



## American National Bank Trust and Investment Services Department

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### 4<sup>th</sup> Quarter 2011 in review

Investors looking back at 2011 several years from now will probably shrug their shoulders and say, uneventful. The major equity markets closed at almost the exact level they had started a year earlier. However, 2011 was anything but uneventful - it was actually one of the most volatile years on record.

Officially, the S&P 500 had no appreciation for 2011 but did manage a total return of 2.1% for the year, all from dividends. It took a great 4<sup>th</sup> quarter to squeak out a gain as the S&P 500 rallied from down 14% for the 3<sup>rd</sup> quarter to up 12% for the 4<sup>th</sup> quarter. Other stock indexes rallied in the 4<sup>th</sup> quarter as well with the Russell 2000 (Small Cap Index) rising 15.5% and the MSCI EAFE Index (International Index) recording a 2.9% gain during the quarter.

The Barclay's Capital Aggregate Bond Index again rose during the 4<sup>th</sup> quarter (up 0.1%) and is up over 7.8% for the year. The yield on the 10-year Treasury bond (generally used benchmark for the bond market) stayed almost unchanged moving from 1.93% at the start of the 4<sup>th</sup> quarter to 1.87% at the end of the quarter. The historic low rates continue to reflect concerns about the global economic recovery, particularly in the US.

The unemployment numbers for December came in a little better than expected. The economy added 200k jobs for the month. In addition, the unemployment rate improved to 8.5% from a revised 8.7% a month earlier. But a recent Gallup poll showed that during the 4<sup>th</sup> quarter the percentage of part-time workers wanting full-time work is 9.7%. Add that to the Unemployed and we arrive at 18.2% either Unemployed or wanting full-time positions. Still a very high number.

Gross Domestic Product (GDP) increased at an annual rate of 1.8% for the third quarter of 2011. GDP data lags and generally has several estimate revisions but data for the 4<sup>th</sup> quarter should remain in the 1-2% annual rate range.

The Federal Reserve continues to remain cautious towards any aggressive measures. In mid-October New York Fed President William Dudley indicated "it's possible" that the Fed could introduce another round of easing. This would be round 3 or called Quantitative Easing 3 (QE3). This will be something to watch as we head into 2012.

In conclusion, markets rebounded in the 4<sup>th</sup> quarter to post modest gains for the full year. The continued mixed signals in the economy led investors, for the most part, to remain on the sidelines.

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**"And this is where our ROI became  
an IOU."**



## **Predictions & Oil**

by Kevin J. O'Connell

*Vice President*

*Trust Officer & Portfolio Management*

Several years ago Byron Wien, then chief strategist at Morgan Stanley, kicked-off the year with his top 10 predictions for the upcoming year. It proved good publicity for Morgan Stanley and soon every financial service firm was doing a top 10 list. Of course, the problem with predictions is that nobody really pays much attention a year from now as to what was predicted. Too often it is not about the accuracy but more about the publicity. That is why we don't place a lot of credibility in top 10 lists but instead use them as talking points with clients.

One such talking point is Wien's 2012 prediction that oil will decline to \$85 a barrel. This is really not a bold prediction but, nevertheless, one we can expand upon.

Living in this part of the country, we are highly aware of the price of oil and the effects it produces on our local economy. For that matter, many of our clients are in the oil business. So talking about the price of oil is about as common as talking about the weather.

Higher oil prices are facing a few headwinds as we move into 2012. First, speculation that conflicts with Iran and North Korea seem to be subsiding and the reality of a worsening crisis in Europe continues to become more of a reality. A collapse in the euro-zone would cause the price of oil to fall for two reasons – overall demand would weaken on fears of a European depression and the US dollar would rise in a flight to quality over the Euro, thus driving down commodity prices.

The second major headwind is the emergence of new shale "plays" around the country. This would add to supply, thus lessening demand and lowering prices. Wien's argument is that the US will become less dependent on Middle East supplies. Shale "plays" like the Marcellus, Bakken, Eagle Ford, and the relatively new Monterey will all contribute to increasing US production.

