



present

INVESTMENT Roundtable

A panel of experts gathered to participate in a roundtable discussion on the topic of investing.



Mark M. Green
Chief Investment
Officer
Oxford Financial
Group Ltd.



Donald W. Hughett
Director of
Qualified Plans
AXA Advisors/
Midwest Financial
Partners



Greg Weirich
Vice President and
Senior Portfolio
Manager
Fifth Third Bank

the discussion

the talking points:

The market is poised for a rebound.

Consumer confidence, Obama agenda are the biggest variables in the market.

Housing market dependent on buyers' job stability.

MODERATOR: Let's start with the topic that's on everyone's minds right now. We've seen the stock market take a nose dive last year and early this year and now starting to make a partial rally though it's got a long way to go. Where do you see the stock market headed for the rest of the year?

HUGHETT: While we certainly hope the worst is over, there could still be more rough waters ahead and that there may be continued volatility in the market, for the remainder of the year, largely driven by the uncertainty surrounding the U.S. automakers and the banking sector. The economy is poised for a start of a rebound but an obstacle of concern is the sudden significant increase in the personal savings rate driven by anxiety of the economy. This savings creates a significant drag on consumption. This obstacle to recovery will likely dissipate when consumer sentiment improves.

GREEN: Our view coming into 2009 was that we've gone through a tremendous economic dislocation, and we're still in the process of that. The way we describe it is that we'll have a period of crisis containment, then a period of deflationary bust, followed by a period of inflationary muddle. The crisis containment is that we work to contain the financial crisis, and concurrent with that, but extending beyond that, will be this deflationary bust which is a continuation of the economic downturn that we're currently in and have been for 16 months now. And then at some point, growth in the economy will resume. We'll begin to get into whatever the new "normal" will be at that point. But we think part of that will include an inflation component unlike anything we've seen in several years. So then, we think about the timing. We had hoped that sometime in the first half of the year that we'd get the crisis contained – that we'd be able to ring-fence the issues that pose systemic risks to

the financial system. We're a long way down that path. Then after that, we've got the period of deflationary bust, the remainder of the economic downturn to work through. That will take us the remainder of 2009 and into 2010. And then, sometime in 2010 and beyond is when the economic expansion will occur. So, let's just say that it's the end of 2009, the economy is beginning to settle out and we start to see signs of sustainable growth, if you look at past economic downturns, the equity market bottomed out relative to the end of the economic downturn. Typically, its several months beforehand. This economic downturn is going to be stretched out a little more. But you can easily make the argument that if we mark the end of the recession as the end of 2009, then back up from there six to nine months to the end of the first or second quarter, you would see a bottom in the equity market if this follows the same pattern as most economic downturn. Sure enough, we saw the market establish some lows in March, and since then we've had a substantial rally. We're not convinced this rally has longevity to it. If we look at past periods of protracted economic downturn, like the Great Depression, we saw periods of fake bear market rallies where we've rallied 20 percent, given it back, then rallied 20 percent and given it back. In fact, in November and December 2008, we saw a rally then, only to give it all back in the first few weeks of January.

WEIRICH: We think the probability is increasing, probably in the neighborhood of 75 percent, that we have seen the bottom. We've rallied 28 percent off the bottom. A lot of the sentiment remains negative. Hedge funds remain under-invested and having a little performance anxiety. So I think they're a ready-source of money to come back into the market. The sell-offs we're having are very shallow. People want to get back into the market. The cash levels are still very, very high. That supports the market. I

don't disagree with Mark. We may go through a period of sideways consolidation for two to four months where we don't vary by more than five to eight percent. The easy part of the rally is behind us. To a large extent, the market was discounting a depression. When it became apparent that things weren't going to be that bad, it quickly gained that back. We're going to have to see some good evidence of growth going forward. It will probably be the end of the year. International Strategy & Investment believes the fourth quarter GDP is going to be positive, and we follow them very closely. Our current range for end of the year target for S&P is roughly 850 to 900, with maybe some upside to 950 if earnings estimates start to increase. ISI is looking at possibly 1000 on the S&P. I think the longer we stay up here, the sooner consumer confidence comes back and allows to inventories go down and sales go up. There are a lot of positives out there.

