



Economic Indicators
September 5, 2013

Economic Indicators

“Economic Indicators: An Update for the 7 Rivers Region” reports on a long-term study of regional economic indicators. The research is ongoing and spans a period of time to enable us to understand and report trends. This project is expected to continuously build on a base of economic information and provide decision makers with valuable tools for strategic planning. The information will also provide a basis for comparison with other regions and a measure of our progress.

State Bank Financial sponsors this research project in collaboration with the University of Wisconsin-La Crosse College of Business Administration and the *La Crosse Tribune*. These programs will continuously build on a base of information and provide decision makers like you with valuable tools for strategic planning.

Specific goals of this project are:

- Support business owners in their business decisions by gathering key local economic indicators and trend information.
- Develop specific economic indicators for this region that are not readily available to decision makers.
- Develop tools to assess our progress in economic growth. Prepare baseline measures that will allow comparison with other regions and measure future progress of the region.
- Track the region’s participation in the “new economy” and development in the high tech arena.
- Bring professionals together with business owners for discussion about the local economy and related critical issues.
- Create a business recruitment and retention tool by publishing the information.

Core economic indicators cover the following areas:

- Employment
- Income
- Cost of Living
- Consumer Attitude and Behavior
- Real Estate and Housing
- Interest Rates
- Equity Performance

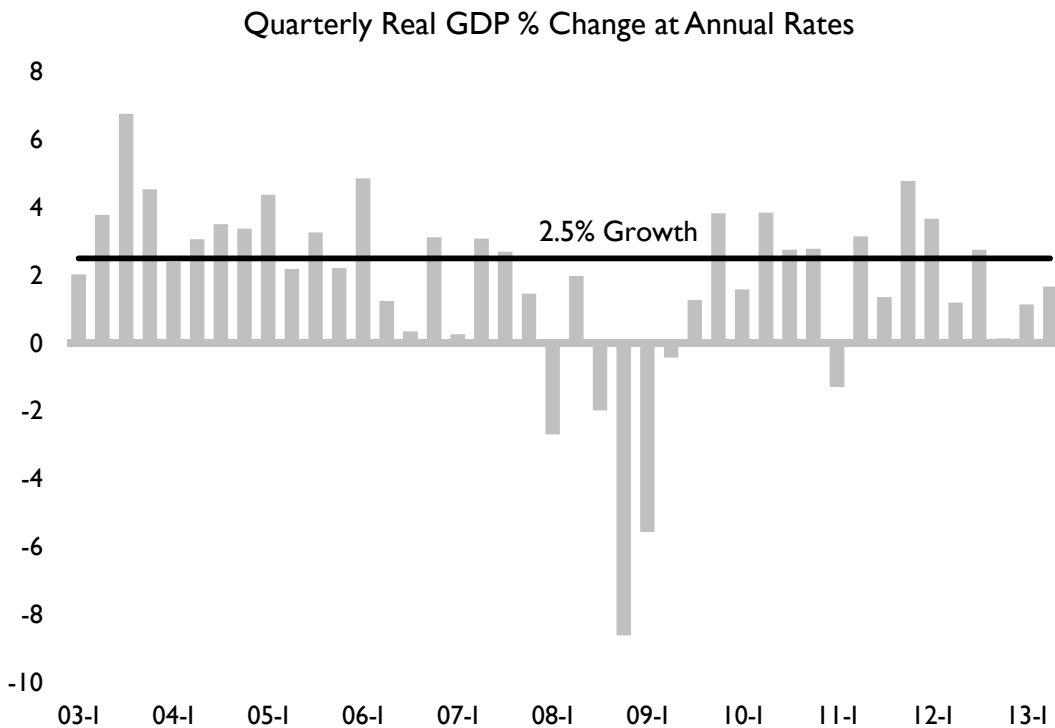
Note: Core economic indicators have been tracked since 2001 to have objective measures for our 7 Rivers Region economy. The number of regional indicators tracked has grown over the years and now far exceeds the space available in this publication. We are working on a solution to provide regular access to updated data on the regional economy.

Economic Indicators and Trends

Taggart J. Brooks, Ph.D., UW-La Crosse Department of Economics

September 2013: Return of the Budget Battles and Economic Policy Uncertainty.

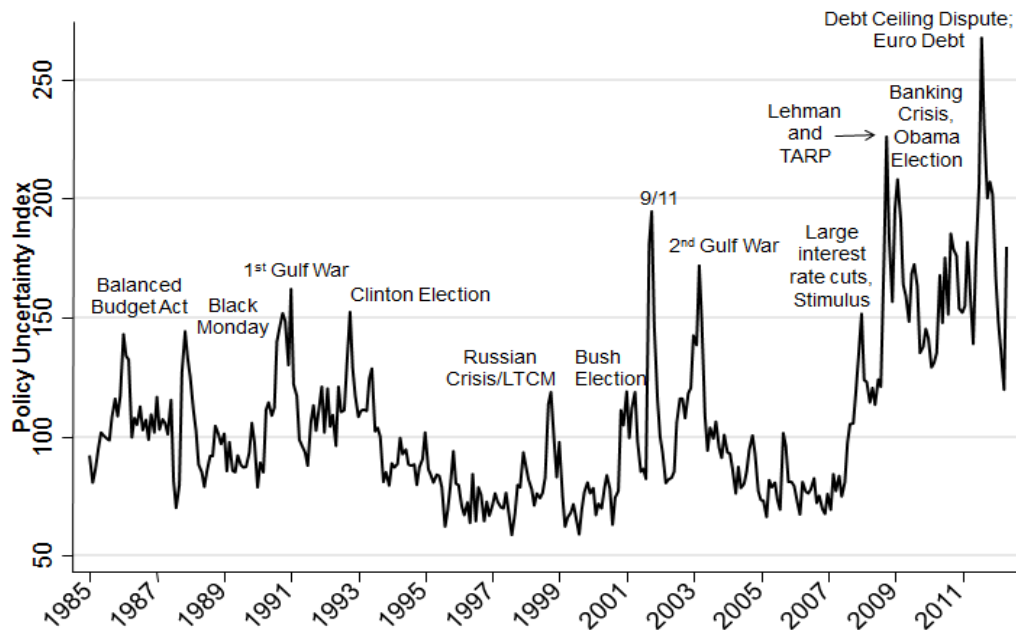
In a slowly growing economy small shocks can easily derail that growth. Last year much time and press was given to the debt ceiling debate and the sequestration. This type of economic policy uncertainty is never a good thing for growth. While only some of the dire predictions of the sequestration have come true,¹ there is no doubt that the sequestration is operating as a fiscal drag on the economy. Real Gross Domestic Product (GDP) growth has been below 2% for both the first and second quarters of 2013. Below is a graph of recent quarterly real GDP at annual rates. I've drawn in a 2.5% line to give some perspective of the economy's potential. Though GDP grew at an annual average of about 3.25% since 1947, recent years have seen a slowdown in GDP growth. 2.5% represents revised estimates of the economy's potential though some economists argue it might be as low as 2%. Either way, recent data has disappointed even such modest revised expectations.



¹ Darla Cameron, David A. Fahrenthold, and Lisa Rein, "Tracking the predicted sequester impacts," *The Washington Post*, June 30, 2013,

<http://www.washingtonpost.com/wp-srv/special/politics/sequestration-federal-agency-update/>

One explanation given for the slowdown prior to 2013 is just the economic policy uncertainty surrounding the debt ceiling debate and sequestration. The argument suggests that firms hold off on capital expenditures in an uncertain environment and this contributes to slow growth. The graph below plots a measure of this policy uncertainty created by economists Scott R. Baker, Nicholas Bloom, and Steven J. Davis. The graph is annotated with some of the events which contributed to large changes in the index in order to give you a sense of the causes of uncertainty over this period.



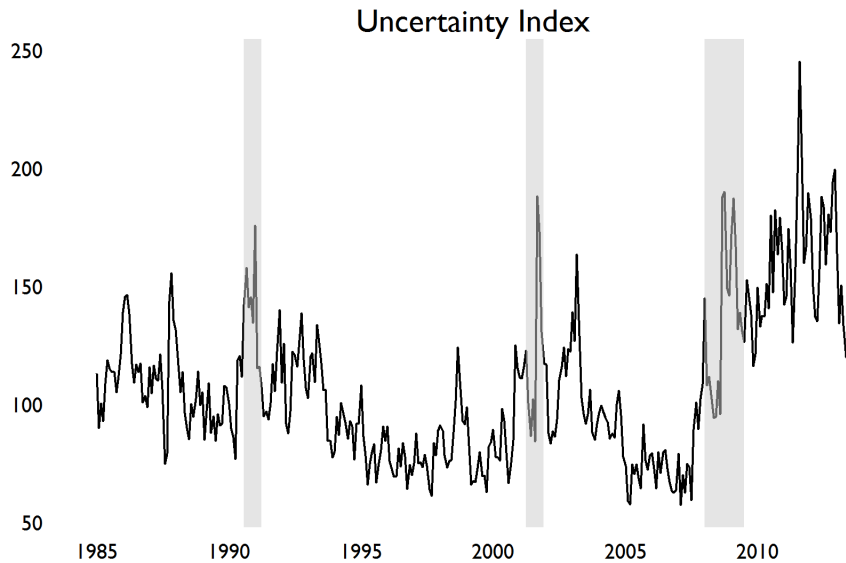
They construct their index as follows:

To measure policy-related economic uncertainty, we construct an index from three types of underlying components. One component quantifies newspaper coverage of policy-related economic uncertainty. A second component reflects the number of federal tax code provisions set to expire in future years. The third component uses disagreement among economic forecasters as a proxy for uncertainty.²

Further details can be found at their website: <http://www.policyuncertainty.com/index.html>. The important thing to note is the recent decrease in policy uncertainty. We no longer wonder about whether or not the sequestration will happen, because it is happening. However, the real or actual effects of the sequestration might now be keeping the economy from more rapid economic growth. That said, recent data from the index dropped it to a level not seen since before the recession. The next graph is an update of the index including the most recent

² Economic Policy Uncertainty, <http://www.policyuncertainty.com/methodology.html>

month. Unfortunately, there are recent hints that the index may begin to rise as the debt ceiling debate seems to be back on the table as a tactic to achieve other legislative ends.³



Given the slow economic growth, policy should be supportive of the economy and delivered with certainty. Unfortunately without those preconditions, being optimistic about the near term is difficult.

Changes in the Housing Market

Locally there are signs to be optimistic about. Our regional housing market continues to experience a solid recovery as depicted in the following graph. The average price change for the previous twelve months was 2.5% with all previous months showing positive gains since June of 2012. It is important to remember these data come from the Wisconsin Multiple Listing Service (MLS) and coverage includes only those homes listed on MLS and sold within the reporting month in one of the 7 Rivers Region counties included (Jackson, Juneau, La Crosse, Monroe, Trempealeau, Vernon Counties, Houston and Winona). Unlike the Case-Shiller Index which attempts to capture only homes which were sold more than once (a repeat sales measure), our measure does not attempt to match the prices of houses sold more than once. We merely use the mean sales price for all homes sold in that month, and thus our measure is subject to changes in the distribution or types of homes being sold in any given month. So we need to be cautious in our interpretations as we cannot be certain we are capturing true price changes.

³ Brett Logiurato, "The GOP Is No Longer Threatening A Government Shutdown And Will Instead Threaten Something Much Worse," *Business Insider*, August 14, 2013, <http://www.businessinsider.com/government-shutdown-debt-ceiling-obamacare-2013-8>

For example, back in 2010 there was a tax credit for first time and existing home buyers.⁴ According to this article from TurboTax:

The Congress and the Obama Administration extended and expanded the wildly popular 2008 first-time homebuyer tax credit. In addition, the income limits were increased, making even more people eligible.

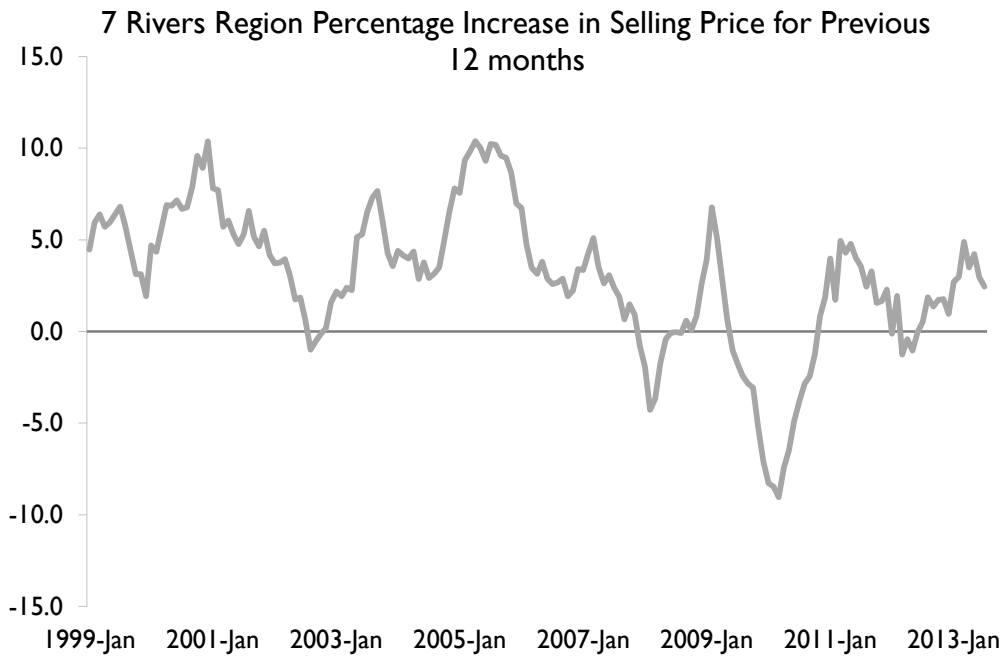
Existing homebuyers are eligible to receive a tax credit of 10% of the purchase price up to \$6,500 if they bought and closed on a replacement home by September 30, 2010. In order to be eligible for the credit, homeowners must have lived in the same principal residence for any five-consecutive-year period during the past eight years. They are not required to sell or dispose of their current home, but the new home must become their principal residence.

If you purchased and closed on a primary residence before September 30, 2010, and are a “first-time” homebuyer, you can qualify for a tax credit of 10% of the purchase price up to \$8,000. To be eligible, you must not have owned a residence in the United States in the previous three years.

To qualify for either credit, you must have signed a binding contract to buy the house by April 30, 2010, and closed on it by September 30, 2010.

