NORTH STAR ASSET MANAGEMENT, INC.

January 2016

INVESTMENT UPDATE

Executive Summary

- Investors faced an uphill battle in 2015 as rapidly declining oil prices and a significantly strengthening dollar pressured corporate profit growth for the year, resulting in weak stock market returns. With these headwinds fading and with corporate earnings poised to return to growth, we believe the stock market should generate better results in 2016.

- For the second year in a row, large capitalization domestic stocks (S&P 500), with a total return of +1.4%, outperformed their small capitalization, foreign, and emerging market peers which experienced losses of -4.4%, -0.8%, and -14.8%, respectively.

- With the S&P 500 trading at a forward P/E multiple in line with its long-term historical average at 15.4x earnings, we do not expect returns to be generated by P/E multiple expansion in 2016. Rather, we expect earnings growth (+5-7%) and dividend yields (2%) to be the primary drivers of returns for the year.

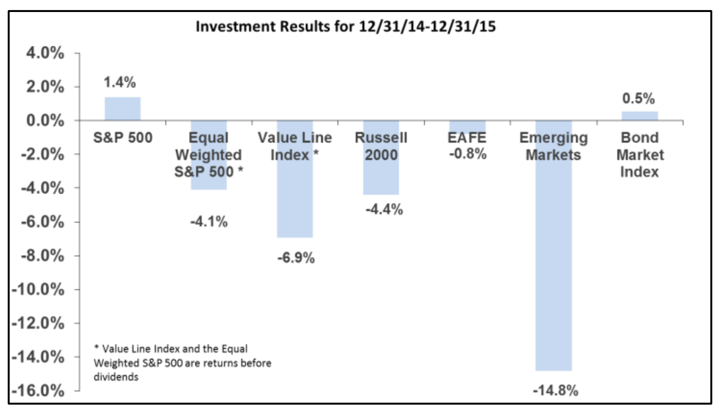
- After seven years of holding the fed funds rate at nearly zero percent, the Fed raised its key short-term interest rate 25 bps to a range of 0.25-0.5%, bringing an end to its near zero interest rate policy. We believe this marks the beginning of a multi-year rate hiking cycle, during which rates will remain highly supportive of faster economic growth.

2015: An Uphill Battle

Investors faced an uphill battle in 2015 as rapidly declining oil prices and a significantly strengthening dollar pressured corporate profit growth. For the year, corporate operating earnings, as measured by the S&P 500, increased only marginally to an estimated $118 per share from $117.86 last year. The lack of earnings growth combined with heightened concerns surrounding when the Fed might raise interest rates, how higher interest rates would affect the economy, slowing growth in China and the emergence of ISIS terrorist attacks around the world resulted in a perfect storm of heightened investor anxiety and weak stock market returns.

The S&P 500 had a positive return (+1.4%) for the year but that was not indicative of the broader markets as small capitalization stocks (Russell 2000), foreign (EAFE), and the emerging markets (MSCI EM) had negative returns of -4.4%, -0.8%, and -14.8%, respectively (see Graph 1). In addition, broader domestic indices, that weren't skewed higher by the outperformance of a number of extremely large companies, were negative for the year as evidenced by the S&P 500 Equal Weighted Index declining -4.1% and the Value Line Composite Index (1675 stocks) falling -6.9%. (The S&P 500 Equal Weighted Index consists of the same stocks that are in the S&P 500 but uses an equal weighting of all stocks in the index while the S&P 500 weights the performance according to the size of the company.) In addition to stocks, commodities also experienced negative returns with the CRB Index down -23.8% including declines of -38.8% for oil and -10.4% for gold. Bond returns (Citi Broad Bond Index) were also very modest at just +0.5% for the year.

Graph 1. Broader Market Returns Mostly Negative in 2015



Despite many headwinds and constant pessimism, the U.S. economy continued to grow at a moderate pace of approximately 2.0% in 2015, slightly slower than the 2.5% economic growth in 2014 and 2013, but faster than the 1.3% and 1.7% growth in 2012 and 2011, respectively. The economy continues to exhibit decent economic momentum as pockets of weakness (manufacturing and commodities) are more than being offset by consumer driven strength in housing, autos, and the service sector. While seemingly stuck in this modest growth mode, the economy still has considerable untapped potential, which could be unleashed

