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

Economic Indicators and Trends

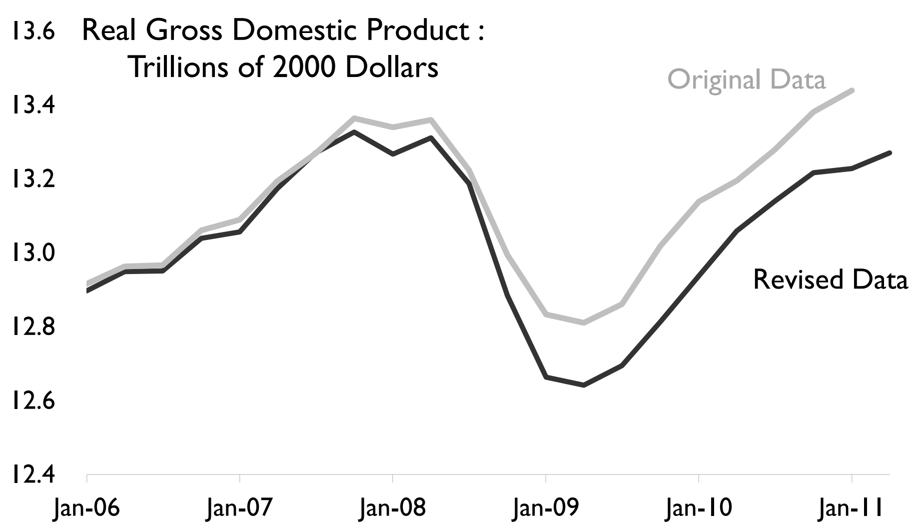
Taggert J. Brooks, Ph.D., UW-La Crosse Department of Economics

Core economic indicators have been tracked since 2001 to have objective measures for our 7 Rivers Region economy. The special focus of the Fall meeting is the unique role of the Mississippi River in our regional economy.

Please note: Dr. Brooks occasionally writes on the 7 Rivers Region Economics blog, which will contain ideas and writings that may or may not be included in this publication provided at the Economic Indicators breakfast meetings. Dr. Brooks will use the blog to track different topics and collect ideas. The Web address is: http://sevenriversecon.blogspot.com/

September 2011

Revisionist History



Recent revisions to GDP find us with less of a mystery about the lack of job growth. As it turns out the recession was far worse than first estimated[1]. The Bureau of Economic Analysis (BEA) routinely revises its estimates for the economy based on new methods, and new or revised data. It turns out the most recent revision was large, but informative as it helps to solve a puzzle facing economists. Why has the unemployment rate remained so high despite the economic growth we have experienced since the recession? It turns out the answers is we have recovered far less than we thought, because the recession was far worse than we originally thought. The graph above compares the two GDP series, with the original data in gray and the revised data in black. A more thorough explanation of the details can be found here[2].

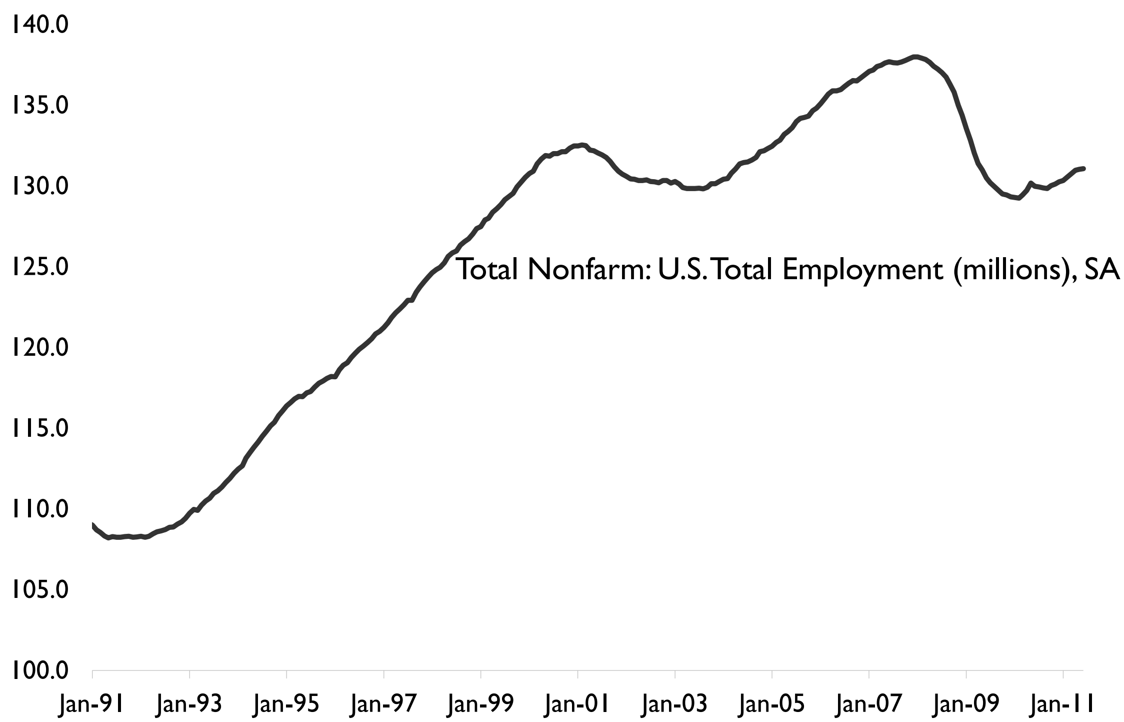
There are however a few items worth mentioning. The original or preliminary data put the decline in GDP in 2008 Q4 and 2009 Q1 at -7.0% and -5.0% whereas the revised data suggests those same quarters actually saw -9.2% and -6.8% declines. This means that the current output gap – the difference

[1] http://www.bea.gov/faq/index.cfm?faq_id=1004
[2] http://www.econbrowser.com/archives/2011/07/tales_from_gdp.html

between what the economy is producing and what it could potentially produce – is far wider than previously thought. It is also worth mentioning that the pace of growth of GDP after the recession was not fundamentally altered, although the growth was starting from a much lower level. We have also not yet achieved the same level of GDP we had in 2007. Using unrevised data, the CBO predicted that GDP would return to potential around 2017, but the revisions, suggest that maybe be a year or two further off[3].

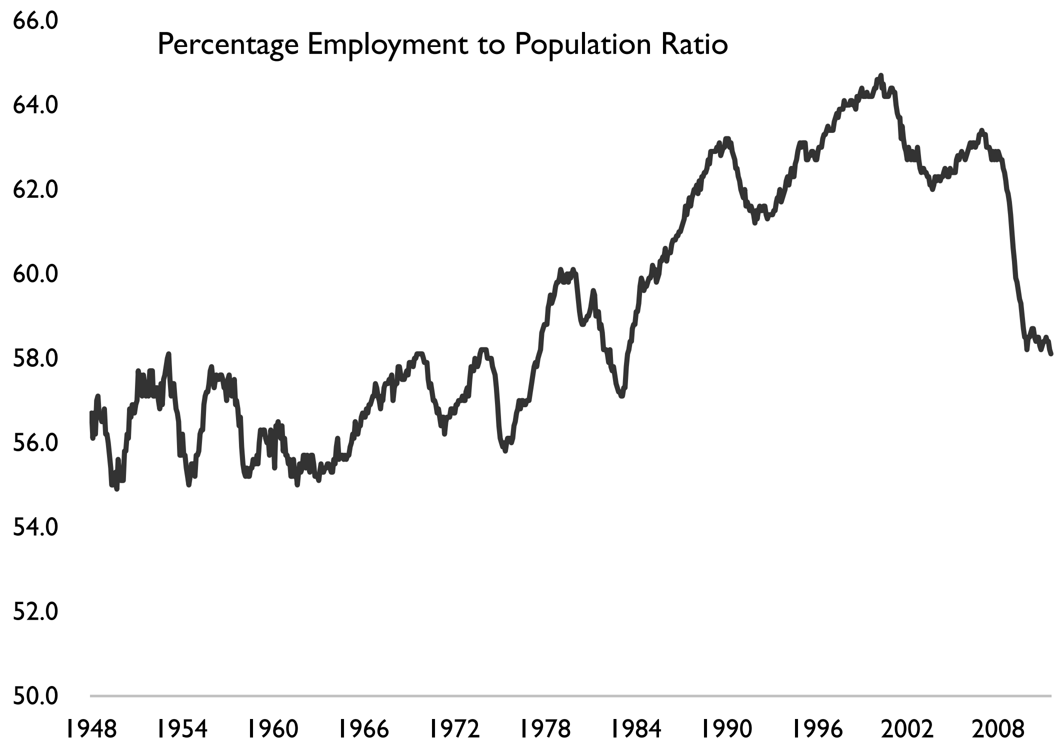
The Labor Market

The revised GDP numbers help us understand why job growth has been so tepid, and unemployment so persistent. Below we find that the level of national employment is still far below the peak reached in 2007.

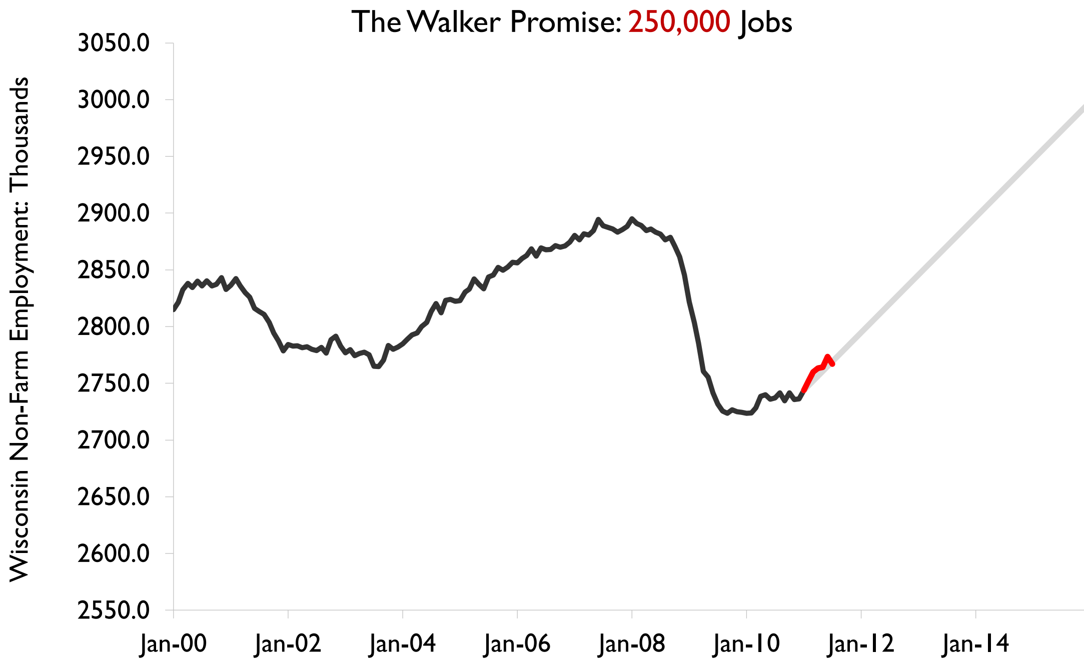


Worrying still is the employment to population ratio. We are experiencing levels not seen since the mid-80s. This should serve a cautionary note for businesses. We will recover from this recession, employment will return, and the employment to population ratio will likely grow, even if not to the peak experienced in 2002. However, it will take a long time, and consumption and consumer confidence are likely to be very weak. We will also begin to see the Baby Boomers drop out of the labor market as they retire, suggesting supply reasons for a permanently lower ratio.

[3] http://www.cbo.gov/ftpdocs/123xx/doc12316/08-24-BudgetEconUpdate.pdf

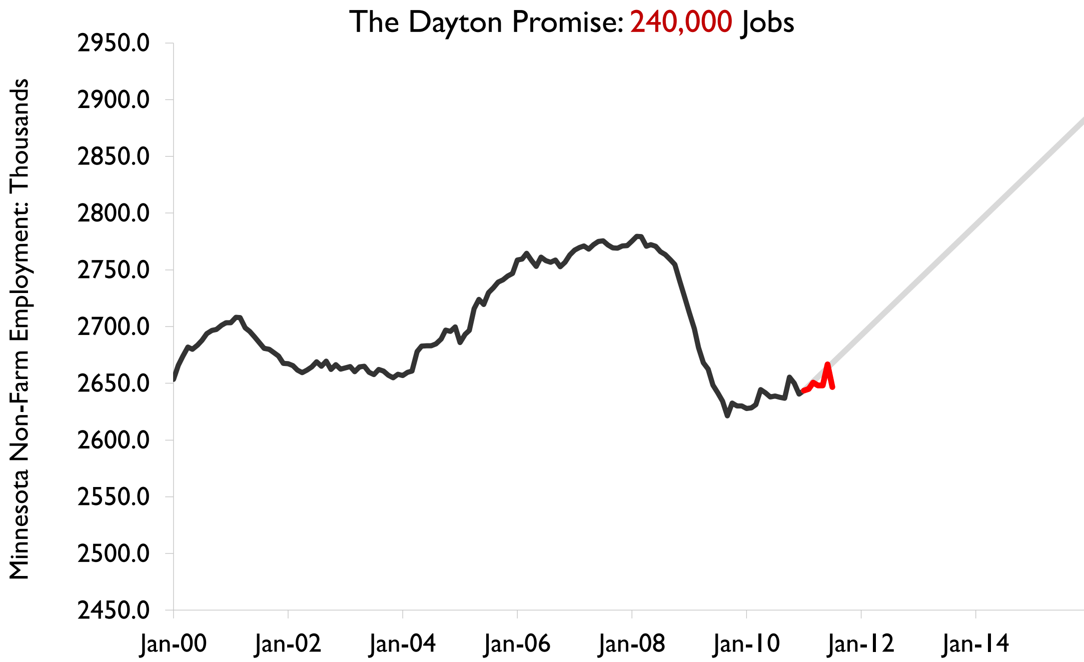


At the state level, Scott Walker promised to create 250,000 jobs in his 4 year tenure as governor. To be clear, governors have little influence over job gains – or losses, and particularly the short term fluctuations, but recent data, despite some setbacks continues to show that the state of Wisconsin is on track to achieve that goal.



