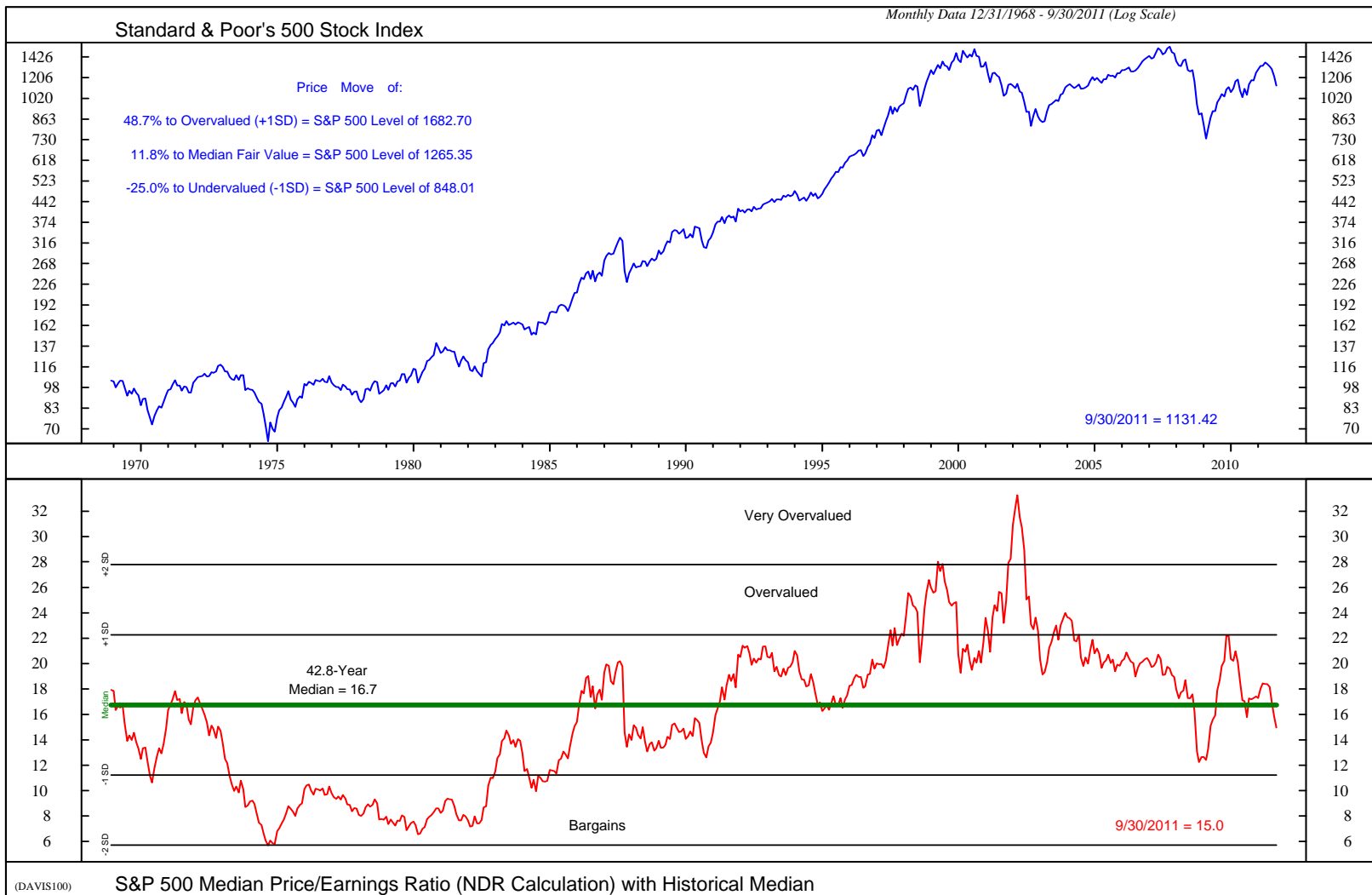


*S&P 500 Index vs. ECRI Weekly Growth Index* - ECRI leads by about a quarter or so.

