



SAN ANTONIO CAPITAL MANAGEMENT QUARTERLY INVESTMENT INSIGHTS

Investing Side by Side

July 2010



Wishing everyone a happy and safe Fourth of July!

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2nd Quarter Market Commentary

The second quarter of 2010 has been characterized by "shock and awe." After a relatively stable run up of over 5% in US equities in the first quarter, markets reversed course, experiencing over a 10% correction at various times. Disappointing economic data and upsetting events flooded the news, from the May 6th "Flash Crash", to the European debt crisis, to the massive BP oil spill in the Gulf of Mexico. Investors didn't know where to turn, and for the most part Treasuries and Gold seemed the only safe havens, with the 10-year Treasury falling below 3%, and gold hitting record highs above \$1200. Markets questioned the viability of the Euro, as deficits in many countries have soared to unsustainable levels, requiring intervention from the European Central Bank (ECB). This not only resulted in a massive downswing in European equities, but the Euro currency as well. As of this writing, currency option markets are now indicating a 10% chance of the Euro reaching parity with the US dollar by the end of the year. *The Silver Lining: Time to go on a European vacation!*

Economic data has been mixed, which is not good for market confidence. The month ended with a 3% pull-back after a surprisingly low June Consumer Confidence number was released on June 28th. However, throughout the quarter there have been some refreshing numbers with regard to manufacturing, implying underlying economic growth and business inventory restocking is occurring. Jobless rates continue to be disappointing with small upticks only related to temporary census workers, and home sales are expected to drop significantly going forward given the end of the new home tax rebate program. Inflation continues to remain in check, with conversations floating more toward deflationary worries than potential inflationary issues.

In Washington, Congress is finalizing its financial reform bill, which at first blush appears to be less onerous than expected which should be a positive for equities. Most of the focus seems to be on consumer protection and increased mortgage loan scrutiny, vs. the more talked about derivative markets. Talk of lowering deficits at the G20 Summit meeting in Toronto led to increased fears of a global slowdown, overshadowing the announcement from the Chinese that they would de-peg the Yuan from the US dollar, allowing for more float and increased manufacturing competition.

Partners Flagship Core Strategies - Portfolio Update

Given the ups and downs of the 2nd quarter, we have made several adjustments to our portfolio allocations, in an effort to reduce our European equity and currency exposure as well as to take advantage of some attractive opportunities in other asset classes.

On April 19th, we made the decision to reduce our European and Japanese equity exposure by 4%, due to our negative outlook for developed countries vs. the US and emerging markets. We moved half of this reduction, or 2%, to cash while investing the remaining 2% in Canadian (1.5%) and Australian (0.50%) equities. The reasoning for these investments is our overall view that "resource rich" countries like Canada and Australia should benefit from increasing demand in emerging market countries over the long run. Emerging markets are experiencing a surge in middle class growth, sparking the need for more fossil fuels and other raw materials used for construction. This demand should also benefit these countries' currencies, allowing them to appreciate vs. the US dollar.

As the situation in Greece mounted throughout the rest of April, we continued to keep close watch on the remainder of our European exposure. On May 6th, rumors began that European banks had stopped overnight lending to one another, sending US Treasury rates down, as investors fled to safety. This coincided with the famous "Flash Crash" incident that saw the Dow plummet over 900 points in twenty minutes. While the eventual blame was placed on high frequency traders, who generally keep markets orderly, signs of increasing problems in European debt markets raised red flags. Our committee felt that the European Central Bankers had little maneuvering room to prevent a possible default, and the continued fear that was mounting between European banks could lead to a potential liquidity crisis. The risks outweighed any potential benefit, therefore we made the decision to eliminate all European equity from the portfolio and move the proceeds to US Treasuries. This move allowed us to avoid a significant portion of the equity and currency downturn.

As time passed, both US and international markets sputtered, and we felt valuations were attractive enough to add to our US equity position. We feel that growth prospects in the US are more favorable than other developed markets, and view emerging equities as a bit rich at these levels. Therefore we added roughly 2.5% to our S&P 500 exposure at the end of May. In addition, with the catastrophe in the gulf, many energy stocks have been hit by mere association with the industry, bringing their prices down to attractive levels. We also feel that this incident will bring more companies onshore and specifically refocus their attention on natural gas over oil. With this view in mind, we recently added 1% to our current energy overweight by investing in natural gas focused exploration and production companies.

Overall, this leaves us with roughly a 7% cash/33% Fixed/60% Equity allocation in our Partners Flagship Core Strategies vehicle, which we feel gives us ample liquidity to take advantage of potential dips in the equity markets.

**Partners Flagship Core Strategies
Performance Net of Fees**

From 12-31-09 to 06-30-10

	2010						
Month	Jan	Feb	Mar	Apr	May	Jun*	ITD*
Return	-1.68%	1.11%	2.61%	0.82%	-4.30%	-1.20%	-2.48%
Benchmark**	-2.29%	0.86%	4.00%	1.11%	-6.09%	N/A	N/A

*Estimated returns, subject to change

**65% MSCI All Countries World/35% Barclays Aggregate Bond Intermediate

Notes: Past performance is not an indicator of future results.

Ask about our other investment strategies. We have portfolio solutions to fit all investors' needs.



San Antonio Capital Management - Investment Methodology

At San Antonio Capital Management, we follow a unique approach to managing money. Unlike many of our peers, we do not tie ourselves to a benchmark, as there is not one single appropriate benchmark or index for all investment periods or all investors. We are not focused on picking stocks, simply with the goal of outperforming the S&P 500 or Dow Jones by 1% or 2%. We do not feel our clients would be impressed with a negative 35% return when the S&P 500 is down 37% (a positive 2% relative return). At the end of the day, relative performance is simply that, relative. How can you honestly feel comfortable claiming good performance when a client loses money?

