GS
INVESTMENTS, INC.
www.gsinvestments.com
612-371-0590

MarketView

Third Quarter 2010

A slowdown, not a meltdown ahead

Some have accused us of being optimistic, something which Glenn and I readily admit to. It is true that we tend to look "on the bright side" of things, often times viewing the "glass" as half-full, not half empty. This is not to say that we are blindly optimistic, rather we believe in this country and its consistent ability to innovate and produce. We are true capitalists at heart, "warts" and all.

With this said, the negative sentiment felt throughout the economy seems pervasive. One only needs to witness the large amount of cash being held out of the market ($4 trillion, according to Forbes magazine) or the run-up (to all-time highs) in the price of gold. Specifically, the bears point out:

- Economic and fiscal stimulus, whatever you may think of them, are both in our rear-view mirror. Further stimulus, although bantered about at the federal and state levels (and excluding an extension of the Bush tax cuts), is not on the horizon as far as we can tell.
- Total US debt, as a percentage of GDP, is now above the 90% level, a level above which private sector growth is difficult.
- The federal deficit is now running at roughly 10.6% of GDP.
- Higher tax rates going into 2011 with the expiration of the Bush tax cuts (more on this later).
- A stock market that corrected more than 15% since reaching its highs only one month ago.
- The indication of a recession by the Economic Research Cycle Institute (ECRI) weekly indicator, something to which a number of people in our business consider a leading economic indicator. Keep in mind that the ECRI is helpful but not infallible. Specifically, the ECRI has correctly identified a recession 70% of the time. Glenn and I feel that this warning, while indicating a 2nd half slowdown in economic activity, is due as much to profit-taking after an 80% market advance (since the March 2009 lows) as it is to an impending economic collapse.

GS Investments, Inc.

Largest Stock Holdings

6/30/2010

Securities	**Pct.**
iShares BRIC Fund	3.23%
Apple Computer Incorporated	3.22%
iShares MSCI Emerging Markets Fund	3.11%
Exxon Mobil Corporation	2.20%
Hasbro Incorporated	1.96%
McDonalds Corporation	1.93%
Wells Fargo Corporation	1.84%
International Business Machines	1.80%
General Mills Incorporated	1.77%
Cisco Systems Incorporated	1.76%

Hearing this, in addition to the constant barrage of gloom and doom broadcast daily, one would seem destined to sell his/her holdings, putting the money into cash or better yet, under the proverbial mattress. Though yield is non-existent here, principal preservation carries the day and provides psychological comfort to those who still bear the scars from 2008. It's not that Glenn and I are unsympathetic to this viewpoint or feel that another significant market rally is about to transpire. We fully understand the inherent

(Continued on page 2)

(Continued from page 1)

risks to the US economy and financial markets; that is, if we, as a country, continue to spend beyond our means, economic prosperity and a subsequent extended market rally is simply implausible.

Certainly, tough choices lay ahead for most Americans, requiring extraordinary leadership (and time) along the way. Despite the storm clouds on the horizon however, we do not believe that the end of the US as we know it is imminent.

As such, Glenn and I need to "put our money where our mouth is." Let's build the case:

- The Ned Davis Research Recession (NDR) Probability Model puts a double -dip recession near 0%. Economic activity, as measured by the Philadelphia Fed Survey, advanced in 47 of 50 states in May. It had also advanced in the three previous three months. The survey also highlighted that 19 states registered positive growth over the past 12 months.
- The Institute for Supply Management Composite Index, a proxy for GDP growth (for both manufacturing and services), shows 4% growth through the remainder of this year into 2011.
- Another Ned Davis index, the Financial Stimulus Index, shows little evidence of recession prior to end of year. In fact, the index showed its first positive reading in May since mid 2009.
- The BCA Research Recession Probability Indicator registered 13%. Typically, this needs to be above 50% before a recession is likely.
- "Real" mortgage rates (the difference between the 30-year fixed-rate mortgage, adjusted for appreciation/depreciation) have leveled at roughly 2%, a positive sign for housing.
- Mortgage delinquencies, although up 36% in Q1, were down 7.5% from the previous quarter.
- Corporate profits continue to impress. As we write, Intel reported that it beat its quarterly earnings estimate by 20% and its revenue target by 5.4%.. Additionally, Alcoa, CSX and GE have all reported solid earnings.
- Bank lending, a concern to many, has slowed its rate of contraction.
- Interest rates and inflation remain low and will likely be restrained throughout 2011.