# Earnings Estimates at Risk?

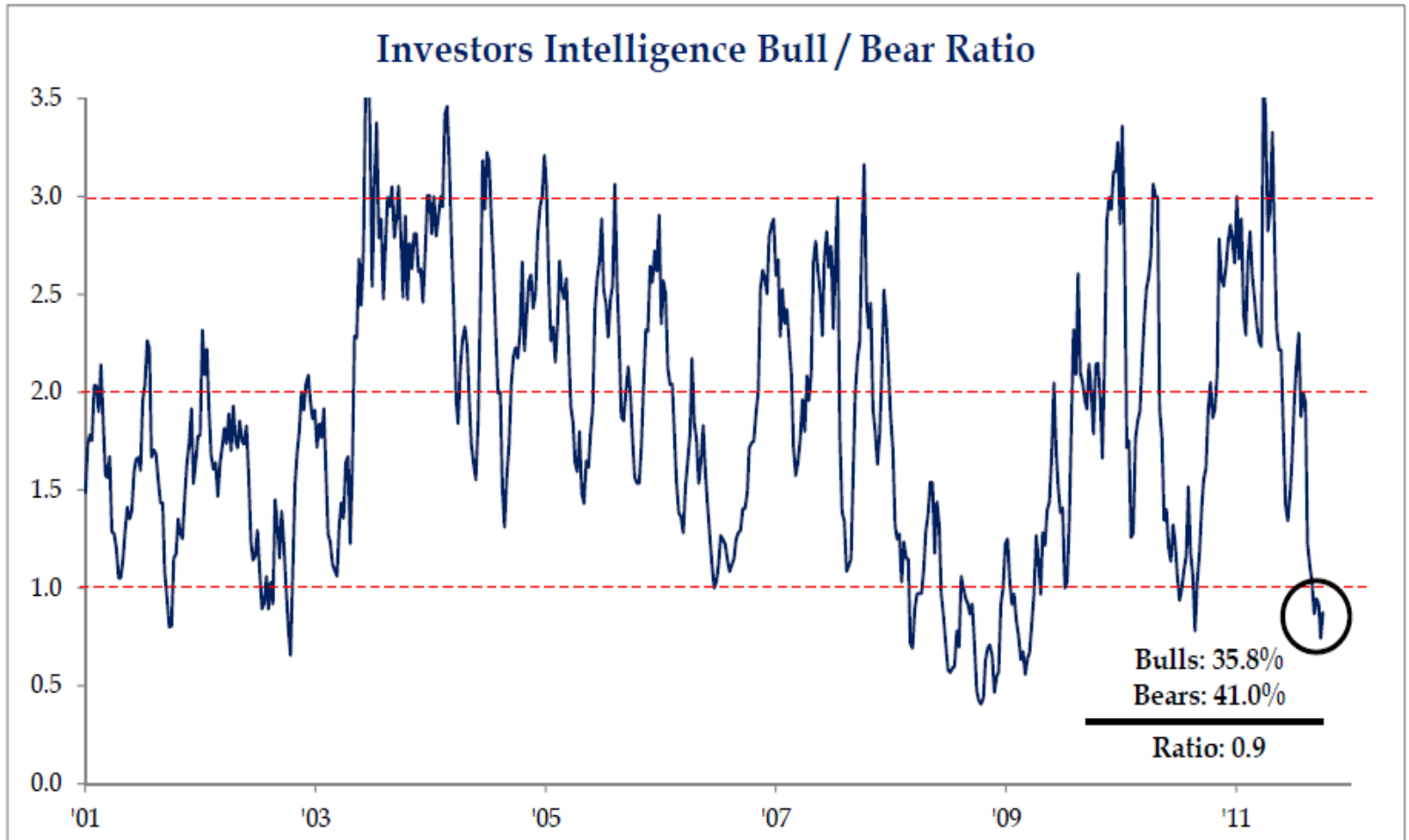


