

Quarterly Insight

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



Fourth Quarter 2011

Letter from the President



Timothy E. Johnson, Ph.D.

Stocks saw dramatic swings during the year, at times bringing back memories of 2008. Fortunately, despite the many headwinds during the year, U.S. stocks still managed to post a positive, albeit small, return. International stocks, however, lost significant ground during the year and were a drag on performance for diversified stock investors. In times of uncertainty, safe haven assets perform well, and 2011 was no different. Despite low yields, investors were buyers of domestic bonds, pushing prices higher in addition to interest earned.

The situation in Europe was certainly a big driver of the volatility. In the past, fiscal problems in a country like Greece would have been shrugged off by investors. In a globally-integrated world, though, markets understand the domino effect that inevitably occurs. Of course, the problems are not limited to Europe. The outcome of the debt ceiling debate in the summer led to a downgrade of our nation's debt. This should have served as a "shot across the bow," but the subsequent response of Washington, including the failure of the "super committee," has been disappointing. Substantive action needs to be taken soon to get our country back on sound fiscal footing.

In a simple world, economic growth and restrained spending would solve the problem, but that is easier said than done. Austerity is not popular, and the deleveraging process takes time. In retrospect, there was too much borrowing and spending going on, which over-inflated economic growth for more than a decade. We are now on the flip side of that, which lowers the growth prospects for much of the world in the near term.

As a result, we have positioned portfolios to "take what the defense gives us." Many large, high-quality companies are trading at attractive valuations, have strong balance sheets, and provide nice dividend yields. The weakness in emerging markets recently has given us an opportunity to gain more exposure for longer-term investors. The bond market should have very muted returns for a while, but it does provide stability. We believe that certain alternative assets, which have lower correlation to more traditional investments, can add value in this environment since interest rates could remain at historical lows for a while.

Our firm continues to do well. We reached \$6 billion in assets this year, and the number of clients that we serve continues to increase. This fall, we went through a three-year planning process that involved every department and employee. The goal was simply to evaluate how we can do better, with client service being the primary emphasis. It has always been important to me to instill a culture of continual improvement, and we are encouraged by this grassroots effort. As we implement these initiatives over the coming years, we believe you will notice a positive difference.

We appreciate your continued confidence and wish you the best in the coming year.

Featuring



Letter from the President
page 1

Market Update
page 2 & 3

JIC News
page 4

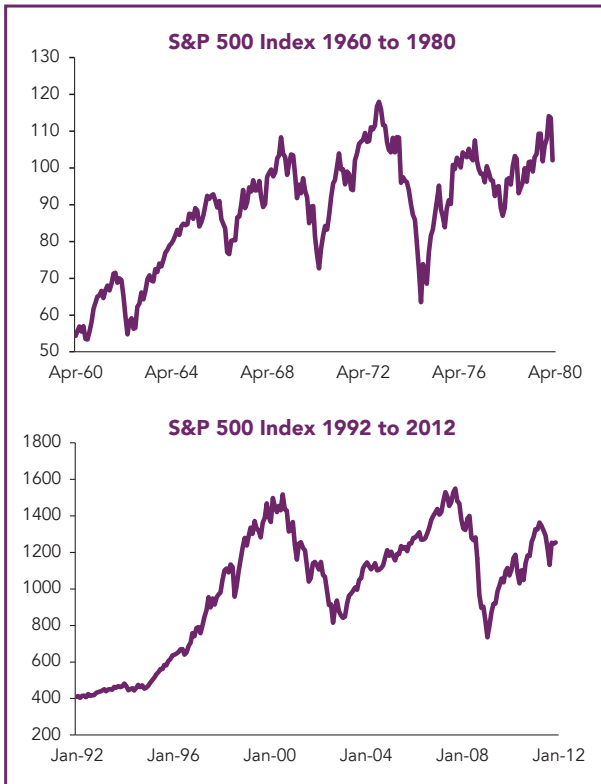
TOTAL RETURN

Year Ending December 31, 2011

S&P 500	2.1%
Dow Jones Industrial Average	8.4%
NASDAQ	-0.8%
Russell 2000	-4.2%
MSCI EAFE (International)	-11.7%
Barclays Aggregate Bond Index	7.8%