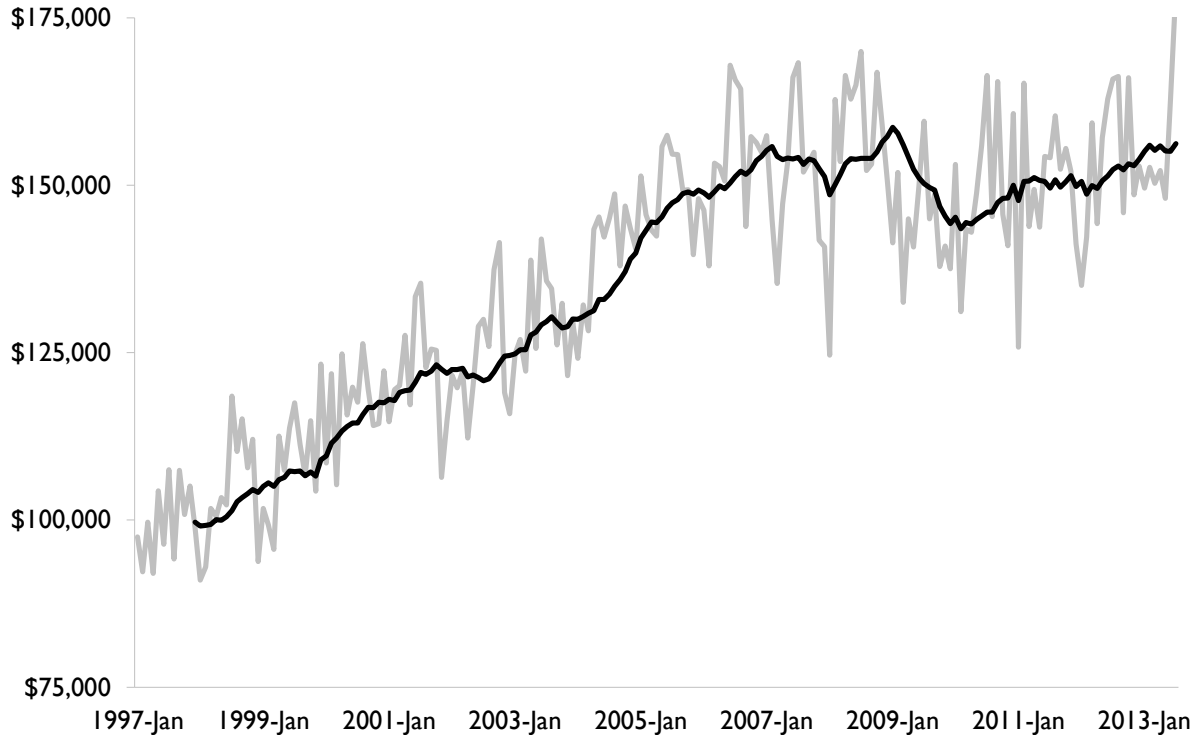
As you can see from the next graph, in both 2008 and 2010 there was a large decrease in average home price during that time, some of which was clearly the result of this tax credit increasing the number of first time buyers in the market. First time buyers tend to buy smaller, less expensive homes, and thus bring the average monthly price down.

⁴ “Summary of Federal Tax Law Changes for 2010-2017,” TurboTax, Updated for Tax Year: 2012, <https://turbotax.intuit.com/tax-tools/tax-tips/IRS-Tax-Return/Summary-of-Federal-Tax-Law-Changes-for-2010-2017/INF12041.html>



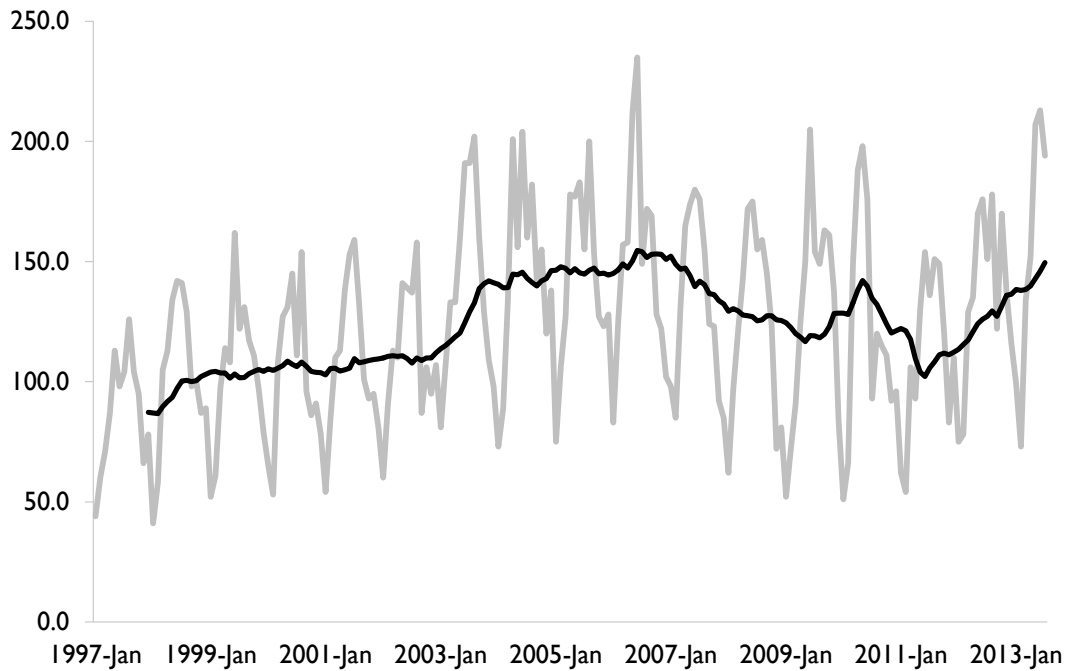
Another look at the evolution of home prices can be found in the level of average prices plotted below, rather than the percentage change in the average price as plotted above. From this picture you can see the most recent month has seen the highest average price since we have been keeping track of the data. The raw averages are in grey, while the black line represents the twelve month moving average designed to make a rough accounting for seasonal effects which are obviously present in the data.

Average Price of Single Family Homes Sold in 7 Rivers Region



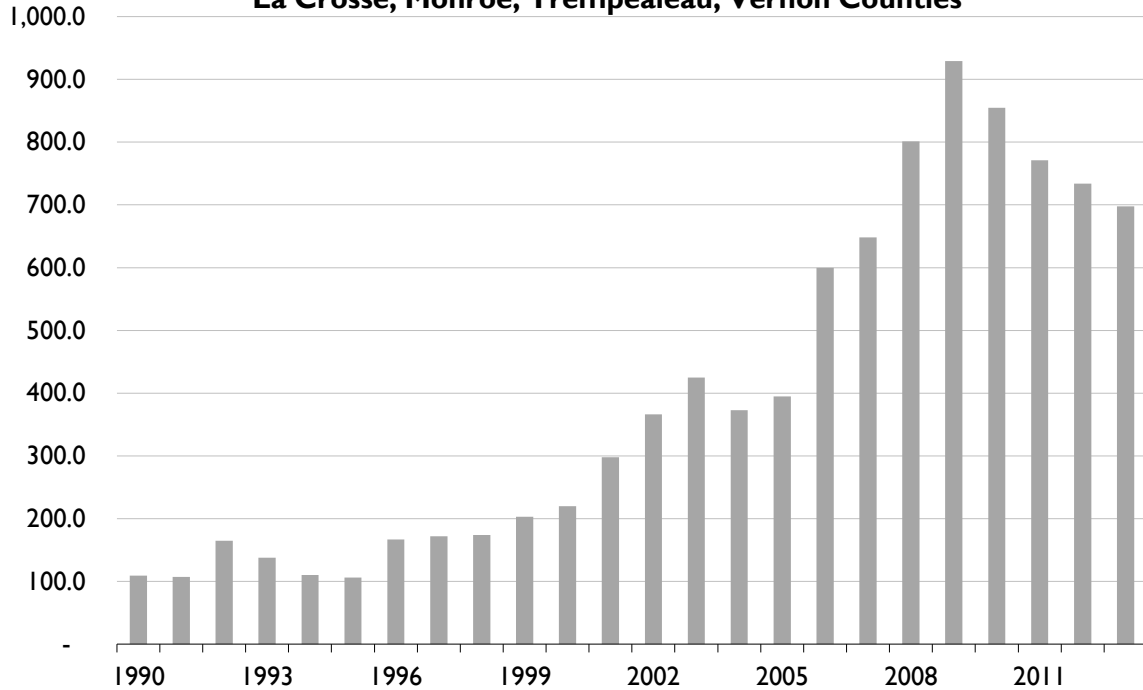
Another metric we track, in addition to the price of homes, is the number of homes which have been sold. The actual number of listings sold in the region during the month of July was 194. The twelve month moving average for the number of listings sold in the region has risen to 146 per month, only slightly below the peak in August of 2006 of 154 listings per month. This combination of rising prices and an increase in the quantity of homes sold suggests our housing market is well on the path of recovery. Other areas of the country have not experienced quite the same rebound as limited supply has kept the number of sales in the market from rebounding. As prices rise, new home production returns, and people regain positive equity in their homes we will see a return to more normal inventory levels and a more normal housing market throughout the rest of the US.

Number of Single Family Listings Sold Monthly 7 Rivers Region



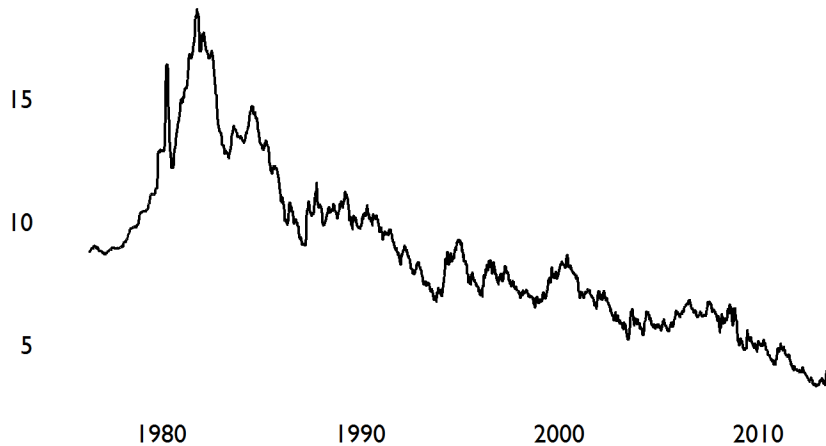
Based on the first 225 days of 2013 – projecting the same pace of foreclosures for the remainder of 2013 gives us an estimate of around 697 foreclosures in the region, down from the peak in 2009 of 929.

Total Number of Foreclosures Filed in Jackson, Juneau, La Crosse, Monroe, Trempealeau, Vernon Counties



Part of what has aided the recovery in housing is the historically low interest rates, brought about in part by the actions of the Federal Reserve. In May the 30-Year fixed rate mortgage rate was at a low of 3.3% and though it has raised more recently it is still only 4.4%. Turning to the graph below we can see how unique a period this is for long term interest rates.

30-Year Fixed Rate Mortgage Average in the United States



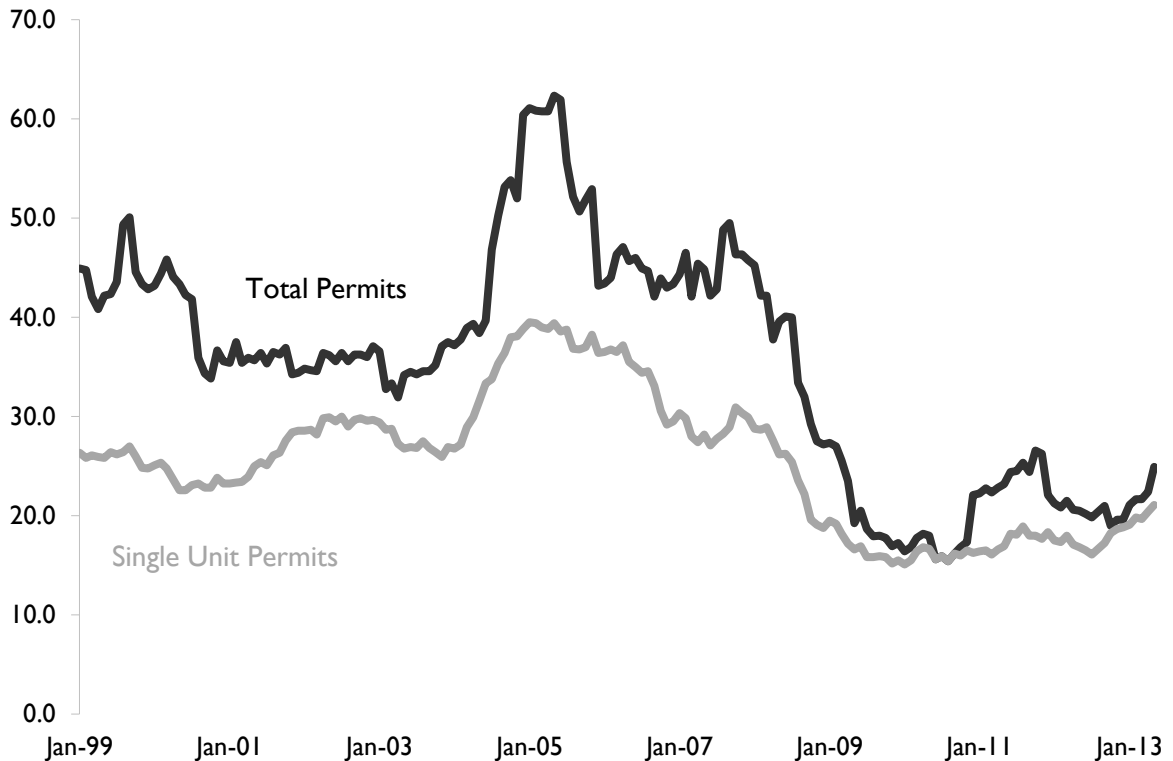
Low rates have also helped the construction industry nationally and locally.⁵

Builder confidence in the market for newly built, single-family homes rose three points to 59 on the National Association of Home Builders/Wells Fargo Housing Market Index (HMI) for August, released today. This fourth consecutive monthly gain brings the index to its highest level in nearly eight years.

Locally while the number of permits has clearly risen in the past few months both the total number of permits and the number of permits for single family homes, it is far from its peak. The data graphed below covers the La Crosse, WI-MN MSA which includes both Houston County, Minnesota, and La Crosse County, Wisconsin.

⁵ "Builder Confidence Rises Three Points in August," *National Association of Home Builders*, August 15, 2013, http://www.nahb.org/news_details.aspx?sectionID=134&newsID=16428

Number of Building Permits in La Crosse MSA



Finally, the housing market is far enough along the road to recovery that the President is contemplating regulatory changes to the market for home loans.

He proposed to “wind down” Fannie Mae and Freddie Mac, for the first time outlining his approach to overhauling the two giant mortgage-finance companies that were taken over by the government when they failed nearly five years ago. The companies, which Mr. Obama described in an appearance here as “not really government, but not really private sector,” recently began to repay taxpayers.

“For too long, these companies were allowed to make big profits buying mortgages, knowing that if their bets went bad, taxpayers would be left holding the bag,” the president said. “It was ‘heads we win, tails you lose.’”

Since early 2011, the administration has voiced support for overhauling Fannie Mae and Freddie Mac, which long benefited from an implicit government guarantee. Years ago the companies came to symbolize a self-dealing Washington culture beneficial to both parties, and especially Democrats, but Mr. Obama’s remarks on what comes next were his most specific.

For several years, the administration held back from revamping the mortgage-finance system for fear of rattling a weakened market.⁶

One wonders what the implicit government guarantee has meant for interest rates in the market. It has obviously subsidized the loans, but by how much? Recall that Fannie Mae for example underwrites "conforming" loans and so called "Jumbo loans" are not covered, thus one might look at the spread between interest rates on conforming and non-conforming loans to see what our market will look like when the regulatory change ends the implied government backstop.

