



April 20, 2009

Kanaly Trust Quarterly Investment Outlook & Strategy Conference Call

James H. Shelton, CFA
Chief Investment Officer

Overview

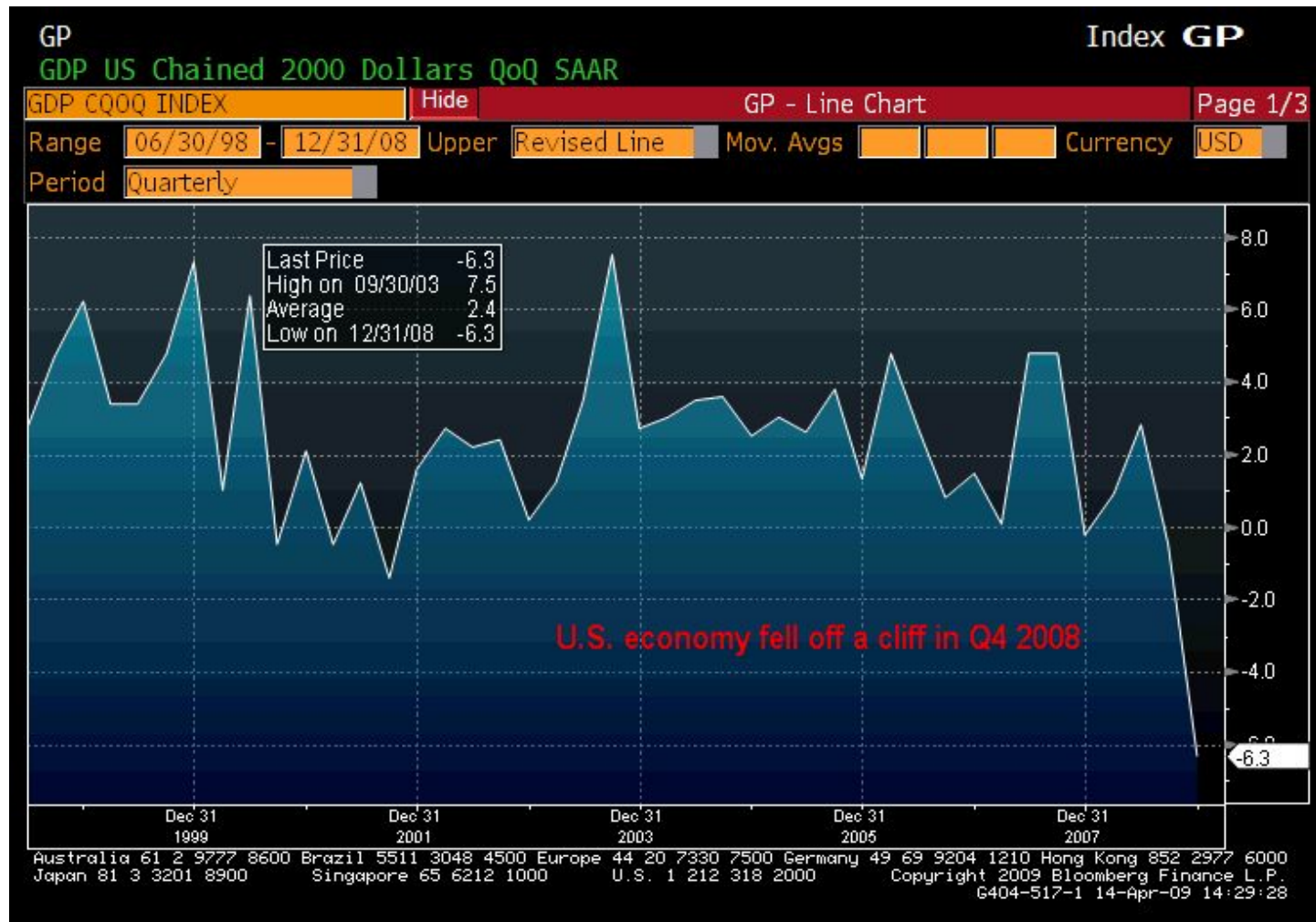
- No change to our economic outlook: sustainable economic recovery not yet in sight
- Much of the government response to the crisis seems likely to prolong the recovery process; high risk of inflation
- At March 9 lows, stocks priced in much of the bad news
- Stocks have enjoyed a strong rally based on economic/company data that is “less bad”
 - Unemployment set to rise further
 - Earnings expectations still too high
 - Toxic assets still on bank balance sheets
- For the rally to continue, one must believe in a “V”-shaped recovery
- Global equities have better risk/reward than government bonds
- Market likely in a broad trading range: actively managed portfolios are likely to perform better than indexed strategies

2009 Market Overview

Index Performance as of March 31, 2009

EQUITIES	<u>1 month</u>	<u>YTD</u>	<u>12 months</u>
S&P 500	8.76	(11.01)	(38.09)
DJIA	7.93	(12.48)	(35.93)
Nasdaq	11.02	(2.79)	(32.25)
Russell 2000	8.93	(14.95)	(37.50)
MSCI EAFE	6.39	(13.85)	(46.20)
MSCI Emerging Mkts	14.38	1.02	(46.90)
FIXED INCOME			
BarCap US 1-3yr Govt	0.53	0.03	3.92
BarCap Int Govt/Credit	0.95	(0.05)	1.96
BarCap High Yield	3.19	5.98	(19.31)
BarCap 5yr Muni	0.45	2.18	6.04
ALTERNATIVES			
HFRI Fund of Funds	0.10	1.10	(16.50)
DJ Wilshire REIT	3.22	(33.92)	(60.66)
DJ AIG Commodity	3.60	(6.31)	(44.99)
Gold	(2.46)	4.20	0.25
Crude Oil	10.95	11.35	(51.11)

Economy fell off a cliff in September 2008



Highest unemployment since 1982; 5 million+ jobs lost



Housing market bottoming? We doubt it...