Source: BLS, http://goo.gl/lE69o

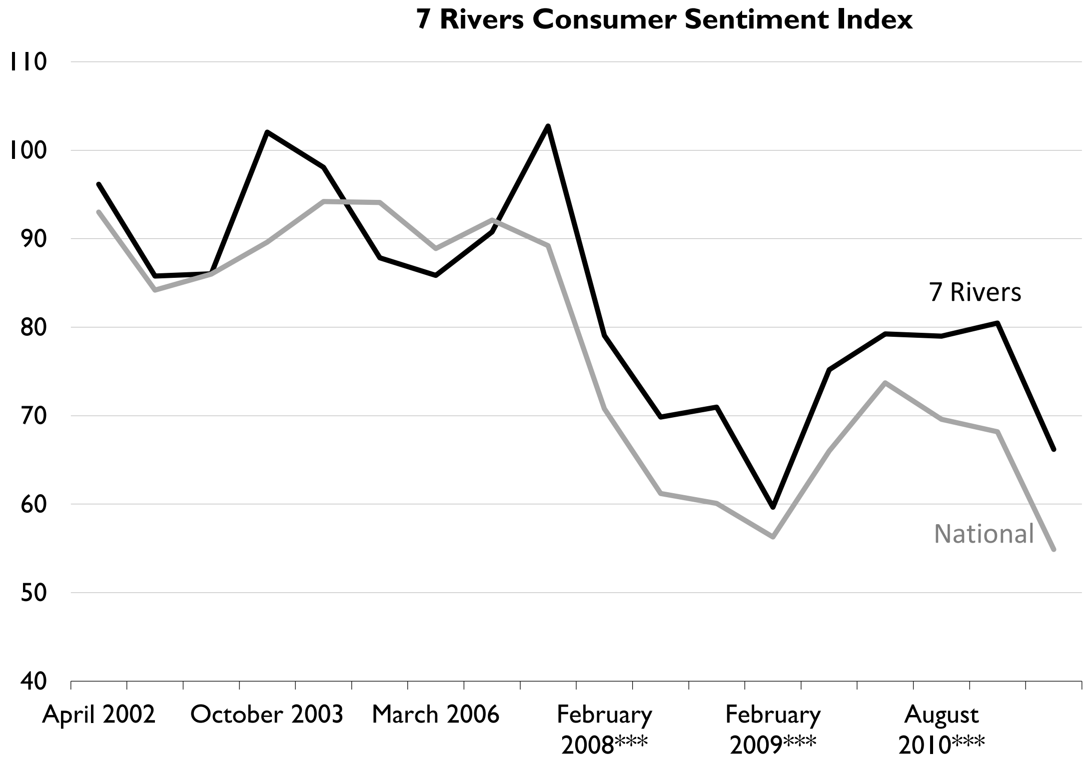
While Mark Dayton did not make the same campaign promise as Scott Walker, it will be interesting to compare the progress in Minnesota as well. However, since Minnesota's level of employment is lower, I've adjust the "goal" so that it is equivalent in percentage terms. The equivalent would require the number of jobs to grow by 240,000. It appears that Minnesota is running slightly behind that pace, but again one should be very careful attributing that to the Governor or his policies since they are at mostly cyclical changes.



Source: BLS, http://goo.gl/IE69o

Consumer Sentiment

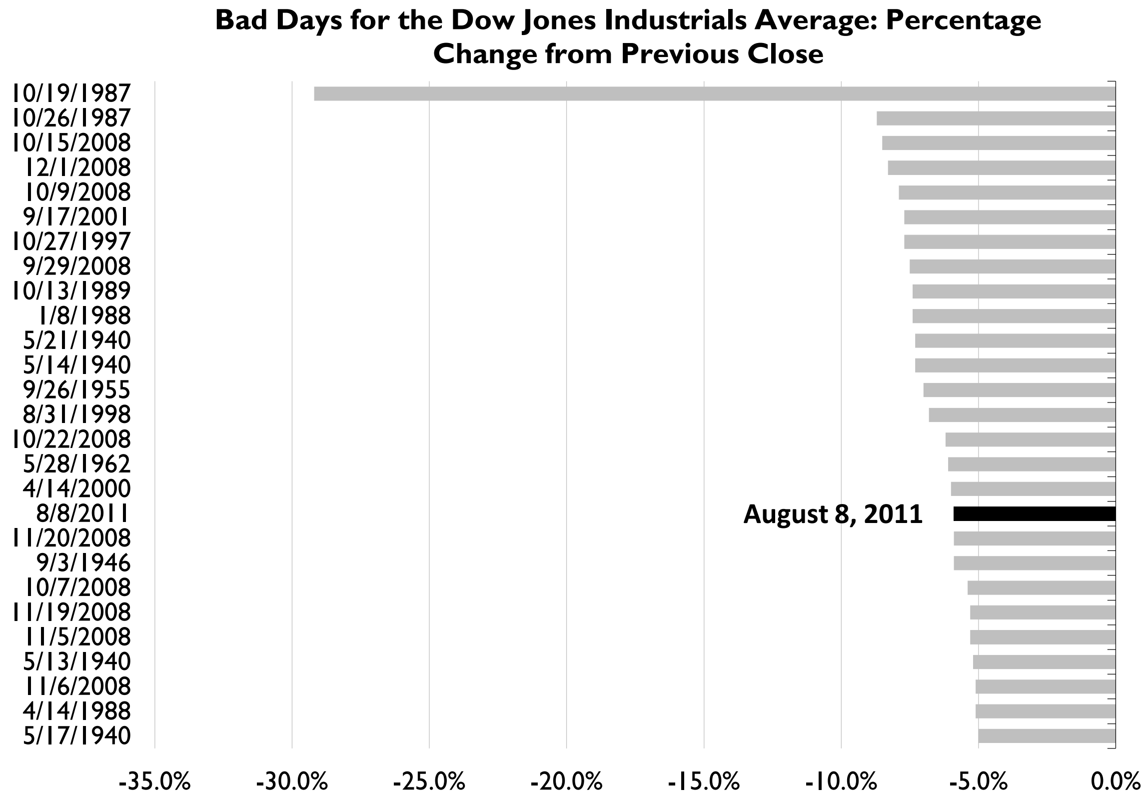
During the first week of August, I distributed via email the semi-annual consumer sentiment survey to 1466 past participants in programs related to the 7 Rivers Region. I received 324 responses for an overall response rate of 22.1%. The graph and table below clearly show the precipitous drop off in both the regional and national indices. The overall consumer sentiment fell from 80.5 in early April to 66.2 in August, while the national index declined from 68.2 to 54.9. The decline can likely be attributed to recent weak economic data and the uncertainty created by the debt ceiling debate. The table below provides all the data since the inception of the regional survey. Although unlike the national index, we have not fallen below the February 2009 lows.



	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**

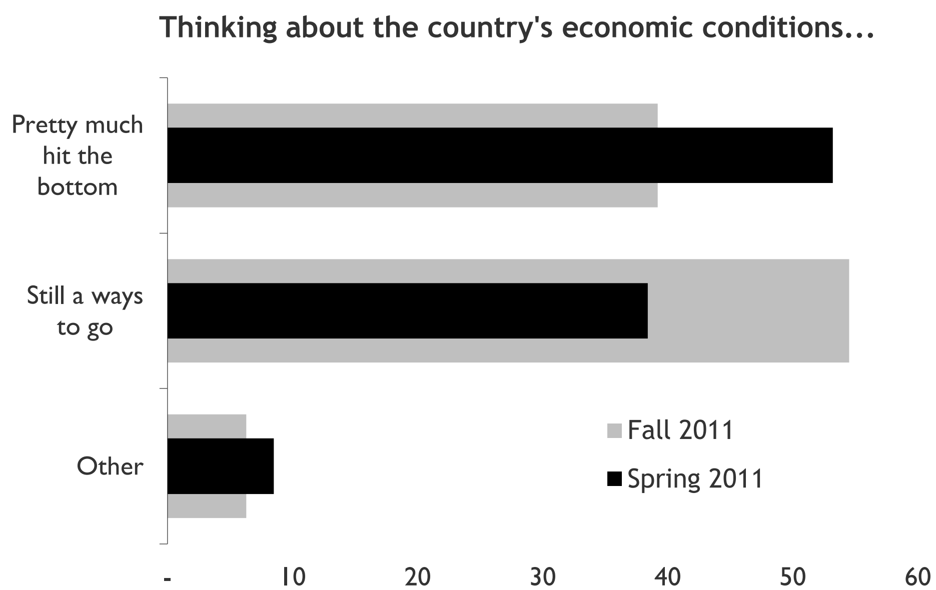
***** Survey moved to the web.**

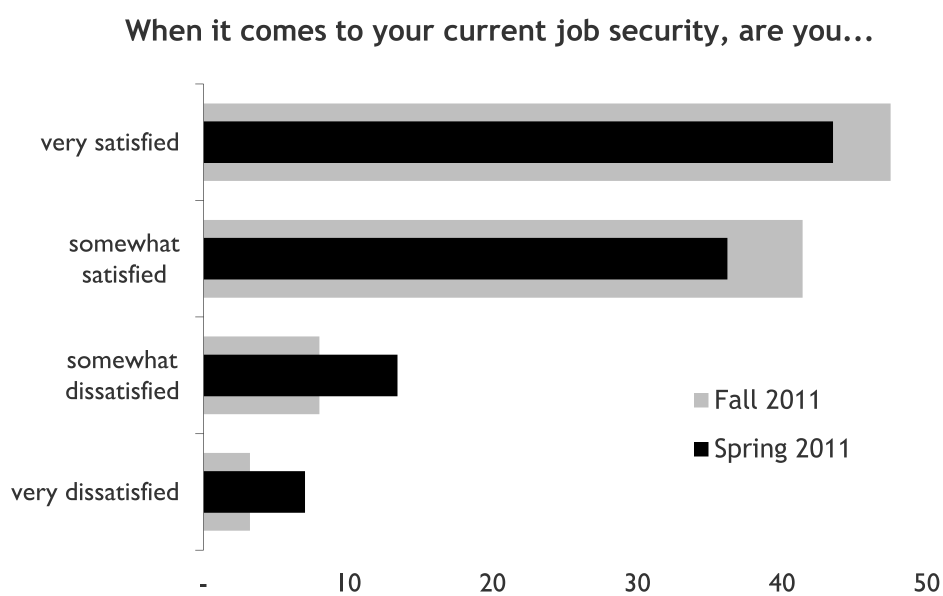
Another important factor, besides the debt ceiling debate, was likely the S&P downgrade and subsequent stock market correction. Though historically it was not nearly as bad as the 1987 crash, it was still a large one day correction and it occurred just 2 days before the first responses came in for the survey.



There are a few other pieces of data that give us pause. The questions below concern the regional sentiment on both job security and on how the economy is progressing. In the spring, a majority of people felt the economy had "pretty much hit the bottom". However, whether it is due to the budget ceiling debate, or the weak economic news, it appears as though a majority of people now feel we "still have a ways to go" to the bottom. This is clearly juxtaposed to their own feelings of job security, which appears to have experienced some modest improvement with more respondents reporting they were very satisfied or somewhat satisfied with their own job security.

There are a few possible explanations. One may be that firms have done all the job cutting that they can, and the employees left realize that the firm cannot afford to lose them. Another explanation may just be that respondents are reacting to national news in one question and their sentiment about the region and their job in the other questions. They may not view those different responses as inconsistent, even though in the aggregate they likely are.