According to research entitled "The Effect of Housing Government-Sponsored Enterprises on Mortgage Rates" by Wayne Passmore, Shane M. Sherlund, and Gillian Burgess it is small.⁷ They estimate it is worth about 7 basis points or about 0.07%. An alternative proposal found in the chapter "Valuing Government Guarantees: Fannie and Freddie Revisited" by Deborah Lucas and Robert McDonald suggests the insurance premium the federal government would have to receive, to be an actuarial fair tradeoff to continue its backing of Fannie and Freddie, would be 20-30 basis points in normal times.⁸

Regional Consumer Sentiment

In early August I distributed via email the semi-annual consumer sentiment survey to 1396 past participants in programs related to the 7 Rivers Region. I received 213 responses for an overall response rate of 15.3%. A table with all the data since the inception of the regional survey is available in the Appendix. We see from February of 2009 to August 2013 the regional overall consumer sentiment index has generally risen, but always remained above the national index. The Current Conditions and the Expectations sub index have both trended upward over the last few surveys, though they have yet to return to their pre-recession levels.

⁶ Jackie Calmes, "Obama Outlines Plans for Fannie Mae and Freddie Mac," *The New York Times*, August 6, 2013, <http://www.nytimes.com/2013/08/07/us/politics/obama-fannie-mae-freddie-mac.html>

⁷ Wayne Passmore, Shane M. Sherlund, Gillian Burgess, July 29, 2005, "The Effect of Housing Government-Sponsored Enterprises on Mortgage Rates," *Wiley Online Library*, <http://onlinelibrary.wiley.com/doi/10.1111/j.1540-6229.2005.00125.x/full>

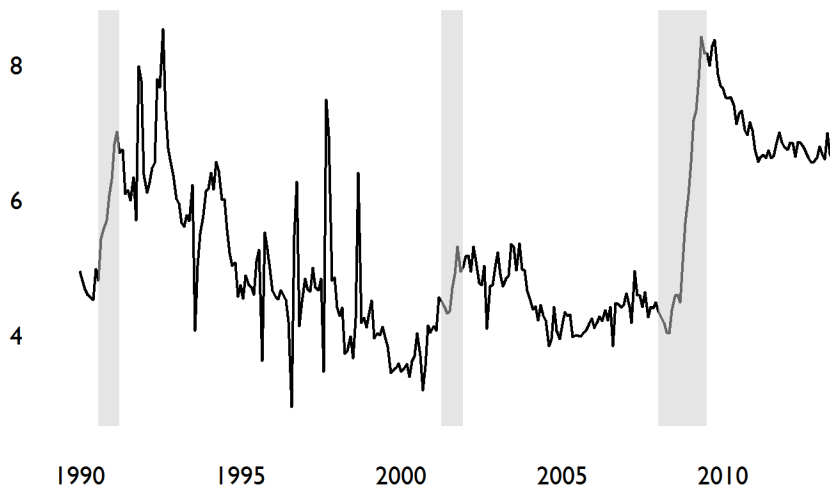
⁸ Deborah Lucas, Robert McDonald, "Valuing Government Guarantees: Fannie and Freddie Revisited," *National Bureau of Economic Research*, February 2010, <http://www.nber.org/chapters/c3041.pdf>

Regional Labor Markets

County level unemployment rates appear to have stalled in their descent back to pre-recession levels. Additional 7 Rivers Region data can be found in the Appendix, but below you can find two examples. The data come from the Bureau of Labor and Statistics (BLS) Local Area Unemployment Statistics (LAUS) program.⁹ They are not seasonally adjusted so I use the ARIMA X-12 method to adjust them. What are presented are then the seasonally adjusted unemployment rates.

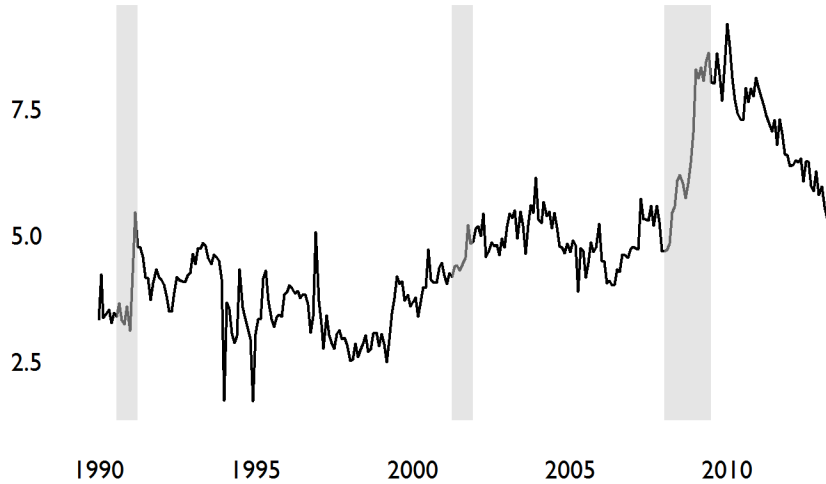
As you can see from the graphs, Monroe County is still three percentage points above the pre-recession level, while Houston County is about two percentage points above its pre-recession level.

Unemployment Rate in Monroe County, WI



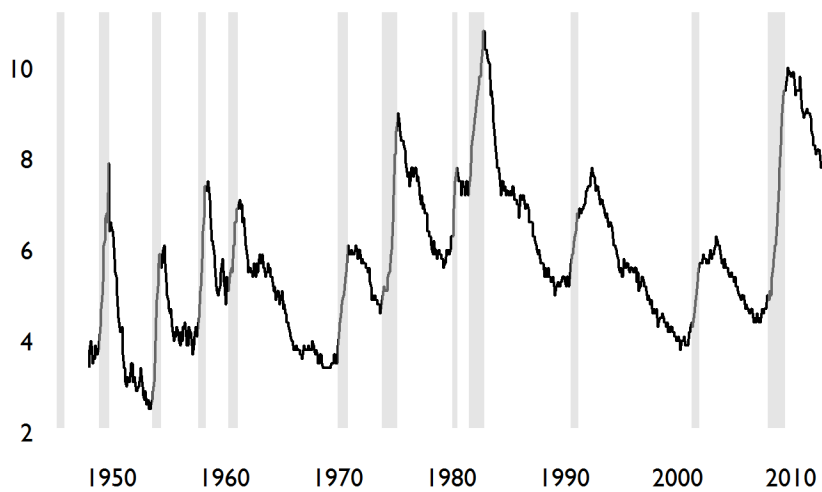
⁹ United States Department of Labor, Bureau of Labor Statistics, <http://www.bls.gov/lau/>

Unemployment Rate in Houston County, MN



While the US national unemployment rate has been falling, it does not appear to have stalled in the same way as local unemployment rates, but it too is three percentage points above its pre-recession level.

Civilian Unemployment Rate





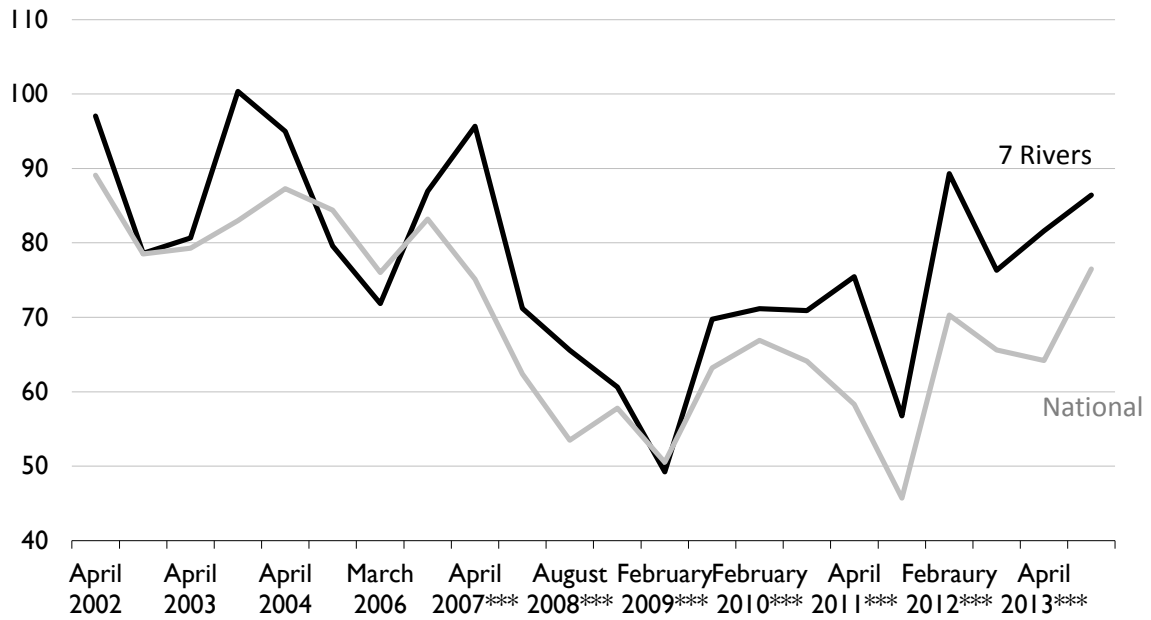
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Appendix

	Consumer Sentiment		Current Conditions		Consumer Expectations	
	7 Rivers	National	7 Rivers	National	7 Rivers	National
April 2002	96.1	93	94.7	99.2	97.1	89.1
November 2002	85.8	84.2	97.0	93.1	78.6	78.5
April 2003	86.0	86	94.4	96.4	80.6	79.3
October 2003	102.0	89.6	104.6	99.9	100.4	83.0
April 2004	98.1	94.2	102.9	105	95.0	87.3
February 2005	87.9	94.1	100.7	109.2	79.6	84.4
March 2006	85.9	88.9	107.6	109.1	71.9	76.0
November 2006	90.8	92.1	96.7	106	86.9	83.2
April 2007***	102.7	89.2	113.7	111.1	95.7	75.1
February 2008***	79.1	70.8	91.3	83.8	71.2	62.4
August 2008***	69.9	61.2	76.5	73.1	65.6	53.5
December 2008***	70.9	60.1	87.0	69.5	60.6	57.8
February 2009***	59.7	56.3	75.9	65.5	49.2	50.5
July 2009***	75.2	66	83.7	70.5	69.7	63.2
February 2010***	79.2	73.7	91.8	84.1	71.2	66.9
August 2010***	79.0	69.6	91.5	69.0	70.9	64.1
April 2011***	80.5	68.2	88.2	83.6	75.5	58.3
August 2011***	66.2	54.9	80.8	69.3	56.8	45.7
February 2012***	94.4	75.3	102.4	83.0	89.3	70.3
August 2012***	84.3	72.3	96.8	82.7	76.3	65.6
April 2013***	88.8	72.3	99.9	84.8	81.6	64.2
August 2013***	93.0	85.1	103.3	98.6	86.4	76.5

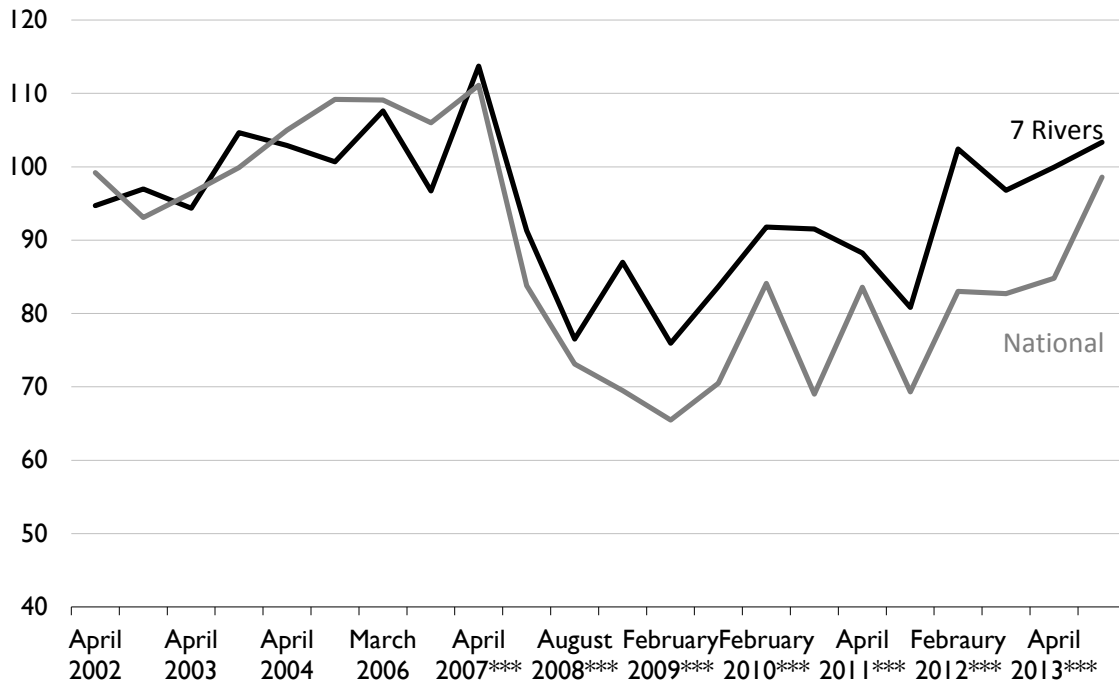
*** Survey moved to the web.