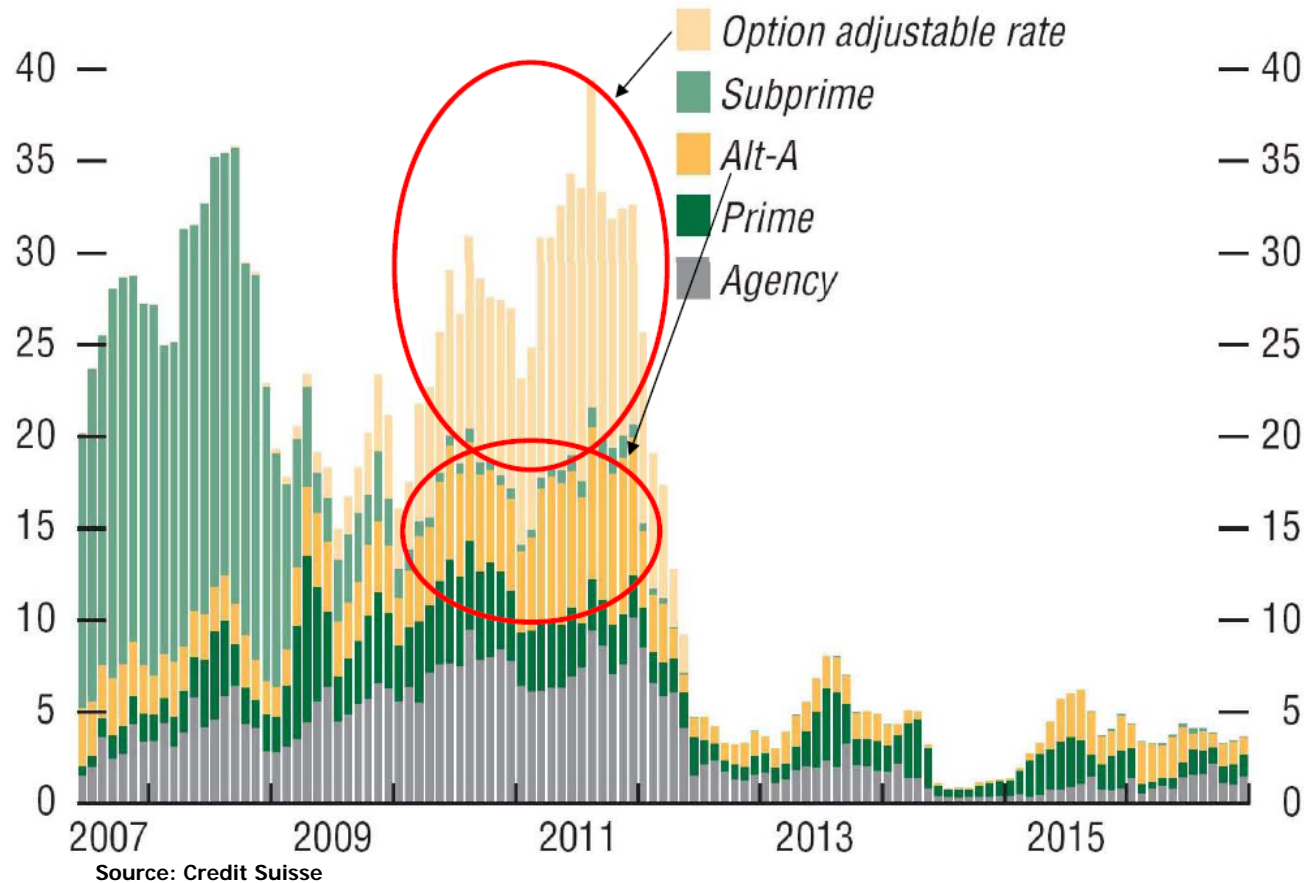
- Housing prices always improve in the Spring

S&P/Case-Shiller Home Price Index QoQ % Change

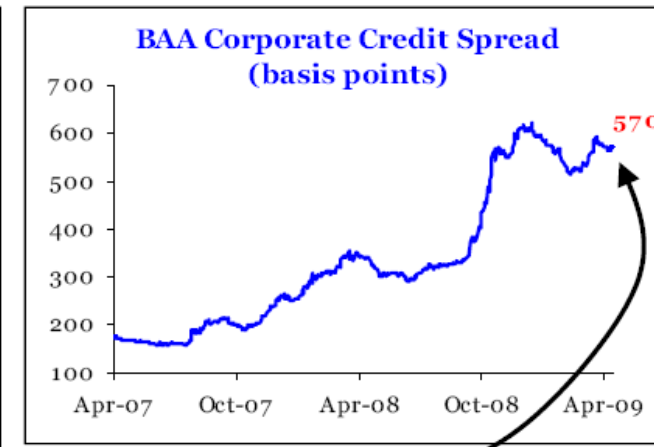
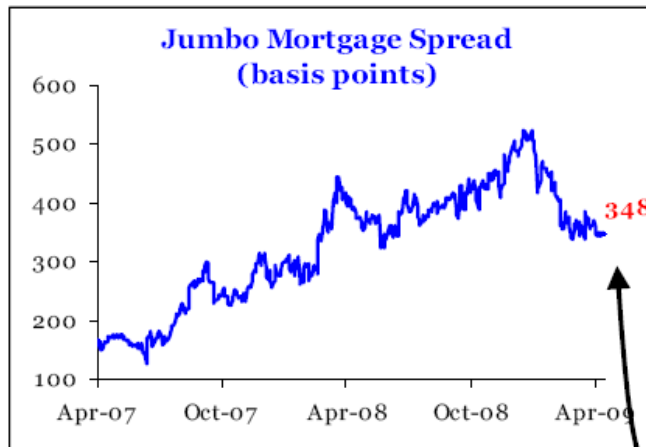
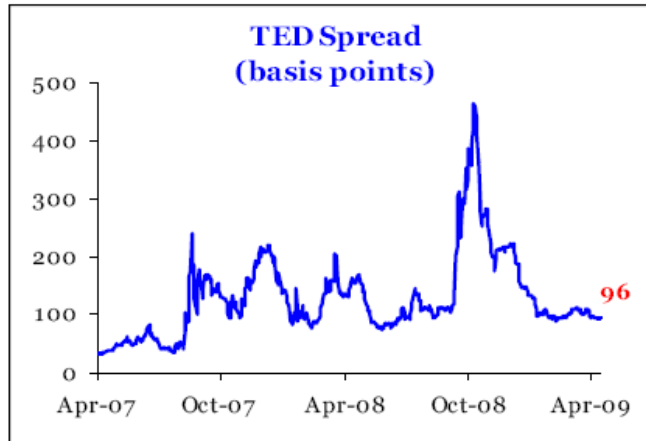


