Dear Fellow Members:

Here’s hoping we all have a happy and prosperous new year in 2012. Every year brings challenges, and the happy years are those when we face our challenges and find ways to overcome them.

I’m sure many of you are thinking about making and keeping New Year’s resolutions. At a personal level, prominent among the list of resolutions for 2012 from my web surfing relate to health (losing weight, exercising, quitting smoking, eating healthy), family and leisure (more time with family, more relaxing time, stress management), and finances (save more, reduce debt, spend wisely). Making resolutions is a step in the right direction, but what is important is to follow through with the resolutions made!

Adding value and enhancing clients’ trust should be at the top of resolutions for the finance and investment professionals. In response to the eroding investor confidence as a result of scandals involving Ponzi schemes, insider trading and other fraudulent activities, the CFA Institute has initiated “Challenging Industry Norms” series examining long-held notions about issues facing the investment industry. As an example, I refer you to an interesting article titled “Investment Professionals: Are You Earning Your Keep?” by Kurt Schacht, JD, CFA, Managing Director of the Standards and Financial Market Integrity division of CFA Institute, for a brief summary of a panel discussion on issues surrounding compensation and performance measurement in the investment management business.

At the society level, I propose one resolution for all of us to keep: How to further improve the CFA Society of Cleveland; for example, a new activity or commitment that will accomplish something of lasting value for our members or a new outreach activity promoting goodwill in the community. To communicate your suggestion, email it to CFA@cleveland.cfasociety.org.

The CFA Institute is taking an increasing role in advocacy matters and issues concerning market integrity, corporate governance, asset manager ethics, regulatory reforms and accounting standards. Activities include research projects; advocating before policymakers, regulators, and standard-setting bodies; media outreach; and promoting codes of professional conduct. Currently, CFAI is seeking new global advocacy volunteers. Please visit the “Collaborate & Network” section of MyCFA to learn how you can register as a CFA Institute volunteer.

Our Society relies heavily on volunteers for planning and executing activities and events. We will soon start identifying officers and committee members for the 12 months starting July 1, 2012. In order to volunteer, please email CFA@cleveland.cfasociety.org with a brief description of yourself and your availability.

Best regards,

Chenchu Bathala, Ph.D., CFA
President, CFA Society of Cleveland
At Key Private Bank, we understand that your financial life is complex, and we take a holistic approach to your planning needs. We listen to your story, get to know your history, identify your unique financial needs, and create an actionable plan designed to help you grow, preserve, and protect your wealth.

You work with a Relationship Manager, who coordinates the different components of your plan to ensure that they work together. A team of financial professionals develops innovative, customized plans to help you achieve both your short- and long-term goals.

Key Private Bank is people, ideas, and financial instruments, working in concert to provide solutions for your financial well-being.

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at 216-828-7877
Ethan M. Heisler, CFA, will likely address a number of topics when he presents to the CFA Society of Cleveland on Jan. 11, including Basel 3, Dodd-Frank, loan origination, liquidity, bank investment portfolios and ZIRP.

Mr. Heisler is a managing director in Fixed Income sales and heads up Citi’s Bank Treasury Resource Group. He has a regular dialogue in the treasury groups of U.S. regional banks, Federal Home Loans, and other financial institutions focused on asset and liability strategies, accounting and bank regulation. He is the editor of the Bank Treasury Newsletter, a monthly publication directed to financial institutions at the treasury level.

Before joining Fixed Income sales in 2003, Mr. Heisler was the senior bank analyst in Corporate Bond Research at Citi, where he was a member of Institutional Investor’s All-American Team for U.S. and Yankee banks. In addition to covering U.S. and European Yankee banks, he also covered banks in emerging markets, including Latin America and Asia.

Previously, Mr. Heisler was the staff director of Bank Analysis at the Federal Reserve Bank of New York, where he covered the large multinational and regional banks, as well as foreign bank branches and agencies. He began his career on Wall Street at Dillon Read and Co. in 1981, on the government desk covering regional banks for repo. He earned an MBA in Finance from New York University in 1988 and a B.A. in Philosophy from Columbia University in 1979. He was awarded the Chartered Financial Analyst designation in 1991.