Consumer Expectations Index



*** Survey moves to web

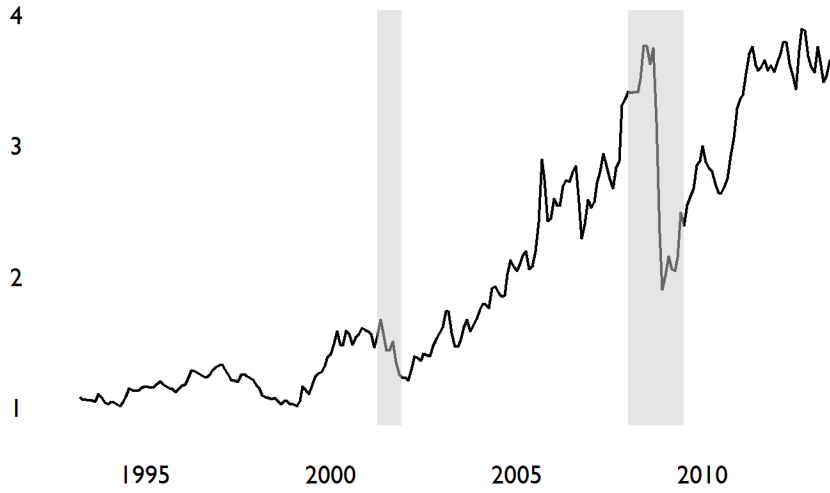
Current Conditions Index



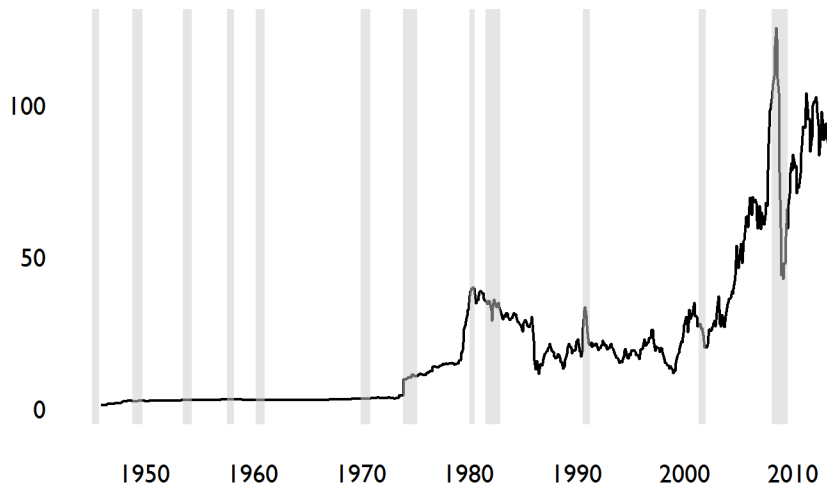
*** Survey moves to web

Appendix: Misc Data

US All Grades All Formulations Gas Price

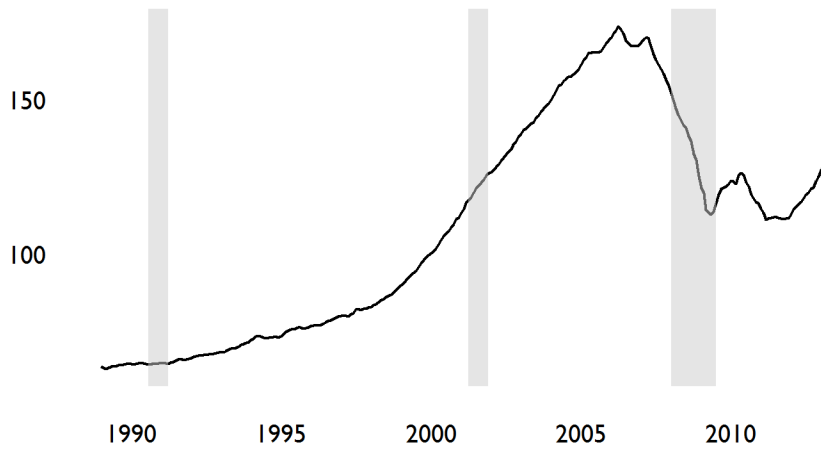


Spot Oil Price: West Texas Intermediate



Appendix: Regional Housing Market Data

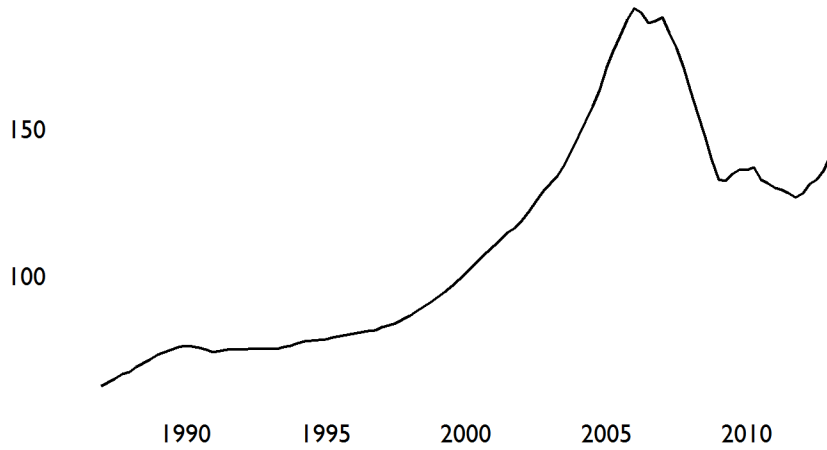
S&P Case-Shiller Home Price Index for Minneapolis, Minnesota



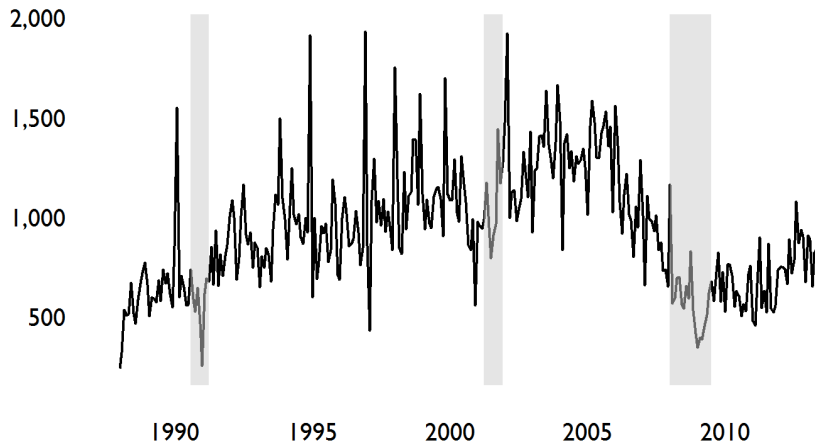
S&P Case-Shiller 20-City Home Price Index



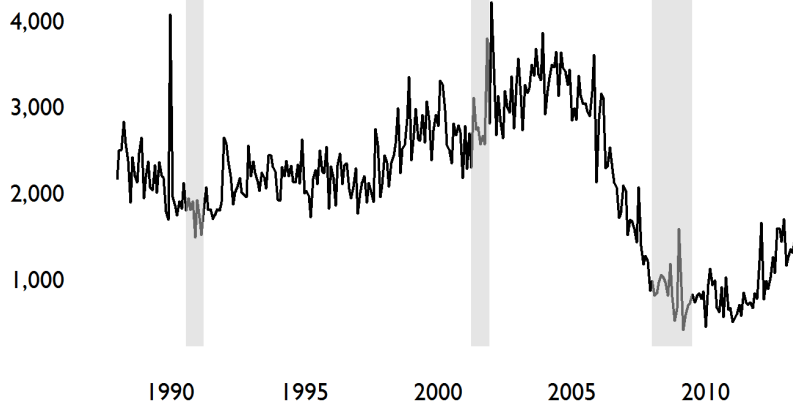
S&P Case-Shiller National Composite Home Price Index for the United States



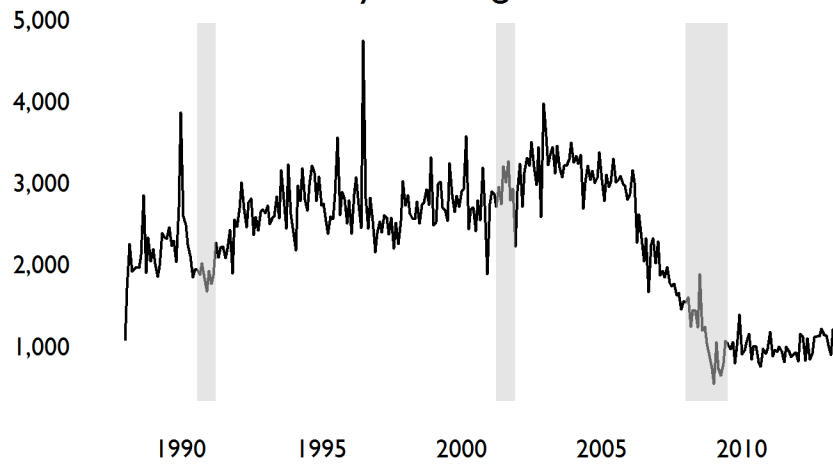
Iowa - New Private Housing Units Authorized By Building Permit



Minnesota - New Private Housing Units Authorized By Building Permit

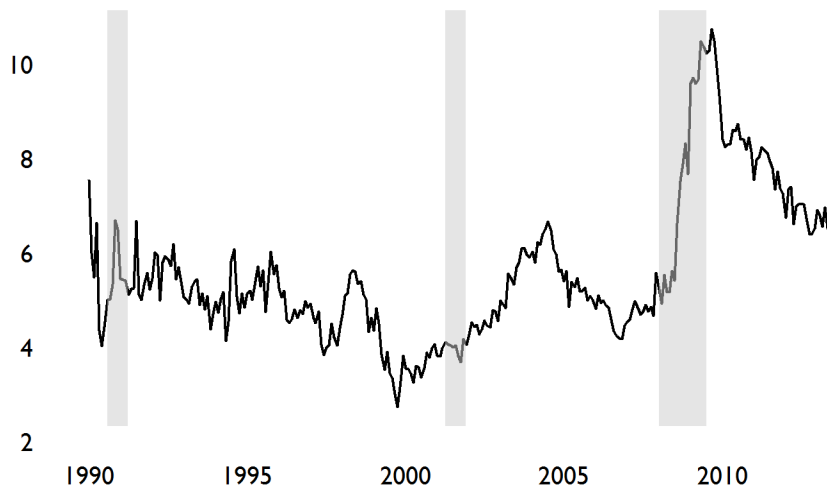


Wisconsin - New Private Housing Units Authorized By Building Permit

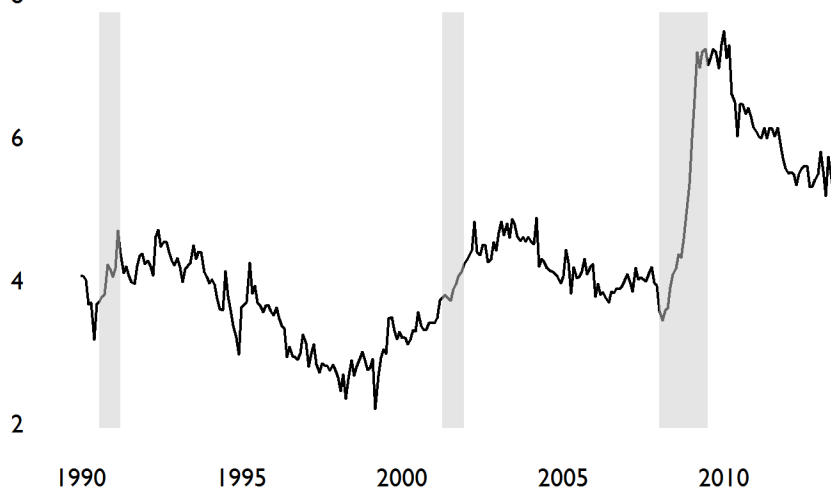


Appendix: Regional Labor Market Data

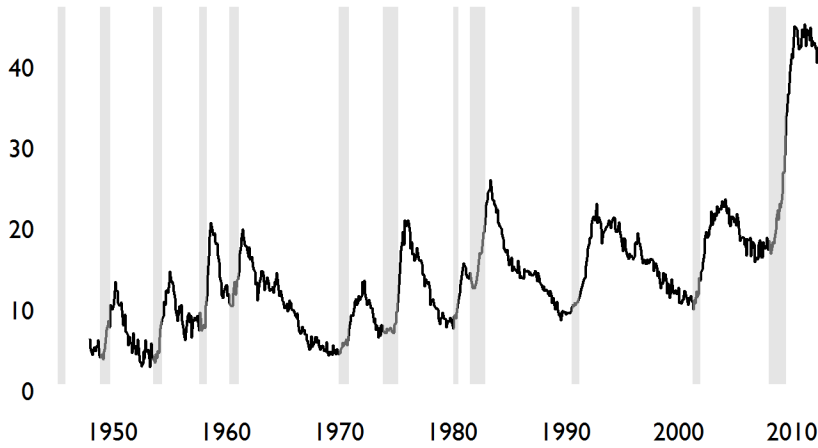
Unemployment Rate in Allamakee County, IA



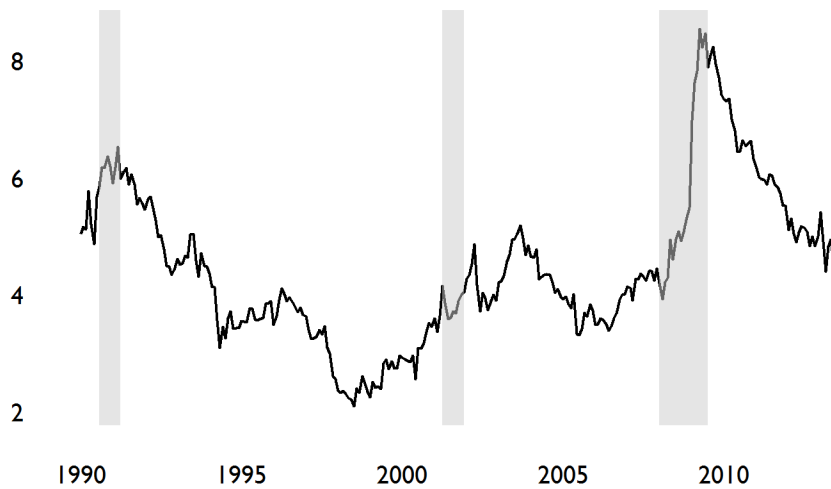
Unemployment Rate in La Crosse, WI-MN (MSA)



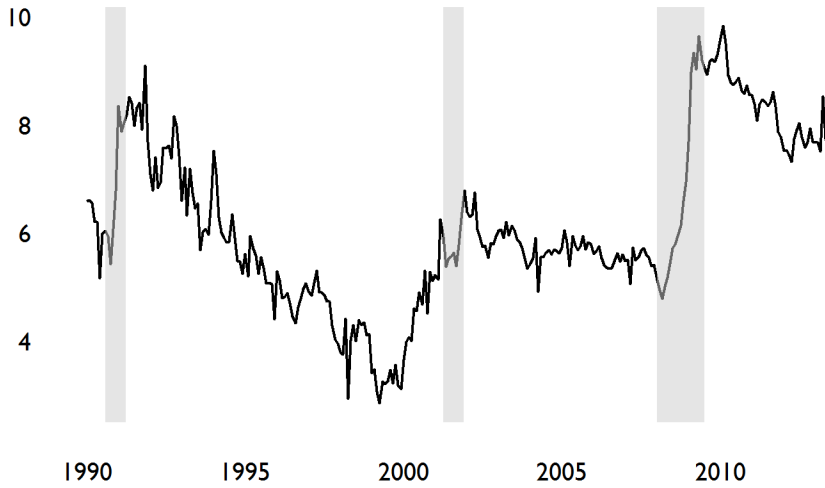
Of Total Unemployed, Percent Unemployed 27 Weeks and Over



