NORTH STAR ASSET MANAGEMENT, INC.

January 2022

INVESTMENT UPDATE

Executive Summary

- 2021 was a strong year for the U.S. economy and produced record growth and profits.
- The consumer is in great shape with record net worth, savings, and rising wages adding to spending power.
- Corporations posted record profits despite a challenging business environment.
- Extraordinary monetary and fiscal stimulus were key drivers of the rapid recovery and strong growth.
- Covid-19 continued to restrain growth but rapid vaccine rollouts and other measures contributed to economies opening up and rapidly recovering.
- Inflation is running at multi-decade highs due to a combination of an exceptional demand environment and supply constraints. It remains the main long-term risk to both bond and stock investors, but we believe inflationary pressures will ease going forward.
- Strong underlying fundamentals position the economy for multi-year above-average growth.
- Stocks posted great returns for the year, and remain attractive to long-term investors due to above-average expected earnings growth. Bond returns were negative for the year and remain less attractive due to high inflation and record low interest rates.

Economic Growth was Strong During 2021

2021 was a strong year for the U.S. economy with real GDP growth of approximately 5.5%, more than double the 20-year average real GDP growth of 1.9%, resulting in soaring corporate profit growth. Headwinds from new, rapidly spreading Covid-19 variants, supply chain disruptions, and elevated inflation were outweighed by strong consumer spending and business activity driven by extraordinary monetary and fiscal policy, rapid vaccine rollouts, and new measures to deal with Covid-19 enabling strong economic growth.

Economic Reopening and Pent-Up Demand Drive Growth

Through the reopening of the economy and highly stimulative fiscal and monetary policies, a powerful wave of pent-up economic activity ensued in 2021 driving strong consumer spending and tremendous business profits. The consumer was in great shape entering 2021 with record net worth, very low debt-service payments, and over $2 trillion in excess savings. The Federal Reserve kept policy very stimulative with interest rates at record lows, despite the strong recovery in the economy, while the government continued to support the economy through record amounts of transfer payments.

These solid fundamentals combined with pent-up demand and strong wage growth drove very strong consumer spending with personal consumption expenditures up over 7% in 2021, well above pre-pandemic levels and above long-term trends. Some of this growth was due to the pent-up demand from the shutting down of the economy in 2020 and subsequent reopening in 2021. However, much of the growth appears sustainable as total wage growth was especially strong in 2021 at 9.9% driven by healthy growth in employment, wage increases, and increased hours. The tightness in the labor market is a result of the strong fundamental backdrop, which has led to many Baby Boomers retiring early, more people quitting their jobs, and less people entering into the labor force. While this drove solid wage growth throughout the year, we believe the fundamentals remain in place for above-average wage growth to continue long term.

Despite the strong economic results in 2021, Covid-19 continued to adversely impact the global and U.S. economies. Businesses continued to face major supply chain constraints and an extremely tight labor market put a lid on growth while also resulting in rapidly rising input and wage costs. Due to exceptional demand, costs were able to be passed through to customers, driving consumer inflation much higher. While supply-chain constraints appear temporary, we believe rising costs for businesses will continue due to the tight labor market, ongoing waves of new COVID-19 variants, and strong anticipated demand. Longer term, the solution to rising labor costs and supply chain constraints for many companies will be to continue to accelerate the pace of investment into technology and automation to drive enhanced efficiency and productivity.

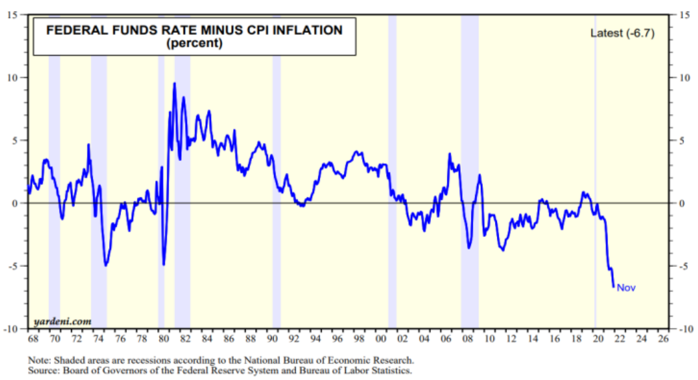
Economic Expansion Intact for 2022

The U.S. economy is positioned for continued above-average growth in 2022. While new Covid-19 variants remain a risk, it appears the combination of vaccines, less severe strains, and other measures should allow the economy to stay open. The consumer remains in great shape and rapidly growing wages should continue to add to strong consumer spending. The business environment remains healthy and poised for another