Construction and Housing

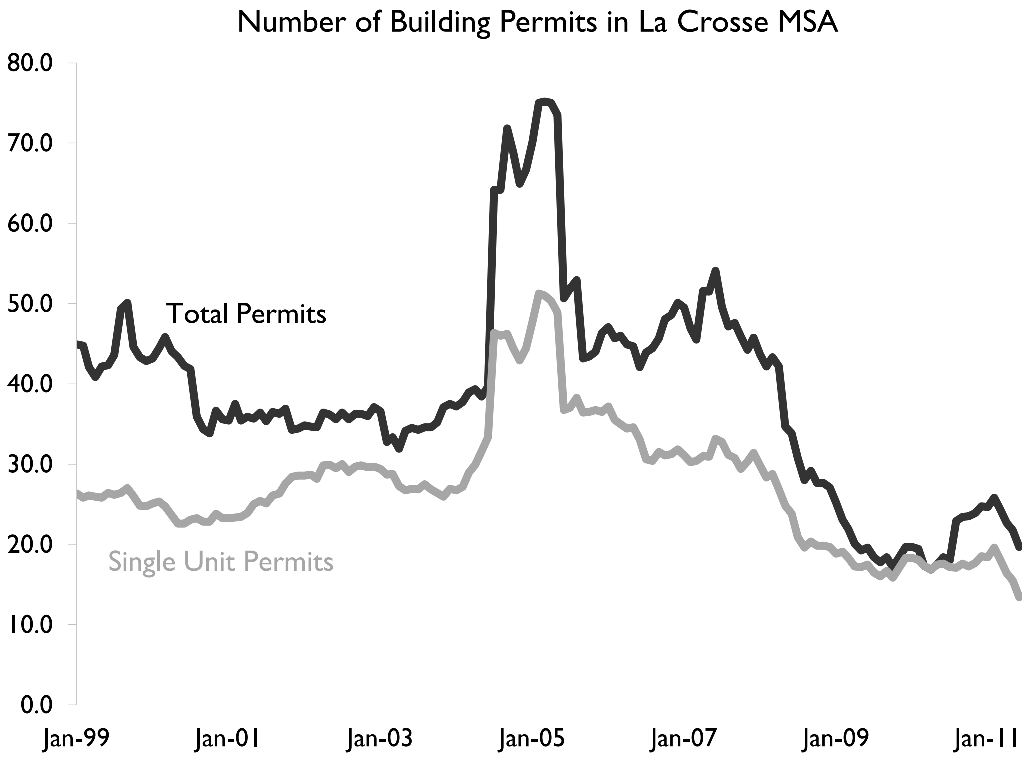
While permits for new buildings may have fallen, our summer has not been without a surge in construction. The hail storms of April 10th, and the Tornado in May, left large portions of the 7 Rivers Region in need of repairs. When thinking about the impact of the storms and subsequent construction, we need to guard against the "broken windows" fallacy. The fallacy, or more appropriately the parable, of the broken window comes from Frederic Bastiat[4]:

[4] http://en.wikisource.org/wiki/That_Which_Is_Seen,_and_That_Which_Is_Not_Seen#Broken_Window

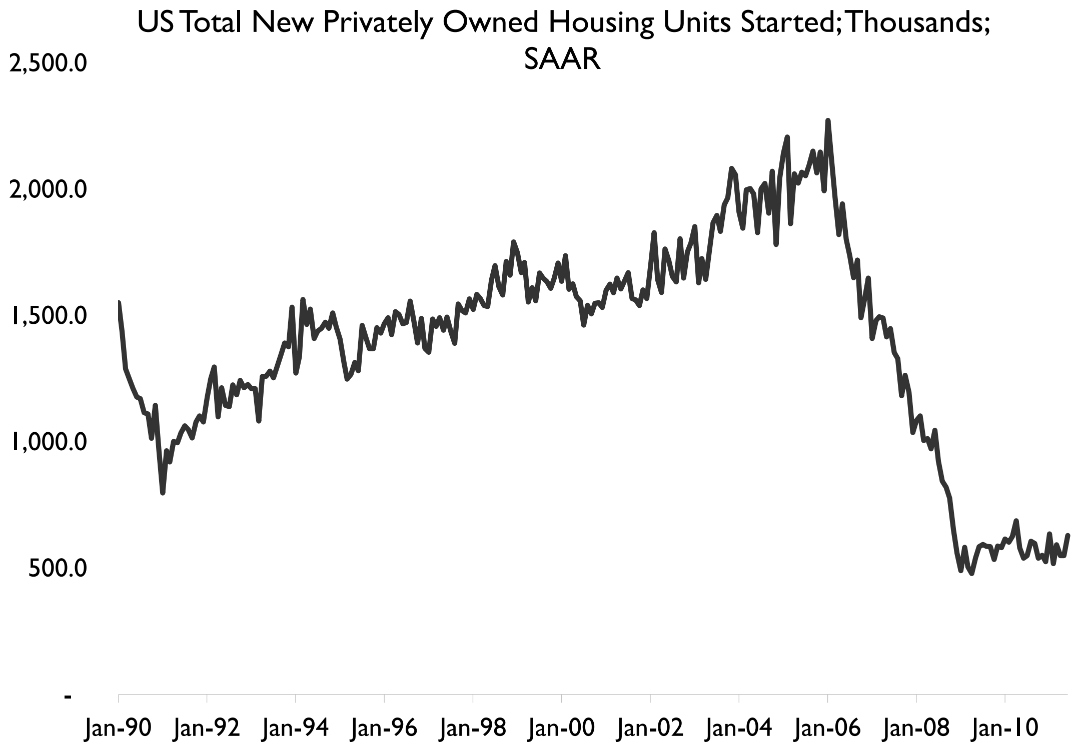
> Have you ever witnessed the anger of the good shopkeeper, James Goodfellow, when his careless son happened to break a pane of glass? If you have been present at such a scene, you will most assuredly bear witness to the fact that every one of the spectators, were there even thirty of them, by common consent apparently, offered the unfortunate owner this invariable consolation—"It is an ill wind that blows nobody good. Everybody must live, and what would become of the glaziers if panes of glass were never broken?"
>
> Now, this form of condolence contains an entire theory, which it will be well to show up in this simple case, seeing that it is precisely the same as that which, unhappily, regulates the greater part of our economical institutions.
>
> Suppose it cost six francs to repair the damage, and you say that the accident brings six francs to the glazier's trade—that it encourages that trade to the amount of six francs—I grant it; I have not a word to say against it; you reason justly. The glazier comes, performs his task, receives his six francs, rubs his hands, and, in his heart, blesses the careless child. All this is that which is seen.
>
> But if, on the other hand, you come to the conclusion, as is too often the case, that it is a good thing to break windows, that it causes money to circulate, and that the encouragement of industry in general will be the result of it, you will oblige me to call out, "Stop there! Your theory is confined to that which is seen; it takes no account of that which is not seen."
>
> It is not seen that as our shopkeeper has spent six francs upon one thing, he cannot spend them upon another. It is not seen that if he had not had a window to replace, he would, perhaps, have replaced his old shoes, or added another book to his library. In short, he would have employed his six francs in some way, which this accident has prevented.

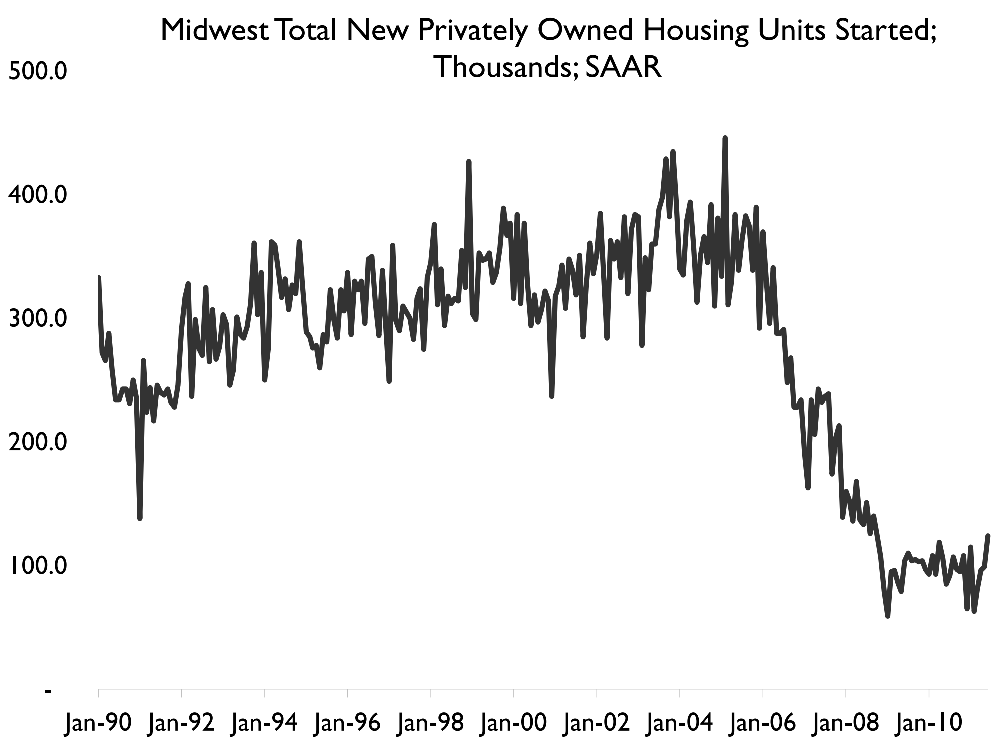
Clearly the damage to homes represents a loss in local wealth, and the degree to which people funded the repairs out of their own pockets it represents merely a shifting of expenditures from the other things they would have spent their money on. However, there is the potential, for a small, positive economic impact to such a storm. And to be clear, I am not saying it was a “good” thing, but rather commenting only on how it may have affected aggregate economic activity in the region.

Insurance companies operate roughly as follows, they take regular premiums, in hopes that their eventual claims are roughly the same – or less - and they earn interest on holding the premiums between those periods. Of course it is much more complex than that, but that is sufficient for us to understand from an economic perspective, funds flow from premium payers to claimants. This summer, the 7 Rivers Region was likely on net, claimants. The degree to which our claims locally were funded by people outside our region represents a flow of funds into our region, and the activity generated – such as a having a roof replaced – results in increased economic activity for the region. However, the positive effects that it may have had on local construction related companies is muted by the fact that a lot of outside contractors were attracted into the area to perform the work. Their earnings then represent a leakage from the local economy. In the end, local builders and roofers were likely very busy this summer, but it wasn’t building new homes. We can see from the chart below, building permits in the MSA (Houston and La Crosse counties) continue at their depressed levels.



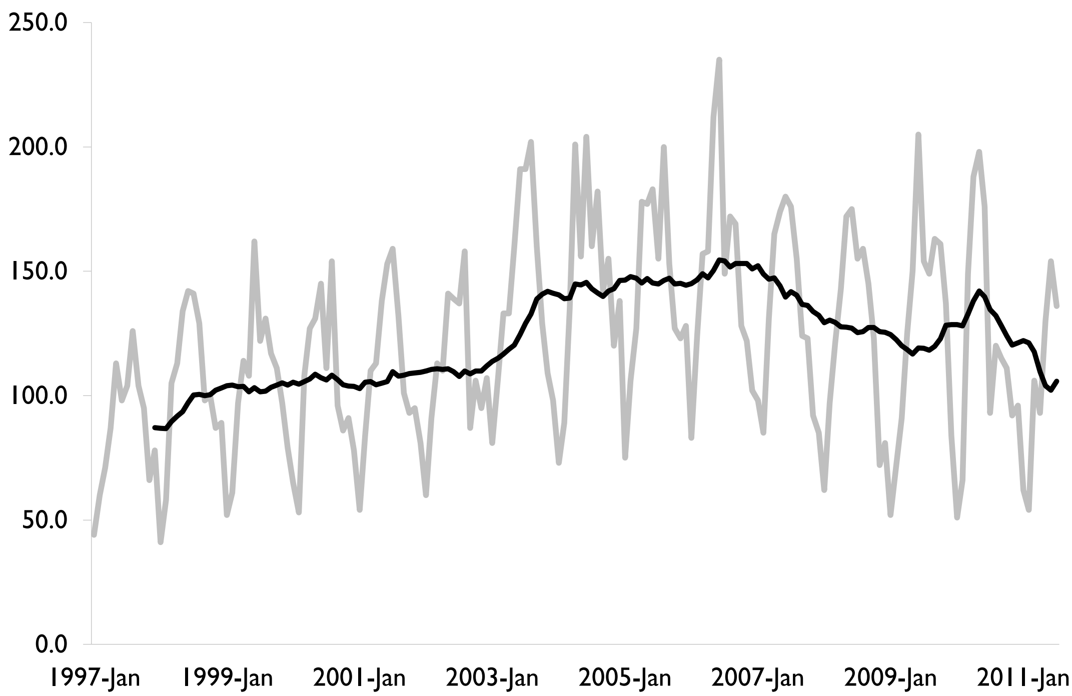
This is however not a just a local problem, but also a regional and national problem. It appears that housing starts have stayed at the low levels they reached in late 2008. This continues to be one of the factors holding back the recovery. We need to work off the excess inventory of houses on the market. Even if we do not return to the construction levels of 2006 – and no one expects we will – merely returning to a sustainable level of construction means a percentage or more of GDP growth.


