



Maribeth S. Rahe
President & CEO



Nicholas P. Sargen
Chief Investment Officer

Happy New Year! Welcome to the winter edition of Fort Washington's Market Thoughts. The fourth quarter of 2005 was a quiet one both in the markets and at Fort Washington as we wrapped up a busy year. The markets have not changed much from 2004 as we continue sideways movement and we anticipate more of the same for 2006. Be sure to read Nick Sargen's commentary and thoughts as we continue to keep you informed on our economic forecasts and predictions.

Here at Fort Washington we are busily preparing for our upcoming move to the new 303 Broadway at Queen City Square office building. "We are excited to be moving our offices to the city's newest building," said Maribeth Rahe, president and chief executive officer of Fort Washington. "We have enjoyed considerable growth and need more space for our firm." We anticipate being settled in our new offices by the end of the first quarter.

In this issue of Market Thoughts we will review the stock and bond markets of 2005 and identify the issues that will affect the coming year. And as always, please let us know how we are doing. We look forward to providing you with our thoughts and re-cap on the market and our latest news and happenings.

2006 Outlook: More of the Same (Again)?

As the new year begins, we are struck by how well the U.S. economy has overcome the headwinds of monetary tightening, surging energy prices and a series of natural disasters. The economy posted its tenth consecutive quarter of growth in excess of 3.0% in the third quarter of 2005. Meanwhile, core inflation, which excludes food and energy, appears to be holding around 2.0%, despite more than a doubling of oil prices in the past two years.

The end-result for 2005 was a lackluster year for U.S. financial markets. Bond investors were not able to earn the coupon rates on bonds, as short and medium-term yields rose. Nonetheless, long-term yields stayed in narrow ranges, despite a 200 basis point rise in the federal funds rate to 4.25%. Meanwhile, the stock market, as measured by the S&P 500 Index, generated a 4.9% total return. Volatility in the bond market was the lowest in nearly 20 years, while stock market volatility was the lowest in four decades.

Turning to 2006, the most likely outcome is that investors will again be able to earn moderate returns on financial assets, assuming the consensus forecast of Wall Street economists pans out. The consensus calls for the economy to slow somewhat, as the housing sector cools; nonetheless, real GDP growth is expected to exceed 3.0%. Core inflation is expected to edge up to about 2.2%.

Monetary policy developments are likely to continue to have the greatest bearing on financial markets. The bond market currently anticipates that the Federal Reserve will boost interest rates one or two more times, to 4.5% or 4.75%, before pausing, but there is a possibility it could reach 5%. Accordingly, we are maintaining an underweight duration position for the time being. However, we are prepared to alter this stance as it becomes clearer that monetary tightening is over.

The wild card in the forecast continues to be energy prices. Crude oil prices recently have fallen to about \$60 per barrel, down from a peak of \$70 per barrel in the wake of Hurricanes Katrina and Rita. This development has provided support to the U.S. stock market, which languished most of this year. Should oil prices stabilize around current levels, the energy and utilities sectors that have led the market for the past two years could trail. We believe large-cap stocks, which have underperformed small- and mid-cap stocks for the past five years, offer equity investors the best value in the market. Also offering better value in the market are growth stocks, which lagged value stocks for five years, but have begun to out-perform recently.

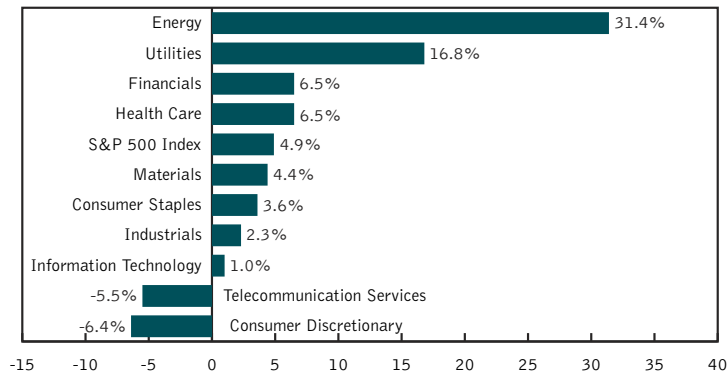
Nicholas P. Sargen
Chief Investment Officer

Stock Market

Exciting is not the word to describe the stock market of 2005. Stocks traded in a narrow range producing sub par returns. One of the biggest dramas was whether the Dow Jones Industrial Average would end in positive territory for the year. It didn't. But don't let the lack of volatility make you complacent. Meaningful changes are likely in 2006. Below we review 2005 and discuss the prospects for stocks in the year ahead.

