NORTH STAR
ASSET MANAGEMENT, INC.

July 2015

INVESTMENT UPDATE

Executive Summary

- While volatility picked up late in the quarter on fears surrounding Greece, we believe the fears are excessive and that these issues will remain largely localized.
- With over 3 million jobs created in the past 12 months, improving wage growth, increasing consumer spending, and an improving housing market, we are starting to see signs that economic growth will continue at the current pace with potential to modestly strengthen.
- The Fed appears ready to raise interest rates this fall for the first time in 9 years. While this will mark the end of the near-zero interest rate policy that has been in place since 2008, the Fed's interest rate policy will remain stimulative for a few more years, providing a tailwind to GDP growth.
- Underlying earnings growth of +11% in the first quarter, excluding the energy sector, remains strong. This gives us confidence that earnings growth can remain resilient for the rest of the year and into 2016, which should continue to drive stock prices higher over time.

Will Greece Leave the Euro?

Our long term thesis on the Euro is that the weaker nations, Italy, Spain, Portugal, and Greece, needed to become more like Germany (i.e. Europe would become the United States of Germany) in terms of work ethic, fiscal discipline, and regulation or they would eventually be forced to leave the Euro. Leaving the Euro is no panacea as this would bring about its own consequences. Global markets would likely force them into tougher austerity measures than the ECB (European Central Bank) has required. The markets would also significantly devalue Greece's new currency, which would in effect spread the pain over the entire population.

After the first European debt crisis a few summers ago, all four of the weaker countries agreed to start moving towards German pro-business policies in exchange for access to bailout funds from the ECB and European Union (EU). Italy, Spain, and Portugal have all moved towards a more pro-business regulatory framework and are feeling better, but not great, about the Euro after having some success resurrecting their economies.

Greece on the other hand agreed to move in the direction of fiscal austerity and pro-business regulation in order to get the bailout, but has fought and resisted implementing most of the changes. As a result, the Greek economy has continued to decline. Instead of looking to the other countries as an example of what might work, the Greeks elected a new Prime Minister in January who ran on the grounds of abandoning austerity. With his election, Greece publicly reneged on their austerity and pro-business promises, accelerating their economic decline and leaving the country with no cash to pay back their debts to the ECB, the EU, and the IMF (International Monetary Fund).

We are not sure how this Greek tragedy will end in the near term as there could still be a last minute bailout agreement. We do know that there is no easy way out for Greece or the European Union and the ECB. Greece needs to either choose to be beholden to the ECB and the EU, or to undergo a massive restructuring of their economy, neither of which is an attractive solution.

Fortunately, we believe the fear of the Greek exit will be much worse (to the investment community, not the Greek citizens) than if they actually leave as the Greek economy is only 2% of the Eurozone (about the same size as Detroit) and the ECB has had years to prepare for a potential Greek exit from the Euro. As a result, we continue to believe the underlying fundamentals of both the stock market and the economy remain solid and do not believe the Greek debt issues will derail the underlying strength we are seeing in the U.S. and the rest of the world.

U.S. Economic Growth Remains Resilient

The U.S. economy remains resilient as GDP grew by nearly +3% year over year (y/y) in the first quarter, despite the headwinds of lower oil prices, a stronger dollar, unusually harsh winter weather, and port strikes on the West Coast. Given recent signs of strength, including the creation of over 3 million jobs in the past 12 months, improving wage growth, increasing consumer spending, and an improving housing market, we anticipate economic growth will continue at the current pace with the potential to modestly strengthen throughout the remainder of the year.

A key component that should provide a tailwind to economic growth is the continued improvement in consumer confidence (see Graph 1). A lack of confidence over the last several years has contributed to the modest but sub-par recovery as consumers have postponed spending in order to reduce debt and build up savings. With consumer confidence improving, consumer net worth at record levels, and financial obligations (debt payments) as a percent of disposable income down to 30

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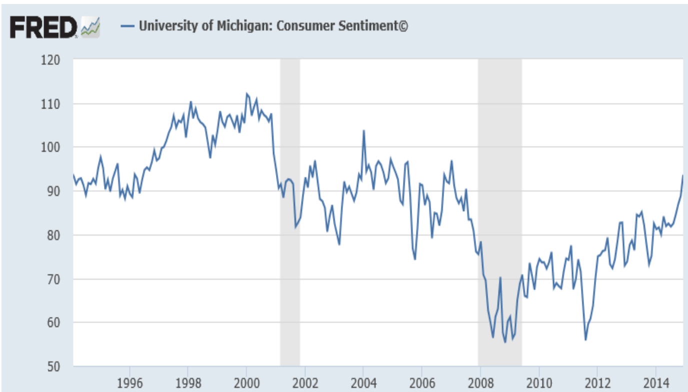
year lows, consumers have the wherewithal and now more confidence to increase spending. While one month doesn't make a trend, consumer spending increased in May at its fastest monthly pace since 2009.