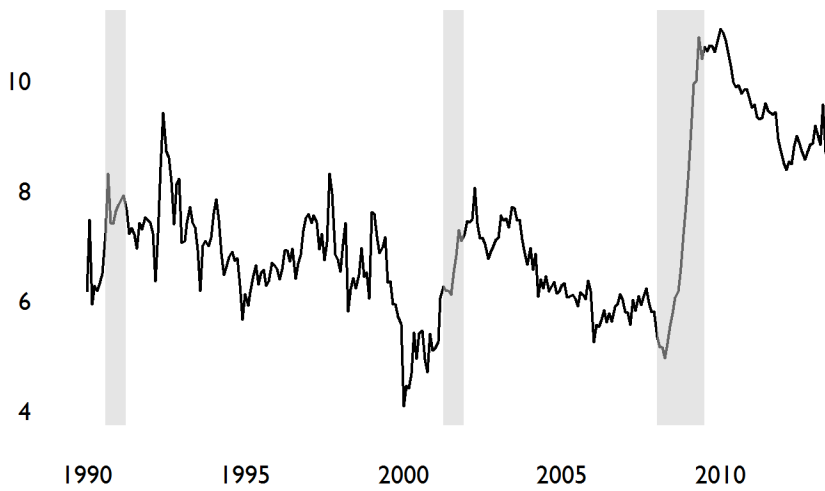
Unemployment Rate in Winona County, MN



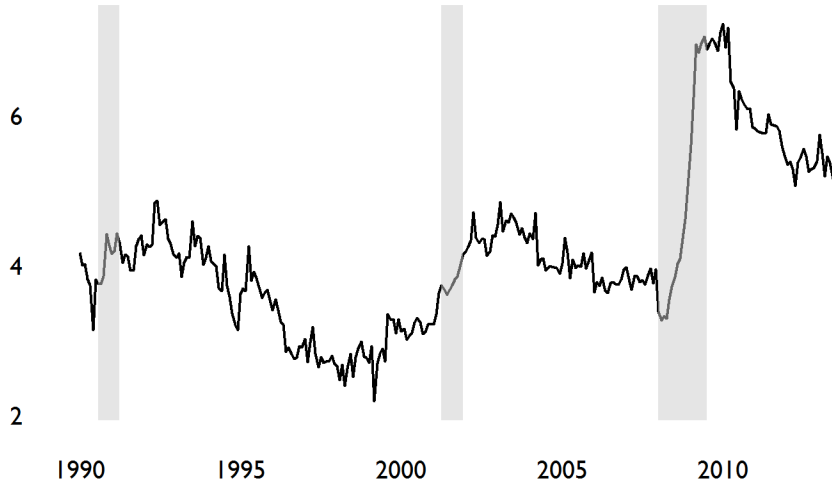
Unemployment Rate in Jackson County, WI



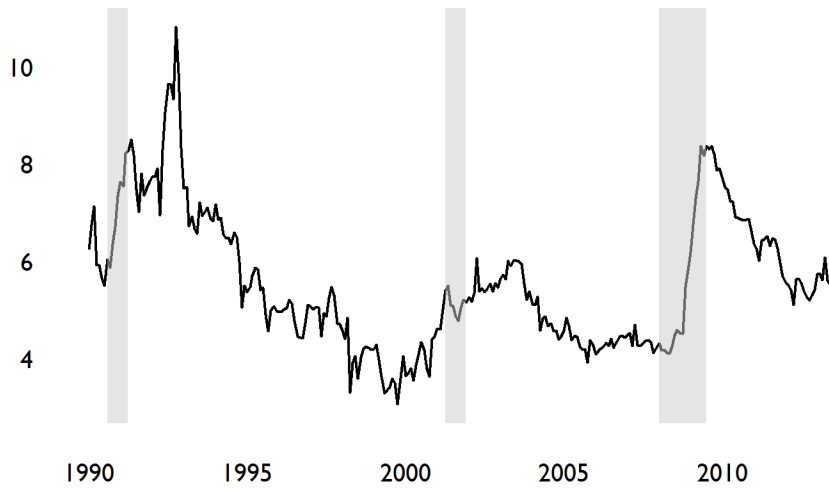
Unemployment Rate in Juneau County, WI



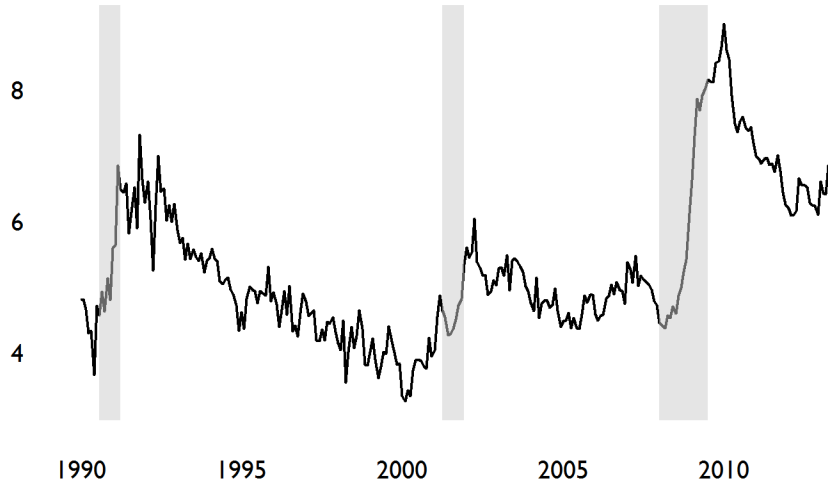
Unemployment Rate in La Crosse County, WI



Unemployment Rate in Trempealeau County, WI

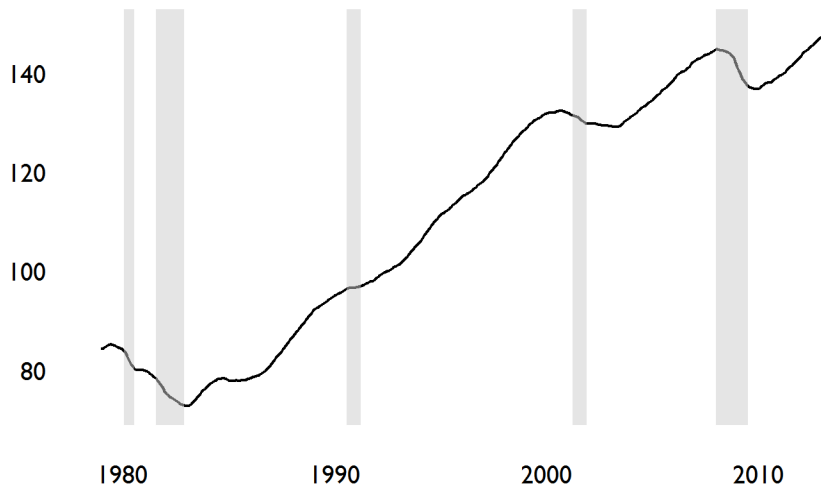


Unemployment Rate in Vernon County, WI

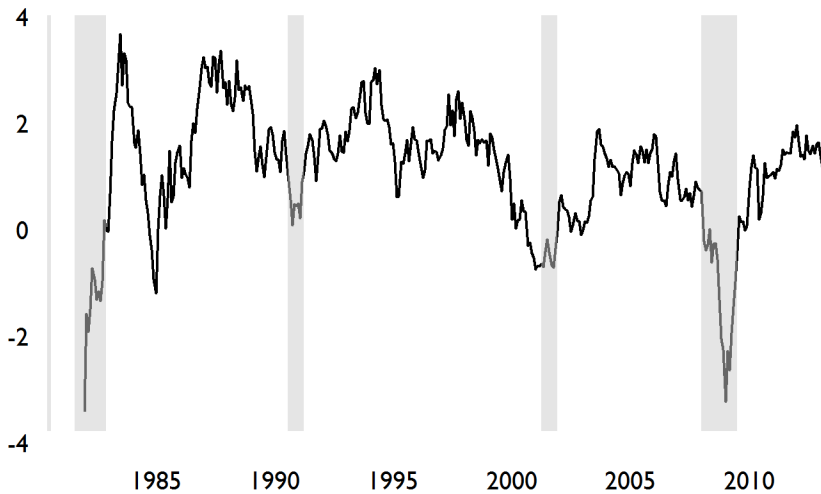


Appendix: Business Cycle Indicators

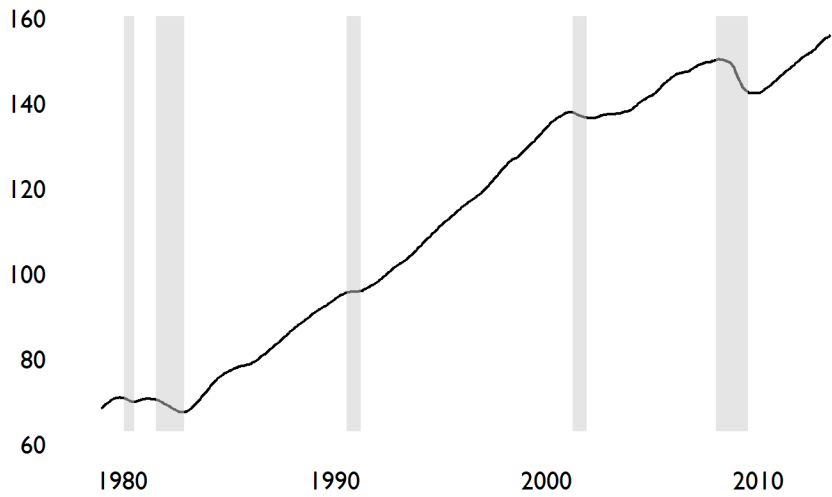
Coincident Economic Activity Index for Iowa



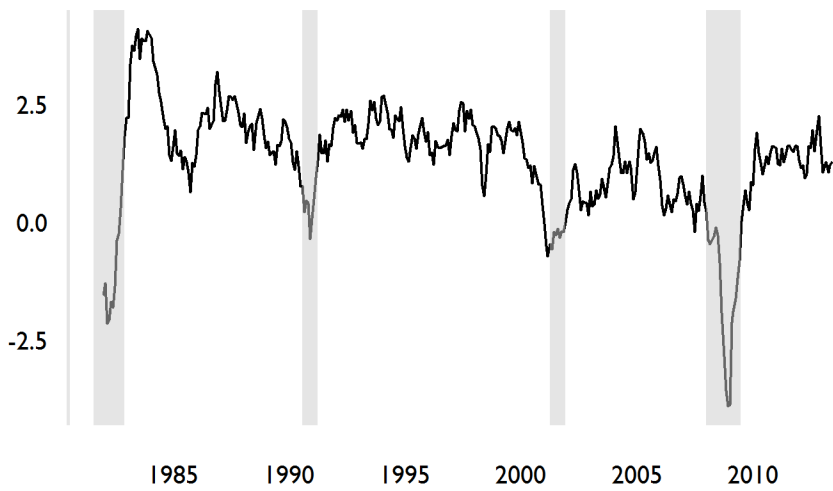
Leading Index for Iowa



Coincident Economic Activity Index for Minnesota



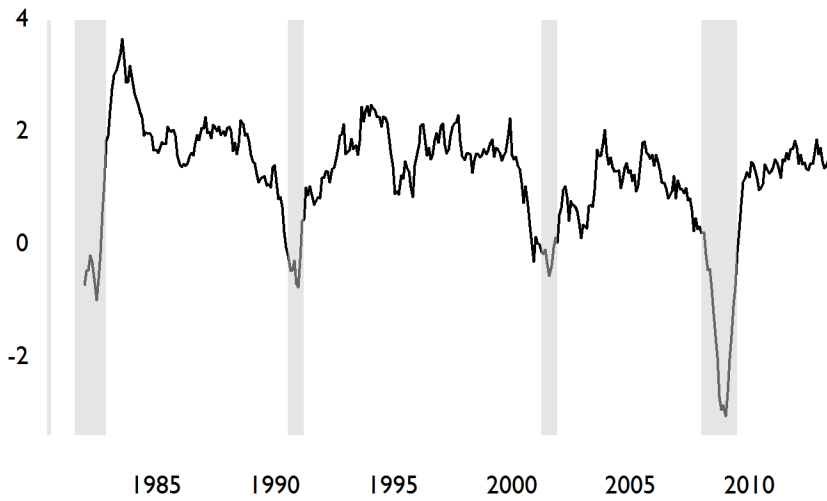
Leading Index for Minnesota



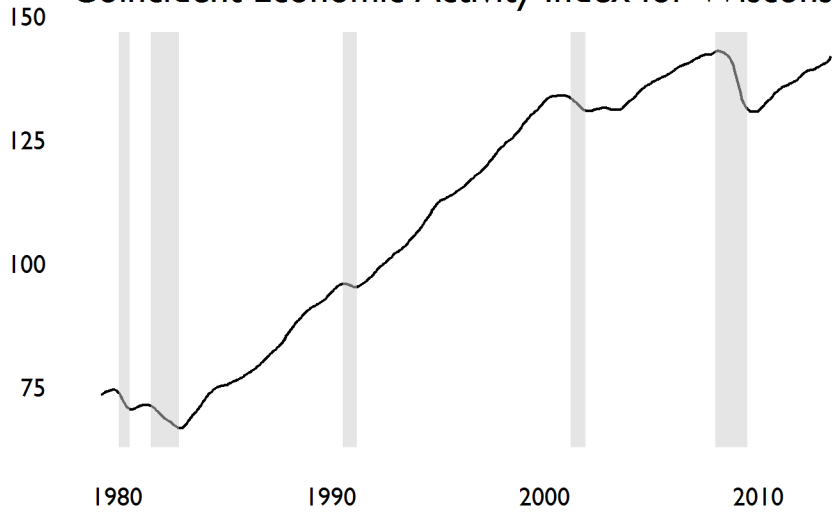
Coincident Economic Activity Index for the United States



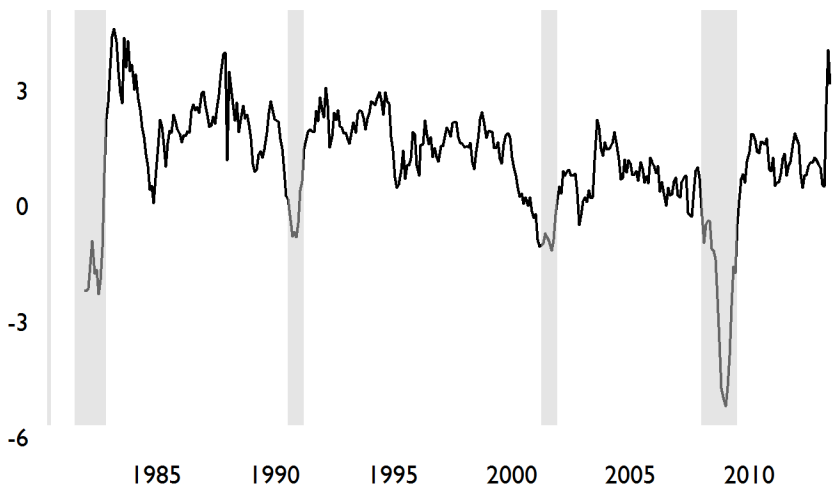
Leading Index for the United States



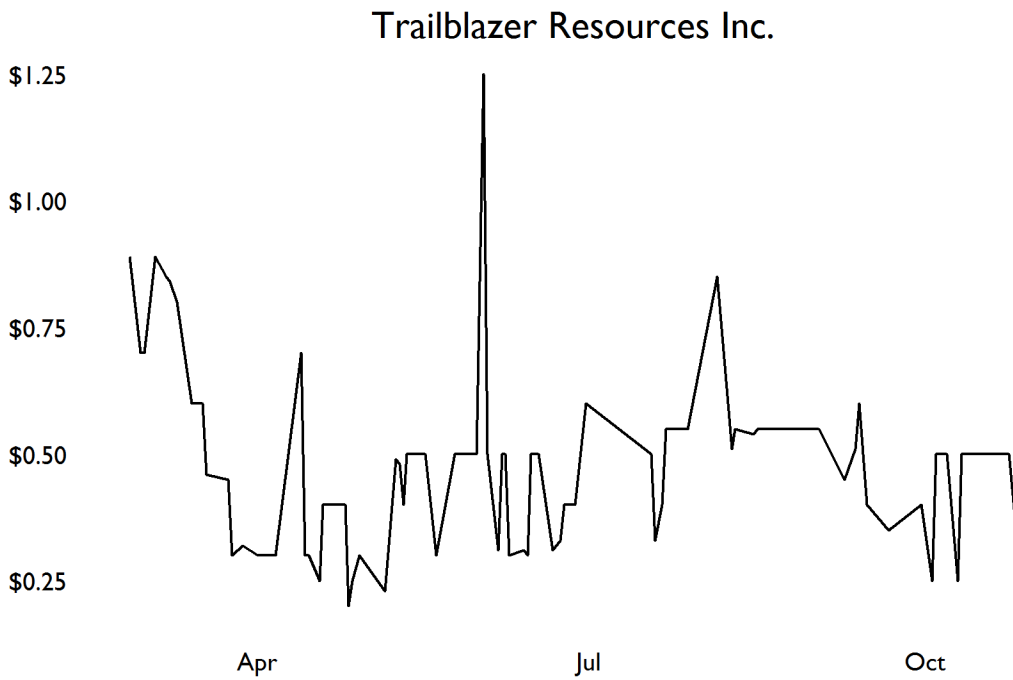
Coincident Economic Activity Index for Wisconsin



