

## INVESTMENT UPDATE

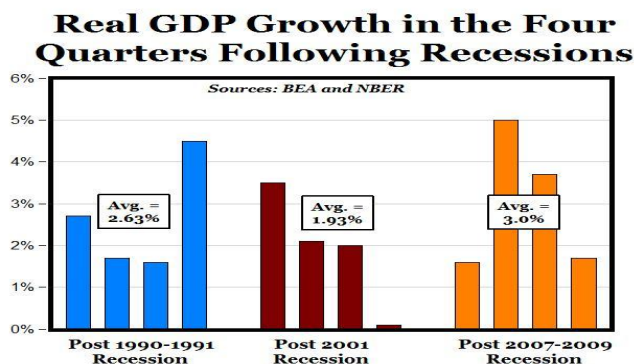
### Executive Summary

- Economic growth is strengthening and finally moving into a self-sustaining expansion. We expect GDP to grow at a +3.0-3.5% rate in 2011.
- Corporations are in excellent financial position to increase spending and job creation. We expect the unemployment rate to gradually shrink in 2011.
- A renewed emphasis on a smaller and more fiscally responsible government will add confidence to the private sector and remove a huge headwind to economic growth.
- Stock market valuation remains attractive with relatively low P/E ratios and strong corporate balance sheets. P/E expansion is possible as confidence returns and investor fund flows begin to favor stock funds.
- We continue to be defensive in our fixed income portfolios and recommend a shorter-than-average duration.

### Economic Growth Continues to Strengthen

Despite fears of a double dip recession in 2010, the U.S. economy has grown for six quarters in a row and appears to be strengthening and finally transitioning into a self-sustaining economic expansion. In fact, growth in this recovery has been better than the prior two recoveries (see Chart 1) aided by faster growth from developing countries. Real GDP growth in the third quarter was better than expected at +2.6% and should be even stronger at +3.5% in the fourth quarter. For 2011, economic growth is expected to grow at an above-average +3.0-3.5%. The extremely stimulative Fed policy, the recent tax legislation, growth in wages and personal income and strong corporate earnings growth resulting in higher job creation and increased capital spending are all driving faster and more sustainable economic growth.

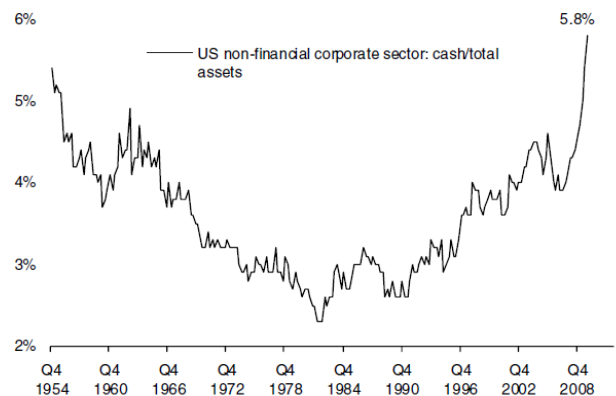
**CHART 1: Economic Growth During This Recovery Faster Than Prior Two Recoveries.**



The missing piece of a self-sustaining recovery has been the lack of meaningful job creation. Over the last two years, corporations have focused on cost cutting, reducing debt, and generating excess cash flow that has resulted in considerable profit margin expansion, record earnings and the strengthening of corporate balance sheets to record cash levels. (see Chart 2). As the recovery has matured, corporations are starting to regain their confidence in underlying demand and are beginning to increase their spending and hiring. We believe private sector job growth will average around +150,000-175,000 per month in 2011, up from +100,000 jobs per month in 2010, causing the unemployment rate to ease gradually over the course of the year. The recent ADP survey for December reinforces our confidence in the outlook as private payrolls increased by 297,000 in December, the largest monthly increase in the survey since 2000. The improvement in job growth will fuel continued improvements in consumer demand and manufacturing, ultimately driving the economy into a self-sustaining growth mode.

**CHART 2: Strong Corporate Balance Sheets Will Eventually Support Stronger Economic Growth.**

**Figure 10: Cash on balance sheet is at 50-year high in the US**



Source: Thomson Reuters, Credit Suisse research

### Election Results Positive for Economic Growth

One of the main headwinds limiting economic growth has been the concern over the irresponsible government spending, the anti-business policies coming out of Washington, and the uncertainty of the tax rates for 2011. This headwind appears to be quickly dissipating. The November election results sent a strong message to Congress that the people wanted a smaller, less intrusive and more fiscally responsible government. Early indications are encouraging that Washington has gotten the message with the recent passage of the pro-growth Tax Relief

Act of 2010 and numerous signs that President Obama is moving towards the center, similar to President Clinton after the 1994 mid-term elections. If this trend continues, we believe corporations will have even more confidence in the economy, potentially resulting in even stronger growth in 2011 and 2012.

