



MinsterBank

Private Wealth Management



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Private Wealth Management

Learn how to grow and protect your wealth through effective planning and smart investing. Whether it's retirement plan solutions, wealth planning, investment management or trusts, the professionals at Minster Bank will help you reach your financial goals.

Experienced Professionals

Our investment team features experienced professionals holding the Certified Public Accountant (CPA), Certified Financial Planner (CFP), and Master of Business Administration (MBA) designations. Each of our team members has at least twenty years of experience in the financial services industry.

Access to the World's Best Money Managers

Our clients enjoy an investment platform that is open architecture, meaning we seek only the best opportunities in each of the asset classes that we invest in. Minster Bank does not have or sell its own mutual funds.

Local Advice & Service

Your investments and trusts are managed locally by our portfolio managers and trust administrators, giving you advice and service that is both personalized and customized.



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Economic Outlook & Investment Strategy

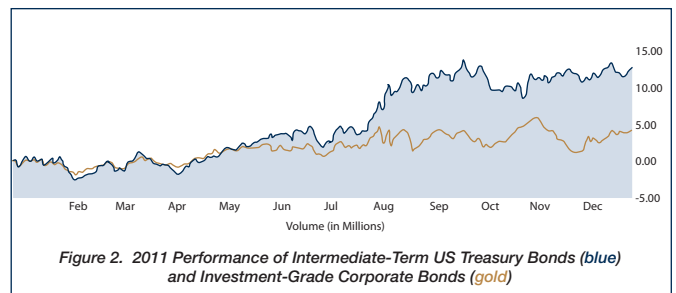
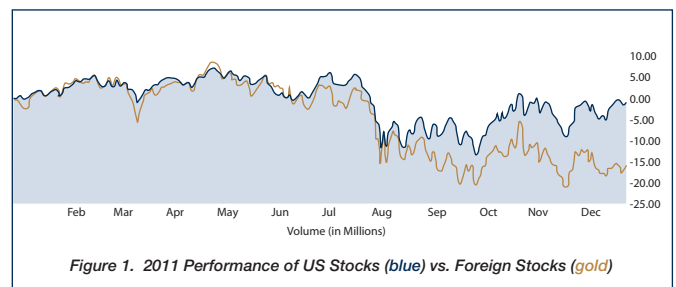
2011: A Challenging Year for Riskier Assets

One year ago, we anticipated that the stock market would experience a decent first half but a challenging second half of the year in 2011. In fact, S&P 500 did just that, posting respectable gains into the summer, then riding a turbulent second half that saw the market claw its way back to the breakeven point by year end. As volatility picked up, it took less than three months for the US market indices to drop 20% from their summer highs to their fall lows.

Despite that volatility, US stocks fared relatively well against foreign stock markets over the course of the year. Due to a stronger dollar and struggling economies overseas, foreign stocks (Figure 1, gold line) widely underperformed their US counterparts (blue line) in the second half. The second half of 2011 was typified by higher volatility, as the markets reacted with mixed emotions to each round of political solutions proposed as a fix for the European debt crisis.

Meanwhile, high quality bonds, like US Treasuries

(Figure 2, blue line) and investment grade corporate bonds (gold line), enjoyed a better year overall when compared to stocks and to lower quality bonds. Our emphasis on those safer investment classes was rewarded in our client portfolios. In the coming year, we will be looking for the right opportunities to once again increase our risk profile by adding foreign bonds and other higher yielding fixed income investments to our portfolios. ■



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2012 Economic Themes

Rising Risks Will Present Opportunities

While we have all become accustomed to a rapidly changing investment landscape in recent years, events in 2012 may place a premium on being able to manage volatility. We anticipate that our roles as portfolio managers may be about to become even more active and more hands-on. Tactical changes to asset allocations in our client accounts may need to become more frequent in order to keep ahead of perceived changes in risks and potential rewards.

The coming year will likely see rising risks, as various situations around the world reach some level of finality. The resulting tumult will present excellent opportunities for investors, and the rewards are likely to go to those who are the most nimble.

Heavy-Handed Central Banks

As you read our investment outlook for the coming year, one peculiar feature stands out. Almost no serious attention is currently being paid to formerly crucial attributes like valuation or other fundamental investment criteria. Rather, the investment landscape is expected to continue to be dominated by macroeconomic and geopolitical trends. Only passing thought is given in the current environment to absolute value of investment assets. As long as the world's central banks maintain their aggressive interventions and continue to flood the markets with cheap money in order to prolong the deficit spending by their governments, markets will continue to respond more forcefully to those stimuli than to traditional valuation measures. Money flows in the immediate future are more likely to be influenced by the race to devalue currencies, and money will find a home where the currency climate is most accommodative, if only temporarily. The acceleration of these currency wars and central bank interventions is what is likely to prompt an increase in volatility in the coming months.

