

Quarterly Insight

Johnson Private Client Group | Johnson Trust Company | Johnson Institutional Management

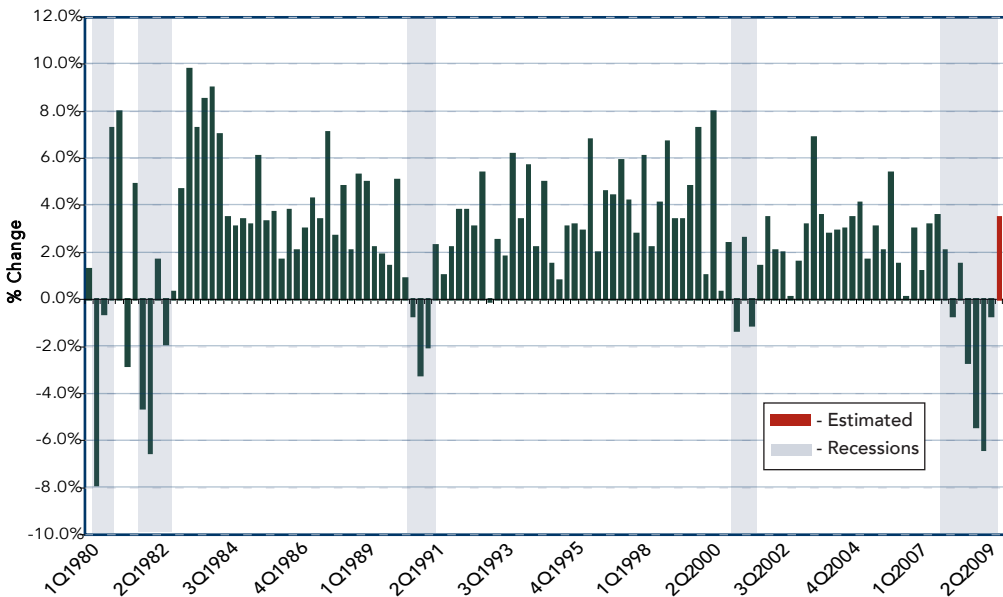


Third Quarter 2009

Market Update

Stocks continued to surge higher during the third quarter as investors grew more confident in the prospects of economic recovery. From its bottom on March 9, the market has now experienced more than a 50% increase in value. This makes the 2009 rally among the ten largest during a calendar year, with each of the other such increases occurring after deep bear markets during either the 1930s or 1970s. Can the recent trend continue? Unfortunately, history suggests this could be difficult. The median change in stocks over the following six months after at least a 50% rise is only 4%, with almost half of the periods actually showing a decline. The longer-term history is also disconcerting with both the latter 1930s and 1970s providing investors with minimal returns. For this market to buck that trend and continue to climb three things need to occur: the economic growth has to sustainably improve; corporate profits must begin to rise again; and quality companies will need to regain leadership.

Annualized Real GDP Change
First Quarter 1980 - Fourth Quarter 2009 (estimated)



The market initially rose in March and April as investors recognized the extreme values that had been reached. Stocks were simply cheap. As the market has continued to advance investors have begun to anticipate changes in the economic landscape. Indeed, the root causes for the recession have begun to ease this year and evidence of improvement is slowly emerging. Housing seems to have stabilized, manufacturing activity has improved, and retail sales have been boosted by programs like the "cash for clunkers." During the recession businesses have depleted inventories to extreme levels and rebuilding them in response to even a modest increase in demand will improve growth during the second half of the year. Better growth among the developing economies of the

Featuring

Market Update
pages 1 & 2

Government Rescue Leads
to a Record Deficit
page 3

JIC welcomes
Tiffany L. Adams, MBA
Director of New Business
Initiatives
page 4

Congratulations to
Sharon G. Tallman, CFP®
page 4

TOTAL RETURN		
Quarter Ending September 30, 2009		
	3Q 2009	YTD
S&P 500	15.6%	19.3%
Dow Jones Industrial Average	15.8%	13.5%
NASDAQ	15.9%	35.6%
Russell 2000	19.3%	22.4%
MSCI EAFE (International)	19.5%	29.6%
REITs	33.3%	17.0%
Barclays Aggregate Bond Index	3.7%	5.7%