Graph 1: Consumer Confidence is Improving



Despite record profits and cash flows, businesses have also been very conservative with their spending since the recession, choosing to reduce debt and increase share buybacks at the expense of investing in equipment and facilities. However, businesses are also turning more optimistic, with the Small Business Optimism Index running at the highest level since the recession. We believe this increased optimism, aided in part by increased access to loans, will give businesses the confidence to make investments in capital projects, further accelerating the pace of economic growth.

Economic Growth Supports the Fed Raising Rates

Given the expectation for continued healthy economic growth, and with both consumers and corporations gaining confidence, we believe the Fed needs to starts raising interest rates soon or risk falling behind the curve. After declining to raise rates in June, it appears as though the Fed will raise interest rates this fall. While this initial interest rate increase will mark the end of the near-zero interest rate policy that has been in place since the end of 2008, it does not bring an end to the Fed's accommodative monetary policy, as interest rates will most likely remain stimulative to economic growth for the next few years. Though the stock market may initially react negatively when the Fed begins raising interest rates, we believe the move is long overdue and that it should be viewed positively for long term investors.

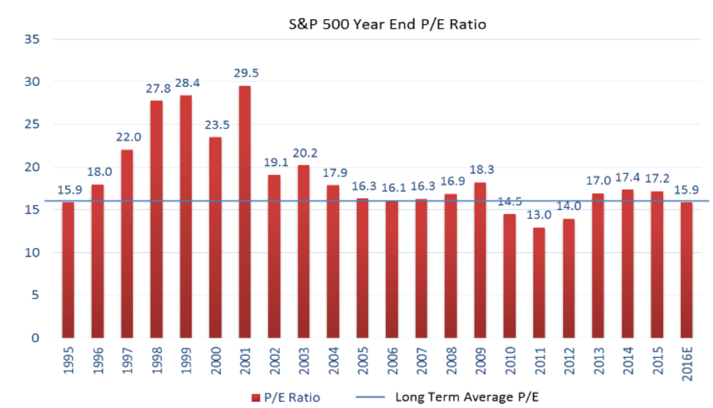
It appears the bond market is already starting to factor in higher short term interest rates as the yield on the 10-year U.S. Treasury bond rose by +43 basis points in the second quarter to 2.35% and is now up +18 basis points for the year. This rise in interest rates is having a negative impact on bond returns with the Citi Broad Bond Index declining -1.7% in the quarter and -0.1% so far this year. Given our belief that interest rates will head higher, we continue to recommend maintaining defensive bond portfolios with relatively short durations.

Underlying Earnings Growth Remains Strong

First quarter earnings for the S&P 500 increased by +1.5% y/y. This growth is quite impressive given the severe drop in oil prices, the sharply strengthening U.S. dollar, unusually harsh winter weather, and port strikes on the West Coast. In fact, if you exclude the energy sector, which experienced a nearly -60% y/y decline in profits in the quarter, earnings for the remaining sectors experienced strong growth of +11% y/y. This underlying strength gives us confidence that earnings growth will remain resilient for the rest of the year and into 2016.

While stocks were off to a decent start to the year heading into the end of the quarter, the S&P 500 fell by -1.8% in the final two days on concerns surrounding Greece. As a result, the S&P 500 posted a modest total return in the quarter of just +0.3%, and a similarly modest return so far this year of just +1.2%. Excluding dividends, the S&P 500 index declined by -0.2% in the second quarter, the first time it has posted a decline in 10 quarters. Small capitalization (Russell 2000), foreign (EAFE), and emerging markets (MSCI EM) stocks have all outperformed the S&P 500 so far this year, with returns of +4.8%, +5.5%, and +3.1%, respectively.

Graph 2: P/E Multiples Expanding, But Remain Reasonable



Despite the price to earnings (P/E) multiple of the S&P 500 being slightly higher than its long term average (see Graph 2), we believe the stock market remains relatively attractively valued for long term investors as modest economic growth, strong corporate profit growth, corporate share repurchases and an acceleration in M&A activity should continue to drive stock prices higher over time. With the Fed expected to begin raising interest rates in the fall, some increase in stock market volatility is likely during the remainder of the year. However, our philosophy of investing in high quality, consistent growth companies should enable client portfolios to continue to enjoy strong returns over the long-term.

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.