The S&P 500 Index produced a total return of 4.9% during 2005. This follows returns of 28.9% and 10.8% in the prior two years. The Russell 2000 Index of small cap stocks rose 4.6%, but mid-cap stocks led the way with the Russell Midcap advancing 12.7%. One interesting aspect of the market last year was the concentration of returns. A review of sector performance in the chart shows that only two sectors — energy and utilities — provided the vast majority of the S&P 500 Index return.

S&P 500 Index Sector Returns
One Year Ended 12/31/05



Our outlook for stocks in 2006 begins with the economic backdrop. The current consensus forecast for GDP growth of 3% to 3.5% would continue the positive environment for stocks of the last two years that was not-too-strong and not-too-weak. Several factors should be monitored for evidence of a weaker than expected economy including the housing sector, the debt-burdened consumer sector and the lagged impact of rising interest rates and energy costs.

Corporate profits are projected to rise further in 2006, but the pace of earnings growth continues to decelerate. Earnings for the S&P 500 Index probably rose 12% in 2005 after growing 21% in 2004. For 2006, earnings of about \$80-\$82 are projected, for growth of

"EXCITING IS NOT THE WORD TO DESCRIBE THE STOCK MARKET OF 2005"

around 7%-9%. Companies are operating very efficiently with high productivity and curtailed labor costs. Profit margins are near historical highs. On the negative side, with margins near peak

levels, profits are more reliant on top line growth. Increasing costs for energy and employee benefits combined with sluggish sales pose risks to earnings estimates.

Implied Valuation Matrix
2006 S&P 500 Index Earnings

		\$78	\$79	\$80	\$81	\$82	\$83
	14	\$1,092	\$1,106	\$1,120	\$1,134	\$1,148	\$1,162
P/E	15	\$1,170	\$1,185	\$1,200	\$1,215	\$1,230	\$1,245
Range	16	\$1,248	\$1,264	\$1,280	\$1,296	\$1,312	\$1,328
	17	\$1,326	\$1,343	\$1,360	\$1,377	\$1,394	\$1,411

We continue to maintain a neutral view toward stock valuations. Many valuation measures are close to long run norms. Of course, those of a bullish or bearish persuasion can find a valuation metric to their liking. For example, stocks look relatively cheap compared to 10-year Treasury yields or in models using today's low core inflation. On the other hand, rising short-term interest rates and paltry dividend yields make stocks look rich. The matrix above illustrates a reasonable range for the S&P 500 Index using various earnings estimates and P/E levels. The S&P 500 Index began the year at 1248 providing roughly equal upside and downside using this matrix.

As the Fed repeatedly raised rates over the last 18 months, P/E ratios contracted, somewhat offsetting strong earnings growth. If indeed the Fed is close to ending its tightening campaign, P/Es may expand a bit, helping to make up for slower earnings growth. Many investors, pointing to the strong market rally in 1995 after the final Fed rate hike, are anticipating a repeat performance.

We see their logic, but have some reservations. First, for the Fed to stop might require signs of significant economic weakness and resultant earnings difficulty. Second, a large drop in long-term rates fueled the 1995 rally as inflation fears receded. This appears less likely today. Next, some of the upside will likely be reflected before the fact as investors begin to discount hints of Fed monetary actions. Finally, uncertainty about Ben Bernanke, Greenspan's replacement as Fed Chairman, could limit the expected positive response.

Other factors could impact the stock market in 2006. Hedge funds continue to attract large sums of money and now dominate short-term trading patterns. Some hedge funds have become more proactive, fueling corporate takeover activity. Some good news in the form of an extension of the low tax rates for capital gains and dividends or more progress in Iraq could positively benefit equities. Lastly, strong corporate cash flows should allow investor friendly actions such as share buybacks, dividend increases and mergers to continue.

Changes may be in store for investors in 2006 after record low levels of volatility. The uncertainties created by Fed tightening, a possible inverted yield curve and decelerating profit growth may snap the market out of the recent doldrums. After six years of underperformance, large-cap stocks could resume a leadership role, especially if investors become concerned about the economy. Prospects are less clear regarding the growth/value debate. Growth stocks began to outperform in 2005 for the first time since 1999. It remains to be seen whether this leadership shift marks the beginning of a multiyear trend.

