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Winter 2011

Cloudy with Increasing Sunny Intervals

We believe that 2011 will be a better year for our economy but still volatile and tricky for investors. The volatility can be a trap for the unwary but an opportunity for the active but prudent investor working to a plan.

In the United States, the 2011 economy will exhibit the same good bits and bad bits as the 2010 economy did. We expect that employment will continue to expand, business investment to increase, and those parts of our economy attuned to technological innovation – the leading edge of manufacturing and export – to fare significantly better.

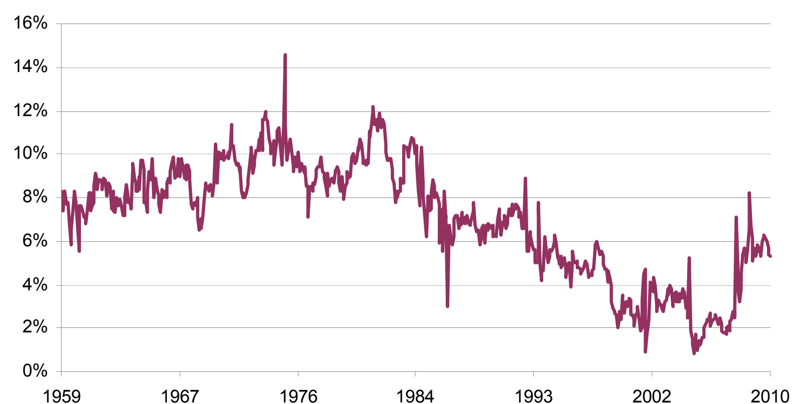
The regions in which these activities take place should see overall improvement, even given the fiscal situations of their local governments. As a corollary, we anticipate that interest rates, especially beyond the short-term rates controlled by the Federal Reserve Board, will continue to rise as the growing economy fuels credit demand.

Housing problems continue

On the other hand, while prospects will be brighter in some regions of the country, the housing sector overall will see further deterioration, spurred by the ongoing flood of foreclosed property. Sustained high unemployment will discourage both first-time buyers and "mover-uppers." Commercial real estate devoted to retail (not just shopping centers but warehouses and ports and other infrastructure) will also continue to suffer.

American households remain more indebted than at any time in modern history. Moreover, their retirement assets have been severely depleted. From their perspective, it is savings that need to be rebuilt, not consumption. As you can see in Chart 1, Americans are indeed saving more, and we believe the savings rate will rise gradually toward 8%.

Chart 1: Personal Savings as a % of Disposable Income



Sources: Bureau of Economic Analysis; Bloomberg

The oversupply of retail space plus the glut of foreclosed houses means that new (especially residential) construction will remain an endangered species. This is bad news for regions that depended particularly heavily on construction, such as Arizona, Nevada, and Florida. In effect, our economy – both regionally and by sector – may be represented as growing islands of activity in a large but shrinking sea of stagnation.

We're doing better than Europe

Outside the U.S., the situation will probably be somewhat less rosy than in 2010. The euro zone continues to struggle with a banking system plagued by excessive bad debts. The "peripheral" economies of Spain, Ireland, Portugal, and Greece will likely need assistance and will probably default in some polite way, and unbridgeable differences in productivity will continue between the German-centered north and the south.

One currency and one set of interest rates cannot reconcile these differences, and we believe that either there will be a radical change in the fiscal governance of the euro zone or the euro may come apart. As a consequence, we remain negative on the euro relative to the dollar.

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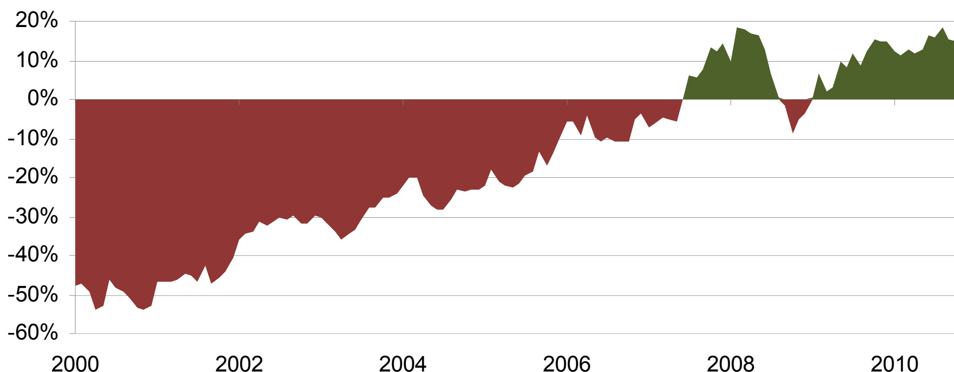
Slowdown coming in emerging markets

Emerging economies experienced a very good recovery from the financial crisis. But the result was largely too much, too fast, bringing with it inflationary pressure from excessive government stimulus as well as asset markets bid up to overvalued levels by enthusiastic but uninformed capital flows from people like the American retail investor. Chart 2 shows that, by the frequently used metric of stock price to book value, values may be too high. We expect a slowdown in growth and a pullback in asset values (and commodity prices) at some point.