# Stocks are Fairly Valued

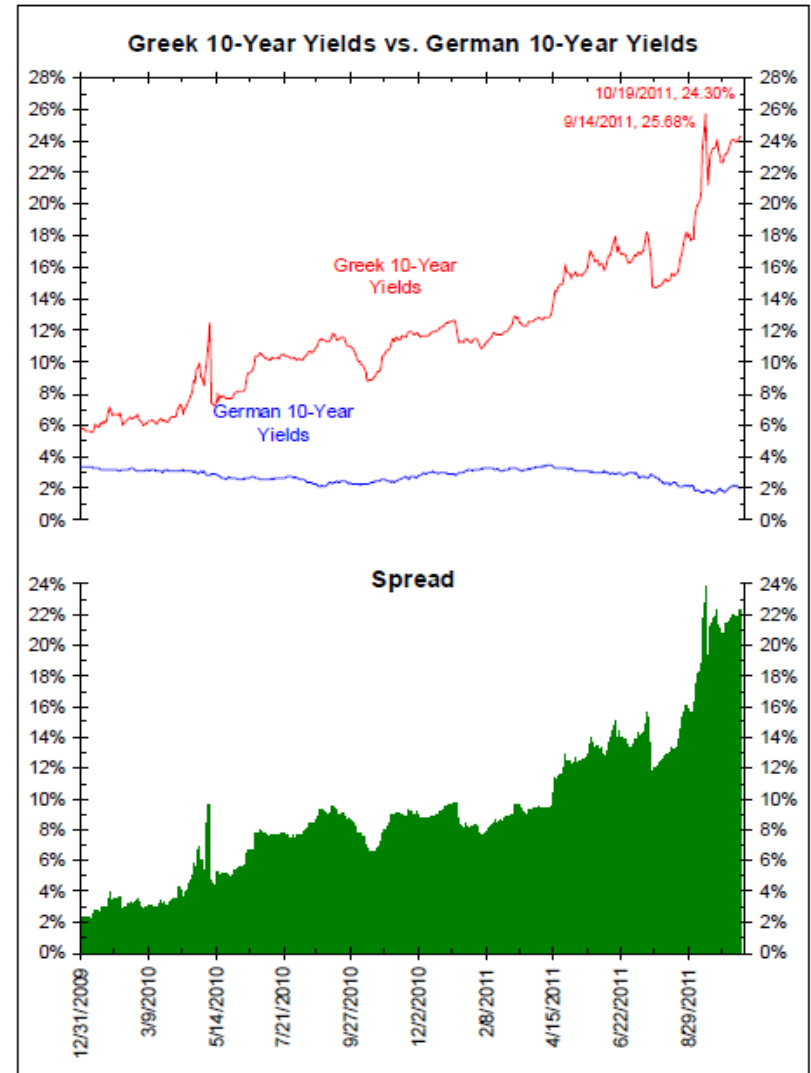
