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Your Guide to Life Planning

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Your Valued Partner at
Alamo Asset Advisors
generaloffice@alamoassetadvisors.com
210-930-9000
210-496-9020
16500 San Pedro
Suite 410
San Antonio, TX 78232
alamoassetadvisors.com

In This Issue

Standard & Poor's Economic Report: The Sum of Oil Fears

By David Wyss, Chief Economist, and Beth Ann Bovino, Senior Economist

MARCH 2011 -- The continued wave of rebellion in the Middle East sent oil prices soaring above $100/barrel, their highest level in over two years. The unrest in Libya and the threat of unrest in Saudi Arabia added to worries of supply disruptions, especially within Europe. How much disruption will occur is completely speculative at this point. But even small changes in output can cause big price swings.

If the turmoil in the Middle East spreads to other oil producers, we could look back on $100/barrel oil with nostalgia. Prices could surpass the 2008 high of $148/barrel very quickly -- and $200/barrel is possible if there is a significant disruption in the Persian Gulf. We believe that the $150/barrel range would threaten to push the U.S. back into recession. The rule of thumb that we use is that a $10 rise in oil prices takes about 20 basis points (bps) off growth in each of the first two years of the price hike. This is a bit less than in the past because natural gas and coal prices no longer react significantly to oil prices.

Houses Move, But Prices Drop

Existing home sales rose 2.7% in January, while new home sales fell 12.6%. The divergence reflects two factors. First, new home sales are counted when the contract is signed, while existing homes count at settlement, which means that the bad January weather had less impact on existing than on new sales. Second, a tax rebate on offer in California created a spike in December sales in that state. The drop in new home sales was almost completely concentrated in the West (down 36.5%), but sales in the West (and nationally) remain up from November. The rise in existing home sales, in contrast, came everywhere except the Northeast, which dropped 4.6%; the West rose 7.9%, the largest regional gain.

The inventory of unsold homes dropped by 0.5% for new homes and 5.1% for existing ones. There is a 7.6-month supply of existing homes and a 7.9-month supply of new homes now on the market. However, this does not include the so-called shadow inventory of homes in process of foreclosure or being temporarily held off the market. Distress sales (foreclosures and short sales) accounted for 37% of existing home sales, up from 36% in December but down from 38% last January. Investors accounted for 23% of purchases (17% last January), and all-cash transactions were a record 32% of purchases (26% last January). The price of the median existing home fell 3.7% from a year ago, to $158,800.

The S&P/Case-Shiller Home Price Index (20-city) fell 2.4% from a year earlier in December, and is now down 31% from its July 2007 peak (and is only 2.3% above its April 2009 low). We expect another 5% drop in the index before it hits bottom this spring. Only Washington and San Diego are up from a year earlier. The largest declines from the peaks are in Las Vegas (down 55.6%) and Phoenix (54.5%). The smallest declines are in Dallas (9.4%) and Denver (11.5%).

The Rest of the Economy

Fourth-quarter real GDP growth was revised downward to 2.8% (annual rate) from the 3.2% reported a month ago. Most of the revision came from state and local governments, the spending decline of which was revised to 2.4% from 0.9%. We had been expecting lower state and local spending as governments try to eliminate their deficits, but the drop came somewhat earlier than expected. Consumer spending was revised slightly downward, to 4.1%. The saving rate was unrevised at 5.4%.

The S&P 500 and Dow Jones Industrial Average hit two-and-a-half year highs in the middle of the month, and the Nasdaq reached its highest level in more than three years.

February 2011 Market Recap

(For the month ended February 28, 2011.)

Unrest overseas played a role in the stock market's initial rise in February, but later helped cause a reversal of fortune that briefly sent prices into a downward trajectory. Each major U.S. equity market index posted gains during the month. Early in February stocks climbed higher in the wake of news that Egyptian President Hosni Mubarak had stepped down. Despite the spread of unrest to other countries in the region, positive domestic earnings and manufacturing data helped stocks continue their ascent. The S&P 500 and Dow Jones Industrial Average hit two-and-a-half year highs in the middle of February, and the Nasdaq reached its highest level in more than three years. The subsequent outbreak of violence in Libya raised fears of higher oil prices, and stock prices dropped for three consecutive days before moving higher again in the final trading sessions of the month. Bond yields generally fell as investors embraced the relative safety of U.S. government debt.