Leading Index for Wisconsin



Appendix: Local Stocks and Stock Indicators



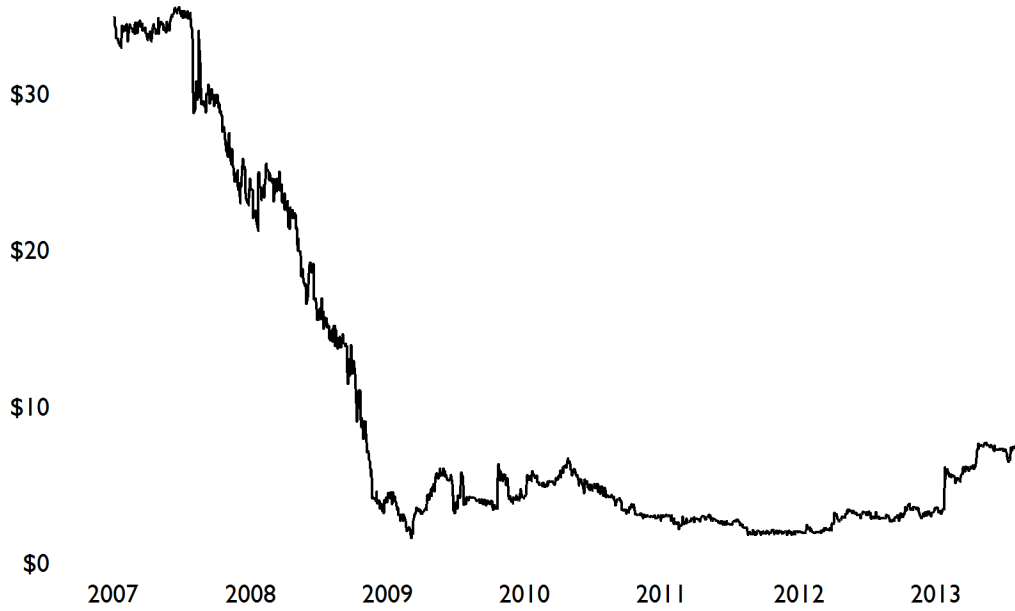
Fastenal Company



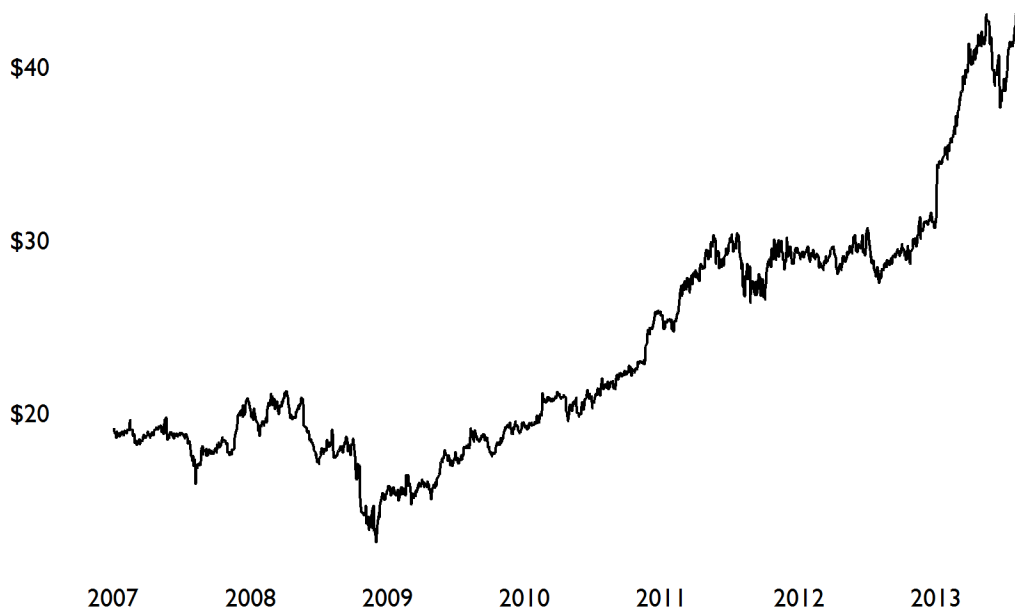
Flexsteel Industries, Inc.



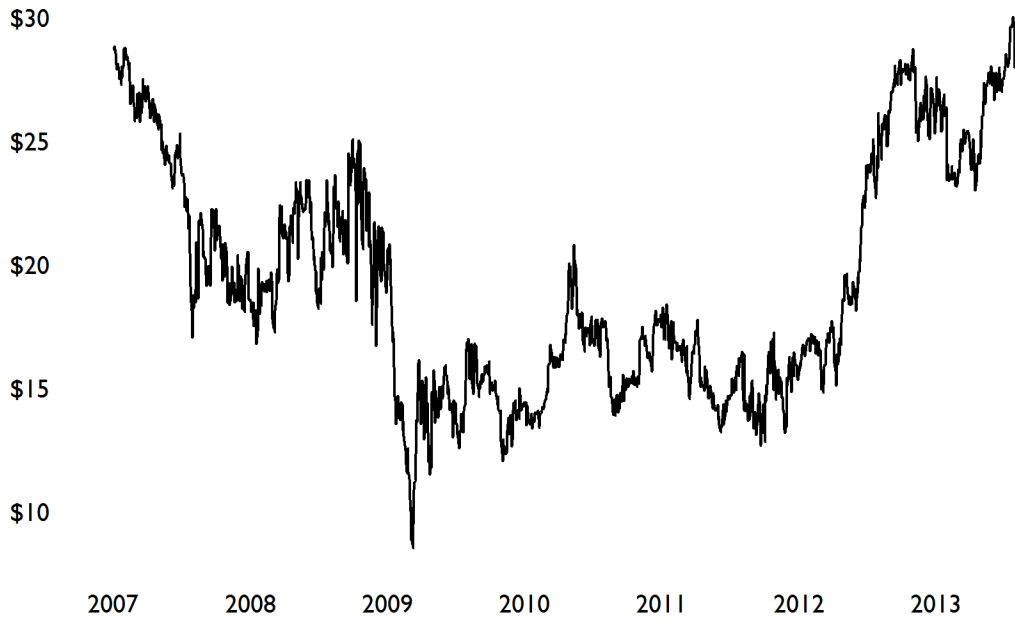
HMN Financial, Inc.



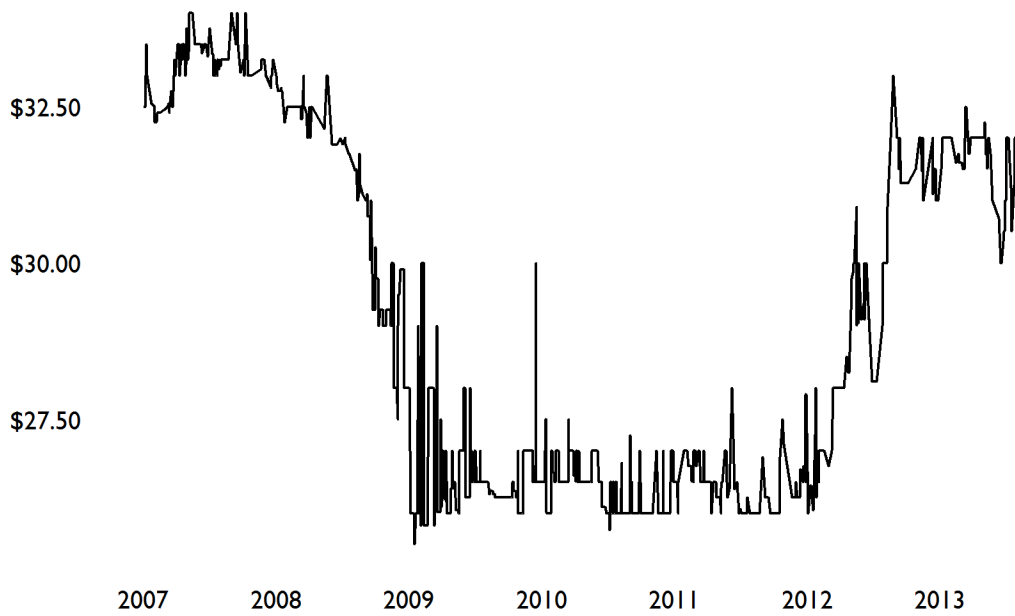
Hormel Foods Corporation



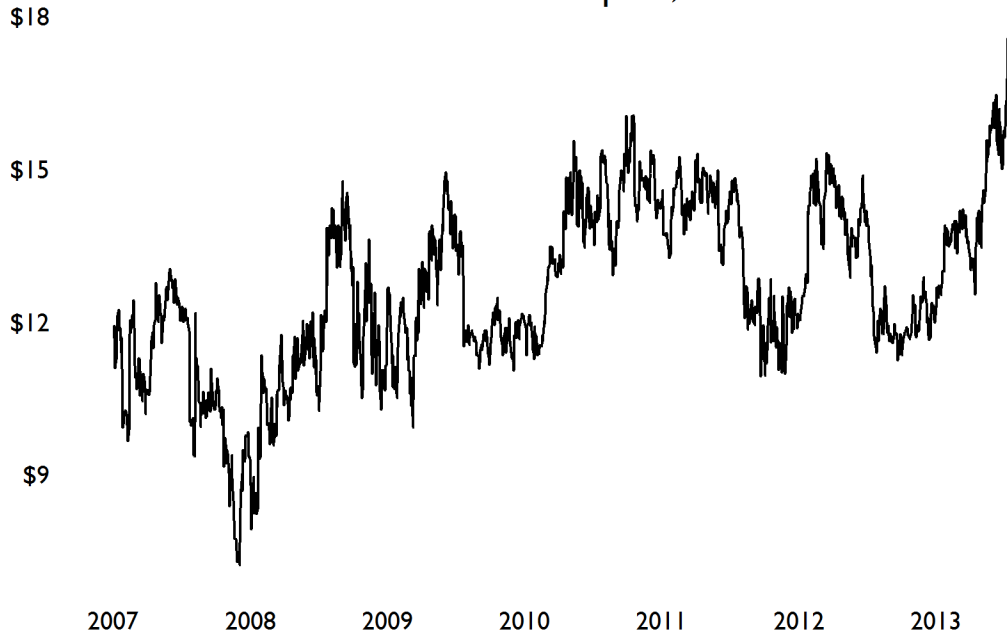
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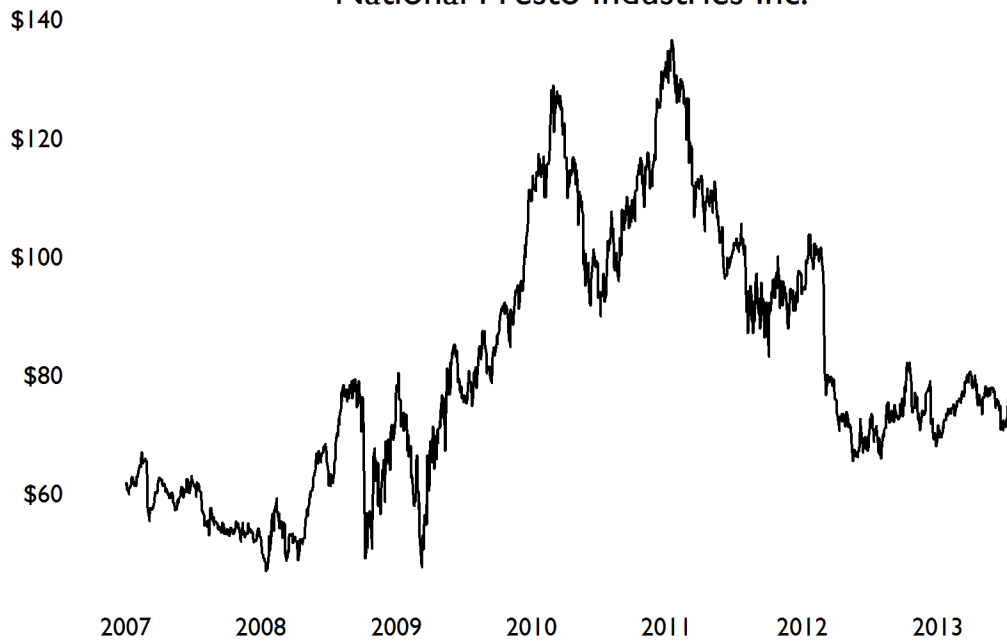
Merchants Financial Group, Inc.



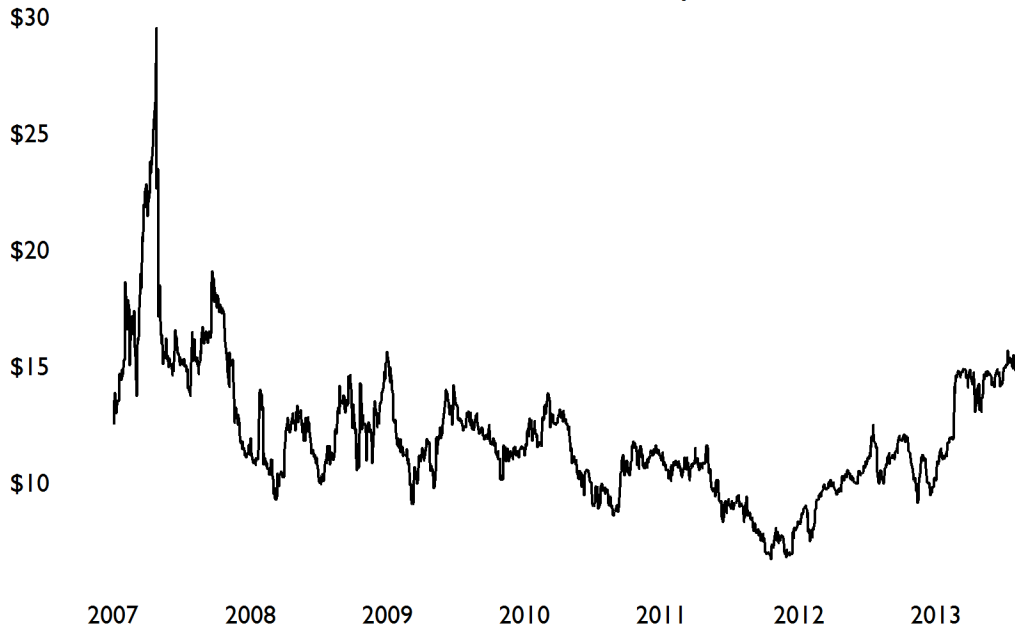
Marten Transport, Ltd



National Presto Industries Inc.