Market Update

The equity market bounced back during the final quarter of the year, fueled by some evidence of an improving economy and hope that the debt crises in Europe will ultimately be contained. Stocks rose more than 11% in the quarter with most of these gains occurring in October. This inched the market back into positive territory for the third consecutive year. However, extreme volatility remains the norm with big price rises typically followed by swift corrections, leaving many investors feeling dizzy. Interest rates have also been volatile, but within a narrower band, stuck near 60-year lows.

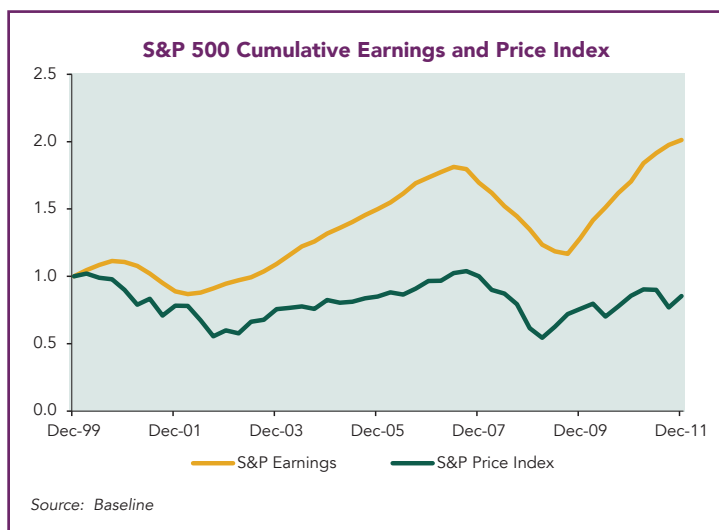


In many ways, the market's swings during 2011 typify the past dozen years. Since the beginning of the millennium, stocks have experienced two substantial drops, each followed by significant rallies. As a result, the total return earned by equity investors over this time period (including dividends) is barely positive and the price of the index is now roughly where it was in late 1998. Such lengthy time periods with no investment return are rare but not unprecedented. The 12-year time frame ending in the early 1940s stands out as the worst on record and the only period of this length where investors actually lost money. The past dozen years ranks as the third worst since 1926. The current flat, but highly volatile period resembles the time period from the mid-1960s to the early 1980s when investors experienced a similar roller coaster ride that ended with no capital appreciation. While that cycle ultimately evolved into the great bull market of the '80s and '90s, we expect more muted returns going forward, most likely in the mid- to upper-single digits.

Despite similar market volatility, there are many differences between today's environment and the one that ended in the early 1980s. Interest rates were far higher back then and the yield curve was inverted – meaning that short rates yielded more than long term – as the Fed fought high and rising inflation.

Today, rates are historically low and inflation is moderate. Unemployment is high today, but it was even higher then. Valuations on stocks are higher today but still reasonable and well below the average historical valuation. A big difference in this current environment is that debt levels are far higher than they were 30 years ago. Reducing both private and public debt will need to occur in the years ahead and will be a clear drag to economic growth. As this occurs, it will also keep risks elevated and volatility high.

Over the long haul, it is the ability of companies to grow their profits that causes stock prices to rise. But there can be extended periods of time when this relationship gets out of sync. Since 2000, corporate earnings have roughly doubled through two distinct economic cycles. Meanwhile, the stock market has gyrated greatly but is essentially unchanged. Many quality companies have seen their profits consistently grow over the last dozen years even as the price of their stock barely budged. For example, Procter & Gamble's earnings are 170% higher today than the year 2000, while the stock has risen only 20%. Coca-Cola has increased its earnings almost 200% as its stock rose just 18%. And Wal-Mart has raised profits over 260% so far this century – and yet the stock price is 10% lower.