134 E. Wisconsin Ave, One Neenah Center, Suite 300, Neenah, WI 54956
phone: (920) 729-7900 *fax*: (920) 729-7904 *website*: www.northstarinvestments.com

year of above-average growth. Forward looking manufacturing and service sector indicators are at the highest levels they have been in decades. Supply chain constraints are expected to ease which should contribute to both growth and easing inflationary pressures. Fiscal spending should moderate and while monetary policy remains extraordinarily stimulative, the Fed has officially pivoted their monetary policy stance, signalling three rate hikes in 2022 and ending their asset purchase programs that have flooded markets with liquidity and supported government borrowing. Even with this shift, Federal Reserve policy should remain stimulative for several years. Given the magnitude of stimulus provided over the last couple of years, the Fed needs to raise the Fed Funds Rate significantly before policy is back to neutral, let alone restrictive as real-yields are the most negative they have been in five decades (see Graph 1). Provided that inflation pressures don't get out of control, above-average real economic growth should continue.

Graph 1: Fed Stimululative as Real Yields the Lowest in Five Decades



Inflation Remains One of the Major Risks

The main concern with the economy potentially growing too fast in 2021 is that it creates rising inflationary pressures that could drive interest rates significantly higher, eventually resulting in a slowdown in economic growth. If this were to occur, it could have a negative impact on both the stock and bond markets. Consumer prices have increased nearly 7% year-over-year through November and are rising at the fastest rate in decades. These inflationary pressures are coming from both excess demand and limited supply. Going forward, we believe that the supply chain constraints (caused by global Covid-19 shutdowns) will gradually ease while demand will remain quite strong, resulting in moderating, but still high, inflationary pressures throughout 2022. The combination of easing supply chain constraints and the Federal Reserve starting to remove its excessively stimuluative policies should start to ease inflationary concerns later in 2022 and into 2023.

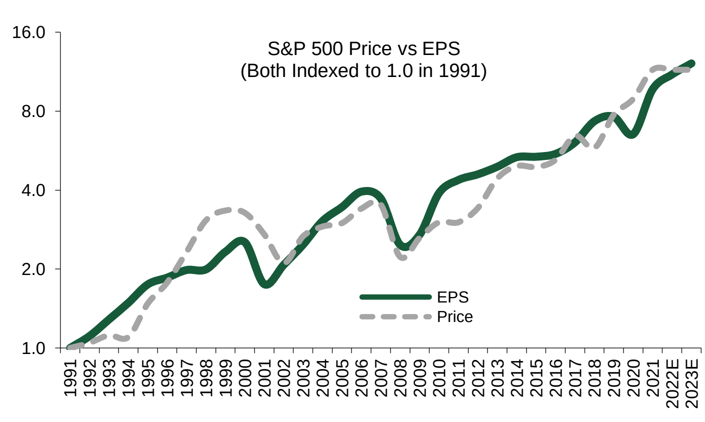
Strong Stock Market Returns Driven by Earnings Growth

Stock market returns for the year were strong, driven by the rapidly recovering and growing economy and exceptional earnings growth. For the year, large capitalization stocks generated a total return of +29% (S&P 500), small capitalization stock returns were +15% (Russell 2000), followed by slower but solid returns in foreign developed markets at +12% (MSCI EAFE), and weaker returns in emerging markets, with returns of -3% (MSCI EM) for the year. Due to the high inflation and subsequent rise in interest rates, fixed income returns were -2% (Citi Broad Bond Index). This marked the first time fixed income returns were negative since 2013.

Relative to 2020 where price-to-earnings (P/E) multiple expansion and expectations for growth drove stock market returns, exceptional earnings growth was the main driver of returns this year. P/E multiples contracted as earnings grew faster than stock prices. Large capitalization stocks (S&P 500) are expected to deliver over +60% growth in earnings per share in 2021, and we continue to expect multi-year above-average earnings growth going forward. With valuations above historical averages, we expect strong corporate earnings growth to be the key driver of stock market returns, as inflation and rising interest rates could continue to push multiples lower. We still believe stocks remain attractive for long-term investors given the above-average expected earnings growth and we continue to favor stocks over bonds. Despite high inflation, interest rates are still near record lows and we expect upward pressures on rates. Bond investors should remain cautious.

In summary, growth in earnings and free cash flows drive stock market returns over the long term (see Graph 2), which is why we continue to appreciate our philosophy of investing primarily in high-quality, consistent-growth companies at reasonable prices. We take comfort knowing that our clients own strong companies that have proven the ability to grow in good and bad times. While stock prices may be volatile in the short-term, the underlying value and long-term growth potential of the companies we invest in do not change that rapidly. We believe the companies we have invested in are well positioned to continue to grow and compound earnings and free cash flows for the long term. Over time, these fundamental factors will overcome short-term concerns and price volatility.

Graph 2: Earnings Growth Drives Stock Returns over Time



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., One Neenah Center, Suite 300, Neenah, WI 54956.