We on the other hand, follow the principles of asset allocation as the driver of long-term portfolio performance. In short, our methodology places more emphasis on the broad building blocks of investing, including cash, bonds, and equity than the underlying securities making up these components. Over time, statistics have proven that it is the asset classes one owns and the timing of that ownership that has the greatest effect on portfolio returns. Therefore, we focus first and foremost on owning the correct asset classes, which are combined to form a diversified portfolio. This diversification lowers the overall risk of a portfolio, reducing the ups and downs of performance through good markets and bad.

Once we have determined the asset allocation of our various investment strategies, we then implement our view through a passive investment vehicle. By "passive" we mean that we don't actively pick stocks or bonds to fill these allocations. Instead we invest in a security called an Exchange Traded Fund or "ETF," which replicates a benchmark or index. For example, if we wanted to invest in US equities, we may buy an ETF that holds the securities of the S&P 500. Or, if we were interested in just owning a specific sector, we could purchase an ETF that just held healthcare stocks. ETFs exist across thousands of indices, allowing us to gain exposure to equities, bonds, currencies, and commodities.

Why ETFs? ETFs are liquid instruments that trade on the exchange just like stocks, allowing us to be nimble in our investment views. We can easily adjust our allocation as market forces change, and gain liquidity quickly to reduce portfolio risk. The instruments are also cost effective, tax efficient, and allow us to access almost any market in the world on behalf of our investors.

In summary, we believe "active asset allocation" combined with "passive implementation" provides great value to our clients. Many advisors will position their clients' assets in a stagnant asset allocation (ex. 60% Equities, 40% bonds), never adjusting the ratio. We believe in active asset allocation based on market forces and valuation. We will make changes to our portfolios as world economic and market situations change. We will also be opportunistic when we feel asset classes are undervalued. Many advisors use active managers to implement or invest their stagnant asset allocations. These active managers, not only have high fees compared to ETFs, but also may have lock-ups, which prevent the advisor from being nimble and changing course in midstream. Alternatively, with our methodology, we can chart the investment waters with ease.



Asset Allocation: A Strategy for All Seasons

Many financial experts believe that asset allocation may be the single most important factor influencing long-term investment returns, regardless of short-term market fluctuations.¹ You could potentially lower your investment risk and increase your chances of meeting your investment goals by maintaining an asset allocation that includes several different types of assets. It's important to understand the different asset classes and the role they may be able to play in your financial strategies.

What Is Asset Allocation?

Asset allocation refers to the mix of different types of investments, such as stocks, bonds, and cash. Because each type of asset has unique risk and return characteristics, the asset allocation an investor chooses is typically determined by that investor's financial goals, time frame, and personal tolerance for investment risk.

Here's a closer look at the risk and reward characteristics of the major asset classes.

- **Stocks:** Over the short term, stock investments typically carry a relatively high level of market risk, or the risk that an investment's value will decrease. However, stocks have historically earned higher average annual returns than other asset classes over longer time periods. Although past performance is no guarantee of future results, stocks may have the potential to generate long-term returns that outpace inflation at the highest rate through the years.
- **Bonds:** In general, bond investments may be less likely to experience severe short-term price swings than stocks, and therefore may offer lower market risk. On the other hand, bonds' overall inflation risk may be higher than that of stocks, because bonds' long-term return potential may be lower. Inflation risk is the risk that an investment's rate of return will not exceed the rate of inflation, effectively reducing the purchasing power of that investment over time. Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and are subject to availability and change in price.
- **Cash investments:** Among the most stable of all asset classes in terms of returns, money market instruments generally carry very low market risk. At the same time, they don't typically have the potential to outpace inflation by as wide a margin as stocks or bonds.

Your precise asset allocation needs may change throughout life, but your need for an appropriate asset allocation never goes away.

¹Asset allocation does not assure a profit or protect against a loss in a declining market.

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Six Tips to Help Get Your Children Involved in College Planning

Is your family looking forward to a school vacation over the next few months? Consider getting a head start on college planning. There are many activities that you can undertake now to ease the college decision-making process later.

1. Encourage Thinking About Careers

Academic areas where your child excels, personal interests, and personality traits come into play in shaping career goals. Encourage younger children to draw a picture of their future career. Look for classes and activities that can help foster their talents and interests. Older children may be able to talk to an adult who has a job in a field that interests them.

2. Visit College Campuses

When your child is in high school, schedule visits to colleges of interest. For younger children, take them to a sporting event or a performance held at a college near your home. If your children have friends with older brothers or sisters in college, see if your child can join them for a campus visit.

3. Take a Broad View

College is more than classes and a dorm room. Pursuing high school sports, the arts, student government, or other interests may stimulate your child in ways that complement academics and enhance the chances of getting accepted at a top school. Encourage children to try a new activity during their next vacation.

4. Be Realistic About Costs

If your children understand how much it costs to attend college, they may better appreciate the financial sacrifices your family makes. Encourage children to open a college account and save money earned from an allowance, part-time jobs, and other endeavors. Help children in middle school or older to research college costs at www.collegeboard.com.

5. Reach Out to College Students

Speaking with college students may help your child better understand the realities of college life. If your younger child needs to write an essay for school, suggest that he or she interview a college student. High schoolers may want to contact college students who attended their high school to learn firsthand about the college experience.

6. Set a Personal Example

Young people become optimistic about their future if their parents are enthusiastic about their present lives. Without preaching, tell your children about the experiences that have made you the person that you are. For example, how did you decide on your career? If you attended college, how did you select your school? Discussing these points will help your child as he or she embarks on a personal journey.

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