Strengthening dollar

The immediate beneficiary of these interventions will likely be the US dollar, which could

enjoy continued strength into the first half of 2012. The Federal Reserve has already embarked on multiple rounds of quantitative easing and so might be seen as less likely (or less able) to embark on the type of grandiose monetary manipulations of foreign central banks. Consequently (and perversely), US dollar-denominated investments may continue to enjoy relative outperformance in the first half of this year. There is, after all, still something to be said for having the nicest house in an otherwise bad neighborhood, and investments in US stocks and bonds may continue to reflect that notion.

Eurozone

Elsewhere in the new year, the European debt crisis should continue to rule the headlines. The crisis is deepening as European leaders look toward a summit meeting on January 30th. Defaults are perhaps inevitable, and more ratings downgrades may lie ahead for relatively stable countries such as France. Greece, Italy and possibly Spain will try to roll maturing bonds and ward off crippling defaults on their sovereign debts, even as their interest rates rocket higher.

European leaders and central bankers are likely to unleash new bailout mechanisms that paper over rather than solve the debt crisis. It would not be surprising to see markets attempt to rally again on renewed hopes with every new bailout scenario. Eventually, the reality will set in that there is no more money left to leverage, and market volatility will ramp up again soon thereafter.

Deflation vs. Inflation

With world economic growth stagnating, expect inflation fears to temporarily calm as talk of its polar opposite – deflation – takes center stage. A recent survey of economists by the AP shows consensus forecasts calling for the European economy to have shrunk by 0.5 percent in 2011 and to lapse into recession this year. Meanwhile, current forecasts for US GDP growth have been lowered to 2-2.5% for the U.S. in 2012, after limping to the finish in 2011 at around 1.75%.

Under this low-growth scenario, one might ask what would prompt a swing back to inflation. That would be debt monetizing, or as some prefer, “turning on the printing presses,” as central banks flood the markets with even more newly printed money.

As the Eurozone crisis deepens, look for tremendous pressure on Germany to allow the printing presses to roll as a way of inflating Europe's way out of its current dilemma. Reluctant Germans remember well the hyper-inflation of the Weimar days but may see monetization as the least painful way of saving the Euro. The result would be a temporary stabilization and even a bounce in stock prices, with the price to be paid sometime later in the form of higher inflation and much higher interest rates when the bill comes due. Of course, the solution wouldn't be advertised as the printing of more Euros, but investors would be well advised to pay attention to the details, rather than to the headlines.

European money printing would be seen as a green light for the Federal Reserve to print more US dollars as a way of temporarily easing our own mountain of debt. So, 2012 has the potential for seeing ever more imaginative means of fiscal stimulus or quantitative easing around the world, starting first in Europe and spreading outward from there. The short-term effect will be warmly welcomed by investors in riskier assets. The longer-term effects might not be so agreeable.

China

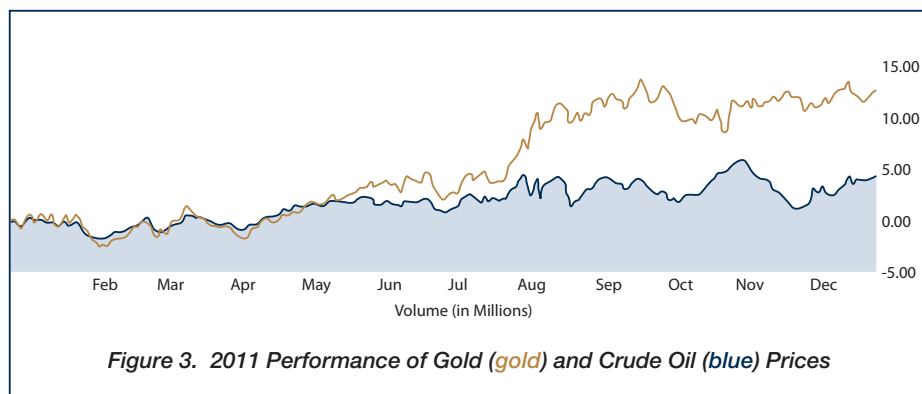
Here is a notion that should cause investors to sit up and take notice: China is also experiencing a slowdown in growth, and its central bankers are looking at ways to ease monetary policy to promote growth. This occurs just as concerns about a housing bubble in China are becoming louder by the day. How well China manages its slowdown, resulting in either a soft or hard landing, will have major ramifications for a world economy that is fragile even without a slower China.

Energy

Oil prices may stand apart from those of other commodities – in spite of a stronger dollar – as geopolitical tensions ramp up with Iran. While these conditions normally warrant a flight to safety, oil (Figure 3, blue line) and gold (gold line) may both enjoy a period of outperformance relative commodities and to other risk assets. You may recall that gold prices decoupled from those of oil in the second half of 2011. If conflict breaks out as a result of current tensions, gold and oil both become more attractive. Gold would respond due to its safe haven status, while oil prices would rise due to supply concerns.

U.S. Elections

As we head into the latter half of 2012, the wildcard in the US is likely to be the Presidential election in November. With 2012 being a year of campaigning, look for a possible change in



sentiment from Washington, as politicians positioning themselves for re-election suddenly rediscover a fondness for American businesses and investors. Anything short of the anti-business/anti-wealth animosity that we have been enduring could produce a positive shift in investor sentiment.

