INVESTMENT UPDATE

Executive Summary

- U.S. economic growth should return to a more normal rate of +3.0-3.5% in 2015 as the momentum from 2014 continues, supported by stronger growth in wages and capital spending.

- With real GDP growth improving and unemployment falling towards 5.0%, the stage is set for the Federal Reserve to begin gradually increasing short-term interest rates this summer. We remain cautious on bonds, keeping durations relatively short.

- Equity returns experienced huge divergence in 2014 as large capitalization stocks (S&P 500) generated a return of +13.7% while small cap equities (Russell 2000) produced a return of only +4.9% and foreign stocks (EAFE) were down -4.9%. This was only the 6th time in the past 45 years that large cap stocks outperformed small stocks, foreign equities, and bonds.

Economic Growth Continues to Improve

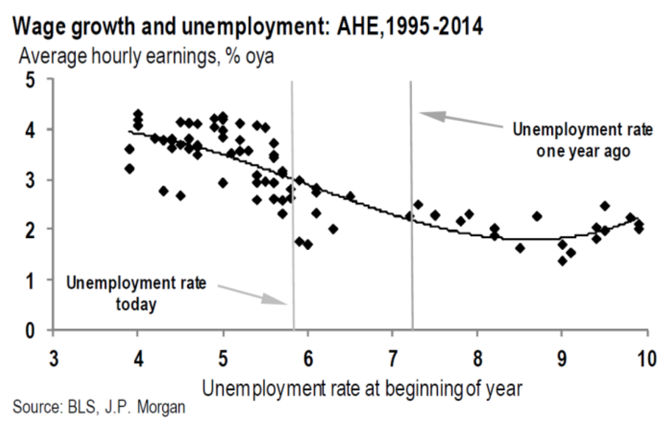
U.S. economic growth appears to be building momentum with +4.6% and +5.0% real GDP growth in the second and third quarters, respectively, up significantly from the +2.2% average rate during the first five years of the recovery. The +5.0% annualized growth in the third quarter was the fastest GDP growth in any quarter since 2003. While we don't believe the fundamentals are in place for consistent growth of +4-5%, they are in place for an improvement to a more normal rate of +3.0-3.5% in 2015.

The virtuous cycle of economic growth requires that excess profits get recycled back into the economy through higher dividends, increased hiring, faster wage growth, and increased capital spending, which drives demand and improves profits even further. So far in this recovery, corporations have earned record profits while increasing dividends, share buybacks, and hiring but without significant improvement in capex and wage growth. One of the key reasons we believe the economy will continue to improve in 2015 is that the two missing fundamentals (acceleration in wage growth and capital spending) in this recovery appear to be materializing.

Lower Unemployment Will Drive Faster Wage Growth

Over the last five years, excess slack in the labor markets has resulted in hourly wage growth averaging only +1.7% per year, compared to more normal rates of hourly wage growth in the +3.0-4.0% range. This is not unexpected as high levels of unemployment are associated with low wage growth (see Chart 1). With the unemployment rate having already fallen from 7.5% to 5.8% during the past 1½ years and with the economy poised to continue adding over 200,000 jobs per month, the unemployment rate should move towards 5.0% by the end of 2015. As Chart 1 indicates, hourly wage growth quickly improves to +3.0-4.5% as unemployment falls closer to 5.0%. This stronger wage growth, combined with increasing discretionary cash flow from the more than -40% drop in the price of gasoline since the summer, should give the consumer the financial wherewithal and confidence to accelerate spending in 2015.

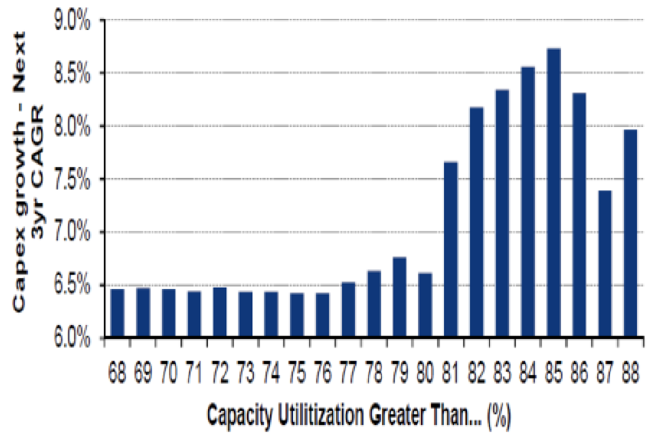
Chart 1: Hourly Wage Growth Accelerates as Unemployment Rate Declines



Higher Capacity Utilization Will Boost Capital Spending

Relatively strong growth in industrial production has taken capacity utilization to levels not seen since before the recession. In fact, U.S. capacity utilization recently rose above the 80% level for the first time in 7 years. This is significant since, historically, the 80% capacity utilization rate has been the tipping point at which businesses begin to boost spending on additional capacity (see Chart 2). While the pace of capital spending growth was already beginning to accelerate in 2014, we believe that rate of investment will rise even further in 2015, helping to strengthen the virtuous cycle of economic growth.