US Total New Privately Owned Housing Units Started; Thousands; SAAR
2,500.0
2,000.0
1,500.0
1,000.0
500.0
-
Jan-90
Jan-92
Jan-94
Jan-96
Jan-98
Jan-00
Jan-02
Jan-04
Jan-06
Jan-08
Jan-10

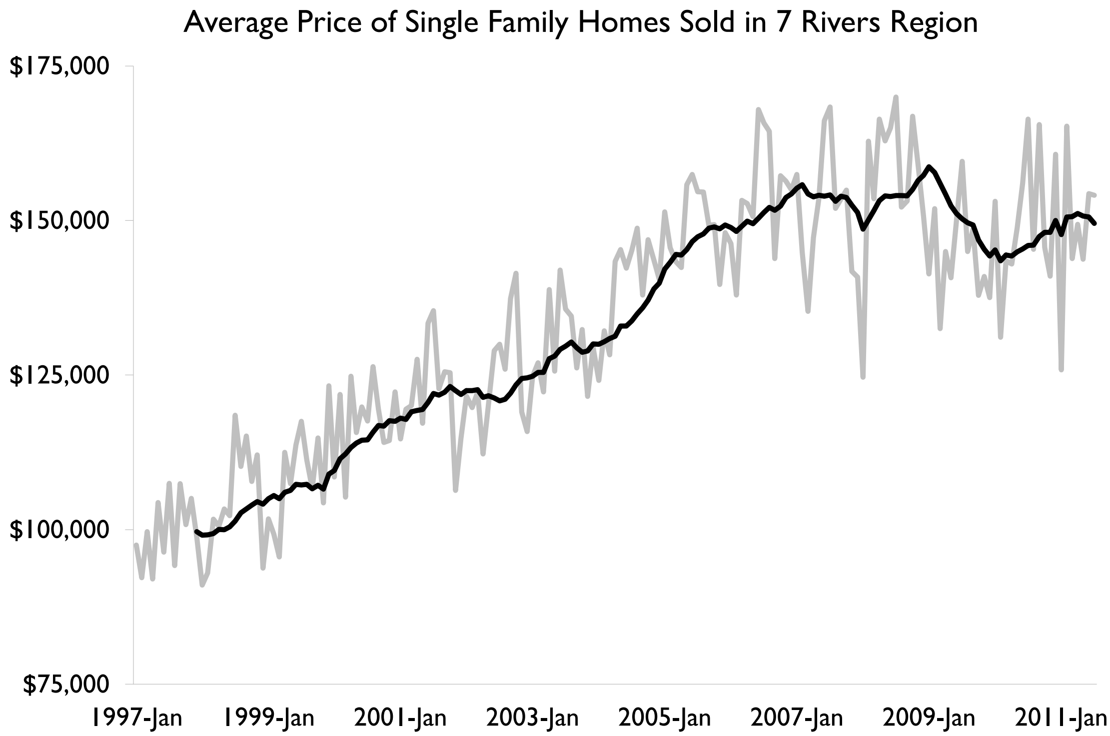

Midwest Total New Privately Owned Housing Units Started; Thousands; SAAR
500.0
400.0
300.0
200.0
100.0
-
Jan-90
Jan-92
Jan-94
Jan-96
Jan-98
Jan-00
Jan-02
Jan-04
Jan-06
Jan-08
Jan-10

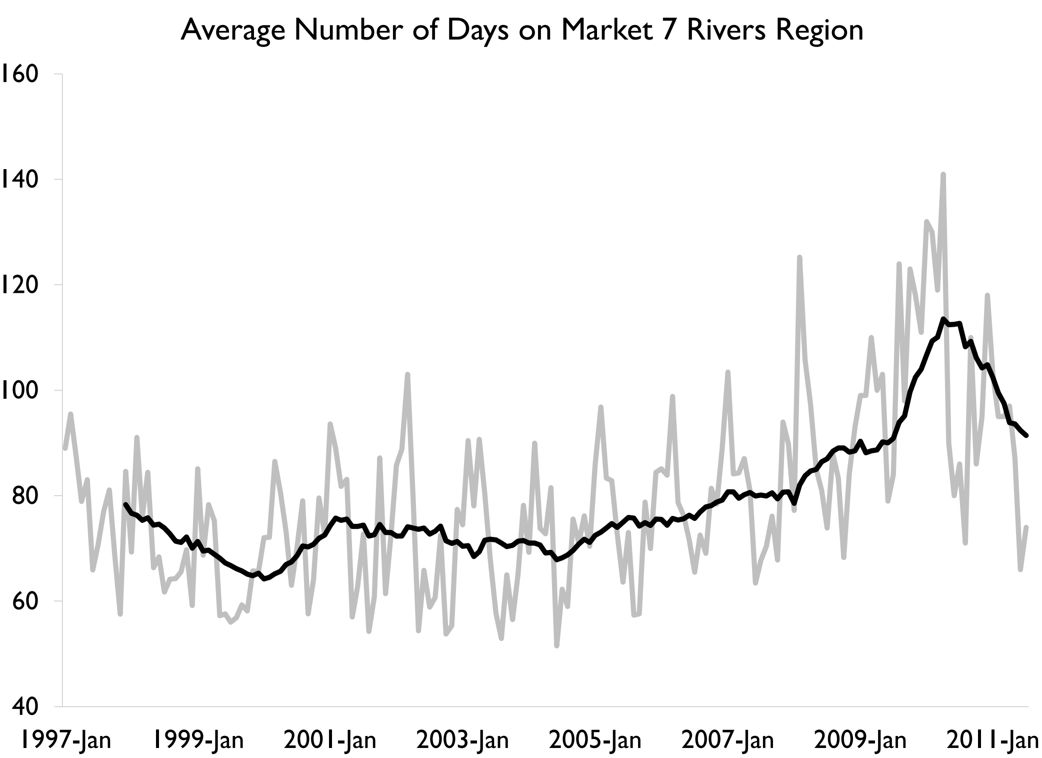
In terms of the local market for single family homes, prices appear to have rebounded, though I should again caution the reader. This data is based on the sales of homes through the MLS, and does not represent the same set of homes every month. The best measure would involve a measure of homes that have previous sold, or what is referred to as a repeat sales measure. So much of the fall in average prices was more likely a change in the types of homes sold. Recall that last year there was a tax credit offered to first time home buyers. They were required to enter into a binding contract by April 30, 2010 in order to receive the credit. We can see the spike in the number of listings sold below. Also, it likely lowered the average price as first time buyers tend to buy less expensive homes. The one positive note is that the average number of days on the market appears to be falling, suggesting we are finally working off some of our excess inventory. Although, there was recently a large number of contracts that were cancelled according to the National Realtors Association[5].

Number of Single Family Listings Sold Monthly 7 Rivers Region



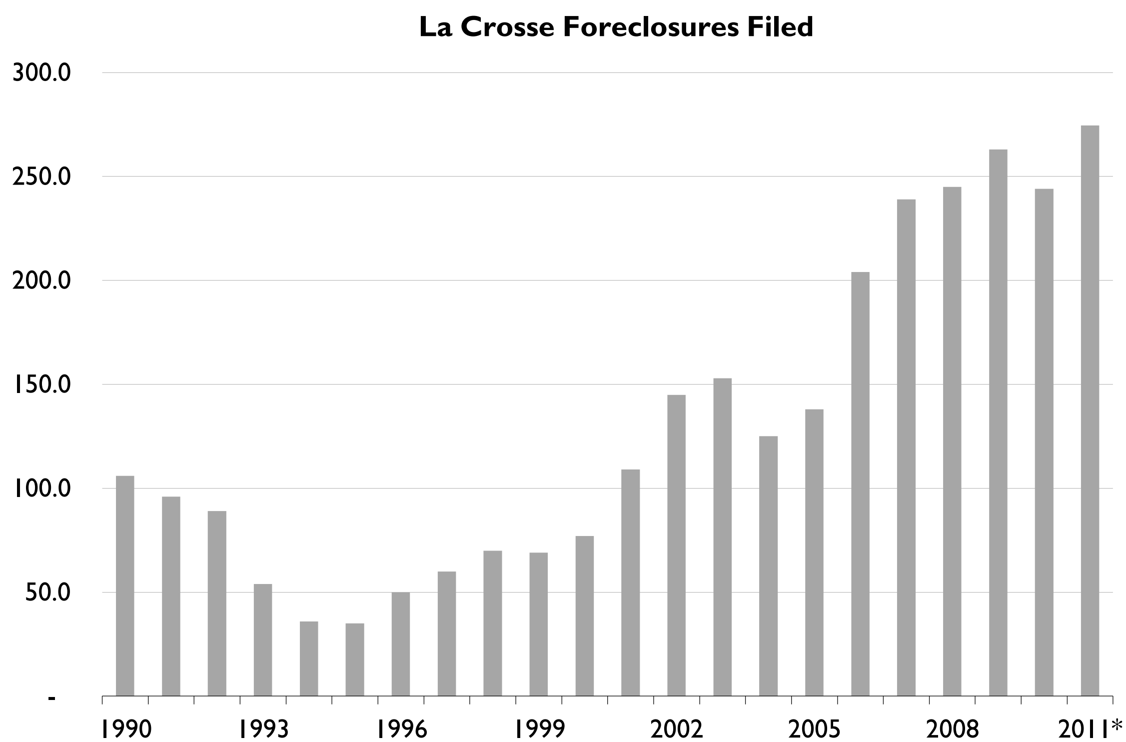
[5] http://realtormag.realtor.org/daily-news/2011/08/22/economic-woes-prompt-buyers-back-out-deals

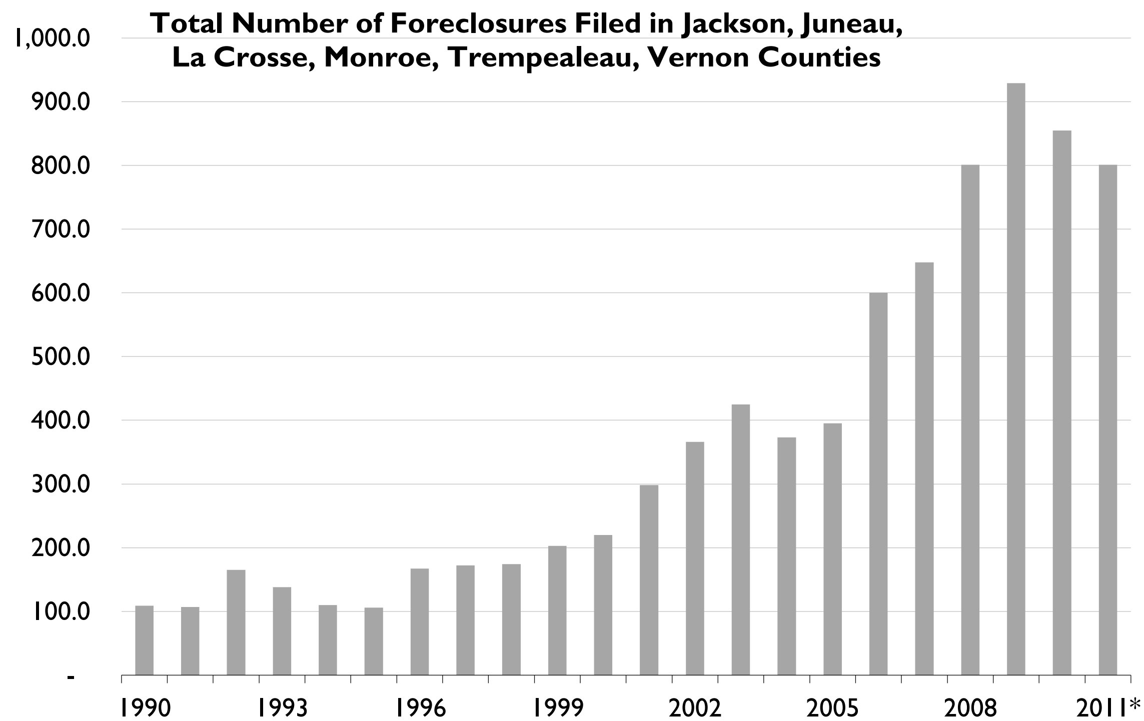

Average Price of Single Family Homes Sold in 7 Rivers Region
$175,000
$150,000
$125,000
$100,000
$75,000
1997-Jan
1999-Jan
2001-Jan
2003-Jan
2005-Jan
2007-Jan
2009-Jan
2011-Jan


Average Number of Days on Market 7 Rivers Region
160
140
120
100
80
60
40
1997-Jan
1999-Jan
2001-Jan
2003-Jan
2005-Jan
2007-Jan
2009-Jan
2011-Jan