Housing market not out of the woods

- Monthly Resets on troubled mortgages will pressure housing for two more years



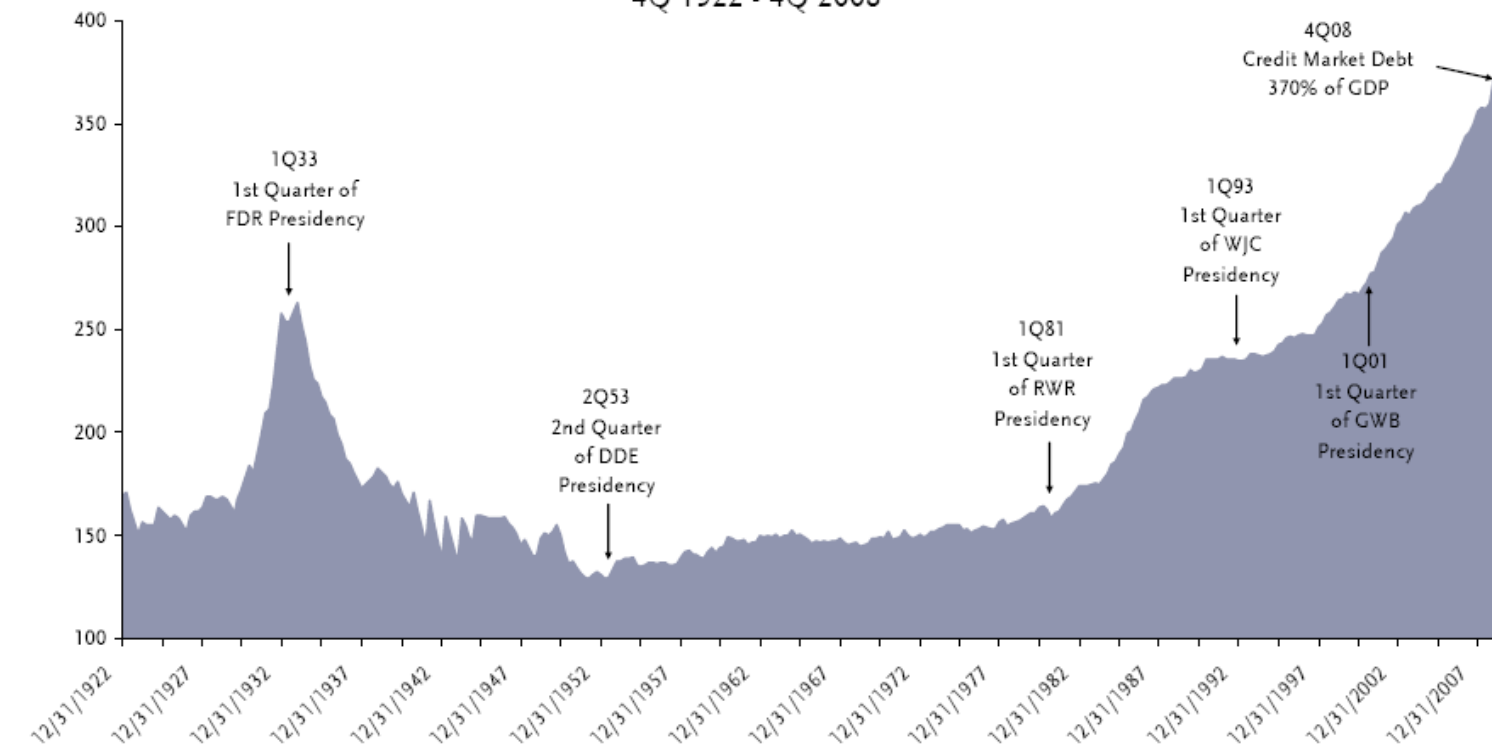
Credit crisis easing, but more needs to be done



Still need to see further improvement here

Too much debt is the long term problem

Total Credit Market Debt as a Percentage of U.S. Gross Domestic Product
4Q 1922 - 4Q 2008



Source: Federal Reserve, U.S. Commerce Department, Ned Davis Research

Diminishing Returns from Debt Financing

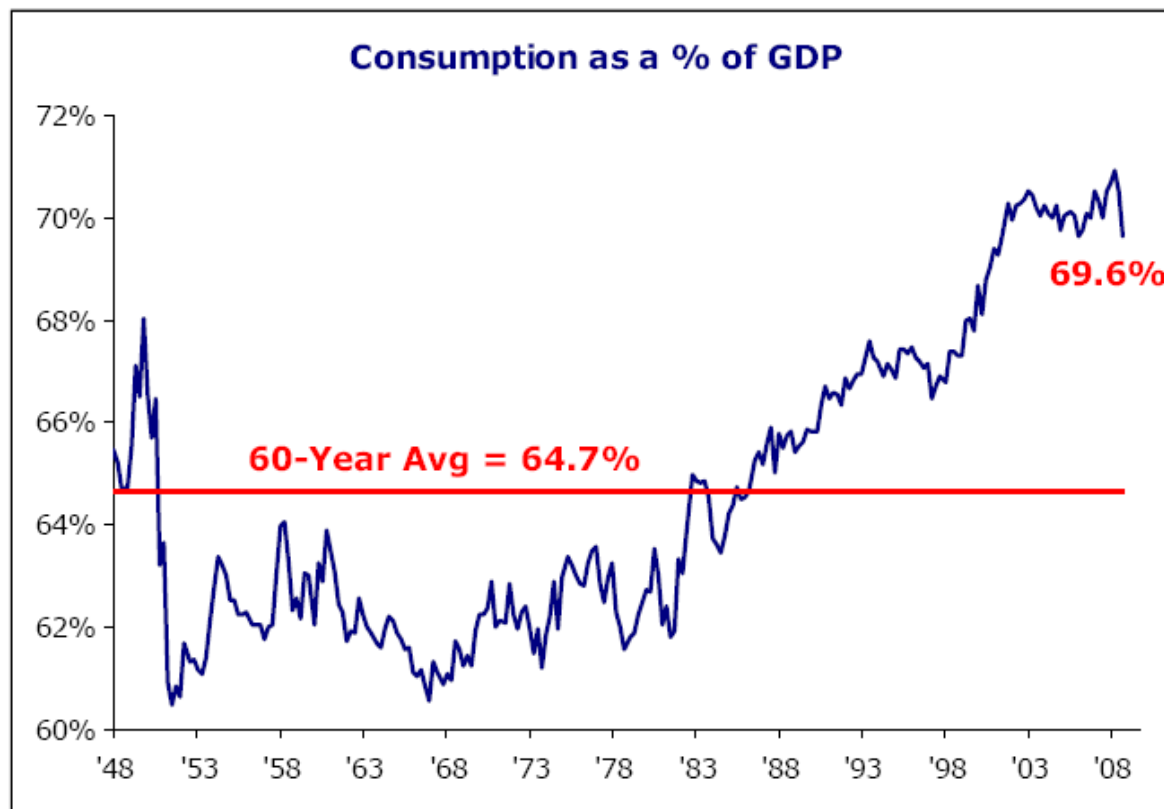
- Table shows how much debt it took each decade to produce one dollar of GDP
- Put another way, \$1 of debt produced only 17 cents of growth this decade
- Too little savings and too much debt...can't borrow our way to prosperity
- If everyone is loaded with debt, then there are few credit worthy borrowers