Chart 2: Capital Spending Historically Accelerates When Capacity Utilization Exceeds 80%



Source: BofA Merrill Lynch US Equity & US Quant Strategy, FactSet, Compustat

While there are also some headwinds to growth in 2015, including a strengthening U.S. dollar and lower energy-related investments, we believe the strength of consumer spending driven by faster wage growth and increased industrial spending will more than offset these headwinds, driving U.S. GDP growth into the +3.0-3.5% range in 2015.

Federal Reserve Will Start to Increase Interest Rates

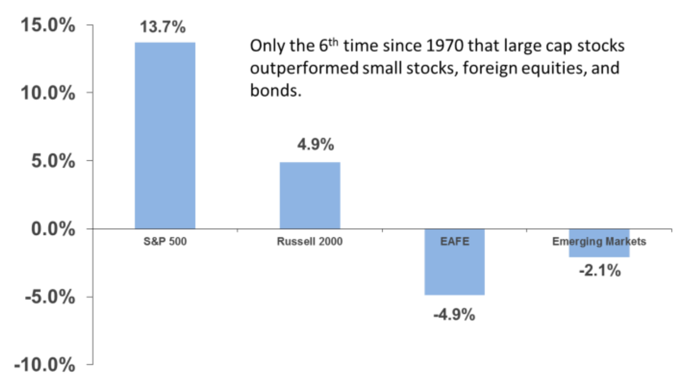
With real GDP growth returning to a more normal level of around +3.0-3.5% and unemployment falling towards 5.0% by the end 2015, we believe the stage is set for the Federal Reserve to begin gradually increasing short-term interest rates this summer. We believe that this process will be gradual and Fed policy will remain relatively stimulative for the economy for the next few years. We were very encouraged when Fed Chairwoman Janet Yellen recently indicated that she believes a normal level for the fed funds rate should be in the 3.0-3.5% range, up significantly from the current 0.25% level. This is a good sign as it indicates that she understands that near-zero interest rates are abnormally low and not healthy for long-term economic growth. We believe increases in short-term interest rates are long overdue and will be beneficial as the ending of interest rate manipulation will allow capital to be more appropriately allocated.

Despite the end of quantitative easing and the strengthening pace of economic growth, the yield on the 10-year U.S. Treasury Bond declined by -85 basis points from a year ago to 2.17%. This decline was primarily a function of strong demand from foreign markets where interest rates are even lower. However, as U.S. economic growth accelerates and the Fed begins raising short-term rates, the entire yield curve will eventually shift higher. Therefore, we continue to recommend defensive bond portfolios with relatively short durations.

Strong Returns for the S&P 500, But Broader Market Returns Exhibit Significant Divergence

Despite numerous anxiety provoking events, including the ending of the Fed's quantitative easing, Russia's encroachment into Ukraine, ISIS's invasion of Iraq, economic slowdowns in Europe and Asia, and the Ebola virus scare, the S&P 500 generated another strong year of returns (+13.7%) as strong economic growth and record corporate profits drove large capitalization stocks higher. However, there was a significant divergence in returns for the year, with small capitalization stocks (Russell 2000) at +4.9%, foreign equities (EAFE) at -4.9%, and emerging market stocks (MSCI EM) at -2.1% all significantly underperforming their large cap, domestic peers (See Chart 3). While foreign and small capitalization stocks underperformed in 2014, we continue to believe that they are an important part of a well-diversified portfolio and that they will provide strong returns over the long-term.

Chart 3: 2014 Equity Market Returns Experienced Significant Divergence



Continued solid economic growth in 2015 should help produce another record year of corporate profits (+7-8% gain). With equity valuations at the high end of their long-term average valuation range of 15-16x forward earnings, we would expect equity returns in 2015 to be driven by corporate profit growth and dividend distributions. Therefore, we anticipate an equity market return for the year at around +8-9% and continue to maintain equity allocations towards the middle of one's targeted range.

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.