NORTH STAR
ASSET MANAGEMENT, INC.

July 2019

INVESTMENT UPDATE

Executive Summary

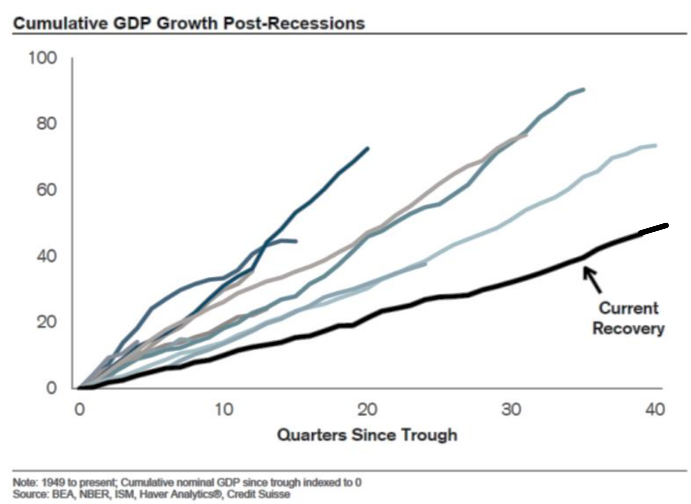
- The current economic expansion has now set a record for the longest expansion in U.S. history at just over 10 years.
- While the expansion may be getting long in the tooth, economic expansions don't die of old age. Strong underlying fundamentals should continue to support economic growth.
- We remain confident that the U.S. economic resilience displayed over the past decade will continue in the near-term, providing support for growing corporate profits, which ultimately drives the stock market higher over time.
- Stocks extended their gains in the second quarter with large capitalization stocks (S&P 500) leading the way with a total return of +18.5% through the first six months of the year, while small capitalization (Russell 2000) and foreign stocks (MSCI EAFE) also generated strong returns at +17.0% and +14.0%, respectively.

Record U.S. Economic Expansion Should Continue

Over the past ten years, the U.S. economy has been resilient despite numerous fear-induced stock market panic attacks, including fears of a double dip recession, the banking crisis in Cyprus and Greece, the fiscal cliff, the taper tantrum, an oil price collapse, Brexit, a slowdown in China, inflation concerns, Fed rate hikes, and trade wars. Yet through all these panic attacks, the economy continued to grow, and has now reached the longest period of economic growth in U.S. history at just over 10 years.

While the current economic expansion appears to be getting a little long in the tooth, economic expansions don't die of old age. In fact, Australia (28 years), Great Britain (17 years) and China (40 years) have all experienced periods of economic growth that lasted much longer than the current U.S. expansion. Furthermore, the current expansion pales in comparison to several post WWII U.S. expansions in terms of the pace and cumulative growth in GDP (see Graph 1), as higher taxes and increased regulation throughout much of the current expansion limited the rate of economic growth to a below normal pace. Over the past few years, pro-business policies of less regulation and lower corporate tax rates have resulted in an acceleration in GDP growth in 2017 and 2018 back to a more normal pace, with growth likely to remain solid in 2019 as well. Despite this acceleration, the cumulative growth in GDP throughout the current expansion still remains well below the expansions of the 60's, 80's, and 90's, indicating that there is still room for the expansion to continue.

Graph 1. Record U.S. Economic Expansion by Length, but not Size



Strong underlying fundamentals, particularly for consumers, also indicate that a continuation of the current economic expansion is likely. Consumer balance sheets are solid, with record high net worth, debt to total assets ratios at the lowest level in nearly 35 years, and debt service costs relative to disposable income remaining at historically low levels (see Graph 2). Consumers have plenty of capacity to continue to spend. At the same time, consumer confidence remains high, likely aided by a strong sense of job security in a very tight labor market, while also benefitting from +4-5% growth in earned income. This is a combination that should encourage continued consumer spending and economic growth.