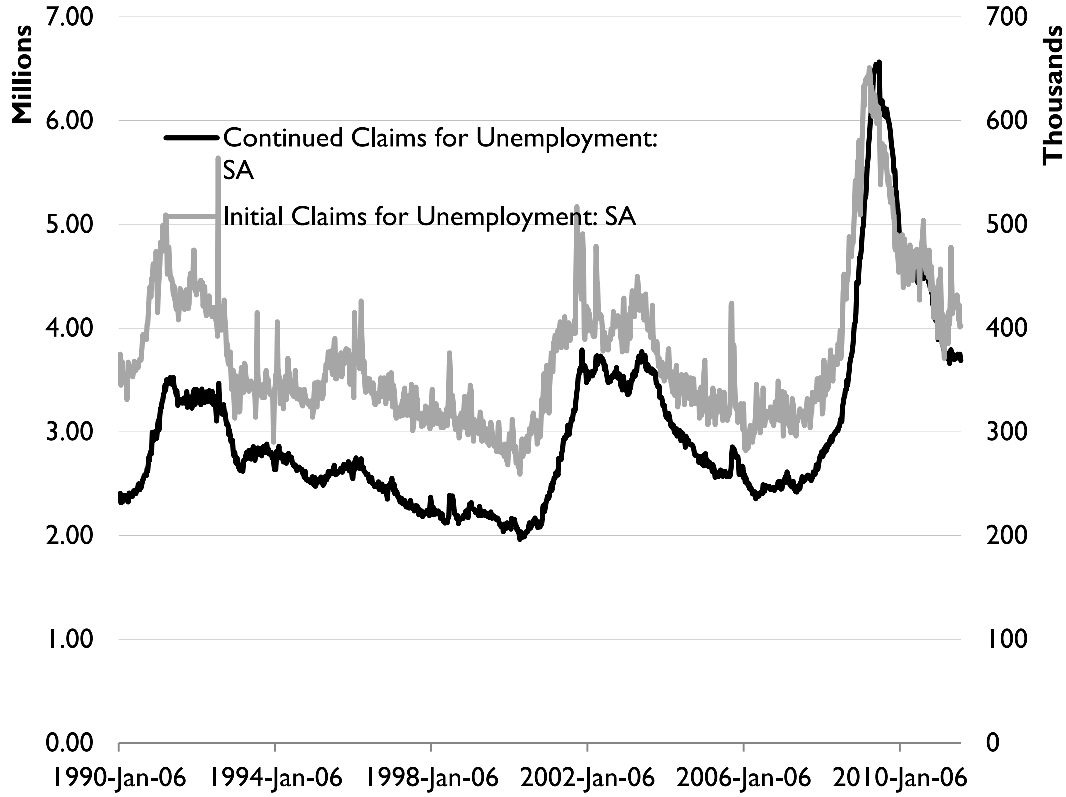
It looks as though the county of La Crosse will see an increase in the number of foreclosures, but this is a very rough guess, based on the number filed to date. I did not account for business or legal holidays in the calendar, nor did I account for any seasonal effects in my forecast. I merely used the fraction of the year that has passed to estimate the likely total for the year. Using that same method for all the counties in the 7 Rivers Region which report foreclosure filings, I am projecting a decline in the number of foreclosures to below 800, from the 2009 high of over 900.

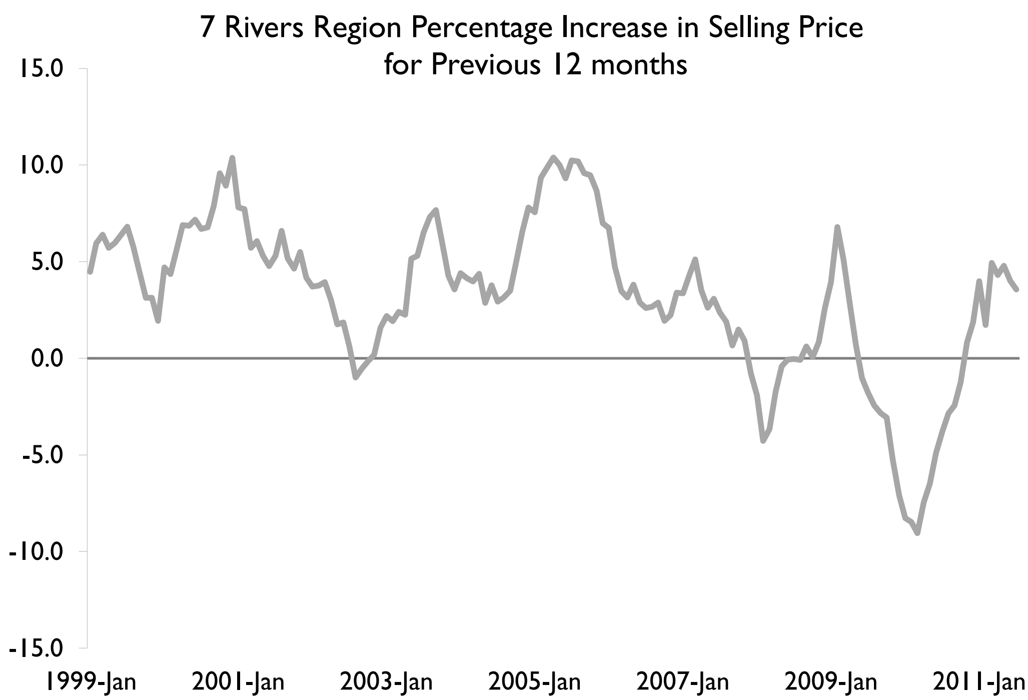
Many national pundits are still pointing to the weak housing market as the major source of slow economic growth. It suggests we still have slow growth going forward as the housing market continues to work through the short sales, foreclosures, and the excess inventories. Once that is done, home prices will hit their final bottom and begin to rise. Only after home prices begin to appreciate will consumers feel confident enough to increase consumption.

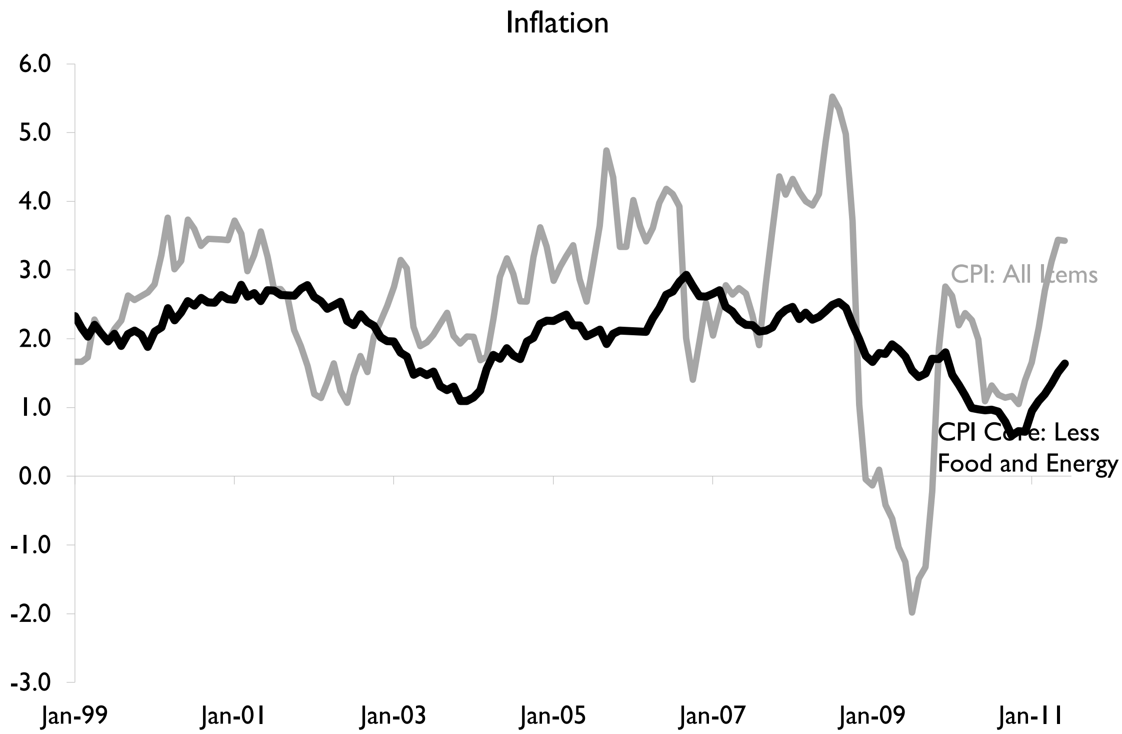


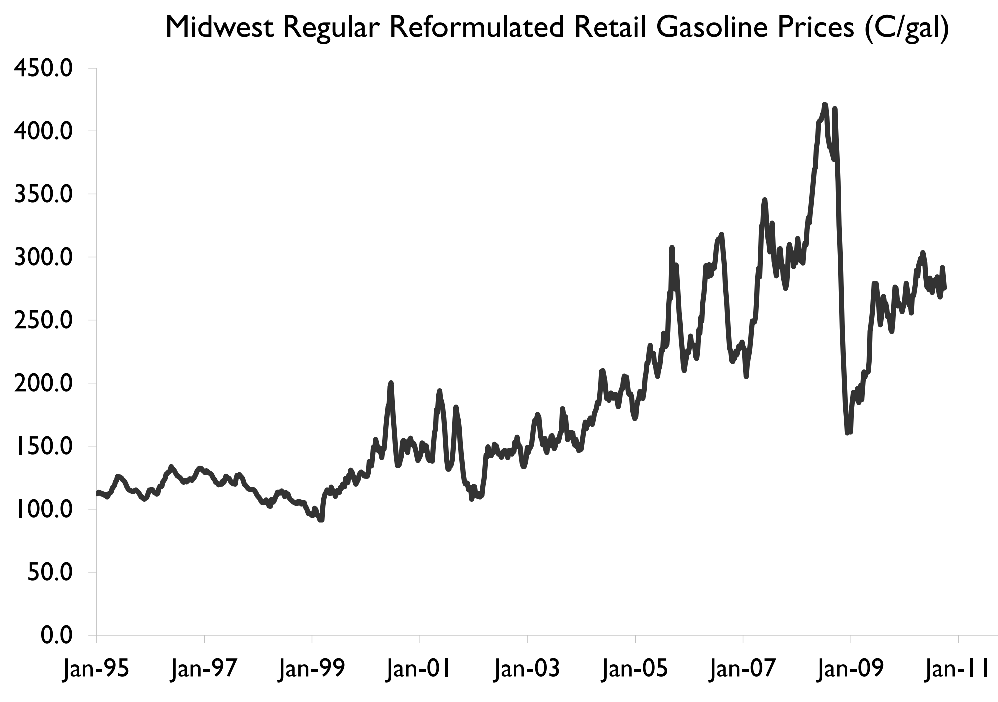

Total Number of Foreclosures Filed in Jackson, Juneau, La Crosse, Monroe, Trempealeau, Vernon Counties
1,000.0
900.0
800.0
700.0
600.0
500.0
400.0
300.0
200.0
100.0
-
1990
1993
1996
1999
2002
2005
2008
2011*

