GS
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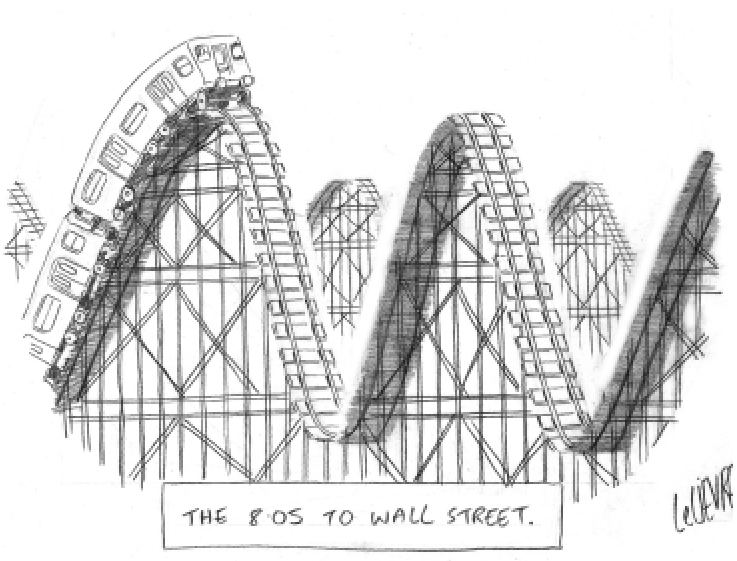
MarketView

First Quarter 2012

2011: A Roller Coaster Ride that Ended Where it Started



In driving the crowded freeways today, it is sometimes important to glance in the rear view mirror as well as focus on the road ahead. Distractions abound in each direction, so a global awareness is helpful to avoid mishap.

An analogy can be drawn with the marketplace. Looking back to 2011 can be helpful when trying to help clear the fog for 2012. Already, pundits are noting that 2012 will be like 2011; markets will be volatile and gains will be difficult, perhaps nonexistent. We think 2012 may be different from 2011, but let's start by looking back to 2011.

Throughout the year 2011 interest rates were unusually low. At the beginning of the year U.S. Treasury bonds were hovering around 3% for ten year maturities and 4% + for thirty year maturities. At the end of the year they were about 1% less for each maturity length. Converting these rates to price changes, while rates moved down, bond prices rose, exceeding the returns of stocks as measured by the S&P 500. Not too many forecasters were expecting lower bond rates when the year began; in fact, Bill Gross manager of the huge PIMCO bond fund made a big bet on higher interest rates and paid the price for this call, as is often the case. Also, at the end of 2011 very short term rates (money market funds) were returning almost nothing.

The Federal Reserve Bank was actively trying to stimulate a lethargic domestic economy. In late summer, following two stimulation moves (QE1 and QE2), it reintroduced "operation twist" in order to lower mortgage interest rates. The response was successful causing mortgage rates to fall. Shortly afterward, the economy moved upward and the stock market jumped.

Early in the year, the stock market (S&P 500) moved up nicely. In the first four months stocks were up roughly 9%, including dividends. But from May through September stocks declined roughly 16%, on the same basis. But along came October when stocks jumped approximately 11%. Quite a ride! Market timers beware. After all this movement up, down and then up, stocks finished the year up roughly 2%, not much for all the hand-wringing that occurred during the year but still positive. An Argus research report recently noted that "the daily change in the S&P 500 in 2011 was a fairly severe 1.04%." One could say that there was lots of volatility for a minimal return.

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Largest Stock Holdings

12/31/2011

Securities	Pct.
Apple Computer Incorporated	2.86%
Exxon Mobil Corporation	2.28%
International Business Machines	2.00%
McDonalds Corporation	1.95%
Visa Incorporated	1.90%
Intel Corporation	1.77%
General Mills Incorporated	1.74%
Philip Morris International	1.70%
Ross Stores Incorporated	1.68%
Microsoft Corporation	1.65%

(Continued on page 2)

(Continued from page 1)

Thompson Reuters Lipper reported that the average diversified stock fund was down 2.9% versus a positive return of 2.1% logged in by the S&P 500. In other words, the average of over 8,000 stock funds underperformed the market by 5%. We are pleased to note that nearly all of our accounts had equity returns EXCEEDING the S&P 500. More than likely, by trying to time the market managers may have missed out on the October market rise or were tripped up otherwise trying to guess the short-term direction of the market. Again, market timers beware.

Fracking

In our minds, 2011 brought to the forefront a long-term game-changer that will significantly affect our economic future, likely resulting in greater energy independence for North America. Specifically, a new drilling technology called "fracking" has allowed companies in the United States to find and produce more oil and natural gas domestically than ever thought possible. More oil produced here reduces the amount the U.S. imports from overseas.