	Median Earnings Expectations	
	2009 Expected Growth%	2010 Expected Growth%
Consumer Discretionary	-7.6	15.1
Consumer Staples	6.2	9.4
Energy	-56.7	20.6
Financials	-21.2	21.5
Health Care	7.6	10.2
Industrials	-18.6	12.6
Information Technology	-4.4	16.3
Materials	-30.4	22.0
Telecomm Services	-8.9	4.0
Utilities	-2.1	7.4
S&P 500	-8.0	12.7

Source: Ned Davis Research

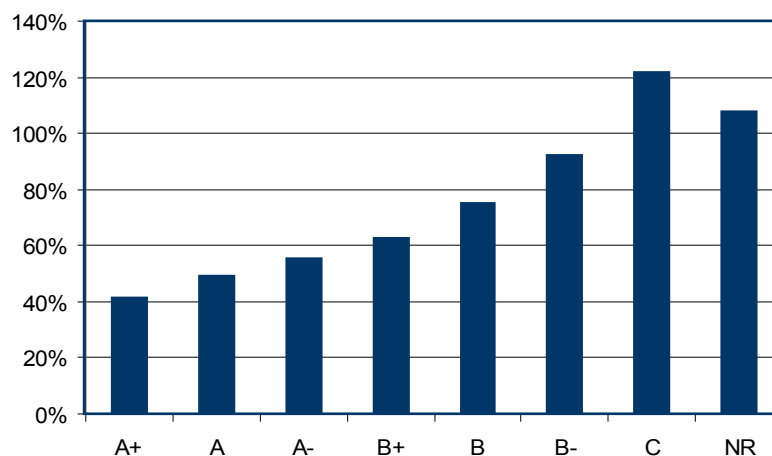
need to improve for the market to continue to move higher. During the first three quarters of this year, earnings from the majority of U.S. companies have been better than investors expected. As a result, analysts have steadily increased their future earnings expectations, and this in turn has helped to push stock prices higher. However, overall profits have actually continued to decline during the year – only at a slower pace than had been originally forecast. In fact, profits for the companies that comprise the S&P 500 have declined for 9 consecutive quarters dating back to the latter half of 2007. For the market to rally further, we now need to see profits begin to increase. On average, only consumer staples and health care companies are showing higher earnings for this year as the weak economy has hurt most other industries. As the above chart indicates, all market sectors are expected to show profit growth next year and that is already factored into investor expectations. Not only does this need to occur, the increase will also need to be driven by real revenue growth and not just cost-cutting so that it could be considered sustainable.

Finally, for the broad stock market to advance further we need to see quality companies regain leadership. While most stocks have risen since the market's low point in early March, lower quality companies have far outperformed the rest of the market. While this is common around turning points, it is not typically sustainable and reflects a risk appetite among stock investors that exceeds the economic environment. Generally lower rated companies are more cyclical in nature and offer investors a higher degree of risk. The stocks of these companies also normally trade at a valuation discount to better quality companies. But, due to their strong performance over the past six months this is currently not the case. Many of the more consistent and better quality companies have risen less this year and are relatively inexpensive. Performance rotation into these higher quality names would better align with the fundamental investment environment and help to sustain the recent market rise. For the overall market to continue to improve, this must begin to occur. ♦

world is also helping to end the recession. Despite continued high levels of unemployment, the U.S. economy is expected to show better than 3% annualized growth during the third and fourth quarters of the year. But such a recovery is modest by historical standards and future growth will likely be held back by slower consumption. As is typical, stocks have risen ahead of the economy and investors already fully anticipate the growth that is ahead. For the market to rise significantly further, this growth must sustain itself throughout 2010 and employment must ultimately show signs of recovery.