Date Range	Change in Debt (\$billions)	Change in GDP (\$billions)	Debt/GDP
12/31/1949 - 12/31/1959	337.6	248.0	1.36
12/31/1959 - 12/31/1969	752.1	491.4	1.53
12/31/1969 - 12/31/1979	2,785.2	1,655.9	1.68
12/31/1979 - 12/31/1989	8,563.7	2,923.8	2.93
12/31/1989 - 12/31/1999	12,566.2	3,935.2	3.19
12/31/1999 - 12/31/2008	27,186.5	4,680.8	5.81

Source: Ned Davis Research

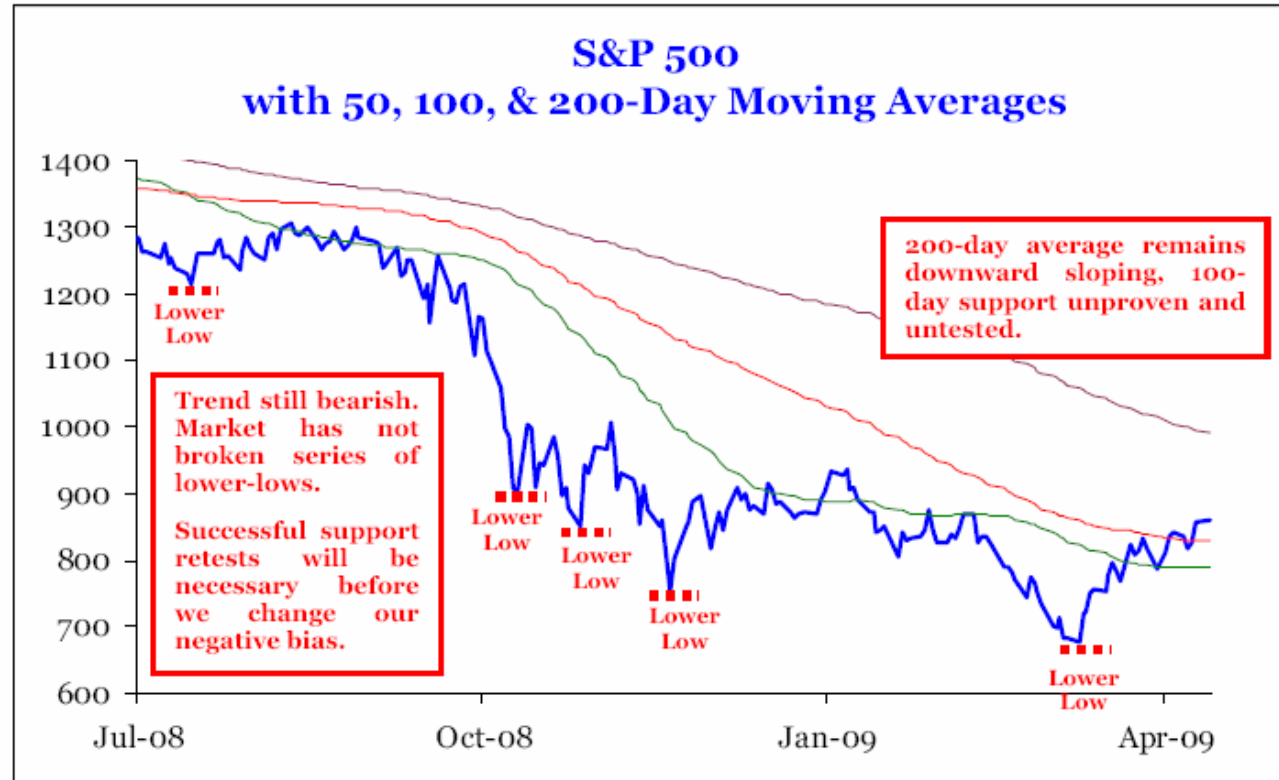
Consumer spending has a long way to fall

- Household balance sheet repair (more savings, paying down debt) likely to drive economic fundamentals over next several years
- In a \$14 trillion economy, reversion to the mean has a huge impact