MODERATOR: In your opinion, what are the biggest variables that will drive the market? Is it how quick inflation comes back or the housing market or something else?

HUGHETT: Consumer sentiment is the greatest factor – consumers must have the confidence to make the large ticket purchase. The biggest hurdle is that we do not yet know if the consumer, shaken by this turmoil, will start to feel more comfortable with spending.

WEIRICH: I think the biggest variable out there is Washington. They came out with their budget. They came out with cap and trade. They came out with health care, a number of programs that were viewed as anti-business, anti-market. We saw how quickly we went down. I think one of the reasons we bottomed was it appeared they did not have enough votes, 60 votes, to get them through the Senate. So while these things had

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Close-up: Mark M. Green

the possibility of going through, the possibility has gone way down. The market is like that. In my mind, that's had the biggest effect on the market. If the government can just stay out of the way for a while and let the cycle do its thing, I believe the market will follow.

GREEN: We would agree. The political overlay on the economic landscape is the most confusing to investors. Nobody has a great deal of certainty with regard to what economic policy is going to be over the short term, much less over the medium and longer term. They changed the rules of the game with regards to TARP. That created a tremendous amount of confusion in the markets earlier. When they put the ban on short sales on financial securities back in the fall after the collapse of Lehman Brothers, that sent shivers through the hedge fund industry. It sparked a lot of redemptions from hedge funds and a lot of forced selling. They certainly created some turmoil in the market that's probably not a lot worse than what they were trying to prevent. When we think about what establishes pricing in the financial markets, we think in terms of economic fundamentals, market valuations, technicals, and sentiment. The market over the last year to 18 months has really been dominated by the technicals and the market sentiment issues. The markets really haven't focused all that much on fundamentals or valuations. At some point, we think the market will begin to shift once the fear has been wrung out of the market. Once the technicals get set aside with regard to the forced redemptions and forced selling in the market, and once investors are able to focus just on valuations and fundamentals, then there's the potential for the markets to respond very positively to signs of strength in the economy. Just last week we heard talk of the green shoots of optimism, and we've seen the market respond to that. There's a lot of pent up demand in the economy. The issue is with the inter-



(Credit) is the lifeblood of our economy, and when the flow is interrupted, the economy suffers the equivalent of a financial cardiac arrest.

— Mark M. Green

ruption with the flow of credit and the banking system. Once that restarts, everyone will feel better. They'll have access to credit, inventories. It's the lifeblood of our economy, and when the flow is interrupted, the economy suffers the equivalent of a financial cardiac arrest.

WEIRICH: And at the same time, you've had the consumer deleveraging in a big way. Not only has credit been tight for consumers and businesses, but the consumer is going out of his way to not incur debt, but also pay down the debt he has. Let's face it, the consumer is not only the engine of growth for our economy, it's the engine of growth for the world economy. It's hard to replace. How long is this going to take - one year, two years, five years - for the consumer to feel comfortable again?

GREEN: We mentioned the amount of cash sitting on the sidelines, and that's another very encouraging sign. There's more cash than the total market value of the S&P 500 right now just sitting in money market accounts

Title: Chief Investment Officer
Company: Oxford Financial Group Ltd.
Expertise: During his 20 years in the investment management industry, Green has had experience in both traditional and non-traditional investment strategies. He has broad expertise including investment policy and guidelines, asset allocation and risk management, and manager evaluation and selection.

Education: A graduate of San Francisco State University, Green holds both a bachelor's degree and master's degree in economics and a bachelor's degree in international relations.

waiting to come back into the financial markets. We think there's a lot of dry powder out there looking for the opportunity to be put back to work. That could certainly limit any downside volatility once we get through the crisis phase. And then, looking farther out, Greg brought up the deleveraging issue, everything we've been through has been very good for our economy for the long-term. Assuming we survive this, and I have every reason to believe we will, a few years down the road I think we'll be in a much better position in regard to household finances and capital formation in the U.S. economy and the way its being deployed. The issue of the budget deficit is a looming one, and that's an area where we have a lot of concern.

WEIRICH: I mentioned earlier, the longer we stay up here, the better it will be because consumer confidence will increase. One of the things, besides the government programs not going through, that helped us back in late February and early March, was the fact that consumer sales, retail sales were up more than expected.

