



2010 – 1ST QUARTER REVIEW AND PREVIEW



BOB'S CORNER

STAYING DISCIPLINED

As I look back over the last three years, I realize that we have lived up to our motto 100%. "It's now how much you make, it's how much you keep!" Since the beginning of the market decline in early 2007, we lost significantly less than the market on the downside and in the last two quarters, we have not made as much for you on the upside relative to the market. We underperformed the last two quarters because we took chips off the table in September 2009. Our view at that point was that the market had bounced a little too fast and far and we needed to make sure we were not headed for a double dip downturn. As more economic data comes to light, we do see the stabilization/foundation forming for hopefully a long and steady expansion. I can promise you one thing, we will underperform a bit but with a view of more volatility ahead, we believe our more defensive discipline will work in our favor!

Thank you for your continued confidence in the All Star Team.

A REAL RECOVERY BEGINS TO TAKE HOLD

MARKET OVERVIEW

The start of 2010 brought additional signs the economy has moved past the "Great Recession" and is now firmly in recovery mode. Corporate profits gained strength as most companies beat 4th quarter earnings expectations by a healthy margin. A big question for corporations is whether revenue growth, rather than spending cuts, will be responsible for future profits. This trend seemed to emerge in the 1st quarter as more cash moved into stocks helping the market grind out modest gains during the quarter. Bond markets remained relatively stable as the Federal Reserve maintained its "zero interest rate" policy. Stocks seem positioned to benefit in an environment of low inflation and low interest rates.

The economy has not yet fully recovered. The housing market is weak and the unemployment rate remains stubbornly high. Yet some stabilization is evident in both areas. The S&P Case-Shiller Home Price Index generated a 1.4% increase in the past quarter and mortgage delinquencies declined for the first time in three years. The economy managed to add 162,000 jobs in March, the first month of sizable job creation since 2007. While both areas will continue to lag, signs pointed to the start of a turnaround in the 1st quarter.

The investment environment was uneven across the globe. Emerging markets such as China and Brazil resumed rapid economic growth, leading the global recovery. Europe and Japan are growing less quickly, and sovereign debt issues in Europe, most notably Greece, and potentially in other European countries are leaving a cloud over the financial fortunes of the continent.

Overall, the 1st quarter represented a positive start to 2010. The continuation of the domestic stock market rally defied skeptics as the general sense now is the economic recovery is gaining traction.

ECONOMY

THE 1ST QUARTER

By the government's latest measure, the economy grew 5.6% in the 4th quarter due in large part to higher productivity levels and increased investment. Businesses are beginning to rebuild inventories and continue to benefit from export growth. Living costs remain under control with the Consumer Price Index measuring inflation at a 2.2% annualized rate. Washington continued to play a major role in the nation's economic story at the start of 2010, as Congress passed and the President signed major health care reform legislation. New financial regulations, in response to the crisis that came to a head in 2008, are currently being developed.

One of the most encouraging economic trends to emerge is the recovery of the manufacturing sector. Strong export growth has helped generate an eight-month improvement in manufacturing activity. The service sector also showed positive developments in the 1st quarter, with the ISM Service Sector index growing to its highest level since October 2007. Both areas experienced favorable hiring trends. While unemployment remains mired at 9.7%, new jobless claims have been falling. Over 8.4 million jobs were lost in the recession, there is a lot of ground to make up, but America is slowly beginning to return to work again. Over the last fifteen months, the economy has gone from losing 780,000 jobs a month to creating 160,000 jobs a month.

Consumers remain generally cautious as sentiment may be improving. Personal spending is 3.4% higher now than during the midst of the recession. This level of increased spending will probably not be as strong going forward due to the fact that consumers are putting more emphasis on paying down debt and rebuilding savings.



LOOKING AHEAD

We anticipate ongoing economic improvement on most fronts, with housing and employment continuing to lag the rest of the recovery. Unlike recent expansions, this one will not be led by consumers, but by business spending. A recent survey by Morgan Stanley indicates that business spending should remain strong, a key to keeping the economic recovery on track. Most businesses indicate an improved environment exists now or will in the next six months. This should boost activity for equipment, software and other business input providers. Companies appear well positioned to maintain profit growth going forward.