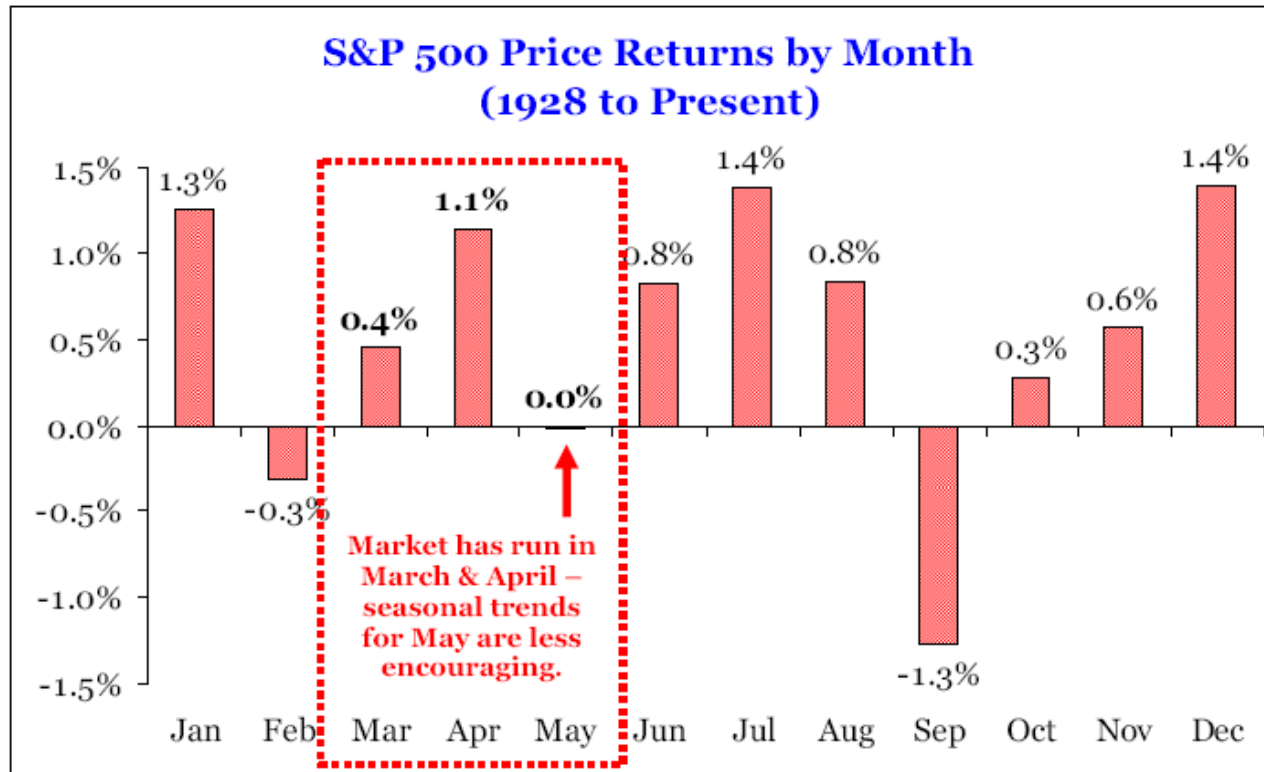
Source: Strategas Research

Market remains in a bearish trend



Source: Strategas Research

Seasonally strong period for the equity markets



Source: Strategas Research

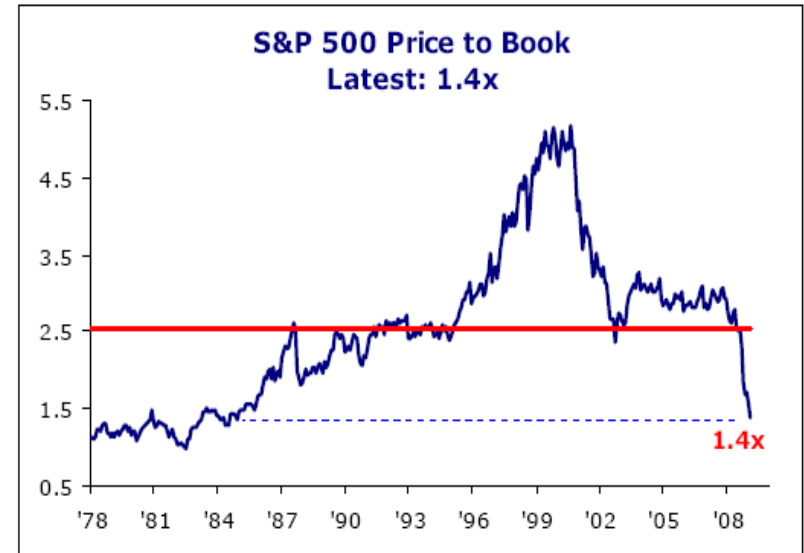
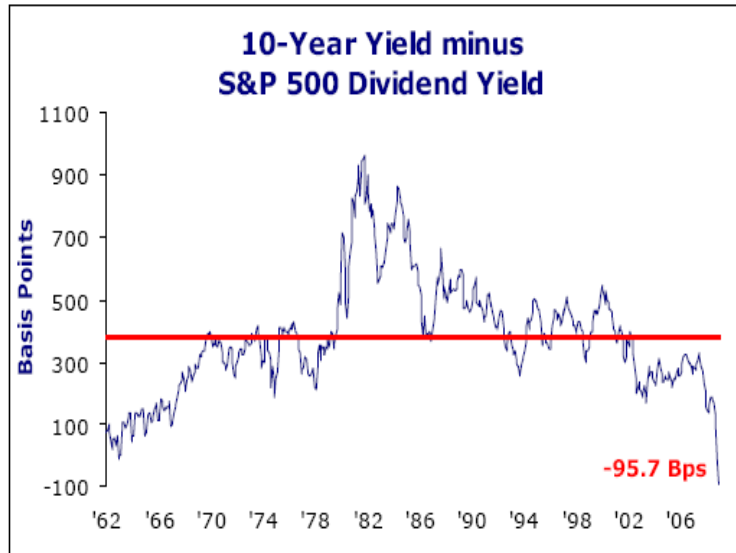
Equity valuations at market bottoms

- Two key questions: 1) how far will earnings fall?; and 2) what multiple will investors pay for trough earnings?

Historical Market Bottoms: Multiples, Treasuries, Inflation, & Taxes					
S&P 500 Trough	Level	Trailing P/E	10-Year Yield	Inflation	Top Marginal Tax Rate
6/1/1932	4.40	10.5x	3.8%	-10.5%	63.0%
4/29/1942	7.47	7.7x	2.4%	12.6%	88.0%
6/14/1949	13.55	5.8x	2.4%	-1.0%	82.1%
10/22/1957	38.98	12.2x	4.0%	2.9%	91.0%
6/27/1962	52.32	16.1x	3.9%	1.2%	91.0%
10/7/1966	73.2	14.8x	5.0%	3.8%	70.0%
5/26/1970	69.29	14.0x	7.9%	6.0%	71.8%
10/3/1974	62.28	8.3x	7.9%	11.8%	70.0%
8/12/1982	102.42	8.8x	13.1%	6.0%	50.0%
12/4/1987	223.92	12.6x	9.0%	4.3%	38.5%
10/11/1990	295.46	13.1x	8.7%	6.4%	31.0%
10/9/2002	776.76	19.8x	3.9%	2.0%	38.6%
Average		12.0x	6.0%	3.8%	65.4%
3/9/2009 Low		13.6x	2.9%	-0.2%	35.0%