Inventories went down. You're getting into a replacement cycle for inventories. So the consumer has been a little better than anticipated. We got information from ISI recently about tax refunds. April tax refunds, year on year, are up 22.8 percent from last year. This is a huge amount of stimulus for the consumer. And so far, April sales appear to be considerably higher than they were last year.

MODERATOR: Let's talk a little more about the availability of credit and the housing market. When do you see those things turning around?

HUGHETT: Tight lending conditions are likely to continue for some time, however, individuals with good credit scores and sustainable income are finding loans more accessible.

WEIRICH: If you look at the housing market, there are typically three factors that play into the consumers' decision to buy a house. First, the prices of the homes. We know those have gone down considerably. Secondly, the mortgage rates and the availability of credit. We haven't seen mortgage rates this low in the past 30 years. And third, job stability. Right now, that's the ingredient that's missing. Even if consumers have a job currently, they may not be confident that it will be there in six or 12 months. But recently, layoff announcements have slowed down and unemployment claims are trending down a little. If that continues, it'll still take six or nine months, but we can begin to expect the market to do a bit better. Once the consumer feels more confident, I think you'll see not a boom but a boom lit in housing purchases. We're already seeing it in refinancing.

GREEN: The housing affordability numbers have shifted dramatically with regard to prices coming down, mortgage rates coming down and average incomes remain relatively stable. Right now, the opportunity to own a home is within reach for a far greater

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number of people than it has been in a long time. Clearly, the prices of homes have been pumped up by some lending issues, the subprime. We've seen a dramatic correction in the housing market both in terms of sales and prices. How far through that process we are is one of the key questions that remain. I think there's a consensus of opinion that we've still got several months to go. Hopefully, by the end of 2009, we'll see some kind of bottom in terms of activity and maybe in terms of prices of the average home. Now, the "average home," what does that mean? There is no national housing market. It's made up of a variety of several regional markets. Certain areas have been hit harder, and they'll take longer to recover. If you look at areas that have dramatic over-building, particularly in more expensive places like Florida or in Arizona and Nevada where there's a lot of activity going on, they'll take longer to recover. But as

far as the price for ordinary markets in middle America, they've never participated in the run-up in pricing and only modestly participated in the correction, those markets could stabilize much more quickly. What we're seeing in terms of the transaction activity is some signs of improvement. But a lot of bottom-feeders are coming out. There's still foreclosure activity. Banks want to get foreclosed homes off their balance sheets. Much of the transactions activity is for distressed sales.

MODERATOR: You brought up the banks. I've heard several bankers talk about the housing market. How do you view the banking industry? Where are we in the process of the banks' recovery?

WEIRICH: That's a tough one.

HUGHETT: Long term this sector is likely to provide returns, however

short term one must acknowledge the influence of governmental ownership and the changing regulatory environment – this sector will take some time.

GREEN: We've spent some time looking at the Federal Reserve data on bank loans, what their balance sheets look like. The monetary policy response to the economic and financial crisis has been truly amazing. To say it's been an aggressive response is an understatement. The Fed has pumped in so much in the way of reserves into the system in order to stabilize it through a variety of different programs. But much of this has ended up on bank balance sheets as free reserves. That's raw materials for making loans. The banks are under a tremendous amount of pressure still because we're in the crisis containment phase. They are all being very prudent in terms of looking at the asset

quality of the loans on their portfolio and trying to build up their balance sheets in order to make it through the crisis. Once we get to a point where the risk of a systemic failure is behind us, there's a lot of dry powder available to banks to make loans. Now, we're still in this economic downturn. If you look at the data, every single economic downturn is accompanied by a sharp slowdown in the growth of loans on balance sheets at banks. That makes sense. Certain loans, like commercial industrial loans, tend to fall off dramatically by 5 to 10 percent year over year. We haven't quite seen that yet, though we've seen pretty sharply. C & I loans are still flat loan models. Real estate loans have come off dramatically, but they haven't declined yet. Consumer loans are actually holding up surprisingly well despite the deleveraging that's occurring. So we think the banks have an opportunity. Those that survive and

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have relatively strong balance sheets and strong asset quality will do well. We're also seeing a sharp rise in loan loss provisions and net loan loss as a share of the average loans on their balance sheets. As long as the economic downturn, bank balance sheets are likely to continue to deteriorate. Their cost of funding is actually higher than you might think. Their net interest margins have come off dramatically. That's put a really strong squeeze on their profitability. The Fed may be targeting a zero to 25 percent fed fund rate, banks are actually at borrowing a little over five percent in the market to actually get money to be able to loan. Once we find out the results of the stress test, there's likely to be some volatility in the financial sector because it's not clear what's going to happen with the banks that will need more capital. Where is that going to come from?

