www.gsinvestments.com

MarketView

Third Quarter 2013

Are higher interest rates at hand?

There has been a significant change of perception in the direction of interest rates. Federal Reserve Chairman Ben Bernanke recently blew cold air on both the bond and stock markets by stating "if" the economy gets stronger and if the unemployment rate moves down toward the 6½% rate, the Federal Reserve Bank will alter its current monetary policy by reducing quantitative easing. Simply put, at some point the Federal Reserve would reduce liquidity in the marketplace by removing its support for low, longer- term interest rates.

" Sir, while we were installing the new auto-trading software one of the techs sneezed and, long story short, our portfolio just lost a third of its value. "

After year's of indicating that fed easing would continue well into the foreseeable future, now the message is that the end may be in sight. As a result, both the bond and stock markets erupted to the downside.

As many of you may know, a rise in interest rates leads to a decline in bond prices. Ten-year U.S. Treasury bonds have recently moved up to 2.5% from an early May rate of 1.6%. Medium and longer-term interest rates have also moved sharply, rising over 1% since early May. Additionally, Mortgage rates have also moved higher (please see the YTD chart of the 30-year fixed rate average below). Prices for securities in each of these areas sharply declined in response, prompting a knee-jerk reaction in the stock market. Immediately following Bernanke's comments two weeks ago, the stock market fell 5.5%, providing the bears and the "sell in May and go away" crowd with a sense of vindication that the inevitable rise in interest rates had begun. However, there may have been a bit of an over reaction. While the change in rates on a relative basis was the largest in decades, we need to keep in perspective that rates were at multi-decade lows. As such, the stock market has fully recovered its losses and moved on to new record highs.

30-year fixed mortgage rate

Source: Freddie Mac

The bond market, on the other hand, has continued to struggle somewhat as many in our business are fearful of a sharp increase in interest rates over the next few months. Of course, the severity and timing of the eventual rise is a topic of great debate among economists and money managers, alike.

In a recent publication of "The Outlook", S&P Capital IQ (a publication of Standard and Poor's), states that "if the economy continues to heal, as we expect, interest rates are unlikely to rise nearly as sharply in the second half of 2013 as they have recently, since significant economic improvement and Fed tapering are already 'baked in the cake'. That is to say the markets have discounted these expectations." Although we agree with this point of view, it may be good to review Bernanke's comments in order to present the facts and to reduce the emotional response.

(Continued on page 2)

(Continued from page 1)

GS Investments, Inc.

Largest Stock Holdings

6/30/2013

Securities	Pct.
Wells Fargo and Company	2.35%
Visa Incorporated	2.05%
US Bancorporation	2.02%
Exxon Mobil Corporation	1.94%
Microsoft Corporation	1.84%
Express Scripts Incorporated	1.72%
Petsmart Incorporated	1.71%
International Business Machines	1.70%
McDonalds Corporation	1.70%
AT&T Incorporated	1.70%

It is well known that interest rates have been at historically low rates for some time, and at some point, rates will rise to more normal levels. The Federal Reserve sets short-term rates, and although it does not control longer-term rates, it does influence them. For several years Mr. Bernanke has remarked that he has several "tools" he can use to influence interest rates and to stimulate liquidity in the financial markets. The more recent tool he has used is referred to as quantitative easing (QE). In short, there have been three phases, QE1, QE2 and QE3. Through quantitative easing the Federal Reserve (the largest buyer of government bonds) buys longer-term government bonds and forces mortgage rates down. This makes home buying more affordable. Think about it. How many readers of this newsletter can remember getting a home mortgage at a 3 1/2% rate (or maybe less)? Granted, a 4 ½% rate is higher than we have seen over the past couple of years, but it is much lower than the 7-9% rates that were common in the 1990's. It is also low when compared to historical mortgage rates since WWII.

Shifting gears to short-term interest rates, inter-bank lending rates, referred to as federal funds, are barely positive. Auto loan rates remain historically low; one needs only to view the current newspaper ads to see that this is true. Corporate commercial paper rates are unusually low and our financial markets continue to be highly liquid. Bernanke noted that although the program to support low long-term interest rates would eventually end, he would keep short-term interest rates low for an extended period. Going back to Alan Greenspan's reign as Federal Reserve chief, it was common to have short rates in a 3-6% range. As we indicated earlier, short rates are barely positive as we write, so 'eventually' getting back to the low point of the normal range should not stop the economy in its tracks. When these rates do eventually rise, they may remain well below the historic range of 3%-6%.