Bond Market

In the fourth quarter of 2005, the bond market, as represented by the Lehman Aggregate Index, returned 0.59%, bringing the year-to-date return to 2.43%. Short-term interest rates continued to rise during the quarter to the highest levels of the year as the Federal Reserve raised the Fed Funds rate an additional 0.50% to 4.25%. Long-term interest rates were slightly more volatile during the quarter, also hitting the highest levels of the year. Over the entire period, however, long-term interest rates were essentially unchanged. A string of benign inflation reports and pessimism as to the strength of the economy as we enter 2006 contributed to the decline in long-term rates relative to short-term rates. This flattening of the yield curve has narrowed the spread of the 2-year and 10-year Treasuries to slightly negative territory (see table below for changes in the yield curve). Portfolio positioning was slightly defensive in terms of interest rates (positioned for higher rates), which was a modest boost to performance relative to the market.

U.S. Treasury Yield Curve (%)

	9/30/05	12/31/05	Change
2-year	4.17	4.40	+0.23
3-year	4.17	4.36	+0.19
5-year	4.19	4.35	+0.16
10-year	4.32	4.39	+0.07
30-year	4.57	4.54	-0.03

Source: Bloomberg

Corporate bonds narrowly underperformed Treasuries in the fourth quarter. Portfolios were neutral to this sector for much of the quarter. Higher quality credits performed the best, as the lower quality segment of the market felt repercussions of continued difficulties in the U.S. automotive industry, as well as a trend of shareholder-friendly activities by many companies (share repurchase programs, LBO speculation, merger activity). Corporate bond risk premiums remain near historically narrow levels. Due to this and our expectation of more shareholder-

focused activities, we are positioning corporate bonds in the portfolios with a neutral weighting and an overall higher quality bias.

10-Year U.S. Treasury Yield



Source: Bloomberg

Mortgage-backed securities (MBS) also underperformed Treasuries during the quarter. Portfolios were overweight this sector, which was a slight negative for performance relative to the market. With interest rates rising to the highest levels for the year, fears of slowing prepayments and increasing interest rate risk of the sector contributed to MBS risk premiums widening relative to Treasuries. As long-term rates settled in December, MBS risk premiums narrowed. We remain positive on the MBS sector going into 2006 and are targeting an overweight in our portfolios relative to the benchmark.

Long-term interest rates are trading near the middle of the range that has existed for much of the past three years. The portfolio is positioned with a modestly defensive stance and will be revisited if interest rates move to higher levels. The position of the portfolio relative to the yield curve remains neutral, although as it becomes clear that the Fed is finished tightening monetary policy, we will look to reposition for a steepening of the yield curve.

ECONOMY & EARNINGS

- ◆ The consensus calls for the economy to slow somewhat as the housing sector cools; nonetheless, real GDP is expected to exceed 3%.
- ◆ Core inflation, which excludes food and energy, should rise only slightly from the 2% level despite the surge in oil prices.
- ◆ Corporate profits are projected to rise about 7% in 2006, but the pace of earnings growth will continue to decelerate.

STOCK MARKET

- ◆ Stock market valuation readings remain neutral with many valuation measures near long run norms.
- ◆ If the Fed is close to ending its tightening campaign, P/E ratios may expand a bit, helping to offset slower earnings growth.
- ◆ Strong corporate cash flows should allow stock friendly actions such as share buybacks, dividend increases and mergers to continue.

BOND MARKET

- ◆ A string of benign inflation reports and pessimism about the economy contributed to a flattening of the yield curve.
- ◆ Corporate bonds narrowly underperformed Treasuries in the fourth quarter and corporate spreads remain narrow.
- ◆ As it becomes clear that the Fed is finished tightening monetary policy, we will look to reposition for a steepening of the yield curve.

Small Cap Growth's First Year!