On Jan. 18, Anthony Rospert, a partner in Thompson Hine’s Business Litigation group, will present: “Dodd Frank and the New Standard of Care: As an Investment Professional, Are You Prepared for Its Impact?” Rospert helps clients overcome legal obstacles in order to protect their assets and manage litigation risk in pursuit of their strategic goals. He focuses his practice on complex business and corporate litigation involving financial service institutions, commercial and contract disputes, indemnification claims, shareholder actions, business transactions, class actions, regulatory enforcement and tax controversies. He received his J.D., magna cum laude, from Vermont Law School in 2003 and his B.A., magna cum laude, from John Carroll University in 2000.

The Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law in July 2010. The new law required the SEC to conduct a study on fiduciary duties of investment advisors and provided the SEC the authority to impose a uniform fiduciary standard of care. The promulgation of any rule by the SEC that imposes a new definition of the standard of care is likely to impact financial service industry participants who provide personalized investment advice and may also have implications in litigation alleging a breach of the standard of care. Understanding the new regulatory environment and being prepared for the new proposed fiduciary standards will be important from both a practical and legal standpoint. The presentation on Jan. 18 will provide an overview of the existing standard of care governing investment professionals, results of the SEC report on the standards of care, and then address potential changes to the standard of care in light of Dodd-Frank.
Key Private Bank

Calendar of Events & Luncheon Meetings
Winter/Spring 2012

February 15
DEFENSE PANEL
Moderated by: Michael F. Ciarmoli, Senior Aerospace and Defense Analyst at KBCM.
Panelists include: Jeff Rolf, VP Commercial Airframe Programs – Parker Hannifin Corporation and Ray Lugo, Executive Director – NASA Glenn.

February 22
Gas Natural General Company Update
BMAD: GAS

March 7
Chris Connor CEO, Sherwin Williams Co.
NYSE: SHW
PLEASE NOTE: This lunch is being held at City Club.

March 14
Jim Boldt, CEO, and Brendan Harrington, CFO, CTG
NASDAQ: CTGX

To register for events, visit http://cfacleveland.eventbrite.com

Progress Through an Anemic Growth Cycle

The annual Forecast Luncheon will take place on Jan. 25 and will feature CFA Society of Cleveland member Bruce McCain, Ph.D., CFA. McCain is Senior Vice President and Chief Investment Strategist for Key Private Bank and directs the research efforts that support that team’s work. He is the past Director of Investment Research for (a predecessor of) KeyBank and also serves as the investment manager on portfolios for both individuals and charitable endowments.

Prior to working at Key, McCain taught courses and conducted research in Organizational Behavior at the Henry B. Tippie College of Business at the University of Iowa.

McCain received a B.A. in Accounting and a B.S. in Psychology from Boise State University and received his Ph.D. in Business Administration from the University of California, Berkeley.

CFASC Happy Hour - Market Garden

Enjoy a Boss Lager Amber, Pearl Street Wheat, Forest City Brown Ale or another of the Market Garden’s exceptional beers with fellow CFASC members after work on Feb. 1. Space is limited, so register early.

On Feb. 8, the CFA Society of Cleveland will welcome Joseph S. Tanious, Vice President and Market Strategist on the J.P. Morgan Funds U.S. Market Strategy Team, for his presentation: “Guide to the Markets.”

In his role, Tanious is responsible for delivering timely market and economic insight to both institutional and retail clients across the country. Since joining the team, he has been instrumental in developing and leading the group’s equity research efforts. Tanious is consistently ranked as a top speaker at major industry conferences and events. He is a frequent guest on Bloomberg TV, has appeared on CNBC and PBS’ Nightly Business Report, and is often quoted in the financial press.