In addition to a sustainable increase in economic activity, corporate profits

Total Return from the Market Low on March 9
by S&P Quality Rating



Source: Baseline

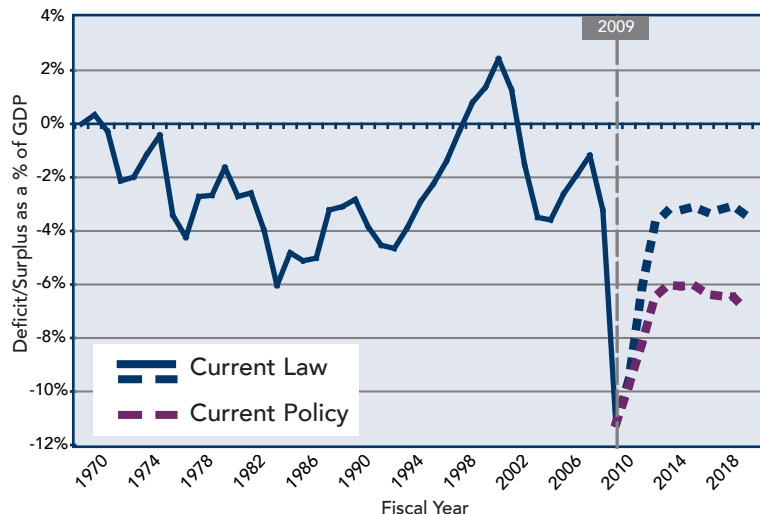
Government Rescue Leads to a Record Deficit

Government policy over the past year has been clear: Rescue the financial system and do it quickly. The stock and bond market recovers this year would suggest that we are on more solid footing. But now the government faces a large budget deficit that will leave some tough choices ahead for the country.

Today, elevated government spending and falling tax receipts have left us with a massive budget deficit that is expected to be \$1.6 trillion in fiscal 2009 according to the non-partisan Congressional Budget Office (CBO). To put this in perspective, at 11% of Gross Domestic Product (GDP), this will be the highest level since World War II.

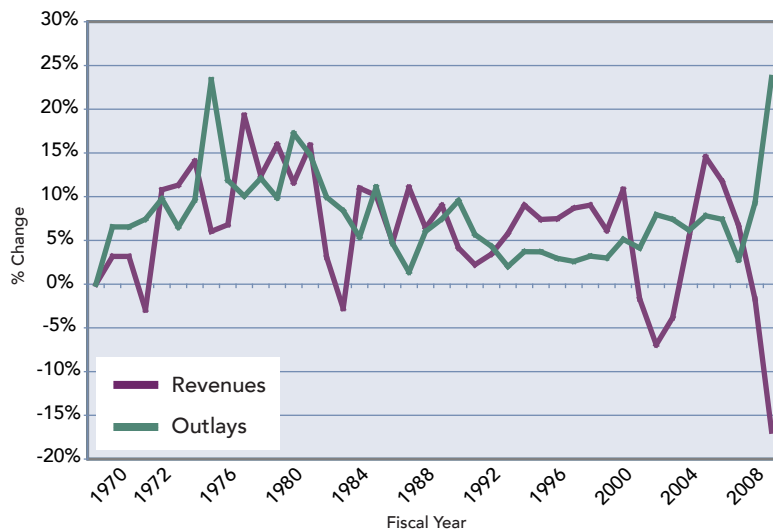
Government spending is expected to rise 24% in the 2009 fiscal year, the largest percentage increase since 1952. A \$700 billion increase in spending relates mostly to the Troubled Asset Relief Program (TARP), the bailout of Fannie Mae and Freddie Mac, and rising unemployment compensation. A sharp recession and rising unemployment also took a toll on the government's tax receipts. Revenues likely dropped by 17%, the largest percentage drop since 1932.