Fracking to produce natural gas has made supplies of this resource much more reliable and plentiful. This has contributed to a 83% reduction ($15.38 v $2.48) in its price since 2005. Currently, natural gas prices in the U.S. are only a fraction of those paid in Europe ($12) and Asia ($18 in some markets), benefitting homeowners and businesses alike.[1] In addition, electric utilities are in the process of converting electric generation from coal to the now more dependable, cheaper, and plentiful natural gas. An added benefit is that natural gas is more environmentally friendly than coal emitting much lower greenhouse gases. Fortunately, this shift away from coal to natural gas can be accomplished seamlessly in many generating facilities. Natural gas currently provides 39% of global power generation. While the percentage in the United States is lower at 25%, the industry is growing rapidly.

Of concern, however, is the environmental impact of the fracking technology; fears of water table/reservoir contamination has led to many environmental discussion around the country. Despite the concerns, use of this technology should continue to grow. We have investments in client portfolios that should benefit from these changes.

Political Developments

Another important issue that gained attention worldwide in 2011 was the excessive spending and ballooning debt of a number of the Eurozone countries, specifically Greece, Italy and Spain. The fear is that the US will inevitably suffer the same fate unless government spending and corresponding debt is brought back under control. The early innings of this overhanging issue were on display this past summer during the debt ceiling debate.

Interestingly, while governments were stumbling, corporations across the globe were doing quite well. Strong earnings growth and healthy balance sheets were common among corporations. Above average dividend increases provided welcome rewards to shareholders. It appears these dividend increases will continue.

1 Simone Sebastian, "Natural gas glut fuels export debate," *Houston Chronicle*, (January 13, 2012).

(Continued on page 3)

Notable Quotes

"The government cannot give to anybody anything that the government does not first take from somebody else."
George Orwell

"A big part of financial freedom is having your heart and mind free from worry about the what-ifs of life."
Suze Orman

"No matter how good the science gets, there are problems that inevitably depend on judgment, on art, on a feel for financial markets."
Martin Feldstein

"Capital as such is not evil; it is its wrong use that is evil."
Mohandas Gandhi

"If you aim at nothing, you will hit it every time."
Zig Ziglar

"In certain trying circumstances, urgent circumstances, desperate circumstances, profanity furnishes a relief denied even to prayer."
Mark Twain

"Economists report that a college education adds many thousands of dollars to a man's lifetime income - which he then spends sending his son to college."
Bill Vaughan

"Money can't buy you happiness but it does bring you a more pleasant form of misery."
Spike Milligan

(Continued from page 2)

Finally, both political parties have called for an overhaul of the corporate tax structure. Most experts agree that the U.S. has one of the most complex corporate tax structures as well as the highest nominal rate (35%) in the developed world. These discussions have resulted in uncertainty for businesses, delaying investments and hiring. However, a well thought out restructure could lead to an improved economic environment in the U.S. with corporations bringing cash reserves, manufacturing plants, and jobs home from overseas. The negative would be that there would be fewer corporate tax attorney jobs.

" AND REMEMBER, SON, NEVER PUT IN YOUR TWO CENTS WORTH UNLESS YOU CAN EXPECT TO GET AT LEAST A NICKLE IN RETURN."

Looking Forward

Many issues that characterized 2011 will carry forward into 2012. How the Eurozone handles its problems, and how domestic issues evolve during this election year will largely determine the fate of the financial markets this year and beyond.

ECONOMIC FORECASTS	
↑	**GDP Growth** Rising to 2.3% this year; from 1.8% in '11.
↑	**Interest rates** 10-year Treasuries near 2.5% in mid-'12
↓	**Unemployment** Below 8.5% by year-end, despite up-ticks early in '12
↓	**Inflation** Slipping back to 2% in '12, after hitting 3.3% in '11
↓	**Crude oil** Highly volatile, but trending toward \$90-\$95/bbl, into spring
↑	**Retail** Solid 6% growth, but slower than in '11

1 Kiplinger Letter, January 6, 2012.

As we begin the year, the economy and the corporate sector seem to be continuing on an upward trajectory. We still believe that stocks are reasonably valued. Specifically, the median stock in the S&P 500 Index trades at 13 times trailing earnings and 12 times next-year's earnings, both indicate reasonable valuation for the market in historical terms.[1]

Bonds could be the risky bet this year if interest rates move higher. As always, caution is warranted. Focusing on the negative however, can be as dangerous as being overly euphoric. We will attempt to strike the right balance as the year progresses.

Jottings…

About one year ago Meredith Whitney, a banking analyst, appeared on '60 Minutes' extolling extreme riskiness in the municipal finance area. She stated that there could be 50 to 100 sizable defaults amounting to hundreds of billions of dollars. Not only did '60 Minutes' report her negative prognostications, but they were picked up by several other media outlets. Municipal bond prices fell sharply. As it turned out, she was patently wrong. It is disappointing to have a wall street "expert" broadcast such a message of false negativity, especially at a time of economic uncertainty such as we now have. The lesson here is to be cautious in your beliefs and reactions to extreme media announcements.