In a world full of surprises, asset prices will swing above and below "fair value." We should see real opportunities to move portfolios toward "cheap" assets and away from "expensive" ones, whether these be domestic or foreign stocks, bonds, or various forms of real assets.

Chart 2: Emerging Market Stocks



Source: Bloomberg, LP

From a slightly different perspective, the investor intent on capital preservation will need to be active. In a world of rising interest rates and (eventually) rising inflation, a bond portfolio ceases to be "safe." A diversified portfolio containing not only bonds but other assets to hedge against inflation and interest-rate increases will be needed.

We are grateful for the opportunity to be your guides in navigating this territory.

George Feiger is the CEO of Contango Capital Advisors and heads the Investment Committee. He is also executive vice president of the firm's parent company, Zions Bancorporation. He holds a PhD in economics from Harvard University and was an associate professor of finance at Stanford's Graduate School of Business.

Estate Planning: Focus on the Family

Most estate planning efforts center on legal and financial issues such as avoiding probate and minimizing taxes. But for many families, an estate represents much more than a dollar figure. Its components echo personal history and their division triggers emotion. The majority of individuals would probably be better off focusing on avoiding family conflicts and establishing equitable strategies for dealing with their heirs.

Thus, while the tax legislation that President Obama recently signed into law is important to some individuals, virtually everyone is affected more profoundly by non-legal issues.

Estate tax returns ... for some

Those to whom the numbers matter should be aware of the law's most widely publicized provision – the reinstatement of the estate tax at a maximum rate of 35%. This provision affects individuals with estates valued at more than $5 million ($10 million for married couples). Smaller estates are exempt.

Whatever the size of your estate, making sure that your family is comfortable with the reasons for your decisions can help avoid misunderstandings and animosity down the road.

In the past, many families who failed to plan lost portions of their estate tax exemptions because the first spouse to die did not have enough assets in the estate to use the full exemption. The new law automatically solves this issue by making the tax exclusion "portable," which means that in most cases, the surviving spouse can transfer up to $10 million tax-free. (See "A Law You Can Live With" on the next page.)

Whatever the size of your estate, making sure that your family is aware of and comfortable with the reasons for your decisions concerning its disposition can help avoid misunderstandings and animosity down the road. And regardless of a family's wealth, carelessness or poor planning can have a substantial impact.

Unintended consequences

A change in your financial plans that you may think is minor may have significant unintended consequences for your heirs. Rather than leave them with an unanticipated surprise, make sure you talk through any changes – including seemingly insignificant ones such as adding a child's name to one of your accounts – with the appropriate professionals.

Don't make a mistake like the one *The Christian Science Monitor* reported some years ago in a story entitled "Planning Can Defuse Fights Over Estates."

> *… a woman came into [the attorney's] office with a crystal figurine she had given to her mother. Because her mother mistakenly bequeathed it to someone else, the daughter smashed it in [his] presence. If she couldn't have it, she said, no one would.*

Similarly, you might want to think twice before naming one of your children as your executor or trustee. By naming an heir to such a position, you run the risk of creating a situation that other family members may perceive as unfair.

Of course, that leaves another, sometimes thorny, decision: whether to name each of your children to some sort of fiduciary position or to look outside the family. Having one of your offspring administer your estate can make sibling rivalries worse. If, instead, you choose a third-party trustee to bear the brunt of complaints, you may at least defuse family tensions. Presumably, too, an experienced professional can safeguard your estate against errors in judgment as well as from individuals ready to take advantage of the unwary.

Sentimental value

In addition to financial issues, emotional factors may also come into play. Consider the sentimental value that may be attached to at least some of your

assets – a prized baseball card collection, your aunt's garnet earnings, the portrait of the twins with their first dog. That potential complication may provide an incentive to talk your children through your reasoning now, as well as to appoint someone outside the family as your executor.

In short, taking effective steps to promote family harmony and avoid bitterness, disagreements, and quarrels among your heirs may add to the complexity and cost of your efforts, but could be well worth it in the long term.

About the author: Kevin Mikan is head of wealth planning for Contango Capital Advisors and president of affiliate Western National Trust Company. Before joining Contango, he served as head of wealth management at UBS Private Banking.

A Law You Can Live With

The two-year extension of reduced individual income tax rates initially put into place by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) is perhaps the most well-known feature of the legislation signed on December 17 by President Obama.

However, the *Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010* will also have a dramatic impact on estate tax law in 2011.

Although the estate tax was temporarily eliminated in 2010, a capital gains tax on an estate's assets still applied. The new law brings the tax back for estates valued above $5 million, but also offers heirs of those who died in 2010 a choice with regard to how they are taxed on those estates.

Other key provisions include:

- A 35% maximum estate tax rate
- A $5 million exclusion for individuals ($10 million for married couples) for 2011 and 2012
- For heirs of those who died during 2010, a choice between carryover basis rules under EGTRRA or the new law's stepped-up basis rules
- The ability of a surviving spouse to employ the portion of the estate tax exclusion not used by the deceased spouse

These provisions will expire on December 31, 2012, unless Congress passes and the president signs legislation to extend them or make them permanent. If no action is taken, the tax laws that were in effect on January 1, 2001, would once again be in force.

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