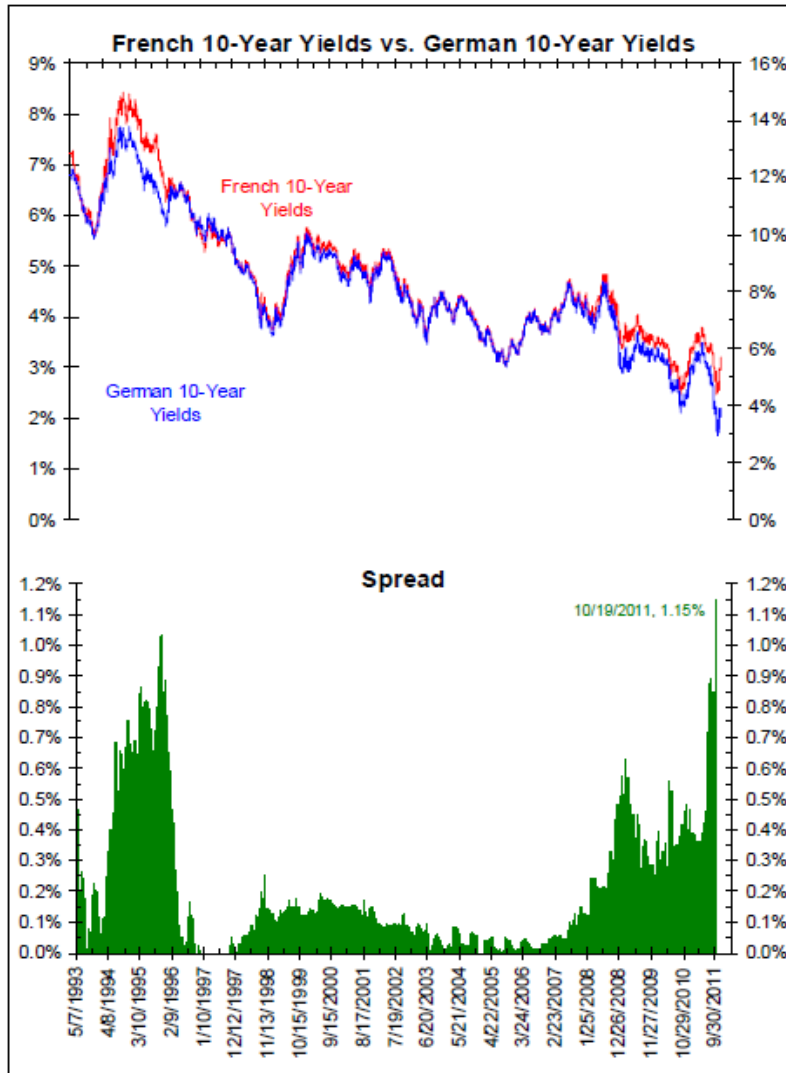