Tanious first joined J.P. Morgan in 2009, where he worked in the Investment Bank on mergers and acquisitions, as well as capital-raising solutions. Prior to joining the firm, he held various positions in both Asset Management and Private Wealth Management at Wells Fargo for nine years. Most recently, he was a Regional Director of Institutional Sales at Wells Fargo Asset Management, where he was responsible for managing key institutional relationships.

Tanious is a CFA Charterholder. He also obtained an M.B.A. in Finance and Economics from Columbia Business School, and a B.A. in Economics from the University of California, Irvine. In addition, he holds series 7, 63 and 65 licenses.
Reflections on China

By Arthur Stupay

I attend an annual board meeting of a China company that makes metal packaging for the China market; it does not export product. It has five plants and serves the main beer and beverage producers. My trip in November gave me further insight into the economy and society that has become our foremost business challenge and opportunity. I will also highlight China’s concerns about the United States regarding the economic outlook, defense policy and currency manipulation.

On arrival in Wuhan, an historic city, about 500 miles east of Shanghai, we encountered sleet and rain. It was a thoroughly gray day we often experience in Cleveland in mid-December. We were met by a minibus to take us from the hotel to corporate headquarters. Of course, we immediately asked the driver to put on the heat. Through an interpreter, we were told that the vehicle was a knockoff of a Toyota vehicle and did not have heat. I thought that this was a metaphor for China’s current state of development. The mini-bus was adequate and operational on the outside, but low quality on the inside. Indeed, many aspects of living conditions there remain inadequate, such as air quality, food and drug inspections, and safety of rails and roads. Yet, the country has made great progress in less than a decade. The Chinese have built impressive airports in many of the main cities; highly ranked hotels are on par with ours. Chinese cuisine is outstanding, with local fresh fruit and vegetables, and abundant meat and fish. The Chinese are also adopting wine culture, with at least one ubiquitous label, Great Wall, available in most restaurants and hotels. Beer is widely consumed, with a per capita that is rising sharply.

A big question is whether China’s 8-10 percent GDP growth rate is dependent on exports to us and also on the recent boom in real estate construction, as Paul Krugman has recently written (New York Times column, December 2011). Since China’s consumption as a share of GDP at 35 percent is one-half of ours, it is obvious that the bulk of its output is exported, with the U.S. a major customer. It is also apparent that the Chinese domestic market is developing rapidly, with shopping centers and giant supermarkets being built in every sizeable city. As a result, Chinese producers are building massive new plants to supply the emerging local market for consumer goods.

In Wuhan, I witnessed the development of a new industrial development zone, formerly farmland and the size of a small city, with several dozen food processing, beverage and packaging plants. But it will take time for this impressive increase in processing capacity to be absorbed by consumers with cash to spend. In a three story Wal-Mart store I visited, I could envision how domestic economic growth is generated. As more shelves are stocked with consumer goods, including appliances and packaged foods, available in an increasing number of super stores, in 50 major markets throughout the country, spending and output will grow steadily. Supermarkets presuppose adequate housing, cars and buses to transport consumers, decent roads, gasoline stations, and parking. In fact, this infrastructure is now being constructed to support consumer spending patterns. But, yes, if the American economy coughs, there will be a chill in China and employment growth will be imperiled. It is already happening in some areas in the south.

On housing, the Chinese have not been immune to the lure of housing speculation and to the pleasures of a nice new apartment. According to Krugman, fully one-half of the GDP represents investment spending—for plant and equipment, infrastructure and housing. About one-half the rise in investment spending is due to housing construction. Chinese authorities have also been late to the game of trying to dampen speculation. As a result of its actions to restrict credit to housing, prices have fallen sharply in many markets and there are growing vacancies. The fall in housing prices will not have the same impact as in the U.S., since Chinese buyers have a greater equity stake than many Americans had at the height of our housing madness in 2008.

