

INVESTMENT UPDATE

Executive Summary

- Real GDP growth of +3% is expected through 2010. The U.S. economy is becoming increasingly competitive with the rest of the world. Employment gains should begin in the first quarter of 2010.
- Stimulative monetary policy expected to continue through much of 2010 and into 2011. Inflationary pressures are building.
- Government policy restricting economic growth. Potential for beneficial political gridlock is increasing. This should help restrain overly aggressive fiscal policies.
- Interest rates have started to increase. With inflationary pressures building and Fed extremely stimulative we plan to keep fixed income duration relatively short.
- The stock market still offers significant upside as corporate earnings rebound and investor confidence improves.

Economy – A Return to Moderate Economic Growth

The economy has made a tremendous recovery in the last six months from the -6.4% GDP growth in the first quarter, -0.7% in the second to +2.2% in the third and an estimated +5.0% in the fourth quarter. Despite the deep recession in the first half of the year, the strong growth in the second half of the year will result in an approximately flat growth for all of 2009. This highlights the underlying strength, resiliency, and stability of the U.S. economy. At \$14 trillion, the economy remains the largest and most dynamic economy in the world. The chart below illustrates just how large the U.S. economy is relative to other countries.

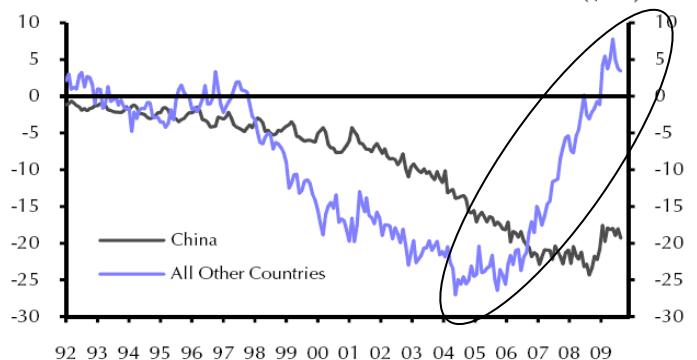
CHART 1: The US Economy Dwarfs Many Other Countries
U.S. States Renamed For Countries With Similar GDP



The economic recovery continues to gain momentum with strong improvement in manufacturing, exports, housing starts, retail sales, corporate profits and even auto sales in the fourth quarter. We expect the recovery to continue to gain strength next year and are estimating a more normal +3.0% GDP growth in 2010. Economic growth will be driven by a resurging manufacturing sector, strong growth in exports and a rebound in new home construction, not the consumer. The economic recovery should start to consistently generate job growth in the first quarter of 2010.

Through a combination of increased productivity and the weakening of the dollar, U.S. businesses have become more competitive with the rest of the world. The best illustration of this can be seen in the strong growth in the non-oil trade balance since 2005 (see Chart 2). The non-oil trade balance excluding China has improved significantly and even shows a positive trade balance for the first time since 1998! The fact that our trade balance with China has stabilized since 2006 is also encouraging. For years, our trade deficit with China increased as more and more production was sent overseas for the cheap labor. The Chinese currency is pegged to the U.S. dollar so that the weaker dollar has not helped our competitiveness. It means that U.S. has had to increase productivity and innovate to stabilize the trade deficit with China. It also means the Chinese economy is beginning to evolve into a consumer of goods, not merely a producer of goods. Because of this increased competitiveness, we believe the underlying economic fundamentals of the recovery should be stronger and more sustainable than after the recession in 2002.

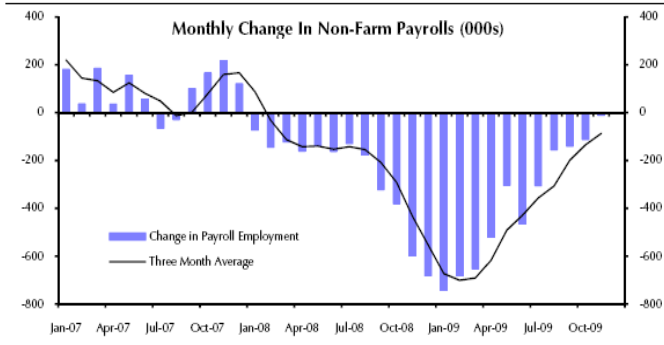
CHART 2: An Amazing Recovery in the Non-Oil Trade Balance
5. Non-Oil Trade Balance – China & Other (\$bn)



Employment growth tends to be a lagging, not leading indicator of economic growth. Nonetheless, positive job creation typically signals that businesses believe in the recovery and that the recovery is transitioning to a more normal and sustainable level. The fact that monthly jobs losses have declined from over

700,000 in January to only 11,000 in November and expectations of employment gains in the first quarter of 2010 add to our confidence in more normal and sustainable economic growth in 2010 (see Chart 3).