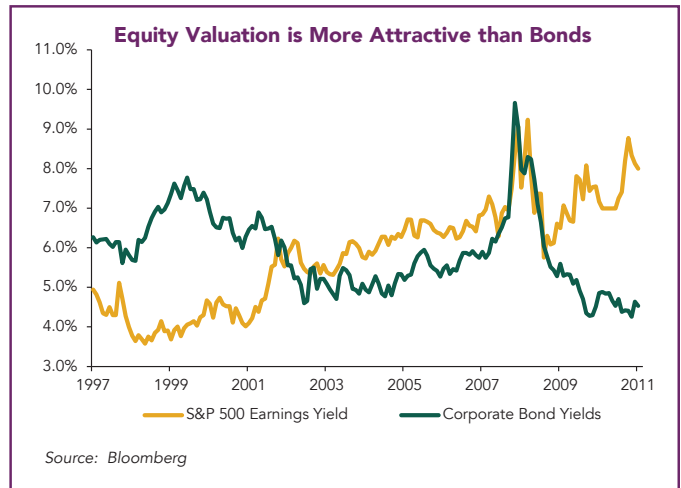
Market Update (continued)

As a result, valuations on many stocks have fallen sharply and are relatively attractive today, especially when compared to bond yields. The nearby chart comparing the earnings yield of the S&P 500 Index (the PE Ratio inverted) to investment-grade corporate bond yields shows that stocks are inexpensive compared to bonds. In fact, this difference is as wide as it has been

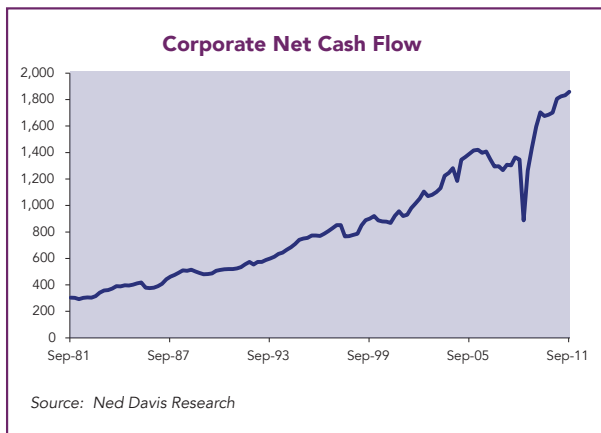
since the depression era. We can also compare the dividend yield on quality companies to the yields available on their bond securities. There are many examples where the common stock of a company has a dividend yield equal to or higher than one of their 10-year bond issues.

Planning Potential

Estate tax laws are scheduled to change in 2013 if no action is taken by Congress. Gift and estate tax planning possibilities exist now that may not be available after 2012. In next quarter's newsletter, we will outline some tax planning ideas that some clients may want to implement before year-end.



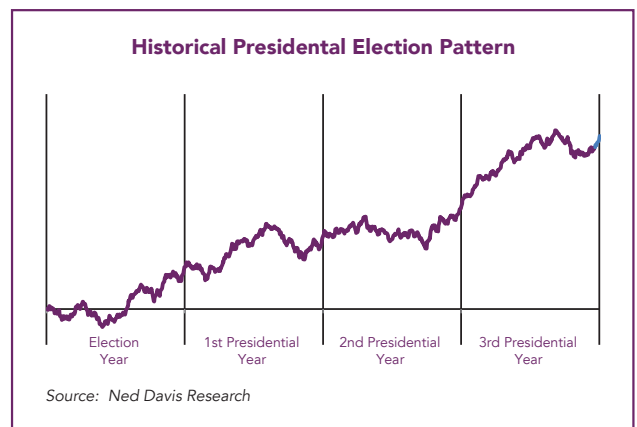
The biggest near-term risk is Europe. Many European nations are experiencing significant fiscal strains and are burdened by excessive debt. European banks are highly invested in these countries and the risk of default is ever increasing. The result could be collapse in the Euro and potential recession around the world. There have been several attempts to resolve this credit crisis, but to-date none seems sufficient. Only the European Central Bank has the strength to create a comprehensive plan large enough to handle the debt problems of countries like Italy and Spain. There are many political headwinds to this, and such a plan may not materialize soon. Until it does, expect the market to remain skittish and volatile.