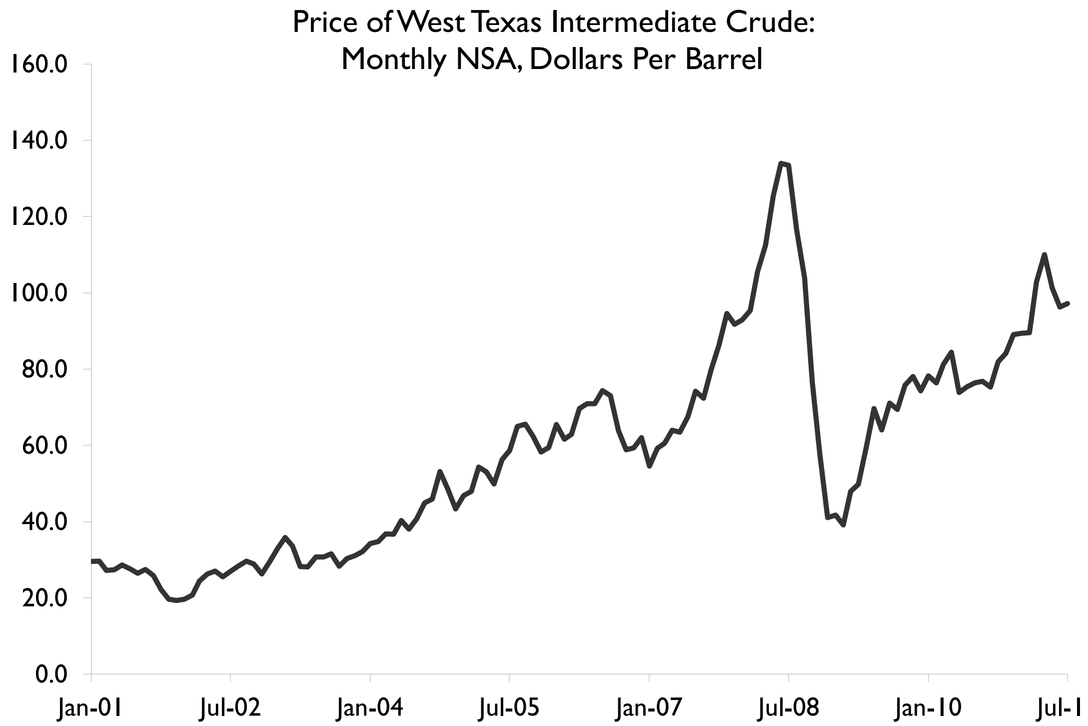
Appendix

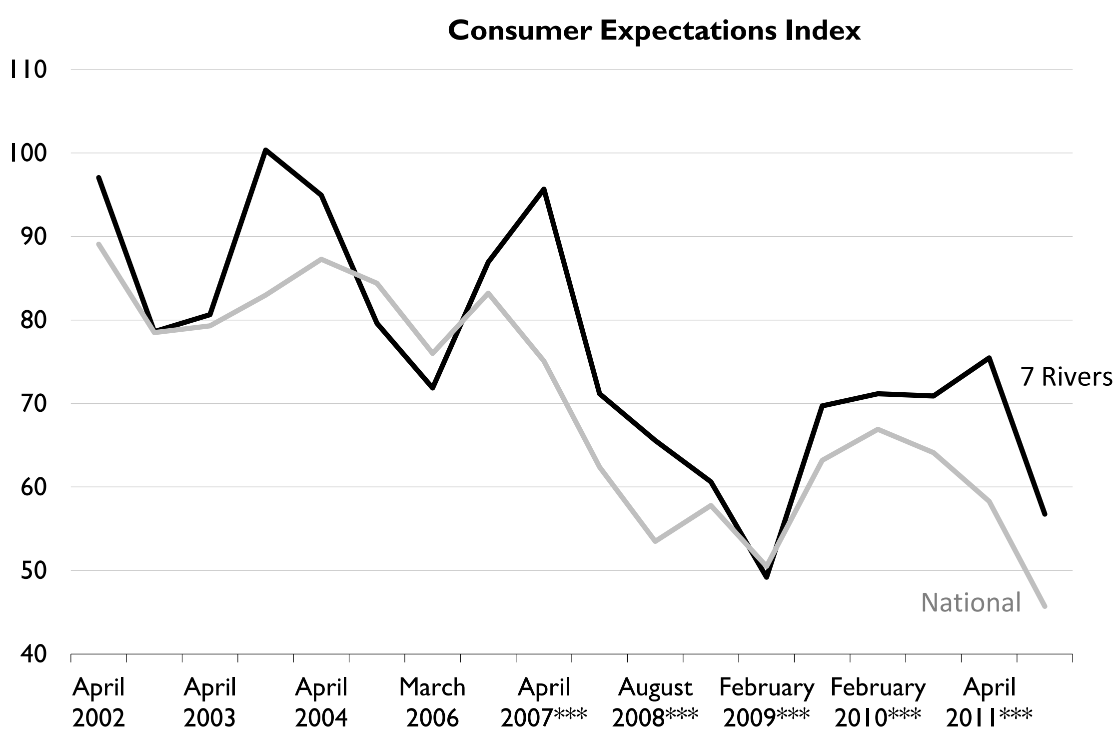

Millions
Thousands
7.00
6.00
5.00
4.00
3.00
2.00
1.00
0.00
700
600
500
400
300
200
100
0
Continued Claims for Unemployment: SA
Initial Claims for Unemployment: SA
1990-Jan-06
1994-Jan-06
1998-Jan-06
2002-Jan-06
2006-Jan-06
2010-Jan-06


7 Rivers Region Percentage Increase in Selling Price for Previous 12 months
15.0
10.0
5.0
0.0
-5.0
-10.0
-15.0
1999-Jan
2001-Jan
2003-Jan
2005-Jan
2007-Jan
2009-Jan
2011-Jan


Inflation
6.0
5.0
4.0
3.0
2.0
1.0
0.0
-1.0
-2.0
-3.0
Jan-99
Jan-01
Jan-03
Jan-05
Jan-07
Jan-09
Jan-11
CPI: All Items
CPI Core: Less Food and Energy


Midwest Regular Reformulated Retail Gasoline Prices (C/gal)
450.0
400.0
350.0
300.0
250.0
200.0
150.0
100.0
50.0
0.0
Jan-95
Jan-97
Jan-99
Jan-01
Jan-03
Jan-05
Jan-07
Jan-09
Jan-11


Price of West Texas Intermediate Crude:
Monthly NSA, Dollars Per Barrel
160.0
140.0
120.0
100.0
80.0
60.0
40.0
20.0
0.0
Jan-01
Jul-02
Jan-04
Jul-05
Jan-07
Jul-08
Jan-10
Jul-11


Consumer Expectations Index
110
100
90
80
70
60
50
40
7 Rivers
National
April 2002
April 2003
April 2004
March 2006
April 2007***
August 2008***
February 2009***
February 2010***
April 2011***

7 Rivers Equity Index (SREI) Update: Region's Firms Show Resiliency in the Face of Recession and Aftermath

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

Introduction
Tracking of the 7 Rivers Equity Index, or 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 amounts 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.
Similar to housing prices and employment rates, the stock prices of the firms within the 7 Rivers Region were not hit as hard as those of others firms in the U.S. during the most recent recession. This resulted in less of a bounce back at the end of the most recent recession, but an increase in value for investors in these firms overall over the past five years that outpaced comparable benchmarks. Financial services firms within the index did not fare as well as the non-financial firms and underperformed comparable firms for the period due to high loan losses and a reduction in business activity.

Construction of the Index and Index Components
Using the methodology developed by Dr. Thomas Krueger, the SREI consists of the exchange-traded firms that are headquartered within 100 miles of La Crosse, WI. 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.
- Great Wolf Resorts, Inc.
- Hormel Foods Corporation
- Marten Transport Ltd.
- National Presto Industries, Inc.
- Renaissance Learning, 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 11 firms that make up the index, eight of the firms are traded on the NASDAQ and the remaining three are traded on the NYSE. Using Standard and Poors' guidelines, two of the firms (Fastenal and Hormel) are large cap firms, three (Marten Transport, National Presto, and Renaissance Learning) are small cap firms, and the remaining six are micro cap firms.

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 July 1st, 2006 and ending June 30th, 2011. The monthly returns are calculated as the 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, thereby calculating 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 1500 Index Fund (Ticker: ISI) and the iShares Russell Microcap Index (Ticker: IWC). The S&P 1500 index tracks the combined performance of the S&P 500 (LargeCap), S&P 400 (MidCap), and S&P 600 (SmallCap) indices. The Russell Microcap Index currently consists of 1,384 of the smallest exchange-traded firms. Criteria for the Russell Microcap 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 differing response to market events. As such, firms in this industry are often analyzed separately from firms in other industries. The benchmarks used for this subsection of the index are the NASDAQ Financial 100 index (Ticker: IXF) and the FBR Small Cap Financial Fund (Ticker: FBRSX). The NASDAQ Financial 100 Index consists of the largest 100 financial services firms by market cap traded on the NASDAQ exchange. The FBR fund is a mutual fund that invests primarily in small cap financial services firms.

Index Performance

Table 1 provides the returns for each firm in the SREI, the returns for the index, and the returns for the S&P 1500 and Microcap indices for each year beginning July 1st, 2006 and ending June 30th, 2011.

According to the National Bureau of Economic Research, the most recent recession began in December of 2007 and ended in June of 2009.[6] The performance of the SREI and the benchmarks reflects this recession period with the return for the SREI at -3.36% for the period 6/30/2007-6/30/2008 and -17.34% for the period 6/30/2008-6/30/2009. The three firms that most contributed to these negative returns were Great Wolf Resorts (-69.00% and -34.31%), HMN Financial (-55.81% and -70.25%) and Flexsteel Industries (-16.79% and -24.15%). These results are not surprising as the three firms represent the recreation, financial, and consumer discretionary spending industries, respectively. The first and last are typically hard hit during recessions and the financial industry was particularly hard hit during the most recent recession. National Presto performed remarkably well during the recession with returns of 38.01% and 22.68% for each of two years described above, respectively. National Presto's performance during the recession was likely due to the noncyclical nature of the majority of its business: national defense and personal hygiene products.

Table 1. Annual Returns for SREI Components and Benchmarks

7 Rivers Index Components	***Annual Total Return for the 12 months beginning July 1st*** **2006**	**2007**	**2008**	**2009**	**2010**
Citizens Community Bancorp	-53.90%	-3.76%	-29.76%	-33.51%	46.21%
Fastenal Co.	28.11%	9.57%	-26.08%	40.67%	52.45%
Flexsteel Industries	17.22%	-16.79%	-24.15%	40.54%	34.94%
Great Wolf Resorts	10.68%	-69.00%	-34.31%	-17.78%	41.44%
Heartland Financial USA	-35.63%	22.80%	-15.94%	7.63%	-14.59%
HMN Financial	-4.07%	-55.81%	-70.25%	2.17%	-42.22%
Hormel Foods	-4.01%	1.94%	6.06%	19.23%	40.76%
Marten Transport	-3.55%	39.05%	-15.22%	28.69%	-3.66%
National Presto	10.54%	38.01%	22.68%	35.50%	7.19%
Renaissance Learning	-17.06%	22.88%	-16.84%	46.67%	6.69%
Rochester Medical	94.84%	-25.86%	13.08%	-25.37%	-7.13%
Median	**-3.55%**	**1.94%**	**-16.84%**	**19.23%**	**7.19%**
Average (Index Return)	**3.92%**	**-3.36%**	**-17.34%**	**13.13%**	**14.74%**
S&P 1500	14.23%	-11.28%	-20.49%	14.08%	24.69%
Russell MicroCap Index	7.69%	-16.40%	-22.04%	15.65%	26.43%

While the SREI did produce negative returns for investors during the recessionary period, it also outperformed both of the benchmarks during that time. For the period, 6/30/2007-6/30/2008, The S&P 1500 index had a return of -11.28% and the Russell MicroCap Index

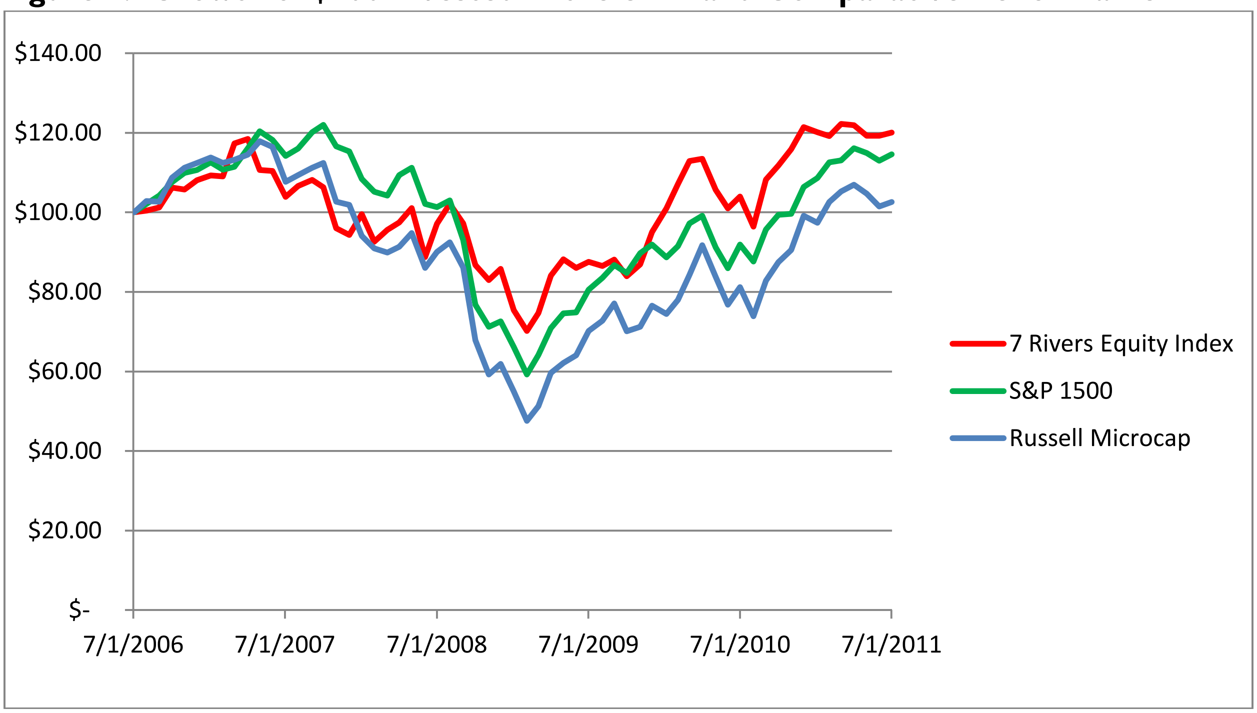
[6] "US Business Cycle Expansions and Contractions" available at: www.nber.org/cycles.html

produced a return of -16.40%. The following year, the returns were -20.49% and -22.04%, respectively.

In the post-recession period, 6/30/2009 through 6/30/2011, the Seven Rivers Index underperformed the benchmarks with a return of 13.13% for the first year compared to 14.08% (S&P 1500) and 15.65% (Russell MicroCap). In the second year of the post-recession period, the return for the SREI was 14.74% compared to 24.69% (S&P 1500) and 26.43% (Russell MicroCap). In the first year, the poorest performing firms were Citizens Community Bancorp (-33.51%), Rochester Medical (-25.37%), and Great Wolf Resorts (-17.78%). For the second year, the worst performing firms were HMN Financial (-42.22%), Heartland Financial (-14.59%), and Rochester Medical (-7.13%). The top performers for the two year period were Fastenal, Flexsteel, and Hormel.