WEIRICH: Do remember they have six months to get that capital once it's been identified that they need it. I would beg to differ a little on the margins. I think the margins are actually starting to expand now. The one thing you saw when you took out Washington Mutual and Wachovia was that they were paying pretty high rates for deposits. Between that and the general move down in rates the end of last year, margins did contract a little bit in the third and fourth quarter. But they're starting to expand now. I think that will help the banks. It's a matter of time now. The banks are identified as needing capital will have two options. They'll either get the capital at the end of six months or they'll be merged into one of the stronger banks. I think the stronger banks, especially JPMorgan right now, that's going to be good for them. They can pay back the TARP money any time the government lets them. I equate them and Goldman Sachs about the same. They can both pay back the TARP pretty much any-time they want. They'll be there for the government to use for any of the weak banks that need to be acquired at pretty good prices. I don't think you'll get the prices you saw on Wachovia and Washington Mutual.

GREEN: When you talk about banking industry, you have to look at three tiers. There are the large money center banks. There are a whole bunch of small banks despite all the consolidation that occurred. And there's a group in the middle. Within those tiers, you've got strong banks and weak banks at all levels. As Greg said, stronger banks will be in the catbird seat in terms of the consolidation that's going to continue and perhaps accelerate once we get through this. To date, we've had 25 banks fail through April. That's the same number that we had for all of 2008. If you just compare those numbers, you'd think things are just continuing to deteriorate. We may have more bank failures. But most of those failures have been relatively small banks that have been easily digested. The FDIC has been able to come over, take control and work out some sort of dissolution. We do think we'll see ongoing consolidation, but the survivors will be in a very strong position. And we'll have the ability to extend credit.

MODERATOR: I'd like to change gears a little and talk about corporate earnings. In your opinion, when will we see corporate earnings growth again?

HUGHETT: As disappointing as the last quarters earnings have been, there is reason for renewed optimism. We are seeing evidence of many corporations that have done an effective job in cutting expenses and positioning themselves for recovery.

WEIRICH: Currently, in the second quarter, we're looking at negative 33 percent earnings growth. Third quarter, negative 20. Fourth quarter is still up in the air because fourth quarter 2008 was so bad – kitchen sink kind of thing. You could actually see a flat, who knows maybe slightly positive, quarter. It's at least fourth quarter and more likely first or second quarter 2010 before you see anything positive.

GREEN: We would agree with that. We don't estimate earnings as precise-

ly as many people do. But corporate earnings are a direct function of the economic environment we're in. And we don't see the economy showing signs of life in terms of expansion until we get into 2010. So we don't expect to see much improvement in earnings between now and then. There's the potential for banks to deteriorate substantially between now and then, and we want to be on the watch for that. So far, looking at the earnings reports that came out for the first quarter, they've been generally better than people expected.

WEIRICH: I think it's amazing if you look at some of the big industrial companies like United Technologies and Honeywell. Considering the negative GDP we have in the current quarter, though we haven't seen the official numbers, these companies are coming out with earnings. Maybe not as good as they were a year ago, but they're pretty decent earnings. It sort of tells me that if we get a year out from now and we see positive GDP growth, these companies will really be moving. Their earnings are going to grow quite a bit, and their prices will follow.

MODERATOR: With all the turmoil and volatility that we've been talking about, what are you telling your clients? How worried are people?

WEIRICH: Everybody is worried. My clients fall into a couple of categories. We've had a few that have called and said, "I can't take it anymore. Get me out of the market." I had a client call just a week before the bottom, and he wanted out. And then a week later, he wanted back in. Then you have others that know it's bad, but they're not watching their statement each month. It's hard for them to look at it. The most important thing we've learned in the last year was which clients we've done the best job on their asset allocation. Are they able to sleep at night despite what the market's doing? With a few exceptions, most of my clients have had the right asset mix. Not that they like what's happened, but they've been conservative enough, based upon their risk levels, to make it through.