Source: Strategas Research

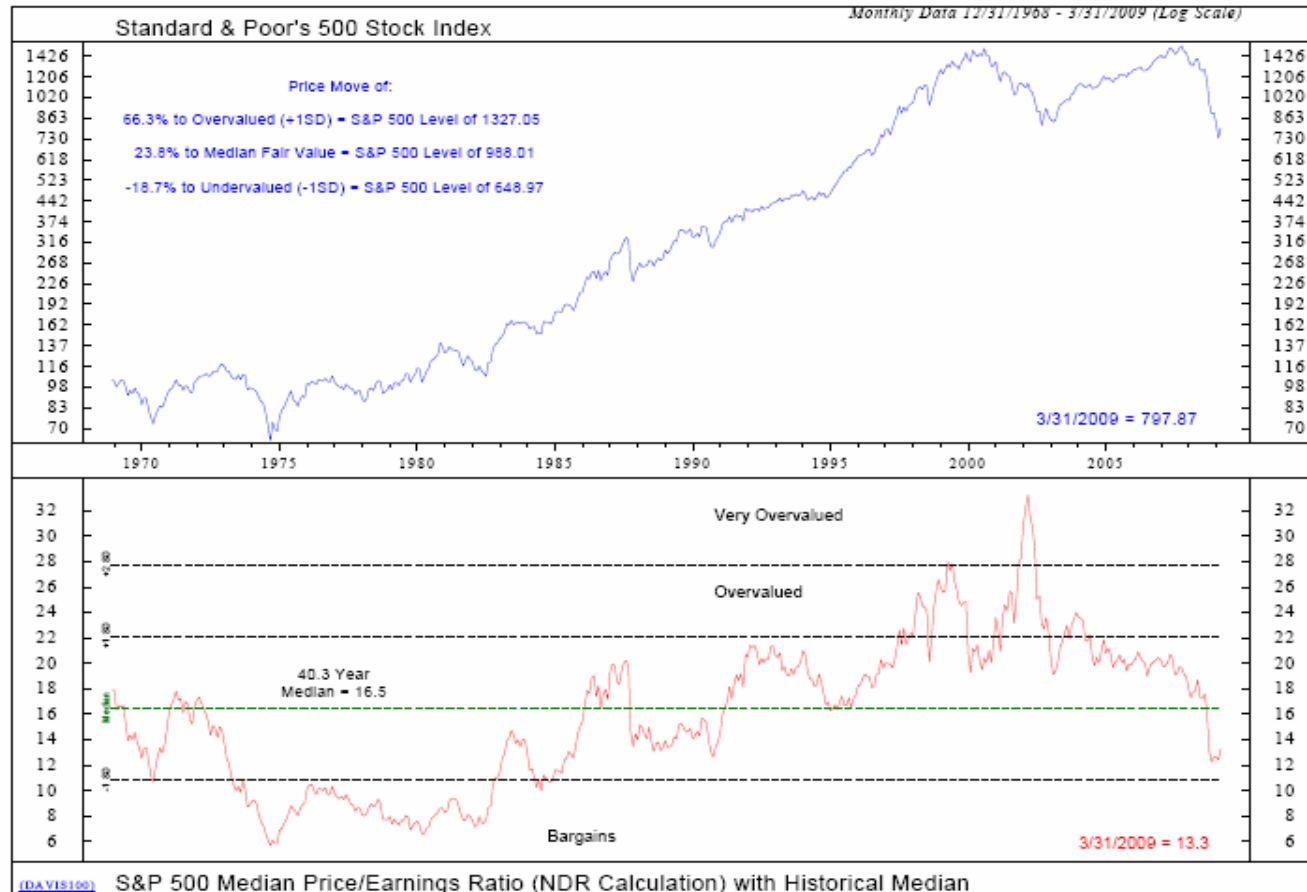
Equity valuations at most attractive levels since early 1980s



Source: Strategas Research

Equity valuations are attractive, but not historically cheap

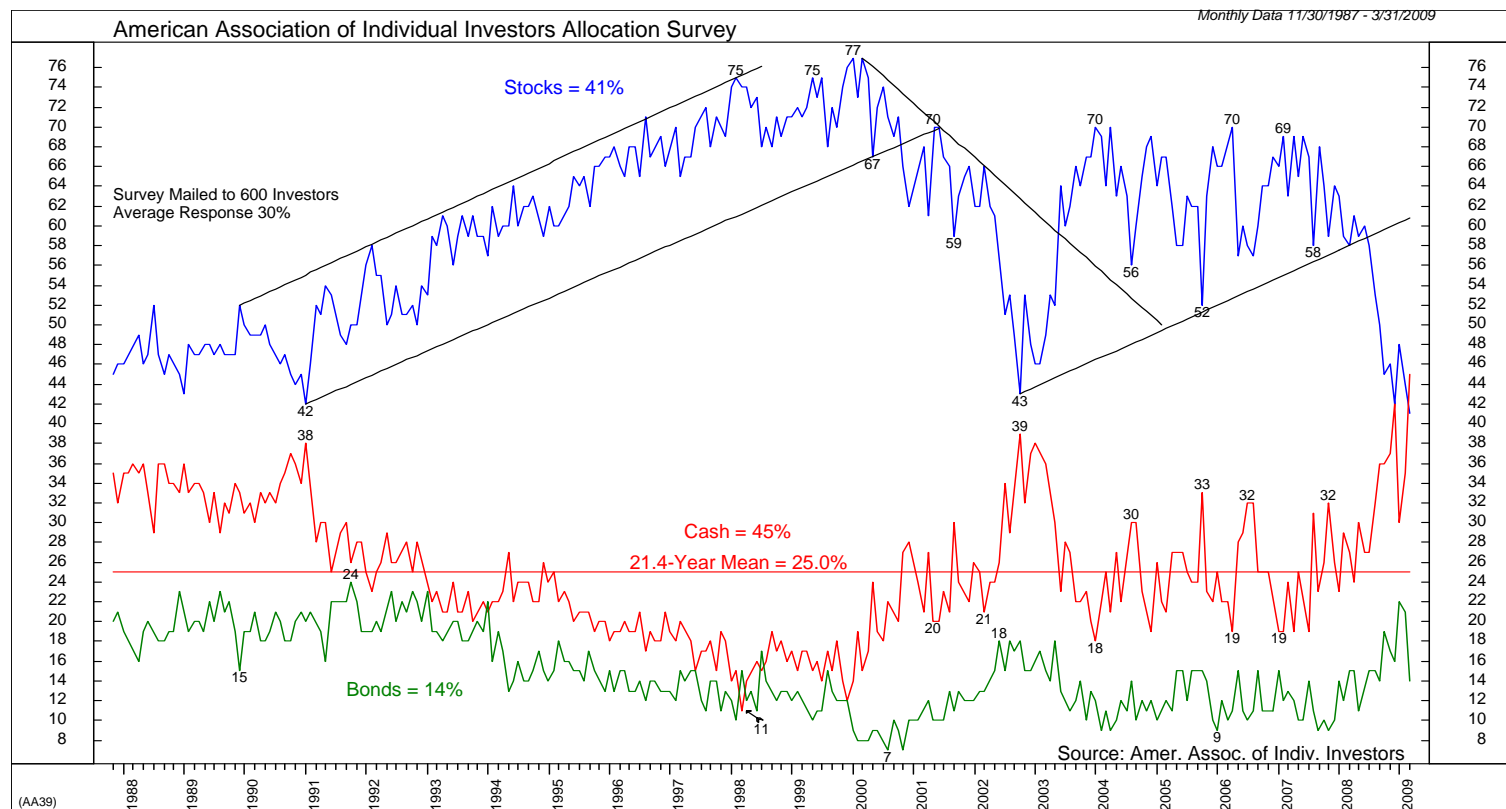
- The S&P 500 trades at a valuation below the 40 year median