Notable Quotes

"The man who smiles when things go wrong has thought of someone to blame it on."
Robert Bloch

"If we knew what we were doing, it wouldn't be called research, would it?"
Albert Einstein

"Scholars have long known that fishing eventually turns men into philosophers. Unfortunately, it is almost impossible to buy decent tackle on a fisherman's salary."
Anonymous

"You can be a good procrastinator if you ever get around to it."
Anonymous

"Someday we'll look back on this moment and plow into a parked car. "
Evan Davis

It's all about the jobs and income

It has long been said that individuals vote with their pocketbooks. Currently, nation-wide unemployment is running at 9.5% (annualized) and there has been no growth in disposable income - money that is available to individuals after taxes are factored in - since January 2009. As such, it should come as no surprise that many Americans are frustrated and looking for change come November. Former Harvard University and University of Gothenburg (Sweden) professor, Douglas A. Hibbs, highlights the correlation between jobs, income and elections.. Says Hibbs, "Income growth has been the best predictor of US Presidential election results since 1952." Adds Hibbs, "It's the broadest measure of economic well-being. It has a very powerful effect." In short, the November elections may not bode well for incumbents.

An Obama Extension?

As the appetite for spending at the state and federal levels continues to increase, so does the likelihood that the Obama Administration may need to consider extending the Bush tax cuts, at least in some form. In an interview with Larry Kudlow of CNBC this last week, Treasury Secretary Timothy Geithner hinted at the notion that the tax cuts might be extended. Said Geithner, "A realization that capital, as well as labor, matters for growth is a good thing."

(Continued on page 3)

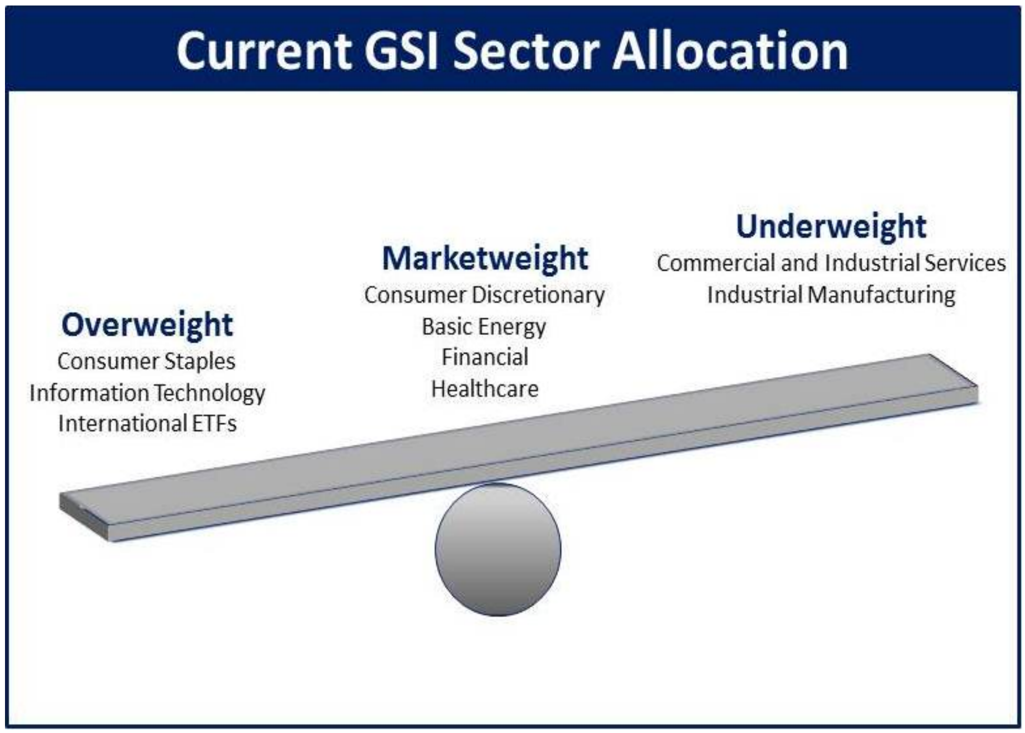
(Continued from page 2)

Bruce Josten, of the US Chamber of Commerce added, ”businesses face huge uncertainty when they try to plan out what their tax liabilities will be next year, or game out credit availability or the investment climate, they just don’t know what it will look like...uncertainty is a real (jobs) killer.”

