First Quarter 2009

BBVA Compass

Insight

An Economic and Financial Perspective

Dear Client:

Welcome to *Insight*. In this issue you will find a guest article on charitable giving as well as economic commentary from our BBVA Compass economic research team.

The past few months have been among the most challenging ever, with the U.S. entering recession and even the most robust developing economies under stress. To combat the crisis, the Federal Reserve has adopted a “full-throttle” approach to rate cuts, and the incoming Obama administration has promised a range of tax cuts and other incentives. This combination of monetary and fiscal relief, along with lower prices for oil and other commodities, augurs for a return to growth in the months ahead.

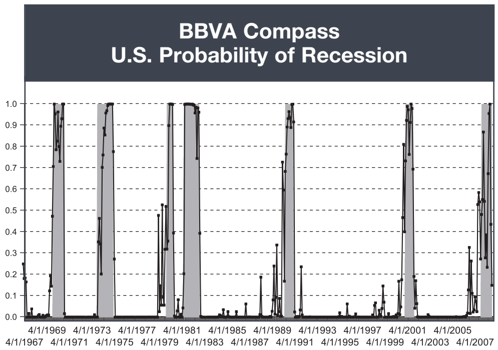
As in life, in the markets there are no guarantees. But it is important to remember that as a nation, we have gone through tough times before, and each time, we have emerged even stronger.

William C. Helms
Senior Executive Vice President and Executive Officer
(713) 831-5837 or bill.helms@compassbank.com

Global Reach

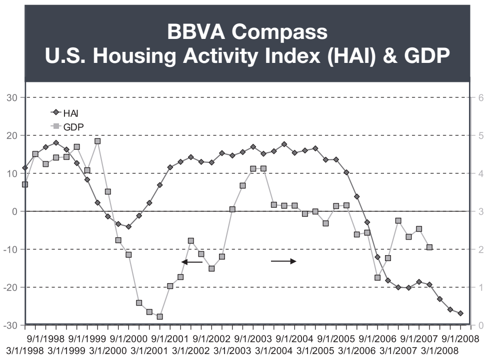
Over the past three months, the financial crisis has outgrown the U.S. and other developed countries and expanded globally. Since the bankruptcy of Lehman Brothers in September, the distortions in global financial markets became even direr, as risk aversion reached extreme levels, liquidity tensions increased to the point where central banks are the only actors and economic growth took a new downward path. There is little shield to the economic malaise around the world in the short term.

In the U.S., the National Bureau of Economic Research (NBER) has already called an official recession that started in December 2007. During the first part of 2008, the economic pain was not felt so much in the big aggregate production numbers, as external demand was able to compensate for the strong deterioration in residential investment and the slowdown in consumption and nonresidential investment. In the last part of the year, however, the economic downturn entered onto a new and dangerous path.



“Builders are cutting prices, but if the housing slump of the early 1990s is a guide, it could take two years to clean out the stock.”

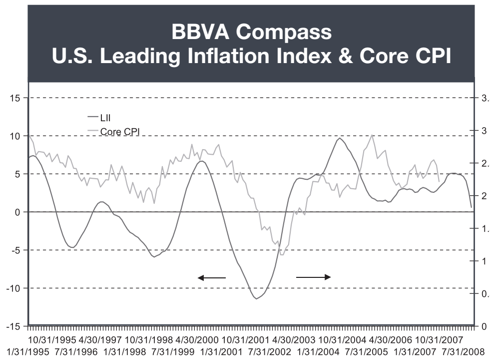
On the one hand, the economic situation worsened. Housing prices have yet to find a bottom, and we are some quarters away from experiencing a stimulus from residential investment. External demand started to falter as growth slowed elsewhere (and in some cases came to a halt), and consumers stopped spending. The prospects of lower demand and the expectation of a deep economic downturn have, in turn, brought forward sharp employment declines which have held back consumers in a context where all families have lost part of their wealth, many of them facing credit constraints, and others are structurally changing their spending pattern to save more.



On the other hand, the situation of many financial firms has led them to constrain credit, and a negative feedback loop seems to be taking place between economic growth and the deterioration in financial institutions and financial instruments, which could make things worse if not stopped in time. It is in this environment where the authorities are reacting fast with measures that range from assistance to homeowners, to fiscal stimulus and injecting public capital in some banks. On its side, the central bank has reduced interest rates to very low levels and it is fast expanding its balance sheet.

A Step Forward

It is amid these initiatives that we expect the U.S. economy to grow at -0.8 percent in 2009, although the risks are on the downside. At present, the measures taken have avoided even worse scenarios, but are not enough to guarantee a recovery in late 2009. We would expect real GDP to grow at rates close to 1 percent if new measures are taken, both on the fiscal front and on the monetary policy side. The current situation calls for new fiscal stimulus in the U.S., and for world leaders to go down the path of further monetary policy stimulus, using nonorthodox methods to increase the size and scope of the quantitative easing.