As interest rates remained low, companies issued a record \$32 billion in high-yield bonds in March. Low interest rates have also helped banks shore up their balance sheets and rebuild loan loss reserves after many were hard hit during the recession. The biggest challenges in the months to come will be to keep economic growth on track as Federal stimulus programs expire and the Federal Reserve begins to raise interest rates once again.

BOND MARKET

THE 1ST QUARTER

The quarter began with concerns that either the economy might go backwards or interest rates could move higher. At this point, neither event has occurred. Credit markets remained firm resulting in most bond market sectors gaining ground to open the year. In the closing weeks of the quarter, interest rates on U.S. Treasury bonds began to rise in anticipation of changes to Federal Reserve policy.

Credit-related bond sectors generated the best performance. Emerging Market Bonds rose 4.86% while Corporate High Yield Bonds gained 4.33%. Bank Loans nearly matched that, with a return of 4.27%. Farther down the list, Multi-Sector Bonds rose 3.68%, Intermediate Bonds returned 2.37% and Municipal Bonds managed a 1.24% gain.

Trailing the pack were Inflation-Protected Bonds (TIPS), up just 0.61%. Long Government Bonds rose only 0.65% as rising yields detracted from bond values. Credit issues in Europe (particularly in Greece, Portugal, Spain and Ireland) hurt the Euro. The dollar gained 6% in value during the quarter, while emerging market currencies also gained ground against most major world currencies.

LOOKING AHEAD

Bond yield spreads (between corporate and government bonds) are narrowing toward historic averages, meaning upside potential may be limited for bonds. The bond market may be most vulnerable to the Fed's withdrawal of liquidity programs. The Fed's \$1.25 trillion mortgage purchasing program ended in the first quarter, leaving private capital to support the market. It creates a risk that mortgage rates could head higher.

Interest rates in general are expected to rise if the economic recovery remains on track. Rising rates typically result in falling bond values especially in government bonds. We expect the Fed to be cautious about changing its own interest rate policy to avoid sidetracking the recovery. As the government copes with continued debt issues, the dollar is likely to have difficulty retaining its recent strength and may lose ground against other currencies over time.

DOMESTIC STOCK MARKET

THE 1ST QUARTER

U.S. stocks enjoyed the best 1st quarter since 1999, as investors were buoyed by strong profits and favorable economic trends. The Russell 3000 Index (a measure of broad U.S. stock market performance) gained 5.94% for the quarter. Though modest compared to the rapid-fire rebound stocks enjoyed in the last ten months of 2009, it was still encouraging.

Small- and Mid-cap stocks led the equity markets with gains of 8.85% and 8.67% respectively. Large-cap stocks rose 5.70%. From a style perspective, value stocks enjoyed an edge over growth stocks, as investors put increasing emphasis on quality dividend paying companies.

Top-performing industry sectors included Industrial stocks (+13.11%), followed by Financial stocks (+11.85%). The rebound in manufacturing boosted industrial issues while banks continued to repay TARP funds and rebuild their balance sheets. Lagging sectors included Telecom (-4.76%) and Utility stocks (-3.37%). Investors were more encouraged about the economy and consequently shifted dollars out of these defensive areas.

An important story is the strength of corporate balance sheets. U.S. non-financial corporations are currently sitting on the highest levels of cash, as a percentage of tangible assets, since the mid-1950s. This is in sharp contrast to the growing debt facing the federal government. Companies are likely to begin putting this money to work. Some have done so already, either through acquisitions, stock buybacks or increased dividend payouts to shareholders. All of these actions create a positive underpinning for the stock market.