While the SREI did underperform the benchmarks during the post-recession period, the trend we see during the recession and post-recession periods reflects lower volatility and greater long-term value creation for the SREI relative to the benchmarks. Figure 1 shows the change in value of $100 invested in the SREI and the two benchmarks for the five year period ending 7/1/2011. The ending value of the index was $120.06, for the S&P 1500 it was $114.63, and for the Russell Microcap Index $102.62.

Figure 1. Growth of $100 Invested in the SREI and Comparative Benchmarks



<u>Financial Firms' Performance</u>
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 performance of this index underperformed the benchmarks for every annual period with the exception of the 12 months beginning 7/1/2007. None of the financial firms in the SREI escaped the measurement period unscathed. Citizens Community and Heartland Financial had a particularly rough year in 2006, with returns of -53.96% and -35.63%, respectively. The recession was difficult for HMN Financial with returns of -55.81% for the 12 month period beginning 7/1/2008 and -70.25% for the period beginning 7/1/2009.

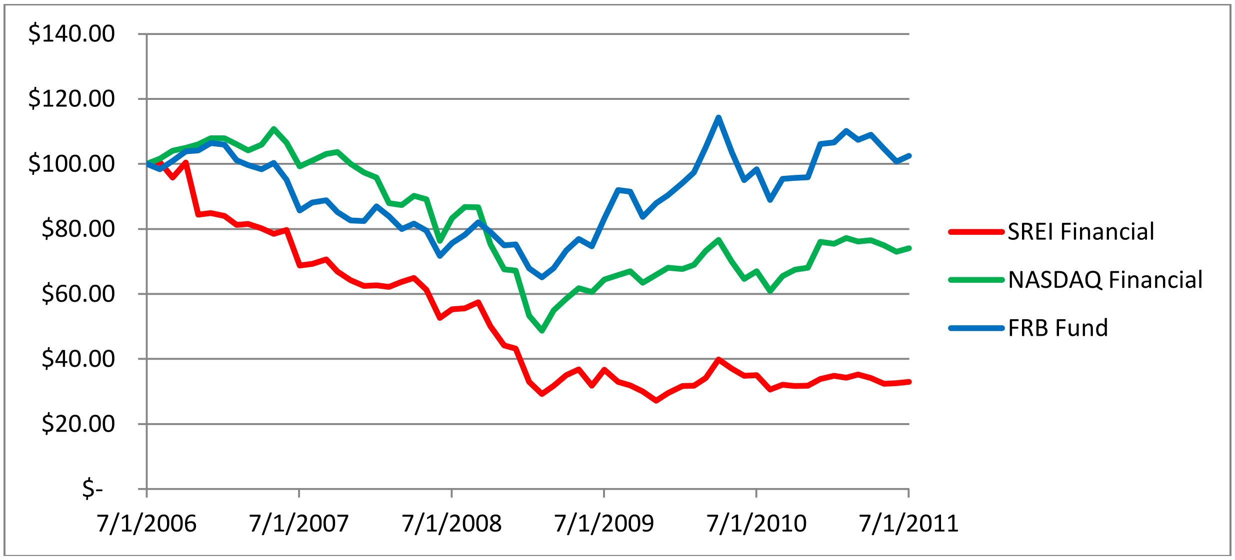
Table 2. Annual Returns for SREI Financials and Benchmarks

	Annual Total Return for the 12 months beginning July 1st				
7 Rivers Index Financial Components	**2006**	**2007**	**2008**	**2009**	**2010**
Citizens Community Bancorp	-53.90%	-3.76%	-29.76%	-33.51%	46.21%
Heartland Financial USA	-35.63%	22.80%	-15.94%	7.63%	-14.59%
HMN Financial	-4.07%	-55.81%	-70.25%	2.17%	-42.22%
Median	**-35.63%**	**-3.76%**	**-29.76%**	**2.17%**	**-14.59%**
Average (Annual Index Return)	**-31.20%**	**-12.25%**	**-38.65%**	**-7.90%**	**-3.53%**
NASDAQ Financial	-0.80%	-16.03%	-22.67%	4.00%	10.59%
FRB Fund	-14.29%	-11.76%	10.01%	18.27%	4.12%

The post-recession period was mixed for each of the firms. Citizens experienced a significant increase in returns in the past year, likely due to a change in top management in 2009 and a change in direction for the firm. Heartland Financial's disappointed results in the last period were primarily due to poor earnings results and falling operating cash flows. HMN Financial's poor results in the last period were triggered by a deferment in paying preferred dividends leading to a turnover in the CEO and Chairperson position.

Figure 2 shows the results of investing $100 in the SREI Financial and into each of the two benchmarks. The $100 initially invested in the SREI Financial would have only been worth $32.94 at the end of the measurement period. The same $100 would have been worth $74.10 if invested in the NASDAQ Financial Index and $102.45 if invested in the FRB Fund.

Figure 2. Growth of $100 Invested in the SREI Financial and Comparative Benchmarks



Accounting Measure Performance

Tables 3, 4 and 5 present income statement information, balance sheet information, and cash flow statement information, respectively, for each of the firms in the SREI and the median and average results for the non-financial and financial firms separately. Reuters, company annual reports, and 10-k reports filed with the SEC were the sources of the information used to complete these tables. Information was gathered for each of the past three fiscal year ends for each firm.

Income Statement Performance

The only consistent income statement trends for the non-financial firms during the three year period were an increasing median and average net profit margin and an increasing average gross profit margin. As a result of the recession, revenues fell for most of the firms in the index for FY 2009 relative to FY 2008 and then increased in 2010 following the end of the recession. The return on equity for the non-financial firms followed the same trend over the three year period, except that the average ROE did not fully recover from the recession. The lack of ROE for Renaissance Learning was driven by significant stock repurchases over the past several years. Since the value of the stock repurchased was recorded at the cost of the stock in the market, the total value of the stock repurchases is greater than the book value of equity of the firm for Renaissance. Stock repurchases are usually seen as a positive sign for a firm.

Great Wolf Resorts stands out as being troubled based on their financial results during the period. The firm had both significantly negative net profit margins as well as negative and decreasing returns on equity, despite rising revenues and rising gross profit margins during the three year period. This poor performance has been driven by increasing selling, general, and administrative expenses during the period. Rochester Medical also experienced a declining net profit margin and return on equity during the three year period. For 2009, the decrease was due largely to decreasing revenue, the decrease in the net profit margin for 2010 was driven by a significant increase in selling, general, and administrative expense from the prior year. A decrease in debt outstanding also contributed to a decrease in the ROE for 2010.

The remainder of the non-financial firms had "bottom-line" results that indicate that they weathered the recession well, with Flexsteel and Hormel bouncing back with results that were an improvement over the 2008 results. As mentioned above, National Presto's results demonstrate that it is generally immune to the effects of this recession.

The bottom-line results for the financial firms correspond with the discouraging trend observed in the stock returns. While Heartland Financial's net profit margin and return on equity bounced back to above pre-recession levels, these measures for HMN Financial and Citizens Community continued to decline in 2010, with a net profit margin of -55.39% and a return on equity of -44.23% for HMN Financial for 2010 and a net profit margin of -26.26% and a return on equity of -13.48% for Citizens Community in 2010.

The poor performance of HMN Financial can be attributed directly to increasing loan losses during the three year period resulting in a memorandum of understanding between the firm and the Office of Thrift Supervision in February of 2009 and culminating into a supervisory agreement between the two in February of 2011. This supervisory agreement requires the firm to improve its capital ratios prior to paying dividends in the future. The poor income statement performance was driven by decrease in interest income from loans across the three years and an increase in the provision for loan losses of $6.682 million in 2010.

Increasing defaults also plagued Citizens Community over the three year period. The decrease in net profit margin and return on equity in 2010 for Citizens was driven by an increase in the provision for loan losses of $5.532 million for the year and a moderate increase in salaries and benefits, occupancy expenses, and professional expenses. The net interest margin is calculated as the net interest income (interest income less interest expense) divided by the average interest-earning assets during the period.

This is a common evaluation measure for financial institutions as the majority of their income comes from interest on loans and the ability to maintain profitability depends on their ability to loan money out at a higher rate of interest than they have to pay to use the funds. As can be seen in Table 3, this measure consistently increased during the three year period and was not the cause of the disappointing results of two of the firms.

	Revenues (in millions)			Gross Profit Margin			Net Profit Margin			Return on Equity		
	2008	2009	2010	2008	2009	2010	2008	2009	2010	2008	2009	2010
Fastenal	$ 2,340.43	$ 1,930.33	$ 2,269.47	52.81%	50.95%	51.77%	11.95%	9.55%	11.69%	24.49%	15.48%	20.69%
Flexsteel Industries	$ 405.65	$ 324.16	$ 326.47	19.35%	18.84%	22.91%	1.05%	-0.47%	3.31%	3.76%	3.17%	9.18%
Great Wolf Resorts	$ 245.54	$ 264.03	$ 284.21	59.31%	58.68%	68.46%	-16.59%	-22.15%	-17.95%	-14.98%	-27.23%	-30.77%
Hormel Foods Corp	$ 6,754.90	$ 6,533.67	$ 7,220.72	15.72%	16.82%	17.16%	4.23%	5.25%	5.86%	14.22%	16.15%	17.61%
Marten Transport	$ 607.10	$ 505.87	$ 516.92	27.25%	31.76%	30.97%	2.98%	3.22%	3.82%	7.07%	5.96%	6.71%
National Presto Industries	$ 448.25	$ 478.47	$ 479.00	17.90%	23.01%	23.71%	9.86%	13.08%	13.26%	14.22%	18.63%	18.47%
Renaissance Learning Inc.	$ 115.22	$ 121.51	$ 130.09	75.92%	79.08%	78.99%	-29.89%	16.39%	18.36%	N/A	N/A	N/A
Rochester Medical Corp.	$ 35.19	$ 34.80	$ 41.44	47.49%	48.36%	47.54%	2.16%	0.32%	-0.60%	1.12%	0.16%	-0.36%
Median	**$ 426.95**	**$ 401.32**	**$ 402.74**	**37.37%**	**40.06%**	**39.25%**	**2.57%**	**4.23%**	**4.84%**	**7.07%**	**5.96%**	**9.18%**
Average	**$ 1,369.04**	**$ 1,274.11**	**$ 1,408.54**	**39.47%**	**40.94%**	**42.69%**	**-1.78%**	**3.15%**	**4.72%**	**7.13%**	**4.62%**	**5.93%**

Financial Firms

	Revenues (in millions)			Net Interest Margin			Net Profit Margin			Return on Equity		
	2008	2009	2010	2008	2009	2010	2008	2009	2010	2008	2009	2010
Citizens Community Bancorp	$ 28.44	$ 25.71	$ 27.01	3.02%	3.28%	3.84%	5.18%	-12.38%	-26.26%	2.00%	-5.18%	-13.48%
Heartland Financial	$ 232.78	$ 256.00	$ 251.26	3.89%	3.99%	4.12%	4.77%	0.48%	7.39%	4.74%	1.99%	7.26%
HMN Financial	$ 73.62	$ 59.96	$ 55.54	3.16%	3.33%	3.36%	-13.81%	-20.92%	-55.39%	-9.06%	-12.55%	-44.23%
Median	**$ 73.62**	**$ 59.96**	**$ 55.54**	**3.16%**	**3.33%**	**3.84%**	**4.77%**	**-12.38%**	**-26.26%**	**2.00%**	**-5.18%**	**-13.48%**
Average	**$ 111.61**	**$ 113.89**	**$ 111.27**	**3.36%**	**3.53%**	**3.77%**	**-1.28%**	**-10.94%**	**-24.75%**	**-0.77%**	**-5.25%**	**-16.82%**

Balance Sheet Analysis

Table 4 provides results of balance sheet ratios for the years 2008-2010 for the firms that comprise the SREI. The current ratio is a measure of the liquidity of the firm and is calculated as current assets divided by current liabilities. The current ratio measures how well a firm could pay its liabilities that are expected to come due in the next year with assets that are expected to be liquidated in the next year. While having a higher current ratio may sound beneficial, and generally does reduce risk, it also reduces the returns to shareholders as liquid assets typically provide little, if any, return. The long-term debt ratio is calculated as the amount of debt that had a maturity date of greater than one year when it was issued divided by the total assets of the firm. A higher debt ratio may result in a higher risk of default and bankruptcy. Conversely, a greater amount of debt in the capital structure concentrates the earnings of the firm to fewer equity holders and increases the return on equity for the firm. Total asset turnover is calculated as sales divided by total assets. It is used as a measure of how well management is utilizing assets to generate sales.