Chinese executives and financial people are critical of the United States for our political gridlock and power struggles fought in the open. They think it is unseemly and will relegate us to a second rate power. They do not have confidence that these battles usually lead to compromise and unity. The Chinese leaders fight their battles behind closed doors and conflicts are rarely made public. Of course, they have them and they are as bitter as they are here; they have no experience with the average person participating in the decisions, through periodic elections, which may result in a complete change of direction.

Some Chinese business leaders reflect their government’s paranoia about our defense policy and our maneuvers off the coast of China. They remain annoyed by our selling advanced fighter jets to Taiwan. They remain surprised by our concern about the size of their defense spending, at 15 percent of ours, or the doubling of their aircraft carrier fleet from one to two carriers. At the business level, some seem to have no idea of our defense support of Japan and South Korea and our commitment to support democratic institutions in Taiwan. As Paul Cheng wrote (On Equal Terms), “The Chinese see such moves as part of a containment strategy.” Also, the run-in between China fishing boats and a U.S. Navy Oceanographic Survey ship in 2009 still rankles as they regard U.S. action as violations of the UN Convention of the Law of the Sea.

On the issue of currency manipulation, there is little question that the Chinese central bank controls the exchange rate within rigid bounds. This is a violation of trade agreements, but it has been going for a decade or more. The underpriced RMB has encouraged many American manufacturers to relocate plants to China. We have also benefited from the continuing low prices for clothing and consumer goods. If we take precipitous action, we will in Jon Huntsman’s (former ambassador to China) view generate a trade war. Our alternatives at this stage are to negotiate and to use tax policy creatively to reduce incentives to relocate.

Arthur Stupay is an analyst at Tower Research. He can be reached at 216-241-3078 or astupay@dix-eaton.com.
Member Spotlight: Fifth Third’s Micro Cap Value Team

Although Fifth Third Bank is headquartered in Cincinnati, a major part of its asset management business resides here in Cleveland, including **Eric Holmes, CFA, Craig Nedbalski, CFA, and Mike Barr, CFA** -- the team in charge of a very successful Micro Cap Value product.

With Holmes as lead manager, Fifth Third’s MCV composite portfolio beat the Russell micro-cap value benchmark by at least 400 basis points in each of the past five years. During the five-year period, the composite (before fees) has increased at a compounded rate of 2.63% per year, versus an annualized decline of 5.18% for the benchmark. The Fifth Third MCV product tends to outperform bear markets. Its 100-or-so stocks represent all industry sectors, and are selected for strong balance sheets and cash flow, as well as an identified revaluation catalyst. When added to the portfolio, a stock’s market cap must be less than $500 million, and it can continue to be held until market cap reaches $1 billion.

In a typical year, some 5-10% of the stocks in the portfolio are bought out by private equity firms or competitors, who are attracted to the same value characteristics that Holmes, Nedbalski and Barr are looking for. Roughly one-third of the stocks in the portfolio have no sell-side coverage, so Holmes and the team do a tremendous amount of primary research. Currently, the fund is overweight in defensive areas such as healthcare and staples. There is cyclical exposure in industries with strong backlogs, such as aerospace and rail cars.

Holmes joined Fifth Third Asset Management in 2003 and has 17 years of investment experience. He has degrees from SUNY Geneseo and Rochester Institute of Technology. Nedbalski joined FTAM in 2005 after 24 years with various divisions of what is now KeyBank. He has degrees from Cleveland State and Baldwin-Wallace. Barr joined FTAM in 2011 and has 24 years of investment experience. He graduated from the University of Missouri.

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Career Corner: Members on the Move

**Warren Coleman, CFA,** is now a Wealth Management Advisor at Fifth Third Bank. Previously, Coleman was VP and Director of Business Development at Lakefront Partners, LP.

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CAREER CORNER & MEMBER SPOTLIGHT

Have you recently switched jobs or know someone else who has?

Would you like to suggest someone for the Member Spotlight (i.e. a person who’s reached a particular milestone, such as 20 years as a member of the CFA Society of Cleveland; who’s received an award, either professionally or personally; or other noteworthy accomplishments, etc.)?

Let us know!