Performance Update

Market Index	1st Qtr	1 Year	2 Years	3 Years	5 Years
DJ Ind Average	2.33	26.78	-3.05	-1.52	3.28
S&P 500	5.41	49.71	-3.69	-4.19	1.91
Russell 2000	8.35	62.76	0.86	-3.99	3.36
S&P Mid-Cap 400	9.09	64.07	2.40	-0.83	5.17
Russell 3000	5.94	52.44	-2.94	-3.99	2.39
MSCI EAFE	0.87	54.44	-9.11	-7.02	3.75
MSCI Em Mrkt USD	2.40	81.08	-2.10	5.34	16.02
NASDAQ Comp	5.68	56.87	2.57	-0.33	3.70
Barclays High-Yield	4.62	56.18	12.26	6.65	7.78
Barclays Agg Bond	1.78	7.69	5.38	6.14	5.44
Barclays Credit Index	2.35	18.71	6.73	6.21	5.49
Barclays Gov Bond	1.11	-0.13	3.35	5.98	5.19
Barclays Corp	2.27	20.83	7.02	6.00	5.37

LOOKING AHEAD

The stock market's dramatic rally going back to March 2009 has created concerns that stock values may not be attractive. Yet the forward price/earnings ratio is around 15, close to historic long-run averages. When compared to alternatives such as bonds or low-yielding cash instruments, stocks appear well positioned. Historically, stocks perform well when inflation and interest rates are low; an environment we expect will persist through 2010.

A diversified stock portfolio should perform competitively as the economic recovery strengthens. Health care stocks appear cheap and should benefit from the uncertainty being removed regarding health care legislation. Increased business spending should benefit technology stocks. Corporate dividends are on the rise, and traditional value style sectors should be well positioned going forward also.

INTERNATIONAL MARKETS

THE 1ST QUARTER

The global recession is fading, several regional foreign central banks in got a jump on the Federal Reserve and began to tighten monetary policy to counter potential inflation threats. This occurred in China, India and the commodity-led economy of Australia. As a result, stocks generated negative returns in China (-1.57%) and Brazil (-0.12%). As a whole, Emerging Markets gained 3.95%, lagging the U.S. market during the period.

European stocks managed a 3.17% gain despite heightened concern about sovereign debt issues and a slow developing economic recovery. The Nikkei Stock Index in Japan rose 8.83%, benefiting from a global recovery that has boosted several major export-related companies. Developed markets across the globe, as measured by the MSCI EAFE Index, gained just 2.17% for the quarter, trailing both U.S. and Emerging Markets.

LOOKING AHEAD

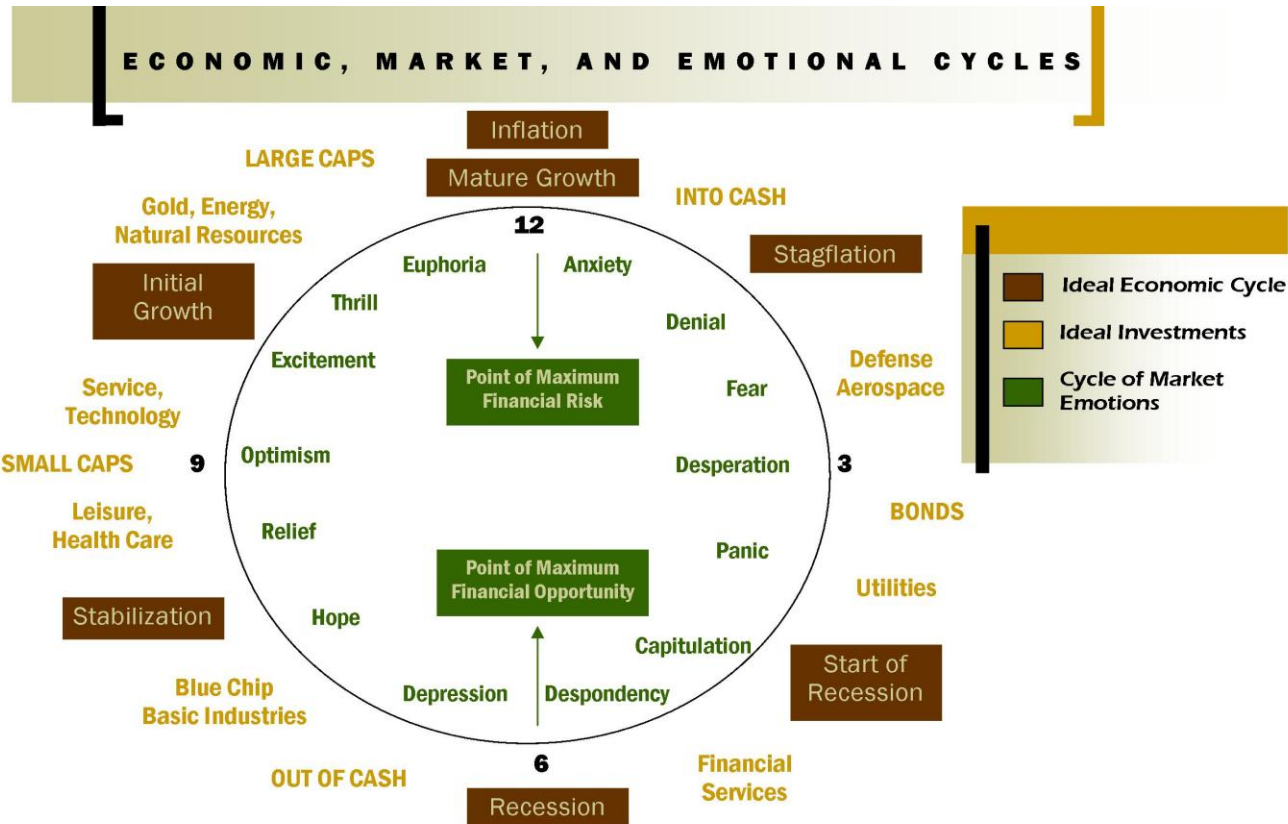
A long-term theme that is already underway is the emergence of a consumer class in emerging market nations, eventually supplanting the U.S. consumer as the driving engine of global economic growth. We look for global stocks to offer the best potential for investors through the rest of 2010, as is evident by price/earnings ratios being lower (trailing P/E ratios of 15x for Emerging versus 32x for U.S. stocks) and estimated growth rates higher when compared to the U.S. markets. These great values have driven our perspective on the fantastic opportunity that lies in the emerging stock markets around the world.