Rochester Medical Corporation



Wausau Paper Corp.





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Seven Rivers Equity Index Update: Strong Recent Performance Consistent with Benchmarks; Indicators Point to Average Performance in the Near Term

Shane Van Dalsem, Ph.D., UW-La Crosse Department of Finance

Introduction

Tracking of the Seven Rivers Equity Index (SREI) began in 2000 as a way to provide information concerning publicly-traded firms headquartered in the 7 Rivers Region to investors and the business community. The value of the index is that it provides a measure of the economic health of the region as several of the businesses within the index have a significant impact on the region. These firms affect the economy of the region in two important ways. First, ownership of the firms is concentrated at higher levels within the area of the firm's headquarters due to the stock ownership of the founders, management, and employees of the firm. As stock returns increase, wealth is imported into the region. Second--to the degree at which the firms' operations occur within the region--profits, cash flows, and investments of the firms are a measure of economic activity and health of the region.

This report covers the performance of the index and its components for the past five years (ending August 1, 2013). During this time period, the country and region have been recovering from one of the largest recessions in the nation's history. During the most recent year, the index has performed similarly to its benchmarks.

In this issue I describe the past performance of the index and examine indicators of future performance of the components of the index. For the past year the performance of the SREI has been consistent with that of its benchmarks. The total return for the index for the 12 month period ending 8/1/2013 was 29.1% compared to 28.8% for the S&P 400 and 28.3% for the Russell Micro-Cap Index. Indicators for short-term future performance (one year or less) suggest that the SREI should provide a return close to that of the overall market.

Construction of the Index and Index Components

The SREI consists of the exchange-traded stocks of firms that are headquartered within 100 miles of La Crosse, Wisconsin. *ReferencesUSA* was used to identify the firms that fulfill the criteria to be included in the index. The firms identified using these criteria are as follows:

Non-Financial Firms:

Fastenal, Inc.
Flexsteel Industries, Inc.
Hormel Foods Corporation
Marten Transport Ltd.
National Presto Industries, Inc.
Rochester Medical Corporation

Financial Services Firms:

Citizens Community Bancorp, Inc.
Heartland Financial USA, Inc.
HMN Financial, Inc.

A brief profile of each of the firms in the index is provided in the Appendix. Of the nine firms that currently make up the index, six of the firms are traded on the NASDAQ and three are traded on the NYSE. Using Standard and Poors' guidelines, two of the firms (Fastenal and



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Hormel) are large-cap firms, two (Marten Transport and National Presto) are small-cap firms, and the remaining five are micro-cap firms. In the past three years, two firms (Renaissance Learning and Great Wolf Resorts) exited the index due to being acquired by firms that are headquartered outside of the 7 Rivers Region.

Stock Performance

Calculation of Returns

The SREI is an equally-weighted index, meaning that it is assumed that an equal dollar amount is invested in each of the stocks at the beginning of the measurement period. The returns for the index were calculated on a monthly basis for a five-year period beginning on August 1, 2008 and ending August 1, 2013. The monthly returns are calculated as the percentage change in the adjusted price on *Yahoo! Finance* from one month to the next. The adjusted price incorporates cash dividends paid, stock splits, reverse stock splits, and stock dividends into the price of the stock, so the return calculated assumes that any dividends paid were reinvested back into the firm. Using the adjusted price provides the total return to the investor.

Benchmarks

For comparison purposes, I chose four benchmarks for the index, two for the total index and two for the financial firms. As mentioned above and shown in the Appendix, the index consists primarily of smaller firms. Standard benchmarks such as the S&P 500 and Dow Jones Industrial Index consist solely of large-cap firms. Small firms tend to have greater price volatility and higher returns when compared to large firms, so the S&P 500 and Dow Jones Index were not used.

The two benchmarks chosen for the total index are the iShares S&P 400 Mid-Cap Exchange Traded Fund (Ticker: IJH) and the iShares Russell Micro-Cap Index (Ticker: IVC). The iShares S&P 400 Mid-Cap Exchange Traded Fund seeks to replicate the returns of the S&P 400 Mid-Cap Index and invests a minimum of 90% of its holdings in the underlying securities of the S&P 400 Index. The Russell Micro-Cap Index currently consists of 1,352 of the smallest exchange-traded firms. Criteria for the Russell Micro-Cap Index is that the firm must be traded on a US exchange (AMSE, NYSE, or NASDAQ) and have a market capitalization of \$300 million or less.

The financial services industry is unique from other industries due to its high level of regulation and often divergent responses to market events. As such, firms in this industry are often analyzed separately from firms in other industries. Because of the regional nature of the three financial companies in the index, the benchmarks chosen are funds that hold equities of regional financial institutions. The benchmarks used for this subsection of the index are the iShares Dow Jones Regional Banks Index (Ticker: IAT) and the SPDR KBW Regional Banking Exchange Traded Fund (Ticker: KRE). The iShares Dow Jones Regional Banks Index consists of 58 equities that are representative of the Dow Jones Regional Banks Index. The SPDR KBW Regional Banking Exchange Traded Fund seeks to replicate the returns of the S&P Regional Banks Select Industry Index and currently invests in 79 equities that are representative of that index.

Index Performance

Table I provides the returns for each firm in the SREI, the average and median return for the

index components, and the returns for the S&P 400 and micro-cap indices for each of the past five years ending August 1.

According to the National Bureau of Economic Research, the most recent recession began in December of 2007 and ended in June of 2009.¹⁰ The performance of the SREI components and the benchmarks reflects the end of this recessionary period with the average (median) return for the SREI components at -21.45% (-26.99%) for the twelve month period ending 8/1/2009.

**Table 1. Annual Returns for SREI Components and Benchmarks
For the 12 month period ending August 1, 2013**

SREI Components	2013	2012	2011	2010	2009
Citizens Community Bancorp	28.72%	5.67%	26.04%	-14.90%	-33.51%
Fastenal Co.	19.16%	30.74%	52.68%	27.31%	-27.76%
Flexsteel Industries	32.56%	34.20%	8.31%	83.75%	-26.99%
Great Wolf Resorts ^a		176.41%	43.43%	-43.59%	-32.89%
Heartland Financial USA	10.89%	78.06%	9.90%	-3.57%	-28.62%
HMN Financial	186.26%	47.19%	-50.96%	-7.16%	-71.56%
Hormel Foods	52.38%	6.13%	30.37%	19.18%	6.08%
Marten Transport	56.32%	-3.60%	-6.04%	15.87%	-14.93%
National Presto	11.40%	-20.00%	3.79%	27.47%	18.23%
Renaissance Learning ^b		11.78%	120.65%	-17.52%	-14.82%
Rochester Medical	39.47%	31.98%	-4.90%	-28.33%	-9.19%
Median	32.56%	30.74%	9.90%	-3.57%	-26.99%
Average	48.57%	36.23%	21.21%	5.32%	-21.45%
S&P 400 Mid-Cap Index	31.14%	12.57%	22.67%	11.56%	-18.46%
Russell Micro-Cap Index	34.91%	15.21%	19.47%	1.58%	-21.35%

^a Great Wolf Resorts was purchased by the Apollo Group during the calendar year 2012.

^b Renaissance Learning was purchased by Permira Funds during calendar year 2011.

The performance of the firms in the index has been strong for the past two periods. For the year ending 8/1/2012, the SREI components significantly outperformed the benchmarks due to the acquisition of Great Wolf Resorts and the turnarounds for Heartland Financial and HMN Financial. The SREI component average significantly outperformed the benchmarks for the period ending 8/1/2012 due to the increase in the stock price for HMN Financial, as a result of its continued improvement, and the strong performance of Hormel Foods and Marten Transport during the period.

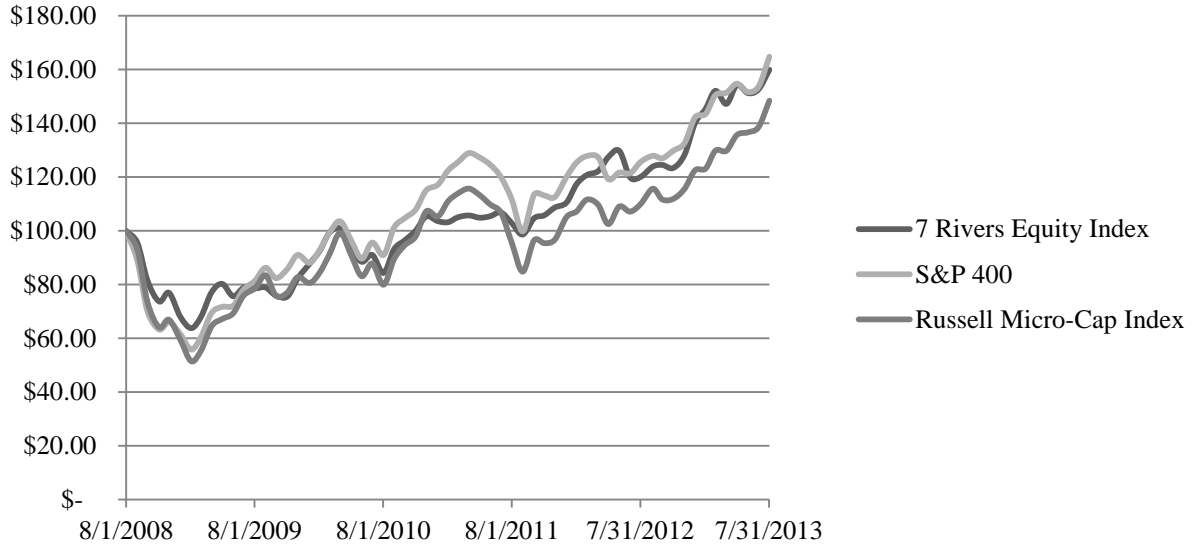
¹⁰ "US Business Cycle Expansions and Contractions," *The National Bureau of Economic Research*, www.nber.org/cycles.html



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Figure I shows the growth of \$100 invested in the SREI equally across each of the component firms and \$100 invested in each of the benchmarks on 4/1/2008 and holding those positions through 8/1/2013.^{11,12} The ending value of the SREI was \$159.87, for the S&P 400 it was \$164.71, and \$148.36 for the Russell Micro-Cap Index.

Figure I. Growth of \$100 Invested in the Seven Rivers Equity Index and Comparative Benchmarks



Financial Firms' Performance

To analyze the performance of the financial services industry firms within the SREI, an equally-weighted portfolio was created using the returns of Citizens Community Bancorp, Heartland Financial USA, and HMN Financial. As seen in Table 2, the SREI financial firms had significant negative returns for the year ending 8/1/2009. The SREI financials outperformed the benchmarks for the last two years due to the performance of HMN Financial and Heartland Financial for the year ending 8/1/2012 and due to the very strong performance of HMN Financial for the period ending 8/1/2013.

The particularly strong performance for HMN Financial in the last year was attributable a decrease in the risk of the loans of the bank. Between 1/22/2013 and 1/24/2013 a 79.41% increase in price coincided with the release of fourth quarter results for 2012 that revealed considerable improvement in loan quality and profitability. A 20.06% increase in price between

¹¹ The results in Table I differ from the results presented in Figure I because the average returns and medians in Table I are based on an equal weighting for each 12 month period, while the graph assumes a 5-year buy and hold strategy.

¹² The amount of the index invested in Renaissance Learning was equally distributed across the remaining firms as of November 1, 2011 for the calculation of the index value. The amount invested in Great Wolf Resorts was equally distributed across the remaining firms as of May 1, 2012 for the calculation of the index value.



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4/17/2013 and 4/23/2013 was the result of the first quarter earnings announcement which included information demonstrating continued improvement in the asset quality of the bank.

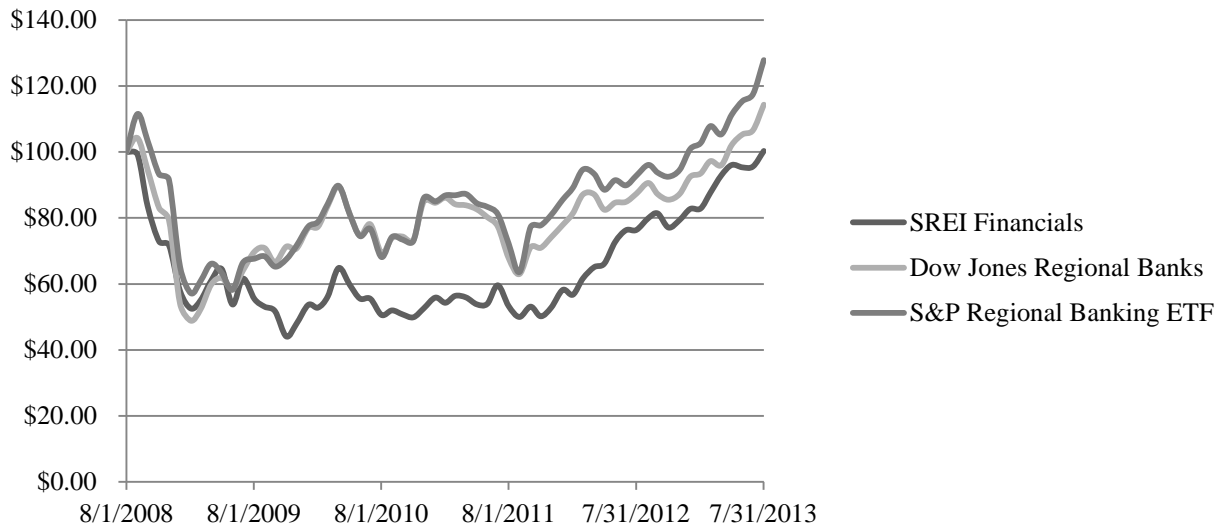
Table 2. Annual Returns for SREI Financials and Benchmarks
For the 12 month period ending August 1, 2013

SREI Financial Components	2013	2012	2011	2010	2009
Citizens Community Bancorp	28.72%	5.67%	26.04%	-14.90%	-33.51%
Heartland Financial USA	10.89%	78.06%	9.90%	-3.57%	-28.62%
HMN Financial	186.26%	47.19%	-50.96%	-7.16%	-71.56%
Median	28.72%	47.19%	9.90%	-7.16%	-33.51%
Average	75.29%	43.64%	-5.01%	-8.54%	-44.56%
iShares DJ Regional Banks	30.86%	28.75%	-2.18%	-0.62%	-30.20%
S&P Regional Banking ETF	37.69%	28.48%	6.05%	0.70%	-32.33%

Figure 2 shows the results of investing \$100 in the 7 Rivers Region Financial Index--also equally-weighted across the firms--and into each of the two benchmarks. The \$100 initially invested in the Seven Rivers Financial Index would have only been worth \$100.31 at the end of the measurement period. The same \$100 would have been worth \$114.33 if invested in the iShares Dow Jones Regional Banks Index and \$127.84 if invested in the S&P Regional Banking Exchange Traded Fund.