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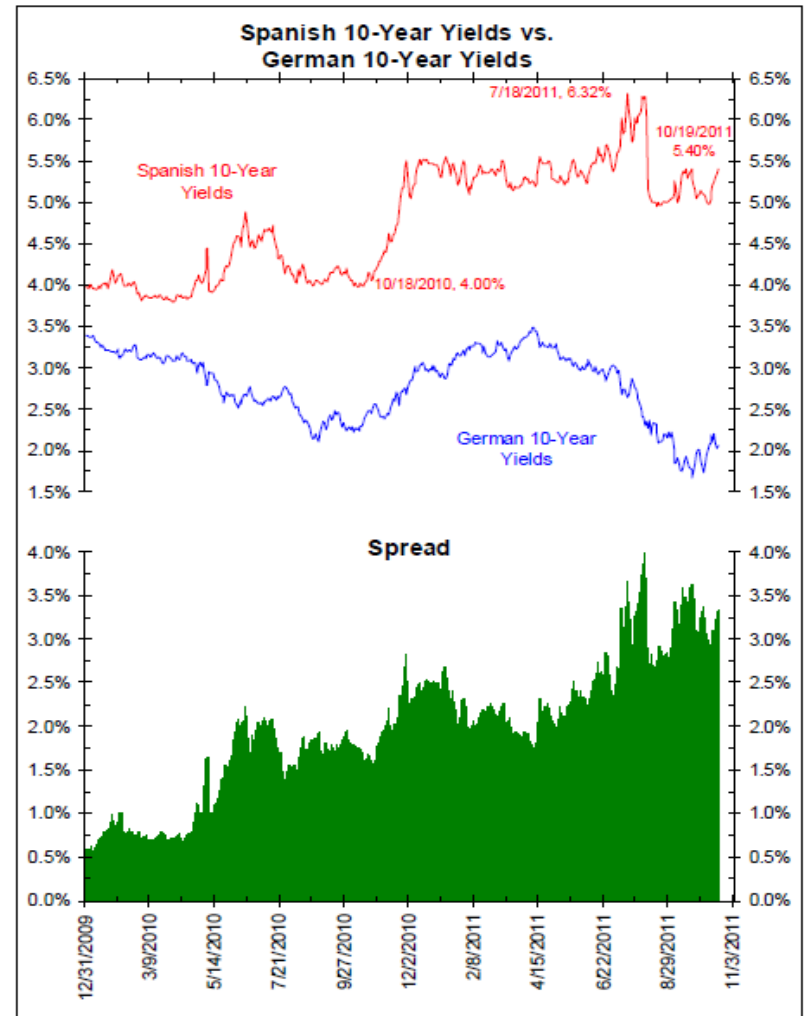
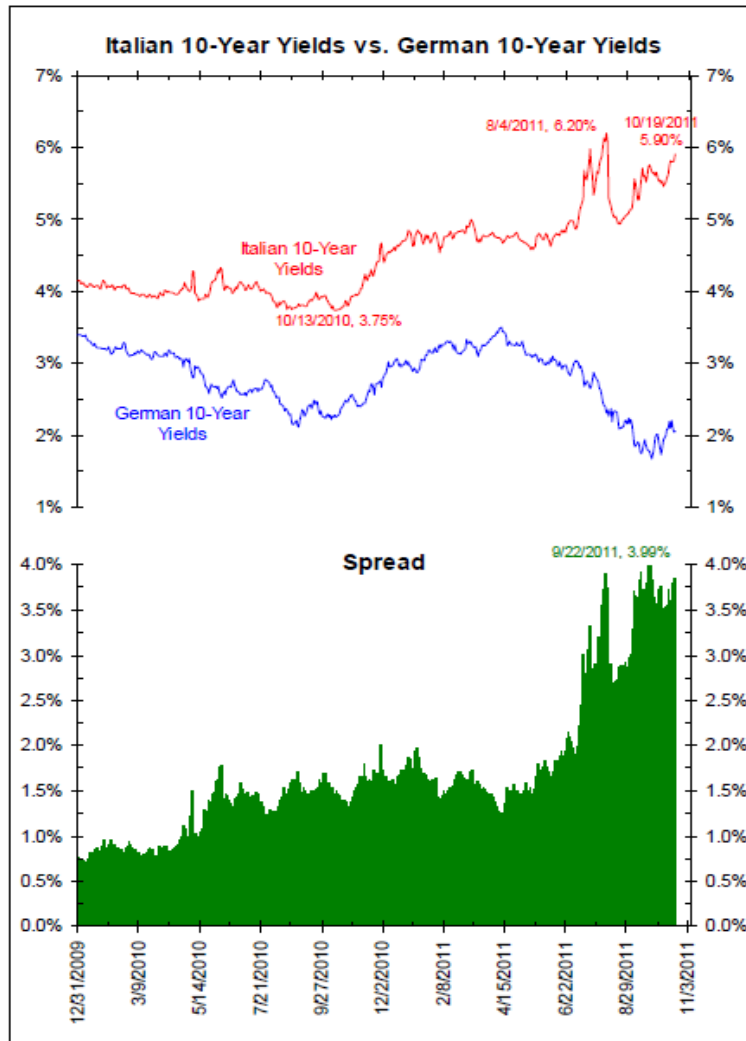
## Investor Sentiment Close to Extreme Levels