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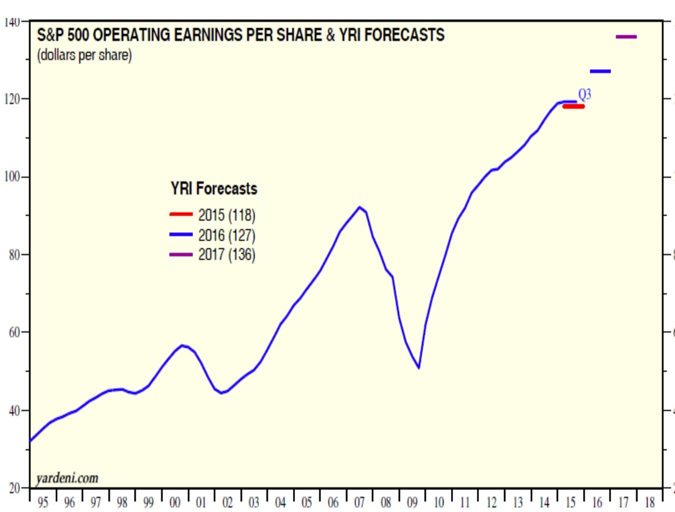
with a shift to more business friendly/growth-oriented fiscal policies such as tax reform, reduced government regulations, limiting government transfer payments, and lowering corporate tax rates to a level more competitive with the rest of the world. While we don't expect any major pro-growth policy shifts this year, continued modest economic growth combined with a return of corporate earnings growth and a lessening of the many headwinds faced in 2015 leads us to believe 2016 will be a better year for stocks than 2015.

Although corporate earnings (as measured by the S&P 500) were flat for the year, the underlying growth of the broader economy was overshadowed by the extreme decline in oil earnings and the strong dollar. We estimate that S&P 500 EPS excluding energy would have increased by approximately +5-7% as the earnings contribution from the energy sector has declined from approximately 7% of S&P 500 EPS to subtracting approximately -2%. This underlying growth is rather impressive considering that approximately 48% of the S&P 500's revenues were negatively impacted by the U.S. dollar strengthening by +24% against a basket of global currencies (DXY Index) in the last 18 months. With the economy expected to continue growing at its current modest pace, the dollar holding relatively stable and a smaller impact from lower oil profitability, corporate earnings should resume growing at a +5-7% annual rate in 2016 (see Graph 2).

Graph 2. Earnings Growth Expected to Return in 2016



Source: Thomson Reuters I/B/E/S.

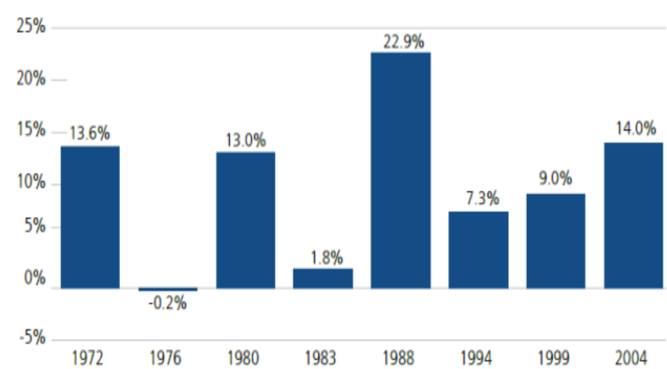
With the S&P 500 trading at a forward P/E multiple in line with its long-term historical average at 15.4x earnings, we do not expect returns to be generated by P/E multiple expansion in 2016. Rather, we expect earnings growth (+5-7%) and dividend yields (2%) to be the primary drivers of returns for the year. However, while we expect equity market performance to improve over 2015, we do expect continued periods of increased volatility throughout the year particularly as investors weigh the pace and degree of the Fed's interest rate hikes. Despite the volatility, our philosophy of investing in high quality, consistent growth companies gives us confidence that our clients should continue to enjoy strong returns over the long term.

Fed Finally Increases Short Term Interest Rates

After seven years of holding the fed funds rate at nearly zero percent, the Fed raised its key short-term interest rate 25 bps to a range of 0.25-0.50%, bringing an end to its near zero interest rate policy. This is a critical first step towards normalizing interest rates and marks the first increase in interest rates in nearly a decade. The tone from Fed President Janet Yellen following the rate increase was very dovish, pointing to future rate increases being highly data dependent. We believe the Fed will raise rates very gradually throughout 2016 and 2017, allowing rates to remain relatively low and continuing to support job growth and higher inflation for the next several years.

While many investors are concerned that the Fed is increasing short-term interest rates, we view this favorably as it indicates the Fed is gaining confidence in the economy. In fact, the Fed stated it was able to raise rates because it believes the economy continues to have decent momentum, that the labor force is healing, and that it expects inflation to increase towards its 2% target. Historically, the S&P 500 has performed relatively well 12 months after the first rate hike. During six out of the last eight interest rate cycles, stock returns in the 12 months following the first rate hike were above +7.3%, with the other two periods experiencing close to flat stock market returns (see Graph 3).

Graph 3. Historical S&P 500 Returns after First Rate Hike



Past performance is no guarantee of future results.
Source: Cornerstone Macro. "Positioning For A Fed Tightening Cycle," September 16, 2015.

In accordance with SEC Rule 204-3(b), our Form ADV is available upon request. Please call or write to Susan C. Beaver, North Star Asset Management, Inc, 59 Racine St., Suite A, Menasha, WI 54952.