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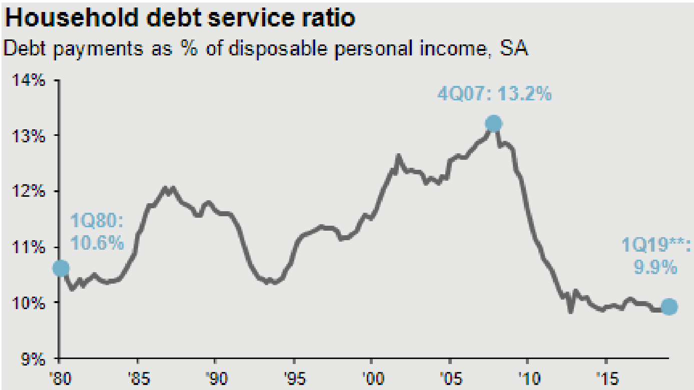
Graph 2. Low Interest Rates Keeping Debt Service Costs Low



Source: J.P. Morgan Asset Management

Corporations are also in good shape with corporate profits and free cash flow running at record highs. This is providing them with the capacity to increase capital investment to grow their businesses and to drive increased productivity. This will be increasingly important in the years ahead as a shortage of available workers, and resulting wage inflation, will require companies to invest in automation and new technology to increase the efficiency of their workers in order to continue to grow their profitability. While corporate debt levels have risen over the past few years, low interest rates have resulted in interest expense as a percentage of overall revenues to be near 35-year lows. Corporations have also increased their usage of long-term financing to lock in these low rates for an extended period of time, providing some level of protection against rising interest rates. Additionally, while uncertainties around global trade have recently had a negative impact on forward looking indicators such as the ISM Manufacturing survey, the survey is still indicating growth for the manufacturing sector of the economy, albeit at a slower pace. Meanwhile, surveys for the services sector, the much larger of the two sectors, remain strong and point toward strong growth from this portion of the economy. Overall, corporations remain healthy and positioned to continue to contribute to economic growth.

While the domestic economy is doing well, developed economies outside of the U.S. are experiencing slower growth, which could cause a modest headwind to U.S. economic growth. We believe this could be partially attributed to the U.S. corporate tax cut that leveled the playing field for U.S. corporations, and is now causing businesses to reduce investments in countries with historically significant tax advantages. Despite slower growth from developed foreign economies, global growth remains in line with the historical pace as growth from emerging market economies remains solid. This should limit the impact the U.S. economy feels from the slowdown in foreign developed market growth.

Overall, we remain confident that the U.S. economic resilience displayed over the past decade will continue in the near term, providing support for growing corporate profits, which ultimately drives the stock market higher over time. While headwinds from a stronger dollar and declining oil prices could cause earnings growth this year to be more modest, these headwinds should dissipate over time and earnings should experience a return to a more normal growth rate in the second half of this year and into 2020. With stocks currently trading at approximately 17.0x forward estimated earnings, we believe stocks remain attractive for long-term investors, particularly in comparison to the yields available on fixed income investments.

Stocks Continue to Generate Strong Returns

Stocks extended their gains in the second quarter, as economic growth and continued growth in corporate profits drove markets to record highs. Large capitalization stocks (S&P 500) continue to lead the way with a total return of +18.5% so far this year. Small capitalization (Russell 2000) and foreign (MSCI EAFE) stocks have also performed well through the first six months of the year, but trail their domestic, large capitalization peers, generating returns of +17.0% and +14.0%, respectively.

Bonds (Citi Broad Bond Index) have also produced strong returns through the first half of the year at +6.1%, benefitting from declining interest rates as the Fed has shifted its stance increasingly towards a rate cut in the near term and as interest rates around the world moved lower. With several countries currently experiencing negative yields on their 10-year sovereign debt, the yield on the 10-year U.S. treasury of around 2.0% looks relatively appealing and has driven foreign investment into these bonds. With inflation running at nearly 2%, and with the 10-year U.S. Treasury at 2.0%, we would anticipate interest rates to move higher over time as investors will ultimately demand a real (inflation-adjusted) return on their investments.

While stock market volatility is likely to persist, we continue to believe that over the long term, investing in high-quality, consistent-growth stocks at reasonable prices is the best way to build wealth for long-term investors.

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., 134 E Wisconsin Ave. One Neenah Center, Suite 300, Neenah, WI 54956.