Contact: Katie Khoury at 216-696-8066 or cfa@cleveland.cfasociety.org
Remembering Edith West, CFA

Edith West, CFA, one our earliest members, passed away on Nov. 26, 2011, at age 97. In 1967, she was awarded a Chartered Financial Analyst designation and became one of 37 members of the Cleveland CFA Society. She was also one of the pioneer female financial analysts nationally. Her specialty was utilities and drug companies, including regional drug and food stores. She was a valued member of research department of National City Bank and Institutional Sales at Prescott Ball & Turben (PBT), the major regional brokerage firm (now part of Wells Fargo). At PBT, she was a prominent analyst, meeting regularly with money managers and institutional investors. At the time, Cleveland was an important headquarters for a number of drug store chains, such as Gray Drug and supermarkets, here and in Chicago. With her academic training, including a master’s degree in finance from Western Reserve University and her activities with Council on World Affairs, regularly participating in meetings and trips, she brought a sophisticated insight to her analysis of the industry and the economy.

- Submitted by Arthur Stupay

Research Challenge: Graders & Judges Needed

The seven Northeast Ohio university teams participating in this year’s CFA Research Challenge are rapidly advancing toward their goal of completing both a written report and an oral presentation in early 2012. At that time, the CFA Society of Cleveland will need four additional graders or judges for written reports and/or oral presentations. The written reports are slated to be completed in early February, with the oral presentations to be held on Saturday, March 3. Please contact Greg Halter at 216-767-1340 to volunteer.

This year’s participating universities are: Ashland University, Case Western Reserve University, Cleveland State University, University of Findlay, Hiram College, John Carroll University and Walsh University.

ABOUT THE RESEARCH CHALLENGE:
The CFA Institute Research Challenge is a global competition which tests the analytic, valuation, report writing, and presentation skills of university students. Last year, nearly 2,500 students from more than 546 universities in 45 countries participated and learned best practices in equity research from leading industry experts.

Local CFA societies host and launch local competitions involving teams of three to five business and finance students from participating universities who work directly with a local company in researching and preparing a company analysis. This year, the CFA Society of Cleveland partnered with RPM International Inc. (NYSE: RPM), a multinational holding company with subsidiaries that manufacture and market high-performance coatings, sealants and specialty chemicals, primarily for maintenance and improvement. The Company’s 2011 sales were $3.4 billion, with 67% to industry worldwide and the remaining 33% to consumers mainly in North America.

• Analysis of a Public Company: Teams research a publicly traded company, and company management presents to the teams and participates in a Q&A session.

• Mentoring by a Professional Research Analyst: Each team works with a CFA Charterholder who mentors the team during the research process and reviews and critiques its report.

• Writing a Research Report: Each team produces an Initiation of Coverage report on its chosen company. The report is reviewed and scored by a group of judges.

• Presentation of Research to a Panel of Experts: The teams’ final presentations are locally evaluated by high-profile panels of experts from top financial institutions: Heads of research, portfolio managers, and chief investment officers from the world’s top firms. The team with the highest combined report and presentation score is the winner.

• The Research Challenge is composed of three main levels of competition. Local, Regional and Global. For more information, visit: http://researchchallenge.org/Pages/Default.aspx.
Recap of Disclosure Insight Luncheon

Matthew Scullen has worked for Wallstreet Money Managers, Inc. since his graduation from The Ohio State University in 2007. He earned his B.A. in economics and now is a Level III Candidate in the CFA program. In his current role, he is responsible for client service and investment administration. He volunteers with the CFA Society of Cleveland’s programming committee and aspires to find a career in investment research in his native Cleveland.

How do you think about risk? In the CFA program, the main focus of risk is through the lens of modern portfolio theory, financial statement analysis and corporate governance. But what if there are alternative, complementary views of risk which the investment community has largely overlooked? John P. Galvin, founder of Disclosure Insights (DI), discussed exactly that with the CFA Society of Cleveland on Dec. 14. To say the presentation was insightful would be an understatement. And I promise you my summary will not do justice for all John shared with us.