Close-up: Donald W. Hughett



Title: Director of Qualified Plans
Company: AXA Advisors/Midwest Financial Partners

Expertise: Hughett attended the AXA Institute at Harvard University to learn advanced techniques in portfolio management. He received a certificate in retirement planning from the Wharton School of the University of Pennsylvania. His practice areas include qualified, defined contribution/benefit plans, asset management strategies, financial strategies and retirement planning.

Education: Hughett holds a bachelor's in business administration from University of Cincinnati.

We are seeing evidence of many corporations that have done an effective job in cutting expenses and positioning themselves for recovery.

— Donald W. Hughett

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Close-up: Greg Weirich



Title: Vice President and Senior Portfolio Manager

Company: Fifth Third Bank

Expertise: Prior to joining Fifth Third in 2005, Weirich was a vice president and senior portfolio manager for a super-regional bank's private client group. He has extensive experience in developing individualized portfolios for high net worth clients based upon their needs and objectives. Weirich has 27 years of trust and investment management experience.

Education: Weirich graduated with a bachelor's of business administration with a major in finance from the University of Texas at Austin.

We do see the high probability that we have seen the bottom and that we're going to see a better year ahead.

— Greg Weirich

Let's face it, eventually the market is going to turn around.

GREEN: One of the biggest challenges and perhaps one of the most dangerous things that can happen during periods of stress in the financial markets is that decisions are made because of emotional and behavioral issues. People get caught up in the events. They get caught up in the news. They get caught up in the volatility. They get caught up in their own fear. They fear losing what they have or not being able to gain what they want. And to prevent or minimize those types of decisions, we encourage all of our clients to have written investment policies that outline their goals and objectives, the constraints they have to operate in and help form the basis of a long-term strategic asset allocation. We try to create realistic expectations in their minds with regard to what can happen to total returns for different parts of their portfolio and their portfolio as a whole based on our views of risks and returns. Of particular interest in this episode has

been the whole issue of risk tolerance. In our view, risk tolerance comes in two parts. One is the financial capacity to bear decline in asset values. Second is the emotional appetite to withstand volatility in the markets. We think it's very important at this point to review your fundamental investment objectives. Makes sure your policy is in order.

MODERATOR: Where are you currently seeing opportunities in the markets? Are there sectors or individual companies that you like right now?

WEIRICH: As far as sectors, we're moving toward overweight in technology, industrials, consumer discretionary. We're still underweight, but not as underweight as we were, in financials. We're looking at bringing health care to underweight because of what's going on in Washington. We don't know where health care legislation is going to go. I mentioned JPMorgan and Goldman Sachs. I almost view them as the same. They're going to have

opportunities. They'll come through this just fine, and they'll be the winners. On the technology side, we like Qualcomm. They beat sales in the current quarter and raised sales forecast for the next quarter. They're tied to China which is still growing. We also see opportunity in two fixed income vehicles. There are two exchange traded funds. One is QD, which is an investment grade bond index. The other is HYG which is the high yield index. The high yield is a little more risky, but will have a higher potential return. We almost view them as stock proxies. As the economy gets better, the spreads between investment grade and high yield or treasuries will come in and contract and give you not only the yield on the exchange traded fund, but also some appreciation. The investment grade yields about 5 or 6 right now. The high yield is about 10.5. It's sort of a chicken way to play the stock market right now and still get paid a dividend.