Third, a continued lag in overall global recovery efforts will stall oil prices. China has recently revised GDP lower and the Federal

Reserve continues to forecast less than stellar growth models, all leading to a sluggish economy going forward.

But this is where I think we could see a surprise and, perhaps, a tailwind for the price of oil.

My argument is simply this; we are in a sluggish economy and oil is still around \$100 per barrel. Imagine if the economy was growing. Now imagine if the economy was booming, where would oil be?

For all of the reasons why oil could decline is exactly why the opposite could occur, causing oil to rise. And if an unplanned event occurs (for instance a conflict with North Korea) we could see a spike in the price of oil. Although these are remote, each of these headwinds could quickly turn and become a tailwind for the price of oil.

All this said, I will join the bandwagon and make a prediction or two, maybe three. First, in the coming year we will see a resolution to the European crises, causing confidence to return and markets to rise, causing oil to rise.

Second, we will see emerging markets, particularly countries like Columbia, Brazil, Indonesia, Korea, India and China all continue to become more developed and grow at an accelerated pace. Many of these countries try to control oil prices with subsidies and fuel price caps. This socio-political control does not work in the long run and would only add fuel to the fire, causing oil to rise.

Third, the Supreme Court overrules Obama Care in late June and this is a major blow to Democrats. Obama's unpopularity further escalates heading into the Republican National Convention held in late August. However, Obama wins a debate or two in September/October and the momentum shifts back to him by November. Obama narrowly wins a second term but Republicans take back the Senate and Congress, all causing oil to rise.

Of course if my predictions are wrong, I certainly won't remind anybody I made them. But if they are right, I am now riding the bandwagon of Market Predictors! Watch out for me in 2013 and have a great 2012.



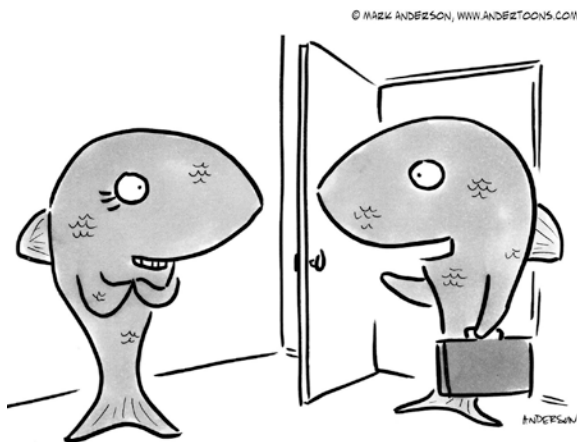
### Bond Market Update....

by Jeffrey S. Schultz  
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There is some speculation that QE3 is in the works. QE3 stands for Quantitative Easing III. It would be another measure by the Federal Reserve to stimulate economic growth. If you recall, the previous program called Quantitative Easing II (QE2) wrapped up in June of 2011. QE2 allowed the Fed to purchase \$600 billion in Treasury securities, thus keeping interest rates low **and** hopefully driving demand for borrowing which leads to growth. Although some may argue the need for QE3, others will ask, "does the Fed know something the market doesn't know?"

Several central bankers inside the Fed have cited the possibility of QE3 and are open to further stimulus if the economy continues to lag. So far, we have not seen much in pick-up from several economic indicators, particularly GDP growth. By now we should have seen some improvements in the economy. Instead, we are seeing virtually no improvement, particularly in the unemployment rate and housing. And add a potentially scary situation in Europe, you can see the possibility of another round of easing.

I would argue we already had a "mini" QE3



"Great news! I've been let go!"

during the 4<sup>th</sup> quarter. In November we saw a coordinated effort by many of the world central banks, including the Fed, throwing money at the European Crisis. This appears to have stemmed the "run on the banks" but left many with the question of "what is next"?