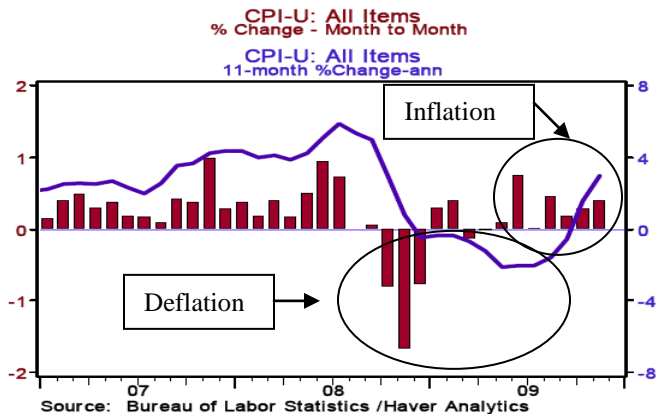
Chart 3: Job Losses Have Declined Meaningfully. Job Growth in 2010



Federal Reserve Policy – Stimulative Through 2010

The Federal Reserve continues to maintain its extremely stimulative monetary policy despite six months of economic growth and continued signs of a strengthening economy. Since Fed actions usually impact the economy with a 12-18 month lag and the Fed is not expected to begin raising rates until the first half of 2010, the economy should have a significant stimulative monetary policy tailwind for the next two years. The problem with the Fed erring on the side of growth is that too much stimulus can lead to higher inflation. We are already seeing signs of increasing inflation as the consumer price index (CPI) for the year through November is up +2.9% (see Chart 4). It appears that the Fed is too focused on the deflation experienced earlier in the year, which was the result of three large negative inflation numbers in the fourth quarter of 2008 (see Chart 4), and not the rise in inflationary pressure throughout the year. If inflation is maintained at the current level, it will force the Fed to increase the Fed funds rates sooner and faster than expected as it would need to increase the Fed Funds rate to 3% just to get back to a 0% real Fed funds rate, which is still considered highly stimulative.

CHART 4: With Inflation on the Rise, There is Increasing Pressure on the Fed to Increase Interest Rates.



Fiscal Policy – Excessive Spending Restricting Growth

The health care bills currently being reconciled between the House and the Senate further supports our belief that the best policy coming from Washington is no policy, as both parties have proven their inability to control spending, waste, fraud, and abuse of taxpayer money. The Country needs health care reform. Unfortunately, the final bill will most likely have very little to do with health care reform and end up costing taxpayers significantly more than anticipated. The current budget deficit of \$1.5 trillion is already unsustainable and restricting the economic recovery as consumers and businesses brace for higher taxes and more regulation. Numerous studies have shown that increased government spending crowds out private spending and results in lower overall economic growth. We are cautiously optimistic that this year’s Congressional elections will signal a turning point back towards more fiscal conservative leadership or, at the very least, a return to gridlock, which should limit further damage to the private sector.

Bond Market – Stay Short

The yield on the 10-year U.S. Treasury Note at the end of the fourth quarter rose to 3.84%, up from 3.30% at the end of third quarter and up from 2.25% at the start of the year. The short end of the yield curve has been remarkably stable with the 1-year U.S. Treasury Note yield only increasing from 0.33% at the start of the year to 0.46% at the end. The rise in interest rates and the steepening of the yield curve have been positives sign that the credit crisis has ended and economic growth is resuming. The Salomon Broad Investment Grade Bond Index produced a total return of +0.0% in the fourth quarter and +5.1% in the year as corporate bond spreads narrowed significantly. With the economy recovering, inflation close to +3.0%, and monetary and fiscal policies still extremely stimulative, we believe U.S. Treasury rates are headed higher. As a result, we continue to recommend a shorter-than-average duration for bond portfolios.

Stock Market - Undervalued

The total return of the S&P 500 was +6.0% in the quarter as better than expected corporate profits and additional signs of improving economic growth drove stocks higher. International and small stocks lagged the S&P 500 with the EAFE return at +2.2% and the Russell 2000 return at +3.9%. For the year, the S&P 500 is up +26.5%, while the Russell 2000 is up +27.2% and the EAFE is up +31.8%. We anticipate additional increases in the stock market in 2010 as the economic recovery continues and strong corporate profit growth leads stocks higher. We currently estimate earnings per share of the S&P 500 to increase to \$80 in 2010 and \$95 in 2011. Stock valuations remain very attractive selling at only 14.0x and 11.7x our 2010 and 2011 S&P 500 earnings estimates. Assuming a more normal 15x P/E ratio, the S&P 500 has upside of 20-30% over the next 12-18 months.

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