Inflation will hardly stand in the way. The Consumer Price Index (CPI), a measure of inflation, will turn negative next year as lower commodity prices and the economic slack will push down prices, and core inflation will be below 1 percent on average in 2009. While this could bring back the main concerns of deflation, we believe the risk is still quite small. As a consequence of this environment, we expect the Fed funds rate to stay at 0.5 percent in 2009 and to rise only gradually in 2010 if things start to get better. In this scenario, long-term rates would go down to levels below 3.5 percent, and could go even lower if the Fed starts purchasing and financing them with money creation.

> "Surging global demand, along with dollar-driven exports, has helped keep the economy humming."

Charitable Giving is More Than Just a Choice

By Connie Rogers, Senior Investment Strategist
BBVA Compass Private Banking, Dallas

'Tis the season for sharing. Charitable giving is not just a matter of deciding how much you wish to give to the not-for-profit organization of your choice. The more complicated decisions may be what kind of assets you give, when you give them and whether gifts are outright or through a vehicle such as a trust or foundation. Being a good steward is not just a dollar amount decision, but also giving smart.

There are several benefits that come with gift giving, such as the potential income tax deduction, decreased size of your taxable estate and the satisfaction of seeing your charitable assets put to good use.

The Art of Current Giving

There are many simple ways to contribute to your favorite charity, such as writing a check to the organization, or making arrangements to pay over the course of a few years. This is the simplest way to make a charitable gift, but may not be the most beneficial way.

Consider donating assets rather than opting for cash or check. The easiest way is to donate appreciated marketable securities. Say you have shares of stock for which you paid $20-per-share, but are now at $80-per-share. If you sell the stock first and write a check to the charity, then you will pay capital gains taxes on the difference between $20 and $80, which decreases the value of your gift. However, if you transfer the shares of stock directly to the charity, then you get credit for the full $80-per-share gift, and the charity as a nonprofit can sell the stock and pay no capital gains tax. Non-marketable securities, such as real estate, can also be donated to the charity. This is a bit more complicated than shares of stock which have a readily attainable market value. The real estate will need to be appraised to put a value on the gift. It is important to first check with the charity to make sure they will accept a noncash/nonmarket securities gift. These examples are all outright gifts; therefore, the donor has no future interest in the assets. A way to establish the gift, but receive future benefits is through a Charitable Lead Trust (CLT).

A Charitable Lead Trust is set up so that the charity has the current right to receive distributions from the trust for a specified number of years, or for the lifetime of a named individual. At the end of the period, the property in the trust passes to individual beneficiaries such as the donor's children or grandchildren. The trust can be set up to either pay a percentage of the value of the trust to the charity each year, or pay a fixed amount. This allows the donor to benefit the charity now, but still preserve an inheritance for his heirs. A CLT can be funded with cash, marketable securities, real estate or other assets. In addition, depending on how the trust is structured, there may or may not be current income tax deductions. Another idea is to give through a community foundation or by establishing a private foundation. The donor makes a gift to the foundation, relinquishing ownership of the assets. Donations from the foundation can be authorized each year (currently a five percent minimum) to approved charities. Certain drawbacks might include foregoing income from assets that's needed to support present lifestyles, future financial uncertainty and control issues.

"By keeping abreast of current market conditions, a portfolio manager can realign a client's fixed income investments to enhance revenue opportunities."

Future Gift Giving

Future gifts are usually very effective once the donor passes away. As a contributor you can direct the gift under your will. In your will or trust document it will state that at your death a certain number of dollars are to be given to a charity or charities. If you are not sure of the value of your estate at the time of your death, you may wish to make the gift a percentage of the value of your estate to ensure that the desired funds are also channeled to kids and grandkids. Charitable bequests are typically satisfied with cash, so assets may be sold to cover the distribution. Embedded capital gains are no longer an issue with post-death gifts since the cost basis is stepped up or adjusted at the date of death.

A Charitable Remainder Trust (CRT) can be established either during your lifetime or at your death, and makes current payments to the donor or other beneficiary during their lifetime. At the end of the life, the trust assets pass to the charity. The payments can either be a fixed amount or based on a percentage of the market value of the trust. If created during your lifetime, you will generally receive a current income tax deduction. If appreciated assets are donated to the trust, no capital gains tax will be payable when the trust sells the assets. The payment-receiving beneficiary will be taxed on the annual payments. The CRT is not part of the donor's estate at death, so estate taxes are decreased as well.

Benefits of future gift giving include keeping assets available during your lifetime for support, and having the ability to change your charitable designation and estate tax reductions.

Things to Ponder

If the donor wishes to "replace" the assets gifted to benefit children or grandchildren, life insurance—owned properly—can be a tool to offset the gift, so a desired amount still transfers to the family. The income tax savings can be used to purchase life insurance in an irrevocable trust replacing the assets passing to charity. In some situations, the family could actually come out better than if no gift was made.

With any of the more sophisticated techniques, there is a cost to establish the entity and to maintain it each year. Generally speaking, $1 million or more is a good benchmark as to whether the technique is practical or not. Again, if you are considering gifting through a trust or other vehicle, you still need advice from your attorney or CPA.

Questions or Comments for the Editor?
Contact Jackie Castillo at (713) 831-5835
or jackie.castillo@compassbank.com