### Stocks Remain Undervalued

The stock market continued its upward trajectory during the fourth quarter with the S&P 500 Index +10.8%, the Russell 2000 (small stocks) up by +16.3%, the EAFE index (international stocks) rising by +6.7%. For the year the S&P 500 increased by +15.1% while small capitalization stocks finished the year up an impressive +27.0%. International stocks lagged, increasing only +7.8%. The stock market rose in the fourth quarter as investors were encouraged by the strengthening of the economy, continued strong corporate profit growth, very attractive stock valuations, and a more balanced political landscape.

The stock market remains undervalued and still offers meaningful upside. Even though the stock market has risen considerably over the past two years, earnings growth has significantly outpaced the growth in the stock market. Since 2008, the S&P 500 has increased by +39.3%, while the earnings of the S&P 500 have increased by +58.5% (see Chart 3), resulting in a shrinking of P/E ratios over the last two years.. The S&P 500 is selling at an attractive 12.8x our 2011 EPS estimate of \$98 per share. This is the lowest forward P/E ratio at the beginning of a year since 1994

**CHART 3: Record Corporate Earnings Expected in 2011 and 2012.**

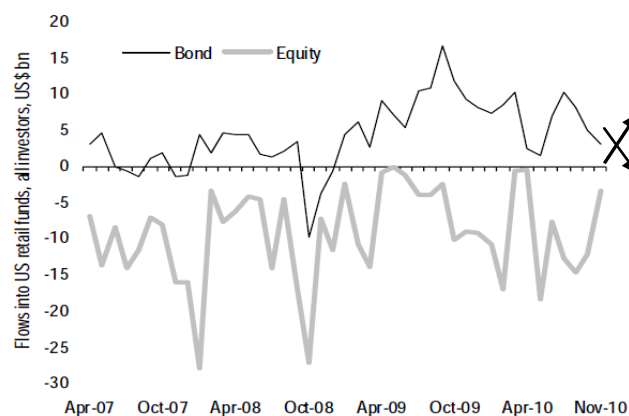
Year	S&P 500 EPS	Change	S&P 500 Year End Price	Change	S&P 500 P/E
2006	87.56	14.5%	1418	13.6%	16.2
2007	90.00	2.8%	1468	3.5%	16.3
2008	54.90	-39.0%	903	-38.5%	16.5
2009	60.00	<b>9.3%</b>	1115	23.5%	18.6
2010E	87.00	<b>45.0%</b>	1258	12.9%	14.5
2011E	98.00	<b>12.6%</b>	1258	0.0%	<b>12.8</b>
2012E	108.00	<b>10.2%</b>	1258	0.0%	<b>11.6</b>

In addition to a very attractive valuation, the underlying fundamentals also point towards higher P/E ratios and higher stock prices. Corporate earnings and cash flows are at record levels and are anticipated to grow another +10-15% in 2011. Corporate balance sheets are very strong, which should lead to a pick-up in mergers and acquisitions activity, increasing share repurchases, and higher dividends. The low interest rate

environment makes stocks that much more attractive relative to bonds. After years of investors favoring bond investments over stocks, we believe the trend is turning in the opposite direction as investors are starting to add to stock mutual funds for the first time in 2 years (see Chart 4). In total, we believe the stock market represents excellent value and will have a number of tailwinds such as M&A, increased share buybacks, increasing dividends, and improving fund flows, all helping to drive stocks higher. Our strategy is to maintain above average-equity ratios in our portfolios.

**CHART 4: Investors Starting to Warm Up to Stocks.**

**Figure 62: US retail equity funds have not seen a single month of net inflows since the beginning of the crisis...**



Source: EPFR, Credit Suisse research

### Bond Market – Continue to Stay Relatively Short

This past year was another positive one for fixed income investors, with investment fund flows into bond funds outpacing that of stock funds for the first 10 months of the year. The yield on the 10 year Treasury Note began 2010 at 3.8% and went as low as 2.4% in the third quarter before finishing the year at 3.3%. Bond returns were solidly in positive territory with the Salomon Broad Investment Grade Bond Index up +6.3% for the year. Interest rates started to rise in the fourth quarter as the European debt crisis fears eased and the U.S. economy gained strength. We expect interest rates to continue rising during 2011 as the Fed begins to increase short-term interest rates later in the year and as economic growth strengthens. We continue to invest fixed income portfolios in a defensive manner with relatively short maturities. As rates rise, our strategy will be to extend the duration of our bond portfolios.

In accordance with SEC Rule 204-3(b), our Form ADV Part II is available upon request. Please call or write to Susan C. Beaver, North Star Asset Management, Inc., P.O. Box 8012, Menasha, Wisconsin 54952-8012