Federal Deficit/Surplus as a % of GDP



Source: Congressional Budget Office (CBO)

Yearly Growth in Government Revenues and Outlays



Source: Congressional Budget Office (CBO)

The future path for the budget deficit is never clear. If current law held, the budget deficit might shrink to more manageable levels as tax receipts increase and stimulus spending winds down. But this assumes the expiration of the Bush tax cuts in 2010 and allowing AMT to apply to a growing share of taxpayers in the upper-middle class. Current policy suggests that these taxes would not be allowed to increase as much as implied by the current law projection for government revenue growth.

Unemployment remains very elevated and Congress is expected to extend certain stimulus programs until that picture improves. Health care reform proposals have included costs as high as \$1 trillion over the next 10 years,

but these reform plans also suggest a meaningful portion of the spending would be offset by higher taxes and private sector sharing of the costs, thus potentially limiting the federal budget impact.

It is widely recognized that the government's budget is on an unsustainable path, as uncontrolled deficits would eventually lead to an impossible federal debt burden. It is imperative that the government fiscal policy now switch quickly and prudently from Rescue to Repair. Beyond the 10-year budget window loom even bigger issues like Social Security, Medicare, and Medicaid.

The economy is recovering and extraordinary spending measures taken to resuscitate the financial system will start to wind down next year. We continue to expect that inflation and interest rates will remain contained in the near-term, further supporting the economy. As public awareness increases of the record deficits and overall debt burden of our country, Congress has at least started to become more concerned. We believe it is critical that budget surpluses, instead of deficits, become the norm in the future. ♦

“ It is imperative that the government fiscal policy now switch quickly and prudently from Rescue to Repair. ”

JIC welcomes Tiffany L. Adams, MBA Director of New Business Initiatives



Tiffany L. Adams

Tiffany Adams joined Johnson Investment Counsel (JIC) in September of 2009 as Director of New Business Initiatives. With our number one priority of improving the quality of our clients' lives, Tiffany is responsible for deepening client relationships by keeping them abreast of the integrated wealth management services available and the good news constantly happening at JIC. Tiffany will also be charged with raising awareness of JIC's compelling story with the business community and prospective clients coupled with overseeing the marketing efforts of the firm.

"I am honored to join the best wealth management firm in the region. JIC's reputation over the past 40 years is unmatched for its sophistication, solid values, strong performance, and dedication towards improving the lives of others. Each day, I continue to be very

impressed with my colleagues' talents and strong loyalty to our client base."

Tiffany resides in Mariemont with her husband, Doug, two sons, Blake (15 years) and Brooks (12 years), and Buffett, her 100 lb. yellow Labrador. She enjoys playing tennis, running, traveling, theater, and spending time with her family and friends. ♦

Congratulations to Sharon G. Tallman, CFP®

JIC is proud to announce that Sharon G. Tallman received her Certified Financial Planner® certification in March of 2009. Sharon joined Johnson Investment Counsel in December 2007 as a Portfolio Manager in our Financial Advisory Services division.

The Certified Financial Planner® certification process involves a rigorous curriculum consisting of six prerequisite courses covering a wide range of financial planning topics. This program culminates with an intensive two-day, ten hour examination.

Johnson Investment Counsel currently has a total of eleven CFP® Certificants on our staff. ♦



Sharon G. Tallman, CFP®

About Us

Johnson Investment Counsel, Inc. is Greater Cincinnati's largest independent wealth management firm, managing more than \$4.0 billion in assets. Johnson Investment Counsel is an employee-owned firm, offering a full range of fee-based, integrated wealth management services, including: investment portfolios, education and retirement planning, cash management, estate planning, trust services, charitable giving, mutual funds, 401(k) plans, IRAs and more. Johnson Investment Counsel has built strong, long-term relationships with individuals and families, charitable organizations, foundations and corporations through three divisions: Johnson Private Client Group, Johnson Institutional Management, and Johnson Trust Company, the only independent trust company in Greater Cincinnati.

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