GREEN: We would certainly echo many of the themes that Greg just outlined. We don't pick individual securities or sectors. We tend to focus more on asset classes. We've been underweight in terms of equities for some time. We're beginning to encourage clients to scale back in to get closer to their longer term targets. Although, we want to make sure we're taking baby steps to move back into the market because there's still some uncertainty there. Within the equity market, though overall, we tend to favor large cap over small cap. If you look at what happened in many of the previous bear markets, once the bear market is over, there's a burst of activity oftentimes in small caps outrunning the large caps. We haven't really seen that this time around. More to the point though, many times those bursts in small caps don't last that long. Then you've got a market timing decision. We think the large cap stocks are a safer choice right now. They have more availability to the credit markets. They also have more exposure overseas. We still like international, although there's some areas of international we're a little concerned about. We like emerging markets, and emerging markets have

been on a tear this year so far. They're up 14 percent in the month of April. They've just run away from everyone else. There's also an inflation component, and we're concerned about inflation going forward. Greg mentioned corporate credit play. We're involved in that as well. We believe that there's an opportunity in the corporate credit, fixed income area that we haven't seen in a long, long time. Spreads for corporate bonds over comparable duration treasuries are at historically wide levels. Some of that is artificially because those treasuries have been held low through the actions of the Treasury and Federal Reserve. Funding costs for corporations in the market have not risen dramatically. If there's an inflation scare, those corporate funding costs will rise. The whole term structured interest rates will rise. But for the time being, I believe there's a tactical opportunity in the corporate credit market. We're waiting for the opportunity in high-yield. We think it may be a little early.

WEIRICH: It's a definitely a little more risky.

MODERATOR: Have you changed your asset allocation recently, or do you expect to?

HUGHETT: Even if you're an aggressive investor, it's never a good idea to put all your eggs in one basket. Those who most successfully weather the market's ups and downs are those who have a variety of investments—some fixed income securities along with a diversified stock portfolio that includes small and large cap, growth and value sectors. Asset allocation—the process of deciding which stock and bond sectors you want in your portfolio and what percentage of each—is important for two reasons. First, by spreading your bets among different types of stocks and bonds you are more likely to protect your assets on the downside—that is, when the market is falling. Second, since no one can predict what next year's winners will be, having a piece of many types of securities makes it more likely that you will pick some winners. Your own asset allocation will depend on

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your age, your investment goals, your tolerance for risk, your tax bracket, and other variables. Please be aware, however, that asset allocation does not guarantee a profit or protect against loss.

WEIRICH: I'd say we're less negative. If we were at a 60/40 asset allocation, we were moving down to 50/50. In the past few weeks, we are moving back up to the normal allocation. We've gone past the normal into the overweighted area. But we're definitely headed back toward normal. We do see the high probability that we have seen the bottom and that we're going to see a better year ahead.

GREEN: I'd say we're doing basically the same thing. We're trying to move closer to a longer term target on equities. We're making that move slowly. Fixed income has typically been overweighted. We want to try

to keep as much of that as we can. Some of the areas that we've pulled some money back in order to be able to fund these steps back into the equity market are from alternative investments. We've been scaling back to a neutral position.

MODERATOR: What are some pitfalls you're seeing investors make?

HUGHETT: It's no question that investors get very emotional when it comes to their money. But rash decisions often lead them to make portfolio changes that may have adverse effects on their growth potential. Instead, investors should replace emotion with a disciplined investment strategy. Don't make long-term decisions based on a short-term view. The key to investing is consistency in all market types.

WEIRICH: Some people looking at the past as an indicator. They

think whatever happened in the last 12 months will happen in the next 12 months. There's been some discussion about what a good investor Warren Buffett has been lately. He has said he like to be greedy when others are fearful and fearful when others are greedy. That's a perfect example. As we saw this 28 percent move in the past six weeks, if you had been hoarding your money and slowly moving it into the market as others became more fearful, you would have seen a nice return even if you didn't time it to the exact bottom.

GREEN: Most of that falls into the behavioral finance category. There are classic mistakes that individual investors make. Probably the most predominant of those is chasing or avoiding past returns. People tend to buy into the things that have done well and sell the things that haven't. And by definition, you'll end up buying toward the

end of the cycle and selling toward the end of the cycle. There's evidence that suggests that a good bit of the last down draft in the market in the first part of March was a capitulation. We commonly see that at the end of a bear market where the bottom falls out of the market altogether. That's the result of the little guy that has gotten to the point of maximum pain. They dial 1-800-GetMeOut.

WEIRICH: One other thing about market timing. There are two decisions you have to make – getting out and getting back in. A lot of people don't do a bad job of getting out of the market. They see it trending down and they get out. But they do a terrible job of getting back into the market. Usually, the market is going back up when you're getting some of the worse news.



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