So, what has the Federal Reserve been trying to do? It has been trying, among other things, to stimulate the housing and auto markets, and guess what? It has worked. These markets are huge forces for our economy. The American consumer accounts for 2/3 of our economic output and housing and autos represent a large part of consumer spending.

Returning to Mr. Bernanke's remarks, he emphasized that that there would possibly be a TAPERING of the Fed's bond buying program. This means that the elimination of the program would take place over time; it would possibly be well into 2014 before the program would be ended. The conclusion to be drawn from this reasoning is that longer-term interest rates will gradually be pushed up (due to the absence of the quantitative easing program) and that short-term rates will remain

Economics Forecasts

GDP Growth	Though slowing in early '13, around 1.75% for the year
Interest Rates	Little change through mid-'13. 10-year T-notes at year-end, 2.25%
Inflation	Rising slightly this year, to about 2.3%
Unemployment	Falling gradually over '13, to around 7.5%
Crude Oil	Trading from $95 to $100/bbl. by Memorial Day
Consumer Confidence	Dampened by fiscal worries, then strengthening in summer

1 Kiplinger Letter, March 15, 2013.

(Continued on page 3)

(Continued from page 2)

"AFTER THIS, I'M GOING TO EXERCISE, EAT RIGHT, CUT BACK ON EXPENSES, AND SAVE..."

low for an extended period. They will return to a more normal ranges only if the economy and the unemployment rate improves.

As a consequence, the bond market will likely remain vulnerable to the slightest movement in interest rates for some time going forward. For this reason we continue to hold elevated levels of cash and shorter maturities in the fixed income portion of clients portfolios to minimize any potential losses.

The stock market, on the other hand, may still have upside potential. S&P's "The Outlook" notes that now, "investor focus will likely shift from using stocks as bond-surrogates toward earnings growth and valuations." Further, it notes "This leads us to maintain our 1780 12-month S&P 500 target." At this time of writing the quote is 1686. Hitting their target would represent a 5.6% increase and adding an annual dividend rate of 2% would be an approximate 8% total return. Of course the risk of achieving this return remains, but the opportunity still presents itself.

Finally, from our top 10 holdings you will note that some of our financials have moved up the ranking list. We believe that an environment where short term rates remain low and long term rates move higher, that banks earnings will improve since they borrow on the short end and issue longer termed loans.

Gleanings…

Predictions/Observations in recent Kiplinger and S & P Outlook publications:

- Regarding tax reform they note, "No chance that Congress will undertake comprehensive reform until after next year's mid-term elections. The two parties are just too far apart."
- Federal student loan debt has now topped $1trillion. Outside of mortgage debt, it is the largest debt held by U.S. consumers.
- In comparison, the amount of auto loan and credit card debt held by U.S. consumers today is approximately $783 billion and $679 billion, respectively.
- Federal student loan delinquencies of 30 days or more are running in excess of 11% while delinquencies of 90 days or more are now at 7.6% of total student loan debt.

Notable Quotes

"Every time in this century we've lowered the tax rates across the board, on employment, on saving, investment and risk-taking in this economy, revenues went up, not down."
Jack Kemp

"A government that spends too much is no different than an a person with a severe drinking problem.."
John Boland

"Inflation is when you pay fifteen dollars for the ten-dollar haircut you used to get for five dollars when you had hair."
Sam Ewing

"The safe way to double your money is to fold it over once and put it in your pocket."
Frank Hubbard

"The economy depends about as much on economists as the weather does on weather forecasters."
Jean-Paul Kauffmann

(Continued on page 4)

(Continued from page 3)

Happy birthday to us and more

GS Investments is celebrating its 20th year in business; this includes a new look to our logo and (soon-to-be-completed, website).

Additionally, we are adding a new software component that will allow us to better address our clients' entire financial situation, including educational and retirement needs. Look for more information in the coming months.

Finally, thanks to those who have continued to support and to work with us. We look forward to even better times to come!

"Our greatest compliment is your referral."

333 South 7th Street, Suite 3060
Minneapolis, Minnesota 55402
Phone (612) 371-0590 Fax (612) 371-9869
www.gsinvestments.com
john@gsinvestments.com / glenn@gsinvestments.com /
greg@gsinvestments.com /sheri@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 owners, 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 20 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 Prior to joining GS Investments in 2010 , Greg spent 15 years at Minneapolis-based Ameriprise Financial, a national leader in financial planning with over 2 million retail clients and $300 billion in assets. Greg served in a variety of roles with the most recent in the Asset Management Group. Here 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.