Fort Washington Investment Advisors, Inc.

High Yield Fixed Income Quarterly Commentary

4Q09

Philosophy

Fort Washington believes that investing in higher quality segments of the High Yield Fixed Income market offers the best alignment of risk and return. This provides the most favorable opportunity to outperform over a full market cycle while maximizing risk-adjusted returns.

Process

Fort Washington's High Yield Fixed Income process narrows the universe of available securities into a group of credits with attractive risk-return relationships. We de-emphasize sectors with unfavorable risk-return relationships and do not buy securities rated CCC or below. Credit selection is led by our experienced portfolio manager and our specialized team of credit research analysts. Fort Washington's larger High Yield Fixed Income positions are generally comprised of well-capitalized companies with proven business models and relatively strong credit ratings.

Investment Professionals

Brendan M. White, CFA
Senior Portfolio Manager
23 Years Experience

William H. Bunn, CFA
Senior Credit Analyst
24 Years Experience

Bernard M. Casey, CFA
Senior Credit Analyst
18 Years Experience

Timothy J. Jossart, CFA
Senior Credit Analyst
17 Years Experience

Anthony L. Longi, Jr.
Senior Credit Analyst
23 Years Experience

Kevin Seagraves, CFA
Senior Credit Analyst
14 Years Experience

Performance

Although the High Yield rally has been rather astonishing, it showed no signs of letting up in the most recent quarter. Spreads continued to tighten, and the Merrill Lynch U.S. High Yield Cash Pay Index generated a total return of +5.8% for the quarter ended December 31st, 2009. This return punctuated an impressive record calendar year return of +56.3% for the index, easily surpassing the prior record of +34.6% set in 1991. As dramatic as the sell-off was in 2008 (-26.2%), the recovery may be equally as remarkable. The calendar year 2009 was also a record year for High Yield new issuance with nearly $153 billion of U.S. denominated issues being priced.

As remarkable as this High Yield rally has been, it would be inappropriate to characterize it as unwarranted. In fact, it can be logically explained by considering the rather dramatic improvement in the investing environment coupled with record wide spreads in the High Yield market at the beginning of the year. In December of 2008, the High Yield market was discounting default rates approaching 20% due to an impaired banking sector, limited access to capital and a recession of unknown length and depth. The application of unprecedented stimulus and government intervention resuscitated the banking system and quickly improved access to capital. Additionally, the recession ended up being shorter than feared and default rates were lower than anticipated. As a result of improving prospects, spreads tightened to more normal levels generating record returns.

It should come as no surprise that the lowest quality segment (CCC-rated securities) performed the best while the higher quality segments (B-rated and BB-rated securities) lagged considerably. CCC-rated securities returned nearly 10% while B-rated and BB-rated securities returned less than 5%. Similarly, distressed paper returned nearly 13%.

As has been the case throughout 2009, those sectors with a large component of distressed securities performed the best while those sectors comprised of higher quality issuers lagged the market. For example, during the quarter, Broadcasting, Publishing and Insurance were among the best performing sectors. Sectors that lagged the market included Aerospace, Utilities and Telecommunications—three of the larger sectors that are generally comprised of higher quality issuers that tend to be less volatile than some of the riskier sectors.

Factors Contributing to Performance

Our portfolios lagged the broad benchmarks due to our higher quality bias but performed in line with BB/B constrained benchmarks. From a security selection standpoint, we were able to add value within the Utility and Energy sectors. Our positive contribution within these sectors resulted from the recovery of securities that had underperformed in the prior quarters. Conversely, our relatively higher quality holdings within the Telecommunication and Technology sectors resulted in negative contributions from security selection.

Similar to prior quarters, contribution from sector allocation was substantially negative during the most recent quarter. Although unfortunate, this is consistent with our philosophy of focusing on the more stable sectors that provide attractive risk adjusted returns over the long term. Our underweight to the Insurance and Banking sectors detracted materially from performance. These sectors were among the best performing sectors and we have limited exposure to these sectors. We continue to assess our underweight exposure to these sectors and are looking for appropriate relative value opportunities consistent with our philosophy and process.

Portfolio Outlook

We look for market returns in 2010 to be moderate, following exceptional gains in 2009. As investors begin to anticipate monetary tightening, the U.S. treasury yield curve is likely to shift higher, while equity markets could become more volatile. However, improving corporate profits should underpin moderate gains in the stock market and provide good stock-pickers with ample opportunities to add value. Aside from unforeseen "black swans," the main risks to this outlook arise from potential policy errors and possible aftershocks in the banking system.

With respect to High Yield bonds, a firming economy and a declining default rate suggest the fundamental underpinnings remain adequate. As such, we remain constructive but with tempered expectations. Whereas 2009 returns were comprised primarily of capital appreciation, we anticipate returns going forward to be comprised primarily of yield. That said, we think High Yield offers attractive relative value, particularly when compared to other fixed income asset classes.

High Yield Fixed Income

We remain comfortable with our portfolio composition and continue to believe our portfolios are properly constructed. As such, we believe we are well positioned for the current environment.

The strength of Fort Washington's High Yield strategy has historically been fundamental credit analysis with particular emphasis on avoiding problem credits. We believe this will continue to add value as negative credit events may have a material impact on returns in this lower return environment. We believe this core competency will provide considerable value to our clients.

We will continue to construct portfolios designed to exhibit less volatility than the broad market and deliver attractive risk adjusted returns. Our portfolios are designed for performance over a full market cycle with focus on protecting principal in down markets, a style that we believe will outperform over the long-term.

Fort Washington
Investment Advisors, Inc.

A member of Western & Southern Financial Group

303 Broadway, Suite 1200, Cincinnati, OH 45202-4220
tel 513.361.7600 • fax 513.361.7605 • FortWashington.com