Despite the uncertain environment, many businesses have improved their balance sheets and continue to experience solid cash flow growth. Corporate America has invested cautiously through this cycle and is positioned to withstand further downturn should it materialize. In addition, valuations in both the stock and bond market generally reflect the potential for economic weakness. This will help cushion any impact if the risks in Europe flare up or if the economy slips back.

Finally, we are entering a Presidential election year, and there have been distinct stock market patterns that have emerged historically. The chart below shows the average pattern of the equity market

throughout an election cycle. It is common for the market to be volatile and without trend during the year we elect a President – at least until the outcome becomes more certain. Given the current harsh political tone, this seems likely to be the case in 2012. This election may have a great impact on future fiscal policy and we expect stocks to remain volatile through at least the first half of the year. But, we find valuations on a longer-term basis compelling, especially compared to bond yields, and expect that corporate profits will continue to trend higher. This will ultimately lead to improvement in the market and aligns with our expectation of mid- to upper-single digit returns over time.



JIC Recognized for Community Service

Johnson Investment Counsel was recently named the recipient of the 2012 Pillar Award for Community Service. This award recognizes the tie between the for-profit and non-profit worlds by honoring organizations and individuals for positively impacting the region and strengthening the community.



Johnson Investment Counsel encourages all of its employees to participate in local organizations for the betterment of the community, the employee and the firm. Seventy-eight percent of our employees volunteer their time with over 144 different non-profit organizations, churches and schools. Our employees serve on 58 boards within the community and hold another 40 leadership positions on various committees and advisory councils. "Giving back" is an important part of our culture, and we appreciate the opportunities we have been given to contribute to the community.

Serving Families at Ronald McDonald House



Again this year, the employees of Johnson Investment Counsel prepared a home-cooked meal for the families at the Ronald McDonald House of Greater Cincinnati. This was truly a firm-wide effort with most of our employees contributing in some fashion, whether it be

preparing and serving the meal, contributing food and supplies, or making a cash donation. On December 1st, 15 of our employees volunteered their time and cooking expertise to prepare the meal, and this year's entire menu was made from scratch. Over 100 family members were served by the end of the night, and all of our volunteers appreciated being given the opportunity to spread some holiday cheer.

Ronald McDonald House holds a special place in the hearts of our employees. In 2005, we lost our dear friend and colleague, Dave Tedford, to colorectal cancer. Soon after Dave's passing, we began sponsoring a room in his honor and name, and in 2011, we made a commitment to permanently support this room. We are pleased to be able to provide ongoing assistance to families who come to Cincinnati to receive medical care for their children.

About Us

Johnson Investment Counsel, Inc. is Greater Cincinnati's largest independent wealth management firm, managing \$6 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.

DIVISIONS

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

SERVICES

- Stock Portfolios
- Bond Portfolios
- Balanced Portfolios
- Integrated Wealth Management
- Trust Accounts
- Pension & Profit Sharing Plans
- Individual Retirement Accounts
- 401(k) Plans
- Foundations
- Endowments
- Johnson Mutual Funds
- Johnson Charitable Gift Fund

OFFICES

CINCINNATI
3777 West Fork Road
Cincinnati, OH 45247
Phone: 513.661.3100
Toll Free: 800.541.0170
Fax: 513.661.3160

COLUMBUS
100 E. Broad Street, Suite 2300
Columbus, OH 43215
Phone: 614.365.9103
Toll Free: 866.365.4523
Fax: 614.365.9943

DAYTON
40 North Main Street, Suite 2110
Dayton, OH 45423
Phone: 937.461.3790
Toll Free: 800.851.9114
Fax: 937.461.2969

www.johnsoninv.com



Johnson Investment Counsel values your trust, loyalty and "word of mouth" endorsements. We welcome your introductions to the people in your life you care about such as family, friends, neighbors, professionals and business associates.