Over the past year, the performance of the Seven Rivers Financial Index has been consistent with that of its benchmarks. For the year ending 8/1/2013, the return for the index was 31.43% compared to 31.08% for the iShares DJ Regional Banks fund and 37.7% for the S&P Regional Banking ETF.

Figure 2. Growth of \$100 Invested in the Seven Rivers Index Financials and Comparative Benchmarks



Measures of Future Expectations

For this issue, I wanted to examine future expectations for the stocks in the SREI. To do this, I've included measurements from the Value Line® Investment Service and price ratio measures from Morningstar®.

Value Line® Measures

The measures from Value Line® were developed by the investment service to predict the future performance of the firms covered by the service. Extensive research has demonstrated that the measures are effective in predicting future performance.

Timeliness and Performance Ranks

The Timeliness Rank is calculated for the largest 1,700 firms covered by Value Line®. The rank is a measure of the predicted price performance for each of the firms relative to each other for the next six to twelve month period. One hundred firms receive a rank of 1 and are predicted to have the best price performance relative to the remaining 1,600 firms. Three hundred firms receive a rank of 2 and are expected to have above average performance. Approximately nine hundred firms receive a rank of 3 and are expected to have average performance.

Approximately three hundred firms receive a rank of 4 and one hundred firms receive a rank of 5. These last two groups reflect the firms with expected lower than average and the lowest performance of the 1,700 firms, respectively. Examples of the data used in determining the

Timeliness Rank include the 10-year trend of relative earnings and prices, recent earnings and price changes, and earnings surprises.¹³

The Performance Rank is calculated similarly to the Timeliness Rank, but is used for mid and small capitalization firms (approximately 1,800 firms). One difference between the two measures that is that the Performance Rank calculation also includes technical ranking information as many of the firms included have a shorter history than those included in the Timeliness Rank system.

As can be seen in Table 3, the average Timeliness/Performance Rank is higher than average at 3.2, suggesting that average stock price growth will be less than that of the average stock for the next six to twelve months. With a rank of 2, the firms with highest expected performance are Flexsteel and Marten Transport. Hormel is expected to have the lowest price growth based on the rank of 5.

Safety Rank

The Safety Rank is a measure of the expected possible downside to a stock over the next six to twelve months, with a rank of 1 for firms with the highest expected level of safety and a rank of 5 for those with the most expected risk. The measure is based on Price Stability Index and the Financial Strength (two additional measures calculated by Value Line®).¹⁴

As reported in Table 3, firms in the SREI are slightly safer than the average firm. The safest firm, according to Value Line, is Hormel and most risky is HMN Financial.

Technical Rank

While the Timeliness and Performance Ranks are used to predict performance over a six to twelve month period, the Technical Rank is a measure of the expected performance over the next three to six month period. Similar to the other ranks, a rank of 1 is used for firms that are expected to have the best price performance in the near future and a rank of 5 is for firms that are expected to have the worst performance. The rank is calculated using an analysis that relates price trends for the firm's stock during the past year to the relative price change over the succeeding three to six months.¹⁵

Contrary to the average Timeliness/Performance rank, the SREI average is slightly lower than average at 2.9, reflecting an expectation that firms in the SREI will perform slightly better than average over the next three to six months. All but one of the firms received a rank of 3; Flexsteel received a rank of 2.

¹³ "Value Line's Ranking System Performance, Value Line®, http://www.valueline.com/About/Ranking_System.aspx

¹⁴ http://www.valueline.com/About/Ranking_System.aspx

¹⁵ http://www.valueline.com/About/Ranking_System.aspx

Price Stability

Price Stability is a measure of the fluctuation of the firm's price around the long-term price trend of the firm's stock. The rank is has a range of 5 (lowest stability) to 100 (most stable) and is a measure of the risk of the firm's stock.¹⁶

Consistent with the slightly lower than average Safety Rank, the Average Price Stability for the SREI firms is higher than average at 61.1. The firm with the lowest price stability is HMN Financial, which is consistent with the returns provided in Tables 1 and 2. Hormel had the highest price stability with and index score of 100.

Price Growth Persistence

The Price Growth Persistence Index also has a range of 5 (lowest persistence) to 100 (most persistent) and is a measure of the tendency to show persistent growth over the past 10 years when compared to the average stock.¹⁷

The Price Growth Persistence average for the SREI firms at 53.3 is near the average for all firms. The financial firms in the index have the lowest persistence at 30 for Heartland Financial, 20 for Citizens Community Bancorp, and 10 for HMN Financial. The firms with the highest persistence are National Presto at 80, Hormel Foods at 90, and Fastenal at 100.

Table 3. Value Line Measures of Future Expectations

SREI Components	Timeliness/ Performance	Safety	Technical	Price Stability	Price Growth Persistence
Citizens Community Bancorp	3.0 ^a	3.0 ^a	3.0	70.0	20.0
Fastenal Co.	3.0	2.0	3.0	75.0	100.0
Flexsteel Industries	2.0	3.0	2.0	55.0	30.0
Heartland Financial	3.0	3.0	3.0	45.0	30.0
HMN Financial	4.0	5.0	3.0	10.0	10.0
Hormel Foods	5.0	1.0	3.0	100.0	90.0
Marten Transport	2.0	2.0	3.0	75.0	70.0
National Presto	4.0	3.0	3.0	65.0	80.0
Rochester Medical	3.0	3.0	3.0	55.0	50.0
Average	3.2	2.8	2.9	61.1	53.3

^aValue Line[®] did not provide a Timeliness/Performance or Safety rankings for CZWI. These measures were calculated based on the averages of comparable firms per Value Line.

¹⁶ "I. Value Line Ranks," Value Line[®], <http://www3.valueline.com/one-ranks.html>

¹⁷ Robert Greene, "Earnings Predictability, Price Growth Persistence and Stock Price Stability," Value Line[®], November 19, 2010,

http://www.valueline.com/Tools/Educational_Articles/Stocks_Detail.aspx?id=9890

Price Ratio Measures

Price ratios are commonly used measures of investors' expectations for the future performance of the firm. They are relative measures with firms typically being measured against their industry and firms and industries being compared to the average measure for the market. A higher ratio is generally interpreted as signaling the expectation of better future performance than a lower ratio.

Price-to-Sales

The price-to-sales ratio is the ratio of the current market capitalization (price per share multiplied by the number of shares outstanding) of the firm to total revenues for the firm for the last 12 months. The price-to-sales ratio is useful for industries that have volatile earnings, in which case the price-to-earnings ratio is not very meaningful. The weakness of the price-to-sales ratio is that it does not take into account expenses for the firm and is sensitive to the level of debt that the firm holds. A low price-to-sales ratio would normally indicate lower expectations for a firm's future growth prospects, but may also signal that a firm is undervalued relative to its industry peers and the market.¹⁸

Table 4 shows that the average firm in the SREI has a lower than average price-to-sales ratio when compared to their industry and a higher ratio than those of the S&P 400 and S&P 500 indices. The firms with the lowest price-to-sales ratio relative to their industry are HMN Financial (difference of 2.8), Citizens Community Bancorp (difference of 1.4) and Heartland Financial (difference of 1.3). The firm with the highest price-to-sales ratio relative to its industry is Fastenal with a difference of 3.3.

Price-to-Book

The price-to-book ratio for a firm is the ratio of the firm's market capitalization to its book value of equity (assets minus liabilities). Because the values of intangible assets are typically not fully recognized on the balance sheet, the price-to-book ratio is usually most useful for firms whose operations require high levels of tangible assets and for financial institutions. Similar to the price-to-sales ratio, a low ratio may indicate lower expectations or an undervalued firm. However, it is generally advisable to avoid firms that have a price-to-book ratio of less than 1, as this indicates that investors assign a market value to the firm's assets that is less than value of the assets on the balance sheet.¹⁹

As seen in Table 4, Citizens Community Bancorp and HMN Financial both have a price-to-book value of less than 1. Consistent with the results for the price-to-sales measure, Fastenal has the highest price-to-book ratio with a value of 8.7.

Similar to the results for the Price-to-Sales ratios, the average price-to-book ratio for the firms in the SREI is greater than those of the S&P 400 and S&P 500, but less than the average for the firms' industries.

¹⁸ "How To Use Price-To-Sales Ratios To Value Stocks," *Investopedia*, February 26, 2013,

<http://www.investopedia.com/articles/fundamental/03/032603.asp>

¹⁹ "Using The Price-To-Book Ratio To Evaluate Companies," *Investopedia*, February 23, 2013,

<http://www.investopedia.com/articles/fundamental/03/112603.asp>

Price-to-Earnings

The price-to-earnings ratio is the most popular of the three ratios for use in analysis. The advantage of the price-to-earnings ratio is that it reflects investor expectations about future earnings, which should eventually flow to investors as distributions or will be reinvested in the firm. A higher price-to-earnings ratio is generally reflective of a higher expected growth rate in earnings in the future. However, the price-to-earnings ratio is sensitive to low and volatile earnings per share and is meaningless if the firm has negative earnings.

The high price-to-earnings ratio of Citizens Community Bancorp is an example of the sensitivity of the measure to low earnings per share. Per *Yahoo! Finance*, the trailing twelve month earnings per share for Citizens is \$0.19, with considerable volatility over the past three years. The high price-to-earnings ratio of the firm at 32.4, as reflected in Table 4, is inconsistent with its relatively low price-to-sales and price-to-book measures.

Overall, the price-to-earnings for the SREI firms is slightly higher than the average for the firms' industries and is considerably higher than those of the S&P 400 and the S&P 500 indices.

Table 4. Morningstar® Price Ratio Measures of Investor Expectations

SREI Components	Price-to-Sales		Price-to-Book		Price-to-Earnings	
	Firm	Industry	Firm	Industry	Firm	Industry
Citizens Community Bancorp	1.7	3.1	0.7	1.3	32.4	14.5
Fastenal Co.	4.6	1.3	8.7	5.3	34.0	27.9
Flexsteel Industries	0.5	1.1	1.2	2.9	13.8	33.6
Heartland Financial USA	1.8	3.1	1.5	1.3	10.4	14.5
HMN Financial	1.0	3.8	0.9	1.3	22.0	18.9
Hormel Foods	1.4	1.4	3.8	4.4	23.2	20.1
Marten Transport	0.9	0.6	1.7	3.5	20.1	23.4
National Presto	1.1	1.1	1.7	2.9	14.1	33.6
Rochester Medical	2.9	3.0	2.7	3.6	51.3	22.6
Average	1.8	2.1	2.5	2.9	24.6	23.2
S&P 400	1.1		2.1		18.0 ^a	
S&P 500	1.5		2.2		15.0 ^a	

^aThe Price/Earnings ratios for the S&P 400 and S&P 500 were not available from Morningstar®, so these were taken from finance.yahoo.com.

Concluding Remarks

The performance of the publicly-traded firms in the 7 Rivers Region for the past year has been consistent with that of its benchmarks. Despite a few rough years, the financial firms in the index appear to be recovering along with the rest of the financial industry. However, the low price-to-book values, even after strong returns for the past year, for Citizens Community Bancorp and HMN Financial are worrisome.



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While the Value Line® indicators do show some extreme values for the firms in the SREI, the diversity of the industries in the region result in average expected outcomes that are in line with the expectations for the market overall for the next three to twelve month time period.

The price-to-sales and price-to book ratios indicate that investors have lower expectations for the firms in the SREI compared to their industry averages. This result may be due to the overall lack of debt that the non-financial firms have. Overall, investors' expectations for the firms in the SREI appear higher than those of the market benchmarks.

Appendix

Non-Financial Firms

Company: **Fastenal Corporation**
Ticker: FAST
Exchange: NASDAQ
Market Cap: \$14.70 Billion
Description: Wholesaler and retailer of industrial and construction supplies. Product lines include fasteners, hydraulic and pneumatic tools, janitorial supplies, and welding equipment.
Institutional Ownership: 82%
Date started trading: March 26, 1990

Company: **Flexsteel Industries, Inc.**
Ticker: FLXS
Exchange: NASDAQ
Market Cap: \$179.05 Million
Description: Manufacturer, importer, and marketer of residential and commercial furniture. Product lines include upholstered and wood furniture, desks, dining tables and chairs, and bedroom furniture.
Institutional Ownership: 45%
Date started trading: February 25, 1992

Company: **Hormel Foods Corporation**
Ticker: HRL
Exchange: NYSE
Market Cap: \$11.33 Billion
Description: Producer and marketer of meat and food products worldwide. Business segments include: grocery products, refrigerated foods, Jennie-O Turkey Stores, and specialty foods.
Institutional Ownership: 33%
Date started trading: January 2, 1990

Company: **Marten Transport Ltd.**
Ticker: MRTN
Exchange: NASDAQ
Market Cap: \$582.68 Million
Description: Truckload carrier that specializes in transporting consumer goods that require a temperature-controlled or insulated environment across North America and Mexico. Business segments are trucking and logistics.
Institutional Ownership: 67%
Date started trading: February 27, 1992



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Company: **National Presto Industries, Inc.**
Ticker: NPK
Exchange: NYSE
Market Cap: \$515.16 Million
Description: Manufacturer of housewares and electrical appliances; defense-related products, such as: training ammunition, fuses, firing devices, and initiators; and diapers and adult incontinence products.
Institutional Ownership: 47%
Date started trading: December 30, 1987

Company: **Rochester Medical Corporation**
Ticker: ROCM
Exchange: NASDAQ
Market Cap: \$183.92 Million
Description: Manufacturer and marketer of PVC and latex-free urinary continence and urine drainage care products.
Institutional Ownership: 43%
Date started trading: August 18, 1995

Financial Services Firms

Company: **Citizens Community Bancorp Inc.**
Ticker: CZWI
Exchange: NASDAQ
Market Cap: \$38.41 Million
Description: Provider of consumer banking services through 18 in-store Wal-Mart Supercenter locations and eight branches in Wisconsin, Minnesota, and Michigan.
Institutional Ownership: 18%
Date started trading: March 30, 2004

Company: **Heartland Financial USA Inc.**
Ticker: HTLF
Exchange: NASDAQ
Market Cap: \$478.22 Million
Description: A multi-bank holding company that has subsidiaries in Iowa, Illinois, Wisconsin, New Mexico, Arizona, Montana, Colorado, and Minnesota.
Institutional Ownership: 40%
Date started trading: January 7, 2000

Company: **HMN Financial, Inc.**
Ticker: HMNF
Exchange: NASDAQ
Market Cap: \$31.94 Million
Description: Operator of retail banking and loan production facilities in Minnesota and Iowa.
Institutional Ownership: 29%
Date started trading: July 30, 1994