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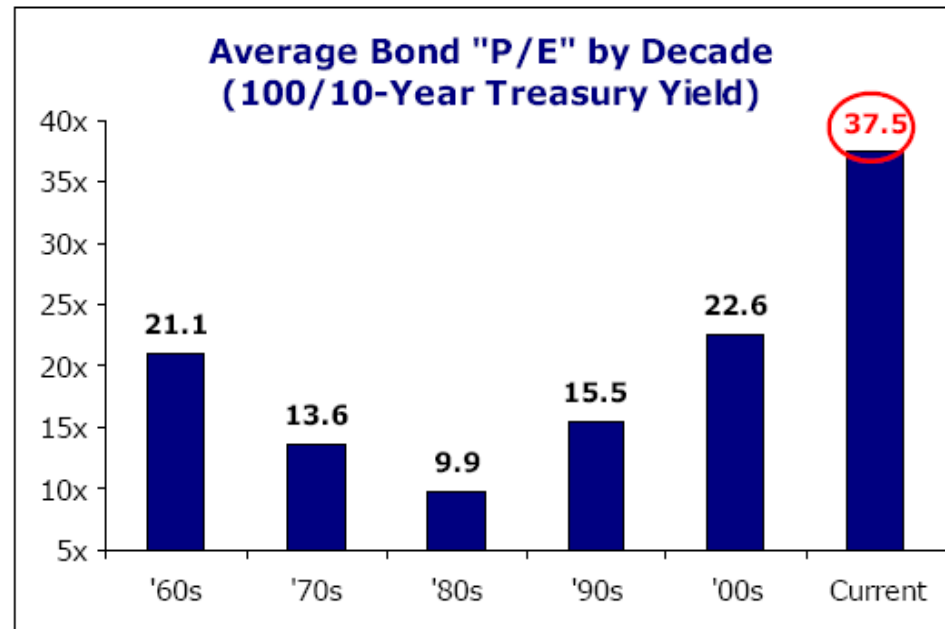
Investors are underweight stocks

- Individual investors have a higher cash allocation in portfolios than at any time since the early 1980s



Treasuries in bubble territory

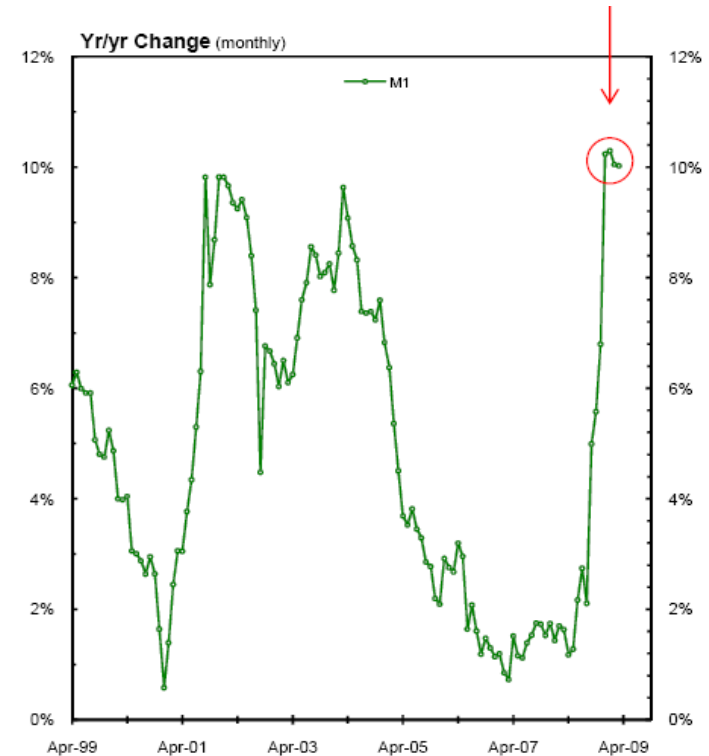
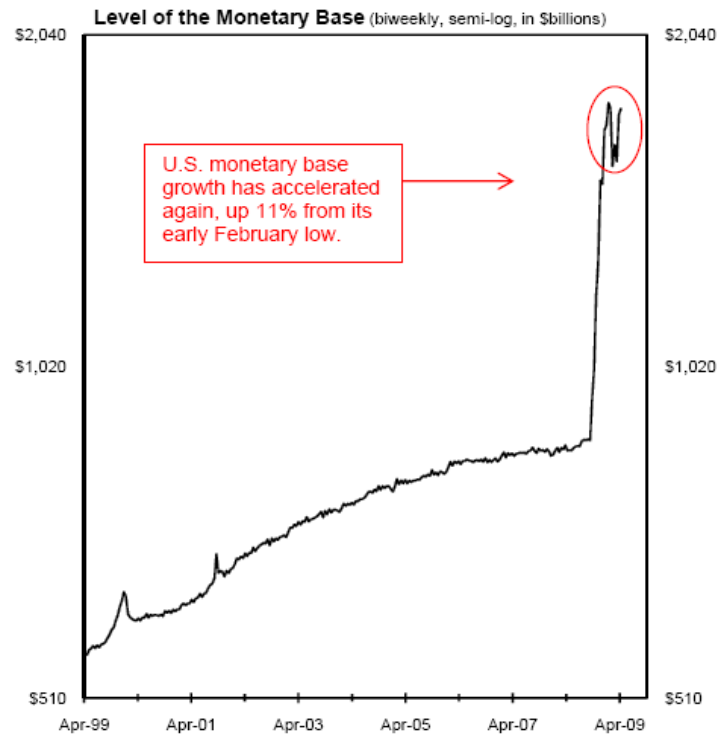
- At nearly 40x earnings (the reciprocal of the yield), Treasury bonds are outrageously expensive



Source: Strategas Research

Inflation in our future?