None of that may help the incumbents, however, if economists are correct in predicting an unemployment rate of close to 8.5% around election time. We expect the markets – which look ahead several months – to begin pricing in likely outcomes of the elections by as early as this summer. ■

Investment Themes

While maintaining adherence to customer goals and to the investment policies governing each of their accounts, we are periodically rebalancing and repositioning client accounts for the financial and economic landscape that is ahead of us. That forecast begins with an economic outlook both here and abroad and extends into an analysis of the likely interest rate environment that our bond portfolios will be facing. These themes are instrumental in formulating our investment recommendations in response to those challenges.

1. Low-Beta Dividend Stocks

With slow economic growth and geopolitical turmoil potentially ahead of us, our preference for stocks will be more defensive in nature. With low bond yields expected to remain with us over the near term, dividends will remain an attractive and important component of total return for investors.

There will probably be a time this year when stock prices are temporarily depressed and

when we will seek to be more aggressive with our allocation toward them. In the meantime, the desire for lower volatility and higher dividends leads us toward utility stocks and preferred stocks. These types of funds are likely to make up a larger percentage of our stock allocations until we see an opportunity to become more aggressive with our stock weightings.

With a stronger US dollar expected in the first half, US stocks will also be favored over their foreign counterparts until circumstances favor a more aggressive stance.

2. Tax-Free Municipal bonds

In 2011 there were widely publicized concerns over a wave of municipal defaults in the U.S. While there were a few bankruptcies and downgrades outside of Ohio, our focus will continue to be on investment-grade bonds of Ohio issuers. While we are aware of the budgetary pressures on state and local governments, municipalities are seen as likely to

combine budget cuts with selected tax hikes in order to maintain their credit ratings and to preserve their access to the capital markets. We see little reason to be concerned about widespread defaults in Ohio at this time.

As an asset class, investment grade Ohio municipal bonds performed very well in 2011, and we will continue to make them a core holding in the taxable portfolios of our high income clients.

3. Treasury Bonds

US Treasury bonds performed very well for our clients in 2011. With interest rates near historic lows now, there is a concern about whether Treasury bonds are still attractive. Longer term, it is difficult to make a case for Treasury bonds at current yields. In the short term, however, Treasuries maintain a unique quality, and that is their safe haven status. If our forecasts of higher volatility in the first half are accurate, Treasuries are likely to enjoy at least one more cycle of outperformance as

a safe haven asset. (Recall that T-bill yields actually went negative for a short period during the credit crisis in 2009 before order was restored to the credit markets). A sovereign default, Eurozone breakup, military conflict in the Middle East, or all of the above, would be the recipe for one last romp for Treasuries.

While fixed-rate Treasuries would perform well under those conditions, the same will not necessarily hold for inflation-protected Treasuries (TIPS). Going back to the forecasts for slower economic growth and subdued inflation expectations, we can build a case for TIPS to begin to underperform fixed-rate bonds over the near term. This is causing us to currently re-evaluate our holdings of allocations toward TIPS. If deflation in response to a global slowdown is in our immediate future (even if only for a short period), then a temporary underweighting of TIPS is in order. Once the inflationary effects of debt monetization become a greater concern, we will then rebalance our portfolios toward TIPS and away from fixed-rate bonds.

If at some point market conditions cause credit spreads to widen to levels that make riskier bonds more attractive, we fully intend to reallocate assets toward higher yielding and global bond funds at that time.

4. Alternative investments: Gold & Energy

Gold added to the equity returns in our portfolios throughout most of 2011. During rebalancing in the summer, we managed to trim back our gold percentages near the all-time high prices.

After pulling back to present levels around \$1,600/oz, gold prices could be at a major support level. A handful of Wall Street analysts expect gold prices to reach \$2,000-2,400/oz in 2012. A deflationary wave and/or dollar strength could see gold falter temporarily (further support is suggested around \$1,300), but the long term prospects for inflation and for currency devaluation are just too compelling for gold not to be an integral part of our equity portfolios. It retains unparalleled significance as both a safe haven and also an inflation hedge.

Energy, on the other hand, is attractive mostly as a hedge against inflation and a weaker dollar. Its allure as a potential safe haven is restricted to the one scenario that has been outlined: Conflict in the Middle East that disrupts worldwide supply. In the absence of geopolitical tensions, oil is mostly a hedge against dollar weakness.

Oil prices started and ended 2011 around \$100/barrel. Many analysts expect prices to stay around this range or to drift slightly lower. Unless there is a conflict-related spike to \$140-150, oil should not pose a significant risk to the economy or to other asset classes in 2012. Energy remains attractive mostly as a source of diversification within our equity allocations but is not expected to be overweighted in the near term.

Inflation expectations will eventually move higher, perhaps as soon as the end of this year. In future updates to our investment strategy, we will explore other inflation hedges and alternative investments that we feel are attractive for adding to our client portfolios. ■

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A Locally Owned Community Bank

Minster Bank has been locally owned since 1914. We strive to provide excellent service, with integrity in the way we do business with the goal of establishing trust and long term relationships. We know that you will benefit from the stability, advice, service and flexibility of a progressive community bank.

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