As for the success of QE2, we have not seen much yet. Cash levels continue to remain extremely high and money is sitting in bank vaults instead of circulating through the system. In addition, inflation seems to be picking-up. Year-over-year inflation increased around 3% for 2011. Finally, oil continues to remain above \$100 per barrel, all suggesting that throwing more money at the economy may not be the answer.

To this point the solution has been to print more money, create a stimulus plan, and go further into debt. After all, the US has nothing physical to define its monetary base and, is currently estimated, the US monetary base is only covered by 15% in gold. But the Fed continues to be the savior of economic collapse as our politicians continue their rhetoric speak and gridlock ideologies.

So what is next? The Fed will meet twice in the upcoming quarter (January 24-25<sup>th</sup> and March 13<sup>th</sup>). It is widely expected the Fed will keep rates unchanged (target federal funds rate at 0-0.25%). The target has been held there for about 3 years but there is a possibility the Fed could enact another round of easing. If it does, the Fed will target areas of the economy that continue to perform poorly, like jobs and housing. One solution would be to purchase more mortgage backed securities which could help both construction jobs and the housing markets.

One thing is for certain, rates continue to remain historically low but we also know they cannot stay low forever. If we see QE3, we will pay very close attention to the Fed statement. The Fed Governors are playing it very close running the risk of rapid inflationary pressures. We will just wonder if they know something that the market doesn't know.



**Your IRA – Do You Need to Contribute?  
Make a Charitable Donation?**

by Kelly J. Smith, CTFA  
Vice President  
Trust Officer

Have you made an IRA contribution for 2011? If not, it's not too late. The deadline to contribute falls on the same day your tax return for 2011 is due. For most that will be April 17<sup>th</sup>, 2012. To be eligible for a Traditional IRA regular contribution, you must not be age 70 ½ or older during the year for which the contribution is being made and must have eligible earned income.

You may contribute up to 100% of your earned income for the year, up to the statutory limit for the year. For 2011 and 2012, this limit is the same as it has been for several years:

Under age 50 - \$5,000  
Over age 50 - \$6,000

A few points to remember, these limits are combined limits for both traditional and ROTH contributions for a year. While you can contribute to both in the same year, the total contribution cannot exceed these limits.

A traditional IRA contribution may be tax deductible. Eligibility for a deduction is based on whether you are an active participant in a qualified retirement plan, your tax return filing status, as well as the amount of adjusted gross income you make in a year. These rules and details can be very confusing and, always know, we would be happy to help you determine if your contribution will be deductible or not. Keep in mind: whether or not the contribution is deductible you will have the benefit of tax-deferred earnings.

To be eligible to make a ROTH IRA contribution you must have eligible earned income and have not earned an amount that exceeds the prescribed limits. The limits change per year and are dependent on your tax filing status.

The limits for 2011 and 2012 for individuals that are Married and Filing Jointly:

2011 - \$169,000 – \$179,000  
2012 - \$173,000 - \$183,000

Single, Head of Household, Married Filing Separately:

2011 - \$107,000 - \$122,000  
2012 - \$110,000 - \$125,000

If you are below these income limits, you are eligible to make a ROTH IRA contribution, if you are above the limits you are not eligible, if you are somewhere in the range you are eligible to make a partial contribution, and we can help you make the calculation.

The tax provision allowing some people to make direct charitable donations from a Traditional IRA has been extended as part of the 2010 Tax Relief Act, but is currently set to expire at the end of 2012. This provision, if right for you and you qualify, can have outstanding benefits.

Once you reach age 70 ½, the IRS allows you to donate up to \$100,000 to charity from your traditional IRA and exclude the entire gifted amount from your taxable income. The donation must be made directly from your IRA to the charity and the charity must be a qualified charity. The IRS also allows you to count this distribution as part or all of your Required Minimum Distribution (RMD) for the tax year. Whether you need the funds from your RMD or not, you are required to take the funds, this is a way to reduce the income tax liability of satisfying the distribution requirement.

If you have any questions or would like to discuss options for your IRA, whether it is contribution rules or the benefits of making charitable donations, we would be happy to discuss them with you.

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