A local mergers and acquisition's (M & A) firm indicated in its recent newsletter that the 4th quarter of 2011 saw its biggest flurry of new seller inquiries since 2005/2006. As many of you may know, mergers and acquisitions activity typically serves as a leading indicator for the economy in general. Perhaps the economy may finally be turning, albeit slowly.

Lastly, we came across a rather simple but sensible formula for growth. Assuming that there are no 'external' events/shocks to the financial system - the potential for which is good - we may have the underpinnings for a reasonable market advance in place for 2012.

1 "S&P Outlook," (January 18, 2012).

(Continued on page 4)

(Continued from page 3)

Specifically, the formula is as follows: [1]

1. **Develop a strong consumer.** A widely-known fact is that consumer spending represents roughly 2/3 of our domestic economy (GDP); for the previous 12 months, ending 9/30/11, the number was 71%, the highest percentage in 60 years.

   Since 1950, the annualized growth in GDP is 3.3%. When consumer spending is greater than 2%, GDP rises at an average of 4.6%. When it is less than 2%, GDP declined an average of 1.4%. Strong GDP equals a strong consumer.

2. **Get businesses to invest.** “If consumers are the flour, businesses are the yeast.” 80% of personal income comes from individuals’ salaries or the profits of the businesses they run. During the last 12 months ending 9/30/11, capital spending was up 27%. $500 billion is forecast to be invested by corporations in 2012. This should be a positive sign for corporate America and, subsequently, investors.

3. **Maintain the current environment.** Interest rates and core inflation remain historically low. This will allow for corporations to borrow or refinance, both catalysts for a stronger economy.

“A pessimist sees the difficulty in every opportunity; an optimist sees the opportunity in every difficulty.” This quote from Winston Churchill resonates with us. As such, we remain cautiously optimistic as we look forward in 2012.

1 “Dow Theory Forecasts,” (December 19, 2011).

Our greatest compliment is your referral.

GS

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GSI Tenets

Who is GSI?

GS Investments, Inc. is an investment management company specializing in individual and institutional asset management. Privately owned and operated, GS Investments, Inc. is run by its Glenn H. Steinke, C.F.A., and John G. Steinke, M.B.A. and Greg Cunningham.

Glenn Steinke, CFA brings over 45 years of investment management experience to the business. Previous capacities include Vice President and Senior Investment Officer with a major pension fund ($1.8 billion under management) and Senior Vice President with a major Minneapolis-based financial institution ($3 billion under management). Glenn is a graduate of the University of Minnesota.

John Steinke MBA offers a broad financial services background with 18 years of portfolio management experience and 7 years of banking experience including capacities as a Vice President of a $50 million bank and as a private banking officer for a large, Minneapolis-based financial institution. John received his BA from Concordia College (Moorhead) and his MBA from the University of Minnesota.

Greg Cunningham comes to us from Minneapolis-based Ameriprise Financial, a national leader in financial planning with over 2 million retail clients and $300 billion in assets. Greg spent 15 years at Ameriprise, most recently in the asset management group. In this role he worked with the Chief Investment Officer in support of the international and domestic hedge funds and with the President and General Manager of Riversource mutual funds. Greg is a graduate of Gustavus Adolphus College in St. Peter, MN.

Sheri Ritchie brings over 20 years of financial services experience to the business. Previous capacities include client service and support positions with Dean Witter and Kemper brokerage firms and a Minneapolis-based investment management firm. Sheri is a graduate of the University of St. Thomas.

GSI Investment Philosophy

GS Investments, Inc. utilizes a balanced approach for the majority of its accounts although each account is tailored to the individual needs of each client. Taxable or tax-exempt bonds are used along with a common stock component. The division between bonds and stocks is determined by the personal objectives of each client. A need for income and a willingness to assume risk are also determinants of an account’s bond/stock mix.

GS Investments, Inc. emphasizes the purchase of quality securities and employs a long-term investment style as market timing, frequent shifts in asset allocation and interest rate forecasting are not consistent with the firm’s philosophy. In depth market analysis and many years of experience support this approach.

GSI Fixed Income Strategy

GS Investments, Inc. emphasizes a staggered maturity approach when purchasing bonds. Individual security investment grades and call protection are considered when making these investments. Quality grades of “A” or higher are favored with tax-exempt issues. Government bonds are dominant among taxable securities.

GSI Equity Strategy

GS Investments, Inc. favors stocks emphasizing quality and growth. Appropriate cyclical growth stocks and small capitalization growth stocks are used periodically as well. Additionally, GS Investments, Inc. believes that a growth oriented philosophy tends to result in less frequent trading and lower tax payments (for taxable accounts) on realized capital gains. This provides a lower cost approach for the client.

GS Investments, Inc. emphasizes client communication. Written investment objectives as well as periodic oral and written reports are used to heighten the understanding between the client and investment manager. In addition, easy to read, detailed reporting is provided by state of the art investment software in order to inform the client of portfolio progress.