So what is so unique about the approach? DI assesses 100 different risk factors relating to SEC activity, accounting/auditor issues, capital markets events, board and executive stability and non-SEC investigative activity. Aside from researching the past five years of SEC filings, Disclosure Insight uses a combination of FOIA requests to the SEC to find any undisclosed activity and SEC comment letters.

Assessing risk isn’t simple unless systematic risk is all you’re concerned with. Buy or sell side, analysts face challenging time constraints which serve as hurdles to properly assessing risk. In general terms, analysts are more focused on forecasts and recommendations than pouring over potential risks in detail. In fact, John had a few justifications analysts use to avoid appropriate risk analysis:

- Overestimating their knowledge of firms and the potential risk factors they carry
- Using Sound bites instead of thorough analysis, i.e. headlines
- Assuming the risk to already be discounted in the stock price
- Attorneys purposefully write disclosure to confuse investors, dissuading them from digging deeper

So as an analyst, why should this matter so much if your primary focus is on providing valuable research to clients or portfolio managers? Well it turns out it matters a great deal. Figure 1 illustrates the relative performance of Disclosure Insights ratings vs. the S&P 500.

Figure 1

![Relative Performance of D.I. Ratings vs. S&P 500 at 2-Dec-11](image-url)
Figure 1 clearly demonstrates that low risk companies can be expected to outperform not only other high risk companies, but the broad market as well. I will be keen to note, however, that this chart only dates performance back to April of 2009. Without a larger sample of returns, one cannot say with confidence that DI’s ratings performance isn’t spurious. What we can say is that the results so far are very promising and that DI’s ratings potentially have significant value to investors.

John’s ideas center around the concept that if management is distracted by SEC investigations, auditor disputes or other regulatory matters, then they have less time to focus on managing the growth and operations of their firm. Another important concept is the materiality threshold: In general, companies are required only to disclose information if deemed material. Management has discretion over what is deemed material.

Considering these two core concepts, it behooves investors to investigate management and any related distractions. This brings us to the meat and potatoes of how to analyze risk like DI: through SEC reviews and inquiries. According to John, there are two SEC divisions that matter: Corporate Finance and the Division of Enforcement.

SEC Corporate Finance issues comment letters and reviews account disclosures in filings at least every three years for publicly traded companies. The letters are correspondence between the SEC and the firm, typically the CFO. When Corporate Finance determines that a line item, accounting practice, or MD&A disclosure is inadequate, they write a letter asking for clarification. This should immediately be a yellow flag at the very least, and a point of reference for analysts to look closer in their own research. An unusual amount of letters outside of the normal review process should also serve as a warning that unsavory practices are ingrained in the culture of the firm. Citigroup is an example of a firm which has had an excessive amount of correspondence, with 32 SEC generated letters since 2006. Comment letters are now available through EDGAR dating back to 2005.

The SEC Division of enforcement begins informal and formal investigations. Don’t be mistaken; both are serious. Tyco is an example of a firm which was only informally investigated. That said, nearly all investigations begin informally. Investigations are often conducted without any disclosure by management or the SEC (materiality threshold in action). Fortunately, FOIA requests to the SEC will bring any investigative activity in plain sight. Having knowledge of current investigations can be a huge advantage to an analyst for having insight most others may not know until it’s too late.

By understanding much of this behind the scenes research, you might wonder how to question management about some of these issues. The materiality threshold, Reg FD and maintaining positive relationships with management can be significant obstacles to finding answers to these sensitive issues. You might hear management say they “can’t discuss” something, which really suggests they won’t. A lack of substance can be a sign there is more to the story. Open ended questions might get results. For instance: “What contact has your company had with SEC Corporate Finance?”

The objective of reviewing comment letters and learning about investigations through FOIA requests is to give you insight ahead of the market. A mosaic in a sense, which can potentially save clients from suffering if otherwise unknown. John left the Society with one useful tidbit to remember; the cockroach theory, if you see one...