The average current ratio among the non-financial firms increased between 2008 and 2009, and decreased significantly in 2010 due to a decrease in the ratio for all firms with the exception of Flexsteel. The median current ratio increased slightly over the time period. Three firms: Marten Transport, National Presto, and Rochester Medical all had decreasing current ratios during the three year period. Rochester Medical's high current ratio is due to having a large amount of short-term investments ($30.967 million at FYE 2010), and high levels of receivables and inventories.

Surprisingly, four of the eight non-financial firms in the SREI have no long-term debt. Of the remaining firms, Great Wolf Resorts has been increasing their debt ratio due to falling asset levels and modest increases in debt each year. Marten Transport had a fairly significant bump in debt in 2010 ($18 million) accompanied by an increase in assets of $45.5 million. Hormel has increased their debt over the three year period, but the increase was outpaced by an increase in assets. Rochester Medical has been systematically paying down the small amount of debt that it has.

The overall trend for the non-financial firms with regard to the total asset turnover has been positive. Great Wolf Resorts and Renaissance Learning have both increased their total asset turnover each year, while the total asset turnover has been decreasing each year for Flexsteel and Marten Transport. Fastenal, Hormel, and National Presto had dips in 2009, but rebounded in 2010.

Table 4. Balance Sheet Analysis of SREI Component Firms

Non-Financial Firms

	Current Ratio			Long-Term Debt Ratio			Total Asset Turnover		
	2008	**2009**	**2010**	**2008**	**2009**	**2010**	**2008**	**2009**	**2010**
Fastenal	6.59	8.22	6.69	0.00%	0.00%	0.00%	1.79	1.45	1.55
Flexsteel Industries	3.54	3.16	3.93	14.42%	6.62%	0.00%	2.51	2.04	1.99
Great Wolf Resorts	0.19	0.72	0.47	60.35%	68.27%	71.61%	0.28	0.31	0.34
Hormel Foods Corp	1.84	2.30	1.69	9.68%	9.48%	8.63%	1.87	1.77	1.78
Marten Transport	1.43	1.34	1.28	14.83%	13.41%	19.10%	1.53	1.22	1.12
National Presto Industries	5.77	5.60	5.18	0.00%	0.00%	0.00%	1.17	1.15	1.32
Renaissance Learning Inc.	0.71	1.02	0.46	0.00%	0.00%	0.00%	1.00	2.26	2.61
Rochester Medical Corp.	10.31	9.00	8.07	7.47%	5.02%	3.49%	0.47	0.47	0.44
Median	**2.69**	**2.73**	**2.81**	**8.57%**	**5.82%**	**1.74%**	**1.35**	**1.34**	**1.43**
Average	**3.80**	**3.92**	**3.47**	**13.34%**	**12.85%**	**12.85%**	**1.33**	**1.34**	**1.39**

Financial Firms

	Loans-to-Assets			Provision for Loan Loss/Total Loans			Equity-to-Assets		
	2008	**2009**	**2010**	**2008**	**2009**	**2010**	**2008**	**2009**	**2010**
Citizens Community Bancorp	77.02%	76.90%	76.76%	0.20%	0.31%	1.51%	14.26%	9.62%	8.39%
Heartland Financial	66.79%	59.07%	59.73%	1.21%	1.65%	1.36%	8.71%	7.71%	8.26%
HMN Financial	78.87%	77.42%	75.74%	3.36%	4.16%	4.00%	6.07%	9.64%	7.90%
Median	**78.87%**	**77.42%**	**76.76%**	**1.21%**	**1.65%**	**1.51%**	**8.71%**	**9.62%**	**8.26%**
Average	**82.57%**	**77.45%**	**77.08%**	**1.59%**	**2.04%**	**2.29%**	**9.68%**	**8.99%**	**8.18%**

For the financial firms, I included the loans-to-assets ratio, provision for loan loss-to-total loans and the equity-to-assets ratio of the firms. The loans-to-assets ratio is a measure of the percent of the firm's assets that are productive with a higher number usually indicating more productive assets. The provision for loan loss is actually an income statement account that shows how much the firm is setting aside for future anticipated loan losses. This ratio indicates the quality and safety of the loans that the firm has made. The equity-to-assets ratio is a measure of the safety of the firm as a higher ratio gives the firm a larger cushion that can absorb future losses. However, a higher ratio also decreases return on equity and may be the result of regulatory action due to poor asset quality.
The loans-to-assets ratio average for the financial firms dropped consistently through the three year period. The decrease was due to declining economic activity and an increase in the value of loans being written off during the period.

The average provision for loan loss as a percent of total loans increased during the three-year period, with a significant increase for Citizens Community Bancorp in 2010. The ratio for HMN Financial was quite high compared to a historical benchmark of 1.20% to 1.25% for this industry. This high ratio is consistent with poor loan quality.

The average equity-to-assets ratio fell consistently during the period. Citizens Community Bancorp saw a consistent decrease during the period. The increase in the provision for loan loss likely contributed to this by deteriorating the profit margin and the resulting level of retained earnings.

Cash Flows Analysis

The operating cash flows, level of capital expenditures, and free cash flows are provided in Table 5. The free cash flows for this table are calculated as operating cash flows less capital expenditures. If not used for paying down debt or held for future investment purposes, free cash flows are cash flows that are available for distribution to stockholders through dividends or stock repurchases. Consistent and growing free cash flows increase the returns to shareholders.

Surprisingly, the average operating cash flows for the non-financial firms increased at the height of the recession due to increases for National Presto, Hormel, Flexsteel, Marten Transport, and Renaissance Learning. As mentioned above, Great Wolf Resorts was especially hard hit during the recession. Contrary to the trend in operating cash flows, the average and median investment into capital expenditures fell over the three year period. Decreases by Hormel and Great Wolf Resorts drove this trend, with increasing investment by National Presto and Marten Transport. The free cash flows followed the trend of the operating cash flows with a bump in 2009 in the average amount with a consistently increasing median. The free cash flows for Great Wolf Resorts have improved dramatically over the three year period, while they fell significantly for Marten Transport.

For the financial firms, the average operating cash flows increased during the three year period with a bump in 2009 from HMN Financial and a large increase for Heartland Financial in 2010. The capital expenditures for the financial firms were fairly insignificant during the period. For banks, capital expenditures are primarily due to opening new branches and updating existing branches, so a lack of activity during this three year period is not surprising. As a result, the free cash flows for the banks follow the trend of the operating cash flows, with an increasing amount over the period 2008-2010.

Concluding Remarks

Much like the rest of the economy in the 7 Rivers Region, the firms of the SREI have shown resiliency with regard to financial performance during the most recent recession and the post-recession period. The mix of non-cyclical and cyclical businesses gives investors in this index less downside risk, yet should provide solid returns in an improving economy. The dark spots on the portfolio have certainly been Citizens Community Bancorp and HMN Financial. Hopefully, as our economy struggles to return to normal, these firms will be able to return profits and positive returns. Great Wolf Resorts, a young company trying to establish itself nationally, had a difficult time due to the nature of the business yet appears to have turned a corner with strong stock price performance during the most recent period analyzed. Rochester Medical also appears to be struggling and should be watched as changes in the health care industry will continue for the foreseeable future.

Table 5. Cash Flow Analysis of SREI Component Firms

Non-Financial Firms

	Operating Cash Flows (in millions)			Capital Expenditures (in millions)			Free Cash Flow (in millions)		
	2008	2009	2010	2008	2009	2010	2008	2009	2010
Fastenal	$ 259.90	$ 306.07	$ 240.49	$ 95.31	$ 52.54	$ 73.60	$ 164.59	$ 253.53	$ 166.89
Flexsteel Industries	$ 8.73	$ 17.31	$ 19.12	$ 1.23	$ 1.20	$ 1.25	$ 7.50	$ 16.11	$ 17.87
Great Wolf Resorts	$ 33.53	$ 12.21	$ 29.11	$ 134.97	$ 49.26	$ 8.68	$ (101.44)	$ (37.05)	$ 20.43
Hormel Foods Corp	$ 271.62	$ 558.77	$ 485.53	$ 125.89	$ 96.96	$ 89.82	$ 145.73	$ 461.81	$ 395.71
Marten Transport	$ 77.04	$ 81.69	$ 64.52	$ 68.56	$ 112.79	$ 121.30	$ 8.48	$ (31.10)	$ (56.78)
National Presto Industries	$ 35.33	$ 62.15	$ 57.77	$ 4.37	$ 3.34	$ 17.97	$ 30.96	$ 58.81	$ 39.80
Renaissance Learning Inc.	$ 24.94	$ 34.35	$ 45.72	$ 1.42	$ 1.08	$ 1.75	$ 23.52	$ 33.27	$ 43.97
Rochester Medical Corp.	$ 2.40	$ 1.68	$ 3.12	$ 1.64	$ 1.23	$ 1.83	$ 0.76	$ 0.45	$ 1.29
Median	**$ 34.43**	**$ 48.25**	**$ 51.75**	**$ 36.47**	**$ 26.30**	**$ 13.33**	**$ 16.00**	**$ 24.69**	**$ 30.12**
Average	**$ 89.19**	**$ 134.28**	**$ 118.17**	**$ 54.17**	**$ 39.80**	**$ 39.53**	**$ 35.01**	**$ 94.48**	**$ 78.65**

Financial Firms

	Operating Cash Flows (in millions)			Capital Expenditures (in millions)			Free Cash Flow (in millions)		
	2008	2009	2010	2008	2009	2010	2008	2009	2010
Citizens Community Bancorp	$ 2.37	$ 3.78	$ 6.43	$ 2.56	$ 3.07	$ 0.31	$ (0.19)	$ 0.71	$ 6.12
Heartland Financial	$ 41.37	$ 39.88	$ 80.44	$ 9.50	$ 6.60	$ 9.61	$ 31.87	$ 33.28	$ 70.83
HMN Financial	$ 162.85	$ 178.90	$ 157.75	$ -	$ -	$ -	$ 162.85	$ 178.90	$ 157.75
Median	**$ 41.37**	**$ 39.88**	**$ 80.44**	**$ 2.56**	**$ 3.07**	**$ 0.31**	**$ 31.87**	**$ 33.28**	**$ 70.83**
Average	**$ 68.86**	**$ 74.19**	**$ 81.54**	**$ 4.02**	**$ 3.22**	**$ 3.31**	**$ 64.84**	**$ 70.96**	**$ 78.23**

APPENDIX

Non-Financial Firms

Company: **Fastenal Corporation**
Ticker: FAST
Exchange: NASDAQ
Market Cap: $10 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: 86%
Date started trading: March 26th, 1990

Company: **Flexsteel Industries, Inc.**
Ticker: FLXS
Exchange: NASDAQ
Market Cap: $100 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: 62%
Date started trading: February 25th, 1992

Company: **Great Wolf Resorts, Inc.**
Ticker: WOLF
Exchange: NASDAQ
Market Cap: $112 Million
Description: Developer, owner, licensor, and operator of family resorts that feature indoor water parks and other entertainment options. The company currently operates or has a licensing agreement with twelve resorts across the United States.
Institutional Ownership: 66%
Date started trading: December 15th, 2004

Company: **Hormel Foods Corporation**
Ticker: HRL
Exchange: NYSE
Market Cap: $8 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: 32%
Date started trading: January 2nd, 1990

Company: **Marten Transport Ltd.**
Ticker: MRTN
Exchange: NASDAQ
Market Cap: $481 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: 70%
Date started trading: February 27th, 1992

Company: **National Presto Industries, Inc.**
Ticker: NPK
Exchange: NYSE
Market Cap: $706 Million
Description: Manufacturer of housewares and electrical appliances; defense-related products, such as: training ammunition, fuzes, firing devices, and initiators; and diapers and adult incontinence products.
Institutional Ownership: 50%
Date started trading: December 30th, 1987

Company: **Renaissance Learning, Inc.**
Ticker: RLRN
Exchange: NASDAQ
Market Cap: $375 Million
Description: Provider of computer-based assessment technology for schools and school districts for grades pre-kindergarten through senior high school.
Institutional Ownership: 16%
Date started trading: June 3rd, 1998

Company: **Rochester Medical Corporation**
Ticker: ROCM
Exchange: NASDAQ
Market Cap: $116 Million
Description: Manufacturer and marketer of PVC and latex-free urinary continence and urine drainage care products.
Institutional Ownership: 41%
Date started trading: August 18th, 1995

Financial Services Firms

Company: **Citizens Community Bancorp Inc.**
Ticker: CZWI
Exchange: NASDAQ
Market Cap: $31 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: 14%
Date started trading: March 30th, 2004

Company: **Heartland Financial USA Inc.**
Ticker: HTLF
Exchange: NASDAQ
Market Cap: $250 Million
Description: A multi-bank holding company that has subsidiaries in Iowa, Illinois, Wisconsin, New Mexico, Arizona, Montana, Colorado, and Minnesota.
Institutional Ownership: 34%
Date started trading: January 7th, 2000

Company: **HMN Financial, Inc.**
Ticker: HMNF
Exchange: NASDAQ
Market Cap: $11 Million
Description: Operator of retail banking and loan production facilities in Minnesota and Iowa.
Institutional Ownership: 27%
Date started trading: July 30th, 1994