Europe's delayed response to the financial crisis is likely to continue to impact the pace of economic recovery in that region. Consumer and health care stocks appear to be the most attractively valued sectors. Japan should benefit from improved exports as the global economy recovers, but faces major challenges in its significant debt (greater than that of the U.S. government) and rapidly aging demographics. A source of global market volatility in coming months could be growing tensions between the U.S. and China regarding China's managing of its currency.

SUMMARY

The so-called "lost decade," the ten-year period ending last December that saw U.S. stocks decline in value (losing 0.20%), may have left some redeeming benefits. The bursting of the technology and housing bubbles created significant pain, as well as the financial crisis and recession. However, the result could be a more favorable environment for stocks, which typically prosper when inflation is low. Excess housing capacity and the state of the job market should keep costs in line in the near term.

At the same time, the global economic recovery is transitioning from one supported by unprecedented government intervention to one that is self-sustaining and potentially could endure longer than past expansions. We believe that the typical 60-70 month expansion could be as long as 90-100 months. This will be an opportunity for investors to position themselves for a slower, but more long-term expansion in stock values.



On the Road to Expansion

Over the last 30 months the economic cycle has produced quite a roller coaster ride for many investors. Most investors have felt the emotion of anxiety, fear, panic, despondency, and are now seeing hope and relief these past six months. What has been constant during this period of the economic “clock” is the clock itself. In our 2nd quarter newsletter in 2006 we used this exact same diagram to remind participants that the economy was not going to continue its potency forever. We started to take our small cap chips off the table at 11:30 and added large cap exposure to weather the storm ahead in 2007 and 2008 (12:30 to 5:00). In early 2009, when panic, capitulation and despondency was everywhere, we started to scoop up investments at a huge discount (emerging market equities and high yield bonds). As 2009 unfolded these good buys helped us gain back the majority of the losses experienced in 2007 and 2008.

As the body of this newsletter indicates, there are signs that our economy continues to mend and improvements in many areas are encouraging (now at 7:00). There continues to be risk to the economy related to the exit strategies of the various government assistance programs, potential interest rate hikes, as well as the ability of consumers to spend while they plow more of their income into paying down debt. But, as we continue to research the risks and potential returns of various asset classes, we will also continue to adjust our portfolios accordingly throughout the rest of this year. Your patience and faith in our process has helped the portfolios succeed on a risk-adjusted basis both over this short-term, tumultuous period and over the long-term.

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