One year ago, in this very publication, we proudly introduced our new Small Cap Growth strategy, an actively managed product from our team of senior portfolio managers in Columbus, Ohio. The strategy was launched in January 2005 with \$50 million in assets under management. As of 12/31/05, we had grown to \$65.7 million in AUM. Returns for the one-year period ending 12/31/05, indicate that we are on track with our objective of 400-500 bps outperformance to the benchmark. The FWIA Small Cap Growth composite returned 8.63% versus 4.17% for the Russell 2000 Growth Index.*

At Fort Washington, we continue to believe that the small-cap sector can provide excellent return opportunities over the long term. But did you know that small-cap is an arena where returns have historically

been significant in the first three years of a strategy's existence and small-cap strategies in general have outperformed their benchmarks over the last 20 years.** Our small-cap growth equity strategy invests in small-cap growth companies with an emphasis on high quality and improving fundamentals, which we believe will provide the best opportunity to generate attractive risk-adjusted returns. In the end, our team of experienced professionals seeks to provide a high quality, small-cap growth product that is positioned to deliver top quartile performance over the long term.

*Returns presented are gross of fees. Past performance is not indicative of future results. **Gregory C. Allen, "The Active Management Premium in Small-Cap U.S. Equities," *The Journal of Portfolio Management*; Volume 31, Number 3, Spring 2005.

Welcome to Fort Washington Investment Advisors!

Fort Washington Investment Advisors, Inc. is pleased to welcome two new clients.

In November, Fort Washington's high yield team was hired by Fifth Third to sub-advise a new high yield mutual fund. The Fifth Third High Yield Bond Fund was launched on November 29th, 2005.

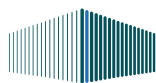
Fort Washington Capital Partners has been hired by Utah Capital Investment Corporation to advise and manage a regional private equity fund.

Fort Washington Investment Advisors, Inc. is also excited to announce two new members to its team.

Carlos Escobar, LDP Associate, joined FWIA in December. Carlos will be working in our marketing area while he is with us.

Julie Kist, Account Administrator, joined FWIA on January 3rd in our Operations area.

Market Thoughts is prepared from sources we believe to be reliable but is not guaranteed and may not be a complete discussion of all material facts. Because each circumstance is unique, we recommend that you contact your financial advisor regarding your individual situation before making investment decisions.



FORT WASHINGTON
INVESTMENT-ADVISORS-INC.
THE POWER OF SPECIALIZED KNOWLEDGE

420 EAST FOURTH STREET
CINCINNATI, OH 45202-3302

TEL
1-888-244-8167

FAX
(513) 361-7605

WEB
www.fortwashington.com

In the News

Fort Washington Investment Advisors' professionals have been featured in a number of publications throughout the quarter. Here is a sampling:

CNBC's Street Signs, December 20, 2005, Nick Sargen, CIO of Fort Washington Investment Advisors, appeared on the program.

iMoneyNet Money Fund Report™, December 16, 2005, Touchstone Institutional Money Market Fund was one of three funds to receive the top ranking among 229 First & Second Tier Institutional Funds in the "Top Performing Money Funds for December 2005". Fort Washington Investment Advisors is the sub-advisor for the fund. iMoneyNet has been collecting money fund statistics and publishing its flagship *Money Fund Report™* since 1975.

*Past performance is not indicative of future results.

PBS' Consuelo Mack WealthTrack, November 11, 2005, Nick Sargen, CIO of Fort Washington Investment Advisors, was a guest panelist on the national program.

Women's Business Cincinnati, November 1, 2005, "Top businesswomen pool their influence" — Maribeth Rahe, President & CEO of Fort Washington Investment Advisors, featured as one of six local members of the Committee of 200, a national networking organization for women.

October 21, 2005, William Bunn, Senior Credit Analyst for Fort Washington Investment Advisors, was a featured speaker at the AMP-Ohio Conference in Ohio. Bill spoke on current trends and in the global energy and power markets.

October 11, 2005, Nick Sargen, CIO for Fort Washington Investment Advisors, was a featured speaker at the Crestone Capital Advisors, LLC Annual Investors Conference in Boulder, Colorado. Nick spoke on "What Will End the Market Stalemate", his economic views for the coming months.

Cincinnati Business Courier, October 7, 2005, "Outstanding Business Women" — Margaret C. Bell, Managing Director of Business Development, Marketing and Client Service for Fort Washington Investment Advisors, was featured in the article.

Hedge Fund & Investment Technology, October 1, 2005, "A Measured Approach" — Quotes by Mark Frietch, Vice President of Operations, and Tim Policinski, Managing Director for Fort Washington Investment Advisors, on the performance measurement and attribution capabilities for the fixed income market.