# Sovereign Credit Risk



# Sovereign Credit Risk

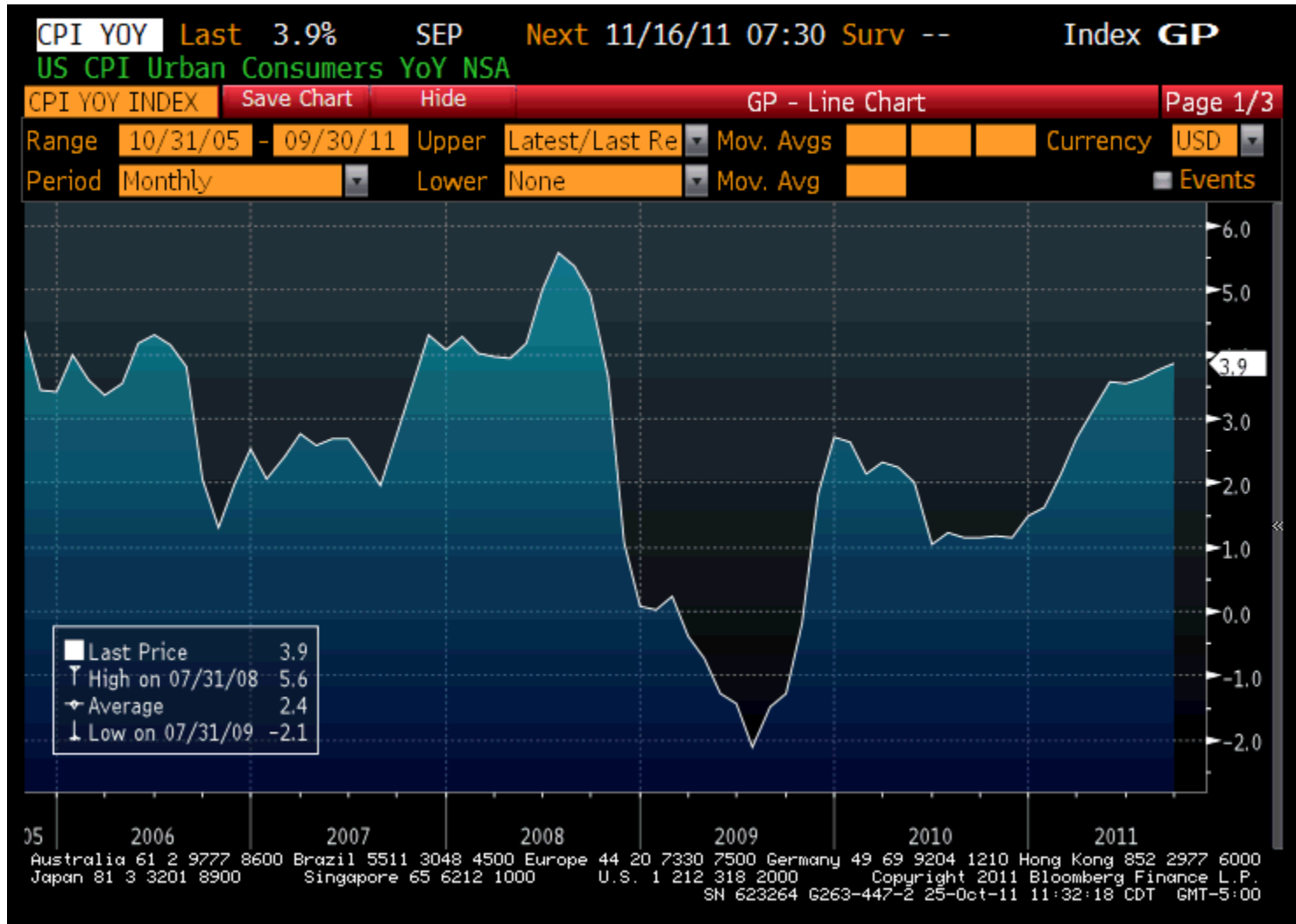


## The Federal Reserve is Out of Ammo



"...the 17 members of the Federal Open Market Committee have been working in the harshest economic environment to harness monetary theory and lessons learned from practice to revive the economy and job creation without forsaking our commitment to maintaining price stability. But the committee's policy has yet to show evidence of working and nobody seems to quite understand why." *Richard W. Fisher, President and CEO of the Federal Reserve Bank of Dallas*

# Inflation Should Limit the Fed's Options



## Investment Strategy

- Focus on preservation of capital
  - reduce risk on market rallies (small caps, emerging markets, low quality fixed income)
  - valuations becoming attractive, but don't think we've reached a bottom
  - keep some powder dry to take advantage of market volatility
- Stick with high quality, large capitalization global stocks
  - preferably those with growing dividends
  - also companies with organic growth drivers
- Invest in investment grade fixed income and high rated municipals
- Make sure portfolio is truly diversified
  - alternative investments play a significant role
  - MLPs, gold, alternative credit, trading strategies (managed futures)

## 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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