Jeffrey Immelt, Chairman of GE and another guest of Kudlow’s agrees, “We (the US) are a pathetic exporter...we have to become an individual powerhouse again but you don’t do this when government and entrepreneurs are not in sync.” Might an extension of the Bush tax cuts put the two in better sync? Stay tuned.

H2 2010 and Beyond

Glenn and I are truly ambivalent about the direction of the economy and US financial markets in the next 12 to 18 months. We believe that advancement or decline will be predicated on additional federal and state spending in addition to ongoing federal and state tax policy, much of which has yet to be determined. One thing that has our attention is the tremendous amount of uninvested cash, currently sitting idle and out of the market. According to Jack Albin, Chief Investment Officer at Harris Private Bank research, “whenever money market assets have exceeded 25% of the capitalization of the Standard & Poor's 500 index, stocks have rallied over the following two years. That number currently is 43% after having peaked at 58% in mid-December.” This is hardly a guarantee but may be an indicator of things to come.



Other interesting tidbits are found below:

Fiscal and Monetary Policy

Fiscal - Bush tax cuts extended to provide “stimulus.”
Monetary - No Fed easing for the remainder of the year, likely extending through 1h 2011.

Economy

GDP - Growth slowing to an annualized 2.5% to 3% throughout 2011.
Inflation - 1% in 2010, growing to 1.5% in 2011.
Interest Rates - Prime rate at 3.25% through Q1 2011, increasing to 4% by year-end 2011.
Unemployment - Remaining at 9.5% through the end of 2010.
Crude Oil - Roughly $70/bbl. throughout the remainder of 2010.

International Equity Markets

China - growth to resume, albeit at a moderated pace.
BRIC - All economies, save Russia, growing nicely for the next 24 to 36 months.

US Financial markets

Equities - Market weighting, with asset allocation and security selection key to success.
Fixed Income/Fixed Income Substitutes - With interest rates near historical lows (and yield almost non-existent), one must

(Continued on page 4)

(Continued from page 3)

assume that the long-term trend for interest rates is up. Short-to medium-term bond or bond ETFs are the most appropriate vehicle here. Electric utilities with sizeable and sustainable yields are feasible fixed income substitutes.

<u>*Cash*</u>– Although a "safe haven" for principal preservation, cash returns are close to 0%.

<u>*Gold*</u> - Gold prices are at new highs. Contrary to the views of others in our industry, we believe that gold is "frothy" at the current time.

<u>*Real Estate*</u> - Real estate, both commercial and residential, have stabilized a bit. Risk also has abated but is still high enough to limit over exposure here.

Although Glenn and I remain optimists at heart, we proceed cautiously as we enter the 2nd half of 2010. We are reminded daily that ours is a humbling business that requires a great deal of patience and discipline. As Edgar Fiedler so adeptly points out, "He who lives by the crystal ball soon learns to eat ground glass."

<u>Sources:</u>

Christopher Chantrill, "US Federal Debt as a Percentage of GDP" (Usgovernmentspending.com, 2010).
Kiplinger Letter, June 25, 2010.
Liz Ann Sonders, "Market Commentary," July12, 2010.
Ned Davis, "Daily Economic Commentary." (Ned Davis Research, June 19, 2010).
Ned Davis, "Market Digest," (Ned Davis Research), June 22, 2010.
Politics and Policy, (Business Week, June 7-13, 2010).

"Our greatest compliment is your referral."

GS

Investments, Inc.

333 South 7th Street, Suite 3060
Minneapolis, Minnesota 55402
Ph (612) 371-0590 Fax (612) 371-9869
www.gsinvestments.com
john@gsinvestments.com glenn@gsinvestments.com

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 two principals, Glenn H. Steinke, C.F.A., and John G. Steinke, M.B.A.

Glenn Steinke 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).

John Steinke offers a broad financial services background with 16 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.

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.