- “Inflation is everywhere and always a monetary phenomenon” – Milton Friedman



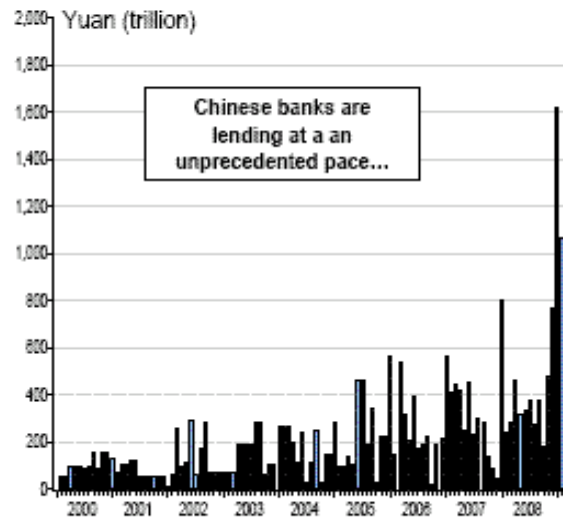
Source: Laffer Associates

Inflation in our future?

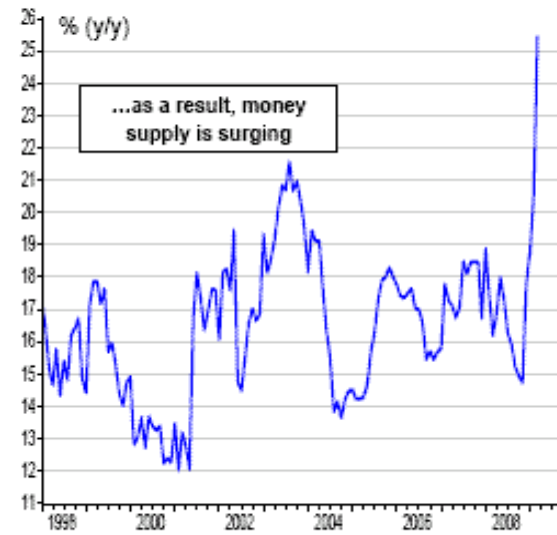
- Huge stimulus programs are not unique to the U.S.

China: Money supply surges in March

Credit extended by Chinese commercial banks



Money supply growth (M2)



NBF Economy & Strategy (data via Bloomberg and Datastream)

Investment Strategy

Asset Allocation to Build & Preserve Wealth

In the current market environment, a traditional portfolio of stocks and bonds may not meet your investment objectives.

ASSET CLASS	Traditional 60% Equity 40% Fixed	30% Equity 30% Fixed 40% Alts
Large Cap Equity	30.00%	7.80%
Small Cap Equity	10.00%	3.60%
Micro Cap Equity		3.60%
International Equity	15.00%	9.60%
Emerging Markets	5.00%	5.40%
Fixed Income	40.00%	30.00%
Liquid Alternatives		24.00%
Hedged Equity		6.00%
Managed Futures		10.00%
Expected Return	8.26%	8.78%
Standard Deviation	10.11%	6.63%
Yield	3.26%	2.11%
Sharpe Ratio	0.35%	0.65%
2008 Return	-19.9%	-14.8%

Importance of Downside Protection

- Bear market losses often take years to recover
- Lower volatility smoothes the ride, allowing your portfolio to maximize the benefits of compounding

How long will it take my portfolio to recover?

<u>Portfolio Loss</u>	<u>Required Return to Breakeven</u>	<u>Years to Breakeven 9% Annual Return</u>
10.0%	11.1%	1.25
15.0%	17.6%	1.83
20.0%	25.0%	2.50
25.0%	33.3%	3.25
30.0%	42.8%	4.00
40.0%	66.7%	5.75
50.0%	100.0%	7.75

* Assumes monthly compounding of returns

What does Kanaly do for me?

Any pilot can land a plane...few can land one on the Hudson River.

- Design portfolios to build and preserve wealth: focus on risk
- Find the very best and brightest investment managers in each asset class
 - Requires substantial investment in people, processes, technology
 - It is impossible for any firm to have in-house expertise to manage portfolios in *all* asset classes required for proper diversification
- Ensure we deliver the best investment value for the costs incurred
- Monitor all components of the portfolio in a dynamic, volatile world



AIM Large Cap Core / AIM Charter Fund

Kanaly has developed a unique partnership with one of the best large cap equity managers in the industry.

Investment Case:

- A conservative cornerstone to a well-diversified portfolio – delivering strong upside participation with stronger downside protection
- Team of 10 seasoned investment professionals under the leadership of a 38 year veteran (Ron Sloan)
- Own high quality companies with above-average growth but which trade at below-average valuations
- Performance ranks in the top four percentile of its peer group relative to its peer group since manager inception
- Volatility of returns consistently ranks lower than 90% of peers
- Highly competitive management fee of 0.35% plus trade costs (AIM Charter Fund retail shares offered at a 1.19% fee)

TCW Total Return Bond Fund (TGLMX)

TGLMX offers an attractive opportunity to capture high current yield and potential price appreciation in high quality mortgage securities.

- Fund has ranked in the top 10% of the Morningstar Intermediate Term Bond universe for the past 5, 10 and 15 years as of 12/31/08
- Fund manager Jeff Gundlach, an expert in mortgage securities analysis, was named Morningstar's Fixed Income Manager of the year in 2006
- Current cash flow yield of 11.5%
- Fund focuses on only the highest quality residential mortgage backed securities, many of which trade at large discounts
- Approximately half of the fund is invested in non-agency mortgage securities, the prices of which anticipate foreclosures far in excess of historical norms

Breckinridge Capital Partners – Municipal Bonds

Kanaly offers clients access to one of the best municipal bond managers at low cost.

- Named *Investment Advisor* magazine's top tax-free fixed income separate account manager of 2008
- A proactive strategy that capitalizes on the municipal bond market's enormous size, diversity and inefficiency
- Today's economic environment and collapse of bond insurers requires thorough credit analysis to minimize risk
- Trading with over 100 dealers, Breckinridge has access to better bonds at higher yields and lower prices than individual investors
- Each portfolio can be customized to individual client needs
- Highly competitive management fee of 0.20%



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