Through 2/28/11*	**February**	**YTD**	**1-Year**	**3-Year**	**5-Year**	**Closing Value**
S&P 500	3.2%	5.5%	20.2%	-0.1%	0.7%	1,327.22
Dow Jones Industrials	2.8%	5.6%	18.4%	-0.1%	2.1%	12,226.34
Nasdaq Composite	3.0%	4.9%	24.3%	7.0%	4.0%	2,782.27

Source: Standard & Poor's. The S&P 500, Dow Jones Industrials, and Nasdaq Composite are unmanaged indexes. It is not possible to invest directly in an index. Past performance is no guarantee of future results.

*Price only. Does not include dividends.

Milestone ahead? The S&P 500 closed the books of February within striking distance of a major milestone in the stock market's post-bust recovery. If the index can manage to close above 1,352 it would represent a doubling of the March 3, 2009, closing level. Only 8 of the prior 15 bull markets since 1932 doubled their bear market closing low. It took them a median 49 months to advance 100%.

Housing still weak Many market watchers believe it may be difficult to sustain a long-term economic and stock market recovery without improvements in the nation's housing market. Unfortunately, February didn't bring a lot of good news. For example, Case-Shiller data showed a 3.9% drop in home prices during the fourth quarter - and a 4.1% annual decline. In addition, the average interest rate on a 30-year mortgage briefly exceeded 5% for the first time since last spring. Rising rates could convince potential buyers - many of whom are still concerned that prices will keep dropping - to stay on the sidelines even longer.

From the Fed In his February 9 testimony before the House Budget Committee, Fed Chairman Ben Bernanke sounded somewhat more upbeat about the economy, though he acknowledged that "the job market has improved only slowly." He also seemed a bit more concerned about inflation, noting that "we have recently seen increases in some highly visible prices," but blamed these mostly on demand from outside the United States together with supply problems or fears. The testimony suggested that the Fed might consider tightening a bit earlier than some analysts had been expecting. Much of the testimony focused on fiscal policy. Bernanke said that "even after economic and financial conditions return to normal, the federal budget will remain on an unsustainable path." But he also said, "A self-sustaining recovery in consumer and business spending may be taking hold."

Treasury notes Bonds benefited from the less certain economic outlook, and yields fell overall as prices rose. The yield on 10-year Treasuries fell from 3.48 to 3.43. The yield on 30-year government bonds dropped from 4.62 to 4.50.

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Estate Planning: The Rules Change Again

The federal government isn't making it easy for Americans to feel confident about their estate plans. In the past four years, the estate tax exemption has performed a jitterbug -- jumping from $2 million with a 45% top tax rate in 2008, disappearing completely in 2010, and ratcheting up to $5 million with a 35% top rate in 2011.

The $5 million/35% threshold will remain in place through 2012, but after that, all bets are off. The current law expires at the end of 2012, and unless Congress acts again to extend or change it, the exemption may revert down to just $1 million, while the top tax rate could rise to 55%.

Estate Taxes: A Moving Target

Year	Exemption	Top Tax Rate
2008	$2,000,000	45%
2009	$3,500,000	45%
2010	Estate tax repealed	0
2011	$5,000,000	35%
2012	$5,000,000	35%
2013	???	???

With so many changes over the years and so much uncertainty for the future, it's a good idea for anyone with an estate in excess of $1 million (both individuals and couples) to meet with financial and tax professionals to map out their estate planning needs.

Gift Tax Exemption: Act Before It's Gone?

As part of the new tax act, the gift tax exemption has increased from $1 million to $5 million. Couples can transfer $10 million. But, as with the estate tax exemption, this "gift" is set to expire at the end of 2012.

One important item of note: While the current estate and gift tax exemptions render certain trust arrangements redundant for many, be sure to consider state tax considerations when drawing up your estate plan. Currently, nearly 20 states impose their own estate tax exemptions that can differ widely from federal law. For example, New Jersey allows an exemption of only $675,000. Be sure to check with your advisors to see if your state imposes taxes on estates and if a trust may still be applicable to your situation.

When you do meet with your estate planning professionals, you should also ensure your overall plan includes the following pieces:

- **Durable power of attorney** -- This document allows you to designate to one or more individuals access and control over your financial assets in the event you are incapacitated or unavailable.
- **Living will and health care proxy** -- A living will spells out your wishes in the event you need life-sustaining medical treatment. A health care proxy is similar to a durable power of attorney, but in this case, it allows your designee(s) to make medical decisions for you when you are unable to do so.
- **Business succession plan** -- Business owners should leave clear instructions as to the transfer of ownership of their entities upon their death or incapacitation. If you have a trust, be sure your succession plan complements your trust provisions.

The information in this article is not intended to be tax advice and may not be applicable to your situation. Please contact your tax advisor for information relevant to your own situation.